Communities & Banking

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from the Editor...

Access to opportunities in home ownership for lower-income individuals is at the core of this issue of *Communities & Banking*. Our feature article examines the use of credit scoring in mortgage underwriting. These risk-assessment models are designed both to streamline the process and to reduce the influence of subjective human judgment. Yet the models themselves — along with the ways lenders might use them to make lending decisions — have sparked considerable debate over how they may affect access to home ownership opportunities.

We also profile The Real Estate Cafe in Cambridge, Massachusetts, which combines real estate buyer brokerage services with a "one-stop shop" where customers can "surf the 'Net" for homes, learn about neighborhoods, and examine property values. The Cafe's buyer representation combined with its many services produces a potentially powerful tool to help lower-income people identify and pursue affordable housing options.

You'll also notice a new section, **Information Exchange,** which outlines some of the growing resources the Federal Reserve Bank of Boston offers through our Community Information Center. The **Compliance Q&A** section discusses the new CRA's community development test, and **Community Developments** lists resources related to this issue's articles and those related to other aspects of community and economic development. C&B

...Where Credit Is Due: Credit Scoring and Mortgage Lending

Rebecca Carter, Federal Reserve Bank of Boston

As the banking industry consolidates and individual banks look for ways to trim expenses, mortgage lending departments are likewise looking for efficiencies, sometimes by using technology and automation. At the same time, these institutions must continue to meet fair lending and CRA requirements. Credit scoring, long used in the consumer lending and credit card arenas, is being touted by many as a tool to help accomplish all of these goals. Both Fannie Mae and Freddie Mac have recently adopted credit scoring as an element in evaluating loans for purchase, and recommend its use among lenders from whom they purchase mortgages.

These new developments have generated considerable discussion among lenders, community organizations, and consumer advocates across the country. The discussion often concerns how this emerging technology interacts with the complexities of lending to low- and moderate-income mortgage applicants, and how its use may affect mortgage underwriting decisions.

As a result, many lenders are taking a "wait and see" attitude about the technology. Jim Cosman from BayBanks Mortgage, Phil Freehan from East Boston Savings Bank, and Jerry Woodworth from Andover Savings Bank all report that their institutions are still evaluating credit scoring as a tool in making mortgage lending decisions. Some believe that it will take time to refine scoring models before they work properly in mortgage lending. And community banks such as East Boston Savings Bank pride themselves on

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Communities & Banking explores viable roles for financial institutions in community economic development. The newsletter is produced by the Federal Reserve Bank of Boston's Public and Community Affairs Department.

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Views expressed are not necessarily those of the Federal Reserve Bank of Boston or the Federal Reserve System. Information about upcoming events and other organizations should be considered strictly informational, not as an endorsement of their activities.

Readers interested in having community development programs or projects described in *Communities & Banking* should contact:

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their ability to assess risk on their own. Phil Freehan from East Boston Savings Bank reports that "We've always looked for ways to approve loans in our community. In 1989 we established a first-time home buyer program, and through that program we've lent more than $10 million without any defaults."

Many lenders recognize that the use of credit scoring models to assess risk may ultimately become standard industry practice. "Credit scoring will play a big role in the mortgage lending industry. It will be a big time saver...[and] I believe it will benefit both the customer and the lender," says Jerry Woodworth from Andover Savings Bank. This understanding is borne out in recent trends: Fair, Isaac & Company, the leading developer and supplier of credit scoring models and services, reports an increase of more than 100 percent in requests from mortgage lenders for credit scores in the four-month period from January through May of 1995. The challenge, therefore, is to ensure that everyone involved in the home purchase process — from the secondary market to community and consumer advocacy groups — understand the significance of credit scoring and apply it appropriately and equitably.

How Are Credit Scores Derived?

Credit scoring models are complex statistical formulas designed to assess lending risk. These models examine borrower characteristics such as the frequency, severity, and dates of delinquencies; utilization of available credit; the number of credit accounts available; the number of recent credit inquiries; the number of recently-opened trade accounts; and the number of finance company accounts. After measuring an individual's performance under each criterion, models consider the measurements simultaneously and weigh each factor based on its relative influence over future payment performance. The analysis ultimately yields a single composite score.

Fair, Isaac & Co. has developed several specialized models, including those tailored to evaluating risk in mortgage lending. Their scoring systems produce what are generally referred to as "FICO" scores. The three credit reporting bureaus — TRW, Equifax, and Trans Union — make use of the scoring models and can produce individual scores upon request.

According to Pete McCorkell, Vice President and General Counsel at Fair, Isaac & Co., ongoing and retrospective studies have shown that the factors examined to yield credit scores correlate significantly with a borrower's likelihood to repay debt. McCorkell acknowledges, however, that such models cannot predict a specific individual's behavior. Instead, they evaluate the risk of lending to that individual by analyzing historical credit and payment information of others with similar profiles.

Credit scoring models are proprietary and consequently public scrutiny is precluded. Suppliers such as Fair, Isaac & Co. provide substantial data to support the validity of their scores but do not publicly release information about how the formulas work. As a result, some question the way these models weigh the factors that produce the score. Because of their proprietary nature, the models take on a black box-like quality and, for many people, the results seem confusing and sometimes arbitrary.

Fair, Isaac & Co. models yield scores that range from 400 to about 900, with higher scores representing a greater likelihood of repayment, and lower scores representing a greater risk of delinquency (See Figure 1: "Distribution of credit scores of good and bad accounts." and Figure 2:

"Credit scores and default rates.") Data from Fair, Isaac & Co. illustrate the variation in mortgage loan performance by credit score range: For example, a FICO bureau score in the 600 to 609 range indicates a 7 percent incidence of mortgage loan charge-off or other major derogatory occurrence, while a FICO bureau score in the 670-679 range indicates a 2.1 percent incidence. The data also indicate, however, that there will always be some loans with high credit scores that do not perform well, and many with low scores that do.

Predictive Power of Credit Scoring Models

Robert Avery et al., in their article "Credit Risk, Credit Scoring, and the Performance of Home Mortgages" (*Federal Reserve Bulletin*, July 1996) analyze proprietary information released to them by Equifax, Inc. that relates credit scores to mortgage loan performance. While the authors cite some limitations to the study data, they indicate that credit scores are good predictors of loan performance. The authors report that "delinquent borrowers disproportionately have scores in the low range....For example, borrowers with low credit scores accounted for 2.1% of all seasoned conventional fixed-rate mortgages, but they accounted for 32% of those that became delinquent." This same trend held true for foreclosure rates. However, the authors also note that even though individuals with low scores comprise a large percentage of delinquencies, most borrowers with low scores are not delinquent. So even though a low credit score signals a lender that risk of default is statistically higher, an individual borrower with a low score may actually pose little risk. Avery, et al. also found that the relationship between income and loan performance appeared slight, and that credit scores predicted foreclosure much better than borrower income.

Credit Scores and the Lending Decision

The credit score assesses the relative risk a loan poses, and suppliers like Fair, Isaac tout the accuracy of that assessment. Yet the score does not determine what degree of risk is appropriate for a given lender or investor, nor does it address the additional complexities of mortgage lending such as loan-to-value ratios and debt-to-income ratios. For this reason, suppliers emphasize the limited role that this information should play in the mortgage credit decision. They stress that it should be used along with other factors in evaluating a mortgage loan application, and that a credit score should never take the place of underwriter judgment.

Government-chartered secondary market institutions evaluate credit scores in making their investment decisions, but likewise leave underwriting decisions to lenders. Fannie Mae and Freddie Mac have, however, established guidelines for lenders to use when underwriting loans, grouping scores into three categories indicating the level of review — whether Basic, Comprehensive, or Cautious — recommended for underwriting a mortgage. (See box on page 4.)

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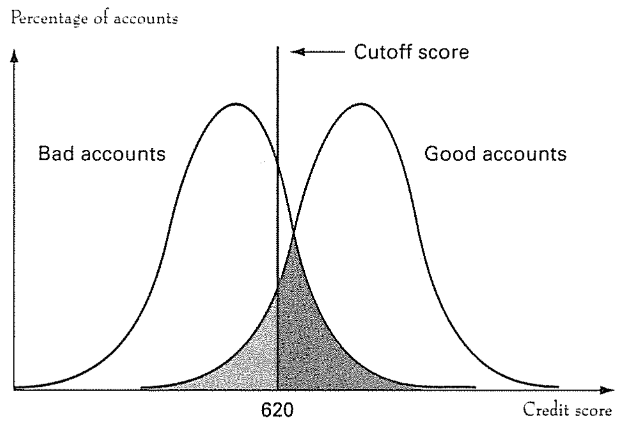
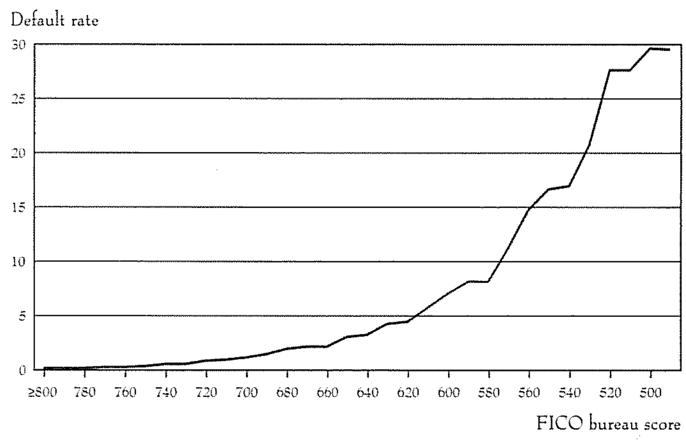
Figure 1
Distribution of credit scores of good and bad accounts



Source: Avery, et. al., "Credit Risk, Credit Scoring, and the Performance of Home Mortgages," *Federal Reserve Bulletin*, July, 1996, p.628.

Figure 2
Credit scores and default rates



Source: Fair, Isaac & Co., Inc.
Data from Fair, Isaac & Co. Equifax Beacon Validation Odds Summary.
Negative performance catagory: charge-off/major derogatory. Performance date: April, 1992.
Observation date: April, 1994 (24-month performance period.) Publication date: March, 1996.

Credit Scoring and Consumer Issues

Consumers and community groups — and some bankers — sometimes regard the use of credit scoring for mortgage lending with doubt, particularly given its black box-like quality. Many agree that one of the benefits of credit scoring systems is improved efficiency in processing loans for high-score, low-risk applicants using a much-simplified, expedited review. Such efficiencies benefit lenders by cutting costs and making it possible to serve customers more quickly, and consumers by simplifying the documentation process, expediting the decision, and potentially lowering origination costs.

Concerns arise, however, when one considers how the use of credit scoring may interact with mortgage underwriting for populations served by many community organizations and home buyer education programs. As Beth Prentice of Neighborhood Reinvestment Corporation points out in her article entitled "Automated Underwriting: Friend or Foe?" (*Stone Soup*, Summer 1996) the use of credit scoring could have an adverse effect on clients of her organization. In her article she cites:

- how the use of credit from finance companies – sometimes the only credit option for lower-income people – is highly correlated with increased risk in the statistical scoring analysis;

- the fact that alternative documentation, used extensively in affordable housing, usually is not included in the credit score, and when it is, only negative information is reported;

- the inability of scoring systems to distinguish a previously poor performer who has gone to a "we'll clean up your credit" company from one who has gone through a solid home buyer education program, and has developed both a new attitude and new ways of using credit;

- how a credit score can drop radically and quickly with recent poor credit performance, while it takes much longer to rebuild a record of financial responsibility to improve one's score.

Prentice discusses further how credit scoring models do not take into account the positive impact of home buyer education programs on the performance of mortgage loans. Mel Stiller, Executive Director of the Consumer Credit Counseling Service of Massachusetts, has similar concerns, worrying that such systems overlook the intricacies of each person's situation. He also notes that mortgage payment behavior, particularly for those who have received credit counseling, may differ substantially from credit card payment history.

Although Neighborhood Reinvestment Corporation has experience- and opinion-based information to support these views, Prentice acknowledges that experiential information is not adequate to demonstrate risk mitigation. She suggests a need for refinement of credit scoring models and underwriting systems to take into account the nuances affecting the likelihood that a borrower will repay. Such refinements, she also notes, could entail considerable statistical substantiation to demonstrate the mitigating influence of credit counseling programs.

Some question what will occur when originator or underwriter judgment is called for, particularly when applicants have FICO scores under 660. Avery et al. report that fully 40 percent of all mortgage loan applicants fall into this grey area, which signals an underwriter to perform a comprehensive or a cautious review. Will underwriters take the time to amass the additional information and documentation required for these loan applications? Will they diligently pursue an equitable second-look process? Or will they reject such applicants or automatically refer them to lenders specializing in higher-risk, higher-interest-rate loans?

Others question the validity of using a national data base as a proxy for a specific community's minority and low- and moderate-income home buyers. Related factors such

Secondary Market Underwriting Guidelines, by Credit Score

Score Range	Underwriter Guideline
Greater than 660:	**Basic review. Underwrite the file as required to confirm the borrower's willingness to repay as agreed.**
660 to 620:	**Comprehensive review. Underwrite all aspects of the borrower's credit history to establish the borrower's willingness to repay as agreed.**
Less than 620:	**Cautious review. Perform a particularly detailed review of all aspects of the borrower's credit history to ensure the borrower's willingness to repay as agreed has been established. Unless there are extenuating circumstances, a credit score in this range should be viewed as a strong indication that the borrower does not show sufficient willingness to repay as agreed.]**

as cultural differences or lack of education in managing credit — both of which could influence payment patterns — might adversely affect the ability of minority and lower-income people to obtain mortgage financing at favorable rates.

Community and consumer advocates are also uneasy about secondary market policies, how they are applied in making investment decisions, and their ultimate effect on credit cost and availability for minority and lower-income home buyers. Some private secondary market investors have established policies whereby they will not purchase loans with credit scores below 680. And Freddie Mac's Peter Mahoney, Senior Vice President and General Counsel, confirms that some customers have agreed contractually not to sell any loan to Freddie Mac with a score under 620. At the same time, he states that "credit quality does not know income," noting that low- and moderate-income people as well as middle- and upper-income people are approximately equally represented in all score ranges.

Avery et al. echo some of the concerns of consumer and community advocates. They assert that, for some groups under-represented in the data base, the scores may lack predictive power. Moreover, they note that developers of credit scoring models report that model performance deteriorates over time, so if the underlying model does not reflect current risk/performance relationships, predictive power may be compromised further.

Benefits with Cautions and Limitations

Credit scoring for the mortgage lending industry poses several advantages: It examines only those factors that credit scoring model developers have determined affect credit risk; it does not consider income, race, or ethnicity in its evaluation; and human subjectivity does not enter into the assessment of creditworthiness. Consequently, its use could create a fairer mortgage lending environment.

The use of credit scoring further promises to create efficiencies for lenders and secondary market investors in working with high-score/low-risk applicants. Better credit decisions may also result from the use of credit scoring. McCorkell of Fair, Isaac & Co. asserts that in switching from subjective to objective decision making, lending institutions may either reduce their delinquency rate by 20 percent to 30 percent — without reducing the acceptance rate; or they may increase their acceptance rate by 20 percent to 30 percent — without increasing their delinquency rate.

When one considers that 40 percent of credit scores fall into a statistical grey area, the impact on home ownership could be substantial.

Lenders and secondary market investors could, however, apply credit scores in ways they are not meant to be used. By basing mortgage lending decisions largely on the credit score, or by using a "marginal" credit score as sole justification for a mortgage loan denial from a minority applicant, particularly if that applicant wanted to purchase a home in a low-income or predominantly minority neighborhood, lenders would overlook their responsibility to review each application fairly and completely. When one considers that 40 percent of credit scores fall into a statistical grey area, the impact on home ownership could be substantial.

Credit scoring models themselves have their limitations. They cannot assess the risk associated with lending to those with non-traditional financial histories, whose credit reports show no credit history, and who therefore have no credit score. Fannie Mae's Robert Englestad confirms that they are committed to continuing the practice of purchasing such loans, and will evaluate them by manual review. Yet lenders must first take the time to underwrite the loans manually for Fannie Mae and Freddie Mac to purchase them.

Credit scores do not take into consideration such factors as a recent illness, job loss, and the like. Underwriters may not give adequate consideration to such extenuating circumstances, which could lead to denial of loans that perhaps could otherwise have been approved.

Finally, credit score reliability depends on the accuracy, completeness, and timeliness of the data contained in credit reports. If the underlying information does not reflect current actual payment performance, then the credit score likewise will be invalid.

Evolution in Mortgage Lending

When Fannie Mae and Freddie Mac embraced the use of credit scoring as a tool in mortgage lending, the mortgage industry, along with other related industries and organizations, took notice. Assessment of creditworthiness, often thought to be the most difficult aspect of mortgage lending, now could be largely free of human subjectivity for the majority of applicants.

A new mortgage lending environment is evolving, one that offers substantial opportunities for better, more efficient lending decisions, but one that also poses risks of misunderstanding or misuse. The complexity of the mortgage lending process, combined with technology's newness in mortgage lending, has created a knowledge gap.

The technology's effectiveness ultimately resides in the ability and willingness of all participants to adjust to this new environment. Developers of credit scoring models, secondary market investors, lending institutions, community organizers, and educators of home buyers all must work to develop products, policies, practices, and educational programs that work effectively with these changing mortgage lending systems.

A new mortgage lending environment is evolving, one that offers substantial opportunities for better, more efficient lending decisions, but one that also poses risks of misunderstanding or misuse.

To help ensure their predictive power, credit scoring model developers continually update their models based on demographic and behavioral changes. These suppliers could also incorporate statistically significant influences of factors such as home buyer education programs, as Neighborhood Reinvestment Corporation's Beth Prentice advocates. By so doing, the models might examine creditworthiness in a manner that more closely reflects the individuality of each applicant's situation.

Effective and equitable use of credit scores in underwriting decisions requires originator and underwriter knowledge of their proper use. Both model developers and secondary market investors are well situated to educate the lending community in using this new technology. Secondary market investors could train lenders in applying credit scores in a way that is equitable and consistent with their underwriting guidelines.

From senior bank managers to loan underwriters, staff members of banking institutions need to understand what credit scoring can — and what it cannot — accomplish. They must also apply scores equitably and consistently in the loan origination process. Senior bank managers in particular should consider establishing clear and consistent guidelines for the use of credit scoring in mortgage lending decisions. These same managers should also consider monitoring their bank's lending activity to ensure that originators and underwriters are serving all customers, especially the 40 percent whose credit scores fall in the grey area. Finally, for those applications that require additional attention, second- and third-look procedures will help a bank treat all customers equitably.

Community organizations may choose to play more than one role. They could educate their clients about applying for mortgages in this new environment; this will require a full understanding of lender and secondary market guidelines and of how various behaviors affect credit scores. Community groups could also advocate credit scoring models that incorporate the effects of home buyer education programs and other influencing factors; they could also work with banks to establish underwriting guidelines that do the same.

Beyond the Scores

Beyond the debate about the validity of using credit scoring models in the mortgage underwriting process, and beyond the diverging forecasts of their potential impact on minority and lower-income individuals, banks have an ongoing responsibility to comply with Community Reinvestment Act regulations. Many bankers have learned that, with the right commitment to developing lending products designed for low- and moderate-income home buyers, the pursuit of CRA compliance can be profitable and rewarding. With a similar commitment to understanding a mortgage underwriting environment that utilizes credit scoring models, and to developing policies that ensure low- and moderate- income individuals are well served, banking institutions will further the goal of the Community Reinvestment Act and serve markets that might not otherwise be served.

See Community Developments to order copies of recent studies and publications on credit scoring.

Information Exchange

The Boston Fed Announces New Community Information Center

The Federal Reserve Bank of Boston's new Community Information Center features information related to community development laws and regulations, financing community development activities, and developing public/private partnerships. The Center is open to the public by calling Susan Cournoyer at 617-973-3174. Watch this section for future updates on Information Center resources. And don't forget to visit the Fed's home page on the World Wide Web, at http://www.bos.frb.org.

Publications

- Public/private partnerships
- Microenterprise lending
- Small business development financing
- Women's business development
- Rural development
- Home Mortgage Disclosure Act analyses and guides
- Community Reinvestment Act analyses and guides

Documents

- CRA Hearing testimony
- Federal Financial Institution Examination Council (FFIEC) Press Releases
- Consent decrees between the Department of Justice and financial institutions
- Housing and community development laws and regulations*
- Bi-weekly updates on development trends and issues*

**An electronic database will be in place by 1997.*

Electronic Information

- Listings of banks and local, regional and state economic development development organizations
- 1995 HMDA data

A Call for Information

The centerpiece of the Federal Reserve's Community Information Center is a data base of New England's community and economic development agencies and organizations. This data base includes information on specific programs and services offered by individual organizations. It is a useful tool for anyone needing access to information about area programs and resources.

We need your help. The data base can only be as accurate and up to date as the information we receive from you.

Please complete the short questionnaire on the following page and then just drop it in the mail, postage paid, to the Federal Reserve.

You can find out more about specific Information Center holdings by calling Susan Cournoyer at 617-973-3174, or you can reach her by e-mail at susan.m.cournoyer@bos.frb.org.

Consolidated CRA Examination Schedule Fourth Quarter, 1996

Examined by the Federal Depost Insurance Corporation

Union Savings Bank
Danbury, CT

Farmington Savings Bank
Farmington, CT

The Putnam Trust Company
Greenwich, CT

MidCon Bank
Kensington, CT

Salisbury Bank and Trust Company
Lakeville, CT

Liberty Bank
Middletown, CT

American Savings Bank
New Britain, CT

The New Milford Bank and Trust Company
New Milford, CT

Newtown Savings Bank
Newtown, CT

Norwalk Savings Society
Norwalk, CT

Ridgefield Bank
Ridgefield, CT

The Bank of Southington
Southington, CT

First Union Bank of Connecticut
Stamford, CT

American Bank of Connecticut
Waterbury, CT

First Bank of West Hartford
West Hartford, CT

The Westport Bank and Trust Company
Westport, CT

Amesbury Co-operative Bank
Amesbury, MA

Hyde Park Savings Bank
Boston, MA

Mercantile Bank and Trust Company
Boston, MA

Roslindale Co-operative Bank of Boston
Boston, MA

The Boston Bank of Commerce
Boston, MA

Wainwright Bank and Trust Company
Boston, MA

Bridgewater Co-operative Bank
Bridgewater, MA

Brookline Co-operative Bank
Brookline, MA

North Cambridge Co-operative Bank
Cambridge, MA

United Bank
Conway, MA

East Bridgewater Co-operative Bank
East Bridgewater, MA

Dukes County Savings Bank
Edgartown, MA

MetroWest Bank
Framingham, MA

Dean Co-operative Bank
Franklin, MA

Cape Ann Savings Bank
Gloucester, MA

Greenfield Co-operative Bank
Greenfield, MA

Pentucket Five Cents Savings Bank
Haverhill, MA

Eastern Bank
Lynn, MA

Northmark Bank
North Andover, MA

Norwood Co-operative Bank
Norwood, MA

Randolph Savings Bank
Randolph, MA

Stoughton Co-operative Bank
Stoughton, MA

Walpole Co-operative Bank
Walpole, MA

Ware Co-operative Bank
Ware, MA

United Co-operative Bank
West Springfield, MA

Woronoco Savings Bank
Westfield, MA

Winchester Savings Bank
Winchester, MA

Wrentham Co-operataive Bank
Wrentham, MA

Kennebec Savings Bank
Augusta, ME

Biddeford Savings Bank
Biddeford, ME

Norway Savings Bank
Norway, ME

Key Bank of Maine
Portland, ME

CFX Bank
Keene, NH

Laconia Savings Bank
Laconia, NH

The Siwooganock Guaranty Savings Bank
Lancaster, NH

Peoples Bank of Littleton
Littleton, NH

First NH Bank
Manchester, NH

First Signature Bank and Trust Company
Portsmouth, NH

Piscataqua Savings Bank
Portsmouth, NH

Andover Bank
Salem, NH

Domestic Loan and Investment Bank
Cranston, RI

PierBank
Narragansett, RI

First Bank and Trust Company
Providence, RI

Key Bank of Vermont
Burlington, VT

Examined by the Office of Thrift Supervision

Naugatuck Valley Savings and Loan Association
Naugatuck, CT

Windsor Federal Savings & Loan Association
Windsor, CT

Union Federal Savings Bank
Boston, MA

Examined by the Office of the Comptroller of the Currency

First Brandon National Bank
Brandon, VT

Patriot National Bank
Stamford, CT

Beverly National Bank
Beverly, MA

Millbury National Bank
Millbury, MA

First & Ocean National Bank
Newburyport, MA

The Lancaster National Bank
Lancaster, NH

Rhode Island Hospital Trust National Bank
Providence, RI

Examined by the Commonwealth of Massachusetts, Division of Banks

Aldenville Credit Union
Chicopee, MA

Berkshire County Savings Bank
Pittsfield, MA

Boston Globe Employee Credit Union
Boston, MA

Braintree Co-operative Bank
Braintree, MA

Cambridge Savings Bank
Cambridge, MA

Cape Cod Bank & Trust Company
Hyannis, MA

Chicopee Municipal Employees Credit Union
Chicopee, MA

Commonwealth Co-operative Bank
Boston, MA

Commonwealth Gas Employee Credit Union
Southborough, MA

County Schools Credit Union
Pittsfield, MA

Easthampton Savings Bank
Easthampton, MA

Economy Co-operative Bank
Merrimac, MA

Embeco Credit Union
E. Longmeadow, MA

Foxborough Savings Bank
Foxborough, MA

Great Barrington Savings Bank
Great Barrington, MA

Grove Bank for Savings
Boston, MA

Haverhill Teachers Credit Union
Haverhill, MA

Leicester Savings Bank
Leicester, MA

Lowell Firefighters Credit Union
Lowell, MA

Mass State Employees Credit Union
Boston, MA

Meetinghouse Co-operative Bank
Boston, MA

Monson Savings Bank
Monson, MA

Newton Municipal Credit Union
Newton, MA

Pyralart Credit Union
Leominster, MA

Roslindale Co-operative Bank
Roslindale, MA

Saint Vincent Hospital Credit Union
Worcester, MA

Saugus Co-operative Bank
Saugus, MA

Somerset Savings Bank
Somerville, MA

United States Trust Company
Boston, MA

US Trust
Boston, MA

Wainwright Bank and Trust Company
Boston, MA

Webster Five Cents Savings Bank
Webster, MA

Community Information Center Survey

Name of Organization: ____________________

Executive Director: ____________________

Mailing Address: ____________________

Telephone: __________ Fax: __________

Date Established: ____________________

Staff Size: __________ Paid: __________ Volunteer: __________

Service Area: ____________________

Type of Organization

- ◯ Nonprofit
- ◯ Public
- ◯ Private
- ◯ Quasi-public
- ◯ For-profit
- ◯ Other: __________

Organizational Focus

- ◯ Economic
- ◯ Community
- ◯ Housing
- ◯ Economic & Community
- ◯ Community & Housing
- ◯ All
- ◯ Economic & Housing

Organizational Mission

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Programs and Services

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Other Contacts

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Just Call for Help

The Federal Reserve Board now has a CRA Assistance Line!

If you have questions related to bank CRA compliance, just call 202/872-7584.

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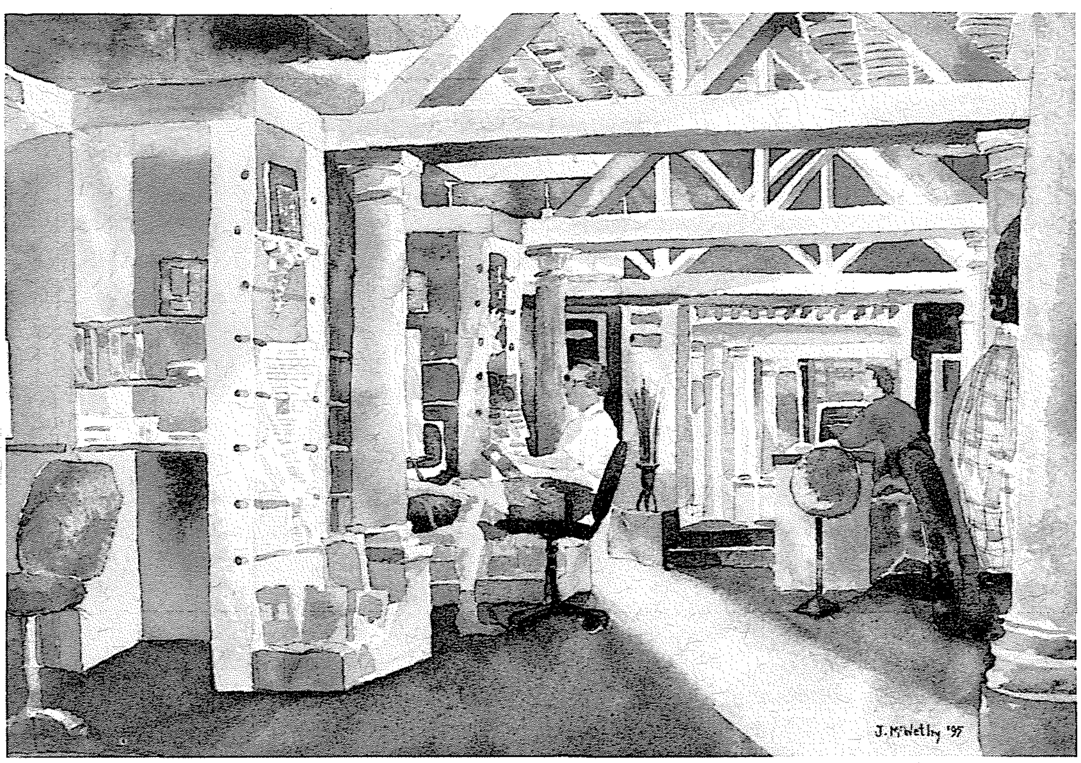
The Real Estate Cafe: Serving Home Ownership in Greater Boston

by Susan Cournoyer, Federal Reserve Bank of Boston

Clergy from several congregations gather at Bill Wendel's Real Estate Cafe in Cambridge, Massachusetts along with real estate brokers, bankers, and representatives of city and nonprofit agencies. Wendel hosts the session, at which the group discusses plans to create an ecumenical organization to develop affordable housing units in Cambridge and surrounding communities. Imbued with a civic focus evidenced in events like this one, the Cafe also embodies a number of trends in the residential real estate industry which could hold promise for low- to moderate-income home buyers, including access to buyer representation and to technology.

The Cafe specializes in providing buyer brokerage services to home buyers. During the day, it functions as a self-service housing information center, offering books as well as Internet resources. 'Cafe' refers to the store's smorgasbord of housing resources and activities. The combination of buyer representation and technological resources positions Bill Wendel and the Real Estate Cafe among the new breed of advisory professionals in the residential real estate industry.



Advisory Role of Buyer Brokers

Traditionally, residential real estate agents have had a fiduciary responsibility to act only in the best interests of the seller. Over the past decade, changes in the residential real estate industry have allowed buyers access to fiduciary representation through buyer brokers. Low- to moderate-income home buyers may find that the various services of buyer brokers can lower the hurdles involved in buying a home. (See box on page 8.)

Buyer agents provide advice and services that seller agents often cannot. Many of them consider it their job to help buyers navigate the home purchase process. In so doing, buyer brokers can identify resources for buyers to use in evaluating metropolitan as well as suburban communities where affordable housing options may exist. They may work with buyers to identify properties for sale or to target neighborhoods with affordable properties; they can recommend analyses of properties to detect potential zoning issues, environmental hazards, and negative events in the history of the house; and they may work with buyers to explore mortgage options and to advise on the home appraisal process. Finally, according to Constance Prokop of Custom Real Estate Services of Concord, Massachusetts and a member of the Massachusetts As-

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sociation of Buyer Agents (MABA), buyer agents can "provide expertise in structuring and negotiating a transaction that optimizes the buyer's ability to purchase a home at the best price."

More Options in Purchasing Services

Changes in the field of residential real estate have led to the development of an array of new compensation options for buyer brokers. The traditional listing agent provides services up front, and receives a sales commission based on a percentage of the sales price at the closing. For buyer brokerage services, compensation arrangements vary. Many buyer agents and listing agents split real estate commissions. However, listing agents vary in their willingness to consider split commissions. Some buyer brokers negotiate fees with their clients. These fees are then either paid separately or are included in the purchase price. Still other buyer agents are charging "a la carte" for their expertise, allowing consumers to select only those specific services they need or want.

The Cafe's Menu Services

The Real Estate Cafe's menu reflects most of these trends in buyer brokerage. Owner Bill Wendel has developed an unusual concentration of services over the last six years. He traces his interest in the housing field back to his father, who was involved in the Model Cities programs in the 1960's. After attending a Jesuit high school, Wendel completed architecture and planning course work at MIT and at Harvard University. The Cafe unites his interests in technology, home buyer education, and the civic benefits of extending home ownership to low- and moderate-income people.

Prospective buyers can sample free seminars at the Real Estate Cafe to start to explore their options. According to Wendel, "the Cafe hosts the 'Renters' Blues Night' on the first of each month. We have an hour-long presentation by somebody who is doing an innovative affordable housing program that's of interest to first-time buyers." In February, this seminar included a presentation by The Boston Company on loan programs for first-time home buyers. Other recently scheduled seminars include "Buying Foreclosed Properties" and "Saying Good-bye to Your Landlord," which outlined the pros and cons of terminating leases early.

Sampling of Buyer Brokerage Services

- Explore home ownership goals
- Credit counseling
- (individualized or program referrals)
- Mortgage pre-approval before starting search
- Consider communities and neighborhoods
- Locate affordable properties
- Target neighborhoods
- Detect negative events in home's history
- Alert buyer to zoning or environmental issues
- Explore mortgage options
- Advise on home appraisal process
- Structure and negotiate home purchase transaction

The Cafe is organized as a series of twenty stations modeled after the home buying process, covering such steps as selecting communities, identifying properties, and locating a lender and a mortgage product. The Cafe stocks a wide range of books and videos and also offers access to computer applications specific to the real estate field. For instance, home buyers can view the Multiple Listing Service (MLS), the centralized data base used to list residential properties for sale. Users can also access a Case Shiller Weiss site that permits a home buyer to evaluate the stated price for a property. Wendel states that he and the Cafe's three other brokers "sift through the real estate sites on the World Wide Web so we can guide buyers through them."

The fee structure at the Real Estate Cafe permits clients to purchase only those services they need. Use of computer resources may be purchased on an hourly basis, with caps of $100 per month and $300 per year. Computer instruction is also offered on an hourly basis. In turn, these fees can be applied to fees incurred for buyer brokerage services. Buyers who elect to use the Real Estate Cafe's buyer brokerage services pay total fees ranging from $2,000 to $5,000. Wendel explains, "If somebody is a self-service client, after $2,000 we split the commission fifty-fifty with them. We never charge more than $5,000." In return for these discounted fees, buyers agree to do some of the work themselves, including driving by properties and attending open houses on their own.

Clients at the Real Estate Cafe have a wide range of incomes. Most are prospective buyers seeking properties in the price range of $100,000 to $150,000. Using the Cafe's resources, they are able to identify Boston neighborhoods such as Dorchester and East Boston as well as Greater Boston communities such as Medford and Waltham where they may find housing in their price range. Clients consider most types of housing, including condos, townhouses, and single family, two-family, and multi-family dwellings.

More Consumer Options

Fannie Mae's 1996 Housing Survey notes that, for low- to moderate-income renters, owning a home is their most important life goal. Changes in the residential real estate industry are beginning to yield more resources to assist buyers in reaching this goal. "New information technologies are reducing costs," observes Bill Wendel. "That's our philosophical cornerstone. We're a funnel for these new technologies and our goal is to make sure that consumers benefit from the savings." C&B

Retail Banking, Community Development, and the New CRA

What kinds of activities generally qualify as community development?

Under the new CRA, community development activities are considered separately from the bank's other lending, investment, and service activities. Consequently, activities considered for community development credit cannot be considered for credit under any other category of the regulation. To qualify for this credit, a bank may provide loans, investments, or financial services that further one of the following purposes: affordable housing; community service; economic development; or community stabilization/revitalization.

What geographic area(s) must be served?

Only loans, investments or services located within a retail institution's assessment area(s) or an area that includes its assessment area(s) will qualify. Some activities in overlapping areas will also qualify, including those that: 1. encourage cooperative activities with community development corporations, other financial institutions or community organizations, government programs and other community institutions; and 2. where there are limited opportunities in its assessment area, allow and encourage a lender to provide loans, investments or services in underserved areas.

Are there any restrictions on the types of loans that will count?

There are three types of loans that will not be considered community development loans:

1. Small business and small farm loans, even when they serve an economic development or community development purpose, will not count as community development loans. Information will be considered under the Large Bank Lending Test. There are some exceptions. Because lenders do not report commercial loans under one million dollars that they do not capture in the Consolidated Reports of Condition and Income, Schedule RC-C, Part II, and in the Thrift Financial Report, Schedule SB, these loans are not considered in the lending test. Therefore, they will count as community development loans.

2. Loans that are HMDA-reportable. For retail banks required by HMDA to report residential lending, these loans will be considered as part of the bank's lending performance. There is one exception: Loans for multi-family (five- or more unit) affordable housing are considered community development loans.

3. Loans collected as Optional Data for consideration as lending activity. If a bank chooses to collect data on consumer and other loans, it will be considered as part of the bank's lending performance.

What will count as a Community Development Investment?

Any investment that meets a community development purpose is eligible, including: 1. lawful investments; 2. deposits or membership shares in community development institutions; and 3. grants or charitable contributions, such as subsidies or grants to eligible consumers or organizations (reduced fees, closing costs or below-market interest rates.) Examiners may consider the entire bank portfolio of qualified investments, not just those made since the last examination.

What kinds of services qualify?

Services must relate to the provision of financial services. Moreover, they cannot have been categorized by the bank as a retail service. For example, if a banker serves on a loan committee of a micro-enterprise lending program, that activity would qualify. However, if the activity does not draw on the bank's financial expertise — if that same banker served food at a local homeless shelter — the activity would not qualify.

How does the new CRA define "Affordable Housing?"

Loans, investments or services must serve households with incomes under 80% of the area median. Housing may be located in a low- or moderate-income area, or it may be located in a higher-income area, but serve low- and moderate-income people. For one- to four-family homes, condominiums, or cooperatives, the beneficiary of the mortgage, investment or service must have an income under 80% of the area median. For multi-family (5+ units) the housing must primarily benefit low- and moderate-income residents. Special needs housing targeted to low- and moderate-income residents also qualifies as affordable housing.

What community services qualify as community development activities?

Loans, investments or services that

meet the needs of low- or moderate-income people qualify. Services include health, educational, day care, and recreational services and those related to credit counseling, housing, small business or economic development. Services must primarily serve households with incomes under 80% of the area median.

What qualifies as economic development under the new CRA?

Any activity will be considered that: directly or indirectly finances businesses or farms with gross annual revenues under one million dollars or; meets SBA's standards for its Development Company or Small Business Investment Company Program. There is no income-targeting required.

Loans, investments or services that create, retain, or improve jobs may also be considered. They include loans or grants to nonprofit or for-profit community organizations that support micro-enterprise lending programs, small business incubators or other such programs.

What constitutes community revitalization and stabilization?

Community revitalization and stabilization activities must benefit low- and moderate-income areas. Middle- and upper-income households may also benefit, but the loan, investment or service must help stabilize or revitalize a low- or moderate-income neighborhood.

Community revitalization and stabilization encompasses a wide range of loans, investments and services, such as: financing of environmental clean-up; redevelopment of an industrial site; and purchase of municipal bonds for infrastructure.

This Q&A is based on written information supplied by the FDIC.

Rebecca Carter

Community Developments

More Information on the New CRA and Community Economic Development

• • Credit Scoring • •

"Credit Risk, Credit Scoring, and the Performance of Home Mortgages," Robert B. Avery, Raphael W. Bostic, Paul S. Calem, and Glenn B. Canner. From the *Federal Reserve Bulletin*, July, 1996, pp. 621-648. This article presents new information about the distribution of credit scores across population groups and the way credit scores relate to the performance of mortgages. For a copy of the article, call Becky Carter at the Federal Reserve Bank of Boston, 617/973-3813; by e-mail: rebecca.carter@bos.frb.org.

"Low- to Moderate-Income and High Minority Area Case Studies." From Fair, Isaac & Co. This paper examines the impact of credit scoring on minority and low- and moderate-income neighborhoods. It also provides background on credit scoring and outlines the differences between credit scoring and judgmental decision-making. For a copy of this paper, call Becky Carter at the Federal Reserve Bank of Boston, 617/973-3813; by e-mail: rebecca.carter@bos.frb.org.

"Automated Underwriting: Friend or Foe," by Beth Prentice. From *Stone Soup,* Summer, 1996, pp. 18-19. This article presents some of the questions that community organizations have about credit scoring in mortgage lending. For a copy of the publication, call Becky Carter at the Federal Reserve Bank of Boston, 617-973-3813; by e-mail: rebecca.carter@bos.frb.org.

Viewpoints. A newsletter from Fair, Isaac & Co. that addresses marketing, technical, and legal issues related to credit scoring. To receive this publication, call Fair, Isaac at 1-800-777-2066.

On the 'Net. For Fair, Isaac & Co.'s home page entitled "Frequently Asked Questions about Mortgages," see http://www.homeowners.com/faq.html. For "Understanding Credit Bureau Scores," visit http://www.nccredit.com/underscores.html. For "Credit Scoring: The Impact on Mortgage Loans," see http://www.mortgage-mart.com/cwatts.html.

• • Affordable Housing • •

A Way Home. This guidebook is designed to help community-based organizations set up their own home buyer education and assistance programs. This publication discusses developing a home buyer counseling program; conducting outreach; providing individual counseling; matching buyers with available properties; and more. From Citizens' Housing and Planning Association. To order, call 1-800-HOME-111. $5 for members; $10 for non-members.

continued on page 11

New CRA Regulation

Community Reinvestment Act Interagency Questions and Answers, issued by the Federal Financial Institutions Examination Council. This Q&A answers many of the questions received from financial institutions, examiners, and others about the new regulation. To receive a copy, contact Becky Carter, Federal Reserve Bank of Boston, Community Affairs Department, P.O. Box 2076, Boston, MA 02106-2076; 617-973-3813; by e-mail: rebecca.carter@bos.frb.org.

Community Reinvestment Act Regulations, Joint Final Rule, issued by the Office of the Comptroller of the Currency, U.S. Department of the Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision. Revisions provide guidance to financial institutions on the assessment of their CRA-related activities. To receive a copy, contact Becky Carter, Federal Reserve Bank of Boston, Community Affairs Department, P.O. Box 2076, Boston, MA 02106-2076; 617/973-3813; by e-mail: rebecca.carter@bos.frb.org.

Examination Procedures for the New Community Reinvestment Act Regulation, issued by the Office of the Comptroller of the Currency, U.S. Department of the Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision. Procedures outline guidelines for compliance examiners to follow when conducting a CRA examination. To receive a copy, contact Becky Carter, Federal Reserve Bank of Boston, Community Affairs Department, P.O. Box 2076, Boston, MA 02106-2076; 617/973-3813; by e-mail: rebecca.carter@bos.frb.org.

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Feature Story, "...Where Credit Is Due: Credit Scoring and Mortgage Lending"
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Compliance Q&A: "Retail Banking, Community Development, and the New CRA"
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Community Development Profile: "The Real Estate Cafe: Serving Home Ownership in Greater Boston"
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- ◯ Somewhat useful/informative
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Community Developments
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Any suggestions or comments on the above articles?

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Please tell us about any program(s) offered by your organization that you would like to have mentioned in *Communities & Banking:*

____

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Are there topics you would like *Communities & Banking* to address or information you would like to see included?

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