USING COMMUNITY DEVELOPMENT BLOCK GRANT FUNDS FOR LEVERAGING

Erica Pascal

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About the Author

Erica Pascal is an Associate of the Woodstock Institute. The Woodstock Institute is a not-for-profit organization which conducts research, training and education for the public, private and voluntary sectors about ways to ameliorate disparities in the availability of capital and credit.

Erica is also the Editor of Land Use Law and Zoning Digest, a monthly publication of the American Society of Planning Officials (ASPO). Among her other activities at ASPO, she writes a monthly column entitled "Legal Digest" for Planning.

Erica has also authored the following publications: Regional Planning, Housing and Civil Rights: The Implementation of the A-95 Review Process in the Chicago Metropolitan Area; and The A-95 Review Process in Illinois.

Erica's educational training includes degrees from the following institutions: B. A., Urban Affairs, Boston University and J. D., Northwestern University School of Law. During her tenure at Northwestern, Erica was an Associate of the Urban-Suburban Investment Study Group of the Center for Urban Affairs.

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One method of encouraging reinvestment which has been successfully tried in several cities is the use of HUD Community Development Block Grant funds for leveraging. Simply stated this involves using a relatively small amount of public money from a local government unit to produce a larger amount of private investment from financial institutions.

The use of Community Development (CD) funds for leveraging is attractive for the following reasons. First, stimulating the use of private investment to achieve a public purpose, such as reinvestment in inner city neighborhoods, may diminish the financial burden experienced by the public sector. In many neighborhoods which have undergone substantial private disinvestment, the housing and credit needs of the residents are met as a result of special programs which are often totally funded and managed by government entities. Leveraging encourages the private sector to serve a portion of the need in such neighborhoods through an investment partnership with the public sector.

Secondly, the limited availability of public funds for housing rehabilitation efforts require that available public money be stretched as far as possible. Using CD funds to leverage private resources may provide a way to stretch scarce public resources for residential rehabilitation. Third, CD funds are flexible and can be used for leveraging. CD grant funds can be used to pay service fees for loan transactions, provide interest

subsidies or establish loan guarantee reserve funds.

CD funds can be leveraged to provide private redevelopment capital in a number of ways. Often, the investment of city money into a community through public improvements may in itself act as a leveraging mechanism to encourage larger amounts of private moneys for rehabilitation and improvement. This is the strategy of the Neighborhood Housing Services model, where the city agrees to upgrade physical facilities in a neighborhood (streets, lights, curbs, parks) in return for financial institutions making money available for home improvement loans and mortgages.[1] In many cities, the public sector funds for the NHS programs have come from CD allocations.

A second method of leveraging CD funds involves an economic development partnership between the city and local investors. An example of this method was attempted in Portsmouth, New Hampshire.[2] The city's Economic Commission entered into a joint project with a development company to develop a 132-acre industrial park. The city agreed to provide $300,000 worth of streets and utilities for the site out of its CD allocation. The city's investment was secured by a first mortgage on the park, whose land alone was valued at $625,000. The developer agreed to repay the city within 10 years, as each acre was sold or leased. The total value of the park was expected to be $1,500,000, thus providing a leveraging ratio of 5 to 1.

A third method involves a contractual agreement between city agencies and local financial institutions. Under

these agreements, city officials work cooperatively with private lenders to locate and process rehabilitation loans for qualified individuals in specified areas. The city then "writes down" or partially subsidizes either the loan itself or the interest rates, thus reducing the lender's risk. Other cities have used CD money to establish "guarantee funds" with lenders to insure loans against default. Following is a partial listing of the type of programs which have been attempted.

Bethlehem, Pennsylvania has used a lump-sum deposit of $70,000 to leverage $1,000,000 in loan commitments from First Valley Bank.[3] The loans are made at half the market interest rate and are serviced at no charge to the city. In addition, there is a grant program financed totally from CD funds. The program in 1½ years of operation has made 72 loans totalling $165,000, and 90 grants at approximately $4500 each. The $70,000 is a default guarantee fund.

Plymouth Borough, Pennsylvania (population 9500) has a rehabilitation program administered through the Luzerne County Redevelopment Authority.[4] The city provided $25,000 in loan guarantees to a local bank which promised $250,000 in loans. The loans are made by the Redevelopment Authority, but administered by the bank at no charge to the city. The program has not yet made any loans.

In Chester, Pennsylvania, CD funds of $ 650,000 are being used to write down interest rates and provide grants.[5] Local banks provide low interest loans at a 6% interest rate

which the city writes down to 3% for homeowners and 4½% for absentee landlords. Owner-occupants may also receive grants of 50% of the rehabilitation costs or $4000, whichever is less. Absentee landlords must agree not to raise rents beyond that reasonably necessary to cover the cost of their loan. To date, 55 homes have been rehabilitated and 72 loans made, at $8000 to $9000 each. Thus, the city's commitment of $650,000 in CD funds has so far returned that amount in loans.

Norfolk, Virginia has operated a local rehabilitation program since 1972.[6] Originally, the program was financed through funds of the Redevelopment and Housing Authority. Since 1974, however, CD funds have been used, thereby allowing the program to expand and diversify. CD funds have been used as guarantee funds with three local banks. Using approximately $50,000/year based on a letter of credit from HUD, the Redevelopment Authority has leveraged $250,000/year in commitments from the participating banks. The banks originate and service the loans, which are targeted to specific neighborhoods. Interest rates are 6¼%.

Hoboken, New Jersey's Municipal Home Improvement Project (MHIP) has made 600 loans since 1972.[7] Since the advent of the Housing and Community Development Act, MHIP has used $850,000 in CD funds to produce over $2,660,000 in loans from local banks. CD funds are used to write down the loans, which effectively reduces the homeowner's payments. Thus, a homeowner

borrowing $6000 would receive $1300 in grants from the MHIP, and borrow $4700 from a participating bank at market interest rates. (The bank loan is 90% guaranteed under FHA Title I Property Improvement Loans). Administrators feel that the CD funds have been an effective leveraging tool.

Portsmouth, Virginia has used $200,000 in CD funds as a subsidy and loan guarantee to provide $500,000 in low-interest rehabilitation loans to project area property owners.[8] As in Norfolk, the Housing and Redevelopment Authority administers the program, since cities may not make loans to property owners under Virginia law. The $200,000 has been deposited in local banks as a guarantee and subsidy against $500,000 received from the banks' purchase of the Authority's 2-year revenue bonds.

The city of Chicago, Illinois provided $500,000 in CD funds as a guarantee for the Home Purchase and Rehabilitation Plan.[9] Administered by a non-profit corporation, the Community Services and Research Corporation, the program provides mortgage and home improvement loans in several target neighborhoods. Twenty participating financial institutions have pledged $7 million in conventional loans, partially guaranteed by private mortgage insurance (7½) and the city (80%). As of August 15, 1977, 17 loans have been made, valued at over $360,000.

Finally, a study by the Brookings Institution on the administration of the Community Development Block Grant program found that 19 participants studied used CD funds as "seed money" to attract funds from private lending institutions for

rehabilitation programs.[10] Leveraging devices include tax free loans, subsidies and guarantee funds.

CD leveraging can thus be an effective strategy for local redevelopment authorities or municipal rehabilitation agencies to encourage private reinvestment in inner-city neighborhoods. It is difficult, however, to develop a measurement of success for such a program. Some cities experienced difficulty in attracting lenders to a rehabilitation loan write down program, and found their commitment of funds (for high-risk loans, administrative costs and interest subsidies) were equal to or greater than the expected commitment from lenders. In an analysis of Pennsylvania cities leveraging efforts, one study found that lenders were reluctant to participate unless the program guaranteed their investment and/or afforded them a reasonable rate of return.[11] In addition, the costs of a rehabilitation program are not measured solely by the write down costs, but must also include administrative expenses and physical improvements to the target neighborhood, which may make the program appear expensive. However, over the long run, this technique might encourage other unsubsidized investment into the neighborhood. Since the approach is new, it is not yet possible to measure its effectiveness in these terms.

In analyzing the utility of leveraging CD funds to encourage private reinvestment, local government officials just consider the size of the subsidy a local government body should provide lenders. Some cities have leveraged CD funds in a ten-

to-one ratio; others have produced a one to one ratio. Determining factors might include the condition of the target neighborhood, the extent of other city commitments to the neighborhood, lender attitudes, presence or absence of state or local regulations on redlining practices, and the availability of other avenues for rehabilitation efforts.

Footnotes

[1] For a description of the Neighborhood Housing Services Strategy, see: Erica Pascal, Neighborhood Housing Service Programs as Instruments of Reinvestment (Chicago: Woodstock Institute, January, 1978).

[2] Economic Commission of the City of Portsmouth, City Hall, 126 Daniel Street, Portsmouth, New Hampshire, 03801.

[3] The Center for Community Change, The Lifeblood of Housing (Alexandria, Virginia: Mt. Vernon Publishing Co., Inc., 1976), p. 51.

[4] Department of Community Affairs for the State of Pennsylvania, A Catalog of Local Housing Rehabilitation Programs in Pennsylvania (June 1976).

[5] ibid.

[6] Norfolk Redevelopment and Housing Authority, Post Office Box 968, Norfolk, Virginia 23501.

[7] See: Patricia Marshall, "Locally-Funded Rehabilitation Programs in Nine Cities," reproduced in the Appendix of Michael A. Agelasto II, Neighborhood Conservation Through Housing Preservation, Washington, D. C.: Library of Congress - Congressional Research Service, August 20, 1976, p. CRS-111. Also see: Real Estate Research Corporation, Neighborhood Preservation: A Catalog of Local Programs (Washington, D. C.: U. S. Government Printing Office, February, 1977).

[8] Henry Schmeltzer, "Leveraging of Community Development Dollars: Ingredients of Success and Failure," Housing and Development Reporter (Washington, D. C.: Bureau of National Affairs, October 1977), p. 278.

[9] Patrick Nash, Project Director and Vice-President, Community Services and Research Corporation, 7 South Dearborn Street, Chicago, Illinois 60603.

[10] Brookings Institution, Block Grants for Community Development (1977).

[11] The Center for Community Change (supra., note 3).