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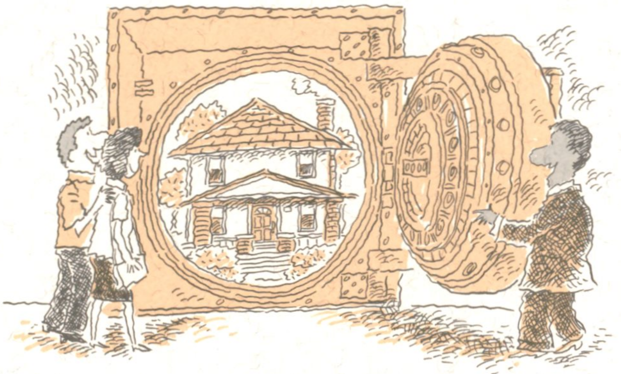
THE FEDERAL RESERVE BANK of ST. LOUIS

COMMUNITY AFFAIRS

June 1994

News and Views on Community Affairs for the Eighth Federal Reserve District

Opening Doors to Home Ownership



Following successful completion of the first phase of its Home Partnership Program, Commerce Bank of St. Louis recently announced that the lending program has been extended. The bank is providing at least $3 million more in affordable housing loans for home buyers in low- and moderate-income census tracts.

During the first round of the program, Commerce made 38 loans totaling $2 million—all to residents with incomes equal to or less than 60 percent of the area's median. Most were made within the city of St. Louis.

"We designed a product to meet the needs of low- and moderate-income home buyers," said Loura Gilbert, Commerce's Community Reinvestment Officer, "and we are pleased that we achieved our goal of making more loans in lower-income neighborhoods."

Nine community groups act as sponsors in the program by helping clients qualify for a Home Partnership loan. The sponsors also conduct home buyer training, which is required for all applicants. Laura Costello of DeSales Community Housing Corporation said: "The program has made it easier for home buyers because it helps with down payment and closing costs. Many that have gone through the program would

(continued on back page)

Public Welfare Investments Rule Proposed for State Members

A proposal to permit state member banks to participate in community development investments, without approval in many cases, is now out for comment. The Federal Reserve Board of Governors is seeking comments on the proposal by July 22, 1994.

The proposed rule identifies public welfare investments that do not require Board approval, leaving less-common investments and investments of more than 5 percent of a bank's capital subject to case-by-case review.

Under the proposal, a state member bank would be able to invest, without Board approval, in an entity established solely to engage in:

- low- and moderate-income housing;
- nonresidential real estate development in a low- or moderate-income area (if the real estate is used mainly by low- and moderate-income persons);
- job training or placement for low- and moderate-income persons;
- small business development in a low- or moderate-income area;
- job creation in a low- or moderate-income area for low- and moderate-income persons; and
- technical assistance and credit counseling to benefit community development.

For a copy of the proposal, call Judy Armstrong of our Community Affairs Office at (314) 444-8646.

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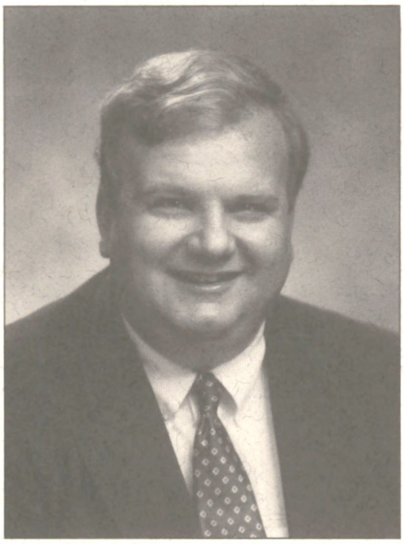
"Second Look" Mortgage Reviews

Following a request for information on mortgage reviews from lenders around the country, Lawrence Lindsey, Federal Reserve Board governor, received more than 500 letters from bankers sharing their experiences with "second look" reviews. Lindsey summarized the results saying that, although each of the responses was unique, common themes emerged.



Lawrence Lindsey

Second Reviews Used

Lindsey said that more than three-quarters of the bankers who responded said they use reviews, which he fit into three major categories: simple, targeted and group.

- Simple reviews are straightforward second looks at all mortgage denials.
- Targeted reviews entail a re-examination of denials with an emphasis on a particular market segment, such as low- and moderate-income or minority applicants. (Targeted reviews should be made in comparison with other applicants, such as accepted white applicants, to ensure that the targeted group is not singled out for review.)
- Group reviews involve the examination of all loans by a committee. Applications are then approved or denied based on group consensus. Although not technically a second review, this type of approval process ensures a similar end result: The loan is reviewed by more than one person before the final loan decision. Feedback from lenders showed this type of review was used more by smaller institutions.

Overwhelmingly, bankers said that the second look procedure was a new initiative within their institutions—72 percent having been implemented within the last two years. Some bankers, however, reported that they have had reviews in place since the 1970s.

Although each bank tailors its second look procedure to its individual needs, most reviewers fit into these categories:

- An executive: the bank president or other senior officer;
- Another bank employee, such as a loan officer, department manager or compliance officer; or
- A committee, whose membership can include senior management, board members, compliance officers and mortgage lending staff.

Most respondents said that their reviews were internal; that is, they used the bank's own staff. Four percent of banks using reviews, however, participated in outside mortgage review boards consisting of local institutions.

Reversal Rates

The success of a second review can be judged, to a degree, by the reversal rate. Of bankers who gave their reversal rates, 50 percent said that they had no reversals to date. The other half had experienced reversals, with several banks logging rates of more than 50 percent. Most reversal rates, however, were evenly distributed within the one percent to 30 percent range.

Bankers were careful to note that, in many cases involving simple reviews, a reversal was conditioned upon the applicant having to accept different loan terms or a different loan product. In other cases, the reversal resulted after the lender received additional information from the applicant. Some respondents experiencing a high reversal rate noted that the rate declined over time as bank staff became more familiar with management's goals.

Other Approaches

In addition to second look reviews, other techniques are used by bankers to ensure fairer and more profitable lending.

- Checklists are used by some institutions to ensure consistency in soliciting information from loan applicants. With a list, all applicants are "coached" equally.
- Shoppers can ensure that branch employees are not engaging in discriminatory behavior, either in person or on the telephone. If a formal shopping program is instituted, however, records may need to be provided to government agencies.
- Promotional materials can highlight special programs for targeted applicants or neighborhoods. Brightly colored fliers, distributed either door-to-door or through neighborhood associations and churches, can encourage applicants who might not otherwise come into the bank.
- Low application fees encourage applicants from economically distressed neighborhoods.
- No cost reapplications for applicants who are denied also have been known to help increase the pool of targeted applicants.

That Extra Mile

In short, sound business benefits come from second look procedures. "It has always been my belief," said Lindsey, "that in banking, like any service industry, the customer reigns supreme. Customers are your reason for being—a view shared by many community bankers."

That said, second look programs can be viewed as an extension of customer service—a commitment to go that extra mile to ensure that no qualified loan goes unmade.

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Lending Discrimination Policy Statement Adopted

FAIR LENDING SEMINARS

FOR: Financial institution presidents, chief executive officers and directors

WHY: To help top management better understand fair lending and institute policies that ensure corporate commitment to nondiscriminatory lending practices

TOPICS: Agency priorities, principals and initiatives; the role of the Department of Justice and the Department of Housing and Urban Development, the secondary market and ways lenders have improved their practices

WHEN & WHERE:
Monday, July 18, 1994
Washington, D.C.

Friday, Aug. 19, 1994
Chicago, Ill.

Friday, Nov. 4, 1994
San Francisco, Calif.

SPONSOR: The FFIEC

For registration forms, contact Judy Armstrong, Community Affairs Office, Federal Reserve Bank of St. Louis, (314)444-8646.

Recently, the Federal Reserve, along with nine other federal agencies responsible for implementing and enforcing the nation's fair lending laws, adopted a policy statement on lending discrimination.

The statement outlines the characteristics of discrimination as set forth in the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act. It applies to all lenders including banks and thrifts, credit unions, mortgage brokers, finance companies, retailers, credit card issuers and others who extend credit of any type.

In addition to identifying specific discriminatory practices prohibited by the ECOA and the Fair Housing Act, the statement also details three methods of proving lending discrimination under the statutes:

Overt Evidence of Discrimination—when a lender blatantly discriminates on a prohibited basis (race or color, national origin, religion, sex, age, handicap, familial status, or income derived from public assistance). Overt evidence of discrimination exists even when a lender expresses—but does not act on—a discriminatory preference.
Example: A lending officer told a customer, "We do not like to make mortgages to Native Americans, but the law says we cannot discriminate, and we have to comply with the law." This statement violated the Fair Housing Act's prohibition on statements expressing a discriminatory preference.

Evidence of Disparate Treatment—when a lender treats applicants differently based on one of the prohibited factors. Disparate treatment ranges from overt discrimination to more subtle disparities in treatment. It does not require any showing that the treatment was motivated by prejudice or a conscious intention to discriminate against a person beyond the difference in treatment itself.

Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well-qualified nor clearly unqualified. First, because the applications are all "close cases," there is more room and need for lender discretion. Second, whether an applicant qualifies may depend on the level of assistance the lender provides in preparing the application.
Example: Two minority borrowers asked a lender about mortgage loans. They were given applications for fixed-rate loans only and were not offered assistance in completing the loan applications. They completed the applications on their own and ultimately failed to qualify. Two similarly situated nonminority borrowers made an identical inquiry about mortgage loans to the same lender. They were given information about both adjustable-rate and fixed-rate mortgages and were given assistance preparing applications that the lender could accept.

Evidence of Disparate Impact—when a lender applies a practice uniformly to all applicants, but the practice has a discriminatory effect on a prohibited basis and is not justified by business necessity. Policies and practices that are neutral on their face and that are applied equally may still, on a prohibited basis, disproportionately and adversely affect a person's access to credit.
Example: A lender's policy is not to extend loans for single-family residences for less than \$60,000. This policy has been in effect for 10 years. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because of their income levels or the value of the houses in the areas in which they live. The lender will be required to justify the "business necessity" for the policy.

The agencies welcome comments about the application of the principles in the policy statement to specific policies and practices.

For copies of the policy statement, which includes answers to 13 questions often asked by lenders and the public, please contact Judy Armstrong of our Community Affairs Office at (314) 444-8646.

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A Lender's View: Successfully Working with Nonprofits

by
Victoria Docauer,
vice president,
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Union Planters National Bank,
Memphis, Tenn.

Like other financial institutions in the Eighth Federal Reserve District, Union Planters National Bank of Memphis continues to seek innovative, workable community development programs. Frequently, these programs involve a combination of public and private resources and expertise.

Such a partnership was created recently when the city of Memphis, Union Planters, Bright Future Homes Inc., and the Christian Methodist Episcopal (CME) Church agreed to work together to help meet the need for affordable single-family residences in the Memphis area. This is a good example of how organizations can combine their individual strengths to create a total program stronger than the sum of the parts.

Coming Together

With New Day Cooperative Inc., a nonprofit corporation affiliated with the CME Church, the partnership has established procedures to construct and finance 272 single-family houses for low-to moderate-income individuals in the Frayser community's St. Elmo subdivision in North Memphis.

NONPROFIT PARTICIPATION

The CME Church, through New Day Cooperative, owns the land on which the houses will be built. In addition, the church has retained Urban Planning and Research Systems (UPRS) to identify, screen, prequalify in accordance with FHA guidelines and refer applicants for mortgage loans to Union Planters.

Getting the Word Out

UPRS is responsible for marketing and advertising the availability of mortgage financing through television and radio ads and mail-outs to churches of all denominations. It also works with the ministers of these churches to identify potential home buyers and then helps applicants evaluate their creditworthiness. In addition, a UPRS representative accompanies each qualified applicant to the bank.

LENDER PARTICIPATION

Union Planters is engaged in a wide range of lending activities, including consumer, commercial and real estate lending. One way that these activities are expanded is by participating with community organizations and local government agencies in programs designed specifically to reach residents in low- and moderate-income neighborhoods of our delineated community.

Bank's Buy-In

For example, Union Planters has committed up to $15 million in long-term mortgage loans to qualified applicants to purchase houses built by Bright Future Homes in the St. Elmo subdivision. The bank also has committed to provide construction financing to the builder when permanent financing is approved.

When Union Planters receives applications from potential home buyers who have already been screened by UPRS, qualifying requirements are completed according to bank and FHA guidelines. Approved applicants are then issued a commitment letter, a copy of which is sent to the bank's construction lending division. They, in turn, authorize Bright Future Homes to begin construction.

Once authorized, homes are to be built within 110 days in accordance with all current building codes and FHA guidelines. Two model homes are also under construction.

Government Helps Out, Too

The city of Memphis, through its Housing and Community Development Division, has agreed to help with downpayment assistance, giving up to $2500 to each qualified and approved mortgage applicant. This amount is forwarded to Union Planters to be escrowed for use by the home buyer when the loan is finalized.

This program was just initiated in late April and hopes remain high that it will provide low-to moderate-income families a new avenue to owning a house. Although the program's biggest goal is to encourage individuals who otherwise might not have attempted to buy a home to consider the possibility, it also aims to revitalize a neighborhood, which, in turn, will boost the city as a whole.

Everyone Benefits

For Union Planters' part, the bank not only has a chance to help make its community better by participating in such partnerships with community organizations, but such projects also make for good business.

Overall, financing community development projects can be profitable and a good start toward helping banks meet their Community Reinvestment Act requirements.

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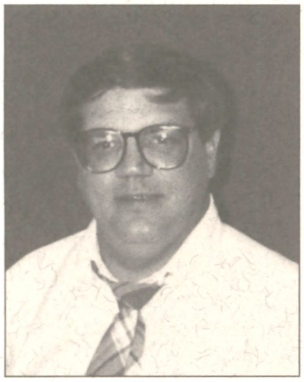
A Nonprofit's View: Successfully Working with Lenders

by
Brian O'Malley,
executive director,
Associated Catholic Charities and Diocese of Memphis Housing Corp.



Despite their best intentions, banks and nonprofit agencies often experience frustration working together. Although common goals abound, difficulties between community groups and banks usually result from a lack of understanding.

Many community organizations spring from grass roots efforts to address their communities' needs. Banks, on the other hand, are designed to safeguard and invest people's money, which means that often they can only commiserate with the plight of neighborhood groups and show them the way to City Hall. Residents then become discouraged about the lack of solutions to their neighborhood's problems, while lenders resent being miscast as villains.

Differing viewpoints aside, strong and productive partnerships between banks and community groups are forged when both sides have a clear understanding of their common interests. What then is the nature of these partnerships that result in successful community development models?

Trust + Communication

As with any successful partnership, a sense of trust must exist. Two factors allow this trust to develop: shared goals and an honest exchange of information. Community groups want a better neighborhood, and lenders want good investment opportunities.

In the late 1980s, for example, Boatmen's Bank of Tennessee joined forces with community groups in the Cooper-Young neighborhood to revitalize that community. The bank's vice president and CRA compliance officer, Bill Stemmler, started out by working with existing community groups to get residents focused on a common goal and later helped form the Cooper-Young Business Association.

A development corporation was formed to spur housing activity, and a new Neighborhood Watch program was instituted. In addition to offering special loan products with below-market rates, Boatmen's also opened a branch in the Cooper-Young section, which has helped to stabilize the area.

Community groups also should be encouraged to invite bank representatives to serve on boards and planning groups to further enhance communication and trust between the two groups. Associated Catholic Charities of Memphis has lenders from many institutions serving as directors on its board and several participate on committees and planning groups, too.

Bankers Provide Leadership

Another factor in successful partnership is bank leadership. Banks may serve as brokers within the nonprofit sector for community groups interested in redeveloping their housing and support services.

Social service agencies with a successful history may need to meet with a community group, and a lender can be the catalyst that unites these groups. NationsBank of Tennessee provided a good example of this leadership when Dorothy Cleaves, community investment coordinator, gave the diocese ideas on what could be done to help its surrounding community. Cleaves also provided information about what other groups are doing in the area so that efforts complement, rather than duplicate, one another.

Tools to Grow

Many small nonprofit agencies lack the administrative structure to react to obvious neighborhood needs. With one typewriter and a volunteer accountant, small agencies aren't always able to respond to opportunities when presented. Banks can encourage larger organizations to serve as fiscal agents to smaller nonprofits and provide administrative services for an appropriate fee. This enables fledgling community groups to become more professional and accountable and, ultimately, flourish.

Even large social service agencies operate with minimal administrative staffs. Banks need to recognize this problem and lend a hand in preparing grant and loan applications. Also, lenders can assist a nonprofit with organizing its financial records and reports to make them easier to understand and monitor and, therefore, more attractive to funding sources.

In short, banks build partnerships with community agencies by creating trust, uniting professionals, serving as leaders to build administrative capacity and seeking out nonprofits with a history of accountability.

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Opening Doors

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not have qualified for a loan through conventional sources."

Lending Program Highlights

Loan Purpose: For purchases and purchase/rehabilitations of one or two family owner-occupied principal residences that are located in census tracts with 80 percent or less of median family income.

A home improvement option allows for a 97 percent maximum loan to value, which is based on the lesser of appraised value at completion of the work or the purchase price plus the cost of improvements.

Interest Rate: 25 basis points below the market rate

Origination Fee: No points or origination fee

Closing Costs: Paid by the bank

Application Fee: $350, which is credited at closing

Loan Term: five, 10, 15, 20, 25, or 30 years

Down Payment: 3 percent of appraised value or a minimum of $1000; private mortgage insurance is not required

Underwriting Requirements: Maximum housing ratio is 33 percent. Maximum total debt ratio is 38 percent. If the borrower has demonstrated the ability to handle a higher percentage of obligations to income, this ratio may exceed 38 percent but may not exceed 40 percent.

For home buyers with incomes between 80 percent and 115 percent of median household income, Commerce offers a modified program. For this range, the interest rate is not discounted, and the down payment requirement is increased to 5 percent of appraised value.

New Resources Available

The St. Louis Fed's Community Affairs Office has new resources available upon request:

The Credit Process: A Guide for Small Business Owners, from the Federal Reserve Bank of New York, offers guidance to small business owners who are seeking outside financing for the first time.

Louisville, Kentucky Community Investment Opportunities, prepared by the St. Louis Fed's Community Affairs staff, identifies credit needs of the Louisville area and profiles local government and nonprofit programs that help address those needs.

Building Bridges to Community Development, the Federal Reserve Bank of St. Louis' 1993 annual report, discusses the Community Reinvestment Act and the activities of the St. Louis Fed's Community Affairs Office.

Closing the Gap: A Guide to Equal Opportunity Lending, a videotape produced by the Federal Reserve System to help financial institutions ensure fair lending within their organizations. Federal Reserve Chairman Alan Greenspan, along with Federal Reserve System employees, present a video rendition of the 10 recommendations featured in the Federal Reserve Bank of Boston's popular publication of the same name. Up to 30 copies may be ordered from VIDICOPY, 650 Vaqueros Ave., Sunnyvale, Calif., 94086, for $9.95 each, including shipping and handling. For rates on more than 30 copies, call VIDICOPY at 1-800-708-7080.

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