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Remarks by

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Good evening. It is always a special pleasure for me to be in Boston and spend an evening with old friends. Tonight's occasion, coming as it does in the midst of a media barrage about victimized lower income homeowners, is timely. It gives us the opportunity to examine certain aspects of one of the major public policy issues of our time -- affordable housing.

But, in another sense, I was initially puzzled by the specific subject assigned to me: Can affordable housing be financed profitably? My first reaction was to be overjoyed. I could deliver the shortest after-dinner speech in history, much to the relief of an overfed audience. My speech would only have eight words. To wit: Can affordable housing be financed profitably? Of course! Then, if you were all still dying to hear me speak, we could talk about the economy or monetary policy or the Red Sox.

On further reflection, I realized you were dead serious and my flip answer to your earnest question needed some explanation. Explanation is even more appropriate given the recent allegations of fraud and loan-sharking in dealing with low-income mortgage borrowers in the Boston market. The perverse interpretation of those stories might be that affordable housing can only be supplied using inferior materials and workmanship and demanding usurious interest rates.

That's baloney!

Affordable housing can be made available to low-income persons using top-quality materials and fine workmanship, and it can be financed profitably by banks and other lenders at competitive rates of interest. But this can only happen if the lenders, especially the banks, recognize that affordable housing is a distinct line of business and not an additional duty assignment for some lender who otherwise doesn't have enough to do. It will require a dedication of financial and managerial resources and a recognition that success will not come by trying to serve this distinct market in the same way one would approach the housing market in Wellesley or Dover.

Let's take it step by step.

First, market analysis. Is there a market? What is the level of potential demand? I don't need to tell anyone in this room the answers to those questions. But I will anyway. There is a very large, steady demand for decent housing among low and moderate income groups. Even in a recession with most real estate demand evaporated, low and moderate priced housing continues to sell at a reasonably brisk pace.

Almost everywhere in the nation there are long waiting lists for affordable rental housing whether privately or publicly owned and operated. Actually, there <u>may</u> be low or moderate income projects somewhere which have had trouble getting leased up, but I confess I don't know where they are.

The bottom line on the market is that the current slack in commercial real estate and high-bracket residential pieces, simply doesn't exist in low and moderate income brackets. The demand there is real, large, and constant.

Any line of business with those market characteristics should be an attractive investment opportunity. The challenge in this case is how to get in on a sound basis.

The second step is to figure out what resources are needed to enter the market and where to get them.

Bankers are by definition lenders. But there are all kinds of lenders. In addition to good and bad, there are other distinctions. There are consumer lenders, large corporate lenders, middle-market lenders, secured lenders, term lenders, construction lenders, on and on. I would argue that affordable housing finance is just as specialized and just as professionally demanding as any of the others. I would also argue that any organization which doesn't recognize that need for specialization is likely to miss the boat. The lender who can successfully and profitably put his bank in the affordable housing finance business has to have at least these following special characteristics:

-- personal knowledge of low and moderate income areas, acquaintance with the community leaders and in-depth information about potential partners in future projects is essential equipment for any effective lender in this area.

-- In order to construct workable deals, the affordable housing lender must know about government subsidies and guarantees, when and how they can be used, how they work, and under what conditions they can be accessed.

-- There are also private sources of assistance which can make deals more doable, but it takes some diligent leg work to find them and know how to use them.

-- Finally, the paperwork needed to document loans in order to qualify for credit enhancements or sources of finance or equity is a challenge in itself. Any lender who does not have a thorough familiarity with this complicated aspect of the business has two strikes on him before he comes to bat.

The bottom line, then, on resources is that the human resource is most important and hardest to get. It can be developed from inside with a lot of patience and determination and a real investment in research and education. Or, it can be brought in from the outside after a careful search. But expertise from whatever source is essential to safe and sound lending policies supported by knowledge of the market and the ability to tap all of the auxiliary sources of capital, partners in lending, or credit enhancements which can assure a profitable outcome.

The third step is to organize for profitable affordable housing lending. Fortunately, there are enough options to suit the level of commitment of any bank.

-- Some have developed special lending units which focus exclusively on affordable housing finance. A notable example is American Security Bank in Washington, D.C. They have had a Community Development lending group for years which focuses on lending for low and moderate income housing. In the last five years, that group has financed over 275 projects in the inner city, totalling over $250 million in loan commitments. I can tell you they have made a real difference in the capital city.

-- Some banks have joined in consortia with other lenders to pool resources, hire experts, and share risks. Examples would be the Community Preservation Corporation in New York, the Community Investment Corporation in Chicago, or the California Community Reinvestment Corporation. Banks finance these operations with loans, lines of credit, or purchase of collateral trust notes, all of which are earning assets for the banks.

-- Some banks finance projects which have been packaged by community intermediaries that specialize in low to moderate income housing projects. A good example would be the Boston Housing Partnership right here.

-- Other banks have formed Community Development Corporations which provide equity as well as debt financing for low and moderate income housing. A New England example would be Merchants Bankshares in Burlington, Vermont, which through its CDC has invested in several low income housing projects. In Massachusetts, as we all know, the banking community created Massachusetts Housing Investment Corporation which provides loans and equity for affordable housing.

As we can see, depending on its preferred means of participation, there are lots of ways for a bank to organize to get into this business.

Fourth, a bank has to <u>work</u> at the business of affordable housing. It doesn't just walk in off the street neatly packaged and ready to go. It is a business of relationships and relationship banking requires painstaking development. In this case, that means relationships with both customers and suppliers.

-- State and local housing agencies that can participate in financing are important. Often projects which they are contemplating have room for or a need for a private partner. The affordable housing team should establish close working relationships with these agencies.

-- Community-based development corporations specializing in development of new housing or rehabilitation of old stock need sound financing, but it is essential that a successful lender know the organization intimately before he lends.

-- Private developers and contractors are active in new development as well as rehabilitation and always need sound imaginative financing. But as in all lending, it is imperative to know the borrower well.

-- Certain realtors specialize in low and moderate income clientele and can be a source of valuable business referrals.

-- And the tenants or property owners in affordable housing units are potential customers for the bank's consumer services, which are, for most banks, among their most profitable.

A many-faceted business exists here, but to be successful the bank which wants to participate has to work hard at developing the relationships which are the key to profitable operations.

Fifth and last, but certainly not least, is pricing. In any business, pricing is a key ingredient of the business plan and can determine success or failure. There is no question that pricing is a complicated challenge when financing affordable housing. It must make the business profitable for the bank, but at the same time avoid inflating rents or sales prices out of the range of affordability for low and moderate income persons. As you know, it is seldom possible to put that combination together without some form of subsidy. There are many useful forms of subsidy including additional equity to reduce the size of debt required; some form of interest-rate subsidy to reduce debt service payments or a third party guarantee which would justify longer terms and more affordable payments for borrowers. A few examples:

-- Interest-rate buy-downs using public, private foundation, or even corporate contribution funds.

-- Low or no-interest second mortgages provided by public programs or community loan funds.

-- Equity investments by limited partnerships utilizing the federal low-income housing tax credit.

-- And there are, in many jurisdictions, state and local government loan guarantee funds.

And there are others. Suffice it to say that banks can find the appropriate partners if they know where to look.

Affordable housing can most certainly be a profitable and rewarding business line for banks. The caveat is that affordable housing finance is not an activity in which banks will be successful if they just write checks and walk away. Like any other successful business, it requires a serious long-term commitment that is well thought out and sustained with bank resources. It must have the endorsement and support of the chief executive officer and the board of directors.

Under all of these conditions, can affordable housing be financed profitably by banks? Again, the answer is an emphatic "of course!"