SAVINGS AND LOAN SERVICE CORPORATIONS AS INSTRUMENTS OF REINVESTMENT

Dennis R. Marino

Lawrence B. Rosser

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

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Summary

This is the last of a series of papers analyzing private sector initiated reinvestment strategies. 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 in 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.

SAVINGS AND LOAN SERVICE CORPORATIONS

AS INSTRUMENTS OF REINVESTMENT

/ The / 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 <u>results</u> achieved by many (including those described below), the <u>flexibility</u> 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 <u>comprehensively</u> 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.

<u>One Twenty-Eight, Inc.</u>
<u>Cincinnati, Ohio</u>

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]ince 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]n 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.