communities and banking

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Communities and Banking seeks to further the practice of community and economic development by exploring effective ways for lenders to work with public, private, and nonprofit sector entities toward proactive compliance with the Community Reinvestment Act.

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FEATURE STORY

www.your-community-bank.com : Community Banks Are Going Online

The rapid growth of the Internet over the past four years is revolutionizing the delivery of goods and services in the economy. Net-savvy consumers are now able to purchase a sundry assortment of products, from books to airline tickets, auto insurance to specialty foods. As electronic commerce continues to permeate the business environment, financial services are also increasingly available for purchase online.

Bankers are discovering that a web site is not just a newfangled public relations tool. More and more large banking institutions are using the Internet for service delivery, primarily because the Net promises to drastically reduce transaction costs. In addition, the Internet has the potential to change the physical nature of banking – lessening dependence on brick and mortar branches for service delivery. In fact, several *Internet-only*, or *transactional Internet banks* are currently operating within the United States, without any physical branches.

And it's not just the mega-banks that are going online. Smaller, community-based institutions – which have thrived despite the industry-wide trend toward consolidation – are using the Internet to retain their competitive edge. Long regarded as the primary cultivators of the "relationship banking" niche, community-based financial institutions are responding to the changing demands of their existing customer base and to the threat of further disintermediation from online brokerages and mutual fund companies.

But as community-based banks enter the fast-paced world of Internet banking, they must also deal with several challenging issues. A host of regulatory concerns are unresolved, including compliance with consumer disclosure laws and the protection of consumer privacy. And there is the broader issue of defining a specific "community" for financial institutions that have either a limited physical presence or none at all. Thus, as the community bank goes online to better serve its local customers, it simultaneously embraces a larger, more diverse, and potentially less loyal cyber-community.

Internet Banking: Development and Future

The growth of Internet usage by financial institutions for marketing and eventually for service delivery has progressed rapidly over the past few years. According to the U.S. General Accounting Office (GAO), in January 1998, 770 banks – approximately 7 percent of banks in the United States – offered online banking services. In that same study, the GAO noted that by the end of 1998 an estimated 4,990 banks were planning to offer online banking services to their customers.

Internet banking is an extension of other, more well-established modes of electronic banking. Automated teller machines (ATMs) and phone banking services, both novelties only a decade ago, are now ubiquitous. Electronic banking in all its forms, has been attractive from the banker's standpoint, because it brings with it enormous cost savings while meeting consumer demands for more convenience. And as part of the larger trend toward electronic service delivery, the Internet has the capacity to greatly enhance the potential cost savings. A recent survey conducted by Booz, Allen & Hamilton found that the costs of delivering banking services through various modes of access ranged from $1.07 per transaction in a physical branch, to $0.27 with an ATM, to $0.02 through dial-up PC banking (or "home banking"), and only $0.01 over the Internet.

Internet delivery can also drastically slash overhead through a reduction in the number of physical branches in operation. In its current form, Internet banking still requires customers to use ATMs for obtaining cash. Apart from ATMs, most Internet-only banks don't have any other physical infrastructure. Many are just warehouses for the banks' servers and back-office processing facilities. These Internet-only institutions serve their customers through their Internet site, telephone-based customer service representatives, and affiliated ATM networks. Other banks that offer Internet banking services are betting that eventually they can close down some branches, as more customers go online.

Internet banking brings advantages to consumers who are comfortable with the technology. First, the above-mentioned cost savings are passed on to the consumer, mainly through lower fees and potentially higher rates on savings and investment vehicles. Second, Internet banking provides added convenience. Consumers get 24-hour banking service from the comfort of their home or office. They can check balances, transfer funds, pay bills, and even apply for and obtain loans through certain web sites. The savings of time are immense. For example, customers looking to apply for loans can compare rates and terms at their computers, complete and submit applications, and often receive notification of approval in minutes. This transforms a multiweek transaction into one that can be completed in a matter of days.

The potential benefit may be still greater in underserved rural areas, where visiting a bank branch can involve traveling long distances. As the banking industry continues to consolidate, rural community groups have often worried that fewer banks will operate in their areas, leading to lessened competition. Internet banking may help rural consumers bypass the obstacles created by geography, allowing them to obtain banking services from anywhere in the United States.

Despite its promising attributes, however, Internet banking has only recently taken off. The primary factor behind the increase in online banking activity is the growing familiarity of American households with the Internet. According to Jupiter Communications, Inc., in 1995 only 800,000 households conducted their banking online; by 1997 that number had grown to 4.5 million. The Progressive Policy Institute estimates that by the year 2001, over 35 percent of U.S. households will be online, adding to the potential number of households that utilize Internet banking. Forrester Research, Inc. of Cambridge, Massachusetts, predicts that by the year 2003 over 18.5 million households will use online banking.

Certainly Internet and PC-based service delivery are not the current methods of choice for most American households. *In Who Uses Electronic Banking? Results from the 1995 Survey of Consumer Finances*, Arthur B. Kennickell and Myron L. Kwast found that while 86.7 percent of households surveyed interacted with their financial institution through an in-person transaction – for example, visiting a branch – only 3.7 percent did so with a computer. While other forms of electronic banking – ATMs, debit cards, direct deposit, phone banking, and electronic transfers – are more commonly utilized, computer-based banking is to some extent still a novelty.

The Involvement of Community Banks

Even though Internet banking is not currently used by most American households, banks are investing considerable sums to go online. Industry experts predict that the Internet will revolutionize the business of banking, given that it offers consumers a tremendous amount of convenience and choice. Banks are investing in Net-based service delivery so that they can offer the latest services as customers become more comfortable with the technology.

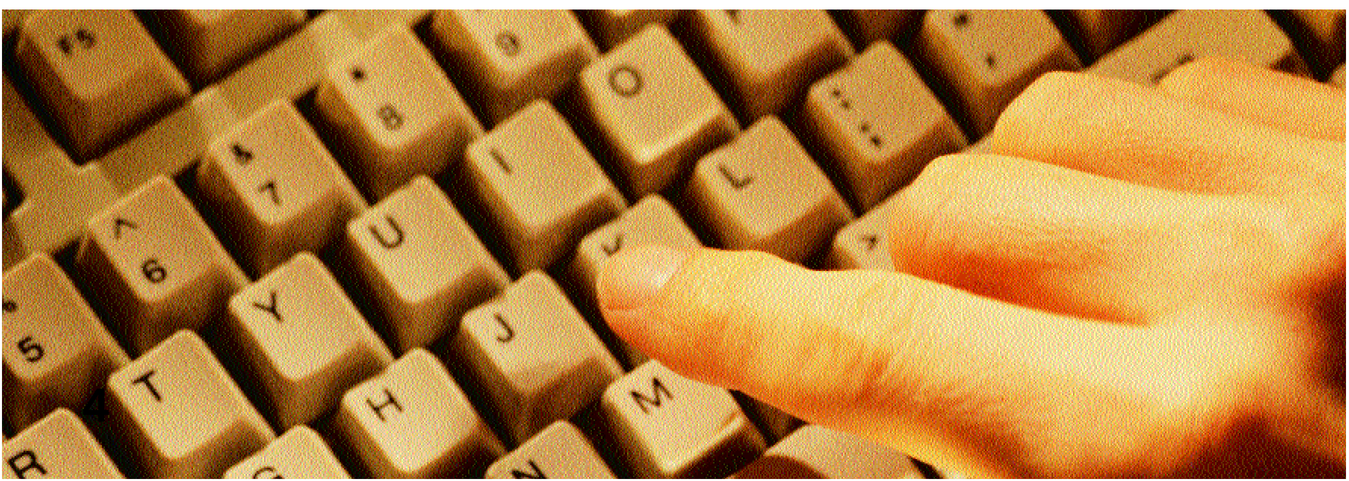
In 1998, over 35 percent of banking web sites offered transactional capabilities to their customers. As the cost of the technology drops, more banks are operating web sites. Larger, national banking institutions have been busy establishing an Internet presence for some time, but smaller community-based institutions were initially reluctant to enter this new area. However, as more Americans turn to the Internet for non-entertainment purposes, such as gathering information on financial matters, community banks have begun to seriously delve into online service delivery.

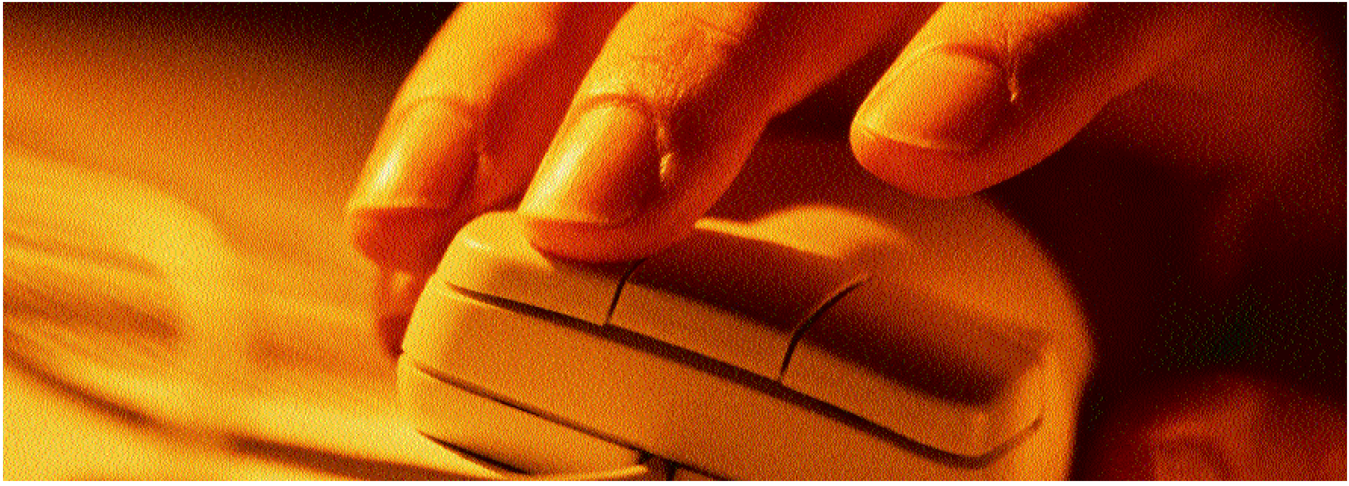
In its 1999 survey of community banks operating in the United States, Grant Thornton LLP found that 65 percent of the community-based institutions surveyed were planning to introduce home banking products to their customers. In that same survey, half of all community banks that were planning to establish web sites in 1999 stated that they would offer transactional capabilities on their Internet sites, ranging from basic account monitoring to bill payment and loan origination.

Obviously the potential for cost savings has drawn many smaller, community-based banks to provide some form of Internet banking to their customers. However, two more compelling reasons are also behind the rise in community bank involvement with Internet banking.

First, while smaller community banks have always capitalized on their local ties and their reputation for providing "relationship banking," they are also keen on responding to the changing technological needs of their customers. Community-based financial institutions are proficient in providing personalized or customized banking services. Industry analysts point out that many small businesses tend to favor dealing with local, community-based banks because they are more attuned to the local business environment. And for many non-corporate customers as well, community banks offer an alternative to the more impersonal service at larger banks, where customers reportedly feel like just another account number. This penchant for cultivating banking relationships has been the major strength of community banks, allowing them to weather the fallout from the large bank mergers dominating the industry.

But clients at community banks also want the conveniences and lower costs of electronic banking products. Technologically savvy customers view the Internet as a more convenient and flexible delivery system. Community banks, faced with these new customer demands, are using the Internet to maintain and enhance their existing customer relationships. Take, for example, Salem Five Cents Savings Bank, a mid-size community bank (assets of $1.1 billion in 1999) headquartered in Salem, Massachusetts, which was among the first community banks to enter online banking. Chairman and CEO William Mitchelson explained that in 1995 his bank decided to establish a web presence "as a response to our customers' need for multiple points of access." Initially customers were reluctant to use the Internet site, but Mr. Mitchelson knew that





“most customers would eventually become comfortable with it, since they already used phone banking and other electronic banking services.” Salem Five’s web site started out as mostly an informational vehicle. As the bank’s management and customers became more comfortable with the medium, Salem Five added more transaction capability.

In this sense, community bankers view Internet banking as another way to offer personalized service to their clients. And given that most Internet users are people in higher income brackets, attracting and accommodating these customers can translate into more lucrative depositor relationships. John Koegel, Marketing Communications Director at Grant Thornton, LLP, points out that “community banks are looking at their customers and they see the Internet as a channel to augment their relationships with their [existing] customers.” Salem Five’s Mr. Mitchelson is emphatic when he states that the Internet allows his bank to “guarantee that we maintain our relationships with our customers.” He also adds, “If we don’t offer the capability, then the customer will go with somebody else.”

Which leads to the second major reason why community banks are now looking to go online: staving off the competition. Community banks face a daunting Internet-based funding challenge, most notably from online brokerages and mutual fund companies. Disintermediation of deposits is nothing new to the banking industry. With low interest rates, consumers are apt to take their money out of bank accounts and place them in higher-yielding investment vehicles offered by nonbank intermediaries. The Internet has added a new twist to this trend. Popular brokerage web sites, approximately 20 percent of which offered transactions in 1998, are luring computer-savvy investors into the world of personalized trading. Mutual fund companies, long a source of intense competition for bank deposits, were among the first financial institutions to offer services on the Internet. Internet search engines and service providers also pose a threat to the community bank. As “portals,” these sites offer users information on a wide variety of topics including financial services, and they can guide customers to nonbank providers already well-established on the Net. For example, many popular search engine and hosting sites have links to online brokerages, mutual fund companies, and the like. These sites serve as gateways to the web sites of the community bank’s main online competitors. Linda Garvelink, Marketing Director for Financial Services at Grant Thornton, explains that community banks are concerned about the scope of online competition. She states, “They’re [community bankers] saying to themselves ‘How long until my customers decide it’s just easier to click on a button while they’re already online to access [a competitor’s] services, rather than use our community bank?’ ”

While larger banks have both a greater core deposit base and the potential to channel depositors to affiliated or subsidiary investment firms, smaller community banks are not always so well equipped to defend against these assaults on their deposits. More and more community banks report that they depend on advances from the Federal Home Loan Bank to maintain liquidity. As their core deposits are threatened by aggressive online competition from nonbanks, some community banks have taken to the Net to try to expand their customer base. Unlike traditional marketing vehicles, the Internet allows the community bank to transcend geographic limitations and compete for deposits virtually anywhere in the world. Without having to invest in costly physical branches, a community bank can market its services and products to a larger group of potential customers, expanding its deposit and loan businesses outside narrowly defined service areas.

For those community banks that are attempting to expand their customer bases, Internet-based service delivery is indeed working. Salem Five's Mr. Mitchelson explains that most of the bank's web-based customers are from outside the immediate area, and that they have customers in all 50 states. Even community banks that are not attempting to attract non-local customers find that their web sites are an effective marketing tool for other purposes. As Ana H. Lyon, Marketing Director at Franklin Savings Bank, Farmington, Maine, states, "It helps to have a web presence, so that people – job applicants, customers who are relocating to the area, vendors -– are more familiar with us before they get to our bank."

Many community banks emphasized in the 1999 Grant Thornton survey that they view the Internet as an "equalizer" of sorts, since it allows even the smallest bank to compete head-to-head with banking and brokerage powerhouses. Salem Five's Mr. Mitchelson states that when it comes to Internet banking, size may not matter. "Big will always beat smaller, but the quick will always beat the slow. Thus, we could get in quicker than most larger banks because we were smaller."

Risks and Challenges: How Well Do You Know Your Customer?

Like large banks, community banks face risks as they venture online. Security concerns are paramount, and many banks have been spending heavily to protect their servers from hackers and unauthorized access. Other concerns that may affect smaller financial institutions include intellectual property and ownership issues, regulatory compliance, and privacy concerns.

Banks that establish web sites face a host of intellectual property and control issues. These may affect community banks more than other banking institutions, since their relatively small size necessitates dependency on third parties to develop, maintain, and process transactions on their sites. Grant Thornton's Ms. Garvelink states, "In talking with many community bankers, most of them are still outsourcing their [web development] work." Charles Bacall, Co-Chair of the Technology & Electronic Commerce Practice Group at Portland-based law firm, Verrill & Dana, LLP explains that the ownership of web sites often becomes a source of contention, especially when banks try to update or change information on what they assume are their proprietary sites. "The main issue is what do you own and what do you have authority over." Mr. Bacall and others advise community banks to be very explicit in their contractual arrangements with third-party web developers over both ownership and site maintenance. Other intellectual property issues include the use of trademarks and copyrighted material.

Another issue is that of ensuring compliance with federal and state banking regulations. This is not a straightforward task, given the rapidly changing regulatory climate concerning most Internet-based banking activities. At present, the Federal Reserve consumer disclosure regulations are out for proposal on whether to allow banks to deliver these disclosures electronically. In the meantime, banks must deliver these to the customer in paper format even if the transaction originated on the Internet, with some exceptions. Linda Monica, Co-Chair of the Technology & Electronic Commerce Practice Group at Verrill & Dana, emphasizes that while many community banks may still outsource their Internet-oriented work, "It is completely the responsibility of the bank to comply with the regulations, and they must control and monitor the web designers." Conversely, she adds, "Web developers need to take the bank's strategy for regulatory compliance – including disclosures – into consideration" when developing site design and functionality.

Finally, concerns over customer relationships and privacy, while they affect banks of all sizes, may be particularly difficult for smaller, community-based institutions. Community banks have always prided themselves on their ability to know and understand the peculiar lending environments in which they operate. Community bankers value their ability to be personally acquainted with their customers. The Internet opens the community bank's doors to a larger, impersonal universe of potential customers. For banks not explicitly using their web sites to attract new customers, there are obvious concerns about who visits their sites. Many community bank websites – whether transactional or not – have explicit online disclaimers explaining their policies on not lending or taking deposits from outside their service areas. Franklin Savings' Ms. Lyon echoes the sentiments of many smaller community bankers when she states, "It puts us at a disadvantage if we don't know what market we're dealing with." For the time being, Franklin Savings Bank employees will turn down Internet-based requests for loan applications from outside their immediate service area.

Grant Thornton's Ms. Garvelink states that among most community bankers a major concern once they go online, is "How do we know our customers the way we know them now?" Ms. Garvelink continues, "Marketing efforts are very important, in order to make sure that the customers you attract are the ones you want to serve." New verification technology offers some help in this area, but the anonymity of the Net can still cause problems.

Efforts to obtain more information about customers can lead community banks into the sticky area of online privacy. Verrill & Dana's Ms. Monica advises that "Banks need to indicate what information is being collected, and the intended purpose." Currently, compliance with privacy laws tends to follow the order from a recent Federal Trade Commission (FTC) enforcement action called *In the Matter of Geocities*. While the Geocities case concerned the collection of information about children on the Internet, its stipulations have general applicability, including the wording of model privacy statements for most e-commerce transactions.

Most transactional banking web sites need explicit disclaimers explaining why information is being collected and who will have access to such consumer information. As noted in a recent interagency study of online banking web sites, those with more sophisticated transactional capabilities often have more stringent and frequent privacy disclosures. These include functions so that customers can verify the accuracy of or remove their personal information on a bank's server. In that same study, 48 percent of banking web sites surveyed had some form of privacy disclosure, but 96 percent of the nation's 50 largest banks and thrifts (by asset size) provided privacy disclosures on their web sites.

Community banks can best deal with these issues through comprehensive technology plans. Grant Thornton's Ms. Garvelink usually asks community banks with a technology plan, "Does it include your Internet site?" According to Grant Thornton's 1999 survey, 51 percent of community banks have a strategic technology plan in place. Some community banks, however, may not include

The Digital Divide: Low- and Moderate-Income Communities and the Net

With regard to low- and moderate-income (LMI) communities, access to emerging Internet technology is the main factor – or the main barrier – when it comes to using online financial services. With the increasing prominence of telecommunications technology, including the Internet, in both the home and in the workplace some have begun to worry about an emerging "digital divide." They fear that those without access to Internet technology – often those in lower income groups – will be unable to participate in a more interconnected, technology-driven economy.

It is true that, while Internet usage is on the rise among all socioeconomic groups, access to the Internet tends to be greater among higher income groups. Surveys conducted by Vanderbilt University and the National Telecommunications and Information Agency (NTIA) have both concluded that the gap in computer ownership in the United States – and by extension Internet usage – can be explained primarily by income and household-type. According to the NTIA, nearly 80 percent of households earning above $75,000 owned a personal computer in 1998, compared to only 16 percent of households in the lowest income category. Low-income rural households are the least likely to own a computer.

Surprisingly, there is little evidence that any such gap in access is widening. In fact, the NTIA noted that in 1994 the average household income of Internet users was $66,300; by 1997 that figure had declined to $51,900. In the long term, as the price of computer hardware declines, more and more LMI individuals will be able to access the Internet from their homes. They then become potential customers for online banking services.

The NTIA also found that among lower-income people with no home-based access to the Internet, there was still an increase between 1994 and 1997 in Internet usage through other access points. These include community centers and educational institutions. Most of the statistics, however, indicate that LMI individuals usually use the Internet for seeking employment, taking distance learning courses, and other job-related tasks. There is still little evidence that, if given access and the opportunity, lower-income Americans will turn to the Internet to obtain financial services.

But these figures belie the tremendous opportunities that Internet technology can bring to traditionally underserved communities. As such, banks are beginning to explore new and innovative ways to introduce their LMI customers to Internet banking, usually through interactive kiosks in their branches and donations to local computer centers.

in these plans the security, regulatory, privacy, and intellectual property policies necessary if they are to expand their Internet presence. Ms. Garvelink notes that "Community banks pride themselves on being 'fast followers' as opposed to being on the 'bleeding edge.' " Unfortunately that may mean that they don't have a comprehensive technology plan which includes their Internet strategy.

No More Bricks & Mortar?

The Internet gives community banks the opportunity to defend, retain, and broaden their customer bases. Given the potential of Internet banking, it's not surprising that community banks are eager to get involved with this service delivery mechanism, in spite of the risks. However, most community bankers do feel that they still must offer traditional delivery options to their customers. Brick and mortar branches, tellers, and front-office staff are all very important to the business of community banking.

For the most part, community banks are bifurcating their services: offering their more technologically savvy customers the latest in Internet banking, while offering other customers the ability to transact in person. Salem Five's Mr. Mitchelson states, "Our philosophy is not to force the functionality on our customers but to let them choose a delivery system. Our mission is to accommodate them, not to disenfranchise them."

In fact, while Internet banking can change how customers interact with their local bank, the medium will most likely complement the brick and mortar branch and its human staff. As Franklin Savings' Ms. Lyon puts it, "Our people are [still] our greatest asset." While she and others believe that the potential for Internet banking usage is tremendous, particularly in rural areas like Maine, she explains, "Customers will make use of the convenience from the technology, but will not be completely dependent on it. They will still use our brick and mortar branches, because people in the area enjoy coming into the bank."

-- by Luxman Nathan
Public & Community Affairs
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AROUND NEW ENGLAND

Affordable Housing in the Greater Boston Area: What Challenges Are LMI Households Facing?

New England's economy is booming. The rising real estate market in Metropolitan Boston is a dramatic illustration of the region's economic health. In the past year alone, housing prices in Boston have risen roughly 10 percent. In the last eight years, average rents in Boston have doubled.

While homeowners and landlords benefit from increasing real estate prices, many experts in affordable housing are concerned that housing prices will adversely affect the local economy over the long term. Limited supply and high demand for housing mean rising home prices and rents, which are pricing many low- and moderate-income (LMI) families out of the Boston-area market. In a recent study by the Massachusetts Institute for a New Commonwealth, housing costs were cited as the most significant threat to Boston's continued prosperity. According to the study, the high cost of living, led by housing costs, is hurting the area's competitive position.

Background

The causes of the present situation can be traced, in part, to the recession of the late 1980s and early 1990s. During the boom years of the 1980s, developers overbuilt, speculating that the market would remain at its fever pitch. When the economy cooled, many properties remained vacant. Banks, whose inventories soon grew to alarming levels, foreclosed on other developments. Although the market eventually absorbed the excess units, the lessons learned by developers were not soon forgotten.

In recent years, developers have become much more selective in building new homes. The high cost of acquiring land has been reflected in new home prices. Expensive homes in affluent communities are more profitable, and most housing developers are choosing to build this type of home. Nicolas Retsinas, Director of the Joint Center for Housing Studies at Harvard University states, "People were burned here in this region because of what happened in the 1980s . . . and the imposition of restrictions on development makes builders and developers somewhat skittish."

One example of these development restrictions is rent control, which was eliminated by most municipalities in the Greater Boston area during the mid 1990s. Mr. Retsinas states, "Generally speaking, whenever something is imposed on a market which adds costs or restricts profits, that tends to chill any investment, and rent control is certainly an example of that." The end of rent control is linked to the dramatic increases in real estate prices, rents, and development in the Cambridge/Boston area.

In addition, the Boston area has become a more popular place to live and work, fueling more demand for housing. As Jackie Roundtree, spokeswoman for The Office of Housing and Urban Development's Boston Office, describes: "The City of Boston, in the past seven to eight years, has done a remarkable job of economic development to improve its community development base, its type of housing, the things that attract people to the city – culture, parks, improved services, clean streets. It's a livable city. Because of the hot job market, young professionals from all over the country with deep pockets are coming to Boston. They want to be in the city and they can afford it, they run the cost up. Low- and moderate-income people are left out." Some residents and community activists worry that the traditional working class is being squeezed out by rising costs. Cortina Vann of Massachusetts Affordable Housing Alliance (MAHA) believes that "people are very fearful; they are paying very expensive rents and a lot of people are having to move."

Residents must also compete for housing with local college students. A two-bedroom apartment may not be affordable for a working family. However, to four college students, the rent for the same two-bedroom apartment may seem inexpensive compared to the limited supply of housing available on Boston-area campuses. While local universities are working to build more student housing, their activities have had little measurable impact on the overall demand for local housing. Clark Ziegler of Massachusetts Housing Partnership (MHP), a quasi-governmental agency, confirms this trend: "When times are this good economically, students are willing and able to pay more than regular working families. I hear a lot from community people that the student housing pressure is a very big factor."

The Challenges Facing Prospective LMI Renters

In 1990, the average rent in Boston for a two-bedroom apartment was $670. In 1998 this skyrocketed to $1350, a rise of 100 percent in eight years. The National Low Income Housing Coalition, in its annual report *Out of Reach: The Gap Between Housing Costs and Income of Poor People in the United States*, found Massachusetts to have the fourth most expensive rental market in the country, lagging behind only Hawaii, New Jersey, and New York. According to this survey, renters in Massachusetts who work 40 hours per week must make at least $15.26 per hour, or 296 percent of the federal minimum wage, to afford a two bedroom apartment.

However, this study perhaps does not tell the whole story. It measures *rent burden* – the percentage of household income used to pay rent – using HUD's Fair Market Rent, which was $940 per month in the Greater Boston area for FY 1999. Only one Boston neighborhood, Dorchester, reported average rents of $950. All other city neighborhoods have advertised rents that generally start at over $1,000 per month and increase from there. Since HUD's Fair Market Rent of $940 is the amount that a Boston-area landlord may receive from a tenant with a Section 8 voucher, it is not surprising that HUD's Section 8 housing program is declining in its usefulness to families in Boston.

HUD has estimated that 34,000 units of Section 8 housing will be lost in the City of Boston by the year 2004. Many landlords who have long-term Section 8 contracts with HUD are choosing not to renew. Instead, owners are returning the units to the lucrative open rental market. Landlords are also paying off HUD-sponsored, low-rate mortgages, which keep rents affordable. After 20 years, landlords have the option to pay off such mortgages and convert their buildings to market rates. Because new Section 8 housing has not been funded, the total number of units available to low-income families is declining. These families are compelled to search for housing on the open market.

The Challenge Facing Prospective LMI Homeowners

Facing an expensive rental market, many families attempt to purchase homes. MAHA's Ms. Vann states, "When rents hit $1,300 to $1,400, people try to buy houses so they can stay in the neighborhood they grew up in." Low interest rates available to potential homebuyers have helped LMI families afford to buy homes. Even as prices rise, bankers have not seen any dramatic decline in the number of mortgages to the LMI community. According to Steven Pierce, Executive Director of the Massachusetts Housing Finance Agency, "There is available housing stock within affordability limits. You can still find a really decent home for $140,000 to $160,000 in the city." Many others in the banking industry echo this statement.

THE SECTION 8 HOUSING PROGRAM

The Section 8 program was created by the Housing and Community Development Act of 1974 and is administered by the U.S. Department of Housing and Urban Development (HUD). As one of the largest federal housing initiatives, Section 8 provides a government rental housing subsidy to low-income individuals. Through a system of rental vouchers and certificates, Section 8 participants are free to choose suitable housing on the open market, and are therefore not limited to dwelling in subsidized housing projects. The program is administered through local housing agencies (HAs), which receive funds from HUD. The HAs pay the landlord a subsidy on behalf of a participating family. The family then pays the landlord the difference between the actual rent charged and the subsidy amount.

Participants must have a family income that does not exceed 50 percent of the median income for their county or metropolitan statistical area (MSA). In the *rental certificate* program, the family usually pays no more than 30 percent of its monthly adjusted income toward rents and utilities. As such, qualifying housing units in the certificate program must not exceed a maximum rental cap determined by the HA. In the *rental voucher* program, the HA determines a payment standard to calculate the amount of subsidy a family will receive. This standard does not affect how much a landlord may charge a Section 8 voucher participant; families can pay more or less than 30 percent of monthly adjusted gross income in rent.

At its inception, the Section 8 program also involved contracts between HUD and landlords. HUD offered the landlords low-interest rate mortgages and other incentives to keep their rentals units affordable for approximately 20 years. Currently, many Section 8 landlords in the Boston area are choosing not to renew their 20-year contracts with HUD. Due to the accelerating local real estate market, many Section 8 landlords are eager to earn market rents on their units. HUD estimates that by 2004, the City of Boston alone will lose 34,000 units of Section 8 housing.

For more information on the Section 8 Program, visit the U.S. Department of Housing and Urban Development's (HUD) web site at http://www.hud.gov

To meet the demand for home purchases, apartments and multifamily homes are being converted into condominiums at an increasing rate. Since condominiums are generally within the price range of moderate-income families, the creation of condominiums has met part of the demand for affordable housing. In February 1999, condominium sales were 26 percent higher than in February 1998. At the same time, the price of condominiums had increased 20.4 percent. However, very little new construction is responsible for putting these condominiums on the market.

While condominium conversion of owner-occupied multifamily homes does add to the overall housing stock, it simultaneously removes an important source of affordable housing from the market. MHP's Mr. Ziegler remarks, "People figured out over time that a triple-decker provided enough rent to substantially help with the mortgage." For many LMI individuals, multifamily properties have always provided an opportunity to qualify for a mortgage, since the extra rental income is taken into consideration by lenders. Condominium conversion involves the break-up of a multifamily property into separate, single-family housing units. Not only do prospective LMI homeowners loose out on acquiring a multifamily property, but they may not be able to afford the resulting condominium units. Currently, the out-of-pocket mortgage payment on a condominium in Boston averages $1,400, while on average the out-of-pocket payment on a triple-decker is less than $600 due to rental income from the additional units.

Available Assistance

In response, public agencies are working harder than ever to assist LMI families in securing affordable housing. For example, HUD is using a new program called *Mark to Market*, which permits HUD to exceed the $940 rental cap in certain circumstances. HUD found that many of the desirable Section 8 buildings were in low-poverty neighborhoods. Jackie Roundtree of HUD confirms, “People want to be in them, they love them. In many cases, where the units look good, are well run, well preserved, and the rents are below market rate, the Secretary [of HUD] is willing to work with the owners to bring those rents up to market, to keep the owner in the program.” This program has helped save many Section 8 units in danger of being turned back to market-rate apartments.

At the same time, first-time homebuyers can use the Massachusetts Housing Finance Agency (MHFA) program, which permits applicants with an income of up to 80 percent of the area median to purchase their first home with as little as 3 percent down. Homebuyers can also receive a below-market interest rate, a favorable underwriting ratio, and access to MHFA's mortgage insurance fund. However, the present income limit to qualify for this program is $60,000 for a one- or two-person household and the maximum single-family home price is $184,000 in the Boston/Cambridge area.

Another program available to first-time homebuyers is the Soft Second Program, a joint initiative of the public and private sectors, administered by the Massachusetts Housing Partnership Fund (MHP) and advocated for by the Massachusetts Affordable Housing Alliance (MAHA). The Soft Second program subsidizes traditional first mortgages to make homeownership possible for LMI families earning up to 60 percent of the area median income. In the Soft Second program, a homebuyer obtains a first mortgage at a below market interest rate for up to 75 percent of the purchase price, and a government-subsidized second mortgage loan for 20 percent. The second mortgage reduces the homebuyer’s down payment to a minimum of 5 percent of the purchase price of the home, compared with the 10 percent minimum down payment on most traditional mortgages. While the first mortgage loan is fully amortized, the LMI homebuyer only pays the interest on the second mortgage for the first ten years. During the first five years, public funds cover up to 75 percent of the interest payments on the second mortgage, further reducing initial debt burden for qualified LMI homebuyers. In addition, the LMI homebuyer does not have to pay for costly private mortgage insurance (PMI) since the lender is extending a first mortgage for only 75 percent of the purchase price.

Under the Soft Second program guidelines, purchase prices are restricted to $150,000 for a condominium or single-family home, $180,000 for a two-family, and $200,000 for a three-family property. Unfortunately, these caps have made this program unworkable in many neighborhoods. With the price restrictions in mind, MAHA has been working with the Commonwealth to raise the purchase price restrictions. MAHA has also asked for and received lending commitments from area banks. In the next five years, area banks have committed to make almost 1,700 loans with a Soft Second component.

Other assistance comes from the City of Boston's Home Center, which works with families in identifying resources for home purchases. The City provides grant assistance with closing costs, homebuyer education classes, and other resources to those seeking a home. The Mayor has set a goal for FY2000 of building 2,000 units of affordable housing. The City has also streamlined its permitting process for development. Finally, Boston has pressured colleges to develop new dormitories that reduce student-housing demand. Boston University is building an 800-room dormitory; Northeastern University is adding 600 rooms.

Despite the programs available to LMI families, the options are still limited for working people who are priced out of the Boston market. Philip Mangano, Executive Director of the Massachusetts Shelter and Housing Alliance, states, “Prices are literally driving working people into a new migratory pattern that is forcing them further and further from their jobs and extended family." Many people are moving farther from Boston, to communities such as Malden, Brockton and Lynn. All of these communities are seeing a rise in school enrollments; at the same time, enrollment is dropping in Boston's neighborhoods such as Allston-Brighton.

The Impact

The housing boom's impact is still rippling out. Professor Karl Case of Wellesley College sums it up this way: "Popular places, unfortunately, are historically mixed- income neighborhoods such as Jamaica Plain, Cambridge, and the South End. The current boom makes it difficult for the poor to stay in those neighborhoods over the long run." Dr. Case believes rising housing costs are dividing people into homogeneous communities according to income and creating a bigger gap between rich (homeowners) and poor (renters).

A more immediate effect of the rising real estate markets can be seen in the labor market. According to a study released this year by the Massachusetts Institute for a New Commonwealth (MASS Inc), the cost of living in the Boston area is over 40 percent higher than the national average. Massachusetts' gross family income is now 23 percent higher than the national average. When adjusted for costs of living in Greater Boston, the per capita income ranking falls from fourth highest in the nation to 22nd. The Mass Inc. study attributes almost all of Boston's high cost of living to the lack of more affordable housing. It concludes that due to the high cost of living "people are voting with their feet and moving elsewhere." This could become problematic, especially if higher skilled workers begin to leave the area in response to accelerating housing prices.

Professor Barry Bluestone, Director of the Center for Urban and Regional Policy at Northeastern University, echoes the sentiments of other Boston-area housing advocates. He states that, "Housing costs have accelerated here so rapidly that we are at a point where if we don't deal with the housing costs question, we could begin to sabotage the very growth that in part created the problem."

-- by Kathleen Gill
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ENTERPRISING

Faith-Based Economic Development Initiatives in New England

Faith-based community economic development may be defined as the involvement of faith-based institutions in projects designed to revitalize their communities, establish sustainable economic development initiatives, attract investments, build wealth, and encourage entrepreneurship. In order to launch their projects, faith-based institutions often form a separate non-profit community development corporation (CDC) or partner with an existing CDC, foundation, local government, or other faith-based institution.

Faith-based institutional involvement in community economic development is certainly not new. The urban-based church has a long history of involvement in community economic development activities, some of which have virtually transformed distressed neighborhoods and restored local pride. While recent cutbacks in federal, state, and local government funding have lessened the amount of funds flowing into many of these communities, such cutbacks have simultaneously stimulated interest in economic development by local churches and other faith-based institutions. Religious institutions are perceived as playing a central and stabilizing role in minority communities, adding credibility to the pursuit of economic development projects. In addition, faith-based institutions – whether based at churches, mosques, or temples – are also perceived by many as an essential source of hope to stimulate change by organizing the local community through collective action.

This article focuses on the varied experiences of four faith-based community development corporations located here in New England. In this article the terms "faith-based institutions" or "faith-based organizations" may refer to churches, temples, mosques, other religious organizations, or even a coalition of faith-based organizations.

Faith-Based Economic Development

Throughout the country, faith-based institutions are becoming more involved in local community economic development work. Dr. Amy Sherman, Director of Urban Ministries at Trinity Presbyterian Church in Charlottesville, Virginia, and author of the book Restorers of Hope, estimates that there are approximately 1,300 faith-based community development corporations in existence throughout the United States. This figure, she explains, "probably counts the larger share of Evangelical and African-American faith-based groups, but probably underrepresents CDCs connected with mainline Protestant and Catholic churches or organizations."

In conducting economic development activities, faith-based institutions have a wide variety of resources at their disposal. Many of the projects undertaken by faith-based institutions are initially capitalized by tithes, offerings, or pledges collected by the institution. In addition to these internal funds, faith-based institutions today are fortunate to have an array of talented and skilled parishioners who are able to lend their ideas, expertise, and time to projects through voluntary efforts. Through this "sweat equity" contribution from the congregation, a faith-based institution can keep its costs low and divert scarce funding to other project areas. Faith-based organizations are also unique in that they are usually the first institution to be selected by private corporations to receive donated equipment, land, or supplies. And since many of these faith-based institutions are prominent within their communities, they are able to take a leadership role in bringing together the different local partners required to facilitate change. In addition, there are also instances where a more experienced faith-based institution will mentor faith-based institutions that are new to community economic development work.

Besides utilizing their tithes and offerings to initiate projects, many faith-based institutions make use of available monetary grants, including funds from HUD, ACORN, LISC, or the federal Community Development Block Grant (CDBG) program. Assistance may also come from private foundations such as the Lilly Endowment, the Walt Disney Company, the Pew Charitable Trust, or the Ford Foundation. Faith-based institutions may also choose to partner with "deep-pocket investors" as a means of getting their projects off the ground. Typically in these deals, investors benefit from the faith-based institution's tax-exempt status through the donation of land or other private property. The nonprofit religious institution also benefits, since the acquisition of such property can be very expensive and might otherwise have hindered project development.

Nationwide, faith-based community development projects involve a wide array of activities, from the construction of affordable housing to commercial real estate development and capital formation. The scope and reach of these projects are by no means limited to the size of the institutions' congregations. For example, in New Orleans, Louisiana, Rev. Dr. Gregory Thomas pastors a congregation with only three hundred and fifty members. However, under the visionary and inspirational direction and leadership of Rev. Thomas, his church has launched a faith-based nonprofit organization called The New Orleans Center for Successful Living. The center has initiated and undertaken housing development projects in the millions of dollars through joint venture partnerships and has been as successful in its efforts as much larger congregations.

Other examples of faith-based projects include the Allen A.M.E. Church Corporation of New York, which is under the direction of Allen African Methodist Episcopal Church where Rev. Floyd Flake is the senior pastor. The corporation boasts a variety of businesses, including the Allen Federal Credit Union, Allen A.M.E. Estates – a development of 50 new, affordable two-family homes – and Allen Transportation Corporation, a for-profit charter bus company. In Chicago, Illinois, the Antioch Missionary Baptist Church has undertaken a series of housing development projects in the neighborhood of Englewood. In the town of Mendenhall, Mississippi, the Mendenhall Bible Church recently constructed a business complex that houses a health clinic, a law office, a school and recreational facilities. And in Cleveland, Ohio, Olivet Institutional Baptist Church joined with the Cleveland University Hospital to launch the Olivet Health and Education Institute, a medical facility that promotes healing in a spiritually supportive environment.

In the New England region, many faith-based institutions have also been involved in community economic development projects. The following four New England-based religious institutions have been very successful in their local efforts, in part because of their ability to capitalize on their leadership positions within their communities. Usually these organizations have had to mobilize scarce resources in order to conduct their development activities. Representing a range of religious backgrounds, these faith-based organizations are involved in diverse projects, including community organizing, commercial development, affordable housing construction, job training, and provision of financial services.

The Nation of Islam, Dorchester, Massachusetts

Back in the late 1970s and early 1980s, the Grove Hall neighborhood of Boston's Dorchester was nicknamed "Murderer's Row" because of the high rates of drug dealing and drug-related criminal activities in the area. In addition, a lot of vacant and abandoned buildings further blighted the community. Minister Don Muhammed of the Nation of Islam stated that during the 1980s, the police began cracking down on the drug dealers in an effort to get them off the streets of Grove Hall.

Around the same time, the Nation of Islam began moving into the area. Shortly thereafter, various Muslim-owned businesses began opening up within the community. But tensions soon arose between the emergent Muslim-owned businesses and the local drug

Unity Plaza in Grove Hall, Dorchester, is one example of the Nation of Islam's economic development work.

dealers. The Nation of Islam began to organize marches and patrols throughout the neighborhood. Their activities attracted the attention of other citizens and police, who soon joined the Muslims in their efforts to reclaim the neighborhood. The community not only was impressed with the stance that the Muslims had taken to protect their property, but also recognized the strength they brought to the area. They were viewed as a stabilizing force within the community because of their ability to bring various religious organizations, businesses, and local residents together to promote change.

Following this effort, the Nation of Islam began to shift its focus from issues of crime and safety to local economic development. Minister Don Muhammed indicated that the goal of the Nation of Islam is "to make their community a wholesome place for people to live, work, and play." This, he expressed, is in keeping with "the vision that Minister Elijah Muhammed had nearly 50 years ago." Minister Don Muhammed stated that the Nation of Islam's philosophy is that "you do not need money if you have people, because if you have people you can always get money."

According to Minister Don Muhammed, the local Nation of Islam used their own "nickels and dimes" to build Unity Plaza, a shopping complex in Grove Hall that houses four businesses. While the organization did not solicit funding from any outside sources for this commercial development project, the City of Boston aided the Nation of Islam in acquiring the land on which Unity Plaza is built. To date, the Grove Hall chapter of the Nation of Islam has not engaged in any projects on a joint venture basis. It is their philosophy that you first must have some successes for yourself, before you can collaborate with other people.

How was the Nation of Islam able to gather support for their project? Minister Don Muhammed said that when people hear about the desires and visions that the Nation of Islam have, they usually offer the organization the benefits of their skills and talent. The Nation of Islam is also very willing to work with other religious groups when their visions and goals run along the same themes. Minister Don Muhammed said that banks have been very responsive to the Nation of Islam's needs. In particular, he indicated that the Boston Bank of Commerce has been very aggressive in providing banking services to the minority community, including the support of similar commercial development projects.

Minster Muhammed indicated that the Nation of Islam's work has influenced other local groups within the community, spurring more economic development activity. For example, the Neighborhood Development Corporation (NDC) of Grove Hall, which is supported by the Nation of Islam, recently broke ground for the new Grove Hall Mall, which will be located in the heart of the neighborhood. This $11 million dollar project will be built on six acres of land and is expected to bring approximately 85 construction jobs to the community as well as 150 permanent jobs. In addition, Boston Mayor Tom Menino recently granted the Main Street Initiative Award to the NDC.

When asked about their measures of success, Minister Don Muhammed replied that the Nation of Islam sees their mission as working on behalf of the community by getting community residents involved in the process. He stated that he feels a sense of accomplishment when he sees people who were once on the verge of entering the poor house but are now doing well economically. Or when he sees individuals who were once involved in criminal activities, and who could have been killed, now doing positive things with their lives. His advice to other faith-based organizations that are considering doing community economic development is, "Believe in God, get up in the morning, and go to work."

Cheshire Interfaith Housing, Cheshire, Connecticut

Cheshire Interfaith Housing (CIH), located in suburban Cheshire, Connecticut, is a non-profit organization composed of seven faith denominations, all working together to provide affordable housing for low-income residents of the area: Cheshire United Methodist Church, Church of the Epiphany, First Congregational Church, St. Bridget's Church, St. Peter's Episcopal Church, St. Thomas Becket Church, and Temple Beth David.

Mr. Don Narducci, Co-Chair of CIH's construction committee, stated that "CIH is a community organization whose goal is focused around the construction of affordable housing, mostly with the assistance of volunteers." His wife, Mrs. Marjorie Narducci, serves as CIH's treasurer. CIH also assists with the repair of houses for homeowners who are unable to afford the repairs. This is done through their PROJECT NINE (Neighborhood in Need) Program.

The idea for Cheshire Interfaith Housing came as a result of a workshop that was held by the Catholic Archdiocese of Hartford. Three Catholic Churches in Cheshire then conducted both a study of the area's housing needs and a survey of the churches in Cheshire to determine the level of interest among area institutions. In the preceding year the Cheshire Housing Partnership Committee, formed by the Town Council, had conducted a survey on housing needs in Cheshire and determined that there was a need for affordable housing. The coalition also wanted local churches to help take on this task. It took approximately two years to formulate CIH and to achieve nonprofit status.

CIH's first housing project seemed to have had a mushrooming effect on other religious organizations, many of which have bought into their concept. According to the Narduccis, CIH's work constantly involves building relationships and spreading the word of what can be accomplished through voluntary faith efforts. CIH's motto is "Building dreams, one house at a time." To date, CIH has built two homes, and they hope to construct two or three more homes within the next couple of years.

Mr. Narducci indicated that their model is similar to that of Habitat for Humanity. The only difference is that CIH does not carry the mortgage for the homeowner. However, some banks are willing to work with prospective homeowners along the way and provide credit counseling to those who are in need of financial literacy or planning services. In order to qualify for one of these homes, an individual need only submit an application and meet the income criterion, which is 60 percent of the area median income. The down payment is obtained through 500 hours of "sweat equity," donated to the building project by the prospective homeowner.

The Narducci's indicated that among area banks one bank in particular, Naugatuck Savings Bank, has been very receptive to their initiative. At their initial meeting with Naugatuck Savings Bank CIH met with the mortgage representative and received a loan for $20,000 interest free, as well as a $2,000 donation to assist with a fundraising event. They have also received funding from HUD and from local private foundations, including the Rossi Foundation.

The first home built by Cheshire Interfaith Housing (CIH) in Cheshire, Connecticut.

There have also been non-monetary donations, from several other sources. For example, a hardware store donates all the paint; a millwork company donates quality windows and doors; a local plumbing contractor does all the plumbing work;and a small contractor donates discounted materials to CIH. A realty company in town initiated a gift of two building lots from a local businessman. The lot on which CIH's first house was built was obtained through a state grant, and the second house was built on a lot purchased by CIH.

Volunteers are also important for CIH. There is no paid staff at Cheshire, nor is there an executive director. There are, however, a president, vice president, secretary and treasurer. CIH's board is made up of two individuals from each of the faith denominations that are involved in the town. A number of individuals not affiliated with a local faith community have also been appointed to the board. The president of CIH is a licensed electrician who donates his time and talents to the project, and Mr. Narducci's background is in engineering. There have been many volunteers, with various professional backgrounds as well as varying age groups, working on the construction pieces. Lawyers from Yale University donated their time to assist CIH with the writing of their charter.

Mt. Moriah Baptist Church, Brockton, Massachusetts

At Amara Computer Center, staff download software on a PC that will be donated to one of the kids participating in the training program.

Amara Community Center was founded in December 1981 by the Rev. Eugene Neville, Pastor and Founder of Mount Moriah Baptist Church in Brockton, Massachusetts, a church with a congregation of approximately 250 members. When the center first opened up, they had two IBM personal computers that the Reverend and his wife originally purchased for their daughters from Mrs. Neville's former employer, IBM Corporation. The computers never made it home, but were instead brought to the church and eventually used to launch the computer center. In the mid 1980s, the church received a further donation of 25 personal computers from IBM.

At its inception, the center provided day care services and an after-school program. It was the first after-school program in the City of Brockton. After approximately seven years, the day care center was phased out, the after-school program remained and Amara began to transform the program into a full-fledged computer training facility. The focus of the program was now on providing technology training to children ages 5 1/2 to 17 years.

When the Amara Community Center first started, it catered primarily to children from the community. However, the center has trained individuals from such organizations as the Brockton Housing Authority, the YMCA, the Boys and Girls Club, the Brockton Private Industry Council, and My Turn, a program for at-risk youths. To date, the center has served over 1,400 individuals. The following are some of the courses that are taught in the program:

- Introduction to the PC;
- Basic Typing, Office Applications;
- Graphics and Animation;
- CD Production; and,
- Creative Writing and Journals.

In addition to computer-oriented classes, the curriculum also includes a conflict resolution component.

Amara also holds a summer computer camp program, which runs each year from June through August. The cost for attending the camp is $100 per week. The congregation and local small businesses are encouraged to "sponsor" a child to attend for a week or two if their parents are unable to afford the cost of the program. As an added incentive, those children passing through the summer camp are given a free computer upon completion, which allows them to practice the techniques learned over the summer. This past summer, Amara gave away 200 Pentium computers at the end of the summer camp program. Beginning in the fall of 1999, Amara plans to provide a six-week computer training program for parents who are interested in taking advantage of this opportunity. Individuals will receive a Pentium computer at the end of their training.

Amara Computer Learning Center has also purchased and installed satellite technology which the Center has already used to conduct four Multi-State Youth Town Meetings. Discussions at these meetings focus on issues such as violence prevention, drugs, and sex. There are also plans for a regional faith-based distance learning network, which will include four churches in the Cambridge, Boston, Brockton, and Rhode Island areas. Amara is also a chartered distance learning center of the Howard University Divinity School – one of ten such centers in the country. As Reverend Neville states, "Students are able to take courses offered anywhere in the world . . . We also have the capacity to provide videoconference services to sister churches, institutions, and organizations throughout New England."

The church is fortunate in that it has been the recipient of donated furniture, office equipment, and computers from various private organizations. Funds are also generated from registration fees and through small grants (including grants from the East/West Foundation and the Pilgrim Foundation). Amara also benefits from in-kind volunteer services donated by parishioners and others.

Rev. Neville indicated that "it would be excellent if banks would form partnerships with the Center to expand its technological outreach program." He further suggested that this could be done "via donation of staff who would volunteer to teach on a Saturday or a weekday, or via the donation of computers or grants for the computer camp."

Messiah Baptist Jubilee Federal Credit Union, Brockton, Massachusetts

The vision for the Messiah Baptist Jubilee Federal Credit Union came from the Church's pastor, Rev. Michael Wayne Walker. Rev. Walker comes from a family of entrepreneurs, and he has very strong feelings about a congregation's need to tithe, save, and invest.

The credit union was founded in October 1983 after the congregation overcame several hurdles to its development. The first challenge had to do with the initial funding for the credit union. The original source of funding came from the congregation. The Church did not have adequate funds in place to get the Credit Union started, and their application was rejected twice by the National Credit Union Administration (NCUA). However, the Pastor was not about to give up on his vision, and the members were asked to save 50 cents a day for a year in order to get the initial funding that was required by the NCUA. Their application to the NCUA was eventually approved.

The NCUA provided the church with the required training on how to run a credit union. There are no paid employees, only volunteers. However, the church has been able to capitalize on the job training opportunities afforded by the credit union in order to train teenagers and young adults (ages 13 and up). Young people and adults are trained in basic financial skills, including taking deposits, reconciling daily balance sheets, and customer service skills. Most of the older volunteers are members of the church with backgrounds in financial services or those who are pursuing degrees in that field. The credit union is open on Sundays (after the church service), as well as on Saturdays and Wednesday evenings.

The majority of the funding for the credit union is received from member deposits. However, the credit union also accepts deposits from non-members of the church. Loans are also made to individuals as far away as New Jersey and North Carolina. However, most of the loans are made within the New England area. Some of the services offered include share accounts (a minimum requirement for membership) and certificates of deposit for 180 days to 24 months with a $500 minimum. The credit union also offers automobile loans, home equity loans, and some first mortgage loans. There are also several investment clubs,

Junior tellers undergoing training at the Messiah Baptist Jubilee Federal Credit Union.

including the 21st Century Smart Investors Fund, a balanced portfolio of equities and fixed-income securities. The credit union has plans to expand its products and services in the near future. However, right now they are limited by their reliance on volunteer employees.

When asked about the credit union's plans for the future, the Chairman of the Credit Union, Ernie Siders, answered that he “would like to see the credit union grow and expand throughout the community and become a source of economic viability for the people it serves.” Mr. Siders, who has an extensive background in finance, is also assisting with the coordination of a series of workshops for other faith-based organizations on fund-raising and grant writing.

Conclusion

In New England and throughout the country, faith-based institutions are contributing to the economic development of their local communities through projects of varying scope and size. In addition to undertaking commercial and housing development projects, faith-based institutions are also involved in education and job training initiatives.

While their range of activities is broad and many have been very successful, the economic development work of most faith-based organizations is not always well-known outside of their communities. This makes it difficult for some faith-based institutions to receive support from banks and government entities. As indicated by staff at these four New England faith-based organizations, while some banks are very supportive of faith-based economic development projects, others unfortunately are not as knowledgeable about their work. Mr. Cicero Wilson, Executive Director of the International Theological Center/Faithworks in Atlanta, Georgia, explained that there is a “lack of understanding [by] both the government and financial institutions of these faith-based programs.” He added that “it is very important for faith-based leaders to engage in conversations with leaders in government and financial institutions.” Perhaps as more faith-based organizations become involved, banks and governmental entities will begin to view them as valuable local allies in achieving their community economic development objectives.

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COMPLIANCE CORNER

REGULATORY Q&A

The following is a sample of recent questions received by the Federal Reserve Bank of Boston, Bank Examination Department's Consumer Regulations Hotline. Consumers and financial institutions with questions can call the hotline at 617-973-3755.

<u>Regulation Z: Truth in Lending (TILA)</u>

Q. ***When may a creditor issue an unsolicited credit card?***

A. The Federal Reserve Board recently revised the Official Staff Commentary to Regulation Z to further address this issue. A creditor is prohibited from issuing a credit card except in response to a consumer's request or application for the card or as a renewal of or substitute for a previously accepted card. The law, however, does not prohibit a creditor from issuing an unsolicited card with a non-credit purpose. For example, an unsolicited card such as a check-guarantee or a purchase price discount card is permissible as long as it cannot be used to obtain credit. A consumer may later be able to convert the card to a credit card if the issuer makes a credit feature available and the consumer requests the card.

Multifunction cards connected with credit plans when they are issued are credit cards and may not be sent without the consumer's prior request or application. If at the time the card is issued, the consumer can either access a credit plan or the consumer has been pre-approved for credit and need only access the card by contacting the issuer, then issuer is in violation of Regulation Z.

Q. ***Must credit card issuers disclose penalty rates on or with an application or solicitation?***

A. Regulation Z requires credit card issuers to provide consumers with certain information on or with applications or solicitations. The information such as annual percentage rate (APR), annual fee, and grace period must be provided in the form of a table with headings. *The Official Staff Commentary to Regulation Z* provides guidance on penalty rates. (Penalty rates are increases in the interest rate triggered by specific events such as exceeding the credit limit or a late payment). The commentary provides that card issuers must disclose in the table the initial rate and the increased penalty rate that may apply. If the penalty rate is based on an index and an increased margin, the issuer must also disclose in the table the index and margin.

The issuer must also disclose the specific event or events that may result in an increased rate, such as "22% APR, if 60 days late." The specific event or events may be located outside of the table if the conditions are noted with an asterisk or other means that directs the consumer to the explanation.

Q. ***The Homeowners Protection Act of 1998 limits the amount of private mortgage insurance (PMI) consumers can be required to purchase. Borrowers may request cancellation of PMI under some circumstances, and lenders must terminate PMI automatically when certain conditions are met. How do these statutory requirements affect the TILA disclosures?***

A. Under Regulation Z, PMI premiums are finance charges and are figured into disclosures such as the APR and payment schedule. TILA disclosures are based on the legal obligation between the parties, and the payment schedule disclosure should reflect all components of the finance charge, including PMI, for the time period when there is a legal obligation to maintain the insurance.

Recent revisions to the Official Staff Commentary provide that the payment schedule should include the borrower's mortgage insurance payments until the date on which the creditor must automatically terminate coverage under the law, even though the consumer may have the right to request that the insurance be cancelled earlier.

Q. ***Section 226.19(b) of Regulation Z pertains to disclosures for certain variable rate transactions. The section permits creditors to provide in the disclosures a statement that the periodic payment may substantially increase or decrease and a maximum interest rate and payment based on a $10,000 loan amount, in lieu of providing a 15-year historical example of index values. Is this choice of disclosures available for open-end transactions as well?***

A. No. This alternative disclosure option is only available for closed-end credit transactions secured by the consumer's dwelling and for a term greater than one year.

Q. ***How can I obtain copies of the revised "Consumer Handbook on Adjustable Rate Mortgages" brochure?***

A. The Board of Governors of the Federal Reserve System (Board) recently revised the *Consumer Handbook on Adjustable Rate Mortgages* brochure. Copies of the revised brochure are available from: Publication Services, Mail Stop 127, Board of Governors of the Federal Reserve System, Washington, DC 20551. The first 100 copies are free. The brochure also is available on the Board's public web site at *http://www.federalreserve.gov/consumers.htm* Please note that creditors may use the earlier version of the brochure until existing supplies are exhausted.

Regulation C: Home Mortgage Disclosure Act (HMDA)

Q. ***If there is more than one co-applicant to purchase property, must the lender report the race and sex of each co-applicant on the HMDA LAR?***

A. No. If there is more than one co-applicant, provide race and sex information only for the first co-applicant listed on the application.

Regulation DD: Truth in Savings

Q. ***Are financial institutions that offer online banking programs permitted to electronically deliver to the consumer periodic statements and related disclosures required under Regulation DD?***

A. Yes. Effective September 1, 1999, the Board issued an interim rule for Regulation DD allowing the issuance of periodic statements electronically for consumer asset accounts if the consumer agrees. The electronic delivery of periodic statements and other disclosures required under Regulation E, which implements the Electronic Funds Transfer Act, is already permissible under the Regulation E interim rule of March 1998. As depository institutions commonly provide a single periodic statement complying with Regulations DD and E, this new interim rule allows depository institutions to issue the combined statement electronically and avoid the cost of printing and mailing the disclosures in paper form.

Note: to allow institutions to provide other disclosures electronically, the Board has proposed additional changes to Regulations DD and E and to three other regulations: Regulation B (Equal Credit Opportunity); Regulation M (Consumer Leasing); and Regulation Z (Truth in Lending).

Q. ***Is a checking account advertised as "free" in compliance with Regulation DD when there is a $25 minimum balance to open the account, but no fee is assessed if the customer does not maintain the minimum balance?***

A. Yes. The account complies with Regulation DD advertising requirements. Regulation DD prohibits financial institutions from advertising an account as "free" if maintenance or activity fees may be assessed. For example, if the institution imposes a fee for not maintaining a minimum balance, this fee would fall within the definition of a maintenance or activity fee, and the "free" account advertisement would be in violation of Regulation DD.

For examples of maintenance and activity fees, see Section 230.8(a) 3 of the *Official Staff Commentary to Regulation DD*.

Regulation D: Reserve Requirements of Depository Institutions

Q. ***Do transfers from a consumer's savings account to his demand deposit account by a telephone voice response system or by home banking system count toward the six transfer limit on savings deposits in Regulation D?***

A. Yes, with some exceptions, transfers made by telephone voice response systems and home banking systems count toward the six transfer limit for savings deposits contained in Regulation D, Section 204.2(d)(2). One exception is that withdrawals by telephone do not count toward the transfer limit if the funds withdrawn are mailed via a check to the depositor.

Regulation E: Electronic Fund Transfers

Q. ***What are the revised time periods under Regulation E for investigating alleged errors involving point-of-sale (POS) transactions, foreign-initiated transactions, and new accounts?***

A. For POS and foreign-initiated transactions, the rule requires financial institutions to provisionally credit an account within 10 business days, rather than 20. Financial Institutions continue to have 90 calendar days to complete the investigation.

For new accounts, financial institutions now have 20 business days to resolve an alleged error before provisionally crediting an account and up to 90 calendar days to complete the investigation.

-- by Carol Lewis & Anthony Ricko
Bank Examination
Federal Reserve Bank of Boston

IN MEMORY

During this past quarter, the Federal Reserve System lost two distinguished colleagues in the Community Affairs function. Both Kenneth P. Fain and Frederick M. Manning worked tirelessly to bridge the gap that once existed between bankers and community groups. The Public & Community Affairs Department of the Federal Reserve Bank of Boston extends our deepest sympathies to the Fain and Manning families. Both gentlemen will be sorely missed.

Kenneth P. Fain

Ken Fain, Community Affairs Specialist at the Board of Governors of the Federal Reserve System, passed away on September 28, 1999 while on business in Chicago. Ken had worked at the Board's Department of Consumer and Community Affairs for the past eight years. His work involved efforts to facilitate public-private partnerships in order to facilitate access to credit for low-income communities. He also wrote speeches for the Chairman and other Governors at the Board. Prior to joining the Federal Reserve System in 1991, Ken worked for the Office of the Comptroller of the Currency (OCC) in a community development capacity. His distinguished career also included work for the Maryland Department of Economic and Community Development, and community reinvestment work for the American Bankers Association.

Frederick M. Manning

Fred Manning, former Vice President and Community Affairs Officer at the Federal Reserve Bank of Philadelphia, passed away on September 17, 1999 following a long illness. Fred's distinguished career spanned 35 years at the Philadelphia Reserve Bank, where from 1981 until 1998 he was responsible for community development initiatives. He was a pioneer, establishing the first separate Community and Consumer Affairs Department in the Federal Reserve System in 1984. Prior to becoming head of the Community and Consumer Affairs function, he held several positions at the Philadelphia Fed including serving as the chief examining officer and as an executive on loan to the Board of Governors in Washington, D.C. Fred's approach to community development could be summed up through his own words: "Simple logic tells us that we need each other."