LINKING LENDERS AND COMMUNITIES

WINTER 2011-2012

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# BRIDGES

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# Rebuilding Household Balance Sheets

## Ray Boshara's Testimony to the U.S. Senate

After joining the St. Louis Fed as a senior advisor in April 2011, Ray Boshara proposed coordinating a new research-based project on household financial stability, with an emphasis on rebuilding the balance sheets of struggling American households. Publications, symposia, a web-based clearinghouse, a "financial stability index," and several outreach events in the Eighth District and nationwide are planned for 2012 and beyond. Boshara's work caught the attention of the U.S. Senate Banking Committee, and he was invited to testify in October 2011 at a hearing entitled "Consumer Protection and Middle Class Wealth Building in an Age of Growing Household Debt." An abridged version of Boshara's testimony appears below; the full text can be found online at www.stlouisfed.org/publications/br.

*By Ray Boshara*

Chairman Brown, Ranking Member Corker and members of the Subcommittee, thank you for the invitation to appear before you today. My efforts to rebuild household balance sheets are focused on families hardest hit by the financial crisis and the economic downturn, those who have experienced significant losses of employment, income and wealth. We know that balance sheets matter because financially healthy families spend, save and invest more, and thereby contribute to economic growth.

**Why Balance Sheets Are Important**

Balance sheets, by which I mean the savings, assets and debts of households, merit attention for three reasons. First, over the past few years we have all seen the damage to families, communities and the broader economy derived from balance sheet challenges. For too many years, household

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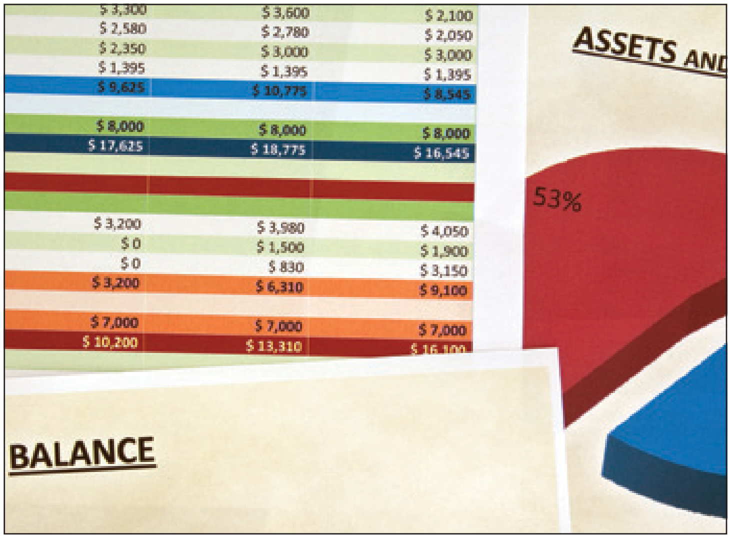


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## RESOURCES

### New Reports on Children's Savings and College Success from Washington University in St. Louis

The Center for Social Development at Washington University in St. Louis (CSD) and the New America Foundation have released the four reports that comprise their series "Creating a Financial Stake in College." Together, these reports outline the vital role of children's savings in achieving college success. They will also provide a foundation for the March 2012 Assets and Education Research Symposium, where leading scholars will present new research on assets and education, review and critique the research to date, and guide future efforts in the field. The reports are available at csd.wustl.edu.

### Housing Market Report from the Federal Reserve Board

The Board has released a white paper on the current condition of the U.S. housing market. It provides a framework for thinking about some of the key housing policy issues and discusses some of the trade-offs that policymakers might consider. Some of the topics covered include the challenges posed by REO properties, the possibility of using some REO properties for rental, and the use of land banks for the disposition of low-value REO properties, among others. To read the report, go to www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf.

## "Balance Sheets"

*continued from Page 1*

debt levels rose, eventually to dangerous levels, while little was done to build up household savings and to diversify family assets beyond housing. When the housing bubble burst, the wealth of many households plunged, leaving balance sheets at historic lows. While balance sheets have improved somewhat in the last couple of years, financial instability remains severe among the poor and persons of color, and reaches well into the middle class.

Second, according to many economists and the International Monetary Fund, weak balance sheets have had negative "wealth effects" on the economy, meaning that households with lower levels of wealth consume less. That, in turn, harms the economy, which in turn further harms households, which further slows economic growth, and so on.

And third, a growing body of evidence shows that families with assets generally do better in life than those without, and that the earlier in life one has assets, the better he or she will do. For example, New York University's Dalton Conley found that "it is really net worth that drives opportunity for the next generation." William Elliott and Sandra Beverly discovered that youth with any kind of a bank account, as long as the account was in the youth's name, are seven times more likely to attend college than those lacking accounts—regardless of academic achievement. Other researchers have also found that small amounts of wealth at the right times can have a transformative effect on the life course.

**Roughly three-quarters of total household debt is mortgage debt, and nearly one-quarter of homeowners nationwide have negative equity.**

### Policy Ideas for Rebuilding Balance Sheets

For families, reducing their debts and rebuilding their savings—or "deleveraging"—is already, painfully and slowly, under way. Yet millions of families need to delever even more, including further measures to address the housing crisis. Roughly three-quarters of total household debt is mortgage debt, and nearly one-quarter of homeowners nationwide have negative equity. Resolving the housing crisis is beyond the scope of my expertise and testimony, but I would like to observe that, historically, homeownership has been an effective route to wealth accumulation for generations of families, including low- and moderate-income families. Accordingly, we should continue to study responsible paths to homeownership for those who are ready and qualified, balancing the risks and the rewards for families, investors, government and others.

With that said, let me offer five policy recommendations to help households rebuild their balance sheets.

First, as the evidence suggests, **build assets as early in life as possible**. Policies that automatically create a savings account at birth for every child born in America, with greater resources available for lower-wealth families, hold promise to expand opportunity and build a stronger middle class over time. Lower-cost alternatives, such as a "Kids' Roth," could be considered as well.

Second, **save and reduce debts at tax time**. Income tax refunds average nearly $3,000, including those received by low-income parents because of the Earned Income Tax Credit (EITC). Such refunds, and the broad reach of the tax system, offer good opportunities to repair or rebuild balance sheets. The IRS' form 8888, which enables all taxpayers to deposit their refunds automatically in up to three separate accounts, holds particular promise in leveraging tax refunds into savings and debt reduction.

Third, **accumulate assets at the workplace**. The workplace has always been and remains a fulcrum for building savings and assets. In fact, the vast majority of pension wealth in the U.S. is structured through employers. To generate more employer-based savings, policymakers could consider proposals to set up automatic payroll deductions into retirement and unrestricted savings accounts managed by financial institutions outside the workplace, similar to the "AutoIRA" concept now being discussed in Washington.

Fourth, **generate unrestricted savings**, which can be used for emergencies or precautionary purposes—and which remain in very high demand by low- and moderate-income consumers. Families with sufficient levels of unrestricted savings are more likely to be banked, to pay down and secure better loans, and to acquire a longer-term asset such as higher education, a small business or a home.

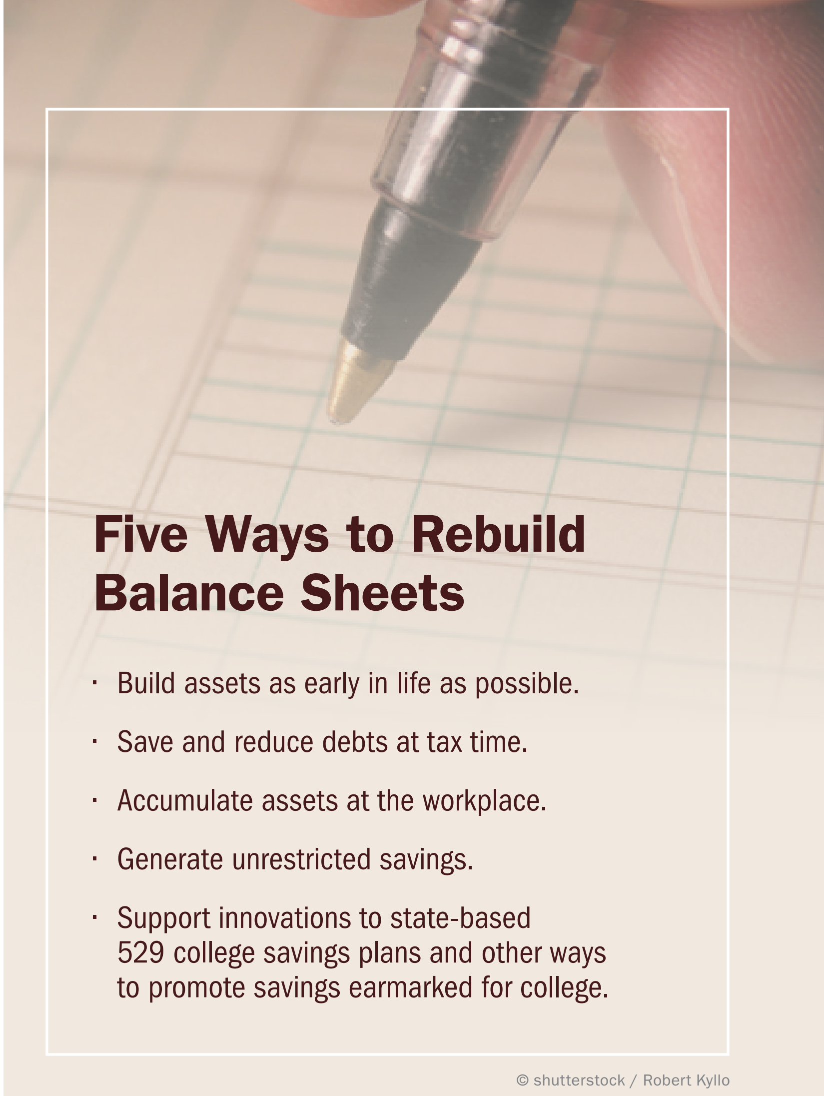
And finally, **consider supporting innovations to state-based 529 college savings plans and other ways to promote savings earmarked for college**. Many studies have documented the role that a good education, especially completion of a postsecondary degree, has on one's future earnings and wealth, and how the lack of an education and skills are among the strongest predictors of downward mobility.

As implied in the recommendations above, there is a great need to diversify the savings and assets of families, especially those below median income. As Federal Reserve Board Vice Chair Janet Yellen has said, "In light of this experience [with collapsing housing prices], it makes sense to think about the development of wealth-building vehicles for low- and moderate-income households that have some of the desirable qualities of homeownership as an investment, but perhaps have less of the risk. ... Although households will likely need to take on some risk in order to accumulate wealth, the risk should not have the potential to destroy a household's financial security. Continued research in this area is badly needed."

### Conclusion

Mr. Chairman, I commend you for convening this hearing today. We know that household debt is both weighing down millions of families and stifling economic growth. Thankfully, we have compelling evidence, some of it presented here, suggesting that rebuilding balance sheets and net worth will help hard-hit families and the broader economy move forward. I hope to make a modest contribution to this critical challenge. Thank you.

*Ray Boshara is a senior advisor at the Federal Reserve Bank of St. Louis. Previously, he served as vice president at the New America Foundation, a Washington, D.C.-based think tank, where he also founded the Asset Building Program.*



## Five Ways to Rebuild Balance Sheets

- Build assets as early in life as possible.
- Save and reduce debts at tax time.
- Accumulate assets at the workplace.
- Generate unrestricted savings.
- Support innovations to state-based 529 college savings plans and other ways to promote savings earmarked for college.

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**We have compelling evidence … suggesting that rebuilding balance sheets and net worth will help hard-hit families and the broader economy move forward.**

# Planning Grant Tries To Ready St. Louis for a Sustainable Future

*By Maggie Hales*

The future, as always, remains uncertain. Yet some trends appear to be safe bets: Costs will rise, economic and social change will continue at a rapid pace, and all levels of government will need to adapt to those rising costs and changing times with an increased emphasis on fiscal, societal and environmental responsibility.

Given those trends and the need for increased government efficiency, preparing for what lies ahead is a good idea. That need for preparation is at the heart of the federal emphasis on sustainability, exemplified in the Department of Housing and Urban Development's (HUD) new Sustainable Communities Regional Planning Grant Program.

In general, sustainability refers to the concept of making decisions about development and government policy by considering the economic, social and environmental impacts of a project. Sustainable development does not focus solely on short-term benefits; it considers long-term effects as well and does not undervalue the true cost of a project by downplaying its negative environmental and social consequences. It stresses the efficient and equitable management of resources, both natural and financial.

In St. Louis, a three-year, $4.7-million grant from HUD to develop a regional plan for sustainable development will not resolve all current challenges. But the intent is to devise methods that municipalities, counties and regions can use to meet the metro area's needs in efficient and responsible ways.

The St. Louis-area grant was announced in October 2010, with funding for planning running through December 2013. The $4.7-million award was the fourth-highest among the 45 regions that received funding from HUD; 225 grant applications were submitted.

Other Eighth District HUD Sustainable Communities Regional Planning grantees include the metro area around Memphis ($2.6 million), which includes parts of Arkansas, Tennessee and Mississippi; Metroplan in Little Rock ($1.4 million); and the East Arkansas Planning and Development District ($2.6 million).

For St. Louis, the East-West Gateway Council of Governments is the lead agency for the planning process and the fiscal agent for the grant. East-West

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Gateway is the federally designated metropolitan planning organization for the city of St. Louis and the surrounding seven counties in Missouri and Illinois.

East-West Gateway has 10 consortium partners contributing to the planning process of the Regional Plan for Sustainable Development. HUD requires that each region's principal city, the county with the largest population, the metropolitan planning organization and a regional public engagement organization be involved in the process.

The effort to develop a regional plan that emphasizes sustainable development is a collaborative partnership that involves HUD, the federal Department of Transportation (DOT) and the Environmental Protection Agency (EPA). The goal is to improve the way the federal government coordinates its transportation, housing and environmental spending, policies and programs so that local communities can become economically vibrant and environmentally sustainable.

The grant program is a recognition that citizens and urban leaders need to understand how rising fuel prices, a struggling economy, an unstable housing market and concern over climate change combine to affect the quality of life in their neighborhoods, cities, counties and states. The theory is that if the federal government and local communities coordinate housing, transportation and environmental priorities, the region as a whole will benefit.

The grant for St. Louis was funded through HUD's Sustainable Communities Initiative, which currently is funding planning efforts throughout the country, although no funds are yet available for implementation. At the core of the planning effort are the six livability principles established by the Partnership for Sustainable Communities, an interagency collaboration of HUD, DOT and EPA. The principles are:

1. provide more transportation choices;
2. promote equitable, affordable housing;
3. enhance economic competitiveness;
4. support existing communities;
5. coordinate policies and leverage investments; and
6. value communities and neighborhoods.

The first year of the planning process in St. Louis was used for coordination and collaboration with local organizations and committee members. An organizational framework was established that will allow an inclusive and comprehensive public engagement phase to be conducted in 2012.

Part of that public engagement component will be conducted throughout the region's community planning areas (CPAs), which were designated as part of the planning process. All of the communities and organizations within each CPA have demonstrated a willingness to work together, even though several jurisdictions might be involved. A CPA can involve several governmental units, including municipalities, school districts and public safety departments, though none will cross county lines.

Any recommendations that evolve from public input during the CPA discussions are intended to provide support, strategies and models for sustainable development. Recommendations will not include any mandates that require local governments to adopt new rules or ordinances to conform to state or federal goals.

The core consortium members planning for sustainable communities consist of East-West Gateway, the City of St. Louis, St. Louis County and FOCUS St. Louis. The other members are Trailnet, Citizens for Modern Transit, Metro, Great Rivers Greenway, Metro St. Louis Equal Housing Opportunity Council, Southwestern Illinois Resource Conservation and Development, and the Applied Research Collaborative (St. Louis University, University of Missouri–St. Louis and Southern Illinois University at Edwardsville). An additional 23 partners consisting of businesses, nonprofit organizations, foundations and individuals are also a part of the effort.

In February 2012, the intensive public engagement process begins, with the intent to incorporate residents' goals, priorities and concerns. That involvement by local citizens will continue throughout the year to identify resources and strategies that will address local and regional sustainable development goals by the end of 2012. Public feedback and refinement of those goals will take place in 2013 before a regional plan is adopted by December 2013.

For more information on HUD's Sustainable Communities Regional Planning Grant Program, visit www.hud.gov and go to Press Room > Press Releases > 2010 > HUD No. 10-233.

*Maggie Hales is deputy executive director for the East-West Gateway Council of Governments in St. Louis.*

### Partnership for Sustainable Communities' Livability Principles

- Provide more transportation choices
- Promote equitable, affordable housing
- Enhance economic competitiveness
- Support existing communities
- Coordinate policies and leverage investments
- Value communities and neighborhoods

**Sustainability refers to the concept of making decisions about development and government policy by considering the economic, social and environmental impacts of a project.**

# Federal Agencies Make Changes to the Home Affordable Refinance Program

*By Julia Maués and Jim Fuchs*

**In October 2011, the Federal Housing Finance Agency (FHFA) announced changes to the Home Affordable Refinance Program (HARP). The stated goal of these changes is to increase the number of "underwater" borrowers[1] eligible to refinance their home mortgages while reducing credit risk for the government-sponsored enterprises (GSE) Fannie Mae and Freddie Mac.**

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### Program Changes

Among the most significant program changes are the elimination of risk-based fees for borrowers who finance into shorter-term mortgages; removal of the loan-to-value (LTV) ceiling for some GSE-backed, fixed-rate mortgages; and a program extension. The announcement indicated that additional details would be released by Fannie and Freddie.

HARP was launched in April 2009 to allow refinancing for homeowners with performing GSE-backed loans with LTVs between 80 and 105 percent.[2] The program did not reach as many borrowers as expected.[3] So, in an effort to address some of its shortcomings, the October FHFA announcement included the following changes:

- Extension of the program through Dec. 31, 2013.
- Removal of the 125 percent LTV ceiling for fixed-rate mortgages owned or guaranteed by GSEs that were originated on or before May 31, 2009. This change does not apply to fixed-rate mortgages with terms greater than 30 years up to 40 years, or adjustable-rate mortgages (ARMs).
- Elimination of risk-based fees for borrowers who finance into shorter-term mortgages.
- Waiver of new appraisal requirements in those instances where a reliable automated valuation model (AVM) appraisal is available.
- Removal of certain seller and servicer representations and warranties on all HARP loans.

### Guidance to Lenders

In November 2011, Freddie Mac and Fannie Mae released guidance to lenders on changes to their loan products that were originated under the expansion and extension of HARP. These details, relating to changes in fees, underwriting standards, and representations and warranties (with additional details released in December) are listed on page 7 and became effective for HARP loans with application dates on or after Dec. 1, 2011.[4]

#### *Changes to Underwriting Requirements*

- Borrowers must be current on their mortgage at the time of an enhanced HARP refinance, with no late payments in the prior six months and no more than one late payment in the prior 12 months.

- At least one borrower must provide source of income information and the lender must verify the source.
- Borrowers are not required to have the same occupancy as when the loan was first originated.
- If the loan payment increases by more than 20 percent under a HARP refinancing, all of the following requirements must be met:
    1. Minimum representative credit score of 620
    2. Maximum debt-to-income (DTI) ratio of 45 percent
    3. Verification of income sources, amounts and other assets if borrower is required to bring funds to closing

***Representations and Warranties***

The lender is relieved from the standard representations and warranties[5] for the new loan if the lender meets both of the following requirements:

1. All data in the loan case file is complete, accurate and not fraudulent
2. The lender follows the instructions provided by the GSE regarding income, employment, asset and fieldwork documentation

***Delivery Fee Cap Adjustments***

The following adjustments will apply to refinances of mortgages with LTV ratios greater than 80 percent[6]:

1. No charge for non-investor property fixed-rate mortgages of less than or equal to 20 years
2. 75 basis points (bps) for non-investor property fixed-rate mortgages of more than 20 years
3. 75 bps for non-investor property mortgages that have an adjustable rate
4. 200 bps for investment property mortgages

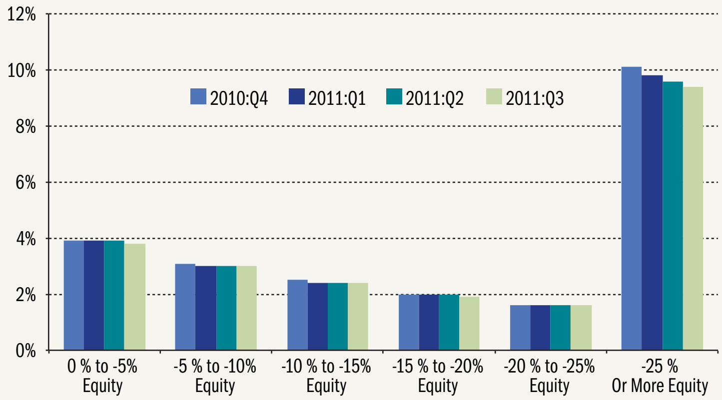
## HARP Implementation

The GSEs' automated underwriting systems cannot handle HARP 2.0 until March 2012; until the systems' update is released, only the current servicer of the GSE loan is able to manually underwrite it. Therefore, if the current servicer of a HARP-eligible mortgage wants to refinance it into a new HARP loan, there is an incentive to do so immediately before competition is possible from other lenders, since only one HARP refinance is allowed per mortgage.

According to CoreLogic, almost 10 percent of all mortgages are underwater by more than 25 percent. Therefore, the removal of the 125 percent LTV cap will increase the number of borrowers who are potentially eligible for refinancing.[7] Moreover, defenders of the program claim that waiving the original loan's representations and warranties makes HARP more attractive to lenders as it will protect them from many of the buy-back requirements they faced under previous rules.[8] Still, it remains to be seen if this will be enough to entice lenders to participate, whether they will impose additional fees or underwriting requirements beyond what the GSEs require, and whether investors will be willing to buy securities backed by these new HARP loans.

## Distribution of Home Equity

Percent Homeowners with Mortgage




**Source: CoreLogic 2011:Q3**

*Julia Maués is a policy analyst and Jim Fuchs is a senior manager in the Banking Supervision and Regulation division, Supervisory Policy and Risk Analysis Unit, at the Federal Reserve Bank of St. Louis.*

**ENDNOTES**

1 An underwater borrower's mortgage debt exceeds the market value of the home.

2 The maximum allowable LTV ratio was increased to 125 percent on July 1, 2009.

3 928,600 borrowers refinanced through HARP as of Sept. 30, 2011.

4 The waiving of the 125 percent LTV ratio will only apply to mortgages settled with the GSEs after Feb. 1, 2012.

5 Eligibility, credit history, liabilities, income and asset management

6 Mortgages with LTV ratios less than or equal to 80 percent will continue to be charged a fee of 200 bps.

7 Note that a significant number of high-LTV loans are not owned or guaranteed by the GSEs, and so are not eligible for HARP under current rules.

8 Under previous HARP rules, representations and warranties entitled Fannie and Freddie to be reimbursed for losses on loans that were poorly underwritten at origination, even if the lender that refinanced the loan was not the originator of the first mortgage.

# St. Louis Fed Pilots Low- and Moderate-Income Survey

*By Andrew A. Pack*


The Federal Reserve's Community Development department gives financial institutions, community-based organizations and government entities the tools they need to effectively address community development issues affecting low- and moderate-income individuals and communities.

To help us accomplish that goal, last fall the St. Louis Fed's Community Development department launched a low- and moderate-income (LMI) survey that gathers information from a wide array of community stakeholders across the Eighth Federal Reserve District. The aim was to gain a better understanding of the challenges and economic well-being of LMI individuals and communities.

An analysis of the responses revealed a few key findings:

- The lack of job availability, insufficient educational attainment and inadequate job skills were overwhelmingly cited as the current and future issues most negatively affecting LMI individuals and communities.
- Seventy percent of respondents said that, if funding were not an issue, they would redevelop areas of their communities to bring in more businesses and jobs and/or increase access to education and workforce development programs to help the LMI community.
- Community and economic developers reported that, in attempts to grow and create new businesses in LMI areas, small businesses showed the most interest in available sites.
- Globalization is impacting urban and rural LMI communities in very different ways. Respondents in metropolitan areas believe that globalization offers more opportunities, while respondents in rural areas indicate that globalization is having a negative impact by creating fewer opportunities for their communities.
- About a third of respondents believe that LMI individuals in their service area are worse off than those in other areas.
- Only four percent of respondents believe that LMI individuals can adequately meet their basic needs.
- Attitudes toward the importance of homeownership as a means to help LMI individuals build assets may be changing. Owning a house was identified by only 11 percent of respondents as one of the top ways to increase the financial stability of LMI households. Avoiding debt, increasing savings and entrepreneurship all ranked higher than owning a house.

The full report is available at www.stlouisfed.org/community_development/LMI_survey. In the future, the St. Louis Fed plans to conduct its LMI survey biannually, with results reported online.

*Andrew A. Pack is a community development specialist at the Little Rock Branch of the Federal Reserve Bank of St. Louis.*

# St. Louis Neighborhood Wins National Award

*By Matthew W. Ashby*

The U.S. Environmental Protection Agency (EPA) has recognized the Old North St. Louis Revitalization Initiative with one of five national prizes for sustainable development. The award supports communities that use innovation to build stronger local economies. Old North received the award for Overall Excellence by building on historic architecture while adding new transit options, grocery, housing and residents.

Old North St. Louis, first built in 1816, sat largely vacant after decades of decline until 1981, when a group of engaged citizens committed themselves to its recovery. At that time, the historic neighborhood covered 85 blocks, the majority of which were vacant or sparsely occupied. Residents, business owners and community leaders formed the Old North St. Louis Restoration Group (ONSLRG) as a not-for-profit corporation and laid the groundwork for the neighborhood's transformation.

ONSLRG engages area residents in concrete community development activities. The goal is to create a highly walkable urban village within the city. Old North's population has increased 28 percent over the last decade, reversing a 50-year pattern of outmigration from the neighborhood. Residents are now active participants in everything from design workshops and building projects to potluck suppers and "quality of life" meetings where community members can raise neighborhood concerns.

Providing a range of housing options has been critical to Old North's success. ONSLRG and its partners have created nearly 200 homes—affordable and market rate, single-family homes and apartments—by developing on vacant lots and renovating abandoned historic buildings rather than demolishing them. These efforts have added housing choices that allowed longtime residents to stay while attracting newcomers. ONSLRG has also completed several large community design projects. Two main blocks have been redeveloped with new sidewalks, benches, street trees and streetlights. The changes, which required rehabilitating 27 vacant buildings, reconnected the commercial district to the neighborhood.

You can read about Old North and the EPA award and watch a video at www.epa.gov/smartgrowth/awards, under 2011 Award Winners. And you can see before and after photos at www.stlouisfed.org/publications/br.

*Matthew W. Ashby is a senior community development specialist at the Federal Reserve Bank of St. Louis.*

Neighborhood revitalization is an ongoing project in Old North St. Louis, winner of the EPA's 2011 national award for overall excellence in smart growth.

# SPANNING THE REGION

THE REGION SERVED BY THE FEDERAL RESERVE BANK OF ST. LOUIS ENCOMPASSES ALL OF ARKANSAS AND PARTS OF ILLINOIS, INDIANA, KENTUCKY, MISSISSIPPI, MISSOURI AND TENNESSEE.

### Additional Capital for Delta Businesses

ACCION Delta is setting up shop across the Delta; with it comes additional capital for entrepreneurs and small businesses in the area.  Microlending services will be provided in the 252 counties and parishes of the federally designated Delta Regional Authority (DRA) area, which includes the states of Alabama, Arkansas, Illinois, Kentucky, Louisiana, Mississippi, Missouri and Tennessee.  ACCION Delta, a community development financial institution (CDFI), is the result of a partnership with ACCION Texas, the nation's largest nonprofit micro- and small-business lender, and Southeast Missouri State University's Douglas C. Greene Center for Innovation and Entrepreneurship, a nationally recognized rural microenterprise development program.

So far, offices have opened in Cape Girardeau, Mo.; Helena-West Helena, Ark.; and North Little Rock, Ark.  Plans are to place a loan officer in each of the DRA states by August 2012.  Contact information for the current loan offices in the Eighth District of the Federal Reserve Bank are listed below:

**Loan Officer Nathanial Owen**
Phillips County Chamber of Commerce
111 Hickory Hill Drive
P.O. Box 762
Helena, AR  72342
Phone: 870-519-9171

**Loan Officer Russell Hampton**
324 W. Pershing
North Little Rock, AR 72114
Phone: 501-444-8585

**Loan Officer Craig Bohnsack**
Southeast Missouri State University
920 Broadway, Suite 107
Cape Girardeau, MO 63701
Phone: 573-587-0908

To learn more about ACCION Delta, visit www.acciondelta.org.  For information about Southeast Missouri State University's Douglas C. Greene Center for Innovation and Entrepreneurship, visit www.semo.edu/cie.

### Mortgage Financing for Illinois Veterans

The Illinois Housing Development Authority has launched "Welcome Home Heroes," a mortgage financing package open to all qualified Illinois veterans, active military personnel, reservists and Illinois National Guard members.  Under the program, a mortgage credit certificate enhances the benefit of the federal homeowner mortgage interest deduction.  Homeowners with the credit are allowed to use 20 percent of their annual mortgage interest as a direct federal tax credit, resulting in a dollar-for-dollar reduction of their annual federal income tax liability.  The remaining 80 percent of their annual mortgage interest continues to qualify as an itemized tax deduction.

To find out more about the program, including application information and local lenders, visit www.ihda.org/homeowner/heroes.htm.

### Illinois Increases Earned-Income Tax Credit

Illinois Gov. Pat Quinn has signed legislation that doubles the state's earned-income tax credit (EITC) from five to 10 percent of the federal EITC, phased in over three years.  This tax relief will help more than 900,000 working families save an extra $100 to $200 a year.  Low- and middle-income working families will receive an additional boost from a $50 increase in the personal exemption, which will now be indexed to inflation.  And while EITC provides help to low-income workers, it also boosts local economies by increasing consumer spending in neighborhood stores and the community.

For more information, visit www2.illinois.gov or www.taxcreditsforworkingfamilies.org/2011/12/illinois-doubles-state-eitc/.

# CALENDAR

## FEBRUARY

### 6-7
**Missouri Economic Development Council Winter Conference—Jefferson City, Mo.**
Sponsor: Missouri Economic Development Council
www.showme.org/registration/medc_winter_2012_flyer.pdf

### 14-17
**OFN Annual Conference: Where CDFIs, Funders, and Investors Meet!—Minneapolis, Minn.**
Sponsor: Opportunity Finance Network
www.opportunityfinance.net/groupmail/conference/11/9.8.11.html

### 15-17
**Mississippi's Annual Affordable Housing Conference—Biloxi, Miss.**
Sponsor: Mississippi Home Corporation
www.mshc.com/2012

## MARCH

### 7
**Mississippi Asset-Building Symposium—Cleveland, Miss.**
Sponsors: Federal Reserve Bank of St. Louis–Memphis Branch, Center for Community and Economic Development (Delta State University)
www.stlouisfed.org/community_development

### 7
**Focus on Art as a Revitalization Tool (Brown Bag Series)—St. Louis, Mo.**
Sponsors: University of Missouri–St. Louis (Community Partnership Project and Nonprofit Management and Leadership Program)
umslce.org/index.php/brown-bag-series

### 18-23
**Exploring Innovation Week—Little Rock, Ark.; Louisville, Ky.; Memphis, Tenn.; St. Louis, Mo.**
Sponsor: Federal Reserve Bank of St. Louis
www.stlouisfed.org/community_development

### 23
**Access to Capital and Credit: Strengthening Rural Businesses—Lexington, Ky.**
Sponsors: OCC, FDIC, Federal Reserve Bank of Cleveland
www.clevelandfed.org/Community_Development/events/20111107/index.cfm

### 25-28
**National Interagency Community Reinvestment Conference—Seattle, Wash.**
Sponsors: Federal Reserve Bank of San Francisco, FDIC, OCC, U.S. Dept. of the Treasury's Community Development Financial Institutions Fund
www.frbsf.org/community/seattle2012

### 25-30
**Empowering Communities for the Future**
**25-29—Excelsior Springs, Mo.**
**26-30—St. Louis, Mo.**
Sponsor: Community Development Academy
muconf.missouri.edu/commdevelopmentacademy/courses.html

### 26-30
**Building Communities from the Grassroots—St. Louis, Mo.**
Sponsor: Community Development Academy
muconf.missouri.edu/commdevelopmentacademy/courses.html

## APRIL

### 16-17
**Governor's Conference on Affordable Housing—Chicago, Ill.**
Sponsor: Illinois Housing Development Authority
www.regonline.com/builder/site/default.aspx?EventID=1048316

### 16-20
**Kentucky Nonprofit Network Week—Various Venues**
Sponsor: Kentucky Nonprofit Network (KNN)
https://kynonprofits.org/events

### 21-28
**Money Smart Week–Metro St. Louis—Greater St. Louis**
Sponsor: Multiple
www.moneysmartweek.org

### 30-May 2
**AEO National Microenterprise Conference—Washington, D.C.**
Sponsor: Association for Enterprise Opportunity
www.aeoworks.org/index.php/site/page/aeo_2012_conference_save_the_date

## MAY

### 9-11
**Save the Date!**
**Reinventing Older Communities–Building Resilient Cities—Philadelphia, Pa.**
Sponsors: Federal Reserve Banks of St. Louis, Boston, Chicago, Cleveland, New York, Philadelphia and Richmond, William Penn Foundation, Penn Institute for Urban Research, FHL Bank Pittsburgh
www.philadelphiafed.org/community-development/events/2012/reinventing-older-communities/

## JUNE

### 28-29
**Save the Date!**
**Housing, Human Capital, and Inequality—Cleveland, Ohio**
Sponsor: Federal Reserve Bank of Cleveland
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# BRIDGES

*Bridges* is a publication of the Community Development Office of the Federal Reserve Bank of St. Louis. It is intended to inform bankers, community development organizations, representatives of state and local government agencies and others in the Eighth District about current issues and initiatives in community and economic development. The Eighth District includes the state of Arkansas and parts of Illinois, Indiana, Kentucky, Mississippi, Missouri and Tennessee.



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# Have you HEARD

## UMSL Takes Over E-mail List

The St. Louis lender and community development electronic mailing list has migrated to a new location. The University of Missouri–St. Louis (UMSL) will now administer this St. Louis community development digest e-mail. The digest will include events and announcements, and will be sent out twice a month. It will consolidate several e-mail lists in an effort to decrease redundancy and to better communicate the strength of the community development profession in the area. For the past nine years, Matt Ashby at the St. Louis Fed has overseen this forum and has done a great job keeping e-mails timely and the list up-to-date. We thank Matt for his stellar service! And thanks also to UMSL for picking up the reins on this important informational service. For more information, please contact Karl Guenther at 314-516-5845 or guentherk@umsl.edu.

## New Project Supports Veteran Housing

The National League of Cities (NLC) and The Home Depot Foundation (HDF) will launch a new effort to help local officials rehabilitate neighborhood housing for returning military veterans, disabled veterans and special-needs populations. HDF will support the efforts of the NLC with a $250,000 grant for 2012. The partnership will leverage HDF's work in a number of cities to support nonprofit partners by funding housing repair and renovation, helping to eliminate barriers in providing rehabilitated housing for vets. For more information, visit homedepotfoundation.org/news-resources/press-releases/2012/the-national-league-of-cities-and-the-home-depot-foundation-launch-project-to-support-veteran-housing.html.

## HUD Seeks "Choice Neighborhoods" Applicants

The Department of Housing and Urban Development (HUD) will offer $110 million in FY 2012 Choice Neighborhood Initiative (CNI) Implementation Grant funds. CNI Implementation Grants support communities involved in revitalization strategies aimed at neighborhood transformation, meeting the program's core goals of transforming distressed public and assisted housing into viable, long-term mixed-income housing, as well as improving safety, transportation and education. The application deadline is April 10. For more information, visit www.grants.gov/search/search.do?mode=VIEW&oppId=137313.

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**Statement of Ray Boshara before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, October 4, 2011**

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# Statement of Ray Boshara Before the Committee on Banking, Housing, and Urban Affairs Financial Institutions and Consumer Protection Subcommittee

**Ray Boshara**

**U.S. Senate | Washington, D.C. | October 4, 2011**

Chairman Brown, Ranking Member Corker, and members of the Subcommittee, thank you for the invitation to appear before you today. My name is Ray Boshara, and I am a senior advisor at the Federal Reserve Bank of St. Louis. Let me state that the views expressed here today are my own views, and not necessarily the views of the Federal Reserve Bank of St. Louis or the Board of Governors of the Federal Reserve System.

At the Federal Reserve Bank of St. Louis, I am organizing a new effort to study mechanisms that promote household financial stability, with a particular emphasis on rebuilding the balance sheets and net worth of American households. My work is focused on families hardest hit by the financial crisis and the economic downturn, those who have experienced significant losses of employment, income, and wealth. We know that balance sheets matter because financially healthy families spend, save, and invest more, and thereby contribute to economic growth.

My testimony is in two parts. In the first part, I discuss why a focus on household balance sheets is necessary. And in the second part, I offer some policy recommendations, based on my own work, to help rebuild the balance sheets of struggling families.

## Why Balance Sheets Are Important

Balance sheets, by which I mean the savings, assets and debts of households, merit attention for three reasons. First, over the past few years we have all seen the damage to families, communities, and the broader economy derived from balance sheet challenges. For too many years, household debt levels rose, eventually to dangerous levels, while little was done to build up household savings and to diversify family assets beyond housing. When the housing bubble burst, the wealth of many households plunged, leaving balance sheets, according to some economists, at a historic low.[1] For instance, Mian and Sufi report that both household debt-to-income and household debt-to-assets ratios reached their highest points since 1950, with the debt-to-income ratio skyrocketing from 2001 to 2007 by more than it had in the prior 45 years.[2]

While balance sheets have improved somewhat in the last couple of years, financial instability remains severe among the poor and persons of color, and reaches into the middle class. Consider these points:

- Three-fifths or more of families across all income groups, according to the 2009 Survey of Consumer Finances (SCF) of the Federal Reserve, reported a decline in wealth between 2007 and 2009, and the typical household lost nearly one-fifth of its wealth, regardless of income group.[3]
- The Pew Research Center finds that, in 2009, typical net worth stood at $5,677 for blacks, $6,325 for Hispanics, and $113,149 for whites. About a third of black and Hispanic households had zero or negative net worth that year, compared with 15 percent of white households.[4]
- Almost half of all households surveyed in the 2009 SCF had less than $3,000 in liquid savings, and 20 percent had less than $3,000 in broader savings.[5]

- Nearly half of all Americans consider themselves financially fragile, meaning that they would "probably" (22.2 percent) or "certainly" (27.9 percent) be unable to come up with $2,000 in 30 days to cope with a financial emergency.[6] Similarly, almost half of all Americans report having trouble making ends meet.[7]
- In a survey by Holtz, Van Horn, and Zukin on the effects of unemployment and the recession, 70 percent of workers reported withdrawing funds saved in college and retirement accounts in order to make ends meet,[8] likely leading to losses of wealth in future years.

Second, weak balance sheets impact economic growth. Weak balance sheets—especially due to lower household wealth—have had negative "wealth effects" on the economy. Case, Quigley, and Shiller state that "the results indicate that increases in housing market wealth have had positive effects upon household consumption, but declines in housing market wealth have had negative and somewhat larger effects upon consumption."[9] In addition, Mian and Sufi show that "household leverage as of 2006 is a powerful statistical predictor of the severity of the 2007–2009 recession across U.S. counties. Those counties that experienced a large increase in household leverage from 2002 to 2006 showed a sharp relative decline in durable consumption starting in the third quarter of 2006—a full year before the official beginning of the recession in the fourth quarter of 2007."[10] Many others, including the Bank for International Settlements and the International Monetary Fund, have recently identified weak household balance sheets as one of the key factors inhibiting economic growth.

And third, a growing body of evidence indicates that families with assets generally do better in life than those without, and generally experience better social, behavioral, and educational outcomes. Conley, using intergenerational data, showed that "parental education and parental assets are the single best predictor of educational (and other socioeconomic) success for blacks and whites. Parental wealth proves so powerful, in fact, that when added to statistical models, parental income, occupation and race no longer appear to matter. That is, while race, income, job status and net worth all tend to vary hand-in-hand, careful statistical parsing shows that it is really net worth that drives opportunity for the next generation."[11]> Moreover, Cooper and Luengo-Prado found that among adults who were in the bottom income quartile from 1984–1989, 34 percent left the bottom by 2003-2005 if their initial savings were low, compared with 55 percent who left the bottom if their initial savings were high—that is, 21 percent more adults moved out of the bottom quartile because they had higher savings.[12] And Butler, Beach, and Winfree found that financial capital, along with family structure and educational attainment, are the three strongest predictors of economic mobility in America.[13]

Further evidence suggests that the earlier in life one has assets, the better that person will do. For example, Cooper and Luengo-Prado found that children of low-saving, low-income parents are significantly less likely to be upwardly mobile than children of high-saving, low-income parents. Specifically, they found that 71 percent of children born to high-saving, low-income parents move up from the bottom income quartile over a generation, compared to only 50 percent of children of low-saving, low-income parents.[14] Elliot and Beverly discovered that, remarkably, youth with any kind of a bank account, as long as the account was in the youth's name, are seven times more likely to attend college than those lacking accounts.[15] Similarly, Zhan and Sherraden found that, after controlling for family income and other parent and child characteristics, financial and nonfinancial assets are positively related to, and unsecured debt is negatively related to, children's college completion.[16] And Shapiro, combining data analysis and in-person interviews with a demographically wide range of families, found that the presence of even small amounts of wealth at the right times can have a "transformative" effect on the life course.[17]

## Policy Ideas for Rebuilding Balance Sheets

For families, reducing their debts and rebuilding their savings—or deleveraging—is already, painfully and slowly, underway. The household savings rate has now reached around five percent, which is significantly down from the nine percent average in the 1980s, on course with the five percent average in the 1990s, but well above the nearly zero rates the U.S. fell to in the first part of this century.[18]

Yet millions of families need to delever even more, although, not surprisingly, economists do not agree on ideal or sustainable levels of household savings and debt. Most agree, however, that rebuilding balance sheets and igniting the economy require continuing measures to resolve the housing and foreclosure crisis. Roughly three-quarters of total household debt is mortgage debt, and nearly one-quarter of homeowners nationwide have negative equity.[19] Specific recommendations to resolve the housing crisis are beyond the scope of my expertise and testimony, so I will focus on other ideas to help families build savings and wealth. However, before doing so, I would like to observe that, historically, homeownership has been an effective route to wealth accumulation for generations of families, including for low- and moderate-income families; accordingly, going forward policymakers and researchers should continue to study responsible paths to homeownership for those who are ready and qualified, with all stakeholders balancing both risks and the rewards.

While several ideas could be offered, let me suggest five savings-based recommendations to rebuild balance sheets that I think hold particular promise.[20] I would like to note that these recommendations are informed by a key insight gleaned from savings experiments in the U.S. and around the world. The most interesting question among researchers is no longer whether low-income families can save, but how they save and what difference it makes. That is, income is not the most important predictor of who saves. Instead, what matters more is who has access to structured savings mechanisms—whether through the workplace, schools, financial institutions, tax returns, community-based organizations, and others. A well-funded asset-building policy, one that includes several billion dollars in tax incentives, is already reaching middle- and upper-income households in the United States,[21] making it easier for them to accumulate savings and wealth; the core policy challenge, then, is to extend those savings mechanisms and incentives to families whose earnings fall below median income.

First, build assets as early in life as possible. As discussed earlier, the evidence thus far suggests that children in homes with assets, or children with assets, do better in life than those lacking assets. Policies that automatically create a savings account at birth for every child born in America, with greater resources available for lower-wealth families, hold promise to expand opportunity and build a stronger middle class over time. Such a policy would, if schools structured financial education classes around the accounts, likely have a significant effect on building financial skills for children and youth—some studies show that financial know-how is the result of regular saving, not the source. If such an ambitious policy cannot be achieved in the near term, then I would suggest the creation of a “Kids Roth” or “Roth at Birth” or “Young Savers Account”—a slightly modified Roth Individual Retirement Account (IRA) that, voluntarily, permits children to open and make contributions to a life-long, tax-benefited account that can also be used for postsecondary education and homeownership (as current Roth IRAs allow). The creation of such a nationally sanctioned product directed at kids would likely spur further experimentation around child savings accounts, which has been hampered by product-related challenges over the last several years.

Second, build assets and reduce debts at tax time. Income tax refunds averaged $2,700 in 2008, while about 24 million Earned Income Tax Credit (EITC) recipients received refunds as large as $4,824.[22] These refunds, and the broad reach of the tax system, offer good opportunities to repair or rebuild balance sheets. The IRS’s form 8888, which enables all taxpayers to deposit their refunds automatically in up to three separate accounts, holds great promise in leveraging tax refunds into savings and debt reduction. For example, savings bonds, in many ways an ideal product for small savers, can now be purchased directly at tax time. Other interesting pilots, including the “Refund to Savings” Initiative, are under way. To further facilitate savings at tax time, the Savers Credit, which encourages retirement savings among low-income taxpayers, could be improved and made available for contributions to college savings accounts, the purchase of savings bonds, and other preretirement assets.

Third, build assets at the workplace. The workplace has always been and remains a fulcrum for building savings and assets. In fact, the vast majority of pension wealth in the U.S. is structured through employers. Experiments, such as those testing “Auto401(k)s” and the “Save More Tomorrow” concept, have generated encouraging results, including for low-income workers, and the Pension Protection Act of 1996 has removed many of the barriers to further expansion of those efforts. To generate more employer-based savings, policymakers could consider proposals to set up automatic payroll deductions into retirement and unrestricted savings accounts outside the workplace, informed by the “AutoIRA” and “AutoSave” concepts currently under discussion. Employers could also encourage direct deposit of paychecks, which appears to lead to better financial inclusion outcomes. Finally, one could also imagine automatic payroll deductions for other assets, such as savings for college or homeownership, with possible incentives to encourage further saving by lower-income workers.

Fourth, build unrestricted savings, which are savings that can be used for emergencies or precautionary purposes and which remain in very high demand by low- and moderate-income consumers.[23] Those with sufficient levels of unrestricted savings are more likely to be banked, more likely to pay down and secure better loans, and more likely to acquire a longer-term asset such as higher education, a small business, or a home. And they do better: The Consumer Federation of America found that low-income families with $500 in emergency savings had better financial outcomes than moderate-income families with lower savings. In addition, McKernan, Ratcliffe, and Vinopal found that households that are “liquid-asset poor” are two to three times more likely than those with liquid assets to experience “material hardship” after a job loss, health emergency, death in the family, or other adverse event.[24] Policymakers could consider several measures to boost unrestricted savings, including (1) expanding the EITC; (2) further studying and testing prepaid cards, which often include a savings “bucket” in addition to transaction services; and (3) promoting reasonably priced small-dollar lending and small-dollar savings programs among financial institutions, nonprofits, and others.

And finally, consider supporting innovations to state-based 529 college savings plans and other ways to generate savings earmarked for college. Many studies have documented the role that a good education, especially completion of a postsecondary degree, has on one’s future earning and wealth, and how the lack of an education and skills are among the strongest predictors of downward mobility. Promising innovations to learn from include (1) the “SEED for Oklahoma Kids” experiment, which is testing 529s established at birth; (2) the “Kindergarten to College” initiative in San Francisco, which is setting up college saving accounts for all of the city’s kindergartners; and (3) the “Early Pells” proposal by the College Board, which would enable a Pell-eligible family to receive a child’s Pell Grant earlier in life as a deposit to a 529 account.

As implied in the recommendations above, there is a great need to diversify the savings and assets of families, especially those below median income. The wealth of these families has been concentrated in homeownership, which has contributed to the stability and upward mobility of millions of families over time—but which, especially when not acquired responsibly, or because of price fluctuations, ended up being a risky asset for too many families. Homeownership, as mentioned earlier, clearly carries both potential risks and rewards that must be carefully weighed. It is wise, therefore, for families to have access to a range of savings products—short- and longer-term, restricted and unrestricted—that lead to as broad a range of financial assets (such as investments and retirement accounts) and productive assets (such as a home, land, post-secondary education, reliable car, or small business) as possible. As Federal Reserve Board Vice Chair Janet Yellen has said, “In light of this experience [with collapsing housing prices], it makes sense to think about the development of wealth-building vehicles for low- and moderate-income households that have some of the desirable qualities of homeownership as an investment, but perhaps have less of the risk. Such instruments should be simple and transparent and might include a savings commitment component. Although households will likely need to take on some risk in order to accumulate wealth, the risk should not have the potential to destroy a household’s financial security. Continued research in this area is badly needed.”[25]

## Conclusion

Mr. Chairman, I commend you for convening this hearing today to look at high levels of household debt, consumer protection, and rebuilding the middle class. We know that household debt is both weighing down millions of families and stifling economic growth. Thankfully, we have compelling evidence, some of it presented here, suggesting that rebuilding balance sheets and net worth will help hard-hit families and the broader economy move forward. I hope to make a modest contribution to this critical challenge, and I would be pleased to answer any questions that you might have.

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