



Comptroller of the Currency  
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# Community Developments

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## When Urban Meets Rural: How Bank-CDC Partnerships Solve Housing Problems

by Rick Cauley, *Vice President, South Valley National Bank*



*Many homebuyers at Los Arroyos contributed their down payment through "sweat equity."*

What happens when urban sprawl overtakes a rural community? To find out, come to Gilroy, California — and see how a vigorous partnership between a bank and a community development corporation is helping to cope with the kind of housing crisis faced by many communities today.

Gilroy, settled in 1850 as a stagecoach stop on the road from San Jose to Monterey, grew to become the commercial hub of the surrounding Santa Clara County farm country, where the emphasis shifted over the years from cattle to tobacco to cheese and then to orchards and row crops. Today Gilroy proudly calls itself the Garlic Capital of the World. As the name suggests, it's a place with strong ties to its rural agricultural roots.

A town of 3,500 people in 1945, Gilroy has now grown to more than 40,000. But it's not Gilroy's growth alone that has created an affordable-housing crunch for farm workers and others. The 800-pound gorilla lies just to the north, less than 30 minutes away via US 101.

### ***Rampant metropolitan sprawl***

San Jose, which had a population of 58,000 in 1945, is now California's third largest city, with a population of more than 917,000. The "capital of Silicon Valley" has the second highest median household income in the U.S., and rampant metropolitan sprawl has by no means been halted by the recent misfortunes of many high-tech industries. San Jose's suburbs are on the march, and the skyrocketing cost of housing has had a serious impact on once-isolated rural towns and small cities like Gilroy.

With median home prices above \$400,000 and two-bedroom apartment rentals running at more than \$1,000 per month in rural communities as far as 90 minutes' drive-time from San Jose, it's clear that the affordable-housing crunch now affects a wide swath of the area's households. In fact, the majority of the labor force involved in agriculture, tourism, retail services, education, law enforcement, and many other industries and services now spends more than 50 percent of family income on housing.

San Jose's impact was making itself felt in Gilroy even in the 1970s, when farm workers and

processing-plant workers began finding it increasingly difficult to put a roof over their heads. South County Housing (SCH), a nonprofit community development corporation, was formed in response. Since 1979, SCH has developed more than 1,300 single- and multifamily housing units for farm worker families, seniors, seasonal laborers, single parents, low-income families, and the homeless. Still headquartered in Gilroy, SCH is currently helping to meet affordable-housing needs in four midcoast California counties. SCH is part of the Rural LISC network of rural development organizations sharing resources and expertise under the auspices of the Local Initiatives Support Corporation (LISC).

South Valley National Bank (SVNB) first partnered with SCH in 1987, when we provided a loan to build farm worker housing. We've been partners ever since. SVNB, a division of Pacific Capital Bancorp which has offices throughout SCH's area of operations, now maintains a full service banking relationship with SCH, providing credit and depository products, ranging from construction loans, lines and letters of credit, commercial real estate loans, and short-term notes on the credit side to operating and investment accounts on the deposit side. We've helped SCH to plan and implement a comprehensive strategy addressing operational, money management, and funding issues.

### ***Life at Los Arroyos***

Let's look at one of SCH's exemplary developments: its 62-acre Los Arroyos complex in Gilroy. SVNB provided some \$25 million to fund a substantial portion of construction costs on this master-planned, multi-phase, 384-unit community, which includes:

- Apartments for seniors
- Apartments for families
- Apartments for developmentally disabled adults
- Single-family homes sold on a turnkey basis to homebuyers with traditional financing
- Single-family self-help homes for which homebuyers contribute more than 1,000 hours of labor in lieu of a down payment
- A childcare center
- A small municipal park

Los Arroyos is designed to be a true community, with a wide range of housing types and a wide range of family incomes. Strolling through the complex, you can't tell the self-help housing from the market-rate homes. That, too, was built into the design.

In 2001, Angela and Antonio Rodriguez joined 10 other families to build self-help homes in Los Arroyos. With Antonio already working two jobs and Angela caring for their two children, the thought of committing 40 hours a week to the project for 10 months was intimidating. But they did it, pulling together with the other families, who became friends as they became neighbors. Angela and Antonio and their children moved into their new three-bedroom home in July 2002.

"Words can't express what this has meant to us," the Rodriguezes say. "The challenge pulled qualities out of us that we never thought we had, and we love that feeling. We are at a very happy place in our lives right now."

How do lower-income families become homeowners at Los Arroyos? With lots of determination and considerable help (see sidebar below).

### *A vital community service*

It's no simple matter to successfully finance affordable housing, particularly when a project is as ambitious and innovative as Los Arroyos. In addition to SVN, many institutions have served as funding sources for SCH, including other banks, the San Francisco Federal Home Loan Bank's Affordable Housing Program, the State of California's HOME program, Lenders for Community Development, Enterprise Foundation, Santa Clara County Housing Trust Fund, and the California Housing Finance Agency. Low-income housing tax credits available to financial institutions have been an important part of Los Arroyos' financing.

Over the years, SCH has grown into a sophisticated entity operating within a variety of financial, operational, and governmental structures. SVN personnel continue to invest the time and resources necessary to both understand the operation and find new ways to enhance the relationship. For example, bank officers suggested pooling investment funds scattered among various financial institutions into a combined account at SVN, a move which had the added benefit of providing collateral for a Portfolio Reserve Line of Credit with an attractive interest rate and fee structure.

In short, a more economical vehicle for funding working capital needs was implemented, benefiting both the customer and the bank. While SCH traditionally funds its pre-development costs internally, this line of credit is available for post-completion carrying costs incurred from when a project is completed until all permanent funding is in place. The line is also available to cover administrative and operating expenses during periods of deficit cash flow resulting from normal fluctuations in revenue streams.

By supplying a substantial portion of South County Housing's financing requirements, South Valley National Bank and our Network of Preferred Community Banks are making a significant contribution to the communities where we work and live. And we, in turn, couldn't ask for a better partner than SCH — a group of dedicated and highly skilled individuals providing a vital service by making excellent housing available to low- and moderate-income residents in one of the nation's most expensive housing markets.

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## **How Sweat Equity Helps Low-Income Families Become Homeowners at Los Arroyos**

Many Californians who might have abandoned hope of ever owning a home have found that self-help can turn the key to success. And the pride that accompanies learning home construction and maintenance skills helps build a strong sense of community ownership — which is vital to the long-term success of any mixed-incomes housing development.

Here's how sweat equity, coupled with help from a variety of funding sources, described below, makes a high-quality 4-bedroom home affordable at Los Arroyos with a sale price of \$420,000.

### **Homebuyer Sweat-Equity Value of Labor - \$18,000**

South County Housing's self-help program requires homebuyers to commit about 40 hours a week for up to 10 months to constructing theirs and their neighbors' homes. Supervised by SCH construction managers, families work at activities such, as framing, drywall, roofing, landscaping, and painting. This is the family's equity investment.

### **Deferred Note/Deed-California HOME Funds - \$20,000**

Deferred notes from the State of California HOME program are non-amortized and require repayment of the original principal plus 3 percent simple annual interest at the end of the 30-year term. At the end of the term, the family either draws upon personal assets built up over time or secures alternate funding to pay off the note.

### **Deferred Note/Deed-FHLB Affordable Housing Program - \$15,000**

The Federal Home Loan Bank's Affordable Housing Program provides subsidies to low-income homebuyers in the form of a 5-year note that is fully forgiven at the end of the term as long as the homebuyer retains the home as the primary residence throughout the term. The FHLB provides funds to Santa Barbara Bank and Trust, a SVNB affiliate, which then originates the loans.

### **Deferred Note-Resale Restriction Recorded on Property - \$227,000**

South County Housing records a deed of trust and resale restriction document on each property that captures the difference between the market value of the home and the total amount of the first mortgage and other deferred loans. The resale restriction allows the original homebuyer to retain equity and accrue additional market value equity while keeping the home affordable to future purchasers if the original homeowner sells the property. The SCH subordinate facility accrues interest and has an equity-sharing provision. The 30-year loan is forgiven at the rate of 10 percent annually beginning in year 20. All amounts due on the SCH loan are assumable to future qualified buyers.

### **First Mortgage with California Housing Finance Agency - \$140,000**

For purchasers of self-help homes, SCH arranges for special California Housing Finance Agency (CalHFA) mortgages, available only to homeowners participating in nonprofit-sponsored self-help developments. Mortgages are 30-year fixed-rate loans at 4 percent, available to families earning below \$45,000 per year (less than 50 percent of the area median income).