A CITIZEN'S GUIDE TO NEIGHBORHOOD REINVESTMENT

Edited by
Dennis R. Marino
And
Lawrence B. Rosser

Woodstock Institute
410 North Michigan Avenue
Chicago, Illinois
(312) 644-4469

A CITIZEN'S GUIDE

TO NEIGHBORHOOD REINVESTMENT

Table of Contents

About the Editors

Dennis R. Marino is Associate Director of Woodstock Institute. Prior to joining the Institute he served as Staff Project Director of the Center for Urban Studies of the University of Illinois at Chicago Circle.

Mr. Marino has authored Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Loans, with Dr. Calvin Bradford; and Regulatory Reform of Appraised and Underwriting Standards: The California Fair Lending Regulations and Guidelines; and An Analysis of the Philadelphia Mortgage Plan; and Demand, Supply and Marketing of Single-Family Mortgage Credit in Mature Communities, with Lawrence B. Rosser. He is currently editing A Citizen's Guide for Neighborhood Property Analysis.

A member of the American Institute of Planners, the American Society of Planning Officials and the Chicago Regional Housing Study and Action Group, Mr. Marino is also an active member of his local neighborhood association.

Mr. Marino attended St. Joseph's College of Philadelphia where he received his B.A., and the University of Illinois at Chicago Circle where he received a Master's Degree in Urban Planning and Policy.

Lawrence B. Rosser has served as Executive Director of Woodstock Institute since its founding in 1973. He is also an Adjunct Lecturer in Urban Affairs at the University of Illinois School of Public Health, a public interest member of the Illinois Savings and Loan Board, an honorary board member of the Chicago Suburban Chapter of the Southern Christian Leadership Conference, and a co-founder and former convener of the Chicago Regional Housing Study and Action Group.

Dr. Rosser also serves as co-chairman of the Insurance Redlining Subcommittee of the Federal National Mortgage Association's Chicago Urban Lending Committee, and as a public interest representative on the Advisory Committee to the National Association of Insurance Commissioners' Redlining Task Force.

His recent publications include the following: Maintaining Viable Communities: The Investment-Disinvestment Process and Some Strategies for Maintenance and Rehabilitation in the Pilsen Community in Chicago, with Calvin Bradford; Community Development Subsidiaries of Bank Holding Companies as Vehicles of Reinvestment; and Savings and Loan Service Corporations as Instruments of Reinvestment; and Demand, Supply and Marketing of Single-Family Mortgage Credit in Mature Communities, with Dennis R. Marino.

He completed his undergraduate studies at the College of William and Mary, and received his M.Th. and D.Mn. degrees from the University of Chicago Divinity School. Dr. Rosser resides on Chicago's south side where he serves on the board of the local community organization.

Part I

INTRODUCTION

Introduction

For more than four decades, public policymakers have attempted to deal with the problems of cities by providing increasing amounts of public subsidies and grants to city governments and needy residents. Gradually the society has come to realize that although the public sector has an important role to play in maintaining and revitalizing urban neighborhoods, ways must be found to redirect the interest of the private sector in investing in cities if they are to be enhanced as structures of family opportunity for their residents.

This guide is designed to provide citizens with an understanding of the crucial role that financial institutions play in maintaining and revitalizing urban neighborhoods. It also provides an overview of the cause and effect of lenders' decisions to disinvest from neighborhoods, and presents strategies which can be initiated by citizens to move lenders from redlining to reinvestment. Disinvestment, as used in this publication, refers primarily to the process by which individuals and institutions systematically withdraw financial resources from a neighborhood perceived to be declining in order to invest those resources elsewhere -- in central business districts; in suburbs; and, even, in developing countries overseas.

The two things that all of the individuals and institutions in a distressed neighborhood have in common are, <u>first,</u> they all feel <u>victimized</u> by the process of disinvestment, and, <u>second,</u> they all feel <u>helpless</u> to thwart the neighborhood's downward spiral. This usually leads all parties involved to the <u>belief that further deterioration is inevitable.</u> Once that assumption becomes widely accepted, everyone acts to "hedge" their risks, and the asset stripping begins in earnest.
More often than not, the public sector's response to a neighborhood in distress is to begin pumping in maintenance money -- in the form of welfare, medicaid and unemployment -- which does little to reverse the downward spiral.

Faced with the above scenario, it is clear that no one individual or institution by itself can restore the neighborhood. In recent years, however, many citizens and public officials have argued that financial institutions have an obligation to try and provide leadership to restore equilibrium to a deteriorating community.
The argument for the special obligation of financial institutions flows from two facts.

First, financial institutions chartered to serve the needs and convenience of a particular geographical area are known as the bank's "primary service area". Recent legislation by Congress indicates that banks and savings and loan associations have a continuing obligation to serve their chartered area even when demographic changes allegedly diminish the economic attractiveness of lending in that area.[1]

The second reason that financial institutions generally are regarded as having special obligations for extending credit in older, racially changing, minority and low-income communities is that in recent years these institutions have mounted aggressive campaigns to collect <u>deposits</u> from these areas. In response, many citizens have argued that if these institutions can continue marketing deposit services to residents of deteriorating areas, they have an obligation also to market <u>credit</u> services.[2]

Hopefully, this guide will provide citizens with the tools and information needed to implement strategies designed to encourage reinvestment in urban neighborhoods by local lenders. It will also present examples of privately initiated reinvestment strategies employed by more enlightened lenders in cities throughout the country.

The utility of this guide will be enhanced if it is used in conjunction with a series of five video on community development banking which was produced by Woodstock Institute during 1978. However, the guide may be utilized independent of the tapes without significantly diminishing its usefulness.

The need for "A Citizen's Guide to Neighborhood Reinvestment" became apparent to the editors of this compendium during a conference entitled "Banking for Non-Bankers" which was sponsored by the Woodstock Institute in June, 1977. More than two hundred people who had applied to attend the conference had to be turned away due to a lack of space at the University of Chicago Center for Continuing Education where the conference was held. To accomodate the interest in further conferences and materials that was expressed both by those who attended the week long conference and by those who were unable to participate, the Woodstock Institute was commissioned by the U.S. Department of Housing and Urban Development, Office of Neighborhoods, Voluntary Associations and Consumer Protection to produce a series of five video tapes on community development banking and a manual which could be used with the tapes as a training aid or independently as a resource guide.

To reinvest is to believe in the future. This guide is designed to provide citizens with a basic understanding of how the assumptions and practices of financial institutions can and must be changed if there is to be a future for urban America.

Footnotes

[1]See Title VIII of the Housing and Community Development Act of 1977.

[2]See Bradford, Marino and Rosser, "Demand, Supply and Marketing of Single-Family Credit in Mature Communities," (Woodstock Institute, 1977).

Part II

AN OVERVIEW:
FROM REDLINING TO REINVESTMENT

Part II

Chapter 1

THE HIGH COSTS OF DISINVESTMENT

About the Author

Stanley J. Hallett represents a unique combination of academic background and practical experience in dealing with neighborhood disinvestment.

Under joint appointment at Northwestern University, Dr. Hallett is a lecturer at the Graduate School of Management, and an associate of the University's Center for Urban Affairs. His research and teaching areas cover inner city banking, urban planning and management, and health action programs. His educational background includes a Ph.D. from Boston University.

Dr. Hallett is President of the Woodstock Institute, a not-for-profit corporation which does policy research and development, conducts public education and provides technical assistance to the public, private and voluntary sectors.

Dr. Hallett has worked extensively in the revitalization of the South Shore area of Chicago. He is a Vice-President of the South Shore National Bank. He serves also as a member of the Board of Director of the Illinois Neighborhood Development Corporation, a bank holding company that owns the bank.

Chapter I

THE HIGH COSTS OF DISINVESTMENT

by Stanley J. Hallett

The budgets of our city and state governments are stretched tight, some to the breaking point. The pressures created by this fiscal strain are prompting a new look at the relationships between our public and private economies, and the ways in which they interact in urban regions. This new look is calling into question some of our traditional ways of doing business, and assumptions on which those ways are based. The purpose of this paper is to probe some of the public policies and private practices and developments which shape the flows of money in urban regions, and to stimulate the inquiry into alternatives for our cities and states.

The paper will look at: 1) the flows of funds in the neighborhood economies; 2) the flows of funds in urban regions; and 3) the costs of the current patterns of investment and disinvestment.[1] The constructive task of exploring alternative policies and programs will be addressed in other papers.

---

[1] "Disinvestment" is discussed in work paper 2 on page 31. It includes actions by individual property owners, financial intermediaries and public officials which result in the reduction in or refusal to extend capital investment in facilities and services within a fairly well defined area of a city.

The Flow of Funds in Neighborhoods

Banks, and other financial institutions, can be viewed as the financial plumbing system of neighborhoods and regions. They are like the sewer and water system needed by every community. For the most part, they are invisible. While used by almost everyone, they are generally out of sight and out of mind, except when they don't work!

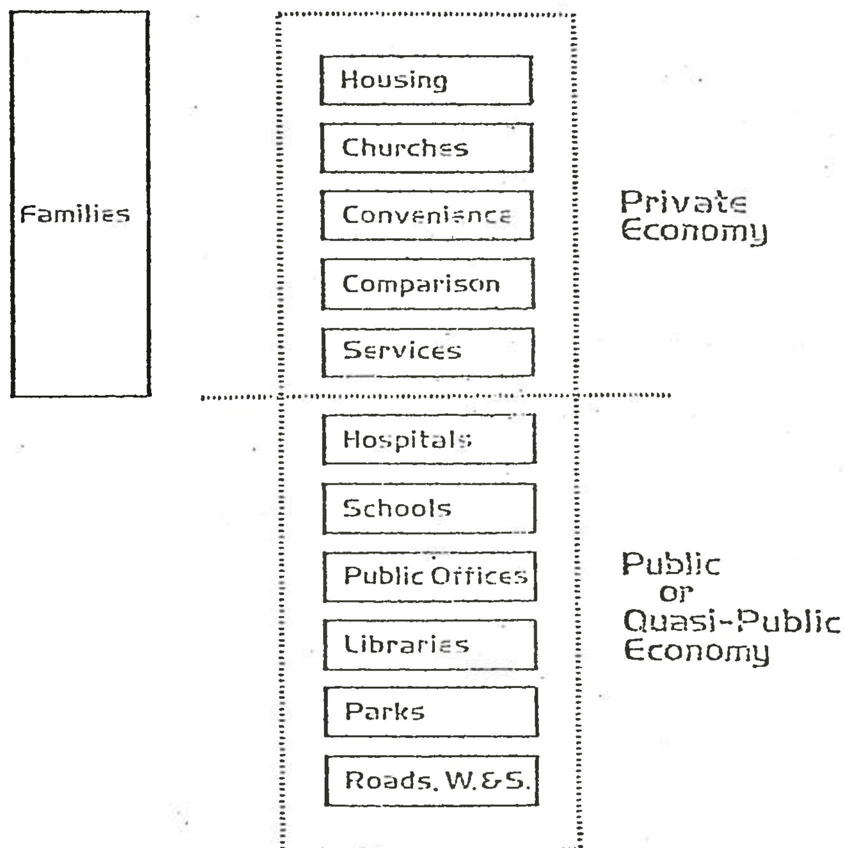
Credit, like the water system, is essential. "Credit" implies belief in the future. To "discredit" is to shut off the funds which is the equivalent of shutting off the water in a house. Banks and Savings and Loans continue to receive deposits from neighborhoods, even when they have shut off the credit. The sewer system still works, and it is not surprising to see neighborhoods going down the drain.

The economy of a neighborhood begins with people, and the activities in which they participate (see figure 1, page 7)*. The private economy includes houses, churches or other associations, convenience shopping such as food, drug, or hardware stores, and comparison shopping such as appliance, clothing, or department stores, and a range of services. The public or quasi-public economy includes institutions such as hospitals, schools, libraries, public offices, parks,

---

*Illustrations in this paper are used by permission of Dr. Hallett from material previously copyrighted.

FIGURE 1
Families and Neighborhood Activities



and physical infra-structure including sewer, water, and roads.

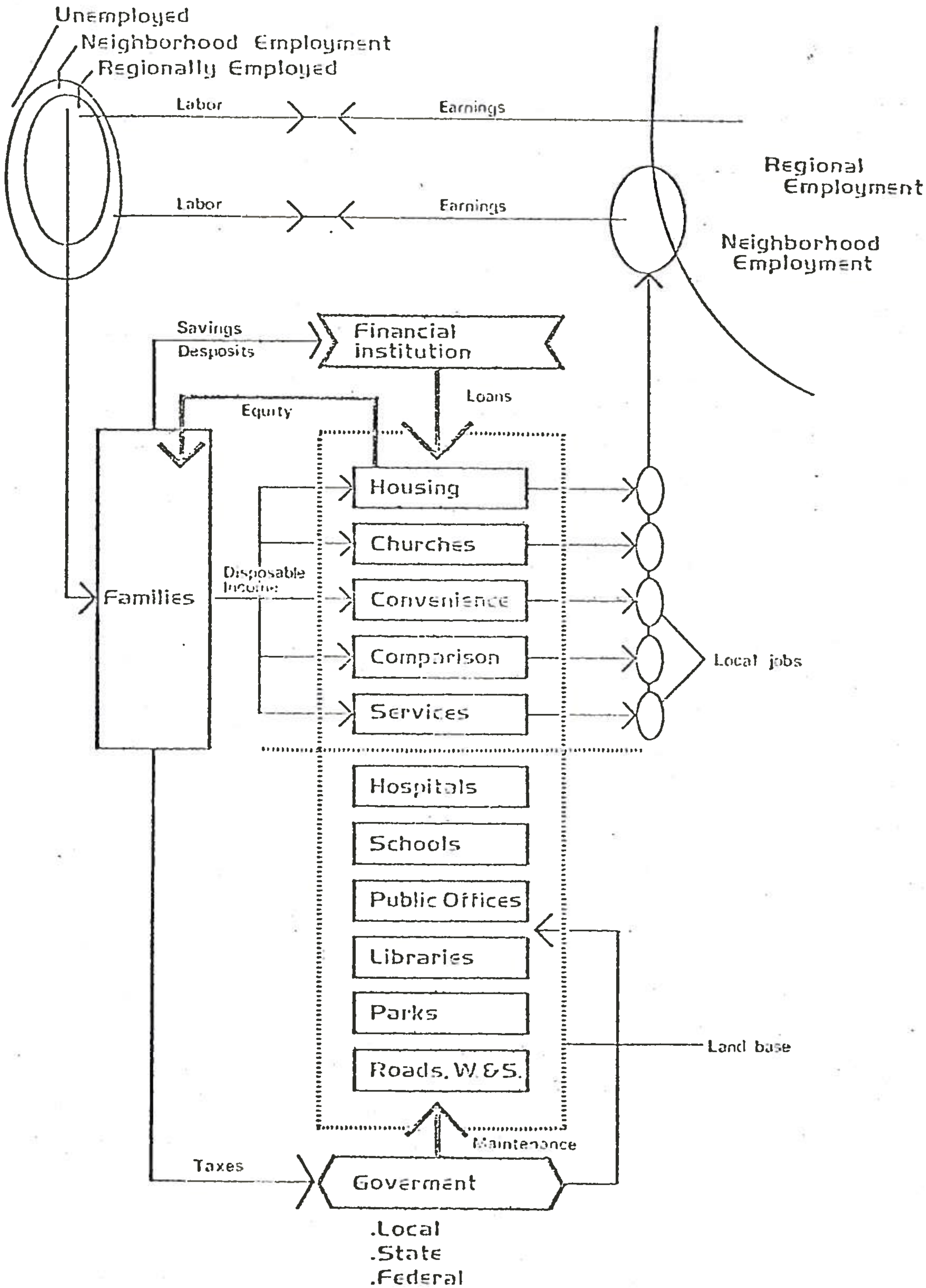
These elements of a neighborhood are linked into a set of relationships which control how much money is going to flow through the piping system of a community (see figure 2, page 5). Members of the households provide the work force, some of whom work at regional jobs, others of whom work in the neighborhood jobs, and the remainder are unemployed, or not part of the work force. It is important to note that consumer-oriented, neighborhood jobs have been increasing rapidly in our economy. Factory employment in actual numbers is about where it was in 1954.

The neighborhood jobs are particularly important for families on the lower rungs of the ladder, where the second or third income counts heavily. Whether or not there is employment for the teen-ager, mother, or grandmother is very important for a family in the $4,000.00 - $8,000.00 a year level trying to move from a status of subsistence to a status of economic growth.

The ways in which the economics of neighborhoods work are keys both to family budgets and to governmental budgets--local, state, and federal. A new neighborhood under construction, or an older neighborhood caught in a downward spiral of deterioration, each make unusual demands on public funds and create

FIGURE 2

Neighborhood Econmic Relationship



Stable Neighborhood

Woodstock Institute Chicago, Illinois

quite different contexts of opportunities or constraints for families.

One way to begin the inquiry is to ask: are we managing city neighborhoods in ways which create opportunities for individuals and families to improve themselves economically, or are we managing them in a way which breeds or creates a welfare trap? Do residents--individuals and families--have a reasonable opportunity to move up the ladder, from survival subsistence where they are dependent on welfare or unemployment, to marginal-independence where they can make it on their own unless there is serious illness or periodic high unemployment? Can they move from there to being initial accumulators, where they have a down-payment on a house or car; or to moderate accumulators with savings, investments, and reserves enough for example, to send children to college? Or, move to rapid accumulators where money is multiplying itself? It is important to keep this ladder of human economic development in mind as we look at the economics of neighborhoods.

People work, generate earnings, and provide a base of disposable income which sustains the activity centers and provides taxes which are channeled by government into facilities and activities. And the neighborhood activity centers provide jobs, which in turn provide income, to keep the cycle working.

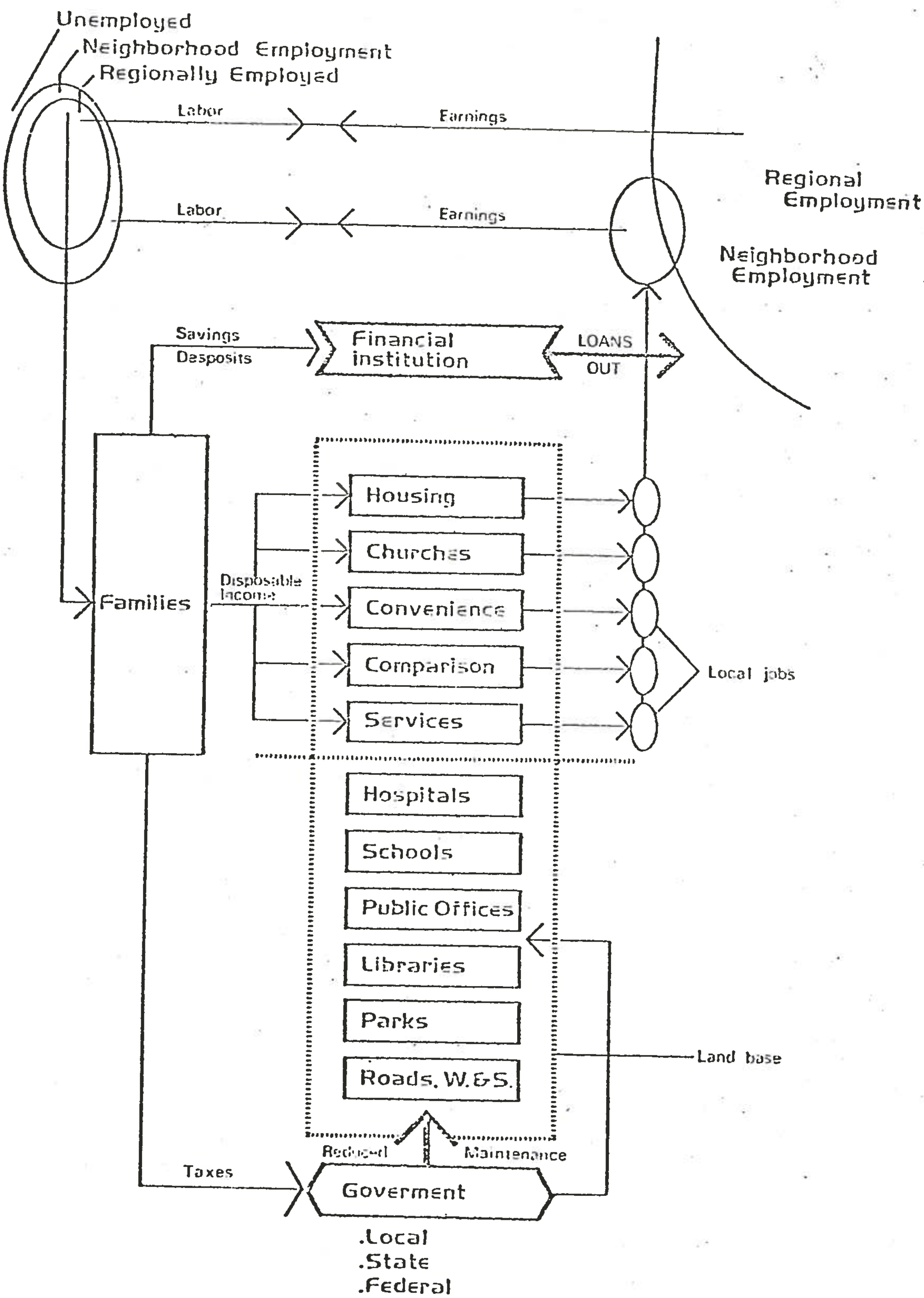
Under normal circumstances, the financial institutions make it possible to aggregate some of the funds, and to extend credit so that people can buy homes. The institutions thereby facilitate the people-family stake in the neighborhood. Institutions also extend credit to the activity centers each of which at times in their history need additional resources to change, adapt, and develop new lines of activity in the face of changing circumstances, values, or opportunities.

The financial institutions, however, may decide to turn off the credit faucet,[2] and instead of pumping money back into the neighborhood, may channel it out (see figure 3, page 8). The reasons given for this decision vary widely. It may be racial or ethnic change in the population, aging of the facilities, a decline in population with a weakening of the market, or something quite idiosyncratic, like new owners of a financial institution who have other uses for the funds.

---

[2]Denying or limiting credit in specified neighborhoods without regard to the credit worthiness of the individual mortgage applicant or the quality of the specific property has come to be known as "Redlining."

FIGURE 3
Denial of Credit



Redlining

The decline in population seems to be an increasingly important factor. The national population shifts from East to West and from North to South, and the regional shifts from central city to suburban and small town mean that increasingly our city neighborhoods will be losing some population. If this triggers a shut off of credit, it will mean the decline in population, instead of being the opportunity for improving neighborhoods and making them more liveable with lower densities, will trigger a downward spiral of deterioration and decay.

As the shut off of credit, or redlining proceeds, several important changes start to occur in the neighborhood economy. Jobs disappear, and with them the income for families whose members held those jobs. An example of this phenomena occurred in the South Shore area of Chicago where it has been estimated that a loss of 300-400 jobs occurred in housing maintenance alone when the area was redlined. Jobs are lost from the commercial and service sectors. And the housing values start to drop, so that even those families who have an investment in a house find that the value of the house is declining faster than their equity is building up. They have been caught in double jeopardy. Taxes start to decline, and government is likely to cut back some of the normal maintenance.

However, government is caught in a peculiar position. As the neighborhood declines (see figure 4, page 11), governmental costs start to rise. Families, having lost their income base, become dependent on welfare or unemployment. Care and medicaid costs start to rise. Social service costs start to go up. And equally important, some of the standard services such as schools and police start to lose their effectiveness. Educating children for jobs which don't exist in their life experience is a frustrating and frequently hated exercise. And the transiency goes up, with educators frustrated at trying to teach a moving stream. Transiency and stakelessness are also critical factors in neighborhood security, and the police fight an expensive, losing battle when the community fabric breaks down. More public funds into family income maintenance and expanded social services does not have the effect of restoring the neighborhood economy. The public costs go up, but the downward spiral continues.

At the same time this process is going on in some neighborhoods, an upward spiral is present in new neighborhoods (see figure 5, page 12). Funds are flowing in through the credit institutions to developers who are generating jobs as they build

FIGURE 4
Neighborhood Decline

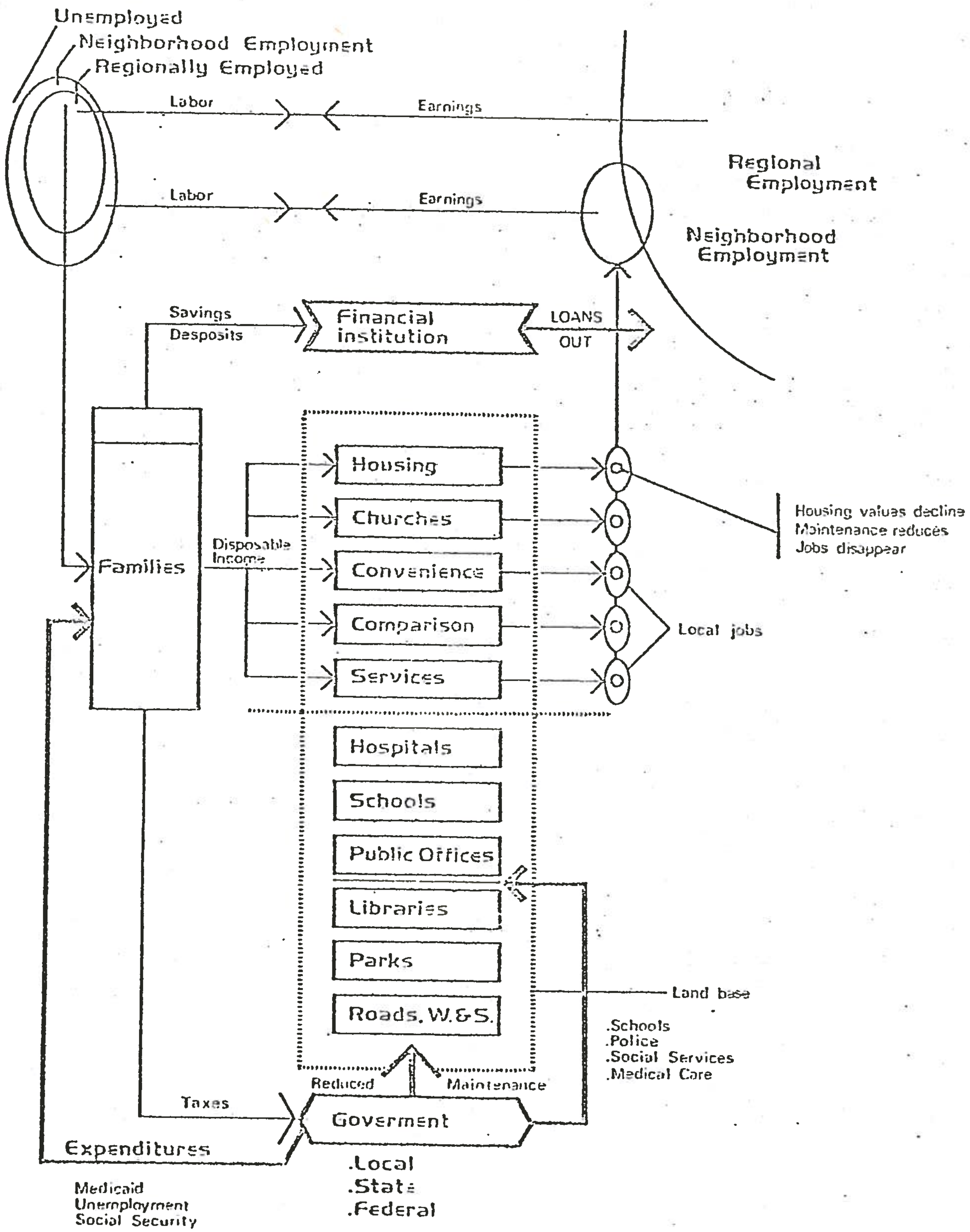
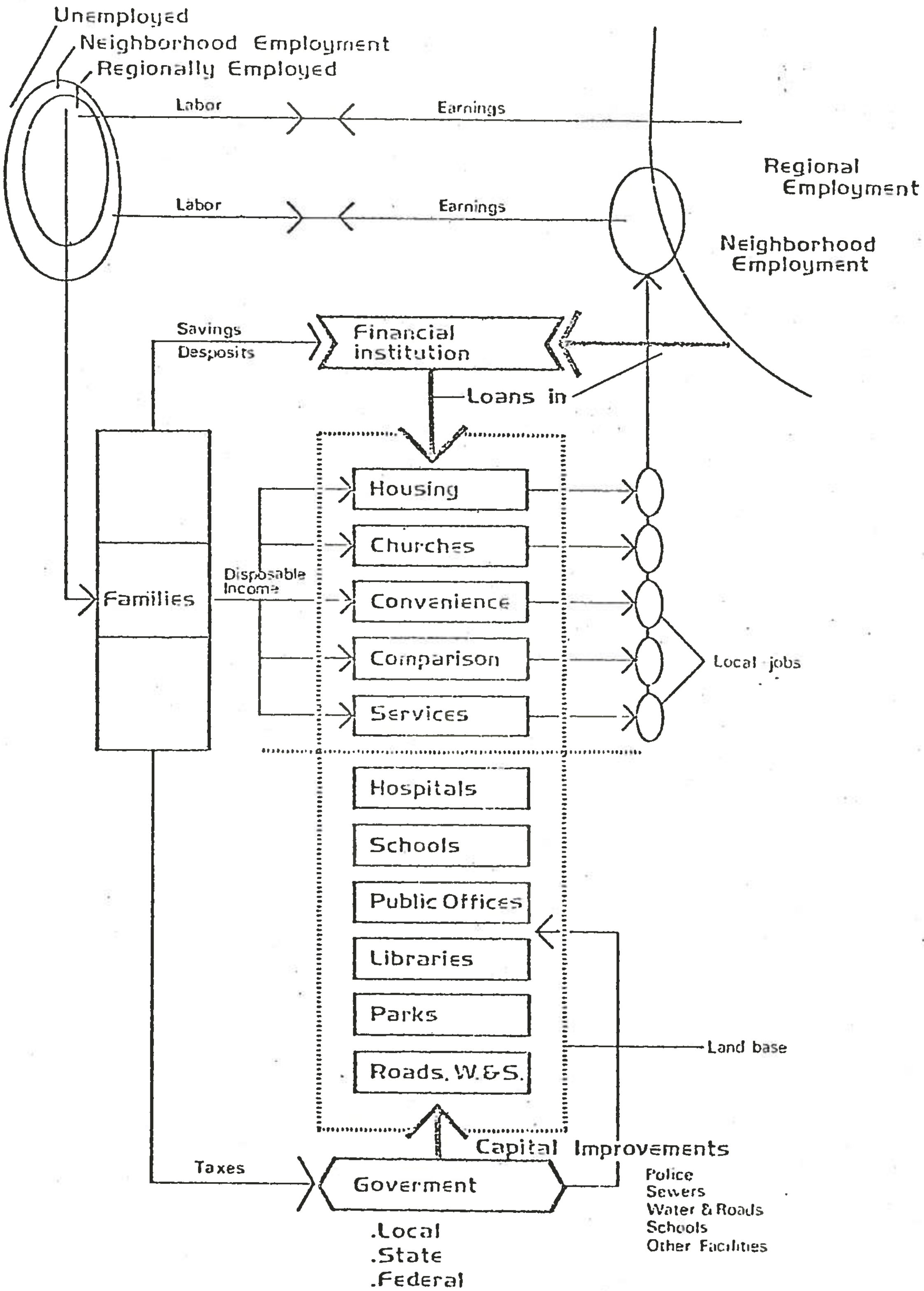


FIGURE 5

New Neighborhood



New Neighborhood

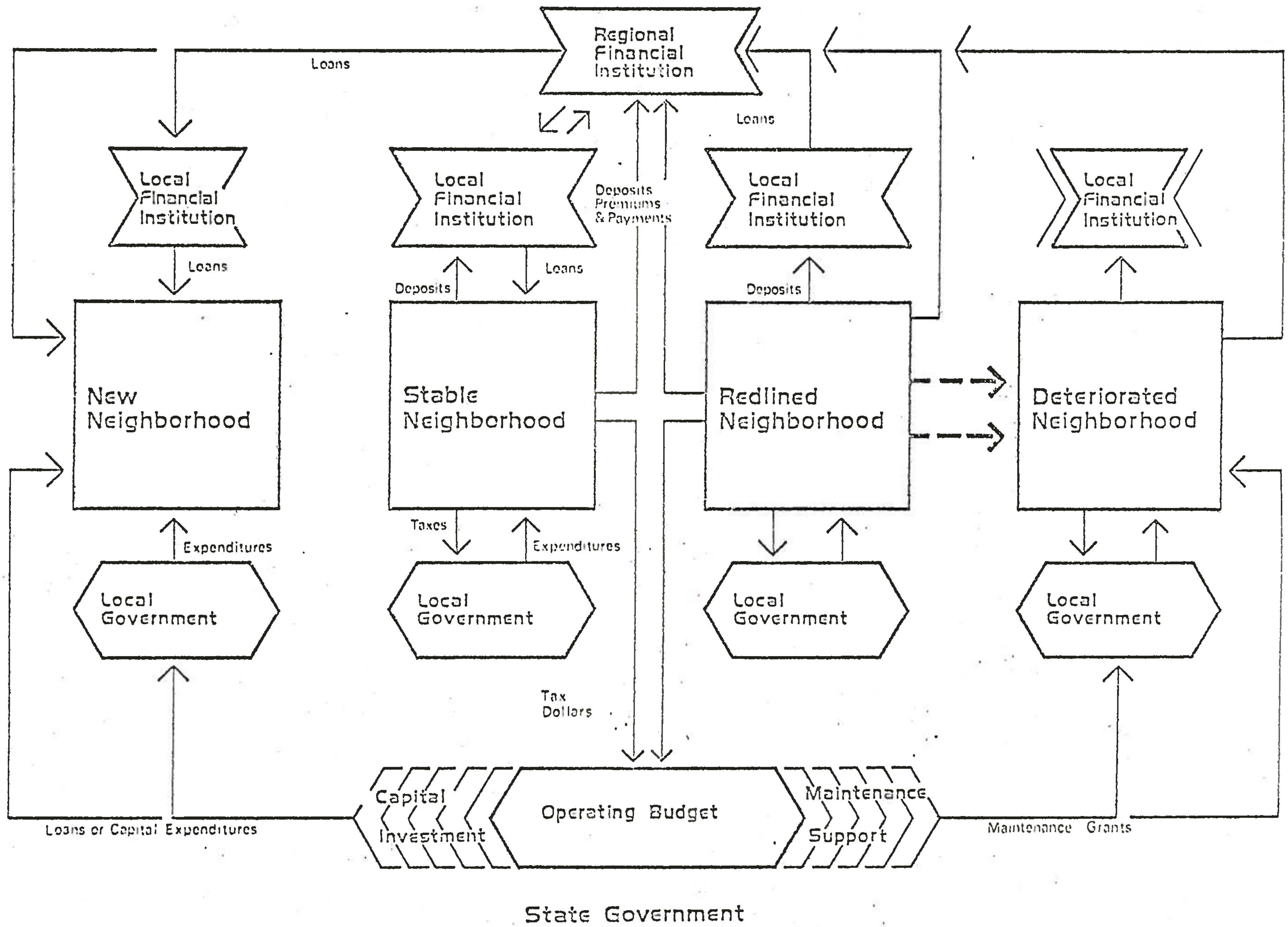
a new community. And large amounts of public funds are flowing into the capital improvements, the roads, sewer, water, and public facilities required for the new community. Values are rising, and those who invest early are in a good position, provided, of course, that development continues.

The Flows of Funds in Urban Regions

If one looks at the flows of funds in a region, (see figure 6, page 14), what one sees is some stable neighborhoods in which the funds are being recycled. Money goes into banks, and flows back as credit. Money is paid as taxes, and comes back as job-generating services. But there are some redlined neighborhoods, where the money is flowing out through the financial institutions. Local banks lend to the regional or money center banks, and they in turn lend the funds in other parts of the region. As the redlining effects proceed, the neighborhood deteriorates. The financial institutions shrink, or may even abandon the area. The maintenance costs of government start to rise.

In the new community funds are flowing in, creating jobs which in turn strengthen the demand for housing and other facilities. Public capital expenditures rise accompanied by increased bonded

FIGURE 6 Regional Flow of Funds



Woodstock Institute Chicago, Illinois

indebtedness. New communities are likely to be mortgaged to the hilt, both in terms of family and public budgets. Failure of a new neighborhood to grow at the projected rate creates serious problems. The very large losses which banks took on Real Estate Investment Trusts in recent years are in large measure a result of the failure of population growth in suburban areas to meet the projections on which their lending had been based.

The regional pattern of new community construction in the suburbs and a demolition derby among city neighborhoods can be viewed as a simultaneous boom-bust cycle, and the faster it goes, the higher the costs to the taxpayer.

The Costs of Disinvestment

The costs of managing a neighborhood from redlining to demolition are enormous. In one Chicago neighborhood, South Shore, calculations were made of the subsidies which were poured into the neighborhood in effort to sustain families after the private economy had collapsed.[3] This neighborhood is one of about

---

[3] This paper develops a concept showing the ways in which disinvestment costs occur. The South Shore data illustrate the process. Other data are being collected and analyzed to estimate disinvestment costs and to trace those costs to sectors of the public and private economies. These data will be presented in subsequent papers.

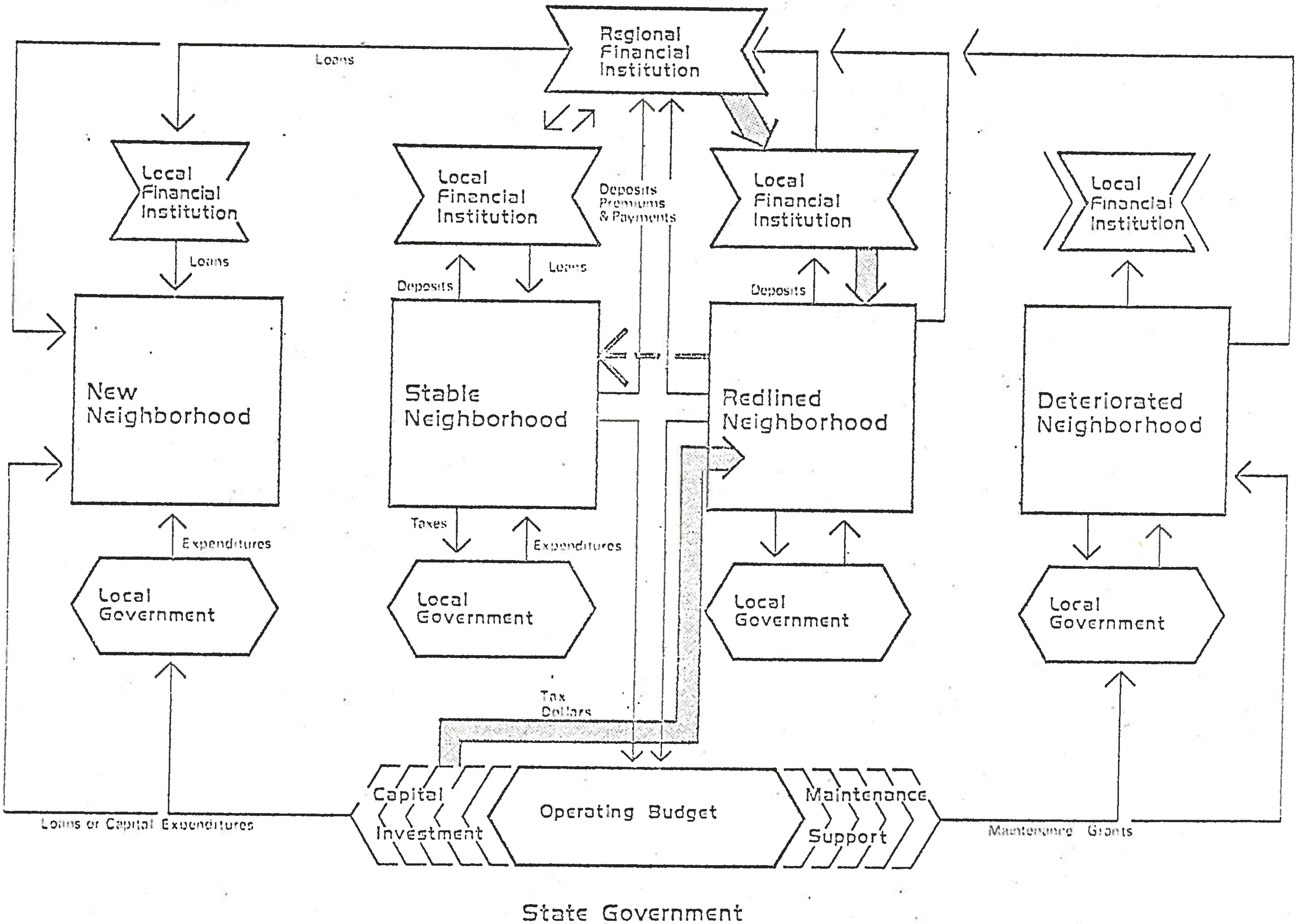
80,000 people. The estimated cost of welfare was approximately $38 million, the cost of Medicaid about $17 million, and unemployment compensation about $9 million. In addition, it was estimated that about one-half the school expenses, $10 million, were wasted because of transiency and teenage frustration. The expense of added police and criminal justice costs increased by about $8 million as a result of the continued decline of community conditions. One could add other cost categories, such as special programs in alcohol and drug abuse, housing subsidies, etc., but the total is already up to $82 million per year. Overall, it seems reasonable to suggest that the cost to the public budgets of managing a neighborhood of this size from redlining to abandonment is well in excess of $500 million.

At the same time, the public is footing the bill for many of the costs of new suburban construction. The public costs of new development for a community of 100,000 people is well in excess of another $500 million. An investment of approximately $2 billion of private funds is also required to build the new community, and these costs are rising rapidly.

What does this mean in terms of the actual dollar costs of disinvestment? In one Chicago neighborhood which was totally redlined by financial institutions five years ago, the South Shore area, these costs were checked. South Shore is a neighborhood which had changed from white to black in the previous decade. To manage that neighborhood to demolition would cost the taxpayers in excess of $½ billion. To rebuild a comparable neighborhood in the suburbs would cost $½ billion in tax monies and $2 billion in private investment and credit. A laundry list was made of everything which one could think of to bring that neighborhood up to snuff, to put it in first class shape, and the total list came to about $120 million. And that, as it turns out, is exactly what the present residents of South Shore have on deposit in banks. All they need is to be able to recycle their own money!

What is needed, then, are ways in which to channel public investment, rather than maintenance dollars, into city neighborhoods (and some suburban communities as well) in ways which will leverage the flow of private dollars (see figure 7, page 18). Private financial institutions need to do a re-assessment of their risk analysis, and develop the creative lending patterns which stimulate the flows of funds in improving and upgrading existing communities. The management resources to channel the flows of funds into existing communities are also needed.

FIGURE 7 Investment Strategy



Woodstock Institute Chicago, Illinois

Instead of a pattern of divergence, in which public policies and private practices contribute to upward spirals of development in some neighborhoods, and to downward spirals of deterioration in others, policies and practices are needed which tend to move neighborhoods and towns toward an equilibrium in which their economies stay balanced and working.

The alternative is to allow a continuation of state governments which are caught between maintenance costs on the one side and capital expenditures on the other, with one foot on either side of the fence, neither foot touching the ground, and wondering why it hurts!

Part II

Chapter 2

AN ANALYSIS OF UNDERWRITING AND APPRAISAL PRACTICES AND THEIR IMPACT ON CREDIT AVAILABILITY

About the Author

Calvin P. Bradford is the Associate Director of the Center for Urban Studies of the University of Illinois at Chicago Circle and an Assistant Professor of Urban Planning and Policy in the College of Urban Sciences of the University of Illinois at Chicago Circle.

Dr. Bradford is the co-author of a recently published study by the U.S. Department of Housing and Urban Development entitled: Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Loans. He is also the co-author of The Role of Mortgage Lending Practices in Older Urban Neighborhoods: Institutional Lenders, Regulatory Agencies and Their Community Impacts.

He serves as an Associate Editor of the Urban Affairs Quarterly, and has been a consultant to community groups, local, state, and federal governments, and public policy organizations.

Dr. Bradford's educational background includes degrees from the following institutions: B.A., History, Trinity College; B.S., Andover-Newton Theological School; M.A., Sociology, Northwestern University; and Ph.D., Sociology, Northwestern University.

AN ANALYSIS OF UNDERWRITING AND APPRAISAL PRACTICES AND THEIR IMPACT ON CREDIT AVAILABILITY

Summary

Two of the primary keys to understanding the issue of disinvestment in inner city and older suburban neighborhoods by some financial institutions are the underwriting and appraisal methods utilized by these institutions. This paper analyzes traditional underwriting and appraisal techniques and the impact they have had on the perceived prudence of lending in older neighborhoods. The paper compares these traditional appraisal and underwriting practices to the existing studies of default and foreclosure risks in older, minority and racially changing communities, concluding that the studies do not substantiate the levels of risks traditionally associated with such areas.

Chapter 2

AN ANALYSIS OF UNDERWRITING AND APPRAISAL PRACTICES AND THEIR IMPACT ON CREDIT AVAILABILITY

by Calvin P. Bradford

> "The biggest problem with our generation of bankers is that they don't know how to do risk analysis." - Ronald Grzywinski, Chairman of the Executive Committee, South Shore National Bank of Chicago.

At the heart of the controversy over redlining, disinvestment and reinvestment is the question of risk analysis. Viewed from a lender's point of view, the decision not to lend -- or to lend on more restrictive terms -- in certain areas which he perceives as risky may appear to be a wise business decision dictated by his responsibility to protect his depositors and stockholders. Viewed from the community's point of view, such decisions cut that community off from its access to vitally needed credit.

Disinvestment studies (conducted by public officials and community groups) which document the lack of conventional mortgage money in older, minority, or racially changing neighborhoods across the country have served to dramatize the issue, and to force examination of it by public officials. These studies, however, do not necessarily address the question of whether lenders are making unfortunate, but essential, business decisions which negatively affect certain neighborhoods in order to avoid taking undue risk and incurring excessive losses on loans in these communities. What separates a wise business decision from one which creates a self-fulfilling prophecy of neighborhood decline is the validity and accuracy of the lenders' claim that community conditions create unacceptable credit risks.

The importance of proper risk analysis is emphasized in a quote from a publication of the nation's single largest mortgage holder:

> Generally, mortgage lenders impose credit restrictions on geographical areas because, rightly or wrongly, they believe that property values have declined or will decline so that the security behind their long-term mortgage loans will disappear before the loans are repaid. If the lender's judgement as to threatened values is correct, his action will prevent consumers from over-improving or over-paying for homes. If the lender's judgement is mistaken, he will contribute to the very decline in neighborhood values which he fears.

It is essential that lenders base their analysis of the risks involved in a loan on sound, well-informed, and trustworthy methods. The analysis of lending risks, which is called <u>loan underwriting</u>, has become more and more professionalized and subject to uniform standards. Many of these professional standards incorporate models of neighborhood life cycles and assumptions about sound neighborhood conditions which are based on little, contradictory, or fragmented evidence. The application of these models or assumptions to a specific loan, in a specific community, at a specific point in time, therefore, may not be a sound practice.

Analyzing Neighborhood Risks: Underwriting

Lenders consider the risks involved in making a loan from two perspectives. The first is the creditworthiness of the borrower. This is called credit underwriting. In the past, credit underwriting has been based on rules of thumb about what sources of income should be taken into account, how much a person should spend on housing, what is the borrower's total debt to income ratio, a person's past credit history, and even a person's race, sex, or religion. Recent changes in federal and state laws now forbid lenders from employing standards which consider the ethnicity, sex or religion of the borrower, and prohibit the arbitrary use of standards which disqualify certain sources of income, such as a wife's second income or welfare payments.

There is no body of literature linking underwriting standards to the lack of availability of credit in low-income, older, minority or racially changing neighborhoods. In spite of this fact, however, standards for determining the creditworthiness of borrowers continue to be the object of public scrutiny since it is clear that their arbitrary use by lenders can reduce, and even shut off credit to entire communities.

The second risk consideration involves what is called property underwriting. When a lender makes a mortgage loan, for example, the property serves as collateral. No lender would want to loan more than the value of the collateral. If the homeowner fails to make the mortgage payments and defaults on the loan, the lender has to foreclose and take the property. He must be able to sell that property for enough to repay the outstanding value of the loan, the lost interest payments, any unpaid real estate taxes on the property, and all of the fees and legal costs associated with foreclosing and reselling the home. If the final sale price is not enough to cover all these costs, then the lender will lose money.

The risk of default exists potentially on every loan. The lender's job is to reduce his risk to a minimum by doing careful underwriting. In order to insure that lenders are prudent underwriters, federal and state laws regulate the lending practices of depository institutions to insure that they loan less than the full market value of a property. The lender is required to have a "cushion" of some amount between the estimated value of the home and the actual amount of the mortgage. Thus the lender requires a downpayment from the purchaser to make up the difference between the sales price of the property and the amount of the loan.

Lenders have property appraised to estimate the value so that they then can determine the amount that they will loan on the property. The appraised market value may not be the same as the sales price since the actual price a person pays may be affected by unique conditions -- such as buying a home at a special low price from a relative, or paying more than it is worth because of some personal sentiment for that home. The appraisal tells the lender the estimated value of the property. However, a mortgage is a long-term loan which is paid back slowly.

Typically a lender requires about a twenty per cent downpayment as a cushion against losses from foreclosure. If the value of the property decreases rapidly, however, then this cushion may not be enough to pay all the costs associated with foreclosure. Thus, the lender must anticipate the trends in the market, and decide whether there are threats to the future value of the property which represent an unreasonable risk for a standard loan.

If the lender perceives that values currently are decreasing, or are likely to during the term of the loan, then the lender has several options: (1) the lender can impose more restrictive conditions on the loan by raising the amount of the downpayment, increasing the interest rate, or shortening the length or "term" of the mortgage. In the first case, the lender loans a smaller amount to reduce what he has at risk. In the second case, the lender charges more for taking the risk. In the last case, the lender gets paid back in a shorter time, reducing the amount of time that his money is at risk. A lender may decide that the risk is so great that he must impose two, or even all three, of these restrictions.

(2) Another option for the lender is to insure the mortgage against loss. There are several private mortgage companies which insure part of the loan value against loss when the lender makes a loan with an unusually low downpayment, say only five or ten percent. Also, the Veteran's Administration (VA) and Federal Housing Administration (FHA) programs guarantee or insure the full value of the loan - thus making it almost risk free for the lender.

(3) The final option for the lender is simply not to make the loan at all. The charge of redlining most commonly occurs when the lender decides not to loan in a certain area at all. Requiring insurance, and/or applying restrictive terms to all loans in certain areas, however, also represents a form of arbitrary denials of credit if the measurable risks do not warrant these measures.

The Link Between Appraisal and Underwriting

As part of the underwriting process, both federally and state regulated lenders are required to base their estimates of the present value of a property on an appraisal.[2] An appraisal is an "expertly informed opinion" of the present value of the property.

There are three standard methods of appraising a property: one based on the income the property will produce; another based on the cost of construction; and a third based on comparing the property to the sales prices of comparable properties.

The last method -- called the market value approach -- is thought of by lenders as the most reliable since they can directly compare subject properties to the existing sales market. The income approach is commonly used for income-producing properties -- such as shopping centers or multi-family buildings -- not only because potential income is the primary consideration, but also because, unlike homes, there may not be enough sales of reasonably comparable income properties to use the market value approach.

The market value approach requires the appraiser to select comparable properties which have sold in the same neighborhood in the recent past. The appraiser must use his subjective judgement to make adjustments when the properties are not exactly comparable in construction, amenities, age, etc. There will always be some adjustments since no two properties are exactly alike in every way. Adjustments must also be made to account for value trends and estimated changes in value which have occurred since the time of the sales of the comparable properties. Finally, if the comparables are not taken from the same neighborhood as the property being appraised, the appraiser will make adjustments for differences in the neighborhoods which he feels affect the value of the property.

These last two considerations -- value trends and neighborhood factors -- draw upon the appraiser's professionally informed judgement about what neighborhood conditions effect property values and what trends in values should be anticipated and incorporated in the appraisal of present value.

Aside from trying to determine the present value of a property, the lender is concerned about the longer term value trends or threats to the security of the property. This part of property underwriting is essentially like appraising except that value trends are anticipated for a longer period of time. Lenders have relied on appraisers, their professional standards, techniques and assumptions for developing their own long-term property underwriting standards. Frequently, lenders train their underwriters by enrolling them in the programs of the professional appraisal organizations.

The Professional View of Neighborhood Risk Factors

The literature, training manuals and texts of the professional real estate appraising industry define the standards, assumptions and models used in judging neighborhood factors and loan risks. A review of the development of its literature reveals the sources upon which these standards, assumptions and models are based.

The early works on appraising and real estate principles reflect views on the relationship between ethnic change, age of the community and community life cycles which still appear in much of the professional materials today. Two theories of urban decay are commonly used to support the contention that neighborhoods pass through natural life cycles and that racial change indicates a cycle of decline. Both of these theories, or models, were developed at the University of Chicago in the 1920's and 1930's. They are the "Human Ecology" model and the "Filtering Model."

The Human Ecology Model was formulated principally by the Chicago School of Sociology in the work of Robert Park, Roderick McKenzie and Ernest Burgess. It became the dominant social model of urban development. This model stems from a strong social Darwinistic tradition, where not only animals, but people were seen to survive and reach positions of power and status because they were inately the strongest species. This school was also heavily influenced by plant biology, particularly studies of how various plants would take over a piece of land previously occupied by different species. It was believed that the "invading" plant, as it was called, drove out the original inhabitants because the invaders were better suited to the particular environment.[3]

When applied to human society and the neighborhood development patterns of urban areas, in particular, this model held that different groups of people "infiltrated" and "invaded" territory held by others, and that through a process of "competition" -- which was a kind of war of survival -- the group most suited to that environment would win out and eventually take over completely. Neighborhoods and communities, therefore, were seen not so much as conscious man-made environments, but rather as natural phenomena subject to the laws "of all nature."

As the level of industrial technology in the society advanced, certain areas were seen as best suited to that level of technology, and thus become the location of the most successful businesses and residents. Areas less suited to advanced technology become inhabited by the businesses and residents least suited for survival at that state in the evolution of society and technology. Thus, areas, neighborhoods and communities were identified as going through natural life-cycles where they grow to a point of success, but then as the technology of the society develops and favors different locations, the community is invaded and taken over by lower uses and lower class people in continuing waves of invasion, competition and succession.

There are temporary plateaus of stability when the area is occupied by a homogeneous population or land use, analogous to a single species of plant taking over its most beneficial location. When this homogeneity is interrupted by the "invasion" of a different type of land use, property or class of persons, however, this starts the downward cycle. According to the literature based on the human ecology model, therefore, the process continues until the area reaches its inevitable place as a slum.

Race and the Models of Decline

Robert Park's own statement about the Eastern Europeans then occupying Chicago's slums best expresses the Darwinistic, and discriminatory biases of this human ecology model of neighborhood dynamics:

> In the great city of the poor, the vicious and the delinquent, crushed together in an unhealthful and contagious intimacy, breed in and in, soul and body, so that it has often occurred to me that those long generations of the Jukes and The Tribes of Ishmael would not show such a persistent and distressing uniformity of vice, crime, and poverty unless they were peculiarly fit for the environment in which they are condemned to exist.[4]

At the same time, a colleague of Park's, Homer Hoyt, was working on real estate models of land values. In an historical analysis of land values in Chicago, Hoyt included a discussion of race and land values. He surveyed some local realtors (members of the Chicago Real Estate Board, which prohibited members from selling to a Black on a White block). One West Side realtor gave him a list of ethnic groups ranked in descending order, from those which are most desirable to those which have the most adverse effect on property values.

The list was as follows:[5]

1. English, Germans, Scotch, Irish, Scandanavians
2. North Italians
3. Bohemians or Czechs
4. Poles

5. Lithuanians
6. Greeks
7. Russians, Jews (Lower Class)
8. South Italians
9. Negroes
10. Mexicans

McMichael's Appraising Manual, often called the Bible of appraising, is a commonly used appraisal text which was first published in 1931. Appraisers were then advised to determine whether there were "undesirable racial elements" in an area.[6] The 1951 edition responds to a Supreme Court decision striking down racially restrictive covenants by saying it created "further confusion to appraising properties in foreign and Negro-occupied districts." The text then praises Hoyt's study of land values in Chicago and reproduces his ranking of ethnic groups and their effect on property values. Following this there is a discussion of how the "ingress" of certain ethnic groups precedes blight.[7] The most recent edition of the text (1975) still contains Hoyt's list![8]

This orientation is superimposed on a work which Hoyt did for the FHA in 1939, The Structure and Growth of Residential Neighborhoods in American Cities.[9] In this book, Hoyt defines what has come to be known as the "filtering" or "trickle-down" model of neighborhood decline. This model suggests that as properties and neighborhoods get older, they filter down into the hands of poorer and less capable people until they finally become slums. This filtering concept, which transforms the human ecology model into real estate terms, has been the basis for various models of the life cycle of neighborhoods in later real estate and appraisal literature.

Although Hoyt is considered the founder of the filtering model, Frederick Babcock, who gained his real estate experience while working in Chicago during the time the Chicago School of Sociology was developing, implied such a filtering concept in his influential 1932 book, The Valuation of Real Estate. After describing six characteristics of neighborhood decline, Babcock states:

> The process can be described as inevitable in all residential districts. Given time, all such areas become decadent districts or slums occupied by the poorest, most incompetent, and least desirable groups in the city. Ragged urchins play on marquetry floors.

Two pages later he comments:

> Most of the variations and differences between people are slight and value declines are, as a result, gradual. But there is one difference in people, namely race, which can result in a very rapid decline. Usually such declines can be partially avoided by segregation and this device has always been in common usage in the South where white and Negro populations have been separated.[10]

The first edition of the American Institute of Real Estate Appraisers' (AIREA) text, published in 1935, echoes Park, Hoyt and Babcock by warning of the adverse effects of the "infiltration of inharmonious racial groups." The text suggests that areas can be protected from these adverse effects by deed restrictions "which forbid whites to sell their homes to blacks."

Acccmpanying his testimony before a HUD meeting on Redlining in July of 1976, Walter Winius of the American Institute of Real Estate Appraisers submitted 21 articles which have appeared in the Institute's "Appraisal Journal" since 1938. "The Journal" does not represent the official position of the Institute, but was described as "A Forum for the presentation of new ideas and concepts having to do with the appraisal of real estate, many of which have ultimately appeared in our textbooks." He explained that an article in 1959 by Charles Abrams "issued a clarion call in respect to the analysis of neighborhoods." That article suggested that there had been a bias against integrated neighborhoods and against blacks, and that this bias was unwarranted. Winius cited several articles published prior to 1967 which demonstrated, using statistical studies, that racial change had no adverse effect on property values.[12] Nevertheless, in the 1967 edition of the Institute's basic text, THE APPRAISAL OF REAL ESTATE, the chapter on Neighborhood Analysis reads:

> The value levels in a residential neighborhood are influenced more by the social characteristics of its present and prospective occupants than by any other factor. Therefore, the appraiser must give major consideration to the importance of social data.
>
> The causes of racial and religious conflicts are not the appraiser's responsibility.

> However, he must recognize the fact that values change when people who are different from those presently occupying an area advance into and infiltrate a neighborhood.[13] (Emphasis ours.)

The Student Outline used in a 1973 session of the Institute's basic course reads:

> Ethnological information also is significant to real estate analysis. As a general rule, homogeneity of the population contributes to stability of real estate values. Information on the percentage of native born whites, foreign whites, and non-white population is important, and the changes in this composition has a significance. As a general rule, minority groups are found at the bottom of the socio-economic ladder, and problems associated with minority group segments of the population can hinder community growth. Similar comments are appropriate for occupational types in a community.[14] (Emphasis ours.)

In a slide show on single-family appraising shown during that course, the scene of a burned out store was accompanied by the words: "...One exceptional factor which may affect value is the influx of inharmonious social or racial groups."[15]

Recent Changes in the Use of Ethnicity in Appraising and Underwriting

In the past few years, there have been several attempts made by appraisal and underwriting organizations to eliminate clear references to the relationship between changes in ethnicity and property values. The most recent text of the American Institute of Real Estate Appraisers

(1973) is purged of the language in the 1967 version which mentioned racial change as a threat to values in a neighborhood.[16] In addition, they introduced in 1976 a set of sample questions and answers on race and property values to be used by their instructors to answer student questions on the subject. These answers also deny that race necessarily effects property values.[17]

The savings and loan industry is the largest originator of home loans, making more than 50 percent of all such mortgages. The Federal Home Loan Bank Board (FHLBB) directly regulates federally chartered savings and loan associations; and through its Federal Savings and Loan Insurance Corporation (FSLIC) indirectly regulates the practices of most state chartered savings and loans.

In 1974, an opinion from the General Counsel for the FHLBB stated that consideration of the ethnic composition of the area where a loan is to be made is a violation of Civil Rights Law.[18] Moreover, later regulations adopted by the FHLBB state:

> The use of lending standards which have no economic basis and which are discriminatory in effect is a violation of law even in the absence of an actual intent to discriminate. However, a standard which has a discriminatory effect is not necessarily improper if its use achieves a sound business purpose which cannot be achieved by means which are not discriminatory in effect or less discriminatory in effect.
>
> Refusal to lend in a particular area solely because of the age of the homes or the income level in a neighborhood may be discriminatory in effect since minority group persons are more

> likely to purchase used housing and to live in low-income neighborhoods. The racial composition of the neighborhood where the loan is to be made is always an improper underwriting consideration.[19] (Emphasis ours.)

The U. S. League of Savings Associations is the trade organization of the savings and loan industry. Among the functions which this organization performs is the training of lenders seeking advancement in the industry. For years the organization has trained its members on the use of its own recommended appraisal form, known as the "Green Hornet " (Residential Appraisal Form 17-PRA). One of the items on this form asked for the "ethnic composition" of the area. The appraiser -- either a staff member of the S & L, or a contract appraiser -- was to check off either "stable" or "unstable" conditions.

In response to the 1974 opinion of the General Counsel of the FHLBB, this form was changed to replace ethnic information with data on "sales velocity." In the League's underwriting text, the wording surrounding the copy of the Green Hornet form was not changed. In addition, the League's 1975 text, Lending Principles and Practices, states that racial change, even fear of racial change, is identified with increased volume of sales -- thus linking sales velocity to ethnic change.[20]

Definition of Stable Neighborhoods

These changes have deleted direct statements that racial change leads to declining communities. The definition of a neighborhood as relatively homogeneous, however, remains. Both the 1967, and the recent(1973) editions of the AIREA text defines a neighborhood as "a homogeneous grouping of individuals, buildings or business enterprises within, or as part of, a larger community."[21] Both versions go on to say:

> Residential neighborhoods assume many of the characteristics of the individuals who live in them. These neighborhoods express the mutual desires of people with comparable interests, related traditions, and similar social and economic status.[22]

The notion that a neighborhood should be homogeneous in order to remain stable or to increase in value is reinforced by what appraisers and underwriters call the principle of conformity. The American Institute of Real Estate Appraisers states that "the principle of conformity holds that maximum value is realized when a degree of sociological and economic homogeneity is present."[23] The manual of the Society of Real Estate Appraisers (SREA) presents eight aspects of the principle of conformity:

1. Similar types of houses.
2. Houses of similar utility.
3. Similar age and size of houses.
4. Similar quality of houses.
5. Similar price range of houses.

> 6. Residents' income in the same general bracket.
> 7. Residents of similar cultural, education, ethnic and social backgrounds. (Emphasis ours.)
> 8. Similar land uses.[24]

The AIREA, in their most recent text, claims that it is "the appraiser's minimum task to analyze the neighborhood in accordance" with the seven principle factors which they claim are advantageous to a neighborhood. One of these factors is "a homogeneous population with a sense of civic responsibility."[25]

Thus while overt references to the adverse effects of racial change on property values have been expunged from recent texts and appraisal forms, the appraiser is left with definitions of stable and desirable neighborhoods which rely heavily on the notions of homogeneity and conformity. The recent version of the AIREA's text removed explicit statements about religious and racial factors but replaces it with this vague statement:

> No matter how attractive a particular neighborhood may be, it does not possess maximum desirability unless it is occupied by people who are reasonably congenial. This imples a community of interest based upon common social or cultural backgrounds. Above all, home purchasers with children usually desire the best advantages that they can afford: and this includes compatible families as neighbors.[26]

It appears that a uniform statement that racial change harms neighborhood values has been replaced by a new position leaving this decision up to the individual appraiser, guided by the neighborhood definition of homogeneity and the principle of conformity.

The Cycle of Decline Model

The belief that neighborhoods inevitably, or at least typically, pass through a life cycle of birth and death has been extracted from the work of Park and Hoyt and placed at the core of the professional appraisal and underwriting wisdom on neighborhood risk analysis. The model has permeated not only real estate literature, but popular beliefs as well. Nonetheless, surprisingly little research has been done on the causes of decline and improvement since Park first introduced the theory in the 1920's based on his analogy to plant behavior.

To test the theory, a study would have to test all the possible causes of decline against each other over a large number of different communities across the country. Such a study would have to be continually repeated to insure that as time passed and the environment changed, the causes of decline didn't also change. All of these studies would have to favor a single model or set of causes in order to justify the acceptance of the model. Among the things which would have to be taken into account as causes of decline or improvement would be not only age and racial change (as is the case with the model used in underwriting texts), but also the individual market behavior of the residents, the actions of government bodies, the impacts of lending decisions on the viability of the neighborhood economy, external conditions such as the state of the regional and national economy, the rate and location of new development, and finally, the interrelationships among all of these factors.

No such study exists! What exists are some fragmented, often conflicting, studies of these individual factors. Most research is based on one, or a small group of communities in one location at one point in time.[27]

Most contemporary descriptions of life cycle models were designed to describe how heavily blighted or abandoned areas progressed to this state.[28] Obviously such areas declined from an earlier and healthier condition. These models can, and do, break down this decline into several stages. There is no indication in such studies, however, that all communities should be expected to pass through these cycles.

The most recent, and most popular, example of life cycle models was published by HUD in 1976. This model is called The Dynamics of Neighborhood Change, and was produced by Public Affairs Counseling -- a division of the Chicago-based Real Estate Research Corporation.[29] The model is based on literature existing before 1974 and not on any new research in the area. The bibliography shows that many of the major disinvestment studies in existence at the time were not included.[30] Much of the literature cited are personal case studies from members of the appraisal and underwriting industry.

The model describes neighborhood decay in terms of these five stages: Healthy, Incipient Decline, Clearly Declining, Accelerating Decline and Abandoned. The model does not claim that decline is inevitable once it begins, as did Babcock. However, the model is based on the existing real estate literature, and reflects many of the racial considerations we have examined.

A "healthy" neighborhood is described by a series of physical, social and economic characteristics. One of those characteristics is "moderate to upper income levels," and another is, "Ethnic homogeneity."[31] As a neighborhood moves into "incipient decline," it is seen as reaching a critical point, since spontaneous recovery from a later stage of decline is seen as extremely difficult.[32] Two of the characteristics which describe a move into the stage of "incipient decline" are listed as "aging housing stock," and "influx of middle income minorities." In the "clearly declining," stage "decrease in white in-movers" and "more minority children in schools"[33] are listed as two characteristics.

The document identifies even the perception of racial change as a factor which might accelerate the process of decline. It reads:

> What is important is how fast the neighborhood declines...First, the cause of the original softening is important. If, for instance, the cause was racial change in neighborhoods some distance away and the intervening neighborhoods are similarly changing, then the rate of decline may increase rapidly. Turnover may shoot up and the neighborhood may move from 'incipient decline' to 'clearly declining' very quickly.[34]

Although there is a lack of evidence in support of such models, they are clearly stated as facts in the appraisal and underwriting professions. For example, the most recent text of the SREA reads:

> All neighborhodds exhibit a life cycle which varies only in the intensity and duration of each phase. The phases are:
>
> (1) Development and Growth. This is the period during which prices are increasing, and the neighborhood is built up.
>
> (2) Stability. This period may last from approximately the 10th to 15th year of the life of the neighborhood, perhaps through its 40th year. This is generally the period of highest value and attractiveness of the neighborhood.
>
> (3) Transition and Decline. This occurs as the attractions of the neighborhood are offset by those of new, competitive areas. The properties become functionally obsolescent, as does the pattern of the neighborhood. New uses begin to move in, and transition frequently results in lower values.
>
> (4) Renewal and Rehabilitation. In some instances, it is possible to renew and revive a neighborhood. Examples may be found in nearly every city: e.g., Old Town in Chicago, and Society Hill in Philadelphia.[35]

<u>Homogeneity, Conformity, and Mortgage Risks</u>

In spite of the emphasis which appraisers and underwriters have placed on the need for homogeneity and conformity of land uses, building types, styles of construction and social characteristics of the residents and aside from some studies of race and property values, there are not studies which systematically compare homogeneous and heterogeneous communities to assess the risk posed by lack of conformity and uniformity. These notions were based on the Human Ecology model derived from analogies to plant behavior.

Though there have been no systematic studies, there is some indication that mixed land uses and building types may actually be <u>beneficial</u>. A major study carried out for HUD tried to estimate the optimum land mix best suited for environmental impacts. This study, <u>The Costs of Sprawl</u>, cited a high degree of mix between commercial, industrial, low-rise and high-rise development as the most beneficial. Moreover, while underwriters have been looking critically at mixed use patterns in older communities, they have viewed the development of the Planned Unit Development (PUD) concept for new development as a sound, even risk reducing, technique. One of the basic tenets of the PUD is that the developer is allowed to mix land uses and combine single-family, multi-family and commercial or industrial uses within the same development area. By not depending upon one particular style of building or one particular market, the developer is supposed to minimize the risk of failure in the project and maximize the development of socially and economically sound communities.

Risks Posed by Race and Racial Change

1. Property Values and Racial Change

An analysis of the major studies on property values and race reveals that in all but one of the studies, property value trends either increased or remained about the same after racial change.[36] In the one study which documents that prices did not rise after racial change -- "Racial Succession and Changing Property Values in Residential Chicago" -- the author notes that values were declining prior to Black entry.[37] Seven of the studies which considered the socio-economic factors of the incoming blacks, indicated that the blacks had either a higher class level or a higher income level than the whites who already lived in the area.[38] Finally, there are two studies of racially changing areas in Chicago which arrive at different conclusions about racial change and property values.[39]

The existing studies of property values and racial change do not take account of the effects of disinvestment. There are some areas where racial change has taken place and where property values have declined, or risen at rates lower than in comparable white areas. One would expect that disinvestment, once it takes place, would eventually effect property values. There is one study which examined both disinvestment and property values.

A detailed study of disinvestment in Northwest Philadelphia compared similar communities, one which changed racially and one which did not.[40] The area which changed racially actually showed increases in family income, level of education and employment status compared to the area which did not change. The study traced both the level of conventional mortgages and the property values in the two areas. Generally, property values rose more in the racially changing area <u>prior</u> to heavy disinvestment by conventional lenders. <u>After</u> several years of disinvestment, property values in the racially changing area slowed and increased at a lower rate than properties in the all white area.

2. <u>Studies of Mortgage Default and Foreclosure</u>

There are a number of studies of factors which predict default and foreclosure. Most of the studies were carried out in the 1960's, during a period of unusually high foreclosure rates throughout the lending industry. Most focused on FHA and VA loans and paid little attention to the factors associated with conventional loans. Since 1970, several more studies have been done, but most of them, like the earlier studies, have serious methodological problems, such as poor and biased samples; exclusion of several factors believed to be important in delinquency and foreclosures; lack of data on a neighborhood level; and lack of attention to explaining the causes of the statistical relationships presented.[41]

Most of the studies suggested that delinquencies and foreclosures were related to factors representing the individual characteristics of the borrower, the conditions of the loan, or the condition of the property.[42] Of the three studies which suggest that neighborhood factors do influence delinquency and foreclosure rates, two of these studies were carried out in the Pittsburgh area.[43]

The one study which was not carried out in Pittsburgh was done by FNMA.[44] It covered only two FHA low-income programs, and used zip codes as the basic unit of analysis. It did not consider the individual loan characteristics which previous studies had found to correlate with mortgage risk. While there were some correlations with neighborhood (actually zip code) characteristics, they were not strong and race was not one of these factors. Interestingly, this study showed that the level of indictments for illegal use of federal housing programs was one of the most important predictors of foreclosure in one program.[45]

A Pittsburgh study found that no neighborhood characteristics were associated with both delinquency and foreclosure, and that only high neighborhood unemployment was associated with foreclosure.[46] All the neighborhood factors together could explain only twelve percent of the delinquency levels and nine percent of the levels of foreclosures on the loans studied.

A second Pittsburgh study by George von Furstenberg and Jeffrey Green represents the most detailed study of neighborhood characteristics and delinquency in mortgage payments.[47] The study found no conclusive relationships. It could not identify any clear relationship between racial characteristics of an area and delinquency rates. The study did find a relationship between the age of the mortgaged property and delinquency, but this was not consistent with an earlier, more extensive, study made by vonFurstenberg alone.[48] The von Furstenberg and Green study suffers from the fact that all the loans studied came from one lender, and do not represent the general market, or even all of Pittsburgh.

The most recent study of mortgage risks was produced by Andrew Brimmer for the U.S. League of Savings Associations.[49] It was published in April of 1977. This report attempts to separate risk from racial discrimination. It concludes that inner city, minority communities represent higher risks. However, the study was not based on any <u>new</u> research. The conclusions were based on an earlier study from the FHLBB which showed that minority-owned S&L's did not perform as well as white owned S & L's.[50]

The study had no data on the actual location or conditions of any loans made by any of the white or minority S & L's, but simply assumed that the white S & L's loaned in white areas and that the minority institutions loaned in inner-city, minority areas. The FHLBB study of minority institutions was not intended to evaluate the lending risks in any area. Like most other such studies, it draws attention to the lack of management expertise -- not lending risks -- as the major cause of low performance by minority institutions. Thus, this study is of limited value since its findings are based on the unfounded assumption that certain minority institutions did not perform well because they were lending in minority neighborhoods.

There are several examples of sound lending opportunities in older, minority, racially changing communities for lenders who ignore the conventional wisdom of decline and risk. At HUD's meeting on discrimination in mortgage lending, held in Hartford in 1974, Robert Gnaizda, a public interest lawyer, presented a study which showed how the largest savings and loans in California had redlined the Mission District of San Francisco. Then he indicated that a minority-owned institution, formed in the last two years, had placed 88% of its loans in the Mission District with not one current delinquency, default or foreclosure.[51] In testimony before HUD's Philadelphia Meeting on Redlining in 1976, James Vitarello of the Washington, D. C. Residential Mortgage Investment Commission, gave an example of another minority-owned institution in Washington (Independent Federal Savings and Loan Association) which has 89% of its loans in the City of Washington. It has no defaults on any of these loans.[52]

In the South Shore community of Chicago, which had been defined as being "clearly declining," a local group of investors bought out the bank which was trying to move out of the area because the racial change and alleged decline had made it impossible for them to survive. The new owners set out to make the bank a vehicle for community development. They have reversed the bank's losses and turned larger profits each year. Last year alone, the bank made 52 home loans in its community. It has only two defaults and no foreclosures on these loans.[53]

In Philadelphia there is a program by several of the commercial and mutual savings banks to revise their underwriting practices in order to include older neighborhoods. The new underwriting criteria permit conventional lending in any block which does not have more than ten percent of the properties abandoned and vacant. Even if the abandonment rate is higher, conventional loans will be made if there is evidence of community activity to put the block back on its feet.[54]

In spite of what many lenders consider these excessively liberal definitions of a sound neighborhood, the delinquency rate for the Philadelphia Plan has been as low or lower than for mortgages in the suburban areas around Philadelphia.[55]

Conclusion

The purpose of this paper has been to describe the training literature of appraisers as a means of better understanding the extent to which built-in biases about the desirability of racially and economically homogeneous communities influence risk analysis. The review should not be taken as a condemnation of appraisers and underwriters, but rather as an attempt to understand how professional training has contributed to the biases that many of them have against lending in older, minority, racially changing, low-income and mixed use neighborhoods.

Many of the underwriting practices used to estimate risk are based on general assumptions of the negative effects of race, age, mixed use and community life cycle. These assumptions seem to have little or no basis in fact -- especially when applied as universal principles. They do not inform us about the actual risks in older, racially changing, minority or mixed use communities. It is not _immediately_ evident what the actual risks in lending in such communities are. What is clear is that the existing rule of thumb methods for judging that risk are not valid or reliable. The actual analysis of risk in a neighborhood must be based on information from that specific community and not on a study conducted in another community, in another state and at some other point in time.

One of the problems which faces those who realize that the old assumptions are not valid is that underwriters have used them for so long that they have not developed data bases of actual measures of risk for the communities they serve. Accordingly, underwriters are not trained to define and recognize what are legitimate indicators of risk.

This lack of sophistication in doing risk analysis is a general problem, and does not apply simply to older communities. The reliance on assumptions that new developments were sound investments due to their being the first of the growth stages in the life cycle of a community have led to massive investments in suburban residential and commercial developments by banks and savings and loan associations. The financial crises and shaky financial status of several of the nation's largest banks, and several savings and loan associations, has not been due to risks involved in lending in older, racially changing, or minority communities. Rather it has been due, in part, to the <u>unanticipated</u> risks involved in speculation in some resort areas, suburban and large-scale commercial developments.

This suggests -- as the Grzywinski quote at the beginning implies -- that lenders must undertake risk analysis on a case-by-case basis, and discard broad generalities and arbitrary rules of thumb. <u>Lenders have a legitimate concern</u>

about protecting their investment in case of foreclosure. They must be able -- especially in the early years of a loan before substantial equity has been built up -- to recoup not only their investment in properties, but also the ancillary costs associated with foreclosure. In order to do this, they must be reasonably certain that the value of the property always exceeds the value of the loan on that property. This requires that they do careful, but individualized, appraisal and underwriting in advance.

Appraisal and underwriting training and techniques will continue to be the subject of close public scrutiny until consumers feel that their access to credit, and their housing choices, are not being artificially limited by outmoded methods of doing risk analysis.

Footnotes

1 Hilbert Fefferman, "The Redlining of Neighborhoods by Mortgage Lending Institutions and What Can Be Done About It," Redlining: A Special Report by FNMA (Washington: Federal National Mortgage Association, January, 1976), p. 28.

2 Banks and savings and loan associations often sell the mortgages they originate to institutions in what is called the secondary mortgage market. The largest of these institutions are government agencies - the Government National Mortgage Association (GNMA) - or are government regulated - the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). These institutions are also required to appraise the properties securing the mortgages they intend to purchase.

3 The first complete presentation of these concepts appears in Robert E. Park, Ernest W. Burgess and Roderick McKenzie, The City (Chicago: University of Chicago Press, 1925).

4 Robert E. Park, The City, p. 45

5 Homer Hoyt, One Hundred Years of Land Values in Chicago (Chicago: The University of Chicago Press, 1933), p. 316.

6 Stanley McMichael, McMichael's Appraising Manual (Fourth Edition; Englewood Cliffs: Prentice-Hall, 1951), pp. 156 and 161.

7 Stanley McMichael, McMichael's Appraising Manual (Fourth Edition; Englewood Cliffs: Prentice-Hall, 1951), pp. 156 and 161.

8 Stanley McMichael, McMichael's Appraising Manual (Sixth Edition; Englewood Cliffs: Prentice-Hall, 1975).

9
Homer Hoyt, The Structure and Growth of Residential Neighborhoods in American Cities (Washington, D. C.: Federal Housing Administration, 1939).

10
Frederick Babcock, The Valuation of Real Estate (New York: McGraw Hill Book Company, 1932), pp. 89 and 91.

11
American Institute of Real Estate Appraisers, Real Estate Appraisal (Chicago: 1935), Text no. 9, p. 10.

12
Statement of Walter Winius before: Office of Fair Housing and Equal Opportunity, U. S. Department of Housing and Urban Development, Administrative Meeting on Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Loans (July 14-16, 1976 in Philadelphia) Transcript of July 14, pp. 14-15.

13
American Institute of Real Estate Appraisers, The Appraisal of Real Estate (Chicago: American Institute of Real Estate Appraisers, 1967), p. 90.

14
American Institute of Real Estate Appraisers, Student Outline - Course 1-A - Real Estate Appraisal (Chicago: American Institute of Real Estate Appraisers, 1973), p. 166.

15
Slide show presented in "Course 1-A - Appraisal of Real Estate" taught by the American Institute of Real Estate Appraisers (Chicago, Illinois, November 6, 1973).

16
American Institute of Real Estate Appraisers, The Appraisal of Real Estate (Chicago: American Institute of Real Estate Appraisers, 1973).

17
Statement of Walter Winius (supra. note 12).

18
Opinion from the FHLBB General Counsel to the FHLBB Office of Housing and Urban Affairs (March 21, 1974).

19
12 C. F. R. 531.8(b) and 531.8(c).

20
See U.S. League of Savings Associations, "Residential Appraisal Form (17-PRA) and Lending Principles and Practices (Chicago: U. S. League of Savings Associations, 1975), p. 67.

21
American Institute of Real Estate Appraisers, The Appraisal of Real Estate, Fifth Edition (1967), p. 82 and Sixth Edition (1973), p. 88.

22
Ibid.

23
Ibid., Sixth Edition, p. 40.

24
Society of Real Estate Appraisers, An Introduction to Appraising Real Property (Chicago: Society of Real Estate Appraisers, 1975), p. 6-11.

25
American Institute of Real Estate Appraisers, The Appraisal of Real Estate, Sixth Edition, p. 99.

26
Ibid., p. 96. See also Plaintiff's Response to the First Set of Interrogatories of the Defendant American Institute of Real Estate Appraisers, filed by the U.S. Department of Justice in the case of U. S. v. American Institute of Real Estate Appraisers, et.al., C. A. No. 76 C 1448 (N.D. Illinois, 1976) for a detailed history of how direct statements about the adverse effects of racial change on property values were gradually replaced with more subtle references to "homogeneity" and "congeniality" in the professional appraisal literature.

27
For example, William Grisby (Housing Markets and Public Policy. Philadelphia: University of Pennsylvania Press, 1963) studied filtering in one Philadelphia neighborhood only - yet his work is widely used as a major restatement of the filtering model applying to all neighborhoods; George Sternlieb and Robert Burchell studied small multi-family properties in Newark and concluded that property decline was largely a result of low demand - and that this decline created significant risks to a lender (Residential Abandonment: The Tenement Landlord Revisited. New Brunswick: Center for Policy Research, 1973); while Frederick Case studied inner city lending in nine cities

and concluded that there were opportunities for sound lending, but that lenders were not taking advantage of them (Inner City Housing and Private Enterprise. New York: Praeger, 1972).

28
Most recent models of decline are modifications of: National Urban League and the Center for Community Change, The National Survey of Housing Abandonment (New York: April, 1971).

29
Public Affairs Counseling, The Dynamics of Neighborhood Change (Washington, D. C., U. S. Department of Housing and Urban Development, 1975). This model was based on previous work on abandonment done by Real Estate Research Corporation for HUD.

30
For example, not included were two studies which have set the tone of much later work on redlining and disinvestment studies: Northwest Community Housing Association, Mortgage Disinvestment in Northwest Philadelphia (Philadelphia, 1973) and Home Ownership Development Program, City of Baltimore, Home Ownership and the Baltimore Mortgage Market (Baltimore: City of Baltimore, 1973).

31
Public Affairs Counseling, The Dynamics of Neighborhood Change, p. 20 - Figure 2: "The Neighborhood Change Process."

32
Ibid., pp. 11-19.

33
Ibid., p. 20 - Figure 2.

34
Ibid., p. 18.

35
Society of Real Estate Appraisers, An Introduction to Appraising Real Property, p. 6-16.

36
See Calvin Bradford and Dennis Marino, Redlining and Disinvestment as a Discriminatory Practice in Residential Mortgage Loans (Washington, D. C.: U. S. Department of Housing and Urban Development, Office of Fair Housing and Equal Opportunity, 1977) section entitled "Evidence

Relating Racial Factors to Mortgage Risk" and the annotated bibliography for a summary and listing of the major studies on race and property values.

37 Frederick E. Schietinger, "Racial Succession and Changing Property Values in Residential Chicago," Urban Sociology, E. Burgess and D. Bogue, eds. (Chicago: University of Chicago Press, 1964), pp. 86-89.

38 Thomas Gilette, "A Study of the Effects of Negro Invasion on Real Estate Value," The American Journal of Economics and Sociology, Volume 15 (January, 1957), pp. 151-162; Erdman Palmore, "Integration and Property Values," Phylon, Volume 27 (Spring, 1966), pp. 15-19; Erdman Palmore and John Howe, "Residential Integration and Property Values," Social Problems, Volume 10 (Summer, 1962); Chester Hunt, "Integrated Housing In Kalamazoo," Research Report on Integrated Housing in Kalamazoo (Kalamazoo, Michigan: Upjohn Institute for Community Research, 1959), pp. 3-25; Chicago Urban League, Housing Costs in the Black Submarket of Chicago: A Reassessment of the Filtering Model (Chicago: Chicago Urban League, 1977); Luigi Laurenti, "Effects of Nonwhite Purchases on Market Prices of Residences," The Appraisal Journal, Volume 20 (July, 1952), pp. 314-329; and Luigi Laurenti, Property Values and Race (Berkeley: University of California Press, 1960).

39 Brian Berry, "Ghetto Expansion and Single-Family Housing Prices: Chicago, 1968-1972," Journal of Urban Economics, Volume 3, Number 4 (October, 1976) sees values declining while the Chicago Urban League (supra. note 38) sees values increasing with racial change.

40 Northwest Community Housing Association, Mortgage Disinvestment in Northwest Philadelphia (supra. note 30).

41 See Kerry Vandell, Barbara S. Hodas and Rachel Bratt, Financial Institutions and Neighborhood Decline: A Review of the Literature (a report prepared for the Federal Home Loan Bank Board by the Joint Center for Urban Studies at Harvard-MIT, under the direction of Arthur P. Solomon, November 1974) and Calvin Bradford and Dennis Marino (supra. note 36) for detailed reviews of the literature on mortgage risks.

42 *Ibid.*, Vandell *et al*, pp. 72-75 and 89-93, and Bradford *and Marino*, pp. *81-88* and 148-153.

43 George von Furstenberg and Jeffrey Green, "The Effect of Income and Race on the Quality of Home Mortgages: A Case for Pittsburgh," George von Furstenberg, Ann R. Horowitz and Bennet Harrison, eds. *Patterns of Racial Discrimination, Volume I: Housing* (Lexington: Lexington Books, 1974) and Alex Williams, William Beranek and James Kenkel, "Factors Affecting Mortgage Credit Risk in Urban Areas - A Pittsburgh Protoptye Analysis," presented at the American Real Estate and Urban Economics Association Meeting, December 29, 1973.

44 Federal National Mortgage Association, Office of Economic Anlysis, *Estimation of the Socio-Economic Determinants of Foreclosures on 221(d)2 and 235 Mortgages* (Washington, D. C.: 1974).

45 Section 221(d)2.

46 Williams, *et. al* (*supra*. note 43).

47 Von Furstenberg and Green (Supra. note 43).

48 The complete summary of the four articles which von Furstenberg wrote from this earlier study can be found in: George von Furstenberg, *Technical Studies of Mortgage Default Risk: An Analysis of the Experience with FHA and VA Home Loans During the Decade 1957-1966* (Ithaca, New York: Center for Urban Development Research - Cornell University, 1971).

49 Brimmer and Company, Inc., *Risk vs. Discrimination in the Expansion of Urban Mortgage Lending* (Chicago: U.S. League of Savings Associations, April, 1977).

50 William D. Bradford, "The Viability and Performance of Minority Controlled Savings and Loan Associations," Research Working Paper No. 62, prepared for the Office of Economic Research, Federal Home Loan Bank Board (1975).

51 Statement of Robert Gnaizda before: Office of Fair Housing and Equal Opportunity, U. S. Department of Housing and Urban Development, Administrative Meeting on Discrimination in the Financing of Housing (May 20-21, 1974 in Hartford, Connecticut), Transcript of May 21, pp. 260-261.

52 Statement of James Vitarello before: Office of Fair Housing nad Equal Opportunity, Administrative Meeting on Redlining and Disinvestment (supra. note 12), July 15, pp. 215-216.

53 Judith Barnard, "Money Matters," Chicago Magazine (February, 1977).

54 Dennis Marino, The Philadelphia Mortgage Plan (Chicago, Illinois: Woodstock Institute, July, 1977).

55 Ibid.

Part III

REINVESTMENT INITIATIVES OF FINANCIAL INSTITUTIONS

Part III

Chapter 1

SOUTH SHORE NATIONAL BANK:

A NEIGHBORHOOD DEVELOPMENT INSTITUTION

About the Author

Margaret Adams is a research associate at Northwestern University in Evanston, Illinois.

Chapter 1

SOUTH SHORE NATIONAL BANK:

A NEIGHBORHOOD DEVELOPMENT INSTITUTION

by Margaret Adams and Lawrence B. Rosser

Summary

The authors begin with the acknowledgement that the conditions in and needs of different neighborhoods often vary considerably even within the same city, and that neither the development banking model discussed herein, nor any other "solution," can be applied across the board. Nevertheless, a discussion of the South Shore National Bank belongs in the series of papers discussing private sector initiated reinvestment strategies since it has become a national symbol for neighborhood groups, public officials and many bankers about the potential role that local financial institutions can play in revitalizing the areas in which they are chartered to do business.

Development banks are like any other commercial bank except for one important difference: their primary goal is to apply their resources -- talent and credit -- to the development of their communities. This does not mean that the managers of this institution eschew profit as a motivation. On the contrary, in fact, they pursue profits relentlessly, but they do so not solely in order to increase their stockholders earnings per share (as do most commercial banks), but rather to increase the resources available to rebuild their chartered service area.

This strategy is based on the assumption that banks have special institutional characteristics which make them ideally suited to the task of neighborhood development. Banks are known in their communities, and should be knowledgeable about their communities. The regulation of the banking industry is well established, and creates a system of checks and balances which helps assure the prudent use of resources. Banks control a pool of credit, and have the ability to attract additional deposits from outside the community. And finally, banks as private businesses are oriented to a pragmatic, project-by-project approach which incorporates measurable standards of performance.[1]

This paper will provide an overview of the history, management, development activities, problems and possibilities of the South Shore National Bank. It will also discuss ways in which other reinvestment strategies can be used to complement this approach to neighborhood development.

SOUTH SHORE NATIONAL BANK:

A NEIGHBORHOOD DEVELOPMENT INSTITUTION

> A little over three years ago new owners and management set out to demonstrate that an inner-city commercial bank could both succeed in the market-place and help rebuild its neighborhood . . . Earnings, development work, and deposit growth last year suggest that these dual goals are in fact compatible.
>
> --1976 Annual Report and Neighborhood Development Audit, South Shore National Bank

Introduction

South Shore is a neighborhood on the south side of Chicago which began experiencing rapid racial transition and disinvestment during the late 1960's and early 1970's. Simultaneously with the changes in the neighborhood, the South Shore National Bank experienced declining deposits and changing clientele. Deposits fell from $72 million in 1967 to $40.6 million by 1973. Total stockholder equity during the same period decreased by almost one-half.[2] Finally, in 1972 the bank applied to the U. S. Comptroller of the Currency for permission to move out of the neighborhood and to relocate in downtown Chicago.

At that point, the South Shore Commission -- a long-established community organization whose business and individual membership was also changing as the neighborhood became resegregated -- took the initiative to protest the bank's plans to abandon its chartered service area. A coalition of community groups, led by the Commission, demanded -- and got -- a commitment from the Comptroller to hold a public hearing in the community about the bank's relocation application. Finally, the Comptroller ruled that the bank had not demonstrated persuasively that it should be allowed to move, and he denied the application.[3]

At the same time, a group of investors headed by Ronald Grzywinski were looking for a bank to purchase. Grzywinski, who had served for several years as president of the nearby Hyde Park Bank and Trust Company where he had established a program of lending to minority entrepreneurs throughout the Chicago metropolitan area, had spent a year as a fellow at the Adlai Stevenson Institute in Chicago developing a proposal to establish a neighborhood development institution. It was Grzywinski's feeling that "neighborhood-based, commercial bank holding companies can assemble a unique combination of managerial and financial resources that can be used to fuse public and private programs into a coordinated thrust for neighborhood renewal, using the skills, controls, and incentives characteristic of well-managed, profit-motivated enterprises."[4]

To test his hypothesis, he formed the Illinois Neighborhood Development Corporation (INDC) as a bank holding company to purchase the South Shore National Bank.[5] The initial offering of INDC shares to raise capital to purchase the bank was aimed primarily at philanthropic sources; foundations and wealthy individuals who were sympathetic with INDC's goals, and who agreed to defer -- not forego -- return on invested equity. Using capital raised from this offering -- along with a loan from a large downtown bank -- INDC completed the purchase of the bank in August, 1973.

The first problem faced by the new management was to stop the outflow of deposits. The two-pronged strategy for accomplishing this was to increase bank services and to initiate an aggressive public relations program designed to let the community know that the bank was in the neighborhood to stay and wanted their business -- borrowing as well as savings. In addition to hiring several new tellers to speed up service for customers in the bank, Grzywinski, who served as chairman of the Bank until 1976 (he is currently chairman of the Executive Committee), and Milton Davis, Bank president, attended numerous coffees and other community functions explaining the new management's policies to community residents. In addition, the bank began extensive renovation on its own building's interior and exterior as a tangible symbol of its community commitment.

By 1975, the bank had checked the deposit outflow, and was able to report to INDC stockholders a net income of $194,000.00. By 1976, total deposits had increased by 16% since the time the bank was purchased, earnings per share stood at \$4.29, the highest level in ten years, and a dividend of \$1.15 per share was declared.

Development Banking

The philosophical basis for the management of South Shore National Bank is evident in their definition and practice of development banking. "Neighborhood development banking," states the Bank's 1976 Annual Report, "is 'green-lining' -- investment in the local community -- in its broadest sense. The South Shore Bank greenlines by extending credit to residents, business, and local organizations and by investing staff time to further neighborhood economic and social objectives."[8]

In practice, development banking has meant that in addition to making loans in its community, the Bank has used its other resources -- talent, institutional influence, administrative and management capacity -- to assist residents in achieving a variety of economic and social objectives. The Bank contributed staff time and its mass mailing capability to assist community groups in a campaign to prevent the City of Chicago from demolishing a complex of buildings once used as an exclusive country club. The community wanted the Chicago Park District which owns them now to convert the structures into an entertainment, conference and museum complex. The community won, and the Park District withdrew plans to replace the once elegant structures with a field house.

The Bank developed a series of brochures which inform customers about Bank charges for various kinds of savings and checking accounts, and advise them how to avoid such charges by tailoring their accounts to their individual needs and financial situation. Management and staff are made available to community organizations as consultants, and the bank conducts regular workshops on various topics such as home maintenance and "How To Balance Your Checkbook."

The need for many of these "non-bank" activities is suggested to the Bank's management by its 19-member Resident Advisory Board. Originally established as an advisory body to serve as a link between the "councils" for the nine areas into which South Shore is divided and the Bank management, the Resident Advisory Board has evolved into a monitoring and quasi-policymaking body for the Bank. Although it has no formal authority, the management is committed to responding to the Resident Advisory Board's criticisms and suggestions about Bank operations, and to providing resources to assist it in spinning-off organizations and projects that the Board deems are necessary for the comprehensive development of the community.[9] In 1976, for example, the Advisory Board served as the catalyst for the establishment of South Shore's first not-for-profit economic development group which was incorporated in September of that year with the assistance of Bank staff.

The group qualifies with the Small Business Administration as a local development company, and, as such, can serve as a conduit for low-interest, long-term loans from the SBA to businesses in the neighborhood.

Residential Development Loans

The management of South Shore Bank "broadly" considers every loan made in South Shore as a community development loan in that it contributes to the long-range economic viability of the area. For purposes of assigning staff time and resources, however, management has relegated certain loans to a Neighborhood Development Center (NDC) according to the following definition: "all new small business loans, higher-risk personal loans, student loans, and multi-family rehabilitation loans to local residents."[10] NDC operates, in other words, as a separate credit department within the bank to handle loans that normally would not be "bankable." The following table illustrates the development loan activity by type of loan during 1976.[11]

Development Loans

New Development Loans: 1976

Type of Loan	Number of Loans	Amount	%
Small Business and Community Organizations	49	$ 698,653	23.9
Mortgage	65	1,416,065	48.3
Education	169	246,518	8.4
Home Improvement	77	321,835	11.0
Development Personal	150	245,734	8.4
Total	510	$2,928,805	100.0%

Mortgage and Home Improvement Lending

Writing in what has come to be regarded as a classical text on bank management, Howard Crosse and George Hempel observe that "The form of lending /̅in which a commercial bank engages̲/ should reflect the demands of the community."[12] When new management took over in 1973, there was a substantial demand for single-family financing in South Shore. Like other racially changing neighborhoods, the impacts of transition were first reflected in the price appreciation -- or lack thereof -- and maintenance of the single-family housing stock. As racial transition increased during the late sixties, prices first dipped perceptibly, then recovered somewhat as a new black market filled the void created by fleeing whites, and finally leveled off at a time when prices for comparable homes in Chicago were rapidly increasing. Home improvement loans and conventional mortgage financing were all but impossible to secure, and the community had a substantial number of Federal Housing Administration (FHA) mortgages and foreclosures.

The new management responded to the need for single-family financing almost immediately, not only because it believed that there was a creditworthy demand for homes in South Shore that was not being met, but also because management realized that this type of financing could produce substantial improvements in -- or, at least, stabilize --

the appearance of the single-family areas of the community. In addition, compared to the other two major categories of lending that obviously were necessary -- multi-family and business -- single-family loans were easier to underwrite while management became more familiar with the community.[13]

Reflecting its continuing belief that development lending should not be synonomous with easy credit, management required single-family home purchasers to put 20% down. In return, the Bank tried to be flexible in its borrower and property underwriting, but always within the bounds of what management considered prudent lending. Later, the Bank persuaded the private mortgage insurance industry to insure some single-family homes where buyers had only 15%, and, in a few cases, only 10% down.

The management's confidence that there was a middle-class market with sufficient equity -- albeit black -- for single-family homes in South Shore has been borne out. Mortgage loans outstanding at the end of 1976 totaled more than $8.5 million, 20% of which were insured by private mortgage insurance companies. Three out of five mortgage loan applications and approximately three out of four home improvement loan requests from South Shore residents were approved. Perhaps most important, however, is the fact that between 1974 and mid-1976, the median selling price of a single-family home in South Shore increased by 19%. While this figure must be used with caution since prices doubled during this period in the most prestigious section of the community, the trend in price appreciation is clearly upward.[14]

Rehabilitation of Multi-Family Dwellings

Much of present South Shore was constructed between 1910 and 1939, and there has been little new construction since that time. Only six percent of the housing stock is less than ten years old. The vast majority of the community's housing is located in rental structures. Of 22,000 units constructed before 1939, for example, more than 81 per cent were multi-family, and that same proportion held for construction post 1939. Today, the community's housing stock consist of approximately 32,000 units, 82.5% of which are rentals. The bulk of the rental units are located in buildings containing five or more apartments, and more than one-fifth are in buildings of 50 or more units.

More important than the number of multi-family units, however, is their distribution. While there are sections of the community which have a predominance of rental buildings, South Shore was built in such a way that large multi-family structures anchor the corners and mid-blocks of many single-family sections. This has made it difficult to stabilize these blocks because of the presence of deteriorated -- and sometimes partially abandoned -- 24 and 36-unit apartment buildings. The problem is exascerbated by the fact that demand for multi-family units is weak due to the renovation needs of many buildings.

In response to this dilemma, Bank management has tried a variety of strategies to get multi-family buildings rehabilitated. For example, the Bank financed the renovation of a 39-unit building for conversion to condominiums, and then provided mortgages to qualified purchasers. Several smaller buildings also have been renovated and converted to condominiums. In addition, South Shore Bank is one of the few commercial banks in Chicago which makes loans to buyers of units in buildings that are cooperatively owned.[15]

The Bank also has cooperated with a service corporation consisting of 60 Chicago area savings and loan associations in its efforts to rehabilitate more than four hundred rental units with financing from the state housing finance authority in one section of the community.[16] Simultaneously, the bank actively sought to identify and encourage several local residents to buy and rehabilitate other multi-family buildings in the immediate area, thereby creating a critical mass both in terms of demand and price appreciation.

Recognizing that traditional banking practices provided little guidance for coping with the magnitude of the problem of multi-family buildings in South Shore, the Bank sought and received a $20,000 foundation grant to establish an experimental program known as the Parkside Banker. Parkside is the most deteriorated section of South Shore largely because it was the first area to undergo racial transition, and hence the first area from which conventional credit was withdrawn. It is predominantly a multi-family area in which a high proportion of the structures are tax delinquent and absentee-owned. The purpose of the Parkside Banker Program was to put a bank officer in the area on a full-time basis for a period of time to develop better information about the credit needs of those resident owners that are still in Parkside, and to increase Bank management's awareness of the magnitude and range of problems which must be addressed before any significant investment in the area can be made.

While not as apparent to the observer as is the stabilization of the single-family stock, as of the end of 1976 there had been modest progress in addressing the multi-family housing problems of South Shore. Twelve buildings had been rehabilitated and converted to condominiums. More than 600 rental units in twelve buildings had been rehabilitated, and another 208 units were in process.[17] While the bank did not finance all of these units, the management feels that the presence of the Bank, and its development lending commitment played an important role in attracting the other institutions that did the rehabilitation.[18]

Development Deposit Program

Disinvestment from neighborhoods occurs for a variety of reasons. In the case of South Shore -- and other older communities that undergo rapid racial transition -- Grzywinski describes the process of disinvestment and deterioration as follows:

> As a neighborhood grows older, it loses its ability to compete with newer neighborhoods for higher income residents, services, and economic investment. The inability to compete sets up a process of deterioration that is often accelerated by (1) market forces which operate independently of social objectives, (2) racial separation and unequal opportunity, and (3) unresponsive public institutions. Each of these factors reinforces the others to create an accelerating spiral of neighborhood decay.[19]

One aspect of the "downward spiral" is the perception on the part of most of the actors involved -- residents, business persons, government officials, landlords, realtors, appraisers, as well as lenders -- that further decay is <u>inevitable</u>. This belief forms the foundation for the assumption that the risks of investing in older, low- and moderate-income, minority or racially changing neighborhoods are unacceptable.

In contrast to this attitude, the Bank's management -- based largely on Grzywinski's previous experiences lending to minority entrepreneurs in a number of inner-city areas -- started with the assumption that the risks of lending in South Shore <u>might</u> be greater in certain cases due to the recent history of public and private disinvestment. The management was convinced, however, that credit nevertheless could be extended prudently in the vast majority of instances if bank officers and staff did careful, individualized underwriting, and "relied heavily on public and, to a lesser extent, on private credit co-insurance programs, e.g. Small Business Administration (SBA) guarantees, Federal Housing Authority /sic./ (FHA) insurance, Illinois student loan guarantees, and private mortgage insurance."[20]

Although the Bank can reduce risks to manageable levels in this manner, the resulting loans are often more costly -- and, therefore, less profitable -- than alternative investments outside the neighborhood. This lower profitability results from several factors. Personnel costs to qualify and counsel borrowers are higher. The extensive application procedures for public coinsurance programs are time consuming. The principal balances of development loans are often so small that interest income does not offset the expenses of making the loans. Accounting and data processing costs are higher when many small loans are made. Finally, although it is difficult to quantify with precision, there is the "lost opportunity cost" the Bank incurs when it invests in long-term, fixed-rate residential loans in its neighborhood rather than lower-risk, higher yield money market instruments.[21]

In order to offset these higher costs and avoid a drain on profits from other banking operations, the management uses a development deposit program pioneered by Grzywinski during his tenure as president of Hyde Park

Bank to support its Urban Development Division. Development deposits are defined as deposits coming from outside of South Shore which are solicited for the express purpose of supporting the Bank's development activities. These deposits -- which pay the same rates and include the same services as regular deposit accounts -- come from individual, institutional and public sources. This program is effective, because depositors are protected up to $40,000 per account by the Federal Deposit Insurance Corporation (FDIC) just as they would be at any other financial institution, and because the management places high priority on keeping development depositors informed about the Bank's progress and development activities.

Bank earnings on development accounts are used to offset additional costs involved in making loans through the NDC. Eventually, the Bank expects that the earnings from this program will cover all of the routine development expenses, and even generate additional "development dividends" which can be used to finance additional activities.[22] According to the Bank's 1976 Annual Report, development deposits which accounted for one-third of the growth in total deposits increased by 45% during the year to a total of $7.8 million, and generated almost $58,500 income for the NDC.[23]

Neighborhood Development Audit

In the opinion of management, development banking at

South Shore includes two unique components: Development deposits; and, development reporting.[24] As with the development deposit program, the impetus for the reporting system came from Grzywinski who asserts that in order "to build mutual confidence and trust" between a neighborhood development institution and its stockholders, development depositors, customers and neighborhood residents, it is imperative that "the costs and profits of development . . . be accurately and publicly reported."[25] For this reason, the Bank publishes each year a "Neighborhood Development Audit." The Audit is included with the current year's annual report, contains detailed itemization of development income and expense, and -- like the financial statements for the Bank -- includes a letter of opinion from the Bank's independent auditors attesting to the fairness of the financial data presented.

Conclusions

The management of South Shore National Bank appears to have broken new ground in turning a privately capitalized, for-profit institution into a vehicle for community development. It is too early to evaluate the extent to which the Bank will be able to restore the South Shore neighborhood's ability to compete successfully for private capital and credit. It is also premature to determine whether or not one of the unintended consequences of doing so successfully will be the displacement of all or a portion of the approximately twenty percent of residents who currently are receiving public assistance. Nevertheless, it is possible to assert that the Bank has set a new standard of responsiveness for inner-city financial institutions. One of the Bank's board members described this important accomplishment in the following way:

> The persistent drive for profitability while at the same time "greenlining" is leading to a new understanding of how both the public and the private sectors' systematic bias against inner-city redevelopment can be reversed.[26]

Due to the widespread optimism about the South Shore Bank model, however, it is important to consider what the senior management of the Bank thinks about its success to date, its limitations, and its replicability.

Consistent with his original plan for creating a neighborhood development institution, Grzywinski continues to feel that "A commercial bank, operating by itself, is an incomplete vehicle for neighborhood development." This assumption is based on the following:

> A true development bank should be an innovative institution which continuously infuses capital, long-term credit, and technical assistance into social and economic improvement projects. It should possess the capacity to initiate development projects when other initiators are unavailable.
>
> By law, commercial banks are limited to the business of banking. However, the Board of Governors of the Federal Reserve System has ruled that bank holding companies may invest in community development corporations. Such non-banking subsidiaries can be organized as initiators of development projects and as sources of venture capital. They

> then complement the banking subsidiary and expand the options available to the parent [holding company]. 27

In addition to the need to have non-bank community development subsidiaries created by the managers of bank holding companies which are serious about having their banking subsidiary do neighborhood development -- Grzywinski's INDC applied in August, 1977 to the Federal Reserve Board for permission to establish both a for-profit and a not-for-profit subsidiary -- Grzywinski also believes that additional public incentives are needed to encourage "the investment of private capital, credit and talent resources to revitalize our urban neighborhoods."[29]

Four incentives he has suggested that states might provide to financial institutions that are engaged in community development activities are as follows:[30]

> 1. A system of coinsuring development credits. As mentioned above, one of the factors which increases the costs of development lending is the complexity of processing public insurance. States could establish a system whereby financial institutions could automatically obtain state insurance on a variety of development credits if these institutions are willing to assume a larger percentage of the risk, e.g. twenty percent. Financial institutions would apply to the appropriate state agency, and be covered by a master policy similiar to that used by private mortgage insurance companies. The twenty percent exposure of the institution would help assure that credits are underwritten prudently.
>
> 2. Secondary market for development credits. The purpose of a secondary market is to allow a financial institution to regain liquidity lost when certain types of loans are made. This permits the institution to sell loans, and use the proceeds to make additional credits. A state-run secondary market that would buy a portion (say 75%) of a package of development loans

would provide a tangible incentive for banks to do increased development lending. The purpose of limiting the percent of the loan package eligible for sale in the secondary market would be to insure that the lender has an incentive to underwrite the loans prudently.

3. Grants to development banks to cover the additional costs of making development loans. If development activity is going to take place on an extensive basis, the development deposit program may not generate sufficient earnings to cover development lending costs. Since development banks contribute to the economic revitalization of communities -- thereby increasing the taxes generated from communities, and decreasing the amount of transfer payments going into communities -- states could justify such grants as being in their long-term economic self-interest.

4. Issuing tax-exempt development bonds. States that issue such bonds could raise funds that could be loaned to development banks at below-market rates. The banks, in turn, would make these funds available to neighborhood users at lower-than-market rates.

In conclusion, it is appropriate to note that in the letter to stockholders accompanying its 1976 Annual Report and Neighborhood Development Audit, senior management of South Shore National Bank made the following observations:

> Favorable beginnings, however, do not justify undue optimism; the most difficult work lies ahead. Long-term recovery will require extraordinary economic and non-economic efforts in commercial and multi-family residential rehabilitation, crime prevention, and school improvement. The Bank's activities are only part of the process involved in redeveloping South Shore. But it is clear now that reinvestment of private resources through publicly regulated financial institutions can be a prime factor in renewing urban neighborhoods.[31]

Footnotes

1 Ronald Grzywinski, Memorandum Re: "Bank Holding Companies as Neighborhood Development Corporations," 1 January, 1976, pp.1-2.

2 South Shore National Bank of Chicago, 1976 Annual Report and Neighborhood Development Audit, p.24.

3 Opinion of the Comptroller of the Currency, Administrator of National Banks, William B. Camp, in the matter of the application of South Shore National Bank to relocate, 5 December, 1972.

4 Ronald Grzywinski, Testimony before the U.S. Senate Banking Committee on the subject of Neighborhood Preservation, 14 June, 1976, pp.1-2.

5 See Part III, Chapter 6.

6 SSNB 1976 Annual Report, p.24.

7 Ibid., pp.24,17.

8 Ibid., p.10.

9 Rosa Moore, member, SSNB Resident Advisory Board, in remarks before "Banking for Non-Bankers Conference" in Chicago, Illinois, 6 June, 1977.

10 SSNB 1976 Annual Report, p.10.

11 Ibid., p.11.

12 Howard D. Crosse and George H. Hempel, Management Policies For Commercial Banks (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1973), p.192.

13 Thomas O'Reilly, Vice President, South Shore National Bank, in remarks before "Banking for Non-Bankers Conference" in Chicago, Illinois, 6 June, 1977.

14
SSNB 1976 Annual Report, p.11.

15
Financial institutions often refuse to make loans to buyers of cooperatively owned apartments since the purchaser never holds title to the unit, only shares of stock in the corporation. These often are not suitable collateral since most cooperatives have a clause in their by-laws prohibiting members from assigning shares as collateral. SSNB's policy is to take an assignment of shares if it can be obtained, but in any event to hold the shares at the Bank in order to make it more difficult to sell the unit without Bank approval. As of November 8, 1977, it is possible to obtain FHA insurance to purchase cooperative apartments. This should make it easier for purchaser and financial institution to make this type of investment.

16
See Part III, Chapter 5.

17
SSNB 1976 Annual Report, p.1.

18
Ronald Grzywinski in remarks before "Banking for Non-Bankers Conference" in Chicago, Illinois, 5 June, 1977.

19
Grzywinski, U.S. Senate Banking Committee Testimony, p.1.

20
Ibid., p.3.

21
SSNB, 1975 Neighborhood Development Audit.

22
SSNB, 1976 Annual Report, p.13.

23
Ibid., p.1.

24
Ibid., p.10

25
Grzywinski, Memorandum Re: "Bank Holding Companies . . .," p.4.

26
SSNB 1976 Annual Report, p.13.

27 Grzywinski, Memorandum Re: "Bank Holding Companies . . .," p.3.

28 See Part III, Chapter 6.

29 Grzywinski, U.S. Senate Banking Committee Testimony, p.1.

30 Ibid., pp.4-5.

31 SSNB 1976 Annual Report, p.1.

Part III

Chapter 2

THE PHILADELPHIA MORTGAGE PLAN: THE TESTING OF TRADITIONAL PERCEPTIONS OF INNER CITY LENDING

Chapter 2

THE PHILADELPHIA MORTGAGE PLAN: THE TESTING OF TRADITIONAL PERCEPTIONS OF INNER CITY LENDING

by Dennis R. Marino

Summary

The purpose of this chapter is to present an analysis of the Philadelphia Mortgage Plan (PMP), a cooperative effort initiated in October, 1975 by the following financial institutions: Philadelphia Savings Fund Society, First Pennsylvania Bank and Philadelphia National Bank. PMP was designed to adjust the lending policies and practices of participating institutions in order to provide conventional home mortgage financing throughout the City of Philadelphia to creditworthy individuals, especially those individuals seeking to purchase single family property in older residential neighborhoods. A PMP mortgage is defined as a mortgage of $ 15,000 or less.

In an era where there is an increasing realization that the revitalization of the inner city primarily depends on the initiative of the private sector, this paper presents a case study of a private sector reinvestment effort initiated without government participation or subsidy. This paper is designed to provide planners and neighborhood advocates with ideas for motivating the private sector in various cities to engage in investment activities intended to ameliorate inner city disinvestment. Neighborhood disinvestment is a process by which institutions and individuals systematically withdraw financial resources from a neighborhood perceived to be declining.

Methodology

This analysis of PMP is based on information obtained through interviews with representatives of participating financial institutions; staff members of the Greater Philadelphia Partnership, a not for profit civic organization which played an interstitial role in creating PMP; and public interest groups and neighborhood residents who have been active in monitoring PMP. The data analysis presented is based on raw data collected by the Greater Philadelphia Partnership and a survey of financial institutions conducted by the Institute for the Study of Civic Values, a not for profit public interest group based in Philadelphia. Other sources which were employed included a literature search of selected periodicals, and a review of Congressional testimony and speeches presented by PMP representatives.[1]

The basic questions which this paper attempts to answer are listed below.

1) What are the goals of the Philadelphia Mortgage Plan?

2) Who are the key actors involved in PMP?

3) Has PMP cased participating lenders to alter their lending policies and practices?

4) Has PMP increased the supply of conventional credit in Philadelphia neighborhoods?

5) Who was responsible for initiating PMP?

6) Why was PMP created?

7) Does the experience of PMP participants validate or invalidate the assumption that inner city lending is a high-risk activity?

8) What is the potential for a PMP type effort to be initiated in other cities?

Goals of PMP and Participants

The basic goal of the Philadelphia Mortgage Plan is modification of traditional lending practices in order to make them more responsive to the credit needs of older Philadelphia communities. The two key components of this effort are the commitment of senior bank management to the goal of the Plan, and the development of a candid working relationship between lenders and neighborhood groups engaged in monitoring PMP.

PMP was not created to be an ongoing special "high risk" lending program separated from the ordinary lending procedures of participating financial institutions. Instead, it was designed to be an effort to adjust, on a permanent basis, policies concerning the underwriting and appraisal of all mortgage applicants and property.

Initially, PMP was assumed by some observers to be an effort where financial institutions were "donating" a special pool of credit to be used to accomplish a "social purpose." In response to such misunderstandings of PMP, James Bodine of First Pennsylvania Bank made the following statement:

> I lament the tendency of some to regard PMP as a special charitable "do-gooder" effort. This is precisely what the PMP is not. It is a sound business proposition and should continue to be a good investment for Philadelphia's financial institutions. Banks can earn a profit on the lending activity that has been stimulated through the PMP.[2]

After the initiation of the Philadelphia Mortgage Plan by the three founding institutions, other local financial corporations began to join the effort. Currently, the following lending institutions are involved in PMP: Beneficial Savings, Central Penn Bank, Community Federal Savings and Loan Association, Fidelity Bank, First Pennsylvania Bank, Girard Bank, Industrial Valley Bank, Lincoln Bank, Philadelphia National Bank, Philadelphia Savings Fund Society, Provident Bank and Western Savings.

Although PMP has been successful in attracting the support and participation of local commercial and savings banks, it has only been able to secure the participation of one savings and loan association. According to the Insured Savings Association of the Delaware Valley (ISA), which represents seventy-eight associations, the savings and loan industry has not particpated in PMP for three reasons. First, associations prefer to devote their reinvestment efforts to the two local Neighborhood Housing Service programs.[3] Secondly, ISA contends that most associations already employ PMP underwriting criteria.[4] Thirdly, ISA members were concerned that the addition of numerous associations to the PMP partnership might complicate the oversight process which has been established between the small number of lenders currently participating and concerned community organizations.[5]

Another factor not stated by the ISA, but of concern to PMP participants, is the savings and loan industry's impression that PMP is viewed by the public as a commercial and savings bank effort. Consequently, associations may be reluctant to join because they would be forced to share publicity with their competitors. Given this concern and the fact that state and federal regulators of financial institutions are beginning to view inner city reinvestment initiatives favorably in reviewing applications for structural changes, associations desire to support efforts, such as NHS, which are viewed as reinvestment strategies primarily facilitated by the savings and loan industry.[6]

In addition to attracting the participation of primary lenders, the three founding institutions were faced with the task of encouraging the involvement of the private mortgage insurance (PMI) industry.[7] Although PMP participants were optimistic about the risk of inner city lending, they are required by regulatory agencies to compel mortgagors who receive mortgages which are for more than 80% of the value of the property financed to purchase private mortgage insurance. Since PMP participants desired to reach that portion of the market which had less than a 20% downpayment, they were dependent on the participation of private mortgage insurance companies to make the Plan work. Fortunately, the private mortgage insurance industry was willing to insure 25% of the difference between the downpayment and the total value of the property purchased.[8]

Organizational Structure

The Philadelphia Mortgage Plan is a voluntary confederation of fourteen financial institutions which is committed to improving the housing stock and condition of inner city neighborhoods through the provision of conventional credit to creditworthy borrowers. All participants have agreed to use underwriting criteria established by the three founding institutions. They also have made a commitment to participate in both a peer and public review of their performance in extending credit to residents of inner city neighborhoods.

The peer review system involves the review of all rejected mortgage applications for $ 15,000 or less by a committee consisting of a loan officer from each participating institution. The loan officer from the institution which rejected a given mortgage application presents his rationale to the review committee. Another member of the committee may feel that the application should have been accepted. This committee member can suggest that the rejecting institution reconsider the loan or suggest that his institution would favorably entertain the application. However, the committee does not have the authority to force an institution to reconsider a rejected loan application.

The public review process consists of quarterly meetings between community representatives and participating lenders. During these meetings, the Greater Philadelphia Partnership presents the latest data on the volume and location of mortgages granted and applications rejected by PMP participants. The meeting is then opened for general discussion concerning the performance of PMP. Although there is a committee of community representatives which monitors PMP performance, this committee has no formal authority over the conduct of the Plan.

PMP Underwriting Reforms

The most heralded aspect of the Philadelphia Mortgage Plan has been the underwriting reforms which have been undertaken by PMP participants. For decades, inner city neighborhoods have been disadvantaged by underwriting practices which devalue inner city property and unjustifiably discriminate against moderate income families which are disproportionately located in the inner city.[9]

In determining whether or not to grant a mortgage loan, lenders engage in a process referred to as loan underwriting. Loan underwriting is divided into two components: credit underwriting and property underwriting.

Credit underwriting is a process whereby a loan officer determines if a mortgage applicant possesses a high probability of repaying the credit extended plus interest. A lender investigates the applicant's credit references, employment history, income, assets and current debts. Prior to the passage of the Equal Credit Opportunity Act (ECOA), lenders refused to consider welfare payments, child support payments or the income of working wives as effective household income.[10] Despite the existence of the ECOA, which prohibits discounting such income, some lenders allegedly continue to refuse to consider welfare income in analyzing an individual's ability to meet monthly debt service. Since households which receive welfare income are disproportionately located in the inner city, inner city neighborhoods are likely to be disadvantaged by standards which prevent the extension of credit to families subsidized by welfare programs.

Prior to the initiation of the Philadelphia Mortgage Plan, some Philadelphia financial institutions did not recognize the income of the co-mortgagor or consider welfare income to be effective income. In 1975, however, PMP participants began to consider such income in credit underwriting. As Herb Bowers, an Assistant Vice-President of Philadelphia National Bank once stated, "what is better confirmed income than welfare? You don't even have to work for it; it's there."[11]

Consequently, PNB and several other lenders established a twice monthly mortgage payment program which was designed to encourage borrowers on public assistance to make their mortgage payments as soon as they receive their checks.

The other part of the analysis performed by a loan officer in analyzing a mortgage application is property underwriting. The purpose of property underwriting is to insure that the value of the property is equal to or greater than the sale price. This is done to protect the lender's investment in case the borrower is unable to repay the mortgage and the lender is forced to take the property through foreclosure. In such cases, the lender must be able to sell the property for a price equal to or greater than the sum equal to the mortgage amount plus the lost interest, and the cost of servicing the loan and selling the property.

Prior to the establishment of the PMP, some Philadelphia financial institutions, like many institutions throughout the country, maintained the following property underwriting standards:

1) No mortgages were granted for properties 75 years of age or older;

2) No mortgages were made in the inner city;

3) No mortgages were granted for the purchase of properties with a sale price of less than $ 15,000.[12]

The cumulative effect of these standards was to withhold conventional mortgage credit from a number of Philadelphia neighborhoods, and to deny conventional financing to a substantial number of moderate-income and lower-income households.

Assuming that the property which a mortgage applicant desired to purchase is not rejected because of the lender's initial property standards, an appraisal of the property will be undertaken. An appraisal is necessary to insure that the market value of the subject property is equal to or greater than the sale price.

On the basis of his professional judgment and available data, an appraiser estimates the value of the property in question. If the appraised value of the property is equal to or greater than the sale price, then the lender may grant a loan, usually for an amount equal to 80% of the sale price. However, if the appraised value is less than the agreed upon sale price, then a loan may be offered for only 80% of the appraised value. Consequently, the borrower would have at least three options: secure the funds required for a larger downpayment; negotiate a reduction in the sale price; or void the purchase contract.

Appraisers have been accused of underappraising property in inner city neighborhoods because of their belief in models of neighborhood decline which implicitly or explicitly suggest that the presence of minorities or low-income residents in the neighborhood where the subject property is located, or in an adjacent neighborhood, represents an inevitable decline in property values.[13] Consequently, appraisers devalue property in such areas on the basis of their <u>perception</u> of the future.[14]

If appraisers believe that property values may decline in the near future and appraise properties for an amount significantly less than the agreed upon sale price, then they alone may reduce property values in that neighborhood. By acting upon their assumptions that values will decline, appraisers can create a self-fulfilling prophecy which often results in neighborhood deterioration. Neighborhoods which incur such pressures are likely to be placed at a competitive disadvantage relative to other areas, particularly exurban areas which appraisers do not perceive to be declining. Neighborhoods which are devalued by appraisers may experience disinvestment by property owners since they will be unable to assume that the value of their properties will appreciate and will therefore be reluctant to make improvements or maintain their properties.

Before the creation of the Philadelphia Mortgage Plan, Philadelphia financial institutions utilized appraisers which employed traditional and accepted appraisal practices which were based on the inevitability of the decline of neighborhoods which were populated, in part, by low- or moderate-income or minority families, or were adjacent to such neighborhoods.

However, during the planning stage of the Philadelphia Mortgage Plan, the initiators of the Plan realized the role that self-fulfilling appraisal practices had played in neighborhood disinvestment. The following comment by Todd Cooke, President of the Philadelphia Savings Fund Society, underscores this point.

> Disinvestment has occurred in the past, not only because banks were reluctant to risk depositors' funds in older neighborhoods, but also because they were hesitant to encourage a prospective homeowner to make an investment which might depreciate owing to the location of the house in a declining neighborhood. In this process,

> the exercise of proper caution -- perhaps, in some instances, excess caution, caused whole neighborhoods to become suspect. The new policies retain the same concern, for home buyer and depositor, but are based on a closer, block-by-block, house-by-house analysis. Essentially, the approach avoids tarring all the properties in one neighborhood with the same brush.[15]

The Philadelphia Mortgage Plan established new appraisal criteria which must be employed by all participating banks as well as appraisers that are hired by PMP banks. The PMP appraisal changes involved the appraising of a given property according to the structural condition of the subject property and all other property located on the immediate block. Consideration of the surrounding "neighborhood" was no longer permitted.

The following statement by Herb Bowers, an Assistant Vice-President of PNB and a certified appraiser, expresses the perspective PNB participants had undertaken in approaching local appraisers.

> ....we talked to the appraisers -- those open-minded, lovable chaps -- about how the neighborhood works on the economic bell scale -- good, excellent, and ugh..... what we said was: 'Okay, we want you (to forget the neighborhood and) appraise the remaining economic life of this block, on the bricks and mortar of the block. We want to know how long the damned house (and other houses on the block) will be there, irrespective of who the occupant is... If behind the block are the headquarters of the Mafia, forget it. We want two sides, corner to corner.[16]

In analyzing the block on which the subject property is located, PMP participants have suggested that appraisers regard the following criteria as favorable to mortgage lending and the appreciation of property values.

1) Abandonment and vacancy rate of no more than 10% in the immediate block;

2) Median property value of $ 6,000 in the immediate block;

3) The existence of a strong and cohesive neighborhood organization which considers the block on which the subject property is located to be part of its area of concern;

4) The presence of a non-profit developer who is rehabilitating abandoned units, or the existence of other ongoing programs by public agencies, lenders or private groups to improve or rehabilitate housing and;

5) Cooperation of absentee owners with neighborhood residents to improve housing and make needed repairs.[17]

Initially, this revisionist approach to the appraisal of inner city property was not well received by appraisers. However, after realizing that participating financial institutions would not hire appraisers who did not employ PMP appraisal criteria, most appraisers had a dramatic change of heart.

Impact of the Philadelphia Mortgage Plan

City of Philadelphia

One method of measuring the impact of PMP on the city of Philadelphia is the total number of mortgages which have been granted. As of December 31, 1977, the financial institutions participating in the Philadelphia Mortgage Plan had received 4,750 applications with an aggregate value of $ 50,019,827.[18] PMP participants had granted 2955 mortgages valued at $ 31,563,615, and had rejected 1,010 applications valued at $ 9,831,405.[19] The average mortgage granted was for $ 10,538.

Although fourteen financial institutions currently participate in the Plan, Table I indicates that the three institutions which created PMP have made 58% of all PMP mortgages.[20] This is probably due to the participation of these institutions since the first day of the Plan; their continuing commitment; and the fact that they have more resources than other local lenders.

The value of PMP mortgages has ranged from $ 3,000 to $ 17,000.[21] Sixty-three percent of all mortgages granted as of December, 1977, were between $ 7,000 and $ 13,000, while 13% were below $ 7,000, and 24% ranged from $ 13,000 to $ 15,000.[22] Forty-five percent of the mortgages were for 95% of the apprased value of the property, 42% of the mortgages were for 90% of appraised value, and 14% were for 80% or 85% of value.[23]

Twenty-one percent of the mortgage applications received were rejected. Thirty percent of the rejections were caused by insufficient income, 26% were due to poor credit, 19% were due to the condition of the subject property, and 12% were the result of the condition of the block in which the property was located.[24]

The racial composition of PMP mortgage applicants has been 70% black, 20% white, and 10% other (Spanish, Oriental, etc.).[25] Two-thirds of all applicants were couples, while one-third were female-headed households.[26] The total family income of applicants ranged from $ 9,000 to $ 15,000 per year.[27]

Although the application rejection rate appears to be high,

Table I

PMP Performance

(October 1977 to July 1977)

Financial Institution	No. of Mortgages Granted	Dollar Amount of Mortgages	Average Mortgage Amount
Philadelphia Nat'l Bank	426	$ 4,356,925	$ 10,227
Philadelphia Savings Fund Society	424	4,722,700	11,138
First Pennsylvania Bank	393	4,239,200	10,786
Girard Bank	248	2,680,100	10,806
Fidelity Bank	167	1,750,515	10,482
Industrial Valley Bank	106	1,125,150	10,614
Continental Bank	105	1,222,050	11,638
Beneficial Savings	81	822,000	10,148
Germantown Savings	67	693,450	10,350
Provident National Bank	65	653,370	10,051
Western Savings	55	568,295	10,332
Central Penn Nat'l Bank	13	149,000	11,461
Frankford Savings	12	112,000	9,333
Community Federal Savings and Loan	0	0	--
Totals	2,162	$ 23,127,755	$ 10,697

Source: The Greater Philadelphia Partnership one has to realize that prior to the initiation of PMP, very few of the households which have obtained mortgages through PMP were able to obtain conventional financing. According to James Bodine, the high rejection rate is, in part, due to the initial perceptions of many real estate brokers who assumed that the Plan was a give away.[28] Bodine has contended that brokers "attempted to sell some badly deteriorated, junk properties through the bank."[29] Allegedly, brokers were performing "sloppy screening jobs" and referring individuals without sufficient income to support the debt service.[30] Since the initial misunderstanding of PMP was ameliorated by Bodine and other lenders, brokers have reportedly been more discriminating about the properties which are referred to PMP participants.

A second measure of the impact of PMP is to examine the distribution of mortgage loans granted by PMP participants. A comparison of mortgages granted in Philadelphia during 1975 with mortgages extended in the city during the first six months of 1976 indicate whether participants shifted their lending emphasis from the suburbs to the city. As indicated in Table II, one institution, Girard Bank, has dramatically shifted from a suburban to an inner city focus, while two other lenders, First Pennsylvania and PSFS, have continued to increase their activity in the city.[31] The other four participants surveyed revealed that almost two-thirds of their mortgage lending during 1975 was in the suburbs.[32] Two of these institutions, Beneficial and Western increased the percentage of their total mortgage lending in the

Table 2

Comparison of Mortgage Lending Activity in City and Suburbs by PMP Participants

Financial Institution	1975 City	1975 Suburbs	First Six Months of 1976 City	First Six Months of 1976 Suburbs	Change 1975-76 City (only)
Girard Bank					
# of mortgages	32	63	67	12	--
% distribution	34%	66%	85%	15%	+51%
First Pennsylvania Bank					
# of mortgages	320	142	332	69	--
% distribution	69%	31%	83%	17%	+14%
Philadelphia Savings Fund Society (PSFS)					
# of mortgages	802	727	669	360	--
% distribution	52%	48%	65%	35%	+13%
Beneficial Savings					
# of mortgages	314	558	160	205	--
% distribution	33%	67%	44%	56%	+11%
Western Savings					
# of mortgages	19	39	15	21	--
% distribution	33%	67%	42%	58%	+9%
Germantown Savings					
# of mortgages	219	467	159	324	--
% distribution	32%	68%	33%	67%	+1%
Provident Bank					
# of mortgages	42	55	39	83	--
% distribution	43%	57%	32%	68%	-11%

Source: Institute for the Study of Civic Values city during the first half of 1976.[33] However, Germantown Savings Bank's portfolio did not change while Provident's record reflects a de-emphasis of city lending relative to suburban lending.[34]

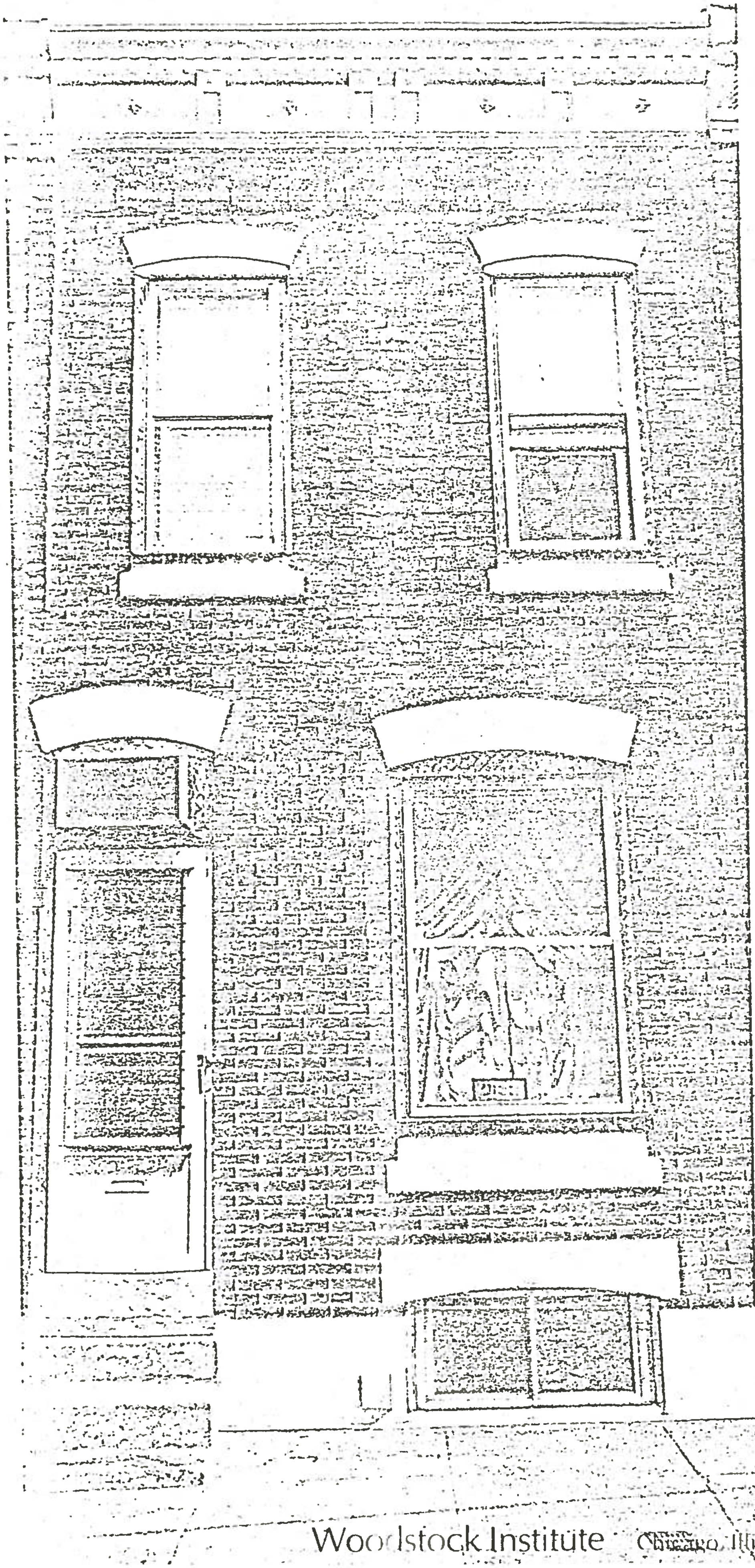
A third measure of the impact of PMP on the city of Philadelphia is the opinion of various community representatives who have actively monitored the Plan.[35] Generally, comments have been favorable although there has been increasing concern regarding the inability of PMP participants to extend credit to very low income groups and their unwillingness to finance the purchase of properties in blocks which do not meet the minimum block criteria established by PMP. Other concerns involve the need for a rehabilitation program and the fear that displacement of poorer residents may be caused by rising property taxes due to the appreciation of property values. Despite these concerns, community spokespersons acknowledge that PMP is pumping some conventional mortgage money into areas which previously were unable to attract conventional credit.

Impact on the Lending Industry

In addition to increasing the supply of conventional credit in Philadelphia, the experience of the Philadelphia Mortgage Plan has begun to raise doubts concerning the lending industry's negative assumptions about urban lending. Most lenders regard inner city lending as characterized by high risks. They also suggest that there is little, if any, demand for conventional credit in city neighborhoods. Recently, these perceptions have been reinforced by the writings of two consultants to the lending industry, Andrew Brimmer and George Benston.[36] On numerous occasions, the findings of these two experts have been cited by lenders as rationale for refusing to extend credit in inner city areas. Brimmer and Benston, however, have overlooked the demand for credit which has been generated by the Philadelphia Mortgage Plan. They have also ignored the low default, reasonable return experience PMP supporters have had with the mortgages they have extended.

Since the start of PMP, a number of participating lenders have actively marketed the availability of credit to brokers, residents of inner city neighborhoods and community organizations. Marketing activities have involved the distribution of flyers (Figure 1), brochures (Figure 2), and advertisements in community and metropolitan newspapers. Some participants have also made presentations to neighborhood groups concerning the goals and operation of PMP. As a result of these activities, a demand for conventional credit was generated which amazed participating lenders.

For years, PMP participants, like their colleagues throughout the country, had assumed that there was little demand for conventional credit in the inner city. However, when they reoriented their lending policies by making flexible loans, and then marketed these loans, they encountered a demand that allegedly did not exist.



A new look at mortgages

The Philadelphia Mortgage Plan is stemming neighborhood deterioration in Philadelphia and giving a new lift to our town.

Civic leaders and the Greater Philadelphia Partnership conceived the Plan. PSFS and two local commercial banks undertook to make it work. And the Plan *is* working.

Mortgage policies have been revised to relate real estate appraisals to individual blocks rather than entire neighborhoods. Applicant qualifications have been liberalized as well. Co-mortgagor and welfare incomes are now counted, for example.

But what is involved here is not charity; it's business. The Philadelphia Mortgage Plan offers financing in older neighborhoods on the same terms as the participating banks are offering elsewhere. Competitive rates are charged on all loans which are generally covered by private mortgage insurance. Since October, 1975, over 1,100 mortgages have been granted for a total of $12,000,000.

PSFS, the other participating mutual and commercial banks (now numbering 12), neighborhood associations, churches, counseling agencies and real estate interests have joined together to carry forward this unusual undertaking in community cooperation. PSFS is proud to have played a part in this effort.

PSFS
THE SAVER'S BANK
The Philadelphia Saving Fund Society
Member FDIC

EQUAL HOUSING LENDER

FIGURE 2

What It Is

The Philadelphia Mortgage Plan is a cooperative effort by major local financial institutions to adjust lending policies to residential mortgage needs as they exist today in Philadelphia.

Under the Plan, the participating banks have adopted revised and uniform lending guidelines to assure that each application for home mortgage financing is considered on an individual basis.

What It Does

Overall, the goal of the Philadelphia Mortgage Plan is to improve housing conditions in Philadelphia. More specifically, it seeks to accomplish this by making mortgage funds available to creditworthy prospective purchasers of residential properties in potentially healthy city neighborhoods which have fallen victim to deterioration and consequent disinvestment.

Lending Criteria

The banks participating in the Plan have modified their lending policies to ensure that decisions are based on evaluations of both property and applicant.

Regarding Applicants:

...Income of borrower's spouse/co-mortgagor will be recognized as effective income.

...Confirmed income from official welfare agencies will also be recognized. (As a general rule, however, support orders will not be considered as such.)

...Loan-to-value ratios of up to 90-95% will be acceptable, provided there is adequate mortgage insurance. Maximum loan amount will be $15,000 and maximum sales price $17,500.

...Amounts necessary to cover annual taxes, fire insurance and private mortgage insurance will be collected monthly.

...Mortgage terms will be based on loan amount and ability to repay.

...Uniform loan application and appraisal forms will be used by the participating institutions.

Regarding Properties:

Homes for which mortgages are sought will be appraised according to their structural state and that of other housing units in the immediate block, and not on generalized perceptions of housing conditions in larger adjacent areas. Prospects for mortgage financing will be most favorable for homes on blocks in which: (1) the median property value is at least $6,000, and, (2) the combined abandonment and vacancy rates do not exceed 10%. However, in cases where these conditions are not present, properties may still be eligible for mortgage funds where a combination of the following factors exists:

...The presence of a strong and cohesive neighborhood or community organization;

...The existence of a rehabilitation or other ongoing housing improvement program by either a non-profit developer, public agency or recognized private group, or;

...A cooperative effort by absentee owners with neighborhood residents to improve housing conditions and make needed repairs on existing dwellings.

How The Program Works

Those seeking mortgage financing should go to any one of the offices listed below and on the back page of this brochure. Trained housing counselors are available to answer questions and assist in the preparation of mortgage applications. For special assistance in the preparation of mortgage applications, or in cases where mortgage financing cannot be provided, participating banks may refer applicants to qualified community organizations and counseling agencies.

Office Locations and Key Personnel of the Philadelphia Mortgage Plan:

Beneficial Savings Bank
1200 Chestnut, Philadelphia, Pa. 19107
Telephone: 923-0700
James J. Connor, Assistant Treasurer

Central Penn National
Public Ledger Building
7th and Chestnut Streets, Philadelphia, Pa. 19106
Telephone: 854-3294
Walter C. Hebden, Assistant Vice President

Continental Bank
Broad and Nedro Streets, Philadelphia, Pa. 19141
Telephone: 823-6494
Louis Pauzano, Assistant Vice President

Fidelity Bank
15th & Sansom Streets, Philadelphia, Pa. 19102
Telephone: 935-7668
John Schultz, Vice President

One mortgage officer involved in processing PMP mortgages expressed his view of PMP's marketing success in the following manner:

> A new market has been created because of the Plan. This is a market that, contrary to expectations, has prospective buyers with reliable income sources (although small) and genuine commitment to own a home. They are purchasing properties that, although low priced, are in livable and respectable condition.[37]

The skeptics in the lending industry assumed that if this latent demand for credit was met, then PMP lenders would shortly be faced with a high rate of foreclosures. Such gloomy predictions were based on experiences such as the high rate of foreclosures in the FHA single-family mortgage insurance programs and the high rate of abandonment in inner city neighborhoods.

The success of PMP during its first two years of operation will probably force such pessimists to rethink their perceptions concerning the risk of inner city lending. As of December, 1977, PMP institutions had extended 2955 mortgages and have had to foreclose on only one property.[38] According to PMP spokespersons, part of the reason for the low foreclosure rate is the use of pre- and post-purchase counseling programs for many of the mortgage recipients.

Despite the ominous predictions of excessive foreclosures, the experience of PMP has indicated that it may be possible to extend credit, without subsidies, to moderate income households and obtain a reasonable return on investment. Such an experience in Philadelphia suggests that there are opportunities in other cities for extending credit to moderate income, but creditworthy families in older neighborhoods.

Lenders in other cities have begun to acknowledge the short-run success of PMP, but are generally withholding judgment until the mortgages are four to five years old. A rule of thumb employed by lenders is that once a mortgage is five years old, the probability of default dramatically declines with each additional year.

In the cities of Seattle and Detroit, lenders have initiated programs which are based, in part, on the Philadelphia Mortgage Plan.[39] In both cases, the programs were started after a review of the experiences of PMP.

Potential for Implementation of PMP Typology in Other Cities

Although the principals involved in the Philadelphia Mortgage Plan believe that PMP type strategies can and <u>should be</u> implemented in other cities, such assumptions are questionable. In an article in Banking Magazine, James Bodine of First Pennsylvania Bank stated the following view of the potential for PMP replication in other cities.

> Seattle and Detroit have already modeled programs after PMP, and there is no reason why other cities cannot do the same. Queries have come from Chicago, New York and Washington, D.C.[40]

In order to assess the potential for the creation of efforts like PMP in other cities, it is necessary to analyze the environment in which PMP was created.

PMP evolved from the participation of three Philadelphia lenders in the Greater Philadelphia Partnership which was engaged in search process for two neighborhoods which would serve as target areas for Neighborhood Housing Service programs. The three lenders were Todd Cooke, President of the Philadelphia Savings Fund Society; James Bodine, Chairman of First Pennsylvania Bank; and Frederick Heldring, President of Philadelphia National Bank. During the search process, these lenders developed a relationship with several indigenous community leaders who had been protesting the practices of Philadelphia's financial corporations which were allegedly accelerating neighborhood deterioration. The lenders and neighborhood representatives participated in a mutual learning experience where lenders learned of the problems of neighborhoods and the neighborhood people realized the intricacies of lending and risk analysis.

After an extensive search process, the lenders and neighborhood representatives collectively concluded that given the large number of disinvested neighborhoods which they had witnessed, more than two Neighborhood Housing Service programs were needed. Consequently, an effort was undertaken to establish a city-wide approach to stabilizing Philadelphia's neighborhoods, which culminated in the creation of PMP.

In forty-six cities, Neighborhood Housing Service programs have been established through the partnership approach which was used in Philadelphia. Lenders and community representatives, along with public officials, have cooperated in each of these cities to select one or two neighborhoods to serve as NHS target areas. However, only in Philadelphia did lenders undertake the initiative to design a serious strategy to revitalize numerous disinvested neighborhoods which they had found during the NHS search process.

On the basis of interviews with PMP participants and a careful review of their public speeches and congressional testimony, the author has found that the following factors played a significant role in the creation of PMP.

First, the principal officials of the three institutions which founded PMP began to realize that the future financial success of their institutions was directly linked to the condition of Philadelphia's economy. Unlike many lenders in other cities who have only begun to understand the relationship between their prosperity and the prosperity of the central business district, the PMP founders also realized the necessity of insuring the vitality of the city's <u>existing</u> residential neighborhoods in order to insure the soundness of their consumer deposit base. They realized that if something was not done immediately to reverse the blighted condition of many inner city neighborhoods, then the city's economy and their institutions would be in deep trouble. The following statement by Todd Cooke exemplifies this understanding:

> ...A bank, unlike many other businesses, is pretty much rooted to a particular community or group of communities. My bank, Philadelphia Savings Fund Society, simply cannot pack up and move to the Sun Belt. We don't want to, but that is just as well because we can't. We have had a

> 160-year association with Philadelphia and the Greater Philadelphia area, and we hope to continue to do business in this community for many years to come. Since this is the case, it is clearly in our interest that the community in which we operate grows and prospers. An essential element in such growth and prosperity is a sound stock of housing sustained by a healthy flow of mortgage financing.[41]

A second significant factor in the creation of PMP was the belief by the participants that the extension of mortgage credit could make a difference in many of the neighborhoods which were beginning to experience deterioration. Unlike much of the lending industry, PMP participants no longer assumed that most of the city was too deteriorated for lending institutions to make a difference. They began to distinguish, on a block-by-block basis, among deteriorated blocks which represented prudent credit risks and those blocks which did not.

A third factor which at least played a role in the involvement of the Philadelphia Savings Fund Society in PMP was the assumption that banks are licensed to serve the <u>needs</u> of the public. The following statement by Todd Cooke explains this often overlooked principle of banking:

> Banks, as components of the service industry, have a marketing <u>opportunity</u> and "franchise" <u>obligation</u> to serve the public. That is what we are set up to do; that is what state regulators, in effect, license us to do, and I think serving the public means just that -- attempting to meet a <u>full range</u> of financial needs as the public perceives them, not simply offering a selection of these services which we, as bankers, find easy and profitable to provide. Older urban neighborhoods need mortgage financing. Banks, as financial service institutions, should attempt to meet that need. (emphasis added)[42]

Although the PMP founders appear to be relatively enlightened concerning the role of financial institutions in stabilizing neighborhoods, until 1975 they were not fulfilling their acknowledged role in many of the city's neighborhoods. Like their associates throughout the country, they too were refusing to extend all but a minimal amount of credit in neighborhoods perceived to be declining. Why did they change their policies in 1975 after years of withdrawing from many neighborhoods?

Throughout the early 1970s, Philadelphia, like most major cities, experienced a considerable amount of activism on the part of citizen's groups protesting the refusal of many lenders to extend credit in older neighborhoods. Initially, many of the lenders which now participate in PMP were defensive when they were attacked by neighborhood groups which had experienced redlining. In early 1975, however, local financial institutions began to respond in a constructive manner to criticisms from neighborhood advocates. Perhaps they were swayed by the arguments of community leaders or they were jolted into rediscovering their commitment to the city by two other forces which were affecting or could potentially affect the banking industry and the city of Philadelphi

A potential threat to the banking industry was the fear of federal or state legislation mandating inner city lending. This may have strongly encouraged the PMP lenders to find a way to meet neighborhood credit needs. In 1975, the Home Mortgage Disclosure Act was passed, despite the massive efforts of the banking lobby, one of the most powerful interests in Washington, to kill the legislation. Consequently, some lenders assumed that almost anything was legislatively possible given the sudden influence of the pro-neighborhood lobby.

Another factor, which directly influenced the City of Philadelphia, may have also stimulated the creation of PMP. This concerned the alleged inability and unwillingness of local government to do anything to reverse the decline of Philadelphia's neighborhoods.

According to some neighborhood leaders, the election of Frank Rizzo as mayor of Philadelphia initiated a process of public disinvestment in neighborhoods, particularly black neighborhoods, which did not support Rizzo. Neighborhood groups contend that as a result of the withdrawl of city services and the cancellation of capital improvements, many neighborhoods began to rapidly deteriorate and financial institutions consequently withdrew support. The ultimate effect of such practices was predicted by many to be the collapse of the city as deterioration spread and destroyed the residential and much commercial tax base.

Assuming that local lenders agreed with neighborhood groups which were accusing Rizzo of such practices, the creation of PMP may have been an effort to reverse the deterioration which was allegedly produced, in part, by the practices of the Rizzo administration.

In the process of investigating PMP, this author found no evidence or statements by PMP lenders which explicitly accused Philadelphia's political administration of such practices. The only reference to the significance of local government support for city neighborhoods was found in the following statement by Todd Cooke:

> An important contribution of local government is to provide the same range and quality of services -- police and fire protection, sanitation, and so on -- in low income neighborhoods as in more affluent areas. With all due respect to local governments, this is sometimes not the case.[43]

Although PMP founders probably did not share the conspiratoral theory of the Rizzo administration maintained by many neighborhood groups, the absence of city representation in PMP, which, in effect, aids the creation of equity stakes for minority residents, is noteworthy.

The key to creation and continued performance of PMP, and the development of PMP-type programs in other cities, is the willingness of the senior management of local financial corporations to meet with neighborhood leaders and learn about the problems which neighborhoods are experiencing. It is particularly important for lenders to understand the problems resulting from private and public investment practices which appear neutral on their face, but are discriminatory in effect towards certain neighborhoods. Such practices often accelerate the demise of inner city housing stock and neighborhood commercial districts. Lenders must also be enlightened with regard to the practices of their institutions which are not only accelerating housing and commercial deterioration, but are also stimulating the decline of their deposit base and their labor force as residents and businesses leave disinvested areas.

If such educational partnerships between neighborhood leaders and lenders can be found, then the potential for a successful PMP-type effort will be enhanced provided that the senior management of financial corporation is committed. Otherwise, any effort will represent no more than a paper strategy with little chance of meaningful implementation.

Interested parties in other cities who desire to establish strategies similar to PMP should attempt to foment working partnerships through reasonable discussion. Confrontation tactics might be utilized if attempts to structure reasonable dialogue fail. However, the nature of such an approach may permanently prevent the development of constructive cooperation between lenders and neighborhood people.

The Philadelphia Mortgage Plan is probably the most significant organized, multi-bank reinvestment program in any single city. Groups in other cities interested in fomenting such a strategy, however, should be aware that the goals and potential success of PMP in revitalizing neighborhoods are limited.

At the close of 1977, PMP had successfully begun to extend conventional credit for the purchase of single-family housing in formerly redlined neighborhoods without incurring even minor losses. Philadelphia, like Baltimore, is a city which is primarily characterized by single-family houses. Consequently, PMP is an appropriate response to the housing related credit needs of Philadelphia. Most of the other older cities of the Northeast and Midwest, however, are plagued by the massive problems of multi-family housing deterioration and abandonment. In cities like New York, Chicago and Boston, large apartment buildings anchor many inner city neighborhoods. Once such buildings deteriorate, then the surrounding neighborhood composed of single-family and smaller multi-unit housing will quickly follow.

Unlike neighborhoods exclusively composed of single-family housing, neighborhoods which consist of both single-family and large multi-unit housing are extremely difficult to revitalize. To date, there have been few successful efforts to slow the deterioration of such neighborhoods. Cities experiencing rapid deterioration of their multi-family housing stock should consider focusing their time and talent on the creation of vehicles to extend credit for the acquisition and renovation of multi-family buildings. The lessons learned from PMP regarding single-family mortgage lending should be implemented by concerned lenders in conjunction with their regular, everyday business without exhausting precious time and talent required to design an unneccessary plan. Such effort should be used to develop a cooperative effort among major financial corporations to stimulate the renewal of older multi-family housing.

Even in Philadelphia, PMP alone will not be sufficient to stabilize the decline of the city's neighborhoods. Additional initiative must be taken by participating lenders to finance the improvement of the small business establishments which populate the major streets of the city's neighborhoods. Concerned lenders must also stimulate the creation of new businesses and meet the credit needs of existing small business entrepreneurs of which will employ or are currently employing existing inner city residents. Unless such steps are undertaken, PMP single-family loans may become less than secure.

PMP represents a landmark effort which has indicated that the extension of single-family mortgages in neighborhoods perceived as marginal investment opportunities is both prudent and profitable. Single-family mortgage lending is a necessary first step, but it is not sufficient to insure the future viability of the City of Philadelphia or any other city. Next, PMP participants must use their creative talents to show the lending industry and neighborhood advocates how to revitalize neighborhood commercial areas and to establish strategies to make those blocks which they now regard as imprudent credit risks to once again become secure investment opportunities.

Footnotes

[1]The literature search consisted of a review of editions of the following publications published since January, 1976: American Banker, Banking Magazine, Business Week, Forbes, Fortune, Journal of Housing, Philadelphia Bulletin, Philadelphia Inquirer, Philadelphia, Planning, Practicing Planner and the Wall Street Journal.

[2]James F. Bodine, "Good for people, good for banks: The Philadelphia Mortgage Plan," Banking Magazine, July, 1977.

[3]The Center for Community Change, The Lifeblood of Housing, (Alexandria, Virginia: Mt. Vernon Publishing Company, Inc., 1976), p. 71.

[4]Ibid.

[5]Ibid.

[6]Due to the passage of the Housing and Community Development Act of 1977, financial institutions are concerned about generating favorable publicity concerning their inner city lending performance. Title VIII of the Act requires federal regulatory agencies to examine each lending institution's performance in meeting the credit needs of all segments of the community in which it is located. Regulatory review of credit performance will occur whenever an institution applies to a regulatory authority for permission to make a structural change (e.g. branching, merger). Theoretically, a regulatory agency can reject such an application if the applicant institution is not sufficiently meeting the credit needs of its community.

[7]Private mortgage insurance provides lenders with insurance on a specified percentage of a mortgage loan for a fee. If the borrower defaults on the loan and foreclosure occurs, then the lenders will be reimbursed by the private mortgage insurance company for that portion of the loan which it had insured.

[8]Continental and MGIC were the two private mortgage insurance companies which have been involved with PMP since its inception.

[9]For a more complete analysis of these underwriting practices see: Calvin Bradford, An Analysis of Underwriting and Appraisal Practices and Their Impaction on Credit Availability, (Chicago, Illinois: Woodstock Institute, 1977).

[10]The Equal Credit Opportunity Act (ECOA) (15 USC 1691) became effective on October 28, 1975 and was implemented by Regulation B (12 CFR 202). ECOA was amended on March 23, 1977. Regulation B prohibits discrimination with respect to any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, receipt of income

from public assistance programs, and good faith exercise of any rights under the Consumer Credit Protection Act.

[11]Herb Bowers, Presentation before Governor's Conference: From Redlining to Reinvestment, Chicago, Illinois, September 1976. Transcript available from the Woodstock Institute, Chicago, Illinois.

[12]May Long, "Community Groups, Banks," Journal of Housing, January 1977, p. 23.

[13]For an analysis of the historical development of contemporary appraisal practices see: Bradford, supra., note 9.

[14]For an understanding of the subjectivity of appraisal practices concerning future value see: Stanley L. McMichael, McMichael's Appraising Manual (Englewood Cliffs, N.J.: Prentice Hall, Inc., 1931). McMichael's Appraising Manual is one of the most frequently used training textbooks in the appraisal industry.

[15]Todd Cooke, Presentation before the Governor's Conference: From Redlining to Reinvestment, Chicago, Illinois, September, 1976.

[16]Bowers, supra., note 11.

[17]Long, supra., note 12.

[18]Greater Philadelphia Partnership, The Philadelphia Mortgage Plan Report, IX, December 31, 1977.

[19]Ibid.

[20]Greater Philadelphia Partnership, The Philadelphia Mortgage Report VII, September 30, 1977. This was the last report which indicated the number of mortgages made by each PMP participant.

[21]Supra., note 18.

[22]Ibid.

[23]Ibid.

[24]Ibid.

[25]Bodine, supra., note 2.

[26]Ibid.

[27]Ibid.

[28]Ibid.

[29]Ibid.

[30] Ibid.

[31] Jane Shull and Hilde Jeffers, Mortgage Money in the City: An Analysis of Mortgage Disclosure Data, (Philadelphia, Pa.: Institute for the Study of Civic Values, 1977).

[32] Ibid.

[33] Ibid.

[34] Ibid.

[35] Such community representatives include Father Joseph Kakalec, the organizer and first president of a city-wide council of community organizers; Shirley Dennis, director of the Housing Association of Delaware Valley; and Reverend William Gray, member, Greater Philadelphia Partnership.

[36] See Andrew Brimmer, Risk vs. Discrimination in the Expansion of Urban Mortgage Lending (Chicago, Illinois: U.S. League of Savings Association, April, 1977).

[37] Long, supra., note 12, p. 24.

[38] Supra., note 18.

[39] Bodine, supra., note 2.

[40] Ibid.

[41] Cooke, supra., note 15.

[42] Ibid.

[43] Ibid.

Part III

Chapter 3

MORTGAGE POOLS:

TOOLS FOR STIMULATING REINVESTMENT

Chapter 3

MORTGAGE POOLS: TOOLS FOR STIMULATING REINVESTMENT

by Dennis R. Marino

Summary

A mortgage pool is established by the commitment of two or more financial institutions of a specified dollar amount to be used for originating mortgages in mature communities which are perceived by participating lenders as questionable risks. A pool presents the opportunity for a number of lenders to make mortgages available in a given area without any one lender incurring a substantial exposure on any mortgage. If a loss is incurred on a mortgage which is foreclosed, then the loss is shared by all participants in the pool. Conversely, all profits which are made on mortgages originated through a pool are usually shared by all participants.

In addition to describing the rationale for establishing a mortgage pool, the author briefly discusses mortgage pools which have been originated in Chicago, Oakland, Saint Louis and Atlanta.

MORTGAGE POOLS: TOOLS FOR STIMULATING REINVESTMENT

Throughout the last five years, the evolving dialogue between lenders and community organizations concerned about the availability of mortgage credit in mature communitites, has resulted in the initiation of a number of mortgage pools throughout the country. Mortgage pools often represent a compromise between lenders who are concerned, but unable or unwilling to extend credit on conventional terms in certain communities perceived as high risk, and community organizations who demand that lenders make conventional mortgages available in their communities. In many cases, a mortgage pool is used to determine the actual risk of lending in a certain area and/or to borrowers of income levels which have been perceived as high risk.

A mortgage pool is a fund which is capitalized by commitments of two or more financial institutions. The purpose of the pool is to grant mortgage loans to applicants who are not able to acquire conventional credit from a lending institution. An applicant is usually unable to acquire a conventional mortgage from an institution because he or she, or the property to be purchased is <u>perceived</u> as a high risk. In such cases, lenders will contend that they perceive an uncomfortable probability that the borrower is likely to default on the mortgage, and they will be forced to foreclose and to recover their reinvestment by reselling the property. If the property is located in a mature community, some lenders are also likely to perceive that they will have difficulty recovering their initial investment.

A mortgage pool is designed to allay the fear of an individual lending institution regarding the extention of mortgage credit in neighborhoods perceived to be high risk. This is accomplished by reducing the individual exposure by any one lender on a given mortgage to a minimal percentage. The total risk incurred on the mortgages financed by a mortgage pool may be either equally shared by all the participating institutions, or a certain percentage of the risk may be equally shared and the remaining risk will be incurred by a private mortgage insurance company. For example, in the case of a mortgage pool which has twenty participants and has twenty percent private mortgage insurance on each mortgage, each participating lender will incur an exposure of four percent of the total value of each mortgage. In some mortgage pools, the exposure of participants is further reduced through partial insurance of each mortgage by local or state government.

Once a mortgage pool is capitalized, the entity administering the pool will begin to originate and service mortgages in a designated target area or for a target population group. The agency which administers the pool is usually one of the institutions participating in the pool, a service corporation or subsidiary created by the participants, or a non-profit corporation, or an agency of state or local government.

All profits generated through the investments of the mortgage pool are usually shared by the participating institutions according to a predetermined formula.

One example of a mortgage pool which involves equal risk sharing among four financial institutions and an insurance company, is the pool created to serve the Uptown community of Chicago. This pool has been capitalized by a three million dollar commitment made collectively by Uptown Federal Savings and Loan, Uptown National Bank, Bank of Ravenswood, Bank of Chicago and the Combined Insurance Company. The pool is not exclusively designed for high risk applicants or property. Instead, it focuses on providing mortgage credit "to borderline underwriting cases in which the applicant's income or property might appear not to be up to snuff."[1] According to a representative of Uptown Federal Savings and Loan, the Uptown community and participating institutions are satisfied with the success of the program.[2]

Another example of a mortgage pool is the Savings Association Mortgage Company of Oakland, California. This pool has been capitalized by twenty-seven savings and loan associations located in Oakland and is designed to provide mortgages for housing purposes by moderate income households.[3] Initiated in 1971, SAMCO was responsible for underwriting and servicing all loans financed by the pool.[4] In 1975, after a rapid growth in the delinquency rate, the participating associations changed the functions of SAMCO. Instead of underwriting mortgages, SAMCO was restricted to purchasing "high risk" mortgages originated by the associations.[5] As of January, 1977, SAMCO had a mortgage portfolio of 1,193 mortgages with an aggregate value of $25 million. At the start of 1976, twenty-two percent of the mortgages in SAMCO's portfolio were delinquent. By January, 1977, however, the delinquency rate had been reduced to ten percent.[6] According to one source, the high rate of delinquency on loans financed through SAMCO was due to careless underwriting and the absence of a post purchase counseling program.[7]

An example of a mortgage pool administered by a savings and loan service corporation is a pool in Saint Louis operated by the Savings Service Corporation. The Savings Service Corporation was created by a group of savings and loan associations which had made a commitment to establish a ten million dollar fund for conventional inner city loans.[8] The operation of the pool involves Savings Service Corporation reviewing rejected loan applications referred to it by savings and loan associations.[9] The rejected applications are reviewed according to two basic criteria: the applicants income and his or her ability to repay the loan; and the capacity of the borrower to maintain the property.[10] According to Robert A. Drohlich, the Vice-President of Savings Service Corporation, approximately 150 mortgages have been originated through the pool.[11]

A mortgage pool which involves risk sharing among lenders, private mortgage insurance companies and local government is the Chicago Home Purchase and Rehabilitation Program (CHPRP). CHPRP is administered by the Community Service and Research

Corporation, a not for profit corporation which believes that by openly and logically measuring risk, it can begin to affect lender attitudes concerning the prudence of investing in inner city neighborhoods.[12]

CHPRP was initiated by a group of twenty Chicago commercial banks and savings and loan associations which made a commitment of $7,000,000 to provide mortgage and rehabilitation loans to moderate income families. The lenders' commitment was leveraged by a loan guarantee fund of $500,000 established by the City of Chicago, and a commitment by private mortgage insurance companies to insure any mortgages which conformed to their underwriting standards. The City of Chicago assumes eighty percent of the risk on each loan granted through CHPRP, and the participating lenders and the private mortgage insurance companies share the remaining exposure. As of August 1977, CHPRP had granted seventeen loans with an aggregate value of $360,000.[13]

Another mortgage pool which has been initiated by savings and loan associations and commercial banks is the Atlanta mortgage pool.[14] This pool was created in response to a recommendation made by Central Atlanta Progress, Inc. (CAP) that the revitalization of Atlanta's inner city neighborhoods and the security of the central business district would be greatly enhanced by the establishment of a mortgage pool with a commitment of $50 million from Atlanta's financial institutions.[15] Seventeen institutions responded to this suggestion by agreeing to make a total commitment of $35 million. The implementation of this pool was sidetracked by the tight money market of 1974, and was not achieved until April, 1976. At the time the pool became operational, the lending community's commitment was increased to $62.5 million. As of July, 1977, approximately 100 mortgages had been made or committed with an approximate value of $3 million.

Conclusion

Mortgage pools provide a vehicle for lenders to make a collective effort to reinvest in mature communities and to test traditional notions of the risk of lending in inner city communities. However, as indicated by Nathaniel Rogg, the author of a study commissioned by the U. S. League of Savings Associations, lenders should not view pools as cosmetic public relation devices. In making a series of recommendations to the savings and loan industry, Rogg made the following suggestion.

> 7. MAKE ... HIGH RISK MORTGAGE LOAN POOLS MORE EFFECTIVE. Lender participation in them should be more than cosmetic and should be reviewed by the institutions involved to this end, as well as to stimulate more widespread use of this device. They need to be "marketed" so that the public in general will know of their availability.[16]

In the process of marketing pools, lenders should not attempt to attract borrowers who clearly qualify for credit based on conventional underwriting standards. Access to mortgage pools should be reserved for those borrowers who have questionable credit histories, marginal income, or borrowers who desire to purchase properties which are perceived as questionable security by lenders. The marketing effort suggested by Rogg should be directed toward this segment of the potential market.

On the other hand, lenders should be wary of those who might attempt to take advantage of the flexible underwriting standards employed by mortgage pools. If pools attempt to finance home purchases by borrowers who clearly lack the capacity to meet monthly mortgage payments, then there will likely be a high incidence of default and foreclosure. In all cases, mortgage pool participants should require pre- and post purchase counseling of all mortgagors.

State government can support mortgage pools in the following ways. First, a state agency could guarantee a percentage of each mortgage made through a pool. Second, regulators of state chartered financial institutions could favorably consider branching applications submitted by institutions which are extending a considerable amount of credit through a pool. Thirdly, the state treasurer could deposit state funds in those institutions which actively participate in pools. Finally, a state housing finance agency could support mortgage pools by aggressively attempting to purchase mortgages originated through a pool.

FOOTNOTES

[1]Comments of John Kain, Vice-President, Uptown Federal Savings and Loan as reported in Chicago Tribune, August 3, 1975.

[2]Ibid.

[3]The description of SAMCO was taken from: Government of the District of Columbia Commission on Residential Mortgage Investment, Strategy For Change: Housing Finance In Washington, D.C., p. 71.

[4]Ibid.

[5]Ibid.

[6]Ibid.

[7]Ibid.

[8]John Egan and Leonard Rubinowitz, An Inventory of Reinvestment Strategies (Chicago, Illinois: Woodstock Institute).

[9]Ibid.

[10]Ibid.

[11]Conversation between Dennis R. Marino and Robert A. Drohlich, December 13, 1977.

[12]Community Service and Research Corporation, 7 South Dearborn, Chicago, Illinois 60603.

[13]Information obtained from Community Service and Research Corporation.

[14]The description of the Atlanta Mortgage Pool is based on William S. Jones and Dennis D. McConnell, "Reinvestment in Atlanta," Urban Land (June, 1976), pp. 22-25.

[15]Central Atlanta Progress, Inc. (CAP) is a private non-profit corporation established by major downtown property owners and business corporations to plan for the orderly development of the central business district. It acts as a catalyst to generate action on those things it considers necessary to maintain and enhance the economic health of the central city.

[16]Nathaniel H. Rogg, Urban Housing Rehabilitation In The United States (Chicago; U.S. League of Savings Associations, 1977), p. 25.

Part III

Chapter 4

MORTGAGE REVIEW PANELS AS INSTRUMENTS OF REINVESTMENT

About the Author

Leonard S. Rubinowitz is an Associate Professor of Law and Urban Affairs at Northwestern University. He received his B.A. Degree from the University of Wisconsin at Madison in 1965 where he majored in history, and his L.L.B. from Yale Law School three years later. Prior to his coming to Northwestern he served as Special Assistant to the Regional Administrator of HUD Region V. In his capacity as a Field Associate of the Brookings Institution since 1975, hw has analyzed Housing Assistance Plans from the Chicago metropolitan area for a study that is being conducted by that institution. He is the author of Low Income Housing: Suburban Strategies (Ballinger Publishing Company, 1974), and numerous law review articles having to do with housing and urban affairs. He was part of a team that conducted research and strategy identification for the Illinois Governor's Commission on Mortgage Practices in 1974, and is the co-editor of a set of working papers used by the Commission entitled "Mortgage Lending Practices in Older Urban Neighborhoods" (Center for Urban Affairs, Northwestern University, 1975).

Chapter 4

MORTGAGE REVIEW PANELS AS INSTRUMENTS OF REINVESTMENT

by Leonard S. Rubinowitz

Summary

Mortgage review panels have been established in fourteen cities to give applicants who are rejected for single-family credit an opportunity for appeal. Most of the panels have been established by groups of lenders or their trade associations, although, as the paper points out, some panels have been set up as a result of statutes or regulations. Panels can be structured with either one or two tiers, and can involve only lenders, or can include regulatory officials and even citizen representatives. In addition to describing the operations of review panels in several cities, the authors discuss the accomplishments of and criticisms about review panels which have emerged largely as a result of the relatively few numbers of complaints that most panels have received.

MORTGAGE REVIEW PANELS AS INSTRUMENTS OF REINVESTMENT

Mortgage review panels are boards or committees to which applicants for loans may appeal if their applications are rejected by a financial institution, or if they are offered terms and conditions other than what they originally applied for. These panels provide an opportunity for an applicant to have a review of the lender's decision. Usually the review process is available only to applicants whose request for a loan has been rejected. In some cases, a review is also available for applicants who are offered a loan on terms and conditions unsatisfactory for them. Generally the review is limited to applications for single-family home mortgages and home improvement loans on structures which will be owner-occupied.

The purposes of mortgage review panels are summarized in the following excerpt from an article about them which appeared in the Savings and Loan News:

> By pledging 'to make sure all citizens are treated fairly and that mortgage funds are available in all neighborhoods,' the objectives of the Chicagoland committee exemplify the most fundamental goals of all other review boards.
>
> More to the point, however, is the commitment involved 'to dissuade the world -- the media, neighborhood groups and government officials -- that geographical discrimination exists in home mortgage lending,' as a Boston review board participant puts it.[1]

If a rejected application merits approval in the judgement of panel members, they seek to have a financial institution make the loan. The procedure is designed to protect against discrimination on the basis of geographical location, and to insure that the applicant will not have to make multiple applications to secure a loan.

Mortgage review boards are initiated either by lenders and industry-wide organizations of lenders, or they are created by a state or local government through legislation or regulations. Panels often include financial institutions regulators and, in some cases, representatives of public interest or community organizations.

Lenders may perform several functions within a mortgage review process. First, they usually agree to inform a rejected applicant about the existence of the review panel and the procedures for making use of it. Second, the lenders on the panels agree to consider making loans to those whose applications are rejected or modified by other lending institutions, when those applications are found meritorious by the review panel. In some cases, each participating lending institution makes a dollar commitment to a mortgage pool to be used in making loans that have been rejected by other lenders.[2] Third, lenders on the panels may also commit themselves to reconsider their own decisions when the review process indicates that rejected applications should have been approved.

A fourth role which lending institutions have been asked to play on some occasions is to adopt appraisal and underwriting criteria which eliminate many of the conventional lending constraints related to location.[3] Finally, in some cases, lenders have been asked to carry out affirmative marketing programs to let the public know that loans and the review process are available. This may involve advertising or other marketing measures by the individual institution, or a contribution to the panel, which then carries out the advertising and marketing process on behalf of participating lenders.

In addition to individual lending institutions, the mortgage review process involves a separate entity, a mortgage review board, panel, or committee. This panel may consist of one or two tiers. In the two-tier situation, there is usually an industry board which does the initial review. If that board affirms the decision of the initial lending institution which rejected the application, the applicant may appeal to a second panel, which may be composed of regulatory officials and members of the public.

The one-tier boards range in composition from an entirely industry board -- composed of lenders and trade association staff persons -- to one which includes members of financial institutions, local or state officials and public members. The review panel may have a specified period of time within which it will not only make its own independent finding, but will also seek to have a financial institution make the loan if it finds that the loan should be made. If the board's conclusion is different from that of the initial lending institution -- and that institution refuses to change its decision -- its responsibility will generally be to find another lending institution which will agree to make the loan. The other responsibility of the mortgage review panel may be to carry out an advertising campaign to make sure that the public is aware of the availability of the review mechanism and the procedures for using it.

The Two Original Forms of Review Panels

Among the earliest of the mortgage review panels were the Milwaukee Area Mortgage Opportunity Plan (MAMOP) and the Home Mortgage Opportunity Committee (HMOC) in Pittsburg. Each of these is a voluntary association of lenders. MAMOP is a one-tiered program while Pittsburg HMOC represents a two-tiered approach.

All home mortgage lenders doing business in Milwaukee County who volunteer to participate are members of MAMOP. The participants include savings and loan associations, banks and mortgage bankers. MAMOP is specifically designed to address discrimination against lending in certain areas, as the following statement indicates:

> The dual purpose of this plan is to encourage home ownership in all areas of Milwaukee County and to afford equal access to either conventional or government backed available financing by mortgage lenders to all prospective home buyers who meet the following criteria: (a) proof of adequate ability and credit background; and (b) purchase at fair market value of one or two home owner-occupied dwellings in sound condition; and (c) transactions documented by an accepted offer to purchase.[4]

Any applicant for a mortgage whose application is rejected may request an evaluation of the lenders' decision by the review panel.

The panel consists of representatives from the City of Milwaukee, Milwaukee County, the State Savings and Loan Commissioner's Office, the Banking Commissioner's Office, an appraiser, a representative of the Federal Home Loan Bank of Chicago, a representative of the Savings and Loan Council of Milwaukee County, and a representative of the Milwaukee Area banks. The review panel evaluates the information submitted by the loan applicant and the lender which rejected the original application.

After its review, the panel either confirms the rejection and states its reasoning for this decision, or it recommends approval of the loan application. In the latter case, the panel may suggest modifications and conditions as it deems appropriate, but it again must state a rationale for its action. If the review panel recommends that the loan be granted, the application is forwarded to a MAMOP lender. If this involves the modification of the terms and conditions of the original application, the applicant is so notified. The participating MAMOP lender who agrees to accept the loan under these terms and conditions then completes the processing of the loan application at its current market interest rate and fees.

In Pittsburg, the Home Mortgage Opportunity Committee was formed by 15 savings and loan associations and two commercial banks. Its stated purpose is as follows:

> 1) to insure that each applicant for a mortgage loan receives equal loan consideration; 2) to make sure that each applicant for a mortgage loan for the purchase or major improvement of a home is knowledgeable that a lender's rejection for a loan request may be appealed to an impartial committee. Review and appeal may be

> obtained when the applicant asserts improper discrimination on the part of the lender; 3) to insure that each applicant who utilizes the procedures established secures prompt response with appropriate explanation.[5]

As in Milwaukee, this committee provides a review for any mortgage applicant who feels that his or her application has been rejected unfairly. While HMOC of Pittsburg does not guarantee that a favorable review by the Committee will lead to a mortgage, its literature for lender members states that "If the original lender rejects /̅an application_7 a second time, the Committee will exert its efforts to place the loan from among the participating lenders, consistent with the terms /̅the Committee_7 has recommended."[6]

HMOC of Pittsburg was the first two-tiered program. The Industry Loan Review Committee is made of members of the participating lending institutions. There are also public interest members who constitute the Public Interest Review Committee. If the Industry Loan Review Committee confirms the initial rejection, it sends the application to the Public Interest Review Committee along with its decision. If the Public Interest Review Committee recommends approval, it returns the application to the original lender. If the original lender continues to reject the application, the committee attempts to place the loan with a participating lender, though no lender is obliged to make the loan.

In response to allegations that some persons are discouraged by lenders from even making application for mortgages or home improvement loans, participating members of HMOC have agreed to document inquiries which do not result in a formal application. The committee agreed to accept complaints from people who had attempted to obtain mortgage financing but who either did not, or were not permitted to, file a formal application. The participating lending institutions also agreed to contribute to the committee for advertising expenses. The amount of these contributions were based on current assets of the lending institution. Funds are used for such purposes as printing posters to be distributed to each member institution for display in their offices.

One-Tiered Review Panels

In Cincinnati, a Mortgage Loan Review Committee was formed by the Better Housing League of Greater Cincinnati. This non-profit civic organization -- which focuses on housing problems in the metropolitan area -- worked with the urban problems committee of the Savings and Loan League of Southwestern Ohio to develop a Mortgage Loan Review Committee.

The review committee is composed of seven members, one each from savings and loan associations, commercial banks, the real estate industry, the bar association, plus three public members. The staff support is provided by the Better Housing League. The committee attempts to make a determination of the feasibility of the loan request. It also has counseling available for loan applicants. If the Better Housing League staff feels that the loan should have been made, it discusses the application with the institution. If resolution is not possible at that level, the matter is referred to the review committee for "direction and guidance."[7] The process is entirely voluntary with all of the parties, and there is no commitment to make any loans.

In Boston, the one-tiered Boston Banks Urban Mortgage Review Board consists of six members, three of whom are representatives of savings banks and three of whom represent community groups.[8] The 12 largest mutual savings banks in Boston agreed to participate in the review board. These institutions represent 93% of thrift institutions' assets in the City.

The procedure in Boston is similar to those described above. An applicant for a mortgage loan whose application is rejected at any of the participating banks may appeal to the board if he or she believes that the rejection was based on the location of the property rather than the condition of the property or the applicant's creditworthiness. If the majority of the board believes that the loan was denied because of the location of the property, the board will recommend that the bank grant the loan. If the savings bank continues to decline to make the loan, one of the other participating savings banks will be asked to make it. As with the other programs, none of the participating institutions is required to issue the loan.

<u>Two-Tiered Review Panels</u>

In Illinois, after an initial effort by the State Commissioner of Savings and Loan Associations to institute a Mortgage Review Panel in 1975, the state and federal councils of savings and loan associations took the lead in establishing a committee in 1976. Under the Home Mortgage Opportunity Committee (HMOC) of Chicagoland, any applicant who is rejected for a mortgage loan is to be informed by the association that there is a right to appeal to this two-tiered committee. The first appeal involves a board composed of five senior officers from the savings and loan industry. If that panel says that the loan should have been made, then the panel takes the responsibility for finding a participating lending institution that will agree to make it. If the initial panel concludes that the loan rejection was justified, then the rejected application automatically is sent to a "public interest panel."

The public interest panel has five members, two of whom are heads of the state and federal savings and loan regulatory agencies, respectively. If the public interest panel concludes that the loan should be made, the industry participants have committed themselves to find a lending institution which will make the mortgage. Thus, the commitment is to make the loan available even if the industry panel feels that the lender was justified in originally rejecting the application.

The institution which rejects an application is responsible for informing the applicant of the reasons for the denial, and the availability of the review committee. Within 15 days of the application for review to HMOC of Chicagoland, a final decision is made. The process has to go through both panels, if necessary, within the specified period.[9]

Similarly, the Seattle Public Reinvestment Review Board has a two-tiered system. The first review is done by a panel composed of nine lender members and one ex-officio representative from the Mayor's Office of Policy and Planning. The lender members are appointed by the Mayor from nominations submitted by participating lending institutions. If the lender review panel determines that the loan should be made, the Board will so recommend to the original lender. If the lending institution continues to be unwilling to make the loan, the review board will place the loan with another participating institution.

If the lender review board determines that the institution was correct in rejecting the loan application, or in offering terms at variance with those it normally offers, the panel will so inform the applicant with a written decision explaining the basis for its decision. This written notice will include a statement explaining that the person has the right to appeal to the public review board. If the public review board concludes that the lending institution and the lenders panel responded inappropriately, it will attempt to persuade the lending institution to reconsider its evaluation.

The Seattle process goes a step beyond the other review panels, because the lenders participating are required to adopt revised appraisal and underwriting standards as well as agree to the purposes and procedures governing the loan review process. These revised standards attempt to concentrate more on the physical conditions of the property and less on the characteristics of the neighborhood where the property is located.[10]

Problems and Performance

Seattle's effort to seek revised appraisal and underwriting guidelines illustrates one of the problems review boards have had in seeking industry participation. In Seattle, although most major banks have adopted the guidelines, most savings and loan associations "refuse to adopt them for fear of antitrust repercussions."[11] It is unlikely that such fears on the part of lenders will inhibit the adoption of uniform appraisal and underwriting guidelines elsewhere, however, since the U. S. Department of Justice said in a business review letter in March, 1977 that similar guidelines -- which were made part of the Boston Plan -- did not violate anti-trust laws. This ruling was based on the Justice Department's assumption that terms and conditions of the mortgages would continue to be established independently by each mutual savings bank participating in the Boston plan.[12]

A second problem has been that different types of depository institutions, savings and loans and banks, have traditionally been in a competitive relationship both for deposits and for certain types of real estate loans. Mortgage review panels which are seen as the product of one type of depository institution may have difficulty attracting members from other types of institutions. One type of non-depository lender in particular, the mortgage banker, has been passed over in many of the mortgage review processes. While the ommission of certain types of lenders can create some problems for voluntary review processes, their ommission can create serious inequities for participating lenders when the mortgage review panel is created by statute or regulatory action. The mortgage review process created by the California Department of Savings and Loan, for example, is restricted to the state chartered savings and loan associations which are regulated by that department.

Even where there has been widespread participation by various types of lending institutions, however, the volume of complaints to the review panels has been low. "With the notable exceptions of the Boston board and the Home Mortgage Opportunity Committee of Chicagoland," noted the Savings and Loan News, "the review requests have been few and far between."[13] Richard E. Knapp, President of Pittsburg's Friendship Federal Savings and Loan, noted that the absence of even one application for "official review" to the HMOC of Pittsburg demonstrates that "the redlining problem was blown out of proportion and does not exist to the extent originally suggested" by community groups.[14]

Mr. Knapp's comments, and the sparcity of complaints to most of the review panels, underscores the need for public policymakers to distinguish between two goals: the elimination of overt discrimination against those actively seeking mortgages or home improvement loans, on the one hand; and, on the other, developing public policies to encourage lenders to take the initiative in meeting what may be termed the "latent" demand for single-family credit in mature communities. Mortgage review panels apparently have contributed to the elimination of overt discrimination. This has happened, as Mr. Knapp himself suggests, in large part because the existence of the panels has "probably resulted in closer scrutiny of borderline applications . . . that might have been appealed had they been rejected" by the originating institutions.[15]

Like other strategies designed to eliminate discrimination in the granting of single-family mortgage credit and/or to stimulate additional lending in certain mature communities, mortgage review panels must be viewed as being most effective when they are used in concert with other private and public initiatives. This point was made forcefully by Robert H. McKinney, Chairman of the Federal Home Loan Bank Board, during his confirmation hearings before the Senate Banking Committee. "Mortgage review committees just have not been working. Complaints have not been filed, and I believe that subtle discrimination has continued in some areas without proper redress. . ." The Chairman then suggested that in addition to making a review of consumer complaints part of the periodic examination process for savings associations, that each Federal Home Loan District Bank establish a "consumer complaint department. . . where complaints could be funneled to a mortgage loan review committee of that District."[16]

Footnotes

1 Mortgage Review Boards: The Second Chance," reprinted from Savings and Loan News September, 1977, p. 1.

2 See forthcoming paper in this series entitled "Mortgage Pools as Instruments for Reinvestment."

3 See discussion below of Seattle panel. Also note that the the larger set of regulations governing lending in urban areas which were adopted by the California Department of Savings and Loans (Memo 76-45) include the creation of mortgage review boards as well as revised appraisal and underwriting criteria. In Philadelphia, Pennsylvania, the Philadelphia Mortgage Plan -- which includes periodic review by participating lenders of all mortgages, approved and rejected -- requires participating lenders to review and, if necessary, revise appraisal and underwriting standards.

4 "Milwaukee Area Mortgage Opportunity Plan," (revised May 26, 1977), MAMOP, 312 East Wisconsin Avenue, Milwaukee, Wisconsin 53202, p. 1.

5 Memorandum from Thomas A. Jones, Chairman, HMOC of Pittsburg, to Members, regarding "Proposed Objectives, Organization and Procedures Adopted 10/15/75," un-dated, p. 1.

6 Ibid., p. 4.

7 Letter from Leonard M. Leick, Better Housing League of Greater Cincinnati, to Kathi Hellerbach, Center for Urban Affairs, Northwestern University, March 1, 1977, p. 2.

8 "Mortgage Review Board Formed in Boston," Trends In Housing, (National Committee Against Discrimination in Housing: Washington, D. C.), Fall Issue 1976, volume 20, Number 4.

9 Home Mortgage Opportunity Committee of Chicagoland, Post Office Box 516, Chicago, Illinois 60690.

10 "Seattle Residential Loan Review Process," Mayor's Office of Policy and Planning, Seattle, Washington, August 19, 1976.

11 "Seattle Redline Board Gets No Complaints," American Banker, March 4, 1977, p. 1.

12 "Massachusetts Forms Mortgage Review Board to Curb Redlining," American Banker, March, 1977, p. 2.

13 "Mortgage Review Panels: The Second Chance," p. 2.

14 Ibid., p. 3.

15 Ibid.

16 Ibid., p. 7.

Part III

Chapter 5

SAVINGS AND LOAN SERVICE CORPORATIONS AS INSTRUMENTS OF REINVESTMENT

Chapter 5

SAVINGS AND LOAN SERVICE CORPORATIONS AS INSTRUMENTS OF REINVESTMENT

by Dennis R. Marino and Lawrence B. Rosser

Summary

Service corporations are subsidiaries of savings and loan associations, and are used as vehicles to make equity and debt investments that savings associations per se are not permitted to make. Service corporations may be wholly owned subsidiaries of one institution (Home Federal Savings of Cincinnati's One Twenty-Eight, Inc.), or they may be owned by a number of associations (The Chicago Area Renewal Effort Service Corporation). In addition, service corporations may function in tandem with local community development corporations (Greater Southwest Service Corporation's partnership with the Greater Southwest Development Corporation of Chicago).

All three service corporations herein discussed are for-profit institutions. In addition to describing their purposes, organization and operations, the authors comment in the concluding section of the paper about how public policymakers can facilitate the work of service corporations as instruments of reinvestment.

Introduction

> /‾The_7 City, as a fundamental institution in our society, is in jeopardy.
>
> --Chicago Area Renewal Effort Service Corporation (RESCORP)

Savings and loan associations have the authority under federal and state regulations to create subsidiaries known as service corporations. Like bank holding company subsidiaries,[1] service corporations can make equity and debt investments which the parent financial institutions are not permitted to make. Although service corporations are used by savings associations to engage in many activities beyond the purview of this paper -- speculative investments in suburban mixed-use developments, for example -- recognition of their utility as instruments for reinvestment in mature communities is growing.

One example of this increased recognition within the savigns and loan industry is the prominence given a recommendation to "make more use of service corporations in inner-city rehabilitation" in a report on urban housing rehabilitation which was recently issued by the United States League of Savings Associations.[2] In another recently published paper prepared by the U. S. League's Urban Affairs Executive Committee, the Federal Home Loan Bank Board (FHLBB) was urged to provide associations with " an additional 1%-of-assets authority so they can fully support urban oriented service corporation activities . . . acting as their own general contractors."[3]

The major reasons for the growing enthusiasm about the service corporation approach are the results achieved by many (including those described below), the flexibility that makes this vehicle readily applicable to local conditions and needs, and the ability of financial institutions to structure a service corporation in ways that enable it to deal comprehensively with neighborhood needs. As the brochure describing The Chicago Area Renewal Effort Service Corporation (RESCORP) states: "The solution of the 'urban problem' must be as diverse and varied as the problem itself. Different communities require different actions, but each approach must concern itself with all of the issues affecting the community."[4] The examples which follow were chosen to illustrate the strengths of this lender initiative.

One Twenty-Eight, Inc.
Cincinnati, Ohio

In August, 1970, Home Federal Savings of Cincinnati established a service corporation known as One Twenty-Eight, Inc.[5] According to George W. Behymer, President of Home Federal, the establishment of the service corporation was the result of the frustration Home Federal experienced in getting contractors to rehabilitate inner-city properties which the association was trying to liquidate for the Federal Savings and Loan Insurance Corporation (FSLIC).

During the last week of March, 1968, Home Federal completed a supervisory merger with another savings association which was being forced to liquidate its assets by the FSLIC. Home Federal agreed to purchase part of the assets, and to liquidate 400 buildings containing a total of 2,100 units which the FSLIC had aquired in the merger. As Home Federal's staff was preparing to sell the FSLIC's properties, the assassination of civil rights leader Dr. Martin Luther King occurred, and the City of Cincinnati -- like many other American cities -- experienced severe civil disturbances. The area most directly affected contained better than eighty percent of the FSLIC inventory.

Once the disorders subsided, Home Federal attempted to preserve the remaining habitable properties by inducing renters to occupy them at minimal rents. By 1969, Home Federal had managed to sell some of the properties, but the association became the unwitting victim of a stringent code enforcement program enacted by the City government. Faced with multiple building code violations, and unable to find contractors willing to work in the areas where the FSLIC properties were located, Home Federal decided to establish the service corporation to serve as its own general contractor.

One Twenty-Eight, Inc. not only corrected all housing code violations on the FSLIC buildings, but it also became an active bidder on contracts let under HUD's Operation Rehab. It even began acting as the general contractor to rehabilitate buildings for private owners. One of the by-products of the service corporation's rehabilitation activities has been the capacity it provides Home Federal's staff in counseling customers who are seeking home improvement loans. One Twenty-Eight, Inc. has also given Home Federal high visibility in inner-city communities, and has helped the association increase its home lending rate in these communities. As Behymer commented in an article he wrote about the service corporation's achievements: "The sophistication of inner city dwellers is not limited to concern over schools, crime rates, and real estate values, but carries over to such things as the ability to insulate a structure properly to minimize energy loss. We would be most pleased if this same awareness was as keen among our suburban home buyers."[6]

The Chicago Area Renewal Effort Service Corporation
Chicago, Illinois

Established in 1973, The Chicago Area Renewal Effort Service Corporation (RESCORP) is owned by more than fifty savings associations in the Chicago metropolitan area. Although there is no limit to the number of savings associations from throughout the state that can participate as stockholders in the corporation, its charter requires that no association may own more than one percent of the shares of the corporation. In addition, none of the participating associations are permitted by law to invest more than one percent of their assets in RESCORP.

The backdrop against which RESCORP was organized was described in stark terms in a report by a non-partisan citizen commission issued last year. That report said in part:

> /̅S_7ince 1965, the spread of abandonment leading to demolition has been so substantial that it is estimated we are losing 53 apartments or homes a day in 1976. . . . /̅I_7n the decade between 1960 and 1970, Chicago lost 159,000 units but had 139,700 added, so that the net loss was just 1,6 percent. Between 1970 and 1974, however, a loss of 85,000 units and construction of only 32,000 (8,000 new units per year compared to 14,000 before) meant a net loss of another 4.5 percent. The tragedy is that a great deal of this lost housing would probably be salvagable and marketable if the money were available and if the deterioration of community settings could be stopped.7

Cognizant of the fact that, "Every individual, business and institution is affected in some way" by this pattern, RESCORP was established to apply concentrated doses of capital, credit and talent to "those areas where trends are still reversible and where community stabalization can occur."[8]

RESCORP participants made two important decisions initially about the activities of the corporation. The first was that it would work solely in the area of rehabilitating multi-family housing. This decision was crucial for its acceptance by citizens and lenders alike since multi-family buildings occupy a dominant position in the configuration of housing patterns within the City, and serve to frustrate many single-family renewal efforts.

In retrospect, an equally important decision was the corporation's commitment to concentrate its efforts in one target area in order to maximize the impact of its efforts. The criteria used to select the first neighborhood -- which was South Shore -- included the fact that the community seemed "renewable," and the importance attached to the presence of a commercial bank in the community which was actively trying to serve as an instrument for community redevelopment.[9] Saul Klibanow, President, explained that RESCORP looked at five factors in arriving at the judgement about the potential for success in the neighborhood: in addition to the presence of South Shore National Bank, the corporation determined that the community had "good location and amenities, strong community groups and institutions, and old, but well constructed buildings."[10]

Using financing provided by the Illinois Housing Development Authority (IHDA), and federal assistance available under HUD's Section 236[11] program, RESCORP was able to reduce the effective interest rate on its first projects to one percent. This first phase, consisting of 148 units in five buildings, had the capacity to accomodate 70 percent market-rate tenants and 30% rent subsidy families. In addition to providing for economic mix in all of their developments, RESCORP engages in aggressive affirmative marketing to attract white tenants to a predominately black neighborhood.[12]

One additional feature of the RESCORP model is worth noting: its tenant selection procedure. Although it gives first priority on rehabilitated units to former residents of its buildings, the corporation heavily emphasizes screening tenants. Visits to prospective tenants at their current residences, credit checks, and applicants' willingness to abide by a set of tenant rules characterize the selection process. Management of rehabilitated buildings to the advantage of both tenant and owner occupies an equally high priority for Klibanow: "Good management means being responsive to tenant needs and being efficient, fair and strict in enforcing the standards of the building."[13]

More than 350 units have undergone substantial rehabilitation at a cost of approximately $ 22,000 per unit. All of the units are currently rented-up, and there is a waiting list. Once a phase is completed, RESCORP sells 95 percent of the interest in the project to private investors whose return on investment is limited to 6 percent, but whose tax shelter advantages are substantial. RESCORP retains 5 percent interest in each project, and remains the managing partner. This arrangement allow the corporation to reinvest its money and to expand its operation. Klibanow has not ruled out the possibility that RESCORP will include cooperative and condominium conversions in its future activities.

Greater Southwest Service Corporation
Chicago, Illinois

The Greater Southwest Service Corporation is -- like its counterparts discussed above -- a for-profit entity. It was established by several savings and loan associations which nave offices on the Southwest side of the City of Chicago. The area has experienced some racial transition and disinvestment in recent years, and several citizens groups greeted its creation with mild enthusiasm. The service corporation was initiated to work with the Greater Southwest Development Corporation in maintaining the commercial and residential viability of the area. All of the savings associations which are shareholders in the service corporation also participate in the policymaking and planning of the development corporation. In addition to the savings and loans, the membership of the development corporation includes representatives from a local commercial bank, Sears and Roebuck Company, Illinois Bell Telephone, Commonwealth Edison, and a number of local businesses. The development corporation is responsible for the overall planning and development of the target area, and the service corporation supervises the rehabilitation of properties designated for such by the development corporation.

The activities of the service and development corporations are designed to indicate the commitment of the lending institutions to the area, thereby instilling confidence in the future of the community by area residents, business persons, investors and prospective residents. The two corporations believe that they are beginning to accomplish this goal through the rehabilitation of key properties in the area. As of September, 1977, two key commercial properties had been rehabilitated. One was a large structure located in the heart of the area's major shopping district. This area had begun to experience disinvestment and deterioration, and merchant confidence in its future was declining.

The two corporations, acting in concert, managed to rehabilitate and lease the building to several new enterprises. The leadership of both corporations viewed this as a significant accomplishment, because of the perception that this area was trapped in a cycle of deterioration which would lead inevitably to further decline. The property is located on the eastern periphery of the Southwest target area, which is several blocks from a community which was seriously impacted by a high rate of abandonment of single-family homes which were insured by the Federal Housing Administration (FHA).

The program put forward by the development corporation to maintain the Southwest area includes several components. First, the corporation intends to show, by example, that the neighborhoods which compose its target area offer opportunities for prudent investment and the establishment of profitable commercial enterprises. Second, a marketing strategy has been implemented to maintain the confidence of existing residents and businesses, and to attract new business. The development corporation has also secured a commitment from financial institutions participating in both the service corporation and the development corporation to make conventional mortgage credit available to qualified buyers, and to affirmatively market home improvement loans in the area. An effort has also been initiated to aquire and rehabilitate abandoned homes now owned by HUD as a result of foreclosure.

The development effort also includes a strategy to rehabilitate multi-family dwellings. As of September, one building containing twenty units had been refurbished and rented-up. Aware of the need to use multiple strategies to impact the area around its target neighborhood, the lenders involved in the service and development corporations also support a Neighborhood Housing Services program in West Englewood, a resegrated area east of the target area.

Conclusions and Possibilities

In addition to the concrete accomplishments of the three service corporations cited above -- and the many others that have emerged during the last seven years -- the importance of these instruments of reinvestment is the confidence that they have generated on the part of lenders and citizens that mature communities can be saved through prudent and individualized underwriting and investment. As the U.S. League's consultant on urban housing rehabilitation noted recently:

> Perhaps we have underestimated the vitality of our cities. The process of urban rehabilitation is neither smooth nor tidy. We may see some social discord. Nevertheless, there is a back-to-the-city movement, plus a stay-in-the-city and fix-up movement on the part of people already there.[14]

Given these trends in many cities, it is important for public policymakers to use public initiatives to nourish this -- and any other -- private sector initiatives which have the capacity to respond to the needs of individual urban communities. Policymakers at all levels of government can support the service corporation efforts. City officials can use public improvements -- street repair, open space, provision of municipal services -- to support private initiatives in target neighborhoods. In addition, cities can develop and effectuate realistic rehabilitation codes which protect the saftey and sanitation of housing without imposing outdated and needlessly expensive new building code standards on older housing. State officials can make greater use of state housing finance agencies to provide financing on a priority basis to service corporations which are attempting urban rehabilitation by using direct lending, mortgage purchase programs and provision of technical assistance. In addition, states can target public capital expenditures for roads, sewers, water and public facilities in neighborhoods where service corporations are actively involved in renewal efforts. Finally, federal officials can be encouraged by policymakers at the state and local level to take special cognizance of service corporations in the federal Community Block Grant and Housing Assistance Program regulations to insure that federal funds are available to service corporations trying to avoid displacement of low-income residents.

Footnotes

[1]See Part III, Chapter 6.

[2] Nathaniel H. Rogg. Urban Housing Rehabilitation In The United States. (United States Savings and Loan League: 1977), p.24.

[3] "New Approaches to Urban Housing" (Urban Affairs Advisory Committee of the United States Savings and Loan League: 1977), pp.13-14.

[4] RESCORP brochure. (RESCORP, 7 South Dearborn Street, Chicago, Illinois 60603).

[5] The complete description of the One Twenty-Eight, Inc. is available in, George W. Behymer, "Cincinnati Service Corporation is Right at Home," Urban Land, June, 1977, pp.9-12.

[6] Ibid.

[7] Judith D. Feins. Managing Chicago's Urban Dollar. (TRUST, Inc., 53 West Jackson Blvd., Chicago, Illinois 60604: 1976), pp. 51-52.

[8] RESCORP brochure.

[9]See Part III, Chapter 1.

[10] Gary Washburn, "New Vistas Buildings Boost South Shore War on Blight," Chicago Tribune, May 2, 1976.

[11] Bureau of National Affairs, "Housing and Development Reporter-Reference File" (Washington, D.C.: BNA), 20:0525.

[12] Washburn.

[13]Ibid.

[14]Rogg, p. 3.

Part III

Chapter 6

COMMUNITY DEVELOPMENT SUBSIDIARIES
OF BANK HOLDING COMPANIES
AS VEHICLES OF REINVESTMENT

Chapter 6

COMMUNITY DEVELOPMENT SUBSIDIARIES OF BANK HOLDING COMPANIES AS VEHICLES OF REINVESTMENT

by Margaret Adams and Lawrence B. Rosser

Summary

This chapter describes how a few bank holding companies have used provisions contained in the 1970 amendments to the Federal Bank Holding Company Act to create or acquire nonbank, community development subsidiaries in order to purchase, rehabilitate and resell and/or operate single and multi-family housing for low- and moderate-income persons. The authors point out that to date, only fourteen bank holding companies have even applied to do community development activities through a subsidiary, and that, of that number, only four are currently engaged in <u>residential</u> redevelopment.

COMMUNITY DEVELOPMENT SUBSIDIARIES OF BANK HOLDING COMPANIES AS VEHICLES OF REINVESTMENT

> Government efforts to reverse the downward spiral of established neighborhoods largely have been ineffective because the various programs have cast government in the role of doer in a sphere of activity which requires considerable innovation, resourcefulness, and competitive drive. Successful activities which require such skills have been performed historically by profit-motivated, privately capitalized business organizations which draw upon public resources, when possible, to accomplish their objectives.
>
> -- Ronald Grzywinski, South Shore National Bank, Chicago, Illinois

Introduction

Commercial banks are privately capitalized businesses which are owned by their stockholders. Like other corporations in our economy, the management policies of banks are determined by those who own a controlling share of their stock. Legally, if one company owns or exercises a controlling interest in the management of another, the first company is a "holding company," and the second a "subsidiary." A holding company which has one or more commercial banks as a subsidiary is known as a bank holding company (BHC).

BHC community development subsidiaries can provide a useful vehicle for residential reinvestment. Properly structured and managed, they are capable of working with their sister subsidiaries -- commercial banks -- to increase the number of rehabilitated residential properties available for sale or rent in a community. The key to community development subsidiaries is the fact that unlike banks -- which are prohibited by law from making equity investments -- they are able to become part or sole owners of real estate projects. As part-owners, these subsidiaries can provide additional capital to developers and thereby assist in making them eligible for prudent bank credit. Or, if there are no other developers interested in rehabilitating units in a particular community, the community development subsidiary can act on its own to purchase, rehabilitate, manage and/or sell single and multi-family properties.

The authority for BHC's to establish community development subsidiaries comes from 1970 amendments to the Federal Bank Holding Company Act.[1] Those amendments state that -- subject to the approval of the Federal Reserve -- BHC's may acquire shares of stock in a corporation, the activities of which are "so closely related to banking ... as to be a proper incident thereto." In making its determination about whether particular activities are appropriate, "the /Federal Reserve/ Board shall consider whether /the activity's/ performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse affects . . . "[2]

Using this legislative mandate as its basis of authority, the Board declared in 1971 that it would permit

BHC subsidiaries to make "equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas."[3] Finally, in August, 1972, the Federal Reserve Board went even further in its interpretation of how the 1970 amendments to the BHC Act could assist BHC's in fulfilling their civic responsibilities. The Board stated that BHC's "possess a unique combination of financial and managerial resources making them particularly suited for a meaningful and substantial role in remedying our social ills."[4]

In its 1972 interpretation, the Board included a list of specific projects that it deemed permissible. This list includes projects for the construction or rehabilitation of low- and moderate-income housing insured by the federal government under Sections 221(d)(3), 221(d)(4) or 236 of the National Housing Act,[5] or similar projects that are insured by state housing finance agencies. The Board also included a list of projects that "may" be deemed permissible as follows: housing projects for low- and moderate-income people which are not insured by public agencies; and commercial facilities which are designed to serve low- and moderate-income persons.

The distinction between projects that are <u>clearly</u> permissible, and those that the Board indicated it <u>may</u> approve appears to be based on the presence or absence of public (federal, state or local) subsidies and/or insurance in the project. For this reason, it behooves state policymakers to be aware of the possibilities and needs of BHC community development subsidiaries as vehicles of reinvestment.

Principal Actors and Their Roles

The parties necessary to initiate BHC community development subsidiaries are the BHC and the Federal Reserve system. The BHC must follow procedures set out in the Federal Reserve Board's Regulation Y to gain approval for conducting nonbank development activities.

If the BHC wishes to start a de novo development subsidiary, it applies to the Federal Reserve Bank for its district by sending proof of properly published legal notification of its intent to begin development activities. The district Federal Reserve Bank, under authority delegated it by the Federal Reserve Board in Washington, D.C., may accept notification. If the district bank makes no objection during a 45-day period following notification, the BHC may proceed with development activities. If the district bank objects, or, if the BHC plans to acquire an existing development corporation, the BHC must make application to the Federal Reserve Board for an individual decision about whether its subsidiary's development activities meet the legislative test set out in Section 4(c)(8) of the BHC Act of 1970.[6]

Examples of BHC Community Development Subsidiaries' Residential Reinvestment Activities

Since passage of the 1970 amendments to the BHC Act, fifteen BHC's either have notified a district Federal Reserve Bank of their intentions to engage in community development activities or have applied to the Federal Reserve Board for permission to do so. (See Appendix A.) Of that number, this paper will examine four that are currently using their subsidiaries to construct and/or rehabilitate housing for low- and moderate-income persons and one BHC whose application to do so has been approved recently by the Board.

Citizens and Southern Corporation

Among the first BHC's to make operational a community development subsidiary dedicated to providing housing for low- and moderate-income persons was Citizens and Southern Corporation of Charleston, South Carolina. Its subsidiary, known as Citizens and Southern Housing Corporation, began operating in 1971. Since that time it has built approximately 270 houses for sale to low- and moderate-income families.

During its first two years, the subsidiary used funds available under Section 235 of the National Housing Act.[7]

When these subsidies were terminated in 1973 by the Nixon administration's moratorium on federal housing programs, Citizens and Southern was left with 28 houses which had been built for sale under the federal program. These houses have since been financed by the subsidiary on terms roughly equivalent to Section 235, using a variable rate mortgage program [8] and some subsidies from the Corporation. Since the moratorium, housing construction has continued at the rate of approximately 20 houses per year.[9]

J. P. Morgan & Company, Inc.

In December, 1971, the Federal Reserve Bank of New York, on behalf of the Board of Governors under delegated authority, approved an application from J. P. Morgan & Company, Inc., to engage in *de novo* community development activity through a wholly-owned for-profit subsidiary known as The 23-Six Corporation. The approval was for "participation in the sponsorship, acquisition, construction, financing, and operation of housing for low- and moderate-income persons within the United States, its territories, possessions, and Puerto Rico pursuant to a Federal, State, or local program . . ."[10]

Although the name of the subsidiary subsequently was changed to the Morgan Community Development Corporation (CDC), the purpose remains that of making available "equity financing to experienced developers of apartment housing for low- and moderate-income families and the elderly."[11] As of September 30, 1977, Morgan CDC has investments in fourteen projects containing 1,019 units in seven states, and has an equity commitment to another 24 units. None of the projects are located in New York State. All use one or more forms of public insurance and/or subsidy. Five of the projects, containing a total of 252 units, have U.S. Department of Housing and Urban Development Section 8 rent subsidy funds available. Three of the projects that are located in Maine -- a total of 100 units -- have piggy-backed Section 8 funds on low-interest financing from the state housing finance agency.[12]

The Morgan CDC also participates in the New York City Preservation Corporation (CPC) -- "a private, not-for-profit corporation established by 34 New York City commercial and savings banks . . . to make short-term construction and long-term mortgage loans for the rehabilitation of residential buildings in neighborhoods that the city government has designated as preservation areas."[13] CPC confines its loans to "individuals, corporate property owners, not-for-profit organizations, and tenant cooperatives" of one-to-four-unit dwellings and will provide a mortgage of up to 90% of the value of the improved property with a mortgage term of thirty years.[14]

Morgan CDC's participation in CPC to date has consisted of a commitment of $100 million for the CPC's loan pool. $5 million has been actually drawn down. In addition, the subsidiary also has a $2 million commitment to make single-family mortgages for moderate-income families in the Bedford-Stuyvesant section of New York City. Of this amount, approximately $775,000 has been loaned out.[15]

First National City Corporation

First National City Corporation, holding company for First National City Bank in New York City, received permission from the Federal Reserve Board in 1972 to make "equity and debt investments in corporations or projects, including joint ventures and partnerships" which provide for new construction and rehabilitation of housing and "related facilities" for low- and moderate-income persons in the New York metropolitan region through a community development subsidiary known as Citicorp Community Development, Inc.[16] This wholly owned subsidiary provides construction financing, seed money and permanent financing for its residential projects.

During the period from 1973-1975, Citicorp Community Development, Inc. provided construction financing for 2,214 units. It also provided equity in the form of seed money -- so-called because these funds are used to cover costs incurred in packaging residential projects in order to secure construction and mortgage financing -- to housing sponsors for 5,571 units, and permanent financing for 594 units. All projects used some form of public insurance and/or subsidy -- such as Federal Housing Administration (FHA) 221(d)(4) and city rehabilitation programs.[17]

In addition to these activities, Citicorp received permission from the Federal Reserve in 1975 to establish Mission Park Corporation to "engage in the construction, ownership and operation of a low- and middle-income housing project and related facilities in the Roxbury section of Boston."[18] Citicorp Community Development, Inc. has an 80% interest in Mission Park Corporation with the remaining interest being held by Harvard University. When completed in 1978, the $41 million project will contain 775 units, 30% of which will be reserved for very low-income minority persons. Mission Park Corporation will operate the project "for the life of the 40-year mortgage, making Citicorp /_through its development subsidiary_7 a major landlord in Boston."[19]

Bank America Corporation

On January 24, 1977, the Federal Reserve approved Bank America Corporation's application to engage in *de novo* activities described as follows: "a community welfare project designed to improve neighborhoods by restoring abandoned and substandard properties located in Oakland to use by purchase, rehabilitation and disposition . . . through a /_not-for-profit_7 subsidiary, BA City Improvement and Restoration Program Corporation" (BA CIRP Corporation).[20] Originally, BA CIRP Corporation had intended to acquire, rehabilitate and resell 30 homes in predominately black East Oakland during 1977.[21] In preparation for that schedule, the BHC committed $150,000 for program funding, and an additional $150,000 line of credit to the subsidiary.

The program became operational in March, and to date the subsidiary has acquired only seven houses. One has been rehabilitated and sold, and another is nearing completion. Sale prices for the refurbished homes will range between $22,000 and $40,000. The role of the development subsidiary is limited to acquisition and rehabilitation so buyers must obtain their mortgage financing. All of the homes qualify for FHA mortgages.[22]

Illinois Neighborhood Development Corporation

In August, 1977, the Illinois Neighborhood Development Corporation (INDC) -- holding company for the South Shore National Bank of Chicago, Illinois -- applied to the Federal Reserve for permission to engage in *de novo* community development activities through two subsidiaries: City Lands Corporation, a for-profit subsidiary; and, The Neighborhood Institute, a not-for-profit affiliate.

The rationale given by INDC for the bifurcation of the profit and not-for-profit functions follows:

> Many aspects of community redevelopment can be addressed successfully by for-profit development activities. Others, however, can only be carried out as not-for-profit projects in the interest of community welfare. Indeed, these "unprofitable" concerns must be dealt with if other for-profit ventures are to succeed. The regeneration of a declining neighborhood requires that the full range

> of problems facing the community be addressed to break the downward spiral of decay. This must be accomplished in such a way that the housing and commercial sectors are upgraded without displacing the low- and moderate-income families who live in the community.
>
> A not-for-profit affiliate of a bank holding company is an appropriate vehicle for selected community welfare activities . . . These activities would include education, manpower development, certain not-for-profit aspects of housing improvements and commercial revitalization, security, energy conservation, and recreation.[23]

The for-profit subsidiary will operate to purchase, rehabilitate or reconstruct and dispose of "abandoned and substandard" properties by using equity participation with developers to help them qualify for prudent bank credit, or by acting on its own. INDC received Federal Reserve approval of its application in December, 1977.

Problems and Possibilities

Perhaps the most significant impediment to more widespread use of BHC community development subsidiaries is regulatory. The Federal Reserve Board interprets Section 4(c)(8) of the 1970 BHC Act as a two-part test. The non-banking activity under scrutiny must be closely related to banking <u>and</u> have public benefits which outweigh any adverse effects of performance of the activity by a BHC. Maintaining both tests gives the Board maximum flexibility in permitting or preventing non-banking activities.[25]

The Board's most extensive discussion of the closely related test arose in the context of an application from a community development corporation located in Chicago, Illinois which applied to the Board to become a BHC.[26] North Lawndale Economic Development Corporation sought to acquire 90% of the voting shares of a proposed new bank to be located in a predominately black, low-income area on Chicago's West side. Although this case illustrates the opposite phenomena from that discussed above -- North Lawndale already was, in effect, a holding company for a community development subsidiary and was trying to acquire a commercial bank as another subsidiary -- the Board's response is illustrative of the regulatory attitude that may confront even well established BHC's which want to engage in non-bank development activities.

North Lawndale based its application on its ability to meet the public welfare part of the test, and assumed that it would also meet the closely related to banking test. The Board ruled that it had permitted BHC's to engage in limited projects to promote the public welfare in the past primarily because these activities would contribute to the banking functions of the holding company -- not because they promoted the public welfare. Since North Lawndale was involved primarily in a wide range of community development activities (maintaining a health care facility, developing residential and commercial facilities), the activities were not limited sufficiently in scope, nor were they closely enough related to banking to qualify the organization to become a BHC. Although the North Lawndale application eventually was approved on the basis of a technicality -- a court ruled that the Federal Reserve had not acted in a timely fashion to disapprove the application[27] -- the Board's precedential ruling in the matter does not bode well for other community development corporations which may wish to enhance their capacity to do development by establishing or acquiring a commercial bank.

A second regulatory barrier may be the Federal Reserve's concern for bank soundness in its application of the standards in Section 4(c)(8). This concern is rooted in the traditional regulatory objectives of and responsibility for protecting the safety of deposits and the stability of the banking system. With a view towards these objectives, the Board analyzes the prospects, managerial skills, earnings, capital adequacy, and debt structure of bank holding companies as well as their banking and nonbanking subsidiaries.[28]

While the Federal Reserve's concern that unprofitable BHC community development activities may jeopardize the safety and soundness of banking subsidiaries is understandable, the regulatory agency compounds the problems of applicants by its equally strong insistence that development activities not be too potentially profitable. Several BHC applications to establish community development subsidiaries have been delayed or denied by the Board on this basis.[29]

Unfortunately, the total number of BHC's which have applied to establish or acquire community development subsidiaries is small; and, of that number, only those cited above have focused on the production and/or rehabilitation of housing for low- and moderate-income persons. These four BHC's also are very large, suggesting that those which own or control medium to small-sized banks may not have the money nor the expertise to take advantage of the community development provisions of the 1970 BHC Act.

Since state governments can do nothing formally to strengthen either the Congressional intent of the BHC Act of 1970 nor to influence the Federal Reserve's regulations concerning its application and approval process, they must look at other ways to encourage BHC entry into the community development field. Two possibilities for state-initiated incentives may be worth considering. The first, and most obvious, is that state housing finance agencies could set aside a certain portion of their low interest financing for BHC community development subsidiaries that are engaged in residential construction and/or rehabilitation. Not only might these "set-asides" help BHC's convince the Federal Reserve that proposed community development subsidiaries possess the capacity to do residential development, but they might also help more moderate-sized holding companies decide to undertake the complex and expensive process of establishing such subsidiaries.

A second kind of state-initiated incentive is neighborhood development grants to assist BHC's in covering the costs associated with establishing and operating community development subsidiaries. BHC's that are successful in receiving approval from the Federal Reserve might be entitled to receive full or partial public reimbursement for their costs. In addition, and, perhaps, more important, state funds could be used for matching grants to non-profit affiliates or equity investments in for-profit subsidiaries of BHC's.

Finally, however, in creating incentives to do reinvestment through BHC community development subsidiaries, public policymakers at all levels may want to work toward the establishment of what Ronald Grzywinski calls an appropriate "constitution" for these entities. The four elements of his suggested constitution for BHC community development subsidiaries are as follows:

1. That the costs and profits of development will be accurately reported.
2. That excess profits will revert to the benefit of the entire community.
3. That control and ownership of the institution will pass to the broad community of local residents who are most directly affected by its actions, so that local savings may always be available for the primary purpose of neighborhood renewal.
4. That the institution will possess the capacity for continuous self-renewal.[30]

If nonbanking subsidiaries of BHC's are to fulfill their potential role as vehicles of reinvestment, both the public and private sectors will have to look more closely at the problems and possibilities of these entities, and develop a rationale and strategies to overcome their current limitations.

Footnotes

[1] Bank Holding Company Act, 12 U.S.C. Section 1843 (1970).

[2] Ibid

[3] 12 C.F.R. Section 225.4(a)(7)(1976).

[4] 12 C.F.R. Section 225.127(a)(1976).

[5] National Housing Act, 12 U.S.C. Section 1701.

[6] Bank Holding Company Act, 12. U.S.C. Section 1843(c)(8)(1970).

[7] National Housing Act, 12 U.S.C. Section 1701.

[8] A mortgage contract that permits an increase or decrease in the interest rate, generally in response to changes in a specified financial indicator. The effect on the mortgagor is that payments fluctuate up or down depending on the mortgagee's cost of money.

[9] Telephone interviews with Joseph Floyd, Citizens and Southern Housing Corporation, Charleston, South Carolina (December, 1976; November, 1977).

[10] Federal Reserve Board, H.2 Release, 1971 No. 49, p.8.

[11] "Equity Financing For Low- and Moderate-Income Multifamily Housing," pamphlet published by Morgan Community Development Corporation, 23 Wall Street, New York, New York 10015.

[12] "Morgan Community Development Corporation Investments & Commitments (As of 9/30/77)," Summary table supplied by Edward M. LaMont, President, Morgan Community Development Corporation.

[13] "A New Source of Housing Loans: Community Preservation Corporation," pamphlet published by The New York City Community Preservation Corporation, 641 Lexington Avenue, New York, New York 10022.

[14] Ibid.

[15] Telephone interview with Edward M. LaMont, President, Morgan Community Development Corporation (November, 1977).

[16]Federal Reserve Board, H.2 Release, 1972 No. 4, p.8.

[17]Telephone interviews with Susan Kargman and Frank Mellone, Citicorp, New York, New York (December, 1976)

[18]Federal Reserve Board, H.2 Release, 1975 No. 17, p.7.

[19]"Two Big Banks Turn to Housing for Inner Cities," The Milwaukee Journal, 23 October, 1977, p.8.

[20]Federal Reserve Board, H.2 Release, 1977 No. 5, p.9.

[21]"Bank America's East Oakland Housing Program Runs Into Problem of Few Available Homes," American Banker, 7 October, 1977, p.1.

[22]Telephone interview with Jerry G. Buscemi, vice president and general manager, City Improvement and Restoration Program Corporation (November, 1977).

[23]"Application for Approval to Engage De Novo in Non-banking Activity as The Neighborhood Institute (TNI)," submitted to the Federal Reserve Bank of Chicago by the Illinois Neighborhood Development Corporation (INDC), 10 August, 1977, pp.6.7.

[24]Federal Reserve Board, Order Approving Acquisition of City Lands Corp. and The Neighborhood Institute, Dec. 19, 1977.

[25]Telephone interview with Larry Cunningham, Federal Reserve Board staff, Washington, D.C. (December, 1976).

[26]Federal Reserve Board Order Re: North Lawndale Economic Development Corporation, Federal Reserve Press Release (June 9, 1976).

[27]North Lawndale Economic Development Corporation v. Federal Reserve Board, No. 76-1607, (Seventh Cir.), 3/31/77.

[28]Bucher, "Bankers and the Bank Holding Company," Remarks to the 79th Annual Convention of the Florida Bankers Association (June 23, 1973), pp.10-12.

[29]Interview with Larry Cunningham.

[30]Ronald Grzywinski, Memorandum Re: "Bank Holding Companies as Neighborhood Development Corporations," 1 January, 1976, p.4.

APPENDIX A

Bank holding companies which have applied to engage *de novo* or acquire existing nonbanking community development subsidiaries, as reported in the Federal Reserve Board's H.2 Releases from 1970-1977. BHC's are listed in alphabetical order.

BankAmerica Corporation, San Francisco, California

Bankmanagers Corporation, Milwaukee, Wisconsin

Citizens and Southern Corporation, Charleston, South Carolina

First Bank System, Inc., Minneapolis, Minnesota

First National Boston Corporation, Boston, Massachusetts

First National City Corporation, New York, New York

First National Company of Sikeston, Inc., Sikeston, Missouri*

First Pennsylvania Corporation, Philadelphia, Pennsylvania

Illinois Neighborhood Development Corporation, Chicago, Illinois

J. P. Morgan & Company, Inc., New York, New York

Lincoln First Banks, Inc., Rochester, New York

Marine Midland Banks, Inc., Buffalo, New York

Nathan Hale Investment Corporation, Norridge, Illinois

R.I.H.T. Corporation, Providence, Rhode Island

---

*Holding company dissolved in 1974.

Part IV

Chapter 1

AN ANALYSIS OF DISCLOSURE LAWS AND REGULATIONS FOR FINANCIAL INSTITUTIONS

Part IV

LEVERAGING FINANCIAL INSTITUTIONS TO ENGAGE IN RESIDENTIAL REINVESTMENT

About the Author

Robert K. Brehm currently serves as Project Coordinator for the Chicago based Rehab: Housing Resource Center. He received his B.A. from Northwestern University in 1977 where he majored in Urban Studies and Political Science. While attending Northwestern he participated in a research internship with the Boston Redevelopment Authority, Housing Revitalization Division. During the internship he had primary responsibility for analyzing disclosure data on Boston area financial institutions which was collected by the Massachusetts Commissioner of Banks. In 1976, Robert served as a consultant to the American Issues Forum Chicago where he wrote a paper entitled Reform of the Municipal Housing Code in Chicago.

Chapter 1

AN ANALYSIS OF DISCLOSURE LAWS AND REGULATIONS FOR FINANCIAL INSTITUTIONS

by Calvin P. Bradford, Robert K. Brehm, and

Leonard S. Rubinowitz

Summary

This chapter review local and state laws and administrative regulations which require financial institutions to disclose their lending records, and in some instances their deposit records, by specified geographic areas to public agencies, public regulators or the general public.

The chapter indicates the various uses of disclosure data by public agencies and regulators. It also describes the range of institutions and areas covered by existing disclosure laws and regulations, the specific information which various disclosure provisions require of financial institutions, and the procedures for the collection, publication and analysis of disclosure data.

AN ANALYSIS OF DISCLOSURE LAWS AND REGULATIONS FOR FINANCIAL INSTITUTIONS

> Disclosure legislation should be the beginning, not the end, of cooperative efforts between governments at all levels and community groups to preserve and restore urban neighborhoods... In many ways, (it) is the best kind of reform legislation because it merely provides community groups and local officials with information, and leaves the precise remedy to the locality.
>
> -- Senator William Proxmire[1]

The term "disclosure" refers to the reporting, by the various types of institutions involved in mortgage lending, of data concerning the financial activity of those institutions. It has been suggested that the information made available through disclosure can be useful to state and local governments in a variety of ways to:

(1) Better select areas for concentrating Community Development Block Grant funds and other revitalization projects;

(2) Target and assist areas beginning to exhibit early signs of disinvestment;

(3) Assess the impact of current rehabilitation and neighborhood preservation projects in attracting new finance into the area;

(4) Determine which lending institutions are involved in specific geographic areas and the degree of their involvement, as background for determining which would be most appropriate to participate in public/private revitalization efforts, or as recipients of public deposits;

(5) Identify those institutions which are less involved in housing finance in disinvested neighborhoods and encourage their greater involvement through workshops, funding incentives, or regulatory sanctions;

(6) Be better prepared to evaluate the need for new branches (in states which allow branching), charters, relocations, or mergers, and to be better prepared to assess the performance of institutions seeking these, and other, forms of conversion, expansion or reduction in services; and

(7) Monitor lending patterns to discover discrimination or arbitrary biases in the granting of credit.[2]

Disclosure legislation has been passed at the federal level,[3] at the state level in Illinois, New Jersey, Connecticut, and Ohio,[4] and has been proposed in several other states including California, Michigan, Minnesota, Pennsylvania, and Washington.[5] Disclosure imposed by state regulation alone is in effect in Massachusetts, California and New York.[6] The cities of Rockford (Illinois), Minneapolis and Cleveland have disclosure ordinances, generally modeled after the first municipal disclosure ordinance passed in Chicago in 1974.[7]

The Appendix to this paper contains a comparison of the provisions of the local, state and federal disclosure requirements now in effect. The provisions of the proposed Missouri disclosure act are also included in this Appendix.

Disclosure laws and ordinances are usually tied to a set of implementing regulations. These regulations often add substantially to the requirements of disclosure legislation. The proposed Minnesota law, for example, simply instructs the state banking commissioner to devise all the requirements. The Connecticut and Ohio laws do not have implementing regulations in effect at this time. At this time it is not clear exactly what requirements will be included in those forthcoming regulations. (Accordingly, the Connecticut and Ohio requirements are not included as part of the discussions in this paper.)

The requirements of present and proposed laws and regulations represent a variety of viewpoints as to which types of information and forms of reporting are both reasonable and necessary in order to permit a thorough analysis which permits an accurate interpretation of the disclosure data. The following elements have been incorporated in one or more of the existing disclosure requirements.

The Range of Institutions and Areas Covered

If one purpose of disclosure requirements is to obtain an accurate picture of the existing mortgage market, then these requirements ought to include all, or a representative portion, of the lenders doing business in an area. Disclosure which includes only a small number of institutions which might be lending in an area may not give an accurate picture of the total mortgage market for that area. On the other hand, if the few lenders included in a particular disclosure requirement represent the vast majority of the lending activity in an area, then little may be gained by including other lenders who may represent only a very small portion of the market.

To the extent that disclosure data is used as one indicator of the demand for loans in an area, there may be similar concerns over how well the disclosure data reflect the total activity in an area. One should keep in mind, however, that decisions to seek loans are conditioned on the availability of credit. That is, when there is more mortgage money available in the market, at reasonable terms, more people are likely to take advantage of this supply. Aggressive marketing is designed to stimulate a demand that would not exist in the absence of such efforts. Therefore, since demand is partly a response to the supply and marketing activities of lenders, data on actual loan activity, without data on supply and marketing, cannot fully measure the need or potential for lending in an area.

State and local provisions vary in the kinds of financial institutions to which they apply disclosure requirements. Some apply to state-chartered institutions only, since these are generally regulated at the state level. Other legislation and regulations seek to impose requirements on federally chartered institutions as well. The legal question remains unsettled as to whether states can impose these requirements on institutions which are chartered and regulated by the federal government.[8] Some states secure this data indirectly, e.g., through making public deposits available to institutions which provide the desired data. Municipal disclosure ordinances in particular have used this approach.

1. Institutions

Most commonly, mortgage lending is done by depository institutions - savings and loan associations and banks are the major ones. Almost all of the present focus on disclosure has been on these institutions. Aside from these institutions, credit unions are included specifically in the Federal Act, the New Jersey and Illinois laws and the Massachusetts regulations.

Mortgage lending is not limited to depository institutions.

Most notable among the non-depository institutions in the home lending market are mortgage bankers.[9] Mortgage bankers specialize in federally insured and guaranteed loans and generally make these kinds of mortgages available in areas where there may be an inadequate supply of conventional mortgage credit on terms and conditions acceptable to prospective purchasers. Nationally, mortgage bankers originate about seventy-five percent of all FHA-insured single-family mortgages. This includes a part, or even the majority, of lending activity in some areas. Only the Illinois statute presently covers mortgage bankers.

Other significant sources of capital and credit include life insurance companies and pension funds. Both of these institutional investors have long term sources of income (employee payments or premiums) which are well suited to long term investments such as mortgages. Both types of institutions currently purchase single-family mortgages and originate or make mortgages on large multi-family, industrial and commercial developments. The Illinois disclosure law applies to insurance companies, as does the bill proposed in Missouri. None of the statutes or administrative requirements initiated to date cover pension funds.

2. Geographic Reporting Areas

Both the size of the areas defined for disclosure and the range of areas included are important concerns for disclosure. Most disclosure requirements provide for disclosure by census tract. A census tract is generally small enough to allow some approximation to neighborhood boundaries, either individually or by aggregating several together. Disclosure at the postal ZIP code level is often easier for coding purposes, though ZIP codes may be so large that they include a variety of different neighborhoods. Reporting on the basis of an area smaller than census tracts would be difficult to code, although some census tracts are large enough to exhibit the same problems as ZIP codes. All present disclosure requirements use census tracts as the reporting areas for the primary areas they cover.

Municipal ordinances generally require detailed disclosure by census tracts within their city limits (the primary area) with a single category for loans in suburban or other areas. The Federal Act and most state requirements apply to selected cities or metropolitan areas. Rural areas are included in the California and New York regulations and in the New Jersey law.

3. Asset Size Requirements

Limitation on instituions included in disclosure measures often includes asset size. The argument for eliminating smaller institutions, such as those under $ 10 million - as in the

Federal Disclosure Act - is that such small institutions have little impact and few resources in themselves. On the other hand, in some areas where these institutions may have little individual impact, collectively they may comprise a significant portion of the market. Thus, their elimination from disclosure records may reduce the usefulness of data relevant to credit needs in such areas.

Deposit Base or Source of Capital

The service areas for financial institutions have traditionally been defined partly by the location of their deposit base. Agencies which regulate depository institutions consider the need for services and the potential for deposit base when deciding upon chartering applications (or branching applications in other states which allow branching).[10] Disclosure data can be used to help determine the commercial and consumer deposit base in an area and to indicate whether a need for additional facilities exists. Disclosure of deposit base data has been included in some disclosure requirements as one means of assisting in making chartering (or branching) decisions and in estimating the performance of existing institutions.

Both the Massachusetts and New York regulations require some form of deposit disclosure. The federal disclosure bill originally included deposit disclosure, though it was later deleted. Deposit data was also deleted from the Illinois law as a special provision in order to make it conform to the

Federal Act. Most of the municipal disclosure ordinances include some disclosure of the deposit base of the reporting institutions.

There are several categories of deposits which may be included. Some present requirements include time deposits (such as savings accounts) and demand deposits (such as checking accounts). The Minneapolis ordinance breaks down time and demand accounts by individual and commercial deposits, but collects the data only for single categories of in-city, out-of-city but in the state, the rest of the state, and out-of-state. The Massachusetts regulations collect time and demand deposits, but release them by reporting areas with a single combined figure for all institutions. The Chicago ordinance is the only disclosure requirement which both collects and releases deposit data for each reporting area for each individual institution.

As a practical matter, coding deposits by geographic areas is more time consuming than coding loans since depository institutions have many more deposits accounts than loans. The New York regulations attempt to deal with this by a detailed procedure which allows institutions with more than 4,000 accounts to use a sample rather than all accounts.

Lending Base for Disclosure

1. Current Versus Total Loan Disclosure

This is the question of whether an institution should disclose only those loans made for a single current reporting period or all the loans (total portfolio) held by the institution regardless of when they were made. Disclosure of the total mortgage portfolio alone would tend to overshadow current lending patterns by the dominance of loans made in the past. Nonetheless, the total portfolio of loans can be one baseline for comparison with current practices.

Generally, disclosure reporting periods are for the most recent year, although they vary from two years for the Cleveland ordinance to monthly for the California regulations. The Illinois law and the Massachusetts regulations require both disclosure for a current period and for the whole portfolio. Data held by the California Department of Savings and Loan makes it possible for that agency to trace lending patterns for over a decade, though their present disclosure regulations require only current monthly reporting.

2. Loan Activity: Applications, Originations and Purchases

Six state or city disclosure provisions, including the St. Louis ordinance, require disclosure of applications received as well as loans made.[11] Thus, this set of regulations provide some data for comparison of characteristics of accepted and denied loans. About half of the existing disclosure requirements include both the mortgages which the institution originates itself and the mortgages which they purchase from other lenders. The first draft of the implementing regulations for the New Jersey law specifically released institutions from reporting loans which they originated, but which they sold within the same year. The final regulations deleted this provision. Such a measure may eliminate from disclosure many loans which make up the total mortgage market. This is particularly true for mortgage bankers whose business depends upon their ability to originate and sell mortgages in a short time period.

3. Loan Characteristics

Information on the characteristics of loans facilitates a determination of whether there are variations in the terms and conditions of loans based on the location of the property. Information under this category generally includes (on a loan by loan or an aggregate basis) whether the loan is conventional or insured, the amount of the loan, the interest rates charged, size of downpayment, term (length) of the loan, and other service fees, application fees or charges for receiving or making the loan. The Chicago, Cleveland and Rockford ordinances require data on interest rates, downpayments and the term,[12] while the New York regulations include both interest rates and term. Massachusetts regulations require reporting of interest rates only and the New Jersey law requires reporting of only the term.

Finally, loan characteristics include the purpose of the loan. All present disclosure requirements include reporting of mortgage loans for certain types of properties. Most also have categories for home improvement or rehabilitation loans. The New Jersey law requires a separate listing for loans from its state housing finance agency. The California regulations, the Illinois law and the Cleveland and Rockford ordinances require data on construction loans. Generally, existing requirements are limited to information on home loans. However, the Chicago ordinance also seeks data related to commercial and consumer loans, in order to assess the flow of credit to local business.

Property Profiles

Information on the characteristics of the property may help to determine the extent to which variations in loan terms and conditions are consistent with these factors. Property profiles contain two types of information - information on the physical characteristics of a property and information on the financial characteristics of the property. Physical data include such things as the type of structure, its use, its size, amenities, type of construction, etc. Economic characteristics include such things as the appraised value, the selling price, or the operating statements (for income producing properties).

The California regulations and the regulations implementing the New Jersey law require data on the age of the property and its selling price. In addition, the California regulations also require data on the size of the living area and the appraised value.

All disclosure requirements include loan activity for single-family (one to four unit) properties. Disclosure regulations and laws include reporting of loans for multi-family structures, though not in the detail required for single-family loans.[13] Reporting for commercial properties is generally omitted, or lumped into a single commercial category - as is the case with the New York, Massachusetts and California regulations and the Minneapolis and Rockford ordinances. Only the California regulations require data on loans for the purchase of vacant land.

Borrower Profiles

California has included in its regulations selected information on the creditworthiness of the borrower(s). Such information includes the borrower(s) total annual and monthly income. These regulations also include certain social data, such as the race and sex of the borrower(s). No other disclosure regulation or law requires such data.[14]

Risk and Loss Experience

Data on actual risk factors are limited. The California regulations require reporting of whether or not neighborhood factors were considered in deciding upon the loan. The Massachusetts regulations require foreclosure data. Only the New York regulations contain detailed information on delinquent, defaulted and foreclosed mortgages and financially distressed properties.

Collection, Publication and Analysis of Disclosure Data

How the regulator collects and uses the data is an important part of the disclosure process. Only the California regulations and the St. Louis ordinance require a formal analysis of the disclosure data by the agency collecting the data. Most disclosure requirements simply guarantee that the public has access to the data for their own uses.

Aside from the categories of data which have been discussed, the form in which the data is collected can aid in analysis. Most forms of disclosure require the reporting of aggregate totals for census tracts or ZIP codes. The California regulations and the regulations implementing the New Jersey law do require individual, loan by loan, reporting. Thus, most data represent either total aggregates of all loans (or deposits) or some type of summary statistic (such as the average interest rate for all loans in a certain area for a selected category). Data collected on such an aggregate basis can be misleading. Average interest rates for two areas may be similar, but in one area they may all be close to that average, while in the other lending policies may produce a wide range of interest rates which happen to average out at about the same level.

Aggregate data may also lead to inaccurate comparisons. One area may show a higher aggregate percentage of rejections than another. Aggregate data on property characteristics may show that the area with the higher loan rejection rate actually had a higher average income for loan applicants. These two pieces of aggregate data might lead to a conclusion that the area with the higher rejection rate was being arbitrarily redlined, when a comparison of individual applicant incomes and rejections might show that each loan rejection was based on clear evidence of insufficient income.

When data are reported for each individual loan, those using the data can aggregate and classify the data by any reporting category. Such reporting systems allow a more flexible form of analysis, not restricted to the aggregate characteristics chosen by those who drafted the reporting forms. One disadvantage of this individualized reporting is that it creates a vastly increased amount of data for the collecting agency (one set of information for each loan rather than one set for each geographic reporting area). Individual reporting may not necessarily increase the burden on the lending institutions since they may have to create individual records in order to sort and tabulate the data for any reasonably detailed set of aggregate reporting categories. Individual reporting may have a second disadvantage for those seeking to analyze the data. Those using the data have to create all of the aggregate categories on their own, thus increasing their costs of analysis.

Finally, some of the regulators and citizens using disclosure data report that the data that has been provided has been incomplete, inaccurate and/or illegible. Detailed checks by agencies such as those in California, New York and Massachusetts have revealed significant errors in reporting. Perhaps the most frequent error has been on the reporting of the census tract locations of loans.[15]

The format for public access to disclosure data varies. Disclosure reports for all institutions are available at a single central location for institutions reporting under the California and Massachusetts regulations, for the Illinois law and for municipal disclosure ordinances.[16] There is no central collection agency for data under the Federal Disclosure Act. All of the disclosure laws and regulations which do not make reports available at a central location do require data for each institution to be publicly available at the main office and designated branches of that institution. Some laws, regulations and ordinances require public access at both places. Generally, provisions are made to insure that citizens are allowed to obtain copies of the reports "at cost" or for "reasonable charges."

The California regulations and the St. Louis ordinance require an analysis by the agency collecting the data. Several other regulations state that certain officials may prosecute or hold hearings based on their review of the data, but they do not actually require either formal review or analysis of all the data. At present, there is not complete analysis of disclosure data by any regulator. Some regulators have analyzed parts of the data. The Commissioner of Banks in Massachusetts periodically releases selected analyses. The Banking Commissioner in New York hired a team of private consultants to analyze the initial set of data there. The final report has not yet been released. Analysis of the California data has not yet been completed or released. The City of Minneapolis has released some tabulations of their disclosure data, but these tabulations only compare city versus non-city loans and do not break down the data on a community basis within the city. Finally, the Community Development agency for the City of St. Louis presented an analysis of the first round of disclosure data to the Funds Committee of the City Council in July of 1977.

Conclusion

Since the proposal for a state disclosure law in Illinois in 1974, there has been a growing number of regulations and laws at the local and state levels. The passing of the federal Home Mortgage Disclosure Act in 1975 did not mark the end of further attempts at state and local disclosure. Citizens and regulators in several states have expressed the view that state and local laws and regulations could improve upon the quantity, quality and uses of disclosure data. Disclosure requirements vary greatly from simple tabulations of the numbers and dollar amounts of single-family mortgages to individualized and detailed reports on many items of information considered important in loan underwriting.

The number of disclosure laws and regulations has increased over the last several years, as has the comprehensiveness of these provisions. Increased attention has been paid to requiring the kinds of data which will permit a determination of whether credit needs are being met adequately in various neighborhoods and communities, so that if deficiencies are revealed, steps can be taken to insure that there is an adequate supply of credit throughout the jurisdiction involved.

Appendix:

Comparison of Disclosure Requirements

The following three-part table compares the provisions of the Federal Disclosure Act, the administrative regulations in California, Massachusetts and New York, the laws and implementing regulations in Illinois and New Jersey, and the municipal ordinances for Chicago, Cleveland, Minneapolis, St. Louis and Rockford (Illinois). The table also includes the provisions of the proposed Missouri state disclosure law - with the limitation that these provisions might be altered by any implementing regulations which would be developed if this proposed law were passed and put into effect.

The key for the tables is as follows:

X	means that this provision applies
?	means that it is not clear whether this provision applies or would apply
10	indicates the asset limitation in millions of dollars for those disclosure provisions which exempt from reporting institutions with assets below a certain level
X^3	means that there is a footnote further explaining some detail of this provision for this particular law, regulation or ordinance

Part I

	Missouri	Rockford	Minneapolis	Cleveland	St. Louis	Chicago	New Jersey	Illinois	New York	Massachusetts	California	Federal Act
Disclosure of Total Portfolio								x		x		
Disclosure for Single Reporting Period	x	x	x	x	x	x	x	x	x	x	x	x
Combined Conventional and Insured Mortgages												
Conventional Mortgages Separate	x	x	x	x	x	x	x	x	x	x	x	x
Combined FHA, VA, or FmHA Category			x	x	x	x	x		x	x		x
Separate FHA, VA, or FmHA Categories	x	x						x			x	
Loans Under State Programs	x						x					
Improvement and/or Rehabilitation	x	x	x	x	x	x	x	x		x	x	x
Construction	x	x		x		x		x			x	
Vacant Land Purchase											x	
Commercial						x						
Consumer						x						
Detailed Reporting – Single-Family	?	x	x	x	x	x	x	x	x	x	x	x
Multi-Family	?	x	x	x	x	x	x	x	x	x	x	x
Some Reporting – Other Real Estate		x	x						x	x	x	
Applications	x	x	x				x	x			x	
Originated Loans	x	x	x	x	x	x	x	x	x9	x	x	x
Purchased Loans	x		x		x		x	?10		x	x	x
Individual or Average Interest Rate		x		x	x5	x			x	x	x	
Individual or Average Downpayment		x		x		x						
Individual or Average Term		x		x	x5	x	x		x		x	
Origination Fees and Charges											x	
Loan to Price (Appraisal) Ratio									x			

Part II

	Missouri	Rockford	Minneapolis	Cleveland	St. Louis	Chicago	New Jersey	Illinois	New York	Massachusetts	California	Federal Act
State Banks and Mutual Savings Banks	X	X	X	X	X	X	X	X	X	X		X
Federal Banks	X	X	X	X	X	X	X	X				X
State Savings and Loans	X	X	X	X	X	X	X	X	X	X	X	X
Federal Savings and Loans	X	X	X	X	X	X	X	X				X
Other Depository Institutions (Credit Unions)							X	X		X		X
Mortgage Bankers	X							X				
Insurance Companies	X							X				
Asset Size Exemptions					10		10		50	20[1]		10
Exemption of Institutions with no office in Selected Metropolitan Areas							X			1		
Metropolitan and Rural Areas							X		X	1	X	
All or Selected Metropolitan Areas Only	X	X	X	X	X	X		X		X		X
Census Tract Level - All Areas		X			X			X			X	X
Census Tract for City or Metropolitan areas only	X		X	X		X	X		X	X		
Zip Code or Single Summary			X	X	X	X	X[4]	X[3]	X	X		X
Category for some Areas												
Combined Deposit Category												
Single and/or Time Deposits			X[6]	X[6]	X[5]	X			X	X[2]		
Demand Accounts (Checking, etc.)			X[6]		X[5]	X				X[2]		
Individual and Commerical Accounts			X[6]									
Annual Reporting			X[8]		X	X			X	X	X	X
Semi-Annual	X	X						X				
Quarterly							X					
Monthly											X	
Other				X[7]								

Part III

	Missouri	Rockford	Minneapolis	Cleveland	St. Louis	Chicago	New Jersey	Illinois	New York	Massachusetts	California	Federal Act
Age of Properties							x				x	
Living Space											x	
Appraised Value											x	
Selling Price							x				x	
Amount of Loan							x				x	
Borrower's Income											x	
Borrower's Race											x	
Borrower's Sex											x	
Borrower's Age											x	
Foreclosure									x	x		
Delinquency and Defaults									x			
Others									x			
Individual Loan-by-Loan Reporting							x				x	
Aggregate Date for Geographic Areas	x	x	x	x	x	x		x	x			x
Analysis Required by Agency	x				x						x	
Some Analysis Done by Agency			x		x				x		x	
Data Available at Central Place	x	x	x	?11	x	x		x		x2	x	
Data at Lending Institutions	x	x	x		x		x		x	x2		x
Part of Anti-Discrimination Legislation	x		x		x	x	x					
Part of Public Deposits Ordinance		x	x	x	x	x						

Footnotes for Text

[1]Statement made by Senator William Proxmire during the following congressional hearings: U.S. Senate. Committee on Banking, Housing and Urban Affairs. The Home Mortgage Disclosure Act of 1975 - To Improve Public Understanding of Depository Institutions in Home Financing. 94th Congress, 1st Session. May 5-8, 1975.

[2]This represents a modification of a list originally taken from: Center for Community Change, The Lifeblood of Housing: A Report to the Commonwealth of Pennsylvania on Housing Investment and Conservation (Alexandria, Virginia: Mount Vernon Publishing Company, 1976), p.34.

[3]The Federal Home Mortgage Disclosure Act of 1975 - Title III of Public Law 94-200 (12 U. S. C. 2801 et seq.) which was implemented under Regulation C (12 CFR 203) drafted by the Board of Governors of the Federal Reserve System and published in the Federal Register on June 14, 1976 (41 FR 23931).

[4]See: Illinois Financial Institutions Disclosure Act (Public Act 79-632), Illinois Revised Statutes, Chapter 95, Section 201, et seq. and implemented by instructions from the Director of the Department of Financial Institutions (undated), "Information and Instructions - Reporting Form - Financial Institutions Disclosure Act;" New Jersey Disclosure Act, Chapter 1, Public Laws of 1977 (N. J. S. A. 17:16F-1 et seq.) and implemented by regulations drafted by the New Jersey Department of Banking (Title 3, Subtitle A, Chapter 1, Subchapter 9, adopted on August 22, 1977); Act to Prohibit Discrimination in Mortgage Lending (Connecticut) (Public Act 77-153, which becomes effective October 1, 1977); and in Ohio there was an amendment to a bill (H.B. 485, amended - passed and signed into law July 17, 1975) which gave authority to the state regulators of commercial banks and savings and loan associations to require disclosure of mortgage activity and to develop implementing regulations; though no regulations have ever been adopted.

[5]For California, see S. B. No. 3 (introduced December 6, 1976); for Michigan see H. B. 4227 (which passed the Michigan House on July 1, 1977); for Minnesota see H. R. 786 (introduced in the spring of 1977); for Pennsylvania see H. B. 986 and S.B. 778 (both introduced on April 26, 1977); and for Washington see H. B. No. 323 (introduced February 9, 1977).

[6]The California Regulations are contained in a memo (No. 75-25) from the California Department of Savings and Loan (July 2, 1976, Los Angeles). These regulations change or enact Subchapters 4, 10, 20, 23 and 24 of Chapter 2, Title 10 of the California Administrative Code, effective August 1, 1976. The New York Regulations are contained in Supervisory Procedure G-107 of the Department of Banking for the State of New York. The final regulations were issued on April 30, 1976. The regulations for the Commonwealth of Massachusetts are contained in a series of directives from the Banking Department. On August 1, 1975, two directives were issued. One defined the format and coverage of disclosure for the current reporting period (including forms A through E for recording the data). The second outlined the process allowing depositors of any state chartered institution to have their institution included, regardless of asset size or location of the institution. On June 14, 1976 (and again on June 9, 1977) a directive was issued defining the coverage and format for disclosure data on each institution's total portfolio of loans (including forms G through K for reporting this data).

[7]Rockford, City Ordinance #1976-11-0 (passed January 19, 1976); Minneapolis, Minnesota Code Section 945.040 (passed in 1974); Cleveland Administrative Code Section 127.34 et seq. (passed April 26, 1976); and Chicago Illinois Codes Chapter 7, Subsection 7-30 et seq. (passed in 1974). Also, while the District of Columbia has no actual disclosure ordinance, they did set up a special commission on Residential Mortgage Investments as a result of a council resolution of July 15, 1974.

[8]Regulation C implementing the Federal Home Mortgage Disclosure Act allows state chartered institutions to opt to report only under state disclosure requirements for states whose disclosure requirements are deemed to satisfy federal standards. Presently, there is a court suit by several

federally chartered institutions in Illinois claiming that they cannot be forced by the state to report under state regulations (which are more detailed than federal requirements). Thus, these lenders are testing the pre-emption question to see if they must comply with state regulations which require more than the federal regulations.

[9] For a description of the functions and role of mortgage bankers and the present forms of regulation of their activities see the forthcoming paper on state efforts to license and regulate mortgage bankers.

[10] A forthcoming paper will discuss the relationship between reinvestment performance and the granting of chartering, branching, and relocation privileges.

[11] They are California, Illinois, New Jersey, Massachusetts, Minneapolis and Rockford.

[12] The St. Louis ordinance does not require data on mortgage rates or terms but allow institutions to supply such data if they choose to do so.

[13] The phrase "by detail" means that no categories are defined to identify different size or types of multi-family properties.

[14] The New York regulations require lenders to keep certain records on income and social characteristics of applicants, but these data are not part of the public disclosure data.

[15] Pilot studies on discrimination in lending were carried out by the federal financial regulatory agencies in 1974. These studies included census tract locations of loan applicants, but in their analysis of the data, agencies deleted any analysis of loan locations due to the high level of inaccuracy in reporting by the individual lending institutions in the surveys.

[16] The Cleveland ordinance does not state directly either which agency shall collect the data or whether it shall be open to the public for inspection.

[17] The New York State Banking Department released to the public a preliminary report: Mortgage Financing and Housing Markets in New York State: A Preliminary Report (May 10, 1977).

Footnotes for Appendix

1 The Commissioner of Banks in Massachusetts has ordered any institution, regardless of its asset size or location, to comply with the disclosure requirements if 25, or more, of the institution's depositors sign such a request.

2 Deposit data is not released on an institution by institution basis, but only in an aggregate form combining the deposits of all reporting institutions for each reporting area. Thus, the disclosure made to the Banking Commissioner is not the same as what is disclosed to the public and the deposit data is not available for inspection at individual lenders' offices.

3 The Illinois law provides for disclosure by both census tract and ZIP code for all areas covered.

4 The regulations implementing the New Jersey law include a category for loans made or purchased out of the state. This is unique.

5 Reporting of deposit data and loan conditions is not required.

6 All accounts listed at the downtown Cleveland offices of reporting institutions have been exempted from this reporting, regardless of the actual location of the person or institution holding the account. This appears to make the deposit data meaningless.

7 Decisions on the deposit of city funds are made every two years. Thus lenders in Cleveland report on a bi-annual basis.

8 There are deposit categories for time and demand accounts from out of the state as well as the non-Minneapolis portion of the Minneapolis-Saint Paul metropolitan area. However, deposit data for the City is not broken down by census tract or ZIP code.

9 Only "own-serviced" loans are reported under the regulations. "Own-serviced" is defined as "a mortgage loan for which the servicing function is performed by the institution that owns the mortgage..." It is not clear that this would include all loans originated by the institution, since it may not include loans originated, but sold. Further it may not include loans purchased, if the institution does not service those loans.

10 Presumably disclosure of the entire portfolio would include loans purchased as well as loans originated and still active, although no mention is made of this in either the Illinois law or the directions for reporting.

11 Although it has been assumed that the data will be collected and examined at an office of the Cleveland City government, the ordinance states neither which office shall collect the data nor that the data shall be made public.

Part IV

Chapter 2

SELECTIVE DEPOSITING BY INDIVIDUALS AND ORGANIZATIONS TO ENCOURAGE REINVESTMENT

About the Author

Kathi Hellerbach is a research assistant at the Center for Urban Affairs at Northwestern University.

Chapter 2

SELECTIVE DEPOSITING BY INDIVIDUALS AND ORGANIZATIONS TO ENCOURAGE REINVESTMENT

by Leonard S. Rubinowitz and Kathi Hellerbach

Summary

This is the second of several chapters which discuss strategies that can be undertaken by the voluntary sector to leverage financial institutions. The strategy of "greenlining" -- so-called by its proponents because it seeks to use the threat of mass withdrawals from a financial institution to increase the flow of mortgage credit into a neighborhood, and, thereby, to reduce or eliminate "redlining" -- began in Chicago around 1970. In addition to discussing how the strategy has been used in several conditions which must be present before individuals and organizations actually will withdraw their deposits when requested to do so by the organizers of the greenlining campaign.

Appendix A consists of a copy of an agreement between the Bank of Ravenswood and the Organization of the Northeast (O.N.E.) in Chicago, Illinois. It is typical of agreements negotiated by community groups which have used the selective depositing strategy, and it is used herein with the permission of the parties involved.

SELECTIVE DEPOSITING BY INDIVIDUALS AND ORGANIZATIONS TO ENCOURAGE REINVESTMENT

In much the same way that state and local governments can use their funds to encourage financial institutions to make loans that serve community needs, groups of individuals and private organizations can make their deposits on a selective basis. The purpose of such selective depositing is to influence lending policies by depositing funds in institutions based on their past performance in serving the community and/or on their future commitment to provide such service.

The future commitments requested may involve specified dollar amounts of mortgage and/or home improvement loans in particular geographical areas such as a small town or a city neighborhood. This is analagous to the public deposits approach, except that it involves non-governmental depositors rather than state and local governemnts. It is an incentive system in which private citizens and organizations may look at the past record of financial institutions or the future commitments which those institutions are willing to make in order to determine where to deposit their funds.

When the selective deposit approach is used by private individuals, it is often done under the auspices of community organizations. That is, the effort involves an organized undertaking rather than a series of individual initiatives. When community organizations attempt to influence lending policies through this selective deposit approach, it is sometimes referred to as "greenlining". The greenlining approach was developed in Chicago around 1970, when older residents of an inner city Italian neighboroood found that their children had been unsuccessful in obtaining mortgages in the neighborhood from local financial institutions. The initial effort of this group was to influence a bank to change its policy by withdrawing their deposits. However, they discovered that their combined assets would not seriously affect the financial situation of the institution.

Community organizers have concluded that in order to influence the lending policies of a financial institution, a careful analysis of the amount of money necessary to affect the institution must be undertaken:

> The (community) organization must gain control over the institution's liquid assets for some limited time period. About 17% of the assets of the average savings and loan association are liquid, in any given year (4.25% for any quarter). If a high percentage of the pledges of savers in the target institutions can actually be implemented over a quarter, then the amount of pledges need not be terriby high. For example, in a one hundred million dollar institution, 5% of the total institutional assets represent five million dollars in pledges from about 1,250 pledges (the average account in the Chicago area is about $4,000).[1]

Thus, the greenlining campaign consists of encouraging individual or organizational depositors to pledge to withdraw their savings from a given institution and place their savings in an institution that has made loans available in the area and/

or is willing to make future commitments to serve the community. The financial institutions that are responsive to the community's needs are thus "greenlined" with depositors' savings. In turn, these institutions agree to reinvest in the neighborhoods by making mortgages and home improvement loans available in their depositors' community.

As in the case of public deposits, the private selective deposit approach requires measuring or assessing the financial institution's past performance or future commitments. For example, evaluation of the institution's future commitments would involve: 1) defining the specific geographic area for which improved service is desired; 2) determining the amount of mortgage loan and home improvement loan funds that are needed to finance home sales and rehabilitation in the neighborhood or community; and 3) determining the appropriate division of responsibility among financial institutions which serve the defined area.

After the initial "greenlining" effort in 1970 in Chicago, there were campaigns initiated throughout the city. By 1975, pledges had been accumulated of $105 million in deposits. In return, several local lending institutions agreed to make specified amounts of mortgage money available within defined jurisdictions.[2]

Similar efforts have been undertaken in other cities. In Milwaukee, in 1972, the West Side Action Council sought agreements from local financial institutions to reinvest in that area of the city. The Council obtained 1.25 million dollars in greenlining pledges which were offered to savings and loan institutions willing to agree to the following: 1) not to "redline" any part of the west side; 2) to make mortgages available there on the same terms as in the newer parts of the city; 3) to give high priority to home and business improvement loans; and (4) to give priority to loans for owner-occupied structures over those to absentee landlords. Several local financial institutions made verbal commitments to reinvest in the neighborhood on this basis. In addition, the institutions agreed to make public all of their lending information, by zip code.[3]

Subsequently, a community organization in the east Flatbush section of Brooklyn, New York organized an effort to influence the lending practices of the Flatbush Federal Savings and Loan Association. The organization's members collected pledges from individual depositors stating that they would withdraw their funds if the Savings and Loan Association would not commit itself to reinvest their funds in the area.

After several months of negotiations between the community group and the management of the lending institution, the group indicated that it would withdraw deposits. Those who had made pledges were asked to act on those pledges and $100,000 were withdrawn from the institution. At that point, the association agreed to make mortgage money available in the community, and to lower the down payments from 30% to 25%. The community group then agreed to wait three months before evaluating the association's reinvestment practices. At the same time, a full-scale advertising campaign was initiated in order to inform the public that mortgage money was once again available in the neighborhood.[4]

Those who have been involved in greenlining campaigns conclude that pledgees are likely to withdraw their funds, if requested to do so, when the following occurs: 1) the depositors are informed that there are relatively convenient alternative financial institutions in which to deposit their funds; 2) depositors are informed that procedures for withdrawal of funds are simple and inexpensive; 3) savers are not asked to remove their savings so rapidly that they lose interest; 4) the effort concentrates on a few institutions and follows up on all pledges in these institutions through mail and personal contact.[5]

A pattern emerges from these efforts by private individuals and organizations to use a selective deposit approach. These groups have become concerned about the practices of financial institutions in the neighborhoods, and have sought agreements with the financial institutions to reinvest in the neighborhoods. If such agreements are not immediately forthcoming, the groups begin to collect pledge cards which state that the individual depositors will withdraw their funds if the bank or savings and loan association does not agree to reinvest in the neighborhood. If further negotiations fail to bring about agreement between the community groups and the institution's management, depositors are asked to withdraw their funds. The community groups seek a specific commitment in terms of dollars and general location for reinvestment by the financial institution.[6] The organizations may also seek to have the institution make its deposit and loan data available. This permits the public to monitor the institution's practices to see if they are in conformity with its reinvestment commitments.

Whether greenlining is an effective strategy for changing the lending patterns of financial institutions is open to debate. Some lenders contend that it is more of an harassing tactic than one which is designed to bring about good faith negotiations between dissatisfied customers and management. Leaders of community groups that have used the strategy -- such as Robert Creamer, formerly director of the Citizen Action Program in Chicago, Illinois -- maintain that greenlining works.[7] One thing is clear, however, and that is the fact that as the problem of disinvestment has become more widely discussed, and the complex interrelationship of various actors (in addition to financial institutions) in the mortgage lending process better understood, community groups that once relied almost solely on the greening strategy have shifted their focus from simply demanding that more mortgage money be made available, to debating with lenders about the <u>terms</u> of mortgage lending.

Financial institutions do compete vigorously to attract consumer deposits as evidenced by the barrage of advertising for special accounts, premiums, etc. Given this competition, it is reasonable to assume that the managements of all but the largest or the most isolated financial institutions will have some concerns about any organized campaign to persuade individual and organizational depositors to move their accounts. In spite of this fact, however, unless individual and organizational greenlining efforts are combined with other strategies -- such as selective depositing of public funds and/or regulatory reform of appraisal and underwriting standards -- the strategy may not achieve the desired goal of increasing the flow of mortgage credit to communities that perceive themselves as having a disinvestment problem.

Footnotes

1 Creamer, Robert. "Organizing Money," from anthology prepared by the Woodstock Institute, Chicago, Illinois for Governor Walker's (D.-Ill.) conference entitled "From Redlining to Reinvestment: Using State Regulatory Authority and Capital Investment Expenditures to Leverage Private Capital and Credit," September 1-2, 1976 (Chicago, Illinois), pp. 16.1-16.5.

2 Ibid.

3 Schieber, Ted. "C.A.P. Charges Loop Banks Ignore Neighborhoods," Chicago Tribune, February 6, 1975, p. 1 (Section Two).

4 "The Greening of East Flatbush," Village Voice, May 2, 1977.

5 "Organizing Money."

6 Werner, Frances; Frey, William and Madway, David M. "Redlining and Disinvestment: Causes, Consequences, and Proposed Remedies." The Clearinghouse Review, October 1976, Vol. 10, No. 7.

7 Creamer, Robert. During panel discussion at conference entitled "Banking for Non-Bankers: The Public Interest and Development Banking," June 5-10, 1977 in Chicago, Illinois. (Sponsored by Woodstock Institute, South Shore National Bank, National Public Interest Research Group, and National Conference on Alternative State and Local Public Policies).

APPENDIX A

This is an understanding between the Organization of the North East, hereinafter referred to as ONE, and the Bank of Ravenswood, hereinafter referred to as the Bank, both of Chicago, Illinois, for the purpose of implementing policies of reciprocal positive support between the bank and the surrounding community residents, businesses, and institutions, as follows:

1. THE COMMUNITY AND THE BANK SERVICE AREA

   ONE's community is Edgewater and Uptown.

   The Bank's service areas are:

   a. Primary Service Area representing 81.5% of total deposits, comprised of postal zip codes 60613, 60614, 60618, 60625, 60626, 60640, 60645, 60657, 60659, 60660.

   b. Secondary Service Area representing 7.7% of total deposits, comprising the rest of the North Side of Chicago.

   As ONE and the Bank continue to interact on policies of reciprocal support, the community in question will be those of Uptown and Edgewater that fall within the Bank's service area.

2. REINVESTMENT POLICIES

   In recognition of the need for availability of credit to community businesses, residents, and institutions to assure long-term vitality of the community, the following policies of reinvestment will be implemented:

   a. Lending priorities to be followed in establishing credit-worthiness of applicants, other factors being equal, are as numbered below:

      (1) Depositors in Primary Service Area

      (2) Depositors in Secondary Service Area

      (3) Other depositors

      (4) Private investors in Primary Service Area

(5) Applicants from Primary Service Area without prior history as investors or depositors

(6) Private investors in Secondary Service Area

(7) Shareholders who are not depositors in either service area

(8) Applicants from Secondary Service Area without prior history as investors or depositors

(9) Other private investors

(10) Other applicants without prior history as investors or depositors

b. The Bank pledges that in regard to Uptown and Edgewater applicants, the criteria for establihsing creditworthiness shall not include the applicant's address, sex, marital status, religion or ethnic origin as negative factors.

c. Records will be kept for a reasonable length of time on all loan applications, whether accepted or denied, and will include notations indicating the person's name and address, amount and purpose of the loan request, and if denied, the reason therefore, along with date of acceptance or denial and the name of the loan officer responsible for processing the application.

d. No applicant will be denied a loan without being told why, and a letter of denial will be furnished to applicant upon request so that he may use the declination to qualify for credit through government or other support programs.

e. The Bank will devote staff time and extra effort toward assisting applicants from Service Areas in Uptown and Edgewater to qualify for loans. Any applicant from those Service Areas not immediately qualifying for a loan will be referred for interview by the loan officer designated Community Development Officer.

f. In recognition that there should be correlation between origin of deposits in the Community and the Bank's obligation to foster reinvestment, the Bank has established or will establish the following average Loan-Deposit ratio goals:

65% overall within one year
65% overall within two years

55% in the Primary Service Area within one year
55% in the Primary Service Area within two years
55% in the Secondary Service Area within one year
55% in the Secondary Service Area within two years

g. The Bank will actively encourage and promote applications for loans from the Community and publicize its Community Development services.

3. UTILIZATION OF GOVERNMENT GUARANTEED LOAN PROGRAMS

In recognition that Federal, State and other governmental agencies offer programs to guarantee certain loans, not to assist financial institutions to maximize profits but to reduce the risk factor in reinvestment programs, the Bank will utilize those programs for qualifying Service Area applicatns from Uptown and Edgewater, to the extent that funds are available under Loan-Deposit ratios.

4. ACCOUNTABILITY

The Bank will furnish to ONE within 60 days after date of this understanding and each six months thereafter a report on geographic origins of deposits and of loan recipients. In addition, when it is mutually agreed that certain community areas require extraordinary attention and efforts to achieve or maintain economic stability, the Bank will make a reasonable attempt to furnish aggregate data on the number, type and total volume of loans in those areas.

5. PUBLIC MONIES

In consideration of the Bank's commitment and responsiveness to the Community, ONE pledges to seek widespread public support, and support of elected and appointed government officials, that public monies designated for construction or operating budgets of projects or programs in our Community be placed on deposit in the Bank and other local responsive financial institutions, for the longest feasible periods and under the most favorable terms obtainable.

6. FOSTERING COMMUNITY SUPPORT

ONE will designate the Bank as a "Community-Responsive Financial Institution" and will promote support of the Bank by direct contact with block clubs, neighborhood councils, religious groups and institutions, as well as the general public of the Community. In return for the Bank's commitment in this understanding, ONE will actively encourage businesses, institutions, and individuals to form relationships with the Bank as depositors and investors. ONE conducts a regular campaign of public information, and the facts about the Bank's adoption and implementation of policies that are in the Community interest will be communicated through public announcements, press releases, and printed materials.

The Bank is also invited to advise ONE from time to time of its position on public issues, and when the Bank's concerns on regulatory or legislative matters are deemed synonymous with the interests of the Community, ONE will so inform the public and community organizations and elected and appointed representatives and officials.

7. DURATION AND RENEWAL OF THIS UNDERSTANDING

In recognition that the Bank may develop special capabilities or that changes in regulatory requirements may be cause for review of this understanding, and in recognition that Community needs may change, representatives of the Bank and ONE will meet regularly in the first week of October, January, April and July to amend this understanding if necessary. In addition, the Bank or ONE may request conferences at any time. This understanding is to remain in effect for a period of one year and is deemed automatically renewed unless ONE or the Bank gives written notice of a desire to negotiate a new understanding 60 days prior to the expiration of this understanding.

Part IV

Chapter 3

EMERGING STRATEGIES TO LEVERAGE THE LENDING PRACTICES OF COMMERCIAL BANKS

About the Author

Andrea Rice Rozran is the Staff Associate of the Woodstock Institute. Previously, she served as vice-president of the League of Women Voters of Chicago and was responsible for the organization's research, public education, and advocacy efforts in the areas of housing and Chicago Government structure and finance. Prior to assuming that position Rozran served as a statistical consultant, reading clinician, and teacher. She is a consumer member of the Health Facilities Planning Board of the State of Illinois, which determines policies and regulates capital expenditures for health care facilities in the State.

Her recent publications include the following: Community Development Credit Unions as Instruments of Reinvestment; Comprehensive Municipal Rehabilitation Programs; Providing Permanent Reserve Stock Powers for Thrift Institutions as an Incentive for Reinvestment, with Lawrence B. Rosser; and a report "City Finance" which was presented at a 1974 symposium on Chicago: An Agenda for Change and reprinted in Chicago's Future: An Anthology of Reports, Speeches and Scholarship Providing an Agenda for Change (Stipes Publishing, Co., 1976).

In addition to a B.A. from the University of Michigan, Rozran received an M.A. from the University of California at Los Angeles and completed Ph.D. course-work at the University of Chicago Department of Education, where she specialized in Language and Reading Instruction, with a focus on research design and statistical analysis.

Rozran resides in Uptown on Chicago's north side, where she is vice-president of Uptown Center Hull House and was a founding member of the Organization of the Northeast.

Chapter 3

EMERGING STRATEGIES TO LEVERAGE THE LENDING PRACTICES OF COMMERCIAL BANKS

By

Andrea Rice Rozran

There is a myth which abounds about the passive nature of financial institutions. The managers of these intermediaries like to think of themselves as objective respondents to propositions that are brought to them. In fact, this is not how most commercial banks, savings banks and savings associations operate at all.

In recent years, largely as a result of close scrutiny by redlining opponents, the business of banking has become better understood. What has emerged is a more accurate picture of an industry which aggressively seeks business in those sectors of the economy that its managers deem will be highly profitable. No passivity is apparent when even the senior management of commercial banks openly courts large developers, big corporations and even municipal officials for their borrowing, trust and municipal bond business.

It seems, in fact, that the only place where financial institutions live up to their self-taught image as "passive" actors is in mature communities. In these area, even <u>if</u> institutions are not arbitrarily denying loans based solely on geographical location, very few are aggressively seeking to provide mortgage, home improvement, consumer and commercial credit. If a potential borrower who lives in an older, racially changing, minority or low-income community walks through a bank's front door, he or she may get a fair hearing on a loan request. Better yet, a small, but nevertheless steadily increasing number of such potential borrowers, get their loans approved. In most cases, however, if they get their loan it is in spite of, and not because of, their bank's affirmative efforts to extend credit in their neighborhood.

In assessing ways to make commercial banks more responsive to the credit needs of mature communities, it is important to remember that it is not enough for an institution simply to respond fairly to propositions brought to it. As Ronald Grzywinski, Chairman of the Executive Committee of the South Shore National Bank in Chicago, Illinois, has often noted, "In our society, the business of rebuilding neighborhoods is nobody's business. What will be required is for institutions that control a pool of credit and have the capacity for sustaining themselves through the profits they make -- like commercial banks -- to take initiatives to make a business out of neighborhood revitalization."[1]

If our mature communities are to be reclaimed as structures of family opportunity for those who still live in them, institutional initiatives to reinvest will be required. It is difficult enough to stop an institution from redlining even though financial regulatory officials at the state and federal levels are becoming more sensitive to this problem. It is doubly difficult, if not impossible in many cases, to get financial institution managers to take the initiative to reinvest in mature communities. Nevertheless, the magnitude of of the problems facing older, racially changing, minority and low-income neighboorhoods, and the unique combination of credit resources that only commercial banks by law can provide, require that citizens attempt to find ways to induce these institutions to market their services affirmatively in mature communities.

There are a few emerging strategies which show some promise of increasing neighborhood advocates' effectiveness in leveraging affirmative reinvestment commitments from commercial banks. These are not substitutes for better known and more direct action oriented campaigns -- such as "greenlining" -- which have been used to force banks to stop engaging in overt discrimination. These strategies are built upon the increased knowledge that citizens have gained about how the banking industry and its regulators operate. While it is still too early to evaluate their effectiveness in leveraging the behavior of banks, using the following strategies where they seem appropriate and monitoring the reactions of the banking industry and regulators, may teach citizens even more about how to make this highly complex industry take neighborhoods seriously and view neighborhoods as opportunities for investment.

In addition to briefly describing each strategy, materials are included which tell how citizens can get additional information from regulatory agencies and from voluntary associations that are employing the strategy.

Stockholder Resolutions

Owners of bank or bank holding company stock may attempt to influence the institution's investment policies by filing stockholder resolutions which, if approved by a majority of the shareholders, would direct management to take more initiative in understanding and meeting the credit needs of mature communities. Even when such resolutions do not pass -- and the vast majority of dissident shareholder resolutions do not -- they may influence a corporation's policies, particularly if they receive sufficient support to qualify for placement in stock proxy statements in future years.

The procedure for filing shareholder resolutions is clearly specified, and failure to comply with the requirements may disqualify the resolution. Any stockholders may file shareholder proposals, and any one stockholder -- including an organization -- is limited to filing three proposals in one year. To qualify for consideration, a proposal must be received 70 days before the anniversary of the previous year's proxy mailing.

Upon receiving such a resolution, management has three options: (1) management can agree to place the resolution on its proxy statement for a vote by the shareholders and consideration during the annual meeting; (2) management can refuse to place the resolution on the proxy statement, in which case the proposer(s) may appeal to the Securities and Exchange Commission (SEC) which determines whether it must be placed on the proxy statement or whether it is disqualified; or (3) management can negotiate with the proposer(s) in an attempt to reach a compromise which will persuade the proposer(s) to withdraw the resolution before the annual meeting takes place.

Although the total number of dissident stockholder resolutions is increasing, shareholder resolutions on redlining and reinvestment are not widespread. In 1978, for example, resolutions on these issues were presented to only three bank holding companies -- Chemical New York Corporation, Continental Illinois Corporation (Chicago), and First Chicago Corporation. (See Appendix A for an example of one such resolution and management's response to it.) The resolutions called upon the holding companies to have their banking subsidiaries undertake reinvestment initiatives. Each of the bank holding companies placed the resolutions in their proxy statements, but recommended that they be rejected by stockholders. In spite of this recommendation, the Continental and First Chicago neighborhood reinvestment resolutions received approximately four percent of the vote, and their sponsors thereby will be permitted to resubmit them next year.[2]

Regulatory References

- Special Counsel of the Securities and Exchange Commission makes the decision about whether shareholder resolutions must be placed on corporate proxy statements. Securities and Exchange Commission, 500 North Capital Street, Washington, D.C. 20549, (202)755-4846.

Programmatic References

- Interfaith Center for Corporate Responsibility provided technical assistance to the groups which filed resolutions with bank holding companies during 1978. ICCR, 475 Riverside Drive, New York, New York 10027, (212)870-2294.

- Illinois Committee on Responsible Investment filed the shareholder resolutions with the Chicago bank holding companies. ICRI, 22 East Van Buren Street, Chicago, Illinois 60605, (312)427-4351.

- Investor Responsibility Research Center is cooperatively funded by a number of major corporations, including some bank holding companies, and is ask by them to review and report on dissident stockholder resolutions. In spite of its sponsorship, IRRC has consistently published fair and objective analyses of reinvestment resolutions. These are usually reprinted in full by management in the proxy statement. IRRC, 1522 "K" Street, N.W., Suite 806, Washington, D.C. 20005, (202)833-3727.

Filing Consumer Complaints With Regulatory Agencies

In order to understand the role that various regulatory agencies can play in facilitating community-responsive lending practices, it is necessary to understand how banking regulation operates. The United State has a dual banking system, which means that banks are chartered and regulated as either state or federal institutions. Once chartered at either level, banks are subjected to extensive and regular periodic examinations.

State financial or banking agencies charter and supervise state banks. Most state chartered banks are also subject to supervision and regulation by one or more of the federal agencies. The Comptroller of the Currency, and office within the United States Treasury Department, grants charters and administers laws relating to national banks. The Federal Reserve System has regulatory and supervisory responsibility for the operation of all member banks. Although national banks are required by law to be members of the Federal Reserve System, state banks seek membership voluntarily. Generally, the larger money center state banks tend to be members, although in recent years membership in the Federal Reserve System has been declining. The Federal Deposit Insurance Corporation (FDIC) insures bank deposits. National banks must have their deposits insured by FDIC. Although only state banks which are members of the Federal Reserve System are required to have FDIC insurance, nearly all state banks are insured by FDIC voluntarily.

The supervisory and regulatory functions of the three federal financial institution regulatory agencies have unique but overlapping purposes. For this reason, the agencies have established cooperative examination procedures which minimize duplication of effort. For example, the Federal Reserve System and FDIC seldom examine national banks, but they do review the examination reports of the Comptroller of the Currency. The Federal Reserve System examines state banks which are Federal Reserve members, and the FDIC examines insured state banks which are not Federal Reserve members. To some extent, the Federal Reserve and FDIC supervision duplicates functions of state bank supervisory agencies. (See Appendix B for a chart showing supervisory responsibilities.)

Until recently, most bank examinations focused on the degree to which banks met "safety and soundness" requirements, and largely ignored the manner in which convenience and credit needs of communities were being served. In recent years, however, a number of new laws have been passed -- including the Fair Housing Act, Equal Credit Opportunity Act, Home Mortgage Disclosure Act, and the Community Reinvestment Act -- and bank examiners are now required to conduct a Consumer Examination to determine whether banks comply with these consumer-oriented laws.

The federal financial regulatory agencies have established procedures for receiving and evaluating consumer complaints. Although there is a division responsible for reviewing complaints which is the same division for examination and supervision of banks, each participating agency will forward misdirected complaints to the appropriate agency.

Among the types of complaints which will be evaluated are those alleging that a bank engages in discriminatory lending practices or has made available inadequate disclosure data. Banks have been encouraged by regulatory agencies to display consumer brochures which describe valid grounds for filing consumer complaints and which include a complaint form and return envelope. (See Appendix C for example of complaint brochure.)

Regulatory agencies also can play a more active role in encouraging banks to meet the credit needs of mature communities. For example, although a bank applying for a charter from either the federal or state authorities must identify the area it intends to serve (its "primary service area") and discuss the credit needs of that area, until recently regulatory agencies did not use the regular periodic examinations or the evaluation of applications for banking privileges -- such as permission to branch, relocate and merge -- as opportunities for evaluating whether a bank met the credit needs of the area it had previously been chartered to serve.

Citizens have been reluctant to participate in the regulatory process until recently and have often missed the opportunity to present evidence on bank performance in meeting the credit needs of its primary service area. In recent years, however, communities affected by applications of financial institutions to make structural changes have begun to present their case to the regulators. In some instances, regulators have taken these views into consideration as they decided the issues before them.

One example involving a bank's application to relocate occurred in 1972. The previous owners of the South Shore National Bank applied to the Comptroller of the Currency for permission to move the bank from the South Shore neighborhood to the lobby of a new commercial highrise in downtown Chicago. A coalition of community groups led by the South Shore Commission demanded and obtained a commitment from the Comptroller to hold a public hearing on the application in the community. After that hearing -- at which the citizens argued that the bank should not be allowed to abandon its primary service area and leave South Shore with no financial institution -- the Comptroller denied the application, and stated that the bank had not been persuavive in demonstrating that undue injury would not result from its abandoning its service area. The bank was sold subsequently, and the new owners have undertaken to turn the institution into a community development bank.[3]

Regulatory References

- Comptroller of the Currency's Handbook for Consumer Examinations is a manual for bank examiners to assist them in conducting examinations of national banks' compliance with state and federal consumer protection laws. It may be purchased from Publications Control, Comptroller of the Currency, Washington, D.C. 20219.

- Copies of acts and regulations governing national banks and pamphlets describing the federal financial regulatory system are available from the Consumer Affairs Division, Comptroller of the Currency, Washington, D.C. 20219.

- Copies of acts and regulations governing the Federal Reserve System and bank holding companies are available from Publications Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or from the Public Information Center at each Federal Reserve Bank. (See Appendix D for a list of Federal Reserve Banks.)

- Complaints against national banks for failure to comply with consumer protection laws may be filed with John Chipouras, Deputy

Director, Comptroller of the Currency, Washington, D.C. 20219, (202)447-1600.

- Complaints against state banks for failure to comply with consumer protection laws may be filed with Janet O. Hart, Consumer Affairs Division, Federal Reserve System, Washington, D.C. 20551, (202)447-1600.

- Complaints against insured state banks for failure to comply with the Fair Housing Act and the Equal Credit Opportunity Act may be filed with Thomas O'Nell, Director, Consumer Affairs and Civil Rights, Federal Deposit Insurance Corporation, Washington, D.C. 20429, (202)389-4668.

- In addition to the above, each of the financial institution regulatory agencies has designated regional staff members who serve as consumer complaint specialists. Regional offices for each agency are listed in the following Appendices:

  Appendix D -- Federal Reserve System Regional Offices

  Appendix E -- Comptroller of the Currency Regional Offices

  Appendix F -- Federal Deposit Insurance Corporation Regional Offices

- In addition to federal financial institution regulatory agencies, many states have created consumer complaint divisions especially in those states which have state disclosure or fiarness in lending statutes. Citizens should contact their state banking or financial institutions department to determine whether such divisions exist. If the institution involved is state chartered, it may be wise to file complaints simultaneously with state and appropriate federal agencies.

Programmatic References

- One of the most active public interest agencies in utilizing the consumer complaint process is National Public Interest Research Group. Refer inquiries to Jon Brown, Esq., National PIRG, Room 419 A, 1346 Connecticut Avenue, N.W., Washington, D.C., (202)833-3935.

- National Training and Information Center (NTIC) provides technical assistance to neighborhood organizations on a wide variety of issues related to reinvestment. One of their publications which may be particularly useful in analyzing the lending behavior of banks is How to Use the Home Mortgage Disclosure Act of 1975 which may be ordered from NTIC for $ 2.00. NTIC, 1123 West Washington, Chicago, Illinois 60607, (312)243-3035.

- National Center for Urban Ethnic Affairs (NCUEA) will consult with local organizations on reinvestment problems. Among the organization's publications which may be useful in developing a consumer complaint is Disclosure and Neighborhood Reinvestment: A Citizens Guide, $ 1.50. NCUEA, 1521 16th Street, N.W., Washington, D.C. 20036, (202)232-3600.

- Of particular interest to neighborhood groups which need technical data about a bank's performance to flesh out a consumer complaint will be How to Research Your Local Bank by Bill Batko, $ 2.00. Order from Institute for Local Self-Reliance, 1717 18th Street, N.W., Washington, D.C. 20009, (202)232-4108.

Community Reinvestment Act

In 1977, Congress passed and the President signed the Housing and Community Development Act. Title VIII of that Act -- which is cited as the Community Reinvestment Act -- explicitly states that a bank is obligated to meet the convenience and credit needs of the community it serves. The Act also directs appropriate federal financial institution regulatory agencies to evaluate the extent to which those needs have been met, both during their regular periodic examinations and whenever a bank applies for deposit insurance or new facilities. For purposes of the Act, "new facilities" or "deposit facilities" are defined as the following: a national bank charter, deposit insurance, a branch office or a facility with the ability to accept deposits, a relocation of a home or branch office, a merger or consolidation, and the aquisition of shares or assets of a bank which is the subsidiary of a bank holding company.

The regulations which will implement the Community Reinvestment Act are being developed by each of the federal regulatory agencies during 1978, and will become effective at the end of the year. When preliminary regulations are issued, there will be an opportunity afforded for public review and comment prior to final promulgation. Although it is difficult to predict the content of the final regulations, it appears that they will provide for citizen involvement, both during the process of specifying the credit needs of a particular community and also during the evaluation of whether a particular bank -- or a branch of that bank -- has met the needs of its community.

Once the Community Reinvestment Act is implemented, citizens will probably find it easier to find out in advance about structural changes that banks want to make. While the form of public notice has not been finalized, regulatory agencies have received proposals which would require banks to post notices in each branch office and would require each federal financial institution regulatory agency to create a regular mailing list of interested parties desiring to be notified of all pending changes by banks doing business in a designated geographical area.

Of particular interest to groups concerned about reinvestment is the probability that under the provisions of the Community Reinvestment Act citizens will have an opportunity to present testimony to the appropriate regulatory agencies when banks seek permission to open additional branch offices at locations remote from areas they are currently obligated to serve, or when banks seek permission to close offices in older neighborhoods.

The current activity of a St. Louis, Missouri community organization in opposing a recently proposed merger of a local bank with a Kansas City, Missouri-based bank holding company is probably indicative of forthcoming citizen action under the Community Reinvestment

Act. In that case, the Manchester-Tower Grove Community Organization -- an affiliate of ACORN -- petitioned the Federal Reserve Board of Governors for a local hearing on the proposed merger. The hearing petition was granted, and local citizens were able to present testimony opposing the merger due to the failure of the local bank to have met its community's credit needs. The hearing was held in April, 1978, and the Federal Reserve has ninety days to render its decision. Currently, Missouri ACORN is considering two other challenges to applications for structural changes.

Regulatory References

- A copy of Title VIII -- the Community Reinvestment Act -- of the Housing and Community Development Act of 1977 is attached as Appendix G.

- Requests for copies of proposed and final regulations implementing the Community Reinvestment Act should be directed to each of the federal financial institution regulatory agencies (see Appendices D, E, and F for list of regional offices).

Programmatic References

- The Center for Community Change (CCC) is coordinating efforts of community organizations and public interest groups to participate in crafting community-responsive draft regulations to implement the Community Reinvestment Act. The organization will also be assisting organizations in responding to proposed regulations that are published by regulatory agencies late in 1978. For more information contact Allen Fishbein and Jeff Zinzmeyer, CCC, 1000 Wisconsin Avenue, N.W., Washington, D.C.20007, (202) 338-8920.

- The National Public Interest Research Group (PIRG) has provided legal representation for Missouri ACORN in its affiliate's challenge to the Manchester-Tower Grove bank merger. Jon Brown, Esq., PIRG, Room 415 A, 1346 Connecticut Avenue, N.W., Washington, D.C. 20036, (202)833-3935.

- In developing testimony for regulatory agencies about the extent to which banks should engage in affirmative marketing of credit services in mature communities, citizens will find the following publication helpful: Demand, Supply and Marketing of Single-Family Credit in Mature Communities by Calvin Bradford, Dennis

Marino and Lawrence Rosser. May be ordered for $ 6.00, prepaid, from Woodstock Institute, 410 North Michigan Avenue, Suite 948, Chicago, Illinois 60611, (312)644-4469.

Conclusion

Reinvesting in mature communities requires talent, commitment and resources. Presumably, commercial banks at least have the last component. Trying to leverage them to obtain the necessary talent to do lending in mature communities, and monitoring their activities to insure that they maintain a sufficently high level of commitment requires that citizens use a combination of strategies. It is hoped that the emerging strategies mentioned above may assist citizens in developing a more diversified set of tools to accomplish this purpose.

Footnotes

[1] "Unscrambling the Golden Eggs." Speech by Ronald Grzywinski before the opening session of the "Banking For Non-Bankers Conference," Chicago, Illinois, June 5, 1977.

[2] According to the rules of the Securities and Exchange Commission, a stockholder resolution must receive at least three percent of the votes cast at an annual meeting the first year that it is proposed in order for it to be placed on the proxy statement the following year. Each succeeding year, this percentage threshold increases. Obviously this rule does not prevent dissident shareholders from modifying their resolution and trying to resubmit it as a "new" resolution, but the modifications must be substantial enough to satisy the SEC that the exercise is not frivolous.

[3] See Part III, Chapter 1.

Excerpt from Continental Illinois Corp.'s Proxy Statement

Stockholder Proposal III: *Community Development*

The Adrian Dominican Sisters of the Adrian Dominican Generalate, 1257 E. Siena Heights Drive, Adrian, Michigan 49221, the beneficial owners (as of December 31, 1977) of 800 shares of Common Stock of the Corporation, have expressed an intention to propose the following resolution at the Meeting:

"WHEREAS Continental has taken leadership in developing new residential construction by initiating and participating in Chicago 21 Corporation, a limited dividend corporation established for redevelopment of the central communities of Chicago which provides private financing in the form of equity capital and construction-mortgage lending and coordinates public and private efforts, including community planning and investment of public resources in infrastructure and public improvements in affected areas.

"WHEREAS Continental is participating in Dearborn Park Corporation (formerly Chicago 21 Corporation), a new residential community adjacent to Chicago's central business district;

"WHEREAS Continental has made equity investment in Dearborn Park Corporation;

"WHEREAS Continental has obligated itself for construction and long-term financing of Dearborn Park;

"WHEREAS Continental has assumed leadership in developing and implementing Dearborn Park through participation of its own president as the corporation's past president and present executive committee member and several vice presidents as advisors;

"WHEREAS Continental has recognized that its welfare "is inextricably linked to the stability of the community in which it is located and the neighborhoods where its customers and employees live and work;"

"BE IT RESOLVED that stockholders request the Directors:

1. To extend the same level of leadership and commitment exhibited in developing and implementing *new* residential construction projects in Chicago, such as Dearborn Park, to creating opportunities for equity and debt investments in the rehabilitation and preservation of existing housing and commercial facilities in mature neighborhoods for the benefit of current residents.

2. To make a report to shareholders within six months of the 1978 annual meeting about the leadership and commitments taken and/or planned in this matter."

Such stockholders submitted the following statement in support of their resolution:

"Through ventures such as Chicago 21, Continental has demonstrated its ability to initiate development projects in Chicago. Continental should take the same level of initiative in developing projects for rehabilitation and preservation of existing housing and commercial facilities. For example, Continental might accomplish this by:

1. Establishing a community development subsidiary of the Corporation (for profit and/or non-profit) as provided by the Bank Holding Company Act of 1970, similar to those established by Bank of America Corporation, Citicorp, and Morgan Guaranty and Trust;
2. Examining and reporting to stockholders the ways in which current underwriting and appraisal policies and practices may inadvertently discourage credit extension to homeowners and business people in existing and minority neighborhoods;
3. Providing money to neighborhood groups for developing plans for preservation of their neighborhoods, as done by Chicago 21 for one area.

"Banks in other cities are demonstrating that investment in existing housing and commercial facilities carries acceptable risk and can be profitable, in comparison to loan losses suffered by banks in other areas in recent years. Continental has already recognized the importance of Chicago's neighborhoods for its own welfare. Support of this proposal can help guarantee that welfare as well as Chicago's future."

Management recommends a vote AGAINST this resolution for the following reasons:

The Board of Directors and management firmly believe that this proposal is unnecessary since it calls for a commitment and a leadership role which the Corporation has already undertaken and reported on from time to time in various corporate publications, as well as in the public press. The Corporation demonstrates leadership in many efforts directed towards

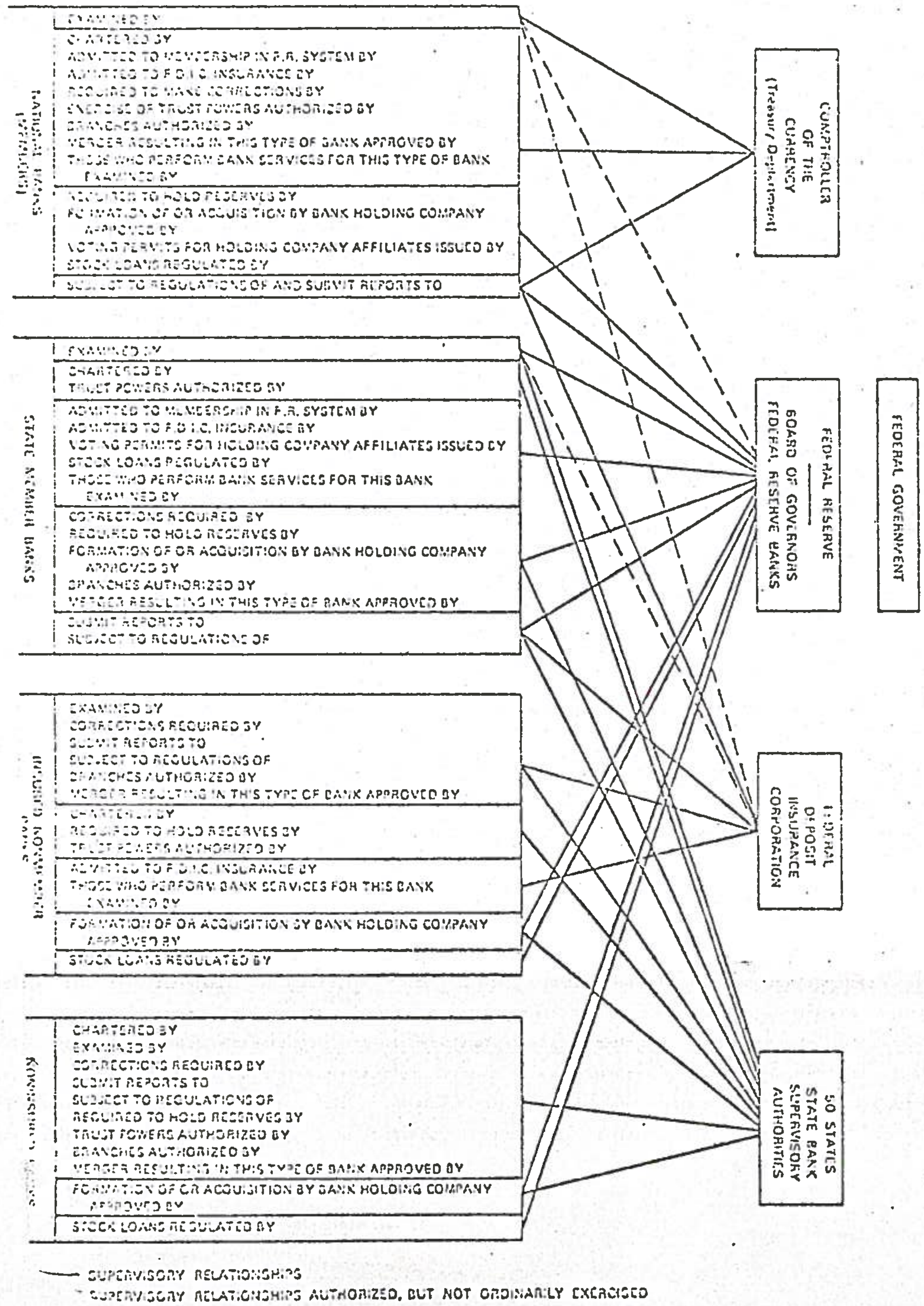
Chicago's community improvement, including the rehabilitation and preservation of existing neighborhoods, to which significant credit, contributions, and resources have been and continue to be committed. These efforts are widely recognized in the Chicago community.

Moreover, because the success of any effort to develop new projects or to rehabilitate existing neighborhoods depends on many factors, including participation in varying degrees by other entities and community groups, the proposal's attempt to require the Corporation to extend the same commitment and level of leadership to all such efforts is impractical. More or less may be needed in individual cases.

The Corporation has published and will continue to publish timely and relevant reports describing its role in the community. The 1977 Continental Illinois Quarterly 1 report to stockholders, for example, included a presentation on the Corporation's efforts in this area which was made at the 1977 annual meeting by its President. The most recent comprehensive report is the 1977 edition of *Because We Live Here*, which was distributed to stockholders at that annual meeting. These publications are available to any interested party upon request addressed to the Secretary of the Corporation. No useful purpose would be served, therefore, by having the Corporation incur the expense of preparing and distributing the additional report sought by the proposal.

For these reasons, management is of the opinion that the proposal should be rejected and accordingly a vote AGAINST is recommended.

SUPERVISION OF THE COMMERCIAL BANKING SYSTEM
Principal Relationships



Source: Crosse, Howard D. and Hempel, George H. Management Policies for Commercial Banks (Englewood Cliffs, New Jersey: 1972).

Comptroller of the Currency
Administrator of National Banks

DO YOU HAVE A COMPLAINT AGAINST A NATIONAL BANK?

If you believe that you have a complaint against a National Bank, this pamphlet is designed to assist you in contacting the Office of the Comptroller of the Currency (OCC), the federal supervisory agency for National Banks. A National Bank is usually identified by the words "National," "National Association," or the letters "N.A." in the bank's name.

Your rights as a consumer are protected by credit laws, fair lending laws and regulated banking practices. Those rights may cover such banking activities as advertising, checking accounts, savings accounts, loan decisions, discrimination, billing procedures, unfair or deceptive acts or practices, etc.

To file a complaint, follow these steps:

- Contact the bank's consumer complaint representative or department and attempt to resolve the problem directly with the bank.
- **If the bank fails to resolve the problem, fill out the enclosed complaint form and mail it to the National Bank Region for your state at the address listed in the pamphlet. No postage is necessary.**

The OCC will acknowlege receipt of your complaint promptly and investigate your claim. You will be informed, in writing, of the results of that investigation.

When your complaint involves someone other than a National Bank, the OCC will refer it to the appropriate federal or state supervisor agency and inform you to whom it has been referred.

John G. Heimann
Comptroller of the Currency

Some of Your Rights As A Consumer

Truth in Lending Act. Makes comparison shopping for loans possible, allowing you to save money. Among other required disclosures, banks must tell you the Annual Percentage Rate (APR) for the loans they offer. By borrowing at 11% APR instead of 12% APR, you will save $117.12 for a $5,000, 48 month car loan. Savings are greater for large loans, such as mortgages.

Fair Credit Billing Act. Provides the means to resolve credit card billing errors promptly and fairly. Also, under certain circumstances, you may withhold payment of any balance due on defective merchandise or services purchased with your credit card.

Consumer Leasing Act. Protects you against incomplete and misleading leasing information. Requires full disclosure of consumer lease terms and enables you to shop wisely The act covers personal property leases, such as automobile leases. It does not cover apartment leases.

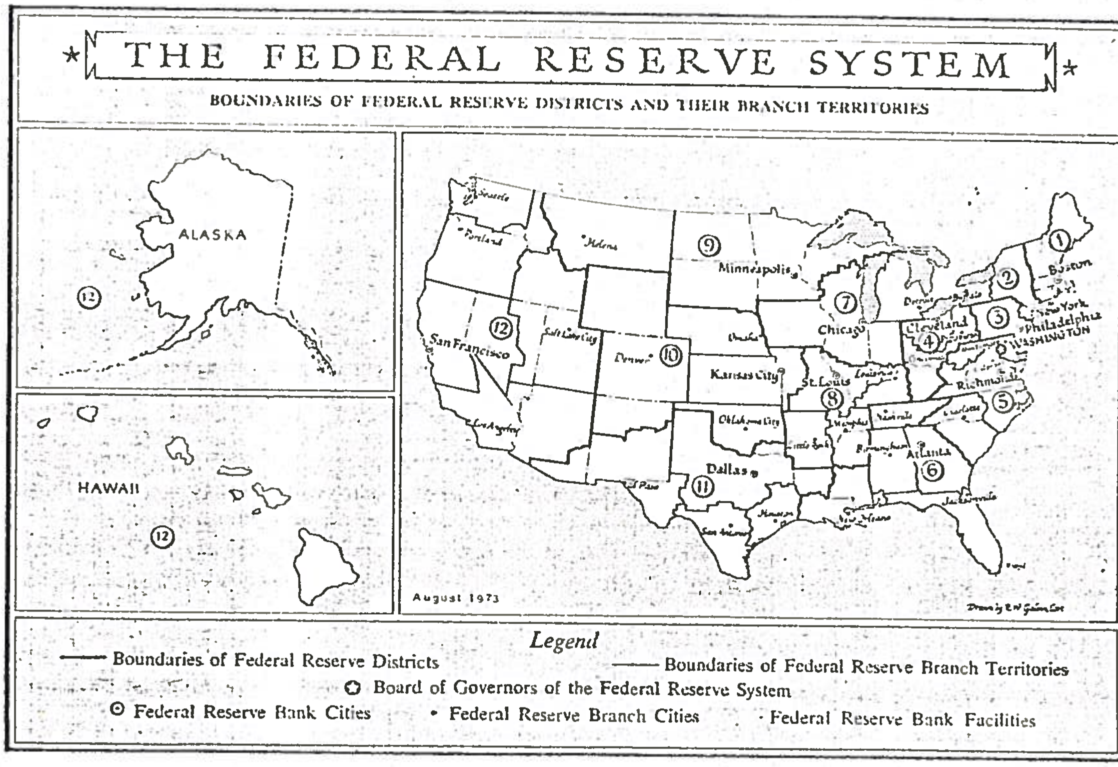
Fair Credit Reporting Act. Allows you to find out the information credit bureaus have on you and to have wrong information corrected. It also requires banks to tell you where they got information about you if they deny you a loan.

Equal Credit Opportunity Act. Prohibits discrimination in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age; or if all or part of your income comes from public assistance (i.e., Social Security); or if you have exercised any right under the Consumer Credit Protection Act (i.e., Truth in Lending). The act does not guarantee that you will get credit. Banks determine this by considering such factors as income, expenses and debts.

Fair Housing Act. Prohibits a bank from denying you a loan to purchase or improve your home, or offering you a loan on less favorable terms, because of your race, color, religion, sex or national origin.

Real Estate Settlement Procedures Act. Requires the bank to disclose the nature and costs of real estate settlements. The bank must provide you with a special information booklet which explains your rights and with a good faith estimate of the cost of settlement services.

State Laws. Each state has laws which give you rights and remedies in consumer credit transactions. Normally, unless a state law directly conflicts with some federal law, the state law will apply and may give you protection. All states have some form of usury law, which establishes maximum rates of interest that creditors can charge you on loans or credit sales. The maximum interest rates vary from state to state and depend upon what kind of credit transaction is involved.



FEDERAL RESERVE BANKS

Presidents and Addresses

Boston
Frank E. Morris
~~30 Pearl Street~~ 600 Atlantic Ave.
Boston, Massachusetts ~~02106~~ 02110

New York
~~Alfred Hayes~~ Paul A. Volcker
33 Liberty Street
New York, New York 10045

Philadelphia
David P. Eastburn
~~925 Chestnut Street~~ 10 N. Sixth St.
Philadelphia, Pennsylvania 19105

Cleveland
Willis J. Winn
1455 East Sixth Street
P. O. Box 6387
Cleveland, Ohio 44101

Richmond
Robert P. Black
100 North Ninth Street
Richmond, Virginia 23261

Atlanta
Monroe Kimbrel
104 Marietta Street, N.W.
Atlanta, Georgia 30303

Chicago
Robert P. Mayo
230 South LaSalle Street
P.O. Box 834
Chicago, Illinois 60690

St. Louis
~~Darryl R. Francis~~ Lawrence K. Roos
411 Locust Street
P.O. Box 442
St. Louis, Missouri 63166

Minneapolis
~~Bruce K. MacLaury~~ Mark H. Willes
250 Marquette Ave.
Minneapolis, Minnesota 55480

Kansas City
~~George H. Clay~~ Roger Guffey
925 Grand Avenue
Federal Reserve Station
Kansas City, Missouri 64198

Dallas
~~Philip E. Coldwell~~ Ernest T. Baughman
400 South Akard Street
Station K
Dallas, Texas 75222

San Francisco
John J. Balles
400 Sansome Street
San Francisco, California 94120

Source: Federal Reserve System

COMPTROLLER OF THE CURRENCY
REGIONAL OFFICES

First National Bank Region
Three Center Plaza, Suite P-400
Boston, Massachusetts 02108
(617) 223-2274
- Maine
- Vermont
- New Hampshire
- Massachusetts
- Rhode Island
- Connecticut

Second National Bank Region
1211 Avenue of the Americas
Suite 4250
New York, New York 10036
(212) 399-2997
- New Jersey
- New York
- Puerto Rico
- Virgin Islands

Third National Bank Region
Three Parkway, Suite 1800
Philadelphia, Pennsylvania 19102
(215) 597-7105
- Pennsylvania
- Delaware

Fourth National Bank Region
One Erieview Plaza
Cleveland, Ohio 44114
(216) 522-7141
- Indiana
- Kentucky
- Ohio

Fifth National Bank Region
F&M Center, Suite 2151
Richmond, Virginia 23277
(804) 643-3517
- Maryland
- North Carolina
- Virginia
- West Virginia
- District of Columbia

Sixth National Bank Region
Suite 2700, Peachtree Cain Tower
229 Peachtree Street, N.E.
Atlanta, Georgia 30303
(404) 221-4926
- Florida
- Georgia
- South Carolina

Seventh National Bank Region
Sears Tower, 233 So. Wacker Dr.
Suite 5750
Chicago, Illinois 60606
(312) 353-0300
- Illinois
- Michigan

Eighth National Bank Region
165 Madison Avenue, Room 800
Memphis, Tennessee 38103
(901) 521-3376
- Alabama
- Arkansas
- Louisiana
- Mississippi
- Tennessee

Ninth National Bank Region
800 Marquette Avenue
1100 Midwest Plaza, East Bldg
Minneapolis, Minnesota 55402
(612) 725-2684
- Minnesota
- North Dakota
- South Dakota
- Wisconsin

Tenth National Bank Region
911 Main Street, Suite 2616
Kansas City, Missouri 64105
(816) 842-1648
- Iowa
- Kansas
- Missouri
- Nebraska

Eleventh National Bank Region
1201 Elm Street, Suite 3800
Dallas, Texas 75270
(214) 655-4400
- Oklahoma
- Texas

Twelfth National Bank Region
1405 Curtis Street, Suite 3000
Denver, Colorado 80202
(303) 837-4883
- Arizona
- Colorado
- New Mexico
- Utah
- Wyoming

Thirteenth National Bank Region
707 S.W. Washington Street
Room 900
Portland, Oregon 87205
(503) 221-3091
- Alaska
- Idaho
- Montana
- Oregon
- Washington

Fourteenth National Bank Region
One Market Plaza
Steuart Street Tower, Suite 2101
San Francisco, California 94105
(415) 556-5042
- California
- Guam
- Hawaii
- Nevada

Source: Comptroller of the Currency

FEDERAL DEPOSIT INSURANCE CORPORATION REGIONAL OFFICES

Suite 2400
Peachtree Center
Harris Tower
233 Peachtree Street, N.E.
Atlanta, Georgia 30303
404/221-6631

2 Center Plaza
Room 810
Boston, Massachusetts 02108
617/233-6420

233 S. Wacker
Sears Tower
Suite 6116
Chicago, Illinois 60606
312/353-2600

37 West Broad Street
Suite 600
Columbus, Ohio 43215
614/469-7301

300 N. Ervay Street
Suite 3300
Dallas, Texas 75201
214/749-7691

2345 Grand Avenue
Suite 1500
Kansas City, Missouri 64108
816/374-2851

First Wisconsin Plaza
1 S. Pinckney Street
Eighth Floor
Madison, Wisconsin 53703
608/252-5226

One Commerce Square
Suite 1800
Memphis, Tennessee 38103
901/521-3872

730 Second Avenue, South
Suite 266
Minneapolis, Minnesota 55402
612/725-2046

345 Park Avenue
21st Floor
New York, New York 10022
212/826-4762

1700 Farnam Street
Suite 1200
Omaha, Nebraska 68102
402/221-3366

510 Penn Center Plaza
Suite 2901
Philadelphia, Pennsylvania 19103
215/597-2295

908 E. Main Street
Suite 435
Richmond, Virginia 23219
804/643-6716

44 Montgomery Street
Suite 3600
San Francisco, California 94104
415/556-2736

Source: Federal Deposit Insurance Corporation

TITLE VIII—COMMUNITY REINVESTMENT

SEC. 801. This title may be cited as the "Community Reinvestment Act of 1977".

SEC. 802. (a) The Congress finds that—

(1) regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business;

(2) the convenience and needs of communities include the need for credit services as well as deposit services; and

(3) regulated financial institutions have continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered.

(b) It is the purpose of this title to require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.

SEC. 803. For the purposes of this title—

(1) the term "appropriate Federal financial supervisory agency" means—

(A) the Comptroller of the Currency with respect to national banks;

(B) the Board of Governors of the Federal Reserve System with respect to State chartered banks which are members of the Federal Reserve System and bank holding companies;

(C) the Federal Deposit Insurance Corporation with respect to State chartered banks and savings banks which are not members of the Federal Reserve System and the deposits of which are insured by the Corporation; and

(D) the Federal Home Loan Bank Board with respect to institutions the deposits of which are insured by the Federal Savings and Loan Insurance Corporation and to savings and loan holding companies;

(2) the term "regulated financial institution" means an insured bank as defined in section 3 of the Federal Deposit Insurance Act or an insured institution as defined in section 401 of the National Housing Act; and

(3) the term "application for a deposit facility" means an application to the appropriate Federal financial supervisory agency otherwise required under Federal law or regulations thereunder for—

(A) a charter for a national bank or Federal savings and loan association;

(B) deposit insurance in connection with a newly chartered State bank, savings bank, savings and loan association or similar institution;

(C) the establishment of a domestic branch or other facility with the ability to accept deposits of a regulated financial institution;

(D) the relocation of the home office or a branch office of a regulated financial institution;

(E) the merger or consolidation with, or the acquisition of the assets, or the assumption of the liabilities of a regulated financial institution requiring approval under section 18(c) of the Federal Deposit Insurance Act or under regulations issued under the authority of title IV of the National Housing Act; or

(F) the acquisition of shares in, or the assets of, a regulated financial institution requiring approval under section 3 of the Bank Holding Company Act of 1956 or section 408(e) of the National Housing Act.

SEC. 804. In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall—

(1) assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution; and

(2) take such record into account in its evaluation of an application for a deposit facility by such institution.

SEC. 805. Each appropriate Federal financial supervisory agency shall include in its annual report to the Congress a section outlining the actions it has taken to carry out its responsibilities under this title.

SEC. 806. Regulations to carry out the purposes of this title shall be published by each appropriate Federal financial supervisory agency, and shall take effect no later than 390 days after the date of enactment of this title.

Part V

NEIGHBORHOOD REINVESTMENT -- FOR WHOM?

About the Author

Erica Pascal if the Staff Attorney for the National Neighborhood Commission. She was formerly the Editor of Land Use and Zoning Digest, a monthly publication of the American Society of Planning Officials (ASPO).

Ms. Pascal has also authored the following publications: Regional Planning, Housing and Civil Rights: The Implementation of the A-95 Review Process in the Chicago Metropolitan Area; and The A-95 Review Process in Illinois.

Ms. Pascal's educational training includes degrees from the following institutions: B.A., Urban Affairs, Boston University and J.D., Northwestern University School of Law. During her tenure at Northwestern Erica was an Associate of the Urban-Suburban Investment Study Group of the Center for Urban Affairs.

NEIGHBORHOOD REINVESTMENT -- FOR WHOM?

by Dennis R. Marino and

Erica Pascal

Summary

This chapter is designed to sound a note of caution to neighborhood residents who are in the process of developing and advocating strategies to revitalize their communities. The authors describe the growing concern over who benefits from neighborhood reinvestment and revitalization, and suggest that citizens carefully consider the goals, unintended consequences and negative impacts of reinvestment efforts. They present selected testimony from a recent Congressional Hearing on the relationship between neighborhood revitalization and displacement. They also review a sample of strategies which have been implemented to counteract displacement and insure that existing residents of inner city neighborhoods benefit from neighborhood reinvestment programs.

The chapter concludes with a statement concerning the fiscal interest of public officials in achieving neighborhood economic integration through reinvestment without causing displacement of existing residents.

NEIGHBORHOOD REINVESTMENT ------ FOR WHOM?

As a result of the dialogue which evolved among neighborhood residents, lenders and public officials over the last decade concerning the plight of older city neighborhoods, effective neighborhood reinvestment efforts have been implemented in several cities. Generally, the investment which has occurred as a result of these efforts has been successful in enabling residents to acquire homes, make improvements on existing homes and refinance existing mortgages. However, during the past year there has been a growing concern over whether or not existing residents of older city neighborhoods will be able to benefit from the reinvestment strategies which they helped implement. In some cases, the credit generated as a result of reinvestment efforts will finance the acquisition and major rehabilitation of inner city property by middle and upper income, non-inner city residents. This growing segment of inner city migrants is finding inner city housing an attractive bargain given the relatively high cost of suburban housing and the transportation related expenses incurred by suburban commuters. This phenomenon should not be perceived as a problem a priori, but should be viewed as an opportunity to create economically integrated communities in communities which are populated exclusively by very low income residents. Since such communities are usually characterized by a considerable supply of vacant housing and vacant land, such integration might be accomplished with a minimal amount of initial displacement. However, unless income generating and equity stakes are created for the poorer residents of the neighborhood, then those residents are likely to be forced out as middle income demand for housing in the area, property values, rents, and tax assessments increase. Unfortunately, there are few examples of neighborhoods which have undergone economic integration that were able to provide income generating opportunities for a significant number of poor residents.

In July, 1977, the Senate Committee on Banking, Housing and Urban Affairs held hearings on displacement. During the course of this hearing, Senator William Proxmire (D., Wisconsin) made the following statement which summarizes the concerns of a number of urban policymakers and neighborhood residents:

> The save the neighborhood movement has come of age. Now is it the time to ask: save the neighborhood for whom? Will the increasing pace of neighborhood revitalization yield healthy, diverse communities, [or] dislocate the old, the poor, and the black residents from older neighborhoods which are newly attractive to young professionals?...How can public policy reconcile the need to upgrade existing housing stock and to attract the middle class back to cities with the even greater need to provide decent housing for the poor? How can we prevent the game of musical chairs that we had under urban renewal, which dislocated more poor people than it housed-which, I guess, is one of the greatest ironies of social policy.[1]

The one point that Senator Proxmire overlooked is that there is also a potential for moderate income and lower middle income families to be displaced by reinvestment strategies which are not sensitive to the needs and capacities of existing residents, or which intend to accomplish neighborhood revitalization by changing the tenancy of the neighborhood to one that is upper income.

During the same hearing, Carl Holman, President of the National Urban Coalition, emphasized the reality of the displacement of working class and elderly households which the Coalition discovered during its survey of the impact of neighborhood reinvestment and revitalization on existing residents of selected neighborhoods in 43 cities.

> ...Our local urban coalitions began reporting that despite the middle class out migration trends reported by census analysts and urbanologists, their communities were beginning to experience filtering back of middle income buyers and renters of remodeled houses and apartments who were pushing out those who were no longer able to stay in their old neighborhoods...A new class of urban nomads is being created. They do not want to move, but move they must because they can no longer afford or sustain their claims to housing in older neighborhoods. Others--including some in this city, /Washington, D.C./ in Baltimore, in Chicago, in Oakland, in Saint Louis--are fighting against considerable odds to hold on to their...physical and financial investments in these neighborhoods. In neighborhoods undergoing revitalization, these people are caught between the vise of middle income renovated areas and the staunchly middle income suburbs. I believe we stand on the threshold of a demographic movement whose effect may well result in the economic resegration and the "suburbanization" of our cities.[2]

Holman indicated that the preliminary conclusion of the Coalition's survey is that the crucial difference before and after the revitalization in almost all of the neighborhoods surveyed--with the exception of neighborhood Housing Service areas--was the social and economic characteristics of the residents.[3] After revitalization activities were initiated, there was usually a replacement of blue collar workers (black and white), the elderly and the unemployed poor by relatively young, white professionals.[4] According to Holman, displacement occurs on a block-by-block basis in a manner similar to the way racial change occurs from white to black in many inner city neighborhoods. In such cases, there have been few opportunities for economic and/or racial integration.

The problem of displacement is one that must be addressed at the beginning of any neighborhood revitalization program, and not addressed remedially as the affects begin to take their toll. There are numerous things a state and/or city might do to prevent reinvestment in and revitalization of neighborhoods at the expense of current neighborhood residents. For example, reinvestment is essentially a speculative venture of investment into a community in hopes of recapturing later value increases. One option is for the city and/or state to become an investor in order to capture some of the value increase for public purposes.

In order to prevent undue speculation at the expense of current residents, the state could impose an additional "speculators tax" on buildings held for short term gain. Another way a city can encourage reinvestment without dislocating current residents is through the property tax mechanism. For example, under the urban homesteading program the reassessment resulting from the increased value of the rehabilitated building is prorated over a certain number of years. In neighborhood revitalization strategies, a similar approach could be employed to insure that current residents are not forced to sell their homes to pay property taxes. Perhaps elderly and moderate income homeowners could be permitted to delay payments of property taxes beyond a maximum level until they sell their homes. Another approach would be in the administration of the building code, either in the form of a modified code for rehabilitated buildings, or on the model that the neighborhood housing services program proposes, a "flexible and sensitive" building code enforcement. Finally, efforts could be made to require that Section 8 housing subsidies be used in buildings undergoing rehab, thus insuring that renter households could remain in the area.

Washington D.C. has tried another approach to preventing the displacement of current residents of neighborhoods undergoing reinvestment and revitalization. Washington residents are predominantly renters, and even single-family homes or townhouses are often rented rather than owner-occupied. In November, 1975, the Washington D.C. City Council passed a rent control ordinance. Section 301 of the ordinance provided that any owner of a single-family dwelling who seeks to sell that building must first make a bona fide offer of the building to the current renter-occupant, who has 45 days to accept the offer. (A similar provision in the condominium ordinance provides that an owner must offer the building to the current tenants before converting the building to condominium).

In one instance, the D.C. ordinance was used to set aside a sale. Center Properties, a developer, bought an entire block of properties in a northwest community called Adams Morgan, which has recently undergone rapid and extensive rehabilitation. The developer attempted to evict all the tenants on the block. The court, in reviewing the action, found the previous owners had not offered the buildings to the tenants, and set aside the sale. Active community support helped the tenants raise the downpayment money and secure mortgages. The city assisted by providing rehabilitation money through community development block grant funds.

It is too early yet to determine if the D.C. ordinance will have any effect. Several neighborhoods in Washington are undergoing severe redevelopment pressure, including Capital Hill, Adams Morgan, DuPont Circle, Mt. Pleasant, and others. A staff member for City Council member David Clark, who introduced the measure, felt that the ordinance would have minimal impact for several reasons. First, prices which even unrehabilitated properties have commanded in the redevelopment areas has been very high. Second, many of the current renters do not have the ability to obtain a mortgage, pay a downpayment, or secure rehabilitation loans. Greater financial assistance will be necessary if the city is truly interested in helping renters become owners and preventing dislocation of long term residents from their neighborhoods.

Another city which is attempting to control the rate of reinvestment and revitalization is the City of Hartford, Connecticut. According to City Councilman Nicholas Carbone, Hartford is attempting to direct middle income migration into neighborhoods experiencing weak housing demands and high vacancies so that stable, but moderate income neighborhoods characterized by tight housing markets are not uprooted. This goal is to be accomplished through a marketing and tax incentive strategy.

Another anti-displacement strategy has been implemented by the Association of Neighborhood Housing Developers of New York City, This strategy involves tenants who live in a multi-family building rehabilitating their own building. In exchange for working on the building, they receive a salary provided by CETA funds and are given a priority right to acquire apartments in these buildings which become cooperatives once they are rehabilitated. A variation of this strategy is to provide in kind payment in the form of partial ownership rights to one of the units for long term unemployed residents who work on these buildings.

Conclusion

Throughout this Guide a range of reinvestment strategies have been presented for consideration of neighborhood residents. With a few exceptions, the preceding chapters presented a strategies which are directed toward providing credit primarily to existing residents for the purchase and rehabilitation of housing, and the refinancing of aged mortgages. In considering which of these strategies might be appropriate for implementation, interested parties should determine what they hope to accomplish through neighborhood reinvestment.

Any reinvestment strategy which is implemented should be tailored to the unique social and economic fabric of existing neighborhoods to insure that displacement does not occur as an unintended consequence of the increased market activity stimulated by the strategy. In those neighborhoods where there is an obvious need to encourage economic integration, an effort should be made to accomplish this without uprooting existing residents. If any residents are displaced as a result of a strategy initiated by any of the three sectors -- public, private or voluntary -- then it is the responsibility of all three sectors to insure that decent, affordable housing is made available in the same neighborhood from which the residents were inadvertently displaced.

Although in some cases local policymakers may desire the massive influx of middle income households and the substantial displacement and outmigration of moderate income households, the public sector will not benefit from such demographic reversals. If whole communities of low and moderate income residents are forced out of inner city areas by market forces, then it is likely that they will locate in another community in the same metropolitan area -- perhaps an inner ring suburb -- where they are likely to be subject to the forces of disinvestment which once plagued their inner city communities. Based on the assumption that middle income people pay more in taxes than they demand in city services, it might be assumed that some municipalities would benefit and some would lose from the above demographic gymnastics. However, any time an opportunity to nurture economic integration is lost, the public sector will lose.

If the reinvestment -- displacement -- disinvestment cycle is permitted to occur repeatedly, then states will be forced to continue to increase their income maintenance budget and be forced -- as Stanley Hallett pointed out above -- to bail out one community while building up another. On the other hand, a reinvestment-economic integration cycle which would enable lower income people to secure income generating opportunities as a result of the added economic activity caused by the influx of middle income households, might reduce or cause the state income maintenance budget to level off. The actualizing of this theory is dependent on the assumption that lower income people will be able to secure the income generating opportunities without being discouraged by discriminatory practices.

Accomplishing neighborhood economic integration without <u>causing</u> displacement of existing residents is the challenge which confronts all urban residents and policymakers faced with the task of neighborhood reinvestment and revitalization.

Footnotes

1 U. S. Senate, Committee on Banking, Housing, and Urban Affairs, "Neighborhood Diversity," Hearings, Opening Statement of Senator William Proxmire, July 7-8, 1977.

2 Ibid., Statement of Carl Holman.

3 Ibid.

4 Ibid.