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Financial Reform Brings New Consumer Protections

By Amy B. Lempert, Community Development Advisor and Outreach Coordinator

On July 21, 2010, President Barack Obama signed into law the Dodd–Frank Wall Street Reform and Consumer Protection Act.[1] The full title of this sweeping legislation suggests its breadth: "An act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services, and for other purposes." The act, which contains 16 sections or "titles," touches almost every aspect of the financial services industry[2] and is "arguably the most substantial financial regulatory reform legislation since the 1930s."[3]

This article summarizes only two sections of the Dodd–Frank Act: Title X — the Consumer Financial Protection Act of 2010 and Title XIV — the Mortgage Reform and Anti-Predatory Lending Act.

Title X — The Consumer Financial Protection Act of 2010

One of the key provisions of Title X of the Dodd–Frank Act, known as the Consumer Financial Protection Act of 2010, is the creation of the Bureau of Consumer Financial Protection. The bureau is to be housed within, but independent of, the Federal Reserve. The director of the bureau will be appointed to a five-year term by the President with the advice and consent of the Senate.

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[1] Pub. L. 111-203, H.R. 4173. The act is available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_public_laws&docid=f:publ203.111.pdf.

[2] Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates, "The Dodd-Frank Act: Significant Impact on Public Companies," memorandum, July 21, 2010. Available at http://www.skadden.com/eimages/The_Dodd-Frank_Act_Significant_Impact_on_Public_Companies.pdf.

[3] Jim Lyon, first vice president of the Federal Reserve Bank of Minnesota and Regulatory Reform Implementation program coordinator at the Board of Governors of the Federal Reserve System, Federal Reserve System intranet video, October 18, 2010.

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COMMUNITY AFFAIRS DEPARTMENT

Kenyatta Burney
Senior Staff Assistant
215-574-6037
kenyatta.burney@phil.frb.org

Albert Chin
Consumer Specialist
215-574-6461
albert.chin@phil.frb.org

Jeri Cohen-Bauman
Lead Administrative Assistant
215-574-6458
jeri.cohen-bauman@phil.frb.org

Andrew T. Hill, Ph.D.
Economic Education Advisor and Team Leader
215-574-4392
andrew.hill@phil.frb.org

Amy B. Lempert
Community Development Advisor and Outreach Coordinator
215-574-6570
amy.lempert@phil.frb.org

Erin Mierzwa
Community Development Specialist and Administrative Coordinator
215-574-6641
erin.mierzwa@phil.frb.org

Dede Myers
Vice President and Community Affairs Officer
215-574-6482
dede.myers@phil.frb.org

Harriet Newburger, Ph.D.
Community Development Research Advisor
215-574-3819
harriet.newburger@phil.frb.org

Keith L. Rolland
Community Development Advisor
215-574-6569
keith.rolland@phil.frb.org

Marvin M. Smith, Ph.D.
Community Development Research Advisor
215-574-6393
marty.smith@phil.frb.org

Brian Tyson
Community Affairs Research Assistant
215-574-3492
brian.tyson@phil.frb.org

John J. Wackes
Community Development Specialist
215-574-3810
john.j.wackes@phil.frb.org

Todd Zartman
Economic Education Specialist
215-574-6457
todd.zartman@phil.frb.org

Message from the Community Affairs Officer

Despite the end of the "Great Recession," the news in many segments of the economy continues to give cause for concern. We have highlighted some of these concerns in this issue of *Cascade*.

This issue begins with an article about the Dodd–Frank Wall Street Reform and Consumer Protection Act, which was passed by Congress and signed into law by President Obama last summer. The new law makes significant changes to how the American financial system will work, and many of these changes involve consumer transactions. Although we could spend days writing about the changes, Amy Lempert's article delves into two areas of great concern to our readers: the new bureau that is being created to protect consumers in financial transactions and the new mortgage and anti-predatory lending regulations. Many more changes are expected over the coming months, so we will keep you posted.

Kendra Fretz, a summer intern from Penn, was so intrigued by a session at our 2010 Rethink. Recover. Rebuild: Reinventing Older Communities conference that she decided to conduct her own unscientific, but interesting, study on the topic that the panelists discussed — the future of community development. She interviewed 19 community development leaders about their thoughts and came away with a consistent view of where the industry must head.

Automobile loans are an important part of many families' debt profile, but different types of lenders provide different financing. In his column, Marty Smith summarizes a study that looks at who defaults on car loans and how the underwriting might be improved.

Late in the summer of 2010, two organizations that played important roles in the history of community development closed their doors. One of these organizations, ShoreBank, was acquired by another entity and is now the Urban Partnership Bank. Bruce Gottschall, who retired as the executive director of Neighborhood Housing Services (NHS) of Chicago after 30 years, has written an interesting piece about the importance of ShoreBank to community development lending. In many respects, ShoreBank taught many of us that lending in low-wealth communities was possible.

The other organization was NHS of America. This secondary market for NeighborWorks purchased loans around the country. Back in the early 1980s when I was an NHS director in Trenton, NJ, NHS of America was the only source for replenishing my organization's loan funds. While I always tried to arrange bank financing for neighborhood homeowners, not everyone was bankable. NHS of America was a valuable resource — its end saddens me. But it reminds me of something a banker said during another recession: "When a bank's customers face hard times, so does the bank." The subprime crisis taught us that if you give marginal borrowers loans they cannot afford, trouble occurs. But NHS of America's closing is a lesson to all advocates that even when you make good loans to low- and moderate-income people, they still face bumps in the road that they may not be able to handle.

Management Team Key to Charter Schools' Success

By Sara Vernon Sterman, Executive Vice President, Community Investment and Capital Markets, The Reinvestment Fund, Philadelphia

Charter schools are increasingly being recognized for the educational alternatives they provide, particularly in low-performing urban school districts. Since the first charter school law was passed in Minnesota in 1991, 40 states and the District of Columbia have passed similar legislation. According to the National Alliance for Public Charter Schools, there are almost 5,000 charter schools serving an estimated 1.66 million students.

Charter schools are independent public schools that operate under contracts, or "charters," for a fixed period of time. The charters are usually authorized by local school districts or sometimes by state departments of education, universities, or independent chartering boards. Tuition-free and nonsectarian, charter schools are to be open to all students on a first-come, first-served basis. If demand exceeds capacity, students are enrolled by a lottery system.[1]

Unlike traditional public schools, charter schools have flexibility over fiscal, operational, and curricular issues, giving them the ability to implement innovative practices that provide diverse educational options. This increased curriculum option as well as their smaller school and class sizes makes charter schools a popular choice for both parents and students.

The Reinvestment Fund has provided financing to Mastery Charter Schools in Philadelphia. This student is one of over 4,000 students who attend Mastery Charter Schools in this city. Mastery currently operates seven schools in Philadelphia, including the Thomas Campus (right).

When it comes to academics, charter school students often do better than their district public school peers.[2] This is especially true of poor and minority students who most frequently fall behind in traditional settings.[3] Charter schools serve a disproportionately high number of economically disadvantaged students (as measured by the percentage of students receiving free and reduced lunches).[4] Compared with traditional public schools, charter schools have fewer safety issues and experience fewer behavior problems;[5] they

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[1] No Child Left Behind Act of 2001. Title V, Part B, Subpart 1, Section 5210(1), available at http://www2.ed.gov/policy/elsec/leg/esea02/pg62.html#sec5210.

[2] Caroline M. Hoxby, Jenny Kang, and Sonali Murarka, "How New York City's Charter Schools Affect Achievement, September 2009 Report," The New York City Charter Schools Evaluation Project, available at http://www.nber.org/~schools/charterschoolseval/how_NYC_charter_schools_affect_achievement_sept2009.pdf.

[3] Caroline M. Hoxby, Jenny Kang, and Sonali Murarka, "How New York City's Charter Schools Affect Achievement, September 2009 Report," The New York City Charter Schools Evaluation Project, available at http://www.nber.org/~schools/charterschoolseval/how_NYC_charter_schools_affect_achievement_sept2009.pdf.

[4] National Alliance for Public Charter Schools, "Public Charter School Dashboard 2009." June 2009, available at http://www.publiccharters.org/files/publications/DataDashboard.pdf.

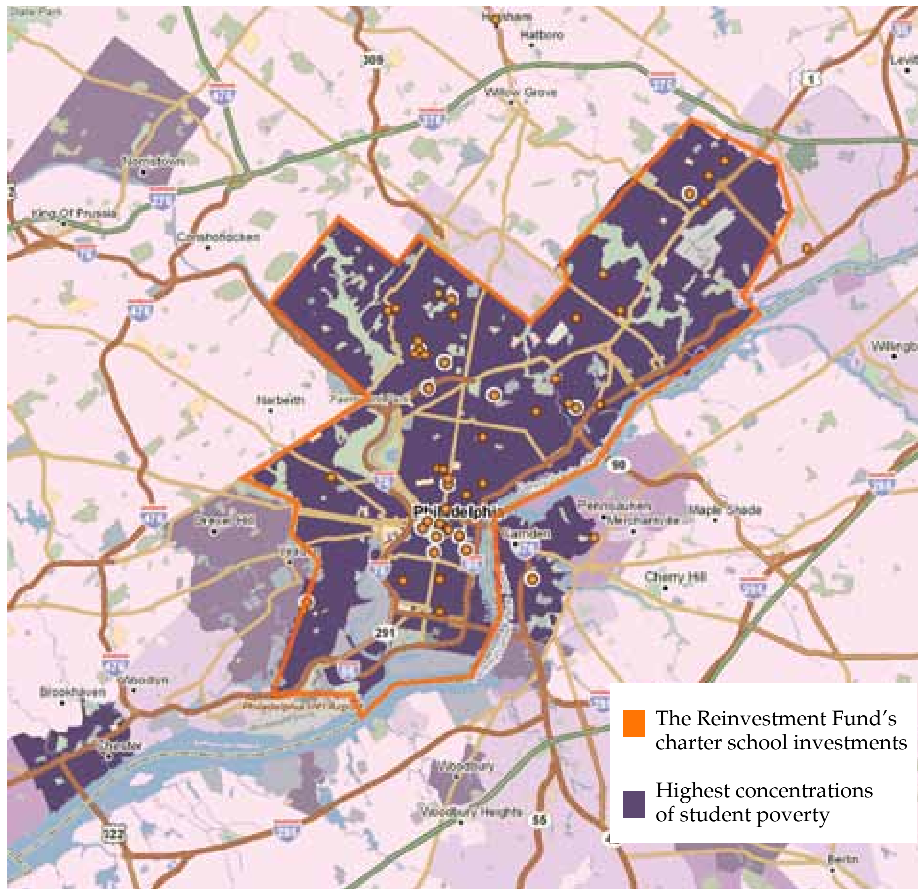
[5] Jon Christensen, "School Safety in Urban Charter and Traditional Public Schools," National Charter School Research Project, March 2007, available at http://www.crpe.org/cs/crpe/download/csr_files/wp_ncsrp_safety_mar07.pdf.

also have higher attendance rates and lower dropout rates.[6]

An emerging trend in the charter school industry is the replication of successful charter programs (e.g., Knowledge Is Power (KIPP), Mastery, Aspire, Achievement First) by high-performing regional or national charter management organizations (CMOs). These models frequently originate in low-performing urban school districts where CMOs are building strong schools that outperform the local district and meet or exceed state standards.

Charter schools are also important community assets. In urban neighborhoods, they can play a role in revitalizing communities by encouraging young middle-income families to stay in their homes.[7] Many charter schools transform dilapidated or abandoned buildings into state-of-the-art facilities and provide necessary services to their communities.[8] Many are open around the clock and on weekends, offering their facilities for community education and recreation outside of traditional school hours.

TRF's Charter School Investments in Philadelphia



PolicyMap; www.policymap.com

A Leading Charter School Lender

The Reinvestment Fund (TRF), a 25-year-old community development financial institution (CDFI) serving the mid-Atlantic region (i.e., Pennsylvania, New Jersey, Delaware, Maryland, and the District of Columbia), has been lending money to charter schools since charter school legislation passed in Pennsylvania in 1997. TRF's first charter school borrowers were community development corporations (CDCs) with which TRF had established financing relationships for affordable housing, child care, and other social service or small business loans. These CDCs felt that improving the educational options in their communities was the next essential step in their plans to strengthen their communities. TRF agreed that high-quality educational alternatives are an essential component of any strategy to strengthen communities, and financing charter schools has become a core part of TRF's lending portfolio. Through September 30, 2010, TRF has provided $189 million in financing to 65 schools serving over 30,000 students in Pennsylvania, New Jersey, Delaware, Maryland, and the District of Columbia. Most of the students served at TRF–financed schools qualify for free or reduced-price lunch. TRF has had one default with no charge-offs and no losses.

[6] Mike Embry, "UH Study Reflects Better Attendance, Behavior at Charter Schools," University of Houston, March 1, 2010, available at http://www.uh.edu/news-events/stories/2010articles/March2010/0301CharterSchools.php.

[7] Robin Halsband, "Charter Schools Benefit Community Economic Development," *Journal of Housing and Community Development*. (November/December 2003), pp. 34–38, available at http://www.ncbcapitalimpact.org/documents/JHCDeduarticle2003_RH.pdf.

[8] Robin Halsband, "Charter Schools Benefit Community Economic Development," *Journal of Housing and Community Development*. (November/December 2003), pp. 34–38, available at http://www.ncbcapitalimpact.org/documents/JHCDeduarticle2003_RH.pdf.

TRF's work with charter schools primarily involves financing real estate. TRF provides acquisition, construction, and permanent financing to charter schools. In keeping with its mission to support sustainable development, many of TRF's loan packages include loans for energy-efficient construction or energy retrofits; every dollar saved in utility expenses increases the amount available for the school's educational program.

TRF works with early-stage schools and continues to support the real estate efforts of charter schools as they mature. Many charter schools start off in rented space. Therefore, TRF provides leasehold improvement loans; some of these loans are essentially unsecured, and others are secured by recorded leasehold mortgages. TRF has provided multiple rounds of financing to some schools as they move from temporary to more permanent facilities. Relying upon credit enhancement provided through the U.S. Department of Education's credit enhancement program, TRF provides subordinated debt to schools as they move on to larger facilities or increase the amenities of their existing facilities. Additionally, TRF has provided a New Markets Tax Credit allocation to four charter school transactions.

In underwriting a charter school transaction, TRF uses the same criteria a lender would use for any commercial transaction: projected cash flow, historical financial performance (if available), collateral, construction team (if applicable), business plan (academic program), and management capacity. However, in TRF's 13 years as a charter school lender, management has emerged as a primary criterion in evaluating the strength of a school, regardless of its track record. Charter schools are founded by a variety of individuals interested in and committed to educational reform, including educators, community organizers, social service organizations, and business leaders. In TRF's experience, it is the breadth and depth of the team — rather than a single entrepreneurial founder — that is a key determining factor in a school's capacity to navigate the academic, political, financial, real estate, and legal challenges to operating a successful program.

JPMorgan Chase Provides Financing to Charter Schools

In the spring of 2010, JPMorgan Chase announced a $325 million initiative to provide financing to high-performing charter schools. Chase is partnering with The Reinvestment Fund (TRF), along with the Low-Income Investment Fund and NCB Capital Impact, to create New Markets Tax Credit (NMTC) financing pools. This commitment by Chase to the growth of charter schools expands TRF's ability to finance strong schools, even in today's challenging credit environment. TRF intends to provide an additional $50 million in loans to finance real estate projects for high-performing, established charter schools that are acquiring, renovating, or expanding their facilities. Charter schools that are replicating or expanding to additional locations are also eligible for financing. Facility projects must be NMTC–eligible.

–Sara Vernon Sterman

Opportunities and Challenges for Lenders

Provision of public education services is under state purview, so charter schools are controlled at the state level. Some states are considered to be more charter friendly than others. However, across the country, charter schools face greater financial challenges than traditional public schools.

Charters are usually issued for a period of five years, although some states/authorizers, such as Arizona and the District of Columbia, issue charters with terms as long as 15 years. Some lenders have found it difficult to assess the risks associated with charter renewal. In TRF's early experience, before any renewals had occurred, all of its loans fully amortized over the term of their four- or five-year charters. But since that time, many rounds of renewal have occurred, and the process has proven to be transparent and predictable in many places. Many lenders now view charter renewal in the same light as annually renewing social service contracts.

In most states, the funding received by charter schools is less than that received by traditional public schools. The actual funding formula varies from state to state and is calculated based on the number of students served and their grade level. On average, charter schools receive approximately 80 percent of the per-pupil funding received by their district public school counterparts (less than 60 percent of district funding in some states).[9] This funding gap exists despite the fact that charter schools typically serve a

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[9] Meagan Batdorff, Larry Maloney, Jay May, et al., "Charter School Funding Inequity Persists," Ball State University, May 2010, available at http://www.bsu.edu/teachers/media/pdf/charterschfunding051710.pdf.

New Jersey Community Capital Strengthens Charter Schools

By Wayne T. Meyer, President, New Jersey Community Capital, Trenton, NJ

New Jersey Community Capital (NJCC) became one of the first community development financial institutions (CDFIs) to offer charter school facility financing when it began making charter school loans more than six years ago. The company started making these loans because traditional lending institutions were unable to meet the facility financing needs of these schools.

Unlike traditional public schools, charter schools do not receive any funding for building, buying, or leasing facilities. Despite this funding disadvantage, many charter schools provide a real educational choice to families living in areas where district schools are underperforming.

The most common financing request is for working capital lines of credit to bridge operating costs from when the school begins operating (typically in August) through when its first local and state funding checks arrive (typically in October or November). NJCC offers flexible financing products, including predevelopment, site acquisition, site renovation, and new construction loans; leveraged debt for New Markets Tax Credit transactions; bridge financing; mini-permanent financing; lease guaranties; and some working capital lines of credit.

NJCC provided direct financing to more than 14 charter school campuses with aggregate loans outstanding of nearly $22 million. Since 2004, NJCC has leveraged over $115 million in charter school development costs that benefit 5,500 students.

In 2006, NJCC received an $8.15 million grant from the U.S. Department of Education's Credit Enhancement for Charter School Facilities program. The grant gave NJCC the ability to provide additional credit support to certain charter school facility loans where additional value was needed or excessive risks needed to be mitigated. NJCC has achieved a leverage ratio of over 11 to 1 with the federal grant.

NJCC believes that education is the bedrock of community change. Charter schools create educational opportunities for young students in New Jersey's most at-risk communities. With more than 11,000 students currently on charter school waiting lists, the demand for charter school facility financing will no doubt continue to grow.

For information, contact Wayne T. Meyer at 609-989-7766 or wmeyer@njclf.com; www.newjerseycommunitycapital.org.

Joseph V. Palazzolo

Students participate in a civics class at TEAM Academy Charter School, located in the former St. Charles Borromeo School in Newark, NJ.

ShoreBank's Legacy and Vision Continue: A Practitioner's Reflections

By Bruce Gottschall, Former Executive Director of Neighborhood Housing Services of Chicago

ShoreBank, headquartered in Chicago, was the largest community development bank in the United States. In August 2010, it was declared insolvent, and Urban Partnership Bank acquired ShoreBank's core deposits and most of the assets of ShoreBank Corporation's Midwest bank out of receivership from the FDIC.

ShoreBank was created at a time of urban turmoil and neighborhood decline. In the late 1960s and early 1970s, people across the country were protesting and demonstrating against the "redlining" of minority, low-income, and older communities. At bank offices and at bank executives' homes, protestors showed their disapproval of banks' lack of lending in certain neighborhoods. Furthermore, it was then an accepted belief that once city neighborhoods started to decline, the downward spiral would inevitably continue. Decline became a self-fulfilling prophecy because many people, including bankers, acted on that belief. An accompanying conviction was that the only way to reverse this decline was to demolish the neighborhoods and start over.

In the midst of this turmoil, in 1973 — before passage of the Home Mortgage Disclosure Act (HMDA, 1975) and the Community Reinvestment Act (CRA, 1977) — a small group of people bought a troubled bank in a declining African-American neighborhood on Chicago's South Side. These people had a dream of improving the neighborhood by using a small private community bank as a base. That might not seem like a novel idea today, but at the time, it went against the accepted wisdom of how to deal with the problem of declining areas. Buying a failing bank in a declining neighborhood took foresight, courage, and dedication, and it also meant taking significant risk. Indeed, many people thought the task of reviving both the bank and the neighborhood was impossible.

The protests had focused attention on the problem, but the enactment of HMDA and the CRA was essential for encouraging banks to provide the credit necessary to make a difference in neighborhoods. However, communities also needed examples of how this type of lending and community development could actually be done. ShoreBank, through its focus on making credit available in a place other institutions had written off, provided such an example.

ShoreBank's vision, which emphasized leadership and the responsibility of private-sector entities in regenerating neighborhoods, changed the game. In particular, the bank helped to shift responsibility for reversing the decline of troubled neighborhoods solely from the government to other institutions, especially banks, because ShoreBank realized that the availability of credit was an essential ingredient for improving neighborhoods. This concept also made a huge difference in creating new models for community investment. By showing that neighborhoods that had been excluded from obtaining credit could improve with the right combination of private and public resources, ShoreBank changed perceptions about what was possible. If a small community bank in a declining area of Chicago could demonstrate the viability of the neighborhood and the bank, there was no reason others couldn't do the same.

ShoreBank introduced the concept of a community-based bank — local knowledge and local presence — to a tough urban neighborhood from which banks had fled. Yet it went much further by setting up for-profit and not-for-profit subsidiaries that helped potential borrowers navigate the loan process and created further investment in the community. In brief, ShoreBank went beyond the legislative mandate of the CRA to create financial services and credit and lending opportunities. It offered concrete evidence that private investment in declining areas could make a difference and showed ways to do it successfully.

> **ShoreBank offered concrete evidence that private investment in declining areas could make a difference.**

ShoreBank also created a base from which to leverage public and other investment resources to further its local development goals. In his book *Community Capitalism*, Richard Taub notes that one of ShoreBank's major strengths was its ability to mobilize outside resources and focus them on the community.[1]

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[1] Richard Taub, *Community Capitalism*. Boston: Harvard Business School Press, 1988.

What Determines Automobile Loan Defaults and Prepayment?

The recent financial meltdown has fostered a rash of loan defaults. Most of the discussion to date has centered on loans in the housing market. However, overlooked are the defaults on loans for motor vehicles or automobiles (cars and light trucks), which are among the largest nonfinancial assets held by Americans. While automobile loans — and automobile insurance when pricing for risk — have some of the same underlying characteristics as mortgage loans, there are differences that have important implications for lenders. In addition to defaults, lenders also incur an effective loss if purchasers prepay their loans. Sumit Agarwal, Brent W. Ambrose, and Souphala Chomsisengphet investigated these issues.[1] The following is a summary of their findings.

Given the prominence of third-party financing in the automobile market and the pricing method used, the authors question whether the risks are adequately reflected in the price charged for the loan.

Lending Behavior and Risks

According to the authors, "roughly three-quarters of automobile purchases are financed through credit, and loans for automobile purchases are one of the most common forms of household borrowing." Previous studies have shown that "third party financing (direct loans) accounts for the largest portion of the automobile credit market, with dealer financing (indirect loans) second and leasing third."

Lenders in the automobile market face two main risks. The foremost risk is "default — that is, the person who took out a loan to buy a car or truck fails to pay it back." While a second important risk is prepayment, where the "car or truck purchaser pays off the loan early, reducing the lender's stream of interest payments."

Given the prominence of third-party financing in the automobile market and the pricing method used, the authors question whether the risks are adequately reflected in the price charged for the loan. This apprehension arises since this segment of the market "relies on a 'house rate' for pricing loans, such that all qualified borrowers with similar risk characteristics [e.g., credit score and down payment] pay the same rate." The point of contention is that the lender does not take into account the automobile's make and model when pricing the loan. This pricing scheme is in contrast with practices presently employed in the auto insurance and mortgage markets. The authors point out that "auto insurers have long recognized that automobile makes and models appeal to different clienteles and that these clienteles have heterogeneous risk profiles and accident rates." Consequently, automobile insurers take into account the make and model that an applicant is insuring, when pricing the automobile policy. Similarly, mortgage lenders factor in "information on the underlying assets (for example, a house) as well as the borrowers' personal characteristics" when originating a loan.

Given the importance of underlying assets in the pricing of products in the insurance and mortgage markets, "the question naturally arises as to whether incorporating information on automobile make and model would help third party lenders refine their loan pricing models." Thus, the authors propose and attempt to answer the following question: "If we assume that the choice of auto make and model reveals individual

[1] Sumit Agarwal, Brent W. Ambrose, and Souphala Chomsisengphet, "Determinants of Automobile Loan Default and Prepayment," Federal Reserve Bank of Chicago *Economic Perspectives*, 32 (Third Quarter 2008), pp. 17–28.

financial (or credit) risk behavior of the borrower, what does this tell us about the borrower's propensity to prepay or default on his loan?"

Data and Methodology

The authors used a proprietary data set from a large financial institution to conduct their analysis. The data contain information on automobile loans originated by the financial institution and offered directly to borrowers. The authors focused on direct loans, since this is the market in which lenders can compete, as opposed to indirect loans that are made available through the dealer. The sample for the analysis consisted of 20,466 direct auto loans with four-year and five-year maturities and fixed rates. The authors tracked the performance of the loans from January 1998 through March 2003, "such that a monthly record of each loan [was] maintained until the automobile loan [was] either paid in full (at loan maturity), prepaid, defaulted, or [stayed] current." Of the total loans in their sample, 4,730 were prepayments and 534 were defaults.[2]

The authors included several variables that reflect the characteristics of the loan and the borrower. In the former, they included "automobile value, automobile age, loan amount, LTV [loan to value], monthly payments, contract rate, time of origination (year and month), and payoff year and month for prepayment and default." For the latter, they included the borrower's credit score, age, and monthly disposable income. They also included the unemployment rate in the county where the borrower resided and used the three-year Treasury note rate as the market rate in the analysis. In addition, the authors knew the automobile's make, model, and year as well as whether the loan was for the purchase of a used or new automobile. The authors noted that their sample of loans had the following median values: $14,027 for the loan amount, 78 percent for the LTV, 8.99 percent for the annual percentage rate (APR), 723 for the credit score, $3,416 for the monthly disposable income, 40 years of age for the owner, 54 months for the age of the loan, and four years for the age of the car. Further, the car's "blue book value (the car's market value) at loan origination [ranged] from $4,625 to $108,000."[3]

The authors used an estimation procedure that allowed them to "determine how borrower consumption decisions can affect loan performance," with a particular focus on the prepayment or default on their loan.

Results

The authors' analysis produced several noteworthy findings,[4] including the following:

- a loan on a new car has a higher probability of prepayment, whereas a loan on a used car has a higher probability of default;
- a decrease in the credit risk of a borrower, as measured by the credit score, lowers the probability of default and raises the probability of prepayment;
- an increase in the LTV increases the probability of default and lowers the probability of prepayment;

Marvin M. Smith, Ph.D.,
Community Development Research Advisor

- an increase in income raises the probability of prepayment, while a rise in unemployment increases the probability of default;
- a decrease in the market rate increases both the probabilities of prepayment and default; and
- loans on most luxury cars have a higher probability of prepayment, whereas loans on most economy cars have a lower probability of default.

Concluding Observations

The authors hasten to note that their study has some limitations — it only considered direct auto loans that were originated primarily in northeastern states by a single lender. Nonetheless, their "results imply that lenders could improve the pricing of automobile loans by considering the type of car collateralizing the loan."

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[2] The authors defined prepayment as paying off a loan in full before maturity and default as a loan that is 60 days past due.

[3] The authors point out that "these statistics [were] comparable with the overall statistics for a typical auto loan portfolio."

[4] See page 25 of Sumit Agarwal, Brent W. Ambrose, and Souphala Chomsisengphet's study in *Economic Perspectives*.

Moving Forward in a Time of Change: The Future of the Community Development Industry

By Kendra Fretz, Community Affairs Intern

The recent recession has affected many business sectors, and the community development industry is no exception. Nonprofit community development corporations (CDCs), community-based organizations (CBOs), and community development financial institutions (CDFIs) have all felt the credit and economic crises as their funders — whether they be banks, foundations, or local, state, or federal governments — faced reduced revenues. Even in good times, the players in the community development world compete for limited resources, but today's environment is particularly challenging.

So what will it take for CDCs and CBOs to attract funding in the future? We initiated this conversation in May 2010 at the Federal Reserve Bank of Philadelphia's Rethink. Recover. Rebuild: Reinventing Older Communities conference. In the final panel, four community development leaders discussed the future of the community development industry, specifically its neighborhood-based groups' need for funding. A key discussion point was the most effective role for CDCs and CBOs, given diminished funding sources and a recent shift in the federal government's strategy toward comprehensive neighborhood development within a regional framework.

Having heard these leaders discuss their thoughts, the Community Affairs Department conducted a qualitative survey of 19 leading stakeholders in the community development industry through phone or in-person interviews. The participants were from all different sectors, including lending institutions, government offices, private foundations, trade associations, CDCs, and intermediaries. The survey objectives were: (1) to identify any patterns or trends around the capacity of CDCs and CBOs as effective community development practitioners; and (2) to look for ways that the recession and the federal government's more comprehensive neighborhood development strategy are changing the industry infrastructure. We also sought to understand how the Fed's Community Affairs Department could strengthen the capacity of the industry and support the various practitioners in their roles.

The following points emerged in our survey:

1. Changing Roles

There is no doubt that the economic recession has resulted in decreased funding for CDCs and CBOs. We also heard that the structure of the community development industry is evolving, as are the traditional roles of stakeholders in the field. During the interviews, several lenders reported that CDCs are being replaced as the developers of affordable housing and mixed-use projects by for-profit entities and that smaller neighborhood nonprofit developers are being replaced by larger regional or statewide nonprofit developers and CDFIs. The increasing role of CDFIs as the distribution channel for private and public funding also challenges CDCs and CBOs to form new partnership structures with CDFIs.

2. Neighborhood Change Agents, Strategic Partnerships

Survey participants noted that the CDC-centered model for distributing funding to low- and moderate-income (LMI) communities has become increasingly less productive, yet most respondents agreed that a real need exists for a neighborhood organization to play a catalytic role in community development projects.

In this context, it appears that a new role for CDCs and CBOs has emerged — as partners with the larger-scale developers. Under the new model, the CDCs and CBOs can plan the structure, manage the political aspects, and deliver zoning and other entitlements, and then rely on the larger-scale developer to produce the structure.

Several respondents also emphasized that the future of community development will entail partnerships across disciplines, including education, workforce, health, physical development, and transportation. As grassroots organizations, CDCs and CBOs know how to engage the "system" and can promote community change as the facilitator for neighborhood and regional stakeholders. The forward-thinking organizations are already adapting to the new reality. One respondent recalls a comment from a CDC executive director: "We no longer call ourselves a CDC, but a neighborhood change organization."

3. A Coherent System as a Solution

Our survey respondents suggested that the community development system is fragmented and lacks a central platform of civic leadership and a unified regional strategy. Without a center, the infrastructure remains thin and spread out.

Respondents recommended an alignment among various funding sources to create a shared vision for the region. The content of the strategy must focus more on the challenges of wealth creation and balancing the needs of existing and new residents. It was recommended that preservation tools include pairing policy with development as well as providing financial literacy and consumer education so that the conversation will change at the community level. Policy should also address fears of gentrification and displacement of long-term residents. CDCs and CBOs as community change agents might present the best vehicle for implementing a more thoughtful approach to new investment.

4. The Fed's Role

The majority of respondents see the Community Affairs Department's most effective role as that of a convener. Respondents noted that the Federal Reserve is the only institution that can break down communication barriers among the community groups and the banking industry. Several respondents suggested that our conferences and meetings focus more on solutions. While the respondents acknowledged that it was beneficial to identify problems, they also emphasized that conversations involving solutions lead to more meaningful results for all parties.

Financial Reform Brings New Consumer Protections ...continued from page 1

On September 17, 2010, the President named Elizabeth Warren as a White House advisor, as well as advisor to the secretary of the Treasury on consumer issues, and charged Warren with heading the effort to set up the bureau. As provided for in the act, the secretary of the Treasury has set July 21, 2011, as the designated transfer date when, with certain limited exceptions, rule-writing, examination, reporting, and enforcement authorities will be transferred to the bureau from the Federal Reserve and other federal banking agencies.[4] Some of these authorities will also be transferred from the U.S. Department of Housing and Urban Development (HUD) and the Federal Trade Commission (FTC).

The act does not transfer authority for the Community Reinvestment Act (CRA) to the bureau; therefore, authority for the CRA will remain with the federal banking agencies.

The bureau will be given authority for the major consumer protection laws, including the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA), the Home Ownership and Equity Protection Act (HOEPA), the Truth in Savings Act, the Fair Credit Reporting Act, and several other consumer protection laws. One notable rulemaking requirement of the Consumer Financial Protection Act is to combine mortgage disclosures under TILA and RESPA.

Some additional highlights of the bureau's authority include the following:

- The bureau will have exclusive federal examination and primary enforcement authority for federal consumer protection laws with respect to insured depository institutions and credit unions with total assets over $10 billion and their affiliates. Examination and enforcement authority for those institutions under $10 billion will remain with the federal banking agencies (i.e., the Fed, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the National Credit Union Administration).

- In addition, with some limited exceptions concerning the FTC's jurisdiction, the bureau will have exclusive consumer examination and enforcement authority for certain nonbanks, including any entity in the mortgage chain, companies providing loan modification and foreclosure relief services, large participants in markets for financial products or services, and entities offering private education or payday loans. The authority will cover nonbank institutions whose conduct in providing consumer financial products or services, as perceived by the bureau, poses a risk to consumers.

- The bureau will be required to institute procedures related to

...continued on next page

[4] The federal banking agencies include the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the National Credit Union Administration. The act transfers the functions of the Office of Thrift Supervision to the OCC.

consumer complaint responses in coordination with the other federal banking agencies.

- Several offices will be established within the bureau, including a new Office of Fair Lending and Equal Opportunity, an Office of Financial Education, an Office of Service Member Affairs, and an Office of Financial Protection for Older Americans.

- A new Consumer Advisory Board will advise and consult with the bureau on various consumer matters. The bureau will seek experts in consumer protection, financial services, community development, fair lending and civil rights, and consumer financial products or services, as well as representatives of depository institutions that primarily serve underserved communities and representatives of communities that have been significantly impacted by higher-priced mortgage loans. The bureau will also seek representation of the interests of "covered persons"[5] and consumers, without regard to party affiliation. No fewer than six members will be appointed on the recommendation of regional Federal Reserve Bank presidents, on a rotating basis.

The Bureau of Consumer Financial Protection will be required to institute procedures related to consumer complaint responses in coordination with the other federal banking agencies.

Title XIV — Mortgage Reform and Anti-Predatory Lending Act[6]

Title XIV of the Dodd–Frank Act provides new rules for several aspects of mortgage lending and designates that rulemaking authority will ultimately be vested in the bureau. Regulations required under the title must be prescribed in their final form within 18 months of the transfer date and are to take effect no later than 12 months after the date of the issuance of the final regulations.

Some highlights of the Mortgage Reform and Anti-Predatory Lending Act include the following:

- Subtitle A — *Residential Mortgage Loan Origination Standards.* This subtitle defines the term "mortgage originator" and prohibits mortgage originators from receiving steering incentives. Broad discretionary regulatory authority is granted to the Federal Reserve, and after the transfer date, to the bureau, to "prohibit or condition terms, acts, or practices relating to residential mortgage loans that the Board [the Board of Governors of the Federal Reserve System, later the bureau] finds to be abusive, unfair, deceptive, predatory, necessary, or proper to ensure that responsible, affordable mortgage credit remains available to consumers."

- Subtitle B — *Minimum Standards for Mortgages.* Creditors are required to make a good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan according to its terms, as well as all applicable taxes, insurance, and assessments. In addition, a borrower can assert a defense to foreclosure against a creditor or assignee when there is a violation of the anti-steering or the ability to repay provisions.

  Prepayment penalties on residential mortgages, when not prohibited altogether, must be phased out after three years. A lender who offers a residential mortgage with a prepayment penalty must also offer a loan without a prepayment penalty. For hybrid adjustable-rate mortgages (ARMs), notices to consumers must include the index and an explanation of how the new interest rate and payment are determined; in addition, the estimated monthly payment and other terms are required to be disclosed prior to six months before the end of an introductory rate period, or if the rate may reset within the first six months of the loan, at loan consummation.

- Subtitle C — *High-Cost Mortgages.* The act amends HOEPA and expands its coverage by including home purchase loans and open-end credit plans, by

[5] The term "covered person" means either any person who engages in offering or providing a consumer financial product or service or any affiliate of that person if the affiliate acts as a service provider to that person.

[6] See "Summary of Mortgage Related Provisions of the Dodd–Frank Wall Street Reform and Consumer Protection Act," July 21, 2010, Mortgage Bankers Association. Available at http://www.mbaa.org/files/ResourceCenter/MIRA/MBASummaryofDoddFrank.pdf.

lowering the interest rate and point/fee thresholds, and by adding prepayment penalties in the points and fees test. Balloon payments and prepayment penalties for high-cost mortgage loans are prohibited, and certain fees are regulated.

- Subtitle D — *Office of Housing Counseling*. An Office of Housing Counseling within HUD will be established to perform a wide range of activities, including research, public outreach, and policy development related to both homeownership and rental counseling. Up to $45 million is authorized for financial assistance to HUD-approved counseling agencies and state housing finance agencies for efficient and successful counseling programs. HUD is required to conduct a study of the root causes of foreclosures using empirical data and to establish and maintain a database on foreclosure and defaults that would be collected, aggregated, and made available at the census tract level.

- Subtitle E — *Mortgage Servicing*. For first lien mortgages on principal dwellings, repayment analysis must include taxes, insurance payments, and "other periodic payments." TILA is amended to require the creditor to establish escrow accounts for certain first lien mortgages for a minimum of five years, or until sufficient equity is reached (or other specified events occur).

- Subtitle F — *Appraisal Activities*. The act establishes appraisal requirements for "subprime mortgages" and appraisal independence requirements. Broker price opinions are prohibited from being used as the primary basis to determine the value of property that would secure a residential mortgage loan, in cases in which the property is purchased by a consumer as a principal dwelling.

- Subtitle G — *Mortgage Resolution and Modification.* HUD is authorized to administer a program to promote the transfer of properties with five or more units that are at risk of foreclosure. The scope of the Protecting Tenants at Foreclosure Act is expanded and extended from 2012 to 2014.

- Subtitle H — *Miscellaneous Provisions.*

  The Emergency Homeowners' Relief Fund is to be established within HUD with $1 billion for grants and loans to certain delinquent borrowers to pay portions of their mortgages, with $50,000 set as the maximum that a homeowner can receive.

  An additional $1 billion is allocated to HUD under the Neighborhood Stabilization Program for assistance to states and local governments for the redevelopment of abandoned and foreclosed properties.

  The act authorizes $35 million for fiscal years 2011 and 2012 to establish grants to state and local organizations to provide foreclosure-related legal services to low- and moderate-income homeowners and tenants.

Summary

The Dodd–Frank Act is a far-reaching overhaul of the U.S. financial regulatory system. Because of the law's scope, as time goes on consumers will continue to learn more about its specific implications.

Other Pertinent Provisions

Although consumer protection and mortgage reform are the focus of this article, there are two additional provisions that were outlined in Title III of the act that were not discussed but that may be of interest to community development practitioners and consumer advocates:

- The act requires the establishment of an Office of Minority and Women Inclusion at all federal banking and certain other federal regulatory agencies by January 21, 2011, that will address matters related to diversity in employment and institutional contracts. The offices will coordinate technical assistance to minority-owned and women-owned businesses and seek diversity in the workforce of the regulators.

- Federal deposit insurance for banks, thrifts, and credit unions was permanently increased to $250,000, retroactive to January 1, 2008.

ShoreBank's Legacy and Vision Continue: A Practitioner's Reflections ... continued from page 7

Throughout the 1980s and early 1990s — a time when the community development lending infrastructure was being built — the financial press ran numerous articles describing how ShoreBank was able to make loans that led to real improvements in the community without losing money. This was an important time in the development of neighborhood-lending expertise because the CRA was being enforced more rigorously, and examples of how to make the act work were vital to furthering community development and building a lending infrastructure to support it. ShoreBank's success countered the claim that there were no lending opportunities in these neighborhoods and dispelled the myth that there was no good banking business to be done there. Through its pragmatic example, ShoreBank engendered institutional changes within banks that led to increased lending to these neighborhoods.

Of course, ShoreBank's influence reached far beyond Chicago and led to one of its most noteworthy achievements. In 1986, working with Bill and Hillary Clinton in Arkansas, ShoreBank staff developed the Southern Bank Corp., an institution modeled after its own work in Chicago. This important institution demonstrated the value of the ShoreBank model. In addition, the relationships that developed out of this effort led to one of ShoreBank's single greatest contributions to community development: its leadership in creating the legislation that established community development financial institutions (CDFIs) and the Bank Enterprise Award (BEA) in 1994. This achievement has been acknowledged by many people who work in the community development arena. President Clinton recognized it in his remarks at the signing ceremony for the CDFI legislation: "[ShoreBank is] a place that I visited, got to know, and got to understand. I've long admired the way they steered private investments into previously underprivileged neighborhoods, to previously undercapitalized and underutilized Americans, proving that a bank can be a remarkable source of hope.…"

Certainly, ShoreBank's efforts inspired those of us who developed the Neighborhood Housing Services (NHS) of Chicago partnership in 1974–75. ShoreBank's example of leading neighborhood revitalization from a community-based bank was important in the development of NHS Chicago. Those of us engaged in this process believed that, following ShoreBank's example, it would be possible to create a partnership among banks, neighborhood residents, and the government to address community lending and investment issues. This helped to develop a sound partnership base led by private resources to serve a range of low- and moderate-income neighborhoods and residents.

Many other bankers have described their visits to ShoreBank and their conversations with its leaders as critical to their own work. For example, Thomas Fitzgibbon, a banker who would become a leader in community development banking, came to Chicago in the late 1970s to observe ShoreBank's activities and use them as a guide for his work in St. Paul/Minneapolis (and later in Washington, D.C. and Chicago). He described ShoreBank as proof that banking institutions can and should play a leadership role in providing access to credit for low- and moderate-income residents and for people of color. Mark Willis, who in 1989 moved from the public sector to head up Chase Bank's community development efforts in New York, said that upon taking up the post at Chase, one of his first trips was to Chicago to meet with ShoreBank staff in order to gain insights that would help him in his work for Chase.

Obviously, ShoreBank's leadership and innovations in community development lending — both nationally and internationally — are far-reaching. This article does not touch on ShoreBank's many other leadership roles and innovative efforts that encouraged others. One area worthy of special mention is ShoreBank's groundbreaking work in lending to owners of small multi-unit residences to fix up and manage these critical but difficult investment properties. Over the years, ShoreBank made loans on 55,000 units of rental housing and created hundreds of minority entrepreneur–investors. In addition, ShoreBank's legacy includes, among other things, hundreds of community development banks and credit unions, NeighborWorks organizations, not-for-profit loan funds, and hundreds of CDFIs that are building on the groundwork laid by ShoreBank. The bank's leadership in many other areas is also unquestioned, for example, socially responsible investing and environmentally conscious lending, the idea of a double and triple bottom line, micro-finance, innovative retail savings products, and innovation on extending services to the unbanked. And ShoreBank's influence is still being felt today. ShoreBank, like all

pioneers, opened new territories as it paved new paths to community improvement and investment for others to follow. Current practitioners in community development investment are truly following in the footsteps of those who came before as they continue to expand the territory, widen the paths, and build knowledge and program infrastructure. Today's practitioners are also working to recognize the current barriers and myths that impede community investment and to develop strategies to overcome them. In short, community development practitioners are heeding the lessons learned from ShoreBank's almost four decades of success and inspiration while moving forward with their efforts to build successful communities.

Perhaps an article on ShoreBank that appeared in *The Economist* sums it up best: "Mainstream banks are now in partnership with these community-based institutions so as to tap their expertise at lending to businesses in difficult environments. ShoreBank may have failed, but the movement it once led is stronger than ever."[2]

Bruce Gottschall was executive director of Neighborhood Housing Services of Chicago from 1975 to 2009. He developed the NHS program in 1974 as a charter member of the NeighborWorks Network.

[2] "ShoreBank: Small Enough to Fail: The Sorry End to a Bold Banking Experiment," *The Economist*, August 26, 2010.

Management Team Key to Charter Schools' Success ... continued from page 5

greater number of students eligible for free or reduced-price lunch than traditional public schools.[10]

Few states offer capital dollars to charter schools for facilities, and typically charter schools cannot access capital funding streams used by district schools. Therefore, they must pay for rent and debt service from operating cash flow. Locating an affordable and suitable facility is one of the most persistent challenges cited by charter schools. School districts are frequently unwilling to share facilities, and even when they do, significant renovations are required to meet the demands of a 21st century educational experience.

Financing facilities for charter schools is a critical piece to making quality educational alternatives accessible to all. It is also a key community development strategy, as these schools bring educational opportunities to many low-income families, serve as community assets, and bring new institutional actors into public education. TRF is committed to being a reliable source of capital to charter schools.

For information, contact Sara Vernon Sterman at 215-574-5800 or sara.vernon.sterman@trfund.com; www.trfund.com.

[10] National Alliance for Public Charter Schools, "Public Charter School Dashboard 2009," June 2009, available at http://www.publiccharters.org/files/publications/DataDashboard.pdf.

TRF Lending Case Study

The Reinvestment Fund (TRF) has provided short- or long-term financing to more than half of the charter schools in the School District of Philadelphia (SDP). Among them, TRF worked with Mastery Charter Schools, a network of middle and high schools that has managed the turnaround of three troubled district schools into high-performing Mastery Charter Schools. With participation from Wachovia Bank (now part of Wells Fargo), TRF financed the conversion of all three of these facilities. In 2006, the SDP invited Mastery to convert Shoemaker Middle School in Philadelphia into a charter school. Poor maintenance and extraordinary wear-and-tear had contributed significantly to the school building's dire condition. An $11 million construction loan from TRF helped Mastery upgrade the HVAC and electric system as well as reconfigure hallways to reflect Mastery's hub system, which limits spaces where students are out of public view. Shoemaker — once among the most violent schools in the district — is now a model school with its students showing dramatic improvements in discipline and academic performance. In state testing conducted in 2006, prior to the conversion, only 30.6 percent of Shoemaker's eighth graders scored proficient or above in math, and only 42.8 percent scored proficient or above in reading. In 2008, proficiency rates increased to 76 percent in math and 79 percent in reading. Over 80 percent of its students qualify for free or reduced-price lunch.

–Sara Vernon Sterman

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2011 Federal Reserve Community Affairs Research Conference
The Changing Landscape of Community Development:
Linking Research with Policy and Practice in Low-Income Communities
April 28–29, 2011, Arlington, Virginia
Crystal Gateway Marriott
The Community Affairs officers of the Federal Reserve System are hosting the seventh Federal Reserve Community Affairs Research Conference. The goal of the conference is to highlight new research that informs community development policy and practice.
For information, go to http://www.frbsf.org/community/conferences/2011ResearchConference/.

SURVEY

Community Outreach Survey

Starting January 2011, the Community Affairs Department of the Federal Reserve Bank of Philadelphia will be sending some of our key stakeholders an electronic survey. This survey will ask your opinion about the needs of low- and moderate-income households in Delaware, New Jersey, and Pennsylvania.

The responses will be completely confidential, and we will release survey results only in aggregate form.

If you receive the survey, please complete it within one week of its receipt.

If you have any questions about the survey, please send an e-mail to the Community Affairs Department at phil.cosurvey@phil.frb.org.