

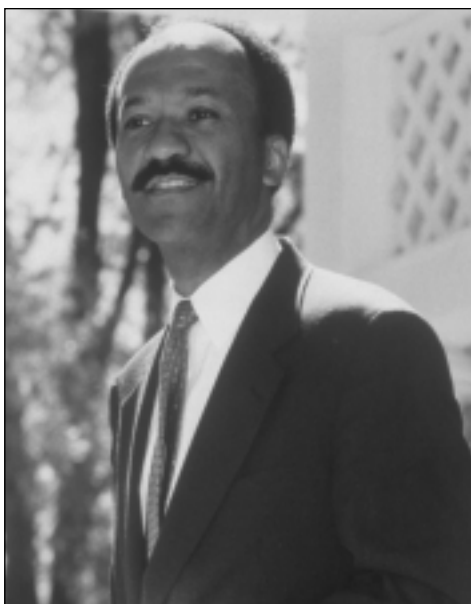


Fannie Mae and the CRA

by **Franklin D. Raines**

Chairman and Chief Executive Officer
Fannie Mae

Adapted from remarks delivered at the Community Affairs conference "Defining 'Qualified' Community Development Investments," held September 28, 1999, in Chicago. The conference was cosponsored by the Federal Reserve Banks of Dallas, Chicago, Richmond and San Francisco. Fannie Mae is the nation's largest source of home mortgage financing.



When it comes to fulfilling the promise of the Community Reinvestment Act, Fannie Mae wants to be the depository institution's best friend. As you know, Fannie Mae is not directly subject to the CRA. However, we are chartered to provide liquidity to the mortgage market to expand home ownership and meet our own percentage-of-business housing goals, which do the same kinds of things that the CRA is meant to do.

Over the last two years, we've worked with dozens of lenders to purchase loans they hold in their CRA portfolios, replenishing their liquidity so they can make more loans. We've purchased over \$3 billion in CRA loans so far, and our objective is to purchase at least \$10 billion of such loans by 2002. More than that, we have a range of CRA initiatives that can help with both the lending test and the investment test in ways that will make business sense to lenders.

CRA loans are not just special loans. Indeed, last year 25 percent of all the loans Fannie Mae bought were for people with incomes at or below 80 percent of the median income. So our everyday activities can become the foundation of a very strong CRA program, which can then be supplemented to meet local needs.

We've also done a number of things with very creative bankers. For example:

- CRA-targeted mortgage-backed securities trades. Through our desks, we identify loans from a target area and put them in a mortgage-backed security that we guarantee to lenders. It becomes a highly targeted investment for the bank. We've done \$1 billion of these so far.

- Real estate mortgage investment conduit (REMIC) securities structured around nonstandard loans with unusual credit characteristics. We've done over \$1.3 billion of special REMICs with lenders in connection with the CRA, plus bulk purchases of seasoned CRA loans from lenders.

Credit-Risk Management

Beyond our CRA commitment, we expand affordable home ownership through our basic business of managing credit risk on mortgages. Our credit-risk management involves trying to hold down the likelihood of loan failures. We've gotten this pretty much down to a science. Using a lot of different tools and technologies, we've managed to drive our credit losses to the lowest levels in our history while expanding access to financing to people who have smaller down payments, weaker credit and lower incomes.

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Helping Businesses Find Financial Resources

Dumas M. Siméus says that if MESBIC Ventures Holding Co. (MVHC) didn't exist, some well-known restaurants would go without his meats, soups, mozzarella sticks, casseroles, vegetables, chicken-fried steaks and fritters. In 1996, MVHC furnished the financial meat and potatoes for Siméus to acquire a Texas business and turn it into Siméus Foods International, the country's 11th largest black-owned corporation. (The *M* in MVHC—MESBIC—stands for “minority enterprise small business investment corporation.”)

From a 140,000-square-foot headquarters in Mansfield, near Dallas, Siméus Foods International's 350 employees make key menu items for national restaurant chains, including Denny's, Taco Cabana, TGI Friday's and Church's Chicken. For some restaurants, Siméus, whose annual revenues top \$160 million, is the sole provider of major menu items.

Dallas-based MVHC provides long-term venture capital to well-managed and growing businesses owned and managed by Hispanics, African-Americans, Indian-Americans, Native Americans and Asian-Americans, says Don Lawhorne, the company's president and CEO. “Life is a series of magnificent opportunities brilliantly disguised as problems,” and hard-to-find capital is one of them, he adds.

The Haitian-born Siméus was president and CEO of Beatrice International Foods, then the country's largest African American-owned corporation, when he

hooked up with MVHC. In pursuit of an opportunity to operate his own business, Siméus left Beatrice and moved to Dallas in 1992 so he and Lawhorne could search for a company to buy. After looking at more than 100 businesses, Siméus acquired Portion-Trol Foods in Mansfield and renamed it.

As lead investor, MVHC worked closely with Siméus in 1996 to put together the agreement and raise the capital for Siméus' \$57.7 million acquisition of Portion-Trol. Siméus and MVHC brought together five other venture capital firms to provide an equity investment of \$13.7 million, including \$2.8 million from MVHC. Two years later, MVHC's investment climbed to \$3.1 million.

In partnership with Siméus, MVHC

provides oversight for the company's finances, and the two organizations work together to develop strategy. Three Siméus representatives and two investors, including one from MVHC, make up the Siméus Foods board of directors.

Lawhorne says Siméus' goal is to deliver competitive returns on private equity investment, which Lawhorne adds would typically exceed 30 percent.

MVHC plans to exit Siméus Foods to look for other opportunities once Siméus is recapitalized through merger or acquisition in about two or three years. MVHC usually stays with a company for five to seven years to get a healthy return on its investment.

MVHC meanwhile has continued building a pool of funds, thanks to its investors. The additional funds give MVHC the chance to invest in and expand larger, more competitive firms, such as Siméus Foods.

Looking for High-Growth Companies

MVHC's assets exceed \$80 million, making it the country's largest minority-focused venture capital firm. Started in 1970, the company is also the country's oldest minority enterprise small business investment corporation.

MVHC looks for high-growth enterprises that can produce significant cash flow



Richard Vinegar (left) and Don Lawhorne (right) talk strategic planning with Dumas M. Siméus, whose Siméus Foods International is the country's 11th largest black-owned firm. Vinegar is senior vice president and Lawhorne president and CEO of MESBIC Ventures Holding Co.

Fast Facts

MESBIC Ventures Holding Co. (MVHC) is the country's oldest minority-enterprise small business investment corporation. MVHC provides long-term venture capital to well-managed, growing businesses owned and operated by minorities. MVHC was the lead investor in Dumas M. Siméus' 1996 acquisition of Portion-Trol Foods, which had a 140,000-square-foot food processing plant in Mansfield, Texas. Siméus Foods International has annual sales of more than \$160 million. In 1998, Siméus acquired Fast Food Merchandisers in Forest City, N.C.

Purchase: Portion-Trol Foods	\$57.7 million	
Sources:		
Senior term debt	\$36 million	
Senior revolving debt	\$3 million	
Seller paper	\$5 million	
Equity	\$13.7 million	
Total		\$57.7 million

(Senior debt is provided by a syndicate that includes three MVHC shareholders: Chase Bank, Wells Fargo Bank and Frost National Bank. The equity investors include Dumas M. Siméus, who invested \$700,000; a consortium of specialized SBICs led by MVHC; and the Texas Growth Fund.)

Uses:		
Purchase price	\$55 million	
Transaction costs	\$2.7 million	
Total		\$57.7 million

For more information:

MESBIC Ventures Holding Co.
(972) 991-1597, www.mvhc.com

Venture capitalists like MVHC provide a highly disciplined structure to start or expand businesses. MVHC is successful because its investment strategy emphasizes growing firms, capital gains, top-flight management talent and large-scale, minority-owned businesses.

and profits. The venture capitalists focus on companies with:

- a proven management team;
- products and services not subject to obsolescence;
- at least 12 straight months of profitability;
- primary operations in Texas, Oklahoma, California, New Mexico, Colorado, Arizona, Arkansas or Louisiana;
- a written business plan; and
- an ability to provide investors financial returns of more than 30 percent annually.

MVHC invests in electronics companies; suppliers for the communications, telecommunications, aerospace and auto industries; broadcast properties; and food processors. MVHC participates in the Small Business Investment Company

Program, created by Congress in 1958 to fill the gap between available venture capital and the needs of small firms.

The program's Small Business Investment Companies (SBICs) are profit-motivated organizations that provide equity capital, long-term loans and management assistance to qualifying small businesses. To support their growth, these emerging companies require equity or equity-type capital that often exceeds what traditional, asset-based credit would provide. The SBIC program addresses this need, particularly for businesses requiring financing from \$300,000 to \$5 million.

Venture capitalists can supplement their own private investment capital with funds borrowed through the Small Business Administration, which licenses and regulates the SBICs. The program includes regular and specialized SBICs;

the latter invest in minority businesses. MVHC owns two specialized SBICs: MESBIC Ventures and Alliance Enterprise Corp.

MVHC's 80 corporate shareholders include Bank of America, Sears, Sunoco, Wells Fargo Bank, Bank One Texas, Brinker International, Texas Instruments, Frito-Lay and Bank United.

The minimum investment is \$100,000, Lawhorne says.

Bank of America in Dallas and its predecessors have worked with MVHC for more than 20 years. Senior Vice President George Carter says his bank will continue with MVHC because the company spreads risks and wealth, and allows Bank of America to reach markets that have been underserved and difficult for

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Tax-Credit Opportunities

Tax-credit programs allow investors to realize return, residents to afford housing

The Texas Housing Finance Corp. (THFC), a low-income housing tax-credit syndicator, brings together investors who can benefit from the receipt of tax credits and developers who can use the investors' money to build affordable housing.

Edwina Carrington, THFC's chief executive officer, says tax credits are crucial to making low-income housing developments affordable and sustainable. From 1993 to 1998, THFC raised \$58 million to help develop 21 housing projects, including more than 1,800 new and refurbished units. "The process grinds to a halt for developers without the equity from investors," Carrington says. "The deals simply would not work. The infusion of equity also allows for lower rents, which makes the housing affordable."

To provide capital for such developments, THFC seeks investors for its funds. These funds then acquire an ownership interest in multifamily housing developments that are entitled to federal tax credits based on a state allocation. The developers get an equity investment from the fund to start and complete construction, and the investors, through the

fund, benefit from the tax credits as well as other incidents of ownership, such as depreciation and losses.

Investors in THFC's funds include Banc One Community Development Corp., Bank of America, Fannie Mae, Freddie Mac, Comerica Bank, Chase Manhattan Corp. and Wells Fargo Bank.

Carrington, bankers and developers alike point to the Tax Reform Act of 1986 as a major force in attracting investors and developers to back low-income housing programs. The Tax Reform Act created the low-income housing tax credit, allowing owners of certain affordable housing projects to earn tax credits for constructing or refurbishing housing that is rent-restricted and serves tenants of certain income levels. The tax credits are awarded over the first 10 years of a qualifying project, although the rent and tenant income restrictions must be maintained for at least 15 years. Most tax-credit units are rented to tenants who earn 60 percent or less of the area median income. Tenants are charged rents that do not exceed 30 percent of their household income, adjusted for family size.

"Tax credits put equity into the deal and allow the units to be rented below market rate," says Barry Kahn, president of Houston developer Hettig & Co., which uses tax credits to make affordable housing developments work. An example is Dayton Park, located in the community of Dayton, about 32 miles northeast of Houston.

Seeing Tax Credits Pay Off

One low-income housing tax-credit portion of Dayton Park—the first of a three-phase development—consists of 50 two-, three- and four-bedroom units that range from 800 to 1,200 square feet. All the units are handicapped adaptable. The community of single-story fourplexes sports plenty of green space, a pool, clubhouse and on-site management. From the street, Dayton Park resembles the typical single-family subdivision.

To start construction in Dayton Park, Hettig & Co. received about \$1.3 million from the Texas Housing Opportunity Fund II, one of THFC's funds. Washington Mutual financed both the construction and permanent loans.

In addition to the 50 units for low-income residents, Hettig & Co. has completed 72 market-rate units at Dayton Park and is using additional tax credits this year to build 52 more affordable housing units. The latter phase will include a 2,200-square-foot community building for the development.

The federal government allots tax credits based on \$1.25 per capita for each state. In Texas, that translates into \$21 million for this year.

Dave Wood, vice president for community development at Bank One, says banks not only realize benefits from investing in the affordable housing tax-credit fund but gain opportunities to make the construction and permanent financing loans. These benefits may include Community Reinvestment Act credit for both the investment and the loan.



Using tax credits, developers can provide affordable rental housing like these attractive homes in Dayton Park, Dayton, Texas.

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Rural Empowerment Zones

Providing sustainable community development



Melly Moroles (left) of the Rio Grande Valley Empowerment Zone Corp. and Marcy Castillo (right) of Texas State Bank display a plate of baked goods made by Julio Torres (center), who opened his own bakery in Edcouch thanks to rural empowerment zone funding.

Armed with \$280 million, banks and their community partners in the Rio Grande Valley Rural Empowerment Zone are making loans, setting up public/private partnerships and establishing job-training programs for South Texas residents living with double-digit unemployment and high poverty rates.

Since 1994, the Rio Grande Valley Empowerment Zone Corp. (RGVEZC), which administers funds in the zone, has helped start 312 new businesses and create 1,577 jobs within the area, exceeding initial expectations. Those businesses include a furniture builder, a cotton gin, a pool-table maker that received a large contract from Wal-Mart—and Julio's Bakery.

In addition, RGVEZC Chief Financial Officer Melly Moroles says the corporation has allocated more than \$6 million to area nonprofit organizations. The nonprofits have leveraged an additional \$13 million from local banks to construct or renovate at least 150 affordable housing units.

The Rio Grande Valley Empowerment Zone is one of eight such zones created in 1994 as part of the multibillion dollar national Community Empowerment Program. The seven other zones are in California, Georgia, Illinois, North Dakota, South Dakota, Mississippi and Kentucky.

Combating Double-Digit Unemployment

Empowerment zone corporations and their local partners are trying to improve the economies of some of the country's

most impoverished areas by keying on economic opportunity, sustainable community development, community-based partnerships and strategic vision for change.

The Rio Grande Valley Empowerment Zone encompasses 227 square miles in Cameron, Hidalgo, Starr and Willacy counties along the Texas–Mexico border. Unemployment hovers at more than 15 percent—nearly four times the national average—and half of the people live below the poverty line.

The RGVEZC combines its \$40 million budget with \$80 million in community development block grants, \$160 million in loan guarantees and various tax incentives to operate the following housing and business development initiatives, all designed to create sustainable development:

First-Time Homebuyer Program.

Amigos del Valle of Mission, Texas, received a \$583,600 grant to develop a revolving loan fund to leverage long-term mortgages from local conventional lending sources. To date, 12 home loans have been made, and six more are in progress.

Brownsville Housing Development.

The Community Development Corp. of Brownsville (CDCB) used a \$1.3 million grant for land acquisition and down payment assistance for 100 single-family

affordable houses. The CDCB also borrowed \$3 million for home construction from local banks.

Small Business Incubator. The RGVEZC put up \$750,000 to build a 23,000-square-foot building for business start-ups and expansions in Port Isabel, Texas. The incubator has been at or near full occupancy for the last year.

Community Investment Fund. The RGVEZC provided \$3 million for small business development loans, including 22 microloans and six commercial loans.

One-Stop Capital Shop. In partnership with the University of Texas–Pan American's Center for Entrepreneurship and Economic Development, the RGVEZC created the one-stop shop to provide technical assistance and counseling. To date, more than 1,400 people have been counseled or trained.

Job Training Program. The Valley Initiative for Development and Advancement received \$679,000 to help local businesses develop a job-training program on a demand basis. More than 165 people have received money for college, 42 have received customized job training and 81 have received basic-skills educa-

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Fannie Mae

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Along the way we've discovered that many of the "givens" about people's creditworthiness are simply wrong, outdated or unfair. For years we—the system—assumed people were unworthy for a prime rate mortgage if they didn't have cash for a 20 percent down payment, didn't have the same job and residence for a long time or didn't have an unblemished credit report. We thought multiple borrowers made for a weaker loan application. But we found a lot of this was based on anecdote. Years of experience and more refined analytical tools have proved these assumptions wrong.

As we've moved forward in affordable housing, we've also assumed our delinquencies would go up. But at Fannie Mae, our credit losses, in fact, have gone down. How is this possible? Because we intervene earlier.

People don't lose their homes because they decide not to pay. It's because they've had some life crisis—a divorce, a death in the family, a job loss. So we intervene earlier, and we work with our lenders to do that, too. We now have Fannie Mae representatives in our major servicers' offices every day, helping banks get people caught up on their loans so they can continue to own their homes. Managing credit risk more smartly has allowed us to serve more and more people and offer mortgages with down payments as low as 3 percent.

Through credit-risk management we also found we didn't need additional mortgage insurance. One of my first acts as Fannie Mae chairman in January was to roll back the mortgage insurance requirement, which has saved buyers millions of dollars and will pull even more consumers into the market.

Affordable Housing Mandate

The U.S. Department of Housing and Urban Development has established

housing goals for us that require more than half our business to serve lower-income borrowers, underserved areas and special affordable housing. Our housing mandate differs from any others in the business; it sets forth percentage-of-business goals, and at year-end we have to demonstrate we have reached them. That's a little hard when we don't originate the mortgages and we can only buy what our lenders are selling us. We think of our housing mandate as CRA on steroids. But we embrace these goals. Indeed, we've set even tougher goals for Fannie Mae.

We lead the marketplace in doing business with low- and moderate-income families largely because of our Trillion Dollar Commitment—our pledge five years ago to invest a trillion dollars by 2001 to help 10 million targeted underserved families achieve home ownership and decent rental housing. This commitment has transformed our company. We've set up a new Housing and Community Development Division and developed new products to serve families in unique situations. And we've set up Partnership Offices all over the country. By next January we'll have 44 offices open, each with a specific investment plan for

that community. We'll have \$300 billion of these investment plans around the country by January, advancing our \$1 trillion goal by pulling targeted families into the market, creating more affordable housing for them and financing their loans.

These plans include significant investment in affordable multifamily rental housing. But many families who are renting want to be homeowners and could be building equity wealth and stronger neighborhoods. They need affordable homes to buy and flexible mortgages to help them surmount financial and credit hurdles. Home ownership is a particular challenge for minorities. Minority home ownership rates lag far behind those of whites—47 percent for minorities compared with 73 percent for whites. To help close this gap, we've chosen a number of cities to roll out our minority home ownership initiative. [In the Eleventh District, Houston has been selected for this program.] And we're also helping immigrant families qualify for mortgages while waiting for their green cards.

The Next Frontier

We know there are millions of hard-working, wage-earning families out

Timely Payment Rewards for Borrowers with Past Credit Problems

Fannie Mae's new Timely Payment Rewards mortgage offers lower-cost financing options for borrowers with past credit difficulties. Qualifying homebuyers will have an interest rate 2 percent below subprime, and, after 24 months of paying the mortgage on time, the borrower is guaranteed a 1 percent interest rate reduction.

This adds up to significant savings over subprime mortgages. For example, with Timely Payment Rewards, a borrower with slightly impaired credit may be eligible for a 30-year, fixed-rate \$100,000 mortgage at an initial interest rate of 9.5 percent and a monthly payment of \$841. After two years without delinquency, the borrower's interest rate would drop to 8.5 percent and the monthly payment to \$769.

In comparison, a loan originating in the subprime market would carry an average interest rate of 11.5 percent with a \$900 monthly payment. (Note: Interest rates may vary depending on market conditions.) Thus, a Timely Payment Rewards mortgage can save homebuyers as much as \$200 a month. ■

there who would love to be homeowners and probably would qualify. As an industry we've been pretty successful in reaching out to people who are ready for home ownership. The next frontier is to prepare more people for home ownership. And the biggest single barrier many families face is credit. By attacking the credit barrier, we can find ways to avoid sending them to the higher-cost subprime markets if they can qualify for conventional financing.

We estimate that about 50 percent of families who are rejected for a mortgage or referred to the subprime market are just a notch below qualifying for the lower-cost prime-rate mortgages. Many are new Americans who have short credit histories; minority families that mainstream lenders don't know about; people with nontraditional job histories; and people who need a chance to repair their credit.

One Fannie Mae survey found that 50 percent of Americans do not know that if they chronically pay their bills late, they will hurt their ability to get a mortgage. One of our new initiatives is an educational program to help the public understand the importance of good credit to home ownership. Another is to serve some people with impaired credit through the Timely Payment Rewards mortgage program (see box).

To sum up, we think Congress made a wise decision 30 years ago when it turned the job of expanding home ownership over to an active secondary market by establishing Fannie Mae as a private, shareholder-owned company. As our mission statement says, "At Fannie Mae we are in the American dream business. Our mission is to tear down barriers, lower costs and increase opportunities for home ownership and affordable rental housing for all Americans, because having a safe place to call home strengthens families, communities and our nation as a whole." ▀



An employee of Siméus Foods International tests the temperature of meats the company will sell to restaurants nationwide.

Venture Capital

Continued from page 3

financial institutions to penetrate. He notes that Lawhorne and his associates have more than 70 years of venture capital experience.

"Bank of America is extremely pleased with the results of its investment in MVHC, recognizing a great relationship with people who really know the business and reaching an underserved market," Carter says. "The relationship is a great marriage."

Carter notes that MVHC is one of the few venture capital firms whose mission is built on community development. He adds that MVHC stands out because its investments range from \$300,000 to \$3 million, compared with other venture capitalists who won't touch anything under \$4 million.

Experts agree that venture capitalists like MVHC provide a highly disciplined structure to start or expand businesses. Timothy Bates, a labor and urban affairs professor at Wayne State University in

Detroit, notes in *Economic Development Quarterly* (February 1997) that MVHC is successful because its investment strategy emphasizes growing firms, capital gains, top-flight management talent and large-scale, minority-owned businesses. Bates adds that MVHC is a model for helping highly educated and skilled minority managers start or join entrepreneurial companies, attract equity-capital investment to those organizations and redirect corporate involvement from philanthropy to business development.

Meanwhile, Siméus is looking to the future. In 1998, Siméus acquired Fast Food Merchandisers, a 170,000-square-foot facility with 350 employees in Forest City, N.C., an acquisition that Siméus says will lead to bigger and better things. Siméus predicts that his company's revenues will reach \$1 billion through acquisitions within five years. He can dream such big dreams, he says, because of MVHC's venture capitalists. ▀

Tax-Credit Opportunities

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“Just as in all real-estate investments, you need to know with whom you are investing and whether the deal makes sense,” Wood says. “All the things you look for in a commercial loan, you look for in this.”

Wood says Bank One invested in low-income housing developments long before the Community Reinvestment Act began emphasizing investments in its performance criteria for financial institutions. He adds that Bank One will likely continue investing in such programs because they are good for the bank and the community.

For more information, contact the Texas Housing Finance Corp., (512) 469-9059. ▀

Did You Know...?

Technical Assistance Resource Guide for Small Business Owners

The Community Affairs Office of the Federal Reserve Bank of Dallas has updated its *Technical Assistance Resource Guide for Small Business Owners*. The guide lists resources that offer technical assistance and loan packaging for small businesses. The information is organized by state and by category.

If you did not receive a copy with this issue of *Banking and Community Perspectives* or if you require additional copies, please call the Dallas Fed's Community Affairs Office, 214-922-5377.

Federal Reserve Posts CRA Performance Ratings on Web

Ratings information dating back to 1990 for banks examined by the Federal Reserve is available on the web at www.bog.frb.fed.us/DCCA/CRA/crate.cfm. Ratings can be reviewed for a single bank or for a particular group of banks.

Rural Empowerment

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tion, such as English-as-a-second-language or GED instruction.

Business Incentives. In addition to capital resources, businesses locating in the empowerment zone may win tax credits, property tax reductions and employer wage credits.

Seeing Promise in the Dreams

RGVEZC leaders point to Julio's Bakery as an example of their dedication to developing sustainable communities. With more than 25 years' experience making breads and pastries, Julio Torres dreamed of owning his own bakery. But a lack of capital had flattened his ambitions.

Today the sweet smells of Mexican bread waft through the air from Julio's Bakery in the town of Edcouch. Loans from Texas State Bank, in partnership with the RGVEZC and the Small Business Administration, enabled Torres, 38, to turn his dream into a reality.

Torres' original bakery opened in October 1996. In early 1998, Torres received an interim loan of \$150,000 from Texas State Bank to cover operating costs and to build a new bakery on land he was leasing with an option to buy. A year later, the RGVEZC partnered with Texas State Bank to lend Torres another \$160,000 to buy the land and equipment. The RGVEZC provided \$64,000 of the second loan, taking a second lien. The Small Business Administration guaranteed 80 percent of Texas State Bank's loans to Torres, who is in good standing with the bank and his creditors.

The new building opened last February. Torres now employs six people.

“We saw a great deal of potential in Julio but were unable to make the loan by ourselves,” says Marcy Castillo, the bank's loan officer. “It would not have been possible without the empowerment zone and the SBA.”

For more information, contact the Rio Grande Valley Empowerment Zone Corporation, (956) 514-4000. ▀



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