Office of the Comptroller of the Currency
Administrator of National Banks

Effective Strategies

for Community Development Finance

The Office of the Comptroller of the Currency (OCC) was established in 1863 as a bureau of the Department of the Treasury. The OCC is headed by the Comptroller, who is appointed by the President, with the advice and consent of the Senate, for a five-year term. The OCC charters, regulates, and supervises approximately 2,600 national banks and 66 federal branches and agencies of foreign banks in the United States, accounting for 58 percent of the nation's banking assets. Its mission is to ensure a safe, sound, and competitive national banking system that supports the citizens, communities, and economy of the United States.

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Community Development Resource Guide (Companion Volume)

The Community Development Resource Guide *provides summaries of approximately 145 publications, videotapes, software applications, World Wide Web sites, and other information resources from more than 60 organizations.*

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INTRODUCTION

Over the last two decades, many U.S. commercial banks have used community development finance techniques to help meet the credit needs of their communities. To better understand successful strategies for community development finance, the OCC studied how selected national banks finance three community development activities: affordable single-family housing, affordable multifamily housing, and direct small business lending. This publication presents strategies that have helped those banks engage effectively in community development (CD) finance. While it does not report on the profitability of CD finance, the publication does describe the processes and programs those banks use to achieve their CD objectives, and provides practical information for other banks that want to undertake CD activities.

For purposes of this study, we set out to determine the practices that contribute to the banks' success in the three CD activities and how these practices fit into each bank's CD delivery and performance assessment processes. We also explored the types of effective relationships between banks and their community partners that help finance local CD activities. We obtained information from national banks, community-based organizations, and government agencies through interviews and supplemental documents provided by the participants.

The willingness of the organizations to share experiences and strategies that benefit low- and moderate-income families and small businesses is consistent with two primary lessons we learned from the study. First, banks that are successful in CD financing actively investigate their communities for CD opportunities appropriate for the markets and take a strategic approach to partnerships with CD organizations and government agencies. Second, banks learn as much as they can from the best in the business, replicate appropriate strategies in local markets, and go back to the drawing board to develop new approaches when previous methods do not work.

Goals and Objectives

This study has two principal objectives:

(1) To highlight effective CD financing practices; and

(2) To illustrate effective partnerships that finance CD activities.

Scope and Definitions

A bank's CD financing may include a broad range of lending, investment,[1] and service activities permissible under federal banking law. This study focuses on three particular lending activities:

- Affordable mortgage loans for owner-occupied, single-family residences;
- Affordable multifamily rental housing financing; and
- Direct lending to small businesses,[2] especially to those companies needing special loan products or delivery mechanisms.

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1 National banks are permitted to make investments in community-based organizations and CD intermediaries that primarily promote the public welfare, including the welfare of low-and moderate-income families or communities under the OCC's regulation on community development corporation and project investments and other public welfare investments (12 CFR Part 24).

2 "Small businesses" are defined for purposes of this study to mean businesses that meet the qualifications of the Small Business Administration's Development Company or the Small Business Investment Company Programs in 13 CFR Part 121.301 or that have annual revenues of $1 million or less.

The study uses an "effective practice," approach rather than a formal, statistical analysis. OCC staff conducted site visits and asked the banks to respond to questions. Specifically, the study is based on the special steps or processes attributed to effective CD finance by a defined group of national banks.

The OCC considered national banks of all asset sizes for the study. The banks that were selected shared certain characteristics with regard to successful CD programs, including the banks' overall safety and soundness condition, their record of CRA performance under the Community Reinvestment Act (CRA), trade association press reports about their successful bank programs, and validating observations from OCC staff and CD intermediaries. All of the banks had assets of $250 million and greater. To ensure that the results would have broad geographic applicability, banking companies were selected from geographic areas across the country. (The study's method is described in appendix A.)

How To Use the Report

The intent of this report is to help national banks and other financial institutions develop effective CD finance programs by sharing strategies for delivering and managing typical loan and investment products that support local CD and reinvestment efforts. We believe the report will be most useful to mid- and regional-size institutions. It outlines approaches that can be used by these banks given their asset size, level of staff dedicated to CD finance, their operations, and their interactions with community partners. For larger institutions, the report will reaffirm the strategies they may already conduct and help them refine or implement new practices. For small institutions, the report will provide strategies that can be replicated, in whole or in part, to help leverage bank resources.

An initial chapter describes common themes about banks' effective strategies for achieving their overall CD objectives. Subsequent chapters describe the banks' practices for each of the study's three CD products. In those chapters, the report describes the banks' effective strategies for delivering CD products, including some indicators of how the banks measure the products' success. The chapters also discuss the challenges and barriers to effective CD finance that the banks identified during the site visits. The appendixes at the end of the report give supplemental information, such as a list of commonly used government programs and other resources, for affordable mortgage lending and multifamily finance and small business lending.

Resource Guide

Accompanying the report is the *Community Development Resource Guide,* which provides brief summaries of approximately 145 publications, videotapes, software applications, World Wide Web sites, and other information from more than 60 organizations. Anyone wanting additional information on a particular topic in the study may contact the organizations listed in the guide and request the materials. The Community Development Resource Guide is not intended to be comprehensive, nor does the OCC specifically endorse any of the organizations listed. However, we believe that the guide brings together information that banks and others may find helpful in learning about CD approaches and tools used in urban and rural areas and in Native American communities.

Acknowledgments

The OCC gratefully acknowledges each of the banks, government agencies, and CD organizations and intermediaries that participated in the study and devoted time, staff, and materials for the report. The report does not reveal proprietary information about the affordable housing and small business lending and investing practices of the study's participants. The OCC does not endorse any government program, CD intermediary, or private enterprise that is described in the report. The names of the participating government and CD organization study partners are listed in appendix H.

STRATEGIES TO ACHIEVE COMMUNITY DEVELOPMENT FINANCE OBJECTIVES

The banks that participated in the study use a variety of effective CD strategies. However, we found that the banks' CD strategies reflect two guiding principles. First, banks that are successful in CD financing actively investigate their communities for CD opportunities appropriate for the markets and take a strategic approach to partnerships with CD organizations and government agencies. Second, banks learn as much as they can from the best in the business, replicate appropriate strategies in local markets, and go back to the drawing board to develop new approaches when previous methods do not work.

The banks' high level of overall profitability during the past five years has enabled them to devote resources and establish a strong foundation for addressing the CD credit, investment, and service needs of their communities. They believe the well-developed strategies they have implemented have resulted in successful CD programs and have helped to create important aspects of their corporate image. In addition, these strategies may also increase the likelihood that their CD programs will continue to be successful, even during economic downturns.

The banks in our study are especially sensitive to the effect of an economic downturn on CD financing because of the limited disposable incomes that are typical of low- and moderate-income and small business borrowers. Consequently, the capacity and ability of government and CD organization partners to respond to changes in local markets or in borrowers' needs may play an important role in sustaining bank efforts in the event of economic weakness.

Effective Strategies

The banks we studied share a number of common strategies in their CD finance programs. Subsequent chapters will present in-depth discussions of these practices as they relate to the specific products. In general, we found that the banks:

- Provide leadership support for CD activities with financial and technical resources and a strong commitment to community development;
- Integrate CD finance into broader business strategies;
- Use a comprehensive approach to CD finance;
- Partner with government and community-based organizations and other corporate leaders; and
- Establish systems and performance measures for gauging the results of CD activities.

Provide leadership support for CD activities with financial resources and a strong commitment to community development

All of the banks in our study pointed to strong leadership as an essential element in their efforts to finance community and economic development. The chief executive officers, boards of directors, and senior managers of the banks in our study provide vision, motivation, and resources to support their banks' CD efforts. They articulate their banks' community and economic development goals, policies, and processes, and encourage staff to try different and innovative strategies, despite the fact that some results may take a long time.

The bank leaders indicated that they support community and economic development efforts for several reasons. First, they believe their banks play an important role in their communities, and that they can enhance and sustain their communities through their CD efforts. Second, most expect their CD efforts will help to expand their customer base. Third, their CD efforts enhance their banks' reputation in their communities. Finally, they expect their CD activities to enhance their CRA records.

To demonstrate their commitment to community development, the banks we studied hire people who understand community and economic development initiatives and who possess a wide range of experience. They look for people who, as one banker stated, have "fire in the belly." The banks hire staff with expertise in real estate and small business lending and a practical knowledge of local, state, and federal government programs that may be used to leverage bank resources. Their staff often represent a variety of cultures and socio-economic backgrounds to help encourage diverse customers to use bank services. The banks' employees are also familiar with the CD organizations and intermediaries in local communities and how relationships with these organizations help banks respond to community needs.

They look for people [staff] who, as one banker stated, have "fire in the belly."

The banks expect managers of CD departments to set goals, which may include volume goals, new product development goals, and goals for customer satisfaction. Managers also help their staff establish personal goals and permit them to spend a portion of their work time performing CD-related volunteer work, such as serving as technical advisors to nonprofit organizations. Finally, they encourage experimentation and test different approaches to find one that succeeds.

Most of the banks in the study employ incentive programs for staff specializing in CD lending. Because CD loans and investments usually take additional time and often involve relatively small transactions, some banks base incentives on the number of transactions that employees make rather than on the dollar amount of those transactions. Other banks provide a higher base salary to compensate for reduced commissions. Many of the banks also have incentive programs that encourage sale leads or referrals from front-line employees to appropriate CD staff.

Integrate CD finance into broader business strategies

Most of the banks in the study design CD finance programs so that they are consistent with the banks' broad objectives of volume, profitability, and serving and expanding markets. The banks' CD finance strategies are typical of their other business lines, which helps to integrate CD financing into their long-term business. Business planning for CD finance generally covers:

- Projections and performance goals that are consistent with current economic, market, and competition conditions;
- Identification and analysis of the primary risks of CD finance, including credit, transaction, compliance, liquidity, and reputation;
- Description of types of CD products that will be offered and policies for lines of authority, underwriting criteria, exception policies, and cure programs;
- Marketing processes, including familiarity with products and markets served;
- Management and administrative issues, such as staffing, training, and determining functions that will be performed in-house versus those outsourced (for example, education and counseling for home purchasers);

- Control systems for risk management, loan review, collections, and quality assurance; and
- Compliance and management information systems and reports to help the banks track individual loan performance and detect any flaws in the credit policies of the CD portfolio in a timely manner.

What differentiates CD finance business planning from other business lines is the banks' understanding of local market conditions and opportunities and building these features into program design and implementation. For example, the banks actively learn about credit enhancements, financing, and technical assistance tools that may be provided by government agencies and CD intermediaries to help them manage the risks of CD lending products. These mechanisms often enable the banks to offer innovative products with flexible underwriting and pricing, which they test and modify frequently and systematically. Establishing alliances with community partners also enables the banks to develop and test-market new products in limited geographic markets before incurring the expenses of adding them to their permanent product lines that cover wide geographic markets.

While these strategies may be unique to CD finance business planning, they have an effect on broader business objectives. For example, the banks explained that their CD finance strategies help to pave the way for the communities' receptiveness to new bank programs and to develop the banks' customer base for the future. In addition, the banks indicated that CD finance strategies are beginning to cross mainstream business lines, especially the banks' consumer products and delivery mechanisms that provide credit to underserved customers. Toward this end, the banks work closely with the department heads of CD finance and other product lines, marketing, loan review and servicing, risk and compliance management, audit, legal, and information technology so that there will be a consistent approach to serving customers and communities across the board.

Use a comprehensive approach to CD finance

The banks in the study view their CD finance programs in the context of a broad strategy for community redevelopment. They recognize that communities that improve and maintain infrastructure and public resources are those that attract new businesses and jobs, encourage existing businesses to expand, and ultimately increase the banks' own customer base.

"... we believe that our business is only as healthy as the communities we serve."

Most successful banks offer a broad range of CD lending, investment, and service products. These support the new construction or rehabilitation of housing, including affordable housing for low- and moderate-income families. In addition, many banks finance shopping centers; industrial developments; downtown "fix-ups"; small, medium, and large businesses; and other commercial and retail developments that create local jobs and provide products and services, particularly for low- and moderate-income persons. Other banks finance hospitals and health-care clinics, educational facilities, churches, libraries, and police and fire stations located in or serving low- and moderate-income and other disadvantaged communities. One bank in the study hires low-income high school youths for summer employment programs and provides local residents with training sessions that focus on job and life skills.

Many of the banks design their CD programs in consultation with government and CD leaders. They target programs and activities in neighborhoods so that development projects work in concert and with a sustained impact. As one banker explained the goals of the bank's CD programs: "...we believe that our business is only as healthy as the communities we serve. We see community development as a key component of our long-term business strategy. [Our programs are designed to have a] far-reaching impact on our communities that will produce additional demand for the bank's traditional products and services."

Partner with government and community-based organizations, and other corporate leaders

All of the banks in the study work in partnership with governments, CD organizations, businesses, and other banks to identify and respond to the community and economic development needs of their communities. Partnerships help the banks to do the harder CD lending, for example, the transactions that involve borrower education and counseling, loan packaging, and subsidies.

Partnerships help the banks to do the harder CD lending...

In many cases, bank interaction with and support of community partners is substantial. The banks evaluate the partnership potential in markets they plan to serve and develop strategies that build on the strengths of available market resources and community leadership. For example, in communities with strong leaders, banks may join them in focusing efforts on providing credit. In other communities, banks may provide staff and capital to community partners that help them build and maintain the capacity to carry out long-term CD projects and programs.

Although working with community partners may pose some challenges for the banks, the benefits can be substantial. The banks indicated that the right partnerships

- Help banks identify credit needs and address affordable housing and economic development projects, which improves the banks' CRA records;
- Provide banks a competitive edge by helping them to reduce development expenses, enhance the ability of their clients to borrow funds, or reduce the risks that may be associated with CD lending; and
- Provide access to new customers who may have few previous banking relationships or to communities that may have cultural or language barriers that limit bank access.

The banks also indicated that partnerships with other lenders through lending consortia or community development corporations may help to broaden their knowledge and share resources.

Establish systems and performance measures for gauging the results of CD activities

The banks indicated that cost effectiveness and cost management are important aspects of CD finance. The banks develop systems to track, monitor, and evaluate CD performance and risk through the collection and monitoring of data.

The banks in our study use quantitative measures to determine how well their CD products perform. Although their measures vary from one bank to another, many banks reported that they use measures that are similar to the ones they use for their conventional products. These include:

- Return on assets
- Return on equity

- Delinquency
- Loan losses
- Pricing
- Volume

For example, some banks compare the projected with the actual return on assets (ROA) of affordable single-family and multifamily lending products. They also compare the return from CD activities to those from more conventional products lines. In setting appropriate targets and calculating the ROA for both CD and conventional products, the banks generally consider interest income, servicing income, and loan fees in the revenue stream. In allocating costs, they include marketing, origination, servicing, underwriting, loan loss reserve allocations, direct overhead, and the cost of funds.

The banks we interviewed also mentioned that their CD financings help to increase market opportunities for other bank or affiliate products, such as credit cards and life insurance. Some banks indicated that the spin-off investments made by other companies and lenders in the same neighborhoods in which the banks made their loans or investments are good indicators of effective CD finance programs.

We found that banks often consider measures to link their CD financing to broader measures of economic development in their communities. For example, they may track how their lending, investment, and service activities have resulted in increases in the number of new or growing small businesses, jobs, affordable housing units, or in the amount of new property and sales taxes. Some of the banks evaluate how their CD activities enhance the quality of life for residents through improvements to neighborhood appearance, infrastructure, and public facilities; reductions in crime; business success and failure rates; and employment and other economic indicators.

Community receptiveness to the banks' programs were the qualitative measures most frequently mentioned by the banks. In addition, we learned that the banks evaluate their image as leaders in their community by conducting interviews with local residents and by publicizing awards from community organizations, positive press coverage, or outstanding CRA ratings from their regulators.

EFFECTIVE AFFORDABLE SINGLE-FAMILY MORTGAGE STRATEGIES

Affordable single-family mortgage lending generally refers to loans made to low- and moderate-income purchasers of one- to four-family units. The study found, however, that the banks define "affordable" mortgages in many different ways. Some banks consider affordable mortgages to be those they hold in their portfolio and conventional mortgages to be those they sell on the secondary market. Others consider affordable mortgages to be those that benefit low- and moderate-income residents. Many use secondary market affordable housing programs like those of Fannie Mae and Federal Home Loan Mortgage Corporation (Freddie Mac) and adopt their definitions. However, all the banks include borrower income, products with high loan-to-value ratios, and the use of nonconventional underwriting criteria among the characteristics of affordable mortgages.

For purposes of this study, one or more of the following features distinguish affordable mortgages from conventional ones:

- Mortgages that are made to applicants with incomes up to 80 percent of the median income;
- Mortgages that have debt ratios above the traditional 28 percent (monthly housing expenses-to-income ratio) and 36 percent (maximum total obligations-to-income ratio);
- Mortgages that have loan-to-value ratios 95 percent or higher of the property's appraised value;
- Mortgages that are made with "flexible" underwriting criteria; and
- Mortgages that involve enhanced servicing procedures, such as early or ongoing delinquency counseling.

Effective Strategies

Most of the banks engage in the following practices to successfully manage their affordable single-family mortgage programs:

- Demonstrate commitment to affordable mortgage lending and hire skilled, dedicated lenders;
- Design affordable mortgage programs that take into account customer needs, internal and external resources, and strategies to limit the bank's risk;
- Broaden affordable mortgage options by using secondary market mechanisms and government guarantees;
- Use flexible mortgage underwriting, but limit the layering of risk factors;[3]
- Offer specialized handling, such as second-look review programs, enhanced servicing, and home buyer education and counseling;
- Participate in partnerships for gap financing and home buyer education, loan workouts, and marketing; and
- Track individual loan performance and modify credit policies and processes.

[3] Layered risk factors refers to the practice of permitting multiple mortgage concessions in the underwriting process.

Demonstrate commitment to affordable mortgage lending and hire skilled lenders

The banks in the study said that strong support by their senior management is vital to their programs. CEOs and senior bank managers play an important part in setting realistic goals and time frames; providing internal systems to track, monitor, and evaluate the affordable mortgage portfolios; and providing the necessary capital and resources.

Most of the banks hire staff with affordable lending experience who are skilled in documenting and assessing an applicant's often incomplete or nontraditional credit history. These persons have skills in evaluating and requesting additional information about nontraditional payment records and credit problems. They may also have experience working with government and housing intermediaries' assistance programs that provide credit counseling, home buyer education, or help the applicants with funds for down payments, closing costs, or rehabilitation expenses not covered by the mortgage.

Successful banks also try to hire staff who reflect the culture of the communities that the banks serve to help break down real and perceived barriers with the potential borrowers. Some banks compensate staff in different ways to account for lower than average loan sizes or difficult or lengthy approval processes.

Design affordable mortgage programs that take into account customer needs, internal and external resources, and strategies to limit the bank's risk

The banks in the study explained that the three primary housing affordability problems confronting potential low- and moderate-income applicants are down payments, closing costs, and high monthly mortgage payments. However, in times of relatively low interest rates and accessible government subsidies, the ability of applicants to manage monthly payments is less an issue than their ability to secure sufficient funds for down payments and closing costs.

The banks indicated that potential customers for affordable mortgages may include persons who have not saved sufficient cash for the 10 percent to 20 percent down payments; whose monthly incomes and carrying expenses do not support conventional loans; or who have nontraditional credit histories. In designing flexible products and underwriting standards, the successful banks have found it necessary to explore government and other programs that can educate borrowers about credit issues and homeownership responsibilities, subsidize the borrowers' equity, or enhance their loans in other ways.

The banks consider internal and external factors when designing their affordable mortgage lending programs. Internal considerations include resources for marketing, origination and servicing, product monitoring and evaluation, and mortgage product targets and pricing. External considerations include the availability and condition of the housing stock, the potential market demand, the credit needs of local residents, and the condition of the local economy. Some banks form or participate on advisory councils to elicit comments from community leaders on proposed products. Most banks consider the products and processes offered by their competitors and evaluate opportunities to work with local government or community organizations that might help offset internal resource limitations.

Many lenders adopt the affordable housing programs that have already been developed by the secondary markets. Secondary market programs help to provide banks with a structure and an outline of requirements for quality control so that affordable mortgage loans can be sold on the secondary market, which increases their liquidity. Most of the banks, however, offer a combination of saleable conventional and government-insured products in addition to portfolio products.

Regardless of the markets, the banks indicated they consider safety and soundness requirements, competitors' products, and the credit needs of local residents when making pricing decisions. We observed that some of the lenders price mortgages at below-market rates, offer mortgage concessions, or waive mortgage insurance in order to reach certain markets. These and other operational and market issues are risk factors that may affect the target goals that the banks set for the affordable mortgage product line. However, as their affordable mortgage programs have matured, the banks have learned to limit the number of concessions offered to any one borrower in order to limit risk. In addition, the banks believe they have learned to use more effectively the credit enhancements and other programs offered by the secondary market, government agencies, and CD intermediaries that help to mitigate the effects of the concessions on the performance of the affordable mortgage portfolio.

Broaden affordable mortgage options by using secondary market mechanisms and government guarantees

Secondary market programs and loan guarantees enable banks to provide affordable mortgage loans by lowering the banks' credit risk. The secondary market helps lenders to package conventional, government-guaranteed, and affordable mortgage loans and sell them to investors. Since the secondary market agencies will purchase the banks' loans only if the loans meet certain underwriting and collateral requirements, the banks invest time and staff to learn about the agencies' programs and requirements in order to design affordable mortgage products; make appropriate loan decisions; and establish appropriate controls, processing, and tracking systems. The banks in the study typically use three secondary market agencies: Fannie Mae, Freddie Mac, and Government National Mortgage Agency (Ginnie Mae).

Government agencies help banks manage their credit risks by providing guarantees that protect lenders against losses when borrowers default. The federal agencies that typically provide loan guarantees on affordable single-family mortgages include the Federal Housing Administration (FHA)/U.S. Department of Housing and Urban Development (HUD), U.S. Department of Agriculture Rural Development (USDA Rural Development), and the Veterans Administration (VA). (Additional information about secondary market programs and government loan guarantee programs administered by these agencies appear in appendix E.)

Use flexible mortgage underwriting, but limit the layering of risk factors

In affordable mortgage lending, banks must balance flexibility in mortgage terms and underwriting with the risks associated with making such adjustments. We found that the banks use the flexibilities offered through the community lending programs of the secondary market agencies. Some of the banks we studied also use underwriting criteria that are outside standard secondary market criteria in order to reach certain low- and moderate-income borrowers.

For example, over the years, the banks have tested a variety of mortgage concessions and flexible underwriting options to help make products affordable, such as pricing loans at below-market interest rates, waiving mortgage insurance, or allowing loan-to-value ratios higher than the secondary market providers typically allow. They have also waived or lowered fees, such as origination fees, to reduce the borrower's closing costs and down payments; permitted gifts and grants to be used for a portion of the down payment and closing costs; allowed debt expense-to-income ratios above those allowed by the secondary market agencies; and considered nontraditional credit reports and job histories.

Mortgage insurance is an area where the banks have explored cost-reduction alternatives. Many of the banks are using secondary market and other private resources to offer reduced monthly mortgage insurance premiums to borrowers that seek mortgages with down payments of less than ten percent. One lender developed a program in which a recoverable grant, provided by a local government and structured as a soft-second mortgage, is used to pay for single premium mortgage insurance at no cost to the borrower. Other banks have purchased master insurance policies on pools of loans that they may later wish to sell.

The banks, mindful of safety and soundness considerations, have observed that successful affordable mortgage programs normally limit the number of concessions offered to any one borrower because risks rise when multiple concessions are permitted. The banks noted that mortgages using multiple concessions are less likely to be saleable in the public secondary market or may be sold only with discounts or recourse requirements.

The banks...have observed that successful affordable mortgage programs normally limit the number of concessions offered to any one borrower because risks rise when multiple concessions are permitted.

In addition, the banks we interviewed also cautioned that the use of relaxed underwriting and mortgage concessions should reflect both broad credit trends and local economic conditions. For example, the banks historically have considered a homeowner to be a good credit risk because of the strong relationship between homeownership and savings. However, as trends relating to increases in home equity lending and refinancings continue, the savings cushion from the home diminishes. Further, other trends and local economic conditions, such as rising or declining property values, may make the homeowner even more vulnerable during economic downturns.

The banks we studied periodically adjust underwriting and program requirements as more information becomes available on the effects of selected factors on credit quality. Several lenders reported that part of their success stems from a process of selective layering or balancing of risk factors, tracking this information, evaluating credit trends and local economic conditions, and readjusting the affordable mortgage design to meet program objectives.

Offer specialized handling, such as second-look review programs, enhanced servicing, and home buyer education and counseling

The banks in the study offer specialized handling in the mortgage process, particularly in reaching credit decisions and managing borrowers with repayment problems. These mechanisms include second-look review programs, home buyer education and counseling, and enhanced loan servicing. Determining how to deliver specialized processing requires the banks to consider fair housing and equal credit opportunity issues so that their lending and processing standards are applied fairly and uniformly to all applicants.[4]

Second-look review programs. Many banks use second-look review programs to help them reach decisions on whether to grant or deny credit to traditionally underserved borrowers. These review programs help to ensure consistency in loan decisions, including the evaluation of safety and soundness considerations and nondiscriminatory lending practices. A few of the banks indicated that second-look review programs have been useful when they use automated processing and credit scoring for the initial screening of mortgage applications.

Some review programs allow lenders to present new or updated credit information or to explore the effect of government programs and other local subsidies on the pending application. The reviews may also suggest strategies that lenders can use to postpone, rather than deny, granting credit to applicants; such strategies may include referrals to providers of home buyer education and counseling.

The banks in the study administer the second-look programs through a committee, unit manager, or in-house credit counselor. To ensure consistency, the banks take special steps to outline review program policies and take corrective actions, as appropriate.

Loan servicing. Although some of the banks reported that write-offs of affordable mortgages are generally comparable to conventional mortgages, a tendency toward higher delinquencies in affordable mortgage portfolios has prompted these banks to establish special servicing procedures. The banks described the importance of tracking individual affordable mortgage loans, including the reasons for any delinquencies. Some banks also track previously delinquent borrowers and stay in contact with them more vigorously than with other borrowers. Banks often contact new and previously delinquent borrowers as soon as five days after the payment due date if payments are late.

The banks described the importance of tracking individual affordable mortgage loans, including the reasons for any delinquencies.

Some lenders may modify loan terms when appropriate or otherwise work with delinquent borrowers. One bank indicated that it encourages "pre-foreclosure" sales to prevent properties from being labeled as "distressed property," and thus hurting the sale price or the value of other properties in the neighborhood.

Some of the lenders have dedicated affordable mortgage collections units to help in correcting loan deficiencies. A few of the banks employ third-party, post-purchase counseling services, particularly with community-based organizations, to provide this service to borrowers. Other banks contract with "loan doctors," companies that specialize in default management.

Lenders believe that an amicable and speedy resolution of borrowers' problems is in their own interest, particularly in cases of borrowers with minimal cash reserves, who generally find it difficult to cure a 60- or 90-day delinquency. Therefore, lenders often require that first-time delinquent borrowers attend a face-to-face counseling session. Most have adopted a "customer assistance" approach, with highly trained employees who have access to resources not normally available for conventional borrowers, such as homeowner counselors.

[4] Lending and processing standards must be in compliance with the Fair Housing Act (42 U.S.C. 3601 et seq.) and the Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.). Banks may establish a preferential special purpose credit program as permitted under the Equal Credit Opportunity Act and Regulation B, 12 CFR § 202.8.

Homeownership education and counseling. Many banks in the study use homeownership education and credit counseling programs to help address credit issues facing mortgage applicants. Some banks structure counseling programs in conjunction with reputable third parties that have expertise or certification in the field. Other lenders have in-house counseling programs and ensure that their affordable housing lenders are trained by third-party experts.

While the banks did not agree on the extent to which homeownership education and counseling actually improved loan and portfolio performance, they generally agreed that they would continue to use these mechanisms for several reasons:

- The banks believe that home buyer education generally improves borrowers' knowledge about the process of buying a home and obtaining a mortgage, and therefore borrowers are better prepared to meet the ongoing responsibilities of homeownership.
- Home buyer counseling allows the banks to make the experience more positive for applicants who do not initially qualify for a loan. The banks may benefit from having creditworthy applicants return when their qualifications have improved.
- An effective education program can publicize the opportunities for homeownership to people who might otherwise not have considered it. This can help to increase the overall demand for the mortgage product.

Some of the banks felt that the timing and frequency of home buyer education and counseling are critical factors for a program's success or failure. They believe that beginning home buyer education before the borrower signs a sales contract helps to provide lasting results. One bank highlighted the availability of counseling services at application time, well before closing the loan, when it provides mandatory Real Estate Settlement Procedures Act (RESPA) disclosures, such as the Good Faith Estimate.

The banks also recognized differences in the quality and delivery of education and counseling programs within the industry. They discussed delivery options for providing education and counseling, such as one-on-one and group settings.

Participate in partnerships for gap financing and home buyer education, loan workouts, and marketing

The banks in the study indicated that relationships with community partners enhance all phases of the mortgage process, particularly in filling financing gaps, providing home buyer education and counseling, alternatives for loan workouts, and marketing.

Gap financing and home buyer education and counseling. Many low- and moderate-income mortgage applicants have good credit histories and can afford monthly housing expenses. However, they may be unable to afford to purchase a home because of expenses relating to closing costs and down payment requirements. They may also lack funds for rehabilitation expenses and may be unable to borrow additional loan funds because of low or stagnant property values. While the banks in the study believe that a minimum amount of borrowers' equity provides important incentives for their ongoing mortgage responsibilities and home maintenance, they recognize potential borrowers may need assistance in filling these financing gaps. In response, most of the banks form partnerships with local CD organizations and local, state, and federal government agencies that provide such assistance.

Some local government programs provide interesting examples. Under one program, the City of Philadelphia provides grants to borrowers for single-premium mortgage insurance policies on bank mortgages, which are, in turn, sold to Fannie Mae. In another program, the City of Pittsburgh has attempted to deal with appraisal gaps by offering second mortgages and grants for rehabilitation expenses in conjunction with bank loans. By allowing a prospective purchaser of the property to assume the second mortgage, Pittsburgh has also helped the banks by adding to the quality of the collateral that the banks hold. Other local government programs provide second and third mortgages with flexible terms to borrowers, thereby keeping the market-rate mortgages affordable.

The banks in the study reported a number of federal programs that provide grants, low-cost loans, and pre- and post-purchase homeowner education and counseling to the home purchaser either directly through banks or through community-based organizations and CD intermediaries. The agencies most commonly identified by banks include HUD and USDA Rural Development. Some of these programs may also provide assistance to homeowners facing foreclosure on their insured loans. (A list of these and other federal programs appears in appendix E.)

Loan workouts. Within the context of affordable mortgage lending, most of the banks view foreclosure as a means of last resort. The foreclosure of one property also may affect the value of other properties in a neighborhood. Some of the banks in the study defer foreclosure, particularly when a homeowner loses his or her job, has a major illness, or experiences another type of temporary emergency.

Some banks in the study support foreclosure mitigation through partnerships with nonprofit organizations. One bank in the study refers delinquent clients to a local community development corporation (CDC), which may provide subsidies to the borrower to help keep the loan current. The CDC also provides pre- and postpurchase homeowner counseling and employment services and develops alternatives to help homeowners avoid foreclosure. For example, the CDC may work with the lender to revise the payment plan so that the owner agrees to bring delinquent payments current by adding extra amounts to regular monthly payments. Or the CDC may work with the lender to change the original terms of the loan so that the homeowner can continue to make affordable payments.

Marketing. The banks, community organizations, and government agencies were unanimous in viewing the development of strong partnerships with each other as the most important marketing technique in affordable mortgage lending. Successful affordable mortgage lenders employ a variety of special vehicles to market their products, including real estate agents or brokers, houses of worship, community organizations, homeownership counseling agencies, community advisory councils, government agencies, and other borrowers.

The banks in the study use conventional marketing strategies through their branch systems or external channels, such as sales promotions; direct mail; and print, outdoor, radio, and television advertising. The banks also use the wholesale channel—mortgage brokers—to identify potential affordable mortgage customers. One bank indicated that it took a less conventional market approach by sending affordable mortgage marketing materials to individuals on rent rolls found in its multifamily mortgage borrower files and tenant lists obtained from public housing authorities.

Some of the banks also use the Internet to market their mortgage products. They believe that this technology helps consumers to apply for loans and to obtain the best prices across a variety of institutions.

Track individual loan performance and modify credit policies and processes

A recurring issue in the discussion of affordable mortgage lending has been the difficulty of obtaining information that allows lenders to evaluate their own performance and compare themselves with the industry. The various definitions of "affordable mortgage" make such evaluations and comparisons difficult. A more important reason is a simple lack of historical data because until recently, affordable lending performance had not been tracked separately or product information has been lost when loans were sold.

By contrast, the banks in the study that have successful affordable lending programs identified the need for such information as early as possible in the program design. They established realistic targets that were separate from the ones they set for conventional mortgage products, tracked their affordable products separately from conventional products, and measured performance by product and by market. They tracked such factors as pricing; specific underwriting features; the type of homeownership counseling and education provided; the sources of applicants and borrowers; loan delinquencies; the type of post-loan servicing provided, such as early intervention and default mitigation; and other bank products and services provided to their borrowers.

The banks later adjusted underwriting criteria and program requirements based on their periodic program evaluations. For example, over a period of three years, one bank adjusted its cash reserve requirements, lengthened the acceptable time that must pass before making a loan following a bankruptcy, and added utility payments to the debt-load calculation. Another bank shortened the time to start its intervention process following a delayed payment.

Our study also found that the banks use measurement techniques that demonstrate similarities between the affordable and conventional mortgage products. The banks establish portfolio goals that target returns that exceed the costs they allocate to each of the products. In calculating the ROA for each of the products, the banks generally consider interest income, servicing income, and loan fees in the revenue stream. In allocating costs, they include origination, servicing, underwriting, allocations for loan loss reserve, direct overhead, and the cost of funds. Some banks also compare the projected and actual ROAs of the affordable mortgage products to the projected and actual ROAs of other bank products. The expected and actual targets for the affordable housing products have generally been lower than the projected and actual targets for the conventional products. The bankers suggested that one reason for the lower targets is that the products may use mortgage concessions, such as reduced origination fees, which are not offset by corresponding interest rate charges.

The banks varied in the amount of detailed information about loan performance they wished to share in this survey. While most of the banks agreed that delinquencies in affordable mortgages were generally higher than in their conventional portfolios, they believed that enhanced loan servicing was an important strategy in bringing down delinquencies in the affordable portfolios. One bank reported that its delinquencies were lower than in its conventional portfolio. Another bank reported that its more recent programs have shown a marked reduction in delinquencies as the bank gained experience in affordable mortgage lending.

Some Challenges and Barriers

A primary concern among the banks and secondary market participants we interviewed is the profitability and loan performance of affordable mortgage lending. The full effect of risk layering, mortgage counseling, enhanced servicing, and other factors has yet to be determined. Some banks hope their tracking mechanisms will provide evidence of profitable opportunities in the long run. Others are waiting for mortgage insurers, government agencies, and secondary market participants to provide these data. They hope that as portfolios mature and more information on successful underwriting becomes available to the industry, credit enhancements and secondary market opportunities will improve.

The banks have the option of securitizing most loans in their affordable mortgage portfolios, which reduces their capital allocation for reserves. However, some of these mortgages present problems to the secondary market, particularly those that are priced below market or lack mortgage insurance. Banks can still sell these mortgages, but they often must sell them at a discount or with recourse. As a result, they often hold the mortgages in their portfolio.

More movement has been made to open up the secondary market to affordable mortgages, particularly those that are seasoned. Some secondary market players offer programs to purchase or securitize portfolio loans that use underwriting criteria that are different than their underwriting criteria. In addition, some of the CD organizations that participated in the study provide secondary market vehicles that banks can use to sell these mortgages.

Another challenge facing the banks is the need to balance flexible underwriting and mortgage concessions with profitability and other safety and soundness considerations. Some banks spoke of having to compete with other financial institutions and nonbank companies that use across-the-board flexibilities to quickly increase their product volume. They expressed concerns about how these practices may lead to problems with credit and reputation risk and overall portfolio problems. In addition, such flexible practices could adversely affect low- and moderate-income neighborhoods if repayment were to become a problem. Foreclosed and boarded-up properties could quickly devalue a neighborhood. The banks have noted, however, that over time, this balancing challenge has been tempered by their more effective use of available credit enhancements and other resources to help mitigate the risks and by their stronger alliances with community leaders who understand profitability and other bank constraints.

Example: An Affordable Mortgage Transaction

The following example of an affordable mortgage for a low- or moderate-income family purchasing its first residence demonstrates how public resources can mitigate the risk to the lender, benefit the home buyer, and achieve local development goals.

Background

The three-bedroom residence to be purchased by the borrower requires some minor rehabilitation. A local church has brought the prospective purchaser to the bank officer. The purchaser has an annual family income of $27,000, with monthly car expenses of $250. The purchaser has been paying $750 in rent and has a good credit history. The purchaser's income is 50 percent of the area median income.

Rehabilitation costs are built into the budget for a total development cost of $70,000. The borrower will put in sweat equity by contributing materials and time to complete some of the minor repairs, such as painting. The city has a program designed to repair and maintain properties such as this one to keep neighborhoods stable. Under the program, the city will make a subordinate loan to the borrower and work with the county to obtain additional gap funds.

The lender plans to sell the mortgage on the secondary market.

Sources of funds

Borrower	$700	
Sweat Equity	1,000	
Down payment	500	
Bank Loan	45,000	*1st Mortgage (7.5%, 30-year term)*
County HOME [5]	18,800	*2nd Mortgage (0%, deferred until year 5, 30-year term)*
City CDBG[6]	3,250	*3rd Mortgage (0 %, due upon sale)*
City	750	*Waiver of permit fees*
Purchase Price	**$70,000**	

Benefit to Borrower

This transaction enables a family of four to purchase the home with total equity of 3 percent. Also, the family's monthly housing expenses will be lower than what it previously paid for rent. The monthly housing expenses (principal, interest, taxes and insurance) will be less than $550, which represents about 24 percent of the family's gross income. (The city's HOME second mortgage will be deferred for the first five years. In years 5 through 30, the family will make $63 in monthly payments to the city for the HOME funds.) The residence is in a neighborhood with schools, shopping, and public transit.

Risk mitigation

Because of the city and county's low-cost funds to the borrower, the loan-to-value ratio of the bank's first mortgage is low—64 percent. Also, the borrower has participated in extensive prepurchase education and counseling. The bank's work with local church and government agencies may increase its reputation in the community.

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5 "Home" refers to the HOME Investment Partnership Program (under 42 U.S.C. 12701 et seq., and 24 CFR Part 92), administered by the U.S. Department of Housing and Urban Development.

6 "CDBG" refers to the Community Development Block Grant Program (under 42 U.S.C. 5301 et seq., and 24 CFR Part 570), administered by the U.S. Department of Housing and Urban Development.

EFFECTIVE AFFORDABLE MULTIFAMILY FINANCE STRATEGIES

Affordable multifamily housing lending generally refers to loans made for the acquisition, construction, or rehabilitation of residential property that includes units to house more than four rental families,[7] typically low- to moderate income. Financing for affordable multifamily properties also may cover pre-development expenses, construction and permanent debt, and often equity investments. Affordable multifamily finance differs from affordable single-family mortgage lending in that the financial relationship is between the bank and the nonprofit or for-profit real estate developer rather than the bank and the low- or moderate-income home purchaser.

Affordable multifamily units provide housing options for newly established households, single-parent households, and older Americans. The challenge facing the participants in the multifamily housing business is constructing and maintaining decent and safe properties that are also affordable to low- and moderate-income persons and families. The banks in the study typically consider properties to be affordable when the majority of units are occupied by low- and moderate-income persons or when their projects qualify for federal assistance, although mixed income strategies of less than a majority low- to moderate-income might work best in some communities.

"Affordability" for rental housing often follows specific federal government program requirements, such as rental expenses that do not exceed 30 percent of a tenant's income, adjusted for family size. Also, in affordable multifamily lending, the target families generally have incomes that are no greater than 80 percent of the area's median income.

Some government-sponsored housing programs do not require a "majority" threshold for low- and moderate-income units. For example, the Federal Low-Income Housing Tax Credit (LIHTC) Program, a primary financing vehicle used by banks, allows a mix of affordable and market-rate units in a project, although it requires that a minimum percentage of units be designated for tenants earning 60 percent or less of the area median income, and that this set-aside is maintained for 15 years.

Affordable rental housing is big business for secondary market providers in urban and rural markets. Fannie Mae indicates that at year-end 1998, it had a portfolio of more than $47 billion in multifamily loans and investments, and 90 percent of this business has served low-to moderate-income families. Freddie Mac has also provided significant financing in support of affordable multifamily housing. Since 1993, Freddie Mac has provided financing for multifamily properties totaling more than $13 billion. This volume represents more than 531,000 apartment units, of which 95 percent were affordable to people with low and moderate incomes.

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7 Multifamily housing generally refers to rental apartments with more than four units, although homeless shelters, special-needs facilities, condominiums, and cooperatives may also fall into this category.

Effective Strategies

Like the banks that are successful in affordable single-family mortgage lending, the ones that have excelled in the area of financing affordable multifamily housing share common practices. In general, the banks

- Survey community needs and resources, enhance staff expertise, and establish alliances with external participants in the multifamily housing market;
- Design program objectives, internal controls, and processes that facilitate finance decisions and servicing;
- Deal with developers who have a strong likelihood of success;
- Structure financing to take into account the construction and operation challenges of affordable multifamily properties;
- Use standard documentation for projects that involve multiple sources of financing;
- Consider investments in federal low-income housing tax credits and monitor those properties;
- Participate in partnerships for marketing, for credit enhancements and other incentives, for resources that stabilize properties, and for strengthening transactions; and
- Track the performance of affordable multifamily loans closely.

Survey community needs and resources, enhance staff expertise, and establish alliances with players in the multifamily housing market

We learned from most of the banks in the study that before committing to affordable multifamily housing lending, they carefully evaluate whether the affordable products will be beneficial for their banks and viable in their communities. The banks study the affordable multifamily housing needs in their communities and evaluate the availability and proximity of amenities, public facilities and services, and surrounding residential and commercial properties that might support or detract from affordable rental housing. They use information from local, regional, and state governments to develop demographic analyses, competitor assessments, economic forecasts, and strategies based on future plans for public improvements and facilities.

The banks also survey other external players in the multifamily housing market. State housing finance agencies, secondary market players, and national CD intermediaries often have a major role in financing equity and debt in affordable multifamily developments. Nonprofit and for-profit developers, builders, local government entities, and CD organizations are sources for future business and provide expertise and credit enhancements that the banks can use to build their multifamily housing portfolios.

The banks in the study rely on staff with experience in affordable multifamily housing lending and investment matters, such as construction and commercial lending, property management, and real estate development. Many banks hire persons who have worked in CD organizations and who have an understanding of secondary market tools and local, state, and federal government programs.

Successful banks often establish professional alliances with legal, accounting, insurance, and syndication experts, especially if their affordable lending portfolio volume is substantial and their roles—as lenders, investors, or both—in multifamily housing transactions are complex. Others arrange third-party contracts with quality providers.

Design program objectives, internal controls, and processes that facilitate finance decisions and servicing

The banks' key managers set forth financial goals and community objectives that help guide staff in the decision-making and internal control processes. They outline the specific targets for returns on assets and equity, the dollar amount of available resources, and the targeted communities and alliances. The banks also consider risk management issues. For example, if the bank holds the permanent loans for these properties and makes investments as a limited partner in them, they may be among the bank's longest maturing assets. The liquidity risk and interest rate risk on the long-term loans could be substantial.

To mitigate or neutralize these risks, the banks in our study carefully establish the total amount of resources they are willing to commit to this type of lending, the number of "deals" they are willing to do annually, and whether or not they will make both construction and permanent loans. The banks may also consider becoming equity partners in the same projects in which they have made loans. Many of the banks in the study draft a specific set of controls and policies related to multifamily housing lending that cover expectations for underwriting, management, construction, lease-up, repayment processes, and tracking the portfolio.

To make credit decisions, risk analysis, and portfolio tracking more efficient, and to sell loans on the secondary market, many banks in the study develop affordable multifamily housing products with uniform terms and underwriting policies. Some of the banks also have a specialized affordable multifamily housing unit and use a centralized process for loan underwriting. This creates a mechanism for consistency and timeliness in loan decisions and helps the banks lend and invest across broad geographic areas.

Within this context of uniform policies and centralized processing, however, the banks may use innovative strategies to ensure that they take into account differences in projects and markets. For example, they may bring their local lending personnel, who are located in branches, into the application process to provide the underwriters with information about the local nonprofit and for-profit developers, variations in local market conditions, available resources, or the quality of collateral.

The banks typically use their branch (or local) lending personnel to provide information to prospective borrowers about options for construction loans, permanent financing, equity investments, and gap financing from other public and private resources. In addition to helping borrowers through the loan application process, local lenders often deliver loan decisions to borrowers, conduct site inspections during construction, and manage the loan disbursements. If the bank is a limited partner investor, the local staff will not only conduct periodic visits, but will also monitor the properties through the construction, lease-up, and operation phases. Local lending personnel can also market to borrowers their other products and services for future needs, such as business or personal credit cards or cash management services.

Deal with developers who have a strong likelihood of success

The banks we interviewed consider a developer's previous experience in constructing affordable multifamily housing an important predictor for success. They consider such factors as the following:

- The long-term viability of the developer's organization, particularly in terms of day-to-day management during the construction and ongoing operation of the rental property. The banks also review the track record of the general contractor and the expertise of the architects and engineers who will provide advice on the plans and scope of the project.
- The developer's financial record of business, personal obligations, and overall financial status, including the quality of guarantees and repayment sources. The banks want to know that a developer's operation produces a positive revenue stream and is likely to continue to do so in the near future.
- The developer's ability to provide ongoing management of the property. The banks take into account the familiarity of the developer or management company with local market conditions and the developer's history of maintaining quality affordable rental property. They consider the experience of the developer or management company in leasing and maintaining appropriate tenant occupancy levels, establishing realistic operating budgets, contracting with third parties for property maintenance, meeting expenses within budget and time frames, and responding to tenant issues.
- Other factors, such as the composition of the borrowers' boards of directors, any prior interaction between the borrowers and other affordable housing developers and local government entities, and community support for the projects.

The banks usually require the developer to commit equity in a project beyond the developer fee, which generally covers the soft costs in the project. To mitigate their risk in the event that a developer or general contractor fails to complete a project, some banks may require a borrower to provide a completion guarantee and the general contractor to provide a letter of credit or a performance bond.

Although the banks in the study prefer to work with experienced affordable housing developers, they recognize that some nonprofit and for-profit affordable housing developers may not have long or well-established track records. Those developers also may lack equity, credit history, or the abilities necessary to deal with such eventualities as a lengthy development process, cost overruns and financial problems, and market changes that affect rental income or expenses.

For developers that lack the appropriate experience, the banks in our study have encouraged them to form joint ventures with experienced affordable housing developers or with housing intermediaries that provide capital and technical assistance during the pre-development and construction phases. National housing intermediaries, such as the Enterprise Foundation, Local Initiatives Support Corporation, Housing Assistance Council, and the Neighborhood Reinvestment Corporation, work with developers throughout the loan period and beyond, helping them maintain the properties and providing other important services and advice. (See appendix E for descriptions of these organizations.)

For developers that lack the appropriate experience, the banks...encourage them to form joint ventures with experienced affordable housing developers or with housing intermediaries...

For some affordable housing developers, the issue of charging developer fees presents a dilemma. Because of community support and the limited income of tenants targeted to occupy the projects, affordable housing developers sometimes limit their development fees. This may pose a problem for developers who would otherwise rely on developer fees for reserves in the event of cost overruns, operating deficits, or unforeseen property maintenance expenses. Some banks, therefore, build reserves into construction budgets for cost overruns or use underwriting criteria that factor in higher operating reserves or debt coverage ratios.

Structure financing to take into account the construction and operation challenges of affordable multifamily properties

Affordable housing projects, especially those involving rehabilitation, may run into problems during construction. Cost overruns may occur if the project requires substantial rehabilitation, if the project has unexpected work that must be completed to correct structural deficiencies, or if the project has unforeseen environmental hazards. In addition, there may be problems with poor construction work or unmet construction deadlines by the general contractor. While these problems are common to all construction, with affordable projects, extra costs may threaten the completion of the projects.

To ensure the successful completion of an affordable housing project, the banks we interviewed take one or more of the following steps:

- Carefully evaluate construction costs, architectural and engineering plans, environmental hazards, and the scope of work;
- Encourage developers to negotiate fixed-price contracts;
- Include hard- and soft-cost contingencies in the development budget, including reserves to cover operating deficits during the lease-up period;
- Perform careful due diligence, such as making title checks for outstanding liens on the property or conducting environmental analyses; and
- Monitor the construction process.

A few banks offer loans that cover pre-development expenses, construction financing, permanent financing, or a combination of all three. Other banks help developers to control costs during construction and operation by offering fixed-rate construction loans and a lock on the permanent loan interest rate that is set before the start of construction. Under this financing arrangement, the developer makes a single loan application involving only one loan underwriting, negotiation, due diligence, and closing, and saves the time and costs of duplicate processing for construction and permanent loans. Stabilizing financing terms, such as interest rates, also helps facilitate the developers ability to secure investors equity funds. The banks provide the financing package in a single closing, which reduces closing costs and fees. Once construction is complete and lease-up targets met, the principal amount of the construction loan converts in an equal amount to a permanent loan.

Affordable multifamily housing projects tend to operate within smaller profit margins than market-rate housing since rental income from low- and moderate-income tenants may not cover expenses resulting from, for example, unexpected capital expenditures, a high turnover of units, or the ongoing maintenance and replacement of apartment fixtures. To address this potential problem, the banks in the study may require

- A maximum loan-to-value ratio that is based on the projected income and expenses of the project;
- The developer to have mortgage insurance (available in some state programs) to compensate for higher loan-to-value ratios;
- The developer to set aside cash for operating reserves and replacement costs over the long term; or
- The developer to meet certain pre-leasing requirements before the construction loan converts to a permanent loan.

The banks generally charge interest rates and fees that are competitive with the conventional loan market and that reflect their costs of doing business and portfolio target objectives. However, some of the banks, particularly those that sell to investors accepting below-market returns, offer favorable rates on loans that serve lower income households.

Establish standard documentation for projects that involve multiple sources of financing

By standardizing documents, the banks are better able to control disbursements, contain cost overruns, and advance construction schedules.

Affordable multifamily housing often involves multiple sources of financing from government, housing intermediaries, CD organizations, foundations, and private resources to fill financing gaps. Generally, these entities have more flexibility to provide funds that

- Substitute for the developer's equity;
- Finance predevelopment expenses;
- Provide a portion of the construction and permanent financing; and
- Cover replacement costs and operating deficits over the project's duration.

Banks typically structure their loans so that they have the first lien, and other financing is subordinate to the banks' debt. Some banks also require either an escrow of public and private subsidies or that their money goes in last. This protects the banks if the subsidies are delayed. Some banks may permit a lower debt coverage ratio if a project has firm commitments from such resources.

Many of the banks in the study have found that closing documents from public and private parties could conflict with bank documents, particularly on collateral positions, prepayment penalties, and other subordination issues. To address this problem, the banks develop standardized closing documents that they use in all affordable housing transactions. (They also work with the parties involved in the transactions to develop standard documents.) The documents define, in clear and plain language, the loan's purpose, required actions and time frames, the order and method of disbursement and repayment, expenses the banks' loans will cover, the collateral and preference order, creditor preference, loan covenants, and the actions that will occur upon a developer's default.

By standardizing documents, the banks are better able to control disbursements, contain cost overruns, and advance construction schedules. Some banks also try to standardize loan agreements so that they can be used in multiple states.

The banks indicated that standardized documentation can lead to cost savings. As one banker said, "Before we went to the standardized documentation, the bank's legal cost to close loans ranged from $20,000 to $40,000 per deal. Those costs do get passed on to the borrower...With standardized loan agreements, our legal cost to close loans is closer to $5,000— maybe as much as $15,000 in some rare cases. When you multiply that by more than one hundred deals per year, we're collectively saving our borrowers around $2 million. That adds to bank profitability and borrower capacity."

Consider investments in federal low-income housing tax credits and monitor those properties

The banks in the study often invest or have an ownership interest in qualifying affordable housing projects that involve federal low-income housing tax credits in return for credits on their federal income tax. (A summary of the program is provided in appendix E.) Some banks also make construction or permanent loans to the LIHTC projects in which they have limited partnership interests. The banks indicated that assuming multiple financing roles in LIHTC projects helps them to better control costs and respond to challenges facing developers. On the other hand, they are also careful that these multiple financing roles do not increase their concentration risk.

The legal authority for national banks to invest in LIHTCs and other public welfare investments is 12 U.S.C. § 24(Eleventh) and the OCC's regulation on national bank CDC, CD project and other public welfare investments (12 CFR Part 24). (OCC program requirements are summarized in appendix C.)

Before making their investments, the banks typically develop detailed files that outline the project, sources and uses of funds, participating parties, and aspects of the development process that they need to monitor carefully. The files also contain the project's operating projections, financial statements and commitments by participating parties, marketing information, third-party agreements, fee and guaranty agreements, legal and tax opinions, partnership agreements, and regulatory approvals. Some banks transfer summaries of this information to a database so that bank personnel assigned to monitor projects can refer to and update the projects' progress through construction, lease-up, and operation.

During construction, the banks review information provided by the developer or general partner, such as the disbursement of funds from other providers, actual construction draws, and architects' certifications. They analyze the actual and proposed budgets to determine variations and changes in the scope or quality of work, and thus can anticipate increases or savings in the investment and determine the actual amount of LIHTCs allocated to the project, which will affect their tax status.

After the developer or general partner completes the project construction, the banks continue to monitor the property to determine whether requirements under the LIHTC program are met and to ensure that the property is properly maintained and effectively managed. If the general partner(s) is no longer able to meet the financial and regulatory obligations, the bank, along with the other limited partner investors, may replace the general partner(s) with one that has greater experience and ability. Typically, the banks

- Perform a net worth analysis of annual audited financial statements of the general partner(s), particularly in terms of his or her ability to meet any guarantee commitments;

- Monitor reports from the general partner(s) about the property, including information about the property's compliance with the requirements of the LIHTC program; and
- Inspect each of the properties at least once a year (more often if there are special considerations).

Participate in partnerships for marketing, for credit enhancements and other incentives, for resources that stabilize properties, and for strengthening transactions

The banks in the study indicated that partnerships with government agencies, community-based organizations, and affordable housing intermediaries provide valuable resources to support the banks' affordable multifamily housing finance programs.

Marketing and obtaining information. The banks develop and maintain relationships with the primary players in the affordable housing arena so that those groups will recognize the banks as the "lenders-of-choice." Specifically, the banks encourage their lending staff to contact

- For-profit and nonprofit developers and community-based organizations to learn about developers' credit issues and renters' needs, discuss the benefits of the banks' affordable multifamily housing programs, and explore financing options with potential borrowers;
- Peer lenders and correspondent banks for opportunities to participate in loans or investments;
- State housing finance agencies (HFAs) for information about programs and the names and track records of nonprofit and for-profit developers that apply for funding;
- Local government, which enables the banks to stay abreast of programs, plans, and decisions made by city council, school, and zoning boards that may affect affordable multifamily housing opportunities; and
- Local and national CD organizations, community leaders, and houses of worship to help the banks learn about neighborhood dynamics, development teams, and renter needs, or as an avenue for the developer to market vacant units or provide training to potential residents about renter responsibilities.

Credit enhancements and other government incentives that expand finance options. The banks in the study reported a number of federal insurance and incentive programs that are particularly useful when financing affordable multifamily housing, including programs administered by HUD, USDA Rural Development, the Internal Revenue Service, and the Federal Home Loan Bank System. (Those programs are summarized in appendix E.)

A number of banks in our study participate in secondary market and private sector programs when making construction and permanent loans. Both Fannie Mae and Freddie Mac have a number of ongoing and pilot programs that are targeted to affordable housing needs, including multifamily rental housing, of low- and moderate-income persons. Some banks also mentioned private sector resources, such as pension funds, to facilitate their lending. For example, the AFL-CIO Housing Investment Trust is an important player in the affordable multifamily housing finance business and invests pension funds in projects that use labor union members during construction. (Those programs are also summarized in appendix E.)

State HFAs issue tax-exempt and taxable housing bonds that are frequently used as permanent, take-out financing for affordable multifamily construction loans. Some states have authorized tax incremental financing (TIF) bonds, which use the increase in taxes generated by new affordable housing and economic development projects as a way to help finance project-related costs. (More information about HFAs' primary programs is included in appendix E.)

The banks indicated government agencies often perform functions that indirectly benefit or stabilize properties that the banks have financed or plan to finance. For example, government agencies provide funds to build or upgrade infrastructure associated with affordable multifamily housing, such as plumbing and sewer connections, sidewalks, street curbs, traffic controls, and street lighting. Cities and towns may provide the resources to deter crime, such as youth services, neighborhood watch and crime prevention teams, citizen patrol programs, and visible police.

Also, government agencies provide mechanisms that help to stabilize or reduce costs in affordable housing developments. Some may sell vacant and abandoned properties to developers at a nominal cost. Some local agencies elect to waive permit, inspection, or other fees, or provide tax abatements. We heard from one bank about a community that promotes affordable multifamily housing by maintaining a list of prospective tenants that a developer/owner could use to market new projects or vacant units.

Housing resources and services that stabilize properties. The banks in our study establish relationships with community-based organizations and housing intermediaries that increase the likelihood of success with affordable properties. These organizations often help to fill an experience gap in the development team or fill a financing gap in a project's total package. In addition, they may provide or arrange special services, such as day- and elder-care, health mobiles, and after-school activities. The banks observed that tenants are less likely to leave housing that is properly maintained and provides family-related services that can help them maintain steady employment. With less turnover, developers and owners can keep vacancy, maintenance, and replacement expenses low, which contributes to the affordable pricing of the rental units.

Participation in loan consortia to strengthen transactions. The banks in the study talked about opportunities to share resources and risks associated with multifamily housing financing, such as loan funds and consortia with other financial institutions. Some of the banks used loan consortia to build their staff expertise in providing loans to affordable multifamily housing developments. They indicated that loan consortia enabled them to try out new products and services, such as permanent lending, financing for pre-development expenses, and technical assistance (particularly when structuring the debt service of loans from public and private sources.)

Consortia may take a number of forms, depending on their purpose and available resources. An informal loan pool may involve a group of financial institutions that agrees to lend to particular communities using common eligibility criteria, loan terms, and conditions. A more formal type of consortium involves a corporate structure that originates loans on behalf of members or stockholders, which include lenders. Some consortia hire staff with expertise in multifamily affordable housing finance and development programs, credit enhancements, and renter subsidies offered by local, state, and federal government agencies. In other consortia, banks provide key managers and staff to serve on loan and investment committees. Consortia often have access to subsidies, credit enhancements, and other resources to offset operating expenses and facilitate affordable housing lending.

Track the performance of affordable multifamily loans closely

Tracking affordable multifamily housing performance is an important component of the banks' risk management. Effective management information systems typically generate monthly, quarterly, and annual reports that show the progress of the individual projects and the product line. The reports generally indicate the number of affordable housing units; the loan type or investment; the loan or investment amount and outstanding balance; the interest rate during construction or on the permanent loan; the fees; the status of the project; and the dates for loan closing, construction start and completion, and loan maturity. The reports help the banks to measure the portfolio's progress by tracking the volume of affordable housing units, loan amounts and outstanding balances, and new and accrued fees.

A key factor in the banks' participation in financing affordable multifamily housing is the ability to sell the construction and permanent mortgages on the secondary market. For loans that are kept in portfolio, however, the banks typically track the repayment status and report delinquencies. They also maintain close contact with owners who are experiencing problems in repaying the banks' loans.

Most of the banks in the study measure the success of affordable multifamily housing lending and investing separately from their conventional multifamily housing loans, although they use similar quantitative measures to track both. In general, the banks reported that their programs meet and often exceed their target returns. In addition, most of the banks indicated that delinquencies in the affordable multifamily portfolio are low, and that defaults are extremely rare.

By pricing their affordable multifamily loans at competitive rates, becoming both lender and equity investor in projects using LIHTCs, using secondary market programs, and fine-tuning strategies for managing risk, many banks are able to earn a rate of return on this product line that is similar to conventional multifamily lending. Moreover, though difficult to measure, most banks expect to cross-sell other products and services to multifamily housing residents, community partners, and companies that do business with developers and owners, which further increases the overall potential product line profitability.

The banks expressed a number of other benefits from their affordable multifamily housing lending programs. They believe their successful affordable multifamily housing programs have helped to enhance their image as "good corporate citizens," resulting in productive relationships with government, businesses, and CD organization leaders. They also see the improvements made by their community partners in local neighborhoods and decreases in crime as spin-off benefits to their programs.

Some Challenges and Barriers

Some of the banks in the study prefer to limit their affordable multifamily finance activities to construction loans. The banks tend to be most familiar with construction financing, and short-term lending provides them with liquidity and minimizes interest rate risk. However, long-term, permanent financing continues to be an important need for affordable housing developers. Traditionally, this financing comes from public-sector resources, such as state HFAs and other federal, state, and local programs that provide mortgage insurance. More recently, insurance companies, pension funds, CD intermediaries, and other long-term investors have provided permanent financing. As public resources dwindle, other sources of permanent financing become more important.

Other banks in the study are willing to hold longer-term assets and provide permanent financing for affordable rental properties. They structure this financing as "mini-perms," in which the permanent loan is repaid from a stream of rental income over five to seven years. The remaining permanent loan balance is then either refinanced by the originating bank, a group of participating lenders (such as a loan consortium), a state HFA, or sold on the secondary market. These banks are also exploring additional secondary market mechanisms, insurance companies, pensions funds, or investments in loan consortia as ways to expand their role in providing permanent financing.

Another challenge facing developers and lenders alike is that affordable multifamily housing occasionally encounters resistance by some local residents. Residents often express concerns that the multifamily housing will cause an increase in traffic flow, in student populations in already crowded schools, or in crime. They may fear that developers will re-create past public housing failures in their neighborhoods. Residents may also be concerned that they will have to shoulder the tax burden for local government to make the necessary public improvements.

The banks in the study indicated that these issues are often difficult to address because they involve people's perceptions. One bank mentioned that its solution is to bring together developers, lenders, businesses, community leaders, and government agencies to develop comprehensive neighborhood strategies that provide a positive quality of life for existing and new residents. Another bank indicated that it strongly encourages affordable housing developers to contact the community representatives and potential funding partners early in the planning and design phases of affordable multifamily projects. The bank found that community input early in the process helps the developers to identify concerns and work toward solutions before project funding is finalized and construction expenses are incurred.

Example: Financing an Affordable Multifamily Housing Project

The following example demonstrates the complex layering of financing that is often needed to support the development and operation of affordable multifamily housing projects. In addition, it shows that creative partnerships can benefit both lenders and their communities.

Background

A nonprofit developer plans to build a 100-unit affordable housing rental project in the downtown area. Although the developer has completed small rehabilitation projects with grants from the city, this project will be the company's first new housing development.

The nonprofit developer will serve as the general partner and manage the construction of the project. A national housing intermediary will work with the developer to secure the LIHTCs and will provide the developer with technical assistance during project planning. In addition, the housing intermediary will provide construction and bridge financing, since the LIHTCs will be phased in during the project's construction and lease-up. Financing will also include subordinated debt from the city and county. The total development budget is $7,000,000, and the cost per unit is $70,000. The loan will be underwritten to meet Fannie Mae requirements.

Sources of funds

Constructions Funds		
Developer	$700,000	*(Land, equity & deferred fee)*
Bank	3,200,000	
Limited Partner Equity	1,900,000	*(LIHTCs)*
City HOME[8]	250,000	
County CDBG[9]	200,000	
CD Intermediary	750,000	*(bridge loan)*
Total	**$7,000,000**	

Permanent Funds		
Developer	$500,000	*(Land, equity & deferred fee)*
Limited Partner	2,850,000	*(LIHTCs)*
Bank loan	3,200,000	*(1st mortgage, 8.5%, due year 15)*
County	200,000	*(2nd mortgage, 3%, due year 15)*
City HOME	250,000	*(3rd mortgage, 0%, due year 20)*
Total	**$7,000,000**	

8 "Home" refers to the HOME Investment Partnership Program (under 42 U.S.C. 12701 et seq., and 24 CFR Part 92), administered by the U.S. Department of Housing and Urban Development.

9 "CDBG" refers to the Community Development Block Grant Program (under 42 U.S.C. 5301 et seq., and 24 CFR Part 570), administered by the U.S. Department of Housing and Urban Development.

Mitigation of risk

During the construction phase, the bank's risk is mitigated by a number of factors. First, the developer has committed to work with a national housing intermediary that provides technical assistance during the project planning and budget preparation. The housing intermediary also monitors the project during construction and provides bridge funds to fill the financing gaps due to the phase-in of equity from the LIHTCs. Second, with a loan at 46 percent of the project's value, the bank's risk is relatively low because of the equity and the public funds. Third, the bank has added hard- and soft-cost contingencies and has capitalized three extra months' interest in the development budget. Finally, the bank carefully monitors the construction process and funding draws to ensure that the other financing parties provide their funds according to the loan agreements.

During the permanent phase, the bank's risk remains low as a result of the full equity disbursement from the LIHTCs, the subordinated public funds, and the deferred developer fee. The bank anticipates a quick lease-up since market studies indicated the vacancy rate for rental properties is 5 percent and the local housing authority has a long waiting list of potential tenants. Also, the nonprofit developer has contracted with an experienced management company to select tenants and manage the operation of the property. Finally, the bank has the option of selling the permanent mortgage to Fannie Mae because the project was underwritten to meet Fannie Mae's affordable lending criteria.

The housing intermediary's bridge loan is taken out by the equity from the LIHTCs that was phased-in during the project's construction and lease-up. An annual, preferred developer fee has been built into the project's operating budget.

Benefits to community

Once the project is completed, all of the units are rented to low- and moderate-income families and elderly residents. To maintain the project's affordability, the county awards 15 years of tax abatements to the project. The project has facilities to provide low-cost preventive health-care services for residents. In addition, the on-site manager refers residents to community agencies for other city services, such as job training.

EFFECTIVE SMALL BUSINESS LENDING STRATEGIES

According to the U.S. Small Business Administration (SBA), the approximately twenty-two million small businesses in this country "employ about 53 percent of the private work force, contribute 47 percent of all sales in the country, create two out of every three new jobs, and produce two and one-half times as many innovations per employee as do large firms."[10] The SBA also notes that the commercial banking system is one of the most important sources of credit to small firms.

The banks in our study generally define small business lending as the part of the market between retail lending and middle-market commercial lending. Typically, the banks further segment the small business market by financing and servicing small business located in traditionally underserved markets. Improving the delivery of credit to these small business customers is an important component of the banks' overall CD finance strategies and objectives. Small business development supports job creation and economic self-sufficiency in low-income communities.

We found a variety of approaches to banks' financing and servicing of small businesses, which organizations of any size or market can adopt. The banks respond to many of the credit and service issues facing small businesses, particularly those located in traditionally underserved markets. For example, small businesses often need diverse types of credit, including secured term loans and unsecured lines of credit. New or expanding small businesses, in particular, may require equity capital and technical assistance, particularly on financial management issues. Many businesses have also expressed to banks their frustration over the lack of timeliness and flexibility on credit decisions. In addition, some businesses are concerned about the lack of loan approval authority among the lending officers with whom they deal regularly.

The study focuses on small business loans of $20,000 to $250,000 to businesses that have one or more of the following characteristics:

- Operate in low- and moderate-income and other disadvantaged communities;
- Are a start-up business or have annual revenues of less than $500,000 and have limited equity capital;
- Have owners who personally create their product or deliver the service;
- Have fewer than 25 employees; and
- Have a local customer base.

EFFECTIVE STRATEGIES

The banks' product lines and approaches vary considerably, but the banks share several effective strategies in small business finance. The banks

- Commit resources, including expert staff, and actively solicit small business customers;
- Learn about small business needs and offer diverse products and services;
- Provide small business customers with easy access to bank products and services;
- Establish streamlined processing for timely decisions;

10 U.S. Small Business Administration, *Small Business Lending in the United States* (Small Business Administration, 1997), Introduction.

- Offer special handling for flexible loan underwriting;
- Consider partnerships to provide options for small business finance, such as guarantees and credit enhancements, technical assistance, and gap financing; and
- Establish systems to track loan performance and profit.

Commit resources, including expert staff, and actively solicit small business customers

The banks in our study treat small business lending as a separate, primary business objective. The banks invest capital, staff, and organizational resources to develop and manage their small business portfolios. They outline financial goals and objectives for the product line, particularly specific targets for ROA and return on equity (ROE). They also consider risk management issues, including how risks can be mitigated or neutralized. They develop internal controls and policies related to small business lending that cover expectations for underwriting, servicing, and tracking the portfolio.

The banks usually require their staff to have a knowledge of government agencies and CD organization programs and resources in order to refer small business clients to them, if necessary and appropriate. Some banks cross-train the small business staff with middle market commercial lenders so that they can provide information that might be needed in the decision process. The banks also provide training to help lenders work with business owners who do not fit a traditional credit profile yet, but who may successfully qualify for programs in other bank departments.

The banks successful in small business lending are active and aggressive in soliciting potential small business customers. Some of the marketing avenues that the banks use include billboards, television, radio, and print media with simple messages that state the banks' goals to make small business loans. Some of the banks also advertise in publications that target women and minorities, and they work with ad agencies to portray women and minorities as business owners in their advertisements. Other banks use the Internet to market programs and to offer easy-to-use loan applications. Some banks rely on an extensive branch network and lending officers to generate small business loans and relationship banking. They develop relationships and support the efforts of government agencies, foundations, universities and colleges, and other CD organizations that provide funds and resources for small business development.

Some of the banks in the study analyze their customers' deposit, mortgage, and consumer credit behaviors to identify potential customers for small business products. They have found small business entrepreneurs often use home equity loans or credit cards to provide start-up funds or operating capital. Entrepreneurs also tend to evidence less consistent deposit amounts than salaried and wage-earning customers.

Other banks target their small business lending to specific businesses or industries, such as high-technology enterprises. They study the technical and financial aspects of those industries and hire or designate lending specialists to call on prospective borrowers. Such niche banks market themselves to companies in the targeted industry in trade publications, at industry trade shows and conventions, at colleges and universities, and with loan brokers.

Understand small business needs and offer a variety of products and services

The banks in the study indicated that an important component of successful small business lending is their understanding of small business credit needs, particularly the needs of businesses located in traditionally underserved markets. To determine appropriate products, services, and delivery mechanisms, the banks use conventional market surveys; participate in small business seminars; and work with community organizations, SBA-sponsored Small Business Development Centers (SBDCs), and chambers of commerce, including those representing women- and minority-owned businesses. The banks also survey the type and number of potential external resources, such as community, government, academic, and corporate entities that offer special services, technical assistance, and gap financing to start-up companies.

The study found that the banks develop products and services targeted to small businesses and offer these in connection with the full array of standard business products. While they might not be able to address every credit issue suggested by their small business customers because of safety and soundness considerations, we observed that the banks have broadened their underwriting approaches and small business product lines in many areas.

For example, most of the banks provide secured, term loans to businesses of all sizes, which typically require both a primary source of repayment (cash flow) and a secondary source (collateral, such as real estate). Term loans can serve a variety of purposes, such as financing machinery and equipment, leasehold improvements, or the acquisition or construction of commercial business property.

However, for service- or expertise-based small businesses, term loans are often unsuitable. Those businesses may lack the business collateral to pledge against the financing or may not be able to afford the loan's ongoing carrying costs. Term loans also may not be the best financing option for small businesses that have temporary credit needs, such as having sufficient working capital to compete for government contracts. In addition, some small businesses have difficulty in demonstrating multiple repayment sources.

The banks have also learned from their surveys that the small businesses that rely on receivables, such as construction contractors, often find it difficult to obtain financing unless they have an unblemished credit history. Small companies, particularly those that are newly established, often need credit in amounts that are smaller than $100,000. These companies use personal credit cards or home equity lines of credit to pay for their short-term working capital needs. The small businesses have indicated to the banks that this type of credit can be expensive and may not enable them to develop a separate business credit history.

To respond to these special credit needs, most of the banks in our study offer both secured and unsecured products, either relying on a business owner's personal credit history to establish repayment ability or allowing the businesses to combine personal and business assets to pledge against the financing. The banks offer checking and savings accounts with overdraft lines of credit and business credit cards that enable small businesses to draw small amounts of financing without having to repeat loan applications. These products can also help to build a credit history in the name of the business, thus initiating the separation of business and personal credit.

Some banks in the study offer equipment leasing services and products. They also offer special credit and debit cards for small businesses, such as cards for employees to buy supplies and business services or cards that provide 30-day revolving credit. A few

... most of the banks in our study offer both secured and unsecured products, either relying on a business owner's personal credit history to establish repayment ability or allowing the business to combine personal and business assets to pledge against the financing.

banks talked about small business credit cards that resemble their regular consumer cards, such as those that provide airline mileage points and other discounts. Other banks provide merchant card accounts, which allow the businesses to accept credit cards from customers. Generally, once the businesses submit a transaction for approval, the banks credit the business checking account for the amount of the transaction, less any processing fees. Merchant card processing enables businesses to conduct a higher volume of sales because they can rely on timely and efficient payment collection.

We also learned that the banks cross-sell other products and services to small business customers. For example, the banks provide information about savings accounts, overdraft protection, retirement and pension accounts, insurance, payroll and cash management. They also provide information about credit and deposit products and trust services that the business owner and his or her family might access for personal use. Other banks in the study seek out small businesses to use for their own supplies and services, which helps create additional business opportunities for the companies and potential customers for the banks.

Provide small business customers with easy access to bank products and services

We found that banks in the study search for ways to provide small businesses with easy access to their products and services. Typically, the banks' marketing channels offer similar small business products and application processing in order to accommodate the small business' banking preference.

The banks observed that offering a variety of delivery channels requires them to give more thought to consistency and coordination in their processing of small business applications.

For example, the banks in the study indicated that for many small businesses, access to bank products and services does not require a face-to-face relationship with a local lender. Toward this end, the banks use sophisticated mass marketing techniques to identify small business customers, send out materials that promote the bank as a small business lender, and include a simple loan application that promises a rapid bank response. The Internet is an increasingly important mechanism that some of the banks use to reach a broad range of small business customers.

On the other hand, the banks mentioned that some of the small businesses they surveyed

- Prefer to have a long-term relationship with a banker who knows their business and can handle both business and personal credit needs;
- Want to learn about the bank's credit criteria and reasons that an application may be declined;
- May be reluctant to approach the bank because of language barriers; and
- Often find it difficult to conduct business with the bank during normal banking hours.

In response, some of the banks offer a "one-stop shopping" strategy in which the business customer has one point of contact for a variety of banking services, both business and personal. Lenders deliver these services either through branch locations or by developing account relationships through targeted outreach programs with owners, business groups, and community-based development organizations. Often these banks will have representatives at business resources centers that are sponsored by CD organizations, government agencies, or banks. Banks' participation at these centers enables them to give small business loan information and technical assistance all in one setting.

The banks offer small businesses a variety of mechanisms to conduct their transactions, such as ATM networks, banking by phone or interactive video, PC banking, and Internet banking. Some banks extend hours at their branches on Saturdays and evenings to accommodate business owners who find it difficult to conduct bank business during normal banking hours. A few banks prepare written materials in various languages and employ or contract staff who speak the same languages as the small business borrowers.

The banks observed that offering a variety of delivery channels requires them to give more thought to consistency and coordination in their processing of small business applications. For example, the banks evaluate the consistency among delivery channels in the types of small business products they offer, pricing and promotions, underwriting and other credit policies, compliance and risk management, performance measures, and cross-selling strategies.

The banks provide ongoing training for lenders about credit and other policies and monitor them to ensure the consistency of loan decisions. The banks also train lenders about products available for small business owners that may be administered by other bank areas. For example, they found that potential small business customers were sometimes lost at the branch level when the branch lenders failed to coordinate with the bank's specialized lending departments, such as those handling the SBA guarantee programs and technical assistance.

In addition, the banks have found it important to train employees about the type of information they should provide to small business customers. The banks encourage their lenders to share information about the various types of business credit and services and corresponding terms and obligations; the documentation that is required to apply for a loan and the banks' credit criteria; and the reasons for the denial and suggestions about how to improve the application if a loan request is declined.

Establish streamlined processing for timely decisions

The banks in the study have learned from their surveys and other information-gathering strategies that efficiency is critical in meeting small business credit needs. In the past, most small business loans were often secured term loans, underwritten with traditional commercial techniques that focused on the experience of select businesses or industries, the feasibility of financial statements, and the quality of collateral. This type of underwriting is prudent for credit decisions on many small business' loan requests. However, if used alone, this approach may not respond to small businesses' small and frequent demands for credit.

In response, some banks transferred some of the techniques they use in providing consumer and installment debt to small business lending. Specifically, the banks place greater reliance on a borrower's personal financial history, recognizing that many small business borrowers, particularly sole proprietors, mix business and personal finances. Said one banker, "We focus on the value of the entrepreneur and look to personal behavior as an indicator of the likelihood of future payment. Then we look at market trends."

Most of the banks in our study use centralized and automated (computer-based) loan processing. The banks generally set up one or more centralized locations or centers to provide basic loan analysis and to make recommendations on small business applications using consistent underwriting criteria. One bank's automated system directs loan applicants to small business loan products that are appropriate for the customer's needs. This type of processing helps banks to manage, in a consistent manner, small business loan applications that they receive from direct and mass mailings, the Internet, the banks' branch systems, and referrals from CD intermediaries, government, or other companies.

The banks indicated that centralized loan processing centers helps lending personnel in their branches to make quick loan decisions while also enabling them to focus more on maintaining customer relationships, providing information, and developing new business. Often, lenders work will with the underwriters in the centralized processing centers if the bank needs more information about an applicant or if a customer requests special loan terms and conditions.

Automated processing provides an important tool for banks' consistency in loan decision-making. For banks that use application scoring systems, automated processing allows them to consider both credit bureau information and information submitted on a small business application, such as employment stability, debt-to-income ratios, assets, and loan-to-value ratios (if real estate is involved). Automated processing also supports the banks' use of credit scoring systems, which consider a person's credit history, current and historic delinquencies, and public records (such as bankruptcies, foreclosures, or judgements).

Credit score models are generally developed on historical data that are periodically validated for predictability and regulatory compliance. Some banks use generic small business credit scoring models. Other banks create their own models by tracking their small business portfolios, current and potential borrowers (industries, loan sizes, and product type), and anticipated and actual loss ratios (performance data). One bank in the study estimates that automated processing and credit scoring have reduced its average cost for processing a small business loan from $250 to $100 and have cut its loan processing time in half.

Although credit scoring is becoming more common, the banks in our study are proceeding with some caution in this area. Historical performance data related to scoring factors are still limited. Therefore, banks are using credit scoring factors and loan performance to develop historical performance data and to adjust scoring factors, as necessary. Generally, the banks in our study also provide guidelines for providing assistance to all credit applications; overriding a credit score; and training, monitoring, and supervising bank employees.

Offer special handling for flexible loan underwriting

Many of the banks indicated that they cannot meet all small business credit needs by using only a standardized processing approach. Therefore, the banks combine automated loan processing with specialized handling for flexible loan underwriting. In some banks, applicants achieving marginal scores from the automated processing centers are sent to departments that handle special small business loan products and government programs. In other banks, particularly those relying on a branch system for generating business, the lending personnel may bypass the automated process centers and send the applicants directly to the banks' specialized departments. As with other business products, determining how to deliver specialized handling requires the banks to consider equal credit opportunity issues so that lending and processing standards are applied fairly and uniformly to all applicants.[11]

Typically, specialized handling involves a second-look review process for applications that achieve marginal scores from the automated systems or that do not meet traditional underwriting criteria, or for borrowers who request special loan products. Some of the banks use an exception review committee, whereas others rely on the judgment of lending officers who have direct, personal experience with the small businesses. These avenues allow the banks to explore ways to successfully restructure loan requests. The banks also indicated that they carefully consider the pattern of overrides of credit scores and the success of specialized lending techniques to refine future products, underwriting criteria, and delivery mechanisms. To ensure consistency, the banks take special steps to outline review program policies and take corrective actions, as appropriate.

Many of the banks in our study refer loan applicants, particularly start-up companies and those needing technical assistance, to CD organizations or government agencies. Other effective strategies include phasing in the purchase of equipment to lower the principal amount of the request, providing alternative collateral or guarantees, and establishing benchmarks and phasing in loan amounts. One bank that lends to companies established by immigrants who do not have business records or who have limited personal credit histories looks at the owner's checking account history, income of a guarantor or co-applicant, and documentation of housing and other payments.

Consider partnerships to provide options for small business finance, such as guarantees and credit enhancements, technical assistance, and gap financing

The banks in the study indicated that their partnerships with government agencies, foundations, universities and colleges, and other CD intermediaries enable them to make safe and sound loans to businesses that otherwise might not meet traditional lending criteria.

Guarantees, credit enhancements, and other government support. Most of the banks in the study use the programs of the SBA to help small business customers. The primary activity of the SBA is to provide guarantees on loans made by banks and other private lenders to small business clients. Not only does this guarantee reduce the probability of a loss to the lender, but the bank does not have to allocate capital as reserves for the portion of the loan that the SBA guarantees. Guarantees also allow a bank to rely on the cash flow of the small business rather than collateral.

Some of the banks sell their SBA loans on the secondary market to increase their liquidity and lending capacity. The banks sell individual loans or pool them to create marketable securities. In addition, the banks benefit because they receive servicing fees during the life of the loans as well as premiums from the sale of the loans.

State and local governments offer or support a host of small business programs that banks may use, including revolving loan funds or quasi-government corporations that provide equity capital, subordinated debt, and guarantees to fill small business financing gaps. A few banks in the study mentioned capital access and linked-deposit programs as two credit enhancement opportunities that support their small business efforts. (The principal programs offered by SBA and other federal, state, and local

11 Banks may establish a preferential special purpose credit program as permitted under the Equal Credit Opportunity Act, 15 U.S.C. § 1691(c)(3), and Regulation B, 12 CFR § 202.8.

government agencies that facilitate banks' small business lending are summarized in appendix F.)

Technical assistance and loan packaging. The banks in the study talked about small business applicants, particularly companies in the early stages, that need assistance in developing feasible goals and sound business plans. The banks indicated that they refer loan applicants for these services to the SBA (primarily to their SBDCs and Service Corps of Retired Executives) and CD organizations that focus on small business finance and development.

An important service that these organizations provide to small businesses is knowledge of the loan application process. Specifically, they provide information about the documentation, credit terms and obligations, and underwriting criteria that banks require. The organizations bring to banks complete and thorough small business loan applications that are ready for swift review, which helps to lower the banks' costs of loan production. The organizations also help small businesses to

- Develop professional resumes, market studies, and business and contingency plans;
- Correct operating deficiencies, improve productivity and marketing, and when necessary, identify the source of problems and recommended processes to correct them;
- Correct past credit problems; and
- Package loans that use SBA or state government guarantees or other gap financing programs.

Gap financing through bank consortia and investments. The banks in the study indicated that some small businesses, particularly new and struggling small businesses, need debt and equity capital on terms that banks cannot meet. The banks participate with the following organizations to help such companies grow into regular bankable borrowers and become a referral source for new customers:

- Loan consortia and revolving loan funds.[12] These mechanisms work especially well when a bank wants to develop expertise in small business underwriting and establish a track record in lending to new industries or in new geographic areas. Because of trained staff, pricing strategies, and access to subsidies and other resources, loan consortia may be appropriate mechanisms for banks to control the risks from lending to businesses that are less than three years old or for loan requests that are very small (less than $25,000).
- CD organizations and other community development financial institutions (CDFIs) that operate revolving loan funds. These organizations provide small businesses with debt and equity capital using flexible terms and conditions. They also may provide very small or microloans.

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12 Consortia and revolving loans funds may take a number of forms depending on their purpose and available resources. An informal loan pool may involve a group of financial institutions that agree to lend to particular communities using common eligibility criteria, loan terms, and conditions. They usually commit a fixed amount of loans or participations in the pool. The pool could refer borrowers to the banks, on a revolving basis, or one bank may serve as the lender of record and participate out each loan to the other banks. A more formal type of consortium involves a corporate structure that originates loans on behalf of members or stockholders, which include lenders. Banks may make investments in these corporations, provide revolving lines of credit, or lend directly to the consortium borrowers. Consortia and revolving loan funds also may have access to subsidies, credit enhancements, technical assistance, and other resources to facilitate lending to small business borrowers.

- Small business investment companies (SBICs). Banks may invest in SBICs, which are formed according to statutory and SBA guidelines, to provide venture capital for new and growing small businesses. SBICs can take equity, or near equity positions in companies that require capital, often for research, product development, or when there is significant lag time before the final products become marketable.

Many banks in the study have formed CDCs as subsidiaries or have invested in multibank or multi-investor CDCs to provide financing and technical assistance to small businesses. Generally, CDCs finance requests from small businesses that do not meet conventional bank credit underwriting standards, such as businesses that lack cash flow or collateral. Typical financing packages from CDCs can include subordinated debt or equity financing for small businesses that receive partial financing from financial institutions, which are also owners or members in the CDC. CDCs may also provide equity or near-equity to small businesses by charging fees, by structuring financing gaps, using warrants, or by participating in the businesses' cash flow.

Establish systems to track loan performance and profit

Most of the banks in the study have separated small business lending from their other commercial lending and have developed separate ongoing tracking systems for data collection and analysis. They typically track borrower characteristics, the amount loaned, the credit criteria used, and the performance data of individual loans as well as the overall portfolio.

We found that the banks have common measures of performance, including return on investment and goals for the dollar amount of new small business loans extended per year. Some banks establish targets for specific local, state, and national markets. Although the banks have varying risk tolerances and industry appetites, none reported concern about the performance of their small business loan portfolios.

Most of the banks rely on computer technology to track individual loan performance. Some banks explained that their computer software allows them to apply a narrow grace period on late loan payments and to generate automatic letters to borrowers who miss payments. If these same borrowers want to adjust their interest rate or loan terms, or if they need additional credit, the software automatically takes into account the borrowers' past credit behavior.

The banks also monitor their small business portfolio data to measure their performance against targets and to detect undesirable trends. Some banks indicated that this is particularly important if they rely on automated processing and credit scoring models as the main screening devices because these borrowers would not have had the same level of review by loan officers as would borrowers applying through traditional channels. In addition, the banks note whether they applied specialized lending techniques to the loans and track the results and performance of those loans. These analyses help the banks evaluate whether original underwriting standards remain valid, if credit models should be adjusted, and where changes to underwriting policies should be made.

Most of the banks indicated that it is important for them to be viewed as effective small business lenders. Some banks, particularly those that use their branch systems to generate small business interest, point to their success both in making loans and selling additional products to those small business customers. Specifically, the banks track the cross-sell ratios of small business loans to home mortgages, insurance, investments, estate planning, and other bank products and services. A few banks also measure their success in small business lending on how innovative their small business products are and how well the community receives their products. Some banks consider the number of new jobs created, existing jobs retained, or improved conditions in communities they serve as measures of success.

A few banks use the speed of processing loans as another benchmark of success. Often, banks that rely on sophisticated computer programs have the edge on traditional small business lenders in terms of quickness in making a credit decision. Centralized loan processing and credit scoring have helped traditional branch banks make progress in offering speedy responses. On the other hand, because of their personal relationships with business borrowers, traditional lenders believe they have the edge in preventing fraud. Banks relying on computer programs use telephones, faxes, and electronic funds transfers to reduce their vulnerability in this area.

Some Challenges and Barriers

The banks in the study described some challenges when providing credit to small businesses, particularly those in traditionally underserved markets. These challenges include combining credit scoring with human subjective review in the decision-making process and working with government and other community partners for effective partnerships to provide credit enhancements, technical assistance, and other resources.

Credit scoring is in widespread use in banks of almost every size. However, banks are faced by the challenge that the process is relatively new and sufficient information about its effects on loan quality is still developing and has not been tested in an economic downturn. Fortunately, most banks realize that if a loan request fails the credit score, the next step is to determine whether that borrowing decision needs to be further examined in light of the applicant's unique characteristics. Most of the banks that use credit scoring systems, no matter how customized those systems may be, realize that specialized lending often requires human judgment in the approval process. The success of specialized lending, including small business lending, depends on thoughtful, business-oriented analysis. The banks realize that not every loan is possible or prudent, but before denying a small business loan request, they explore alternatives. As mentioned earlier, the banks use different approaches, such as collaborations with other banks, government agencies, CD organizations, and small business representatives, to understand small business credit needs, market issues, and opportunities for partnerships.

Despite the strides made by banks, government, and CD organizations in the small business area, many businesses are unaware of the kinds of financial and technical support that are available to them. Often there are social and language barriers, especially as communities become more culturally diverse. On a local level, many banks in the study use collaborative forums involving their government and CD organization partners to learn more about the credit and other needs of small businesses and to develop ways of reaching those that need the assistance. In addition, some banks believe that over the years, technical assistance providers, such as the SBDCs, have improved the quality and delivery of their entrepreneurial training to small businesses.

The banks indicate that participation in government programs and with other CD organizations is not without cost. The banks have proved that they can make most credit decisions on small business loans within three days. However, loans that involve guarantees from the SBA or funds from government agencies and CD organizations may take much longer, which frustrates both the bank and borrower. The SBA also charges fees for use of its programs.

Some banks indicated that government programs have complex requirements and burdensome applications. However, the SBA sponsors some relatively new programs, such as the Specialized 7(a) SBAExpress Program and Specialized 7(a) Minority and Women's Pre-Qualification Loan Program, which provide fast responses on credit decisions. Most banks in the study have contacted the SBA for information on those programs and others that can help lenders become more efficient in packaging SBA loans. One bank suggested that the financial industry might also work with CD intermediaries and political leaders to design legislative changes so that banks can provide responsive, low-cost loans and services to small businesses.

Finally, partnering with CD organizations may present uncertainties. In theory and in practice, the banks recognize the value of local CD organizations in providing education and technical assistance, equity and soft-second financing, and helping to deliver small business loans. However, some CD organizations have better track records than others, perhaps reflecting geographic differences or staffing and budget constraints. We found that banks in the study carefully evaluate the CD organizations in their communities to dispel any uncertainties they might have about the organizations' responsiveness or quality of services involving small business customers. The banks in the study consider a variety of arrangements with organizations, particularly less experienced ones. These include providing grants, serving on their boards of directors, or loaning officers to serve on credit and underwriting committees until the organizations develop the ability to operate without such assistance. One bank sponsors training on small business underwriting and loan servicing for employees of certain CD organizations.

Example: A Small Business Loan Transaction

The following provides an example of a small business transaction using gap financing subsidies from a CD intermediary organization and credit enhancement from the SBA.

Background

A husband and wife establish a partnership to start a neighborhood bakery. In a nearby community, the wife's father also owns a bakery, which the family has managed for the past 20 years. The couple has experience in the bakery business because they worked at the father's company for many years, often managing the entire operation in his absence.

The couple requires $175,000 to purchase and rehabilitate the building in which the new bakery will be located. (The building will be depreciated over 27.5 years, straight-line method.) They have a good credit history, with personal assets that include $10,000 in cash, $20,000 in equipment (depreciated over 10 years, straight-line method) and $15,000 in equity in their home. They plan to invest $5,000 in cash equity for working capital, $20,000 in equipment, and sweat equity for the rehabilitation.

The couple estimates the bakery's net annual income to be $40,000. The husband will continue his full-time job with another company and earn an annual income of $38,000. He will also work part-time at the bakery. The couple plans to hire one full-time assistant for the hours the bakery is open to the public.

The father will provide a personal guarantee for the first mortgage loan. In addition, the father has credit with suppliers that the couple may use to guarantee the purchase of supplies for the new bakery.

Sources and uses of funds

Sources of Funds		
Bank	$140,000	*(1st mortgage, 80% LTV, variable rate, due year 10)*
CD group	35,000	*(2nd mortgage, 8%, due year 5)*
Owners	20,000	*(equipment)*
Owners	20,000	*(cash)*
Total	**$200,000**	

Uses of Funds		
	$175,000	*(purchase and rehabilitation)*
	20,000	*(equipment)*
	5,000	*(working capital)*
Total	**$200,000**	

Income/expense projections		
Gross sales	$200,000	
Operating expenses	-160,000	
Net income	40,000	
Debt service	-20,000	*(bank loan)*
Debt service	-9,000	*(CD group)*
Depreciation	+7,364	*(building and equipment)*
Net cash flow	**$18,364**	

Risk

The bank will provide a first mortgage loan, secured by a first deed of trust on the commercial real estate, in the amount of $140,000, which is 80 percent of the value of the building and improvements. The bank is SBA-certified and plans to seek a guarantee from the SBA for the amount of its loan. The financing gap of $35,000 will be provided by a local CD intermediary, which maintains the bank's debt coverage ratio to well above 1.25:1. The bank may securitize and sell its loan, which has the SBA guarantee. The bank also considers that the husband's income of $38,000 will also provide additional support for the loan.

Benefit to owners

The projected financial statements show that the bakery can comfortably support the expenses, debt service, and working capital needs associated with the new operation. The owners intend to establish credit with the suppliers and initiate the separation of their business and personal credit with the bank. In addition, the owners hope the bakery business will have a positive effect on the community because the building will no longer be vacant. In fact, friends of theirs talk about opening a restaurant in the same neighborhood. The owners plan to hire additional help once their bakery business expands.

APPENDIXES

APPENDIX A
METHOD

The OCC used the following steps to conduct the study, analyze and validate the information that was collected, and report the findings.

Project Objectives

Many banks are exploring innovative techniques to successfully meet the credit needs of communities they serve. To gain a better understanding of CD finance techniques, the OCC studied national bank financing in support of affordable single-family housing, affordable multifamily housing, and direct small business lending. The study was intended to reflect the views of institutions that have been operating CD programs for almost a decade and have successfully overcome marketing, underwriting, originating, and servicing challenges.

Two goals were set for the study:

- To highlight effective CD financing practices.
- To illustrate effective partnerships that finance CD activities.

The report was also intended to provide CD organizations and government agencies with information about bank practices that have resulted in successful affordable single- and multifamily housing and small business lending and investing. Such information might help them understand how to approach banks and other financial institutions with partnering opportunities.

Working Group

The OCC formed a working group composed of seven Washington and district staff members to conduct this study. Most of the working group members had community and economic development expertise because of their direct and daily work with banks, government agencies, CD providers, and local residents and businesses. In addition, four of the members were also national bank examiners.

Information Collection

Identification of successful banks, CD organizations, and government agencies

The working group used a best or "effective practices" approach for the study rather than a formal, statistical analysis. The study is based on the special steps or processes attributed to effective CD programs by a defined group of national banks.

As an initial step, the working group developed baseline criteria for successful CD finance programs based on characteristics that banks had described in previous CD conferences and finance industry resources and interagency collaborations. The group also considered information the OCC had gathered from its internal processes, such as compliance examinations of large and small banks, investment proposal reviews, and corporate applications.

Next, the working group asked OCC staff to nominate large and small national banks that successfully delivered affordable single- and multifamily housing and small business lending products. The group also asked staff to identify characteristics that make these organizations successful, based on the group's baseline criteria of effective practices.

From this exercise, the working group identified 143 small national banks (with assets of less than $250 million) and large national banks (with assets of $250 million and greater) as potential candidates for further research. These institutions were financially sound[13] and had outstanding CRA ratings.[14] On the CRA rating, each of the banks had an outstanding community development component.[15] The working group also identified 72 CD intermediaries or organizations, and 31 local, state, and federal agencies from these sources.

OCC staff nominated the above potential group of study participants and identified one or more of the following characteristics that made each of the national banks successful:

- The bank had a unique delivery system for one of the study's products.
- The bank generated a significant product loan volume.
- The bank served a broad market that included low- and moderate-income individuals or small businesses.
- The bank attempted different approaches to address the community and economic development needs of its market area.
- The bank had partnerships with CD groups and government agencies resulting in their use of credit enhancement, special financing, or other resources to help manage the risks associated with the products.

The working group took steps to refine the list of potential study partner candidates so that there would be a manageable number for site visits and data collection.[16] Members read the banks' CRA performance evaluations[17] to determine which of the banks met most of the above criteria.

Banks were removed from the sample after the working group's second review and comparison of the performance evaluations and some of the quantitative measures relating to the banks' overall safety and soundness records. The group also took into consideration trade association press reports about successful bank programs as well as validating comments from OCC staff and CD intermediaries.

The group chose national banks that were located throughout the entire country so that the results would have broad geographic applicability. All of the banks are large institutions, and at least one bank is located in each of the OCC's six districts. They all

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13 The working group considered the banks' CAMELS ratings, as of January 1,1997.

14 The CRA ratings of banks are as of December 31, 1996.

15 The "community development component" was one of the twelve assessment factors under the CRA prior to the 1995 revisions. The revised CRA rules applicable to retail banks no longer consist of the twelve assessment factors that included the community development assessment factor; however, community development activities are currently considered during evaluation under the lending, investment, and service tests applicable to large banks) and small business performance test (applicable to small banks).

16 Although other national banks may be successful in delivering the study's products, and other CD organizations and government agencies may be effective partners in facilitating banks' CD finance activities, the working group limited the number of participants in the study to meet resource and time requirements. The OCC does not endorse any financial institution, government program, CD intermediary, or private enterprise that is described in the report.

17 The group used CRA performance evaluations that were written before December 31, 1996.

operate in low- and moderate-income communities, in a mix of urban, suburban, and rural areas that continue to have community and economic development challenges. In addition, the group selected government agencies and CD intermediaries with which at least one, if not most, of the banks have partnered to carry out CD activities. (The goverment agencies and CD intermediaries that participated in the study are listed in appendix H.)

Site visits to each bank, CD organization, and government agency to collect data

OCC staff conducted site visits of the ten national banks, nine CD intermediaries, and nine government agencies that participated as study partners. The site-visit teams requested information from three banks on affordable single-family mortgages; three banks for small business lending; two banks for financing for affordable multifamily developments; and two banks for CD investments in intermediaries. Although the site-visit teams did not interview each bank for all of the products, all of the banks were free to share information about the study's other topics. Most of the banks took advantage of this opportunity during the interviews.

The working group members developed the following questions for the site-visit interviews of the banks:

- What are the special actions or practices banks take to successfully deliver the CD product?
- How do these actions or steps fit in and affect the banks' delivery and monitoring processes?
- How do the banks measure their success in delivering the CD product?
- How do the banks reassess or allocate capital for the CD product line?
- How does the product line affect the future of the banks and the banks' communities?

The questions for the CD organizations and government agencies were designed to obtain information about the services, technical assistance, funds, and credit enhancements they provide to facilitate the banks' delivery of the study's products and their roles and relationships within the community.

During the interview process, some of the banks, government agencies, and CD organizations provided related written materials and videos that covered studies and models of success on topics related to affordable housing and small business programs and products. The working group included these materials in its analysis.

Information Analysis

Analysis of common practices for all products

The site visits revealed effective practices the national banks use to meet their CD finance objectives, and this information is described in the report's second section, "Strategies to Achieve Community Development Finance Objectives." Appendix C discusses common themes about banks' CD investments and the value of creating relationships with public and private community partners. The study also summarizes the results of interviews and information from the CD organizations and government agencies and strategies they use to promote banks' CD finance programs. This information is described in appendix D.

Analysis of specific practices of each of the products

The site-visit information revealed specific effective practices for each of the lending products in the study. The third, fourth, and fifth sections of the report describe the specific practices that are applicable to each of the study's products—affordable single-family mortgage lending, affordable multifamily housing finance, and small business lending.

Review of related studies

A number of government agencies, bank trade groups, and CD organizations have conducted studies on topics that relate to the OCC's study. The working group also considered information from such studies to validate and enhance the data from banks, CD intermediaries and government agencies. Those studies are listed in appendix I.

Information Validation

Focus groups

After conducting site visits of the participating banks and organizations and consolidating preliminary findings, the working group conducted two focus meetings to test the validity and usefulness of the information. The working group invited the OCC's compliance examiners and community reinvestment and development staff to participate in the focus meetings since they have practical experience in community and economic development lending, services, and investments. Later, the group considered and refined the study's preliminary findings based on the two focus groups' suggestions and obtained additional information from banks, where necessary.

Use of Consultants

The working group hired two consultants for the study. The first consultant, an expert in community development, provided the working group with advice on the general framework for the project's scope and process. The second consultant, experienced in providing information and training on CD finance to major financial institutions and to the banking community, provided advice for the focus group meetings. She also reviewed the draft report to determine whether the information is practical for small and large institutions and whether the processes identified by banks have an impact on strengthening communities. The working group considered and refined the report based on recommendations from the consultant. The consultants are identified in appendix H.

Review of draft materials by bank study partners

The working group provided the draft report to the banks that participated in the study. The primary purpose of their review was to ensure that the report accurately reflected what the parties had conveyed during the site visits. The working group also obtained additional clarifications on certain aspects of the study if data from the site visits were not clear, particularly regarding the measures of success. The working group incorporated the participants' comments into the final report.

APPENDIX B
EFFECTIVE COMMUNITY DEVELOPMENT FINANCE STRATEGIES CHECKLIST

Overall CD Finance Strategies

- ❑ Provide leadership support for CD activities with financial and technical resources and a strong commitment to community development.
- ❑ Integrate CD finance into broader business strategies.
- ❑ Use a comprehensive approach to CD finance.
- ❑ Partner with government and community-based organizations, and other corporate leaders.
- ❑ Establish systems and performance measures for gauging the results of CD activities.

Affordable Single-Family Mortgage Lending Strategies

- ❑ Demonstrate commitment to affordable mortgage lending and hire skilled, dedicated lenders.
- ❑ Design affordable mortgage programs that take into account customer needs, internal and external resources, and strategies to limit the bank's risk.
- ❑ Broaden affordable mortgage options by using secondary market mechanisms and government guarantees.
- ❑ Use flexible mortgage underwriting, but limit the layering of risk factors.
- ❑ Offer specialized handling, such as second-look review programs, enhanced servicing, and home buyer education and counseling.
- ❑ Participate in partnerships for gap financing and home buyer education, loan workouts, and marketing.
- ❑ Track individual loan performance and modify credit policies and processes.

Affordable Multifamily Housing Finance Strategies

- ❑ Survey community needs and resources, enhance staff expertise, and establish alliances with external participants in the multifamily housing market.
- ❑ Design program objectives, internal controls, and processes that facilitate finance decisions and servicing.
- ❑ Deal with developers who have a strong likelihood of success,.
- ❑ Structure financing to take into account the construction and operation challenges of affordable multifamily properties.
- ❑ Use standard documentation for projects that involve multiple sources of financing.
- ❑ Consider investments in federal low-income housing tax credits and monitor those properties.
- ❑ Participate in partnerships for marketing, for credit enhancements and other incentives, for resources that stabilize properties, and for strengthening transactions.
- ❑ Track the performance of affordable multifamily loans closely.

Small Business Lending Strategies

- ❑ Commit resources, including expert staff, and actively solicit small business customers.
- ❑ Learn about small business needs and offer diverse products and services.
- ❑ Provide small business customers with easy access to bank products and services.
- ❑ Establish streamlined processing for timely decisions.
- ❑ Offer special handling for flexible loan underwriting.
- ❑ Consider partnerships to provide options for small business finance, such as guarantees and credit enhancements, technical assistance, and gap financing.
- ❑ Establish systems to track loan performance and profit.

APPENDIX C
COMMUNITY DEVELOPMENT INVESTMENTS AND PARTNERSHIP SUPPORT

Increasing access to equity capital in underserved urban and rural areas is a challenge facing many banks active in CD finance. To increase market penetration and to help move businesses, organizations, and individuals into more traditional banking relationships, many banks make direct community development equity investments and engage in other activities that supplement their regular loans and services.

Why Banks Engage in CD Investments and Partnership Support

The banks we interviewed engage in CD investments and other financing partnerships with community-based organizations and CD intermediaries as a means to increase their potential customer base. The banks create opportunities within their marketing areas so that they will be able to make loans and receive deposits from customers that they might otherwise never see.

At the same time, the banks recognize that not all organizations and communities are alike. Consequently, they implement appropriate partnership strategies that build on the organizations' strengths. For example, some organizations may have been unable to sustain a relationship with a lender for a variety of reasons. By attempting to stabilize and fortify those enterprises, through such means as grants and technical assistance, the banks create a bond that may provide options for mitigating their lending risk over the long term. On the other hand, the banks' investments or joint ventures with CD organizations that have a proven track record and previous lending relationship may provide the banks with more immediate benefits, such as reasonable returns.

Changes to tax laws and an overall reduction in federal funds available for housing, community, and economic programs have resulted in state and local governments creating programs that require private sector participation in CD investments. These programs include second position and low- or no-interest loans, grants (recoverable only if the owner sells the property), and interest rate buydowns. In other cases, local nonprofit organizations fill the gaps by acting as the recipients of loan funds combined with investments from foundations and businesses, including commercial banks.

Banks keep abreast of local and state programs to know which nonprofit organizations are recipients of subsidies in order to build successful, extensive, and comprehensive CD programs. The banks that are the most successful in the CD arena recognize that they can have their greatest impact when they work with community groups, understand local and state government programs, help potential clients find capital, and provide market-rate loans. Working together, the various participants share the risks and learn the vital lessons necessary to make each subsequent venture more likely to succeed than the last.

In summary, a bank's CD investments and other financing partnerships, such as bank consortia, provide the following benefits:

- The cost associated with a particular transaction is reduced when each institution shares specialized expertise.

- The risk associated with a particular CD effort is minimized because the bank is liable only up to the amount of its investment.
- The results of multifaceted, focused efforts by a respected group of entities are more visible within the community and can bring additional capital for economic expansion into the neighborhood.
- The opportunity for small and large banks to participate in significant CD activities is enhanced by the greater number of experts and resources available when more than one participant is involved.

Types of CD Investments and Partnership Support

The following are some typical ways banks engage in CD investments or other financing partnerships. These activities may receive positive consideration under CRA.

CDC, CD project, and other public welfare investments

National banks may make investments that are designed primarily to promote the public welfare pursuant to 12 USC § 24(Eleventh) and 12 CFR Part 24. (Other financial institutions have similar investment authority.) Specifically, this means that banks may make equity or debt investments in community development corporations (CDCs), CD projects, and other organizations that support community and economic initiatives. These investments support such activities as real estate development, equity and near-equity loans for start-up and expanding small businesses, activities that revitalize or stabilize a government-designated area, and other activities that supplement or enhance the banks' traditional lending. They also may be used to help nonprofit organizations leverage financing from more traditional sources.

Banks make investments, for example, in nonprofit and for-profit corporations, bank and multi-investor CDCs, limited partnerships, limited liability companies, community development financial institutions (including CD banks), and CD loan funds. Besides having an ownership stake in these organizations, many banks serve as advisors; lend senior and executive staff; contribute facilities, equipment, and expertise; and sit as directors, along with community leaders, on their governing boards.

To enhance the viability of community-based organizations and investments, the OCC's regulation allows public welfare investments that meet the following guidelines:

- The investment primarily benefits low- and moderate-income individuals, low- and moderate-income areas, or other areas targeted for redevelopment by local, state, tribal, or federal government (including federal enterprise communities and federal empowerment zones).
- There is nonbank community support or participation in the investment.

Banks may self-certify most CDC, CD projects, and other public welfare investments up to 5 percent of their capital and surplus. With prior OCC approval, banks can make public welfare investments up to 10 percent. However, banks may not make investments that would expose them to unlimited liability.

CD securities

National banks may purchase CD securities under the OCC's investment securities regulation (12 CFR Part 1). CD securities are securities backed by interests in pools of CD loans, such as loans to borrowers in low- and moderate-income areas or to small businesses. Typically, a nationally recognized statistical rating agency does not rate these securities. The OCC permits a bank to purchase and hold these unrated securities if the bank concludes, based on reliable estimates, that the obligor can probably satisfy its obligations under the security, and if the bank believes that the security may be sold with reasonable promptness at a price that corresponds reasonably to its fair value. A bank's acquisition of CD securities must be consistent with safe and sound banking practices.

Under Part 1, national banks may purchase securities acquired on the basis of reliable estimates including, but not limited to, CD securities, in an aggregate amount no greater than 5 percent of their capital and surplus.

SBIC investments

National banks and some state banks are permitted to purchase stock in small business investment companies (SBICs). SBICs are venture capital firms licensed by the SBA. Typically, they support small business start-ups and expansions by providing a combination of longer term debt, equity investments, and management counseling. Some banks form SBIC subsidiaries. Of the more than 300 active SBICs organized throughout the country, 95 SBICs are owned or controlled by banks.[18]

The legal authority for national banks to make investments in SBICs is 15 USC § 682(b), which permits a bank to invest, on an aggregate basis, up to 5 percent of its capital and surplus in shares of SBIC stock. State banks that are members of Federal Reserve System, as well as non-member state banks, may make such investments pursuant to applicable state law. Thrifts may invest up to 1 percent of their total assets in Section 301(d) licensees that are formed for the purpose of aiding members of a Federal Home Loan Bank.[19]

Charitable contributions

Banks can support community and economic development activities by providing contributions to community-based organizations, CD intermediaries, or foundations. Under 24 USC §24(Eighth), a national bank may contribute to community funds or to charitable, philanthropic, or benevolent instrumentalities conducive to public welfare, if the bank is located in a state with laws that do not expressly prohibit state banking institutions from contributing to such funds or instrumentalities.

Mortgage-backed securities

Banks may purchase securities that are backed by home mortgage loans in accordance with the requirements of 12 CFR Part 1. Some private companies have programs to assemble and securitize pools of mortgages that include properties located in a bank's assessment area and are made to borrowers with incomes below 80 percent of the area median income.

Municipal or mortgage revenue bonds

Banks can purchase municipal or mortgage revenue bonds that are obligations issued by state and municipal authorities, consistent with the requirements and limitations of 12 USC 24(Seventh) and the OCC's implementing regulations at 12 CFR Part 1. These bonds provide capital for the government entities to purchase, bundle, and sell mortgages in the private market.

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18 Small Business Administration, Investment Division, Outstanding Licenses Report, June 30, 1999.

19 12 USC § 1464(c)(4)(D).

Loans are normally originated by participating lenders according to guidelines contained in memoranda of understanding between the issuer and the lenders. The government agencies may target the obligations to activities that primarily support affordable housing, small businesses, or other CD purposes. In addition, the agencies may target particular low- and moderate-income communities or other distressed areas that are served by the investor banks.

Revolving loan funds and lending consortia

Banks that want to share resources and risks associated with CD financing often form revolving loan funds and consortia with financial institutions and other community partners. The banks use these mechanisms to make regular bankable loans to borrowers and may loan up to their legal lending limits.[20] Consortia also allow banks to partner with each other and other public and private entities to focus on one or more community revitalization projects or areas. Consortia may have access to subsidies, credit enhancements, technical assistance, and other resources to facilitate lending to underserved borrowers and areas.

Revolving loan funds and consortia provide affordable housing and economic development credit primarily to individuals and small companies that cannot attract private financing. Typically, these mechanisms recycle repayments by relending the capital to other individuals and businesses.

Revolving loan funds and consortia may take a number of forms, depending on their purpose and available resources. An informal loan pool may involve a group of financial institutions that agree to lend to particular communities using common eligibility criteria, loan terms, and conditions. They usually commit a fixed amount of loans or participations in the pool. The pool could refer borrowers to the banks, on a revolving basis, or one bank may serve as the lender of record and participate out each loan to the other banks.

A more formal type of consortium involves a corporate structure that originates loans on behalf of members or stockholders, which include lenders. Banks may make investments in these corporations, provide revolving lines of credit, or lend directly to the consortium's borrowers.

Some consortia hire staff with expertise in the type of financing that is being offered. They also look for staff that is knowledgeable about the use of credit enhancements and subsidies offered by government agencies and CD intermediaries. In other consortia, banks provide key managers and staff to serve on loan and investment committees.

How Banks' Evaluate CD Investments and Other Financing Partnerships

The banks in the study consider a number of other factors when deciding how much to invest, lend, or contribute to community-based organizations and CD intermediaries. Initially, the banks evaluate whether the investment or partnership opportunity is consistent with their overall CD strategy. Their CD strategies often cover the scope of activities in which the banks want to be involved, the banks' intended role and participation in the entities or projects, how long the banks want to be involved, and the banks' overall financial condition.

A bank also considers the organizations' purposes, programs, and activities; capitalization plans and potential investors (especially for start-up projects); management and

20 12 USC § 24(Seventh).

staffing plans; operating and risk management policies and ability to respond to changing markets; and the availability of private and government resources for technical and financial assistance. Bankers often consult with legal, tax, and accounting advisors when assessing organizations and determining investment amounts.

It is important to note that for-profit organizations often attract capital from a variety of private corporations and individual investors that take advantage of cash flow or tax shelter benefits. Nonprofit corporations usually attract capital from governments and foundations in the form of loans and grants.

The banks in the study recognized that some CD investment activities will generate more income than others. For example, limited partner investments in affordable housing projects that involve federal low-income housing tax credits tend to produce higher returns when compared to other types of CD investments.

Following are some criteria or prerequisites that the banks in the study use to lead them to successful CD investments:

- The CD investments match the bank's strategy for community development and will make one or more positive changes in the bank's communities or markets.
- The CD investments are legally permissible, consistent with safe and sound banking practices, and may receive positive CRA consideration.
- The organizations in which banks make CD investments have sufficient capital from a variety of sources to be sustainable and produce tangible, visible results.
- The organizations in which banks make CD investments are well-staffed and managed.
- The organizations in which banks make CD investments contain mechanisms for measuring performance against goals and objectives.
- The organizations in which banks make CD investments provide financing or services that supplement the banks' regular business and have the potential of bringing new deposits and borrowers to the banks for traditional lending and services.
- The organizations in which banks make CD investments have mechanisms that give local residents a stake in the effort and facilitate information sharing between the banks and their community partners.

CRA Consideration of CD Investments

Regardless of the performance test under which a bank is evaluated,[21] a bank may receive positive consideration for CD investments if those CD investments are "qualified investments" under the CRA regulations. A "qualified investment" is a

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21 Large banks' CRA performance is typically evaluated under the lending, investment and service tests. Examiners consider large banks' qualified investments under the investment test. *See* 12 CFR § 25.23(a). In a small bank examination, examiners may adjust a bank's evaluation under the small bank performance criteria, if appropriate, based on lending-related qualified investments. *See* 12 CFR § 25.26(a)(1). *See also* Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment, 64 Fed. Reg. 23, 618, 23,638 (May 3, 1999) (Q and A 1 addressing § —.26(a) (consideration of small institutions' lending-related activities)). Qualified investments may also be considered to determine if a small bank merits an outstanding CRA rating. *See* 12 CFR pt. 25 app. A(d)(2). *See also* Q and A 5 addressing §—.26(a), 64 Fed. Reg. at 23,639. The community development test, which is appropriate for wholesale and limited purpose banks, evaluates, inter alia, the number and amount of qualified investments. *See* 12 CFR § 25.25(c)(1). And, finally, banks evaluated on the basis of a strategic plan must include in their plan show they intend to meet the credit needs of their assessment area(s). They may meet credit needs through lending, *investment*, and/or services, as appropriate. *See* 12 CFR § 25.27(f)(1) (emphasis added).

lawful investment, deposit, membership share, or grant that has as its primary purpose community development.[22] "Community development" is defined in the regulations to mean:

- Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;
- Community services targeted to low- or moderate-income individuals;
- Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of $1 million or less; or
- Activities that revitalize or stabilize low- or moderate-income geographies.[23]

Under the appropriate CRA performance tests, examiners will give positive consideration to qualified investments that help meet the credit needs of an institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s).[24] And, in the case of wholesale and limited purpose banks that are evaluated under the community development test, examiners will give positive consideration to qualified investments nationwide if the bank has adequately addressed the needs of its assessment area(s).[25]

Some investments may not be considered qualified investments under CRA. However, banks still may choose to invest because of the long-term benefits to their franchise.

22 12 CFR § 25.12(s).

23 12 CFR § 25.12(h).

24 12 CFR § 25.23(a).

25 12 CFR § 25.25(e).

APPENDIX D
WAYS COMMUNITY DEVELOPMENT ORGANIZATIONS AND GOVERNMENT AGENCIES FACILITATE BANKS' CD FINANCE PROGRAMS

This section of the report summarizes the ways the CD organizations, intermediaries and the federal, state, and local government agencies support the banks' CD finance efforts.

CD Organizations' Strategies for Partnerships with Banks

Community development organizations or intermediaries have a primary purpose of serving the public good, such as promoting affordable housing, services, and jobs for low- and moderate-income persons; small business growth and expansion; and other commercial enterprises that stabilize neighborhoods. They may be organized as non-profit or for-profit corporations, foundations, limited partnerships, or limited liability companies, and may have a variety of public and private funding sources to capitalize their operations and programs. Some CD organizations may be single purpose in scope; others may undertake a broad range of CD activities.

Although CD organizations may vary in purpose, scale, scope and capability, they generally serve as linchpins in promoting public-private partnerships. We learned that they facilitate banks' CD activities by

- Providing resources and services that supplement banks' activities;
- Directly implementing and supporting projects in which banks lend or invest;
- Providing market information about neighborhoods to banks; and
- Enhancing communication between banks and community residents.

Provide resources and services that supplement banks' activities

Financial resources

Most of the CD organizations provide financial resources to supplement banks' regular lending and investments. Because they usually have the flexibility to respond quickly and creatively to the financing needs of developers and small businesses, they can provide riskier, up-front capital for land acquisition and predevelopment expenses. Community development organizations may also have the flexibility to structure small subordinated loans with repayments linked to the financial feasibility of the transactions.

Many CD organizations have links to secondary market vehicles. It is not unusual for CD organizations to partner with Fannie Mae and Freddie Mac to sell their permanent affordable single- and multifamily loans. Several CD organizations have created their own secondary market vehicles that purchase loans from private and nonprofit lenders and sell them to a variety of investors.

Technical assistance

Many of the CD organizations provide a wide range of technical assistance and training. They provide credit counseling and educate borrowers about the responsibilities of owning and maintaining a home. They often have expertise in packaging a variety of public and private resources, including subsidies and government loan guarantees. These skills help to reduce banks' transaction costs relating to delivering all three affordable housing and small business products in the study. Others work with small businesses to develop business plans, marketing strategies, and loan packages that help to promote growth and expansion.

Complementary Services

Some CD organizations provide day care for children and the elderly, and health care and transportation services that increase the likelihood for success of affordable multifamily developments in certain markets. One CD organization administers government funds for local agencies, while others enlist local residents to provide "sweat equity" in developments.

Directly implement projects in which banks lend or invest

Many CD organizations have evolved into the role of project developers to address local community development needs. They receive funding and technical assistance support from government, national intermediaries, foundations, and corporate sponsors, and have become experienced real estate developers of affordable housing, small business incubators, and neighborhood commercial centers. Several national CD organizations, such as those sponsored by Enterprise Foundation and the Local Initiatives Support Corporation, serve as general partners with local CD affiliates in developing low-income rental housing. Banks may make investments, as limited partners, with CD organizations to build affordable housing using federal low-income housing tax credits (LIHTCs).

A few CD organizations have assisted affordable housing and small business developers by taking a marketing role that can help to ensure more rapid stability, and often the success, of projects in which the banks have lent or invested money.

Provide market information about neighborhoods to banks

The CD organizations we interviewed indicated a willingness to work with banks by providing information about neighborhoods, particularly low- and moderate-income neighborhoods and other disadvantaged communities. Banks often look to them to identify entrepreneurs who may be customers for small business loans or to refer potential home mortgage borrowers. Some CD organizations have assisted banks by locating vacant and substandard properties that may become new affordable housing or commercial developments that will bring families and capital into disadvantaged areas. Other CD organizations help banks by evaluating new bank products and services or participating in pilot programs.

Enhance communication between banks and community residents

Community development organizations often serve as links between banks and their community residents by providing a mechanism through which the banks offer basic services. Some individuals and groups, particularly those with cultural and language barriers, feel vulnerable in dealing with banks directly. With the help of CD organizations, these same people will talk to banks about basic banking services and may graduate to traditional borrowing for home mortgages or to start businesses. In some instances, CD organizations are effective in helping to resolve real or perceived conflicts between individuals or groups and banks.

Many CD organizations are effective in building a common vision among the private sector (including banks), the public sector, and community leaders. They help develop strategies that recognize everyone's goals and interests and often promote a comprehensive approach to dealing with local issues.

Government Agencies' Strategies for Partnerships with Banks

By virtue of why and how they are organized, government agencies also have the primary goal of serving a public good. Local, regional, state, and federal agencies are often linked together in terms of funding sources, goals, and requirements of programs they administer. Because their primary purpose is to serve the public, most government agencies have performance measures that differ from banks and other corporate partners. Consequently, they typically use staff and funding resources to administer programs and projects that may not produce results immediately. This provides them flexibility to test, fine-tune, and revamp programs and products to create profitable situations for both lenders and borrowers in the affordable housing and small business process.

The agencies we interviewed identify common effective strategies for facilitating banks' delivery of the products by

- Helping banks manage risk by providing guarantees, subordinate loans, linked deposits, incentives, and information about partnership opportunities;
- Reducing the developers' predevelopment and transaction expenses;
- Improving and enhancing the borrowers' equity and likelihood for success;
- Developing comprehensive plans for community revitalization; and
- Promoting social changes by implementing programs that guide banks' CD finance objectives.

Help banks manage risk by providing guarantees, subordinate loans, linked deposits, incentives, and information about partnership opportunities

Guarantees, subordinated debt, and other enhancements

Government agencies help banks manage the risk of lending to small businesses, affordable single- and multifamily housing developers, or low- and moderate-income home purchasers by providing loan guarantees that protect the lender against losses when a borrower defaults. As guarantor, the agency pays the bank a portion of the defaulted loan, the portion varying depending on the agency, program, and intended use. Some agencies allow a bank to charge market rates and appropriate fees for the government-guaranteed loan. Depending on the agency and program, the guarantee may allow the bank to sell the loan on the secondary market or to make loans with longer terms and fixed rates. Banks using these secondary market vehicles must meet certain government underwriting standards.

Most government agencies provide gap financing in affordable housing and small business transactions. They may provide subordinated second or third mortgage loans to borrowers in conjunction with a lender's financing or funds from CD organizations. When underwriting government funds, these agencies have the flexibility to make very small "microloans," defer principal or interest, charge below-market interest rates, or consider long loan terms.

The secondary market serves as a conduit that links lenders with investors and provides liquidity for banks to make additional loans. The largest secondary market vehicles include those created by Congress: Fannie Mae, the Federal Home Loan Mortgage Corporation (Freddie Mac), and Government National Mortgage Agency (Ginnie Mae).

Some government agencies deposit their funds in banks and structure them as "linked deposits." The linked deposit allows a commercial lender to be compensated for projected losses that may result from offering certain types of loans for affordable housing or to small businesses for other types of government-sponsored commercial and economic initiatives. Banks often make concessions on interest rates, terms, or other underwriting policies because they are receiving income as a result of the market-rate government deposits.

One government program, the Community Development Financial Institutions (CDFI) Fund, provides incentives directly to lenders. The CDFI Fund is administered by the Department of the Treasury and provides assessment credits to banks that lend or invest in economically disadvantaged communities.[26]

Programs and partnership opportunities

Many of the government agencies are willing to provide information to lenders, such as program descriptions, loan requirements and application processes. They may also survey residents and businesses to gather information about the market and credit issues, test programs and products, and learn about barriers to credit and opportunities for revitalization. Government agencies tend to place their offices in major business centers and often have multiple offices that cover broad geographic markets. This helps them identify trends, other resources, and opportunities for banks' loans, investments, and services. A few agencies mentioned that they maintain lists of local nonprofit and for-profit developers, construction contractors and subcontractors, low- and moderate-income tenants, real estate agents and brokers, appraisers, insurance agencies, small businesses, landlords, CD organizations, technical assistance providers, and educational resources to which lenders can refer clients who are involved in the loan process.

Reduce the developers' predevelopment and transaction expenses

Land and site improvements represent substantial expenses in a developer's budget. Some government agencies may help developers of affordable housing properties and

[26] *See* 12 USC § 4713. The Administrator of the CDFI Fund may award assessment credits to an applicant insured depository institution that engages in "qualifying activities." "Qualifying activities" are described in the Bank Enterprise Act of 1991, as amended, to include, for example, originating qualified loans and providing other assistance to low-and moderate-income persons in distressed communities or enterprises integrally involved with such neighborhoods, and increasing the amount of new equity investments in CDFIs. *See* 12 USC 1834a(a)(2).

small businesses to defray these expenses. For example, local agencies, particularly those that serve urban areas, may have a stock of abandoned, vacant lots and housing and commercial properties. These agencies may work with CD organizations to manage the sale of foreclosed properties and to ensure that their redevelopment activities meet residents' community and economic development needs.

The agencies may also help reduce development costs by selling the properties at a nominal cost or by securing a subordinated mortgage on the properties. They may waive permit, inspection, and other fees or provide tax abatements. Government agencies have helped developers, particularly nonprofit organizations, during the construction phase by preparing specifications and cost estimates, managing the bid process, and supervising construction. Some agencies may waive usual development fees or provide infrastructure, such as water and sewer lines, using public funds.

Government agencies have the flexibility to provide the more risky money first. Borrowers can use government funds, rather than the lender's construction loan, for planning and other expenses associated with developing real estate, such as land acquisition, appraisals, feasibility studies, property clearing, and improvements. In addition, some agencies have worked with developers and lenders to standardize the government's documentation and disbursement schedules so that subsequent phases or developments will take less time to complete.

Improve and enhance the borrowers' equity and likelihood for success

Grants and subordinate loans

Many government agencies provide funds that substitute for equity directly to low- and moderate-income persons or families, small business owners, or nonprofit or for-profit developers. This can take the form of grants or deferred and subordinate loans, which reduce the amount of principal the borrower requires from a lender. Although some agencies are willing to provide grants to borrowers, more frequently they structure their financing as loans with recapture of principal and interest for future initiatives.

Government agencies help borrowers of affordable mortgages by providing down-payment or settlement-cost assistance. Some agencies provide equity to small companies for property acquisition, renovation, working capital, or equipment. Other agencies provide funds to developers to build small business incubators that provide space and business services for starting or expanding small companies.

Tax incentives

Some government agencies provide tax incentives to developers that enhance their ability to raise equity in the private market. These incentives also increase the financial feasibility of the affordable housing and economic development initiatives during construction and start-up phases. For example, in many states, the Department of Housing and Urban Development (HUD) and the U.S. Department of Agriculture (USDA) have designated "empowerment zones," "enterprise communities," and "rural development investment areas."[27] Developers and investors that build and enhance

[27] *See* 26 USC § 1391 et seq. State and local governments nominate areas for designation as "empowerment zones," "enterprise communities" and "rural development investment areas." Depending on the type of area, either the secretary of agriculture or the secretary of HUD awards designation to a limited number of areas.

these areas through community and economic development initiatives are generally eligible for federal tax incentives or tax abatements.

Another incentive program, which represents one of the largest federal housing production programs, is the Federal Low-Income Housing Tax Credit Program. The program, coordinated through the Department of Treasury, the Internal Revenue Service, HUD, and the states, provides investors—including banks—with dollar-for-dollar credits for taxes they would otherwise pay. To demonstrate that they are serving low- and moderate-income families, the housing project must meet certain standards for 15 years; otherwise, the tax credits are subject to recapture.[28]

Education and technical assistance

Government agencies help enhance the likelihood of success of low- and moderate-income or small business borrowers by providing education and information before and after the lenders make loans. Agencies do this either directly or indirectly through funding relationships with CD organizations.

Some government agencies promote affordable single-family mortgage lending by providing or funding homeownership counseling and education programs. They also provide homeowners with self-help information and maintenance assistance through grants and education. Some agencies promote affordable multifamily development by maintaining a list of available tenants, which small business developers may use to achieve desired occupancy levels in projects with special requirements. Other agencies sponsor training for tenants on renter rights and responsibilities.

Government agencies also address the education and information needs of small businesses, usually in coordination with educational centers and private sector companies. They sponsor credit counseling, management training, loan packaging, accounting services, and computer training; conduct conferences and workshops; provide referrals to lenders and businesses (to serve as mentors); and maintain resource libraries.

Develop comprehensive plans for community revitalization

When most of the government agencies define "community development," they describe the comprehensive process of developing and improving housing, jobs, community facilities and services, infrastructure, and the quality of life for all residents of the community. They frequently develop specific, interrelated plans to prevent hazardous conditions, address residents' needs, and sustain community revitalization.

Planning enables government agencies to know where communities have been and determine where they should go. Although agencies have the resources to collect data and develop strategies for community revitalization, some believe the most useful plans are those that include input from local residents and business leaders, including banks. As new community and economic development efforts are being considered, many governments invite business and community involvement. Community leaders and businesses often are asked to identify laws that may need to be updated to reduce costs or enhance a project's operations.

Local and regional government agencies develop plans to comply with a number of state and federal planning requirements. These plans can provide important insight to

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28 *See* 26 USC § 42. Each state is allowed a maximum amount each year. States award their limited housing credits to qualified housing projects annually.

lenders evaluating CD initiatives. Some of the plans may result in federal funding that local agencies can reinvest in local community and economic development projects.[29] Federal funds associated with local planning come from such agencies as the Department of Commerce (Economic Development Administration); USDA (Rural Development, Forest Service, and Resource Conservation and Development); Department of Labor; Department of Health and Human Services; HUD; Environmental Protection Agency; Department of Transportation; Federal Emergency Management Agency; National Endowment for the Arts; and National Park Service.

Promote social changes by implementing programs that guide banks' CD finance objectives

Many government agencies help to promote social change by targeting programs to low- and moderate-income persons, minorities, small businesses, and women—groups that often have been disenfranchised from financial services, the American dream of owning a home, or building a business. When government provides enhancements, funds, and services that affect both the borrower and lender in affordable housing (particularly homeownership) and small business initiatives, it increases the likelihood that these segments of the population will be brought into the mainstream of American society and have greater access to credit and employment opportunities.

29 "Federal Planning Requirements: An Overview of What Local Officials Must Do to Secure Funding of their Programs and Projects," *Economic Development Digest*, April 1997.

APPENDIX E
PARTNERSHIP RESOURCES FOR AFFORDABLE MORTGAGE LENDING AND MULTIFAMILY FINANCE

A number of secondary market resources, government programs, and national housing intermediaries help banks with their affordable single-family and multifamily lending initiatives. Many of these programs are targeted to low- and moderate income persons and families. The following list is a summary of programs that were most frequently mentioned by the banks, government agencies, and CD intermediaries participating in the study.[30]

Secondary Market Resources and Other Private Resources

The secondary market serves as a conduit that links lenders with investors and provides liquidity for banks to make additional loans.

Fannie Mae

Fannie Mae was created by Congress in 1938 and is the largest of the secondary market agencies. It promotes housing by attracting investment capital into mortgage lending and buys billions of dollars' worth of mortgages annually from lenders. Fannie Mae has partnership offices in many cities around the United States that assist lenders in working with various mortgage programs and in creating new public-private partnership programs with local and state housing agencies. Some of Fannie Mae's programs targeting low-, moderate-, and middle-income families include:

- ***Community Home Buyer's Program***—This program offers a 3 percent down payment, 15- to 30-year fixed-rate mortgage with up to 33/38[31] debt-to-income ratios, and no cash reserves are required. Home buyer education is required, but can be waived in certain circumstances; post-purchase early delinquency counseling is recommended. Fannie Mae also offers a graduated payment option that minimizes the payment amount in the first few years.
- ***Fannie 97***—This program requires a 3 percent down payment and is designed for applicants with the income to afford the monthly payments but without sufficient cash for the down payment. The maximum debt-to-income ratios are 33/36 for a 25-year loan and 28/36 for a 30-year loan. One month's payment reserves are needed for closing. Home buyer education and post-purchase early delinquency counseling are both required.
- ***3/2 Option***—This product allows borrowers to use 3 percent from their own funds for the down payment. The remaining 2 percent can be a gift from a family member; a grant or unsecured loan from a private nonprofit or govern-

30 Please note that the list of secondary market resources, government programs, private sector resources, and CD intermediaries is meant to point to resources that banks may use. It is not meant to be exhaustive, nor does it mean to reflect the effectiveness, efficiency, or popularity of any particular program. The OCC does not endorse any particular government program, CD intermediary, or private enterprise that is described in this section.

31 The first number refers to the front-end ratio. This ratio compares the monthly housing costs to the total household income. The second number refers to the back-end ratio. This ratio compares a household's total monthly debts to total household income.

ment agency; or, sometimes, secured financing from a government or private nonprofit agency. The maximum debt-to-income ratios are 33/38. No cash reserves are required at closing. Fannie Mae requires home buyer education and recommends post-purchase early delinquency counseling.

- ***CRA Portfolio Transactions: Single-family and Multifamily***—Under this program, Fannie Mae purchases portfolio loans from lenders, particularly loans that may have been originated using underwriting criteria that are different from Fannie Mae's criteria. The program focuses on the track record of the payment and the creditworthiness of the homeowner since the time the mortgage was issued by the lender.
- ***FannieMaps Plus***—Fannie Mae offers a software package that uses maps and demographic information to help banks identify and develop demographic profiles (for example, income, housing stock, owner-occupancy, age) of communities in their assessment area.
- ***Targeted Mortgage-Backed Securities***—Fannie Mae facilitates transactions between Fannie Mae lenders and investors who seek "qualified investments," under the CRA investment test. This investment vehicle pools loans made to borrowers with incomes below 80 percent of the area median income, and the geographic distribution of the loans is defined to meet the CRA assessment area of each investor.

Fannie Mae also offers programs and products that allow flexibility in income guidelines when done in conjunction with local government-designated target areas or government subsidy programs, community-based lease-purchase programs, community land trusts, and employer-assisted housing. Fannie Mae provides other credit enhancement options, such as mortgage insurance for portfolio products. In addition, Fannie Mae can lower the cost of its insurance coverage for borrowers with mortgages carrying five percent to ten-percent down payments that are originated by lenders using its automated underwriting system, Desktop Underwriter. This provides opportunities for first-time home purchasers who haven't accumulated the required funds for down payments and who may have difficulties with high monthly loan charges.

Federal Home Loan Mortgage Corporation (Freddie Mac)

Freddie Mac is a secondary market agency created by Congress in 1970. Although it primarily buys conventional mortgages from banks, it also offers affordable mortgage programs. In addition, Freddie Mac has developed programs in cooperation with the U.S. Department of Housing and Urban Development (HUD); the Federal Housing Administration (FHA); the U.S. Department of Agriculture Rural Development (USDA Rural Development); the Neighborhood Reinvestment Corporation; and other government, private nonprofit, and Native American agencies. Some of Freddie Mac's affordable housing programs include:

- ***Affordable Gold® 5***—This program allows a 95 percent loan-to-value mortgage with the 5 percent down payment from borrower's personal cash.
- ***Affordable Gold® 3/2***—Under this program, borrowers can qualify for mortgages with a minimum down payment of 3 percent of their own cash and the other 2 percent from other sources. It also allows a 95 percent loan-to-value ratio, higher debt-to-income ratios than their conforming mortgages, and the possible waiver of borrower reserves at closing.

- ***Affordable Gold® 97***—This program allows a 97 percent loan-to-value mortgage with the 3 percent down payment from borrower's personal cash.
- ***Affordable Seconds®***—This program allows subsidized secondary financing from federal, state, and local housing agencies; a regional Federal Home Loan Bank program; nonprofit and religious organizations; or a borrower's employer. Borrowers can use Affordable Seconds® toward their down payment, closing costs, prepaids and rehabilitation costs with total loan-to-value ratios up to 105 percent.
- ***Community Gold*** —This program provides a mortgage product for lenders in communities participating in a Freddie Mac Community Development Lending initiative or alliance and where a local community organization offers comprehensive homeownership counseling. The program allows underserved borrowers to finance purchases, refinances, and the rehabilitation of one- to-four-unit properties. The total loan-to-value of the mortgages can be up to 105 percent for the purchase and 120 percent for the purchase and rehabilitation of properties. The program also allows individual development accounts—borrowers' savings matched by foundation grant funds—as borrowers' personal cash for use toward the down payments and closing costs.
- ***NeighborWorks®***—Freddie Mac joined the Neighborhood Reinvestment Corporation's Campaign for Homeownership and purchases loans with low down payments (5 percent), up to 95 percent loan-to-value ratios on one- and two-family homes, and rehabilitation financing as part of the loan.
- ***HOME WORKS!*** —Created in conjunction with HUD, this program offers borrowers a 3/2 option; a way to finance their first home by combining HOME Investment Partnership Program (HOME) funds and first-mortgage capital supplied by Freddie Mac for mortgages up to 115 percent total loan-to-value for rehabilitated houses; and other flexible underwriting features. This program involves the expertise of local housing and finance agencies to manage the rehabilitation process so that banks can sell the mortgages at closing.

Freddie Mac also offers innovative financing for two- to four-family houses, lease/purchase mortgages, Native American mortgage programs, and FHA 203(k) rehabilitation mortgages, and works with local and state housing finance agencies to create programs that can be customized for local needs. In addition, Freddie Mac offers an automated underwriting tool, Gold Measure®, and service, Loan Prospector®, that evaluate a potential borrower's ability to meet a mortgage obligation and delivers loan purchase decisions within short time frames.

Both Fannie Mae and Freddie Mac offer affordable housing programs for multifamily properties that help depository institutions increase their portfolio liquidity. For example, both companies have programs that offer favorable underwriting terms and interest rates for mortgages that serve low- and moderate-income persons and provide credit enhancements for tax-exempt mortgage revenue bonds that are issued by state and local housing finance agencies. They also offer programs that combine construction and permanent loans in one application process and lock the mortgage interest rate for both pieces of financing at the start of construction. In addition, they have programs that involve equity investments in low-income housing tax credit projects and that provide other types of credit enhancements.

Government National Mortgage Agency (Ginnie Mae)

Ginnie Mae, another secondary market mechanism created by Congress, promotes liquidity largely by guaranteeing the timely payment of principal and interest of mortgages with the full faith and credit of the United States. Lenders are approved by Ginnie Mae to issue securities that are pass-through certificates representing an interest in a pool of mortgages for which the payment of interest and principal is passed on to investors.

- ***Targeted Urban Ownership Initiative—*** Ginnie Mae is leading a federal initiative to provide $1 billion in mortgages as part of this program. Ginnie Mae reduces the fees it charges lenders by up to 50 percent when the lenders make mortgages in any of 72 communities across the country that are designated as Urban Empowerment Zones, Supplemental Empowerment Zones, Enterprise Communities, or Enhanced Enterprise Communities. About 33 million people live in those communities.

Other private resources

Private mortgage insurers provide tools to lenders for increasing opportunities for affordable mortgages. For example, the Mortgage Guaranty Insurance Corporation (MGIC) provides private mortgage insurance to home purchasers. The majority of MGIC's private mortgage insurance business to home buyers is to borrowers in central cities who earn less than 100 percent of the area median income. Lenders who deal with MGIC may offer options to borrowers who seek mortgages with five percent to ten percent down payments. MGIC allows borrowers to roll part of the insurance costs either into the loan amount or into the interest rate, thereby reducing the monthly premiums. These options can help marginal borrowers buy a house and others to buy more costly homes than they thought they could afford.

Another large private mortgage insurer, General Electric (GE) Capital Mortgage Corporation, has insured more than $4 billion in loans under its Community Home Buyer's Program. GE Capital helps home buyers with low down payments (less than 20 percent) qualify for affordable mortgage loans; offers mortgage insurance options for customers to save money at closing; and provides equity, construction, and permanent financing for multifamily projects involving low-income housing tax credits.

Pension funds also represent a large source of capital for affordable housing development. For example, the AFL-CIO Housing Investment Trust invests pension funds in projects that use labor union members during construction. The trust provides developers with permanent financing, and in conjunction with banks, Fannie Mae, and Freddie Mac, offers a forward commitment on a loan's interest rate. To assist developers of affordable rental properties, the AFL-CIO also provides combined construction and permanent loans, using favorable rates and fees because of the single loan closing. It may also use the combination construction and permanent loan program for projects that involve FHA-insured loans or those that use taxable bonds issued by state housing finance agencies.

Loan Guarantee Programs

Federal Housing Administration (FHA)/HUD

The FHA administers several single-family mortgage insurance programs designed to promote homeownership. This insurance allows a home buyer to make a modest down payment and obtain a mortgage for the balance of the purchase price on properties with one to four units. Because the lender is protected by this insurance, it enables the lender to offer more liberal mortgage terms than the prospective homeowner might otherwise obtain. The FHA insures fixed rate and adjustable rate mortgages originated by HUD-approved financial institutions, as well as rehabilitation loans and reverse mortgages.

The FHA also insures multifamily properties with more than 4 units, nursing homes, assisted living facilities, hospitals, and other health care facilities. These programs enable borrowers to obtain long-term, fixed-rate, nonrecourse financing through qualified multifamily lenders. The borrower pays a mortgage premium to the lender, out of the project's cash flow, which is then passed through to the FHA in return for the insurance. This premium compensates the FHA for its risk and cost of doing business.

In addition, HUD administers asset management programs, including those that enable the FHA to pay lenders partial claims to cure a default if the loan is at least four months delinquent; to allow mortgagees to enter into special forbearance agreements; and to modify mortgage obligations for a borrower who has recovered from financial distress, but whose net income has been reduced to a lower level. When foreclosure is elected, the single- or multifamily properties are bought either by a third party at the foreclosure, or by the FHA. If the FHA acquires the property, the agency assumes the property's ownership until it can be sold.

Some of the FHA's insurance programs for single- and multifamily properties include:

- ***Section 184-Indian Home Loan Guarantee Program***—This program provides loan guarantees of 100 percent to lenders for one-to-four-family homes located in Indian or Alaska Native areas where land may be held in trust by the U.S. government for the benefit of a particular tribe or individual. The loan involves tribal participation in the creation of a leasehold for the use of tribal trust land. It also allows established underwriting procedures and uses uniform mortgage instruments that enhance the sale of the mortgage on the secondary market. In the case of default or foreclosure, the responsibility of acquiring the property and keeping the land ownership in the tribal trust status is the responsibility of the federal government. In 1998, the program initiated a "direct guarantee" process. This allows lenders the choice of underwriting the loan or forwarding it to the underwriting staff of the National Office of Native American Programs.

  Under the program, the loans may be used for the construction, acquisition, or rehabilitation of homes. Loan limits are generally up to 150 percent of the established FHA limits in the area. The loan amount can be up to 97 percent of the first $25,000 of the home's value and up to 95 percent of the remainder of the home's value. Some closing costs can be included in the financing. There are no income limits.

- ***Section 203(b)-Single-family mortgage insurance***—This program provides mortgage insurance to lenders for persons and families that purchase or refinance a principal residence. The mortgage loan is funded by a lending institution and insured by the FHA. Borrowers must meet standard the FHA credit qualifications. Loans will be made up to 97 percent loan-to-value and may be used to finance closing costs and the up-front mortgage insurance premium. Maximum mortgage amounts are set according to the location of the property.

- ***Section 203(k)-Single-family purchase/rehabilitation mortgage insurance***—This program provides mortgage insurance to lenders for persons, small-scale investors, and nonprofit organizations that purchase (or refinance) and rehabilitate one- to-four-family residences that are at least one year old. A portion of the loan proceeds are used to acquire the property or pay off the existing mortgage, and the remaining funds are placed in an escrow account and released as the rehabilitation is completed. The cost of the rehabilitation must be at least $5,000, but the total value of the property must still fall within the FHA mortgage limit for the area. The value of the property is determined by either (1) the value of the property before rehabilitation, plus the proposed renovation costs that are certified by a FHA appraiser; or (2) 110 percent of the appraised value of the property after rehabilitation, whichever is less.
- ***Section 221(d)-Mortgage insurance for single-room occupancy projects***—This program provides mortgage insurance for multifamily properties consisting of single-room occupancy (SRO) apartments. These apartments are intended for people—usually a single person—who have a source of income, but are priced out of the rental apartment market. Each SRO apartment can have its own kitchen or bathroom facilities, or these facilities can be shared by several apartments. The maximum mortgage term is 40 years, and there are no rental subsidies. The amount of the loan may not exceed 90 percent of the estimated replacement cost.
- ***Section 221(d)(3) and Section 221(d)(4)-Mortgage insurance for rental and cooperative housing***—This program insures mortgages for the new construction or substantial rehabilitation of multifamily rental properties with five or more units. Projects may be designed for residents who are elderly (age 62 or older) or who have disabilities. Nonprofit and cooperative sponsors use Section 221(d)(3) and may receive an insured mortgage for the full amount of the HUD/FHA estimated replacement cost of the project. For-profit sponsors use Section 221(d)(4) and can receive a maximum mortgage of 90 percent of the HUD/FHA replacement cost estimates.
- ***Section 223(f)-Multifamily mortgage insurance for existing properties***—This program provides mortgage insurance for up to 85 percent of value for the purchase or refinance of existing multifamily rental properties. Properties must have 5 or more units and must not require substantial rehabilitation. The term on these mortgages is 35 years.
- ***Section 231-Mortgage insurance for properties with elderly occupants***—This program provides mortgage insurance for up to 90 percent for for-profit owners and up to 100 percent for nonprofit owners to finance the construction and rehabilitation of housing for properties that are restricted to elderly occupants (62 years of age and older).
- ***Section 232-Mortgage insurance for nursing homes/board care facilities***—This program provides mortgage insurance for up to 90 percent of the value for the new construction or the substantial rehabilitation of nursing homes, intermediate care facilities, board and care homes, and assisted living facilities.
- ***Section 237-Single-family mortgage insurance for special credit risks***—This program provides mortgage insurance for low- or moderate-income persons who are unable to meet standard credit requirements. The use of this program

is at the discretion of HUD, and borrowers do not have to meet the standard FHA credit criteria. Borrowers may be eligible for 97 percent financing and can include closing cost expenses and the monthly mortgage insurance premium with the loan. Eligible properties are one-unit structures and the maximum mortgage amount is $21,000 (or less in some areas).

- ***Section 251-Insurance for adjustable rate mortgages (ARMS)***—This insurance program insures the home purchase or refinancing of loans with interest rates that may increase or decrease over time, enabling consumers to purchase or refinance their homes at a lower initial interest rate. The FHA uses the 1-year Treasury Constant Maturities Index to determine the interest rate changes. The maximum amount that the interest rate may increase or decrease in any one year is 1 percent point. Over the life of the loan, the maximum interest rate change is 5 percentage points from the initial rate. Other features of the program include: down payments as low as 3 percent; closing costs that can be financed; and limits on some of the fees that lenders can charge. To ensure that the program serves low- and moderate-income people, the FHA sets limits on the dollar value of the mortgage loan.
- ***Section 255-Home equity conversion mortgage***—This insurance program allows elderly homeowners (aged 62 and over) to convert equity in their homes to a monthly stream of income or to a line of credit through a reverse mortgage. Loan proceeds are paid out according to a payment plan selected by the borrower. A reverse mortgage is repaid in one payment, after the death of the borrower or when the borrower no longer occupies the property as a principal residence.
- ***(Title I)-Property improvement loan insurance***—This insurance program insures loans to finance the light or moderate rehabilitation of properties, as well as the construction of nonresidential buildings on the properties. The FHA insures lenders for up to 90 percent of any single loan, with a maximum insurance coverage limited to a total of 10 percent of the total amount insured. The maximum loan amount is $25,000 for improving a single-family home or for improving or building a nonresidential structure. For improving a multi-family structure, the maximum loan amount is $12,000 per family unit, not to exceed a total of $60,000 for the structure. These are fixed rate loans, at market rates, and such loans can have terms up to 20 years.
- ***(Title I)-Manufactured home loan insurance***—This insurance program insures loans on manufactured homes, up to $48,600, and insures lenders against losses of up to 90 percent of the value of a single loan. The total insurance coverage is limited to 10 percent of the lender's Title I portfolio. The buyer must agree to make a 5 percent down payment, and interest rate payments are determined by the lender.
- ***(Title VI)-HUD Loan***s—This program authorizes HUD to guarantee the financial obligations issued by Indian tribes or their tribally designated housing entities to finance affordable housing activities. To ensure repayment of notes or other obligations, applicants must pledge their Indian Housing Block Grant funds and other security as required by HUD.

USDA Rural Development Rural Housing Service (RHS)

The RHS provides guarantees on loans made by financial institutions for single- and multifamily residences in rural areas. Generally, these programs are limited to communities with populations of less than 10,000, or not more than 20,000 people if there is a serious lack of mortgage credit.

- ***Section 502-Guaranteed Rural Housing Loan***—This program provides loan guarantees to low- and moderate-income rural residents (up to 115 percent of median income) for the purchase of new or existing residential units. Loan terms are for 30 years and interest rates are negotiated with the lender. The loan provides for 100 percent loan-to-value finance. It can include closing costs and requires no private mortgage insurance.
- ***Section 502-Leveraged rural home loan partnership***—This partnership of the Federal Home Loan Bank System (FHLB), Rural Local Initiative Support Corporation, and RHS creates leveraging opportunities between local RHS offices, local nonprofit organizations, local lenders, and federal home loan banks (FHLBs). Specifically, in this partnership, the nonprofit organization packages the applications, provides homeownership counseling, and finds a home or developer to build the home. The local lender and RHS underwrite the loan and provide the long-term mortgage financing. The FHLB provides money to the local lender through either its Affordable Housing Program or Community Investment Program at lower than market interest rates.
- ***Section 538-Guaranteed Rural Rental Housing Program***—This insurance program is intended to reach rural residents with incomes up to 115 percent of the median income. The loans can be used for the acquisition, construction, and rehabilitation of new or existing properties, rental mobile homes and parks, and congregate care. The guarantees may be used in conjunction with other subsidy programs, such as the LIHTC, HOME, and state rental assistance programs. The terms of loans may be up to 40 years, and the interest rates of loans must be fixed, as negotiated between the lender and borrower, within the RHS limits. For nonprofit corporations and public bodies, the loan amount may be up to 97 percent of the value or development cost, whichever is lower. For for-profit owners, the loan amount is up to 90 percent of the value or development cost, whichever is lower. The guarantee is limited to 90 percent of the loan amount.

Veteran's Administration (VA)

The VA provides loan guarantees for loans originated by financial institutions to qualified veterans of the United States armed forces. The VA's guarantee protects lenders against loss if payments are not made and encourages lenders to offer veterans more favorable loan terms. The agency set maximum loan amounts for mortgages it will insure, which apply to the borrower, depending on the borrower's income level and the appraised value of the property. The VA also offers products that are targeted to elderly homeowners, such as reverse mortgages, home equity loans, and interest rate reduction refinancing loans.

Gap Financing, Incentives, and Grants

Federal, state, and local government agencies help banks manage the risk of lending to low- and moderate-income home purchasers by providing funds, in whole or part, that home buyers must bring to closing. In addition, they may provide funds to nonprofit organizations for building administrative and operational capacity to develop affordable properties or assist potential home buyers through the mortgage process.

Government agencies also provide gap funds and services that affect the development and continued operation of affordable multifamily housing developments. Some programs mitigate risk for the lender, the developer, or the owner of the properties or directly assist tenants that will occupy the units.

U.S. Department of Housing and Urban Development (HUD)

HUD administers a variety of programs that are directly targeted to state and local government and public housing agencies (PHAs) for implementing housing and community development programs. In recent years, HUD has implemented the consolidated planning process to assist communities in designing an overall community strategy for using these federal funds.

HUD distributes a large part of its over $30 billion annual appropriation to communities through formula grants, based on specific programs, or through Section 8 contract renewals. HUD also administers grant programs where communities compete with one another for program funding. Since Fiscal Year 1998, HUD has notified the public of, and distributed funding for, these competitive grant programs through a Super Notice of Funding Availability (SuperNOFA). The SuperNOFA streamlines the application process for users of competitive programs by standardizing the grant application, program requirements, and selection process.

The following are some of HUD's contract renewal, formula-based, and competitive grant programs that assist affordable housing development:

- ***Section 8-Rental Certificate and Rental Voucher Programs and Contract Renewals***—One of the largest HUD programs is the Section 8 program, which provides funding to local PHAs so that they may provide rental certificates or rental vouchers to qualified low-income households. These rental certificates and vouchers provide rent subsidies that generally equal the difference between 30 percent of the household's adjusted income and the HUD-approved fair market rent (for certificates) or the PHA-approved payment standard (for vouchers). The subsidies are paid directly to the landlord by the PHA. Eligible applicants are very low-income tenants whose incomes do not exceed 50 percent of the median income.

  In addition, HUD administers funds for renewing contracts between HUD and private owners of multifamily housing. The renewed contracts provide the private owners with FHA-mortgage guarantees on the condition that a certain portion of the rental units continue to be made available to Section 8 renters for the duration of the contract.

- ***Community Development Block Grant (CDBG) Program***—The CDBG Program is HUD's primary program for community revitalization and provides annual grants on a formula basis to entitled cities and counties. CDBG funds are administered by state and local governments and must principally benefit low- and moderate-income persons, aid in the prevention or elimination of slums or blight, or meet other urgent community needs. State and local agencies develop their own plans and priorities for using these funds as long as most of the funding over a three-year period benefits low- and moderate-income persons. Communities use CDBG funds for building and improving public facilities; for partnership with banks for home buyer counseling, down payment and closing cost assistance, and foreclosure mitigation; and for subordinated financing in affordable multifamily developments.

- ***Section 108-Loan guarantees***—Section 108 is a loan guarantee provision of the CDBG Program. Entitlement communities may borrow up to 5 times their most recent annual CDBG allocations, which serve as the security for local government borrowings for housing rehabilitation and economic development loans. These obligations are financed through underwritten public offerings, and the maximum repayment period is 20 years. Projects financed from Section 108 funds must meet CDBG criteria.
- ***HOME Investment Partnerships Program (HOME)***—The HOME Program provides funds to governmental units on a formula basis so that they may design affordable housing strategies for low- and moderate income persons and families that address local needs and housing conditions. Fifteen percent of HOME funds must be targeted for housing that is owned, developed, or sponsored by nonprofit organizations known as Community Housing Development Organizations (CHDOs), which administer housing-related programs. HOME funds can be used for borrowers' down payment and closing cost expenses, for second mortgages with lower rates, for guarantees, for home buyer education, and to support capacity-building activities for nonprofit organizations. In multifamily housing, HOME funds can be used for rental assistance for tenants and for hard and soft costs related to new and rehabilitated rental housing production.
- ***Public Housing Modernization-Comprehensive Grants Program***—This program is the primary source of modernization funds used by the larger PHAs to make physical improvements to public housing units and improve the PHA's management and operation. The funds are based on a formula to PHAs that operate at least 250 units of publicly owned housing. The full range of eligible activities is broad and can include economic development, self-sufficiency, and resident service initiatives.
- ***Indian Housing Block Grants Program***—This program provides annual grants, on a formula basis, to all eligible Indian tribes and Alaska Native Villages upon approval of an Indian Housing Plan. The funds may be used for a wide range of affordable housing activities.
- ***Emergency shelter grants (ESG)***—This program is designed to improve the quality of existing emergency shelters for homeless people, make available additional shelters and transitional housing, meet the costs of operating shelters, provide essential social services to homeless individuals, and support programs that help prevent homelessness. ESG provides funding to state and local governments using the same formula as the CDBG Program.
- ***Housing Opportunities for Persons with AIDS (HOPWA)***—This formula program provides funds to states and cities in metropolitan areas for housing assistance and supportive services for low-income people with HIV/AIDS and their families. Funding may be used for a range of activities, including housing information services; project or tenant-based assistance; short-term rent, mortgage, and utility payments; housing and development operations; and supportive services.
- ***HOPE VI (revitalization grants and demolition grants)***—These competitive grant programs provide funding to PHAs for the revitalization of severely distressed or obsolete public housing sites. PHAs can use the federal funds for the rehabilitation and demolition of units; for the construction of replacement

housing; for the provision of rental assistance to tenants who are displaced; for the provision of self-sufficiency services for tenants; and for programs designed to improve the management of public housing.

- ***Section 202- Supportive Housing for the Elderly***—This competitive grant program provides capital advances for rental housing projects with supportive services that serve very low-income elderly persons (62 years or older). The program provides interest-free advances to private, nonprofit organizations to construct or rehabilitate rental housing. The advance remains interest-free and need not be repaid as long as the housing remains available for very low-income elderly people for at least 40 years. The program also provides rental assistance for project residents.
- ***Section 811- Supportive Housing for Persons with Disabilities (including mainstream housing opportunities for persons with disabilities)***—This competitive grant program provides capital advances to assist nonprofit corporations to finance the acquisition, construction, or rehabilitation of group homes or housing and other expenses of supportive housing for low-income persons with disabilities. The advance remains interest-free and need not be repaid as long as the housing remains available for low-income persons with disabilities for at least 40 years. The program also provides rental assistance for project residents.
- ***Rural Housing and Capacity Building Program***—This competitive grant program provides funding to increase the supply of affordable housing, to support innovative projects for housing and economic development in rural areas, and to provide seed capital for entities that develop opportunities in rural areas.
- ***Housing Counseling Program***—This competitive grant program provides HUD-approved local housing counseling agencies, HUD-approved housing intermediaries, and state housing finance agencies with funding to administer programs involving prepurchase counseling, financial management, property maintenance, and other matters that may be appropriate for low- and moderate-income persons who want to improve their housing conditions.
- ***Section 8-Welfare-to-Work Rental Voucher Program***—This competitive program provides funding to PHAs, including tribes and tribally designated housing entities, for Section 8 rental assistance to help eligible families make the transition from welfare to work.

Federal Low-Income Housing Tax Credits (LIHTCs)

The LIHTC program is within the U.S. Department of Treasury and its Internal Revenue Service (IRS). The Internal Revenue Code allocates credits to states based on a per-capita income formula, and state housing finance agencies administer the program. Developers use these credits to raise equity capital. Under the program, investors are provided with tax incentives against the taxes they would otherwise pay. These credits are based on the cost of new or rehabilitated housing development and are usable by the owners of these projects for 10 years. The IRS requires that states assign at least ten percent of their tax credits to properties sponsored by nonprofit organizations.

The owners must set aside a minimum percentage of the units for households earning 60 percent or less of the area median income and maintain the set-aside for 15 years. A

LIHTC project would meet this test in one of two ways: (1) 20 percent or more of the residential units must be rented to tenants with incomes of 50 percent or less of area median gross income; or (2) 40 percent or more of the residential units must be rented to tenants with income of 60 percent or less of area median gross income.

Federal Home Loan Bank System

The Federal Home Loan Bank System was created by Congress in 1932 as a privately capitalized organization. The system is made up of 12 regional federal home loan banks (FHLBs), and its purpose is to support the residential mortgage and CD lending of its member-stockholders. Eligible members within each of the regional banks include commercial banks, savings institutions, credit unions, and insurance companies.

All eligible members may compete for funds through their regional FHLB. The funds are distributed by the regional banks through competition. Individual borrowers receive their funds through nonprofit organizations, for-profit developers, and state and local agencies, which apply for these funds through the members.

- ***Affordable Housing Program (AHP)***—This program subsidizes the interest rate on advances to members to encourage them to engage in lending to low- and moderate-income single- and multifamily housing. This enables the financial institutions to price affordable housing loans competitively and offer them at lower costs to nonprofit sponsors of affordable housing. Projects may be for the purchase, construction, or rehabilitation of affordable housing units. Many organizations use this financing as subordinated loans.
- ***Homeowner set-aside***—The FHLBs set aside a portion of their AHP funds for this special program. Low- and moderate-income families may receive up to $10,000 for down payment, closing, and counseling costs on the purchase or rehabilitation of owner-occupied property. If a homeowner sells the home within five years of receiving the AHP funds, the homeowner must repay a prorated portion of the funds.
- ***Community Investment Program (CIP)***—The CIP program subsidizes the interest rate on advances to members for affordable housing, economic development, and commercial revitalization. The CIP funds may be used for home mortgages and improvements, rental housing, modified housing for the handicapped, and community health care facilities. The CIP funds for housing projects must benefit families or individuals with incomes of no more than 115 percent of the area median.
- ***Letters of credit (LOCs)***—This program permits the FHLBs, which all have AAA credit ratings, to issue standby LOCs that assist their members in housing and community lending, asset/liability management, and liquidity and other funding. Under the program, the LOCs serve as a form of guarantee that the member will fulfill its duties under a contract with a third party. Member financial institutions have used the LOCs to secure public unit deposits, to credit enhance tax-exempt housing bonds, and to support a member's commercial paper issuance.

USDA Rural Development, Rural Housing Service (RHS)

The RHS provides a number of loan and grant programs that directly finance affordable single- and multifamily housing in rural areas.

- ***Section 502-Rural housing direct loans***—This program provides loans directly to low- and very low-income rural residents to purchase, construct, repair, or relocate a dwelling and related facilities. Loan terms are typically 33 years.

- ***Section 504-home improvement and repair loans and grants***—This program provides loans and grants to very low-income rural homeowners to remove health and safety hazards in their homes and to make homes accessible for persons with disabilities. Grants are available for people 62 years and older who cannot afford to repay a loan.
- ***Section 515-Direct Rural Rental Housing Program***—This program provides government financing to private or public nonprofit organizations for building or rehabilitating rental units for low- and moderate-income residents in rural areas. Typically, residents are provided rental assistance so that very low-income families benefit by the program's financing. The interest rate of the loans is tied to the cost of money to the government, and the maximum term is 30 years, amortized up to a maximum of 50 years.
- ***Section 523 and Section 524-rural housing site loans***—This program provides loans with favorable terms to private or public nonprofit organizations for the purchase and development of building sites into desirable communities for low- and moderate-income residents.
- ***Housing subsidies***—RHS can help subsidize monthly mortgage and rental payments, limiting these costs to no more than 30 percent of the adjusted monthly income of the applicant. These subsidies can be used in conjunction with the RHS homeownership, rural rental, and the farm labor programs.
- ***Community facilities loans***—RHS provides funds to public entities, Indian tribes, and nonprofit corporations to construct, enlarge, extend, or otherwise improve community facilities that provide essential services in rural areas with populations of less than 50,000. RHS also guarantees community facility loans made by banks or other eligible lenders.
- ***Self-help housing loans***—RHS provides loans to groups of six to eight low-income families to help each other build homes. These funds can be used for materials, site development, and the skilled labor. The families must agree to work together until all homes are finished.
- ***Housing preservation grants***—RHS provides qualified, public nonprofit organizations and public agencies with grant funds to assist very low- and low-income homeowners repair and rehabilitate their homes in rural areas. These funds may also be provided to rental property owners and co-operatives to repair and rehabilitate their units if they agree to make such units available to very low- and low-income persons.
- ***Farm labor housing***—Farm labor housing loans and grants enable farmers, public or private nonprofit organizations, and units of state and local governments to build, buy, or repair farm labor housing in either dormitory or multifamily apartment style.

U.S. Department of the Interior, Bureau of Indian Affairs (BIA)

The BIA administers the Housing Improvement Program to provide assistance to needy families living on or near a reservation community who have limited resources and do not qualify for or otherwise receive assistance from other housing programs. The program emphasizes the repair and renovation of existing housing. It provides up to $2,500 in housing repairs for conditions that threaten the health and/or safety of the occupants. It may also provide up to $35,000 in repairs or renovation to improve the condition of a homeowner's dwelling so that it meets applicable building code standards.

The recipients of these funds (1) are members of a federally recognized American Indian tribe or a Alaskan Native village; (2) live in appproved tribal service areas; and (3) have annual incomes that do not exceed 125 percent of the U.S. Department of Health and Human Services' poverty-income guidelines. About 85 percent of the tribes operate the program through self-determination agreements or self-governance compacts. The remaining tribes receive program services directly from the BIA.

State housing finance agencies

Housing finance agencies (HFAs) operate in every state, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico. Many HFAs provide a secondary market for reduced rate mortgages to lower income home buyers and for affordable rental housing development. HFAs in nearly every state also allocate federal LIHTCs to help finance the development of affordable apartments and operate other housing and community development programs. Each state HFA maintains a web site that may serve as a source of specific program information. The HFAs' primary CD programs include:

- ***LIHTC program***—In almost every state, HFAs administer the federal LIHTC program. LIHTCs are allocated to each state at $1.25 times the state population. To get LIHTCs, a housing development must rank high enough under the plan that each state develops to judge competing affordable developments against the state's affordable housing needs. Generally, states give priority to developments that serve the lowest income families for the longest periods of time. When evaluating affordable housing proposals, HFAs consider the sources and uses of funds, government subsidies, reasonableness of costs, and the developer and builder profits. After approval of the LIHTC properties, HFAs also monitor the physical condition of the apartment units and compliance with the federally required tenant income and rent restrictions. HFAs report noncompliance to the IRS, which can recapture the LIHTCs from noncompliant owners.
- ***Mortgage revenue bonds (MRBs)***—State and local governments sell tax-exempt housing bonds and pass on the interest savings in discount mortgages for low- and moderate-income, first-time home buyers and for the construction of low-cost rental apartments. Native American nations also have this authority.

  Congress limits the annual amount of MRB, industrial development, and other tax exempt bonds that states may issue. For single-family housing, MRBs must be used for the first home purchase by a family that earns not more than the median income in the state or locality. Also, MRBs can finance homes that cost no more than 90 percent of an area's average home price. MRBs help to reduce the monthly expenses for the home purchaser and can also provide down payment and closing cost assistance for lower income home buyers. Congress discourages MRB borrowing by a family that could buy conventionally, by requiring any MRB borrower whose income rises significantly to pay the federal government up to half of any profit from the resale of the home within nine years.

Multifamily MRBs provide low-interest mortgage financing to developers. At least 40 percent of families who rent these apartments cannot earn more than 60 percent of an area's median income, or at least 20 percent cannot earn more than 50 percent of the area's median income. The apartments must remain affordable for at least 15 years. Some states have combined multifamily MRBs with LIHTCs and HOME block grant funds to serve even lower income families for longer periods than the law requires.

- ***HOME Investment Partnerships Program***—States get 40 percent of the federal HOME funds under a formula that measures affordable housing needs. (Localities get the remaining 60 percent.) States must submit a comprehensive affordable housing plan for HUD's approval. Every four HOME dollars must be matched by a dollar of state or local funds. States use HOME funds for rental subsidies and to meet a wide variety of affordable housing needs, such as for the purchase, rehabilitation, and new construction of housing properties.

Public Housing Agencies (PHAs) and Tribal Housing Entities

Public housing agencies are created by local governments and they administer HUD's public housing and other programs. In 1961, Native American tribes became eligible to participate in HUD's public housing programs. They established Indian housing authorities (IHAs) comparable to PHAs. In 1997, Congress separated Indian housing programs from public housing programs and mandated that most Indian and Alaska Native housing assistance from HUD be awarded in the form of block grants to tribes and their tribally designated housing entities (TDHEs). All tribes are eligible for Indian housing funds. Tribes may designate their former IHAs as TDHEs, establish new TDHEs, or choose to manage the funds directly. TDHEs are organized into eight regional associations.

National Housing Intermediaries

National housing intermediaries provide a variety of resources to help banks in the affordable single-family and multifamily lending arenas. Resources include financing and technical assistance to increase homeownership in distressed communities and providing gap funds and capacity-building services to developers of affordable multifamily housing. Some of the housing intermediaries also provide investment opportunities for banks that are interested in federal LIHTCs.

The Enterprise Foundation (Enterprise)

The Enterprise Foundation is a nonprofit organization, established in 1982, that uses the housing process as an organizing tool for improving the quality of life of low- and moderate-income persons and families. One of its primary programs provides direct technical assistance and capacity building for nonprofit developers of affordable multifamily housing. Enterprise staff work with developers to form project plans, conduct feasibility and market studies, coordinate the financing package, and monitor the general contractor during the construction process. They also advise developers and owners on issues involving tenant selection and property management. Enterprise often awards grants and bridge loans for land acquisition and predevelopment expenses.

Through its subsidiary, the Enterprise Social Investment Corporation (ESIC), Enterprise raises capital from corporations, including banks, and makes equity investments in properties involving federal LIHTCs. ESIC enters joint-venture relationships with nonprofit developers and helps them manage projects during construction and operation.

Housing Assistance Council (HAC)

HAC is a nonprofit organization, formed in 1971, that focuses on the availability of low-cost housing in rural areas of the country. With funding from federal sources, HAC offers technical assistance and operates revolving loan funds that provide capital for land acquisition, predevelopment expenses, and construction costs associated with affordable housing. It participates with local housing authorities, nonprofit organizations, and other public and private parties to support affordable single- and multifamily housing developments. The organization has staff with bilingual capabilities and provides its services where affordable housing is critical, such as *colonias*, Appalachia, and Indian reservations.

HAC provides seed money, loans with flexible terms, and loans in conjunction with conventional financing. It is also willing to subordinate its funds to priority liens. HAC may also offer loan guarantees and may make deposits in banks to allow them to make construction loans at favorable rates to rural developers. HAC also provides technical assistance, training, research, and information services on government financing, housing development and rehabilitation (particularly in rural areas), and water and waste disposal systems. In some cases, HAC serves as a co-general partner with developers and provides technical advice to them during project planning and construction.

Local Initiatives Support Corporation (LISC)

LISC is a nonprofit corporation, formed in 1979, that enhances the capacity of community groups to develop affordable housing and job-creating projects. LISC provides technical assistance to nonprofit developers of affordable multifamily housing during the planning, construction, and operation phases of projects. It also provides grants and low-cost funds that developers can use to substitute for equity or pay for predevelopment expenses.

LISC assists developers through lenders' loan processes and helps them to obtain funds from other public and private resources. It fosters community support for projects by bringing together the business, government, banking, and local leaders in a community. LISC affiliate organizations, organized as funds, create national investment pools that raise capital from corporations, including banks, for investments in projects involving federal LIHTCs.

Neighborhood Reinvestment Corporation (NRC)

NRC is a congressionally chartered, nonprofit corporation that was formed in 1968 to create, strengthen, and expand community-based development organizations and revitalize distressed communities. The NRC charters and supports locally funded community organizations, known as NeighborWorks® organizations, that are located in more than 150 cities across the country. The NRC provides NeighborWorks® organizations with capital, education and technical assistance, and assistance in local collaborative efforts.

Homeownership is a vital component of NRC's strategies for enhancing community stability. Since 1993, the NRC has increased its focus and resources to this end through its "Campaign for Home Ownership" initiative. The NRC also has a subsidiary, the Neighborhood Housing Services of America (NHSA), that provides a secondary market mechanism for the purchase and sale of loans made by local NeighborWorks® organizations that support affordable single- and multifamily properties.

The NeighborWorks® organizations make loans for affordable housing and community development activities from their revolving loan funds. These mechanisms are capitalized by NRC grants and matching funds from local foundations, government agencies, and private sector investors. Loans from the NeighborWorks® organizations support:

- The development of affordable single- and multifamily housing;
- Down payment assistance and second mortgages to low- and moderate-income home buyers; and
- Home improvements by homeowners who are not able to obtain financing conventionally.

In addition, many NeighborWorks® organizations own and manage rental housing as a means of stabilizing communities. They also provide home buyer education and counseling to prospective purchasers; work directly with banks to identify purchasers who can qualify for conventional bank mortgages; prepare bids, specifications, and cost estimates, and provide homeowners with referrals for contractors and financial counseling. Some NeighborWorks® organizations also engage in activities that help to revitalize commercial districts and create jobs.

APPENDIX F
PARTNERSHIP RESOURCES FOR SMALL BUSINESS LENDING

The following list is a summary of federal, state, and local government programs most frequently mentioned by the study's participating banks, government agencies, and CD intermediaries that help deliver loans to small businesses, including women- and minority-owned businesses.[32]

Federal Programs

U.S. Small Business Administration (SBA)

The SBA is the primary federal source for financing small businesses and for information on small business issues. The SBA facilitates small businesses' access to credit by providing guarantees on loans made by banks and other private lenders to small business clients. Not only does this guarantee reduce the probability of a loss to the lender, but the bank does not have to allocate capital as reserves for the portion of the loan that the SBA guarantees. In addition, guarantees allow a bank to rely on the cash flow of the small business rather than collateral.

For those lenders that meet certain SBA criteria and regularly make SBA loans, the SBA offers streamlined processing. The SBA gives certified lenders a partial delegation of authority and a three-day turnaround on their applications. Preferred lenders are given full delegated lending authority to make loans in exchange for a lower rate of guarantee. These lenders may also use regular SBA loan processing. For many SBA programs, electronic processing is permitted.

- ***7(a) Loan Guaranty Program***—The 7(a) Loan Guaranty Program is one of the SBA's primary programs. It provides funds to start-up or existing businesses for almost any business purpose, such as land acquisition and development, construction, machinery and equipment, inventory, and working capital. Generally, the SBA guarantees up to 75 percent of the loan, and the amount of SBA's maximum exposure is $750,000. (The SBA allows some exceptions to these limits.) The SBA also has size and eligibility requirements for businesses that are assisted under the program. The loan maturity is usually 5 to 10 years, and up to 25 years for fixed asset loans. The repayment term depends on the ability of the borrower to pay. Interest rates are negotiated between the business and the lender, and the rates can be fixed or variable. The SBA establishes maximum interest rates based on the amount of the loan and its maturity.
- ***Specialized 7(a): SBALowDoc Program***—This program allows banks to make guaranteed loans under $150,000 and is designed to streamline and expedite the review process, usually in less than 3 days. The program allows for a SBA guarantee up to 80 percent of loans up to $100,000 and a SBA guarantee of 75 percent for loans between $100,000 and $150,000.

[32] Please note that the list of federal government programs is meant to point to resources that banks may use. It is not meant to be exhaustive, nor does it mean to reflect the effectiveness, efficiency, or popularity of any particular program. The OCC does not endorse any particular government program, private enterprise, or CD intermediary described in this section.

- ***Specialized 7(a): SBAExpress Program***—This program provides loan guarantees for small business loans up to $150,000 made by lenders using their own forms and processes. Lenders provide minimal paperwork to the SBA to obtain a 50 percent guarantee on the loan and can take most servicing actions without prior approval by the SBA. The program allows lenders to provide uninsured lines of credit up to $25,000. The program is currently being offered through a limited number of lenders.
- ***Specialized 7(a): CAPLines Program***— The CAPLines Program helps small businesses meet their short-term and cyclical working capital needs. The guarantee amount, business eligibility requirements, and other program requirements are generally the same as under the regular 7(a) program. CAPLines are credit line programs that allow maturity of up to five years, although a shorter initial maturity may be established. Generally, the lines can be revolving or nonrevolving. Interest rates are negotiated between the small business and the lender, and the rates can be up to 2.25 percent over the prime rate. The five CAPLines programs are: (1) seasonal line—advances against anticipated inventory and accounts receivable that help businesses during peak seasons when they experience seasonal sales fluctuations; (2) contract line—finances the direct labor and material costs associated with performing assignable contract(s); (3) builders line—finances the direct labor and material costs associated with the construction or renovation of commercial or residential buildings; (4) standard asset-based line—an asset-based revolving line for businesses that are unable to meet the credit standards associated with long-term credit; and (5) small asset-based line—an asset-based revolving line of credit up to $200,000 that generally operates like the standard asset-based line program.
- ***Specialized 7(a): International trade loans***—The SBA can guarantee up to $1,250,000 in combined working-capital, facilities, and equipment loans for businesses that engage in international trade. The business must ensure that the loan will significantly expand or develop an export market and must be able to provide a business plan that reasonably projects export sales sufficient to cover the loan. Also, the business must demonstrate how it is adversely affected by import competition and develop plans for upgrading equipment or facilities to improve its competitive position.
- ***Specialized 7(a): Export working capital loans***—The SBA guarantees short-term working capital loans made by participating lenders to exporters. The program is a combined effort of the SBA and the Export-Import Bank. The SBA can guarantee 90 percent of a loan amount, up to $750,000. When a loan is combined with an international trade loan, the SBA's exposure can go up to $1.25 million.
- ***Specialized 7(a): Pollution control loans***—This program provides loan guarantees to eligible small businesses for the financing of the planning, design, or installation of a pollution control facility. The facility, such as a recycling center, must reduce, abate, or control any form of pollution. The SBA can guarantee up to $1,000,000 of the small business loan.
- ***Specialized 7(a): DELTA***—This program is a joint effort between the SBA and U.S. Department of Defense. It provides financial and technical assistance to defense-dependent small firms that are adversely affected by cutbacks in

defense programs. The companies must have derived at least 25 percent of their revenues from defense-related contracts or subcontracts in any one of five prior operating years. The companies must also meet the program's policy objectives in terms of retaining or creating jobs or retooling or expanding their plants. The program provides guarantees of up to $1.25 million under the 7(a) program and up to $1 million under the certified development company (504) loan program. (See 504 Certified Development Company Loan Program below.) However, the total amount under both programs cannot exceed $1.25 million.

- ***Specialized 7(a): Qualified employee trusts***—This program allows banks to provide guarantees for employee stock ownership plans. The plan must be sponsored by the employer company and qualify under regulations set by either the Internal Revenue Code (as an employee stock ownership plan or ESOP) or the U.S. Department of Labor (the Employee Retirement Income Security Act or ERISA). The maximum amount the SBA can guarantee is generally $750,000.
- ***Specialized 7(a): Minority and women's prequalification loan programs***—This program involves the SBA's issuance of a forward commitment to guarantee a small business loan. When lenders consider loan requests from borrowers who have received this prequalification letter, lenders have SBA's assurance that the loan request will meet the SBA's eligibility and underwriting standards. Assuming the borrower has no material or significant deviation in the loan package, the SBA will issue its guarantee to the lender.

  Under the program, eligible businesses include those that are at least 51 percent owned, operated, and managed by people of ethnic or racial minorities or by women; businesses with average annual sales for the preceding three years that do not exceed $5 million; and businesses that employ fewer than 100 people, including employees of any affiliates.

  CD intermediaries that participate with the SBA work with borrowers to prescreen and present the package to the SBA. After the SBA's prequalification approval, borrowers can "shop" their loan requests. The CD intermediary (usually a small business development center, or SBDC) can help the borrower locate a lender offering the most competitive rates. The women's prequalification program uses only nonprofit organizations as intermediaries; the minority program uses for-profit intermediaries as well.
- ***Section 504 Certified Development Company (504) Loan Program***—Certified development companies are nonprofit corporations sponsored by public and private sector representatives that meet SBA criteria. These organizations manage the SBA's 504 program, which provides long-term, fixed rate financing at reasonable rates for businesses needing to build or acquire an industrial or commercial building or to buy machinery and equipment. Certified development companies may also manage local government and private sector revolving loan funds.

  This program facilitates bank lending by providing subordinate debt financing. In typical transactions, a bank provides at least 50 percent of the financing in return for a first mortgage. The SBA funds up to 40 percent through a guaranteed debenture, and the small business contributes 10 percent. The limit on the SBA guarantee is $1 million. Together with other financing, the program can finance projects costing $2.5 million or more.

Interest rates on the 504 loans are pegged to an increment above the current market rate for five-year and 10-year U.S. Treasury issues. Maturities of 10 and 20 years are available. Businesses that qualify under the 504 program have a tangible net worth less than or equal to $6 million and an average net income less than or equal to $2 million after taxes for the preceding two years. Also, loans cannot be made to businesses that are engaged in speculation or investment in rental real estate; for working capital or inventory; or for consolidating, repaying, or refinancing debt.

- ***Microloan Program***—Under this program, the SBA provides grants and loans to qualified small business intermediaries, usually nonprofit organizations or quasi-governmental organizations. These organizations use this funding to make short-term, fixed rate loans of less than $25,000 for start-up and expanding small businesses. The maximum term is six years, and interest rates vary, depending upon the intermediary lender. The intermediaries may also use the funds to provide technical assistance to the borrowers.
- ***Community Adjustment and Investment Program (CAIP)***—The CAIP was created to help communities that have suffered job losses due to changing trade patterns with Mexico and Canada following the North American Free Trade Agreement (NAFTA). The SBA waives the guarantee fee, usually paid by the borrower, for loans under the CAIP. Typically, this amounts to about 3 percent of the guaranteed amount. To be eligible, all applicants must provide a written estimate that the number of jobs to be created or preserved within 24 months of the disbursement must not exceed $70,000 of federally guaranteed funds per job created or preserved.

  The USDA and SBA are lending partners under this program. SBA can guarantee 7(a) loans in any CAIP community. The USDA can guarantee loans only in rural areas, usually to counties.
- ***Small Business Investment Company (SBIC) Program***—This program is administered by venture capital organizations that are licensed by the SBA. The program combines private capital with SBA guaranteed funds for small business start-up and growth. Typically, they provide longer term debt, equity investments, and management counseling to their small business customers. National banks and some state banks are permitted to purchase stock in SBICs. Some banks form SBIC subsidiaries.
- ***Secondary market for SBA guaranteed loans***—There is a secondary market for loans guaranteed by the SBA. Lenders are able to sell both the guaranteed and unguaranteed portions of the loans to investors, and thereby improve their liquidity.
- ***Surety Bond Program***—By law, contractors to the federal government must post surety bonds on federal construction projects valued at $25,000 or more. Many state, county, city, and private sector projects require bonding as well. The SBA can guarantee bid, performance, and payment bonds for contracts up to $1.25 million for small businesses that cannot obtain bonds through regular commercial channels. Bonds may be obtained by contractors who apply for preapproval from the SBA through a surety bonding agent. In addition, the

SBA authorizes preferred sureties to issue, monitor, and service bonds without prior SBA approval.

- ***Technical assistance and other services***—The SBA facilitates small business participation in the federal government's procurement of goods and services, conducts small business research, and provides a broad range of education, counseling, mentoring, and technical assistance services through SBDCs, Service Corps of Retired Executives (SCORE) and small business institutes.

  SBDCs are located in every state, usually connected with colleges and universities, and are funded and managed by the SBA, state and local governments, and educational institutions. The organizations provide information, training, and consultation to small businesses at little or no cost on such topics as marketing; developing business plans; strategies for meeting lender credit requirements; and accounting, personnel, and other financial management. They also refer borrowers to sources of equity capital and flexible financing that supplement loans they could obtain through conventional lender avenues.

U.S. Department of Treasury

The Community Development Financial Institutions Fund (CDFI) is a wholly owned government corporation within the U.S. Department of Treasury. The CDFI Fund, established under a 1994 federal government initiative, provides strategic investments and leverages private sector funds that promote access to capital and local economic growth.

The CDFI Fund assists CDFIs, specialized financial institutions that work in market niches that have been underserved by traditional financial institutions. CDFIs provide a wide range of products and services, such as affordable home mortgages and homeownership counseling, and capital and technical assistance for start-up and minority-owned small businesses. They also support the building of community facilities. CDFIs include community development banks, credit unions, loan funds, venture capital funds, and microenterprise loan funds.

The CDFI Fund has three award programs: the CDFI Program, the Bank Enterprise Award (BEA) Program, and the Presidential Awards for Excellence in Microenterprise Development.

- ***CDFI Program***—This program invests in CDFIs using flexible tools such as equity investments, loans, grants and deposits, depending upon market and institutional needs. The program has three separate components. The first is the fund's main program, the core component, in which CDFIs, or entities proposing to become CDFIs, may apply for financial and technical assistance. The second component, the intermediary component, is designed specifically for intermediaries that focus primarily on the financing of other CDFIs. The third component, the technical assistance component, is designed to address the capacity needs of CDFIs that have significant potential for increasing their community development impact.
- ***BEA Program***—This program provides incentives for regulated banks and thrifts to invest in CDFIs and to increase their services, lending, and investments within the distressed communities they serve. The BEA Program supports the community reinvestment efforts of these financial institutions.

- ***Presidential Awards for Excellence in Microenterprise Development Program***—This program is a non-monetary award program to bring wider attention to the important role and successes of domestic microenterprise development. The program recognizes organizations for enhancing the economic opportunities of disadvantaged individuals.

U.S. Department of Housing and Urban Development (HUD)

HUD supports community and economic development initiatives through its formula, competitive grant, and loan guarantee programs.

- ***Community Development Block Grants (CDBG)***—The CDBG Program provides annual grants on a formula basis to entitled cities and counties. Communities may use these funds to provide assistance to profit-motivated businesses to carry out economic development activities. Within this context, CDBG funds must principally benefit low- and moderate-income persons, aid in the prevention or elimination of slums or blight, or meet other urgent community needs. State and local agencies develop their own plans and priorities for using these funds as long as most of the funding over a three-year period benefits low- and moderate-income persons. Communities may also use Section 108 loan guarantees, a loan guarantee provision of the CDBG Program, for economic development purposes.
- ***Economic Development Initiative (EDI)***—This competitive grant program promotes economic development activities by providing local governments with grant funds to modify or reduce the debt service associated with Section 108 loans. The grant funds can be used to reduce the interest rate charged to businesses, fund loss reserves, or for other purposes that would increase the likelihood that cash flow will be generated by the economic development project.
- ***Youthbuild***—This competitive grant program provides funds to states, local governments, public agencies, and nonprofit organizations to construct or rehabilitate housing for low-income and homeless persons. The program supports the job creation associated with the construction of such housing and employs young people who have dropped out of school. The participants learn on-site construction skills and alternate this experience with off-site academic job skills training and counseling. Rehabilitated buildings can be rented or sold to low-income families or individuals, or the buildings can be used for programs for the homeless.
- ***Brownfields Economic Development Initiative (BEDI)***—This competitive grant program is designed to help cities redevelop abandoned, idled, or underutilized industrial and commercial facilities where expansion or redevelopment is complicated by real or perceived environmental contamination. BEDI provides funding to local governments that can be used in conjunction with Section 108 loan guarantees to finance the redevelopment of these sites.
- ***Section 4 Loan Guarantee Recovery Fund***— This loan guarantee program assists nonprofit organizations to finance the rebuilding of property that has been damaged or destroyed by acts of arson or terrorism. HUD provides the loan guarantees up to 100 percent for loans that finance the replacement of damaged property with comparable new property. Loans may be guaranteed for up to 20 years and may have flexible repayment terms.

U.S. Department of Agriculture (USDA)

HUD and USDA administer the Empowerment Zones (EZs) and Enterprise Communities (ECs) program. Since 1994, 23 urban and seven rural areas have been designated as EZs to receive a combination of tax incentives and block grants to help them implement 10-year, community-wide strategic plans to promote overall revitalization. In addition, 65 urban and 43 rural communities have been designated as ECs to receive block grant funds and tax exempt financing. In 1997, Native American tribes became eligible to apply to the EZ/EC program and are currently among the recipients.

Each urban EZ was awarded $100 million and each rural EZ was awarded $40 million. The communities use these funds to leverage additional private investment from foundations, businesses and other sources. At the time we conducted this study, total public and private investment in these areas exceeded $4 billion.

What sets this program apart from other revitalization efforts is that the community drives the decision making. Each EZ/EC community has written benchmarks or quantifiable goals that determine how the money will be spent and what the results of the activity will be. The focus of activities in EZs and ECs include business-related job creation, expansion, and retention; investment pools for capital access and innovative financing needs; job and occupation skills training; and business support services and assistance.

USDA Rural Development

The USDA administers programs that facilitate small business growth and economic development opportunities in rural areas. The departments within the USDA that manage these activities include:

- Office of Community Development, which administers the EZ and EC program with HUD;
- Rural Utilities Service (RUS), which manages a variety of loan and grants programs for electric energy, telecommunications, and water and waste disposal projects;
- Rural Business Cooperative Service (RBS), which works in partnership with the private sector and community-based organizations to provide financial assistance and business planning for projects that create or preserve the quality of jobs and/or promote a clean rural environment;
- Alternative Agricultural Research and Commercialization (AARC) Corporation, which promotes new research and assists with the commercialization of new, non-food uses of agricultural commodities; and
- 1890, 1862, and 1994 Land-Grant Institutions, which is a cooperative effort between the USDA and historically black land-grant universities to develop income-producing projects for underdeveloped rural communities.

Some of USDA's programs include the following:

- ***Alternative Agricultural Research and Commercialization Program***—This program may finance up to 50 percent of small business projects that develop new, nonfood, commercial uses for agricultural and forestry materials and the processes for such projects. The program's funds can be structured as equity-like gap financing.
- ***Business and Industrial Guaranteed Loan Program***—This program provides guarantees of up to 90 percent for businesses located in rural areas. These

loans can be used for working capital, machinery and equipment, buildings and real estate, and certain debt financing. Loan guarantees are limited to a maximum of $10 million per borrower.

- ***Intermediary Relending Program***—This program makes loans to finance business facilities and CD projects in rural areas. The agency makes loans directly to intermediaries that may be nonprofit corporations, public agencies, Native American tribes, or cooperatives. The intermediaries can borrow up to $2 million for 30 years, at 1 percent interest. The intermediaries provide long-term loans to small businesses, capped at $150,000 per recipient.
- ***Rural Business Enterprise Grants Program***—This program provides grants to government entities, nonprofit corporations, and Native American tribes for the acquisition and development of land, infrastructure, or industrial sites, or for establishing revolving loan funds and operating capital for businesses. These organizations provide funds to small and emerging enterprises in rural areas. The funds may be used for the acquisition and the development of land and construction of buildings, plants, equipment, access roads, parking areas, and utility extensions; refinancing; fees; technical assistance and training; working capital; assistance to third parties; production of television programs to provide information to rural residents; and long-distance learning networks.
- ***Rural Economic Development Loan Program***—This program provides zero-interest loans to RUS borrowers for projects that create jobs in rural areas or that provide infrastructure or community facilities in rural areas. RUS borrowers pass these funds to companies as zero-interest loans. A maximum of $750,000 per loan application may be requested.
- ***Rural Economic Development Grant Program***—This program provides grants to RUS organizations that establish revolving loan funds to businesses that provide infrastructure or community facilities leading to economic stability in rural areas. A maximum of $350,000 per loan application may be requested.

U.S. Department of Commerce Economic Development Administration (EDA)

The Economic Development Administration administers a number of programs authorized under the Economic Adjustment Program (Title IX). These programs provide grants to state and local government agencies, nonprofit organizations representing redevelopment areas, economic development districts, and Native American tribes to help defray the costs of planning strategies that help address economic development problems in those areas.

The EDA administers a local technical assistance program that focuses on technical and market feasibility studies of economic development projects or programs. Another EDA program supports the development of public works by improving the infrastructure and facilities in distressed communities to help them attract new industry. The EDA's trade adjustment assistance program is intended to help firms that have been injured by increased imports. In addition, the EDA has a demonstration program to undertake and report on the securitization of economic development loans from revolving loan funds.

U.S. Department of Commerce Minority Business Development Agency (MBDA)

The Minority Business Development Agency fosters the creation, growth, and expansion of minority-owned businesses in America. MDBA's assistance is provided to socially or economically disadvantaged individuals who own or wish to start a businesses.

MDBA provides funding for minority business development centers, Native American business development centers, business resource centers, and minority business opportunities committees that are located throughout the country. These centers are operated by private firms, state and local government agencies, Native American tribes, and educational institutions. The centers provide entrepreneurs with one-on-one assistance in writing business plans, marketing, management, and financial planning in the preparation of financial and bonding proposals for business ventures. They also provide business referrals. The MBDA and its network, however, do not have authority to make grants, loans, or loan guarantees.

U.S. Department of Health and Human Services (HHS)

The U.S. Department of Health and Human Services administers an economic development program in both urban and rural areas under its Commuity Services Block Grant Program. HHS provides grants to nonprofit community development corporations that implement business development opportunities and job creation programs for low-income persons. HHS has identified several industries and services that are opportunities for job creation programs, such as construction, transporation, lead abatement/asbestos removal, food, and day care.

U.S. Department of Transportation, Federal Highway Administration

The Transportation Equity Act for the 21st Century (TEA-21) authorizes federal funding for highway, highway safety, transit, and other surface transportation programs through 2003. TEA-21 programs allow states flexible use of federal funding, particularly on transportation strategies to boost local economies. In addition, TEA-21 emphasizes measures to improve the environment, foster economic development, and develop a strong planning process as the foundation for good transportation decisions.

Federal Home Loan Bank System

The Federal Home Loan Bank System requires its 12 federal home loan banks (FHLBs) to administer programs that support the community and economic development lending of its member-stockholders.

- ***Community Investment Program (CIP)***—The Community Investment Program (CIP) subsidizes the interest rate on advances to members for affordable housing, economic development, and commercial revitalization. The CIP funds may be used for capital improvements for small businesses and for the development of industrial facilities, civic centers, social service facilities, and community health care facilities. The funds for economic development purposes must benefit low- and moderate-income households with incomes up to 80 percent of the median for the area or that are located in low- and moderate-income neighborhoods.
- ***Community Investment Cash Advance (CICA)***—This program assists member institutions' financing of economic development projects for targeted beneficiaries and for economic development projects that benefit populations not served by the CIP program. The program permits two special programs: Rural Development Advances (RDAs) and Urban Development Advances (UDAs). Targeted beneficiaries include small businesses and specified economic development projects, such as those located in an empowerment zone

or involving properties in communities that have experienced NAFTA-related job losses or have been affected by military base closings. Each FHLB offering this program must develop and adopt a community lending plan, which it makes in consultation with local communities, that describes how the FHLB will meet credit needs and opportunities and steps for implementing the plan.

- ***Letters of credit (LOCs)***—This program permits the FHLBs, which all have AAA credit ratings, to issue standby LOCs to assist their members in housing and community lending, asset/liability management, and liquidity and other funding. Under this program, the LOCs serve as a form of guarantee that the member institution will fulfill its duties under a contract with a third party. The LOC program allows the FHLBs to accept collateral, such as secured small business loans and investment-grade bonds issued by state or local governments, for LOCs used to finance housing and economic development lending activities.

U.S. Department of the Interior Bureau of Indian Affairs (BIA)

The Bureau of Indian Affairs administers a variety of programs that support economic development efforts on Native American reservations. In addition to the following financing programs, BIA provides technical assistance for start-up and expanding small businesses.

- ***Loan Guaranty Fund***—This program provides the BIA's guarantee on loans made by lenders to small businesses owned by Native Americans. (Native American ownership of the businesses must be at least 51 percent.) Guarantees are up to 90 percent, and the BIA has limits for individual loan amounts and maximums for tribes and organizations.
- ***Business Development Grant Program***—This program provides seed capital for start-up and expanding small businesses that locate on or near reservations. The BIA has limits for individual loan amounts and maximums for tribes. In addition, these grants must be matched by funds from other sources.
- ***Revolving loan funds***—The BIA provides loans with flexible terms to small businesses that undertake community and economic development projects on reservations. The maximum amount of the loan is 80 percent of program costs, up to amounts capped by the BIA.

State and Local Programs

State and local governments offer or support a variety of small business programs that banks may use. These programs administer revolving loan funds or support quasi-government corporations that provide equity capital, subordinated debt, and guarantees to fill small business financing gaps. The programs may also provide educational services that help to enhance the business owners' ability to borrow funds. The following are three types of local programs that support economic development initiatives.

Capital Access Programs (CAP)

CAP programs create an insurance fund that protects a bank against losses in its small business loan portfolio. The fund is increased each time a participating bank closes a small business loan. Programs are currently available in 20 states and two municipalities.

The small business borrower and the state or local agency administering the program each pay, at loan closing, into an account that is reserved to insure loans made by the participating bank. The amount paid into the account at closing is calculated as a percentage of the loan. Typically, the small business and the agency administering the program each will pay from 1 percent to 3 percent of the loan amount. In the event the bank sustains losses on any of the loans it has designated to be covered by the program, the account will be available to cover the losses.

Each bank has its own separate insurance account and determines which loans will be included in the program. In some cases, the government agency administering the program may set certain limits—such as loan size—on loans that are enrolled in the program.

CAP programs are attractive and flexible in several ways. Banks use their own underwriting criteria to make the small business credit decisions and can set their own loan terms, including balloon payments, floating rates, and any other reasonable and customary terms. The banks' credit decisions and loan conditions are not reviewed by a government agency, except to determine that each loan the banks enroll is within certain general limits. Government agencies find that their administrative overhead is generally low because they pay relatively few dollars into the insurance accounts.

Linked deposits

Some state and local government agencies deposit their funds in banks and structure them as linked deposits. The linked deposit allows a commercial lender to be compensated for projected losses that may result from offering certain types of affordable housing, small business, or economic development loans, or from lending to borrowers with credit or equity challenges. Banks often make concessions on borrowers' interest rates, terms, or other underwriting policies because they are receiving income as a result of the market-rate government deposits.

Tax-exempt bond financing

State or local government can issue enterprise zone facility bonds to raise funds to provide an enterprise zone business with a qualified zone property, under requirements specified in the Internal Revenue Code. At least 95 percent of the net proceeds from the bond issue must be used to finance the acquisition and development of qualified zone properties whose principal users are enterprise zone businesses and certain lands that are used for related purposes (for example, land where the business is located and a parking lot for customers and employees). Tax-exempt bonds generally have lower interest rates than conventional financing.

APPENDIX G
GOVERNMENT CONTACTS

Federal Agencies

U.S. Department of Agriculture, Rural Development
14th Street and Independence Avenue, SW
Washington, DC 20250
(202) 720-4323
http://www.rurdev.usda.gov

U.S. Department of Commerce, Economic Development Administration
14th & Constitution Avenue, NW, Room 7804
Washington, DC 20230
(202) 482-5081
http://www.doc.gov/eda

U.S. Department of Housing and Urban Development
451 Seventh Street, SW
Washington, DC 20419-8000
(202) 708-3728
http://www.hud.gov

U.S. Department of the Interior, Bureau of Indian Affairs
1849 C Street NW
Washington, DC 20240
(202) 208-3671
http://www.doi.gov/bureau-indian-affairs.html

U.S. Department of Transportation, Federal Highway Administration
700 7th Street, SW
Washington, DC 20590
(202) 366-4000
http://www.fhwa.dot.gov

U.S. Department of the Treasury, Community Development Loan Fund
1500 Pennsylvania Avenue, NW
Washington, DC 20220
(202) 622-8662
http://www.treas.gov/domfin/cdfi

U.S. Department of Veterans Affairs
Veterans Benefits Administration
Washington, DC 20420
(202) 273-5674
http://www.va.gov

U.S. Internal Revenue Service, Federal Low-Income Housing Tax Credits
1601 Market Street, 20th Floor
Philadelphia. PA 19103-2337
(215) 597-2145
http://www.irs.treas.gov

U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549
(202) 942-7040
http://www.sec.gov

U.S. Small Business Administration
Information Office, Office of Advocacy
409 Third Street, SW
Washington, DC 20416
(202) 205-6531
http://www.sba.gov

Federal Financial Regulators (community affairs contacts)

Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Community and Consumer Policy
(202) 874-4428

Community Affairs Department
(202) 874-4930

http://www.occ.treas.gov

Community Reinvestment and Development (CRD) Specialists

The OCC's Community Reinvestment and Development Specialists (CRDs) are the bridge between the general public and the banking industry. The CRD specialists provide technical advice to national banks and their community partners, bank examiners, and other OCC staff on community development topics, options for satisfying CRA responsibilities, and how to expand access to credit to low- and moderate-income individuals and small businesses. The OCC has two CRDs in each of its six districts. The CRDs can be reached by accessing the OCC's Web site at http://www.occ.treas.gov.

Board of Governors, Federal Reserve System
Community Affairs
20th and C Streets, NW
Washington, DC 20511-0001
(202) 452-3378
http://www.bog.frb.fed.us

Federal Deposit Insurance Corporation
Community Affairs
550 17th Street, NW
1730 Pennsylvania Avenue, NW
Washington, DC 20429
(202) 942-3270
http://www.fdic.gov

Federal Housing Finance Board
Public Affairs
1777 F Street, NW
Washington, DC 20006
(202) 408-2957
http://www.fhfb.gov

National Credit Union Administration
Community Development Credit Unions
1750 Duke Street
Alexandria, VA 22314
(703) 518-6610
http://www.ncua.gov

Office of Thrift Supervision
Community Affairs
1700 G Street, NW
Washington, DC 20552
(202) 906-7857
http://www.ots.treas.gov

APPENDIX H
PARTICIPATING GOVERNMENT AND COMMUNITY DEVELOPMENT PARTNERS

CD Organizations or Intermediaries

Association of Community Organizations for Reform Now (ACORN), Brooklyn, N.Y.

AFL-CIO Investment Trust, Washington, D.C.

Chicago Association of Neighborhood Development Organizations (CANDO), Chicago, Ill.

Chattanooga Neighborhood Enterprise, Chattanooga, Tenn.

Fannie Mae, Northeast Regional Office, Philadelphia, Pa.

Local Initiatives Support Corporation, New York, N.Y.

Mortgage Guaranty Insurance Company (MGIC), Milwaukee, Wis.

Community Development Financial Institutions Coalition, Philadelphia, Pa.

Neighborhood Reinvestment Corporation, Washington, D.C.

Neighborhood Housing Services of America, Inc., Oakland, Calif.

Southern Dallas Development Corporation, Dallas, Tex.

Government Agencies

Cleveland Department of Economic Development, Cleveland, Ohio

Federal Home Loan Bank of Des Moines, Des Moines, Iowa

U. S. Department of Housing and Urban Development, Texas State Office, Fort Worth, Tex.

U. S. Department of Housing and Urban Development, Office of Economic Development, Washington, D.C.

Commonwealth of Massachusetts, Minority Business Enterprise and Small Businesses, Boston, Mass.

State of Ohio, Department of Development, Columbus, Ohio

U. S. Department of Agriculture, Rural Economic and Community Development, St. Paul, Minn.

U. S. Small Business Administration, San Francisco, Calif.

State of Texas, Department of Housing and Community Affairs, Austin, Tex.

External Consultants

KPMG Peat Marwick LLP, Washington, D.C.

The Quality Network, Boston, Mass.

The OCC gratefully acknowledges each of the participating partners in the study. However, the OCC does not endorse any government program, CD organization, or private enterprise that is described in the report.

APPENDIX I
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The OCC welcomes your comments or questions about this publication. Please write to the Community Reinvestment and Development Program, Mail Stop 6-7, Office of the Comptroller of the Currency, Washington DC 20219, or call (202) 874-4428. You are encouraged to visit the OCC Web site at http:/www.occ.treas.gov.