Community Developments

Comptroller of the Currency
Administrator of National Banks

from the Community Development Division

SECURITIZATION: A STRATEGY FOR INCREASED INNER-CITY LENDING

–by Paul Pryde, Jr., president, Capital Access Group, LLC

Selling loans has promise as a strategy for financing underserved inner-city borrowers.

America's cities are endangered by the inability of inner-city firms, residents, and service organizations to obtain needed credit. This inability is derived from two factors. The first is risk. Private lenders and investors fear that inner-city loans will not be repaid. The second factor is cost; small loans are more expensive than large loans.

Asset securitization can help overcome these credit barriers. Securitization involves the transfer of loans by a lender to a special-purpose corporation or trust that issues certificates entitling the holder to the loan cash flows. The certificates are then sold to investors. The lender uses the cash to make more loans.

Securitization reduces risk because a diversified portfolio of loans is inherently less risky than an individual loan. Similarly, it reduces costs because fixed transaction expenses can be distributed over an entire loan pool rather than charged to a single loan.

In addition to these two benefits, securitization is making lending more specialized. Increasingly, a loan transaction involves several participants. One firm will originate the loan; another might fund it; still, another will purchase and package it into securities for sale to investors. With increased specialization have come greater efficiency, more innovative loan products, and lower loan prices.

The benefits associated with securitization suggest a new type of inner-city lending partnership, one in which government, community development lenders and depository institutions assume different lending tasks according to their respective strengths and capabilities.

- **Loan origination**. Community development finance institutions are in the business of making loans to underserved borrowers. They would actually make and service loans.
- **Loan funding.** Commercial banks are short-term lenders. They would provide lines of credit that community development finance institutions would use to advance funds to borrowers.

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- **Loan underwriting and liquidity**. Secondary market institutions buy loans. "Conduits," such as Minnesota's Community Reinvestment Fund, would purchase loans meeting specified underwriting guidelines, thus "taking out" the banks.

- **Credit support**. Government is better at guaranteeing loans than at making them. Public agencies would use their resources to establish insurance and loan-loss programs. To avoid appropriating new funds, government agencies could back their guarantees with existing loan portfolios.

This lending partnership could be a powerful credit machine for the inner-city — one with the promise to make real progress against one of the nation's most intractable problems. For additional information contact Paul Pryde at (703) 243-9100.

Norwest Bank's Community Home Ownership Program

–by Patricia L. Hanson, president, Community Development Norwest Bank Minnesota, N.A.

The Community Home Ownership Program (CHOP) at Norwest Bank Minnesota, N.A. (NBM) makes home loans available in the cities of Minneapolis and St. Paul. CHOP is a community partnership effort, combining the resources and skills of Norwest Bank Minnesota, Norwest Mortgage, community organizations, and the commitment of every CHOP applicant. CHOP makes the dream of homeownership and community revitalization come true.

The bank's goals in establishing CHOP were to: fill the gap in the credit needs of the identified communities; revitalize the communities the bank serves; maintain adequate underwriting guidelines to ensure the continuation of the program; and to maintain its excellent CRA rating. The initial target area for the program was in census tracts that were identified as declining by the 1980 census data. The boundaries were expanded with the data received from the 1990 census, and in September 1997, the boundaries of the program were extended to include the entire cities of Minneapolis and St. Paul.

Key guidelines of CHOP include: private mortgage insurance not required; 15-or 30-year fixed rate terms; debt-to-income ratio maximum 38 percent; available down payment assistance; mortgage loans at market rate interest; and a flexible credit report of one year of income continuity, regardless of variety of employers. Because the CHOP began as a community revitalization effort, there are no income limits for eligible borrowers.

The demand for CHOP ranges between $15 million and $25 million per year. Due to the balance sheet implications of holding 30-year fixed-rate assets, making sure these loans are eligible for insurance and securitization remains a priority for the bank. Securitization of the loans is planned for every other year, or when the portfolio approaches $100 million.

The first securitization that NBM processed was in October 1994. It was for $17 million of the portfolio with the Federal National Mortgage Association (Fannie Mae). Pool insurance was purchased with GE Mortgage. The process to work out this first deal took more than two years to accomplish. According to Fannie Mae, this was the first such transaction in the country. In December 1996, a second securitization for $31 million of the CHOP portfolio was completed with Fannie Mae. The Mortgage Guaranty Insurance Corporation (MGIC) was the provider of the pool insurance this time. Norwest Bank Minnesota currently holds the majority of the investments on the bank's balance sheet.

The benefits of the program are that the bank is able to convert 30-year fixed rate assets into readily saleable securities that ensures liquidity for the bank. A strong program also ensures that the bank will be able to continue to offer CHOP to the community. For additional information or questions, please contact: Patricia Hanson, president, Community Development, Norwest Bank Minnesota, N.A. at (612) 667-8851.

CDFI Fund Proposes to Enhance Business Lending with States' Capital Access Programs

State-run Capital Access Programs (CAPs) facilitate community development by helping banks make small business loans with slightly higher risk, while eliminating the paperwork of loan guarantees. Recently proposed legislation, the Community Development Financial Institutions Fund (CDFI) Amendments Act of 1998 (HR 3617), would allow the CDFI Fund to reimburse a portion of state contributions to their CAPs. The CDFI currently does not have the authority to reimburse states for CAPs. The CDFI Fund, administered by the Department of Treasury, provides matching capital and technical assistance to qualifying CDFI organizations, including banks whose primary mission is to promote community development.

CAP encourages small business lending in a highly cost-efficient way. CAPs create funded loan loss reserves at individual banks; typically, the reserves are funded by a borrower fee charged at a loan closing, by a bank contribution, and by a state match of the total borrower and bank contribution. The borrower obtains his or her loan and loan approval directly from the bank. The program allows banks to use their own underwriting standards with no governmental review. The bank charges the borrower an up-front premium that varies from 3 to 7 percent, determined by the lender. Borrowers are able to shop around for rates and premiums to ensure they are receiving the best deal available.

The bank deposits all of its CAP fees into an account held at the originating bank. Should the bank ever record a loss on a CAP loan, the bank simply deducts the loss amount from the CAP reserve. This encourages banks to make many CAP loans to build up the reserve. At the same time, if banks over collected CAP premiums compared to their losses, they would be missing the opportunity to approve even more CAP loans. Banks use the CAP program prudently because they must absorb any losses greater than the reserve account.

This proposed CDFI Fund incentive will encourage more states to adopt CAPs and would encourage existing state CAPs to expand their programs. As of March, 20 states had enacted CAPs with over $950 million in small business loans with an average size of about $65,000. Currently, over 560 banks participate in state CAP programs. Despite the CAP programs' success, some states' programs are limited by low funding levels, low loan ceilings, or restrictive eligibility requirements.

Nationwide CAP Loan Volume through 1997

	Cumulative Dollars	Cumulative Loans
1997	$950 MM	16,257
1996	$742 MM	12,988
1995	$579 MM	10,139

Launched in 1995, the CDFI Fund also operates its Core program, which has invested over $75 million directly in CDFIs, and the Bank Enterprise Award (BEA) program, that awards funds to mainstream financial institutions that increase their development lending.

You may fax questions or comments to the Office of Community Development Policy, Department of Treasury at (202) 622-5672.

First Union's Securitization of Affordable Mortgage Loans

–by Maury Zeitler, Program Coordinator, Community Development Division

In a move designed to benefit the underserved housing market, First Union Capital Markets Corporation publicly offered $384.6 million worth of securities-backed Community Development (CD) loans. This is one of the first examples of the public securitization of these types of loans in the industry.

The affordable mortgages were originated or acquired by First Union and its subsidiaries and are serviced by First Union Mortgage Corporation. CD loans are targeted to low- and moderate-income borrowers and neighborhoods.

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Most of the loans were eligible for credit under the Community Reinvestment Act of 1977 (CRA).

"The securitization of these affordable mortgages allows us to redeploy capital back into our communities and to expand our ability to provide credit to low and moderate income individuals," noted Jane Henderson, the managing director of First Union's Community Reinvestment and Fair Lending programs. "First Union is committed to promoting home ownership in traditionally underserved markets through a comprehensive line of competitive and flexible affordable mortgage products. This transaction enables us to continue to aggressively serve those markets."

The $384.6 million in senior certificates are guaranteed by the Federal Home Loan Mortgage Corporation (Freddie Mac) and carry an implied "AAA" rating. First Union Capital Markets Corporation is the investment banking subsidiary of First Union Corporation.

"We are extremely pleased by how well this transaction was received by investors as many of the tranches were significantly over-subscribed," said Owen Williams, the managing director of First Union's trading and fixed-income sales group. "This offering is further proof of investors' strong desire for a diverse range of collateral." Brian Simpson, managing director of First Union Corporation's Structured Products and Real Estate Group, said the transaction shows how First Union effectively uses asset securitization in managing its own balance sheet. "Securitizing assets enable First Union to continue to grow its loan portfolio, while at the same time generate additional fee income," Simpson said. "We also have been very successful in providing innovative asset finance services to clients. We believe there is opportunity to expand our . . . loan securitization capabilities to other companies in the market."

According to First Union, its' community development loans and investments averages $4.7 billion per year. First Union offers a broad range of financial products and services to low-and moderate-income communities, including affordable housing mortgages, home improvement loans, consumer loans, secured credit cards, small business loans, small farm loans, micro-lending and low-income housing tax credits.

For additional information, contact Jane Henderson, managing director, Community Reinvestment and Fair Lending Group, First Union Corporation at (704) 383-4114.

OCC News

Acting Comptroller Addresses Credit Underwriting Concerns

In action designed to halt the erosion of underwriting standards in national banks, Acting Comptroller Julie Williams announced that she was taking action to advise examiners to dig deeper into national bank loan portfolios. The announcement, made during a speech at a risk management conference, held July 13, in Chicago, is the latest in a series of actions taken by the OCC. "Our previous actions and admonitions have not had the full impact we hoped to achieve," Williams noted at the conference, sponsored by Robert Morris Associates. Some of the problems most commonly encountered by examiners include overly generous maturity schedules, inadequate capital, and lack of personal guarantees from borrowers. "Because banks have not shifted gears to the extent we believe the situation requires, we are shifting gears ourselves to enhance our focus on credit risk."

This action emphasizes other measures the OCC is taking to stem a trend of what it considers a decline in credit underwriting standards. (See the article on new examination for Large Banks on page 5.) Bank managers are expected to develop special programs to monitor the loans that are identified by the examiners.

"These steps are not intended to be punitive, but rather to focus the industry's attention on things they have the ability to fix before there are problems," Williams explained. The OCC has

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been looking at underwriting standards for quite some time. In October of last year, former Comptroller Eugene A. Ludwig directed examiners to review underwriting policies with the senior level management at every national bank. Other federal financial regulatory agencies have issued similar warnings. For additional information, visit the OCC's Web site at *http://www.occ.treas.gov*.

OCC Releases Corporate Guide to Assist Native Americans

The OCC released *A Guide to Tribal Ownership of a National Bank* at the **Building Economic Self-Determination in Indian Communities** conference held in Washington, D.C., on August 5 and 6. The guide summarizes the OCC's guidance to tribes considering the establishment of a national bank charter and other important considerations for tribes pursuing tribal ownership of a national bank. The guide is a complement to the *Comptroller's Corporate Manual*, which contains the OCC's policies and procedures for forming a new bank or entering the national banking system.

In announcing the release of the guide, Acting Comptroller Julie Williams said, "Our hope is that this guide will facilitate tribal decisions to strengthen their communities through tribal ownership of a national bank." For additional information on national bank chartering, contact Jan Kalmus in Bank Organization and Structure at (202) 874-5060 or Maury Zeilter in Community Development at (202) 874-4930.

OCC Issues New Exam Procedures for Large Banks

On July 22, the OCC issued updated examination guidelines for risk management of large banks. The guidelines have been revised to help examiners implement supervision-by-risk policies and to stem what the OCC believes is an erosion of underwriting standards. Acting Comptroller Williams said, "We're trying to get more systematic about how examiners collect basic information on the institutions they supervise. In particular we want them to do more 'drilling down' into specific transactions." The new procedures are in effect for banks with assets of $1 billion or more and include step-by-step instructions to help examiners measure a bank's exposure to the nine categories of risk established by the OCC. When a risk management problem is identified, the examiners will be expected to dig deeper into the portfolio and identify specific loans that have problems. Problems could be inadequate collateral or a loan with a high risk of default. These measures should also help in the OCC's fight against falling underwriting standards, particularly in the 80 national banks in the large bank category. For additional information, visit the OCC's Web site at *http://www.occ.treas.gov*.

OCC Advises Industry to Explore Creative Approaches to Meeting Minority Small Business Needs

In the recently issued Office of the Comptroller of the Currency's (OCC) advisory letter, AL 98-9, *Access to Financing for Minority Small Businesses*, dated July 15, 1998, the OCC identified some of the approaches national banks use to successfully meet the financial needs of the minority small business community. Acting Comptroller Julie L. Williams noted that "a positive attitude is the hallmark of the banker who sees minority small business lending not as a legal 'compliance' or political responsibility, but as a business opportunity waiting to be seized upon. In other words, bankers who are successful, treat minority small business loans as a profit center, not as a compliance cost." The advisory letter includes information that was shared with the OCC by national bankers, minority- and small-business owners, and business development officials who participated in outreach meetings held by the OCC in eight cities. The advisory letter can be obtained from the OCC's Web site, *http:/www.occ.treas.gov,* or by calling OCC's Information Line at (202) 479-0141.

State of the Nation's Housing 1998

The Joint Center for Housing Studies at Harvard University recently published its annual report on the nation's housing. *State of the Nation's Housing 1998* provides a broad-stroke picture of the housing situation in the U.S. and discusses trends and changes that are likely to occur in the near future. The report states that with eight years of sustained growth, housing production and sales in the U.S. have risen to all-time highs. This growth appears to be across-the-board, with young adults moving more rapidly into the house-buying market, and minority and moderate-income households also purchasing homes in record numbers. However, the large disparity between minority and white homeownership rates remains nearly unchanged, despite flexible financing opportunities and low interest rates.

A major finding of the study is that the next decade will provide opportunities for housing production and the services associated with the sale and purchase of a home. Steady growth is expected in the number of households, and an increase in the demand for second homes should keep annual construction rates at least as high as those of the 1990s.

The report also states that, "Despite the vigor of the national economy, the absolute number of extremely and very-low-income renter households in need of decent, safe, and affordable housing has yet to retreat." As recently as 1995, 5.5 million renter households and 3.8 million owner households were spending more than half their incomes on housing and/or living in severely inadequate units. Most of these households have extremely low incomes.

Copies of the report are available on the Joint Center for Housing Studies Web site: *http://www.gsd.harvard.edu/jcenter.*

Community Developments is published four times a year by the Community Development Division of the Office of the Comptroller of the Currency. To be placed on the mailing list, send your name, organization name, and mailing address by mail to Comptroller of the Currency, Community Development Division, Washington, DC 20219, or by fax to (202) 874-5566.

Treasury and SBA to Coordinate BusinessLINC: Learning, Information, Networking, and Collaboration

In a June 5, announcement, Vice President Al Gore named U.S. Treasury Secretary Robert Rubin and U.S. Small Business Administration Administrator Aida Alvarez as coordinators of the new BusinessLINC program. Vice President Gore said, "BusinessLINC will help foster entrepreneurship and build on our community empowerment efforts."

Many small-business owners are not able to access the network of information, experience, resources, and personal contacts that are available to larger businesses. This access is necessary if small businesses are to compete successfully in today's marketplace. Statistics show that minority- and women-owned small businesses, as well as small businesses located in distressed communities in urban and rural areas, find it more difficult to access these networks.

BusinessLINC is holding a series of regional meetings across the country, each focusing on different strategies to develop business-to-business links. Information from the results of these meetings, which will include representatives from small and large businesses and community leaders, will be distributed. A final report will be issued that profiles successful programs and explores new ways to increase private-sector participation in these efforts.

Additional information is available on the BusinessLINC Web site at: *http://www.treas.gov/businesslinc.*

Vice President Gore Awards Brownfields Grants

On July 15, Vice President Al Gore announced the award of 71 new grants, totaling over $14 million, to help communities clean up and redevelop abandoned, contaminated properties known as Brownfields and return them to useful economic development centers. "There is no greater example of the environment and the economy working together hand-in-hand to benefit the American people than the Administration's efforts to clean up and revitalize Brownfields." the Vice President noted.

The announcement of the grants was made at the White House Community Empowerment Conference.

Through July, the federal government has awarded more than $42 million through 228 Brownfields grants to cities, states, towns, counties, and tribes. The grants have created over 2,000 jobs and leveraged almost $1 billion for redevelopment. For additional information, contact Becky Brooks, Environmental Protection Agency, at (202) 260-8474.

SBA Cuts Fees for Surety Bond Program

The Small Business Administration (SBA) ordered a reduction in the fees for its Surety Bond Guarantee Program, SBA Administrator Aida Alvarez announced in early July. The reductions come as a result of a decline in the number of claims filed and an increase in the recoveries.

"In the tough competition for construction and service contracts, the SBA's surety bond program can spell the difference between success and failure for thousands of small contractors without the resources to qualify for surety bonds on their own," noted Administrator Alvarez. Under the fee reductions, the percent fee charged by surety companies to small business contractors is reduced from 23 to 20 percent, and the contractor fee of $7.45 per thousand dollars on the total contract is reduced to $6 per thousand.

Private Mortgage Insurance Relief Bill Signed

President Bill Clinton recently signed Public Law 105-216, the Homeowners Protection Act of 1998. The law became effective on July 29. The law requires automatic cancellation and notice of cancellation rights of private mortgage insurance (PMI) required as a condition for entering into a residential mortgage transaction.

The homeowner protections contained in this bill cover the owner of a single family dwelling that is the primary residence of the mortgagor. Lenders are required to terminate PMI on a mortgage loan when the original value ratio of the property securing the loan reaches 80 percent, if the home has not depreciated below its current purchase price and the homeowner has maintained a good payment history. Automatic cancellation occurs when the outstanding balance of the mortgage reaches 78 percent of the original value of the property.

The bill contains exceptions for high-risk loans. For high-risk mortgages that do not exceed the annual conforming loan limit under section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act, the automatic cancellation trigger is at the half-life or midterm of the loan if the mortgage is current according to the terms of the loan. For high-risk mortgages that are above the conforming loan limit level, the automatic trigger level is 77 percent of the original value of the property. For additional information contact Beth Knickerbocker, Community and Consumer Law, at (202) 874-5750.

To obtain copies of OCC publications, send a written request, with $15 payment (check or money order) to: Comptroller of the Currency, PO Box 70004, Chicago, IL 60673-0004. Some OCC publications, including advisory letters, are available on the OCC's Web site at: http://www.occ.treas.gov.