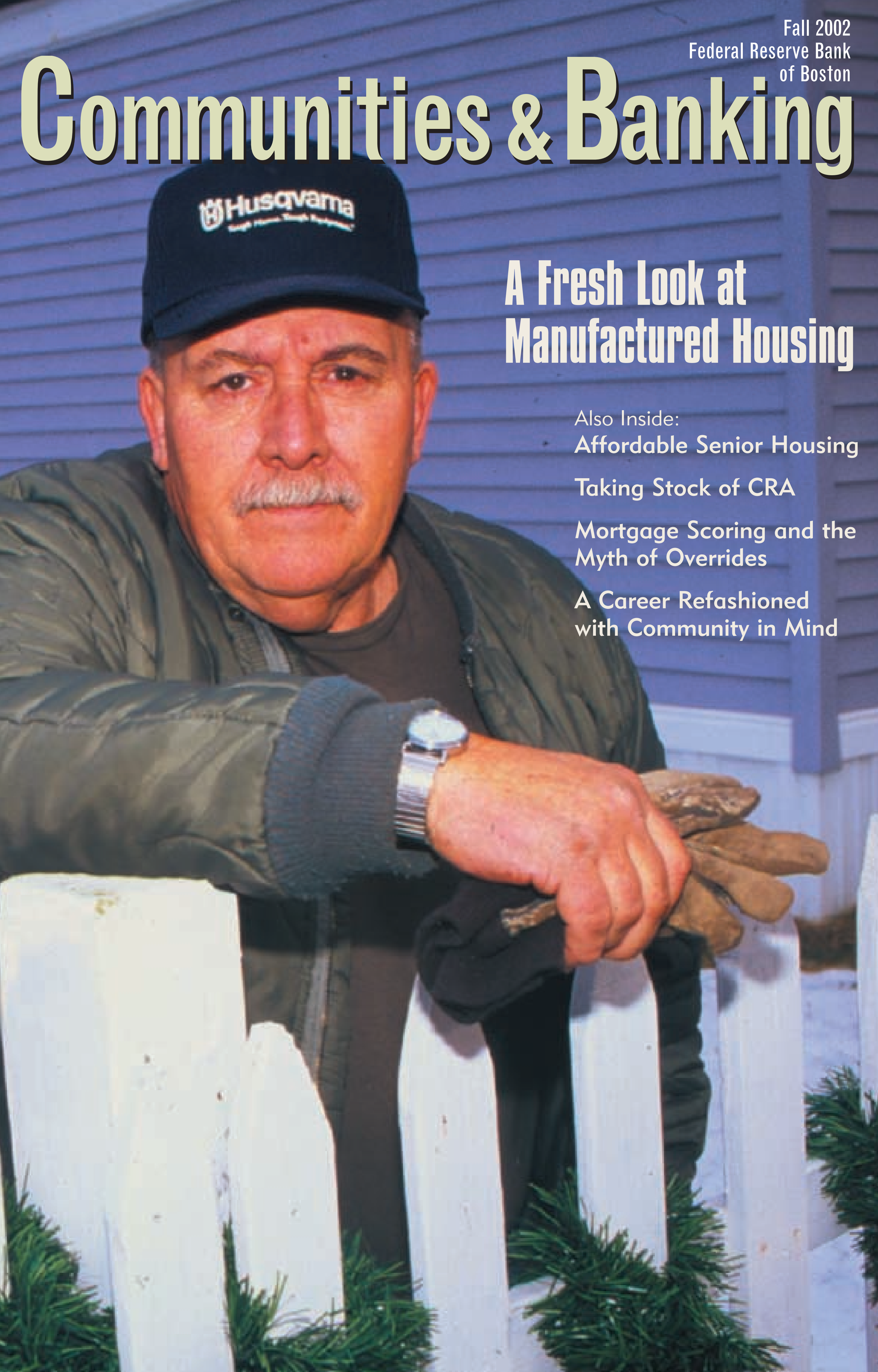
Fall 2002
Federal Reserve Bank
of Boston

Communities & Banking



A Fresh Look at Manufactured Housing

Also Inside:

Affordable Senior Housing

Taking Stock of CRA

Mortgage Scoring and the Myth of Overrides

A Career Refashioned with Community in Mind

Communities & Banking

The mission of *Communities & Banking* is to enhance community and economic development by exploring effective ways for lenders to work with public, private, and nonprofit sectors toward proactive compliance with the Community Reinvestment Act.

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Kristin Kanders

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THIS ISSUE:

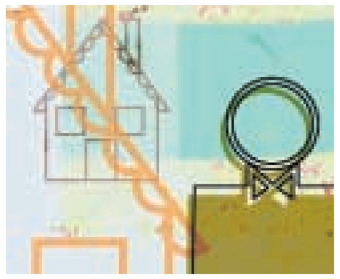
enterprising

Manufactured housing park cooperatives are becoming popular in New Hampshire, and for good reason. Cooperative ownership brings numerous benefits to residents who previously owned a home on rented land. Paul Bradley tells how these cooperatives have grown and explains what is yet to be done.

affordable housing

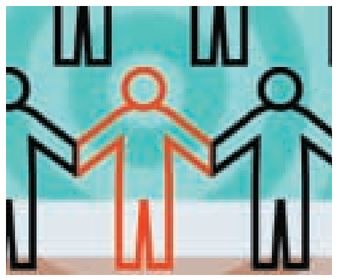
Seniors have particular needs that make finding appropriate and affordable rental housing difficult. With a surge in senior population expected over the next two decades, the housing situation will likely get worse. George Samuels describes how New England is faring.

research review



Over the past 25 years, the Community Reinvestment Act has been found to expand access to mortgage credit. But the banking world keeps evolving. Lending gains were strong during the 1990s, yet disparities still exist. This article provides highlights of an important paper that was produced by Harvard University on CRA's silver anniversary.

banking trends



While many perceive a dark side to the use of overrides in the mortgage underwriting process, Stanley Longhofer of Wichita State University disagrees. This article concludes the five-part series on credit scoring and fair mortgage lending.

first person

Plans change. Elizabeth Hart was in law school preparing for further career development when she decided to launch an independent nonprofit organization to help women move from welfare to work. She's learned a lot along the way, and she uses that knowledge to support women and their families.

On the cover: Jack Lapham, in front of his manufactured home in New Hampshire. Cover photo and photography on pages 6 and 7 by Geoff Forester. Photo on page 3 by Dan Habib. Other photos and images for manufactured housing article courtesy of the New Hamshire Community Loan Fund.

A Fresh Look at Manufactured Housing

By Paul Bradley, New Hampshire Community Loan Fund

In 1984, a real estate transaction in a popular lakeside town in New Hampshire started a transformation in manufactured housing parks around the country. The deal, which included a $43,000 loan from the New Hampshire Community Loan Fund, gave the 13 tenants in the Meredith Trailer Park ownership of the land underneath their homes. It would provide a national blueprint for how tenants in parks could have

Members of New Hampshire's first manufactured housing cooperative, formed in 1984, celebrate their achievement.

some control over their rents, improve their neighborhood, and build a homeownership asset.

The concept was simple: homeowners form a self-governing corporation that buys the land beneath their homes. Homeowners each own one share of the corporation and serve as directors and volunteers to manage it and its community. Sources for acquisition and improvements financing are commercial banks, the Loan Fund, and state and federal loan and grant programs.

In the intervening 18 years, manufactured housing park cooperatives have taken hold in New Hampshire, with 57 resident-owned manufactured housing communities currently representing 12 percent of the state's parks. The Loan Fund has advanced over $15 million to these cooperative borrowers, while conventional senior lenders have loaned them over $40 million. To date, there have been no failures or defaults.

Such news is welcome to residents of manufactured housing parks who know that stabilizing the affordability of their homes is vital, and for whom other moderately priced housing is difficult to find. In New Hampshire, like many states, the availability of low- and moderate-income housing is squeezed by demand that far outstrips supply. Manufactured housing parks, in particular, help to meet some of that demand. Five percent of New Hampshire's housing units are located in the state's 460 manufactured housing parks.

THE BOTTOM LINE: WHAT MANUFACTURED HOUSING IS AND WHY IT DOESN'T WORK BETTER

Factory-built homes produced under the national building code (the "HUD Code") are by law "manufactured housing." A manufactured home arrives on a steel chassis that is an integral part of the structure. By contrast, a modular home – which is also factory-built – is built according to local building codes. In general, a modular home is entirely wood-framed and crane-lifted onto a foundation.

Historically, manufactured housing has been called "mobile homes," or worse, "trailers." Today, there are roughly nine million manufactured homes in use, with nearly one-half of these homes located in investor-owned communities commonly referred to as "mobile home parks" or "trailer parks."

The mobile home and trailer terms reflect the manufactured housing industry's origins in the travel trailer business that developed following World War II. In fact, the manufactured housing industry was started by automobile executives as a way to capitalize on surplus production capacity and Americans' increasing levels of leisure time. To a large degree, manufactured housing's poor performance as an affordable housing resource is a result of the travel trailer industry's morphing into a permanent housing sector without much evolution of the underlying business practices.

These business practices are rooted in three aspects of the travel trailer industry: site rental, merchandising sales, and consumer financing. When campgrounds opened year-round, site space for trailers became rented on a monthly basis, but with few long-term protections for homeowners. Additionally, manufactured homes today are still sold as travel trailers were, with local dealers employing "quick sale" merchandising. And finally, consumers of manufactured housing contend with consumer financing practices that are not as balanced, disciplined, or efficient as those of the mortgage market for stick-built housing. If manufactured housing is to be a housing sector that works for consumers, it's time to rethink these business models and move to more conventional, single-family lending practices.

From its origin in the travel trailer business, manufactured housing has changed dramatically. Its business practices, however, are still stuck in the past.

Looking Closer at "Land-Lease" Communities

Whether in New Hampshire or Texas, manufactured housing parks have a fairly straightforward definition: parcels of land on which two or more manufactured homes sit. What distinguishes manufactured housing parks from other kinds of planned communities is that the millions of Americans who live in these parks are both homeowners and tenants; they own their home and rent their lot from a park owner. The implications of a permanent housing sector based on such a model, whereby residents have equity invested in their home yet lack the economic and legal powers normally associated with homeownership, is fundamentally destabilizing for working and retired people and their families.

Beginning in the 1970s, residents of New Hampshire's manufactured housing parks started facing a new challenge. Increasingly, small, local operators began selling their parks to large regional, national, and international investors. When this happened, homeowners who relied on their rental site for much of their home's value and stability got rocked. While good park operators exist, the industry is home to many troubling practitioners who take advantage of park residents' points of exposure.

Ironically, more often than not, there are no leases in "land lease" communities, and protections that one expects from a lease are nonexistent. People owning a home on rented land are susceptible to three primary risks because of their unique situation.

Excessive Rent Increases
Since homeowners have no real options for relocating their homes once sited, the principle of market rents in parks doesn't hold. Even in the face of excessive rent increases, many homeowners cannot afford to move. Even if they could afford it, few, if any, sites are available to move to.

Health and Safety Violations
Neglect of the infrastructure can mean leaking effluent from septic systems, poor water quality and low water pressure, exposed electrical lines, and all-engulfing potholes. Weak town and state enforcement of such health and safety concerns and homeowners' fear of retribution by the landowner too often keep homeowners from speaking out.

Park Closure
A horrendous surprise exists for homeowners and their housing lenders who discover that the park owner is closing the park. The "highest and best value" analysis is a cold science that, in the case of parks, results in presumably higher returns for one investor and loss of housing for most of the homeowners. Successful lobbying has given New Hampshire park residents an 18-month closure notice; Georgia law only grants 30 days.

Moreover, every time a park sells to a new investor, homeowners effectively absorb higher rents, which pay the new investor's debt and return on equity. A resident of 30 years will have paid for the park two or three times through rental payments. A resident buy-out of the park removes the property from the speculative real estate market and allows homeowners to retire acquisition financing once and for all.

Banks' Role in Financing Cooperative Park Purchases

The resident-ownership model reverses a park ownership model rooted in short-term camping stays to one that is appropriate for long-term residency and asset accumulation among lower-income homeowners. The financial gap between what park residents can raise through the proceeds of selling membership shares and the 75 to 80 percent loan-to-value ratio that a bank will provide has been filled by the Loan Fund in a senior/subordinate debt package.

The leadership and positive experiences of the Loan Fund and the New Hampshire Housing Finance Authority, which helped finance several early cooperative parks, gave banks the confidence that this was a legitimate and safe line of business. Since 1988, New Hampshire's banks, both large and small, have reliably provided first mortgage financing for cooperative purchases. "Cooperative park loans are a good credit for us on a number of fronts — the borrowers have a very good track record and are strong community credits for us," says Tom Potter, vice president of commercial lending for the Bank of New Hampshire. "The Loan Fund is key to this — without their second and their technical assistance, we couldn't do these loans."

POWER OF OWNERSHIP

In the late 1970s, Jack Lapham got a quick lesson in tenant rights. "In my park in Boscawen, NH, the owner gave us 54 days to get out. He did it in the name of a dollar bill. He wanted to build something else there," said the retired police officer.

Lapham had no choice. He sold his home at a huge loss and moved. He swore he'd never live in a manufactured housing park again.

But things change. In 2000, he and his wife moved into a three-bedroom home in Breezy Acres Co-op in Epsom, NH. "Unlike the other park I lived in, we own the land here," said Lapham. "If you own something, it's yours."

The Breezy Acres Co-op was bought by tenants in 1992, with assistance from the New Hampshire Community Loan Fund, a bank, New Hampshire's Community Development Finance Authority, and the New Hampshire Housing Finance Authority. Faulty septic systems and detrimental drainage problems were fixed.

"Parks carry a stigma with them, but if more people were exposed to parks like this one, they'd appreciate how nice and quiet it is," he said. "This is a well-kept secret."

THE NEW HAMPSHIRE COMMUNITY LOAN FUND: A BRIDGE BETWEEN INVESTORS AND SELF-HELP COMMUNITY GROUPS

The Loan Fund was founded in 1983 on two beliefs: that one of the barriers preventing people with low incomes from achieving greater self sufficiency is sometimes a lack of access to credit; and that people and organizations that have (or manage) financial resources are willing to help their neighbors if they have a mechanism to do so. The private, nonprofit Loan Fund was formed to be that mechanism by providing loans and technical assistance to community-based affordable housing and economic development projects in New Hampshire. In 18 years, the Loan Fund has made more than 376 loans totaling $36.4 million.

The Loan Fund also provides technical assistance because, in addition to capital, community groups need customized information and training to reach their goals. For instance, many people would not even begin to organize in manufactured housing parks, believing ownership impossible. The sense of possibility may be the Loan Fund's most important product.

Marking the creation of the 50th resident-owned manufactured housing community in NH, representatives of the Loan Fund, Federal Home Loan Bank of Boston, and Bank of New Hampshire surround Sheila Finch, chair of the Freedom Hill Co-op in Loudon.

While early debt packages included fairly traditional commercial terms, including adjustable-rate mortgages, fixed-rate loans are now the norm. Sensitivity to rate risk is especially strong in cooperative parks as the single source of income is member rents, and it is in everyone's best interest to keep rents stable. In the early 1990s, the Federal Home Loan Bank of Boston began a fixed-rate community development advance for its member banks, thereby enabling commercial banks to offer long-term, fixed-rate loans to cooperatives.

The Challenges and Benefits of Financing Park Cooperatives

On the surface, it is understandable why these projects might challenge conventional lenders: The co-ops have revolving leadership; a property may have infrastructure in disrepair; and the co-op owners are a nontraditional borrower group. Indeed, all are true. Cooperatives establish a democratic framework for resident participation in co-op decisions, they rehabilitate the park itself, and they rely on rent they charge themselves to repay loans and pay expenses. But the difficulties presented by this kind of ownership are also the cooperatives' strengths. In overcoming these challenges, co-ops lead to stronger and more cohesive communities, which benefit everyone.

"We decided to call our cooperative New Beginning — we wanted to change our reputation in town," said a founding member of New Beginning Cooperative in Winchester, New Hampshire. "Before we bought the park, the police would be in the park every day for one thing or another — drunks fighting in the street, domestic violence, kid problems. Now, the police rarely come here — people don't put up with it anymore. We found a new beginning . . . no, we *made* a new beginning."

The Loan Fund provides training and support to all co-op leaders with a front-line staff of five full-time specialists in finance, infrastructure, and organizational development. In addition to one-on-one technical assistance and training, the Loan Fund staff also generates a quarterly newsletter, arranges regional leadership training sessions, and organizes a biannual conference.

Home Loans in Resident-Owned Communities Are an Emerging Market

Housing finance in parks is largely rooted in consumer lending practices and dominated by nonbank subprime lenders. The manufactured housing finance system treats the home as personal property rather than real estate. (For some historical perspective, see the sidebar "The Bottom Line: What Manufactured Housing Is and Why It Is Doesn't Work Better.") This means that the regulatory oversight that would happen with real estate loans is absent from the financing of many manufactured homes; dealer kickbacks and referral fees, for example, are not prohibited. In recently reported cases, these financing deals have included yield-sharing agreements between lenders and dealers, sales-price excesses, and other predatory-like conventions. In addition, distribution networks and merchandising methods remain focused on quick sales and indirect financing.

ENERGIZING A COMMUNITY

Dottie Hillock is sold on the South Parrish Road Co-op in rural Winchester, NH. "I feel very comfortable here," said Hillock, a native of the state's southwestern town. "We all watch out for everyone."

The 58-year-old bookkeeper said that when she first moved to her home in 1989, people kept to themselves. "Everyone paid their rent and was just kind of there."

But when the co-op bought the park in 1992, the neighbors began stepping out – including Hillock. She was elected secretary of the co-op board and then became its president. Since then, she's been tapped by town officials for important town posts, including a seat on the Board of Selectmen. Rents in the co-op are now stable, and major improvements to the water, road, and septic systems are complete.

A community meetinghouse has been established through the co-op's purchase of a former member's home. Volunteers from the park refurbished the home and, with profits from tag sales and bake sales, bought a new refrigerator and stove to support hosting neighborhood functions.

MISSING OUT

In just ten minutes, 140 families living in the Cotton Farm Village Co-op saw their dream of park ownership vanish. They were unable to exceed a rival bid of $3.3 million in a 1999 auction for the property.

"It was discouraging," recalled Guy Pichette, who still lives in the Danville, NH, manufactured housing park. "We had decided we had to keep lot rents at $290 a month. Some people lived on fixed incomes. We couldn't bid more than $3.2 million and keep rents under $300."

Six months later, the park was sold to an investment group from New York. And in a twist, the new owners increased monthly lot rents to $330. "Nobody ever thought the rents would go that high," said the 52-year-old accountant. "We've taken a big hit."

The tenants remain active in case they get another shot at buying the property. "You always have to have hope, I guess," said Pichette. "You just never know what will happen."

Cooperatives steady the land beneath members' homes, but co-op homeowners must still contend with a critical and destabilizing home financing issue: Subprime and other high interest rate lenders control 85 percent of the market. The following statistics tell a story by themselves:

* One in five mortgagers in New Hampshire's cooperative parks pays in excess of 14 percent interest on his or her home loan.

* The median interest rate paid by homeowners in cooperative parks is 11.8 percent.

Furthermore, even though three in ten houses in parks are mortgage-free, home-equity loans for value-enhancing home improvements are not available to manufactured housing owners in parks.

Many homeowners manage to meet their obligations despite these harsh conditions. "We had to pay 17 percent," said one park resident. "We either paid it or we didn't get the house." And as noted by Richard Genz of Housing and Community Insight in "Why Advocates Need to Rethink Manufactured Housing" (*Housing Policy Debate*, 2001), it is unlikely that manufactured housing borrowers are charged higher interest rates because they are inherently a riskier group. In practice, manufactured housing owners are "subprime" because of their housing choice, not because of their credit quality.

To address the lack of reasonably priced home mortgage loans the Loan Fund is beginning a new program founded on the belief that homeowners in resident-owned communities represent a better risk profile than the market recognizes. The Loan Fund's role as a community development lender is to demonstrate the possibilities within targeted lower-income markets and pave the way for traditional banks to increasingly serve this market.

The Loan Fund's new Cooperative Home Loan Program will originate, season, pool, and sell standardized home mortgage loans from resident-owned parks. The program's goal is to introduce single-family loan practices and attract bank capital into a homeownership market that desperately needs and deserves it. The Loan Fund believes it can offer banks CRA-rich manufactured home loan pools that offer an attractive rate of return. Currently the Loan Fund is working with several banks in New Hampshire to structure a collaborative initiative that will take advantage of the Loan Fund's strong consumer ties, market knowledge, and balance sheet to leverage bank capital on a continual basis. The Loan Fund's long-term objective is to see conventional lenders meeting the mortgage loan needs of lower-income homeowners in resident-owned communities.

Resident-owned land and healthy housing finance markets are key elements for making manufactured homes a stable and appreciating source of affordable housing for working and retired citizens. New Hampshire's cooperatives are proving it is possible, one locally controlled community at a time.

Paul Bradley is vice president and program manager for the the New Hampshire Community Loan Fund's Manufactured Housing Park Program. For more information, you may contact him at pbradley@nhclf.org or at 7 Wall Street, Concord, NH 03301. His organization's web address is www.nhclf.org.

REJECTING MINIMUM STANDARDS

Shirley Hooker has lived in the same Tilton, NH, location since 1975. She's seen a lot of changes. "When I first moved here the lot rent was $50 a month. But it kept going up, close to $200 before we bought the park in 1993," said Hooker, former treasurer of the Windy Hill Housing Co-op.

The 77-year-old massage therapist says the previous owner did little to maintain the park. "Everything was minimal," she said. "He used the cheapest materials and that's why everything kept breaking."

But tenants got a break in 1993. They beat out a competing buyer to purchase the 48-site community with loans from the Loan Fund and a local bank. In nine years, lot rents have increased once – by five dollars. At the same time, roads have been repaved, water systems improved, and septic systems replaced.

"The co-op is such a wonderful idea," said Hooker. "That we have low-cost living is such a nice situation."

New England's Share of a Quiet Crisis

By George Samuels, Federal Reserve Bank of Boston

On a warm September day in the small village of Barton, Vermont, the phone rings in Paul LaFontaine's office. It's a caller from Florida, inquiring about whether any apartments are available for rent. Unfortunately, none are. LaFontaine, 73, is manager of Barton Chamber Apartments, one of the largest providers of subsidized housing for seniors in northern New England's rural areas. He laments the 50-person waiting list for the 47-unit complex, and says, "If I could do it again, I would have built one of those skyscrapers like you see in the city."

The shortage of affordable housing, evident in northern Vermont and elsewhere in the nation, is nothing new. But the urgency of affordable rental housing for seniors, those 65 years and older, moved to center stage with the June 2002 release to the U.S. Congress of a report entitled "A Quiet Crisis in America." Produced by the bipartisan Commission on Affordable Housing and Health Facility Needs in the 21st Century (the "Seniors Commission"), the report finds that many seniors not only face a dire affordable rental housing situation, but also often lack the health and support services they need as they age.

Paul LaFontaine, top, with his assistant Pauline Sinon. Below, Katherine Sample, 86, is a tenant of Barton Chamber Apartments, where she has been living for 12 years.

While many recommendations in the report were developed by the entire Seniors Commission, six of thirteen commissioners signed a minority report calling for a more aggressive targeting of federal resources and programs to the neediest seniors. As Ellen Feingold, co-chair of the commission and a signer of the minority report, says, "We agree with much of the material in the majority report, but wanted to stress what we found to be the most desperate need, and that was a shortage of housing and support services for low- and moderate-income elderly." In many cases, lower-income seniors are unable to pay for decent housing or support services, and go without them. In light of the "Quiet Crisis" findings, this article takes a closer look at affordable rental housing for seniors in New England. (The majority and minority reports are available at www.seniorscommission.gov.)

"Demand is outpacing the supply of affordable and physically accessible elderly rental housing."

Senior Affordable Housing Needs

Roughly 20 percent of seniors are renters. They face many of the same issues as working families and others who try to access affordable rental housing, but their situation can be more severe. Many seniors have physical needs that require special housing modifications (such as bathroom grab bars or ground-level living) or easy access to healthcare and support-service networks. Andrew Kochera, researcher at AARP's Public Policy Institute, notes, "Demand is outpacing the supply of affordable and physically accessible elderly rental housing. Through our studies we have found that oftentimes conventional architecture does not meet the needs of older persons. As the elderly age, their needs evolve. Our spaces must take into account their changing needs."

Further, many senior renters face serious cost burdens, ruling out care-coordinated housing such as assisted living, which is designed for aging in place. According to *Housing America's Seniors*, a report by Robert Schafer of Harvard University's Joint Center for Housing Studies, over one-half of all senior renters spend more than 30 percent of their incomes on housing costs. A 1999 study by AARP found that the median income of senior renters was \$12,608, while their median annual housing costs were \$5,772. The cost burden issue is especially significant for seniors because many live on modest fixed incomes. As housing prices continue to rise, the number of seniors with housing cost burdens can be expected to grow.

State of the Current Stock

Nationwide, there are an estimated 1.7 million units of subsidized rental housing for seniors. According to the Council for Large Public Housing Agencies, the largest population of seniors in such housing, nearly one million, live in public housing. Close to 70 percent of this group live in public housing units that are 30 to 50 years old, and many units need modernization. Public housing authorities in some of New England's cities report lengthy waiting lists and long average waiting times for units. (See table below.)

Senior Public Housing Units and Waiting Lists
Selected New England Cities

HOUSING AUTHORITY CITY, STATE	NUMBER OF SENIOR UNITS	NUMBER ON WAITING LIST	AVERAGE WAIT (MONTHS)
Boston Housing Authority Boston, MA	3,820	1,970	18
Manchester Housing Authority Manchester, NH	876	600	12–18
Providence Housing Authority Providence, RI	398	96	6–8
Burlington Housing Authority Burlington, VT	209	98	6–9

Source: Data gathered from phone conversations with public housing authority occupancy staff in September 2002. Public housing authorities keep their own statistics on waiting lists and average wait time. Seniors in public housing include those aged 62 and above; some counts above include disabled persons below age 62.

“If we cannot **preserve** what we have, we will never be able to **meet the need.**”

Other subsidized rental housing programs also show long waiting lists. For example, a 1999 survey by AARP found that there were nine applicants for every unit of Section 202 housing (the federal government’s principal subsidized housing program for seniors, see resources section on pages 12 and 13) that became available. Says Kochera, whose department funded the survey, “Vacancy rates for these programs are very tight – significantly lower than rates for market housing. This is key because waiting time is important, as elderly needs may change during the wait.”

Need Will Increase

Waiting lists may get longer, as a large portion of the current public stock is in disrepair and at risk of being converted to market-rate housing. Moreover, production levels of new housing have fallen, mainly because federal funding has decreased. And finally, the senior population is expected to surge in the next two decades.

Thousands of subsidized units for seniors are in jeopardy of being converted to market-rate housing. Much of this housing was created in the 1960s and 1970s using 40-year contracts between the federal government and property owners. Under these contracts, owners can prepay their mortgages before the contract is up, or can “opt-out” of the agreement once the contract expires. With market prices climbing across the country, many owners are deciding to convert their affordable developments to market-rate housing. As Feingold notes, “The preservation issue is the most important. If we cannot preserve what we have, we will never be able to meet the need.” In New England, some 1,067 rental units of subsidized senior housing have been lost in recent years, and over 30,000 units are at risk. (See table at right.)

To mitigate the situation, the Department of Housing and Urban Development (HUD) has designed a number of programs to stem the flow of lost units, including the 1999 Mark-Up-To-Market program. This program subsidizes tenant rents up to the market-rate level, as long as owners agree to extend their current Section 8 contracts for at least five years. Unlike previous Section 8 contracts, owners can keep all the surplus cash flow from the properties, giving them further incentive to keep properties affordable. It is unclear how many total units have been saved under Mark-Up-To-Market, but with owners able to receive payments comparable to market rents, more owners may choose to participate.

Collaboration is crucial in making such stopgap measures work, as an example from Boston’s Jamaica Plain neighborhood illustrates. In September 2002, City of Boston and HUD officials negotiated a deal with the owner of the Forestvale Apartments in Jamaica Plain to keep units affordable. The owner’s Section 8 contract was expiring, and he was planning to “opt-out” and raise rents. Tenants, especially older ones who had lived at Forestvale for many years, complained for months about having nowhere to go. City and HUD officials worked out an eight-year contract extension to keep close to 85 percent of the units affordable. The agreement also included higher rent subsidies for the owner.

Production of new housing for low- and moderate-income seniors is dependent on funding from the federal government, through programs administered by the Department of Agriculture and the Department of Housing and Urban Development. While the Department of Agriculture’s housing program budget has remained relatively stable over the past two decades, HUD’s budget for housing subsidies has decreased substantially in real dollar terms. According to a 2000 *Housing Policy Debate* study by Peter Drier of Occidental College, HUD’s housing subsidy budget fell 83 percent from 1978 to 1997, from $72 billion to $12 billion, using 1997 constant dollars.

Likewise, production levels in senior housing development programs are down. For example, production in the Section 202 program decreased from nearly 14,000 units in 1981 to about 7,000 units in 2001. Fiscal year 2002 shows a further decline, to less than 6,000 units.

Over the next two decades, as the U.S. senior population balloons, the need for affordable senior housing is likely to increase. By the year 2025, the number of seniors is projected to grow by more than 80 percent, whereas the entire U.S. population should increase by only 20 percent. According to the 2000 Census, 35 million, or one in eight residents is a senior, and in New England the proportion is one in seven. By 2025, over 62 million, or one in five residents nationwide and in New England will be a senior. (See table on page 12.)

This extraordinary expansion is fueled by the aging baby-boomer generation and longer lifespans. Data from the Center for Disease Control’s National Center of Health Statistics show that someone who is currently 65 years old can expect to live for another 18 years.

Building Affordable Senior Rental Housing

The Seniors Commission report estimates that by 2020, an additional 730,000 subsidized rental units will be required to house the burgeoning senior population. The minority report, claiming that this figure only maintains the status quo, calls for the development of 60,000 units per year, or 1,080,000 units by 2020. Meeting this goal would require a major increase in federal funding in programs such as Section 202, which remains the main tool for developing affordable senior rental housing. Despite this, the current administration’s proposed 2003 budget shows a decrease in funding for this program.

In recent years, mixed financing – combining funds from different housing development programs – has been the primary vehicle for developing all kinds of affordable housing. Yet technical rules in the Section 202 program prevent nonprofit developers from combining 202 funds with other federal funding resources. For example, the Section 202 program currently provides development grants solely to nonprofit sponsors of senior housing. This arrangement makes it difficult to mix Section 202 funds with equity from the Low-Income Housing Tax Credit (LIHTC) program, as tax credit deals require a for-profit owner that can use the credits to offset tax liability.

Fortunately, mixing Section 202 and LIHTC funds will soon be possible. Under the American Homeownership Act of 2000, limited partnerships that have a nonprofit sponsor as their sole general partner became eligible for ownership of Section 202 properties. As a result, Section 202 sponsors can benefit from LIHTC equity because the other partners in the limited partnership can use the credits. Proposed rules for mixed financing under the Section 202 program were scheduled for release in September 2002 and, as of this writing, are expected soon.

Coordinating Services

In addition to advocating for greater production and preservation, the Seniors Commission urges coordination of housing, health, and support services in government-subsidized elderly housing programs. Under the current system, housing services and health and support services are provided by separate federal departments. These departments use their own eligibility standards, with the result that some tenants of senior subsidized housing are not receiving health or support services. As Kochera notes, “We found that the issue of coordinated housing and support services was key. . . . There’s not a lot of linkage at the federal level.”

To counter this, many managers of subsidized housing for seniors foster

Subsidized Senior Rental Housing Units
Lost, At-Risk, and Current Totals

STATE	LOST	AT-RISK	CURRENT TOTALS
Connecticut	209	5,938	15,536
Maine	232	822	5,909
Massachusetts	342	21,648	37,616
New Hampshire	284	956	4,655
Rhode Island	0	1,384	12,022
Vermont	0	228	2,458
New England	1,067	30,976	78,196
United States	11,204	324,001	711,829

Source: National Housing Trust (2002) report prepared for the Seniors Commission. This report can be found at www.seniorscommission.gov.

A Model Development with Just One Problem

Developments of Jewish Community Housing for the Elderly (JCHE) provide seniors with the opportunity to age in place, in an environment where they can access health and support services. As Ellen Feingold, president of JCHE and also of the Seniors Commission, notes, “Growing older does not have to mean growing more sedentary. Our buildings are full of life.”

In total, JCHE owns and manages five senior developments in Massachusetts, three located in Brighton, and two in Newton. The developments house some 1,300 tenants, with an average income of less than $10,000. Tenants are aged 62 and above, with an average age of 80. Tenants benefit from numerous on-site amenities and support services that assist with housekeeping, meals, transportation, and fitness. Tenants also are fortunate that JCHE has links with local nonprofits that provide further support services on a daily basis.

The developments were built over the past three decades, with financing from several federal and state sources including Section 202 and the Massachusetts Housing Finance Agency. JCHE has received numerous awards for its senior housing programs, and was recently recognized by the American Association of Homes and Services for the Aging.

The problem? There is a tremendous need for more of this kind of housing. Feingold wants to develop more, and says that her organization is currently looking for a site to build another development. Open locations in the Boston area, however, are scarce and expensive. The other option, renovating an existing building into senior housing, can also be costly because of code requirements. In the meantime, the waiting list continues to grow. Over 1,800 people are currently waiting for JHCE housing, with an average wait of two to six years.

Senior Population Figures
Current and Projected

STATE	YEAR 2000 TOTAL POP.	YEAR 2000 SENIOR POP.	YEAR 2000 PERCENT SENIOR	YEAR 2025 TOTAL POP.	YEAR 2025 SENIOR POP.	YEAR 2025 PERCENT SENIOR
Connecticut	3,405,565	469,287	14	3,739,000	671,000	18
Maine	1,274,923	183,642	14	1,423,000	304,000	21
Massachusetts	6,349,097	859,601	14	6,902,000	1,252,000	18
New Hampshire	1,235,786	148,039	12	1,439,000	273,000	19
Rhode Island	1,048,319	152,719	15	1,141,000	214,000	19
Vermont	608,827	77,295	13	678,000	138,000	20
New England	13,922,517	1,890,583	14	15,322,000	2,852,000	19
United States	281,421,906	34,991,753	12	337,815,000	62,641,000	19

Source: U.S. Census

collaborations, where possible, with outside, often nearby organizations to provide support services. While this improvised solution can work and is relatively low cost, the lack of linkages in rural areas is problematic. In particular, rural areas often do not have support service networks in their vicinity, nor the transportation resources to get to them. Such is the case in Barton, Vermont, at the development managed by Paul LaFontaine.

The average annual income for tenants of Barton Chamber Apartments is under $11,000, and many receive rental subsidies. While some of these tenants have arrangements with outside providers for meal service, as a whole, the residents lack transportation and personal-care services. The village of Barton (population 1,400) provides emergency services, but to visit their doctors, many tenants must take a cab to the hospital 15 miles away. Tenants also make a five- to ten-minute walk to do their shopping and other chores. For LaFontaine, health and safety concerns raised by such a situation are even more pressing because the average tenant in his development is 80 years old.

LaFontaine is pleased that his tenants enjoy their apartments, but he is concerned that increasing demand for units and services will require more action on the part of the community and, ultimately, more support from state and federal programs. His message, which echoes the findings of the Seniors Commission, deserves attention. The Seniors Commission warns of an impending crisis in housing and caring for our nation's seniors, but it's possible the crisis will prove to be less overwhelming if we start to address the problem now.

George Samuels is a community affairs supervisor with the Federal Reserve Bank of Boston.

Selected Resources for Financing Affordable Senior Housing

Federal Resources

Section 202
Enacted under the 1959 National Housing Act, Section 202 Supportive Housing for the Elderly is the only federally funded housing program that targets older persons. Currently, the program provides capital grants to nonprofit developers for the construction of units for seniors. Production levels peaked in the early 1980s at about 14,000 units per year. For fiscal year 2003, there is enough funding for nearly 6,000 new units.
Total Units: 319,502
Senior Units: 319,502

Section 515
Administered by the Rural Housing Service of the U.S. Department of Agriculture, Section 515 is a below-market interest rate loan program that provides financing to developers for the construction of low-income housing in rural areas. Section 515 is still in operation, but funding for the production of units has decreased in recent years.
Total Units: 453,275
Senior Units: 190,829

Section 8, Tenant-Based Rental Assistance
Enacted in 1974, this program provides rent subsidies to property owners who provide housing to Section 8 recipients. In its current form, tenants use vouchers to secure housing on the private market. The federal government pays the difference between 30 percent of the tenant's income and the fair market rent, a standard based on the rent for comparable units in the geographic area.
Total vouchers: 1,420,000
Senior vouchers: 213,000

Low-Income Housing Tax Credit
Enacted under the Tax Reform Act of 1986, the Low-Income Housing Tax Credit (LIHTC) program is currently the premier vehicle for building low-income housing. The LIHTC program is funded through the Internal Revenue Service and is administered by state housing agencies. Investors provide equity to a project by purchasing credits from the developer that they can use to offset their tax liability.

Production peaked in 1989 at about 130,000 units and is now under 60,000 units a year. According to the National Low Income Housing Coalition, however, the dollar volume of housing credits has increased by 40 percent over the past two years. Credit allocation is based on state population, with each state now receiving $1.75 per capita in housing credit allocation each year, up from $1.25 per capita. Credit amounts will be indexed for inflation starting in 2003. For equity distribution among states, small states now receive a minimum annual allocation of $2 million.
Total Units:* 433,427
Senior Units:* 108,357
* The numbers above are for units produced using LIHTC subsidies without other federal subsidies. An additional 290,000 LIHTC units are subsidized through Section 8 or Section 515. Around 72,000 of these are occupied by seniors.

HOME Investment Partnership Program
Begun under the Cranston–Gonzalez National Affordable Housing Act of 1990, the HOME Investment Partnership Program is a federally funded block grant program for the development of affordable housing. Funds are distributed to state and local jurisdictions and can be used for rental assistance and homeownership opportunities. Participating jurisdictions are required to provide at least 25 percent in matching funds.
Total Units: 125,100
Senior Units: 20,016

Community Development Block Grants
Started in 1974, the Community Development Block Grant program provides grants to state and local governments to support an array of community and economic development activities. Funds are used to improve neighborhood facilities and revitalize areas; they can be used for senior housing, senior centers, and support services such as transportation.

Government Sponsored Enterprises
Government Sponsored Enterprises — Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLB) — can be useful sources for financing development of affordable senior housing. Since 1989, the Federal Home Loan Banks have been required to dedicate 10 percent of their annual net income to the Affordable Housing Program. The AHP was enacted by Congress, and awards funds on a competitive basis to affordable housing projects that are sponsored by FHLB-member institutions working with community-based nonprofit partners. According to the National Low Income Housing Coalition, the FHLBs have leveraged nearly $22 billion in affordable housing investments, creating close to 313,000 affordable housing units.

Since 1992, both Fannie Mae and Freddie Mac have had annual affordable housing goals that are established, monitored, and enforced by HUD. According to the Seniors Commission, Fannie and Freddie have provided commitments on affordable housing projects, but mainly those using the Low Income Housing Tax Credit. Fannie has also been a significant purchaser of tax credits.

State and Local Resources

Affordable Housing Trust Funds
One noteworthy state and local program is the affordable housing trust fund. Many cities, counties, and states form housing trust funds by dedicating public funds to support the production and preservation of affordable housing. According to the National Low Income Housing Coalition, there are close to 257 housing trust funds in the United States. Thirty-six states have created these funds, the remainder have been set up by cities and counties. NLIHC estimates that housing trust funds spend more than $500 million on affordable housing annually, and have, on average, leveraged an additional $2.5 billion to $5 billion in public and private capital.

Multifamily Housing Bonds
State and local governments sell tax-exempt Multifamily Housing Bonds to finance the construction of low-income housing. Investors buy these low-interest rate bonds because income from them is tax-free. The federal government caps the amount of bonds that can be issued by each state. Currently, the cap is $75 per capita, with a $225 million minimum per state.

Multifamily Housing Bonds have provided financing to produce more than 750,000 apartments affordable to lower-income families. It is not clear how many of these units are occupied by seniors. Multifamily Housing Bonds are a part of the Mortgage Revenue Bond Program. The cap for each state also includes bonds for financing single-family homes for first-time homebuyers. Nearly 2.3 million families have become homeowners under the program.

In the Count

Additional units are not being added to the stock listed below because the programs have been discontinued. However, some rehabilitation and replacement is ongoing; renovation and preservation are issues with these units.

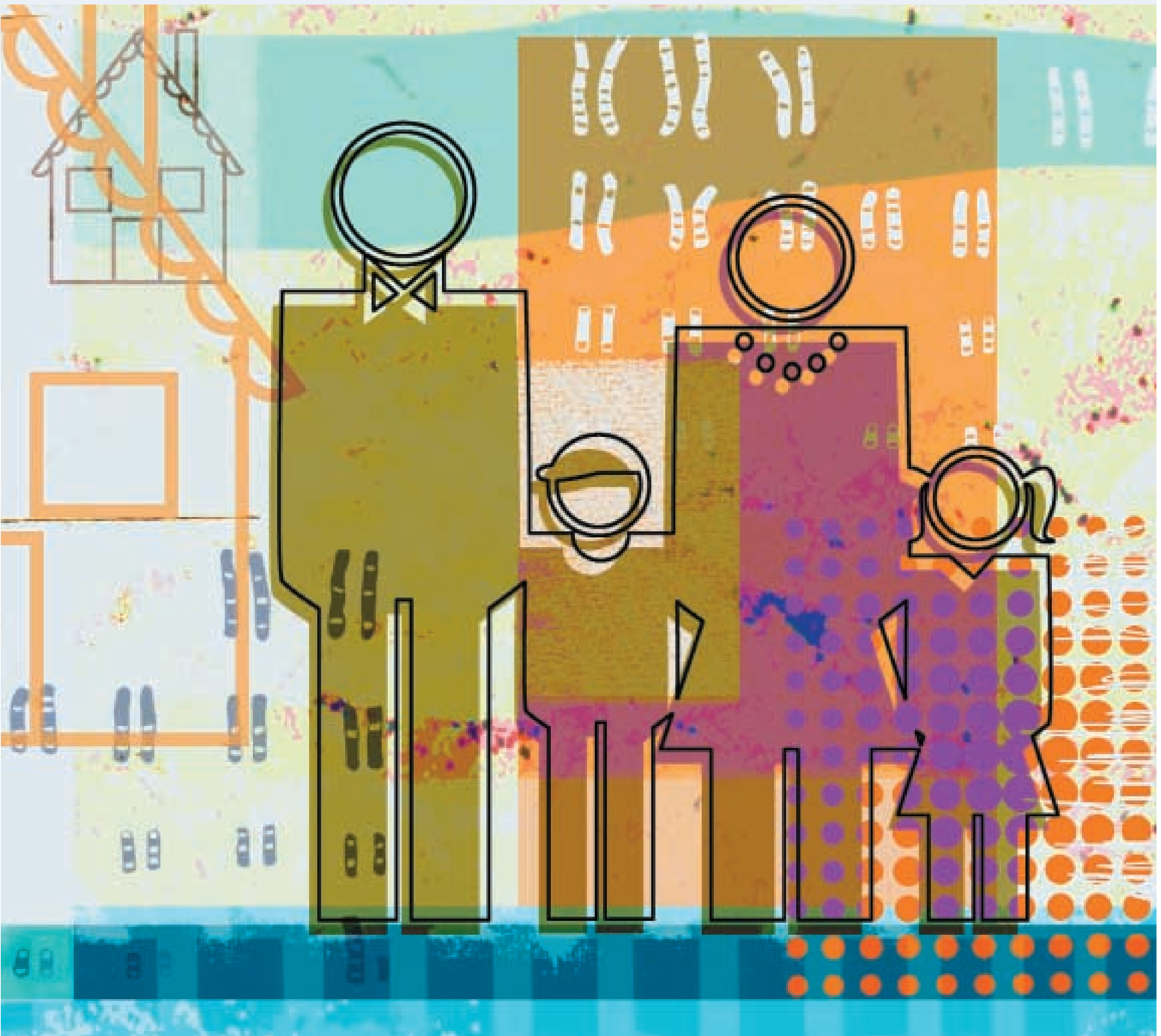
Federal Housing Program	Senior Units
Public Housing	358,400
Section 8 (project-based)	343,673
Section 221	21,437
Section 236	146,053

Note: Housing units cited above are national figures and are from a 2002 report entitled, "A Summary of Federal Rental Housing Programs." Visit http://research.aarp.org/il/fs85_housing.html for a copy of the report.

Taking Stock of CRA

By Julia Reade, Federal Reserve Bank of Boston

This spring, the Joint Center for Housing Studies of Harvard University released a report that reviewed the strengths and weaknesses of the Community Reinvestment Act over recent years. The authors have two main conclusions. First, the Community Reinvestment Act (CRA) does have its intended effect of expanding access to mortgage capital. Second, fewer and fewer mortgages are covered by CRA regulations, and this has eroded the impact of CRA. The Joint Center report stresses that CRA modernization is an important policy debate and offers broad suggestions for reform. (The full report, "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System," is available at www.jchs.harvard.edu/crareport.html.)



CRA was enacted 25 years ago to increase access to capital for traditionally underserved populations. Concern existed that banks accepted deposits from households in low-income communities, but refused to subsequently grant adequate credit to those households. Under CRA, depository institutions are encouraged to have active lending in the areas where they operate.

CRA has been successful in opening up lending to underserved populations. Recent dramatic consolidation in the banking industry and a large rise in lending by nondepository institutions, such as independent mortgage companies, however, have many concerned that CRA is becoming less effective. The Joint Center report addresses these concerns by analyzing trends in Home Mortgage Disclosure Act data between 1993 and 2000, the period with the most recent and highest quality data. The analyses are complemented by extensive qualitative interviews.

Homeownership and Lending to Underserved Populations

During the 1990s, many individuals in historically underserved populations became homeowners. Likewise, the highest gains in mortgage lending were to these low-income households, low-income communities, and minorities.

Lending to lower-income people and communities grew an impressive 77 percent during the time period. Though this is a dramatic increase, lending to higher-income people in higher-income communities rose 43 percent. The share of home-purchase loans that went to lower-income people and communities rose to 36 percent. However, the bulk of loans (64 percent), still went to higher-income people in higher-income communities. (See Table 1 below for a detailed breakdown.) Lower-income communities also experienced higher levels of house price appreciation and housing turnover than higher-income communities. Both of these conditions are consistent with increased access to mortgage lending.

Minorities also experienced dramatic gains in lending. Home-purchase loans to Hispanics surged 140 percent; for blacks, the increase was 94 percent; and for other minorities, the gain was 92 percent. Meanwhile, lending to whites rose 27 percent. The minority share of home-purchase borrowers grew from 17 percent in 1993 to 25 percent in 2000.

Despite these gains, concern about disparities in lending to underserved populations is still warranted. In metropolitan areas, 35 percent of all households live in low-income neighborhoods, but these neighborhoods receive only 13 percent of mortgage loans originated. Disparities also exist by race and ethnicity. Homeownership rates in 2000 were nearly 75 percent for whites, but less than 50 percent for minorities.

The CRA Effect

As noted in the Joint Center report, CRA may have led to some of these lending gains. However, these increases may have also stemmed from a strong economic situation, new lending products, growth in the secondary mortgage industry, technological advances in mortgage lending, fair housing and lending enforcement, and a rising number of government-insured loans, among other things.

The report attempts to control for some of these influences to gauge CRA's effect. The authors' technique is to break loans into three types, described below, and to see if lending patterns differ across the groups. If the current economy dictated all the changes in lending patterns, then lending in each of the three groups would probably be affected similarly. If lending to lower-income households or areas is stronger for loans covered under CRA, it suggests that CRA is having an impact.

Table 1: More Lending to Low-Income People and Communities

Lower-income people and communities have seen the highest gains in originations of home-purchase loans. Despite the dramatic growth, these loans still make up a small share of the total number of loans.

POPULATION	PERCENT RISE IN HOME PURCHASE LOANS 1993 TO 2000	PERCENT OF TOTAL LOANS IN METROPOLITAN AREAS 2000
Lower-Income People in Lower-Income Communities	94	6
Higher-Income People in Lower-Income Communities	79	7
Lower-Income People in Higher-Income Communities	72	23
Higher-Income People in Higher-Income Communities	43	64

Source: Joint Center Enhanced HMDA Database. "Lower-income borrowers" are defined as families with less than 80 percent of the metropolitan area median income. "Lower-income communities" are defined as census tracts with median family income less than 80 percent of the metropolitan area median family income.

The three groups of loans used to determine whether CRA has an effect come from both CRA-regulated lenders and nonregulated ones. CRA-regulated lenders include banks and savings associations with deposits insured by the Federal Deposit Insurance Corporation. Loans made by these institutions fall into two of the three groups: loans made inside assessment areas (these loans get detailed reviews by regulators), and loans made outside assessment areas (these loans get "scant" reviews by regulators). The third group of loans represent lenders not regulated by CRA. (As such, these loans are not reviewed.) Nonregulated lenders include independent mortgage companies, credit unions, consumer finance companies (such as credit card issuers), and mortgage company subsidiaries of insurance, financial services, and home building companies.

What Works

The Joint Center report states that CRA does expand access to mortgage capital. CRA-regulated institutions have measurably different lending patterns than they would have if CRA did not exist. One indication of this is that CRA-regulated institutions originate a higher proportion of loans to lower-income people and communities than they would if they were not under CRA. Another sign is that CRA-regulated institutions have lower denial rates for low-income people and low-income areas than other institutions. In qualitative interviews with lenders, CRA-regulated institutions said that CRA did not directly affect their business plans, but affected them "at the margin."

The researchers found important differences in CRA-regulated lending for different kinds of loans. As shown in Table 2, CRA-regulated institutions have a higher proportion of their prime conventional mortgage loans going to low-income people and low-income areas than other institutions do. CRA-regulated lending is particularly strong in providing prime conventional lending to disadvantaged minorities.

Less than one-third of mortgages are covered under CRA, and that share is shrinking.

In some metropolitan areas, less than one-tenth of mortgages are covered.

The report emphasizes that the loans deserving attention are prime conventional loans. It argues that government-backed loans do not provide a good measure of how banks lend in their assessment areas. Government-backed loans are considered "pass-through operations" which are immediately resold to the secondary market. In addition, these loans have "noticeably different" costs and associated fee structures. The authors summarize that "CRA-regulated entities continue to lead others in extending prime conventional loans to lower-income people and communities, an outcome that was envisioned in the enactment of CRA more than two decades ago."

Table 2: Regulation Has an Impact

This table shows the share of conventional prime loans that went to lower-income people and communities by race and ethnicity during 2000. Loans made to minorities within assessment areas (AAs) by CRA-regulated organizations are most likely to serve low-income people and communities.

POPULATION	CRA REGULATED ORGANIZATIONS		NON-CRA REGULATED ORGANIZATIONS
	Within AA	Outside AA	
Whites	29	26	26
Blacks	61	44	41
Hispanics	54	43	39
Other	26	23	23
All Races	31	26	26

Source: Joint Center Enhanced HMDA Database.

What Does Not Work

While CRA may benefit underserved populations, its relevance is decreasing. Less than one-third of mortgages are covered under CRA, and that share is shrinking. In some metropolitan areas, less than one-tenth of mortgages are covered. The authors also conclude that CRA currently has a "minimal" impact on lending in rural areas.

Surprisingly, CRA offers the least protection for populations it was created to serve. About 25 percent of refinance loans to lower-income borrowers and communities are covered, but for higher-income borrowers and communities, the coverage is nearly 35 percent. Coverage gaps disfavoring lower-income borrowers and communities also exist for home-purchase loans, but they are much smaller.

Minorities also have lower levels of CRA coverage. For home purchases, about 32 percent of loans to whites are covered under CRA; for Hispanics, only 26 percent are covered; for blacks, just 23 percent are covered. Gaps in coverage for refinancing are even larger: CRA covers 36 percent of loans to whites, 32 percent of refinance loans to Hispanics, and 21 percent of refinance loans to blacks.

Some of these gaps are due to CRA's differential coverage of loan types. For example, 25 percent of all refinance loans are subprime, but less than 5 percent of subprime refinance loans are covered by CRA. Because nearly one-half of refinance loans originated to blacks are subprime, blacks are disproportionately affected by CRA's low coverage of subprime lenders.

What Happened?

When CRA was passed, thrifts and local banks dominated lending, but their influence has been waning. In the past decade, independent mortgage companies and other lenders not regulated under CRA have grown rapidly. In addition, patterns of lending for CRA-regulated institutions have changed, which, in turn, affected the number of loans covered by CRA. The relaxation of interstate banking laws has allowed banks to greatly expand lending outside traditional local areas. This has led to CRA-regulated institutions making increasing numbers of loans that are not tightly reviewed under CRA. The report states that such outside assessment-area lending is currently the fastest-growing type of mortgage lending.

What Now?

CRA could be modified by two broad approaches. The Act could be extended to regulate a larger share of mortgage lending, a traditional focus of CRA. One way of doing this would be to expand coverage to include institutions that have not been covered before, such as independent mortgage companies. Another way would be to increase the breadth of CRA coverage for loans made by institutions that are already CRA-regulated; for instance, extending CRA coverage of loans made by institutions operating outside their local areas.

The other approach would be to modify CRA by building on the Act's branch-banking focus. Although mortgage lending today is far less linked to branch-based deposit-gathering institutions than in the past, local branches still play an important role in providing community development lending and financial services for lower-income people and communities. CRA could be adapted so that it more broadly emphasizes access to financial services to lower-income people and communities.

With such evidence that the power and relevance of CRA is weakening, the Joint Center authors believe that CRA should be updated to reflect today's realities. Numerous other stakeholders have voiced their opinions about CRA, and many have submitted comments to the federal regulatory agencies, who are assessing these comments. *Communities & Banking* will provide updates on CRA modernization as they occur.

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Community-Based Advocacy Adapts

In the past, many community-based advocates sought to help local communities by influencing the mortgage lending operations of local banks. However, with ties between lenders and communities weakening, advocacy groups are being forced to adapt their strategies. The increasingly complex structure of lending institutions, with spin-offs and subsidiaries, makes it difficult to determine the role of any particular lender in a community. Poor data on loan interest rates and prices cloud the issues even more.

The rise in nationwide lending has run parallel to an increase in nationwide advocacy groups. This has led to competition for limited funding between local and national organizations. Community groups used to rely heavily on local banks for funding. Nationwide banking institutions appear to have shifted much of their nonprofit funding from local to national advocacy groups. Some local organizations have tried to adapt by developing networks with other groups to span wider geographies. In Illinois, for example, community groups from all across the state are forming alliances to push antipredatory lending regulations through its legislature.

Many advocacy groups have broadened their focus from mortgage lending. They now cover more wide-ranging topics in access to financial services for lower-income people and communities, among other economic development strategies. Educational programs, such as homebuyer counseling and financial literacy, are becoming more important.

Mortgage Scoring and the Myth of Overrides

By Stanley D. Longhofer
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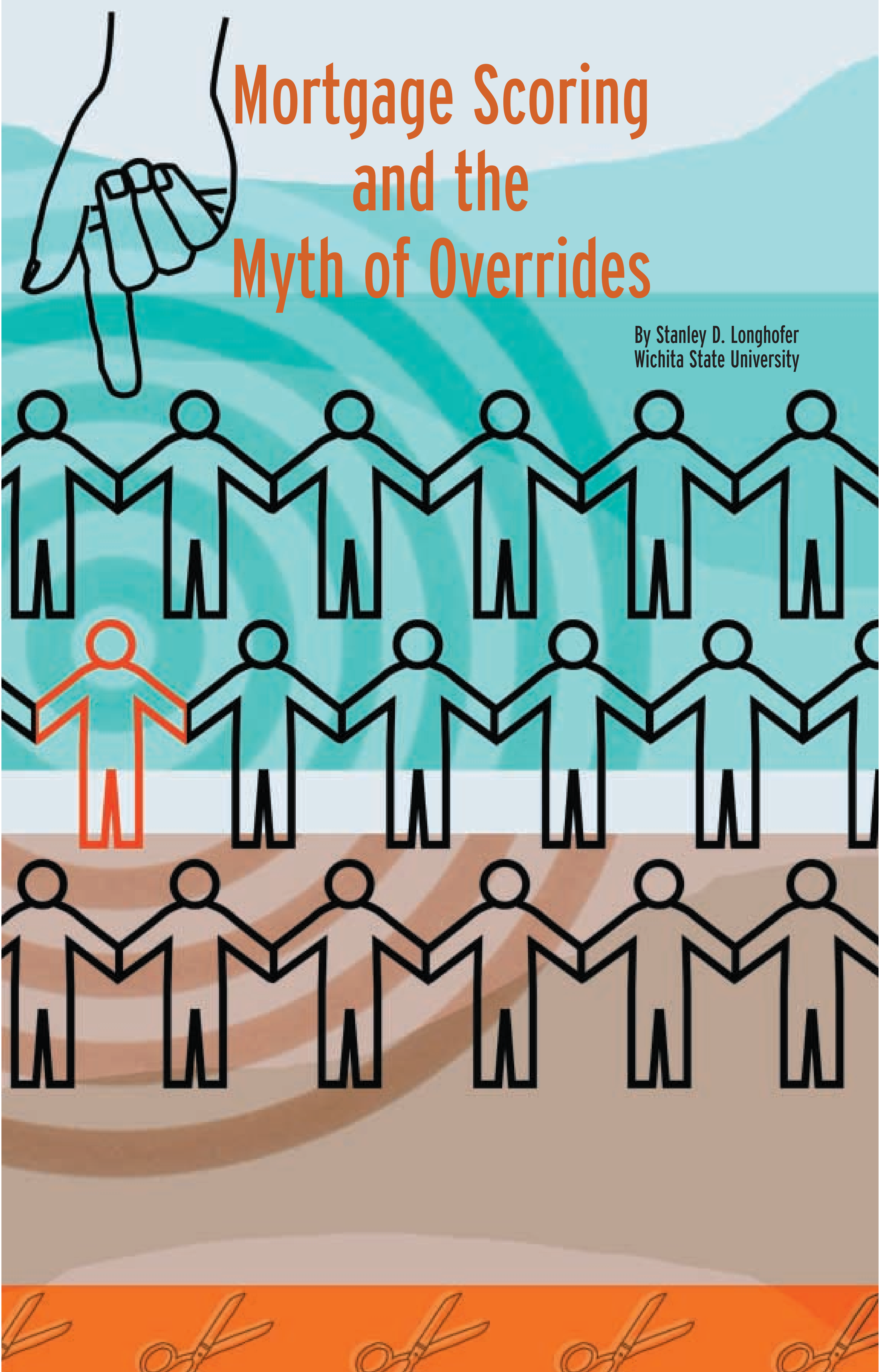

Perspectives on Credit Scoring and Fair Mortgage Lending

Concluding Article in a Five-Part Series

Editor's Note: This article is one of a group of commentaries on the impact of overrides (when the scoring system suggests one outcome and the lender chooses another) in the mortgage credit-scoring process. For further discussion on this topic, see the Communities & Banking *web site at www.bos.frb.org/commdev/html/c&b.htm.*

One of the most significant developments in the mortgage market over the past decade has been the formation and growing acceptance of computerized credit-scoring models as a supplement to or a replacement for traditional manual underwriting techniques. Programs such as Fannie Mae's *Desktop Underwriter* and Freddie Mac's *Loan Prospector* incorporate performance information from literally hundreds of thousands of mortgage loans to provide a fast, objective, and statistically reliable method for comparing the complex trade-offs inherent in mortgage underwriting.

In addition to assisting lenders in risk assessment, these objective scoring models can be a powerful tool for increasing consumers' access to mortgage credit. Not only does their increased efficiency translate into reduced closing costs for consumers – a significant barrier for many lower-income households – but if used exclusively, these models could effectively eliminate overt bigotry and disparate treatment from the underwriting process, as protected class status is explicitly excluded from these models. Thus, scoring models hold out great promise to make the mortgage market more fair and accessible.

Ultimately, however, mortgage underwriting can never be fully relegated to an automated scoring model, nor indeed should it be; subjective human evaluation will always be essential for some portion of all mortgage applications. Why? Despite the power of scoring models, there are often factors an underwriter would like to consider for which there is insufficient historical data for computers to analyze, or for which a subjective interpretation is required. For example, a lender may wish to discount a period of past delinquencies that can be traced to a documented medical problem from which the applicant has recovered. Such "idiosyncratic" factors cannot be incorporated into an objective scoring model, even though they may provide information that is vital to underwriting credit risk.

This subjective analysis may, in fact, have further benefits in improving access to mortgage credit, particularly for lower-income and minority households. Research over the past two decades – including a Boston Fed study – has provided evidence that these households are more prone to the very "application idiosyncrasies" that automated scoring models may be unable to process. Thus, subjective analysis is a crucial step in ensuring that creditworthy minority and lower-income households receive the credit for which they are qualified.

At the same time, however, many perceive a dark side to the use of overrides in the underwriting process. In particular, a subjective analysis may allow lenders to inject intentional or inadvertent prejudicial bias in the underwriting process. Additionally, lenders may be too unwilling to reverse the conclusions of the scoring model, either because the subjective analysis itself is too much effort or because secondary-market purchasers may be unwilling to purchase loans that were originally "rejected" by the scoring model. As a result, many consumer advocates are skeptical that the benefits promised by mortgage-scoring programs will actually be realized.

Many perceive a dark side to the use of overrides in the underwriting process.

Thus, we are faced with the question of how to extract the benefits inherent in scoring models while ensuring that any follow-up subjective analysis is applied fairly and consistently. The challenge is to make sure that any overrides to the objective analysis promote rather than hinder credit-access objectives. This is fundamentally no different from what must already be done in the context of a manual mortgage underwriting process. In fact, the term "override" is a misnomer in the context of mortgage underwriting, as the scoring model is not designed to provide a definitive underwriting decision. To understand how subjectivity and "overrides" fit into the mortgage-scoring process, it is important to understand how scoring models are used and how they are not used.

The process of mortgage underwriting is essentially the same, whether it is done manually or electronically. An applicant's characteristics are compared to an explicit set of "ideal" standards (for instance, maximum expense and loan-to-value ratios, maximum number of delinquencies, and sufficient verified liquid assets). Although these standards are stated as the lender's "requirements," as a matter of practice, all applicants who exceed this ideal are approved, as are many who fall short. This implies that the lender's true minimum underwriting standard is lower than that required by the objective guidelines.

These objective standards are used to sort the applications into three groups that we characterize as Yes, No, and Maybe. Applications that possess all of the ideal characteristics (the Yes group) are almost universally approved. When they are rejected, it is usually because of a material change in the information that put them into the Yes group to begin with (for example, the applicant who was previously employed suffered a sudden layoff).

Similarly, the No group consists of applications for which no further analysis is necessary because they clearly represent too great a credit risk. Applicants in this group may have severe blemishes on their credit reports, very unstable income, or high proposed loan-to-value ratios. As a practical matter, the No group is generally quite small, as such individuals will rarely even complete the application process. Furthermore, even those few obvious No applications that do get processed will generally be treated as a part of the Maybe group and, therefore, will be reviewed again in a subjective manner.

The term "override" is a misnomer in the context of mortgage underwriting.

The remaining applications represent the vast group of Maybes, which must be reevaluated using more subjective analysis. At this stage, the underwriter attempts to ascertain whether the applicant's favorable characteristics are sufficient enough to outweigh any factors that fail to meet the ideal standard or if there are mitigating circumstances that offset the fact that the application does not meet the ideal standards.

Whether an automated scoring model or a manual underwriting model is employed, the purpose of the objective analysis is not to determine which applications should be approved and which should be denied, but rather to isolate those applications that require further subjective evaluation. Scoring models can improve the integrity and efficiency of the subjective process in several ways. First, automated systems can process many more applications much more quickly than manual analysis. They not only shorten the time lapse between application and loan closing, they also reduce the cost of processing relatively standard applications, freeing up an underwriter's time to focus on the Maybe group.

Second, scoring models are developed using objectively verified performance information. Therefore, they can do a more-effective job of assessing risk layering or considering the trade-offs among different factors. For example, is a 20 percent front-end ratio enough to offset a 45 percent back-end ratio? Is a spotless credit record over the past year enough to offset three 60-day mortgage delinquencies that occurred two years ago? While underwriters can make subjective assessments of such trade-offs, scoring models can do this quickly, objectively, and consistently across applications. The upshot is that scoring models effectively reduce the number of Maybes (generally moving many into the Yes group), once again allowing underwriters to focus their efforts on applications that really require human judgment.

Third, the purpose of the subjective analysis itself is different when used in conjunction with a scoring model. Subjective analysis is used only if the application contains factors that occur too infrequently in the general population for the scoring model to accurately assess, or if the application is missing some crucial information required by the scoring model. These same judgments must be made with a manual underwriting process as well. However, manual underwriting must also evaluate subjectively the impact of risk layering. In other words, manual underwriting involves the subjective consideration of both "irregular" and "marginal" applications, the latter of which can be sorted objectively by a scoring model. Thus, using a scoring model actually reduces a lender's reliance on subjectivity in making underwriting decisions.

As described above, the intent of a subjective review is to collect and weigh all of the relevant information in order to come to a Yes or No decision for each application that a scoring model identifies as a Maybe. Clearly, a subjective review does not "override" an underwriting decision made by the scoring model, as no such decision is actually made. Instead, the subjective review comes to a Yes or No underwriting decision that the scoring model explicitly recognized it could not make.

Subjective review does not "override" an underwriting decision made by the scoring model, as no such decision is actually made.

This is in contrast to what typically occurs with the use of credit scores in making consumer credit decisions. With credit cards and other personal loans, an applicant's score, as reported by a credit bureau, is often the only factor a lender considers, and deviations from a predetermined cut-off are relatively infrequent. In the context of consumer credit, the term "override" is perfectly appropriate to describe, for example, a decision to lend to an applicant whose score does not meet the cut-off.

Mortgage lending decisions involve much more complex trade-offs than consumer credit, so lenders never rely solely on a credit bureau score. In addition, the opportunity to subjectively review the Maybe group is essential if lenders are to use scoring models to create greater access to credit. If the subjective process were eliminated or curtailed in a meaningful way, out of concerns about fairness or bias, the efficiency of a scoring model would be compromised.

For example, if subjectivity were eliminated, lenders would be forced to either deny loans sorted into the Maybe group or lower the bar defining what constitutes a Yes. If the first path is taken, lower-income applicants would bear the brunt of this policy, because of their greater likelihood of falling into this group. On the other hand, if the Yes bar is lowered, then the cost of mortgage credit would have to increase to offset the poor underwriting decisions the scoring model would be forced to make. Once again, this would disproportionately affect lower-income applicants because their ability to purchase a home is affected more directly by mortgage pricing.

The real question, then, is how do we make sure that any subjective analysis is conducted both fairly and accurately. Consistency across applications is the key. Yet this is inherently difficult, given that these applications require subjective analysis precisely because they are unique and not completely comparable with others. As a result, a subjective process can mask illegal discrimination. Thus, the techniques lenders should apply to monitor subjective analysis for compliance with fair lending laws are the same with scoring models as they are with automated manual underwriting.

While there are differences in the supporting role played by subjectivity with scoring models versus manual underwriting, these differences give scoring models a unique and important role in expanding access to mortgage credit. Their superior ability to assess the layering of risks (especially in cases of marginal applications) significantly reduces the number of applications to which subjectivity is applied. Scoring models also greatly improve underwriting efficiency, in part by allowing lenders to focus their underwriting efforts on applications that are too unique for computers to analyze. Furthermore, these models provide a benchmark for lenders in conducting their subjective assessments, giving them better information with which to make their evaluations. In the end, lenders' ability to combine scoring models with subjective analysis will bring the full power of scoring models to promote fair lending and broader credit-market access.

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Before taking the position at Wichita State, Longhofer was a financial economist at the Federal Reserve Bank of Cleveland, where he was a founding member of the Federal Reserve System's Fair Lending Advisory Group. Longhofer's research on mortgage discrimination, financial contracting, and bankruptcy has been published in leading academic journals, including the Journal of Real Estate Finance and Economics, *the* Journal of Money, Credit, and Banking, *the* Journal of Financial Intermediation, *and the* European Economic Review. *In addition, he has written several popular articles on the mortgage market and other related topics. He holds a doctoral degree in economics from the University of Illinois.*

Refashioning My Career with Community in Mind

Leaving Law School with Inspiration from 60 Minutes

Elizabeth Hart is founder and executive director of Tailored for Success.

Experts in personal productivity always encourage people to make goals and have a "five-year plan." Having worked my way up the career ladder from legal secretary to paralegal, I had as my plan to go to law school, become a lawyer, and give back to the community through *pro bono* work. However, my plans changed quite unexpectedly one Sunday night.

During my first year of law school, on an unusual, not-in-the-library evening, I was home watching television. When the news program *60 Minutes* came on, it immediately caught my attention. It featured a woman who, while in law school, started an organization to help low-income women in New York return to the workforce. The organization was called Dress for Success.

Dress for Success's clients were making the transition off welfare and trying to secure employment, yet they lacked the financial resources to purchase business attire. The women had no idea how to dress professionally or handle themselves on job interviews. Volunteers at Dress for Success helped the women choose suits, coached them in interviewing techniques, and encouraged them to believe in their ability to succeed. At first, the clients were skeptical about wearing suits and the difference they could make in their appearance – but donning office attire, the women quickly changed their minds. They began to carry themselves with dignity, and you could tell from the expressions on their faces that their self-esteem was improving.

After watching the segment on Dress for Success, I realized I wanted to work directly with low-income women on an everyday basis, rather than do occasional *pro bono* work as an attorney. Changing my law career plan took deep introspection, but fortunately I had good role models and mentors in my life who encouraged my ambitions.

My first step was self-education. I contacted Dress for Success to learn as much as possible about its work. Having limited experience in the nonprofit sector, I took a class on how to start and run a nonprofit organization. As my passion for my work grew, I enrolled in Cambridge College, where I received a master's degree in management with a concentration in nonprofit management. Although I was passionate, I was also realistic. I knew I would need more than passion to pay the bills, so I decided to keep my "day job" while I launched the agency.

Second, I laid the groundwork for my organization. I made contact with a variety of welfare-to-work, job training, and domestic violence centers in the North Shore and Boston areas that could prescreen and refer clients to me. All the while, I collected business suits, crafted a marketing plan, recruited volunteers, and searched for affordable office space.

At last I was ready for business. In July of 2000, I opened Tailored for Success in Malden, Mass., a nonprofit organization dedicated to helping economically disadvantaged women find and keep employment. My typical client is a single mother between the ages of 18 and 55 with one to two children. She may come from a situation where she became pregnant and was unable finish high school, or she may have finished high school but did not pursue college. In some instances, she cannot speak English very well, which makes her entry into the workforce even more difficult. The women referred to Tailored for Success represent diverse races and ethnicities – but they are all trained with necessary job skills, and they all share a motivation to succeed.

Despite being motivated, our clients are constantly struggling to make a better life for themselves and their families. Obstacles such as not knowing how to interview effectively, having low self-esteem, and having to fight the "welfare mother" stereotype can be truly overwhelming. These impediments, combined with the work-related issues of high daycare costs, transportation difficulties, and low-paying jobs, can make remaining on welfare more attractive than working. My agency helps women challenge these stereotypes and obstacles on their way back to the workplace.

Until I started Tailored for Success, I, like many people, held false assumptions about the transition from welfare to work. I assumed that a woman leaves the welfare rolls by completing a job training program, interviewing, and getting a job. Once she secures employment, I naively assumed she would know automatically how to move up in the workplace and understand its unwritten rules. These false assumptions create an overly simplistic view of what women in transition must go through to secure employment. If someone has been out of the workforce for an extended period of time, or if this is her first "real job," she won't instinctively know how to interview; the unwritten rules of the workplace will be foreign to her.

And, even if a woman is trained to do a certain job, she still faces a Catch 22: You need a job to buy business attire, but in order to get the job, you first must be dressed appropriately. Our clients do not have the financial resources to buy suits, nor do they have anything in their closets that vaguely resembles proper business attire. Dressing the part is crucial, however, because people make appearance-based judgments within the first five to ten seconds of meeting someone. If women trying to shift off welfare don't look appropriate, regardless of their training or skills, employers will unfairly judge them as incapable.

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With many companies downsizing and closing, Tailored for Success's services are especially critical. My clients compete with individuals who have more education, experience, and training than they, so making a good impression takes on even greater importance. Clients come to my agency on an appointment-only basis and are seen in a boutique-like setting. Each client receives two suits for interviewing and, once she secures employment, is entitled to receive a full week's work of clothing for a confident start in the workplace.

Beyond providing business attire, Tailored for Success teaches business-appropriate make-up application, gives each client individualized interview coaching, and offers career development workshops on business etiquette, workplace ethics, and payraise negotiations, because these are vital skills women need in their new careers. To date, Tailored for Success has served 100 women –most of whom, I am proud to say, have successfully returned to the workforce.

Over the past two years, I have learned many things. For one, being the founder and executive director of a grassroots nonprofit organization is very demanding, but very rewarding. Serving as executive director is similar to being a chief executive officer in private industry – but with fewer resources and staff. The roles I fill range from spokesperson to recruiter of volunteers – and the agency's success depends on my ability to secure clothing donations and financial support. Thankfully, I can rely on a dedicated group of volunteers to help sort clothes, work with clients, and raise funds.

Although running a nonprofit while working full time is challenging, it has enabled me to grow professionally while making a difference. Like many people, I always thought that in order to get ahead you needed to set goals, make plans, and pursue them. I still believe this is true, but what I've learned is that you also have to be flexible enough to adapt to unexpected situations. So although I originally made plans to become a lawyer, now my goals and plans revolve around the agency's continued growth and success – similar to the plans my clients have for a brighter future for themselves and their children.

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Photo by Jane Weingarten

These seniors found affordable housing in Brighton, Mass., that meets their needs. Many others have not been so fortunate.

New England's Share of a Quiet Crisis, page 8

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