COMMUNITY REINVESTMENT

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NATIONAL HOUSING DEVELOPMENT CORPORATION

Nonprofit is Focused on Preserving Affordable Housing

By Kathy Kenny and John Trauth

Despite the robust American economy, the need for affordable housing continues to grow. Today, affordable housing is available for only one-quarter of those who need it. As a nation, we are not building enough affordable housing to keep up with the huge demand. Many experts have recognized this problem, including the National Housing Conference, which has called for a bold new affordable housing production program. At the same

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AN EXCHANGE OF COMMUNITY DEVELOPMENT ISSUES AND IDEAS

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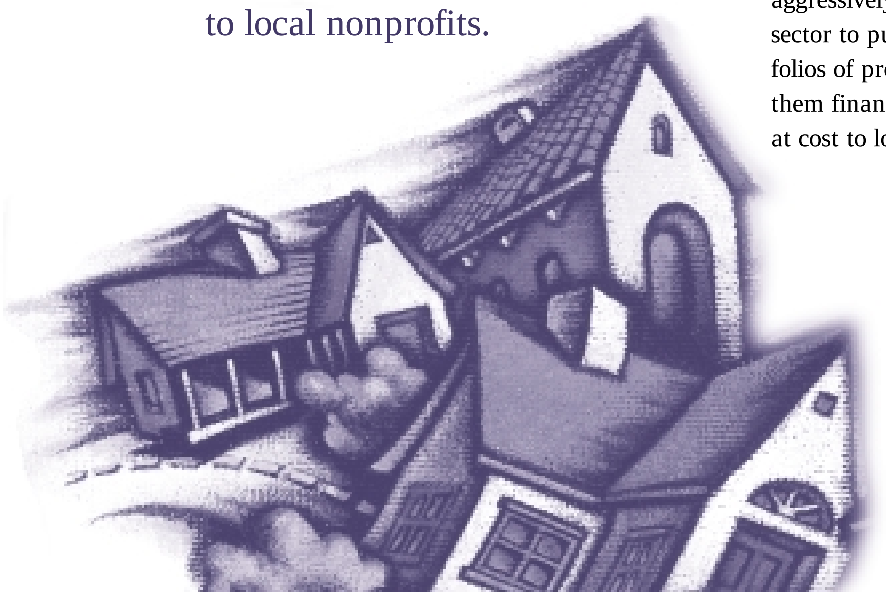
time, the stock of existing affordable rental housing is diminishing through neglect, deterioration, and—most importantly—the pending expiration of federal subsidies.

In the 1970s, the federal government entered into contracts with private owners to create affordable housing projects in return for a long-term (25- to 30-year) commitment from the government to provide monthly rent subsidies for the tenants. The Section 8 program, administered by the Department of Housing and Urban Development, is the primary vehicle for these subsidy dollars. The Department of Agriculture's Section 515 program has also built affordable rental housing in rural areas. Although these subsidies are not expiring, some owners are interested in selling their properties to local nonprofits.



Now, a large percentage of these government rent-subsidy contracts are expiring without the expectation of renewal. Over the next three years, the largest transfer of affordable real estate assets in history will take place, exposing upwards of 800,000 affordable apartments—now regulated and subsidized by HUD—to market-rate conversion.

The National Housing Development Corporation (NHDC) was created to respond to this need. It is the first national intermediary of its type to emerge from the West Coast, growing out of an award-winning housing preservation program operated by the nonprofit Southern California Housing Development Corporation. NHDC's mission is to improve the quality of life for lower-income families by acquiring and preserving the nation's affordable housing stock. Partnering with other nonprofit preservation efforts, it will compete aggressively with the private sector to purchase large portfolios of properties, restructure them financially, and sell them at cost to local nonprofits.

ABOUT THE AUTHORS

Kathy Kenny and **John Trauth** are organizational planning and development consultants specializing in the start-up of large-scale initiatives in affordable housing and community development. They are currently assisting the National Housing Development Corporation through its start-up phase. John Trauth was instrumental in the creation of the BRIDGE Housing Corporation and the Southern California Housing Development Corporation, two highly successful regional nonprofit housing developers. Kathy Kenny has served as a planning consultant to the Council on Foundations, the League of California Community Foundations, the National Economic Development and Law Center, and the Federal Reserve Bank of San Francisco.

> **TIMING IS OF THE ESSENCE, AS THE MAJORITY OF THE AT-RISK SECTION 8 PROJECTS WILL FACE SUBSIDY EXPIRATION IN THE NEXT THREE YEARS. IF THESE PROPERTIES ARE LOST TO CONVENTIONAL BUYERS AND CONVERTED TO MARKET-RATE HOUSING, REPLACING THIS INVENTORY WILL BECOME COST-PROHIBITIVE.**

Under nonprofit ownership, affordability can be maintained in perpetuity. NHDC's goal is to preserve a significant portion of the nation's at-risk properties, with an initial target of acquiring 60,000 units in three years.

Congress has recognized this need and has endorsed the NHDC model. Two million dollars has been earmarked in the 1999–2000 budget for NHDC's initial seed capital. In addition, a national foundation has approved a seed grant for the first two years of operation.

UNITED NATIONAL PRESERVATION TRUST

NHDC's program, also called the United National Preservation Trust, negotiates directly with portfolio owners for properties across the country. It is designed to be a large-scale acquisition and warehouse facility that will purchase larger portfolios of at-risk affordable housing properties, concentrating on those beyond the financial or geographic reach of local nonprofits *(see chart, page 6)*. NHDC will reposition and stabilize the properties and finally will disaggregate and sell off individual properties at cost to qualified local nonprofit organizations.

NHDC's holding period (12 to 36 months) will enable local nonprofits to assemble the necessary resources (tax credits, HOME funds, and local subsidies) to purchase the properties and assume property-management functions. NHDC will continue to act in a limited asset-management oversight role, retaining the ability to correct future problems.

The NHDC program is based on the concept of "harmonious differentiation," through which it will work with and complement housing, community development, and preservation efforts of other national intermediaries such as the National Council of La Raza and the Congress of National Black Churches. In addition, properties acquired by NHDC will be available for purchase by qualified affiliates of the Neighborhood Reinvestment Corporation, Local Initiatives Support Corporation, Enterprise Foundation, National Association of Housing Partnerships, National Affordable Housing Preservation Associates, and others *(see box, page 5)*.

NHDC will also work closely with the National Council of State Housing Agencies and its state-level members, who will identify at-risk properties and may provide property financing.

TARGET MARKETS

In addition to the large number of existing low-income rental housing units which are immediately at risk because of market-rate conversion, the program will also target older assisted-subsidy-dependent properties, conventional affordable apartments owned by real estate investment trusts, low-income housing tax credit properties reaching lock-in expiration, and large-scale neighborhood revitalization projects that are beyond the reach of local nonprofits.

NHDC has targeted the mid-Atlantic, Midwest, and West Coast first because the majority of expiring Section 8 properties are located in those regions.

ACQUISITION AND FINANCING

NHDC will focus on properties that can be underwritten, purchased, and preserved under a "renewed affordability" paradigm, whereby permanent affordability—independent of future federal subsidies—can be achieved through a combination of a reasonable acquisition price and value added through financial and operational restructuring, below-market financing, tax credits, local subsidies and nonprofit ownership.

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With the initial seed capital in place, NHDC staff is actively working to identify and purchase its first at-risk portfolios. Timing is of the essence, as the majority of the at-risk Section 8 projects will face subsidy expiration in the next three years. If these properties are lost to conventional buyers and converted to market-rate housing, replacing this inventory will become cost-prohibitive.

Opportunities exist for banks and other financial institutions to provide seed capital to support NHDC's initial activities in their market areas, as well as to provide acquisition and permanent financing for NHDC properties, eventually assumable by the ultimate owner/manager, the local nonprofits.

Once it is up and running, NHDC will generate income from transaction fees, special preservation funds (intermediary technical assistance grants), cash flows from acquired properties, transfer fees to local nonprofits (based on a limited cost-reimbursement formula) and asset-management fees. NHDC projects that it will achieve self-sufficiency in four years, based on an aggressive acquisition strategy.

To reach self-sufficiency, NHDC projects a need for $5 million in seed capital ($2 million of which has been provided by Congress). NHDC is in the process of raising the remaining seed capital from financial institutions, foundations, corporations, and future congressional appropriations.

CRA INVESTMENT OPPORTUNITY

NHDC is developing an investment fund whereby participating financial institutions will receive CRA investment credit by acquiring existing affordable housing at risk of market conversion. Acquisitions will be structured as a risk-shared equity pool LLC in which NHDC is the managing member and participating financial institutions are the equity investors and members. Investments are targeted for $5 million increments, although smaller investments will be considered. The investment will have a projected holding period of three years and a maximum of six years, with a projected return of 5 percent to 8 percent plus return of capital. The fund will make every effort to target its acquisitions to match investors' service areas, broadly defined as states and regions where investors do business. However, for NHDC to have the flexibility to respond to areas of greatest need, 25 percent of the funds will be reserved for use in any location. As soon as properties are repositioned, stabilized, and a qualified local nonprofit is in place, NHDC will sell or transfer the property to that organization. At that time, the investors' equity capital will be repaid. As an alternative, and at each individual investor's discretion, equity capital can be recycled as a new capital contribution to acquire future properties on the same basis. If there is no otherwise viable affordability-oriented transaction, the property can be sold at market value as a last resort.

NHDC PERSONNEL

While NHDC is a new national intermediary, NHDC staff have a long and impressive history in affordable housing preservation. Jeff Burum, NHDC's executive director, was the founder and driving force behind Southern California Housing Development Corporation (SoCal Housing), a large and very successful regional nonprofit that preserves affordable rental housing in Southern California. Under Burum's seven-year stewardship, SoCal Housing preserved more than 3,000 housing units with an asset value exceeding $130 million. Other key staff members from SoCal Housing are also involved with NHDC. Sebastian Sterpa, former chairman of the California Housing Finance Agency, will serve as the board of director's initial chairman. Other members of NHDC's board are being recruited and include key national leaders in the nonprofit, philanthropic, private, and public sectors.

Fourth District At-Risk Section 8 Units

Number of units 110 percent or below fair market rents expiring by 2004

STATE	RANK (OUT OF 51)	ASSISTED UNITS	TOTAL UNITS
OHIO	2	32,839	59,083
PENNSYLVANIA	14	12,803	36,441
KENTUCKY	27	6,825	16,393
WEST VIRGINIA	43	1,553	6,150

In addition, NHDC has assembled a team of experts to assist with acquisitions, organizational planning and development, and public finance. Team members include Rick Johnston, managing director of public finance, U.S. Bank/ Piper Jaffray; Kathy Kenney, organizational planning and development consultant; David Smith, founder and president, Recapitalization Advisors, one of the nation's leading specialists in HUD inventory; and John Trauth, organizational planning and development consultant.

NHDC's ultimate goal is to help local communities take greater control of one of their most precious assets—the housing stock that shelters lower-income families and seniors. Without a doubt, preserving this housing stock is a huge undertaking, one that, in order to be successful, will require coordination, cooperation, considerable expertise, and strong financial support. Management fees can also contribute to the sustainability of local nonprofit operations, providing additional capital to address other community needs.

Through its working relationships with other preservation agencies and through its board of directors, NHDC is positioned to make a major difference in the preservation of our nation's affordable

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Affordable Housing Preservation Organizations

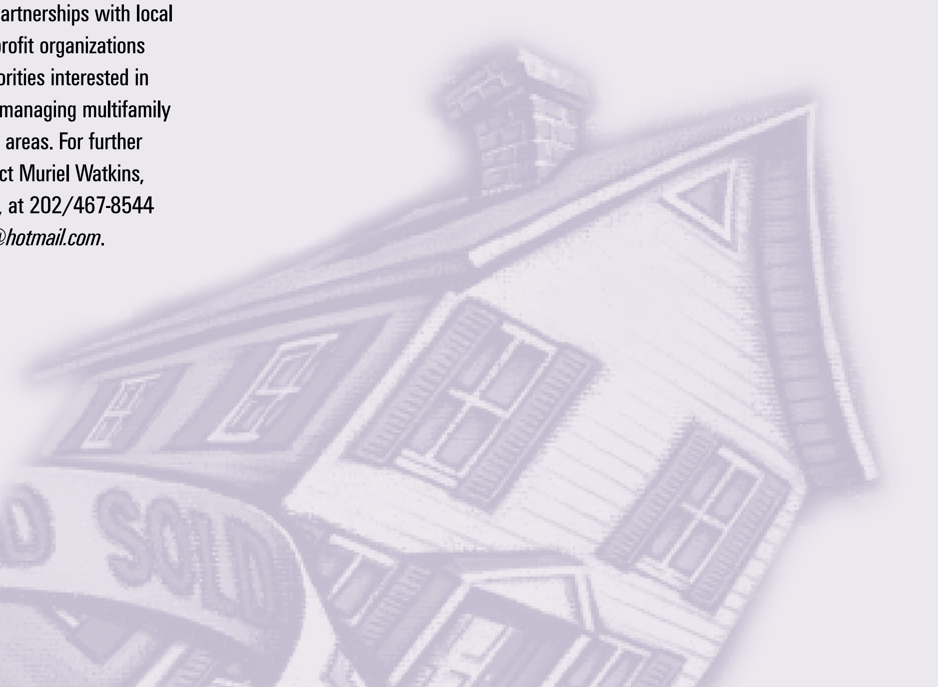
Community Development Trust, Inc.
The Community Development Trust is a for-profit real estate investment trust created in 1998 by the Local Initiatives Support Corporation, a national community development intermediary. CDT acquires long-term fixed-rate mortgages collateralized by affordable multifamily housing and other community development assets. CDT also invests equity in community development projects that meet CRA requirements. As a real estate investment trust, CDT can offer current owners of affordable housing a tax-deferred exchange that helps property owners who have exhausted their tax benefits. More than $30 million in initial capital was raised from 18 institutional investors including banks, insurance companies, and one CDFI. For further information, contact Judd S. Levy, president and chief executive officer, at 212/ 271-5099 or *jlevy@commdevtrust.com*.

National Affordable Housing Preservation Associates
NAHPA is a national nonprofit organized to promote preservation of affordable multifamily housing in rural areas and small towns. NAHPA is currently completing acquisitions in Illinois and Vermont, with a goal of acquiring 3,000 units over three years. The USDA Rural Housing Service has affirmed a financing model for preservation properties to attract private lenders. NAHPA is now looking to build an organization and to establish partnerships with local and regional nonprofit organizations and housing authorities interested in acquiring and/or managing multifamily properties in rural areas. For further information contact Muriel Watkins, executive director, at 202/467-8544 or *murielwatkins@hotmail.com*.

National Association of Housing Partnerships
NAHP comprises 60 regional nonprofit housing organizations in 32 states. NAHP's new affiliate, the nonprofit Housing Partnership Development Fund, will provide a loan facility for NAHP members, primarily for purchase of portfolios of HUD-assisted properties. The fund will offer technical assistance with financing for predevelopment costs. The fund has received CDFI designation, meaning that bank investors can receive CRA credit and cash awards. One million dollars in investment has been raised to date toward a goal of $3 million. For further information contact Kathy Farrell at 617/720-1999, ext. 204, or *farrell@nahp.net*.

Neighborhood Capital Corporation
NCC was formed in January 2000 by members of the Multi-Family Housing Initiative of the Neighborhood Reinvestment Corporation. NCC membership, comprising the multifamily organizations in the NeighborWorks Network, owns and operates 15,000 units of multifamily housing. NCC's primary function will be aggregating capital for the timely acquisition of affordable multifamily housing for its member organizations. NCC members plan to increase their combined portfolio by 10,000 units by the end of 2003. NCC intends to work with other organizations, including National Housing Development Corporation, National Housing Trust/Enterprise Preservation Corporation, and the National Association of Housing Partnerships. The NCC board has commenced an executive search process. For further information, contact Bill Sullivan at 303/863-8651, ext. 211, or *sullivanb@rmmha.com*.

National Housing Trust Enterprise Preservation Corporation
The National Housing Trust is a nonprofit intermediary located in Washington, D.C. The Trust was founded in 1986 to preserve existing multifamily affordable housing. In 1999, the Trust and the Enterprise Foundation launched the NHT Enterprise Preservation Corporation, which will purchase real estate from owners of multifamily housing, targeting markets with insufficient local nonprofit capacity or interest to effectively complete a transaction. This new nonprofit entity plans to acquire 5,000 apartments over the next five years. NHT Enterprise will focus its activities in the mid-Atlantic, South, and Midwest regions. For further information contact Scott Kline, vice president for acquisitions at 202/333-8931 or *skline@nhtinc.org*, or visit *www.nhtinc.org*.



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housing stock. NHDC's success will directly translate into success for the local nonprofits that wish to play a role in the preservation of affordable housing in their communities.

For additional information, contact the National Housing Development Corporation, 8265 Aspen Street, Rancho Cucamonga, CA 91730, 909/ 291-1400, *jburum@nhdc.org.* Or visit NHDC's Web site at *www.nhdc.org.*

How the National Housing Development Corporation Preserves Affordable Housing

BUY	HOLD	RESTRUCTURE/REPOSITION	SELL (AT COST)
Housing Portfolios at Risk →	National Housing Development Corporation United National Preservation Trust →	● Hud ● CD Trust ● Improved Cash Flow ● Improved Property Management ● Other Cost Savings →	**NONPROFITS** ● Local Initiatives Support Corporation ● Enterprise Foundation ● Neighborhood Reinvestment Corporation ● Congress of National Black Churches ● La Raza ● National Association of Housing Partnerships
		Restructuring Tools	
	$5 Million Start-up ● Congress ● Banks ● Insurance companies ● HUD ● Foundations **$100 Million Interim Acquisition Line** ● Banks ● Insurance companies ● HFAs ● Foundations ● Others		**Permanent Debt** ● HFAs ● Banks ● Consortia ● Private sector ● Insurance companies **Subsidies/ Equities** ● Local, state goverment ● LIHTC ● Congress ● Foundations
GOAL: Prevent Market-rate Conversion	Maintain Affordability while Nonprofits Prepare to Purchase	Stabilize Property	Transfer to Local Control Permanent Affordability

Cleveland Fed Tackles Opportunities, Challenges in 2000

BY RUTH CLEVENGER, COMMUNITY AFFAIRS OFFICER

What a year! From financial modernization to Y2K, 1999 proved that a new world of banking is upon us. The Community Affairs team at the Federal Reserve Bank of Cleveland enjoyed an equally eventful year, developing new programs, expanding outreach into the small towns and rural areas of the Fourth District, and creating strategic alliances with community development professionals in banking, government, and the nonprofit sector.

We begin the new millennium with optimism. The economy is strong, unemployment is low, and more low- and moderate-income individuals have access to consumer and mortgage credit than ever before. Many lenders have developed competitive credit and equity-investment products and have forged mutually beneficial working relationships with other community development practitioners.

But there are new challenges, too. Our contacts at community-based organizations tell us they are alarmed by the rise in predatory lending practices, which threaten to undo years of hard work helping low- and moderate-income people own their homes. There is a growing demand for microloan programs and a need for technical assistance and training for the microentrepreneurs who benefit from these loans. And there is uncertainty over the impact of financial services modernization legislation on the Community Reinvestment Act.

To address these opportunities and challenges, the Cleveland Fed's Community Affairs staff has put together an aggressive agenda of public programs and outreach efforts for 2000. In addition, late last year a research analyst was added to the staff, giving us greater capacity for collecting and analyzing data and producing special reports. Highlights of the coming year include:

Public Programs

- Conference focusing on legislative and regulatory developments, to include predatory lending, financial modernization, the CRA investment test, and microenterprise, to be held this fall in Cleveland.
- Series of "Making Cities Work" programs in Pittsburgh and Cleveland, in cooperation with the Pittsburgh History and Landmarks Foundation, the Cleveland Restoration Society, and the Sustainable Communities Coalition.
- Roundtable discussions on community reinvestment, fair lending, and economic development, to be held throughout the Fourth District.
- Rural economic development summit with the Federal Reserve Banks of Richmond and Atlanta.

Research and Analysis

- Community profiles of targeted geographic areas that will identify credit needs and opportunities.
- Special reports on current issues such as predatory lending and microenterprise.
- In-depth analysis of HMDA data.

Outreach and Technical Assistance

- Partnership with the Fannie Mae Pittsburgh Partnership Office to increase home ownership among African Americans in southwest Pennsylvania.
- Continued support for the Access to Capital Network in Cleveland.
- Support for the formation of an Ohio Microenterprise Network.
- Support for the Financial Resources for the Environment in Pennsylvania, a brownfields reclamation and redevelopment effort sponsored by the Federal Reserve Banks of Cleveland and Philadelphia, the Phoenix Land Recycling Company, and the Development Fund.

Ruth Clevenger
Assistant Vice President
and Community Affairs Officer

CR Forum is for and about you. From *Fourth District Profile* to *In My Opinion*, our intention is to provide an arena for the exchange of ideas and best practices. Please help us shape the future of ***CR Forum*** by completing the readership survey inside this issue so that we can write about the issues, programs, and products that interest you most. For this issue only, we have suspended two of our regular features—*Fourth District Profile* and *In My Opinion*—to include this report and survey, as well as our lead story on the National Housing Development Corporation. In addition, we've included the full text of Federal Reserve Chairman Alan Greenspan's remarks, "Economic Challenges in the New Century," before the annual conference of the National Community Reinvestment Coalition on March 22. In his remarks, Chairman Greenspan refers to lingering disparities in wealth and concern over the upsurge in abusive lending practices.

The Federal Reserve Bank of Cleveland's community affairs activities share the same goal as its monetary policy, payments system, and bank regulation activities: To foster a fair and efficient market environment in which people can prosper through their own efforts. Acting as catalysts, conveners, and consultants, we seek to identify best practices, build partnerships, and provide training and technical assistance to community development practitioners.

REMARKS BY CHAIRMAN ALAN GREENSPAN

ECONOMIC CHALLENGES IN THE NEW CENTURY

Before the Annual Conference of the National Community Reinvestment Coalition, Washington, D.C., March 22, 2000

OVER the past several days, you have been engaged in sharing a good deal of practical information on developments in the financial services industry and on the evolving set of laws and regulations that influence the availability of credit in the communities that you serve. No doubt, many of you are here this morning because of your long-standing interest in the Federal Reserve's implementation of the Community Reinvestment Act (CRA). However, because we are now in the final stages of drafting regulations on the Sunshine Provisions of the Gramm-Leach-Bliley Act, I am prohibited from commenting at this time. Instead, I would like to discuss with you, in broader terms, some of the challenges facing businesses, workers, and consumers—including those in your communities—as the U.S. economy embarks on a new century.

As you know, we have recently established a record for the longest economic expansion in this nation's history. In recent years, it has become increasingly clear that this business cycle differs in a very profound way from the cycles that have characterized post–World War II America. Not only has the expansion achieved record length, but it has done so with far stronger growth than expected. A key factor behind this impressive performance has been the remarkable acceleration in labor productivity, with output per hour in the nonfinancial corporate sector increasing since 1995 at nearly double the average pace of the preceding quarter-century. And because technological change has spawned so many opportunities for businesses to expand the range and value of their goods and services, the introduction of new efficiencies has not led to higher unemployment. Rather, the recent period of technological innovation has created a vibrant economy in which opportunities for jobs and new businesses have expanded, enhancing the living standards of a large majority of Americans.

Our challenge, then, is to ensure that we—both policy makers and community leaders—extend the favorable macroeconomic performance and strive to bolster the capabilities of all Americans to share in the prosperity that is being generated.

When historians look back at the latter half of the 1990s a decade or two hence, I suspect that they will conclude that we are now living through a pivotal period in American economic history. New technologies that evolved from the cumulative innovations of the past half-century have now begun to bring about dramatic changes in the way goods and services are produced and in the way they are distributed to final users.

How did we arrive at such a fascinating and, to some, unsettling point in history? While the process of innovation, of course, is never-ending, the development of the transistor after World War II appears in retrospect to have initiated a special wave of innovative synergies. It brought us the microprocessor, the computer, satellites, and the joining of laser and fiber-optic technologies. By the 1990s, these and a number of lesser but critical innovations had, in turn, fostered an enormous new capacity to capture, analyze, and disseminate information. It is the growing use of information technology throughout the economy that makes the current period unique.

Our challenge, then, is to ensure that we—both policy makers and community leaders—extend the favorable macroeconomic performance and strive to bolster the capabilities of all Americans to share in the prosperity that is being generated.

Alan Greenspan

FOR the consumer, advances in technology and in the flow of information have greatly facilitated the development of a wide range of new financial products that are better suited to meeting the preferences of diverse populations. Similarly, in the case of consumer and business credit, computer and telecommunications technologies—the same forces that are shaping the broader economy—have lowered the cost and broadened the scope of financial services. As a consequence of these developments, borrowers and lenders are increasingly able to transact directly with each other, and we have seen a proliferation of specialized lenders and new financial products that are tailored to meet very specific market needs. At the same time, the development of credit-scoring models and the securitization of pools of loans hold the potential for opening the door to national credit markets for a broad spectrum of businesses operating in local and regional markets. Indeed, the CRA data on small business lending show that institutions located outside the local community are an important source of credit for many businesses.

Much attention is focused on the role of corporate giants in fostering innovation, but we would be foolish to understate the extent to which America's innovative energy draws, and will continue to draw, from the interaction of both large and small businesses. Nowhere in the world are the synergies of small and large businesses operating side by side in a dynamic and competitive market economy more apparent than in this country. Of course, the surging growth of young high-tech firms and the flashy presence of new Internet businesses capture the most public attention. But judging from our contacts through our regional Federal Reserve Banks and information collected in surveys of small businesses, times have been good for expanding traditional lines of business as well. The most common complaints include the difficulty of finding qualified workers in the midst of strong competing demands for labor. In the current expansion, the vast majority of small businesses have not listed access to credit as their top concern, although, as you know, many business owners are quite apprehensive about the future as the familiar ways of financing business undergo sometimes dramatic changes.

Several recent developments hold the promise of improving links between financial institutions and the small businesses in your communities. First, major banks and finance companies are trying mass-market approaches to small business finance, similar to the approaches used in the consumer credit arena for many years, and this effort has greatly expanded the competition for loans. In addition, new innovative intermediaries—such as community development corporations and multibank and investor loan pools—are seeking to develop expertise in specific segments of the marketplace for small and minority businesses.

I would like to emphasize, however, that credit alone is not the answer for small businesses. They must have equity capital before they are considered viable candidates for debt financing. Equity acts as a buffer against the vagaries of the marketplace, and it is, accordingly, a sign of the creditworthiness of a business enterprise and the commitment of its owner. This is especially true in lower-income communities, where the weight of expansive debt obligations on small firms can severely impede growth prospects or more readily lead to business failures.

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Overall, our evolving economic and financial systems have been highly successful in promoting growth and higher standards

OVERALL, our evolving economic and financial systems have been highly successful in promoting growth and higher standards of living for the majority of our citizens. But we need to reach further to engage those who have not been able to participate. One way is through the education and training of our workforce—that is, enhancing our stock of "human capital," which is a necessary complement to our ever-changing physical capital. A major consequence of the fast-paced technological change of recent years and the growth of the conceptual emphasis of our nation's output has been to increase the demand for skilled workers. In today's economy, skill has taken on a much broader meaning than it had only a decade or two ago. Today's workers must be prepared along many dimensions—not only with technical know-how but also with the ability to create, analyze, and transform information and with the capacity to interact effectively with others. Moreover, they must recognize that, with new technologies coming rapidly on line, the skills that they develop today will likely not last a lifetime.

Traditionally, broader human capital skills have been associated with higher education, and accordingly the demand for college-trained workers has been increasing rapidly. The result has been that, over the past several decades, the economic returns to workers with college training have on average outstripped those to workers who stopped their formal schooling with a high-school diploma or less. In the past few years, real wage gains for college-educated workers have continued to be rapid, but owing to dynamic economic growth and tightening labor markets, increases for other workers, on average, have kept pace. Nonetheless, a wide gap between the wages of college-educated workers and those of high-school-trained workers remains.

Another consequence of rapid economic and technological change that needs to be addressed is a higher level of worker insecurity, which is the result, I suspect, of fears of potential job skill obsolescence. Despite the tightest labor markets in a generation, more workers currently report that they are fearful of losing their jobs than similar surveys found in 1991 at the bottom of the last recession. The marked move of capital from failing technologies to those at the cutting edge has quickened the pace at which job skills become obsolete. The completion of high school once equipped the average worker with sufficient skills to last a lifetime. That is no longer true, as evidenced by the trends in workers returning to school and in businesses expanding and upgrading their on-the-job training.

Certainly, higher education will continue to play an important role in preparing workers to meet the evolving demands for skilled labor. But the pressure to enlarge the pool of skilled workers requires that we recognize the significant contributions of other educational programs in your communities. Community colleges, for example, have become an important provider of job skills training not just for students who may eventually move on to a four-year college or university but for individuals with jobs—particularly older workers seeking to retool or retrain. In some cases, community colleges are providing contract training for employers, part of a broader trend in which employers and their workers are recognizing that to maintain human capital, investment in formal training programs must complement experience on the job.

As one might expect, greater worker insecurities are also creating political pressures to reduce the fierce global competition that has emerged in the wake of our 1990s technology boom. Protectionist measures, I have no doubt, could temporarily reduce some worker anxieties by inhibiting these competitive forces. However, over the longer run such actions would slow innovation and impede the rise in living standards. They could not alter the eventual shifts in production that owe to enormous changes in relative prices across the economy. Protectionism might enable a worker in a declining industry to hold onto his job longer. But would it not be better for that worker to seek a new career in a

of living for the majority of our citizens. But we need to reach further to engage those who have not been able to participate.

more viable industry at age 35 than to hang on until age 50, when alternative job opportunities would be far scarcer and when the lifetime benefits of additional education and training would be necessarily smaller? To be sure, assisting those who are already close to retirement in failing industries is an imperative. But that can be readily accomplished without distorting necessary capital flows to newer technologies through protectionist measures. More generally, we must ensure that our whole population receives an education that will allow full participation in this dynamic period of American economic history.

No doubt, in your communities many workers may view the changing needs of their employers as a threat to the security of their job; and perhaps students preparing to enter the work-force see the demand for rising skills as a hurdle too high to overcome with the limited resources available to them. You, as community leaders, can continue to explore ways of developing creative linkages between businesses and educational institutions to better prepare students for the rising demands of the workplace and to help workers, who must keep up with those changing demands and who must cope with the consequences of global competition, renew and upgrade their skills.

AS I indicated earlier, one notable aspect of the remarkable performance of our economy in recent years has been the substantial, and relatively broadly based, rise in real income. During the past several years, workers, including those at the low end of the wage distribution, have seen noticeable increases in the inflation-adjusted value of their wages; more comprehensive Census Bureau figures on the real money income of families also show gains in each quintile between 1996 and 1998, and presumably when the 1999 data become available further improvement will be evident. These recent increases for low-income workers, however, have not reversed the rise in wage inequality that occurred during the 1980s and early 1990s when the gap in wages between those at the top and the bottom of the distribution was widening considerably. Nonetheless, the leveling off in that disturbing trend is an encouraging sign of what can be achieved if we can maintain strong and dynamic labor markets accompanied by low inflation.

Of course, we need also to consider trends in wealth, which, more fundamentally than earnings or income, represent a measure of the ability of households to consume. The Federal Reserve's *Survey of Consumer Finances* indicates that the median real net worth of families increased $17\frac{1}{2}$ percent between 1995 and 1998. As one might expect, the rising stock market coupled with the spreading ownership of equities was an important factor. However, even in the face of the strong aggregate trend, median net worth declined over this period for families with incomes below $25,000, and medians for non-whites and Hispanics were little changed.

That families with low-to-moderate incomes and minorities did not appear to fully benefit from the highly favorable economic developments of the mid-1990s is, of course, troubling, and the survey results warrant a closer look. In the details, we find that families with incomes below $25,000 did increase their direct or indirect holdings of stock, and more reported that they had a transactions account. However, they were less likely to hold nonfinancial assets—particularly homes, which constitute the bulk of the value of assets for those below the top quintile according to income. At the same time, one encouraging finding from the survey is that the homeownership rate among minorities rose from 44 percent to 47 percent between 1995 and 1998, which may be a sign of improved access to credit for minorities.

Although market specialization, competition, and innovation have vastly expanded credit to virtually all income

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By removing the non-economic distortions that arise as a result of discrimination, we can generate higher returns to both human and physical capital.

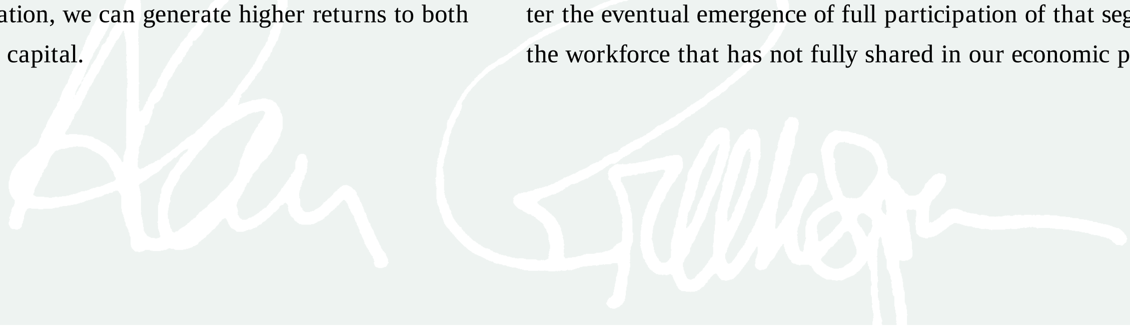
classes, under certain circumstances this expanded access may not be entirely beneficial, either for customers in general or for lower-income communities. Of concern are abusive lending practices that target specific neighborhoods or vulnerable segments of the population and can result in unaffordable payments, equity stripping, and foreclosure. The Federal Reserve is working on several fronts to address these issues and recently convened an interagency group to identify aberrant behaviors and develop methods to address them.

I have no illusions that the task of breaking down barriers that have produced disparities in income and wealth will be simple. It remains an important goal because societies cannot thrive if significant segments perceive their functioning as unjust. Although we have achieved much in this regard, more remains to be done. Despite the considerable progress evident in recent decades in reducing racial and other forms of discrimination, this job is far from complete.

Discrimination is against the interests of business—yet business people too often practice it. To the extent that market participants discriminate, they erect barriers to the free flow of capital and labor to their most profitable employment, and the distribution of output is distorted. In the end, costs are higher, less real output is produced, and national wealth accumulation is slowed. By removing the non-economic distortions that arise as a result of discrimination, we can generate higher returns to both human and physical capital.

We are experiencing an extraordinary period of economic innovation. At the policy level, we must work to configure monetary policies that will foster a continuation of solid growth and low inflation. Beyond this primary mandate, we at the Federal Reserve are also responding to the challenge of ensuring that all communities can fully participate in our growing prosperity. With our Community Affairs program we provide information, instruction, and technical assistance to a diverse range of constituents regarding community reinvestment, community economic development, fair lending, and related issues. Our reach is broad: during 1999 more than 15,000 participants attended our conferences and seminars, and we responded to more than 800 requests for in-depth technical assistance. We are also increasing the research focus on topics related to community and economic development and in 2001 will host a second national conference, this one focusing on the theme of changing financial markets and community development. Your participation in, and support of, these activities is important because you play such a crucial role in helping communities respond to the evolving financial, educational, and technological demands of this new century.

AS I indicated in my opening remarks, future historians are likely to conclude that the past five years have been a pivotal period in American economic history. I trust they will also conclude that it was a period that set in place policies to foster the eventual emergence of full participation of that segment of the workforce that has not fully shared in our economic progress.



Federal Reserve Bank of Cleveland *CR Forum* Reader Survey Please help us shape the future of *CR Forum* by taking a few minutes to complete this readership survey so that we can cover the issues, programs, and products that interest you most.

COMMUNITY REINVESTMENT
cr
forum

SURVEY

Please answer the following questions and return this survey in the enclosed envelope. Responses must be returned by July 1, 2000 to be included in the analysis. Please use the comment section for any remarks you wish to add.

Newsletter Format

Please check the answers that most closely match your point of view.

A. I read *CR Forum*

_____Every time it comes out
_____Frequently
_____Cover to cover
_____Only select features
_____Not at all

B. I find the structure and appearance *CR Forum* (check all that apply)

_____Easy to read
_____Information is accessible and easy to find
_____Professional
_____Includes good photographs and art
_____Confusing
_____Hard to follow

C. I would prefer to receive *CR Forum*

_____In its current form (regular mail)
_____By fax
_____By e-mail
_____On the World Wide Web

D. If there were a nominal fee for *CR Forum*, I would be willing to pay it.

[ ] Yes [ ] No

Newsletter Content

A. Please rank the features of *CR Forum* from 1 to 5.

1 = like most 5 = like least

_____Fourth District Profile
_____In My Opinion
_____Cover story/special feature
_____Of Interest
_____Events

B. Please rate the content of the articles in *CR Forum* based on the following criteria

1 = excellent 2 = good 3 = average 4 = poor

_____Technical level of information covered
_____Story length
_____Timeliness
_____Topical nature of stories and relevance to your work
_____Conciseness
_____In-depth treatment of subjects
_____Reliability as a source of information
_____Trusted source of analysis
_____Concepts clearly presented
_____Other ______________________________

C. *CR Forum* is always in search of emerging issues and interesting programs. Would you or your organization like to be contacted concerning any of the following:

Please contact me or my organization to appear in a *Fourth District Profile* article.

[ ] Yes [ ] No

Please contact me to submit an *In My Opinion* article.

[ ] Yes [ ] No

Please contact me or my organization to be included in a feature story.

[ ] Yes [ ] No

Newsletter Impact

Please check the answers closest to your opinion (check all that apply).

A. The *CR Forum* newsletter

_____Helps in my decision making
_____Provides useful information that I file for reference
_____Is appropriate to my line of business
_____Provides information on advances and trends in community development
_____Aids me in giving presentations
_____Gives me discussion material to exchange with colleagues
_____Is a publication I share or pass along to others.
_____Is no help at all, I throw it away
_____Other ______________________________

TEAR HERE

B. I find the overall content of the *CR Forum* newsletter to be:

_____Excellent
_____Very good
_____Satisfactory
_____Somewhat useful
_____Not really useful
_____Less than satisfactory
_____Poor

C. Compared to other community development newsletters you receive, how would you rate your overall satisfaction with *CR Forum*'s usefulness of information?

_____Very satisfied
_____Satisfied
_____Somewhat satisfied
_____Somewhat dissatisfied
_____Dissatisfied
_____Very dissatisfied
_____This is the only community development newsletter I receive

Future of *CR Forum*

A. Please check other features or topics you'd like to see covered in *CR Forum* (check all that apply).

_____Case studies
_____Legislative reviews
_____News from the Federal Reserve (CRA regulations, consumer compliance issues, economic trends, etc.)
_____Point/counterpoint articles
_____Networking assistance
_____Successful community/economic development models
_____Public/private partnership stories
_____Current community development resources
_____Special topics such as economic commentaries, community reinvestment issues

B. Please rate which features or topics you'd like most to see covered in *CR Forum*.
1 = like most 4 = like least

_____Case studies	[1]	[2]	[3]	[4]
_____Legislative reviews	[1]	[2]	[3]	[4]
_____News from the Federal Reserve *(CRA regulations, consumer compliance issues, economic trends, etc.)*	[1]	[2]	[3]	[4]
_____Point/counterpoint articles	[1]	[2]	[3]	[4]
_____Networking assistance	[1]	[2]	[3]	[4]
_____Successful community/economic development models	[1]	[2]	[3]	[4]
_____Public/private partnership stories	[1]	[2]	[3]	[4]
_____Current community development resources	[1]	[2]	[3]	[4]

_____Special topics_______________________________________

____

C. What subjects would you like to see the Community Affairs Office discuss in a separate in-depth publication?
(For example, brownfields, predatory lending, emerging trends, the "unbanked," etc.)

____
____
____
____
____

Demographics

We need some background data from you. The following information will help us better understand you, our readers. Your responses will be kept entirely confidential.

Name ___________________________________

Type of position ___________________________________

Type of organization [ ] For profit [ ] Nonprofit [ ] Government
[ ] Banking [ ] Business [ ] Education [ ] Other

Street address ___________________________________

City, State, Zip ___________________________________

Telephone ___________________________________

Fax ___________________________________

E-mail ___________________________________

Including yourself, how many people are employed at your place of work?
[ ] Under 25 [ ] 25–100 [ ] More than 100

Please indicate your age
[ ] Under 25 [ ] 25–34 [ ] 35–44 [ ] 45–54
[ ] 55–64 [ ] 65–74 [ ] 75 and over

Please indicate your level of education
[ ] High school graduate [ ] College graduate
[ ] Graduate degree [ ] Post-graduate degree

Do you wish to continue receiving *CR Forum*?
[ ] Yes [ ] No

THANK YOU VERY MUCH FOR YOUR TIME AND HELP!

REGULATORY UPDATE

Private Mortgage Insurance

by Connie Smith, Examiner
Federal Reserve Bank of Cleveland
Banking Supervision & Regulation

Private mortgage insurance, or PMI, protects lenders in the event of default. Generally, it is required on loans for which the borrower has less than 20 percent equity, based on the appraised value of the property or the sale price.

The Homeowners Protection Act, which became effective July 29, 1999, requires lenders to provide certain disclosures and notifications to borrowers for loans on which private mortgage insurance is required.

● For loans closed on or after July 29, 1999, lenders must provide borrowers with an initial amortization schedule and disclosure explaining when PMI may be cancelled. Thereafter, lenders must provide annual disclosures explaining consumers' cancellation and termination rights and an address and telephone number the consumer may use to contact the loan servicer. Requirements for canceling PMI vary depending on whether the borrower or the lender pays the PMI, whether the loan has a fixed or variable rate, and whether the loan is designated as high risk.

● For fixed-rate and adjustable-rate mortgages not classified as high risk, borrowers may submit a written request to cancel PMI when the loan balance is scheduled to reach 80 percent of the original value of the property, securing the loan based on the initial amortization schedule. PMI will automatically terminate when the loan reaches a 78 percent loan-to-value ratio and the loan is current. For high-risk loans, PMI cannot be required beyond the midpoint of the amortization period, as long as payments are current.

● For loans with lender-paid PMI, the borrower may not cancel PMI. PMI terminates only when the loan is refinanced, paid off, or otherwise terminated.

● For loans closed prior to July 29, 1999—and therefore not covered under the act—loan servicers must provide an annual written statement to borrowers explaining that PMI may be cancelled, with the lender's consent, if they have met certain requirements; the disclosure must provide an address and telephone number the borrower may use to contact the servicer.

The federal financial regulatory agencies have been granted enforcement authority under this act; however, no agency has been given rule-writing authority.

CR FORUM
ACKNOWLEDGMENTS

Please contact the following members of the Community Affairs staff if you have questions or would like additional copies of this publication.

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We welcome your comments and suggestions.

# of interest

Mortgage Credit Partnership Guide

Mortgage Credit Partnership projects seek equitable opportunity for home ownership for all financially qualified individuals, from their first contact with a real estate agent, to getting an appraisal, obtaining insurance, and applying for a mortgage. By bringing together representatives from local insurance, real estate, appraisal, lending, and other related industries, the projects identify barriers to fair and equal access in the home-purchase process.

MCP projects have been implemented—with great success—in Boston, Chicago, Cincinnati, Cleveland, New York, St. Louis, and San Francisco. Their success stories have been collected in a free, step-by-step resource guide that can help you create a similar collaboration in your area. To order the MCP Resource Guide, contact the Federal Reserve Bank of St. Louis at 314/444-8761. For more information about the MCP project in your community, contact the Federal Reserve Bank of Cleveland at 216/579-2903.

Fed Launches Community Affairs Web Site

The Federal Reserve System's national community affairs Web site is now online at *www.federalreserve.gov/communityaffairs/national/*. The site provides current information on issues such as access to capital and credit, community development, microenterprise, predatory lending, and CRA, as well as upcoming Federal Reserve programs nationwide and links to additional resources.

National Community Development Lending School to be Held at Washington University

The 2000 National Community Development Lending School will take place July 16–20 at Washington University in St. Louis; the School will focus on attracting and underwriting consistently profitable community development business. Training will cover single-family and multifamily housing, small business development, commercial real estate, and community facilities lending, with an emphasis on the day-to-day mechanics of underwriting community development loans and ensuring their long-term profitability. Experts in the field developed the curriculum and serve as the school's faculty.

For program information or to request a brochure, contact Fred Mendez at the Federal Reserve Bank of San Francisco at 415/974-2722, or check the San Francisco Fed's Web site at *www.frbsf.org/frbsf/events*. Enrollment is limited to 60 community development lenders who possess a minimum of one year and a maximum of five years of community development experience.

Cleveland Fed Conducts CRA Exams

In the second quarter of 2000, the Banking Supervision and Regulation Department of the Cleveland Fed will conduct Community Reinvestment Act compliance exams for two Ohio banks:

Buckeye Community Bank
Lorain, Ohio
May 29, 2000

Settlers Bank
Marietta, Ohio
June 19, 2000

Fed Makes New 'Payday Loans' Rule

The Federal Reserve recently published a regulation requiring businesses that offer payday loans—short-term, high-interest cash advances made against borrowers' paychecks—to disclose to customers in writing the annual loan interest rate. Storefront lenders often provide payday loans that can carry triple-digit interest rates on an annual basis. The central bank's rule clarifies that payday loans are subject to the terms of the Truth in Lending Act, which says lenders must disclose in writing, before the transaction is completed, the finance charge for the loan and its annual percentage rate. The rule took effect March 31, but compliance is voluntary until October 1.

Federal Reserve Board Member Governor Gramlich Discusses Predatory Lending at the Fair Housing Council of New York

Access to credit for lower-income and minority borrowers has increased dramatically over the past five years, Governor Gramlich said in his recent address to the Fair Housing Council of New York in Syracuse. However, he said, a negative effect of increased access to credit has been seen in predatory lending cases where some low-income borrowers are substantially worse off as a result of the terms of their credit.

Gramlich stressed the importance of understanding the difference between predatory lending and subprime and their opposite effects in low-income and minority neighborhoods. Subprime lending increases access to credit for people with less than perfect credit histories for a reasonable price based on loan risk and transactions costs, enabling people to purchase homes, build home equity, and increase their net worth. Predatory lending involves tactics such as outright fraud, deception, falsifications, and abuses of loan terms and practices that leave borrowers substantially worse off as a result of the credit terms. Gramlich noted that the Federal Reserve has convened a nine-agency working group that will focus on common approaches to tighten enforcement of existing statutes, identifying predatory practices that might be limited by stronger regulations or legislative changes, and establishing a coordinated attack on predatory practices. The complete text of Gramlich's speech is on the Web at http://www.bog.frb.fed.us/boarddocs/speeches/2000/.