FEDERAL RESERVE BANK OF MINNEAPOLIS

Editor's note - Issue 1, 2006

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AUTHOR

Paula Woessner

Senior Publications Editor, Community Development and Engagement

Our two main features in this issue of *Community Dividend* explore efforts to address specific challenges in the community and economic development fields.

The challenge discussed in our first feature is the lack of uniform commercial laws in Indian Country, with particular focus on a type of commerce called *secured transactions*. The absence of uniform laws governing secured transactions can hinder economic development by making outside lenders reluctant to do business with tribes and tribal members. In 2001, a committee of commercial law experts from the National Conference of Commissioners on Uniform State Laws set out to create a model secured transaction code for Indian Country that would provide uniformity on key legal points while allowing tribes to adapt the law to suit their unique traditions and circumstances. Working closely with an advisory group of tribal representatives, committee members analyzed and debated every aspect of secured transaction law and gradually drafted the new code. The Model Tribal Secured Transactions Act was completed in the summer of 2005, after a four-year drafting effort, and a number of tribes have already taken steps to implement it.

Our second feature discusses a challenge that frustrates some community development researchers: How do you perform inexpensive, up-to-date monitoring of neighborhood conditions when most neighborhood-level data resources tend to be either costly or out-of-date? The article examines recent research that suggests annual, inexpensive data from the Home Mortgage Disclosure Act (HMDA) can serve as proxies for a few important indicators of neighborhood health. When those proxies are tested in the Twin Cities region, the analysis indicates that HMDA data can be useful tools for tracking neighborhood changes in an affordable, timely way.

Bridges joins Swanson as Ninth District CAC member

Dorothy Bridges, president and chief executive officer of Franklin Bank in Minneapolis, recently joined Lori Swanson, solicitor general for the State of Minnesota, as a Ninth District representative to the Federal Reserve System's Consumer Advisory Council.

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Dorothy Bridges, president and chief executive officer of Franklin Bank in Minneapolis, recently became one of ten new members appointed to the Federal Reserve's Consumer Advisory Council (CAC). The CAC, which was established in 1976, meets three times a year to advise the Board of Governors of the Federal Reserve System (Board) on matters related to consumers, communities and the financial services industry. Members are appointed by the Board and serve staggered, three-year terms.

Bridges began her career in banking with First Bank System in Missoula, Mont., in 1979. After leaving First Bank in 1993, she was a bank regulatory compliance consultant in Ohio from 1993 to 1995 and served as vice president and chief credit officer for the Minneapolis-based Community Reinvestment Fund from 1995 to 1999. She joined Franklin Bank in April 1999, becoming the only African American woman to head a Minnesota bank. Franklin Bank focuses on serving the financial needs of small businesses, nonprofit entities and socially conscious individuals through two offices with a combined staff of 35. Under Bridges' leadership, the institution has grown in total asset size from $48 million to $127 million. Bridges volunteers in the Twin Cities community in several capacities and serves on the boards of prominent local foundations and organizations, including the Minneapolis Foundation and Twin Cities LISC.

Bridges joins Lori Swanson as one of two CAC members from the Ninth District. Swanson, who was appointed to the council in 2003, is the current solicitor general for the State of Minnesota. The Board also designated Swanson to serve as CAC chair through December 2006, when her term on the council will end.

As solicitor general, Swanson is responsible for various civil actions undertaken by the Attorney General's Office on behalf of the public. During her tenure, she has supervised cases against "mortgage foreclosure rescue specialists" who defrauded homeowners, financial institutions that sold private account information to telemarketers, and numerous other companies or organizations perpetrating fraud or other unlawful practices against Minnesota residents. In addition to enforcing the state's consumer protection laws, Swanson is responsible for the attorney general's efforts to educate consumers about their legal rights in the marketplace. Prior to her appointment as solicitor general, Swanson served as Minnesota's deputy attorney general from 1999 to 2002.

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Minnesota loan fund offers capital through community collaboration

Numerous small businesses and nonprofit organizations located in rural communities throughout Minnesota are benefiting from an innovative, nonprofit economic development loan fund known as the Minnesota Community Capital Fund.

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AUTHOR

Scott Martin

Numerous small businesses and nonprofit organizations located in rural communities throughout Minnesota are benefiting from an innovative, nonprofit economic development loan fund known as the Minnesota Community Capital Fund (MCCF). In the past three years, the Fund has financed projects as diverse as the launch of a new child care center, the relocation and expansion of an environmental lab, and the major expansion of a cold storage warehouse and distribution center—all by facilitating a unique collaboration between banks and local government community development agencies.

The Northland Institute, a Minneapolis-based nonprofit organization, launched MCCF in early 2003 with the financial support of Minnesota's Blandin Foundation. Since that time, MCCF has attracted nearly 70 members throughout rural Minnesota and approved 46 loans totaling more than $12 million to small businesses and nonprofit organizations.

Pooling resources to access capital

MCCF members, which include cities, counties, electric utilities and regional development organizations, have pooled their limited local development financing resources to access significantly more loan capital through the Minneapolis-based Community Reinvestment Fund (CRF), which operates a specialized, national secondary market for community development financing.

With memberships ranging from $25,000 to $250,000, MCCF's member organizations can sponsor business loans of up to ten times the amount of funds they contribute to the pool, up to a maximum of $2.5 million per loan.

All loan requests begin with a local bank that wants to partner with MCCF, which offers fixed-rate subordinate debt financing for all kinds of businesses and for almost any business purpose. The participating bank determines the level of gap financing from MCCF that will enable the bank to make its loan. Since all MCCF loans are sold to CRF upon closing, the fund always has money to lend to growing businesses in its member communities. Further, banks that participate with MCCF in financing a project may be eligible for credit under the Community Reinvestment Act.[1/]

As the following MCCF projects demonstrate, the collaboration among the fund, its members and bank partners has already had a tangible effect on Minnesota's rural communities.

Helping a company maintain its competitive edge

When Cass Forest Products (CFP), a Cass Lake, Minn.-based forest products wholesaler, reached its lending limit at Security Bank in Bemidji, Minn., the company needed an alternative source of capital to finance some critical business-improvement projects.

In particular, CFP wanted to expand its retail manufacturing facility, Aitkin Hardwoods, and enhance the facility's showroom. Additionally, the company needed to expand its production and storage area.

"For approximately two years, we tried to obtain Small Business Administration and U.S. Department of Agriculture loans to support our business expansion," says Dave Goetz, chief executive officer of CFP. "Because we didn't meet the borrower requirements for these loans, we were forced to tap into our operating line of credit to begin funding the improvement projects. As a result, we hit a lending limit at our bank and were forced to find a way to restructure our debt. We had to find another source for the capital we needed to continue to grow our business."

That's when Goetz turned to Ross Wagner, economic development and forest industry coordinator for Aitkin County.

"We've been a member of MCCF since it was founded, so I felt this program could be the solution to Cass Forest Products' financing challenges," says Wagner. "Compared to the other loan programs the company explored, the MCCF loan process was more straightforward and less time-consuming. We were pleased to sponsor this business loan, which will help a small business in an economically underserved area further prosper and compete in a demanding industry."

Another MCCF member, Minnesota Power, cosponsored the loan with Aitkin County, enabling the fund to provide CFP with a loan of $480,000. This loan is unique for two reasons. Since CFP had reached its lending limit with Security Bank, MCCF provided 100 percent of a project's financing for the first time in its history. Second, MCCF provided the loan through the U.S. Department of the Treasury's New Markets Tax Credit Program, which is aimed at stimulating private investment in low-income communities.[2/]

Terry Matson, senior vice president at Security Bank, is thrilled his client received the required capital through MCCF.

"Cass Forest Products' financial position is complicated from a collateral, lien position and debt perspective because it has an employee stock ownership plan, or ESOP," comments Matson. "Consequently, it was difficult to use programs from the U.S. Department of Agriculture and other government agencies because they required a total restructure—including a first mortgage on all of the company real estate that would have resulted in a loss of the ESOP tax advantages for the company. We're extremely pleased we were able to work with MCCF to obtain the total loan amount Cass Forest Products needed."

Because the MCCF financing enabled CFP to pay off the first mortgage on its Aitkin property with Security Bank, the company may be able to obtain additional funds from the bank to support future operating needs.

"To remain competitive in an increasingly commoditized market, it's critical for us to continue to make business enhancements that will enable us to work as smartly and efficiently as possible," Goetz adds. "The MCCF loan helps ensure we'll have the resources to make that happen."

Funding the expansion of a small town hospital

Recently, Community Memorial Hospital (CMH) and Sunnyside Health Care Center (SHCC) in Cloquet, Minn., decided it was time for a facelift and expansion—the size and scope of which would require more dollars than CMH had spent on its facility since it opened in 1957.

The organization knew a large, concerted community fundraising effort would be required to raise the $14 million needed for the project. With Wells Fargo as the lead financial institution, CMH raised nearly $2 million in initial pledges from the local community. This funding was a great start, but the hospital had a long way to go to reach its $14 million goal.

"Originally, we believed we could secure all of the financing we needed through community pledges and one loan from one bank," says Rick Breuer, chief executive officer of CMH and SHCC. "However, at the eleventh hour, the bank indicated it wanted to structure the financing a bit differently to reduce some of its risk. That's when several members of MCCF became involved in the deal."

The City of Cloquet, Minnesota Power, Great River Energy and Carlton County sponsored the CMH deal, pooling all of the dollars available to them through their MCCF memberships to provide the hospital with a $2.5 million loan—the maximum amount under the MCCF program.

"We knew the city alone could not provide all of the gap financing required to get the hospital deal done," explains Brian Fritsinger, Cloquet city administrator and MCCF board member. "We're thrilled that MCCF was creative in pulling several of its members together to obtain the necessary capital. The project has been very well received in this community, which was in great need of expanded medical services."

In addition to the MCCF loan, project financing was provided by Wells Fargo Bank and the Northland Foundation, which enabled the hospital to triple the size of its emergency room and renovate its surgery department by replacing two old operating rooms with four state-of-the-art rooms and three endoscopic suites. The hospital also added a new lab, radiology department and pharmacy.

SHCC benefited as well. The facility gained a new dining and activity center on each floor, and air conditioning was installed throughout the building.

"It's very difficult for health care facilities in small markets to accumulate the equity capital needed for major expansions," comments Dan Moschet, vice president of business banking for Wells Fargo's northern Minnesota district. "In order for a significant facility expansion to be 'bankable,' it's often necessary to partner with lenders like Wells Fargo that are willing to take subordinate lien positions as a substitute for equity. Having an organization like MCCF stepping up and providing the additional funding was critical to the success of a project like Cloquet's Community Memorial Hospital expansion."

Breuer best sums up the benefits of the project when he explains, "Our original building was built for a different era of health care. Now, the quality of our building has caught up with the high quality of care we've been providing for decades."

Expanding the model to urban areas

To build on the successes of the MCCF model, the Northland Institute recently launched an urban counterpart to the fund. The Twin Cities Community Capital Fund (TCCCF) is designed to serve communities in the seven-county Twin Cities metropolitan area. It was launched in July 2005, with Wells Fargo Foundation Minnesota as the lead grantmaker. TCCCF is currently enlisting members and developing its network of financial partners. To date, 26 Twin Cities area communities have already signed on as members. Those communities will soon begin to share in the benefits of their collaboration, as TCCCF recently opened for business and is ready to finance its first development projects.

Scott Martin is president of MCCF and TCCCF. For more information on the funds, including loan applications and a membership list, visit www.mncommunitycapitalfund.org and www.tcccf.org, or contact Martin by phone at (952) 546-9049 or via e-mail at smartin@mncommunitycapitalfund.org or smartin@tcccf.org.

1/ The Community Reinvestment Act, or CRA, was enacted in 1977 to encourage financial institutions to meet the credit needs of their local communities, with special emphasis on low- and moderate-income neighborhoods. In 2005, the CRA underwent significant revisions that included expanding the definition of community development in order to promote revitalization in rural areas. For more information on the revisions, visit www.federalreserve.gov/boarddocs/press/bcreg/2005/20050719/.

2/ The New Markets Tax Credit Program allocates federal income tax credits to taxpayers who make equity investments in designated community development entities. For more information, visit www.cdfifund.gov/what_we_do/programs_id.asp?programID=5.

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Can HMDA data herald neighborhood changes?

For years, researchers have used data collected under the Home Mortgage Disclosure Act (HMDA) to examine important fair lending issues. Could HMDA data also be used to collect neighborhood-level analyses?

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AUTHOR

Michael Grover

Assistant Vice President, Community Development and Engagement

For the community development field, there is great value in data resources that can be used to monitor neighborhood changes. This sort of data can measure the impact of targeted investments in urban neighborhoods and function as an early warning system if neighborhood conditions decline.

However, most data sets that are inexpensive and widely available to the public present two basic problems for those interested in conducting a neighborhood-level analysis: namely, the frequency and geographic detail of the data. Census data, for example, are widely available, easy to access, and offer a wide range of information at a detailed geographic level. But since they are only collected every ten years, the data do not lend themselves to research by those interested in the up-to-date monitoring of neighborhoods.[1/] Other data sets that are updated more frequently, such as quarterly employment and unemployment information, present the opposite problem, as they are typically only available at higher levels of geographic aggregation, such as city or county level. (There are more rigorous ways to conduct neighborhood-level analyses, but they are often expensive and may be beyond the capacity of some community-based organizations to undertake. For more information, see the sidebar following this article.)

Some in the field suggest data from the Home Mortgage Disclosure Act (HMDA) could be used to fill this neighborhood-level information gap. HMDA, enacted in 1975, requires most mortgage lending institutions to collect and disclose information about their lending patterns. This information includes borrower demographics, such as income and race; and loan characteristics, such as property location and loan amount. Congress designed HMDA to 1) assist in determining whether financial institutions were meeting the housing needs of their service areas, 2) target investments where they are needed and 3) identify possible discriminatory lending patterns. (For information on recent changes to HMDA, see the sidebar below.)

For years, researchers have used HMDA data to examine important fair lending issues, particularly in the analysis of the spatial and racial distribution of lending and lending outcomes for a specific lender or within and across Metropolitan Statistical Areas (MSA). Could HMDA data also be used to conduct neighborhood-level analyses? Recent research suggests that they might.

Filling the gaps with HMDA

Under HMDA, lenders annually report data for individual loan applications, including information about the loan and the borrower, at the census tract level. Each fall, the Federal Financial Institutions Examination Council releases lender-reported application data for the previous calendar year for a small fee ($50 for the entire U.S. in 2005). The geographic level of detail provided in the HMDA data, combined with their low cost and annual release, are appealing characteristics for those interested in community and neighborhood development.

Recent regulatory changes expand HMDA data

Since the enactment of the Home Mortgage Disclosure Act (HMDA) in 1975, the Board of Governors of the Federal Reserve System (Board) has made periodic amendments to Regulation C, which implements the act. These changes have increased the variety and amount of information that mortgage lenders are required to collect and disclose under HMDA. With each round of revisions, HMDA data have become more comprehensive and, as a result, more useful to researchers who seek to analyze lending patterns and related issues. The most recent revisions to Regulation C, which took effect in 2004, expand the HMDA data set once again. Specifics:

New data fields. In a Board-driven effort to monitor a new and growing segment of the market that makes "high-priced" mortgage loans, the revised Regulation C adds three new fields under which lenders must disclose loan data: pricing information, including interest rates and fees, for loan applications above a specified rate threshold; the lien status of an application; and whether a loan is subject to the Home Ownership and Equity Protection Act. With regard to pricing information, lenders are required to report the spread between the annual percentage rate on an application and the rate on Treasury securities of comparable maturity for loans with spreads above designated thresholds. The thresholds for reporting differ by lien status: 3 percentage points for first liens and 5 percentage points for junior liens.

Improved data collection and consistency. The revised HMDA regulation requires lenders to designate a property code for each application, in order to distinguish between single-family, manufactured and multi-family housing types. It also requires lenders to use the race and ethnicity classification system common to other federal data collection systems, such as the U.S. Census. The system allows individuals to select more than one race under their specified ethnicity.

Additional information on HMDA changes is available through the Board at www.federalreserve.gov/publications_papers/bulletin/2005/summer05_hmda.pdf and the Federal Financial Institutions Examination Council at www.ffiec.gov/hmda.

In a 2005 analysis of a long list of detailed neighborhood indicators, researchers George Galster, Chris Hayes and Jennifer Johnson[2/] concluded that HMDA data are useful for monitoring several important dimensions of neighborhood conditions. They began their analysis by gathering dozens of public and proprietary variables that reflect social and economic conditions at the census tract level for five urban areas (Boston; Cleveland; Indianapolis; Oakland, Calif.; and Providence, R.I.) between 1993 and 1999. These cities are atypical in that they collected and organized extensive "neighborhood indicator" data in the mid-1990s. Galster, Hayes and Johnson augmented these 1993-1999 city-provided variables with additional census tract data from the 1990 Census. This rounded out their large set of neighborhood indicators.

Galster, Hayes and Johnson then looked to see if a few of their indicators might possess the following two key properties: 1) they are available cheaply, universally (i.e., widely enough to include most neighborhoods) and at least annually and 2) they reflect much of the information about neighborhood conditions contained in the large set of neighborhood indicators (most of which are not available cheaply, universally and annually). Variables with these two properties would be useful to city governments and neighborhood organizations because they would allow economical, annual monitoring of neighborhoods for possible changes in social and economic conditions—something that is generally difficult to do.

To find such variables, Galster, Hayes and Johnson proceeded in two steps. First, they used a statistical technique called *factor analysis* to identify six dimensions of neighborhood conditions that summarized most of the information in their full list of neighborhood indicators. They invented labels for each of these six dimensions—social Disadvantage, Housing Type and Tenure, Prestige, Business and Employment, Crime, and Housing Vacancy—based on the types of indicators from the full list that were most closely associated statistically with each dimension. For example, the Prestige dimension got its name from the fact that it mainly reflected indicator variables like the percentage of college-educated or professional persons and the median home value in the census tracts. Second, they used another statistical technique called *regression analysis* to test how well each of these six dimensions of neighborhood conditions correlated with each of the cheaply and universally available indicators, including indicators based on HMDA data.

For these researchers, HMDA data provided a useful proxy for three of the six dimensions of neighborhood conditions: Social Disadvantage, Prestige, and Housing Type and Tenure.[3/]

The Social Disadvantage dimension, which mainly reflects indicators such as welfare usage, unemployment, teen birthrates, and female-headed households, was proxied reasonably well by the two-year average rate of home purchase mortgage approvals, computed from HMDA data. The Prestige dimension, discussed above, was well proxied by the two-year median amount of loans for home purchase, computed from HMDA data for each census tract. Finally, the Housing Type and Tenure dimension of neighborhood conditions, which mainly reflects the proportion of single-family and owner-occupied homes in each census tract, was reasonably well proxied by the two-year average number of total mortgage loan applications, again computed from HMDA data.

It is important to remember that Galster, Hayes and Johnson's results are specific to the time periods and five urban areas for which they had data, so there is no guarantee that the same correlations will hold true for other time periods or urban areas. However, since the same HMDA variables worked consistently in their analysis, from 1993 to 1999 for all five urban areas, there is some reason to believe the same HMDA-based proxies may work elsewhere to highlight possible changes in neighborhood conditions that merit the attention of residents and the organizations and local governments that serve them.

So what could these HMDA-based proxies show for urban areas in the Ninth District? To explore that question, we turn to an analysis of conditions in the District's largest MSA. Our analysis uses data from 1992 to 2004 to calculate Galster, Hayes and Johnson's three HMDA-based proxies for the seven-county Twin Cities metropolitan region and selected subareas, with special focus on the two communities that constitute North Minneapolis. A caveat: It is important to keep in mind that the aim of this analysis is merely to provide indicators of neighborhood conditions. The HMDA-based proxies have not been specifically tested for validity in the Twin Cities and, at best, can only approximate movements in the full range of social indicators for which they stand.

Twin Cities analysis

The north side of Minneapolis, often called North Minneapolis for short, is the quarter of the city that lies north of downtown and west of the Mississippi River. It is made up of two smaller communities: Near North, which lies immediately north of downtown, and Camden, which lies between Near North and the city's northern border. It seems likely that annual monitoring of neighborhood conditions in North Minneapolis, of the type the HMDA data seem to make possible, would be of interest to its residents and those who serve them. On the one hand, many households in North Minneapolis appear to be financially vulnerable based on recent high concentrations of foreclosures in the area and, according to Census 2000, high concentrations of poverty, unemployment and low-income residents. On the other hand, this part of the city is potentially attractive for investment and the neighborhood changes it can bring, as it is close to downtown, has an affordable housing stock and has been targeted through recent private and public revitalization efforts (especially the Near North community).

An analysis of HMDA data for the six two-year time periods, from 1992-1993 to 2003-2004,[4/] for the three HMDA-proxied neighborhood indicators—social Disadvantage, Prestige and Housing Type and Tenure—reveals important differences in level and trend for the census tracts that compose the north side of the city, as compared to the whole of Minneapolis, Hennepin County and the seven-county region. With regard to Social Disadvantage, the HMDA proxy (the proportion of originated home purchase applications) is consistently lower on the north side than in the three broader geographic areas (city, county and region) for all six two-year time periods. The rate for North Minneapolis reached its peak of 60 percent early in the 1994-1996 period, as it did in the broader geographic areas, and remained at least six percentage points below the rate for the city, county and region during the remaining five two-year periods. Within this area of the city, the origination rate for Camden was at least five percentage points higher than that for Near North. Thus, according to this HMDA proxy, the relative degree of social disadvantage on the north side changed very little over the period.

Despite no relative change in the Social Disadvantage proxy, the HMDA proxy for Prestige (median amount of loans for home purchase) reveals North Minneapolis started low but recently rose rapidly. The median loan amount for North Minneapolis dropped slightly between 1992-1993 and 1994-1996, as the median amount for the broader geographic areas increased. While the city's north side did not keep pace early on, the median loan amount for North Minneapolis has increased at a higher rate than for the three broader geographic areas since the 1997-1998 period. In addition, the total percent change over the six two-year periods (148 percent) outperformed the broader geographic areas. Both the Camden and Near North communities exhibited roughly the same pattern for median loan amounts during this period. However, Near North increased at a higher rate over the period (almost 200 percent) and had a higher median loan amount in 2003-2004 compared to Camden.

Lastly, the HMDA proxy for Housing Type and Tenure (the average number of total mortgage applications per census tract) for North Minneapolis reveals positive biennial percentage increases, even as other areas posted declines. The total change of almost 375 percent from 1992-1993 to 2003-2004 is well beyond the rate of increase for the three broader geographic areas. Within North Minneapolis, the per-tract application average in Camden outpaced Near North by a ratio of at least 2 to 1 during this period and accounted for much of the strength in the level of this indicator for North Minneapolis. Still, Near North did experience the highest rate of change, over 500 percent, between 1992-1993 and 2003-2004.

Conclusions and uncertainties

What do these findings imply about trends in these north side communities between 1992 and 2004? The tentative analysis of the three neighborhood indicators for North Minneapolis broadly indicates that the area may be transforming, primarily due to an increasingly vibrant housing market. If the findings of Galster, Hayes and Johnson can be applied to Minneapolis, the HMDA data proxies suggest that 1) the degree of Social Disadvantage historically present on the north side did not dramatically change between 1992 and 2004; 2) neighborhood Prestige grew slowly during the 1990s, but increased rapidly during the last six years; and 3) neighborhood housing activity has grown at a strong rate since the early 1990s, especially in Camden. While differences between Camden and Near North existed, both communities followed a trend line for the first two indicators that was common to all geographic levels.

While this analysis of HMDA data is useful, especially because it allows for a neighborhood-level analysis beyond the fixed time points of the 1990 Census and Census 2000, it raises a number of questions and concerns when applied. Most of these concerns focus on the interpretation of findings and, more importantly, the ability of HMDA data as structured by Galster, Hayes and Johnson to serve as proxies beyond the cities and period of time for which they were tested.

With regard to the first point, which is more important when using HMDA data as a proxy for an indicator, the level of change or the percentage change? In other words, using the North Minneapolis example, is it more important to focus on the fact that Camden accounted for the overall housing market increase for the area, or the fact that the percentage change over the time period was greatest in Near North? Whatever question is at hand will, most likely, determine which phenomenon is deemed more important.

Regarding the second point, the ability of these HMDA proxies to serve as predictors of neighborhood indicators, at least for the Twin Cities, is open to discussion. This uncertainty is mainly due to a basic assumption lying beneath any application of Galster, Hayes and Johnson's work to more recent years, that the mortgage lending market has remained constant since the mid-1990s. Two important changes since the mid- to late 1990s, namely the increase in the number of refinance applications and the rapid advent of subprime lending, have the potential to challenge the usefulness of one of the HMDA-based surrogates: the Housing Type and Tenure proxy.

As detailed above, the housing market in North Minneapolis, especially in the Camden community, generally outperformed the city, county and region in terms of per-tract applications. The arrival of subprime lending was an important mortgage market change in the late 1990s, especially for refinance applications, and appears to have had an effect on the Housing Type and Tenure proxy. Between 1992 and 2004, refinance applications reported by subprime lenders[5/] increased by 600 percent, compared to 168 percent for prime lenders, to account for almost one-third of the refinance market in Minnesota.

Looking more closely at refinance and home purchase applications for this period reveals that beginning in 1999-2000, North Minneapolis experienced a strong period of refinance compared to the three broader geographic areas, which either experienced declines or stabilization. This pattern suggests that refinance activity in North Minneapolis census tracts may not follow a traditional pattern based on market interest rate fluctuations, but may be affected by the differential growth in subprime or perhaps predatory refinancing in North Minneapolis. This finding implies that changes in the way mortgage markets operate could impair the usefulness of this HMDA proxy and, at the very least, suggest that this measure may need further refinement.

Thus, it is important not to simply use the proxy findings without a deeper examination of underlying trends within the HMDA data. For example, an increase in the total number of loan applications reported under HMDA (i.e., an increase in the variable that forms the Housing Type and Tenure proxy) may indeed reveal that a neighborhood housing market has picked up steam. On the other hand, if this increase is largely due to a market change, such as the increase in subprime refinance seen in North Minneapolis, then the utility of this HMDA proxy as presently calculated could be problematic. In either case, it is important for anyone calculating these proxies to become familiar with what the detailed HMDA data reveal about mortgage lending at the neighborhood level. Not doing so could lead to the creation of an ineffective early warning system for neighborhoods.

Even with these reservations, the use of HMDA data as tools to monitor neighborhood conditions shows a great deal of promise. More work on when and how to apply and interpret these proxies in a neighborhood-level analysis is warranted.

1/ According to the U.S. Census Bureau, the American Community Survey may, if fully funded and implemented, eliminate the need for the long form in the 2010 Census and make data available more frequently.

2/ George Galster, Chris Hayes and Jennifer Johnson, "Identifying Robust, Parsimonious Neighborhood Indicators," *Journal of Planning Education and Research* (24) 2005, p. 265-280.

3/ The Business and Employment Activity dimension was proxied well by a count of businesses based on data collected by Dunn and Bradstreet. The count is available annually and fairly cheaply for most neighborhoods. For two dimensions—Crime and Housing Vacancy—Galster, Hayes and Johnson did not identify a cheaply and universally available annual proxy.

4/ HMDA data from 1995 for the Twin Cities are unavailable, so the six two-year time periods for this analysis are as follows: 1992-1993, 1994-1996, 1997-1998, 1999-2000, 2001-2002 and 2003-2004.

5/ Lender type is determined by a list of subprime and manufactured home lenders compiled annually by the U.S. Department of Housing and Urban Development for the years 1996-2002. For 2003 and 2004, the lenders listed for 2002 were used. For more information, visit www.huduser.org/datasets/manu.html.

Richmond study addresses reinvestment research challenges

Measuring the economic outcomes of investments in urban neighborhoods is difficult, if not impossible, to accomplish due to a number of challenges related to data collection and methodology. Data on neighborhood investment are typically collected—if at all—at a high level of aggregation, such as the census tract or neighborhood level, and rarely in a comprehensive manner. That makes it difficult to measure the outcome of investments precisely. In addition to these important data issues is a whole host of methodological concerns that can potentially limit the validity of an outcome analysis, such as the challenges of precisely attributing outcomes to specific investments or measuring the outcome of an investment at the right place and point in time (especially since its effects may appear after a number of years).

A recently released Federal Reserve Bank of Richmond study, *The Ripple Effect: The Economic Impacts of Targeted Public and Nonprofit Investment on Neighborhood Development,* aims to surmount these challenges in its analysis of targeted neighborhood investments in the city of Richmond, Va. At a Community Development Forum that the Federal Reserve Bank of Minneapolis and Twin Cities LISC cosponsored in December of 2005, Professor George Galster of Wayne State University, Greta Harris of Richmond LISC and Dan Tatar of the Federal Reserve Bank of Richmond discussed the study, along with Richmond's Neighborhoods in Bloom targeted investment program.

The Richmond study goes far beyond the usual anecdotes about the importance of community development work by quantifying the positive results of a well-defined, replicable investment strategy. In fact, key stakeholders in the effort believe this study can provide essential guidance to other communities about how best to accomplish and measure revitalization in America's urban centers and first-ring suburbs.

In brief, the study evaluates the outcomes of targeted investments made to specific neighborhoods in Richmond over a five-year period starting in 1999. The use of neighborhood-level investment data organized at the block level makes this research effort and study unique, as does the Adjusted Interrupted Time Series analysis model that researchers used to estimate the outcome of investments. Comparisons of housing price changes in Richmond's targeted and untargeted neighborhoods yield the following key findings:

- Housing prices in targeted neighborhoods appreciated at an annual rate of 9.9 percent above the citywide average.
- Areas bordering the targeted neighborhoods also experienced an increase in housing prices (5.3 percent annually) above the citywide average.
- The most significant home price impact occurred after reaching a per-block investment threshold of $20,100, which boosted prices by 50 percent initially and a rate of 9.6 percent thereafter.

To access the study, visit www.richmondfed.org/community_development/ . To obtain a hard copy, call (612) 204-5869 or e-mail communityaffairs@mpls.frb.org.

Michael Grover

Assistant Vice President, Community Development and Engagement

Michael leads our efforts to promote the economic resilience and mobility of low- to moderate-income individuals and communities across the Ninth Federal Reserve District. He has conducted research and published articles on affordable housing, community development corporations, homeownership disparities, and foreclosure patterns and mitigation efforts.

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A super model: New secured transaction code offers legal uniformity, economic promise for Indian Country

A recently completed model law that covers a type of commerce called "secured transactions" could provide the legal structure and consistency American Indian tribes need to facilitate borrowing from off-reservation partners or other tribes.

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AUTHOR

Paula Woessner

Senior Publications Editor, Community Development and Engagement

The importance of a community's physical infrastructure is plain to see. A half-completed road or unsound bridge can isolate a town, keeping people and goods from moving freely. A community's legal infrastructure is just as essential, though far less visible. Without adequate laws to support its commerce and other affairs, a community cannot inspire confidence in outside parties, and its economy suffers.

A case in point: Access to affordable credit is limited on many American Indian reservations due to the absence or insufficiency of laws protecting creditors' rights. For tribes seeking to address the issue, a solution is now available. A recently completed model law that covers a type of commerce called *secured transactions* could provide the legal structure and consistency tribes need to facilitate borrowing from off-reservation partners or other tribes.

A matter of risk

The term *secured transaction* refers to a loan or other extension of credit where a borrower gives a security interest in his or her designated personal property—that is, property other than real estate—as collateral to a creditor. If the borrower fails to repay or otherwise defaults, the creditor is entitled to take possession of the collateral. Most loans for big-ticket purchases like cars and home appliances fall in this category, as do loans to cover equipment and inventory purchases, operating costs and other essentials that keep businesses running.

State laws governing secured transactions are fairly uniformly modeled on Article 9 of the Uniform Commercial Code, or UCC. The UCC creates a consistent legal environment for commercial transactions throughout much of the U.S. The National Conference of Commissioners on Uniform State Laws (NCCUSL) drafted the UCC in the 1940s and the code was later adopted by all 50 states. (For more information on NCCUSL, see the sidebar below.)

Thanks to the UCC, the legal infrastructure for many aspects of commerce is a given in most places. The code provides uniformity among state laws, enabling efficient cross-border business to take place. Because all states have adopted Article 9, lenders and borrowers usually feel confident the law will protect their interests—even if the two parties are located in different states.

On the reservations and other tribal lands collectively known as Indian Country, it's often a different story. As sovereign nations, American Indian tribes are not subject to state law and are free to adopt their own commercial codes. As a result, tribal commercial laws—to the extent they have been adopted at all—vary in depth and breadth. Laws governing secured transactions are absent or weak on many reservations, which can make outside parties reluctant to lend to tribal entities, entrepreneurs and consumers. The uncertain legal environment introduces an element of risk. Many lenders respond to the risk in one of two ways: avoiding it altogether by not offering loans, or offsetting it by shortening loan terms and charging high interest. The situation limits access to affordable credit, which is a fundamental component of any sustainable business venture. That, in turn, hinders economic development in Indian Country.

Heightened awareness prompts a response

An increased emphasis on Indian entrepreneurship and the development of tribally owned businesses in the last decade has brought a heightened awareness of the issue. As more tribes and tribal members launch commercial enterprises and initiate partnerships with off-reservation firms, more of them encounter barriers to credit, and the importance of a sound legal infrastructure becomes more apparent.

Tribes have used a variety of approaches to address the problem. Some adopted Article 9, but did so prior to 2000, when substantial revisions were made to the act. Others have implemented Article 9 as adopted by the state in which their reservation is located. Still others have adopted discrete components of Article 9, such as those governing collection practices. While these last two approaches are better than adopting no law at all, each presents issues. The wholesale adoption of state law can lead to conflicts with tribal customs, traditions, or other tribal laws. The adoption of an isolated Article 9 creates legal gaps, because the article is an integrated part of the whole UCC and incorporates provisions of other UCC articles by reference.

In 2001, in response to the increased awareness of the need for a workable commercial legal infrastructure in Indian Country, and at the request of several tribes, a committee of NCCUSL commissioners launched an effort to draft the Model Tribal Secured Transactions Act, or Model Tribal Act (MTA). The purpose of the MTA is to provide model legislation for tribes to build sound legal infrastructures that will facilitate transactions with outside lenders, businesses and other tribes. A secondary, but no less practical, goal of the effort is to save Indian tribes the enormous legal fees they would incur if they sought to create their own secured transaction codes.

A uniform, yet adaptable, law

As drafting got under way, committee members kept a few key principles in mind. The new code should be shorter and less complex than Article 9, to facilitate the adoption process; it should incorporate provisions from other UCC articles, to make the act a stand-alone law; and, most importantly, it should be consistent with the core principles of the model UCC's Article 9 while allowing tribes the flexibility to make modifications to address specific tribal customs, laws or other needs.

Sue Woodrow, Community Affairs managing project director at the Helena, Mont., branch of the Minneapolis Fed, echoes that point. Woodrow served as an advisor to the MTA drafting committee from the outset.

"Our chief goal and challenge was to allow for customization while maintaining uniformity in the key transactional pieces of the law," she says. "The code had to be harmonized enough with UCC Article 9 to facilitate secured transactions across reservation and state boundaries, but flexible enough for tribes to make it their own."

The drafting committee comprised more than a dozen NCCUSL commissioners, all experts on aspects of commercial law. In addition to Woodrow, advisors included legal counsel for several California rancherias and representatives from 10 Indian tribes. Participating tribes included the Crow Nation, Sac and Fox Nation, Navajo Nation, Chitimacha Tribe of Louisiana, Oneida Indian Nation of New York, Cherokee Nation, Confederated Tribes of the Warm Springs Reservation, Chickasaw Nation, and Little Traverse Bay Bands of Odawa Indians.

During semiannual meetings, frequent conference calls and countless e-mail exchanges, MTA committee members and advisors examined every line of the UCC's Article 9, plus several interrelated UCC articles, and gradually pieced together the new code. As they worked through each section, committee members created case studies to test what they had drafted, then presented the scenarios to the whole group for debate. In Woodrow's view, the approach was invaluable.

"The process produced sound results and demonstrated the benefit of doing this with a large group," she recalls. "A number of our debates raised scenarios and issues that no single person could have thought of."

Inconsistencies and adaptations

The greatest amount of debate centered on issues where tribal policies, traditions or other laws were inconsistent with the UCC. One example is *self-help repossession.* As adopted by the states, the UCC provides that if a borrower fails to make loan payments—on an auto loan, for example—the financing company can repossess the car on its own, without working through the court system, so long as it does not breach the peace. The practice is controversial in Indian Country, where repossession practices by outside companies on some reservations have been deemed unreasonable or even abusive. In acknowledgement of the issue, the MTA does not provide for self-help repossessions and instead requires creditors to work through tribal courts. However, for tribes that do want to allow self-help repossessions, alternative language is available.

Fixtures are another example. Fixtures include things like furnaces or kitchen sinks that start out as freestanding items and are later attached to real property such as homes or land. Upon their attachment, they become hybrid items—part personal property, part real property. In most places, land is simply bought and sold, and the fixtures go with it. Not always so in Indian Country, where much of the land is held in trust by the federal government and cannot be sold or otherwise encumbered, such as with a security interest, without special permissions. To avoid issues related to trust land, the MTA excludes property that is not freely transferable, or *alienable,* from its scope.

As they incorporated adaptable language into the MTA, NCCUSL committee members exercised some adaptability of their own. During the drafting process, they took the unusual step of creating a practical guide to ease comprehension and adoption of the code.

"Commercial law is so complex," explains Woodrow, who chaired the task force that drafted the guide. "Some of the issues are extremely difficult for lawyers who've specialized in this field for years to sort out. As we drafted the code, the need for an accessible guide to the law became apparent."

The resulting *Implementation Guide* features plain-language commentary on each provision of the code. It also discusses UCC filing system options for tribes, incorporates a model filing system regulation and raises important policy issues for tribal legislatures to consider. The guide's drafters hope it will serve as a resource for tribes and an educational tool for the legal community.

Spreading the word

The committee finalized the MTA in August of 2005, after four years of drafting. Currently, committee members and advisors are promoting the code at every opportunity. Woodrow alone has given more than 20 presentations on the MTA at various community development and Indian economic development conferences and workshops, and at educational sessions for state agencies and the legal community. The Minneapolis Fed is partnering with NCCUSL and regional tribal organizations to develop a legal curriculum for training tribal judges and attorneys who will be working with and adjudicating issues under the MTA. The curriculum's drafters hope to roll it out at regional training events in the first half of 2006.

Promotional efforts by organizations outside of NCCUSL and the Federal Reserve are at an early stage. The U.S. Department of the Interior's Bureau of Indian Affairs recently began providing MTA implementation funding to tribes, to help them cover the costs of legal counsel or other needed assistance. Financial institutions, which have a potentially huge stake in the expansion of lending to Indian Country, have expressed some interest in promoting widespread adoption of the code.

Initial tribal responses to the MTA are positive. A number of tribes have expressed strong interest in the act or are already taking steps toward implementing it. Processes and time frames for adopting new laws vary from tribe to tribe; in many cases, a tribe's governing body must first carefully review and discuss the code in order to resolve any policy issues, and then pass a resolution of adoption. Depending on their bylaws or constitutions, tribes will then be ready to either adopt the code or put the question up for vote in a public referendum. For a given tribe, the whole process could take months from start to finish.

The Crow experience

The very first tribe to pursue MTA implementation happens to be located in the Ninth District. Leaders of the Crow Nation of Montana, who served on the NCCUSL committee's advisory group, first became aware of the MTA three years ago when the tribe's economic development director, Shawn Realbird, attended a conference featuring a presentation by Woodrow on NCCUSL's MTA drafting effort. The act's promise of uniformity struck Realbird, who was searching for a commercial code to fit the Crow Nation.

"Uniformity is one of the primary objectives of economic development," he asserts. "For an Indian tribe, uniformity will eliminate insecurity on the part of investors, lending institutions, financial people, attorneys and anyone else who's involved. It ensures that contracts, documents and agreements are consistent. It's the focal point."

Realbird expressed his interest in the MTA to Woodrow, who later invited him to join the NCCUSL effort as an advisor. He provided feedback and cultural insights for the remainder of the drafting process.

The Crow Nation's executive branch submitted the MTA to the tribal legislature for approval on July 18, 2005—"before the ink on the act was dry," recalls Realbird. The full, 18-member legislature then sent the act to its judicial committee for discussion. During regular meetings over several months, the committee has been examining the act bit by bit, talking through issues related to self-help and court-ordered repossessions, investors' rights and other matters.

According to Realbird, legislators have been receptive to the MTA—after they got over the initial shock of paging through the document.

"The act is over a hundred pages long, and there's a lot of complex information to comprehend. It must have seemed overwhelming to them at first. Once we started going over it paragraph by paragraph, they became more comfortable with it."

The Crow Nation's discussions of the MTA feature an extra layer of complexity. All of the tribe's official business is conducted in the Crow language, and Realbird has to translate the act's legal terminology from English to Crow, using culturally relevant phrases to convey terms like *interest rate* and *collateral*, which have no counterpart in the Crow tongue.

"It's extremely hard to translate these terms into something that's meaningful in our language," he says. "Many times, I have to explain something three or four ways before the concept is clear."

Realbird anticipates the legislature will vote on the MTA soon, which could enable him to meet a March 15, 2006, implementation deadline set by Crow Nation Tribal Chairman Carl Venne.

Passage of the act would mark the end of a "big, long process" and, Realbird predicts, the beginning of a new era of prosperity for the Crow Nation. The basis of his prediction? Location, location, location. The Crow Reservation covers a vast chunk of southeastern Montana, close to Yellowstone National Park, the City of Billings, the Black Hills and the junction of Interstate 90 and State Highway 212—two corridors that carry heavy tourist traffic for much of the year.

"With commercial laws in place, the Crow people will be able to provide services and businesses to capture that traffic," says Realbird. "We'll have hotels, restaurants, art shops, catering companies, horse rentals and culture-based businesses like Indian dance groups. The Crow Reservation will turn into another Jackson Hole."

Realbird's vision includes opportunities to tap some of the reservation's natural resources.

"We're one of the last markets in the U.S. that's never been explored for its energy reserves. We have 2.5 million acres of property, and it contains oil and gas deposits, 17 billion tons of recoverable coal and trillions of cubic feet of coal bed methane. When we have a commercial code, energy companies will be able to invest here. It'll enable us to assist the U.S. by developing and selling energy, to help bring down prices for consumers."

Next steps for the Crow Nation include working to adopt additional commercial laws, to create a more comprehensive legal framework for the reservation. As Realbird observes, "One law needs another in order for economic development to happen."

Putting the wheels in motion

Tribes with their own visions of economic development are starting down the same path the Crow Nation is following. Other tribes moving to consider or implement the MTA include the Chippewa-Cree Tribe of Rocky Boy's Reservation, Eastern Shoshone and Northern Arapaho Tribes of the Wind River Reservation, Sac and Fox Nation, Confederated Tribes of the Warm Springs Reservation and Oglala Sioux Tribe.

As tribal legislatures begin the painstaking process of reviewing and discussing the MTA's provisions line by line, they are helping strengthen the commercial legal infrastructure of Indian Country, tribe by tribe. And once a strong infrastructure is in place, tribal communities may finally be able to realize their full economic potential.

In Realbird's words, "Economic development in Indian Country is like a Ferrari. When we get commercial codes in place, we can turn the key in the ignition, and the wheels of commerce can start moving forward. More people will become involved in the economy by selling or purchasing goods. Once those wheels are moving, there's no way the car can stop and stall. It's just a matter of starting it."

For more information on the MTA drafting effort, contact Sue Woodrow at (406) 447-3806 or susan.woodrow@mpls.frb.org. To access the MTA and accompanying Implementation Guide, *visit www.nccusl.org/Update/ and click on "Final Acts & Legislation."*

As it becomes available, information on MTA implementation training sessions will be posted on the Community Affairs calendar.

NCCUSL basics

The National Conference of Commissioners on Uniform State Laws (NCCUSL) is a nonpartisan governmental organization that drafts and promotes model laws to ensure legislative uniformity among states. NCCUSL consists of more than 300 lawyers appointed by the 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. Members serve without compensation, donating their time to the conference. The organization's operating costs are covered by state appropriations, with some funding from the American Bar Association, the American Law Institute, and foundation and federal grants.

Although NCCUSL is little-known outside legal circles, its laws affect many aspects of Americans' personal and financial lives. Since its founding in 1892, the conference has created more than 250 model codes that govern nearly all types of private civil affairs, such as commercial transactions, family and domestic relations, probate and trusts, and real estate.

For additional information, visit www.nccusl.org/Update/.