MORTGAGE POOLS: TOOLS FOR STIMULATING REINVESTMENT

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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.

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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 investment 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.