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Pennsylvania Launches Broad-Based Response to Foreclosure Problem

By Keith L. Rolland, Community Development Advisor

Six state departments and agencies in Pennsylvania are investigating a high rate of foreclosure filings in fast-growing Monroe County and are searching for long-term remedies in light of a statewide increase in foreclosures.

In the fall of 2003, Pennsylvania Governor Edward G. Rendell established a Monroe County task force with representatives from the Office of the Governor, Office of the Attorney General, Pennsylvania Department of Banking (DOB), Pennsylvania Department of Community and Economic Development, Pennsylvania Department of State, Pennsylvania Housing Finance Agency (PHFA), and the U.S. Department of Housing and Urban Development. The DOB is taking the lead on the task force.

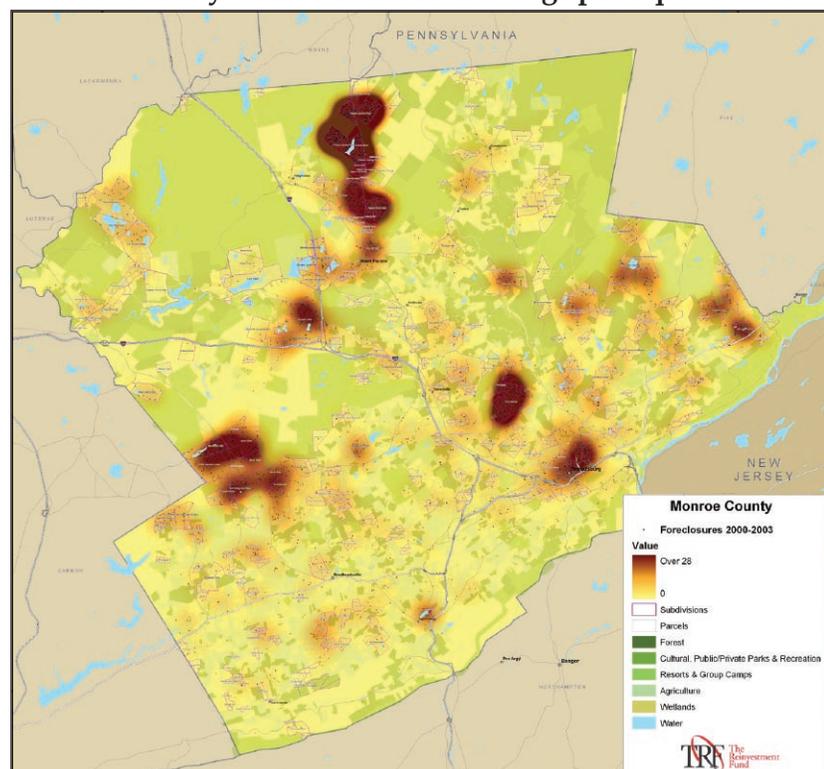
At the request of the DOB and PHFA, The Reinvestment Fund (TRF), based in Philadelphia, prepared a study analyzing foreclosures in Monroe County. The two agencies have also

commissioned TRF to prepare a report on statewide foreclosures that is expected at the end of 2004.

The TRF study examined initial foreclosure filings in Monroe and seven other counties. Monroe County foreclosure filings were analyzed using transaction histories of properties, applications made under PHFA's Homeowners Emergency Mortgage Assistance Program (HEMAP),

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The Reinvestment Fund's Analysis of Monroe County Prothonotary Data: Foreclosure Filings per Square Mile



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Message from the Community Affairs Officer

Everywhere you turn there are stories of foreclosures, families thrown out of their homes because they cannot pay their mortgages. The stories are often heart-wrenching, and when the local sheriff stops sales, he becomes a local hero.

But what exactly is going on? The Reinvestment Fund (TRF) is leading the way to understanding the problem. Starting with Monroe County and then looking at other counties in the Commonwealth of Pennsylvania, TRF is helping the secretary of banking, the Pennsylvania Housing Finance Agency, and an industry-advisory group to understand the problem. Among the points that TRF reported is that Monroe County's foreclosures occurred within an average of 2.8 years of loan closing, which is about a year shorter than the average in Montgomery County, and nearly a year shorter than the average in Philadelphia County. TRF also reported that most of the foreclosures were in just 12 subdivisions and five townships, which is a disturbing pattern.

The best way to determine what led to foreclosure is to review loan files and look for patterns on a variety of factors: loan to value, debt-to-income ratios, credit history, cost of financing, and borrower's reserves. TRF had hoped to speak to the families involved in foreclosure filings in Monroe County, but many had left their homes and could not be located.

Robert F. Cotterman, a researcher who analyzed FHA-insured loans for the U.S. Department of Housing and Urban Development, studied the factors that influence dollar-loss rates and default probabilities of FHA borrowers. We have highlighted his report in "Spotlight on Research." If you are interested in helping new homeowners stay in their homes (and lenders take lower losses), read this article.

And then there are the CDCs and CDFIs stepping in to help the troubled homeowner. NHS of Chicago realized that the homeowners who had bought in NHS neighborhoods without the benefit of NHS homeownership counseling or financing were losing their homes to foreclosure. To protect housing values and the stability of these neighborhoods, the Chicago NHS stepped in to stop the decline by working with sub-prime lenders and servicers as well as borrowers and the city of Chicago. The program is still new, but it is making headway on a very tough problem. We hope to hear of Third District organizations doing the same in the near future.



Please Note:

The Philadelphia Fed has a new web address. Go to www.PhiladelphiaFed.org to find Community Affairs publications and other information.

Pennsylvania Launches Broad-Based Response to Foreclosure Problem

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HUD-1 settlement sheets, and appraisals where available.

In Monroe County from 1990 to 2000, the population increased 45 percent, to 138,687 residents, the number of housing units increased 23 percent, to 67,581, and the unemployment rate increased from 5.6 percent to 6.6 percent, according to the study. Of the people who moved into Monroe County from 1995 to 2000, 54 percent came from Pennsylvania, 19 percent from New York, 16 percent from New Jersey, and 11 percent from other states, the study shows.

The study found that 6,129 mortgage foreclosures were filed in Monroe County from 1995 to 2003. The annual number of foreclosure filings increased in all but two of the years in that nine-year period, rising from 388 in 1995 to 940 in 2003. The filings were concentrated in five townships and 12 subdivisions.

The study added: "Loans on the Monroe County Prothonotary's foreclosure filing list from 2000 through 2003 more likely involved an inflated sale price than those not in foreclosure, are disproportionately subprime and went into foreclosure faster than other Pennsylvania counties for which comparable data was available."

The study said that from 2000 to 2003 the time between origination and foreclosure averaged 2.8 years. Approximately 64 percent of foreclosed loans were for home purchase, while the balance were for home equity or refinance.

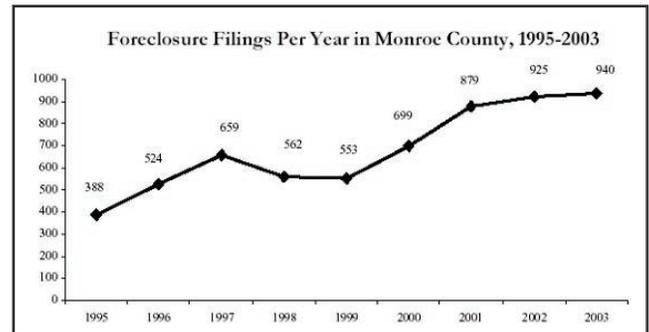
The study focuses on foreclosure fil-

ings, not actual foreclosures, and does not pinpoint the causes for the large number of foreclosures in Monroe County. Ira Goldstein, TRF's director of public policy and program assessment, explained that it proved difficult to obtain data on different facets of the home-buying process, including appraisals, and that TRF had limited access to loan files of borrowers who lost their houses in Monroe County. Compounding the problem, many of the borrowers could not be located, he said.

In one of the state government's responses to Monroe County foreclosures, the Office of the Attorney General has filed three lawsuits seeking \$21.4 million in restitution, penalties, and the Commonwealth's costs from 46 builders/developers, mortgage brokers, and appraisers in connection with the complaints of 278 consumers.

In October, DOB and PHFA caseworkers were working with more than 250 homeowners and the lenders who hold the owners' mortgages to try to voluntarily restructure loans and resolve disputes. If those voluntary discussions are unsuccessful, a formal panel with representatives from the DOB, PHFA, Attorney General's Office, and the Pennsylvania Department of State is expected to review some of the complaints.

A. William Schenck III, Pennsylvania's secretary of banking, said that the DOB would increase its



Source: The Reinvestment Fund's Analysis of Monroe County Prothonotary Data

staff 30 percent, to 154 employees, by June 2005 in order to better enforce the state's consumer protection laws. The agency will strengthen its examination capability, conduct extensive background checks on applicants for licenses, increase to seven its consumer assistance staff, track consumer complaints by type and geography, and add a specialist in financial fraud, he said.

Secretary Schenck said he hopes to find a way to include an independent third party such as a credit counselor to help review documents and terms with consumers before they close on subprime home purchase or refinance loans.

He noted that subprime and conventional lenders who hold foreclosed mortgage loans in Monroe County have been "cooperative" in trying to find workout solutions.

Brian Hudson, executive director of PHFA, said that PHFA had established a network of four nonprofits to provide housing and credit counseling to Monroe County homeowners and had provided funding and staff training. Also, PHFA and DOB have conducted a total of eight seminars in Monroe County to enable homeowners to share their experi-

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Pennsylvania Launches Broad-Based Response to Foreclosure Problem

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ences with state-agency representatives, he said.

Hudson explained that PHFA's HEMAP program has not been applicable to most of the Monroe County homeowners because the appraised value of their homes is typically well below the mortgage amount. The program was established, he said, for situations of temporary unemployment or illness with the likelihood that homebuyers could resume regular mortgage payments.

Meanwhile, the Pennsylvania Department of State permanently removed three appraisers' rights to practice and has taken disciplinary action against several other appraisers, while other state officials have enlisted eight appraisers in Monroe

and adjacent counties to provide reduced-cost appraisals for consumers in workout situations.

The state is also preparing to implement a uniform construction code in light of the fact that inspections were not conducted on many newly constructed Monroe County properties, which had serious defects and later went into foreclosure.

In another action, Fannie Mae has agreed to purchase \$1 million of restructured loans of Monroe County borrowers who had good credit before they encountered problems on their current mortgages.

Goldstein and DOB officials said the experience of consumers in

Monroe County underscored the importance of education, especially for first-time buyers, in the home-buying process. The state's office of financial education, which is located within the DOB, is working with Monroe County school districts to include financial education in their curricula.

The TRF report and a letter from Secretary Schenck to lenders and brokers may be viewed at www.banking.state.pa.us/banking/site/default.asp. For information on state responses in Monroe County, contact Lydia Hernández-Vélez, deputy secretary of the DOB, at lehernande@state.pa.us, or Brian Hudson, executive director of PHFA, at bhudson@phfa.org. For information on the TRF study, contact Margaret Berger Bradley, TRF's director of strategic planning, at margaret.bradley@trfund.com.

Chicago NHS Links Resources to Prevent Foreclosures

By Keith L. Rolland, Community Development Advisor

Neighborhood Housing Services of Chicago (NHSC) has begun to work with servicers of subprime loans in the past 18 months to try to jointly assist borrowers who have loans at risk of foreclosure.

Bruce Gottschall, currently a Fannie Mae fellow on leave from his position as executive director of NHSC, said that "Chicago is a laboratory" of pilot partnerships with NHSC, subprime servicers and lenders, and the city of Chicago. The results will be shared by Neighborhood Reinvestment Corporation (NR), which expects to launch a national center on foreclosure solutions by September 2005 and which is exploring

ways to do in-depth research on foreclosures.

NHSC wants to prevent foreclosures if possible because they have a substantial negative impact on neighborhoods where NHSC has cultivated homeownership for decades. The servicers, for their part, want to avoid foreclosures if possible because they are costly.

Gottschall said NHSC formed the partnerships in part because it found that "the biggest jump in foreclosures in NHSC's targeted neighborhoods was in subprime loans." He added: "NHSC wanted to create new relationships because

the subprime market was evolving and we wanted the servicers, most of which did not have a local branch or staff, to understand the local market. So we decided to talk to them." In talking to the servicers, NHSC realized that "they have a lot of tools and interest in solving the problem," he said.

Gottschall said that the subprime servicers with which NHSC is working closely include Homecomings Financial Network (HFN)—the servicing affiliate of GMAC-RFC—Citigroup affiliates, and Chase Manhattan Mortgage Corporation.

Prior to the partnerships, a borrower

facing foreclosure contacted NHSC, which worked with the borrower and the lender through the lender's 800 telephone number, Gottschall said. Nowadays, NHSC knows the names and phone numbers of individuals at servicers who may be contacted by either NHSC or borrowers. Another resource that is now available is a city-operated "311" hotline that can connect a caller with a credit counselor.

Gottschall said that servicers report that more than half of the borrowers who are behind in their payments never talk to their servicers. "The borrowers probably think it's hopeless," he said. Gottschall also said the loan mitigation specialists at the servicers may not know of all the public and private resources available to such borrowers. NHSC itself can make small grants or loans, and one result of the discussions with the servicers is that "we link all the resources," he said.

The partnerships seek to preserve homeownership whenever possible through counseling, loss mitigation, and loan workouts and, if foreclosure is unavoidable, to preserve the vacant properties as neighborhood assets.

NHSC launched a homeownership preservation initiative (HOPI) in 2000 to begin to address rising foreclosures, and nearly two dozen subprime lenders are now represented on a HOPI advisory committee. An NHSC staff member and industry member jointly lead working groups on loss mitigation and outreach, REO disposition, origination issues and foreclosure prevention, capital-market innovation, and public

relations and communications.

NHSC, which has 105 full-time staff members and a \$7 million operating budget, lends citywide for home purchase, home improvements, rehabilitation, and refinance, provides pre- and post-purchase counseling, rehabilitates and sells houses, owns and manages rental properties, and is involved in community organizing and community

In the subprime market, it is very common for delinquent loans to move into foreclosure without the borrower being made aware in a timely fashion of possible loan modifications and workout options.

Development Implications of the New Mortgage Market, a detailed report on the subprime market. The report discusses NHSC's work with Homecomings Financial Network (HFN), which had a representative based in the NHSC office. HFN and NHSC also collaborated on a financial education workshop attended by 45 HFN borrowers who were residents of four NHSC-targeted neighborhoods and who ranged from those



This is one of a series of vacant properties that have been rehabilitated and sold to homeowners by Neighborhood Housing Services of Chicago (NHSC) in Chicago's Back of the Yards neighborhood. The property had been abandoned and gone into foreclosure before the previous lender donated the property to NHSC in September 2003. The property was sold for fair-market value in August 2004.

development in nine neighborhoods.

In March 2004, NHSC released *Preserving Homeownership: Community-*

current on their loans to those in foreclosure.

The report explains that "servicing rights are bought and sold regularly, and various aspects of servicing a single loan may be handled by different entities. As a result, should a problem arise, borrowers and their advocates often encounter obstacles simply talking to a person who has the capacity to investigate and resolve the problem."

It adds: "In the subprime market, it is very common for delinquent loans to move into foreclosure without the borrower being made aware in a timely fashion of possible loan modifications and workout options, not to mention publicly available

...continued on page 6

Chicago NHS Links Resources to Prevent Foreclosures ...continued from page 5

foreclosure avoidance programs.”

Similarly, the report says, servicing firms have elaborate systems that determine a loss-minimizing route to cure a default but “ignore information that could change this calculation because they do not have access to a detailed menu of municipal, state, and federal programs” that can assist borrowers.

It recommends that escrow funds become a standard feature of all subprime loans to help borrowers more easily make property tax and other large home-related payments. It also recommends studying the neighborhood impact of foreclosures because foreclosed properties that become vacant or poorly maintained

may undermine the appeal and market value of other properties in the neighborhood.

The NHSC report says: “While consumers must be shielded from egregious credit collection practices, in many instances existing regulations have the unintended consequence of limiting the options of servicers trying to arrange early workout options for borrowers in danger of losing their homes.”

The report says that subprime servicers and rating agencies are in the early stages of discovering what constitutes best practices in subprime servicing. Ameriquest Mortgage Company is one sub-

prime lender that has developed its servicing best practices.*

The report concludes that “the public policy posed by the subprime mortgage industry is how to balance the need to continue to expand access to capital without exposing consumers, neighborhoods, and investors to unacceptably high levels of risk.”

For information on NHSC’s work with subprime lenders and servicers, contact Bruce Gottschall at bgottschall@nhschicago.org; www.nhschicago.org.

To see the NHSC report, go to www.nw.org and click on publications, then homeownership and mortgage finance.

* The practices may be seen at www.ameriquetmortgage.com.

Subprime Market Reaches Record High Level In First Half of 2004

Editor’s Note: The following information is provided to illuminate recent lending activity in the subprime market. The information is from Inside B&C Lending, a newsletter published by Inside Mortgage Finance Publications in Bethesda, MD.

Subprime lenders originated loans totaling an estimated \$252.6 billion in the first half of 2004, a record high for a six-month period and up 87.1 percent over the corresponding period in 2003, according to the August 9, 2004, issue of the publication *Inside B&C Lending*.

The publication said that in contrast, during the same period overall originations of one- to four-family residential mortgages fell nearly 30

percent, FHA lending dropped 32.8 percent, and VA lending declined 31.9 percent.

During the first half of 2004, subprime lenders increased their share of total mortgage production to 18.2 percent, their highest market share since 1997, *Inside B&C Lending* said.

It gave the following reasons for subprime lenders’ experiencing much stronger growth than prime lenders: the end of the refinance boom has not had as much impact in the subprime market and brokers have reportedly begun to focus their efforts on hard-to-place loans; there has been a proliferation this year of adjustable-rate mortgages, including interest-

only loans, which are popular with marginal borrowers trying to cope with increasing home prices; and the securitization market has been strong. It said that 60.3 percent of the subprime loans generated during the first half of the year were included in securitization pools.

Inside B&C Lending estimated that Ameriquest Mortgage Company was the leading B&C lender, with \$38.16 billion in new subprime loans and a 15.1 percent market share in the first six months of 2004. Ameriquest increased its subprime lending 163.2 percent over the year-earlier period, it said.

The publication defines B&C mortgages as less than A quality, non-

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agency loans secured by real estate. Its estimates are based on data provided by subprime mortgage and home equity lenders, earnings reports, and public documents. Its data include wholesale purchases,

including loans closed by correspondents.

Using the same data sources, the publication estimated in its August 23, 2004, issue that the 25 largest subprime servicers held 81.3

percent of a total of \$822.5 billion in subprime loans that were outstanding at the end of June 2004.

Ameriquest Mortgage Company was the servicer that held the largest loan portfolio, which totaled \$71.84 billion.

Banks Make Home Improvement Loans to Philadelphia Residents With Impaired Credit

The Greater Philadelphia Urban Affairs Coalition (GPUAC) has developed a pilot program in which participating lenders make home improvement loans to homeowners with impaired credit who might otherwise have no alternative but high-cost loans.

Owner-occupants of one- to four-family homes in Philadelphia with incomes up to 115 percent of median family income are eligible for fixed-rate loans in the program, which became operational in July 2003 with funding from the city of Philadelphia's Neighborhood Transformation Initiative. A reserve fund provides some coverage for losses based on the borrowers' FICO scores, which generally range from 580 to 620. (Credit bureau risk scores produced from models developed by Fair Isaac Corporation are commonly known as FICO scores.)

Loans are of two types: secured loans up to \$25,000 for a maximum of 20 years (PHIL-Plus), and unsecured loans up to \$10,000 for a maximum of 10 years (Mini-PHIL). Up to 50 percent of both types of loans can be used to pay off existing debt.

Donald C. Kelly, director of GPUAC's community and economic development division, said that 58 loans have been closed in the

program as of September 30, 2004, with an average size of \$19,500.

Participating lenders are Bank of America, N.A., Beneficial Savings Bank, Citizens Bank of Pennsylvania, Commerce Bank, N.A., National Penn Bank, PNC Bank, N.A., Sovereign Bank, and United Bank of Philadelphia. Wachovia Bank has given some financial support but is not participating in the loan program.

Kelly said that one of the most appealing aspects of the program is the chance to pay off existing debt.

Nonprofit housing counseling agencies play a critical role in the [loan] program.

"A lot of people have higher debt payments than they're comfortable with and want to find ways to replace the payments with more reasonably priced debt," he said.

Nonprofit housing counseling agencies play a critical role in the program. The process begins when the borrower contacts one of 25 housing counseling agencies and meets with a counselor. The counselor obtains preliminary information and sends it to GPUAC, which verifies that the borrower meets eligibility requirements and sends the package to a participating bank selected by the borrower. The borrower makes an

appointment with the bank, which conditionally approves or denies the application.

In the case of PHIL-Plus, the borrower meets again with the counselor and arranges for an inspection with the counselor's assistance. The borrower pays the inspection fee, which averages \$300. The work plan must include essential health-and-safety and structural deficiencies identified in the inspection. The borrower gets a contractor's estimate with the counselor's assistance.

The borrower returns to the bank with the inspection, final work plan, and contractor's estimate. Loan proceeds go to the borrower, not the contractor.

After the work is completed, the Philadelphia Redevelopment Authority conducts an after-work inspection at no cost to the borrower. The borrower is strongly encouraged to retain 10 percent of the contractor's total fees until the final inspection is conducted.

The program's long-term goal, Kelly explained, is to enable banks to become more comfortable with borrowers who have moderately impaired credit.

For information, contact Donald C. Kelly at (215) 851-1738 or dkelly@gpuac.org; www.gpuac.org.

PHFA Spurs Mixed-Income Housing Construction to Revitalize Urban Neighborhoods

By Keith L. Rolland, Community Development Advisor

An initiative of the Pennsylvania Housing Finance Agency (PHFA) has contributed to the development and new construction of mixed-income, single-family for-sale developments totaling 1,095 homes in 20 deteriorated urban areas.

Robert F. Bobincheck, director of PHFA's office of strategic planning and policy, said: "The goal of the homeownership construction initiative (HCI) is to rebuild urban

neighborhoods. One of the ways to do this is to attract a mixed-income population, which helps stabilize communities." HCI is designed to attract homeowners in attractive duplex, townhouse, and detached-unit developments with parking and other amenities that would normally be found in suburban areas.

During the past four years, PHFA has provided nearly \$30 million

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A concrete fabrication plant that made road barriers in Coatesville, PA, was replaced by 50 affordable townhouses through the housing construction initiative (HCI) of the Pennsylvania Housing Finance Agency. The National Council of State Housing Agencies gave PHFA an award in 2003 for encouraging new production through its HCI program.

PHFA and PNC Bank Partner to Finance Mixed-Use Buildings

Main streets, a vital part of the economy of cities and towns across Pennsylvania, contain many buildings with stores on the street level and apartments on upper floors. In response to the challenge of financing these mixed-use buildings, the Pennsylvania Housing Finance Agency (PHFA) has begun to make loans for the rehabilitation of residential portions of vacant properties while banks provide first-mortgage loans for the remaining financing needs of the properties. The banks may also provide working capital or other loans to owners of businesses located in the properties.

In April, as part of PHFA's mixed-use financing initiative, the agency awarded \$1.9 million for the rehabilitation of mixed-use properties in eight communities. This amount included \$750,000 provided by the Pennsylvania Department of Community and Economic Development.

Robert F. Bobincheck, director of PHFA's office of strategic planning and policy, said that PNC Bank, N.A. has agreed to consider loans for vacant properties that are approved for PHFA loans in the mixed-use initiative. The PHFA loans are made at 2 percent interest for 20 years, while the bank loans are made at market interest rates, he said.

Amy Lempert, a vice president with PNC Bank, N.A., said that the need for public subsidy to complement bank financing on mixed-use projects surfaced at a meeting of the bank's community development advisory committee about two years ago. The discussion involved Lempert, representatives of Philadelphia Local Initiatives Support Corporation (which had started a program to assist eight commercial corridors in Philadelphia), the Philadelphia Association of Community Development Corporations, and Mark Schwartz, executive director of Regional

Housing Legal Services. Schwartz, a member of PHFA's board, began discussions with PHFA that led to creation of the program.

Mixed-use buildings have long been regarded as a financing challenge because of the distinct housing and commercial components. Last year, *Back to Prosperity: A Competitive Agenda for Renewing Pennsylvania*, prepared by the Brookings Institution Center on Urban and Metropolitan Policy, recommended a coordinated state approach to support the development of mixed-use properties.

A request for proposals for the next mixed-use funding round is expected in March 2005, with proposals due in August 2005. The initiative is part of PHFA's homeownership choice programs.

For information, contact Robert F. Bobincheck at (717) 780-1801 or bbobincheck@phfa.org; www.phfa.org.



A decaying neighborhood in North Philadelphia was revitalized with a 50-unit development by the Asociación de Puertorriqueños en Marcha (APM) through the Pennsylvania Housing Finance Agency's homeownership construction initiative. APM is developing another 55 new homes that are adjacent to the original site and are expected to sell for between \$85,000 and \$100,000.

and leveraged over \$223 million through HCI. In 2003, the National Council of State Housing Agencies gave PHFA an award for "encouraging new production" through its HCI program.

HCI funded a 50-unit development by the nonprofit Asociación de Puertorriqueños en Marcha (APM) that dramatically revitalized a decaying area of North Philadelphia. Other HCI funding contributed to the first large-scale single-family development in Chester in 30 years.

HCI also funded 25 family units on a former industrial site near downtown Hazleton and funded 50 affordable townhouses that complement nearby private market-rate development in Coatesville.

HCI typically requires a three-way partnership: a municipal entity, a for-profit builder or developer, and a nonprofit builder or developer. PHFA funding must be matched by the development sponsor at least one-to-one. Half of the sponsor's match must come from the municipality. The leveraging ratio in approved applications has ranged

from 5:1 to 17:1, Bobincheck said.

PHFA and other government funds subsidize the difference between the construction cost and the sale price. It cost approximately \$137,000 to build the APM homes, which were

sold two years ago for \$55,000—and have recently been appraised at \$95,000, Bobincheck explained. The buyers could sell and make a windfall profit, but none has chosen to do so, he said, adding that PHFA's board is concerned about that possibility and is looking to prevent such action. APM is developing another 55 new homes adjacent to the original site that are expected to sell for between \$85,000 and \$100,000.

PHFA's loan is made to the strongest of the three partners (the municipal entity, for-profit builder or developer, or nonprofit builder or developer) and is not made to the homeowner. "Our PHFA money stays in the community," Bobincheck said, "rolling over and helping increase housing values through an innovative internal mechanism to finance HCI."

PHFA provides 90 percent of its allocation for each development to the sponsor for project costs and sets aside 10 percent of the loan amount for an investment account consisting of securities of government or government-sponsored

entities. PHFA expects that the total amount allocated for HCI developments will be recaptured over 30 years through the return on the securities.

Although PHFA's HCI funds do not come with restrictions on buyers' incomes, most municipal and federal funds in HCI developments require that buyers be low and moderate income (LMI). As a result, PHFA money may be used to construct moderately priced units, while municipal and federal funds are used for LMI units.

PHFA's HCI funds are provided early in the development process and are often used for site-acquisition, infrastructure, and construction costs. PHFA funds may not be used for any developer fees.

At least one HCI partner "must be a strong partner with the experience and ability to get things done" and one partner must attend a PHFA pre-development seminar, a requirement that has helped increase the quality of applications, Bobincheck said.

HCI-funded developments must have a minimum of 50 homeowner units in municipalities with a population of 50,000 or more and 25 units in municipalities with a population of less than 50,000.

Although HCI focuses on new construction, it has also provided funding for the rehabilitation of 30 for-sale condominiums in McKeesport and Meadville, in central and western Pennsylvania.

HCI is part of PHFA's homeownership choice programs (HCP). Earlier this year, PHFA started a new HCP program, the neighborhood revi-

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PHFA Spurs Mixed-Income Housing Construction to Revitalize Urban Neighborhoods

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talization initiative (NRI), which is designed to help municipalities revitalize urban areas by rehabilitating small numbers of vacant properties and constructing in-fill units for purchase as single-family

units. It has the same partnership and matching-fund requirements as HCI.

The request for proposals for the next round of funding is expected

to be available in March 2005, with proposals due in August 2005.

For information, contact Robert F. Bobincheck at (717) 780-1801 or bbobincheck@phfa.org; www.phfa.org.

CDFI Expands Business Lending in Southern New Jersey

The Cooperative Business Assistance Corporation (CBAC), a community development financial institution (CDFI) that makes loans to small businesses, has increased its lending in southern New Jersey during the past four years. Its default and delinquency rates are lower than they were prior to this expansion in lending.

Formed in 1987, CBAC is located in Camden. It has specific loan products for the city of Camden, the Atlantic City area, Cumberland and Gloucester counties, and the city of Woodbury. Eight banks take a 70 percent participation of the loans, while CBAC funds the balance, primarily with federal and state funds. Loans are typically made for equipment purchase, inventory, real estate acquisition, or working capital.

United Bank, PNC Bank, N.A., Sun National Bank, Susquehanna Patriot Bank, and Wachovia Bank.

While CBAC normally participates in loan packages totaling \$250,000 or less, it sometimes joins in larger financing packages with the New Jersey Economic Development Authority (NJEDA) or a bank serving as the primary lender. In 2003–2004, it participated in six such loans ranging from \$700,000 to \$1,362,000.

CBAC also administers two Small Business Administration (SBA) programs that can be used in Atlantic, Camden, Cape May, Cumberland, Gloucester, and Salem counties: a microloan program in which CBAC makes direct loans of up to \$35,000 for working capital, inventory, and equipment purchases; and the 504 program in

which CBAC packages loans of up to \$2 million for the acquisition of real estate, equipment, and building construction. A bank partner shares 50 percent of the 504 loan.

During each of the last three years, CBAC received both SBA's distinguished lender award for making the most microloans in New Jersey and SBA's bronze award for total SBA lending.

CBAC has made a total of 511 loans in which CBAC funding of \$19.5 million has leveraged private funding of \$41.8 million. In the last seven years, CBAC's loan portfolio has increased from approximately 50 loans totaling \$1.8 million, to 200 loans totaling \$7.5 million. It has also packaged five SBA 504 loans. A summary of CBAC's activity during the last four years is shown in the table below.

The eight banks participating in CBAC are Bank of America, N.A., Citizens Bank of Pennsylvania, Commerce Bank, N.A., Hudson

CBAC Lending						
Fiscal Yr.*	Loans Closed	CBAC Portion	Banks' Portion	Total	Total Portfolio Defaults (Based on Dollars Loaned)	Total Portfolio Delinquencies (30 days or more)
2001-2002	60	\$2.1 MM	\$9.5 MM	\$11.6 MM	1.45%	2.02%
2002-2003	67	\$2.4 MM	\$5.1 MM	\$7.6 MM	1.89%	1.81%
2003-2004	94	\$3.2 MM	\$6.4 MM	\$9.6 MM	1.20%	1.54%
2004-2005	28**	\$738,297	\$966,500	\$1.7 MM	1.25%	1.51%
* July 1 to June 30						
** as of September 30, 2004						

R. Michael Diemer has been CBAC's executive director since 1996. He says the organization has reduced its losses and delinquencies substantially during the past decade because of more experienced personnel and closer supervision of borrowers through the use of efficient data-reporting systems. CBAC has four former bank lenders on its staff.

CBAC's diverse borrowers include steel manufacturers, trucking companies, automotive supply and repair businesses, a crab-fishing business, horse stables, accounting and insurance firms, restaurants, medical supply firms, a funeral home, furniture stores, and a baker.

One of CBAC's recent borrowers is Little Sport, a new business in Maple Shade, New Jersey, that operates a multi-sports facility for young children. Jennifer Baker Foley, Little Sport's owner and CEO, said she raised funds through a private placement. When extra financing was needed, however, she was turned down by a bank, which referred her to CBAC. In September 2004, CBAC provided Little Sport

CBAC's biggest challenge is obtaining low-cost funds in order to have a sufficient "spread" to make its loans.

with a \$30,700 loan for equipment purchase.

CBAC provides a wide range of technical assistance, such as monitoring borrowers' bookkeeping methods and, under a contract with NJEDA, mentoring borrowers. In addition, it services about 50 loans made in Philadelphia, Perth Amboy, New Jersey, and southern New Jersey.

Banks often refer business clients to CBAC. Russell B. Haas, commercial loan officer at CBAC, observed that CBAC has a large network of bank lenders and "not a day goes by that we don't get a call from a bank." CBAC also periodically participates with banks on individual deals and on three occasions has guaranteed a bank loan.

Sun National Bank has invited CBAC lenders to give presentations to its lenders in different regions so they will be aware of CBAC products that might make a deal bankable, and Sun's denial letter refers business borrowers to CBAC for assistance, according to CBAC and Sun officials.

Diemer said that CBAC still has a lending niche because very few banks are interested in making loans of under \$250,000 because of the low profit margins on such loans.

CBAC's biggest challenge is obtaining low-cost funds in order to have a sufficient "spread" to make its loans, Diemer said. It has a staff of eight full-time equivalents and a budget of \$900,000, supported by grants from federal, state, and foundation sources, and with low-interest loans and investments from banks and government agencies. In April, CBAC received an \$800,000 loan from USDA Rural Development's Intermediary Relending Program for use in Cumberland County, New Jersey.



The Cooperative Business Assistance Corporation (CBAC) has a diverse portfolio of business borrowers, including the owner of Rainbow III, a charter fishing boat based in Ocean City, NJ. CBAC made an \$18,500 loan in May 2004 for equipment and working capital under the microloan program of the Small Business Administration (SBA). CBAC had previously made a loan to the owner for a smaller fishing boat in conjunction with a loan from Sturdy Savings Bank, Stone Harbor, NJ. Shown holding an SBA check are Jim Kosci, SBA district director; R. Michael Diemer, CBAC's executive director; Victor Hartley, owner; and Russell B. Haas, CBAC commercial loan officer.

Diemer previously worked as a commercial lender for about 10 years at banks in Maine, Vermont, and New Hampshire and earlier served for 18 years in Montpelier, Vermont, as district director of the Farmers Home Administration (which was reorganized as USDA Rural Development, Farm Service Agency, and Rural Business-Cooperative Service).

Many communities become interested in starting loan pools for area businesses, but it's usually impractical to do so, Diemer said. In many cases, after a loan-delivery system has been established and lenders have been enlisted to review applications, loan volume has proven to be low, he said.

He believes that resources must be concentrated in a geographic area in order to have economic development impact. As a result, his long-term goal is to increase loans and services in the six-county region now served by CBAC, rather than expanding to other counties.

For information, contact R. Michael Diemer at (856) 966-8181 or mdiemer@cbaclenders.com.

Enterprise Center Focuses on High-Growth Minority-Owned Businesses

The Enterprise Center (TEC) has changed its primary focus from nurturing start-up businesses in a Philadelphia incubator to strengthening established Pennsylvania businesses with high-growth potential.

Della Clark, president and CEO of TEC, said, "We had to rethink our mission and programs. Businesses are much more mobile today and can set up less expensively, so we moved away from the place-based strategy we started 15 years ago."

TEC's main activity is operating a Pennsylvania Minority Business Development Center (PMBDC), which will focus on assisting minority-owned businesses in Pennsylvania that generate \$500,000 or more in annual revenues and that have high-growth potential. TEC has a contract with the U.S. Department of Commerce's Minority Business Develop-

ment Agency (MBDA) to operate the center from January 2004 to January 2006.

Under the MBDA program, minority-owned businesses are defined as those owned and operated by African Americans, Asians, Hasidic Jews, Hispanics, and Pacific Islanders. TEC assists these businesses in obtaining federal government contracts, and the Center can pay for consulting services, at low cost to the companies, in such areas as marketing, technology, and accounting.

Jacqueline Hill, director of business relationships at PMBDC, previously held a position with the African American Chamber of Commerce in Philadelphia, managed an incubator in Pittsburgh, and was executive director of the Pittsburgh Community Reinvestment Group.

In other activities, TEC is seeking to develop retail stores, commercial offices, and housing along Market Street near its offices in West Philadelphia. Clark said she hoped that the development, entitled Enterprise Heights, would be a model for "an urban neighborhood-based business campus."

In addition, TEC has been approved as an SBA microlender in one of several small-business loan activities at the center. TEC also operates two business plan classes and a youth entrepreneurship program.

For information, contact Della Clark at (215) 895-4005 or dellac@theenterprisecenter.com or Jacqueline Hill at (215) 895-4032 or jhill@pambdc.com; www.pambdc.com.

Calendar of Events

Promises and Pitfalls: As Consumer Finance Options Multiply, Who Is Being Served and at What Cost?

The Federal Reserve System's Fourth Community Affairs Research Conference

April 7-8, 2005, The Capitol Hilton, Washington, DC

For information, contact CA-Researchconference@clev.frb.org.

Advancing Regional Equity and Smart Growth: The Second National Summit

The Funders' Network for Smart Growth and Livable Communities and PolicyLink

May 23-25, 2005, Philadelphia, PA

For information, contact Jesse Leon at (305) 667-6350, ext. 204, or jesse@fundersnetwork.org; www.fundersnetwork.org.

Nonprofit Developer Active in Temple University Neighborhood

By Keith L. Rolland, Community Development Advisor

Beech Interplex, Inc., a nonprofit active in the neighborhood west of Temple University, is constructing 135 student housing units for 453 students and is assisting two private developers that plan to build 151 homeownership units and an additional 25 student-housing units.

An independent nonprofit that works closely with many community organizations, Beech focuses on the area near Cecil B. Moore Avenue, which was a thriving middle-class neighborhood in the 1930s and 1940s. The neighborhood fell into disrepair after many owners could not afford the major repairs needed on their homes and converted them into apartments. The neighborhood deteriorated further after riots in the late 1960s.

During the past nine years, Beech has developed a charter school for the Women's Christian Alliance (an 85-year-old social service provider) and 14 homeownership units, and the company has renovated the building that contains Beech's offices, retail shops, and Temple University's



Temple University recently completed a \$16.3 Entertainment and Community Education Center (ECEC) located across the street from Beech Interplex, Inc. The 61,000-square-foot ECEC contains broadcast facilities for WRTI-FM, offices, retail space, a center providing community residents with job postings and computers, and offices for a partnership with area public schools.

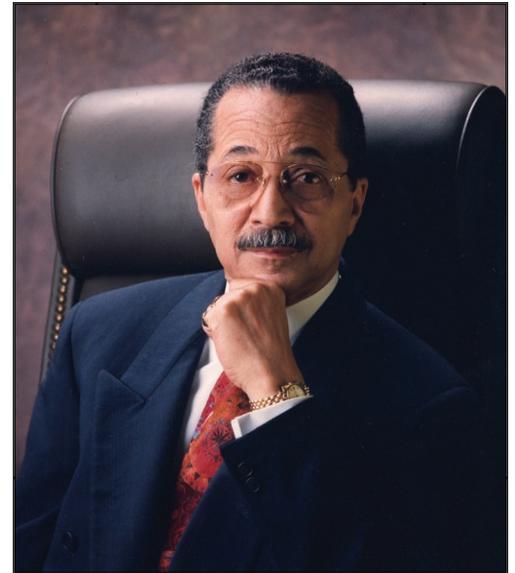
small business development center. Beech acted as project manager for the owner of the Blue Horizon, a professional boxing venue since 1970, in a \$2 million project that renovated the boxing site and created a multi-purpose facility.

Floyd W. Alston, president and CEO of Beech, said: "We do projects that require a lot of hand-holding and assembling of parcels. These projects wouldn't get done by private investors."

In late 2001, Beech launched the Beech Capital Venture Corporation (BCVC), a separately incorporated entity funded with a \$1 million loan from a private investor. BCVC has made three loans totaling \$192,000 and has made two commitments totaling \$112,500, to such businesses as a construction company, incense manufacturer, grocery store, and car-repair firm. BCVC, which has no defaults and delinquencies on the loans, is providing technical assistance to the businesses through a grant from the CDFI Fund. In August 2004, the CDFI Fund of the U.S. Department of the Treasury designated BCVC as a Community Development Financial Institution. BCVC's loan fund serves businesses in North, West, and Northwest Philadelphia.

Beech is the community development partner with developer Bart Blatstein on a major complex at Cecil B. Moore Avenue and Broad Street that will include retail stores, restaurants, a theater, and apartments.

Meanwhile, the decision of Beneficial Savings Bank to build a full-



Floyd W. Alston, President and CEO of Beech, Inc.

service drive-through branch on Cecil B. Moore Avenue, says Alston, is a strong positive development since there are very few branches in the surrounding community. Beech Interplex is developer of the new branch, which is expected to open in the first half of 2005.

In the future, Beech plans to renovate a mixed-use property that will include a restaurant, housing-management, and foundation offices; convert a school into housing for older people who are raising grandchildren; and develop a new library.

Much of Beech's operating budget is funded through development fees and rents, giving the nonprofit a strong degree of self-sufficiency. Beech's three full-time staff consists of Alston; Kenneth Scott, vice president and a former engineer; and Christine Brown, office manager. Larry J. Griffin, vice president of lending for BCVC, is a former lender at Berean Bank and Meridian Bank.

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Foreclosures: Factors That Influence Default and Loss Rates

Homeownership can bring great joy and the potential for financial gain. If not dealt with properly, it can also lead to heartache and dire monetary consequences. Owning a home entails maintaining it and fulfilling financial obligations. While not doing the former might lower the home's market value, failure to do the latter could result in foreclosure. The increase in the number of mortgage foreclosures is not only a concern of homeowners but also the lenders who supply their mortgages. The rise in the number of foreclosures across the nation has raised our awareness of the devastation that foreclosure creates and challenged our understanding of the underlying causes.

While academics and practitioners have studied foreclosures, they have focused primarily on default and the factors that contribute to it. These studies have given lenders in both the conventional and FHA sectors valuable information for assessing risk when evaluating prospective loans. Moreover, FHA mortgage scoring relies solely on default probability for determining risk.

In a recent study for the U.S. Department of Housing and Urban Development's Office of Policy Development and Research,¹ Robert F. Cotterman points out that while knowledge of default probabilities is useful, previous studies have given little if any attention to the dollar value of losses and its determinants. He argues that underwriting guidelines and

loss mitigation strategies should also consider loss severity along with default probabilities. Cotterman addresses this imbalance by developing estimates of the effect of location factors and borrower characteristics on loss severity.

Why is it important to consider loss severity when evaluating risk? Cotterman notes that one reason is the possibility that factors influence the probability of default differently than they influence loss severity. A better understanding could lead to improved assessments of portfolio risk.

Another rationale is that loss severity is related to race differently than the probability of default. This is of particular interest since minorities are subject to relatively more factors that lead to default than non-minorities. As a result, mortgage scoring systems based solely on default probabilities tend to assign less favorable scores to minorities. Those concerned with this racial disparity in scoring outcomes suggest that when minorities default, they tend, on average, to generate smaller dollar losses.

Consequently, a mortgage scoring system based on dollar losses instead of solely on default might improve the fate of minorities.

Data and Methodology

Cotterman uses data on FHA-insured loans from 1992, 1994, and



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1996 to investigate the factors that influence both default probabilities and dollar loss rates, as well as the manner in which such influence arises. He uses different levels of analysis, ranging from simple statistical summaries and descriptive regressions to more sophisticated statistical analysis. Cotterman sought to provide some insight into what underlies loan loss, as well as to allow what is learned to be used in underwriting practice. Thus, he restricted the characteristics to be studied to those that could be obtained at the time of loan applications. He also recognized that defaults may occur over the full term of a loan. Nonetheless, Cotterman limited the defaults to those occurring within the first three years of a loan because of data limitations. Plus default is generally much more heavily concentrated in the early years of a loan.

¹ "Analysis of FHA Single-Family Default and Loss Rates." Unicon Research Corporation: Santa Monica, CA, March 2004. Cotterman is vice president of Unicon. The study can be seen at www.huduser.org/publications/pdf/fhsinglefamilydefaultlossrates.pdf.

Before discussing his results, Cotterman clearly defines key terms used in his analysis. For example, the loss rate of a defaulted loan is the number of dollars lost per dollar lent. He further distinguishes between two types of loss rates: conditional and unconditional. The former is calculated over only those loans that default, while the latter is calculated over all loans: those that default and those that do not. Moreover, the unconditional loss rate is equal to the conditional loss rate multiplied by the default rate.

Cotterman offers the following example to illustrate this relationship. If “the default rate were 5 percent and the loss rate among those defaulting (i.e., the conditional loss rate) were 60 percent, then the unconditional loss rate would be 3 percent ($0.05 \times 0.6 = 0.03$). That is, even though losses are, on average, 60 cents on the dollar among defaulting loans, losses are on average only 3 cents on the dollar among all loans.”

Cotterman indicates his preference for using the unconditional loss rate for its usefulness in valuing a portfolio of loans and in deciding whether to underwrite a loan as compared with simply knowing the expected default rate.

Since Cotterman’s specification of an unconditional loss rate contains the default rate as a component, any attempt to determine the factors underlying the former must consider the specification and estimation of the latter. Thus, he estimates a model of default alongside a model of conditional loss rates. The explanatory variables Cotterman uses

in his default model fall into five categories (with some examples for each): credit characteristics—a proxy for a borrower’s capacity to pay (front-end ratio, credit score, and number of reserve monthly payments after closing); characteristics of the loan (loan-to-value ratio and note rate); characteristics of the area housing market and home relative to the area market (house price growth and relative house prices); race- and income-related characteristics of the individual and neighborhood (applicant’s race and monthly income); and other characteristics (tract income and judicial foreclosure state).²

Cotterman identifies several components that contribute to the loss rate, including the unpaid principal balance less sales price received in property disposition, forgone interest, holding cost, sales expense, and foreclosure, acquisition, and conveyance (FAC) costs. He finds that the components vary in their contribution to the loss rate: unpaid balance less sales price contributes the most; foregone interest, FAC, and sales expense contribute about the same; and holding cost contributes the least.

Findings and Implications

Cotterman’s analysis yields some revealing findings. While some findings might seem intuitive, they underscore the importance of thoughtful analysis to confirm conventional wisdom. Overall his results point to the important role that differences in the timing of default-related events—the time from origination until default, the time spent in foreclosure processing, and the time spent in prop-

erty disposition—play in determining loss rates. Loans that take longer to default tend to lower dollar loss rates, while loss rates tend to rise with the amount of time spent in foreclosure and property disposition. Moreover, various key characteristics of the borrower, the lender, and the market affect loss rates differently. For example, increases in the front-end ratio, loan-to-value ratio, the note rate, and borrower incomes tend to increase loss rates. Increases in credit scores, mortgage payments held in reserve, loan amounts, house price growth, relative house prices, and tract incomes tend to lower loss rates. His results also suggest that blacks, Hispanics, and those in underserved areas and judicial foreclosure states tend to have higher loss rates.

The interplay between default rates and loss rates was apparent in Cotterman’s analysis of data on applicants in 1992 and 1996. He found that even though the loss rates per default fell while the default probabilities rose, the loss rates per loan rose across these cohorts because the default probabilities were dominant. His estimations, though quite tentative, indicate that using expected unconditional loss rates as a basis for underwriting rather than default probabilities would be unlikely to improve the prospects of black applicants. Using such an underwriting scheme to rank risks (rather than using only estimated default probabilities) would lower blacks’ representation in the low-risk category and raise it in the high-risk category. In general, Cotterman suggests that a mortgage scoring system based on both the probability of default and dollar losses yields a more comprehensive measure of risk.

² A judicial foreclosure state is one in which mortgages are used for the purchase of real property. Once a lender in one of these states proves that a loan is in default and has exhausted all attempts to resolve the matter with the homeowner, the lender can seek relief in the courts, i.e., a judicial foreclosure.

Nonprofit Developer Active in Temple University Neighborhood

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Alston grew up in North Philadelphia and welcomed the chance to continue his work in the neighborhood after he retired nearly 15 years ago as a vice president in community relations at CoreStates Bank, N.A. After his retirement, Alston also served on the Philadelphia school board for 10 years, including several years as its president.

From 1990 to 1995, a predecessor organization, the Beech Corporation, led a community clean-up to remove abandoned cars and graffiti, worked with about 250 homeowners to rehabilitate facades and

systems, instituted school-based day-care and health programs, and formed joint ventures with other social-service providers.

“There were a great many people working hard in this area,” Alston recalled, “but they weren’t working together.” Alston convened leaders of community organizations and city agencies involved in the area into a consortium. About 75 people from more than 50 organizations still meet several times a year in the consortium, which, Alston said, “has proved to be a very significant move to bring the community together.”

Alston, who is 78, shared insights from his work. Nonprofits, he said, must have a degree of patience in dealing with bureaucracies and setbacks; get to know, understand, and learn to work with city, state, and federal officials; keep their commitments; and stay focused in their work and avoid being pulled off course by funding availability.

For information, contact Floyd W. Alston at (215) 763-8824 or beech@icdc.com.

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