COMMUNITY DEVELOPMENT LENDING: CASE STUDIES OF COMMERCIAL BANK LENDING PROGRAMS

by

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ABSTRACT

In general commercial bank lending is very conservative. Banks lend in areas they believe will prosper and bring a good return to their investment. For the most part, this precludes lending in central city and minority communities. The history of redlining not only demonstrates bankers' reluctance but often times their absolute refusal to lend in such communities.

Today there is a new type of lending -- community development lending -- which goes against the grain of traditional lending. Lenders in this field concentrate their lending in low-income, central city communities. They finance community development which addresses community needs including low- and moderately priced housing (rental and ownership), small business investment, and commercial redevelopment. In financing this development, lenders work closely with community organizations as well as local governments to utilize each one's special resources in development. Such lending allows the three groups -- bankers, community organizations, and local governments -- to work in a cooperative spirit rather than an adversarial one.

Although commercial bank programs for community development lending are not widespread in the U.S., they are a unique and effective model for reinvesting in central cities. This research provides background to the decline and disinvestment of central cities as well as to community development efforts. It also details how commercial banks lend. The remainder of the study describes how three banks established, operated, and perceived their individual programs for community development lending. The study concludes with a critique of the programs and the author's thoughts and recommendations for community development lending.

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1. INTRODUCTION

The primary purpose of this study is to describe the efforts and analyze the effects of commercial bank programs for community development lending. While programs like these are not widespread in the national banking industry, they are significant. They provide opportunitie s for partnership between local government, community organizations, and commercial banks. Under such programs, these three groups coordinate development efforts in neighborhoods which have not seen substantial investment for decades. Additionally, the programs provide the vehicle by which these groups build and rehabilitate low- and moderate-income housing, provide capital to small business owners, and develop commercial areas to serve neighborhoods. This study details the need for community development lending by private banks. Furthermore, it illustrates how such programs were established, how they operate, and the benefits they bring to community development efforts. Finally it analyzes problematic areas for these programs and recommends possible courses of action for the three major actors.

1.1 OVERVIEW OF COMMUNITY DEVELOPMENT LENDING HISTORY

In the early 1970's "redlining" became a national issue. Politicians, activists, and academics recognized private banks and other financial institutions consciously discriminated against minority communities by consistently denying mortgage loans to property owners in these communities. Many regional and local studies showed this type of discrimination was not a factor related to income but rather to race. Bankers perceived minority communities as high-risk loan areas regardless of the community's income level. As a result of this perception, many lenders redlined -- implemented a policy of no lending -- in minority communities.

With many quantitative studies suggesting or demonstrating the practice of redlining and many consumer groups lobbying against the practice, the nation's political leaders were under pressure to pass legislation designed to prevent redlining. In 1975 the federal Home Mortgage Disclosure Act (HMDA) forced lenders to disclose information regarding the location of their home-mortgage loans. Unfortunately this legislation had no enforcement mechanism -- bankers simply disclosed information to bank regulators and the public. In many cases bankers presented information about their lending community generally not specifically, making it difficult to discern the exact location and number of loans in certain areas of the lending community.

Consequently additional legislation passed in 1977. The Community Reinvestment Act (CRA) required lenders to designate their communities for which they are required to meet the credit needs. CRA also required lenders to inform the public about the legislation by posting CRA legislation notices in the bank and encouraging use of the "Public Comment File" to comment on bank performance. Although the legislation provided a CRA performance review by federal bank regulators to enforce community lending, this enforcement mechanism is greatly underutilized. Regulators find bank performance acceptable in 97% of annual bank reviews and, in recent congressional testimony, regulators admitted they have not enforced CRA compliance very well. As a result, the burden of enforcement rests almost entirely with community groups who, under the provisions of the legislation, are able to protest bank expansions or mergers on the basis of their community lending records.

1.2 Overview of Community Development Lending Today

More than a decade after the passage of HMDA and CRA, discriminatory lending practices are still an issue. Recent studies in Detroit and Atlanta illustrate dramatic differences between Black and White areas, with comparable income levels, regarding the amount of mortgage lending by private banks. In 1988 the U.S. Senate Committee on Banking, Housing, and Urban Affairs held hearings on the effectiveness of CRA legislation and possibilities for amendments. Additionally community organizations continue in their efforts to protest bank expansions, demonstrating clear dissatisfaction with bank lending in their communities.

While such discriminating practices continue, most minority communities find themselves in great need of private financing sources. These communities suffer from a history in which the private and public sectors refused to make investments because of the perception that these areas would decline in the future. Disinvestment practices based on such low estimations of property values became self-fulfilling prophecies. Property owners could not obtain mortgage loans for improvements or renovations, deterioration of the housing stock occurred, owner's confidence in investment value decreased, and property values eventually declined in a very real sense. This phenomenon of housing disinvestment, combined with business disinvestment, left communities in a severe state of economic decline. Although the cycle of disinvestment and decline hit many urban communities hardest in the 1960's, they continue to suffer from the effects of disinvestment. More recently, President Reagan's New Federalism and severe budget cuts in federal, state, and local programs mean these areas have lost much of the public support they once received. Given the recent election of President Bush, community organizations foresee the Reagan agenda continuing and, thus, look to the private sector for investment capital.

Despite awareness of the issue and the demonstrated need for community lending, there are several factors which work as a force to perpetuate discriminatory lending practices. First, the CRA legislation is weak and vague. Bankers are given broad requirements and regulators are very lenient in assessing bank lending records. Community organizations bear the burden of enforcement by challenging banks when they attempt to expand. Second, there remains an underlying perception in the banking industry that minority communities are high-risk loan areas.

This perception is reinforced by three other factors -- a history of not lending in minority communities; the movement away from local, personal banking; and a lack of experience in community lending. Redlining prevented bankers from gaining any sort of knowledge or familiarity with lending in minority communities. This historical problem is only exacerbated by the movement away from local, personal banking. In the age of automated tellers and the proliferation of bank branches, bankers in urban areas are generally unfamiliar with their customers. This environment makes it difficult for bankers to maintain lending relationships with populations they have historically worked with. But this environment is extremely unconducive to community lending, given bankers first must establish lending relationships with minority communities and then work at maintaining them. Without experience in lending to community development projects and their often complex deal structures, bankers cannot accurately assess them in terms of risk, collateral, and cash flows. For this reason they continue to view community lending as high-risk and are, for the most part, unwilling to do such lending.

1.3 Studying Community Development Lending

In spite of the cumulative effects of the forementioned factors, there are several banks in the nation which have implemented programs for community development lending. In order to understand how these programs work, case studies of three different banks are presented in this research. The case study method of research was selected to provide a firm basis upon which to describe how programs operate and compare different aspects of each bank's program. Additionally, the case studies utilize written material on the bank's program as well as formatted interviews with bank representatives. The interview was chosen as a component of the case study to provide information on the perceptions and attitudes of bankers involved in community development lending. The banks used as case studies for this particular research were selected because of their special efforts to address community development lending needs. Although each bank has implemented a community development lending program, these specific banks were chosen because they demonstrate different contexts, program design, types of loans, and perceptions with which the programs were initiated.

This study of community development lending programs by private banks has four main purposes: 1.) to demonstrate the mechanics of how such programs operate; 2.) to point out possible obstacles to these programs bankers should recognize; 3.) to recommend strategies for bankers, regulators, local governments, and community groups to establish programs; and 4.) to further inquiry and research of this subject. In chapter two a detailed history of community development is discussed. Chapter three provides information on private bank lending in general. Three case studies of banks in Cleveland, Washington, D.C., and Chicago are presented in chapter four. Chapter five provides a critique of the lending programs used in the case studies. The author's conclusions of and recommendations for community development lending are given in chapter six.

It should be noted this research reflects the author's biases which are 1.) private lenders have a responsibility to all segments of their lending community as stated in their charters; 2.) through community development lending programs private lenders can meet charter responsibilities as well as CRA requirements; and, most importantly, 3.) community development lending programs are economically beneficial to private lenders as well as the communities they serve.

2. BACKGROUND OF COMMUNITY DEVELOPMENT

The purpose of this chapter is to provide background to community development. It is critical to understand what forces moved inner-city communities toward their present conditions in order to comprehend their need for community development lending. Additionally, this chapter provides insight to the efforts and needs of community economic development as they exist today.

2.1 DECLINE OF URBAN AREAS

Since the 1950's the older, industrial cities of the Northeast and Midwest (Snowbelt Cities)[1] have undergone dramatic changes. Losses in population and certain types of employment have had the most significant effects on these cities. Rapid suburbanization occurred during the 1950's and 1960's and these cities lost much of their populations to nearby suburbs. Additionally these areas suffered overall losses in their employment bases.

However, it is important to note how losses in both population and employment were selective. In terms of population losses, cities experienced tremendous decreases in White population along with significant increases in Black population. Whites left the urban areas in great numbers. They had higher incomes and could afford to move to the more affluent suburbs. On the other hand, large numbers of Blacks from the South and more rural areas of the North migrated to these cities in search of employment and better opportunities. At the same time these urban areas suffered significant losses in certain types of employment, mainly manufacturing. Many manufacturing companies also moved out to the suburbs where taxes and rents were lower. Although other types of employment such as those in the service and high-tech industries increased, these employment increases were minor in comparison to the tremendous decreases in manufacturing employment.

Such selective losses in population and employment drastically altered the Snowbelt Cities. Today the population of central cities in these metropolitan areas is predominantly Black, a significant number of whom are low income and have poor job skills. However, these areas lack employment which is entry-level or lowskill. As a result of these changes, the people who live in inner-cities find themselves cut off from available employment and the Snowbelt Cities themselves suffer critical decreases in terms of total size and aggregate personal income levels of their resident populations.[2]

The changes which occurred in Snowbelt Cities brought on repercussions which impacted the cities greatly. Large population losses brought on extensive housing abandonment. Major tracts of residentially zoned land, physically and environmentally suitable for housing, were left vacant.[3] Without the demand of the large populations they once served, commercial businesses also declined. As a result, "once vibrant residential and commercial areas of the cities" began to severely decay.[4]

DISINVESTMENT

As the process of decline began in the Snowbelt cities, disinvestment by the private and public sectors exacerbated the problem. Disinvestment is the "general failure of landlords, lenders, business, and local government to make investments in particular areas because of their pessimistic evaluation of that neighborhood's future.[5]" Lenders and businesses invested in new housing construction in suburban areas or, at the very most, in those areas on the outermost periphery of the cities. The new housing built in these areas served to exclude housing for low-income people through "zoning laws, building standards, sanitation requirements, and sheer racial discrimination."[6] Local governments also invested in highways and other transportation systems which made urban employment more accessible to suburban residents rather than inner-city residents.

With the lack of private and public investment capital, central city residents and business owners found it difficult if not impossible to obtain financing. Any available financing was unaffordable due to unreasonable loan terms, interest rates, mortgage payments, and fees. This resulted in further deterioration of property, reduced cash flows for owners, decreased maintenance, higher debt service burden, and decreased and declining housing stock.[7] Additionally, as the housing market changed, the commercial market also changed. Small business investment decreased and chain supermarkets and department stores closed in these areas. The overall result was a higher cost for lower quality housing and a loss of investment and commercial business.

Urban Renewal

The urban renewal effort was a series of federal programs under the revised provisions of the 1954 Housing Act. The programs were intended to revitalize blighted areas of cities across the United States. Initially, urban renewal targeted housing as a top priority since public housing was reduced to 10,000 units per year from a target of 800,000 units over six years in the housing legislation of 1949.[8] But as urban renewal programs got underway, housing became less of a priority while general redevelopment efforts gained in importance. The federal Urban Renewal Administration stated 10% of funds could be used for non-residential development and later increased this figure to 35%. At the same time, capital grants for redevelopment increased from $500 million for five years to $400 million for two years.[9] Through the revised programs the United States Congress authorized $10 billion for redevelopment by 1968.

Unfortunately, most of the monies were used to address blight and slum areas only in terms of non-residential development projects. City planners and mayors utilized urban renewal grants to revitalize their central business districts. Consequently, redevelopment manifested itself in such forms as office buildings, department stores, hotels, convention centers, theaters, and sports stadiums.[10] As a result urban renewal benefitted those who needed it least -- slum real estate owners, banks with remaining investments in urban areas, and secondary mortgage lenders -- because city officials offered them good sale prices for tracts of land necessary for large, downtown development projects.

Undoubtedly these types of projects were important to urban renewal efforts. However, these developments proliferated while housing needs went unmet. Additionally projects such as these often served to displace people from low-income housing, which was primarily located in the downtown area. In the end urban renewal not only failed to meet the urban housing need, it further exacerbated the need by displacing low-income people and creating such unbalanced commercial growth vis a vis residential growth.

Redlining

Redlining is a practice by banks and other lenders in which they refuse mortgage and other loans irrespective of a borrower's credit or property condition and irrespective of magnitude or rate of growth of deposits originating from the community.[11] This refusal to lend in certain areas is generally based on a perception of the area as high-risk. More often than not "high-risk" has been synonymous with minority community in the banking industry. Although redlining was most prevalent in the 1960's and early 1970's, more recent studies demonstrate lending discrimination based on race still occurs. The following are findings from studies in lending discrimination. They demonstrate varying degrees of discrimination in several different forms.

- in St. Louis, six and one-half times the amount of loans from banks in the city went to the suburbs as compared to the city.[12]

- in Bronx County, race had significant bearing on lending and three major banks showed a clear distinct pattern of disinvestment during the 1960's.[13]

- in Pittsburgh, lenders are more conservative in neighborhoods with greater than 20% Black population and, while differences in lending among city neighborhoods may be related to economic factors and variables reflecting risk, racial composition of neighborhoods may affect the level of risk in the lender's mind.[14]

- in California, several case studies showed Blacks had 52% chance of being denied a mortgage and 63% chance of higher interest rates and loan fees, while Hispanics had 31% and 75% chances, respectively, and 50% chance of having their property underappraised.[15]

- in Atlanta, six years of lender reports from the city's major banks showed Whites received 5 times as many home loans as Blacks of the same income; banks and savings and loans returned 9¢ of each dollar deposited by Blacks in home loans to Black neighborhoods compared to 15¢ for Whites in White neighborhoods.[16]

- in Washington, D.C., studies showed two comparable central city tracts differing only in racial composition received drastically different aggregate loan amounts. A tract with 50% more minorities received more than $2 million less in loans.[17]

- in Detroit, lenders approved loans in White middle-income neighborhoods over Black middle-income ones by a ratio of 1.54 to 1 in 1981 and by a ratio of 3.14 to 1 in 1986.[18] In 1986 Michigan's seven largest financial institutions received $30.1 billion in deposits from the tri-county area which includes Detroit. Of these deposits, 13% ($3.9 billion) came from Detroit neighborhoods. Yet of mortgage

> loans made in the tri-county area, only 5.6% (1,600) went to Detroit neighborhoods.[19]

As a form of disinvestment, redlining served as a means to further the decline of the inner-cities specifically and of minority communities generally. Lending discrimination is often an insurmountable obstacle for minority residents and, like other forms of disinvestment, it threatens the livelihood of their communities. Redlining is a contributor to declining housing stock, decreased property maintenance, abandonment, and foreclosure. Without adequate financing, current property owners cannot maintain their property and prospective owners cannot purchase property. Additionally, it is likely discrimination in lending is responsible for a major portion of lower home-ownership rates for blacks in comparison to whites of similar socio-economic backgrounds.[20]

While redlining and other forms of disinvestment contributed greatly to the decline of central city communities, mostly minority, other forms of discrimination have effectively kept minorities out of suburban areas. Collusion by realtors, banks, mortgage lenders, and other lenders; racial zoning; violence; and threats of violence all served to maintain racial segregation in housing.[21] Consequently, the population of central cities is largely made up of minorities who have been effectively excluded from suburban areas and left with the declining and decreased housing stock of the inner-city.

At this point it is important to note the controversy which exists regarding redlining. While many studies demonstrated redlining patterns in bank lending, other studies claimed there was no evidence of lending discrimination. There are a significant number of academic researchers, as well as commercial lenders, who claim there is no clear evidence of lenders discriminating on the basis of race.

2.2 Community Development Strategy

In many cities, the residents of low-income communities recognized the many sources of decline and disinvestment in their communities. They searched for a strategy which would give them self-determination and reduce dependence on external resources. Nevertheless, community groups realized the need for some external resources. But the way in which these resources were used needed to change. Community groups desired a strategy in which self-determination and community participation would identify community needs and utilize both internal and external resources for the benefit of the entire community. From this idea arose the strategy of community development.

The crises of the inner-cities during the mid-1960's focused community leaders' attention on community control of their neighborhoods. Rather than exerting community control in detrimental forms, i.e. riots, they sought to use it to increase and maintain the strength of their human and financial capital. At the same time, government agencies such as the Office of Economic Opportunity (OEO), which later became the Community Services Administration (CSA), recognized the failure of federal programs to address the needs of inner-city residents.[22] Even the federal Community Action Program which spawned local Community Action Agencies, only delivered services to "needy" individuals in programs such as Head Start or job and health counseling.[23] These programs addressed the needs of the individual rather than the needs of the whole community. At this time community leaders wanted to focus on revitalizing the entire community rather than aiding their neighborhoods through programs which focused on individuals. Knowing their needs better than government officials, community leaders took the primary role in creating a tool, the community development corporation, to achieve self-determination.

COMMUNITY DEVELOPMENT CORPORATIONS

In establishing self-determination, the community development corporations (CDCs) emphasized the community and community benefits. CDCs were first developed by several different communities in the mid-1960's. They proposed a comprehensive strategy to develop physical, economic, and social resources while at the same time preventing the export of these resources to outside areas. CDCs used resources, financial capital and technical assistance, from external sources while community self-determination decided how such resources were used. The private sector was also expected to contribute by providing financial and technical assistance in addition to participating in CDC boards of directors and sheltering markets for CDC ventures.[24] The federal government's role was to provide financing and technical assistance. Eventually the Equal Opportunity Act of 1964, with Title VII of the Community Economic Development Amendement, stated CDCs were intended to. . . .

> "encourage the development of special programs by which the residents of urban and rural low-income areas may through self-help mobilization of the community at large, with appropriate federal assistance, improve the quality of their economic and social participation in community life in such a way as to contribute to the elimination of poverty and the establishment of permanent economic and social benefits."[25]

Several government programs, on the federal and state levels, contributed to community development efforts. The programs were decentralized to insure local people were determining priorities and solutions. At the federal level, the United State Congress established the Special Impact Program (SIP) in OEO in the late 1960's. SIP funded community development groups who undertook comprehensive plans for neighborhood development.[26] The Department of Housing and Urban Development initiated the Neighborhood Self-Help program to further community economic development. At the state level, Massachusetts was the first to demonstrate support for community development. The Community Development Finance Corporation and the Community Economic Development Assistance Corporation in Massachusetts institutionalized providing financial and technical resources to CDCs.[27] Other states such as Florida, Minnesota and Ohio soon followed with similar institutions.

In the private sector many foundations and other specially designed agencies supported community development. The leader in the efforts was the Ford Foundation. In the early years of CDCs Ford chose several model groups, in its "grey areas" program, to support through tremendous financial resources. Later, Ford continued to provide financial resources to CDCs by spreading out smaller grants among more CDCs. Another leader is the Local Initiatives Support Corporation (LISC), Ford's financial "spin-off." It provides financial and technical assistance to CDCs by gaining support from other major corporations and foundations. By 1984 LISC provided over $80 million to local community development groups.[28] Many other private foundations and church groups organized their own funds to support community development but on smaller scales than those of Ford or LISC.

Other Actors In Community Development

In addition to CDCs, other types of organizations work in the development field to revitalize declining neighborhoods. Some private, for-profit developers invest in projects within these areas. Generally it is on a project by project basis rather than a continuing commitment to the area. However, some of the developers do a significant number of projects in neighborhoods which have supported previous development. Another set of actors is minority developers and small business owners. Often times these two groups feel strong commitments to central-city neighborhoods either because they grew up there or have done business there for years. Their specific knowledge of an area assists them in determining market demand for particular products. Minority developers and small business owners frequently do small and medium size development projects. Depending on previous development experience, they might require more technical assistance than other developers.

Community Development Efforts And Needs

Knowing the objective of community development organizations is to develop physical, economic, and social resources, it is important to understand the different efforts they make to achieve this objective. Development efforts range from general resident advocacy to large-scale commercial development projects. In the late 1960's many CDCs concentrated in economic development such as job creation and small-business ventures. Today CDCs work primarily in the area of housing, including housing development, rehabilitation, and housing cooperatives. Additionally CDCs and other community-based organizations provide other programs such as job training, daycare, healthcare clinics, and home weatherization programs.

Funding sources, which were more abundant in the late 1960's and early 1970's, have been substantially reduced in the late 1980's. From the public sector, the Reagan years and New Federalism have cut or terminated many federal programs. In 1981 CSA, formerly known as OEO, was abolished. Similarly the Neighborhood Self-Help Development program from HUD was terminated during the same period. These, along with major cuts in Community Development Block Grants, severely limit the ability of CDCs to conduct community development.

The significant reductions in public funds also affect the availability of private funds. Foundations who support CDCs through grants and loans, often do so on the basis of the CDC's ability to garner government financing. The private sector seeks partnership with government in contributing to community development. As a result foundations such as Ford have reduced their support to CDCs. The grants and loans they do make have a smaller dollar amount than the ones they gave in earlier years. Consequently, CDCs and other community-based organizations, while increasing their leadership and development capacities, have lost a significant portion of their funding. This impairs community development efforts by all community-based organizations.

In regard to other actors in community development, they too are in need of access to financing. As with CDCs, these developers need access to financing for projects in these areas because most lenders still refuse to lend there. As a result, even experienced developers are not guaranteed of finding a bank willing to lend. For minority developers and small business owners the situation is more serious. They generally need more technical and professional assistance because they have less experience in developing and borrowing. For a bank, providing this kind of assistance requires time, staff, and financial resources -- all of which they are reluctant to give for smaller projects in "high-risk" neighborhoods.

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3. COMMERCIAL BANK LENDING

This chapter illustrates the mechanics of how commercial banks lend. To understand how banks evaluate community development projects, it is critical to know exactly how they have traditionally conducted lending. Additionally, this chapter provides a basis of comparison for understanding how both traditional lending programs and community development lending programs operate.

3.1 LENDING

Traditionally, commercial banks' loan portfolios concentrated in commercial and consumer loans, including construction loans which are generally short-term (1 to 3 years). In the last 15 years, however, commercial banks increased their participation in the mortgage loan market[1] and expanded from mostly short-term mortgage loans to also include long-term loans in their financing operations of real estate.[2] Generally commercial banks issue long-term mortgage loans and subsequently sell them to the secondary market. The secondary market is composed of mortgage investors who purchase mortgages from banks and other direct mortgage lenders (primary market). Because lenders in the primary mortgage market significantly increased long-term lending efforts, their lending practices can greatly impact neighborhoods and community revitalization efforts.

Along with commercial banks, several different types of financial institutions -- savings and loan associations, mortgage companies, the Government National Mortgage Association, credit unions, pension funds, etc. -- compose the community of lenders and investors in the national mortgage loan market. This study discusses the role of commercial banks as mortgage lenders. Other institutions are discussed only in so far as they play a role in the activities of commercial banks.

HOW COMMERCIAL BANKS ARE STRUCTURED

Commercial banks are "private financial institutions organized to accumulate funds primarily through time and demand deposits and to make these funds available to finance the nation's commerce and industry."[3] Banks make profits by charging a higher interest rate for money loaned than the interest they pay on money accepted as deposits. Additionally they charge for bank services such as checking accounts, savings accounts, loan fees, and credit cards. Banks provide mortgage loans (primary mortgage market) directly to borrowers and sell them to mortgage investors, the secondary mortgage market. This allows banks to untie their financial resources from long-term mortgages (20 to 30 years) and, thus, continue providing available financing for loans.

Commercial banks are regulated at the federal level by the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (Fed), and the Federal Deposit Insurance Corporation (FDIC). At the state level, they are regulated by each state's banking agency.[4] Regulators intervene in bank operations in various ways. First, commercial banks must be either federally- or state-chartered by a regulating agency prior to conducting business. Before issuing a charter, the OCC and most state banking agencies require the bank to meet "the convenience and needs of the community to be served by the bank."[5] Generally, this "community" is defined as the geographic area from which the bank expects to attain 75% of its deposits as well as loans.[6] Second, regulators set standard guidelines to insure banks use safe and sound banking practices. These guidelines regulate such aspects of banking as maximum loan terms and maximum aggregate lending as a percentage of total deposits or capital. Third, regulators review and grant bank requests for relocation, expansion, branching, and merging. Regulators grant and deny such requests on the basis of the bank's history, financial solvency, and ability to meet its charter obligations.

How Commercial Banks Lend

In discussing commercial bank lending, there is a distinction between lending to development projects and lending to individuals. The present discussion of how banks lend and, later discussion of the case, studies primarily refer to bank lending for community development projects -- that is, projects initiated by community groups or individuals which encompass more than a single-family residence.

Underwriting, the process of analyzing loan risk by banks, generally includes four basic areas of criteria -- credit of the borrower, character of the borrower, the project's collateral value, and the project's cash flow. The credit of the borrower is critical in analyzing risk. Banks look favorably on borrowers who have an established history of good credit. On the other hand, a borrower, whose credit history illustrates an inability to meet financial obligations, represents a much greater risk to lenders. Those borrowers without a credit history, good or bad, are unknown to lenders. Because lenders have few means to measure this borrower's ability to manage credit, they often perceive him or her as a risk comparable to a borrower with a bad credit history.[7]

The character of the borrower refers to how well lenders know him or her. In part this knowledge is subjective character assessment, which may be ascertained through business relationships. But it is also influenced by the borrower's net worth which frequently determines the ability to borrow as well as the amount of borrowing.[8] Unlike the borrower's character, assessing a project's collateral is more concrete. Generally, bankers lend no more than 80% of a project's appraised value.[9] Similarly, lenders calculate annual project income streams to determine the project's ability to pay debt service (i.e., mortgage payments). To gauge this ability, lenders use a debt service coverage ratio (DSCR) which states a project's net income in relation to its debt service. A project with a DSCR of 1.25 has 25¢ surplus income for every $1 paid in debt service. Projects which are considered less risky by lenders can get financing with a lower DSCR than more risky projects. That is, projects with a small margin of surplus income and perceived as risky have greater difficulty attaining financing.

In determining the risk of a particular development project, lenders also consider requirements by the secondary mortgage market. As stated previously, lenders frequently sell long-term mortgage loans to secondary mortgage market investors in order to release their financial resources for further primary mortgage lending. The main investors in the secondary mortgage market are the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC).[10] If lenders plan to sell their mortgage loans in the secondary market, they must insure they package the loans in terms mortgage investors find satisfactory. Often mortgage investors such as FNMA and FHLMC require higher DSCR and lenders must meet this requirement when lending in the primary mortgage market. This is a significant fact considering, in 1987 FNMA alone assisted 1.1 million home buyers or owners through their efforts in the secondary market.[11] Additionally, FNMA acquired more than 50% of these loans from thrift institutions and commercial banks.

3.2 EFFORTS TO REFORM LENDING

In the 1970's the issue of redlining surfaced as a major national issue. Community activists, academics, and politicians realized extreme differences in lending patterns among different geographic areas had severe repercussions. Lenders deprived certain communities, namely inner-city and minority communities, of access to credit. Without access to financial resources homeowners could not make home improvements, prospective buyers could not purchase homes, and property owners could not maintain their buildings. Community activists knew this and, aided by redlining studies condemning lending practices across the nation, pressured government to enact legislation prohibiting such practices.

HOME MORTGAGE DISCLOSURE ACT

In late 1975 the United States Congress passed th Home Mortgage Disclosure Act (HMDA). By forcing lenders to disclose information regarding geographic location of mortgage loans, legislators and activists hoped HMDA would encourage lending in communities which previously had no access to financing. After amendments to the original Senate Bill, the legislation required private lenders to disclose information regarding home mortgage loans based on zip codes or census tracts. HMDA also called for lenders to provide data on the aggregate number and dollar amount of five types of residential loans -- "government-insured mortgage loans (Federal Housing Administration, Veterans Administration, or Farmers Home Administration), conventional mortgage loans, home improvement loans, non-occupant mortgage loans, and mortgage loans on multi-family dwellings."[12] Additionally, HMDA charged bank regulators with the task of insuring lenders complied with the legislation's provisions. The OCC, the Fed, and the FDIC reviewed bank records to insure banks disclosed information and lending patterns met the "convenience and needs" clause of bank charters.

The HMDA legislation was a major achievement in trying to establish fair bank lending practices. Unfortunately, HMDA's provisions were not as far reaching as they might have been and this created problems First the legislation only requires lenders to disclose information on loans made. That is, they are not forced to divulge data on loan applicants who were rejected. Without information on rejected applicants, it is difficult to ascertain if banks are rejecting credit-worthy applicants and or discriminating on the basis of geographic location or race. In addition to this, HMDA requires lenders to disclose information based only on census tract or zip code. Therefore, the data is not a good tool for analyzing the characteristics of individuals who received loans or the average amount of loans. HMDA critics want congress to amend the legislation with provisions requiring disclosure of specific information on every individual loan inquiry, whether or not the loan is eventually made.[13] Although numerous consumer groups and academics conducted studies based on HMDA data during the 1970's and 1980's, their findings often reported evidence as inconclusive or only suggestive of redlining activity.

COMMUNITY REINVESTMENT ACT

Because they believed redlining practices still existed and because HMDA did not prove as effective as they hoped, activists continued to lobby for further legislation. Almost two years after the enactment of HMDA, Congress passed the Community Reinvestment Act (CRA) of 1977. The law required banks to 1.) submit annual CRA statements to regulators regarding their community lending records; 2.) post the CRA statement in the bank where it is accessible to the public; and 3.) inform the public of its right to submit comments on the bank's lending record to the bank' CRA file. The assumption that the private sector should be the prime source for financing economic and housing development and that private banks should meet community needs in accordance with their charter requirements provided the basis for the CRA legislation. Under the provisions of the law, regulators enforce compliance by reviewing bank CRA statements when banks request permission to merge, branch, relocate, or expand. Additionally, the CRA allows public groups to challenge banks' requests for merging or branching. In challenging banks, community groups must demonstrate the bank's failure to comply with its CRA obligations.

Many significant facts regarding the practical implementation of the CRA emerged in the last decade. First, in reviewing banks' CRA performances, regulators display a significant degree of leniency. In recent congressional hearings on the effectiveness of CRA, Senator Proxmire noted,

> "almost all (lenders) get high ratings year after year and almost none is ever held back . . . more than 97% of all lenders passed with flying colors. What's more in the last 10 years, only 8 -- that's 8 of 40,000 applications reviewed by the agencies were denied."[14]

Similarly Calvin Bradford, a senior fellow at the Hubert Humphrey Institute of Public Affairs, cited the lack of effort in enforcing the CRA on behalf of bank regulators. In Bradford's opinion regulators often give banks passing CRA reviews regardless of evidence demonstrating non-compliance. Bradford cited,

> "the Philadelphia Fed basically telling people that no matter what the HMDA patterns show, that's not sufficient to turn down a bank, no matter what. The Atlanta Fed, I would say, is basically making a rule that there is no such thing as race discrimination. They had one bank there, Trust Company, that essentially admitted that its loan product, its mortgage product, was only appealing to upper income mobile whites, and yet they said to the Fed, don't apply the effects test to us. The Fed said OK, we won't do that. They did have one loan product which was available and which they thought might appeal to lower income and minority people and they refused to advertise that.....The Fed approved their application without comment."[15]

For these reasons community groups often state, in practice, CRA places the burden of enforcement on them through bank challenges. Bankers too complain about the legislation. Although some claim it threatens safe and sound lending practices by forcing banks to make risky loans, most bankers disagree with the vague wording of the act. They state the language is so vague they are unclear as to what constitutes CRA compliance.

3.3 CURRENT STATE OF LENDING

The banking environment is ever-changing and these changes often dramatically affect lending practices. Today's banking industry is impacted by several different forces including technological advances, increasing expertise of community groups, decreasing role of the federal government, and the growth of national banking. Together these forces alter the overall lending environment and, more specifically, the environment for community development lending.

FACTORS PROHIBITING COMMUNITY DEVELOPMENT LENDING

In general the resources of community organizations have decreased. Cutbacks in federal programs such as Community Development Block Grants significantly impact community organizations. Without public resources for administrative and overhead costs, it is difficult for community development groups to, first, gain technical capacity and, later, meet pre-development costs. Additionally, some lenders require public resources in projects for which they provide financing. Without these resources, community organizations have great difficulty garnering private financing. In regards to CRA challenges, community organizations require some financial support while issuing protests which consume time, labor, and funds. Decreases in critical resources leave community organizations with less opportunity to improve their development capacity and with fewer means to fight discriminatory lending.

In the banking industry itself, fears regarding community development lending are very common. Many lenders perceive this type of lending as extremely risky. Community development loans are thought to have high default rates in comparison to other types of loans.[16] It is also commonly believed that, when community groups do become involved in lending, banks are pushed to make unsound loans.[17] Moreover, some bankers view community development lending as social work or philanthropy rather than good banking business. For these reasons, a majority of bankers are reluctant to initiate efforts or programs for community development lending.

As stated previously, bank regulators lack rigorous enforcement of CRA compliance. This lax attitude regarding compliance is transferred to lenders themselves. Because regulators for the most part ignore evidence of non-compliance, lenders continue to neglect the credit needs of some of their communities. The unwillingness of regulators to enforce CRA simply transfers the burden of enforcement to community groups, who are generally inadequately equipped or financed to hold that responsibility.

FACTORS ENCOURAGING COMMUNITY DEVELOPMENT LENDING

One critical factor encouraging community development lending is the effect of CRA on the banking industry. First, community groups in many cities successfully challenged banks or negotiated settlements with banks who faced the possibility of a challenge. In Philadelphia, Providence, Cleveland, and Chicago, consumer groups extracted lending agreements which call for a specific amount of lending by a bank over a given period of time.[18] In Chicago community groups settled on $150 million in community lending by three banks and in Philadelphia a major bank agreed to lend $55 million in low-interest loans.[19] Nationally, CRA helped community groups obtain 150 lending agreements. Secondly, as community groups become more effective at leveraging their power to obtain lending agreements, bankers grow wary of CRA challenges. This fact alone encourages lenders to meet CRA requirements and make concerted efforts in community lending rather than risk a challenge.[20]

Related to this issue is the deregulation of the financial markets in recent years. The banking industry has become an increasingly regional and national industry. As deregulation encourages banks to merge, acquire, and expand, community groups are provided with many more opportunities to initiate challenges. In addition there is growing competition among financial institutions including commercial banks, savings and loans, life insurance companies, and securities firms.[21] As a result, commercial banks as well as other lenders want to capture new and different corners of the financial markets. Community economic development is simply another source of demand for a commercial bank's product -- loan capital.

Movements on the part of the public sector as well as other private actors also encourage lending for community development efforts. As the federal government reduces its level of participation in financing development, it increasingly seeks partnership with the private sector. More and more, government utilizes its financial and political resources to leverage greater resources from private markets. For this reason, government encourages private participation in development and helps support that participation with grants and programs which work in conjunction with private capital. This is appealing for private lenders because it means they have a partner with whom to share the risk. Similarly, other private programs such as the Local Initiatives Support Corporation (LISC) also share the risk with lenders. As they issue grants and loans for community development efforts, they act as partners to commercial banks who can then decrease their own exposure to risk.

In addition the American Bankers Association (ABA) recently affirmed the importance of community development lending to the industry. In October of 1988 Thomas Rideout, President of the ABA, stated "issues of compliance, community involvement, and consumer concerns are increasingly important to the banking industry, and . . . the development of industry strategies and responses will be a priority during his presidency."[22] Rideout established a task force on community involvement and consumer compliance in hopes of finding solutions, acceptable to both banks and community groups, to community concerns. Furthermore, the ABA Housing and Real Estate Finance Division created a subcommittee on community development lending. The subcommittee's stated mission is to "promote through information and specific action community development lending as a wholesale banking product line" and to "identify the business opportunities of community development lending."[23] Although task forces and subcommittees are not the most pro-active responses possible, this acknowledgment by the industry's primary professional association demonstrates the increasing importance and awareness of community development lending in the banking industry.

But perhaps the most encouraging factors for community development lending in the banking industry are programs by private banks. Programs for community development lending demonstrate how this type of lending can be successful, explain specifically how it is managed, detail the guidelines, and point to possible obstacles. The following chapters describe, critique, and make recommendations for three programs by commercial banks for community development lending.

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[2] Dennis, Marshall W. *Fundamentals of Mortgage Lending.* (Reston: Reston Publiching, 1978), p.41.
[3] *Ibid.*
[4] *Ibid.*, p.42.
[5] Illinois Housing Development Authority, *op.cit.*, p.84.
[6] *Ibid.*, p.97.
[7] Kollias, Karen. "Community Development Lending: Cutting Edge for Good Business. " (Washington: American Security Bank, 1988), p.17.
[8] *Ibid.*
[9] *Ibid.*
[10] Dennis, *op.cit.*, p. 111,117.
[11] *Fannie Mae's Low- And Moderate-Income Housing Initiatives.* (Washington: Fannie Mae, December 1988), p.3.
[12] Metzger, John T. and Marc A. Weiss. *The Role of Private Lending in Neighborhood Development: The Chicago Experience.* (Chicago: Center for Urban Affairs and Policy Research, Northwestern University, 1988), p.19.

[13]Schafer, Robert and Helen F. Ladd. *Discrimination in Mortgage Lending.* (Cambridge: MIT Press, 1981), p.315.
[14]U.S. Senate Committee on Banking, Housing, and Urban Affairs. *Community Reinvestment Act.* (Washington: U.S. Government Printing House, March 1988), p.1.
[15]*Ibid.*, p.97.
[16]Federal Reserve Bank of Boston Lending Seminar. Excerpt from presentation Robert Stearns. (Boston: April 12, 1989).
[17]*Ibid.*
[18]Metzger, *op.cit.*, p.54.
[19]*Ibid.*, p.37.
[20]Kollias, *op.cit.*, p.13.
[21]Florida, Richard L., ed. *Housing and the New Financial Markets.* (New Brunswick: Rutgers University, 1986), p.227.
[22]American Bankers Association. "ABA President Establishes Special Task Force on Community Involvement and Consumer Compliance." (Washington: ABA News Release, October 1988), p.1.
[23]_____. *Mission Statement Subcommittee on Community Development Lending.* American Bankers Association Housing & Real Estate Finance Division. (Washington: American Bankers Association).

4. PRIVATE BANK PROGRAMS FOR COMMUNITY DEVELOPMENT LENDING: THREE CASE STUDIES

This chapter demonstrates how three bank programs operate in their community development lending efforts. Each program is described with an emphasis on how the program was established and what type of lending is done. Examples of projects completed are given. Although all three programs do small business lending, examples focus on financing for residential projects. This reflects the fact that the programs concentrate in this area (with usually 60-70% of their loans in this category) as well as illustrates the differences between projects traditional and community development lenders finance. Additionally, the chapter provides insight as to how bankers involved with these programs view community development lending.

4.1 FIRST NATIONAL BANK OF CHICAGO - CHICAGO, ILLINOIS

BACKGROUND AND CONTEXT

In Chicago community-based organizations had worked hard against redlining practices. Armed with the Home Mortgage Disclosure Act and the Chicago Disclosure Ordinance, which used city deposits to leverage information disclosures and anti-redlining pledges[1], community groups hoped to challenge banks. Unfortunately, Illinois prohibited branch banking which gives community organizations the opportunities to protest requests for branches or mergers.[2] Even with that obstacle, however, in the late 1970's and early 1980's community groups managed to arrange several reinvestment agreements with local banks.[3] In 1982 Illinois passed a new law which allowed intrastate acquisitions.[4] With this legislation the number of bank requests for mergers, acquisitions, and branches grew which in turn increased the opportunities for challenges by community groups.

In mid-1983 a major corporation in Chicago intended to acquire another major Chicago corporation. First Chicago Corporation, the bank holding company for First National Bank of Chicago which was the city's second largest bank, wanted to acquire American National Corporation, the bank holding company for American National Bank which was the city's fifth largest bank.[5] The acquisition was of great significance in that it would propel First National Bank of Chicago to the eighth largest bank in the country.[6] The First National acquisition was a tremendous opportunity for community groups to challenge the bank, given it had done very little lending in low- and moderate-income neighborhoods.[7]

The Chicago Reinvestment Alliance was the key to negotiating an agreement with First National Bank of Chicago. More than thirty community organizations including the National Training and Information Center, the Chicago Association of Neighborhood Development Organizations, and the Chicago Rehab Network coalesced to form the Alliance in late 1983. The ad hoc coalition was composed of organizations which specialized in such areas as legislative lobbying, community organizing, and neighborhood development. The Alliance, concerned by city politics, federal program cutbacks, and large banks' expansion plans, had a "broad goal of improving and expanding employment and housing opportunities in their communities through the strategy of community reinvestment."[8] With data on First National's deposits and loans illustrating a poor lending record to local communities, the Alliance had the ability to wage a strong bank challenge. In light of this Barry Sullivan, chairman of First Chicago Corporation, agreed to negotiate a lending agreement with the Alliance in December 1983. Members of the Alliance and bank executives negotiated the agreement from January to March 1984.[9]

On March 6, 1984 both the Chicago Reinvestment Alliance and First Chicago announced a major reinvestment agreement. Over a period of five years First National Bank of Chicago agreed to lend, through its Neighborhood Lending Program, $100 million in low- and moderate-income neighborhoods for the purposes of affordable housing and business development. Additionally, First Chicago Corporation and its foundation agreed to give $400,000 in grants to community groups, neighborhood-based groups, not-for-profit borrowers, and technical assistance groups.[10] It also agreed to purcahse $20 million in Small Business Administration guaranteed loans from other lenders in order to free capital for further local reinvestment. The $100 million in loan money was divided in the following categories and amounts:

Single-family Loans	$15 million
Multi-family Loans	$60 million
Commercial and Industrial Loans	$20 million
Mixed-use Loans	$5 million

First Chicago established the Neighborhood Banking Division within the bank and charged it with implementing the new Neighborhood Lending Program. Moreover, in April 1984, it created the Review Board, composed of five representatives chosen by the Alliance and five by the bank, in order to monitor the lending program and resolve continuing issues. The Board's responsibilities include insuring loans qualify as part of $100 million loan pool, projects are not causing displacement, and housing is affordable according to low- and moderate-income levels in Chicago.

PROGRAM DESCRIPTION

The Neighborhood Lending Program targets Chicago's low- and moderate-income neighborhoods for investment of its $100 million loan pool. In order to be eligible an area must have an income equal to or less than 80% of Chicago's median income. This qualifies almost 66% of Chicago census tracts for these loans.[11] In regards to community participation the Neighborhood Lending Program incorporates community groups into its program in three primary ways. First, members of community groups make up half of the Review Board. Through the Board, community groups voice concerns over displacement and advocate for borrowers who the bank might not be likely to consider. It should be noted the bank has final authority in whether or not to make a loan. Secondly, community groups help in packaging loan requests. The Chicago Rehab Network screens deals, educates borrowers, and packages loans for multi-family projects while the Chicago Association of Neighborhood Development Organizations does the same for commercial projects.[12] Community groups receive "points" or loan fees which would normally go to the bank. The third way in which community groups participate in the program is by endorsing borrowers. Each potential borrower must receive an endorsement from at least one community group. This insures loans meet both the bank's and the Alliance's objectives for community reinvestment.

As stated previously, loan money is designated for small business, commercial and industrial, and single- and multi-family housing (both housing purchase and rehabilitation). Loans are both long-term, 20-year for commercial loans and 30-year for residential loans, as well as short-term, 1-year construction loans which may roll into long-term permanent loans. To this point, First National keeps its loans from this program in its portfolio. That is, it does not sell these loans to the secondary market. Community groups made this stipulation in the original lending agreement. First National finances multi-family projects for properties generally with six to eighteen units. These loans usually range from $100,000 to $600,000 although it does provide loans of $1 million for larger properties.[13] In its lending First National requires a debt service coverage ratio of 1.2 (i.e., $1.2 of income for every $1 of mortgage debt). In some cases the income of a property supports more debt than appraisal values indicate. This is due to underappraising -- appraising property below its actual value based on perceptions of low property values for the area -- in certain neighborhoods.[14] In regards to rehabilitation, loans for these projects must be no greater than 80% of the post-rehabilitation property value. First National's program also works closely with other agencies to finance projects. Funds from city, state, and federal programs are used in coordination with First National's loans to finance projects which might not otherwise be feasible.[15]

Examples of Community Development Loans

The Chicago Rehab Network referred an owner of a 6-unit apartment building on the south side of Chicago to First National for refinancing and rehabilitation loans. The owner's original estimate for rehabilitation costs was almost $150,000. After an appraisal by city architects, First National estimated total rehabilitation costs at approximately $180,000. While the building was located in a depressed area, lending officers knew it was close to public transportation, some commercial business, and highways. First National agreed to lend $90,000 in a first mortgage 6-month construction loan. The loan later converted to a 1-year adjustable rate mortgage which matured 30 years from the end of construction. First National financed this project in conjunction with the Chicago Department of Housing which provided a second long-term mortgage of nearly $150,000. The Department of Housing also assisted qualified renters, who could not meet the low- to moderate-income rents, with Section 8 rental subsidies.

The Norman Apartments project consisted of a large mixed-use building rehabilitation in the Uptown area of Chicago. Of the 154 units in the building, nearly half were single-room occupancy units. First National financed the rehabilitation project with an 18-month construction loan of $1.78 million and, upon construction completion, converted it to a 30-year adjustable rate mortgage loan. The developers, who are committed to providing low- and moderate-income housing, rented single-room units for $240 per month. Prior to rehabilitation, these units rented for $75 per week. Additionally, the developers made a concerted effort to retain previous tenants by lowering rent for those who could not meet even a small rental increase. This effort was critical given many tenants' only source of income is social security, general assistance, or unemployment.

BANKERS' PERSPECTIVES

In April of 1989 the Neighborhood Lending Program marked the end of its fifth year in operation. Although the original lending commitment called for $100 million in loans over five years, the program only completed a little more than $75 million in that time. This was due in part to a low volume of business in the program's first years. After the program's first three years, community groups and bank officials recognized the unit was not doing as much lending as they expected. Bank officers took a more proactive position by actively seeking customers and opening its doors to the public. In its fourth year the lending unit more than doubled the amount of loans it had done in the previous three years. In April 1989 First National bank announced another five year commitment for $150 million, including $25 million from its previous commitment.

Within First National Bank the Neighborhood Lending Unit is viewed as one of the best profit centers. Although officials expected it to lose money initially, the unit managed to make a profit. The lending unit makes favorable loans at the lower end of the market rate scale. In terms of its default rate the unit had one foreclosure in more than 250 loans. Bankers at First National cite the lending unit as unique in several different ways. First, the unit makes loans in neighborhoods which other lenders are unwilling to loan to. Furthermore, the unit does a great deal of rehabilitation, mixed-use, and non-profit lending -- lending areas which most of the banking industry is reluctant to address. Of its portfolio, 20% of the unit's loans are to non-profit organizations. The lending unit is also willing to undertake complex deals. Frequently loans are made which involve community groups as well as government agencies and their resources. Although these deals are more time consuming, bank officials realize these projects would not get financed without the supplemental resources of government programs.

4.2 AmeriTrust Development Bank - Cleveland, Ohio

Background and Context

In 1983 AmeriTrust Company, a bank located in Cleveland, sought a mechanism which would help it meet its charter responsibility of serving its entire community including low- and moderate-income neighborhoods. Three years prior to this, the company was the target of two CRA challenges based on its lending patterns and practices. Although the company met the challenges with success, in 1983 new management decided to more actively address community concerns. The bank chose to create the Development Finance Unit which had the following three primary functions:

1. Calling on neighborhood development organizations to determine credit needs.
2. Helping these organizations shape their requests into conventional loan packages.
3. Serving as advocates for these loan requests through the loan review process within the bank.[16]

Within only a few months bank executives realized the new unit was highly successful. It dispelled many myths executives still had and gave them some critical insight to community development lending.[17] First, the unit proved the bank did not have to lower its credit standards in order to make these loans. Bankers found they could make these types of loans using the same credit criteria they used when making other loans. Second, they discovered these loans could be financially feasible. That is, the bank made the loans while remaining within market pricing in terms of interest rates and fees. Third, the bank's new unit demonstrated the market for these types of loans. Bank officers and lenders had anticipated a small amount of market demand and were quite surprised when demand greatly exceeded their expectations.

The success and unexpected lessons demonstrated by the Development Finance Unit propelled the bank to move further in its community development lending efforts. Initially, bank officers wanted to expand the unit in order to meet the unexpected demand they had encountered. However, further consideration of the issue raised a new possibility -- creating a subsidiary bank specifically designated to address community development needs. In this way, the bank hoped to draw deposits from large investors and corporations -- interested in socially responsible investments in the local market -- to finance these loans. After more detailed planning, the bank opened the subsidiary bank known as the AmeriTrust Development Bank in April 1986. The Ohio Superintendent of Banks issued a charter to Ameritrust which began with a five member staff and $3.9 million of initial capital from its holding company.

PROGRAM DESCRIPTION

AmeriTrust Development Bank is a commercial bank based on the premise that assets placed in the bank are used for local development projects. AmeriTrust is a full-service bank which offers a wide range of bank services and products to its investors. As stated previously, AmeriTrust seeks major corporations and institutions to make substantial investments in the bank. Like other commercial banks AmeriTrust provides investment saving products such as money market deposit accounts, statement savings accounts, investment certificates, and certificates of deposit.

In terms of its lending, AmeriTrust concentrates in four areas -- residential real estate loans to individuals, home improvement loans to individuals, commercial real estate loans, and commercial loans to small business.[18] Residential real estate loans, both first and second mortgage loans, have terms with fixed or adjustable interest rates. These loans have 15- or 30-year terms with rates, closing costs, and terms varying depending on loan type. AmeriTrust has not sold its loans to the secondary market on a broad scale. Presently the bank is considering selling a significant amount of its loan portfolio to the secondary market in order to make more loan capital available. For owner-occupied single family purchases the bank requires a 10% down payment while it requires a 20% down payment and a 15-year term for an investor purchase loan. The bank also makes home improvement loans. For these loans the bank combines a first mortgage purchase loan with a rehabilitation loan. After a repair estimate and an "after repair" appraisal of value, the bank processes the loan and holds repair payment until owner and bank are satisfied with completed work. In addition to its rehabilitation loans for single family purchases, AmeriTrust is also a participant of Cleveland Action to Support Housing (CASH), in which it works with local government, owners/occupants, and landlords to rehabilitate 1-4 unit family and mixed-use facilities. The bank offers loans for these projects at below market interest rates.

In regard to its commercial real estate and small business loans, AmeriTrust offers standard and specially designed loan packages to meet credit needs. For commercial real estate loans the bank has two primary criteria borrowers must meet. First, it requires a property to have a minimum loan to value ratio of 75%. That is, the total loan amount must equal no more than 75% of the total appraised value of the property. Second, the bank requires a debt service coverage ratio of 1.2 on variable rate mortgages. Stated more simply, this means the project must generate $1.2 of income for every $1 of debt service payments. Furthermore, the bank works with a number of government loan programs to make a loan package which meets an individual's or organization's credit needs. In terms of small business loans AmeriTrust provides loans for short-term working capital to business and non-profit organizations. These loans are designed to provide financing for equipment acquisition, working capital, and lines of credit. In making these loans AmeriTrust reviews the borrower's collateral, cash flows, projected budget forecasts, management experience, and previous financial statements.

EXAMPLES OF COMMUNITY DEVELOPMENT LOANS

In one of its larger projects, Lexington Village, AmeriTrust provided financing for multi-family housing. Lexington Village consists of 135 multi-family units of new construction in the Hough area. For AmeriTrust this was a demonstration project -- it was one of their initial projects and it was located very near the site of the Hough area riots. The project brought together a for-profit developer and a non-profit developer. AmeriTrust financed the project with a $600,000 second mortgage loan. Currently phase two of Lexington Village is in progress. It consists of more newly constructed multi-family units and involves the six major private lenders in Cleveland.

Central Villa is another project financed by AmeriTrust. Located within the city, Central Villa is made up of 20 newly constructed single-family homes. It is the first new development in the area in decades. Central Villa, like Lexington Village, was developed by a non-profit corporation in partnership with a for-profit development company. AmeriTrust financed the first ten parcels with $550,000 in mortgage loans. Central Villa also has a phase two which consists of 25 additional units and involves three other local lenders.

BANKERS' PERSPECTIVES

Today bank officials are pleased with what they consider the program's successes. Officials expected the bank's deposits and loans to grow by $5 million each within the first two years. They also expected the bank to operate at a loss for the first five operating years. However, the bank's operations over its first two years exceeded all expectations. Deposits reached $11 million while loans reached $20 million by the second year. Moreover at the end of 1987 the bank enjoyed a net operating profit of nearly $150,000. By the end of fiscal year 1988 AmeriTrust had assets of approximately $40 million while earning more than $250,000.[19] Bank officials are also proud of their default rate. When compared to its lead bank's default rate, AmeriTrust's was lower in both residential real estate and small business loans. This points to the fact that the bank maintains strong standards of credit quality in its lending. Although bank officials are pleased with the bank's success, they do acknowledge a small margin of profit. In 1988 AmeriTrust's return on equity and return on assets were 5% and .85%, respectively. This is low compared to targeted industry standards of 15% and 1%. Nevertheless bank officials expect AmeriTrust, based on the premise of local money working for local good, to continue prospering in terms of its profits, volume of business, and default rate.

Bankers at AmeriTrust view the role of the bank as "providing access to debt financing for those traditionally denied the opportunity." In this case that group consists of individuals in low- and moderate-income areas as well as small businesses, minority- and female-owned businesses, and non-profit organizations. They focus on loans which 1.) maintain or increase employment opportunities and 2.) improve or increase the supply of residential housing stock. Through their efforts in community development lending, AmeriTrust officials believe other lending is increased because it has increased the strength and viability of the local investment market. The bank defines success for itself in the following five critical areas:

1. Positive neighborhood impact
2. Positive market feedback
3. Influence in community development arena
4. Leadership among lenders in the field
5. Profitability

AmeriTrust representatives note that community groups and regulators are also satisfied with the program. Community groups, who provide deposits as well as assist in developing new loan products which suit their credit needs, have given significant positive feedback regarding the bank's efforts. They also encourage other lenders in the area to get involved with community development efforts. Regulators, while pleased with the bank's performance, encourage it to provide more detailed documentation of its lending activity.

In terms of affecting other banks, AmeriTrust officials believe exposure to community development lending programs will have the greatest impact. When bankers are exposed to motivations, failures, successes, and operations of their peers who specialize in this area, they will be more willing to move in the same direction. Community groups and regulators also play a vital role in encouraging other banks to do community development lending. By identifying resources from the public sector and other private institutions, community organizations expose banks to partners who can share financial risks. Similarly, regulators can encourage banks through CRA reviews as well as informing the industry about specific community development lending programs and their successes.

4.3 American Security Bank - Washington, District of Columbia

Background and Context

In March of 1986 American Security Bank, a nationally chartered bank in the District of Columbia, established a new lending group within the bank. Bank executives established and designed the new lending group to meet community development credit needs. Unlike some other banks, American Security did not take this action as a response to a CRA challenge. Instead, top bank executives made community development lending a priority for the bank. The bank's chairman of the board and chief executive officer Daniel J. Callahan III provided the necessary leadership. As a native of Washington, Callahan committed himself and the bank to the communities of Washington. Callahan's basis for this strong commitment and leadership is found in his statement that "it is the responsibility of every member of the community to assist in improving the quality of life for everyone in that community . . . . not soley because it is profitable or because it is expected, but because it is also the right thing to do."[20]

Under this kind of leadership, American Security created the Community Development Group in the Real Estate Division. In the beginning only one person coordinated the group. Bank officials viewed the group as a profit center with the purpose of providing loans to projects in D.C. neighborhoods. The group expected projects to be both beneficial to the community as well as economically feasible. Prior to the establishment of the group, American Security hired a new executive vice president of the Real Estate Division who had a great deal of active experience in structuring complex deals. Although previously the bank participated in community development projects, its involvement was not well-known.

PROGRAM DESCRIPTION

The Community Development Group targeted very specific District neighborhoods in which to lend. Its priority was to lend in areas which had "been redlined and suffered from a lack of any substantial private investment for several years."[21] Executives selected this strategy based on the following considerations:

- staff had knowledge of and experience with these neighborhoods and market demand.
- no other lenders were investing in these areas so there was no competition.
- projects would have considerable community benefit since they were developments in affordable housing, retail business, or small business.
- public sector resources would be available since the city also targeted these neighborhoods as community development areas.
- lending would have considerable impact since these neighborhoods provided opportunities for several projects.
- non-profit and minority developers in these areas were committed to community development projects.[22]

In establishing its loans products, the lending group considered both the needs of the targeted areas and the types of developments they intended to finance. Because of these two considerations the group offers a variety of loan products including lines of credit, letters of credit, acquisition loans, pre-development loans, mini-permanent loans, and permanent loans. Mini-permanent loans are a special product particularly geared toward the group's targeted projects. Generally these loans have terms of 3-5 years which allow the developer time to stabilize his or her cash flow from a project. With a stable cash flow, a developer is then able to obtain permanent financing from another lender. Similarly, pre-development loans allow developers to cover costs before construction or permanent financing is available.

Generally the group uses standard underwriting criteria when making loans. Its primary concern is to assess factors which affect cash flow and collateral. In light of this the group calculates the debt service coverage ratio only for the bank's debt; accepts reserves or guarantees as debt service coverage when cash flow is minimal; and views other finance sources as project equity. Additionally, the group does not reject borrowers with little credit history or minimal financial statements. Instead, in these cases, it requires a demonstrated technical capacity to conduct development. All these considerations mean the group finances projects which might not fit the traditional definition of a "viable" project. However, because of its willingness to do such projects, the group has worked with various types of organizations. First, it has close ties to local government agencies, especially those with subordinate loan or rental subsidy programs. Secondly, the group frequently works with major real estate developers who have the capacity to complete larger projects. Thirdly, the group established and maintained relationships with several minority developers and small business owners as well as with a few non-profit organizations. Furthermore, it works closely with investors in the secondary mortgage market. The group brings introduces investors to projects in its early stages in order for the investor to understand how the project is financed and consider purchasing the long-term mortgage

EXAMPLES OF COMMUNITY DEVELOPMENT LOANS

In Adams-Morgan, a gentrifying area of the District, the lending group worked with a community self-help group to turn Champlain Court into a tenant-owned cooperative. Residents feared their apartment building would be converted to condominiums and sought to purchase it. The project involved three city programs which provided the group with a short-term loan for more than $700,000, a long-term loan of $664,000, and rental subsidies once the project was completed. For its part, the lending group provided the project with $1.6 million dollar in loans for rehabilitation and other costs. Champlain Court is now a 20 unit tenant-owned cooperative on a block which now has three other rehabilitation projects underway.

In the Southeast area of the District, the lending group assisted in financing the Buena Vista Apartments Complex. A local non-profit organization, concentrating in building low- and moderate-priced housing, sought to purchase the complex. Although most of the complex was closed for over a year due to all the garbage on the property, the organization felt it could be rehabilitated for low- and moderate-income renters. Both the city and the lending group provided financing; the city issued a $750,000 loan through its rental rehabiliation program while the lending group provided almost $1.8 million in loans. The Buena Vista apartments contain 49 low- and modertely-priced rental units which may be purchased by renters after three years in the complex.

BANKERS' PERSPECTIVES

By late 1987, after only one and a half years in business, American Security executives and the group's staff were pleased with the programs efforts and believe it has been good business for the bank. In that time the group made more than $100 million in loan commitments. More importantly, these loans were located exclusively in the District's inner-city communities. By the end of 1988 the group made almost $200 million in loans. The group's staff also grew to nine members, six of them being loan officers. It's portfolio reflects the types of development the group originally intended to undertake. Housing project developments compose 60% of the group's loan portfolio while projects for retail, commercial, and mixed-use make up 35% of the portfolio. Other activities such as lines of credit account for the portfolio's remaining 5%. During this time the group also enjoyed an outstanding recording in regard to defaults. With over $100 million in loans, the group experienced no foreclosures or problems with delinquent loan payments.

The group's staff has unique perceptions regarding investment. In any neighborhood, only the first loan made is considered "at risk". The group views subsequent loans as protecting its investment given it has already loaned once in the area. Moreover, the group concentrates its loan in certain areas. This is contrary to traditional lending which tries to spread risk by lending in different markets. However, the group believes its concentrated form of lending makes the bank a "responsive corporate citizen and active participant" in community affairs. By doing numerous projects in a single area, it allows the group's projects to have a greater amd faster impact on revitalization in the targeted neighborhoods. Similarly, the group views extra time spent with inexperienced developers as another form of investment. While traditional lenders might not perceive this as cost effective, the group states it builds a clientele of loyal customers who rely on American Security for most of their banking needs. By altering its perceptions about lending and community development, the group has provided millions in financing for community development projects in the District of Columbia.

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[1] *Ibid.*, p.14.
[2] *Ibid.*, p.24.
[3] *Ibid.*, p.25.
[4] *Ibid.*, p.31.
[5] Metzger, John T. and Marc A. Weiss. *The Role of Private Lending in Neighborhood Development: The Chicago Experience*. (Chicago: Center for Urban Affairs and Policy Research, Northwestern University, March 1988), p.34.
[6] *Ibid.*
[7] "First Chicago Neighborhood Investment and Revitalization Program". (Chicago: First Chicago Corporation, March 1989), p.1.
[8] *Ibid.*
[9] "Historical Development of Neighborhood Lending Programs in Chicago". (Chicago: First Chicago Corporation, April 1989), p.1.
[10] "Historical Development of Neighborhood Lending Programs in Chicago", *op. cit.*, p.2.
[11] "Background on First Chicago's Neighborhood Lending Program". (ChicagoL First Chicago Corporation, April 1989), p.1.
[12] "Historical Development of Neighborhood Lending Programs in Chicago", *op.cit.*
[13] U.S. Senate on Banking, Housing, and Urban Affairs. *Community Reinvestment Act*. (Washington: U.S. Government Printing House, March 1988), p.187.
[14] Federal Reserve Bank of Boston Lending Seminar. Excerpt from presentation by Kristin Faust. (Boston: April 1989).
[15] U.S. Senate on Banking, Housing, and Urban Affairs, *op.cit.*
[16] *Ibid.*, p.176.
[17] *Ibid.*
[18] *Ibid*, p.177.
[19] Forde, John P. "There's Profit Amid the Pitfalls". *American Banker*. (Washington: American Banker, March 28, 1989), p.17.
[20] Dean, Theresa J. "Outreach Programs Need Top Leadership". (Washington: American Bankers Association Bankers Weekly,January, 17, 1989), p.5.
[21] Kollias, *op. cit.*, p.20.
[22] *Ibid.*

5. CRITIQUE OF PRIVATE BANK PROGRAMS FOR COMMUNITY DEVELOPMENT LENDING

This chapter describes the differences between the three programs for community development lending and traditional lending programs. It also describes the benefits such programs bring to the field of community development. Lastly, it discusses problematic aspects as well as opportunities for improvement in community development programs.

5.1 DIFFERENCES FROM TRADITIONAL BANK LENDING

Community development lending programs differ substantially from traditional lending programs. These differences are evident in various ways, from how lending is approached to the tenets of underwriting. In traditional lending bankers use safe and sound lending practices for the purpose of making profits. While community development lenders also intend to make profits through safe and sound lending, their priority is to make loans which bring benefits to community residents. In some cases they view this as not only a charter responsibility but also as a social one. This strong sense of responsibility to the bank as well as to the community often engenders an equally strong commitment to make projects feasible.

Another point of difference between these two types of lenders is where they lend. Traditional lenders tend to invest in secure, proven markets which insure a return on their investment. On the other hand, community development lenders purposely lend in markets which other lenders will not touch -- markets where decline and disinvestment have been the norm. Although such markets do not appear as wise investments at first glance, community development lenders make good loans in these areas and have not had problems in terms of their default rates.

Traditional and community development lenders also differ in client and project types. Both groups of lenders deal with for-profit real estate developers. However while traditional lenders focus on this type of client, community development lenders are primarily concerned with attaining non-profit organizations, minority business owners, and small business owners as clients. They are willing to devote the extra time, coordinative efforts, and assistance projects with these groups often require. Furthermore, lenders in community development are more inclined to work with public agencies. Local government programs often provide critical resources to non-profits, small business owners, and minority developers. Subsidies from these programs serve as linchpins in financing community development projects. Community development lenders are committed to such complex deals despite the fact they usually require more time. Ultimately extra time spent on such projects reduces how cost effective they are and, consequently, decreases the final margin of profit. Yet lenders in this field know the extra efforts are what make community development projects work and they are willing to forego some of the profits in order to achieve this.

Project types span a wide-range for lenders in community development. These lenders finance such projects as commercial strip centers; low-income, multi-family rental units; tenant-owned cooperatives; large, single-family unit developments; and rehabilitated apartment buildings. Contrary to this, traditional lenders concentrate on financing individual mortgage loans for single-family homes. Moreover, they are highly skeptical of cooperatives, rehabilitations, and low-income rental housing primarily because they perceive such projects as unduly risky. For this reason, they are extremely reluctant about lending to projects of this nature.

The two groups of lenders also use different means to underwrite loans as well as offering different loan products. In underwriting loans, community development lenders tend to emphasize a project's cash flow in relation to the amount of project debt. For this reason, they finance as much debt as the project's cash flow can support with a comfortable surplus to meet the debt service coverage ratio. Traditional lenders probably would not finance a project with a cash flow sufficient to meet the debt service coverage ratio if, for example, an appraisal valued the project below the total loan amount. For them, a project whose appraisal does not support the total loan amount is not feasible. Additionally lenders in community development acknowledge other sources of financing (i.e., grants, subsidies, other loans) as project income. This increases a project's viability by increasing its overall cash flow and the amount of debt it can support.

Furthermore, community lenders generally do not turn away clients without established credit which frequently happens in traditional lending. Instead they emphasize technical and development experience in these cases. In terms of loan products, community development lenders provide unsecured lines of credit, mini-permanent loans, and construction loans which convert to long-term mortgages. All these products are suited to meet the needs particular to community development organizations. Often with little collateral or no stable cash flow history, projects require lines of credit or mini-permanent loans in order to reach a stabilizing period. After a project achieves stability, it is then much easier to get permanent financing.

In short, lenders in the area of community development express a unique view of lending. They are able to overcome myths and misconceptions of lending in certain communities. They have creative and innovative ways of using traditional underwriting criteria. They demonstrate a new willingness to lend in low- and moderate-income neighborhoods. They are interested in development which meets community needs. For these reasons they differ considerably from traditional lenders.

5.2 Benefits Programs Bring To Community Development

The primary benefit such programs bring to community development is access to investment capital. Generally targeted communities have experienced a high degree of decline and disinvestment. Prior to special lending programs, investors had not been in these markets for decades. Usually lending programs are established with commitments to invest millions in loans. Furthermore, the presence of this investment capital leverages more capital from other sources. Projects financed by these programs frequently involve other investment partners such as local government, other private banks, and private foundations. Without the initial lending program, other investors are much less likely to enter low- and moderate-income communities. This is evidenced by many foundations who require community development groups to garner some private financing as a condition for receiving grants.

Another critical benefit of community development lending programs is meeting community needs. Most of these communities suffer from a declining housing stock, a lack of affordable housing, and a lack of retail business. Lending programs provide financing for community development projects designed to increase rental and homeownership units, maintain housing affordability, and return commercial business to the neighborhood. Additionally, program lenders work closely with community organizations, through which residents have a voice in deciding what type of development will occur and where it will occur. In this way community residents can have significant influence on how their community is developed.

Community development lending also greatly benefits non-profit organizations. More often than not these organizations lack staff with technical and professional skills or development experience. By working closely with lenders who have experience and skills in this field, community organizations increase their ability to conduct development. Moreover, assistance from banks and other developers is often gained at no financial cost to the community organization. This is extremely important since most of these organizations lack adequate funding for administrative and operational costs.

5.3 Problematic Aspects of Programs

Although community development lending brings with it very important benefits, it also has some important potential disadvantages. First, without careful consideration and prevention efforts, community development lending might serve to displace those it is trying to serve. Substantial amounts of redevelopment and reinvestment might drive up rents and/or spur gentrification. Once prices increase, long-time low-income residents of the neighborhood will be forced to move. Similarly, housing developed for low- and moderate-income people through these lending programs might revert to market prices in later years. Lenders must insure that financing is structured to maintain housing at affordable prices. Unless this is done, developers and lenders alike simply serve as mechanisms for increasing displacement, gentrification, and housing costs.

Lenders in this field should also be wary of over-reliance on public sector resources. Vulnerable to political tides, public sector programs may experience sporadic periods of growth as well as cutbacks. If community development lending programs rely heavily on the public sector, they too are vulnerable to potential cutbacks. Drastic cutbacks might cause lenders to greatly reduce the amount of lending or alter the types of projects they do. By only lending to projects in conjunction with local government programs, community development lenders lock themselves into a certain type of project and significantly decrease their ability to function without such programs.

In selecting community organizations to work with, lenders must decide to what degree the group speaks for the community. It is possible for a lending program to miss the real concerns of the community if it only communicates with a select group of community organizations. This is especially true if banks work with only large community groups, who may have become removed from the real needs and concerns of neighborhood residents.

Additionally it is critical to consider the impacts of how a community development lending program is structured. In the case of AmeriTrust, bank executives elected to set up a separate bank which was responsible for community development lending. This strategy separates community development lending from other bank lending. Clearly this negates the goal of incorporating community development lending into the overall structure of a bank and its lending divisions. It also denies community development lending the financial support of other types of lending. Generally community development lending earns a smaller profit than other lending. If it is isolated in a single bank rather than in a lending unit, banks cannot support it with other more profitable lending units. While AmeriTrust does important work in the field of community development lending, the structure of the bank may be detrimental to this field in the long run by isolating it from other types of lending.

5.4 Opportunities For Program Improvements

In order to institutionalize community participation, lending programs should set up a formal structure. Of the three programs in this study, only First National of Chicago had a formal Review Board composed of bankers as well as community members. Having such a mechanism would help insure the program's efforts remain in line with community objectives. Additionally, a formal structure would survive regardless of the presence of key community leaders. In this way concerned residents would have an on-going committee to raise community issues and oversee the bank's lending.

Similarly lenders could form cooperative organizations with a variety of groups. Development associations, civic groups, local government officials, business associations, and community organizations all participate in one or more aspects of development. Like lenders, these groups have a strong interest in the reinvestment in and revitalization of their communities. By forming committees or associations to promote community development, they increase their financial resources; provide partnership to share risk; increase professional and technical capacity; and serve as a system of checks and balances to one another. This is critical to development given that it is a multi-faceted process which affects many segments of the community.

As cited in the case studies, many non-profit and small developers lack adequate technical skills. Although some organizations such as LISC and the Ford Foundation provide some technical assistance, it is not adequate. Lending programs could address this issue in two ways. First, in structuring deals with large developers, lenders could encourage partnership with non-profit and small developers. In this way these developers could gain experience in the field without exposing themselves, the bank, or their partners to an undue amount of risk. Secondly, bank programs could set up a structure in which bank staff members allocated a portion of time to educating and training non-profit developers. Training could consist of seminars or workshops which teach fundamentals of real estate financial analysis and lending. Such efforts would be an investment by the bank in human capital. With more skilled and trained developers in the community, the bank is securing a more reliable and experienced clientele.

6. CONCLUSION

The field of community development involves a host of actors, each with a particular view of its role as well as the role of the others. More often than not these groups find themselves in conflict with each other rather than in partnership. Banks claim community groups ask for too much in terms of providing financing. Bank regulators urge banks to do more in the area of community development yet they are reluctant to strictly enforce reinvestment obligations. Community groups cite regulators as abdicating their role as enforcers and claim banks continue to redline and neglect credit needs of many communities. Local governments call on banks to provide more capital to certain communities while at the same time investing very little of local tax revenues in these neighborhoods. In short, it appears each actor knows exactly what the roles of the others are although each is less clear about its own role. It is in this context that community development takes place.

Banks, as a source of large amounts of capital, play an integral role in community development. They have the financial and technical resources to invest in communities which suffer from years of decline and disinvestment. In turn, their investment leverages capital from other private and public institutions. Because of this great influence, it is crucial for other actors involved in the community development process to encourage the participation of banks. Although banks cannot and should not bear the entire burden of providing resources for reinvestment, their resources combined with those of the other parties can have a tremendous impact on community development.

As stated previously, the process of community development is often not one of cooperation. However, out of this process has arisen a vehicle -- bank programs for community development lending -- which provides the opportunity for the involved parties to coordinate efforts in a cooperative spirit and meet their individual needs. For banks, the programs are beneficial on many levels. First they meet charter obligations as well as legislative obligations (HMDA and CRA) to meet the credit needs from the communities which provide the bank's deposits. Second, the programs generate profits for the bank. Although they are less profitable than other types of lending, the programs have not proven to lose money or bring unusually high default rates on the bank. Moreover the programs make socially responsible investments, which is important to many bank executives as well as bank loan officers. Although in general people might be skeptical of this, they should not underestimate the effect of this ideal on the motivations and perceptions of bankers.

For communities, the programs provide many benefits. First, they address community needs for credit and financing of development projects. Credit and financing which heretofore was not available in these communities. Moreover, they provide a vehicle for community individuals and organizations to work in partnership with banks rather than as adversaries. In this way community groups combine their knowledge of the community and its needs with the bank's financial and technical resources in order to revitalize their neighborhoods.

The programs provide the same type of partnership to local governments. While local governments often target communities for reinvestment, they frequently lack the capital to undertake substantial reinvestment. Through community development lending programs, the banks act as partners to local government in order to leverage more capital than either one could individually. They also allow both parties to decrease their exposure to risk, which makes banks and local governments more willing to reinvest in their communities.

In short, bank community development lending programs are the vehicles by which the actors participating in development can address their common interests, concerns, and goals.

Unfortunately community development lending programs are not widespread in the national banking industry. They are a relatively recent innovation and their existence is not well known. However, there are a few important means of disseminating information on these lending programs and encouraging their establishment by other banks.

First, bank regulators must encourage this type of lending. Regulators have the power to oversee banks and enforce charter and legislative obligations. They must be more strict in their enforcement as well as more suggestive as to programs banks can undertake to meet their obligations. This is not only the role regulators should play but it is in fact what their responsibilities dictate. Officials in local governments have a similar role. City funds are generally deposited in local banks. It is considered a coup for banks to receive these funds as deposits since they are usually very large. In light of this, city officials can use public funds to leverage more community development lending. They can require banks to initiate or further community development lending programs as a condition of receiving public funds for deposit.

The banking industry as a whole, as well as those banks who have established programs, must also disseminate information on community development lending programs. Knowledge of operations, obstacles, and successes of their peers in this area will encourage other bankers to move in the same direction and dispel some of the myths and misconceptions regarding community development lending.

Community groups also have a critical role in promoting this type of lending. For their part, community groups must continue to scrutinize bank lending. When bank lending patterns show discrimination or neglect of certain communities, community organizations must use this information to negotiate with or challenge the bank. For community groups the ability to issue a challenge is a source of leverage over banks. It enables them to push banks in a more progressive direction of lending -- a direction banks might not willingly go without encouragement and/or pressure from community groups.

As community development is a process involving many actors, these same actors are all necessary to promote and encourage -- using both carrots and sticks -- the establishment of bank programs for community development lending. Only by concerted efforts by all parties can these programs flourish and be successful in financing of community development.

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