



An Interview with
**Laurence H.
Meyer**

Board of Governors
Federal Reserve System

Governor Meyer addresses the role of monetary policy, the banking industry and community partnerships in community reinvestment and economic development.



PERSPECTIVES: Why do you consider lending partnerships among banks, non-profit organizations and, at times, local government important to the future of community and economic development?

GOVERNOR MEYER: The concept of community and economic development has changed over the years. The rehabilitation or production of affordable housing units, though important, is hardly considered sufficient. Community development encompasses community building, which requires community leadership and participation and much more comprehensive strategies. Rebuilding neighborhoods and communities entails helping create economic value and economic opportunity through job creation, training and services for those of limited means.

The ongoing budget debates have raised the question of how to use federal dollars more effectively. One objective is

to obtain the most public benefit for the fewest federal dollars. Public/private partnerships can leverage these limited subsidy funds and significantly impact the growth and development of a local community or neighborhood.

Large federal programs for this purpose are probably a thing of the past. Public policy now emphasizes decentralization; community and economic development programs must now reflect local solutions to local problems and private sector participation, assisted at times by governmental agencies. Years ago the majority of funds for community development were public funds, and most of the key players were governmental, especially local and state housing or economic development agencies. The few nationally driven and financed housing programs and housing rehabilitation resources could not really address the individual and unique needs of a community.

A partnership of neighborhood residents, nonprofit development groups and the public and private sectors that attacks neighborhood problems on a comprehensive basis is now the key to successful community and economic development.

PERSPECTIVES: What is the role monetary policy can and cannot play in promoting affordable housing and economic development?

GOVERNOR MEYER: Monetary policy can, at least indirectly, make a substantial contribution to affordable housing by pursuing price stability and maximum sustainable employment—the dual mandate that Congress has established for the Federal Reserve.

By promoting price stability, mone-

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There's No Place Like Home

Title I Home Improvement Loan Program



Lawrence George and his wife Ruby (center) show off their new front door, which was one of several improvements the couple made with the help of a Title I home improvement loan.

Greg Williams (left) of Arlington National Bank helped George obtain the loan. At right is William Oliver, rehab consultant with Fannie Mae.

Lawrence George, a mechanic for the Tandy Subway Co. in Fort Worth for the past two years, had no mortgage on his southeast Fort Worth home. However, the house needed extensive repairs, and George wanted to do some remodeling. He needed \$16,320 to repair the foundation, replace the roof, install new windows and doors, enclose a porch, pour a driveway and add a carport.

George was able to borrow the money from Arlington National Bank in Arlington, Texas, through the Federal Housing Administration's (FHA) Title I program. Title I is a loan guarantee for 90 percent of the loan amount.

As part of the National Housing Act

of 1934, Title I was created to help creditworthy homeowners obtain financing for up to \$25,000 worth of home improvements with up to 20 years to repay. The interest rate is negotiable, depending on the current market rate. While Title I loans are available to borrowers of all income levels, according to Greg Williams, vice president of Arlington National Bank, most of his bank's Title I customers earn less than 80 percent of the median family income.

"Many times, Title I customers simply do not have enough equity in their homes to borrow from conventional sources for home improvements," says Williams, "and some properties need more renovations than their appraised worth can justify in a conventional home improvement loan. In other instances, applicants may have blemished credit for something beyond their control, like large medical bills or being laid off. With Title I, we have more flexibility in making loans."

According to Williams, Arlington National has averaged \$1.5 million worth of Title I loans per month since starting the program in July 1997. As a "local relationship bank," most of Arlington National's Title I customers are referrals from local contractors and the bank's network of lenders from other financial institutions.

"Of course, these loans are not without risks," cautions Williams. "They require a lot of paperwork to complete the whole package. And if you don't pay close attention to every detail in preparing the documentation, your bank could be on the hook for the whole amount of a failed loan."

Two years ago, Fannie Mae began purchasing FHA Title I home improvement loans from lenders approved to sell and service second mortgages and Title I loans, thus providing the lender with the means for making more Title I loans. Fannie Mae purchases 100 percent of the loan, including the lender's liability, on one- to four-family homes (excluding

manufactured homes), provided the loan does not exceed \$25,000.

With the median age of existing homes now passing the quarter-century mark, according to Fannie Mae, much of the nation's housing needs refurbishing. And a considerable number of homes in need of repair belong to low- to moderate-income families who may not have access to conventional means for financing rehab projects.

George's home is in the Polytechnic Heights area of southeast Fort Worth. The area was established in 1890 when the founding fathers of Polytechnic College (now Texas Wesleyan University) subdivided land around the college to establish a townsite, according to Quentin McGown of Texas Wesleyan University. Sale of the property was to pay for building the college. The townsite was incorporated as Polytechnic Heights in 1914 and remained a separate city until being annexed by Fort Worth in 1922. Most of the two-bedroom, one-bath frame houses average 1,100 to 1,500 square feet and were built between 1915 and 1935.

In the 1960s, many aging first-generation owners moved, and their children turned the homes into rental property. In the mid-1970s, Fort Worth experienced an apartment building boom. To entice renters, apartment complexes offered perks like the first month's rent free and all bills paid. Roughly 40 percent of the Polytechnic Heights population moved out, leaving many houses vacant. As with many abandoned properties, drug and gang activity moved into the empty houses, continuing the neighborhood's downward spiral.

Polytechnic Heights reached its lowest point in the mid-1980s. Then the city and nonprofit rehab developers began focusing their attention on the area with a number of law enforcement and community revitalization programs. Financial institutions, including Arlington National Bank, began making home improvement loans in the area, and young families are

beginning to move into the neighborhood.

The neighborhood is showing other signs of new life. A major bank opened a branch in the area, and a large supermarket chain plans to build a store in a new shopping center nearby. Fort Worth recently announced plans to focus development efforts on the southeast quadrant of the city, which will mean significant infrastructure upgrades to streets and sewers.

"The Title I program is a good tool for revitalizing and stabilizing neighborhoods that might otherwise just continue to deteriorate when owners can't afford to refurbish aging properties," says William Oliver, rehab consultant with Fannie Mae. "We're promoting the program with other lenders in the community because we've seen the positive effect it's had in places like Philadelphia and Los Angeles." ▀

Fast Facts

Title I Home Improvement Loan

Lawrence George had no mortgage on his home in the southeast Fort Worth neighborhood known as Polytechnic Heights. However, the house needed extensive rehabilitation, including repairs to the foundation and a new roof, windows and doors. Arlington National Bank made a home improvement loan using a Federal Housing Administration Title I, 90 percent guarantee. The loan was sold to Fannie Mae.

Arlington National Bank \$16,320 loan
(240 months at 12.9 percent interest)

**Federal Housing Administration
Title I Loan Guarantee** Guaranteed 90 percent of the loan

Fannie Mae Purchased 100 percent of the loan from
Arlington National Bank

For more information: **Arlington National Bank**
(817) 548-3195
Fannie Mae
(972) 773-7466
HUD Customer Service Center
(800) 767-7468
<http://www.hud.gov/handbook.html>



Williams, Oliver and George check the new carport, another improvement funded by the Title I loan.

Mastering the Plan

Developing a New Community

McAllen Affordable Homes Inc. (MAHI) has reached a milestone by selling the last of the 240 residential lots in its largest affordable housing development to date—Los Encinos (The Oaks). MAHI is a nonprofit organization that specializes in rehab construction and building of affordable homes. The present organization grew from McAllen Affordable Services, a rehab company formed in 1976.

In 1993, MAHI had just finished

developing sites for a 94-home subdivision in south McAllen. The lots had sold in less than a year, an indication of the need for affordable housing. “The MAHI board had already identified a 60-acre tract of sorghum and sunflowers in a geographical area known historically as the *colonia* Los Balboas as the site for its next affordable housing development,” says Robert A. Calvillo, executive director of MAHI. The land was located adjacent to a 27-acre tract the McAllen Independent

School District had chosen as the site for a new elementary school.

MAHI Chairman Glen Roney—who is also chairman of Texas State Bank of McAllen—negotiated to acquire the Los Encinos site at an attractive price. With 60 acres, MAHI had room to develop more than just houses. So the MAHI board worked with the city, community groups and the school board in developing a concept for a planned community, complete with the school, affordable homes, a park and a library.

When Randy McClellan, chairman of the Rio Grande Valley Region of Chase Bank of Texas, succeeded Roney as chairman of the MAHI board in September 1993, he continued the

process of developing a master plan by visiting with leaders in south McAllen and hosting public gatherings to involve the community in planning the development.

Paul Moxley, president of Texas State Bank and Roney’s replacement on the MAHI board, led negotiations with the city to provide some improvements necessary to the development. MAHI donated 20 acres, and the school district donated seven acres for the park, which includes lighted baseball and soccer fields, tennis and volleyball courts, a swimming pool and other amenities.

MAHI broke ground on Los Encinos in June 1994, and construction began that September. The typical family qualifying for a home in the development earns an average of 62 percent of the median income for the area, and some families earn less than 50 percent.

With a \$500 down payment toward the purchase of a lot, many hard-working, low-income families take the first step toward realizing the dream of owning their own homes. MAHI finances the remaining \$5,100 of the lot’s price for three years at 5 percent interest. If at the end of 18 months applicants have been able to reduce the balance on their lot loans to roughly \$2,500, they can apply for a mortgage to cover both construction and any amount they still owe on their lot. MAHI makes the original 20-year mortgage to qualifying applicants using funds from the U.S. Department of Housing and Urban Development’s HOME program. Upon completion of the home, MAHI sells about half of the loan amount to a participating bank. To date, Chase Bank of Texas, Laredo National Bank and Lone Star Bank have purchased most of the loans.

Although MAHI uses less stringent underwriting standards, applicants must demonstrate sufficient income to support the debt and have maintained an adequate credit history. Using the equity accumulated in the lot as a down payment, the applicant pays no points, and

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Robert Calvillo, executive director, McAllen Affordable Homes Inc., and Paul Moxley, president, Texas State Bank, look over a copy of the plan for the Los Encinos affordable housing development in McAllen, Texas.

Capital from the Capitol

*New funding source for
Texas' small- and medium-sized
businesses and nonprofit
organizations*

The Texas Legislature recently enacted a bill establishing the Texas Capital Access Fund, which makes obtaining credit easier for small- and medium-sized businesses and nonprofit organizations. These businesses may lack sufficient collateral, or they may not have been in operation long enough to qualify for conventional financing. The Texas Capital Access Fund is not a loan guarantee program; rather, it creates a new type of loan-loss reserve account to which the borrower, the lender and the state contribute. The fund is similar to programs currently being used in 20 other states.

Upon origination of a Capital Access loan, the borrower pays a standard loan fee, a risk-adjusted interest rate plus a Capital Access fee of 2 percent to 3 percent of the loan amount. The Capital Access fee is paid into a loan-loss reserve account that is owned and operated by the state and set up in the lending bank. The amount of the fee is negotiated with the lender based on the risk associated with the loan. The lender also contributes an equal amount to the loan-loss reserve account. Then the state will, at a minimum, match 100 percent of the borrower's and lender's contributions with money from the Texas Capital Access Fund—up to \$35,000 for a single loan and \$150,000 for a single bor-

rower over a three-year period.

The Texas Capital Access Fund offers advantages for both the borrower and the lender. "The beauty of the program is that 'near bankable' businesses can have access to lines of credit as well as term loans," says Ted Sparks, senior vice president of Wells Fargo Bank's North Texas Business Lending Division. The Wells Fargo Bank in San Antonio made the first loan after Texas Capital Access funds became available this past October.

"The cofunded loan-loss reserve account created by the Texas Capital Access Fund allows us to use underwriting guidelines that are more flexible than our conventional guidelines, which will allow us to say yes to more small-business loan requests," says Sparks.

Lenders using the program make all the credit and pricing decisions, so there is no waiting for outside approval, and paperwork is minimal. Lenders fax a one- or two-page loan enrollment form to the state.

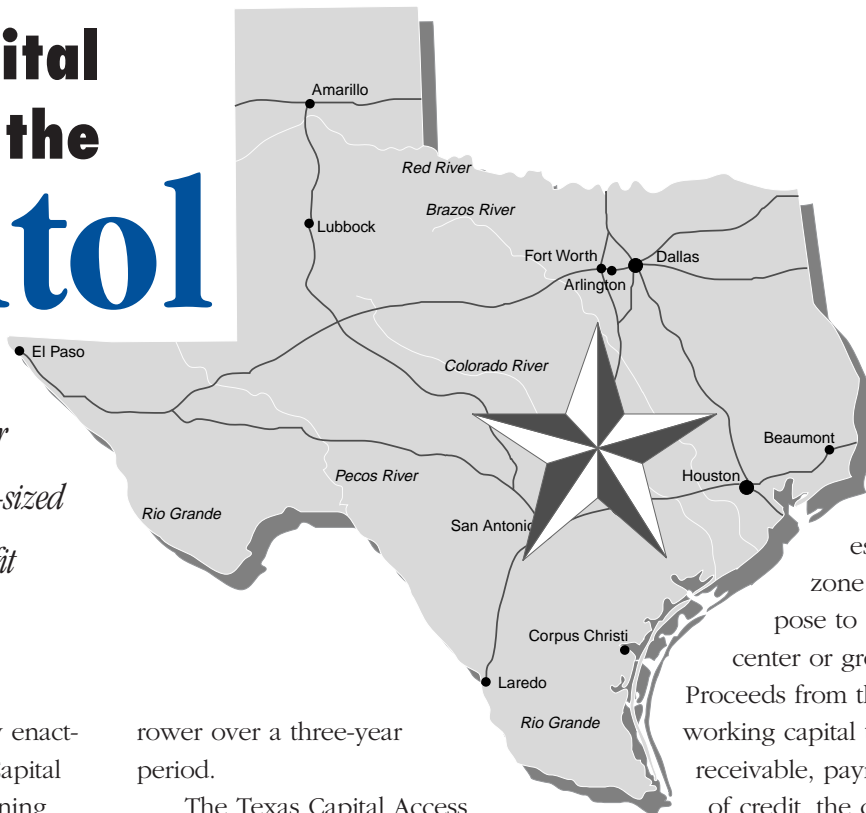
Eligible borrowers are nonprofit organizations and businesses with fewer than 500 employees that do not qualify for conventional financing. The businesses must either be headquartered in Texas or at least 51 percent of their employees

must be located in the state. Special consideration is given to businesses and nonprofits that are either located in an established enterprise zone or operate, or propose to operate, a day care center or group day care home. Proceeds from the loan may provide working capital to cover accounts receivable, payroll, inventory, lines of credit, the cost of exporting and other financing needs. Or they can be used to purchase, build or lease buildings and equipment.

As the lender makes more Texas Capital Access loans, its loan-loss reserve account grows. The lender can access money in the loan-loss account only to cover actual losses from defaults. The state withdraws the interest on its contributions to cover the costs of promoting and administering the program. Any of the withdrawn portion not used goes into the Texas Capital Access Fund.

Billiecarole and A.L. Simmons, owners of Pump Movers in San Antonio, were the first to receive a loan under the Texas Capital Access Fund. They received a line of credit to replace the 1982 truck and equipment they use to install the fresh- and waste-water pumps they sell to municipalities. Although their business did not meet the eligibility requirements for a conventional loan, under the new Texas Capital Access Fund Wells Fargo could grant them the credit they needed.

For additional information, contact: Texas Capital Access Fund, Texas Department of Economic Development, (512) 936-0269. **D**



Meyer *Continued from page 1*

tary policy can keep nominal interest rates low. Most forms of spending depend primarily on real interest rates, but the housing market is, to a large extent, affected by nominal interest rates, which can affect the ability of potential homeowners to qualify for and maintain mortgage loans. Nominal interest rates rise and fall in response to changes in inflation expectations, so the pursuit of price stability directly contributes to lower mortgage interest rates.

To the extent that the Federal Reserve is successful in helping maintain maximum sustainable employment, it will contribute to a healthy economic environment of stable and high levels of income and employment. During these times, monetary policy contributes significantly to affordable housing and economic development initiatives. Clearly, recessions and periods of high unemployment increase economic stress and exacerbate affordable housing problems.

“Monetary policy cannot directly relieve social problems.”

However, it is important to remember that there are limits to what monetary policy can do. Monetary policy cannot directly relieve social problems. In particular, monetary policy cannot target specific segments of the income distribution, individual regions or communities, or particular sectors of the economy. Deteriorating neighborhoods, poor housing conditions, overcrowded schools or schools in bad repair, crime and drugs are problems that are best addressed and resolved by local community action.

The Federal Reserve would exceed the limits of what monetary policy can do if it were to raise or lower interest rates to support social goals. Currently the U.S. economic performance is outstanding. We have an excellent combina-

tion of healthy growth, low inflation, low unemployment, a growing stock market and a declining federal budget deficit. But there are challenges even during the “good times.” One challenge is to determine the risks associated with the current environment and ascertain the optimum position for monetary policy to ensure the continuation of current economic conditions.

PERSPECTIVES: What are your observations regarding the data on small-business lending that were recently released to the public?

GOVERNOR MEYER: The Community Reinvestment Act (CRA) of 1977 was revised in 1995 to make CRA assessments less burdensome and more performance based. The revised CRA requires larger commercial banks and savings institutions to collect and report data pertaining to the geographic distribution of their small-business and small-farm lending.

The 2,078 lenders reported 2.4 million small-business loans, totaling \$147 billion, which follow the distribution of the population and businesses across census tracts. The majority of the small-business loans were made in central cities and suburban areas, but most were extended in business rather than residential areas.

Conclusions from these data should be drawn with caution due to the limitations and challenges that currently exist in evaluating and assessing the data. It is important to note that the data do not reflect all small-business lending activity. Small banks are not required to report lending activity. Additionally, the current definition for small businesses could potentially eliminate businesses that have expanded operations and are just over the \$1 million cutoff point. The data also reflect only loans originated or purchased. They do not reflect applications turned down or withdrawn by the customer, nor do they reflect small-business loans secured by property.

Additional challenges in assessing

the data include the fact that small businesses or small farms receive loans in one location but use them to support business activities in other areas. Businesses reporting a post office box as their address could also skew the data. Finally, the data only reflect credit extension, not the credit needs of any particular area.

However, these data can be very useful to the examiners in ascertaining the degree to which financial institutions are responding to the needs of the communities they serve. Examiners can use this information to measure the growth and development of future programs. This information will also be helpful to banks and thrifts as they calculate their market share within a specific geographic location or evaluate the profitability of a product or service.

PERSPECTIVES: You have said that technology and financial innovation are combining to profoundly change the way financial institutions measure, take and manage risk. How do you anticipate these changes affecting community and economic development lending?

GOVERNOR MEYER: By using a highly creative and diverse set of financial tools and techniques to enhance access to credit, many banks and thrifts have made community development a line of business. Credit scoring is one tool currently being used as a bridge between traditional and automated underwriting. Credit scoring has significantly increased the degree to which low- and moderate-income households have access to credit. When used properly, credit-scoring systems ensure that credit decisions are based solely on risk. This means that claims of credit discrimination on the basis of race, gender, sex, creed or other prohibitive basis factors should become measurably lower as the use of credit-scoring systems increases. These systems could assist banks and thrifts in the creation of innovative lending products, including affordable mortgage loans, that will continue to increase

the access to credit.

Credit-scoring systems increase consistency and speed in evaluating the risk that may be associated with a small-business loan and may increase lending to small businesses. Lenders can make credit decisions quickly (in minutes rather than hours or days), increase the pool of available credit and develop a variety of products for small-business owners. Additionally, credit scoring has increased the level of competition, providing small-business owners greater flexibility and more options.

However, credit-scoring systems do raise some concerns. Although these systems are valuable tools, the human element provides value not found in a numeric system. Credit underwriters and loan originators have the opportunity to meet face-to-face with the customer, develop a relationship and obtain information that is critical in determining the creditworthiness of an applicant.

“Credit-scoring systems should be viewed as tools and should not be relied upon solely for the measurement of an applicant’s creditworthiness.”

Another concern about credit-scoring systems is the composition of the model used to score the credit. Most models were developed for general underwriting that traditionally has been done for middle- and upper-income individuals. Considering that there are recognized differences in underwriting loans for low- and moderate-income applicants (for example, credit and employment histories), these models may not be as effective for these applicants. In fact, there may be a need for refinements or specialization in the models used for affordable housing loans. Given these considerations, credit-scoring systems should be viewed as tools and should not be relied upon solely for the measurement of an applicant’s creditworthiness.

PERSPECTIVES: Nonbank financial services companies are growing rapidly in many communities. Given the increased lending and investment in low- and moderate-income neighborhoods by banks since the passage of the CRA, should nonbank financial services companies be encouraged to reinvest in the communities they serve?

GOVERNOR MEYER: The issue of enforcing CRA regulations on nonbank financial services companies is more complex than it first appears.

Banking is a privilege, not a right. Banks are chartered by the government and are provided guarantees in exchange for serving their communities. Both state and national charters include explicit language about serving the “convenience and needs” of the bank’s community. In effect, the CRA just reaffirms this commitment. Additionally, the charter gives banks access to government safety nets through deposit insurance, the discount window and payment-system guarantees. Without the charters issued to banks by the government, nonbank financial services companies have neither access to these safety nets nor the implied commitment to serve the community.

Since the advent of the CRA, millions of dollars of bank funds have been invested in low- and moderate-income neighborhoods. Banks have developed new products and leveraged public funds for community development as well as increased access to credit for traditionally underserved populations. On the basis of these results and good corporate citizenship, a case could be made for encouraging reinvestment by nonbank financial companies.

However, since this is a matter of social policy, the extent to which nonbank financial services companies are encouraged to reinvest in communities is a decision more appropriate for the Congress to consider. ▀

Did You Know. . .?

Appointments to Federal Reserve’s Consumer Advisory Council

The Board of Governors of the Federal Reserve System has appointed Walter J. Boyer and Gwenn Kyzer to its Consumer Advisory Council.

Boyer is president of United Central Bank, a minority-owned bank headquartered in Garland, Texas, with branches in Dallas, Houston and Arlington. It is a commercial and consumer bank specializing in niche markets, especially the large Asian populations in Texas.

Ms. Kyzer is vice president for Information Services at Experian, a global provider of consumer and business credit reporting, credit-scoring and other analytical tools, and target-marketing information and services. Ms. Kyzer’s current responsibilities include expansion of the marketing information business and fair information practice for Experian’s direct marketing business.

The Consumer Advisory Council is made up of 30 members who represent consumers, lending institutions and other sectors. Appointed for three-year terms, members meet three times annually to advise the Board of Governors on consumer issues.



Randy McClellan, chairman of the Rio Grande Valley Region of Chase Bank of Texas, hosted public gatherings to involve the community in planning the Los Encinos development.

Encinos development, MAHI won a Fannie Mae Foundation Maxwell Award of Excellence for community revitalization in 1997.

“The area around Los Encinos was virtually a

forgotten part of the city,” says MAHI’s Calvillo. “This development has helped put the focus back on south McAllen. Today more than 105 families own their own homes in Los Encinos. And although all the lots are sold, another 400 families remain on MAHI’s list of applicants.

“MAHI continues to plan other developments,” Calvillo says. “Even though we are still involved in Los Encinos, we have 30 acres under contract in north McAllen for our next affordable housing development. And we’re still scouting locations for other affordable housing ventures.” ■

the closing costs are rolled into the loan amount. Loans average \$36,000 to \$38,000, making house payments approximately \$360 per month. An important aspect of qualifying an applicant is the requirement for counseling on owning a home from a HUD-approved agency.

MAHI builds three- and four-bedroom homes featuring one and two baths, a kitchen, a dining/family room and a carport. Buyers have several options in choosing the amenities that will go into their homes. Landscaping in the standard home package includes two oak trees (*encinos*).

As a result of the success of the Los

FEDERAL RESERVE BANK OF DALLAS
P.O. BOX 655906
DALLAS, TEXAS 75265-5906



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OF DALLAS**

Perspectives

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Federal Reserve Bank of Dallas
Community Affairs Office
P.O. Box 655906, Dallas, Texas 75265-5906
214-922-5286

Gloria Vasquez Brown

Vice President
gloria.v.brown@dal.frb.org

Nancy C. Vickrey

Community Affairs Officer
nancy.vickrey@dal.frb.org

Ariel D. Cisneros

Community Affairs Specialist
ariel.cisneros@dal.frb.org

Jim V. Foster

Community Affairs Specialist
jim.foster@dal.frb.org

Bobbie K. Salgado

Houston Branch, Community Affairs Specialist
bobbie.salgado@dal.frb.org

Publications Director: Kay Champagne

Writing: Barbara Beverlin

Editor: Anne L. Coursey

Design: Gene Autry

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