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THE PLANNER'S ROLE IN FACILITATING  
PRIVATE SECTOR REINVESTMENT

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## ABOUT THE WOODSTOCK INSTITUTE

Established in 1973, the Institute conducts policy analysis and provides technical assistance on urban revitalization. It is an Illinois chartered not-for-profit corporation which is supported by foundation grants and contract research with financial institutions and government agencies.

Since its inception, the Institute has been active in promoting the need for greater linkage between the *privileges* that financial institutions enjoy due to our financial regulatory system (e.g. protection from market area and price competition, etc.) and the *performance* of these institutions in meeting the credit needs of inner city neighborhoods. Its focus on financial institutions is due to the Institute's belief that public tax dollars and private investment capital are not fungible. While it is important that neighborhoods in distress have an adequate inflow of public dollars, these funds cannot be used over the long-run as a substitute for disinvested private dollars.

The Institute believes that ways must be found to leverage private capital and credit back into mature communities if these areas are to survive as structures of family opportunity for those who live in them. To facilitate this process, the Institute has defined its role as that of examining the assumptions that lenders and financial institution regulators have about extending credit in mature communities, developing an inventory of successful private and public sector reinvestment programs, and educating citizens, lenders and public officials about the opportunities -- as well as the problems -- inherent in community development lending.

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THE PLANNER'S ROLE IN FACILITATING  
PRIVATE SECTOR REINVESTMENT

*Introduction*

This report is designed to aid local and state governments who are are confronted with the task of designing strategies to facilitate private sector reinvestment in older neighborhoods. How to encourage the provision of credit in neighborhoods which have suffered from inadequate access to credit in the past is a serious problem facing many local governments.

Chapter 2 of this report will discuss the attempts of some local governments to leverage reinvestment through various financing mechanisms. Among the programs presented are: public loan insurance efforts; loan purchase programs; interest rate subsidies; and direct lending and grants by local governments.

Chapter 3 presents a number of indirect efforts which local governments can institute to support their efforts to attract capital. Among these are homeownership, counseling, rent referral and management services, code enforcement, equity guarantee programs, recycling tax delinquent properties and urban homesteading. In addition, the authors also describe the importance of using financial institution regulatory policy as a device for securing the participation of local lenders.

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Chapter 4 reviews attempts by several state agencies to encourage private lending in older neighborhoods through such programs as loans-to-lenders; selective capital improvements; mortgage insurance; mortgage purchase programs; and depositing of public funds. Two states, California and Massachusetts, have developed a comprehensive urban development policy which is intended to promote the revitalization of inner city neighborhoods through state initiative.

In Chapter 5 the reader is presented with case studies of three reinvestment efforts which were initiated by private financial institutions. The purpose of this chapter is to inform planners of these progressive strategies and to examine the significant support services which could be or have been provided by public planning agencies.

Chapter 6 provides a summary and conclusion and offers some guidance to local governments in designing programs which serve as a catalyst for private lending rather than institutionalizing publicly subsidized lending.

*Neighborhood Reinvestment: An Overview*

Neighborhood reinvestment is a term used to describe the process by which the public and private sectors develop confidence in the future of a declining neighborhood and begin to provide the essential services and credit which enable it to be once again maintained or developed as an attractive environment. Reinvestment also involves a commitment from neighborhood residents to invest in their community by upgrading their homes and supporting local businesses.

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For neighborhood reinvestment to be successful it is essential that access to credit be established. Older neighborhoods, like all communities, require constant access to credit. Residential, consumer, commercial and institutional credit are all significant. Residential credit entails single and multi-family mortgage as well as rehabilitation loans. Without such loans, prospective residents will be unable to buy and existing residents will be unable to sell properties in the neighborhood; the commitment to incur maintenance expenses will inevitably suffer.

The withdrawal of credit from a neighborhood not only has a detrimental effect on the housing stock, it also results in the deterioration of local business districts and the decline of institutional activities in the neighborhood. Without credit for retail purchases, consumers are unable to support local businesses. Local business owners themselves need credit in order to refurbish stores, maintain sufficient inventory, or expand.

Often overlooked, but critically important is the need for institutional credit. Churches, recreational associations, private schools, day care and health care centers, and community organizations enhance the quality of life particularly in low-and moderate-income neighborhoods. Without credit to offset cash flow problems, these organizations may be forced to curtail activities.

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In addition to requiring a constant flow of private credit, older neighborhoods exhibit a critical need for public investment in the form of public services and capital improvement projects. When analyzing the risk of extending housing credit in a given neighborhood, lenders consider the quality of city services and public infrastructure as well as the characteristics of the property and the applicant. They often assume that there is a direct relationship between the quality of public services and the stability of the neighborhood. In the eyes of a loan officer, a neighborhood characterized by deteriorated streets, inadequate police protection and poor waste removal represents an imprudent lending environment. Mature neighborhoods are typically characterized by aging infrastructure and there is often a compelling need to upgrade sewer and water systems, rebuild streets and sidewalks, and rehabilitate recreational and social service centers. Although obviously not all lending institutions which have decided to restrict lending in a given neighborhood have done so because of their perception that local government had disinvested first, it is an important consideration.

Regardless of whether the flow of private credit for housing is restricted because of perceived public disinvestment or due to other consideration, the impact on a neighborhood is disastrous. The demand for single-family housing in the area will diminish due to the difficulty of securing

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mortgages, existing residents will be unable to sell their properties, and will have less incentive to maintain their homes. Those residents who desire to continue the maintenance and modernization of their homes will encounter difficulty.

Large, pre-World War II, multi-family buildings experience particularly severe problems as a result of the restricted supply of credit. These buildings require constant maintenance and gradual renovation to attract rents which enable owners to maintain a reasonable cash flow. Lacking credit to finance renovations and major maintenance expenses, multi-family property owners will be forced to minimize, if not eliminate needed maintenance and renovation projects. Another disincentive for maintaining older apartment buildings in credit-starved neighborhoods is the limited probability that a multi-family property can be sold for a reasonable profit due to the inability of prospective buyers to secure financing. Consequently, large apartment buildings in these neighborhoods begin to deteriorate and have a negative effect upon smaller apartment buildings and single-family homes.

On the Federal level, some response to neighborhood disinvestment has been initiated. For example, Congress enacted the Housing and Community Development Act of 1977 which authorizes federal financial regulatory agencies to review the performance of a financial institution in meeting all of the credit needs of the communities it serves.<sup>1</sup> A review

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will occur whenever an institution applies to the appropriate regulatory agency for permission to open or close a branch office, to merge with another institution, or to make one of several other types of structural changes. The 1977 Act also calls for the development of incentives by Community Development Block Grant recipients to stimulate private investment and community revitalization.<sup>2</sup>

In response to citizen concern about the need for housing credit, state and local governments have also enacted legislation and initiated special programs to stimulate reinvestment. The implementation of such legislation and the management of reinvestment programs have clear implications for planners.

LEVERAGING STRATEGIES FOR LOCAL  
PLANNERS: FINANCING PROGRAMS

*Introduction*

Many financial institutions perceive lending in older neighborhoods as a high risk venture. In order to induce conventional lending in such neighborhoods, cities are designing programs which reduce lenders risk on individual loans. Several of these programs will be discussed in this chapter.

*Public Loan Insurance Program*

Public loan insurance programs are strategies whereby a public agency insures all or a portion of the financial exposure incurred by a lender in originating a loan. Through loan insurance programs, local governments may encourage lenders to approve loans in situations where the risks are perceived as too great for an uninsured loan, or it may encourage lenders to grant more favorable conditions on a loan which is normally perceived as representing a questionable risk. For example, by attaching mortgage insurance to a loan, a lender may approve a 90% to 95% mortgage, whereas if the insurance had not been available, the mortgagor might have been required to make a downpayment of 20% to 35% of the purchase price. Mortgage insurance programs can be developed for single-family or multi-family housing.

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Insurance programs can also be developed for rehabilitation programs. Several cities, including Chicago; Milwaukee; Hoboken, New Jersey; and New York, have established loan insurance programs designed to stimulate conventional lending in selected neighborhoods.

An innovative local program which utilizes both public and private mortgage insurance<sup>1</sup> is the Chicago Home Mortgage Purchase and Rehabilitation Program<sup>2</sup>. Sponsored by the Community Service and Research Corporation (CSRC) and the City of Chicago, this effort is designed to make low-downpayment market interest rate mortgage loans available to creditworthy individuals who will purchase or refinance single-family homes or two-to-four unit apartment buildings in target neighborhoods.

CSRC is funded by the City of Chicago with additional operating funds received from local financial institutions. The mortgage funds are pledged by a group of participating institutions. The loans are coinsured by the City of Chicago, the Mortgage Guarantee Insurance Company and participating lenders. The city's participation in the insurance pool is supported by \$500,000 in Community Development Block Grant funds. As of June 1978, 110 loans valued at \$2.7 million had been approved.

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Milwaukee's Homeowner Maintenance Assistance Program insures conventional rehabilitation loans originated in targeted neighborhoods.<sup>3</sup> In order to qualify for the program,

a neighborhood must experience "housing market problems" or the majority of the residents must have household income below eighty percent of the median income of the City of Milwaukee. "Housing market problems" are considered to be declining property values, housing deterioration, or evidence of physical blight.

The program is administered by the Neighborhood Improvement Development Corporation (NIDC) which is supported by CDBG funds. NIDC selects the target neighborhoods, publicizes the program and helps potential borrowers prepare applications which are then forwarded to participating financial institutions. Lenders are responsible for underwriting the loan and appraising the property which is to be rehabilitated.

A second component of the program is a subsidized interest rate. The subsidy is four percent which during the summer of 1978 reduced the market interest rate from 10-10½% to 6%. The funds for the interest subsidy are provided by investing the loan default fund in long term securities and short term certificates of deposit. The city deposits \$278,000 in the default fund per \$1 million of loans. \$200,000 of the deposit is invested in securities and \$78,000 in certificates. The earnings from these two investments are used to capitalize the interest subsidy fund.

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As of September 1978, 7600 application requests had been received. 4200 applications had been processed and 2700 had been approved. The average loan was \$3,400. The average household income of the borrowers was within \$2 of the median income of the city. Thirty percent of the households receiving loans had an annual income of below \$13,840.

The Philadelphia Purchase and Home Improvement Loan Guarantee Assistance Program (PHILGAP) is a loan insurance effort designed to encourage financial institutions to make conventional financing available in "higher-risk areas" by insuring the top 25% of mortgages on existing homes.<sup>4</sup> Applicants must be owner-occupants of single-family or duplex properties. The maximum loan eligible for PHILGAP is \$20,000.

The PHILGAP insurance fund was capitalized in 1977 by a \$500,000 grant from the William Penn Foundation and \$500,000 from the City of Philadelphia's Community Development Block Grant allocation.

The City of Hoboken has undertaken a multi-family rehabilitation effort which includes a loan insurance component and an interest rate subsidy.<sup>5</sup> Through its Tenement Rehab Program, the city insures twenty percent of the loans made to owners of large apartment buildings in selected neighborhoods for the purpose of rehabilitation. An interest rate subsidy of four-to-five percent is also

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provided to reduce the total cost of rehabilitation.

In order to insure that rehabilitation projects are successful, the city assists property owners in the preparation of design plans, cash flow statements and the selection of contractors. The program staff, interest rate subsidy fund and mortgage insurance fund are financed by a CDBG allocation and a grant from the Urban Reinvestment Task Force. By leveraging private credit and providing technical assistance, the Tenement Rehab Program has made possible the rehabilitation of twelve apartment buildings containing 55 units.

The New York City Rehabilitation Mortgage Insurance Corporation (REMIC) is a public benefit corporation which also provides loan insurance for multi-family buildings in designated areas.<sup>6</sup> REMIC insures twenty percent of each approved loan which is used to purchase property or re-finance an existing mortgage. Ninety percent of each rehabilitation loan is insured by REMIC, provided that ninety percent of the loan does not exceed fifty percent of the total cost of rehabilitation.

As of August 1978, REMIC had issued insurance commitments in the amount of \$9.3 million which had leveraged the extension of \$19.4 million in loans. REMIC has been actively insuring loans for two years, without incurring any delinquencies.

Although REMIC was initially capitalized by a grant from the City of New York, it has become self-supporting through insurance premiums and the return on its investments.

*Loan Purchase Programs*

Another device for reducing lenders' risk in extending mortgage credit is through the establishment of loan purchase programs. Such strategies have been utilized by state housing finance agencies to stimulate private reinvestment. However, until the establishment of the Chicago Mortgage Purchase Program in June 1978, there were no loan purchase programs created by local governments.

The Chicago program involves the purchase of mortgages which are originated in the city of Chicago by First Federal Savings and Loan Association.<sup>7</sup> The mortgages are purchased by the city with proceeds derived from the sale of tax-exempt municipal revenue bonds. The principal and interest due on the bonds will be retired by the mortgage payments of the households which receive mortgages under the program. Theoretically the bond holders will incur all losses associated with defaulted mortgages. Their risk, however, will be minimized through the use of private mortgage insurance, prudent underwriting standards and a mortgage reserve fund. First Federal will not incur any financial exposure in extending the mortgages, but will receive origination and servicing fees.

The program is primarily directed toward enticing middle income households to purchase property in the city. E. Stanley Enlund, chairman of First Federal, has established that the maximum mortgage loan will be about \$80,000 and that downpayments of 5% or 10% of the purchase price will be required.<sup>8</sup> The program calls for a \$40,000 limit on the adjusted family income of borrowers. The income ceiling was added to deter speculators and wealthy residents from exhausting the funds derived from the bond sale.

A significant feature of the program is an interest rate subsidy. As of June 1978, First Federal's interest rate for single-family mortgages at 80% of purchase price was 10%. First Federal and the City of Chicago have agreed that mortgages which the city will purchase with the proceeds from the August, 1978 revenue bond sale will have an interest rate of 7.99%. The reduced rate amounts to savings in interest payments of \$100 per month during the first year of mortgage of \$60,000. Proponents of the program suggest that the subsidy will attract buyers into the city who previously were only considering suburban homes.

The City of Denver has developed a mortgage purchase program which is, in part, based on the Chicago effort.<sup>9</sup> Denver has issued a \$50 million municipal revenue bond to capitalize a fund to purchase low-interest mortgages originated in the city by Midland Savings. The city will purchase

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mortgages extended to mortgagors whose adjusted annual family income is \$20,000 or less. The mortgages will have an interest rate which is 2-3% below the market rate. Structures to be purchased with the loan proceeds can be either single-family or contain two-to-four units. At least 75% of the mortgages purchased must be secured by single-family properties.

Denver's Office of Policy Analysis contends that the program will benefit the city by increasing the availability of financing thereby making homeownership possible for more people particularly moderate income families.<sup>10</sup> Secondly, the low-interest loans will decrease the cost of Denver housing and make it more competitive with suburban housing. Other positive impacts cited include increasing the assessed valuation of the city and stimulating the home construction and rehabilitation industries.

Potential negative factors are considered to be added inflationary pressures and a diminution of the rental housing supply due to condominium conversions. Despite these costs, the Office of Policy Analysis believes that the program will provide a significant net benefit for Denver.

The Urban Redevelopment Authority of Pittsburgh has designed a reinvestment strategy which involves an interest rate subsidy and a home improvement loan purchase program.<sup>11</sup> A group of three banks and ten savings and loan associations

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have agreed to make home improvement loans throughout the city at below market rates to low and moderate income home buyers. The loans will be available at a maximum of 8% to middle income borrowers with an annual household income less than \$25,000. Loans with a 3% interest rate will be made to borrowers with income under \$13,750.

The Redevelopment Authority will purchase loans with the proceeds of the sale of \$10.9 million in revenue bonds, and \$3 million in Community Development Block Grant funds. Originating lenders will service the loans on behalf of the Authority for \$2.25 per loan per month.

Like the Chicago program, the principal and interest due on the bonds will be secured by the loan repayments of the borrowers and a lien on the property which is improved. The bonds are further secured by the fact that the loans are 90% insured by the Federal Housing Administration (FHA). If a borrower defaults on a loan, FHA will reimburse the mortgage holder, in effect, the bondholder, for 90% of the loan amount.

An interesting twist to this program is that participating financial institutions have agreed to buy back the loans from the Redevelopment Authority which have been in default for 180 days. These loans will be repurchased for 90% of their value.

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*Direct Lending By Local Governments*

Direct lending is a mechanism which has been employed by some local governments to increase the supply of credit for home improvement loans and, in some cases, for mortgage loans. Although such programs do provide needed credit to certain neighborhoods, they are not considered effective devices for leveraging private sector lending.

Unlike the leveraging programs discussed previously, publicly administered lending programs do not provide opportunities for private lenders to underwrite and service loans on an individual basis. Consequently lenders fail to learn, by personal experience, that older neighborhoods do not necessarily represent imprudent environments for extending credit.

Direct lending programs are usually capitalized with funds acquired through the sale of municipal revenue bonds, loans from commercial banks, or Community Development Block Grants.

One example of a direct lending effort is the rehabilitation loan program established by the City of Dayton, Ohio.<sup>12</sup> Through this program, moderate income homeowners are able to obtain loans which are 90% guaranteed by the Federal Housing Administration (Title I). The loans are provided with a subsidized interest rate of 2%.

The city obtained the capital for the program by

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borrowing from local banks at a reduced interest rate, using the FHA-insured loans as security. Financial institutions are usually willing to extend credit to municipal corporations at attractive interest rates because the interest derived from such loans is tax-exempt. If a lender is willing to lend to a city at the rate of 5%, then the money can be extended by the city at 6% and 1% can be retained to cover administrative costs.

Portsmouth, Virginia developed a rehabilitation loan program in 1973.<sup>13</sup> Like similar programs in other cities, the effort was initiated in response to the city's inability to obtain a sufficient supply of funds from the Section 312 loan program. The Portsmouth program was capitalized through the sale of \$500,000 of revenue bonds to a consortium of local lenders. The loans have been granted to residents of target neighborhoods.

#### *Direct Grants*

Another device which has been used by some cities to stimulate private lending has been the establishment of public grant programs combined with private loans to finance individual housing purchases or improvements by moderate income homebuyers or property owners.

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In Pittsburgh the Urban Redevelopment Authority administers an innovative program designed to stimulate private investment and new construction of single-family homes in moderate income neighborhoods which were designated as urban renewal areas.<sup>14</sup> The Redevelopment Authority, in conjunction with Equibank, and several developers, has established a market for new housing opportunities among low and moderate income families. According to Richard Paternoster, former planning director of Pittsburgh, the market was created by making the cost of such housing affordable, with downpayments as low as \$640.<sup>15</sup> The city pays the difference between the actual cost of the unit and the amount the buyer pays through a value established by the city and the bank. The estimated fair market value for each unit has always been lower than the construction cost incurred by the developer.

As of December, 1976, the average subsidy per unit was \$13,000 which, according to Paternoster, raised the eyebrows of some local officials. Paternoster defends the high cost of the program by responding that it is an appropriate mechanism for promoting community development and equity stakes for moderate income families rather than enforcing the dependency of traditional social welfare efforts.

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He considers the program to be a public investment necessary to sell publicly owned land, to cause taxable development to occur, and to bring economic vitality back to these neighborhoods.

In addition the program encourages financial institutions to extend credit to moderate income homebuyers where lenders have been reluctant to extend credit. The high per unit cost of the program, however, may make its adoption prohibitive for most local governments.

The City of Chicago has established a grant/loan program to assist owners of multi-unit properties citywide.<sup>16</sup> The city provides a grant for half the cost of rehabilitation, up to \$250,000 for approved properties. To be eligible, the property owner must hold clear title and obtain a firm commitment for the financing of the remaining 50% of the rehabilitation cost. The owner must also demonstrate that the property can be operated on a financially viable basis once it is rehabilitated. As of May, 1978, nine projects, comprising 169 units had been approved. Applications for 107 other projects had been received.

The city capitalized the 50/50 program with an allocation of \$1,250,000 from third year CDBG funds. The program is projected to receive \$3.5 million from year IV CDBG funds.

*Footnotes*

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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.

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For more information, contact Patrick Nash, Vice President, Chicago Services and Research Corporation, Seven South Dearborn, Chicago, IL. 60603.

3

For more information contact Dan Boyce, Director, Homeowner Maintenance Assistance Program; (414) 278-2671.

4

For more information contact Roberta Waterson, Director, The Philadelphia Purchase and Home Improvement Loan Guarantee Assistance Program, 11th Floor, City Hall Annex, Philadelphia, PA. 19107; (215) MU6-7068.

5

For more information contact S. Kenneth Pai, Director of Planning and Economic Development, 84 Washington Street, Hoboken, New Jersey 07030.

6

For more information contact New York City Rehabilitation Mortgage Insurance Corporation, 71 Broadway, New York, N.Y., 10006; (212) 425-9351.

7

For more information contact Clark Burris, Comptroller, City of Chicago, 121 N. LaSalle Street-Suite 501, Chicago, Illinois, 60602; (312) 744-7100. Also contact E. Stanley Enlund, Chairman, First Federal Savings and Loan Association of Chicago, One South Dearborn, Chicago, Illinois; (312) 346-3500.

8

Statement made by E. Stanley Enlund during press conference announcing the program, June, 1978.

9

For more information contact John P. Hall, Senior Policy Analyst, Office of Policy Analysis, City and County of Denver, Suite 4A, 1313 Tremont Place, Denver, Colorado, 80204; (303) 575-5701. Also see *Midland Federal Savings And Loan Association and City and County of Denver - Origination and Service Agreement*, August 1, 1978.

10

City and County of Denver, Office of Policy Analysis, *Report On The Midland Federal Savings And Loan Association Proposal To The City And County Of Denver For The Proposed Issuance Of \$50 Million In Development Revenue Bonds For Housing Purposes For Low-And Moderate-Income Persons And families In The City And County Of Denver*; August, 1978.

11

For more information contact Peter Ponne, Finance Administrator, Urban Redevelopment Authority, City of Pittsburgh, 200 Ross Street, Pittsburgh, PA. 15219. Also see the following bond prospectus: *Urban Redevelopment Authority of Pittsburgh, Home Improvement Loan Bonds*, 1978, Series A, July 20, 1978.

12

For more information contact Department of Urban Development, Division of Redevelopment, 824 E. 15th Street, Dayton, Ohio 45402.

13

For more information contact Portsmouth Redevelopment and Housing Authority, P.O.Box 1098, Portsmouth, Virginia 23705.

14

For more information contact Peter Ponne. See note 11.

15

Robert Pasternoster, "Pittsburgh Subsidizes New Home Mortgages", *Practicing Planner*, December, 1977, pp.40-42.

16

The description of the Chicago grant/loan program is based, in part, on Pat Rosenbaum, *Neighborhood Rehabilitation in Chicago*, 1978. For more information contact City of Chicago Department of Planning, City and Community Development, 201 N. LaSalle Street, Room 1000, City Hall, Chicago, Illinois 60602.

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SUPPORTIVE STRATEGIES FOR LOCAL PLANNERS*Introduction*

Loan guarantees, mortgage purchase programs, and interest rate subsidies may not be sufficient incentives to attract lenders into extending conventional credit to residents of some older neighborhoods. Some financial institutions may also request or insist upon the establishment of support programs to be funded and/or administered by local governments. These programs may include homeownership counseling services; rent referral and management services; code enforcement; equity guarantees; and special capital improvement efforts. Even if lenders do not insist upon the creation of such programs, local planners may find that their establishment may encourage reluctant lenders to participate in neighborhood reinvestment efforts.

*Homeownership Counseling*

Many lenders insist on the development of homeownership counseling programs as a necessary first step before they will participate in reinvestment strategies for moderate income homeowners. The residents for whom such programs are designed are inexperienced about obtaining or repaying mortgages, or maintaining a home. Consequently lenders view services which counsel such households favorably. From the lender's perspective, a competent counseling program can be an effective risk-hedging device which will avert delinquencies.

A report by the Washington, D. C. Commission on Residential Mortgage Investments described the value of homeownership counseling in the following manner.

*Effective counseling can help combat the misconceptions of potential borrowers and lenders by explaining the loan process; sending a program assistant with the family on visits to the lending institution; helping in the preparation of the loan application; and resolving communication problems. Counseling is most effective when it is performed prior to the actual home purchase, so that the benefits and responsibilities of homeownership can be fully understood. Counseling at this stage can help a family avoid the struggles of delinquency.<sup>1</sup>*

Local governments can establish counseling programs or contract with private agencies to provide the services. In Washington, D.C., a city-wide counseling service has been proposed which would offer the following services: pre-purchase and delinquency counseling; group homeownership education sessions; and information and communication services to match housing with prospective homebuyers.<sup>2</sup>

Many counseling programs only provide services to clients who are voluntarily seeking counseling. Some programs, however, service clients who have applied or desire to apply to special mortgage or home improvement loan programs which require pre-purchase counseling. For example, households which desire to acquire a loan through the Chicago Home Mortgage Purchase and Rehabilitation Program must receive counseling from the staff of one of the City of Chicago's Community Service Centers.

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Planners should be aware of lenders' preference for publicly supported counseling programs when designing reinvestment efforts intended to service moderate income households. Counseling services are relatively inexpensive and may be able to avert problems with loan repayment and home maintenance.

*Rent Referral and Management Services*

Rent referral and multi-family housing management programs are significant services which local governments can provide or support to stimulate private reinvestment in older neighborhoods. Services provided by such programs include tenant and landlord referral services, management support services for multi-family landlords, and assistance for tenant organizations and block clubs.

The role of local government in organizing and operating housing centers has ranged from establishing programs as appendages of existing agencies to providing financial support to privately operated, not-for-profit centers.

The Housing Resource Center of Chicago's Uptown Center Hull House is an example of a housing referral and management center which receives local government support.<sup>3</sup> One of the Center's programs is a tenant-landlord clearinghouse effort designed to match good tenants with good landlords. Tenants are recruited, screened and referred to properties which have been certified by the Center's staff of inspectors.

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In order to be certified, a property must pass an annual inspection, which includes a detailed survey of the building's physical plant and interviews with current tenants. The Center also provides certified property owners with management and technical assistance services.

As a result of participating in the Housing Resource Center's programs, a number of landlords have made substantial improvements on their properties, while some have decided to retain ownership of buildings they had considered selling.

*Code Enforcement*

A sensitive code enforcement program is a significant support service which local planners can implement to encourage lenders to extend credit in neighborhoods characterized by a high proportion of older, multi-family properties. Many lenders are reluctant to grant loans to owners of single-family and smaller multi-family buildings in these neighborhoods. They fear that the decline of large apartment buildings will adversely affect the marketability of the neighborhood, thereby threatening the value of the properties which serve as the security for their loans.

An effective code enforcement program can help to insure that properties are maintained in reasonable condition. However, planners responsible for managing such a program must realize that code enforcement without concomitant rehabilitation loan/grant programs to finance required improvements may cause housing abandonment.<sup>4</sup> Code enforcement

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programs which are inflexible may cause owners to decide that it is more profitable to walk away from their buildings rather than make the repairs required by local inspectors. In some cases, the owners of buildings in violation of the local housing code are maximizing short-term profits and have no intention of maintaining their properties. However, many owners who find their buildings plagued with serious violations are inexperienced entrepreneurs troubled by severe cash flow problems. These struggling landlords lack capital or the ability to acquire credit to make required improvements. Such entrepreneurs can often be helped through technical and financial assistance from local governments.

Designers and managers of code enforcement programs should not only be sensitive to the financial condition of property owners, but they must also be sensible about distinguishing between serious and minor violations. There are a few local housing codes which, if enforced to the letter, would not yield minor violations on nearly every property.

*Equity Guarantee Program*

An equity guarantee program is a strategy which can be used by planners to minimize lenders' concern about threats to the value of single-family property which serves as the security for loans granted in older neighborhoods.

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This is particularly true in the case of neighborhoods which are undergoing racial change or are adjacent to such areas. In order to attract lenders to extend credit in these areas, they must be assured that in the event of a foreclosure they will not be faced with a situation where the unpaid balance of the loan is greater than the market value of the property.

An equity assurance program insures property owners and lenders against a decline in the market value of single-family property. The program is predicated on the assumption that by providing lenders and property owners with assurance that their property values will be protected, there will be a continuing private market for housing and available credit which will insure a reasonable appreciation of property values. Consequently there will be no need to make claims against the insurance fund.

Equity insurance can be provided either by a private insurance company or by a governmental entity using property tax revenues, bonding authority, and/or state or federal grants. If the insurance is provided by private insurance carriers, planners can play a significant role by assisting in the development, marketing and monitoring of the program.

In a community with an equity assurance program, any eligible homeowner who wished to secure equity assurance is required to have his or her property appraised in order to establish the value of the home. The insurance program would provide

compensation to the owner or the mortgagee for the difference between the sale price of the house and the appraised value. The insurance might cover the full loss or might pay a percentage of the loss, such as 80%. For example, if the appraised value of a home was \$30,000 and it was sold for \$27,000, the equity assurance program might pay the seller \$2,400, or 80% of the difference between \$30,000 and \$27,000. Thus, the seller would lose \$600 instead of \$3,000.

Since the purpose of an equity guarantee effort is to contribute to neighborhood stabilization, a specified time period might be required after the insurance is obtained before the guarantee could be activated. In order to insure that the homeowner would take full advantage of the normal market mechanism to sell the house at maximum price, the program might include a waiting period from the time the home is placed on the market until the guarantee is determined to be necessary and is paid. To prevent abuse, equity assurance policies might include the condition that the insurance benefits would not compensate the homeowner for loss due to the homeowner's own negligence or lack of maintenance.

A municipally-sponsored equity assurance plan became operational in the Village of Oak Park, Illinois, during 1978.<sup>4</sup> Since Oak Park is on the border of Chicago's Austin neighborhood, which had experienced serious housing abandonment and deterioration, many observers had predicted that Oak Park would experience significant deterioration during the late 1970's. In an effort to bolster residents' confidence in

the future of Oak Park, the equity assurance program was created.

The purpose of the program is described by the following excerpt from the village's application for Federal assistance.

*The Equity Assurance Program is an attempt to deal with fear - specifically, economic fear - that when non-whites integrate a community, property values will decrease. This fear is not necessarily based on fact, but on a pre-conceived notion that this is true ... To put it simply, if one can insure his home against various physical perils, and do so quite routinely, one ought to be able to insure it against economic perils as well. This concept is especially significant because, although loss through physical perils may cause difficulties to the person who experiences it, it is generally an isolated loss with relatively little effect on the rest of the community. Economic perils, on the other hand, whether real or illusory, have a "ripple" effect through a community, causing extreme instability.<sup>5</sup>*

The Oak Park Equity Assurance Plan was authorized in a municipal ordinance, which also created a property tax levy to support a reserve insurance fund. In addition to the tax levy, the reserve fund includes a contribution of \$20,000 from the Urban Reinvestment Task Force. Operating expenses will be supported by a portion of the interest earned on the reserve fund and by a \$15 charge to participating taxpayers. Start up costs for the plan have been provided by a municipal appropriation and by a grant from the Ford Foundation.

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Participation in the Equity Assurance Plan is available to owner-occupants of detached single-family dwellings who make application and pay a \$90 fee, which includes a \$75 appraisal charge. The village has selected three appraisal firms which have had experience with appraising property in Oak Park to appraise all properties.

Reappraisals are permitted once every twelve months to permit adjustments to the initial appraisal because of inflation, increased market value, or home improvements. The cost of reappraisals sought because of home improvements are shared by the village and homeowners. Homeowners bear the cost of reappraisals sought to adjust for inflation or increased market value.

In order to limit the plan to protection against declining market values because of local factors, an amendment to the ordinance specified that in the event of national economic decline, the Village Board reserves the right to review, revise and suspend payouts.

Participating homeowners cannot file for claims until five years after they had been accepted by the program. After that time, in order to obtain claims, homeowners must have had the property on the market for 120 days, at least 90 of which the property must have had been listed with a member of the local real estate board or a multiple listing service with coverage in the local market.

As of July, 1978, applications had not yet been taken for Oak Park's Equity Assurance Plan. Therefore, it is difficult to predict its success. Local real estate brokers, however, view the plan as stimulating the demand for housing and believe that because of it, they will be able to convince undecided purchasers to buy a home in Oak Park by offering equity assurance as a guarantee on their investment. Lenders should also react favorably, since they are virtually assured of obtaining their loan repayment when a property is re-sold, because the plan insures that participating homeowners will receive a minimum of 80% of their purchase price. Some mild opposition has come from citizens who believe that by implementing the plan, the village will conjure up fears of declining property values. These citizens indicate that although the program might have been useful several years ago, it is not needed now.

*Capital Improvements*

Traditional techniques for upgrading of specific neighborhoods through concentrated capital improvements and enhanced city services can play an important role both directly and indirectly to leverage private credit and capital. The allocation of capital improvements to an inner city neighborhood is a good indication to the lending community that the local government maintains confidence in the future of the area and considers it worthy of investment of limited public funds. Although local planners have often

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used capital improvements as an incentive for attracting private developers and lenders to invest in downtown redevelopment sites and industrial urban renewal areas, until recently, only a few local governments have employed such strategies to attract lenders to extend housing credit in older suburban and inner city neighborhoods.

A significant local effort which uses capital improvements to leverage private lending is the Neighborhood Housing Services program (NHS).<sup>6</sup> The sponsor of NHS is the Urban Reinvestment Task Force which is composed of representatives from the six federal financial institution regulatory agencies and the U.S. Department of Housing and Urban Development. The Task Force selects target neighborhoods and provides local NHS programs with technical and financial assistance. The local NHS, however, is responsible for generating most of its operating budget from local public and private sources. As of July, 1978, there were 56 NHS programs operating in 47 cities.

In reviewing requests for the establishment of NHS programs, the Task Force applies the following criteria for selecting a target neighborhood:

1. Basically sound housing structures showing early signs of lack of maintenance and deterioration.
2. Difficulty obtaining mortgages and home improvement loans.
3. A substantial number of owner-occupied structures (greater than 50%).

4. Distinct boundaries with a stable anchor on one or two boundaries.
5. An area large enough to stimulate the imagination of those who must invest their energy and funds but small enough to permit an early visible success (1,000 - 2,000 structures).
6. Median income no less than 80% of the city-wide median.
7. Average repair costs not in excess of \$5,000.<sup>7</sup>

Once the target area is selected, a Board of Directors is selected. The directors include lenders, local public officials and neighborhood residents. Local government's role in the NHS partnership is to provide needed public capital improvements, adequate public services, appropriate planning and zoning services, and a sensitive code compliance program. Once NHS secures this commitment from the city, it then encourages local lenders to agree to grant all bankable loans in the target neighborhood. In many cities, NHS programs have been successful in leveraging private money with public commitments and then using the leveraged private investment to secure a second round of public commitment.

The NHS program in St. Louis provides an illustration of the effective use of publicly financed capital improvements to leverage private credit into a neighborhood. The City of St. Louis has supported NHS activities in the local target neighborhood by providing \$240,000 in new street, curbs and sidewalks (1977-78); and \$47,200 in street resurfacing (1976-77).

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In response, 33 local financial institutions have contributed to the NHS operating fund and have made a commitment to grant all bankable loans in the area.<sup>8</sup>

In areas without NHS programs, public planners can attempt to develop public/private partnerships through direct negotiations with local lenders. Such efforts can maximize the impact of limited public funds invested in declining neighborhoods by leveraging private credit.

*City Services*

Just as capital expenditures can be used to develop lender confidence in neighborhoods, city services can be targeted to a specific neighborhood to accomplish the same goal. Such services include snow removal, police and fire services, trash removal, street cleaning, removal of abandoned cars, housing code enforcement, and tree trimming and other maintenance efforts.

The provision of increased city services as a leveraging technique is effective because both existing and potential residents of a neighborhood, as well as lenders, view the level of city services as an important indicator of local government's confidence in the neighborhood's future. Some residents assume that the diminution of local services is an early warning signal that their neighborhood is declining. Certain residents will attempt to take political action to secure more services, but many will leave the community

for neighborhoods which are able to secure a higher standard of services. As indicated by the following quotation from Robert Lineberry, people who are in the market for housing tend to avoid areas with a reputation for inadequate services.

Several economists have developed a theoretical model of residential location choice...that assumes that location decisions are a function of citizen evaluation of packages of taxes and services offered by various communities. Tiebout suggests the following:

Consider the case of the city resident about to move...What variables will influence his choice of a municipality (or a neighborhood)? If he has children, a high level of expenditures on schools may be important. Another person may prefer a community with a (public) golf course. The availability and quality of such facilities as beaches, parks, police protection, roads, and parking facilities<sup>9</sup> will enter into the decision-making process...

If a neighborhood becomes unattractive in the marketplace due to poor local services, then local lending institutions will become concerned about the security of their loans and will begin to restrict the supply of conventional credit. In some cases, however, the withdrawal of conventional credit has been the catalyst for, rather than the effect of, the restriction of local services and household decisions to avoid a certain area.

Elmder Young, Jr., a Senior Vice-President of Philadelphia's First Pennsylvania Bank, which participates in the Philadelphia Mortgage Plan, indicated in the following comment the consideration some lenders give to local government services

when determining the security of lending in a given block or neighborhood.

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 and moderate income neighborhoods as in more affluent areas. With all due respect to local governments, this is sometimes not the case, and the Philadelphia Mortgage Plan makes it a point, in evaluating a block, to determine that it has not been abandoned by its city servants and city workers as well as by some of its inhabitants.<sup>10</sup>

By insuring that the level of city services in a neighborhood is sufficient, public planners can provide assurances to local lenders that city hall has not written off the neighborhood.

#### *Urban Development Action Grants*

In response to the creation of the Urban Development Action Grant Program (UDAG), a number of local governments have created strategies to leverage private capital and credit into inner city neighborhoods. UDAG funds are made available to "severely distressed cities and urban counties to help alleviate physical and economic deterioration through reclamation of neighborhoods plagued by excessive housing abandonment or deterioration, and through community revitalization in areas with population outmigration or a stagnating or declining tax base".<sup>11</sup> One of the major criteria used by HUD in approving UDAG grants is the nature and extend of financial participation by private entities in proposed projects.

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The City of Birmingham, Alabama, will use its UDAG grant to provide capital improvements which include the resurfacing of streets, traffic flow improvements, and additional infrastructure necessary to support a high-rise apartment complex for the elderly, a low-rise complex for families and a rehabilitation effort.<sup>12</sup> The city will also construct a police precinct station and a nursing home. Private funds committed to the project involve \$10.1 million. Public funds include the \$1.1 million Action Grant and \$1.7 million from the local government.

Bridgeport, Connecticut, has been awarded an Action Grant to make grants to homeowners for housing rehabilitation.<sup>13</sup> The city will use \$696,000 in UDAG funds to cover 20% of the cost of rehabilitation, up to \$2,000. Private financial institutions have committed \$2.6 million in the form of loans to cover the remaining cost of rehabilitation. \$171,000 in Community Development Block Grant funds will be used for administrative costs.

Newark, New Jersey, has received an Action Grant to support a program similar to the Bridgeport home improvement effort.<sup>14</sup> UDAG funds will be used to give homeowners in eight neighborhoods a 20% rebate on the cost of home improvements up to \$20,000. If homeowners use Newark based contractors, they will receive an additional rebate of 5%. The program will be made possible by a commitment of \$8.5 million in home improvement loans by five Newark financial institutions.

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Another city which will use UDAG funds for neighborhood housing revitalization is Jersey City, New Jersey.<sup>15</sup> Jersey City will engage in a combined housing rehabilitation and new construction project that will produce 600 units, 400 of them for moderate income families. Private developers will acquire and rehabilitate 300 units, 200 of which will be for moderate income families. The city will also develop 300 units. The private sector commitment to this revitalization effort includes \$12 million for rehabilitation and \$8.2 million for new construction.

*Urban Homesteading*

Most of the reinvestment strategies and support programs discussed previously can be effective tools for stimulating private lending in older neighborhoods which have experienced deterioration, but appear to possess the potential for revitalization through the provision of private credit and public investment. Many planners, however, are confronted by the challenge of revitalizing neighborhoods characterized by high rates of property abandonment and tax delinquency.

Attracting private, conventional credit into such neighborhoods is perceived as an improbable, if not possible, task by some concerned planners and citizens. Most lenders view these neighborhoods as imprudent environments for extending credit. Even those lenders

who are committed to inner city reinvestment view blocks plagued by an abandonment rate of ten percent or more as unsound lending environments. Before substantial private investment can be attracted to such blocks, abandoned properties will have to be restored.

Urban homesteading is a program designed to return abandoned housing to the normal housing market. The first local homesteading program was established in 1973 by the City of Wilmington, Delaware.<sup>16</sup> Shortly thereafter, other cities, including Baltimore,<sup>17</sup> Philadelphia<sup>18</sup> and Newark, New Jersey<sup>19</sup>, established similar programs.

Through homesteading programs, local governments or quasi-governmental corporations purchase abandoned residential property and sell it for a token amount to purchasers who possess the resources to rehabilitate the structures. In order to promote neighborhood stability, the programs usually require the homesteaders to reside in their homes for a specified period, generally from three to five years.

Homesteading programs require substantial time and energy from local planners. The components of a typical program are: organization of the program; selection and acquisition of properties; marketing of the program, selection of homesteaders; matching homesteaders to available properties; providing financial and technical assistance to homesteaders; and assuring the provision

of needed municipal services to neighborhoods targeted by homesteading efforts.

One of the requirements for structure selection is that the municipality must be able to acquire title to the property before the property can be made available to homesteaders. Sponsoring municipalities have a number of methods available for acquiring title in properties:

(1) foreclosure on tax delinquent parcels; (2) public nuisance proceedings; (3) eminent domain proceeding (4) direct purchase; and (5) acquisition of title from HUD on properties it has acquired through foreclosure and FHA-insured mortgages. Acquiring title to properties through foreclosure on tax delinquent parcels has been the traditional method of acquiring structures for urban homesteading. However, this process usually takes considerable time.

Homesteading may consist of individuals or groups such as not-for-profit housing development corporations and neighborhood coalitions. In New York City, for example, "sweat equity" homesteading projects have been undertaken by several groups, including the People's Development Corporation and the Eleventh Street Movement. People's Development Corporation is active in the South Bronx and the Eleventh Street Movement is operating on the Lower East Side.<sup>20</sup> Most

cities have used different selection criteria for organizations than they have used to select individuals for homesteading programs.

The minimum eligibility requirements for individual applicants vary widely among homesteading programs. Some cities carefully evaluate and select homesteaders on the basis of their perceived financial ability, while other cities permit applicants to determine whether they can handle the responsibilities of rehabilitation and home ownership. Applicants possessing building tradeskills and craftsmanship ability are usually considered favorably.

Once a pool of eligible homesteaders is created, families must be matched to particular properties. Some municipalities actually perform this matching in order to insure that homesteaders will not be required to undertake rehabilitation programs beyond their resources, while others permit any eligible homesteaders to bid on properties which are available for homesteading. Some of these bidding procedures take the form of a lottery, others an auction.

Most municipalities have undertaken basic clean-up and securing of the homestead properties in order to insure that the property will not deteriorate before occupancy takes place. But additional municipal services may be needed, ranging from treatment for rat infestation and lead paint to general upgrading of municipal services in the area surrounding the homestead property.

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Securing financing for the rehabilitation of homestead properties has not been an easy task due to the reluctance of lenders to extend credit at risk in areas plagued by abandoned homes.

Baltimore established the Residential Environmental Assistance Loan Program in 1972 to provide rehabilitation loans to homesteaders.<sup>21</sup> The program was capitalized by a \$3 million bond issue. Loans are granted at an interest rate of 6% for 20 years in amounts up to \$17,400.

The homesteading program in Philadelphia has secured financing from the Urban Homesteading Finance Corporation.<sup>22</sup> The Finance Corporation provides short-term financing in the form of six month, 6% rehabilitation loans to homesteaders. Long term financing can be secured from the Pennsylvania Housing Finance Agency at 3 to 7% interest for terms of five to fifteen years.

Wilmington, Delaware is prevented by state constitution from using public funds to improve private property.<sup>23</sup> Consequently, the city has developed an agreement with eight local lenders to provide financing to homesteaders. Each institution has made a commitment to grant three loans annually on homestead properties. The loans are partially guaranteed by the city and feature a reduced interest rate.

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*Preventing Abandonment Through  
Acquisition and Revitalization of Tax Delinquent Property*

Investigation of the relationship between housing abandonment and tax delinquency has indicated that there is a positive correlation between multi-family property which is tax delinquent for two or more years, and property abandonment.<sup>24</sup> Once taxes become delinquent for two or more successive years, there is a high probability that such property will be abandoned within five years unless local government intervenes. In order to save properties from abandonment, planners should develop tax delinquency indicators to serve as early warning signals that certain multi-family buildings are in trouble.

There is often a considerable quantity of tax delinquent property in deteriorated neighborhoods. Among multi-family residential structures, there are two common causes of tax delinquency. In many cases, insufficient rental income causes property owners to defer tax payments until their cash flow improves. A second cause of delinquency is the property owner who desires to maximize short term profits by deferring maintenance and refusing to pay taxes.

Regardless of the cause, abandonment rapidly reduces the marketability of a neighborhood and restricts residents' access to conventional credit. To maintain a neighborhood's attractiveness, strategies should be developed by local governments to acquire tax-delinquent properties from owners who are

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maximizing short term profit at the expense of the surrounding neighborhood. Owners who are not necessarily milking their properties, but who are unable to provide necessary improvements, should be provided with management counseling or referred to potential buyers who could manage the properties in a prudent and profitable manner.

In most municipalities, the disposition of tax delinquent property is governed by statutes which follow a similar sequence, with some variations among jurisdictions. This sequence begins with a period during which back taxes may be repaid with interest by the owner. Following a specified period of time, the property is sold for back taxes to a third party with a subsequent period during which the previous owner may redeem the property. The tax sale is accomplished by means of an auction at which the minimum acceptable bid is usually the amount of the back taxes, penalties, and costs related to the sale. If no acceptable bid is made, as is often the case with multi-family properties in deteriorated neighborhoods, the title remains in the hands of the original owner, and the taxes remain unpaid. After a specified period of time, the property is foreclosed. The property then reverts to the city because few private parties want to take title, especially after an extended period of delinquency during which the property has experienced considerable vandalism.

In many communities, this system is an ineffective method for preventing neighborhood disinvestment and deterioration due to abandonment. First, multi-family property on sale

for taxes is not very attractive to potential buyers since debts secured by the property (i.e., mortgages and mechanics' liens) are transferred along with the title and become obligations of the new owner. Second, properties which are not sold early in the delinquency cycle become less likely to be purchased in successive years, since each year adds another year's worth of back taxes to the major rehabilitation, which discourages potential bidders who do not want to commit themselves to an extensive investment, particularly in those communities which do not have tax abatement programs for multi-family rehabilitation.

One strategy which may be an effective mechanism for breaking the vicious cycle of tax delinquency, abandonment and demolition is the creation of a public agency to acquire and resell tax delinquency property. Such a strategy has been proposed for the city of Chicago by TRUST, Inc., a local civic group.<sup>25</sup> TRUST's proposal calls for the establishment of a Land Reutilization Commission to serve as a bridge between private sector actors in the transfer of tax delinquent property. This Commission would have several purposes: one would be to bring delinquent property back on the tax rolls; a second would be to encourage the transfer of delinquent property to an owner who is willing to rehabilitate and manage the property in a responsible manner; a third would be to stabilize the neighborhood in which the delinquent property is located in order to discourage further delinquency; a fourth would be to demonstrate to lenders that

the neighborhood is viable and that credit extended to neighborhood residents is a prudent risk.

Two states, Missouri and Ohio, have enacted legislation authorizing the creation of Land Reutilization Authorities (LRA).<sup>26</sup> The Missouri statute, which was passed in 1971, only authorizes the city of St. Louis to establish an LRA. The Ohio statute, however, permits all municipalities to establish such an authority.

The St. Louis Land Reutilization Authority is directed by a three member board appointed by elected city officials. The goal of the authority is to acquire tax delinquent parcels and return them to the tax rolls. At the annual sheriff's sale, each delinquent parcel is auctioned to the highest bidder, subject to the requirement that the minimum bid be enough to pay back taxes, penalties and the cost of administration. If any parcel is offered for sale on three different days and no bid is received, the St. Louis LRA is assumed to have title to the property. Titles transferred to the LRA are free and clear of all liens. The Cleveland land revitalization effort is assumed to have title to a tax delinquent parcel after two unsuccessful auctions provided that the property is determined to be non-productive. A nonproductive property is either devoid of structures or is occupied by one or more structures which are both unoccupied and condemned by the city.

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The St. Louis and Cleveland efforts both have discretion to hold property, to convert property to public use and to sell property to private developers with or without competitive bidding. If the reutilization agencies are able to acquire and recycle tax delinquent, multi-family property, then many neighborhoods may be restored as prudent environments for extending credit.

*Financial Institution Regulators:  
Facilitators for Stimulating Private Reinvestment*

Securing financial institution participation in a reinvestment program can be a difficult task for planners unless they understand the operation of financial institutions and are respected by the local lending community. If planners are unable to leverage the participation of the local lending industry through the provision of risk hedging devices and support strategies previously discussed, then financial institution regulators may be of invaluable assistance.

Since the 1930's, commercial banks and savings and loan associations have been highly regulated by state and Federal governments.<sup>27</sup> The determination of which level of government supervises a financial institution is dependent upon whether the institution is a savings and loan association or a commercial bank, and whether it is state or federally-chartered. A federally chartered savings and loan association is regulated by the Federal Home Loan Bank Board and its deposits are insured by the Federal Savings and Loan Insurance

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Corporation (FSLIC). Commercial banks which are federally-chartered are regulated by the Comptroller of the Currency and insured by the Federal Deposit Insurance Corporation (FDIC). State-chartered savings and loan associations are supervised by a state savings and loan commissioner and are insured by the FSLIC. Commercial banks with state charters are regulated by a state bank commissioner and and are insured by the FDIC. Commercial banks which are members of the Federal Reserve System are also regulated by the Federal Reserve Board.

One of the most important functions of a regulatory agency from a reinvestment perspective is the authority to approve or disapprove applications by financial institutions seeking to engage in structural changes. Such changes include the opening of a new branch office, the extension of deposit insurance, the merger of two institutions, or the relocation of a banking facility.

As a result of Title VIII (Community Reinvestment) of the Housing and Community Development Act of 1977, Federal regulatory agencies must consider community responsive lending as a criterion in evaluating applications for structural change.<sup>28</sup> If an institution is not attempting to meet the credit needs of all segments of its community in a prudent manner, then its application will be negatively affected.

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Pursuant to this legislation, each financial institution is required to prepare a Community Reinvestment Act (CRA) statement for each community which the institution serves. Each CRA statement must include the delineation of the primary service area. It must also include a list of specific types of credit which the institution is prepared to extend within the local community. In addition, each statement must describe how the institution's efforts, including *special credit-related programs*, help to meet community credit needs.

As a result of the implementation of the Community Reinvestment Act, financial institutions should be looking for opportunities to participate in public/private programs which will help them fulfill their obligation to serve the credit needs of their communities. Planners should check with state and Federal regulators for a list of institutions desiring to participate in such efforts. In exchange for participation, public agencies should be willing to submit favorable testimony to regulators when participating institutions are subjected to credit performance reviews.

Regulators also influence the lending industry through the establishment of acceptable standards for the underwriting of loans and the appraisal of property. A few state and Federal agencies have recently revised underwriting and appraisal standards in an effort to eliminate practices which are allegedly discriminatory in effect against certain neighborhoods. If a planner encounters an underwriting or

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appraisal practice which disadvantages a neighborhood he or she serves, then the management of the particular lending institution should be approached. If a reasonable response is not received from the lender, then the appropriate regulatory agency could be approached. However, in light of CRA and growing industry sensitivity to inner city lending, the involvement of regulators will probably be unnecessary.

One of the most significant problems in moderate-income neighborhoods is the relocation of lending facilities to moderate-and upper-income areas. This often leaves the neighborhood without any access to conventional credit. The Department of Savings and Loan of the State of California is one of the state regulatory agencies which is attempting to mitigate this problem.<sup>29</sup>

State-chartered associations requesting the relocation of an existing facility are required to file a Neighborhood Impact Statement with the Department of Savings and Loan. This statement must describe the characteristics of the facility's existing area; the geographical sources of the facility's deposits in the existing area; the geographic distribution of mortgage loans in the existing area during the last three years, and most importantly, how the existing area will continue to be served after the change of location is made.

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The California Savings and Loan Commissioners reviews the NIS and holds public hearings to determine whether the relocation will promote reinvestment or aggravate disinvestment. If the relocation will restrict the flow of credit into the area currently served by the facility, then the commissioner may reject the applications.

Planners in California desiring to avert the closing of a lending facility are able to cooperate with the Commissioner to insure that the positive effect of a publicly initiated investment effort is not ameliorated by the disinvestment of a private financial institution. Planners in other states can also consult with regulatory officials to insure that relocations do not have a deleterious effect on older neighborhoods.

*Footnotes*

1

D.C. Commission on Residential Mortgage Investment, *Strategy For Change: Housing Finance in Washington, D.C.* (Washington, D.C.: Government of The District of Columbia, Commission on Residential Mortgage Investment), 1977, p. 62.

2

*Ibid.*

3

Housing Resource Center of The Uptown Center-Hull House Association, 4520 N. Beacon, Chicago, Ill., 60640, (312) 561-1350.

4

Many of the local rehabilitation finance programs established in the late 1960's were designed to finance the elimination of code violations.

5

Village of Oak Park, Illinois, Application for Federal Assistance, Department of Housing and Urban Development, Innovative Projects Proposal- FY76, July 1, 1976, p.4.

6

For additional information concerning the Neighborhood Housing Services effort, contact the Urban Reinvestment Task Force, Suite 600, 1120 19th Street, N.W., Washington, D.C., 20036 (202) 634-1689

7

Urban Reinvestment Task Force, "Neighborhood Housing Services" (May 7, 1974), p.2.

8

Erica Pascal, "Neighborhood Housing Services Programs As Instruments of Reinvestment" (Chicago: Woodstock Institute, 1977), p.9.

9

Robert L. Lineberry, "Mandating Urban Equality: The Distribution of Municipal Public Services", *Texas Law Review* (December 1974), p.27, footnote 10.

10

Statement of Elmer Young, Jr., Senior Vice-President, Corporate Responsibility, First Pennsylvania Corporation and Bank, Philadelphia, Pennsylvania.

11

*The Housing and Community Development Act of 1977*, Public Law 95128, 42USC 5318, Section 119 (a).

12

Bureau of National Affairs, *Housing and Development Reporter*, "Current Developments, " "HUD's Description of Urban Development Action Grants to be Funded", pp.1154-1157.

13

*Ibid.*

14

*Ibid.*

15

*Ibid.*

16

The Wilmington Homesteading Program is administered by the city's urban renewal office. For more information, see James W, Hughes and Kenneth D. Beakly, Jr., *Urban Homesteading* (New Brunswick, New Jersey: The Center for Urban Policy Research - Rutgers University, 1975)

17

For a description of the Baltimore program, see *Homesteading: The Third Year - 1976*, available from the Department of Housing and Community Development, Homeownership Development Program, Baltimore, Maryland.

18

An analysis of the Philadelphia effort is provided by Hughes and Beakly (see note 16).

19

The Newark program is also described in the Hughes and Beakly book (see note 16).

20

For more information, contact Eleventh Street Movement, 519 E. 11th Street, New York, N.Y., 10009.

21

*Supra.*, note 16, pp. 96-97.

22

*Ibid.*, pp. 142-144.

23

*Ibid.*, pp. 115-118.

24

For confirmation of this point, see George Sternlieb, *The Tenement Landlord Revisited*, (New Brunswick, New Jersey: The Center for Urban Policy Research, Rutgers University).

25

Trust, *Urban Neighborhoods: An Action Report on The Impact of Tax Assessment and Tax Delinquency Policies* (April, 1978).

26

The discussion of Land Reutilization Authorities is based on Arthur Lyons, *Taxation As A Strategy To Encourage Reinvestment*, (Chicago: Woodstock Institute, 1977).

27

For a description of the responsibilities of state and federal regulators, contact the appropriate regional or state offices.

28

*The Housing and Community Development Act of 1977*, Public Law 95128, Title VIII, "Community Reinvestment". For final regulations, see the *Federal Register*, part V, 47144-47155, October 12, 1978.

STATE STRATEGIES FOR STIMULATING  
PRIVATE REINVESTMENT INITIATIVES

*Capital Investments*

In most Northeastern and North Central states, the withdrawal of private investment from certain older neighborhoods has been accompanied by a significant growth in the investment of private resources in developing communities on the periphery of metropolitan areas. These new communities, in turn, have drawn middle-income families, commercial and industrial employers, and retail stores from the inner core of metropolitan areas.<sup>1</sup>

Many lenders view neighborhoods which have experienced such losses as unattractive environments for extending long-term credit. They assume that such areas will inevitably decline as middle-income families continue to migrate to newly developed communities with homogeneous populations. Often this assumption becomes a self-fulfilling prophecy.

Although many urban observers have viewed the metropolitan development process solely as a *private* sector response to authentic market demand, some have suggested that the public sector makes this development process possible through the provision of capital investments.<sup>2</sup>

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Most analysts who recognize the public role in the development process have limited their analysis to the federal government's role as facilitator of suburban development. Usually the federal government is criticized for blindly promoting suburban development at the expense of neighborhoods through the provision of FHA-mortgage insurance and highway construction grants. Few development observers, however, have realized the state's role in fueling exurban development.

Publicly financed sewer systems, roads and highways are essential infrastructure required to make a development possible. Although these development facilitators are primarily financed by federal funds, states play a critical role by establishing priority lists for sewer and highway projects. In Massachusetts, for example, the top priority until recently has been to support, if not create, new growth in exurban areas. Maintenance of deteriorating inner city infrastructure was an underfunded secondary priority.

In response to a debate about the impact of highways on private, exurban development, the Illinois Department of Transportation (IDOT) examined the impact of a highway constructed through farmland on the fringe of the Chicago metropolitan area. IDOT's staff gave the following summary report of their findings.

A 13.5 mile freeway link opened to traffic in 1974 cost the state and local governments \$ 8.5 million (\$85 million, total cost)

Two years later, commercial and industrial development that had occurred since the highway construction began was measured at just three of the seven interchanges along the route. That development is valued at \$195 million, making a ratio of state and local investment to private investment 1:23.

Constructed predominately through farmland on the suburban fringe, the facility involved virtually no dislocation of existing development. Further, IDOT staff believe that of the total development, at least \$90 million in industrial development can be traced to plants that have moved-out from the central city [of Chicago].<sup>3</sup>

During 1975, the Office of State Planning (OSP) of the Commonwealth of Massachusetts was charged by Governor Michael Dukakis with the responsibility of developing a statewide strategy to facilitate private reinvestment in older cities and towns. OSP prepared a document, *Towards a Growth Policy for Massachusetts*, which analyzed the role of the state in facilitating private investment in exurban centers.<sup>4</sup>

The essential question which the report raised was "Should state agencies be responding to privately induced demand or should private sector development activity occur within the context defined by the public sector?" On the basis of an analysis of several agencies of the Commonwealth, OSP concluded that state administrators had viewed their proper role as responding to demand *induced* by the private sector. Agency administrators had provided sewers, highways,

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and other infrastructure investments which served as corridors for new development on the metropolitan fringe at the expense of existing urban centers.

According to OSP, these practices were the result of a failure to consider the adverse impacts of exurban growth, and a lack of coordination among agency administrators concerning a state growth policy sensitive to the needs of urban centers. In response to these findings, Governor Dukakis initiated a cabinet level, Commonwealth-wide planning process to insure that his administration did not continue the past practices of inducing growth which pulled human and economic resources from urban neighborhoods.

Although the shaping of private sector growth by public planning is a controversial political issue, the Massachusetts Development Cabinet has made some difficult decisions. For example, a dispute arose over the siting of a proposed shopping center in the western part of the Commonwealth which was likely to serve as a magnet for additional commercial and housing development. One possible site for the shopping center was downtown Pittsfield, an existing urban center that had expressed an interest in becoming the commercial center for that part of the state. The developer preferred to construct the facility

on the periphery of Lenox, which would have caused a drain on that community's downtown shopping district. As the *National Journal* reported, the state's message to the developer was clear. "If you proceed with the Lenox site, there will be no access to the state highway. Forget about your development. We just won't permit it".<sup>5</sup>

The state of Michigan has also realized the need for a development cabinet. In 1977, Governor William G. Milliken established an Urban Action Group charged with several responsibilities, including the analysis of existing state programs affecting urban areas.<sup>6</sup>

One of the recommendations of the Action Group was the creation of an interdepartmental development cabinet to coordinate on an ongoing basis the state's overall urban policy, and to develop a rational, comprehensive state-wide capital investment strategy. The need for the development cabinet strategy was articulated by the Action Group in the following manner:

*Sewer and water locations are determined by the Department of Natural Resources. Highway routes are set by the Department of State Highways and Transportation .... Since the decisions concerning these capital investments are spread among various departments, any consistent state strategy is more a result of coincidence than conscious design .... The essential element [of neighborhood reinvestment and revitalization] must be an effective growth management policy. Rather than allow continued haphazard development, the cabinet should take an active role in determining when and where public infrastructure investments will be funded.*<sup>7</sup>

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The state of California has also adopted an Urban Development Policy with the primary objective of renewing and maintaining existing urban areas, both cities and suburbs. <sup>8</sup> One of the mechanisms for implementing this policy is a balanced state capital investment program which will first meet the needs of existing communities and, secondly, service new development in conformance with public objectives.

The California Urban Policy emphasizes that government alone cannot solve urban problems. It calls for a partnership between the public and private sectors to reverse haphazard exurban growth patterns and to invest in neighborhoods cooperatively.

The potential of the state planning process for leveraging private credit into older neighborhoods through balanced growth planning and prudent investment of needed capital expenditures is immense. Such initiatives can play an important role in reversing the development pattern which drains city neighborhoods and builds up exurban communities. Without such efforts, some neighborhoods will continue to lose their diverse economic bases, and will remain unable to maintain themselves by attracting private credit.

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*State Housing Finance Agencies*

Planners working for state government can also tailor the programs of state housing finance agencies to facilitate reinvestment. Over three-fourths of the states in the U.S. have established state housing finance agencies (HFA). Traditionally the most significant function of an HFA has been the granting of construction and permanent loans to developers of low-and moderate-income housing.<sup>9</sup> However, many states have passed enabling legislation to permit the following HFA activities: loan insurance programs; purchase of single-family and rehabilitation loans originated by private lenders; and provision of loans to lenders for the granting of mortgages to residents of designated neighborhoods or to moderate-income families.

Housing finance agencies raise capital for programmatic endeavors through the sale of tax-exempt bonds. HFA's are able to compete for capital with higher yield private investments because their bondholders do not pay Federal income tax on the interest they receive. HFA bonds are generally not secured by the pledge of the full faith and credit of the state. They are usually secured by the moral obligation of the state, by a reserve fund, or by mortgages.

Two state housing finance agencies which have been active in facilitating private reinvestment in older neighborhoods are the Maryland Housing Fund and the New Jersey Mortgage Finance Agency (NJMFA).

In 1971 the General Assembly of the State of Maryland authorized the Baltimore Housing Fund to establish a Baltimore City Mortgage Insurance Program.<sup>10</sup> The following statement from the enabling legislation underscores the reinvestment focus of the program.

*It is generally recognized that the flow of mortgage funds to help build suburban areas and so-called redlining practices have led dramatically to the decline of home ownership in central cities ... The purpose of the pilot program is to demonstrate, through innovative efforts to stimulate the flow of mortgage funds by insuring qualified lending institutions against loss, that economic and social vitality can be restored in our large urban centers.*

The pilot program offers 100% insurance for mortgages granted by private lenders. Mortgages covered by the insurance must have a minimum downpayment of \$500. If a borrower defaults on a mortgage and foreclosure is required, then the lender is reimbursed by the Housing Fund for any loss incurred.

As of June, 1977, 467 mortgages had been insured by the Housing Fund with a foreclosure rate of 1.9%. 46% of the mortgages had been insured by buyers who have made downpayments of \$500 or less. The average maturity of the loans insured by the Fund is two and one-half years, while some loans have been outstanding for five years.<sup>12</sup>

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Nathan S. Betnun of the Maryland Department of Housing and Economic Development, which administers the Baltimore Fund, has stated that as a result of the relatively low foreclosure rate, some lenders have begun to make mortgages with only private mortgage insurance coverage in neighborhoods previously perceived to be unsound lending environments.<sup>13</sup> If Betnun's observation is accurate, the Pilot Program is a model example of how a public agency can gradually encourage private lenders to extend credit in older neighborhoods without public subsidy or loan guarantees.

The New Jersey Mortgage Finance Agency (NJMFA) established a Neighborhood Loan Program in April, 1977.<sup>14</sup> The goal of the program is to encourage private investment in New Jersey cities by lowering interest rates, removing the risk to lending institutions, and encouraging municipal investment in eligible neighborhoods. The program involves a commitment by NJMFA to purchase mortgages originated by private lenders for the purchase of one-to-four family housing units in eligible neighborhoods. The Agency's staff determines which neighborhoods are eligible by reviewing census data and mortgage lending activity within individual neighborhoods. Once the staff has decided that a neighborhood is not receiving sufficient financing, a determination will be made concerning the prudence of granting mortgages to neighborhood residents.

In examining the neighborhoods, the Agency looks at such factors as median family income, present level of home ownership, condition of housing stock, number of single-family dwellings, existence of concerned community groups, and the likelihood that adequate municipal services will be maintained.

To insure the quality of mortgages granted under the program, NJMFA attempts to provide homeownership counseling services to potential borrowers in eligible neighborhoods. The program staff also actively promotes the mortgage effort through aggressive marketing to inform residents of the availability of mortgage credit.

As of May 22, 1978, the Neighborhood Loan Program's portfolio included 976 mortgages with an aggregate value of \$26,139,289. The mortgages had a 7½% interest rate and a minimum term of thirty years. The portfolio included conventional mortgages and mortgages insured by either the Veterans Administration or the Federal Housing Administration. The program had a delinquency rate of 0.5% and only one loan in foreclosure. If the foreclosure is consummated, the Agency anticipates only a nominal loss since the property can be resold.<sup>15</sup>

The New Jersey Mortgage Finance Agency has also established a Home Improvement Loan Program (HIP).<sup>16</sup> The goal of this program is to stimulate the repair and improvement of one-to-four family homes and the installation of energy savings measures. HIP will attempt to accomplish this goal by purchasing FHA-insured Title I home improvement loans which are granted by private lenders to low-and moderate-income households. The loans will be granted at an interest rate of 7 3/4%. They will be underwritten and closed by participating lenders and then sold to NJMFA. Lending institutions will receive an origination fee of \$75 per loan. According to NJMFA, the major incentives to lenders are the ability to increase their loan volume and to attract deposits from HIP loan recipients who may not currently utilize the institution's services. The agency has accepted commitments from 49 lending institutions to originate home improvement loans with a total value of \$8,715,000 during the first year of the program.<sup>17</sup>

Although HIP is a state-wide program with no geographic restrictions, it does have an urban emphasis. The staff visualizes the program working in tandem with many urban county and municipal home improvement and neighborhood development programs funded by Federal Community Development Block Grants.

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Two housing finance agencies which have established similar programs are the Minnesota State Housing Finance Agency<sup>18</sup> and the Michigan Housing Development Authority.<sup>19</sup> The Minnesota program was established in August, 1975. The program has averaged approximately 7,000 loans per year valued at \$30 million. Like the New Jersey program, loans are originated by financial institutions and sold to the housing finance agency. As of June 1978, the program had not experienced a default. The Michigan program, which is modeled on the Minnesota effort, will become fully operational during the third quarter of 1978.

Another vehicle which is used by the New Jersey Mortgage Finance Agency and nine other state housing finance agencies is the loans to lenders program.<sup>20</sup> The New Jersey effort has been described as the model for loans to lenders programs.<sup>21</sup> The New Jersey program provides low interest loans to mortgage lending institutions with the requirement that the proceeds be used for residential housing. The agency sets the interest rate which can be charged on the loans originated with these funds and requires that the loans be granted within nine months of receiving the funds.

In an attempt to stimulate inner city lending, NJMFA has created two options for lenders participating in the loans to lenders program. Under Plan A, lenders are permitted to charge the maximum interest rate established by the agency. However, under Plan B, in which participants agree to make mortgages in credit deficient areas, lenders can charge an additional .25% above the interest ceiling.

The Illinois Housing Development Authority's (IHDA) loans to lenders program also attempts to target loans to urban neighborhoods by requiring that participating lenders use the proceeds of IDHA loans to make new residential mortgages within the institution's primary service area (PSA).<sup>22</sup> The PSA is defined as the region composed of "contiguous zip code areas within the state where 60% of the deposits of the lending institution originate" or "such other areas agreed upon by IDHA and the lending institutions."<sup>23</sup> A lending institution which uses the proceeds of the IDHA loans to originate mortgages outside its PSA would be disqualified from the program.

*Selective Depositing of Public Funds*

Another state strategy which can be used to encourage neighborhood reinvestment is the selective depositing of public funds.

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State governments routinely deposit funds with financial institutions for varying time periods. The depositing of funds is advantageous to governmental entities and financial institutions. State governments receive an interest on the funds they deposit while financial institutions use the funds to make high-yield, short-term investments.

Although planners generally do not serve as treasurers or work as staff in treasurers' offices, they may desire to influence the allocation of public deposits in order to stimulate the flow of housing credit into older neighborhoods. Planners can work with treasurers to use a financial institution's overall credit performance in older neighborhoods or their participation in a publicly-sponsored revitalization effort, as a criterion for allocating deposits. By leveraging the extension of private credit in neighborhoods with public deposits, planners can stretch the limited community development and housing rehabilitation funds which their agencies administer.

There are two types of public deposits: demand and time. Demand deposits are placed in accounts equivalent to consumer checking accounts. These accounts are used to pay the government's bills and payroll, and to provide for other daily financial needs. This type of account is awarded to the financial institution which is able to provide the most efficient service. These funds are usually deposited with large commercial banks.

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Time deposits are funds which are placed with a financial institution for extended time periods. Some funds may be deposited for 30 or 90 days, while other funds are deposited for one year or more. Time deposits are usually placed on a competitive basis, based on the interest rate which financial institutions are willing to pay on these deposits.

In recent years a few government entities have begun to deposit public funds with financial institutions which have extended credit for certain purposes and to certain groups of borrowers which traditionally have suffered from inadequate access to credit. Some governments have selectively deposited funds with institutions which grant small business and farm loans, mortgage loans to city residents, or credit to women and minorities.

In 1968 the State Treasurer of Illinois developed the first formal depository effort linked to an institution's performance in extending credits which the treasurer considered to be needed for economic and social development.<sup>24</sup> The Illinois Treasurer established four funds, two of which are administered according to the linked-deposit concept. The other two funds are administered in a manner which provides the maximum rate of return and insures an even geographic spread of state funds.

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One of the linked-deposit efforts is the Illinois Specific Opportunity Program which encourages financial institutions to participate in the financing of particular public projects. For example, when the state was in danger of losing \$95 million of federally subsidized housing because interim financing could not be obtained, the state treasurer persuaded a group of commercial banks to supply the needed financing. In exchange, the banks received an allocation of state funds for deposit. Deposits have also been used to leverage the purchase of government bonds, student loans and small business loans.

The Community Service Program is the other Illinois fund which uses a linked-deposit concept. Unlike the Specific Opportunity Program, however, it rewards financial institutions for their *past* history of involvement in community service oriented loans. Loans which are viewed favorably include loans to community development corporations, FHA and VA-insured residential financing, loans insured by the Small Business Administration and student loans.

Illinois depositories must pledge not to reject arbitrarily mortgage loans for residential properties within any specific part of the communities they serve because of the location of the property. They must also make a commitment to grant loans for the construction and/or purchase of low- and moderate-income property throughout their service areas within the limits of legal and prudent financial practices.

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A Ford Foundation funded analysis of these two depository programs concluded that they had encouraged financial institutions to become more community-oriented. In addition, the study found that the linked-deposit system had brought a reasonable rate of return to the state.<sup>25</sup>

The State Treasurer of Colorado instituted a linked-deposit program in 1975 which encourages the extension of loans considered beneficial to Colorado's economy.<sup>26</sup>

Funds of the state of Colorado which are available for time deposits are placed in two ways. Short-term time deposits (less than one year) are placed with those institutions which offer to pay the highest interest rate. Long-term time deposits (one year or more) are also placed on an interest rate bid basis. The interest rate offered, however, is adjusted upward by the treasurer if the institution has extended a higher than average volume of loans which the treasurer considers necessary to stimulate economic and social development.

A commercial bank's interest rate offer for long-term time deposits is increased if it has originated a higher dollar amount of loans in the following categories than the average commercial bank in its region: student and small business loans; agricultural loans; loans for low cost and older homes; loans insured by the Small Business Administration; and loans granted to minority group members and women. A savings and loan association's interest rate offer is increased if it has originated a higher than average volume of low cost

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single-family housing loans, older single-family housing loans and low cost multi-family housing loans.

As indicated in the 1976 annual report of the Colorado State Treasury, the Colorado linked-deposit program has rewarded those financial institutions which had provided a substantial amount of credit for housing, business and agricultural development within the state of Colorado. The report contends that although, in some cases, the interest received by the state was lower than would have been received if the funds were placed at the highest available rate, the flow of credit into certain communities should eventually generate additional state revenues through the tax system. More importantly, however, the job opportunities created through the extension of such credits may reduce state expenditures for welfare and unemployment benefits. Selective depositing strategies can also be utilized by local governments to encourage urban lending.

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THE PLANNER'S ROLE IN ENHANCING  
REINVESTMENT EFFORTS INITIATED BY THE PRIVATE SECTOR

*Introduction*

Many practicing planners were trained at a time when graduate planning schools did not offer extensive courses on the operation and role of financial institutions in urban development. Even today, planning students must often look outside of graduate planning offerings to find courses on banking and private sector finance. While it is encouraging that more planners than ever are availing themselves of the opportunity to learn about the private sector as part of their preparation to administer planning programs for public agencies, the need for such knowledge is increasing rapidly.

Today at the Federal level substantial emphasis is being placed upon including in applications for public funds an indication of how these funds will be used in combination with private sector capital and credit. This chapter has been included to give the practicing planner an indication of how some private sector institutions are trying to serve as catalysts for neighborhood revitalization, and the ways in which public agencies have enhanced these efforts.

Two things should be noted about the examples which follow. First, they have been selected primarily because they

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set new standards of performance for the financial institutions industry. To this extent, the institutions discussed below are breaking new ground and are *not* representative. This leads to the second comment. It is fair to say that most local financial institutions with which the planner must work are not engaged in efforts to revitalize their communities to the extent that the institutions cited below are trying to do. This does not mean, however, that other institutions cannot be persuaded by well informed planners to play a more active role in neighborhood revitalization. It is simply an indication of the fact that many of those engaged in lending, like many professional planners, are trying to adjust to a new era in which their institutions are being held more accountable for their performance in reinvesting their resources in older, racially changing, minority and low-income communities.

The examples discussed below range from a commercial bank which was purchased by a group of investors for the express purpose of trying to use it as a catalyst for neighborhood renewal to the more familiar concept of several financial institutions working together through a not-for-profit development corporation to accomplish redevelopment which individual institutions by themselves would be unable to accomplish.

Each of the brief case studies will attempt to discuss the extent to which the programs have been aided, frustrated or largely ignored by the public sector. The reason for including this information is to provide the planner with some indication of how he/she might stimulate or enhance such programs in their own community.

*South Shore Bank: Chicago, Illinois*

Since 1973 when a group of investors purchased the South Shore Bank on the south side of Chicago, attention has focused on this unique institution. Like any other commercial bank, South Shore is operated for profit. And yet, there is a difference: namely, the bank's management is charged by its stockholders with using a portion of the bank's earnings to increase the resources available to rebuild the neighborhood in which it is located. The philosophy of the investing group was summarized in the Bank's 1976 Annual Report as follows:

*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.<sup>1</sup>*

South Shore is a neighborhood 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. 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 received 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.<sup>2</sup>

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

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as a fellow at the Adlai Stevenson Insitute 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." <sup>3</sup>

To test his hypothesis, he formed the Illinois Neighborhood Development Corporation (INDC) as a bank holding company to purchase the South Shore National Bank. 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.

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.

By the end of last year, South Shore Bank had assets of more than \$65 million dollars. Almost one-third of its total loan portfolio, or some \$10.2 million, was invested in its immediate neighborhood. During 1977, the Bank approved 70% of the applications it received for mortgages on single-family homes in its community. Recognizing that its community needs various kinds of credit to survive, the Bank also has made a concentrated effort to increase all types of lending in South Shore. Figure 1 summarizes the Bank's development lending through the end of 1977 by category.

*Figure 1*

"Development Loans Outstanding 12/31/77"

| <i>Category of Loan</i>             | <i>#</i> | <i>Outstanding Balance</i> |
|-------------------------------------|----------|----------------------------|
| Small Business                      | 72       | \$ 962,045                 |
| Community Organization              | 14       | 134,103                    |
| Mortgages (single and multi-family) | 286      | 6,895,773                  |
| Home Improvement                    | 251      | 822,000                    |
| Education                           | 637      | 1,083,411                  |
| Development/personal                | 121      | 376,702                    |
| TOTALS                              | 1,381    | \$10,274,034               |

SOURCE: The South Shore National Bank of Chicago, *1977 Annual Report and Neighborhood Development Audit*, p. 9.

While it is difficult to quantify the impacts that the availability of credit has on a community, it is possible to indicate that there has been substantial price appreciation

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in the single-family homes in the community. During the decade ending in 1977, there has been 57% price appreciation for single-family homes in South Shore. While this figure must be used with caution due to the general impact of inflation during this same period, it is a hopeful sign since the community had moved from white to black by the early 1970's and since it was totally redlined until new management bought the bank in 1973.<sup>4</sup>

Another positive impact which is particularly important to public policymakers is the decrease in tax delinquency on large, multi-family buildings. In the 31-square block area of the community where the bank has concentrated most of its multi-family rehabilitation and mortgage lending, for example, there were no new tax delinquencies in 1977.

To date, the role of the public sector in encouraging the Bank's activities has been modest but important. Since one of South Shore Bank's biggest problems is the large number of low-balance accounts that it must service for residents in the community, the depositing of public funds in the bank by the City of Chicago and government agencies has been helpful. In addition to some City and Chicago Board of Education deposits, the Illinois Treasurer and the Illinois Housing Development Authority maintain certificates of deposit at the Bank.

In the area of single-family housing, two City of

Chicago Departments are assisting the Bank in rehabilitating nine HUD-owned and abandoned townhouses. The City Department of Human Services has provided a staff grant to the neighborhood organization which is spearheading the project, and the City Department of Urban Renewal made an interest-free interim construction loan of \$155,000 for the project. The Bank has provided technical assistance to the community organization and stands ready to finance the purchase of creditworthy borrowers of the rehabilitated dwellings at \$22,000 per unit.

The City of Chicago has designated a portion of its Community Development funds for a "50-50 Rehabilitation Program." Using these funds, a developer can be reimbursed for up to one-half of the cost of doing multi-family rehabilitation. During 1977, a 30-unit apartment building in South Shore was rehabilitated using a grant of \$91,000 from the city's program coupled with a Bank loan of \$219,000 and developer equity of \$30,000. Largely as a result of the savings realized in rehabilitation costs by combining public and private resources, the cost of rehabilitation of the units was held to approximately \$4,500, and average rents had to be increased by only \$60 per month.

Since South Shore is intersected by three major commercial shopping strips, the deterioration of these areas has been of major concern to the Bank and community residents. For the first time since the Community Development Block Grant program became operative, the city designated the

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major commercial strip in the community as part of its community development planning process. While it is still not clear what this will mean in terms of public improvements or grants for the renewal of this shopping area, the fact that the strip is now part of the "official" area of concern for the City has increased private developer confidence in its future.

As the Bank learned during 1977, in some areas public decisions *not* to do certain things are as important as specific improvement programs. The Bank contributed staff time and its mass mailing capability to assist community groups in a campaign to prevent the Chicago Park District from demolishing a complex of buildings once used as an exclusive country club. The community wanted the Park District which now owns the club to convert the structures into an entertainment, conference center and museum complex. After more than a year of holding public hearings, the Park District announced that this valuable community amenity would be refurbished rather than demolished.

Finally, in its 1977 annual report, the Bank announced that the Assessor for the County of Cook -- in which Chicago is located -- had lowered property taxes on twenty-two resident owned multi-family buildings. This important action by the County will have the effect of increasing the cash flow on these distressed properties, and probably will keep them from becoming further deteriorated and eventually abandoned.

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*Philadelphia Mortgage Plan: Philadelphia, Pennsylvania*<sup>5</sup>

The Philadelphia Mortgage Plan (PMP) is a program involving fourteen financial institutions which have agreed that they will each make conventional mortgage credit available in inner-city Philadelphia. PMP was initiated in October, 1975 by two commercial banks and one mutual savings bank. The need for PMP was suggested by an organization known as the *Greater Philadelphia Partnership*. The partnership, consisting of 26 civic and business leaders, was established in 1974 to "seek fresh solutions to specific urban and regional problems".<sup>6</sup>

Perhaps the most interesting thing about the Partnership is that soon after serving as the catalyst to establish a Neighborhood Housing Services Program<sup>7</sup> in Philadelphia during 1975, it went on to suggest the need for PMP to serve *non-NHS* neighborhoods. The Partnership, it should be noted, was helped to this conclusion by the negative reactions of residents in areas not chosen to participate in the NHS program. In fact, May Long, formerly PMP Coordinator, said in 1977 that, "In view of (non-NHS) community spokesmen, the NHS commitment on the part of Philadelphia lenders was merely a token effort; there was no reason why banks could not stimulate residential reinvestment throughout *all* neighborhoods of Philadelphia".<sup>8</sup>

PMP was the product of meetings between representatives of these disaffected communities and the leadership from

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two commercial banks and one mutual savings bank. Throughout the discussions leading up to the announcement of PMP, the community leaders stressed the need for lenders to reform the appraisal and underwriting standards used *throughout* the city. They especially were vehement about avoiding any plan that would lead to the establishment of lending "quotas" for their neighborhoods.

A second important factor which influenced the flexibility of the lenders in the discussions with neighborhood representatives was the shifting legislative climate at both the state and federal levels which favored the passage of laws to curb mortgage redlining. James F. Bodine, president of one of the commercial banks -- First Pennsylvania -- that helped devise PMP, said in announcing the plan in October, 1975: "It (PMP) is an answer to (charges of redlining). It didn't come up that way, but if the banks didn't do this, we would have been legislated into doing it".<sup>9</sup>

The heart of PMP is the agreement of participating lenders to revise their loan underwriting standards on a permanent basis. This led to substantial changes in evaluating both the potential borrower and the subject property. PMP institutions agreed, for example, that they would consider the income of co-mortgagors (usually, but not always, a working spouse) *and* they agreed to consider public assistance payments as income. To further demonstrate their willingness to make mortgages to persons receiving public assistance,

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and to help such persons budget their income, the lenders established a twice monthly mortgage payment which coincided with the arrival of assistance payments.

On the property underwriting side, the PMP plan changed two well-established lender practices. First, the lenders agreed to make mortgages of less than \$15,000. Prior to that time, most lenders would not grant a mortgage on property with a sale price of less than this amount. Due to the depressed market for properties in much of Philadelphia, therefore, the effect of this rule of thumb was that no mortgages were written in the city.

The second major property underwriting modification had to do with appraisal practices. Prior to the initiation of PMP, appraisers considered the entire neighborhood surrounding the subject property in determining its current market value. Since few inner-city neighborhoods were *completely* free of blight, appraisers frequently reported that subject properties were worth far less than the price for which they were selling. The effect of this practice was to force a potential buyer to increase his or her downpayment substantially. In the event that the buyer could not do so, the lender refused to grant a mortgage.

PMP lenders insist that appraisers consider only the physical condition of the subject property and the condition of the immediate block on which the property is located. The purpose of this requirement is to force appraisers to dis-

regard negative factors which do not immediately affect the subject property. Not satisfied, perhaps, that appraisers would evaluate even the immediate block with sufficient objectivity, the PMP went so far as to suggest that appraisers regard the following criteria as *favorable* when appraising inner-city property:

- 1) Abandonment *and* vacancy rate of no more than 10% in 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. 10

The results of the PMP are interesting, not only because of the number of mortgages granted in areas previously considered too risky for conventional lending, but also because of the reactions of loan officers to this "new market". As of June 30, 1978, institutions participating in the PMP have granted 3,598 mortgages with an aggregate value of \$38,431,705. The current delinquency and foreclosure rates of 1.6 and .1 %, respectively, are not only acceptable, they are clearly lower than many loan officers expected when the PMP was initiated.<sup>11</sup> "When asked their reaction to

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PMP's results," reported May Long, "the overwhelming majority of mortgage officers expressed surprise at the success of the plan. They had not anticipated either the quality of properties or of applicants ..." 12

From the perspective of public officials who may be interested in trying to stimulate a PMP-type of program in their cities, it is worth noting that to date there has been no *direct* participation by the public sector in PMP.

One of the ways in which the City of Philadelphia eventually may be drawn into playing a direct role in the PMP is in addressing the needs of blocks which have an abandonment and vacancy rate of more than 10%. Since PMP underwriting guidelines establish this figure as a maximum for extending conventional credit, measures must be devised to lower the vacancy rate of these blocks. It is conceivable that a combination of Community Development Block Grant and Urban Development Action Grant funds could be used to address the most severely blighted blocks. At last report, "The PMP

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is encouraging the city to rehabilitate largely vacant blocks . . .". 13

*RESCORP: Chicago, Illinois*

In a recent interview, George Stone, assistant commissioner of Chicago's Department of Planning, City and Community Development noted that the public sector is limited in its ability to address the scale of housing problems in most cities. "It all goes back" said Stone, "to the fact that you can't rehab a whole city with public money. You have to get major private investment into rehabilitation." 14

What Stone did not say, but what is widely understood today, is that another essential component of any *comprehensive* housing rehabilitation scheme is attention to the needs of both single and multi-family buildings. In many cities, large apartment buildings are interspersed among single-family dwellings. Even when strategies to purchase and improve the single-family stock are employed, their ultimate success depends in large measure upon reversing the deterioration of the larger buildings. For this reason, the last two case studies of private sector initiatives in this chapter will focus on efforts to address the problems of multi-family buildings.

The Chicago Area Renewal Effort Services Corporation (RESCORP) has 52 savings and loan associations as share-

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holders. As the name suggests, the organization is a special type of corporation which savings associations are permitted to establish pursuant to the Housing Act of 1964 and subsequent regulations promulgated by the Federal Home Loan Bank Board (FHLBB) in 1970. An Association may establish its own service corporation, or as is the case with RESCORP, several associations may jointly own the corporation. Each association is permitted to invest up to 1% of its total assets in service corporations.

Savings and loan service corporations first became practical vehicles for the rehabilitation of inner-city housing after the FHLBB modified its regulations governing the permissible activities of these entities in 1970. Currently, service corporations are permitted to engage in the following kinds of activities; originating, servicing and retaining first mortgages on single and multi-family properties; development for sale or rental of unimproved or improved real estate; renovation, maintenance and management of rental properties; and, the formation of joint ventures with other corporations.<sup>15</sup>

In other words, these subsidiary corporations are permitted by law to make equity and debt investments that their parent corporations cannot. For this reason they are ideal instrumentalities for engaging in the range of activities necessary to address the problems of residential rehabilitation.

RESCORP's roots go back to 1971 when the president

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of a Chicago savings association persuaded the Federal Home Loan Bank of Chicago to undertake an effort to pull together savings and loan executives from the metropolitan area to explore how the industry could address problems of housing blight and deterioration in the city. The organization's status as a legal for-profit entity was recognized in January, 1972 by the Illinois Secretary of State. In order to draw in a larger number of shareholders -- and, in recognition of the fact that Chicago is an integral part of the metropolitan region -- RESCORP's chartered service area is the entire six-county, Chicago SMSA. To capitalize the corporation, associations throughout the metropolitan area who were willing to become shareholders were assessed one-hundreth of 1% of their assets.

By 1973, RESCORP had \$600,00 in capital, and a full-time staff. At its February meeting that year, its board adopted the following long-term goals for the organization:

- \* *To engage in actions relating to housing which aid in the solution of urban problems.*
- \* *To be a profitable venture but to define profit both in terms of the bottom line and the economic improvement in the community.*
- \* *To demonstrate and represent the collective concern of our shareholders and the savings industry as a whole for the urban condition.*
- \* *To act as a communication link or information conduit.*
- \* *To maintain high standards of quality.*

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- \* *To respect and involve the communities in which we work,*
  - \* *To act as a community catalyst.*
  - \* *To have the courage to innovate and the good sense to do things that work.*<sup>16</sup>

At the same meeting, it was agreed that the operational focus of the organization would be on doing rehabilitation "in those areas where trends are still reversible and where community stabilization can occur." In addition, the board expressed an interest in having RESCORP's activities serve to attract "new residents" to blighted areas in order to promote "a reversal of migration patterns."<sup>17</sup>

RESCORP's initial efforts have been concentrated in the same neighborhood which constitutes the primary service area of South Shore National Bank. The primary reason for choosing this area was that it met the impact criteria discussed above, e.g. while the neighborhood had undergone racial transition and was suffering the effects of disinvestment, it was in the relatively early stages of decline and could be turned around. Contributory factors that went into selecting South Shore may have been the fact that the Bank had been purchased by new community-oriented investors the previous year, and that Saul Klibanow, president and chief executive officer of RESCORP, had been a resident of the area and a leader in the local community organization.

The first project involved the complete rehabilitation

of 148 apartments located in five buildings within the same block. Using a \$3.3 million, below market-rate loan from the Illinois Housing Development Authority (IHDA) and a Section 236 federal rent subsidy commitment, the project was completed. It is now fully rented, and there is a waiting list for units. As of the end of June, 1978, approximately 27% of the tenants are paying market rentals (ranging from \$205 to \$329 per month), and the remaining are paying subsidized rents (from \$140 to \$279 per month). The racial composition of the project, called New Vistas I, is 95% black and 5% white.

The second phase of RESCORP's South Shore rehabilitation initiative, New Vistas II, reached sustaining occupancy (95%) on July 25, 1978. The project includes six buildings containing 154 units. Like New Vistas I, interim construction financing was obtained from IHDA. There are Section 8 subsidies available for 50% of the units in New Vistas II. Rents range from \$284 to \$447 per month, a testimony to the increase in construction costs which occurred between the time New Vistas I & II were started. Less than 2% of the units in the latter project are occupied by whites.

Plans are now completed for RESCORP to joint venture with an Hispanic not-for-profit development corporation to rehabilitate 160 units in six buildings on Chicago's northwest side. A letter of commitment for financing has been issued by IHDA, and a reservation for Section 8 subsidies for

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100% of the units has been obtained.<sup>18</sup>

In April, it was reported that RESCORP's board is so encouraged by its success to date that "it has set a production level goal of 1,000 dwelling units per year for the not-to-distant future."<sup>19</sup> In spite of this optimism, this innovative corporation must work continually at overcoming obstacles to production.

Two of these obstacles are related to possible public policy flaws at the local government level. Chicago, like virtually every other major city in the country, has no *rehabilitation code*. The practical effect of this is that developers who attempt to upgrade older, multi-family buildings must meet *new* construction standards. Not only does this mean that the costs of doing rehabilitation are higher, but it also imposes an element of uncertainty in preparing specifications and obtaining financing. If a developer, for example, plans to repair broken plaster walls and in the process actually opens the wall, he is obligated to then bring up to code everything (plumbing, electrical, etc.) that is behind the wall. This requirement applies even though the plumbing and electrical systems may be perfectly adequate from a safety and sanitation standpoint.

The second local public policy problem relates to the practice of reassessing property upward after rehabilitation. While there is an appeals procedure that owners can use to ameliorate the impacts of substantial upward

assessment following rehabilitation, it has been described by some developers as a form of "Russian roulette" since one can never calculate with certainty the degree of tax abatement that will be granted. This is a particularly troublesome failure of local public policy since officials are quick to admit that one of the primary benefits of multi-family rehabilitation is that "it stabilizes the tax base for a property which conceivably could have gone into abandonment and ended up in demolition in building court." 20

*The New York City Community Preservation  
Corporation: New York City*

The New York City Preservation Corporation (CPC) presents an interesting contrast to strategies mentioned previously in this chapter, because of the cooperation with and direct support of city officials since CPC's inception. CPC is a private, not-for-profit housing finance corporation. It was established in 1974 by a group of commercial banks and mutual savings banks. At the end of 1977, there were eleven commercial and 25 mutual savings banks participating in the organization.

CPC describes itself as an organization which is trying "to establish a new and realistic financing mechanism through which banking and other financial interests can be bought together with the government of New York City in an effort to preserve the housing stock of local neighborhoods." 21 CPC is a private sector initiative, but one that has tailored its approach to housing rehabilitation to mesh with

public priorities. Evidence of this can be found in the fact that CPC participating financial institutions have decided to concentrate their efforts in two neighborhoods which have been designated by the New York City Planning Commission as neighborhood preservation areas -- Crown Heights in Brooklyn and Washington Heights in Manhattan. The corporation's approach, states its descriptive literature, "reflects a belief that without action by landlords, tenants, financial institutions, and city agencies to rehabilitate still sound housing, deterioration will spread, and entire neighborhoods may be lost." <sup>22</sup>

While the CPC can provide financing for the rehabilitation of single-family (one-to-four units) dwellings and apartment buildings, its participating institutions seem to be aware of the need to finance enough units in one location to create a visible display of redevelopment. For this reason, like RESCORP, CPC's first project involved an 87 unit apartment building. This was followed by additional commitments totaling \$15 million of mortgage financing for the rehabilitation of 2,500 apartments.

In support of its emphasis on rehabilitation of multi-family buildings, the organization's 1977 *Annual Report* cited the following figures:

- \* 60% of our City's 2.2 million apartment units are in buildings more than 50 years old;
- \* 20-30,000 housing units are being lost annually to abandonment, fire and demolition;

- \* *the cost of moderate rehabilitation of an apartment building is \$5-10,000 per unit;*
- \* *today's costs of constructing a new apartment is \$50,000 per unit.* <sup>23</sup>

Given the fact that few financial institutions in the country acting on their own are willing even to finance multi-family rehabilitation, there is another interesting aspect to CPC: the stated intention of the corporation *not* to become a substitute for individual lender initiatives.

The funding for the CPC consist of three parts. Participating institutions have contributed \$800,000 capital to cover operating expenses. In addition, they have pledged \$8 million to be used as a revolving loan fund for construction financing. Borrowers who utilize this fund pay interest which helps to cover CPC's expenses. Finally, the take out mortgages on projects are provided by a \$32 million fund which is raised by CPC's issuing collateral trust notes. Participating institutions purchase the notes, and thereby share in the mortgages granted by CPC. Mortgages can be held by CPC or sold to either the Federal National Mortgage Association (FNMA) or the Government National Mortgage Association (GNMA).

Before discussing specific ways in which the public sector participates in the program, there is one corporate purpose which is unique, but important. That purpose is to "make recommendations based upon CPC's actual and recorded experience for the strengthening or modification of government housing programs." <sup>24</sup> To this end, CPC has produced an

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extensive step-by-step chart showing the process involved in processing a multi-family rehabilitation loan. (See Figure 1.) While it must be acknowledged that this process will be more complicated in a city like New York which has rent control, having this extensive laundry list of requirements should be of enormous assistance to public policymakers as they seek ways to facilitate the participation of the private sector in multi-family rehabilitation in cities without such controls.

The government of New York City has extended support to CPC in a variety of ways. Two of those are noteworthy here, because of their applicability to other cities. The first involves the development of procedures with the CPC to coordinate the reservation of Section 8 subsidy at the time a mortgage is being negotiated. The obvious advantage to both the developer and the city is that this reservation removes one of the sources of concern to an entrepreneur: namely, the uncertainty, in spite of marketing studies, about whether the rehabilitated unit will be able to attract and/or retain qualified tenants capable of paying increased rents after rehabilitation.

The second specific instance of cooperation with local officials which has enhanced CPC's chances of success is the creation by the city of the Rehabilitation Mortgage Insurance Corporation (REMIC), and that corporation's commitment of \$5.8 million to partially insure CPC's mortgages.

As of the end of August, 1977, CPC had granted approximately \$7 million in mortgage loans in Washington Heights and Crown Heights on buildings containing more than 1,100 units. In Crown Heights, the average loan has been \$6,700 per unit, and in Washington Heights the average has been \$5,300 per unit. CPC reported that during the fiscal year ending August, 1977 all of its multi-family loans were made at a 9% interest rate for a term of 20-25 years.<sup>25</sup>

In their letter accompanying CPC's report, the chairman and president made the following observations which summarize why the practicing planner must be involved in facilitating private sector reinvestment:

*The obstacles to neighborhood preservation are formidable. We do not, however, believe that they are beyond the reach of those in both the private sector and government who are prepared to take the steps necessary to succeed.*<sup>26</sup>

#### *Conclusion*

If the examples of private sector rehabilitation initiatives cited above are to increase, it is clear that the public sector must play a more active role in fostering and supporting such initiatives. Providing leadership to develop a rehabilitation code and advocating for changes in property tax policies are only two examples of ways in which planners in the public sector can play a constructive role. Intentional utilization of existing CDBG programs in cooperation with local financial institutions represent another important initiative.

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Finally, as the South Shore National Bank example illustrates it is perhaps as important for public officials to examine the negative consequences of existing programs -- including inappropriate demolition of potential community amenities, allocation of capital improvements, etc. -- as it is to develop new programs.

*Footnotes*

- 1  
South Shore National Bank of Chicago, *1976 Annual Report and Neighborhood Development Audit*, p. 24.
- 2  
Opinion of the U. S. Comptroller of the Currency, Administrator of National Banks, William B. Camp, in the matter of the application of South Shore National Bank to relocate, December 5, 1972.
- 3  
Ronald Grzywinski, Testimony before the U. S. Senate Banking Committee on the subject of Neighborhood Preservation, pp. 1-2.
- 4  
South Shore National Bank of Chicago, *1977 Annual Report and Neighborhood Development Audit*, p. 5.
- 5  
For a complete analysis of the Philadelphia Mortgage Plan see Dennis R. Marino, *The Philadelphia Mortgage Plan: The Testing of Traditional Perceptions of Inner-City Lending* (Chicago: Woodstock Institute, 1978).
- 6  
May Long, "Community Groups, Banks Work Together to Fight Neighborhood Disinvestment; Philadelphia Plan Works," *Journal of Housing*, June, 1977, p. 22.
- 7  
See Chapter 11 of this paper for discussion of Neighborhood Housing Services program.
- 8  
*Op. cit.*, Long.
- 9  
Raymond A. Berens, "Loan Change Called Answer to Redlining," *Philadelphia Evening Bulletin*, October 10, 1975.
- 10  
*Supra*, Long, p. 23.

<sup>22</sup> *Ibid.*

<sup>23</sup> CPC, *Annual Report 1977*, p. 2.

<sup>24</sup> *Supra*, note 22, p. 8.

<sup>25</sup> *Supra*, note 22, p. 8.

<sup>26</sup> *Supra*, note 22, p. 1.

SUMMARY AND CONCLUSION

The preceding chapters have presented a range of strategies which can be used by the public sector to leverage private credit into inner city neighborhoods for housing purchases and rehabilitation. The importance of leveraging private investment for the purpose of neighborhood development is becoming increasingly more significant given the impact of proposition 13 fever on the public psyche.

In campaigns throughout the country, candidates for elected office have promised to reduce taxation and slash government spending. If these promises are kept, public funds for neighborhood revitalization may be drastically affected. Some public officials, who have always espoused the New Deal philosophy of "government as doer", have recognized that the public sector *modus operandi* in the next decade will probably not reflect their perspective. This growing sentiment is underscored by the following statement from President Carter's State of the Union message.

*As President, I've had to ask you, the Members of Congress, and you, the American people, to come to grips with some of the most difficult and hard questions facing our society.*

*We need patience and goodwill, but we also need to realize that there is a limit to the role and the function of government. Government cannot solve our problems, it can't set our goals, it cannot define our vision. Government cannot eliminate poverty or provide a bountiful*

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*economy or reduce inflation or save our cities or cure illiteracy or provide energy. And government cannot mandate goodness...those of us who govern can sometimes inspire, and we can identify needs and resources, but we simply cannot be the managers of everything and everybody.<sup>1</sup>*

The objective of publicly initiated reinvestment efforts should be to use publicly financed mechanisms to encourage lenders to make loans which will provide them with the experience necessary to realize that extending credit in inner city neighborhoods is not necessarily unsound. The goal of such programs should be to encourage lenders to make similar loans after two or three years without extensive public insurance or subsidies. The role of local and state governments, once this goal is achieved, ought to be the provision of appropriate support services as described in Chapter 3.

Failure to design public reinvestment efforts in such a manner may encourage the institutionalization of public mechanisms which directly or in-effect guarantee loans which could be prudently underwritten by the private sector without any public involvement or expense.

As public revenue at all levels of government is reduced through tax cuts, the funds for public intervention will be restricted. Even local mortgage purchase programs may be restricted once the Federal Treasury is forced to consider carefully the revenue lost through the issuance of tax-exempt revenue bonds. The Treasury Department may look

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upon this mechanism with considerable skepticism, especially when the proceeds are used to subsidize borrowers who are obviously creditworthy and could be served with conventional mortgage funds. Irrespective of a revenue crunch, the Treasury Department is viewing these programs with disapproval since the mortgage loans they purchase could just as well be purchased by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.<sup>2</sup>

If local governments are unable to leverage private action to accomplish public economic objectives while making a profit, they will be in serious trouble when forced to curtail programmatic activity due to reductions in local, state and federal revenue.

A final caveat concerns an obvious, but often overlooked characteristic of financial institutions. Savings and loan associations, commercial banks and savings banks are for-profit corporations. The management of these institutions has a responsibility to both shareholders and depositors. Management is committed to the responsibility of maximizing earnings for shareholders. It is also obligated to the protection of depositors' interests through the safe and sound investment of funds on deposit. Planners and public policymakers often overlook the bottom line responsibility of private entities.

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When designing programs to attract lender participation in reinvestment efforts, planners must not overlook the bottom line fixation. If the intended beneficiaries of the program represent questionable credit risks, then risk-hedging mechanisms should be provided. However, if potential borrowers *clearly* have no capacity to repay the loans, do not attempt to convince lenders that they are good credit risks. By doing so, creditability will be lost as well as the opportunity to create a program which will benefit households with a limited capacity to manage a small mortgage or home improvement loan.

The determination of which loan is a questionable risk and which is a minimal risk can only be accurately made on a case-by-case basis. Public reinvestment efforts should not cater to borrowers who clearly have the capacity to repay the loan and make a 20% downpayment. Such loans should be made by lenders with appropriate terms and exposure.

An interesting point raised by the discussion of the South Shore National Bank experience and the Philadelphia Mortgage Plan is whether most reinvestment efforts to date have been overly cautious. The actors involved in these two efforts have been extending credit to allegedly marginal risks without the benefit of public mortgage insurance or interest rate subsidies. In both cases, delinquency rates

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have been exceedingly low and foreclosure rates have been less than the *normal* market served by many lending institutions.

Hopefully, programs using risk reduction mechanisms will gradually encourage lenders to extend credit to the local equivalent of the borrowers and neighborhoods served by the Philadelphia Mortgage Plan and South Shore National Bank.

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State of the Union Message delivered by President Carter before a joint session of Congress, January 19, 1978.

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The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association are secondary mortgage market entities which purchase mortgages generated by primary lending institutions such as commercial banks, savings banks and savings and loan associations. These purchases enable primary institutions to generate more mortgages than would be possible if there were no secondary market purchases, since primary lending institutions are legally limited to committing only a certain percentage of their assets in long term loans. For a more complete description of the role of the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association in promoting inner city reinvestment see: U.S. Senate, Committee on Banking, Housing and Urban Affairs, 94th Congress 2nd Session, *Secondary Mortgage Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation*, Hearings, December 9-13, 1976.

Listed below are the steps which presently are required for the processing of each rehabilitation loan originated by CPC. For presentation purposes, steps are grouped under common headings and listed numerically. In practice, many of the actions occur concurrently, and, in fact, the taking of many steps is dependent upon the completion of some other step (e.g., the setting of a tenant's rent subsidy being dependent upon the setting of the apartment's new rent).

The following abbreviations are used:  
 BD — Buildings Department (involving 4 separate sections within borough and central offices)  
 CAB — Conciliation and Appeals Board  
 DRO — District Rent Office  
 EPA — Environmental Protection Adminin.  
 FD — Finance Department  
 HA — New York City Housing Authority  
 HPD — Department of Housing Preservation and Development, formerly HDA (involving 2 separate central divisions)  
 NMO — CPC's neighborhood mortgage officer  
 NPO — HPD's local neighborhood preservation office  
 RC — Department of Rent and Housing Maintenance (involving 2 separate central offices)

- A. From Contact to Submission of Application**
1. Owner's contact and receipt of CPC Request for Information.
  2. Owner obtains cost estimates for proposed rehabilitation.
  3. Owner's submission of Request for Information with estimates to CPC.
  4. NMO's inspection of building.
  5. NMO's review of submissions, negotiation with owner and tentative loan recommendation.
  6. CPC Mortgage Review Committee approves NMO's recommendation.
  7. CPC issues loan application.
  8. Owner's submission of application with application deposit.
  9. CPC engineer's property inspection and issuance of report.
  10. CPC obtains independent appraisal of "property"—"as is" and "after rehab" value.
  11. NMO inspects operation of owner's other buildings, if any, and reviews applicant's credit and references.

12. NMO concides negotiation is and makes loan recommendation.
13. CPC Mortgage Review Committee reviews recommendation.
- B. From Loan Approval to Rehabilitation Loan Closing**
14. CPC Board of Directors approves loan.
15. CPC issues commitment letter with "advisory opinion" instructions and application forms.
16. NMO meets with owner to explain "advisory opinion" process and assist in completion of applications.
17. Owner completes applications for rent restructuring, tax abatement and "Section 8" rent subsidy advisory opinions.
18. NMO reviews applications and owner submits to NPO.
19. CPC forwards appraiser's certificate and other data to NPO.
20. NPO calculates tax abatement and forwards to HPD.
21. HPD issues advisory opinion for tax abatement.
22. NPO issues advisory opinion for restructured rents.
23. Owner notifies "rent-controlled" tenants of rehabilitation, rent increases and availability of rent subsidies on form letter approved by HPD.
24. Owner notifies "rent-stabilized" tenants on form letter approved by CAB staff.
25. Individual tenants who believe themselves to be eligible for rent subsidy respond to NPO.
26. NPO requests preliminary building inspection by HA for "Section 8" acceptability.
27. HA inspector performs preliminary building inspection.
28. NPO calculates Section 8 reservations for building's tenants and forwards to HPD.
29. HPD issues advisory opinion for Section 8.
30. Owner, general contractor and CPC engineer complete construction contract.
31. NMO and CPC approve construction contract.
32. NMO and CPC review and approve advisory opinions.
33. CPC applies for REMIC mortgage insurance commitment.
34. REMIC Board of Directors approves and staff issues commitment.
35. Owner obtains required fire insurance acceptable to CPC.

36. and performance bond acceptable to CPC.
37. Rehabilitation loan closed.
- C. During Rehabilitation**
38. Owner or contractor obtains permits for rehabilitation work from BD (separate offices within BD for different rehab items).
39. CPC engineer inspects work performed.
40. CPC processes requests for building loan advances (6-12 per rehabilitation project).
41. Upon completion of each work item, contractor obtains separate inspections from different offices within BD and EPA.
42. CPC engineer does final inspection.
43. CPC engineer issues CPC "certificate of final completion".
44. RC inspects building for code violations.
- D. Rent Increases—"Controlled" Units**
45. When rehabilitation 75% completed, owner prepares and files with NPO application for restructured rents.
46. NPO calculates restructured rents and forwards to RC.
47. RC forwards to DRO which issues new rent orders—copies to each affected tenant and owner, memos to NPO and CPC.
- E. Tax Abatement (J-51)**
48. Owner completes J-51 application and submits to HPD.
49. Owner requests BD certificate.
50. BD forwards certificate to HPD.
51. HPD issues owner "certificate of reasonable cost".
52. Owner files "certificate" and "green sheets" with FD.
- F. Tenant Rent Subsidies ("Section 8")**
53. When rehabilitation 75% completed, NPO transmits letter to building's tenants repeating availability of rent subsidies.
54. Individual tenants fill out and submit applications to NPO.
55. NPO forwards applications and projected apartment rents to HPD.
56. HPD forwards applications and projected rents to HA.
57. HA interviews applicants (with back-up financial data) and certifies eligibility.
58. HA conducts program briefing for eligible tenants.
59. Owner notifies NPO that apartments ready for HA inspection, NPO notifies HPD which arranges with HA for building inspection.
- G. Rent Increases—"Stabilized" Units**
60. After obtaining all approvals from BD and EPA, owner applies to CAB for rent increase for "stabilized" units.
61. Owner notifies "stabilized" tenants of requested rent increase.
62. CAB reviews tenant responses, if any.
63. CAB requests RC to inspect completed rehabilitation if tenant questions work.
64. RC inspects and forwards report to CAB.
65. CAB staff reviews submissions and makes recommendation to CAB.
66. CAB authorizes rent increase notice to "stabilized" tenants.
67. Owner notifies NPO of rent increases to permit Section 8 subsidy to commence for rent-stabilized tenants.
- H. Conversion to Permanent Loan and Issuance of CPC's Collateral Trust Notes**
68. After rehabilitation loan completed and new rents, tax abatement and tenant subsidies processed, CPC converts rehabilitation loan to permanent loan.
69. CPC converts REMIC commitment for mortgage insurance to a mortgage insurance policy.
70. CPC issues collateral trust notes to institutional purchasers.