

# Cascade

a community development publication of the Federal Reserve Bank of Philadelphia

## Chicago NHS Starts Loan Pool to Refinance Predatory Loans

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

A Chicago community development financial institution (CDFI) has started the pilot phase of a program to refinance predatory loans with an initial \$2 million loan pool created from investments by 16 Chicago-area banks.

The CDFI, the Neighborhood Housing Services of Chicago, Inc. (NHSC), started the Neighborhood Ownership Recovery Mortgage Assistance Loan (NORMAL<sup>sm</sup>) program in June 2000 and has approved 10 loans in the program's first few months. NHSC staff initially analyze borrowers' existing loans and related closing documents and provide counseling, intervention, and negotiation with the lender.

When necessary, pro bono and Legal Assistance Foundation attorneys negotiate pay-off amounts with lenders and NHSC originates a NORMAL<sup>sm</sup> loan to refinance the negotiated loan settlement amount.

Jim Wheaton, NHSC's associate director, explained in an interview that NHSC's involvement in the predatory lending issue originated with the foreclosure-intervention counseling it began in 1996. NHSC developed a foreclosure-intervention program partly as a result of the Federal Reserve Bank of Chicago's Mortgage Credit Access Partnership task force on FHA lending. As a counseling agency certified by the U.S. Department of Housing and

Urban Development, NHSC worked with borrowers, mortgage companies, and banks to develop renegotiated payment plans on conventional loans and with FHA lenders to ensure that FHA's loss mitigation measures were employed wherever applicable.

As part of its foreclosure-intervention activity, NHSC used a loan pool funded by a city of Chicago community development block grant appropriation to provide loans averaging \$6000 that enabled 90 families to reinstate their mortgages. In addition to these loans, more than 400 other home owners avoided foreclosure through

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## Philadelphia Fed's Minority Entrepreneurs Conference Called a Success

By Marilyn Wimp, Media Consultant, Public Affairs Department, Federal Reserve Bank of Philadelphia

Philadelphia's minority entrepreneurs discovered how to find debt or equity financing, assess urban markets, and plan for company growth during a day-long conference sponsored by the Federal Reserve Bank of Philadelphia.

The Bank's Community and Consumer Affairs Department organized the September 27 event to address issues related to minority business owners. The conference was designed to introduce entrepreneurs to the resources they need to start or expand their businesses.

Keynote speaker Dick Vermeil, chairman of Bridge Tech Partners, outlined the leadership qualities essential to entrepreneurs. His speech, peppered with his own experiences as a football coach, held the nearly 100 audience members captive.

The conference was divided into four sessions: financing options, government incentives, technical assistance, and emerging markets initiatives. Throughout the conference, entrepreneurs had an opportunity to exchange ideas and

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## Message from the Community Affairs Officer

Late this year, the Federal Reserve Bank of Philadelphia hosted three meetings on predatory lending. Our co-sponsors included The Reinvestment Fund, the source for a considerable amount of research on the issue in Philadelphia, and the Federal Reserve Bank of Cleveland, whose District covers the western part of Pennsylvania. We planned each of these day-long meetings to highlight how The Reinvestment Fund identified the extent and scope of the problem. We hope that interested organizations in other communities can use similar techniques to determine if the problem exists in their neighborhoods.

But once the problem is identified, what are the solutions? While 10 federal regulatory agencies are developing a policy statement that will recommend long-term solutions, what can be done for the consumer already in trouble? In many cases, legal counsel should be the first step. But what about alternative financing options? Can this debt be refinanced at a lower interest rate, or are these borrowers truly high-risk and the current rate reflects that fact? Are there independent parties that can help a borrower determine what is best?

Two organizations we highlight in this issue of *Cascade* are trying to

do just that. Neighborhood Housing Services (NHS) of Chicago, Inc., and the Association of Community Organizations for Reform Now (ACORN) are working with borrowers and lenders to resolve the problem. NHS has a long history of helping home owners to make choices about needed home improvements and then to finance the same with an affordable loan. Over the years, it has helped some 300 families avoid foreclosure. Now it is trying to help those people who have obtained high-cost loans and are at risk of losing their homes if they fall behind in payments. It is a labor-intensive, expensive effort.

ACORN has taken a different tack—it is working with a subprime lender, Ameriquest, to achieve a better balance between a high-risk borrower's need for financing and a lender's need to price a loan based on risk. The details are included in our story.

Whatever these organizations' level of success, consumers must still protect themselves. Understanding financial terms and products is critical to any individual's long-term prospects for wealth, no matter how small. As regulators, we can do our best to outlaw certain deceitful practices, but every consumer needs to understand the financial



services he or she is using. First-time home owners and the parties that help them achieve ownership need to recognize that getting a house is only the starting point, not the finish line. Maintaining that asset and being financially stable require constant attention.

Out of the heartbreak of predatory lending stories we hope will come more efforts to support existing home owners, as well as new ones.

## Chicago NHS Starts Loan Pool to Refinance Predatory Loans

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NHSC's intervention and counseling.

Wheaton said that in the course of its foreclosure counseling, NHSC began to see an increasing number of consumers who had highly irregular loans and who were at risk of foreclosure. NHSC encountered a variety of scenarios in these loans: consumers with substantial equity who never had the capacity to make payments on their loans; loans refinanced several times in a year; loan origination and other fees in excess of 10 percent of the loan amount; and overstated income used to qualify the borrower. Most of the loans

involved refinances of existing mortgages and were originated through mortgage brokers, Wheaton said. About one-third were linked to a purported home improvement.

The loans were concentrated in minority neighborhoods and in neighborhood areas that had undergone or were experiencing racial and ethnic change. Particular targets for these kinds of loans were senior citizens who had paid off a mortgage or long-term home owners who had a small mortgage balance or substantial equity in the house.

One person counseled by NHSC was CS, a 70-year-old widow who

had lived in her home in Chicago's Austin community for more than 25 years. She had a fixed income that was supplemented with part-time work as a school crossing guard. From 1993 to 1998, CS obtained three separate loans from subprime lenders to make repairs to her house. In 1998, she responded to a mortgage broker's solicitation stating that loans were available in amounts up to 125 percent of the appraised value of a house, and no income verification was needed. A loan in the amount of \$93,500 at 12.5 percent interest was originated, increasing her monthly obligation to

\$1124. The mortgage broker received a fee of \$8925, and the lender received additional fees of \$1500. After a lawsuit was filed against the lender and broker, the lender accepted \$70,000 as payment in full for the outstanding mortgage balance. CS became the first home owner to receive a loan through the NORMAL<sup>sm</sup> program, with a new fixed-rate loan at 8.5 percent and monthly payments of approximately \$665.

Eligibility for the NORMAL<sup>sm</sup> program requires that the borrower be the owner-occupant of a one- to four-unit residence who has refinanced or purchased a home in the past three years. In addition, the property must be in a low- to moderate-income neighborhood of Chicago, or the borrower must have a gross annual household income of less than 120 percent of area median income. NHSC counselors also identify loans that involve fraud or have predatory characteristics and consider the borrowers eligible for the program.

Other considerations in determining eligibility are that the borrower's equity prior to refinance was in excess of 50 percent of property value and the loan-to-value is now greater than 90 percent; the borrower is 62 years or older or has

owned the property for 20 years or more; and the refinance included home improvements that were not completed, were overpriced, or were completed in an unacceptable manner.

The first 10 approved loans in the NORMAL<sup>sm</sup> program averaged \$68,000. The negotiated settlement amounts that were refinanced represented reductions in amounts owed ranging from \$5000 to \$30,000.

The city of Chicago has committed \$1.2 million for the ongoing operation of the program and for a loan loss reserve. The loss reserve is equal to 6 percent of loan originations and protects participating lenders against losses on a NORMAL<sup>sm</sup> loan for two years after origination. The city of Chicago became the first municipality in the country to pass an anti-predatory lending ordinance. Lending institutions and their affiliates that engage in predatory lending practices are barred from receiving city deposits or engaging in other business with the city.

Twenty NHSC employees (out of a total staff of 120) are engaged full or part time in various aspects of the NORMAL<sup>sm</sup> program, including counseling, negotiating with lenders, loan origination, loss mitigation activities, and accounting.

NORMAL<sup>sm</sup> loans will be serviced by NHSC for up to two years, with a goal of selling the loans to a participating lender during that time. The purchaser would then service the loans.

Wheaton said that the NORMAL<sup>sm</sup> program could be replicated elsewhere. Key ingredients would be a lender or lenders that would be willing to participate in a loan pool and an entity that can provide counseling and intervention services and has the capacity to originate new loans in a timely manner.

In the short time that NORMAL<sup>sm</sup> has existed, Wheaton said, NHSC has learned that it is important to keep borrower eligibility criteria flexible and balanced. Eligibility criteria should be reviewed regularly to ensure that the program remains responsive to the need, he said. Any nonprofit that wants to start a similar program must have the capacity to originate and package properly documented loans in a manner that would be acceptable for sale to a participating lender at a later date.

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## Minority Entrepreneurs Conference Called a Success ...continued from page 1

discuss investment opportunities with the experts and other entrepreneurs during the networking sessions.

"Minority businesses are an important part of our community, and we're concerned about reports that minority businesses are being denied credit more often than nonminority owners," said Dede Myers, vice president of the Philadelphia Fed's Community Affairs Department.

"Finding the best financial resources for small businesses may mean looking at options beyond traditional banks," Myers said. This conference recognized venture capi-

talists; federal, state, and local government programs; and many other types of community development financial institutions that serve small businesses.

Financing options for entrepreneurs were presented by Alan Wilson, director of the Commerical Lending Group, The Reinvestment

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*Jeff Kiesel, president, GE Small Business Solutions, talks to an attendee at the Minority Entrepreneurs Conference, which was held at the Federal Reserve Bank of Philadelphia on September 27.*

Fund; Angela Brown, program director for Jobs and Income, LISC Minority Venture Capital; and Rick Gessner, general partner of GS Capital LP.

Speakers covering topics related to business plans and technical assistance with startups included Della Clark, president of The Enterprise Center; Marion Zajac, project officer of the New Jersey Entrepreneurial Training Institute; Don Addison, division chief, Mercer County Office of Economic Opportunity and Affirmative Action; and Marjorie Anderson, director of the Minority Business Development Center.

Lynn Whiteside, chief executive officer of Social Compact, presented new research on the growing strength of minority markets in several major cities. A panel of speakers, which included Ivan Smith, a partner with Avalon Capital Partners; Clarence Mosely Jr., vice president of Chase Business Resource Centers; and Jeff Kiesel, president of GE Small Business Solutions, ex-

plained the technical assistance their companies can provide to businesses.

Outlining economic development programs for the group were Curtis Jones, executive director of the Philadelphia Commercial Development Corp, and Tom Tolan, district director of the U.S. Small Business Administration.

Today, nearly 23 million small businesses play a significant role in America's economic growth; together they employ more than half the private-sector workforce and generate nearly half the sales revenues of all U.S. firms. Although Philadelphia is viewed as having a solid entrepreneurial base, more support is needed to expand that base — especially when it comes to minority entrepreneurs. In the Philadelphia region, African American businesses account for about 5 percent of all firms in our region and generate less than 2 percent of gross receipts, according to research by the Pennsylvania Economy League.

“Our role is to work for change in Philadelphia and in the Fed's Third District. We want minority business owners to know the Fed is here to help guide them when it comes to identifying credit needs and sources,” Myers said.

Community Affairs departments in Federal Reserve Banks across the country are working to promote grass roots economic development by partnering with community groups. The Federal Reserve Bank of Boston held a national conference that brought together African American ministries to explore ways in which the church can help its members gain more financial security through investments like home ownership. The Philadelphia Fed gave its support to this conference, which drew 400 participants from across the country.

“We plan to continue to bring people and resources together here in Philadelphia as well as supporting efforts around the country. We're already exploring our options for next year,” Myers said.

## Public-Housing Residents Become Home Buyers

*By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia*

A federal program that enables public-housing residents to become home owners presents opportunities for banks and nonprofit organizations to work with county and small-city public-housing authorities (PHAs).

About half of the 57 PHAs in eastern and central Pennsylvania are participating in the Section 5(h) Home Ownership Program. Together, they have 742 units for sale, of which 439 have already been sold. The Delaware State Housing Authority, which developed a forerunner of the 5(h) program, plans to sell 15 units and has sold 13. The Atlantic City Housing Authority has the only 5(h) program in southern New Jersey.

PHAs work with buyers for several years or more to prepare them

for ownership and most PHAs provide silent “soft second” mortgages to modernize the units and make them more affordable to low-income buyers. Buyers' maximum income is 80 percent or less of area median income in the 5(h) program, which has been operational since 1992.

PHA 5(h) plans, which must be approved by the U.S. Department of Housing and Urban Development, vary widely. PHAs may sell existing units, acquire and rehabilitate units on the open market, or fund new construction. They may sell units to tenants who live in public housing or who receive Section 8 vouchers or certificates or to eligible residents in the broader community.

Banks are one of the sources of

permanent mortgages to the buyers. Nonprofit organizations provide home-ownership counseling and case-management services and sometimes acquire units and sell them to PHAs. The PHAs use proceeds from the sale of the units to build housing that meets current needs.

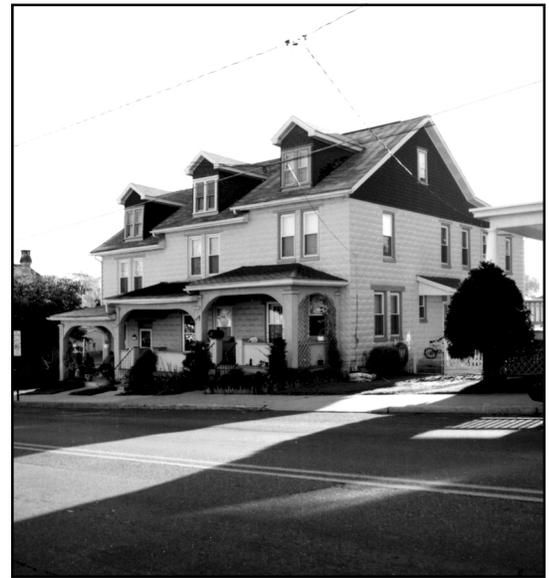
In one of the most active 5(h) programs in the Third Federal Reserve District, the Luzerne County Housing Authority (LCHA) has sold 203 units since 1992. David Fagula, executive director of LCHA, said that the program has worked well and that LCHA has provided buyers with a five-year warranty covering major systems. LCHA has used proceeds from sale of the units to build 159 housing units for older people and low-income families and

to rehabilitate about 45 houses.

Since buyers in the 5(h) program obtain mortgages from a wide range of different lenders, information is limited on defaults and delinquencies in 5(h) programs such as that of the LCHA. However, a spokesperson for Manufacturers and Traders Trust Company (M&T Bank), which acquired Franklin First Savings Bank in

Wilkes-Barre, Pennsylvania, said that Franklin First had made 153 5(h) loans, of which 129 were outstanding. The past due balance on the 129 loans is 11.8 percent – higher than an overall past due balance of about 7 percent in Franklin First's CRA portfolio, which encompassed the 5(h) program and 10 other products, he said. Default data were unavailable from M&T Bank, but the LCHA reported that the foreclosure rate on its 203 5(h) units was 4 percent.

Chris Gulotta, executive director of the Cumberland County Housing and Redevelopment Authorities (CCHRA), said that the 5(h) program has worked extremely well and has allowed CCHRA to make loans to very low-income house-



*These houses are examples of the types of properties that public housing authorities rehabilitate for sale. The Luzerne County Housing Authority fixed up the house at left, and the Cumberland County Housing and Redevelopment Authorities rehabbed the house at right.*

holds, including many single heads of households. Of 50 units targeted for sale, 35 have been sold. Gulotta said that there had been no defaults in the CCHRA program but that he did not have information on delinquencies.

A distinctive characteristic of CCHRA's program is a three-year lease with an option to purchase, which enabled most of its buyers to save part of their rent for down payments. Another feature is a home maintenance program taught by staff at the local vocational-technical high school.

The Lehigh County Housing Authority (LCHA) has sold 20 units

in the 5(h) program and has had no defaults or delinquencies. Features of Lehigh County's program include a 100 percent guarantee of the first mortgage as well as a three-year warranty against systems failure.

John Seitz, executive director of LCHA, said that the 5(h) program is an attractive program for banks. "Banks can get penetration in low-income markets that they otherwise might not reach," he said. "Besides, it's a very protected situation. Buyers usually have regular Section 8 payments, and the PHAs screen carefully and follow up with buyers."

## **NJ State Government Funds Faith-Based Organizations**

*By El-Rhonda Williams Alston, Esq., Administrator, Office of Faith-Based Initiatives*

A program in New Jersey offers proof that communities of faith and state and local governments can work together to deliver quality services to low- and moderate-income families. Under Governor Christine Todd Whitman's faith-based community development initiative, nearly \$15 million in the form of grants has been awarded to 100 faith-based community development corporations (CDCs).

Throughout the Garden State, these CDCs provide an array of ser-

vices from child care and job development and training to adult/senior citizen programs and health care for the poor and working poor. New Jersey is the only state that has implemented and funded a faith-based community development initiative.

A primary goal of this initiative is to assist citizens making the transition from welfare to work. Many of the grantees operate programs geared to removing the barriers that hamper former welfare recipients'

transition to work, and these programs have made an impact on the success of these new employees.

As of August 1, 2000, grants are funding programs and services that assist low- to moderate-income families with the following:

- Job development and training
- After-school youth mentoring and tutoring programs
- Transitional services to ex-offenders (both juveniles and adults)

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- Medical assistance to the working poor
- Support services for women with AIDS and their children
- Drug counseling programs
- Services to support families moving from welfare to work
- Adult day care and transportation
- Intergenerational programs
- Computer literacy
- Music appreciation

In addition to the above, the Office of Faith-Based Initiatives, under the leadership of Jane M. Kenny, commissioner of the Department of Community Affairs (DCA), will collaborate with the Department of Human Services (DHS) to administer a post-temporary assistance to needy families (TANF) program. This program will award federal dollars to faith-based community development corporations, houses of worship, and community-based organizations to engage in outreach and referral services to the post-TANF population to make them aware that they may be entitled to noncash benefits such as:

- Child care
- Transportation
- Food stamps
- Medicare
- Other services

Our partners — Public Service Electric and Gas, The Chase Manhattan Bank, and the Center for Non-Profit Corporations — have

helped the business and financial communities embrace the governor's faith-based community development initiative. Furthermore, their generous contribution helped the Office of Faith-Based Initiatives create the New Jersey Faith-Based Training Institute, which provides comprehensive community-development training to all communities of faith. It was designed to meet the ever-increasing needs of communities of faith to respond to the rapidly changing needs of the communities in which their houses of worship are located and to the changes brought under welfare reform. The New Jersey Faith-Based Training Institute began operations on March 8, 2000.

### Funding

Houses of worship cannot receive state funding directly, but community development corporations that are sponsored by faith-based organizations and have 501(c)3 tax-exempt status are eligible to receive state funds. But houses of worship are eligible for training from the New Jersey Faith-Based Training Institute. Funding is multi-year and based on performance and availability of funds.

Houses of worship, however, may compete equally with community development corporations for selected types of federal funding. The DHS/DCA collaboration, which is based on federal law, has

awarded funds to at least one house of worship to do outreach and referrals for post-TANF families.

### Advisory Groups

In addition to the Department of Community Affairs' Office of Faith-Based Initiatives, the New Jersey Department of Human Services has a faith-based task force that advises its commissioner, Michele Guhl, on policy matters that affect New Jersey's communities of faith. The New Jersey Department of Labor has also created a new Office of Interfaith and Community Partnership under its commissioner's directive.

### Legislation

The New Jersey legislature is currently considering a bill that would institutionalize the faith-based initiative. The bill proposes that New Jersey allocate \$10 million annually to support the faith-based community development initiative.

### Applicants/Grantees

Over the past three years, more than 300 groups have applied for funding under the faith-based initiative. More than 100 have been awarded grants for programs and services. Grant recipients come from different regions (urban, rural, northern, southern) and represent many different religious faiths and ethnic groups.

*For more information, contact the Office of Faith-Based Initiatives at 609-984-6952 or e-mail your questions to [faithbased@dca.state.nj.us](mailto:faithbased@dca.state.nj.us).*

## National City Community Development Corporation Creates Affordable-Housing Partnership in Pennsylvania

*By Jim Gutowski, Vice President, National City Bank of Pennsylvania*

Since 1982, National City Community Development Corporation of Pennsylvania (NCCDC) has been involved in developing affordable housing that, in turn, has contributed to the renaissance of neighborhoods. However, the need for more affordable housing in the 22 counties of western Pennsylvania that comprise NCCDC's market area far exceeds what NCCDC and other lenders, working individually,

can meet. So, in 1997, NCCDC developed a model of an equity partnership for housing rehab/new construction projects designed for low- and moderate-income residents. Projects are under way in Pennsylvania in Beaver County, Mercer County, and, most recently, Lawrence County. This article focuses on the structure of the partnership, using the Lawrence County project as an example, and iden-

tifies the multiple funding sources.

### Needs Assessment

NCCDC begins the process in any community by assessing local need. Through meetings with local government officials and community and housing groups, information is gathered to determine current housing conditions and residents' needs and expectations. Next, NCCDC looks for a local organization that has both a commitment to

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# Subprime Lender Adopts Best Practices in Agreement with ACORN

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

In the midst of national debate about predatory lending, Ameriquest Mortgage Company, a leading subprime lender, and the Association of Community Organizations for Reform Now (ACORN) are beginning to implement an agreement in which Ameriquest will make loans totaling up to \$360 million and follow “best practices” and ACORN Housing Corporation (AHC) will provide low-income residents with financial education and counseling.

The agreement, which followed ACORN’s demonstrations against Ameriquest and months of negotiations, applies to targeted zip codes in 10 cities, including Philadelphia, from 2000 to 2003. Ameriquest agreed to provide loans to AHC-counseled borrowers with an interest rate 50 basis points below market, to avoid prepayment penalties, and to limit points to 3 percent.

Ameriquest’s best practices include a one-week rescission period instead of the required three days, full and timely disclosure of loan terms in simple English, and reporting of borrowers’ repayment histories to credit bureaus.

Ameriquest also agreed to continue to avoid some of the most contentious subprime industry practices, such as single-premium credit life insurance, balloon payments, negative amortization loans, and “flipping” – frequent refinancings that result in new fees and deplete owners’ equity. Adam Bass, senior executive vice president and general counsel of Ameriquest, explained that the company did not engage in these practices prior to the agreement and had a policy of refusing to refinance a loan for its own borrowers within a two-year period.

Ameriquest will provide simplified early disclosure and contact information on housing counseling agencies certified by the U.S. Department of Housing and Urban Development, he said. At closing, the borrower will receive a one-page summary of the salient loan terms.

Bruce Dorpalen, director of housing counseling for AHC, said in an interview that AHC counselors are working “to match products with what people’s needs are.” AHC will try to be “an honest broker” that explains an array of products from different companies, he explained. “AHC is committed to tracking the payment performance of all such products and to assisting delinquent borrowers to become current with their loans.”

Dorpalen, who supervises 64 AHC counselors around the country, said that AHC’s experience is that inner-city subprime borrowers often are taking inappropriate and very expensive loan products. Typically, many such borrowers have substantial equity in their houses and need to borrow, for example, only \$5,000 to put in a new furnace or repair a car, Dorpalen said. However, what often happens is the subprime lender gives the borrower a cash-out refinance of his or her existing mortgage and an expensive new adjustable rate mortgage with high fees, he explained. A common practice, he added, is a 3/27 loan in which the first three years are at a lower fixed rate and the subsequent 27 years are at a higher adjustable rate.

Bass said that Ameriquest “was trying to address the larger question of bait-and-switch” through the seven-day rescission period and the simplified disclosures. All lenders are required by federal law to send borrowers a good faith estimate within 72 hours of accepting the application. However, after this time,

lenders often receive credit and income documentation, as well as appraisals, lien verifications, and preliminary title reports, that may give a different picture and risk profile of a borrower, Bass said.

The situation is more complicated in the subprime market, Bass explained. Whereas loan applicants in the A market are either approved or denied, applicants in the B/C market often are offered any of a wide range of products in which price and terms are related to risk.

“We want our borrowers to understand their loans, and we decided to give them more time to contact loan counselors, other lenders, or advisors and to provide simplified loan documents as a remedy to the perceived problem,” Bass said.

Bass noted that he thinks that subprime lenders legitimately provide access to credit in traditionally underserved markets and that the instances of abuse in the subprime market were relatively few. He added that other subprime lenders who have called Ameriquest about the agreement are particularly interested in the seven-day rescission, simple English disclosures, and referrals to housing counseling agencies.



Officials of Ameriquest Mortgage Company and the Association of Community Organizations for Reform Now (ACORN) celebrate a joint lending agreement in July in Washington, D.C. Shown from left to right are Kirk Langs, president, Ameriquest Mortgage Company; Maude Hurd, national president, ACORN; and Wade Henderson, executive director, Leadership Conference on Civil Rights.

# Subprime Lender Adopts Best Practices in Agreement with ACORN

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Some B/C borrowers could qualify for A products. "Subprime lenders who have loan applicants with good credit do not refer them to the A market but charge them high fees as if they belong in the B/C market," Dorpalen commented. Some B/C borrowers have experienced a single negative event, such as a divorce, loss of a job, or a relative's unpaid loan, possibly resulting in a judgment, and many find it difficult to move up to the A market.

ACORN's goal is to standardize the subprime market, Dorpalen said. He explained that the average life of subprime loans is less than two years because of loan flipping and that typical pre-payment penalties make these loans very expensive. He said that ACORN wants such loans to be stabilized into longer term products and that it is very important for low- and moderate-income buyers to have 30-year fixed-interest mortgages so they can afford payments over the long term.

Subprime lenders have great technological capacity, using data on outstanding mortgages, appraisals, and borrowers to do highly tar-

geted marketing to inner-city residents, Dorpalen pointed out. This capacity is coupled with sales people who work in a very personal, purportedly helpful manner with elderly and other isolated borrowers, he said. The result is that borrowers trust loan sales people who are not looking out for their financial interests, he added. ACORN plans to do mailings, hold credit fairs, and work with housing contractors to educate low-income residents.

Dorpalen said, "Predatory lending threatens the ability of African-Americans and Hispanics to continue to be home owners and jeopardizes the security of the elderly." A recent ACORN report said that in 1999 subprime lenders made 45.1 percent of all conventional refinancing loans made to African-Americans, compared to 19.5 percent of those made to Latinos and 12.1 percent to whites. (The data exclude loans for manufactured housing.)

The best practices code of conduct was developed in meetings among officials of Ameriquest, ACORN, and the Consumer Mortgage Education Consortium. The

consortium – which is composed of the Leadership Conference on Civil Rights, the National Association of Neighborhoods, and the National Fair Housing Alliance – is providing ongoing information on the B/C credit market.

Ameriquest's primary product is a first mortgage loan for purchase or refinance of a one- to four-family residence. It is one of the nation's largest lenders for this type of product. Ameriquest has made approximately \$380 million of such loans during the past three years in Philadelphia and in Bucks, Chester, Delaware, and Montgomery counties, Bass said.

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## National City Community Development Corporation Creates Affordable-Housing Partnership in Pennsylvania ...continued from page 6

meeting these housing needs and the ability to coordinate a housing project. This organization then becomes the general partner in the partnership, and NCCDC serves as limited partner. In the case of Lawrence County, the Lawrence County Family Center was identified as having the commitment and capacity to address housing conditions in its county.

Once the local agency is identified, meetings are held with city and county officials on the subjects of funding sources, home-owner counseling, job training, and determination of potential target areas for the project. When these participants are deciding on which geographic area is best suited for a renaissance project, they consider a number of factors: presence of infrastructure;

presence in the neighborhood of anchor institutions such as churches, schools, hospitals, and stores; and the willingness of government officials to seek community development block grant (CDBG) funds to build or repair infrastructure, and HOME funds, both of which come from the U.S. Department of Housing and Urban Development.

While different geographic areas are being considered, NCCDC representatives schedule meetings with local residents, most of whom are renters interested in owning homes. At these meetings, representatives from local banks discuss the various mortgage products, rates, the application process, and the credit standards required to secure financing. From the meetings, NCCDC determines into which ar-

reas of the community current residents would or would not relocate as well as the extent of formal credit-counseling and home-ownership classes needed to facilitate qualifying the residents for mortgages.

Another important step is to meet with banks that have a presence in the community to determine their interest in taking part in the project as limited partners that pool their funds. The banks provide the funds on a flat-fee basis rather than on a daily-interest basis, which provides the general partner with a fixed cost from which to negotiate contracts and keeps the accounting process as simple as possible.

### Partnership

Once a partnership agreement is set up, the project can move forward. The general partner runs the

project locally, which involves locating real estate; negotiating contracts for purchase, rehabilitation, and/or new construction of housing units; and, ultimately, selling the homes to qualified buyers. The general partner also applies for and receives funds to bring the actual cost of the project down to an affordable level for the home buyers. The limited partners provide equity for the general partner to buy land and build houses and/or to buy properties and renovate them. The partnership takes ownership of each property during construction or rehabilitation and transfers the home to the purchaser at time of sale. If a property does not sell immediately, interest-carrying costs do not increase because the funds were provided on a flat-fee basis.

### Specific Projects

In the Lawrence County Family Center project, the partners have committed themselves to developing 41 affordable-housing units over the next three years, with a mix of 16 new-construction units and 25 rehabilitated units. The first units to be completed will be eight new-construction units in the city of New Castle. To date, in addition to the \$2.4 million committed as equity by the six limited-partner banks, the project has secured CDBG and HOME funds for housing construction/rehabilitation costs as well as funds from the Federal Home Loan Bank's Affordable Housing Program (AHP) and Home Buyer Equity

Fund (HBEF) program, which help finance home buyers' costs. The partnership is awaiting final determination from the Pennsylvania Department of Community and Economic Development (DCED) on a request for a Community Housing Development Organization (CHDO) operating grant.

Two partnerships preceded the one in Lawrence County. In Beaver County, seven banks committed \$2.5 million as equity to create 100 affordable units over three years. In Mercer County, three banks committed \$1.08 million as equity to create 25 affordable units, also over a three-year period. For these two partnerships, federal and county governments committed CDBG, HOME, and Act 137 (County Housing Trust) funds, as well as AHP and HBEF funds to ensure that the properties would remain affordable.

By the end of this year, NCCDC will be working on project rollouts in Crawford and Erie counties. The model is replicable because the role of general partner can be filled by any local housing or redevelopment authority, social-service agency, or for-profit developer willing and able to take on the additional work. Generally, banks are favorably disposed to these partnerships because the banks can gain credit for all three tests on a Community Reinvestment Act (CRA) examination. They can infuse equity up front for rehab/re-



*The house pictured is the first of five houses to be built on a street in Wheatland, Pennsylvania, as part of the Mercer County Housing Starts Partnership. Hosanna Industries is the contractor. Sale prices are \$62,500 to \$63,500. Mortgage amounts range from \$38,000 to \$44,000, depending on buyer's income; subsidy money is \$18,000 to \$24,000. Photo courtesy of National City Bank of Pennsylvania.*

construction for investment test credit, offer discounted mortgages for lending test credit, and/or sit on the partnership committee for service test credit. Federal and state agencies, like HUD and DCED, have shown support by releasing funds for each project to date. In this time of acute need for affordable-housing, NCCDC feels that it has developed a unique process for delivering affordable housing while promoting the continued viability of existing communities.

*If you would like to discuss this concept in greater detail, contact Jim Gutowski at (412) 644-7638 or via e-mail at [James.Gutowski@National-City.com](mailto:James.Gutowski@National-City.com).*

## Bank Makes Equity Equivalent Investment in CDFI

*By Donald W. James, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia*

**F**irst Commonwealth Bank has made an equity equivalent investment (EQ2) in The Progress Fund, a community development financial institution (CDFI) headquartered in Hollidaysburg, Pennsylvania. Under the agreement, First Commonwealth will invest up to \$500,000 in The Progress Fund for the next 15 years. The entire \$500,000 investment will be used to make small-business loans, supporting The Progress Fund's goal of ex-

panding the number of living-wage jobs in the region.

First Commonwealth Bank, based in Indiana, Pennsylvania, operates through nine division banks covering 17 counties in western and central Pennsylvania and is an affiliate of First Commonwealth Financial Corporation, a \$4.3 billion financial services holding company also headquartered in Indiana, Pennsylvania.

The Progress Fund, a federally

certified CDFI since July 9, 1998, serves small businesses in nine counties of southwestern and south-central Pennsylvania. Its lending focuses on businesses involved in the tourism industry, such as bed and breakfasts, campgrounds, recreational sites, visitor attractions, specialty grocery stores, and other tourism-related operations, or to projects that involve the rehabilitation of historic properties.

*...continued on page 10*

## Equity Equivalent Investments

The equity equivalent investment, a relatively new financial instrument, is designed specifically to function like equity for nonprofit CDFIs. Traditionally, nonprofit CDFIs raised the equity capital needed to support their lending and investment activities only through capital grants or, in some instances, from retained earnings. In 1995, National Community Capital Association (NCCA), a well-known CDFI in Philadelphia, Pennsylvania, started the Bank Equity Project to create a new financial instrument that would function like equity for nonprofit CDFIs. NCCA introduced the first EQ2 when it closed a \$1 million investment from Citibank in February 1997. (See "EQ2 Essential Attributes.") Like permanent capital, the EQ2 enhances a CDFI's lending flexibility and increases debt capacity by protecting senior lenders from losses. Unlike permanent capital, the investment must eventually be repaid and requires interest payments during its term. Also, it must have a rolling term and an indeterminate maturity. If the asset's maturity date is fixed, the investment would be debt rather than equity. In the case of First Commonwealth Bank and The Progress Fund, at the end of each of the first five years,

the bank is obligated to extend the investment's maturity date for an additional year unless The Progress Fund defaults. After the first five years, the bank determines whether it wants to extend the investment's maturity annually for another five years or another 10 years.

### Treatment Under CRA

The investing bank can choose how its investment is treated under CRA. The entire amount of the investment in the CDFI could be considered a qualified investment under the investment test. Or if the investing bank chooses consideration under the lending test, the investing bank is entitled to claim a pro rata share of the community development loans made by the CDFI, provided the loans benefit the bank's assessment area or a broader state-wide or regional area that includes the assessment area. The bank's pro rata share of loans originated is equal to the percentage of equity capital provided by the bank. If the bank opts for lending test consideration, some of its investment may still receive investment test credit, but the amount recognized for investment test credit is "offset" by the portion recognized under the lending test. (See CRA Q & A .23(b), dated April 28, 2000.)

## EQ2 Essential Attributes

1. The equity equivalent is carried as an investment on the investor's balance sheet in accordance with generally accepted accounting principles (GAAP).
2. It is a general obligation of the CDFI that is not secured by any of the CDFI's assets.
3. It is fully subordinated to the right of repayment of all of the CDFI's other creditors.
4. It does not give the investor the right to accelerate payment unless the CDFI ceases its normal operations (i.e., changes its line of business).
5. It carries an interest rate that is not tied to any income received by the CDFI.
6. It has a rolling term and, therefore, an indeterminate maturity.

*Source: Margaret B. Lehr, "Equity Equivalent Investments in Nonprofit CDFIs," National Community Capital Association Technical Assistance Memo, 1998, p.2.*

*For more information on equity equivalent investments, contact Allyson Randolph, National Community Capital Association, at (215) 923-4754, or David Kahley, The Progress Fund, at (814) 696-9380.*

## Texas Banks Form Venture Capital Fund

*By Sally Burke, Senior Editor and Publications Manager, Federal Reserve Bank of Philadelphia*

In Texas, 56 small banks have gone where small banks haven't gone before: they've formed a venture capital fund. The Independent Bankers Capital Fund, L.P. (IBCF), sponsored by The Independent BankersBank (TIB) of Irving, Texas, is also licensed by the Small Business Administration as a small business investment company (SBIC), making it the first SBIC owned by small to mid-size community banks. The participating banks are all customers or shareholders of TIB, which supplies correspondent banking services to small and communi-

ty banks in Texas and other states in the Southwest.

Because of the limitations imposed by banking regulations, it's hard for small banks to come up with venture capital funds on their own. "Under regulatory limitations, you need a relatively large bank to make a viable investment on its own," explains Barry Conrad, the fund's manager. "TIB was a significant help in getting this fund going."

To participate in IBCF, an individual bank must commit a minimum of \$200,000 or 5 percent of its

regulatory capital. The fund, which had \$70 million as of May 2000, has made its first two investments: \$1.5 million to a manufacturer of medical products in Tyler, Texas, and \$1.8 million to a producer of automotive after-market products in Fort Worth. In both cases, the money was used to help a small company buy a division of another company, thus keeping jobs in Texas. In fact, a California-based company was interested in acquiring the Fort Worth company. Had it done so, it would have closed the operations there and moved the company —

and its jobs— to California. Thanks to the equity investment from IBCF, at least 24 jobs will stay in Fort Worth.

According to Conrad, the fund's targeted internal rate of return from its investments is approximately 30 percent a year. Conrad cautions, however, that this rate is realistic only if the management teams of investee portfolio companies can do

what they say they can.

Can this type of setup work in other parts of the country? Other regions are, at least, interested in finding out more. Thus far, Conrad says, he's fielded inquiries from Wisconsin, Virginia, and Nebraska. And the queries have come from several quarters, including bank trade associations.

Kevin Drew, senior vice presi-

dent of correspondent banking for TIB, sums up IBCF this way: "Overall, we are quite pleased with the progress of the fund and feel strongly that we are providing an equity source of capital to many communities that are not actively marketed by the national funds."

*For more information, call Barry Conrad at 214-765-1351.*

## Bank's Participation Recognized in CRA Exam

*By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia*

**T**he Bryn Mawr Trust Company in Bryn Mawr, Pennsylvania, received recognition in its latest Community Reinvestment Act (CRA) examination for its participation on a task force exploring establishment of a financing entity for cleaning up and redeveloping brownfields and other environmentally impaired lands in Pennsylvania.

The bank's participation in the Financial Resources for the Environment (FRE) task force was mentioned in the public disclosure part of the bank's CRA exam, which was conducted by the Federal Reserve Bank of Philadelphia. The bank received recognition in the service test

portion of the exam, which evaluated the bank's CRA performance as of June 5, 2000.

One aspect of the service test involves analyzing the extent and innovativeness of a bank's community-development services. These services include activities that revitalize or stabilize low- or moderate-income areas.

FRE's goals are to promote community and economic development, sustainable growth, public health and environmental protection, and economic and environmental stewardship, according to its mission statement. The stewardship goal entails supporting clean-up and rede-

velopment efforts in disadvantaged areas, minority communities, low- and moderate-income neighborhoods, or areas targeted for redevelopment by federal, state, or local governments.

Two officers of Bryn Mawr Trust Company, Robert J. Ricciardi, executive vice president, and Geoffrey L. Halberstadt, group vice president, serve on the FRE task force. Halberstadt also served on the task force committees that drafted FRE's mission statement and proposed its organizational structure.

## Calendar of Events

### **Rural Voices: Sharing Our Stories**

San Diego, CA, March 12-14, 2001

Sponsored by Rural Community Assistance Corporation

For information, call RCAC at 916-447-2854.

### **Federal Reserve System Conference:**

#### **Changing Financial Markets and Community Development**

Washington, D.C., April 5-6, 2001

For information, call Lynn Elaine Browne, Federal Reserve Bank of Boston, at 617-973-3091 or send email to [Lynn.Browne@bos.frb.org](mailto:Lynn.Browne@bos.frb.org).

### **Faith-Based Community Financial Education Conference**

April 25, 2001

Sponsored by the Federal Reserve Bank of Philadelphia

Location to be announced. For more information, call Rose Howe at 215-574-6116.

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