FEDERAL RESERVE BANK OF KANSAS CITY

community Reinvestment

COMMUNITY AFFAIRS DEPARTMENT

Summer 1993

New Newsletter

Helping readers find creative solutions to community issues is the goal of the new ***Community Reinvestment*** newsletter. It will feature information about individuals and organizations that use innovative approaches to economic development, and will emphasize how diverse partners can work together in a reinvestment process that results in healthy, livable communities.

By providing information about resources, offering educational programs, and bringing people together to resolve problems, the Federal Reserve's Community Affairs Department can act as a catalyst for community reinvestment--which leads to more jobs, more stable communities, more investment, and a stronger economy.

Through the newsletter we can inform you about successful projects and programs and ideas that can make a difference in your community. We can help you get to know people who make a difference in community reinvestment. In this inaugural issue, we start with an interview with Federal Reserve Governor Lawrence Lindsey.

We hope our new newsletter will offer you information, insight and inspiration.

Thomas M. Hoenig, President
Federal Reserve Bank of Kansas City

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PROFILE

Larry Lindsey speaks out on CRA

***As the Federal Reserve** Board member responsible for Community and Consumer Affairs, Lawrence B. Lindsey has toured cities across the country to see for himself whether the Community Reinvestment Act is an effective tool for community reinvestment. He stresses the need for caution toward government "tinkering" with the market and says that CRA is certainly not perfect. However, he believes CRA has encouraged banks to do more of what they have to do anyway in*

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What's it all about?

What do bankers, neighborhood residents, government service providers, business people and community leaders have in common? A stake in community reinvestment! Although it's sometimes difficult for people with such diverse interests to see their common goals, the most exciting and interesting development projects--those "undoable deals"--have been done precisely because individuals with very different experiences and perspectives have been able to pool their resources and work together to get something done.

The new ***Community Reinvestment*** newsletter is expected to be of interest not only to people who are individually very different, but also to people in the geographically and economically diverse states in the Tenth Federal Reserve District. The district includes Colorado, Kansas, western Missouri, Nebraska, northern New Mexico, Oklahoma and Wyoming. Our economy relies on agriculture and factories, tourists and telecommunications, education and transportation. The banking system is likewise diverse, with small community banks existing alongside larger, sometimes out-of-state institutions. Does all this and more really fit together? We think the answer is yes, and you'll see that reflected in the newsletter.

As each issue is produced, we will be looking at how diverse partners can work together in a community reinvestment process. Some of the questions we will be asking as articles are written for the newsletter include:

Is there a partnership approach?

How does this program, project, organization, and/or individual contribute to community reinvestment? Why is it useful to work with these partners? What do the different people bring to the table? What are the linkages among individuals and groups, the programs and deals? Who plays what role?

How are problems being solved?

What are the issues? What is the decision-making process? What factors helped the project succeed? How do innovative, creative people get results? What are the challenges?

How will this information help someone complete a deal that otherwise couldn't be done? What can be replicated? What are the practical "how to's?" What information about resources, regulations or legislation will be useful? What are sources of more information?

What's behind the issues?

Why was this program established? Why is this project being done? What are the challenges? How does the deal look from different viewpoints? What does or does not work well? What is the history behind this?

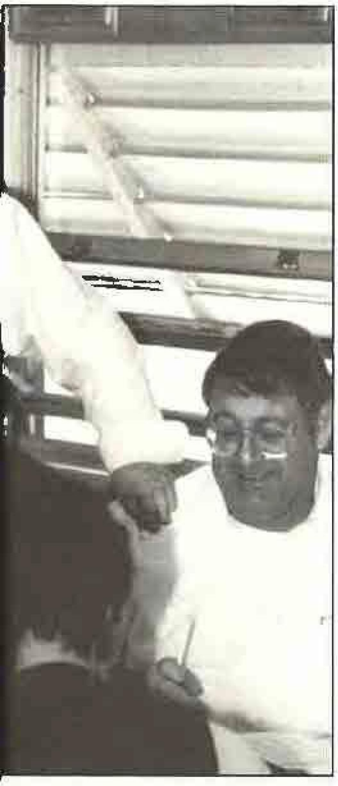
Along with asking these kinds of questions, we will be looking for articles that fit into several regular categories of the newsletter. We plan to feature community reinvestment partners, projects, resources, and personal profiles. We'll also include "news briefs" about projects and activities.

If you know other people who might like to receive ***Community Reinvestment,*** please let us know. □

Our first issue includes a lot about us, but future issues will be mostly about you. Please send us your ideas and comments, and let us know about your projects.

RESOURCES

Unique solutions in development finance



Russ Berry (standing), Acting SBA District Director, confers with participants in a development finance workshop in Pueblo, Colorado.

Some skeptics say that it just doesn't work to get too many cooks stirring the broth, but a mixture of perspectives and expertise is just what makes Colorado's "Energizing Your Local Economy" workshops so useful, according to the program's presenters and participants.

The workshops, which bring together local lenders, community leaders, economic development professionals and various government representatives, explore the theory and practice of working in partnerships for economic development. Participants take home a resource book that is a "how to" reference for financing future projects. "It's the most useful workshop I've ever attended," said one participant.

The program was developed and is sponsored by the Federal Reserve Bank of Kansas City in cooperation with the Colorado Bankers Association, the Rocky Mountain Chapter of the American Institute of Banking, the Colorado Office of Business Development, the Colorado Housing and Finance Authority, the Small Business Administration, the state's Small Business Development Centers, Colorado Public Service Company, the Front Range Regional Economic Development Corporation, and Colorado National Bank.

Several out-of-state participants and local leaders have helped spur efforts to stage the programs in their own areas. Diverse partners are currently working to develop the program in Wyoming, New Mexico, Oklahoma and Missouri. Workshops are scheduled in Colorado in July and September, in Oklahoma in July, and in Wyoming in September, October and November. For more information, contact the Community Affairs Department at the Federal Reserve Bank of Kansas City, 816-881-2890. ❑

Closing the Gap

"Fair lending is good business," according to Richard F. Syron, President of the Federal Reserve Bank of Boston. "Access to credit, free from considerations of race or national origin, is essential to the economic health of both lenders and borrowers." These remarks are in the forward to *Closing the Gap: A Guide to Equal Opportunity Lending,* which was recently published by the Boston Federal Reserve.

The booklet is a follow-up of the 1992 study by the Boston Fed that examined Home Mortgage Disclosure Act (HMDA) data, which has become known as "The Boston Study." For *Closing the Gap,* the Federal Reserve Bank of Boston gathered recommendations for "best practice" from lending institutions and consumer groups. "With their help," said Syron," we have developed a comprehensive program for lenders who seek to ensure that all loan applicants are treated fairly and to expand their markets to reach a more diverse customer base."

Persons interested in receiving a copy of *Closing the Gap* should contact the Community Affairs Department at the Federal Reserve Bank of Kansas City, 816-881-2890.

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SOMEONE SAID. . .

"Even if you're on the right track, you're going to get run over if you're standing still."

-- Will Rogers

NEWS BRIEFS

Development builds for its market

New commercial development that will generate taxes that will begin stimulating housing construction and renovation was recently approved in Kansas City, Missouri. The housing will attract families with purchasing power, which will support the businesses. Successful businesses will in turn generate more taxes, which will further stimulate housing development--it's a cycle that will build in an upward spiral over the next 23 years in a five-square-mile, primarily low- to moderate-income midtown community.

Over $38 million dollars is expected to be pumped into the economy. The innovative plan, which integrates commercial and residential development needs, stipulates use of tax increment financing from the new commercial development for nearby off-site housing.

This means that one-half the taxes that are generated over and beyond the present tax base will be spent on housing. Details about how the funds will be used are in the process of being worked out, with expectations that the focus will be primarily on single-family housing. Minority partners will share ownership in the commercial development, and a substantial portion of the construction will be done by minority firms. It's an innovative approach to community reinvestment, and has already sparked interest from other cities around the country.

"It's like providing the infantry to support the cavalry in the battle against the forces of disinvestment," said Councilman Jim Glover, who developed the plan. "Without the housing commitment that ensures a strong market, our major tenants--Kmart, Payless Cashways Lumber and Building Materials, and Meiners Sunfresh Grocers--would not have considered locating in this area." ☐

CRA a major factor in Denver banks selection

When the city of Denver went shopping for banking services this year, they looked for a good return and service on the $7 million a day they have on deposit. They also looked for banks that were socially responsible.

"Our belief is that in return for and as part of the banks handling our business, they need to commit to enhanced efforts at community development and equal opportunity lending," said Mayor Wellington Webb. "By equally weighting community development commitment with price-and-service, we are sending a clear message of the partnership role we expect Denver's banks to share with the City," Webb said.

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The City is evaluating proposals from eight banks, and expects to make a decision by the end of June. The evaluation process includes a public forum for comments about their experience with the banks from citizens. ☐

Innovative financing for small business

Financing small business expansion sometimes requires lenders to take somewhat higher risks. The Oklahoma Capital Access Program (OCAP) was formed by the state to get more money to small businesses and give banks better assurances of repayment. "We've generated twice what we had projected for our first year," said Program Manager Karla Graham. The original projections were based on the experience of the highly-successful Michigan program after which the Oklahoma program was modeled.

"We've generated twice what we had projected for our first year."

Loans enrolled in the program are protected by a portfolio insurance program structure, funded in equal parts by the participating lender and OCAP. When a bank becomes a participant in the program, an earmarked off-balance-sheet reserve account is established for that bank. Based on the bank's risk assessment, it sets aside from 3 to 7 percent of the loan amount in its special reserve account, which may be charged to the borrower. Including OCAP's matching contribution, this results in a total of 6 to 14 percent of every program loan being set aside in the bank's special reserve account.

One important feature of the program is its simplicity and ease of access. Banks may place loans in the program at their option, with the process regulated by the market, not the government. As borrowers shop lenders for the best deal on a loan, they create competitive pressures that force lenders to keep risk assessments, and their attending loan loss contributions, realistic.

One important feature of the program is its simplicity and ease of access.

Should losses occur from loans enrolled in the program, the bank may draw upon its reserve for recovery. To date, 56 banks with 198 locations have enrolled in the program and over $3 million in loans has been generated. There have been no loan losses, and 130 new jobs have been created. □

Norwest bank of Omaha links with churches

Churches are the most respected and trusted of the institutions in the low- to moderate-income neighborhoods of North Omaha, Nebraska, according to Cliff Perry, president of the north branch of Norwest Bank. Therefore, it only makes good business sense to turn to them as both a marketing resource and a key to community reinvestment.

In an effort to learn about and meet the credit needs of residents in the area, Norwest Bank has joined with the churches to create an innovative program called Partnership Banking. Norwest officials initially met several times with ministers to discuss the availability of banking services and credit. Out of these sessions, Norwest and the churches were able to identify credit and retail needs and jointly develop specific programs tailored to those needs.

"We're creating good customers for the bank, and both the bank and the community benefit."

To help in the marketing of Partnership Banking to congregations, each church selected an in-church coordinator to identify potential participants. The area includes more than 12,000 potential bank customers.

"The key component in this program is education," said Perry. "If people have been educated on how to use our products and services, we will guarantee them access. It takes time, and it's expensive up front, but over the long haul it pays off. We're creating good customers for the bank, and both the bank and the community benefit." □

PARTNERS

HomeWorks: Educating for Ownership

"Taking the time and effort to educate prospective home buyers may not seem worthwhile to bankers up front," said former banker Michael Shaughnessy, "but if they do it, in the long run they're creating customers, and it pays off." Shaughnessy is a program director for the HomeWorks Program, which educates first-time buyers about buying and maintaining a house.

Several lenders in metropolitan Kansas City initiated HomeWorks in 1991. They were participating in a program to make loans to low- and moderate-income homebuyers, and saw a clear need for educating inexperienced buyers. They realized that separately their training capacity was limited, but decided that together they could help provide education for home buyers through a nonprofit agency with expertise in training.

The Kansas City Neighborhood Alliance (KCNA), which provides support and services to neighborhood groups in Kansas City, Missouri and Kansas City, Kansas, was a willing partner. Neighborhood Housing Services of Kansas City (NHS), with its experience in working with lenders and neighborhood residents, soon became another partner in this cooperative educational venture.

Some participants in the HomeWorks program are referred by lenders after they have found a house and been pre-approved for a loan. For them, a "fast-track" condensed training session is available, with emphasis on closing procedures and ownership responsibilities. "The most common statement we've heard from these participants is I wish I had known about the program before I started looking," said Shaughnessy.

"I really enjoy working with people who have gone through the HomeWorks program. They are informed, they understand the process, and there are very few closing problems."

"That's because it tells you so much about the initial process and what you need to do to prepare yourself for the 'journey' to home ownership." Banker Scott Berghaus, who is a vice president at Boatmen's First National Bank, said, "I really enjoy working with people who have gone through the HomeWorks program. They are informed, they understand the process, and there are very few closing problems."

Other participants are referred to HomeWorks by the City of Kansas City, Kansas, Department of Development, which requires all applicants for their low- and moderate-income housing programs to complete the training. Still others learn about the program from monthly advertisements in local newspapers or by word-of-mouth from friends.

For most participants, the first step in the process is one-on-one counseling with Turner Pettway, HomeWorks trainer at the Neighborhood Alliance. "This is when we get acquainted and establish a level of trust," said Pettway. "People learn in this interview that we'll give them a clear, unbiased picture of the steps they'll need to take to buy a home. We review their credit, and they learn if it's realistic for them to start planning to buy their own home. If it is realistic, they learn that it will take time, often 18 months or two years from the time they start preparing themselves for

New home owner Sherry Drummer discusses doorway finish with Turner Pettway.

Scott Berghaus and Christie Cade-Penney check the status of loan applications.

home ownership." If applicants are unlikely to qualify for home ownership in the next two to five years, they are referred elsewhere for credit or employment counseling or other assistance.

After counseling, people who meet minimum criteria for potential home ownership attend a four-hour training session. Here they learn about what to expect in the home buying process, and receive a home ownership workbook provided by Fannie Mae (the Federal National Mortgage Association).

If applicants need more savings or have some credit issues to clear up but could qualify for home ownership within the next 12 to 18 months they are referred to the Homebuyer's Club. This group, which currently has 19 families participating, meets once a month. One chapter of the workbook is covered in each session, and participants discuss their experiences, compare notes on progress, and provide support for one another in "staying clean" in their efforts to build a sound credit record and save money. "The Homebuyers Club really helps people build new habits," said Shaughnessy, "and it helps people understand the long-term cash flow needs of home ownership."

"Our goal is to generate more home ownership in the urban core of the city."

When training has been completed, KCNA presents qualified participants with completion certificates. People who are ready to look for a home to purchase are referred to Neighborhood Housing Services for assistance.

Neighborhood Housing Services works with participants to determine how much prospective buyers can afford to pay for a house. They provide information about options for financing, help identify available affordable properties, and develop strategies to complete the home purchase process. They maintain a list of real estate agents aggressively working with urban core sales. A committee consisting of participating lenders works with KCNA and NHS staff to evaluate a household's ability to meet underwriting criteria for loan programs.

"Our goal is to generate more home ownership in the urban core of the city," said NHS staff member Christie Cade-Penney. "To accomplish that goal, we work with individual home buyers, and we also work with banks and savings and loans to analyze what mortgage products are or are not working. We encourage lending institutions to design programs that will be effective for buyers of houses in the $20,000-50,000 range who do not have a long-term credit history."

As more participants move through the program and purchase houses, post-purchase training will be expanded, with emphasis on the responsibilities of home ownership. It will provide workshops and seminars addressing maintenance and minor home repair, weatherization, security and safety, budgeting and money management for new home owners.

"Although helping people buy their own homes is the specific goal of HomeWorks," said Cade-Penney, "we do that by helping people learn how to better manage their personal finances. The first impact of HomeWorks has been individuals increasing their credit worthiness. That has a long-term impact on those people's lives, on their local businesses, and on the community as a whole." □

Interview with Larry Lindsey

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order to survive: serve the needs of their communities.

Lindsey was appointed to serve on the seven-member Federal Reserve Board in November 1991 to fill an unexpired term that ends in 2000. Prior to joining the Board, he was a Special Assistant to the President for Policy Development at the White House. He is also a former professor of Economics at Harvard University.

He looks people straight in the eye when talking with them. He asks questions, and smiles often. "We don't always agree on issues," said one community leader, " but I really like Larry. And he's intellectually honest."

(Lindsey was interviewed on April 8th in Cleveland by Larry Meeker and Sharon Blevins. The interview has been edited for length and clarity.)

C.R. A year after the riots in East Los Angeles, the second Rodney King trial was a reminder to some that race is still an issue in America and that the market system may not offer equal opportunity to all. In your view, does the market offer equal opportunity?

A. I think the point about the market is not that it ever works perfectly, but that generally, it's the best thing we have. Economists often talk about an advantage of the market being that the only color it recognizes is the green of money. While that may be true, in general the market does not eliminate the focus on black and white. It does, however, make market participants pay a price if they discriminate based on non-economic factors. What we often forget is that the real racial horrors in America's past were mandated not by the market, but by local governments. Buses were segregated by city ordinances, and states mandated "separate but equal" schools.

It was state action that kept blacks from voting. So that was hardly the market working; that was the state.

C.R. Given the record, can federal government intervention, particularly economic intervention, help with some of these problems?

A. The federal government first prohibited state governments from enforcing discrimination, so clearly that was an intervention that was an improvement. The real test of government intervention is whether, when all is said and done, it has improved on the market solution.

C.R. Has the Community Reinvestment Act (CRA) improved on the market solution?

"The real test of government intervention is whether, when all is said and done, it has improved on the market solution."

A. I think so. I think the banks were, I'll use the term "getting lazy," about pursuing profit opportunities throughout the areas they served. Because of CRA, banks have channeled quite a bit of money to inner cities. The Center for Community Change estimates that banks have made $35 billion in direct loan commitments to inner cities as a result of CRA, which compares very favorably to the size of some direct government programs. To date, CRA has been a very positive area of government intervention. Not perfect, but positive, and it's an improvement on what preceded it.

C.R. Did you think CRA was positive intervention when you were appointed to the Board of Governors?

A. I deliberately didn't have a view when I came on the Board of Governors. After Board Chairman Alan Greenspan appointed me chairman of our Consumer and Community Affairs Committee, I set about finding out about CRA for myself. I tried to keep an open mind about it. I scheduled lots of trips, and made sure that whenever I was in a city, I toured community redevelopment projects. I don't feel I'm an expert, but I do think I have a good sense about what is working and what is not working.

C.R. You said the banks were "getting lazy." Why would they ignore profitable lending opportunities?

A. We all get lazy. I think it's part of human nature, and it's often part of organizational behavior as well. A firm tends to pursue markets where it does well and has been rewarded for success. Banks aren't the only ones to do that--IBM did it, too, and IBM is now in trouble as a result. Oil companies did it, and they ran into trouble. When you have a going, profitable concern, it takes a bit of organizational courage to develop new product lines. CRA makes banks look for profits where they otherwise might not.

C.R.. What role do you think the Federal Reserve can play in eliminating discrimination?

A. First, as bank supervisors, we conduct CRA exams. Second, the Fed can begin a cross-pollination of ideas. In the last six months, I have been impressed by how many similar types of solutions to discrimination problems are springing up around the country. I think one of the reasons is that we often provide a forum for ideas. At a recent meeting with members of a Federal Reserve lenders advisory council, members were talking about their different programs to improve their lending activities as reflected by their Home Mortgage Disclosure Act (HMDA) numbers.

"To date, CRA has been a very positive area of government intervention."

Member A had set up a two-stage review process, in which minority applicants who had been rejected went through a stage one review, and if rejected again, went on to a stage two review with three minority employees of the bank. The intent was to do as much as they could to review minority applicants fairly. They had made some progress, but they weren't happy with how things came out.

Member B said what they did was have their stage one reviewers talk to the original applicants. When an application had already been rejected by someone using essentially the same lending criteria, they thought others were also liable to reject it unless they could talk with the applicant and find out why that same reason for rejection should not be used. They felt that this approach was working.

Then Member C said they did that as well, but they also had their reviewer do a follow-up and maintain the loans in her portfolio. She became the "dorm mother" to a lot of these applicants, and as a result, there have been no defaults in this portfolio. I'm anxious to meet this "dorm mother!"

So there we had it. Each institution was doing something slightly different to improve their lending record. Each was experimenting, because review procedures are fairly new to banks. At this meeting, they learned from each other. I think that the cross-pollination of ideas such as this is an important function of the Fed.

C.R. On a related subject, a 1992 study conducted by the Federal Reserve Bank of Boston using HMDA and other data concluded that, after accounting for over 30 credit-related variables, race remained a significant factor in home mortgage loan denials in Boston. Do you think if the Boston study were replicated in other cities it would produce similar results?

A. I don't think it would be helpful to replicate the Boston study, at least at this time. Down the road, it may be worthwhile as a means of comparison. What we would hope to find, say in five years, is that the unexplained lending disparities will have disappeared. Right now, I don't think results from other studies would vary that much.

C.R. Why do we seldom find discrimination in the regulatory examination process? What's the problem?

A. I don't know that there is a problem. We have a way of doing things that I think works well for bank supervisors, and that is to look for a culprit and a villain in individual loans. That's the way we go about safety and soundness regulation, and that's the way we pursue CRA and HMDA enforcement. I think that is appropriate to our mission.

C.R. Does this mean the statistical approach used by Boston would find evidence of discrimination, whereas the examiner would not?

A. Yes. The reason the examiners did not find evidence of discrimination, while the Boston statistical study did, was that all the applicants who were rejected were rejected for reasons that would be considered valid. They had imperfect loan files. Lots of people who were accepted also had imperfect loan files, but they probably convinced the loan officer that their imperfections had been corrected, or at least that they were not sufficient reason for rejection. So when you look at any one loan, you're not going to find discrimination.

"I'm a great believer in the use of statistics, but there are dangers in the statistical approach as well... when you rely on statistics, the word "victim" loses its usual meaning."

Now, let's look at it from the other point of view. What we did in Boston was look at loans statistically. I'm a great believer in the use of statistics, but there are dangers in the statistical approach as well. When you set up a purely statistical model, you often exclude variables that may be relevant. For example, suppose an applicant lies on his/her application. That's not going to show up in the loan file, but that would be a good reason to reject the loan.

To carry that a little further, President Clinton has talked about the need for character loans and character evaluation as a part of lending. Character loans used to be what most small business lending was all about. Well, what that implies is that you're supposed to get an impression of the personality of the applicant and not just his or her numbers. If in fact we want to make more loans on "charactor," that means that nonquantifiable variables are supposed to be more important. That is exactly the opposite of going the statistical route.

Yet another problem with the statistical approach is that even after it's all quantified, what you end up with is a probability about a certain applicant--that this person had, for example, a 70 percent chance of being accepted. Well, if we look at the statistical model we may say, aha! Here is someone with a 70 percent chance of being accepted who was rejected, and then we conclude this person is a victim. Frankly, 30 percent of the people with that person's characteristics SHOULD have been rejected. What we're pointing out is that when you rely on statistics, the term "victim" loses its usual meaning.

C.R. Are you concerned with the new emphasis on character loans? Is this an open door for some to discriminate?

A. We're getting back to the issue of government action, and I think government action often has unintended consequences. I have no doubt that President Clinton has no intention at all of increasing lending discrimination by saying let's make more character loans. I also don't argue with your observation that, unfortunately, discrimination may be one of the unintended consequences, although I think the net effect would be small.

"Government action often has unintended consequences."

C.R. The Boston study looked at credit from the perspective of how an applicant was treated after an application has been filed. A different set of studies has looked at pre-screening, or discouraging a person from applying for credit. To investigate this type of discrimination, paired testers have been used, where persons of different races with similar credit histories apply for loans at a bank and their treatment is then compared. As part of the bank examination process, should we look at pre-screening issues, and should we use paired testers?

A. What I have suggested is that institutions hire shoppers, and I use the term "shoppers" instead of testers. I think if I were running a service business, I would want to know what people thought about the kind of job my business was doing. I would ask friends who would be candid with me to try it out and come back with a report, and I would just consider that a basic service-business kind of operation. I believe this kind of monitoring should be done with regard to how members of minority groups are treated by banks.

So I'm all for doing that. But I think it is the banks who should do it, because what you're really getting is anecdotal information. For example, maybe this person was rude to me. Well, you're not going to be able to prove that statistically. It's valuable information, but it's not the kind of thing you bring an enforcement action about.

If we, the regulators, were to use testers for enforcement actions, we would have to send a statistically significant number of testers into a bank, enough to establish some kind of basis other than impressions that something was wrong. Now, if you send five sets of paired testers to a bank in the space of a month, it would take an exceptionally dumb manager not to figure out that something funny was going on. So I frankly don't think it would work very well.

C.R. Are there other ways that you think we could address some of these issues we've been up against?

A. First of all, because I'm an optimist, I think that by and large people want to do the right thing. In spite of the results of the Boston study, all the banks in the study had antidiscrimination policies in place, so at least their intent was to do the right thing. I think what we're having is a problem of organizational behavior and that's why we're failing to reach our goals.

My impression, after one year and several months on the job, is that we need to do three things. The first is to review rejected loan applications, and I would recommend a review that includes talking to the applicant. By doing that, we'll be able to offer coaching to applicants, which is what banks are really doing in the review process: finding out why a person had a problem with a loan application and seeing if a way can be found to solve that problem. We need to demonstrate that being told, "You have a problem with your file" is not necessarily a final rejection.

Second, we need to provide consumer education. We have a number of models, such as the Neighborhood Housing Services model used in Cleveland and other cities. What we're really doing is educating for success in home ownership.

As we talk about consumer education, however, we need some awareness of the different ways we learn about managing our finances. Now, I suppose the most open people about personal financial affairs I can imagine are economists. We sit around and talk about mortgage points and getting this kind of deal and that kind of deal. I have been told in my travels and have come to believe that different social groups and different occupational groups really are more or less open about how much they paid for their car, how much they paid for their house, and what's involved in shopping around for a loan.

What this type of friendly discussion really does is provide a form of consumer education. In fact, in spite of what I learned from my talkative economist friends, I wish I had been counseled a little more before I bought my first home. I hope that minority community groups and churches will continue to take an active role in encouraging an informal exchange of information along with offering more formal educational programs. We all know education is needed.

The third thing we need to do is encourage outreach, which is a combination of review and education. You can review with a person and you can provide education and counseling, but unless you go out and try to find applicants, you're not going to be very successful.

"We need to do three things: The first is to review rejected loan applications... Second, we need to provide consumer education... Third, we need to encourage outreach."

What the Boston study taught us is that there aren't any simple solutions out there. This is a very complex sociological problem that we're trying to solve with our training as economists and bankers and accountants. If we pursue review, education and outreach for five years and that hasn't solved the problem, then maybe we ought to try something else. But for now, that's what I would do.

C.R. The model of, "we'll try this and see if it works?"

A. It's not a bad model! The problem may be racism, but the real question is, how are you going to change it? The response is often silence, or "take it to court." Okay, we've taken banks to court, but they already had an antidiscrimination policy on record. Their problem was that they have not been able to change their organizational behavior to carry out their policy. You can fine them, you can take them to court, and you can give them all lousy CRA ratings, but until we propose workable solutions, we're not going to get anywhere.

C.R. From a neighborhood perspective, I've heard two theories describing decline. One is that a neighborhood starts to decline, and banks pick up that signal and cease to lend. The other is that they cease to lend, and neighborhood decline follows. What do you think happens?

A. Taking the South Shore community in Chicago as an example, Jean Pogge, who is vice president of South Shore Bank there, suggested that it was the first of your stories, that communities decline and banks react. My hunch is, that's what usually happens. Again, it goes back to the nature of banks and organizations in general. They tend to be very conservative, cautious institutions, and that means that they're trend-followers and not trend-setters. That's why it's so difficult to get banks to go into a neighborhood and start to lead the turnaround. That's just an impression, and it's the South Shore Bank story--but I'm sure that actually the answer is some of both.

"The problem may be racism, but the real question is how are you going to change it?"

C.R. Why should banks and savings and loans have an obligation to serve lower-income people? Can their needs be met just as well by credit unions, finance companies, and other non-bank financial institutions?

A. First, there's a legal reason, which is that banks are established by charters, and those charters stipulate that they must serve their entire community. Now, if you're asking me the economic reason, it is that banks are going to have trouble surviving if they don't start serving their entire community. I don't mean to tell bankers how to do their business, but the bricks-and-mortar type of financial institution, with its large staff, is an expensive form of financial intermediation. Fidelity Investment Services, or any of the other large financial institutions like them, achieve economies of scale in intermediation that are miles ahead of banks.

In order for banks to pay for themselves and survive, they have to do something that Fidelity can't. What I would argue they can do is use their physical presence in the neighborhood. By doing this, they can observe who is and is not a good credit risk and attain superior loan performance. This means their lending has to be community-based.

C.R. How does that reconcile with the current bank merger activity?

A. You don't have to be a community bank to do community-based lending. There are some large regional banks that have very decentralized decision-making structures. They can take advantage of that, while at the same time achieving economies of scale with back office operations and interregional diversification. Ultimately, until banks fully serve their local communities they're not going to be able to compete with the Fidelities of the world. The market's a good teacher. If banks are not pursuing a successful marketing strategy, the market is going to pull them down.

C.R. A prominent Kansas City banker recently expressed great fear that the government was going to attempt to use banks to cure the social ills of the country. Is this what we're asking?

A. There's no question that some see it that way. In 1991, Joe Kennedy, who now chairs the House Banking Subcommittee, said that he saw CRA as a way of achieving social good without costing the government anything. I think that is an expression of the kind of view you just described. What I'm saying is that banks' obligation to serve their community predates CRA. CRA is simply a formalization of that obligation.

C.R. There have been many complaints about CRA enforcement, and some banks say they want us to tell them how many loans to make in what census tracts so they can be done with it. The other side of that, of course, is credit allocation, with a bank being told how much money to loan in what locations. Community groups, on the other hand, say examiners focus too much on numbers, and we don't see many numbers. Are we on the right track with the examination process, looking at process over numbers?

A. Well, I tend to think so, but I think our approach has a time that is limited. The President is very committed to performance, not process--his phrase is "performance not paperwork." I think we're going to see substantial change in the way CRA is approached. We may give to those bankers you just spoke about exactly what they say they want. You know that old curse, "don't want anything too much or you might get it"? Well, they may get it.

C.R. In dealing with community reinvestment issues, I often encounter situations that require the involvement of a number of different people and organizations. In your view, how important are partnerships in community redevelopment?

A. Partnerships are crucial. What I'm struck with across the country is that where things are working well, the first thing that's in place is someone with an entrepreneurial spirit who can pull together resources from diverse places, cut through paperwork, and build a vision and commitment to getting something done. The second thing that's required is cooperation from the city or the locality. I've seen some urban planning policies that work well, and some that don't.

"...banks are going to have trouble surviving if they don't start serving their entire community."

There's a difference, for example, in how Cleveland and Pittsburgh deal with abandoned property. In Pittsburgh, in order to take over vacant or abandoned land or buildings, you have to pay all the back taxes, plus interest, going back to the time when the taxes first became delinquent. Needless to say, there is a lot of vacant land there, because the taxes can be more than the property is worth. This is particularly prohibitive if you want to rehabilitate a building, or build low- and moderate-income housing on a site with 18 years of back taxes. In the Hills section of Pittsburgh, which in most other towns would be a "yuppie kingdom" because it's right next to downtown with a beautiful view, 40 percent of the land is vacant. The buildings that were there were burned out in 1968, and no one will come in and pay the back taxes.

Cleveland, on the other hand, has an aggressive foreclosure policy on back taxes, where as soon as the foreclosure is completed, they will sell the property for a dollar to nonprofit organizations or even to for-profit organizations that promise to build on the land. I didn't see in Cleveland the scale of vacant land that I saw in Pittsburgh.

C.R. In closing, what would you like to have accomplished by the time you leave the Federal Reserve Board in the year 2000?

A. I was born in the year of the Brown v. Board of Education decision. When I look at what has been done since then to try to produce quality in our public education system, I don't see enough results. I just hope that in my seven remaining years on the Board, we can do more to promote equal credit opportunity than what we've been able to do in the last 39 years to produce equal educational opportunities. □

Members of the Federal Reserve System's Board of Governors are appointed by the President of the United States and confirmed by the Senate. They serve 14-year terms, which helps insulate them from political pressure. Governor Lindsey is completing a term left open by a resignation. Board members serve on the the Federal Open Market Committee (FOMC), along with five Federal Reserve Bank Presidents. The FOMC makes key decisions affecting the cost and availablility of money and credit. The Board is responsible for implementation by regulation of major Federal consumer credit laws, such as the Community Reinvestment Act, Truth in Lending, and Equal Credit Opportunity.

Closing the Gap: Questions to ask

(continued from page 3)

Closing the Gap recommends that people responsible for providing credit regularly ask themselves questions such as these:

1. When we hire, do we promote a cultural diversity that is reflective of the communities we serve?
2. When hiring among lending staff, do interviewers take into account possible racial prejudices of job applicants?
3. Do we train all of our staff in the area of equal lending?
4. Do we have any mechanisms through which unfair lending practices, policies, or procedures may be detected? If so, are we able to determine the effectiveness of these mechanisms?
5. Do we inform all potential borrowers, regardless of their race or ethnicity or the location of the property, about all of our lending programs so they may decide which best fit their needs?
6. Do we deliberately steer minority mortgage applicants to federally insured programs because we assume that minorities are less creditworthy?
7. Do we have mortgage lending practices that include location of property as a risk factor?
8. Does our mortgage pre-qualifying procedure tend to encourage or discourage minority applicants?
9. Do we offer homebuyer education programs for potential applicants who are unfamiliar with the mortgage lending process?
10. Do we regularly review our advertising to see if the choice of illustrations or models suggests a customer preference based on race?
11. Are we as assertive in attracting minority loan applicants as we are in attracting white applicants?
12. Are we familiar with the practices of the real estate and mortgage brokers and appraisers with whom we do business?
13. Do we encourage the brokers and appraisers with whom we do business to be constructively active in minority communities?
14. All things being equal, do white and minority credit applicants have the same chance of getting a loan from this financial institution? □

Staff promotes community reinvestment

L*arry Meeker, Community* Affairs Officer and Assistant Vice President, has headed the Community Affairs Department at the Kansas City Federal Reserve Bank since it was started in 1987, and has been at the Fed since 1974. With a bachelor's degree in mechanical engineering, a master's degree in business administration, and a doctorate in finance from the University of Kansas, he has the experience and the sense to deal with almost any situation. Larry is famous at the Fed for his quick wit and collection of contemporary art.

John Wood, Senior Community Affairs Coordinator, joined the Fed in 1990. He was formerly a manager and loan officer at Citizens' Jackson County Bank and before that was on the staff of the Community Development Department of Kansas City, Missouri. A native of Virginia, he holds a bachelor's degree from Virginia Union University and a master's degree in public administration from Ohio State University. With a little spare time and some sunshine, you'll find him on the nearest golf course.

Sharon Blevins joined the staff at the end of 1992 as Senior Community Affairs Assistant. She was formerly executive director of a community development corporation that helped generate over $100 million in new investment, and of an organization addressing metropolitan Kansas City issues. She has a bachelor's degree in American studies and is near completion of a master's degree in public administration at the University of Missouri - Kansas City. In her leisure time she reads or adds another coat of paint someplace in her seventy-year-old house.

Larry Meeker, John Wood and Sharon Blevins review the development finance notebook.

SOMEONE SAID. . .

"I know of no safe depository of the ultimate powers of the society but the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them, but to inform their discretion by education. This is the true corrective of abuses of constitutional power."

-- Thomas Jefferson

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Larry G. Meeker,
Assistant Vice President and
Community Affairs Officer

John A. Wood
Senior Community Affairs Coordinator

Sharon M. Blevins
Editor and Senior Community Affairs Assistant

Mike Korando
Senior Graphic Designer

Photographs:
Matt Pozel, Sharon Blevins, Kathy Rogers of Neighborhood Housing Services