FEDERAL RESERVE BANK OF DALLAS

BANKING & COMMUNITY

Perspectives

THIRD QUARTER 2000

Tapping an Untapped Market

Private–private partnership provides affordable housing for underserved market

Antonio Matarranz looks across Dallas/Fort Worth and sees a vast untapped market for his affordable houses: non-English-speaking Hispanics, a niche historically overlooked.

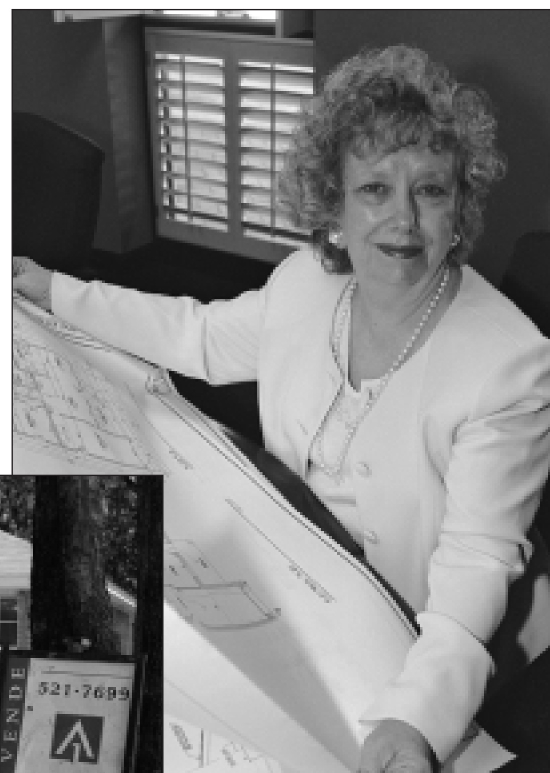
Matarranz, president of Dallas-based Avangard Real Estate Services Inc., teams with local financial institutions to offer special loan packages to potential Hispanic homebuyers who may be reluctant to seek loans because of their lack of credit history and English-speaking skills. “It is a market not being fully served, and it is continuing to grow,” he says.

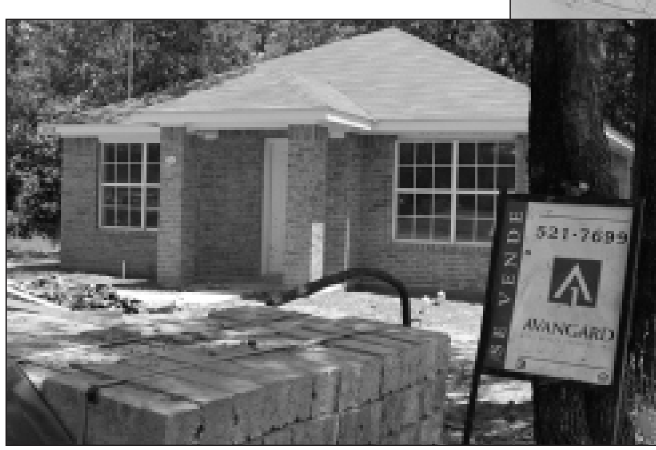
Matarranz estimates that 98,000 Hispanic families in Dallas/Fort Worth can qualify to purchase one of his 900- to 1,600-square-foot houses, which range from $70,000 to $110,000. Many of these families pay more in rent for a one-bedroom apartment than they would for a new house. Although anybody can purchase Matarranz’s houses, most of his buyers are Hispanics, many of whom hear and read Matarranz’s advertisements in local Hispanic media.

Matarranz has built more than 250 homes since starting his construction business in 1994. Last year he developed 42 houses in Dallas and eight in Fort Worth; this year he plans to complete 60 houses in Dallas and 15 in Fort Worth. Last year Avangard Real Estate Services, which Matarranz started in 1986, sold 500 homes, with an average selling price of $80,000.

Matarranz buys vacant lots in existing neighborhoods and builds brick houses with three bedrooms, two bathrooms and a one-car garage. The dwellings have

Reva Bartlett, senior vice president at North Dallas Bank & Trust, reviews building plans for one of the many houses marketed by Avangard Real Estate Services Inc.





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Fast Facts

Avangard Real Estate Services Inc. is a for-profit housing development company, real estate brokerage and homebuying seminar provider that targets Hispanics in Dallas and Fort Worth. Avangard started in 1986 and has built more than 250 houses. Last year the organization sold 500 houses.

North Dallas Bank & Trust, a $636.5 million-asset bank, is working with Avangard to penetrate the Dallas Hispanic market. The HomeStart Mortgage Program, which the bank developed, assists first-time and low- to moderate-income homebuyers.

HomeStart Mortgage Program

- ✔ A seven-year loan with a 30-year amortization
- ✔ 95 percent loan to value
- ✔ No underwriting fee
- ✔ No commitment fee
- ✔ No private mortgage insurance required
- ✔ No prepayment penalty
- ✔ Loan holders can reduce interest rate by 0.25 percent by opening a checking or savings account and opting for automatic debit of loan payments.

For more information:

Avangard Real Estate Services Inc.
(214) 521-7699

North Dallas Bank & Trust
HomeStart Mortgage Program
(972) 716-7189

central air and heat, stove, dishwasher, and washer and dryer hookups.

Educating Homebuyers and Bankers

Because he is addressing a market with special needs, Matarranz does more than build and sell homes. Educating consumers, he says, is the key to eliminating the fear of buying a house. Matarranz has developed a book that guides Spanish-speaking consumers through the homebuying process. Along with lenders, title companies, housing inspectors and real estate agents, Avangard also cosponsors free seminars for potential homebuyers.

Matarranz says he is educating not only consumers but also banks to understand more about this specialized market. More than half his potential homebuyers don't have bank accounts or established credit and use cash for their purchases. When these customers apply for a loan, he says, banks must recognize the applicants' strong work ethic and good credit risk despite their lack of credit history. In these cases, financial institutions accept nontraditional credit references, such as letters from landlords, utility firms and insurance companies, to establish a credit history.

HomeStart Mortgage Program

For four years, North Dallas Bank & Trust has worked with Matarranz to serve first-time and low- to moderate-income homebuyers who would not qualify under traditional mortgage underwriting criteria, says Senior Vice President Reva Bartlett. The HomeStart Mortgage Program (HSMP) provides seven-year loans with a 30-year amortization.

An HSMP loan, which the bank can close in about 10 days, averages $75,000 and can range up to $100,000. After seven years, a homeowner can refinance the loan or, in some cases, sell the house and purchase a bigger one. And there is no prepayment penalty. HSMP requires no underwriting fee, saving the customer about $150, and no private mortgage insurance, which reduces the homeowner's monthly payment by about $30. In addition, the program requires no commitment fee, which results in savings of up to 1 percent of the loan amount. If potential homebuyers open a checking or savings account with the bank and opt for automatic debit of their loan payments, their mortgage rate will be reduced by 0.25 percent.

The bank markets the product through homebuying fairs, Avangard's seminars, and presentations to churches and local community groups. The bank finds that these are good quality loans with a history of no foreclosures.

Other lenders that have worked with Matarranz and participated in his seminars include Compass Bank, Northern Trust Bank, Bank of America, Chase and World Savings Bank. Matarranz also teams with other companies to provide Spanish-speaking real estate, accounting, legal and insurance services under one roof.

Family-Friendly Loans

Jorge and Luz Maria Garza are excited about the house they bought from Matarranz in April. Their new home is close to where they have lived for more than 13 years. Now, they have three bedrooms, two baths and more space for their two young children—a stark contrast from the one-bedroom apartment they lived in before buying the house.

Ms. Garza says she and her husband plan to add a fence and plant flowers. "I love the space I have in our house," she says. "Our 5-year-old daughter will still be able to attend kindergarten in the neighborhood school. Just a few years ago, we wouldn't have thought we would ever have our own home."

A Circle of Ten

Veteran grant writer uses her experience to teach others

"Give me three days and I'll teach you how to write successful grant applications," Kathy Holdway confidently told a small group of people from nonprofit organizations back in 1996.

Thus, A Circle of Ten was born. The class quickly became a driving force in East Texas by helping representatives of nonprofit organizations gain skills to write effective grant applications. Holdway relies on her 16 years of experience in nonprofit grant writing to teach the topic. The class size is limited to 10, hence the name A Circle of Ten.

The course is held monthly in Whitehouse, near Tyler, and consists of two parts. During the first three-day session, participants study community and program development, types of proposals and steps in the grant-writing process. They also learn how to build meaningful contacts in the funding world, how to identify appropriate funding sources and how to rebound when their requests are turned down.

During the second three-day session, the students apply what they have learned. They work in teams to write grant proposals from start to finish. The proposals are then submitted to potential funding sources.

As Holdway, the Circle's president, puts it, "You do not have to be a professional grant writer to be successful. You have existing skills and knowledge—and you don't have to be perfect to make it happen."

Scholarships Awarded

As of May, A Circle of Ten's alumni included 372 people from 222 agencies. Since 1996, sponsors have awarded more than 300 scholarships to grant writers for the class, which costs $550. The awards range from $50 to $100, depending on need and the sponsor's criteria.

The United Way of Tyler/Smith County has given 237 scholarships. Southside Bank of Tyler has given 33. Other scholarships have come from foundations and agencies representing social services, housing, education and hospitals. Southside Bank requires that the individual focus on grants for housing, education or child care programs for low- to moderate-income families.

As the Circle's board chairman, Southside Bank Vice President James Shaw contributes his financial expertise to help the group operate as a nonprofit organization. The fact that the United Way provides scholarships "is good evidence that somebody knows it is successful," Shaw says. "These collaborations build networking and grant teams that improve the services in their communities."

Success Stories

For many participants, the classes are paying off. In 1998, agencies that sent people to A Circle of Ten won more than $5 million in grants. Grant writers for the Troup and Winona school districts each won more than $300,000 to improve reading programs at elementary schools.

Anne Payne, executive director of Habitat for Humanity of Smith County, parlayed her Circle training in 1998 into $403,250 for the agency. "A Circle of Ten helped me have more confidence in what I was doing," Payne says. "I can now go after the funds needed to build capacity."

Payne says the training helped her expand the Habitat agency—previously volunteer driven—to two full-time and three part-time employees. Since 1991, the organization has built 22 homes, with another 10 slated for completion this year. The agency now receives funds for infrastructure, land purchase and site preparation, enabling Payne to assemble groups of lots rather than use scattered sites. "We no longer build one house at a time; we build neighborhoods," Payne says.

For additional information, contact A Circle of Ten at (903) 839-8978.

Grant writers brainstorm during a Circle of Ten class. They include Christine Morawski (left) and Brian Bowman (right) of the University of Texas Health Center of Tyler and the Rev. Greg Littlefield of Family of Faith Daycare Center, Tyler.

Where Are They Now?

A Second Look at Multibank CDC–Small Business Pairings

Since its start in 1992, Banking & Community Perspectives *has profiled public–private partnerships to show how such collaborative efforts can help banks make loans otherwise outside their reach.*

Several articles highlighted how a multibank community development corporation (CDC) financed the expansion of a small business. Following up on those stories, we look at where both parties are now. We also talked with professionals in the field to gain more insight about how these development organizations are handling an ever-changing marketplace.

Sengchanh "Sam" Khamphoumanivong, owner of Sam's Auto Repair, shows Gil Gonzalez, president of SABDF, his busy garage.

Azteca Steel and Southern Dallas Development Fund

("Working Capital," First Quarter 1993)

Then

In 1993, the 2-year-old Southern Dallas Development Fund (SDDF) made 12 loans totaling $700,000 in South Dallas. Azteca Steel, a 3-year-old minority-owned firm, had won contracts to install reinforced steel for general contractors hired by the Texas Department of Transportation. Company revenues of $2 million were enough to pay its 23 employees and break even for the year, but not enough to cover payroll for upcoming contracts. A $100,00 loan from SDDF enabled Azteca to fulfill the contracts.

Now

Since its creation in 1991, the SDDF has made 86 loans totaling more than $5.7 million and leveraged an additional $6.2 million in bank loans. Combined, this has led to the creation or retention of 492 jobs. The SDDF recently expanded its lending market citywide for businesses that are minority-owned or that agree to hire low-income people.

Azteca Steel increased its revenues from $2.2 million in 1993 to $16.5 million in 1999, outpacing its annual growth goal of 10 percent. Azteca has grown to 87 permanent employees and expanded its service area to include the Dallas/Fort Worth metroplex, Houston and Austin. The company has business relationships with D/FW International Airport, the Texas Department of Transportation and Arena Group, which is building a new sports facility in downtown Dallas.

Sam's Auto Repair and the San Antonio Business Development Fund

("The Power to Move," Second Quarter 1997)

Then

In 1997, the San Antonio Business Development Fund (SABDF) loaned small businesses more than $600,000. With the fund's emphasis on equity and debt financing to underserved markets, SABDF leaders saw an opportunity when CaminoReal Bank approached them about helping finance expansion of Sam's Auto Repair, located in a low- to moderate-income neighborhood.

After three years of operating in a one-car, unpaved garage without an automotive lift, Sengchanh "Sam" Khamphoumanivong needed to move to larger quarters. With nearly $200,000 from CaminoReal, San Antonio Local Development Co. and the SABDF, Khamphoumanivong moved his operation to a six-bay garage with an attached convenience store.

Now

The SABDF has provided $2.5 million in financing and leveraged $10.2 million in bank loans since its start in 1995, creating or retaining 1,274 jobs. In the three years since Khamphoumanivong received financing for his auto-body shop, he has nearly doubled sales and added one employee.

Schlotzky's Entrepreneur Theo Rolfe and William Mann Jr. CDC

("Taste of Success," Fourth Quarter 1998)

Then

William Mann Jr. CDC (WMCDC) made 15 small-business loans totaling nearly $600,000 in 1998, creating 158 new jobs. One highlight was a financing package put together for a small-business franchise owned by entrepreneur Theo Rolfe.

Rolfe secured a prime location in southeast Fort Worth to open his second Schlotzky's franchise but needed financing for construction and operation. A Wells Fargo Bank loan that was guaranteed by the Small Business Administration and additional financing from William Mann CDC totaled $246,500. By the time "Taste for Success" was published in 1998, Rolfe had opened his third Schlotzky's location, in Weatherford, Texas.

Now

WMCDC made 17 small-business loans totaling nearly $800,000 in 1999, creating 105 new jobs. Since its start in 1995, WMCDC has made $2.5 million in loans and leveraged an additional $4 million in bank loans. Rolfe paid off his WMCDC loan in January, two years ahead of schedule. With 51 employees and annual revenues of about $2 million, he plans to open a fourth store in Dallas that he projects will create 23 jobs and increase his annual revenues to $2.75 million.

Adapting to a Changing Marketplace

For several years, banks have used multibank CDCs as a mechanism to make loans in underserved markets. The ability to make equity investments and loans to small businesses and community development projects and shared risk have made this type of financial intermediary an option for banks seeking to meet local credit needs.

Multibank CDCs vary as much as the communities they serve, but they have shared common experiences. Staff members from the San Antonio Business Development Fund, Southern Dallas Development Fund, William Mann Jr. CDC and Austin Community Development Corp. offer these tips:

- Establish a strategic plan for the organization.
- Establish performance goals and report results to board members and stakeholders.
- Develop a diverse capitalization strategy.
- Know your market; good market research is worth the investment.
- Have board members abstain when a vote represents a conflict of interest.
- Use outsourcing when it makes sense; for example, for underwriting, pre- and postloan mentoring, and loan accounting.
- Establish prudent underwriting criteria and enforce them.
- Make loans that make sense, not because of political pressure.
- Diversify loan portfolios among industries.
- Use tools like revenue-participation fees to compensate for loans with relatively high perceived risk.
- Require training and mentoring for high-risk borrowers.
- Risk-grade every loan in the portfolio every month.
- Monitor continuously. Require quarterly financial statements from borrowers and charge fees for late statements.
- Actively collect past-due accounts.

Multibank CDCs, while successful in some communities, continue to face challenges. Stiff competition for funding means organizations must be lean and efficient and have loan portfolios that operate well to attract investment. Accessing diverse sources of capital can allow CDCs to operate portfolios large enough to generate income and reduce reliance on outside funding. If multibank CDCs are to continue being considered by banks as a mechanism for penetrating underserved markets, they must be efficient, professionally managed and able to provide a return to investors.

Multibank CDC	Year of inception	Number of loans	Loan amount	Amount leveraged in bank loans	Number of jobs created and retained
Southern Dallas Development Fund	1991	86	$5.7 million	$6.2 million	492
San Antonio Business Development Fund	1994	61	$2.5 million	$10.2 million	1,274
William Mann Jr. CDC	1995	64	$2.5 million	$4 million	405

NOTES: The numbers are as of year-end 1999. The Greater Houston Small Business Equity Fund was highlighted in the second quarter 1995 issue. Its investors have since dissolved the organization. The business it provided with financing is still operating in Houston.

Community Development at a Crossroads

The following are excerpts from an article written by Lawrence B. Lindsey and published in The NeighborWorks Journal, *Winter 2000. Lindsey holds the Arthur F. Burns Chair at the American Enterprise Institute for Public Policy Research. He formerly served on the Board of Governors of the Federal Reserve.*

Lawrence B. Lindsey

In the spring of 1999, several busloads of protesters arrived at the house of Senate Banking Committee Chairman Phil Gramm. They trampled his garden and lawn, banged on his windows, harassed his wife and left his property strewn with litter. They did this in the name of "community development" and defense of the Community Reinvestment Act. Meanwhile, in hundreds of cities and towns across the country, community development professionals made homeowners out of tens of thousands of families, arranged billions of dollars in financing and changed the face of America.

These are the two faces of community development: noisy protest and quiet accomplishment. Of course, it is fair to argue that today's successes might not have been possible without the protests of the past. But that is a point about the past. Today we must look to our future.

In that future we are going to have to choose. It is not possible to credibly present oneself as a sophisticated real-estate developer capable of responsibly managing a multimillion-dollar project yet spend weekends littering a senator's lawn with toilet paper. Of course, many of today's corporate and political leaders spent their college days in protest marches. One can act one way at age 20 and another at age 40. It is called growing up.

The community development industry is growing up too…and fast. Take the Neighborhood Reinvestment Corporation as an example. Just eight years ago, when I became a Governor of the Federal Reserve and was first introduced to the Neighborhood Reinvestment Corporation and the NeighborWorks® system, there had never been a campaign for home ownership. The thought of creating 10,000 new homeowners in five years was considered extremely ambitious. In the end, however, we exceeded our expectations, creating home-ownership opportunities for nearly 16,000 families.

Back then, the number of what we now call "community development financial institutions" could probably be counted on two hands. Today, there is an awards program for CDFIs with many times that number of annual winners.

This is what growing up is all about: new missions, increased responsibilities, access, leadership and becoming a role model. Community development has become an industry. It is not just a "nice idea" anymore. It is delivering goods and services that people need and that the country needs. As long as it continues to meet those needs, to deliver as promised, it will continue to grow.

In any industry there are some people and companies that do things well. And some that do things less well. There are also some rip-off artists who seek to prey on the unsuspecting. Community development is no exception.

But some groups don't meet the most minimal of standards, and some aren't really interested in community development at all. All of us know they exist. They specialize in shakedowns. They threaten to picket a financial institution or lodge a CRA protest unless some demands are met. Those demands usually involve a payment in cash or kind. These groups do not solely target financial institutions.

Consider one so-called community development group, which, unfortunately, has a national reputation. They will arrange a mortgage for you…at a price. Although they say you won't have to pay private mortgage insurance, you do have to chip in $50 per month for five years. On a $60,000 loan this amounts to a 100-basis-point "insurance" premium, high by any standard. But that's not all you have to give. You also owe the organization five days a year. This "corvée" labor can be fulfilled by showing up for a protest organized by the group, circulating petitions or some other political activity sponsored by the group. One last thing, you also must agree to allow the group to garnish your wages in the event you become delinquent in your payments—something banks do not do.

Who are these people empowering? Yes, they get people into homes. But not without some strings that wealthier people (i.e., middle income and above) do not have to face. Should political activism really be mandated in order to obtain a home mortgage?

Or consider another so-called community group's alleged success. They had been criticized as "extortionists" by the president of a major bank. The community group began filing CRA protests at every opportunity against the bank. They finally relented after being paid off—and by getting the bank to write a formal letter to members of Congress disavowing the comments of the bank's president. Unfortunately, this story is now widespread in both banking and political circles. The result is, as one regulator put it, "CRA seems to be about repealing the First Amendment."

Groups like this—and the one that protested at Sen. Gramm's house—are giving community development a bad name. Although they may get short-term political and financial payoffs, the industry as a whole pays the price of losing its most important asset—a good reputation.

Your reputation as community development professionals is demeaned every time one of those bad apples scores a political or financial hit. They are sullying your name, and they are getting away with it because the legitimate and successful people in the community development industry remain silent.

What is a politician to think of the community development industry when his only experience is people littering his front lawn and threatening his wife? What is a banker to think of the integrity of the people in our industry when his colleagues' experience is that they are extortionists?

But that is not us, you might say, and you'd be right. But how does anyone know? Has anyone in the legitimate portion of the community development industry objected to these antics? Has

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Did You Know. . .?

Fannie Mae Sets New Guidelines to Combat Predatory Lending

To help protect consumers from abusive lending practices, the nation's largest source of home mortgage financing has established new anti-predatory lending policies for the loans it purchases from lenders. The following summarizes the guidelines:

Steering. For loans delivered to Fannie Mae, the company expects that lenders, regardless of the underwriting method they use, will have determined the borrower's ability to repay the mortgage debt. In addition, lenders should offer mortgage applicants the full range of products for which they qualify and should specifically avoid steering borrowers to high-cost products designed for less creditworthy borrowers if the applicants can qualify for lower cost products.

Excessive fees. Lenders should have their own guidelines and policies addressing the fees originators and brokers can charge a borrower on loan originations. The points and fees charged a borrower should not exceed 5 percent, except when this would result in an unprofitable origination (for example, because of the small loan amount).

Prepaid single-premium credit life insurance policies. Fannie Mae will not purchase or securitize mortgages for which a prepaid single-premium credit life insurance policy was sold to the borrower in connection with the loan's origination. This applies whether the premium is financed in the mortgage amount or paid from the borrower's funds.

Prepayment penalties. Fannie Mae will only consider allowing prepayment penalties under the terms of a negotiated contract and when the lender adheres to these criteria:

◆ A mortgage with a prepayment penalty should provide some benefit to the borrower (such as a rate or fee reduction for accepting the prepayment premium).

◆ The borrower should be offered the choice of another mortgage product that does not require such a penalty. The terms of the provision requiring a prepayment penalty should be adequately disclosed to the borrower.

◆ The prepayment penalty should not be charged when the mortgage debt is accelerated because of the borrower's default in making payments.

Full-file credit reporting. Borrowers' entire payment history must be reported to credit bureaus regularly because it gives a borrower with a good payment record more opportunity to obtain new financing and better mortgage terms when the need arises.

Servicing practices. Fannie Mae generally requires servicers to maintain escrow accounts for the monthly deposit of funds to pay taxes, ground rents, mortgage insurance premiums and so on. In some cases, the company will allow its servicers to waive the requirement on a case-by-case basis. However, the company suggests that waivers not be granted to protect borrowers with blemished credit records from additional risk of default.

More information on Fannie Mae's guidelines can be found on its web site, www.fanniemae.com.

Community Development

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anyone said publicly, these guys don't represent me? The silence is deafening.

Unfortunately, the community development industry has some self-proclaimed members who are using the name of community development to advance their own selfish agendas. The rest of us can sit back and say to ourselves, "We're not like them," and be right. But our reputations will still be affected. Long into the future we will all be fighting the impression that community development involves extortion.

It doesn't have to be that way. But silence now is not the answer. It is time to announce loudly, "We've grown up. We're business people, maybe more socially active than most, but competent to handle the responsibilities that access to political and financial power entails."

The community development industry is at a crossroads. It cannot demand the recognition and respect that a multibillion-dollar industry—that provides decent communities for millions of people—deserves when it also tolerates ethical standards that do not fit those responsibilities. More important, we cannot let others use our good name. The name is now worth something.

By the way, it doesn't take much to stop others from ruining your reputation—just a short note to let people know that [these individuals] don't speak for you. You might start with Sen. Gramm. Tell him you're sorry to hear what some people did to his front yard. Tell him you are a real community development professional, they aren't. Invite him to come see the front yards that your community development efforts have made possible. Introduce him to the people who own new homes. Or send him some pictures.

You can research the history of any industry in America and you will find a point at which it crossed a threshold from one full of backyard operators and fly-by-night operations to one with wide acceptance and brand names. The transition invariably meant a change in standard operating procedures and the demise of many that clung to the old ways. Community development is at that point now. It is up to you to decide its future.

FEDERAL RESERVE BANK OF DALLAS

Perspectives
Third Quarter 2000

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