

# THE ROLE OF COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS IN HOME OWNERSHIP FINANCE

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## Abstract

Community Development Financial Institutions (CDFIs) provide a range of financing products to low-income and minority borrowers, with mortgage lending making up approximately one-fourth of all of this activity. In this capacity, CDFIs play an important role in promoting homeownership opportunities for borrowers and communities that have been historically denied access to mainstream sources of credit, and that have increasingly been targeted by high-priced or predatory loans. To attain a fuller understanding of how CDFIs fit within the mortgage market in general, this analysis explores the following four issues: (1) whether and how CDFIs provide access to mortgage finance; (2) whether and how CDFIs keep homeowners in mortgages; (3) whether and how CDFIs provide mortgage financing in rural markets; and (4) whether and how CDFIs save borrowers from predatory or unsustainable mortgages.

Our analysis suggests three different roles CDFIs play in mortgage finance, and corresponding strategies supporting these roles for CDFIs. These roles are: CDFIs as alternative lending sources; CDFIs as complements and partners with mainstream financial institutions; and CDFIs as innovators within the mortgage market.

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## Executive Summary

Community Development Financial Institutions (CDFIs) provide a range of financing products to low-income and minority borrowers, with mortgage lending making up approximately one-fourth of all of this activity. In this capacity, CDFIs play an important role in promoting homeownership opportunities for borrowers and communities that have been historically denied access to mainstream sources of credit, and that have increasingly been targeted by high-priced or predatory loans. The CDFI Data Project (CDP) estimates that CDFIs originated 15,109 mortgages in 2005. However, little is known about how CDFI home loans fit within the greater landscape of mortgage finance. To attain a fuller understanding of how CDFIs fit within the mortgage market in general, this analysis explores the following four issues:

- Whether and how CDFIs provide access to mortgage finance: A look at CDFI mortgage originations.
- Whether and how CDFIs keep homeowners in mortgages: A look at the performance of mortgages that CDFIs originated.
- Whether and how CDFIs provide mortgage financing in niche markets: A look at CDFI lending in rural places.
- Whether and how CDFIs save borrowers from predatory or unsustainable mortgages: A look at CDFIs responding to the foreclosure crisis.

## Findings and Implications

Our analysis suggests three different roles that CDFIs play in mortgage finance, and corresponding strategies to support CDFI mortgage finance:

***CDFIs serve as an alternative lending source.*** Our findings show that CDFI mortgage lending is a very small segment of all mortgage lending—too small to provide a true alternative in the mortgage market. However, CDFI loans perform well compared to both subprime lending and lending by the Federal Housing Administration (FHA). We conclude that initiatives that would increase the scope and scale of CDFI mortgage finance are good investments.

***CDFIs complement and partner with mainstream lenders to extend financing to target communities.*** We find that many CDFIs use gap financing mortgage products (non-first-lien loans). This suggests that CDFIs are complementing and partnering with mainstream financial institutions to maximize their impact with limited resources. These loans often take the riskiest positions for the smallest rewards. For CDFIs to sustainably continue filling this gap, ongoing subsidy will be required.

***CDFIs have an impact on market practice and policy through innovation and research.*** Our research shows CDFIs creating innovative new programs in foreclosure prevention, intervention, and recovery. Furthermore, CDFI products illustrate methods to prudently assess and take risk in niche markets. This strategy can be advanced through dissemination of best practices and additional thoughtful and robust research on the market and performance of CDFI mortgages.

## I. Introduction, Brief History, and Literature Review

“Community development financial institutions (CDFIs) help to address the financial needs of underserved, predominantly low-income communities” (CDFI Data Project [CDP] 2006). They accomplish this mission by providing an alternative source of financial services, credit, and investment capital to traditional financial markets. By providing these services CDFIs “fill gaps in financing for economically disadvantaged people and communities” (Pinsky 2001, 5). As of 2006, over 1,000 CDFIs were active in the United States.

In seeking to fulfill their larger mission, many CDFIs are active in home mortgage lending, and they reported originating 15,109 home mortgages in 2005 (CDP 2006). In 2003, home mortgage lending represented 22 percent of CDFI financing activity, making it one of the largest financing activities that the CDFIs conducted.

Despite the amount of CDFI resources committed to mortgage finance, information about their home lending activity is limited. Case studies have examined individual CDFI home mortgage lending, but information about the industry as a whole is sparse. The information that does exist consists almost entirely of general descriptive statistics collected by the CDFI Data Project (CDP). The lack of information is partially a result of the youth of the field, as CDFIs began to consolidate as an industry only in the 1990s. The diversity of the institution types further complicates industry-wide analysis of any aspect of CDFI activity. The common thread within the industry—to provide fairly priced financial services to underserved communities—includes organizations with a variety of services and structures. The transaction-level report (TLR) component of the CDFI Fund’s Community Investment Impact System (CIIS) data has the potential to answer questions about CDFI home mortgage lending activity. The TLR standardizes data points to create a data set that is comparable across the variety of institutions. By focusing on transaction-level activity, as opposed to the institutional level, it minimizes the difficulties arising from the diversity of CDFIs. For a variety of reasons, however, CIIS does not fully describe CDFI mortgage lending. In Section IV of this paper and in Appendix A we fully describe the limitations of the TLR and recommend changes that would improve the dataset.

An alternative source of data that many financial institutions use, which includes some CDFIs, is the information reported about their mortgage lending to the Federal Financial Institutions Examination Council (FFIEC), as required by the Home Mortgage Disclosure Act (HMDA). HMDA data are standardized and required, and as a result they can be very useful in understanding mortgage originations. They also have the advantage of facilitating the comparison of CDFIs with other lender groups. Unfortunately, only some CDFIs (those with large volumes and active in metropolitan areas) are required to submit these data.

This paper seeks to draw on the data that are available in order to fill some of the gaps related to CDFI activity in home mortgage lending, and to describe the role CDFIs play in the broader home mortgage market.

First, the findings in this paper provide a broad overview of CDFI home lending activity based on the 2006 TLR and the 2003 and 2006 HMDA data sets, as well as information from the 2000 Census. The descriptive statistics describe the markets served and products provided, and can be further divided into those that relate to the borrowers and those that relate to the location of the loan. Geographic markets were chosen as a focus because of the history of geographic-based discrimination in the housing market, as well as past research indicating that neighborhood characteristics affect lending products and outcomes (Capone 2002). Second, this paper compares two of the primary mortgage product lines present in the data sets, first- and second-lien mortgages. The decision to look at these product lines was a response to Dan Immergluck's paper on analyzing CDFI impacts (Immergluck 2006). Third, this paper compares CDFI lending activity with prime, subprime, and FHA lending. This comparison between loan types focuses on markets served and products provided.

In addition to analyzing originations, this paper examines home loan performance. The performance data from the TLR data set are supplemented with data obtained from First American Core Logic concerning loans originated in 2006 in Cook County, Illinois, and Wake and Durham Counties, North Carolina.

Rural markets are one sub-market CDFIs serve. These markets are not well described in public origination or performance data, so we decided to look more closely at this type of CDFI lending using a case study approach, through interviews with eight CDFIs actively making home loans in rural areas.

Finally, the paper describes programs and products that CDFIs are developing and using to respond to the current foreclosure crisis by helping to prevent foreclosures, intervening in the foreclosure process, and/or helping families and neighborhoods recover from foreclosures. Information from this section was obtained with the help of the Opportunity Finance Network (OFN) and through case study interviews.

## **A Brief History of the CDFI Industry**

The CDFI industry coalesced in the 1990s out of a number of different lineages. Minority-owned and operated banks began serving low-income minority communities in the late 1800s. Credit unions focused on serving local communities emerged later and dominated the CDFI field until the 1960s. During the 1960s and 1970s, community development corporations (CDCs) were established. In the 1980s, larger nonprofit loan funds began to emerge. These organizations increased the focus on financial services in community development.

The Clinton administration initiated two actions that were essential to solidifying the community development finance industry: changes in enforcement of the Community Reinvestment Act (CRA) and evaluation led to increased bank funding to CDCs and CDFIs; and the creation of the community Development Financial Institutions Fund (CDFI Fund) in 1994. The CDFI Fund was created as a division of the Treasury Department, and charged with increasing the availability of affordable capital to historically underserved markets and populations. As of 2005 it provided over \$820 million in direct financing through the CDFI and Bank Enterprise Award (BEA)

programs. The CDFI Fund works extensively to support the development of loan funds, banks, credit unions, and venture capital funds that have a mission to serve low- and moderate-income markets and populations. As of 2008 the fund has certified 803 CDFIs (CDFI Fund 2008).<sup>1</sup>

During the consolidation of the CDFI industry in the 1990s, four primary CDFI types emerged: credit unions, banks, loan funds, and venture capital funds. This paper primarily focuses on the first three types because venture capital funds do not originate home mortgages.

The CDFI industry provides a diverse selection of products including retail banking services, home mortgage lending, construction lending, community facilities finance, and debt and equity for small businesses. CDFIs provide these services with the goal of “increasing economic growth and job creation in low-income areas; creating housing for low-income individuals; stabilizing population decline in distressed communities; improving the availability and quality of community facilities in underserved markets; increasing the number of business owned by women and ethnic minorities; and promoting the growth of businesses that do not harm the environment” (Rubin 2008).

#### **Where Do CDFIs Fit?**

One of the most important questions facing CDFIs is: What is the relationship between traditional service providers and CDFIs? One view is that CDFIs should act as a *supplement* to traditional lenders, leveraging their knowledge and connections to historically disadvantaged communities to ease entry into the traditional financial system. This approach emphasizes products such as second mortgages that cover closing costs and downpayments, and allow borrowers to qualify for home mortgages from traditional lenders. Organizations operating as supplements may also partner with traditional financial service providers to create referral networks.

Others see CDFIs as financial service *entrepreneurs* and thus view their role as exploring, testing, and proving new markets and products so as to induce traditional lenders to adopt these products and enter these markets. Supporters of the entrepreneurial role of CDFIs point to the tiny size of the industry in comparison to traditional lenders, arguing that only the traditional players possess sufficient scale and resources to have an impact on the financial services provided to underserved communities across the nation.

Another perspective is that traditional lenders are incapable of meeting the needs of traditionally underserved communities, and that CDFIs should serve as a *competitive alternative* to them. In this model, either traditional lenders will alter their practices in order to provide affordable credit to underserved communities, or CDFIs will gain a dominant market position within that community. Those who place a high value on the local control of capital, a practice that is more often associated with CDFIs than traditional financial institutions, tout this competitive alternative model as being better for the community.

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<sup>1</sup> The CDFI Fund certifies organizations as CDFIs. Not all organizations that operate as CDFIs have sought out this certification, but any organization seeking funding from the CDFI Fund must first obtain it.

In addition to the debate about the relationship between CDFIs and traditional lenders, there is discussion about what constitutes a successful CDFI. Some argue that we should expect CDFIs to have higher loan loss rates because they are pushing into underserved markets and creating new products. Others say this higher level of risk is justified because of the subsidized capital CDFIs receive from foundations, wealthy donors, and the government, thus creating an obligation to serve the neediest and the highest-risk portions of the market. On the other hand, those who push for CDFIs to achieve similar loan loss and delinquency rates as traditional financial service providers support their position by pointing out that this will encourage traditional providers to enter underserved markets, and that keeping losses down makes CDFIs more sustainable and allows more borrowers to be served.

Our paper uses the homeownership finance arena as a lens through which to better understand the complex interplay between CDFIs and other lenders in the homeownership finance arena, beginning with a look to the literature.

## Literature Review

Limited research has been conducted that specifically focuses on CDFI mortgage lending. Two CDFI industry reports—the OFN’s annual report of the CDFI Data Project<sup>2</sup> (CDP) and a summary report of data from the CDFI Fund’s CIIS reporting system, do provide a baseline understanding of how home mortgage lending fits into the overall work of CDFIs. However, neither data set has been used to describe the role of CDFIs in home mortgage finance. There has been some published research, albeit a limited amount, that investigates CDFI and nonprofit home mortgage originations. A greater body of literature has examined the extension of home mortgage loans by all types of institutions to nontraditional borrowers.

### Mortgage Lending within All CDFI Activity

Home mortgage financing is just one of the ways CDFIs fulfill their missions to extend financing to underserved markets. The 2005 CDP annual report showed that just under half of total financing went towards housing, which includes CDFI financing for rental housing and home mortgages. The “Three Year Trend Analysis of Community Investment Impact System Institutional Level Report Data FY 2003-2005”<sup>3</sup> (Bershadker et. al. 2007) shows that, on

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<sup>2</sup> The CDFI Data Project is an industry collaborative that produces data about CDFIs. The goal of the CDP is to ensure access to and use of data to improve practice and attract resources to the CDFI field. The 2005 CDP annual report is estimated provide data about roughly half the CDFIs in existence. Descriptive statistics from the CDP’s annual reports are based on over 170 data points, and provide a broad range of information about CDFIs, including: population served, geography served, institutional characteristics, financing activity, and outcome (CDP, 2005).

<sup>3</sup> “Three Year Trend Analysis of Community Investment Impact System Institutional Level Report Data FY 2003-2005” includes descriptive statistics about CDFI portfolios, capital, operating revenue, characteristics, originations, and impacts. The data contained within the report is entirely derived from CIIS, and represents 223 respondents for 2003, 236 for 2004, and 173 for 2005, with 86 respondents reporting for all three years. The report provides descriptive statistics about the proportion of CDFI home mortgage loans that are originated each year and held in CDFIs’ portfolios not available from the CDP annual reports.

average, 23.1 percent of a CDFI's outstanding portfolio is composed of home mortgages. The report finds that older CDFIs make home mortgage loans at less than half the rate of younger CDFIs, though without explaining this difference.

### **Populations CDFIs Serve**

The CDP's annual industry reports find that CDFIs consistently serve minority, female, and low-income populations at higher rates than traditional lenders. The most recent report, for fiscal year 2005, found that 69 percent of CDFI clients are low-income, 58 percent are minorities, and 52 percent are women. Additionally, close to 40 percent of CDP respondents serve major urban areas, about 25 percent serve minor urban communities, and about 33 percent serve rural communities.

Quercia and Stegman (2001) examined Self-Help Credit Union's Community Advantage Program (CAP). Under this program, the CDFI purchases non-conforming affordable loans from multiple lenders and then provides a guarantee that entices Fannie Mae to purchase the loans. In comparison to Fannie Mae's overall business portfolio, the share of minorities in this affordable home mortgage portfolio was more than twice as high, while the rate of female borrowers and those under the age of 30 was almost three times as high. In addition, the proportion of CAP borrowers that were at or below 60 percent of the area median income (AMI) was five times as high, and a full 41 percent were located in rural areas.

Hornburg (2004) surveyed home mortgage brokerage activity among nonprofit financial service providers. His survey covered 34 nonprofits and 5,052 home mortgage loans. The racial distribution of these home borrowers was roughly 40 percent white and 60 percent minority, with half the respondents reporting a Hispanic ethnicity. Hornburg found that the average loan size was nearly 40 percent larger for white borrowers than black borrowers. Just over 40 percent of the borrowers were reported to have an income under 80 percent of the AMI, and only 10 percent reported income over 100 percent of AMI.

### **Mortgage Financing for Non-Traditional Borrowers**

The national home mortgage market has undergone significant changes over the last twenty years. Multiple researchers offer strong evidence to suggest that a "dual" mortgage market has emerged representing a continuation of the discrimination in lending toward minority and low-income communities that previously existed in the form of excluding these communities from financing altogether. The result is a separate but unequal market where subprime mortgages provided to the nontraditional segments are higher in cost and more onerous in terms than the prime mortgages that reach traditional borrowers. Since CDFIs tend to serve nontraditional borrowers as well, we look at the literature describing how the dual market serves nontraditional borrowers.

HMDA data for 2002 shows that 38.6 percent of African-Americans with an income between 80-120 percent of AMI received a prime mortgage, while 68.5 percent of white borrowers in the same income bracket received prime mortgages (Apgar 2004). In 2001, for the market as a whole, subprime lending represented 6 percent of total home purchase loans originated, but for

low-income communities subprime loans comprised over 10 percent. From 1993 to 2001, subprime lending for home refinancing in low-income communities increased four-fold, to 27 percent of this market (Apgar 2004).

Immergluck and Wiles (1999) reviewed neighborhood lending activity in Chicago in the late 1990s and found a higher proportion of prime lenders in white upper-income neighborhoods, and a higher proportion of FHA and subprime activity in minority and low-income communities. They argued that the racial disparities between prime and subprime and FHA lending were not fully explained by borrower credit characteristics. They concluded that a dual mortgage market existed in Chicago, and that it was a product of the failure of prime lenders to attempt to identify strong borrowers that existed in minority and low-income communities (Immergluck and Wiles 1999).

Pennington-Cross, Yezer, and Nichols (2000) measured borrower credit quality, sampled real estate transactions, and drew upon HMDA and FHA data to evaluate the factors that influenced the type of mortgage a borrower received. They concluded that income, credit history, debt, census tract characteristics, as well as race and ethnicity, were significant factors. Fishbein and Bunce (2000) also directly tackled the question of whether risk factors could explain the racial disparity in subprime lending, concluding that they could not.

Bradford (2002) used HMDA and 2000 Census data to discover that black and Hispanic borrowers were disproportionately represented in subprime refinance markets, and that this pattern persisted across all regions and metropolitan statistical areas (MSAs). This study did not control for risk factors, but it did show that the dual market is not localized.

### **Risk in Lending to Non-Traditional Borrowers**

Quercia (2001) reviewed several studies that compared the risk of affordable home mortgage loans to traditional home mortgage loans, finding no consensus as to whether affordable home mortgages had a higher risk level than traditional mortgages. Quercia pointed out the flaws in how the risk of affordable home mortgage lending is compared to traditional home mortgage lending, and how the choice of benchmarks can affect the perceived performance of affordable loans. In addition, Manchester (2002) and Bostic (2007) described the targeting goals set out by HUD for the GSE's affordable lending, and how these goals in turn drive commercial lenders to lend directly to the same disadvantaged populations and underserved neighborhoods that CDFIs target in their home mortgage lending.

The literature begins to describe the landscape for mortgage lending in underserved markets but leaves substantial gaps, particularly on whether and how CDFIs serve these markets. Furthermore, comparative performance has not been studied. In this paper, we use TLR data, HMDA data, loan performance information obtained from property records, and 2000 Census data to further describe this landscape and establish a framework for understanding the various channels through which mortgage capital reaches these borrowers and communities. We also look at two additional roles CDFIs play to illustrate how they serve as rural mortgage lenders and the variety of responses they have articulated to the current foreclosure crisis.

## II. Origination of CDFI Mortgages

### Homeownership, the Mortgage Origination Market, and CDFIs

Homeownership has been supported by the U.S. government since the Great Depression because of its positive impacts on households and the surrounding community. Home equity represents the largest single portion of total wealth for the majority of households in the U.S. (Retsinas and Belsky 2005, 173). Homeownership—considered an essential ingredient for healthy neighborhoods because of the stability, sense of ownership and community, and legal rights associated with owning a home—is most attainable through affordable financing.

CDFIs, as well as other types of lenders, provide access to this vital mortgage finance. In this section we explore mortgage market origination trends, particularly those that shaped the period covered by the CIIS data (2003 - 2006). Then, using that data, we look in depth at CDFI mortgage origination patterns and compare them to those of other lender types.

#### Understanding the Landscape: Trends in Mortgage Originations

This paper relies on data describing mortgage originations between 2003 and 2006, before the onset of the current mortgage crisis. Beginning in the mid-2007 subprime mortgages began defaulting at extraordinary rates leading to the highest rate of foreclosures ever seen in this country. The market response to this surge in foreclosures continues to evolve daily. In section V we further explore this crisis and the responses CDFIs have offered to help borrowers and communities. However, in this section, we focus on trends that shaped the environment of mortgage lending for the period covered by the CIIS data.

The home mortgage market fundamentally transformed throughout the 1980s, 1990s and early 2000s. The evolution of the secondary market, technological innovation, the growth of the subprime submarket, decline in FHA lending, industry consolidation, and the rise of brokers all played important roles in the development of the mortgage market in which the loans we examine were made. Further, each of these trends has important implications for CDFI mortgage lending.

**Secondary Mortgage Market:** In 1990, fewer than half of all mortgages were securitized and sold on the secondary market, but as of 2003, securitizations had risen to nearly 70 percent (Inside Mortgage Finance [IMF] 2008). Prior to the emergence of the secondary market, home mortgage lenders held the mortgages they originated in portfolio. With the rise of the secondary market and the securitization process, many of these loans are now funded through complex networks and global capital market investors.

**Mortgage Technology:** The rise of the secondary market called for greater standardization in mortgages and origination practices. Large firms also demanded a high rate of throughput to generate profit, further encouraging the move toward greater standardization, routinization, and automation of home mortgage lending (Listokin et al. 2000). Mortgage risk is now assessed by a

combination of credit scores and underwriting software, and both of these tools rely on econometric models that are built on historical default data to project risk (Jacob 2006, 5).

**The Subprime Market:** In 1999, subprime lending represented roughly 5 percent of the total activity in the home mortgage market. By 2006, its share had grown to 16 percent. Combined with the burgeoning “Alt-A<sup>4</sup>” market, these two segments made up more than one-third of all mortgages in 2006 (IMF 2007). In addition to regulatory changes<sup>5</sup>, subprime lending was fueled by the availability of capital through the secondary market for these products; by 2007, 93 percent (\$433 billion) of subprime/Alt-A originations were securitized (IMF 2008).<sup>6</sup>

Subprime mortgages differ from prime mortgages in a number of ways—subprime loans are characterized by higher interest rates and fees, the presence of prepayment penalties, and little or no documentation of borrower income. A subprime mortgage is more likely than a prime mortgage to be originated for a minority or low-income borrower, and carry higher rates of default and delinquency. Additionally, subprime mortgages are much more likely than prime mortgages to be delivered to the market through a broker.

**Decline of FHA Lending:** The rise of subprime lending coincided with the marginalization of FHA-insured loans: Over the period from 2001 to 2006, FHA market share fell from 6 percent to less than 2 percent (IMF 2008).<sup>7</sup> Because the FHA program enables the purchase of a home with minimal downpayment, has a maximum loan limit, and is generally considered flexible in its underwriting criteria, these loans were often used by lower- and middle-income, minority and first-time homebuyers. There is also evidence that FHA loans served many of the same communities as subprime loans.<sup>8</sup>

**Industry Consolidation:** The top 25 originators increased their market share from 28.4 percent to 78 percent from 1989 to 2002 (Apgar, et al. 2004, 11). Greater access to capital provided by the secondary market, relaxation of state and federal laws barring intrastate banking during the 1980s, and economies of scale arising from automated mortgage delivery systems all favored consolidation within the mortgage market. This consolidation resulted in a shift away from retail lending in favor of wholesale activities<sup>9</sup> through which large mortgage originators have limited

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<sup>4</sup> Alt-A loans are home loans that are considered less risky than sub-prime loans, but riskier than prime loans.

<sup>5</sup> The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) in 1980, and, in 1982, the Alternative Mortgage Transaction Parity Act (AMTPA) in particular.

<sup>6</sup> As noted above, this summary focuses on the period through 2006. Clearly since that time the subprime market has changed— most notably the market has virtually collapsed.

<sup>7</sup> As noted above, this summary focuses on the period through 2006. Clearly since that time, along with the decline in the subprime market, FHA has again become a more prominent player in the market.

<sup>8</sup> See Rodda et al. (2005) and Ding et al. (2008) for a discussion of the market overlap between FHA, subprime, and prime mortgages.

<sup>9</sup> Characterized as correspondent lending—where a smaller mortgage originator underwrites and funds a loan, and then sells it, and wholesale lending—where a broker identifies the customer, processes the application, and then funds the loan using the wholesale lender’s money.

involvement in the underwriting of the loan. The new reliance on wholesale activity to generate originations has increased large mortgage originators' ability to lend in communities in which they do not have a physical presence: particularly in low-income and minority neighborhoods (Apgar et al. 2004, 19).

**Expanded Role of Mortgage Brokers:** Concurrently, mortgage brokers underwent a stunning expansion of their role. From 1995 to 2002 the number of brokerage firms almost doubled to 44,000, up from only 7,000 in 1987 (Apgar et al. 2004, 16). This explosive growth is mainly attributable to the unprecedented demand for volume originations created by a steadily increasing supply of capital and facilitated by the automation of the underwriting process.

Brokers were suited to respond to this opportunity because they were able to reach into communities where large originators lacked a retail presence. They also operated under an incentive structure that motivated them to engage in behavior that maximizes the volume of loans approved and the cost of the mortgage to the borrower, even if it resulted in an increased risk of default or prepayment.<sup>10</sup>

**Implications for CDFIs:** Each of the origination trends described above points to opportunities for CDFIs.

CDFIs have largely not engaged in the *secondary market*, a potentially vast source of capital that could support CDFI home mortgage lending. One of the main barriers to connecting CDFIs and the secondary market is the lack of historical data on CDFI home mortgage outcomes through different types of markets.

If *automated underwriting* is not able to accurately evaluate the risk of minority and low- and moderate- income populations, then a gap exists in the coverage of the home mortgage market. CDFIs are well-positioned to fill this gap if they can more accurately identify the risk of these populations compared with traditional lenders.

CDFIs extend mortgages to higher-risk borrowers much as *subprime* lenders do, because they address similar gaps in financing resulting from the lack of participation by lower- cost conventional mortgage lenders and the reduced presence of *FHA*. But CDFI activity in the subprime borrower segment has the potential to educate borrowers about the appropriate price for their risk level, and to compete with other lenders in terms of price. If CDFIs are able to show low rates of default and delinquency on loans to non-prime borrowers, some for-profit lenders are likely to examine CDFIs' lending process and adopt it if it is also cost-effective.

Change and *consolidation* in the home mortgage market has brought competition into markets where CDFIs historically had been the only home mortgage lender. Adapting to this competition calls for CDFIs to reexamine and improve their business practice just as a for-profit firm would

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<sup>10</sup> As with other trends, this scenario has recently changed dramatically .

in the face of new competition. The new mortgage market also challenges CDFIs to explore repositioning themselves within the changed market to achieve their mission of providing underserved markets with access to fairly priced financial products.

Finally, the interests of CDFIs and originators are much more closely aligned than those of *brokers* and originators. CDFIs' mission steers them away from the moral hazard of cutting corners to gain approval for originations. Hornberg (2004) wrote about the opportunities and challenges incumbent in CDFIs positioning themselves in the mortgage market as brokers. Overall he concluded that this role could expand CDFIs' ability to serve underserved markets, and to generate the fees necessary to be sustainable.

### *Changes since 2006*

As subprime loans have begun to default at extraordinary rates, the overall mortgage market has undergone rapid change. Many subprime lenders – including Countrywide, one of the largest – have gone out of business. Prime lenders, along with Fannie Mae and Freddie Mac, have changed their underwriting requirements (requiring higher LTV ratios, higher credit scores, decreasing lending overall in declining markets, etc). And regulators have proposed stricter regulation of bank and non-bank lenders (including brokers). In response to the subprime foreclosure crisis policymakers have looked to modernize and strengthen FHA lending, which up until this crisis had seen its market share shrink. The country is still very much in the midst of the subprime foreclosure crisis which promises to change the overall mortgage market, and the role of CDFIs within the market, in ways we cannot predict today.

## **Analysis of Mortgage Origination Data**

### **Data and Analysis Methodology**

This paper draws on a data set that combines elements of several other data sets: the 2003 and 2006 HMDA data sets, a combined data set created by the CDFI Fund including data from the 2003 – 2006 TLR, and the 2000 Census. In order to describe the greatest number of CDFI mortgages, we combined loans from the two HMDA data sets with loans from the TLR data set.<sup>11</sup> A description of the census tract in which each mortgage was made was added to the combined data set by pulling data from the 2000 Census. Then, basic descriptive statistics of data points were generated, relating to the terms of the mortgage products, the profile of borrowers, the markets served, and the outcome of mortgages. These descriptive statistics revealed that CDFIs used two primary mortgage product groups, first- and second-lien mortgages. Another round of descriptive statistics divided the combined data by lien position in order to identify patterns exhibited by first- and second-lien mortgages separately. The results of these descriptive statistics are summarized below.

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<sup>11</sup> It should be noted that the combined CDFI data set is “apples and oranges” because the TLR data reports loans in the portfolio at the time of reporting, while the HMDA data reports loans originated during the year.

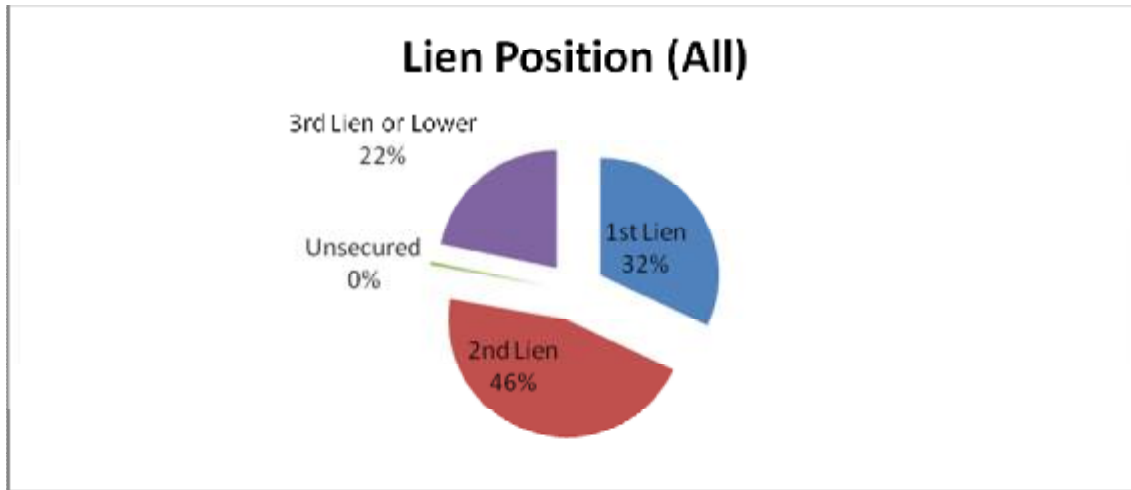
In order to provide a reference point for CDFI home mortgage activity, as well as to aid in establishing CDFIs' position in the overall mortgage market, selected descriptive statistics from the 2006 HMDA data set were compared with descriptive statistics from the combined data set. The statistics were limited to those that existed in both the HMDA and TLR data sets. Three mortgage types were identified within the 2006 HMDA data set: prime, FHA, and subprime. This permitted CDFI mortgages to be contrasted, not with the overall mortgage market, but with specific loan types. The results of the comparisons of CDFI mortgages and the other three mortgage types are laid out after the discussion of CDFI originations alone.

The data used for analysis in this section are limited by two inconsistencies: how CDFIs reported to TLR from year to year and how CDFIs reported for each variable. These drawbacks were addressed by providing information about the number of valid responses for each variable. The comparisons made between CDFI, prime, subprime, and FHA loans are limited by the quality of the lenders identified for each group. A more detailed description of the data sources, their limitations, and how lenders were assigned to each group appears in Appendix A.

### **CDFI Lending Profile**

First, we remark that CDFI mortgage lending is a very small piece of the entire mortgage market. The CDFI Data Project reported 15,019 home mortgages originated by CDFIs in fiscal year 2005. In that same year, the HMDA dataset included 10,823,696 owner-occupied home purchases. Even when we isolated owner-occupied home purchases in low-income census tracts and/or to low-income borrowers, the number of HMDA mortgages still dwarfed the number of CDFI loans.

Second, we note that lien position is an important factor in understanding CDFI mortgage lending activity. CDFIs do not always provide the primary source of mortgage financing (first-lien), yet they still play an important role by providing subordinated lien loans. Many low-income families are unable to afford a home without a secondary source of financing to cover downpayments and other associated mortgage fees. Therefore, many CDFIs help families fill financing gaps through second- and other lien loans. Borrower, property location, and product characteristics differed depending on the type of financing provided. As indicated in Figure 1 below, second-lien mortgages were the largest proportion of CDFI mortgage loans in our dataset by number of loans.



**Figure 1: Lien Position of CDFI Loans.**

Note that only 8,615 loans in the TLR dataset reported lien position. Of those loans marked with lien position, the median loan value of first-lien loans was only \$33,500, and \$14,000 for second lien loans. We used this information to reclassify loans that did not specify lien position as first or second lien.<sup>12</sup>

***Borrowers***

The profile of CDFI home mortgage borrowers illustrates the degree to which CDFIs reach underserved populations. Given the history and evidence of continuing racial and income discrimination in the mortgage market, information describing who CDFIs serve, and to what degree, provides an understanding of how CDFIs are seeking to correct the imbalances in the larger mortgage market. Table 1 summarizes key demographic characteristics of the borrowers in our origination dataset.

**Table 1: CDFI Borrower Demographic Characteristics**

	All Loans	First-Lien Loans	Second-Lien Loans
<b>Race</b>			
White	47%	49%	44%
Black	41%	38%	46%
Asian	6%	8%	2%
American Indian	3%	3%	4%

<sup>12</sup> Those loans that were unmarked and were for less than \$24,000 were assumed to be second-lien; 3,456 loans fell into this category. Those loans that were for over \$30,000 and unmarked were assumed to be first-lien; 3,507 loans were in this category. Those loans that fell between \$24,000 and \$30,000 were not included in either category. All of the comparisons of first- and second-lien loans include the 6,963 loans that were assigned to a lien position by this method.

	All Loans	First-Lien Loans	Second-Lien Loans
Other	3%	2%	4%
Hispanic <sup>13</sup>	23%		
<b>Gender</b>			
Male	54%	64%	37%
Female	43%	33%	59%
Both	3%	3%	4%
<b>Income<sup>14</sup></b>			
Very-low-income	13%	23%	6%
Low-income	38%	35%	42%
Not low-income	44%	35%	49%
Other	5%	7%	3%

Source: Combined CDFI Mortgage data set.

Given that 12.4 percent of the overall U.S. population is black and that less than 9 percent of loans made in 2006 went to black borrowers, CDFIs clearly serve a disproportionate African-American population through their mortgage lending activities (U.S. Census 2006). It is also interesting to note that the proportion of black borrowers increases for second-lien mortgages. In regards to gender, a much larger proportion of female borrowers are receiving second-lien mortgages, while men dominate the first-lien market.

As part of their mission and purpose, CDFIs serve low-income borrowers. However, a higher proportion of first-lien borrowers had very low incomes, as compared to second-lien mortgage borrowers. Our analysis also found that 14 percent of CDFI home borrowers were unbanked prior to receiving their mortgages. Also, an impressive 78 percent of CDFI mortgage borrowers were first-time homeowners.<sup>15</sup>

The median credit score for CDFI home mortgage borrowers was 660 points, 63 points lower than the national median (Credit Source Online 2008). While there are no universal cut-off points for credit scores, 674 points is a commonly used threshold to divide prime and subprime borrowers (Credit Source Online 2008). If this 674 cutoff were applied to those borrowers that received home mortgages from CDFIs, 57 percent would be classified as subprime. In addition, using the score of 700 as a dividing line, 31 percent of CDFI borrowers would be classified as

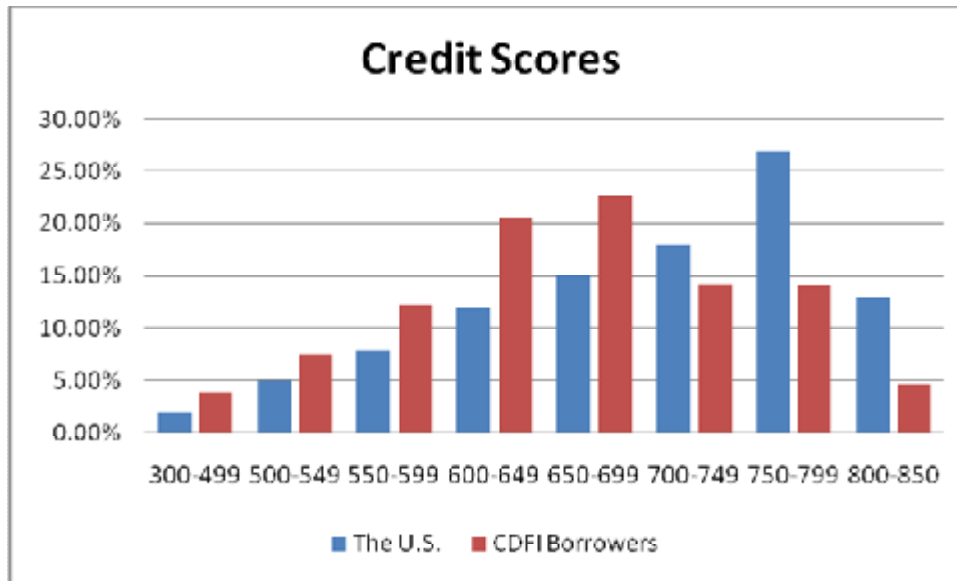
<sup>13</sup> Hispanic was recorded as an ethnicity; therefore a borrower could be marked as Hispanic and as any racial group. There were valid responses for only 5,021 loans. The remainder of mortgages left this category blank. It was difficult to determine within TLR whether the field was blank because the borrower was not Hispanic or because the CDFI had not reported this data. This variable was consolidated from TLR and HMDA data.

<sup>14</sup> The CDFI Fund defines “very-low-income” as being 60 percent or less of AMI; “low-income” as being 60-80 percent of AMI; and “not low-income” as greater than 80 percent AMI.

<sup>15</sup> Percentages are calculated only for those transactions where the data was provided.

having good or excellent credit. Figure 2 compares the distribution of CDFI borrowers' credit scores and the distribution for the U.S.<sup>16</sup>

**Figure 2: CDFI Borrower Credit Scores**



Source: Combined CDFI Mortgage data set and <http://www.creditsourceonline.com/credit-score-stats.html>, Accessed on February 12, 2008.

### *Lending Locations*

Six states accounted for 62 percent of the 15,922 loans in the data set: North Carolina (3,038), Texas (1,835), Tennessee (1,697), New York (1,230), California (1,123), and Colorado (913).<sup>17</sup> Generally, states with large concentrations of CDFI loans are also home to the largest CDFIs. This distribution is even more highly concentrated than state-level statistics convey: 8,494 home mortgages were located within only 20 counties, with the largest three containing over a thousand loans each. This geographic concentration indicates that CDFIs tend to concentrate their lending in familiar local markets.

We look more deeply into the locations where CDFIs make mortgage loans by investigating the characteristics of the census tracts where the loans were made. Historical discrimination against low-income and minority communities is conventionally measured by the characteristics of the census tracts where mortgages are made. Therefore, the demographic and economic traits of census tracts are important for measuring the degree to which CDFI home mortgage lending is correcting for historical and continuing discrimination against selected communities and bringing

<sup>16</sup> There were valid responses for 1,206 loans for this variable. Despite the low response rate, the variable was included because of its importance.

<sup>17</sup> No CDFI home mortgages were reported in Alaska, Delaware, Idaho, Nebraska, and Nevada, New Hampshire, North Dakota, Rhode Island, and South Carolina.

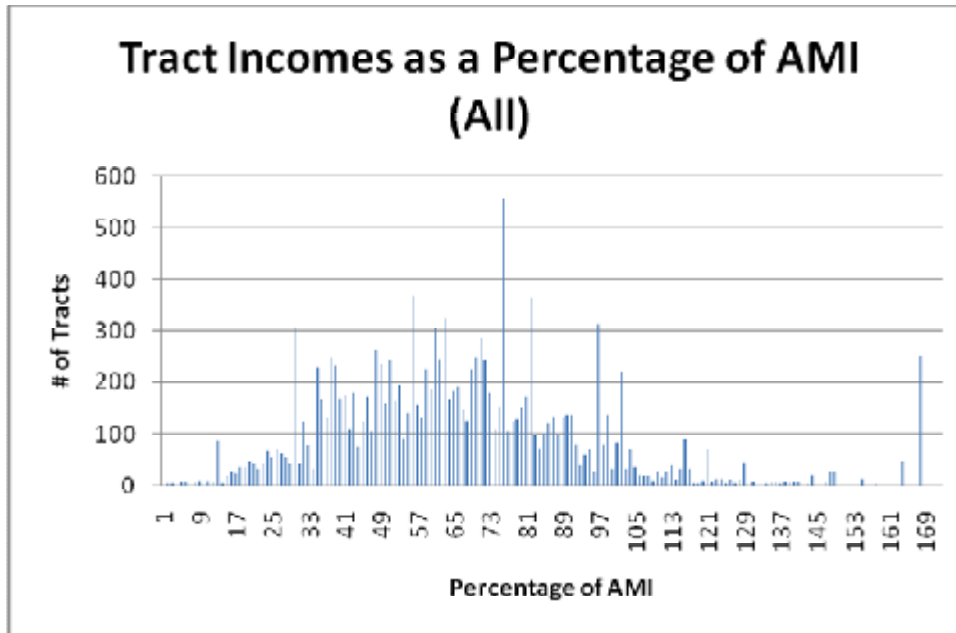
investment to disinvested areas. Understanding the characteristics of the communities where CDFIs are making home mortgages also has implications for the level of risk that these mortgages carry. Some evidence suggests that the characteristics of a census tract may be more important than borrower characteristics to determining default risk (Capone 2001, 2). Where FIPS codes were present in our origination dataset (11, 800 records), we matched the code to Census tract-level data, looking at selected variables from among the 2000 Census household and individual variables. Tract Race and Ethnicity and Household Income were selected to assess the demographic composition of the neighborhoods traditionally associated with discrimination and redlining. We also selected variables that measure the economic vitality of the neighborhood, such as Percentage Renting, Median Home Value, and Median Household Income.

As we hypothesized, the data analysis revealed that CDFIs are making mortgages in low-income communities (See Figure 3). A majority (55 percent) of the census tracts where CDFIs made home mortgages had median incomes less than 80 percent of AMI. In addition, a quarter of CDFI mortgage-lending tracts were classified as “very-low-income.” There was not an appreciable difference between first- and second-lien mortgages.<sup>18</sup>

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<sup>18</sup> There was valid information for 13,989 responses for this variable.

Figure 3: Income Characteristic of Tracts Where CDFI Mortgages Were Made



Source: Combined CDFI Mortgage data set and 2000 Census.

**Mortgage Products**

An analysis of the interest rates on CDFI home mortgages provides insight into the degree to which CDFIs are substituting for traditional mortgage financing. That is, the closer the cost of a CDFI mortgage to the market rate, the less likely borrowers are to take a CDFI home mortgage if they are otherwise able to access a traditional home product.

The length of mortgage maturity indicates in part how CDFIs must balance the needs of their borrowers with the institutional need to re-circulate capital quickly. An understanding of the diversity of mortgage products CDFIs offer is provided by the Interest Rate and Amortization Type variables.

Table 2: Characteristics of CDFI Mortgage Products (Interest Rate, Spread)

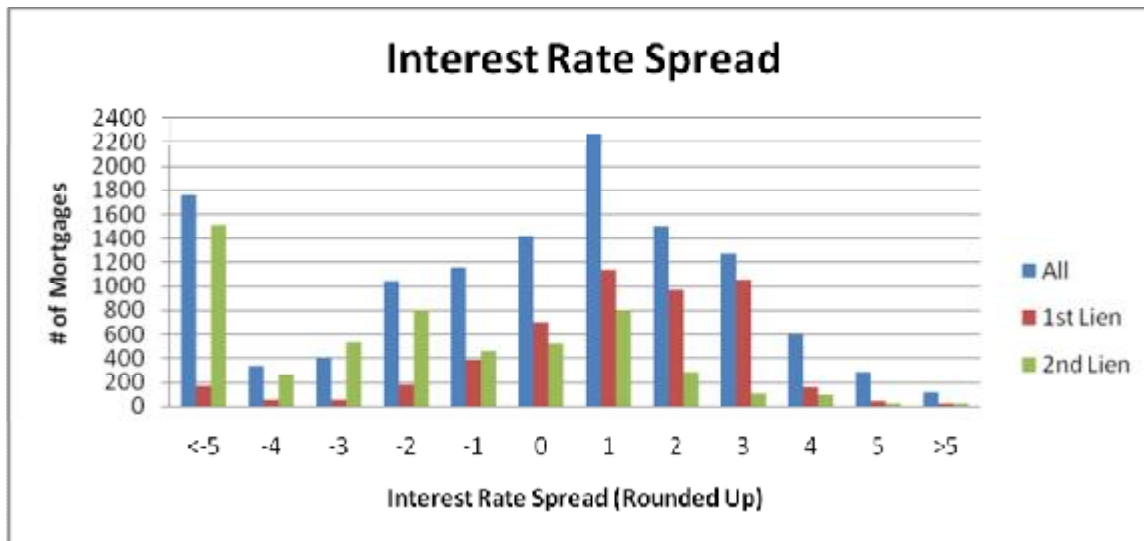
All CDFI Loans	
Median original interest rate	5.38%
Mean original interest rate	4.89%
Percent with 3% interest rate	36%
Percent with 0% interest rate	15%
Percent with >8.4% interest rate	10%
Median interest rate spread	-0.87
Mean interest rate spread	-1.569

Source: Combined CDFI Mortgage data set

As indicated in Table 2, the median and mean interest rates on CDFI mortgages were approximately 5 percent. However, rates varied significantly by lien type. First-lien loans had a median interest rate of 7 percent, whereas second-lien loans had a median of 3 percent.<sup>19</sup> Driving this low median, 20 percent of second-lien loans had a 0 percent interest rate.

We also looked at rate spread, to show how CDFI mortgage interest rates compared to typical market interest rates.<sup>20</sup> Forty-one percent of CDFI loans showed a positive interest rate spread (over the market average for fixed rate mortgages), and 40 percent had an interest rate spread of -2 percent or lower, as shown in Figure 4. As with overall interest rates, interest rate spread for first-lien and second-lien loans varied considerably: second-lien loans showed a large negative spread (-2.8), whereas first-lien loans had a slight positive spread (.7).

**Figure 4: Interest Rate Spread on CDFI Mortgages**



Source: Combined CDFI Mortgage data set and Freddie Mac 30 year PMMS data set, <http://www.freddiemac.com/pmms/pmms30.htm>

The vast majority, 89.8 percent, of home mortgages originated by CDFIs had fixed interest rates and the distribution was similar for first- and second-lien loans.<sup>21</sup> As indicated in Table 3, the median loan term for first-lien mortgages was three times longer than the median loan term for second-lien mortgages.<sup>22</sup>

<sup>19</sup> For first-lien mortgages there were 4,919 valid observations. For second-lien mortgages there were 5,423 valid observations.

<sup>20</sup> See Methodology for how interest rate spread was calculated. There were valid responses for 11,834 loans.

<sup>21</sup> There were 10,519 valid responses for this variable.

<sup>22</sup> For first-lien mortgages there were 3,783 valid observations. For second-lien mortgages there were 4,659 valid observations.

**Table 3: Characteristics of CDFI Mortgages (Term, Value, Amortization)**

	<b>All Loans</b>	<b>First-Lien Loans</b>	<b>Second-Lien Loans</b>
<b>Loan Term</b>			
<b>Median loan term</b>	180 months	360 months	120 months
<b>Mean loan term</b>	147 months	292 months	151 months
<b>Percent with 360 months term</b>	40%	60%	10%
<b>Loan Value</b>			
<b>Median loan value</b>	\$25,000	\$70,000	\$8,600
<b>Mean loan value</b>	\$49,662	\$52,900	\$12,745
<b>Amortization Type</b>			
<b>Full amortization</b>	63%	83%	64%
<b>Partial amortization</b>	3%	7%	1%
<b>Balloon</b>	11%	1%	18%
<b>Non-amortization</b>	2%	0%	3%
<b>Other</b>	21%	9%	14%

**Source: Combined CDFI Mortgage data set.**

Just under 30 percent of the home loans were for less than \$10,000, and just over 10 percent were for loans greater than or equal to \$100,000.<sup>23</sup> Also, first-lien mortgages were significantly larger than second-lien mortgages, as shown by the large difference (more than \$60,000) between the median loan values for these two mortgage types.<sup>24</sup>

The majority of both first- and second-lien mortgages were fully amortizing. Mortgages with balloon payments comprised just 1.2 percent of first-lien mortgages, but 18 percent of second-lien mortgages.<sup>25</sup>

Origination fees were charged for 49 percent of mortgages, and the most common amount charged was \$500 (although prices ranged from \$18 to \$6,100). Only 10 percent had origination fees higher than \$500.<sup>26</sup> First- and second-lien mortgages did not differ significantly for this variable. Points were bought on less than 1 percent of mortgages; 2.5 points were the most points purchased on any mortgage, and most mortgages that had points purchased had only one point purchased.<sup>27</sup> Post-purchase assistance was reported for 19 percent of mortgages. The

<sup>23</sup> There were valid responses for all 15,922 loans. The loans from HMDA are rounded to the nearest thousand; the TLR loans are not rounded.

<sup>24</sup> This comparison was for those liens that were marked in the TLR data as first- or second-lien mortgages and did not include those that were assigned to a lien group based on size, due to the bias this would create.

<sup>25</sup> There were valid responses from 6,183 mortgages.

<sup>26</sup> There were valid responses for 2,856 loans.

<sup>27</sup> There were valid responses for 2,617 loans.

majority of post- purchase assistance was reported as 10 hours or less, but some respondents reported up to 45 hours of assistance.<sup>28</sup>

**Comparison of CDFI, Prime, FHA, and Subprime Lending**

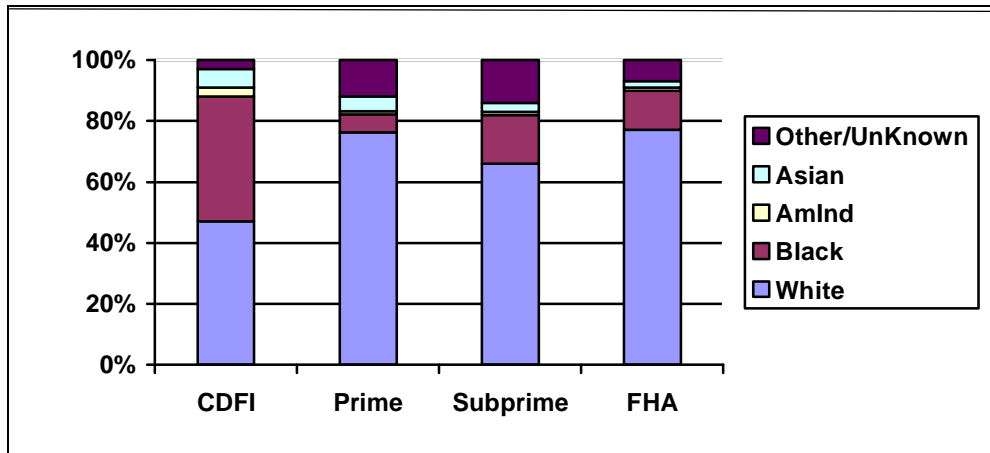
Comparing CDFI home mortgage lending with prime, FHA, and subprime loans illuminates the role of CDFIs within the overall mortgage market. Knowing the degree to which CDFIs reach low-income and minority markets will help clarify whether and how CDFIs work to address low homeownership rates among traditionally underserved populations. We examine the profile of CDFI borrowers versus those of other loan types, first overall, and then just for the subsegment of loans made to low-income borrowers, and for the subsegment of loans made in low-income census tracts.

**Borrowers**

CDFI borrowers were far more likely to be minorities than were prime, FHA, or subprime borrowers. Hispanic borrowers who indicated white as their race, or did not select a race, composed the largest minority group for prime, FHA, and subprime lenders. As is clear in Figure 5, the difference in the percentage of black prime borrowers was striking.

The borrower race distribution for prime, FHA, and subprime low-income-only borrowers (income < 80 percent of AMI), and the distribution for those located in low-income-only tracts, showed similar differences, except that the proportion of Hispanic borrowers was much lower among low-income borrowers than among those who lived in low-income tracts.

**Figure 5: Differences in Borrower Race—CDFI, Prime, Subprime, and FHA Originations**



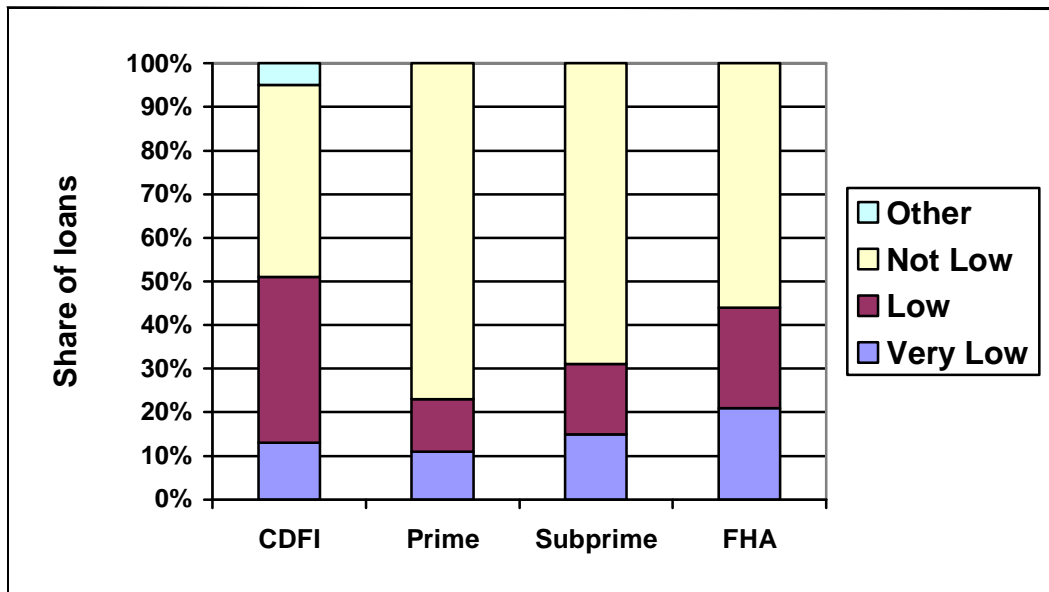
Source: HMDA 2006 and Combined CDFI Mortgage data set.

<sup>28</sup> There were 1,555 valid responses for this variable.

CDFIs disproportionately reach female borrowers, a segment that has traditionally had less access to credit. Prime, FHA, and subprime borrowers were all more likely to be male than CDFI borrowers; the rates were 65, 63, and 59 percent respectively, in comparison to 54 percent male CDFI borrowers. However, these gender differences disappeared among the low-income-only portion of prime, FHA, and subprime borrowers, and the low-income tract portions.

Prime, FHA, and subprime borrowers were less likely to be low-income than CDFI borrowers. The picture of lending to very-low income borrowers is more complicated: the proportion of very-low-income borrowers for CDFIs was only slightly higher than for prime borrowers, comparable to the proportion for subprime borrowers and below the proportion for FHA borrowers. However, CDFIs overall serve more low- and very-low income borrowers than any of the other three lender groups.

Figure 6: Differences in Borrower Income — CDFI, Prime, Subprime, and FHA Originations



Source: HMDA 2006 and Combined CDFI Mortgage data set.

**Lending Locations**

Fifty-eight percent of CDFI loans were in low-income communities (census tracts where income is 80 percent or less of AMI), a significantly higher rate than for prime (14 percent), FHA (20 percent), and subprime (25 percent) lenders. The proportion of mortgages CDFIs made in communities where the majority of the population belonged to a minority racial or ethnic group—29 percent—the same as for subprime, and higher than for prime and FHA lenders, at 17 percent each.

*Mortgage Products*<sup>29</sup>

CDFI mortgages were much smaller than mortgages originated by the other three lender types. The largest 10 percent of CDFI-originated mortgages were over \$123,000, which was similar to the median size of FHA loans. The smallest 10 percent of mortgages originated by prime, FHA, and subprime lenders were, respectively, under \$75,000, under \$70,000, and under \$59,000, which was in the 70 to 80 percentile range of CDFI mortgages. Eighteen percent of prime, FHA, and subprime loans fell at or below the 75<sup>th</sup> percentile of CDFI lending. The rates were similar for the low-income borrower portion of mortgages originated by these lenders.

## Conclusions

The findings from the data analysis suggest that CDFIs are making positive contributions in the three roles traditionally envisioned for them: innovators, competitors, and as a supplement to traditional lending. The degree of positive impact in each of these three areas is limited by the size of CDFI home mortgage lending relative to the overall mortgage market, as CDFI mortgage lending constitutes a very small portion of national mortgage lending.

The profiles of the mortgage products and borrowers served by CDFI home mortgage lending make it clear that CDFIs are pioneering new types of mortgages and finding ways to underwrite borrowers, and borrowers in communities, that traditionally have been viewed as too high-risk. By acting as innovators in these areas, CDFIs have the potential to affect the practices of larger home mortgage lending organizations.

The data indicate that the terms of CDFI home mortgages are diverse in a number of areas. The time to maturity varies from as short as a few years to the more traditional 30- year maturity. There is also great diversity in the interest types, amortization types, and interest rates among the mortgages originated by CDFIs. This diversity of mortgage products indicates that CDFIs, much more than other lenders, customize their mortgages to fit the needs of the borrower and to fill specific niches in the mortgage market.

The lower credit scores and incomes of many CDFI borrowers may prevent them from meeting the underwriting requirements of traditional prime lenders. However, CDFIs do lend to this higher-risk group. The income level and housing value of census tracts where CDFIs make their home mortgages are far lower than those for prime, FHA, and subprime loans, while the proportion of renters and minority residents is far higher. No direct information about the underwriting criteria CDFIs use is available, but the income, credit scores of borrowers, and profiles of the communities they serve hint that CDFIs have developed a successful method of serving a population that is traditionally deemed higher-risk. While it is clear that CDFIs are using an alternative approach to home mortgage underwriting, further study and publicity of these underwriting practices is necessary in order to better understand and spread these innovations.

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<sup>29</sup> These figures are a comparison of first-lien loans only.

There is evidence that CDFIs act as limited competitive alternatives to subprime and other home mortgage lenders in niche sub-markets in certain geographic areas. The CDFI niche represents a very small and specific part of the overall mortgage market: they provide smaller end mortgages to minority and low-income borrowers who live primarily in minority and low-income communities. Even within this portion of the mortgage market, CDFIs play a much smaller role than prime and subprime lenders. However, CDFI activity is concentrated in a limited number of counties across the nation, raising the possibility that CDFIs are able to influence the local mortgage market through the specialized products they offer and the targeted population they serve.

Many CDFI mortgages are a supplement to other home mortgage financing sources. The large number of second-lien and other lien mortgages, along with the small size of most CDFI home mortgages relative to home values, indicates that other financing sources are involved. This means that CDFIs are leveraging their home mortgage loans with financing from other sources. Without information on what financing sources are being leveraged, and to what degree, it is difficult to measure the extent to which CDFIs are acting as supplements to the traditional mortgage market.

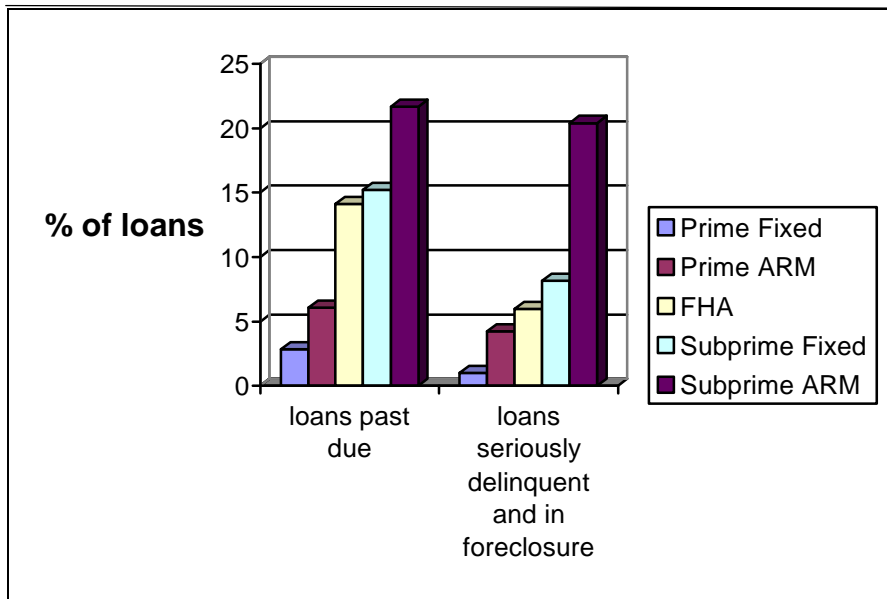
### III. Sustainability of CDFI Mortgages

If CDFIs were filling the lending gaps described above by making risky, default-prone loans, they would fail in their mission to address the needs of underserved communities. The national foreclosure crisis highlights the devastating effect that irresponsible lending practices can have on households, communities, and even financial institutions.

Further, documenting performance of CDFIs’ mortgages is central to their ability to attract capital, as CDFIs with successful lending records appeal to investors from both the financial and impact perspectives. In addition, documenting good loan performance in otherwise underserved markets enables the CDFIs to prove these markets to be viable and profitable prospects for mainstream—and non-predatory—financing. Therefore, a key indicator of whether CDFIs are achieving their missions of helping households and communities build and sustain wealth, and of demonstrating the viability of their target markets, is the loans’ default and delinquency performance.

It is clear that different lending programs exhibit differences in performance (see Figure 7). For example, as of the fourth quarter of 2007, prime fixed rate loans had an overall delinquency rate of 2.82 percent, while subprime ARM loans had a delinquency rate nearly eight times that, 21.7 percent (MBA National Delinquency Survey 4Q2007). Other product types fell between these two marks.

**Figure 7: Delinquency for Prime, FHA and Subprime Mortgages**



Source: Mortgage Bankers Association of America, National Delinquency Survey, Q407.

In general, higher default rates are correlated with certain risk factors: weaker credit, lower equity, and inadequate income to meet debt obligations. Subprime loans, by definition, should

go to borrowers who do not meet the qualifications for prime loans, while FHA borrowers tend to have little cash to close, and high loan-to-value ratios.

As previously discussed, CDFI borrowers generally have weaker credit scores and, based on the CDFI mission, would be presumed to have lower home equity.<sup>30</sup> Thus, these loans would be expected to default at higher rates than prime loans. From an income and credit standpoint, CDFI borrowers appear to have profiles similar to those of subprime borrowers. The average credit score for a subprime mortgage borrower is 623, which is only 33 points lower than the average credit score for a CDFI borrower in our dataset (Ashcraft and Schuerman 2008). Roughly one-third of CDFI borrowers have a credit score of 623 or lower. As discussed in Section II, 51 percent of CDFI borrowers have either low or very low incomes, while 31 percent of subprime borrowers have incomes that fall within this range. By contrast, CDFI borrowers typically receive counseling and intangible support from the CDFI, the loans are fully underwritten for ability to repay, and the loan terms are typically less onerous than those that may be associated with subprime loans (prepayment penalties, heavy up-front fees, and high and/or unpredictable interest rates).

The Center for Responsible Lending estimates that the subprime lending boom will ultimately cause a net loss of homeownership. That is, while an estimated 9 percent of subprime loans were made to first-time homebuyers, an estimated 15 percent of all subprime loans are expected to end in foreclosure; thus, the net impact on homeownership is -6 percent of subprime loans, or an estimated 931,429 households (CRL 2007). This net negative impact is likely to be greatest among populations and communities where subprime lending activity was strongest: minority and moderate-income borrowers and their neighborhoods. A look at the HMDA data presented earlier shows that 49 percent—*half*—of all black borrowers in 2006 obtained subprime loans, compared with only 24 percent of white borrowers.

Likewise, ample evidence exists that subprime lending is concentrated in minority neighborhoods. Incidences of mass foreclosures are often spatially concentrated, following lending patterns. In previous decades, for example, FHA has come under fire for enabling lending practices that ultimately resulted in swaths of neighborhood foreclosures. Again, in 2007, we see geographically concentrated foreclosure patterns in many areas.<sup>31</sup>

Against this backdrop, we examine whether CDFI loans perform differently from other non-prime/non-conforming loan types. Also, in a later section, we consider the potential CDFI response to the current foreclosure crisis.

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<sup>30</sup> CHS data does not record loan-to-value.

<sup>31</sup> See Ding et al. 2008 for a review of the literature on spatial concentrations of subprime and FHA mortgages, particularly in minority and low-income neighborhoods.

## CIIS Data on CDFI Mortgage Performance

For each reporting year, CIIS records the following performance-related information for loans still active at the start of the reporting period: status at the end of the reporting period,<sup>32</sup> number of times 60 days past due,<sup>33</sup> and delinquency status at time of reporting. Of these, the third variable is the most informative. Among the 6,825 CIIS loans reported for 2006, 7.63 percent were 30 or more days past due, compared to only 1.54 percent of prime loans, 6.86 percent of FHA loans, and 6.67 percent of subprime loans as of mid-year 2006 (MBA National Delinquency Survey 2Q2006). 4.07 percent were seriously delinquent, 90 or more days past due, compared to 0.75 percent of prime loans, 5.4 percent of FHA loans, and 6.24 percent of subprime loans.<sup>34</sup> Thus it would appear that although CIIS-reported loans were more likely to experience some delinquency, they were less likely to reach severe delinquency than FHA and subprime loans.

However, the loans reported in CIIS have quite a different profile than the rest of the loans in the market. First, the industry data are for first-lien loans, while the CIIS data include second and “other” lien types. In fact, “other” lien loans make up 15 percent of the loans reported, and have a 30+-day delinquency rate of just 1.39 percent and a 90+ day delinquency rate of only 0.99 percent, which is much lower than the other categories. Second-lien mortgages reported in CIIS have a delinquency rate that is 41 percent lower than that of firsts, and a 90+ day delinquency rate that is 17 percent lower. If these second and other liens are helping underserved borrowers attain and maintain homeownership, then their good performance should be a sign that they are succeeding. It may also suggest that gap financing is an effective tool for CDFIs.

Differences in loan features by lien position may explain some of these differences in performance. For example, almost 10 percent of the second liens and 40 percent of the “other” lien loans report an amortization type other than fully amortizing (non-amortizing, partially amortizing, or the most popular, “other”). The overall 30+-day delinquency rate of the non-fully-amortizing loans is negligible, and none of the 564 second-lien or other lien non-fully-amortizing loans were reported delinquent in 2006.

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<sup>32</sup> Because CDFIs report status only for loans that were active during each reporting period, we do not know the history of each full book of business by year of origination. And though we have CIIS data for 2003 through 2006, we cannot construct a full history, because some CDFIs did not report in 2003, and some did not report in 2006. We used the stacked dataset, where we deleted duplicate observations of the same loan except for the last observation, and combined all reporting periods together. For loans that were on the CDFI’s books at the beginning of any of the reporting periods, 7 percent closed in good standing during the reporting year, 2 percent were sold, 0.5 percent were restructured, and 0.2 percent were charged off. 90.3 percent (12,058) of the loans remained active at the end of the year.

<sup>33</sup> Among the loans still active at the end of the reporting period, 0.7 percent were marked as ever having been delinquent for 60 days or longer. 0.2 percent of loans were marked as having been delinquent for 60 days more than once. These numbers cannot be reconciled with the “delinquent when data was reported” numbers. This might be the result of 10,561 TLR loans leaving this field blank, but reporting delinquency information for the “delinquent when data was reported” field. Because of this, no conclusions can be based on this data field.

<sup>34</sup> The MBA Delinquency figures for 90+ days combines 90+ and in foreclosure. It is assumed that the CIIS reporting includes loans in foreclosure as over 90 days past due.

Also, CDFI loans often feature low or even zero interest; not a single one of the zero-interest loans was reported delinquent in 2006, and less than 2 percent of loans with rates below 4 percent were reported delinquent in 2006. Below-market and no-interest loans are more prevalent among second and “other” lien loans than among first-lien loans, fewer than 5 percent of which carried a rate below 4 percent. Mid-range rate loans (4 percent to 6 percent interest rate) also had a low delinquency rate, and were most likely to be second-lien loans. Most of the amortizing first-lien loans were priced at above 6 percent, and this category carried the highest 30+-day delinquency rate, 13.9 percent overall. Another 11 percent of the loans did not specify rate, and these carried a delinquency rate just a little higher than the overall average.

Because so many of the other loans are non-amortizing or zero interest, or both, we remove all “other” lien loans so we can better see the relationship between amortization type, rate category, lien position, and delinquency rate (Table 4).

**Table 4: 30+day Delinquency Rates for First- and Second-Lien CDFI Mortgages**<sup>35</sup>

Interest Rate	Full Amort (n=4711)		Other Amort (n=350)		No Amort (n=85)		Total
	1 <sup>st</sup>	2 <sup>nd</sup>	1 <sup>st</sup>	2 <sup>nd</sup>	1 <sup>st</sup> (n=0)	2 <sup>nd</sup> (n=85)	
<b>&gt; 6%</b> (n=3237)	13.9% (n=2516)	8.2% (n=601)	8.7% (n=109)	0 (n=11)	n=0		12.6%
<b>4-6%</b> (n=855)	.5% (n=379)	6.2% (n=325)	1.9% (n=116)	0 (n=35)	n=0		2.8%
<b>.1-4%</b> (n=522)	0 (n=149)	4.2% (n=335)	0 (n=4)	0 (n=34)	n=0		2.7%
<b>0</b> (n=447)	0 (n=62)	0 (n=344)	0 (n=5)	0 (n=36)	0 (n=0)	0 (n=85)	0%
<b>Subtotal</b> (n=5146)	11.3% (n=3106)	5.2% (n=1605)	4.7% (n=234)	0 (n=116)	0 (n=0)	0 (n=85)	8.6%
<b>Unspecified</b> (n=668)	3.1% (n=255)	12.8% (n=413)	n=0	n=0	n=0		9.1%
<b>Total</b> (n=5814)	10.7%	6.7%					8.7%

Source: Combined CDFI Mortgage data set.

<sup>35</sup> It should be noted that only one loan was explicitly identified as non-amortizing and zero interest (and it is not included in the data above). There were 4,553 loans where amortization type was not provided (two-thirds of the loans), and we treated these as fully amortizing for the purposes of the above analysis. Ninety percent of the zero interest loans were either fully amortizing (62 percent) or unspecified amortization (28 percent). Therefore, if our treatment of the unspecified amortizing loans is generally correct, then it stands to reason that virtually all the loans reported do involve some sort of repayment, be it in the form of interest, principal, or some combination.

Borrower characteristics are another factor in performance. Only 15 percent of the loans on record provided borrower credit scores, and those with a reported score performed better than all those without any score. However, with this caveat in mind, those with reported scores below 680 had a delinquency rate 250 percent higher than those with reported scores above 680.<sup>36</sup>

Additionally, first-time homebuyers had a delinquency rate 250 percent higher than the non-first time homebuyers (with 86 percent of loans reporting this data). With 58 percent reporting income category, the performance appears “U” shaped, with loans to both “very-low-income” and “not-low-income” borrowers having more than twice the delinquency incidence of those to “low-income” borrowers. Another “U” pattern is seen when looking at loan amount, with small loans under \$20,000 and larger loans over \$100,000 performing better than average, loans between \$20,000 and \$50,000 performing on par with the average, and loans between \$50,000 and \$100,000 reporting a delinquency rate that is higher than average.

Performance is also a function of seasoning: a group of loans originated four years ago will typically exhibit higher delinquency today than a group of identical loans originated six months ago. For example, at the end of the 2006 reporting period, among CIIS loans reported, loans originated in 2001 or earlier had a delinquency rate twice the average level; those originated between 2002 and 2004 had a delinquency rate 1.5 times the average; and those originated in 2005 and 2006 had a delinquency rate about half the average.

In addition, loan performance is driven by local market factors such as house value trends and the health of the local economy. In fact, the delinquency rates reported in CIIS varied most dramatically by state (though this may also be a function of dominant CDFI practices). For the 73 percent of records where we were able to identify census tracts, we observed that loans located in tracts with median home value over \$100,000 exhibit delinquency rates about 20 percent lower than average, while those in tracts with median values below \$100,000 performed about 50 percent worse than average (without much variation when broken down below that level). Regarding census tract income as a percent of AMI, loans in tracts with income at or below 60 percent of AMI had a delinquency rate 60 percent to 70 percent above the average, those in tracts with median income between 60 percent and 80 percent of AMI had a delinquency rate 30 percent to 40 percent higher than average, those in tracts with income between 80 percent and 100 percent of AMI had a delinquency rate about 20 percent higher than average, and those in tracts with income above 100 percent of AMI had a delinquency rate 15 percent below average. In cases without census tract information (27 percent of loans) performance was significantly better (75 percent) than average.

When looking at gross industry data, CDFI loans seem to have a better serious delinquency rate than subprime and FHA loans. However, the product profile of CDFI loans is quite different from the other loan types, and this product flexibility—around interest rate and repayment

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<sup>36</sup> This ratio applies to both the 30+ and the 90+ day delinquency rate, as it will for the remainder of this section unless otherwise specified. Generally, 90+ day delinquency rates varied consistently with 30+ day delinquency rates.

schedules—appears to contribute to this performance differential. Among the fully amortizing first-lien mortgages bearing interest above 4 percent<sup>37</sup>, the 30+ day delinquency rate of the CIIS reported loans is actually higher than that for FHA (6.86 percent) and subprime (6.67 percent) during the same time period, but the 90+ day delinquency rate of 5.43 percent is comparable to the 5.4 percent for FHA loans, and still below the 6.24 percent seriously delinquent rate for subprime loans. We noted that performance also varies by borrower, loan, and market factors, which suggests that this high-level benchmarking exercise is not an “apples to apples” comparison. Finally, we should point out that much of the CDFI 90+ day delinquent inventory is very aged: more than half of the 90+day delinquencies are more than six months delinquent, 28 percent are a year or more past due, and 8 percent are two or more years old. If CDFI lending flexibility extends the default timelines, this may further distort their delinquent inventory when compared to that of other lender types. However, we have no way to verify this. We simply point out the factors that drive CDFI delinquency performance, factors that also make for an inappropriate benchmark against national averages.

## Data and Analysis Methodology

To make a more “apples to apples” comparison of CDFI loans to other loan types, it is important to control for the factors mentioned above. Ideally, a model that controls for borrower, loan, and economic factors would be constructed and used to evaluate the relative performance of CDFI loans versus other products. However, no common dataset tracks CDFI loans and the other types, so we constructed a trial dataset of our own, from property records obtained through First American Title’s Core Logic. Appendix A describes our methodology in detail; but in brief, to control for year of origination and local market factors, two markets and a single origination year were selected. The markets were Wake and Durham Counties in North Carolina and Cook County, Illinois, and the years were 2003 and 2006. Our objective was to obtain a random sample of 100 loans for each loan category (CDFI, prime, FHA, and subprime) for each origination year for each market, and compare their performance. Loans had to be on first liens on owner-occupied properties, and fall between \$20,000 and \$350,000. Budget and time constraints limited the quality and depth of the data obtained, as Appendix A describes in more detail, but the major limitations are:

The small sample size and limited data collected on each loan make this dataset only a “blunt instrument,” and in fact there were not even 100 CDFI loans in all cases.

Loan type was identified based on lender category; therefore, a few loans could have been mislabeled. Cross-market comparisons should be avoided, as we used the same loan-size brackets for both markets, but this likely represents a very different slice within each market. Comparisons over time are not possible because the samples draw from a single year.

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<sup>37</sup> Includes the unspecified rate loans.

## Market Context: Cook County, Illinois, and Durham/Wake Counties, North Carolina

A description of these markets and of the activity of the local mortgage markets is helpful in putting the results of the comparison of outcomes in context. Appendix B gives more detail, but highlights are as follows:

Cook County, Illinois, home to the city of Chicago, has 5.4 million people living in 1.9 million households. The population is just over half white and about one-quarter black. The homeownership rate is 61.7 percent. The median home value is \$284,900, median income is \$50,691, and 46 percent of home-owning households have home values in excess of four times their annual income.

The much smaller Wake and Durham Counties (home to the Raleigh/Cary and Durham MSAs), with 851,000 residents in 331,000 households, have similar racial composition and homeownership rates, a very slightly higher median income, but a much lower median home value of \$191,550. Only 21 percent of households here have a house values greater than four times their income (American Community Survey 2006).

In terms of lending activity, in 2006 Cook County reported just over 181,000 HMDA mortgages (American Community Survey 2006).<sup>38</sup> More than 60 percent of the loans were prime, while one-third were subprime (FHA had a 2 percent share). Of the 37,178 mortgages originated in Durham and Wake Counties in 2006, prime was 73 percent of the market, subprime only 22 percent, and FHA 5 percent. In Cook County, 59 percent of black borrowers in 2006 were served by subprime lenders, versus 26 percent of white borrowers. In Durham and Wake Counties just over 40 percent of black borrowers received subprime loans in 2006, compared to just over 10 percent of white borrowers. Between CIIS and HMDA reporting by CDFIs, we were able to identify 240 CDFI loans in Cook County and 84 in Durham/Wake County originated in 2006. As in the overall comparison, FHA, subprime, and CDFI loans were more likely to go to female borrowers and minority borrowers than were prime loans. In Cook County, 85 percent of CDFI loans went to black borrowers, compared with only 11 percent of prime loans, 48 percent of FHA loans, and 35 percent of subprime. By contrast, in Durham and Wake Counties, only 16 percent of CDFI loans were reported as being made to black borrowers, still a greater share than the 10 percent share of prime, but well below the 33 percent and 38 percent among FHA and subprime, respectively. In both markets, CDFI loans were slightly less likely to be made to Hispanic borrowers than any of the other loan types.

In both areas, CDFI loans were much more likely to be made in census tracts with larger minority populations. For example, in Cook County, 82 percent of the CDFI-reported loans were in tracts with 50 percent or higher minority population share, compared with 34 percent for

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<sup>38</sup> Owner-occupied, first-lien, originated mortgages only.

prime, 57 percent for FHA, and 60 percent for subprime. In Durham and Wake Counties, while only 33 percent of reported CDFI loans were in 50 percent+ minority tracts, that was more than six times the 5.2 percent share of prime loans going to high-minority tracts. In each sample, the gaps were greatest by tract income: in Cook County nearly 90 percent of CDFI loans went to low-income census tracts, versus one-quarter of prime, one-third of FHA, and 43 percent of subprime loans made that year. In Durham and Wake counties, CDFIs made 61 percent of their loans in low-income tracts, nearly 10 times the portion of prime loans made in those same tracts that year. Appendix C provides additional detail about the markets and lending patterns in both years.

Most recently, the foreclosure rate has been rising in both markets, but the situation appears worse in Cook County. As of the third quarter of 2007, the Chicago MSA was ranked 41<sup>st</sup> in foreclosures among the 100 largest MSAs, with 1 foreclosure filing for every 188 households, while the Raleigh/Cary MSA<sup>39</sup> was ranked 67<sup>th</sup> with 1 filing for every 319 households (RealtyTrac 2008). According to the National Association of Realtors®, Chicago MSA median sales price for existing single-family homes reached a peak of \$276,600 in 2007, but is down 6.6 percent in the first quarter of 2008 compared to the first quarter of 2007. The Raleigh/Cary MSA's median price was \$224,000 and still climbing as of the end of 2007, while Durham's was \$178,000 and also still climbing slightly into the first quarter of 2008 (National Association of Realtors® 2008).

In sum, homeowners in Cook County appear to be under more stress than in the Raleigh markets, with higher home prices relative to income and greater default rates. Home price trends suggest that the Cook County/Chicago market may have been experiencing more of a “bubble” in 2006 than the Durham/Wake/Raleigh market. Subprime was a slightly larger force in the Cook County market in 2006 than in Durham/Wake. In both markets, CDFI-reported loans are a miniscule part of the total market, but they do disproportionately serve minority and low-income borrowers and census tracts at a greater rate than the other loan types.

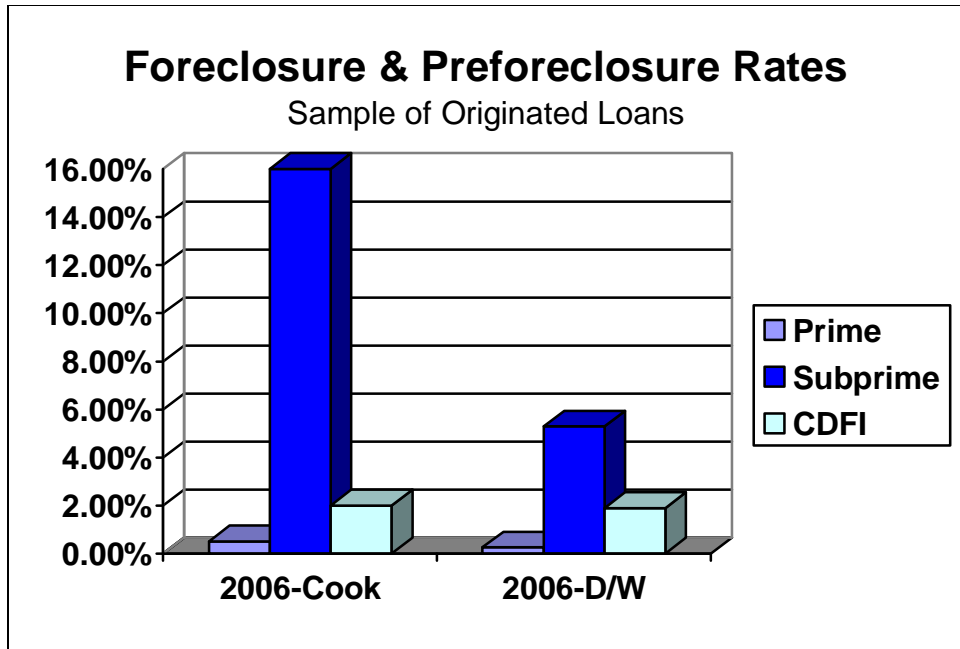
## **Comparison of CDFI, Prime, and Subprime—Snapshot of Foreclosure Rates**

Turning to the sample of loans pulled from the property records in both markets, Figure 8 shows the share of loans foreclosed, currently in foreclosure, or in pre-foreclosure within each of three categories: prime, subprime, and CDFI. The sample of prime loans originated in 2006, in both markets, has registered virtually no defaults, which is not surprising given the newness of this book of business. Default rates for CDFI-originated loans are several times higher (4 to 7 times) than for prime loans, not surprising given the risk profile of CDFI loans and borrowers. Subprime loans, though, have registered default rates that are 20 to 30 times higher than those for prime loans, an extraordinary gap considering that subprime loans and CDFI loans share similar

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<sup>39</sup> This figure does not include the Durham MSA, which was not listed in these top 100 MSAs.

customers, as our data has shown, and as both exist to serve borrowers not served by prime lenders. Assessing the extent to which this performance difference is explained by differences in borrower and loan risk characteristics between subprime lending and CDFI lending is not within the scope of this analysis. However, these data support the finding that CDFI lending (in these markets, in 2006) has led to much more sustainable homeownership than subprime lending.

Figure 8: Performance for Prime, Subprime, and CDFI Mortgages<sup>40</sup>

Source: First American Title's Core Logic.

As mentioned previously, it would be ideal to use this dataset for multivariate analysis to tease out the factors most linked with default in each category. However, this dataset has too few observations within each loan category to make such analysis feasible. Instead, we see this as a prototype test of the usefulness of property records in doing this type of analysis, because no other dataset is available to compare CDFI loan performance to that of other loan types. Using the data obtained from Core Logic, one could identify origination year, loan-to-value and property characteristics (with supplemental valuation and sales data), additional liens, property location (and thus, neighborhood characteristics), and whether the loan was an ARM or fixed-rate product. This data source does not provide race, income, or credit score of the borrower, although it does include borrower name, and thus there may be ways to enhance the borrower specifications.

Our conclusion from this rudimentary analysis is that—at least when controlling for year of origination and market by using these cohorts—CDFI loans appear to outperform the subprime loans within each cohort. Our conclusions are tempered by the fact that we did limit the data to owner-occupied loans within a certain size range, albeit a broad one, and that, while we do not

<sup>40</sup> Sample sizes: n=200 for each of subprime and CDFI in Cook County; 197 for prime. N=388 for prime in D/W County, 399 for subprime, 158 for CDFI.

control for borrower risk and property risk characteristics, our earlier analysis suggests that CDFIs are lending to populations that are not fully served by the prime market, but are more similar to those served by subprime loans.

## Conclusions

This section of the paper attempts to enhance our understanding of the role of CDFIs in financing sustainable homeownership in their target markets. With adequate loan and performance data, we hoped to investigate the tension between demonstrating the financial viability of under- or mis-served markets, and providing better-than-market or gap financing to disadvantaged borrowers (with subsidies potentially in the form of higher defaults, or in lower interest rates and more-flexible repayment terms, or some combination). While the data limitations prevent us from providing definitive evidence, when supplemented by the origination data provided in Section II, our analysis at least allow us to further describe some of the ways CDFIs employ different mortgage lending strategies.

First, there are those making amortizing, first-lien mortgages at rates generally comparable to prime market rates to underserved market segments, thus acting as a competitive alternative to higher-cost loans. They are also doing market testing and demonstrating that while the risk profile of these borrowers might deter mainstream lenders, the data suggest that these borrowers are not defaulting at the rate of subprime mortgages.

Second, there are the CDFIs who are clearly providing gap and/or subsidized financing through low rates and flexible repayment terms. These flexible practices are most commonly found in the subordinate lien loans, which might indicate that other lenders are providing the primary mortgage and the CDFI is making the deal work through gap financing. While these flexible terms and conditions may require greater subsidy of the CDFI's activity, these loans also appear (based on CIIS-reported data) to have very low default rates, and thus may be resulting in more-sustainable homeownership for low-income and minority households and communities.

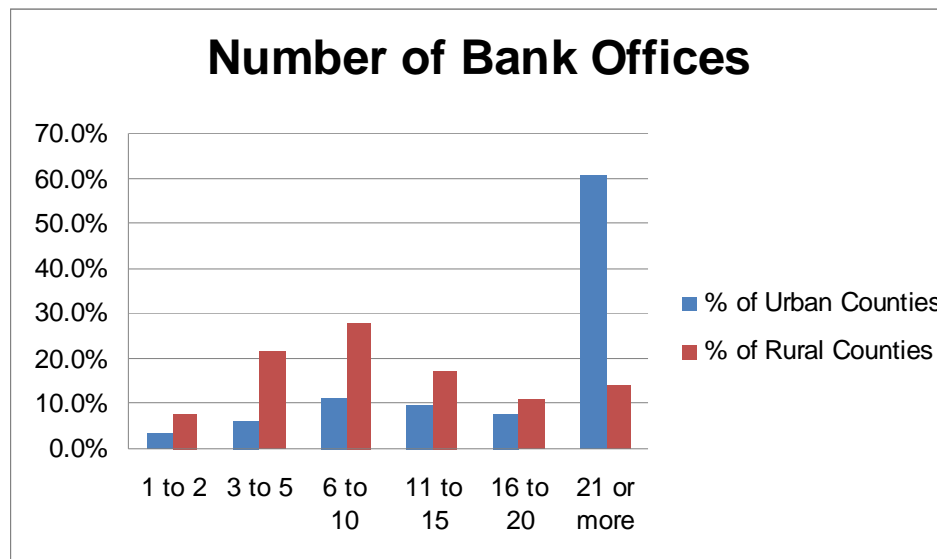
We cannot overemphasize that the data presented here are only suggestive and have significant shortcomings that we have documented here and more extensively in other sections of the report. Our research has convinced us that further development of, and access to, loan-level datasets is feasible and should be pursued. Accurate and comparable loan performance data is critical to CDFIs' ability of to offer a competitive and viable alternative mortgage source, to justify subsidized gap financing, and to demonstrate ways to improve lending practices and policies to expand homeownership.

## IV. CDFIs and Rural Mortgage Lending

According to the U.S. Census Bureau, 25 percent of the total American population and 97.5 percent of the total U.S. land area is classified as rural (USDA 2008).<sup>41</sup> However, rural is a subjective and complex definition, and each government agency has its own measures of rurality. This inconsistency in defining rural populations is just one of the many challenges facing CDFI rural mortgage lenders. In general, financial institutions in rural areas must contend with larger distances between borrowers, lower-income borrowers, and less educated borrowers. According to the USDA Economic Research Service (ERS), the 2002 US non-metro per capita income was \$9,097 less than the metro per capita income. Furthermore, while 12 percent of metro Americans were living in poverty in 1999, 15 percent of non-metro Americans were in poverty. To compound this rural poverty, over 1.5 times as many metro residents have completed college than non-metro residents (USDA 2008).

Rural residents are also much less likely to have a choice of or access to financial institutions. An analysis of FDIC Summary of Deposits Data from 2006 reveals that 7.8 percent of rural counties have two or fewer banking offices, while only 3.4 percent of urban counties have so few banks. In addition, as seen in Figure 9, only 14.2 percent of rural counties have more than 20 banking offices, while 60.8 percent of urban areas are home to more than 20 bank offices.

**Figure 9: Bank Offices in Urban and Rural Counties**



Source: FDIC Summary of Deposits Survey.

<sup>41</sup> For a complete Census Bureau definition of rural, see: US Census Bureau. "Urban and Rural Definitions." <http://www.census.gov/population/censusdata/urdef.txt>

The presence of so few banks may have created opportunities for subprime and predatory lenders. A 2004 report by the Housing Assistance Council found that subprime loans gained increasing popularity in all parts of the United States during the 1990s, and that they were particularly problematic for rural owners of manufactured homes (HAC 2004).

## Data Limitations

Not only is the practice of rural lending challenging, but investigating rural lending is also a challenge. Only partial and sometimes unreliable origination and performance data to describe rural CDFI lending are publicly available.

HMDA provides limited data on originations of rural home loans. Two regulations limit the number of rural loans reported in HMDA: 1) only lending organizations with a branch in an MSA are required to report to HMDA; and 2) lenders below a threshold asset size are not required to report to HMDA (FFIEC 2006).<sup>42</sup> Since rural lenders are not located in MSAs and since many have relatively few assets, we cannot rely on HMDA to describe rural mortgage originations.

Performance data are also unavailable for rural mortgage lending. First American Title's Core Logic, which supplied the performance data used in Part III of this paper, does not collect and aggregate public courthouse records for any rural locations. Although these data are available in individual courthouses throughout America, sifting through and combining these data into a dataset for analysis would require sorting through reams of paper at individual county courthouses.

We were able to isolate rural lending in the TLR dataset; however, this dataset is limited to those CDFIs who were awarded competitive CDFI grants, and further limited since recipients are required to report for three years only. While the TLR dataset gives some indication of the extent of rural lending, many CDFIs making home loans in rural areas are not present in this dataset. To supplement the information in the TLR, we also identified CDFIs who have substantial rural memberships through the National Federation of Community Development Credit Unions (NFCDCU), a useful but also not exhaustive listing.

As a result of these data limitations, we turned to direct interviews and a case study approach to investigate this aspect of CDFI mortgage lending. First, we look to what limited data is available about rural mortgage lending in the TLR dataset.

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<sup>42</sup> For example, an institution with assets of \$34 million or less on December 31, 2004 did not have to collect HMDA data in 2005.

## Characteristics of CDFI Rural Mortgages—Evidence from the TLR

The TLR datasets for 2003-2006 contained 2,866 CDFI home loans that can be classified as rural. However, only six states accounted for 75 percent of the 2,866 rural mortgages in the data set: New York (458), California (458), Colorado (453), North Carolina (316), Kentucky (223), and South Dakota (215). In fact, just three counties accounted for 36 percent of these rural loans. Only a single CDFI within each of the markets accounted for all the reported activity in that market; thus the CIIS data may be driven as much by the practices of those few CDFIs as by the rural nature of their markets.

The CIIS reported that rural loans had the same distribution of first- and second-lien loans as the non-rural loans, and very nearly the same distribution of amortization types.<sup>43</sup> Somewhat surprising, perhaps, is the fact that the loan amounts were not substantially different, as evidenced by Table 5.

**Table 5: CDFI Rural Mortgage Loan Size**

	<b>Rural</b>	<b>Non-Rural</b>
<b>Loan Size</b>		
<b>Percent under \$20,000</b>	40%	42%
<b>Percent over \$100,000</b>	10%	16%
<b>Median loan amount</b>	\$25,600	\$31,000
<b>Mean loan amount</b>	\$54,500	\$44,300

Source: Combined CDFI Mortgage data set.

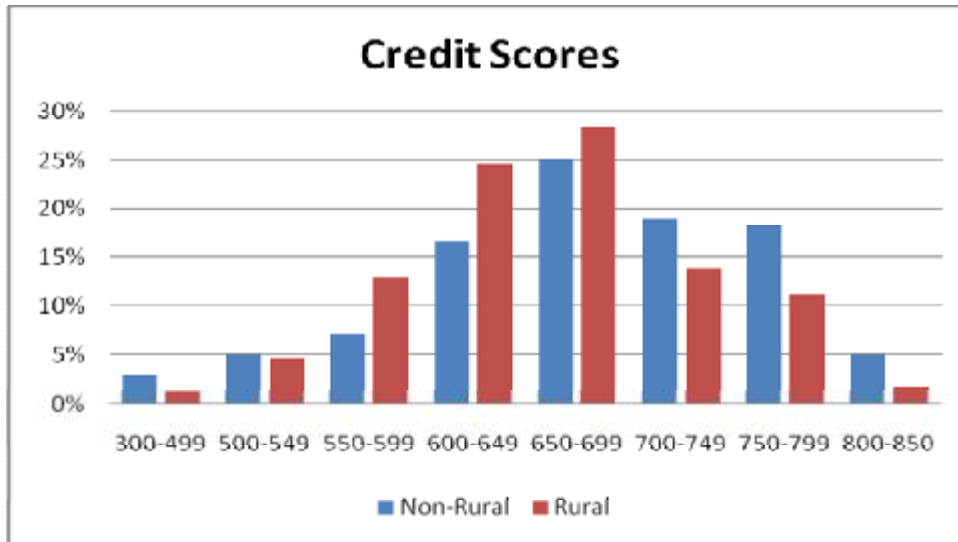
### Borrowers

Figure 10 shows that the credit score distribution of rural and non-rural borrowers is fairly similar, with the exception of a higher percentage of non-rural borrowers who have credit scores above 700.

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<sup>43</sup> There were 4,487 valid observations for non-rural mortgages and 625 for rural mortgages.

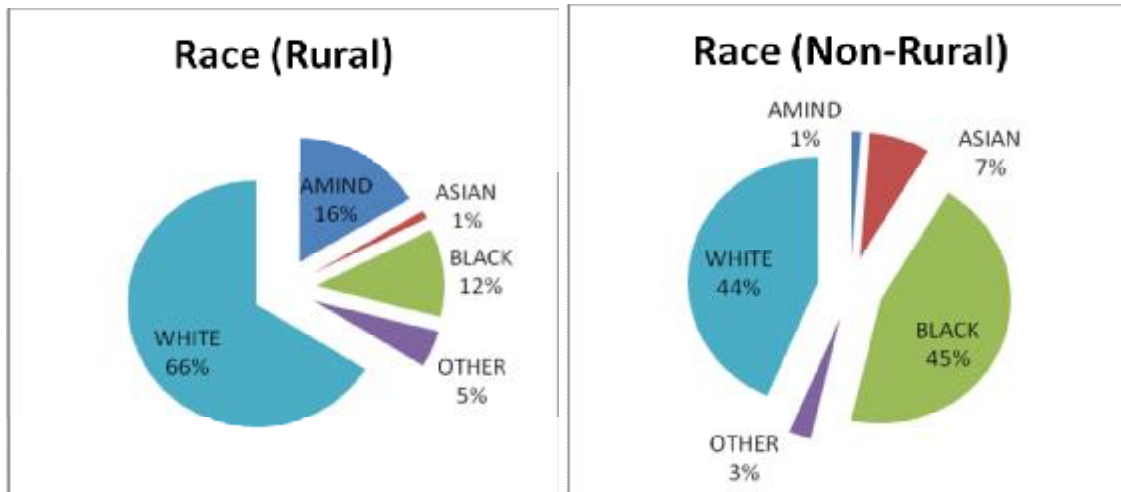
Figure 10: CDFI Rural Borrower Credit Scores



Source: Combined CDFI Mortgage data set.

Black borrowers made up a much smaller portion of rural borrowers, as compared to non-rural borrowers, while white borrowers made up a far larger portion of rural borrowers (see Figure 11). The larger presence of American Indians in rural areas was partially a product of a few CDFIs whose mission is to serve native populations, which tend to be concentrated in rural areas.<sup>44</sup>

Figure 11: CDFI Rural Borrower Race



Source: Combined CDFI Mortgage data set.

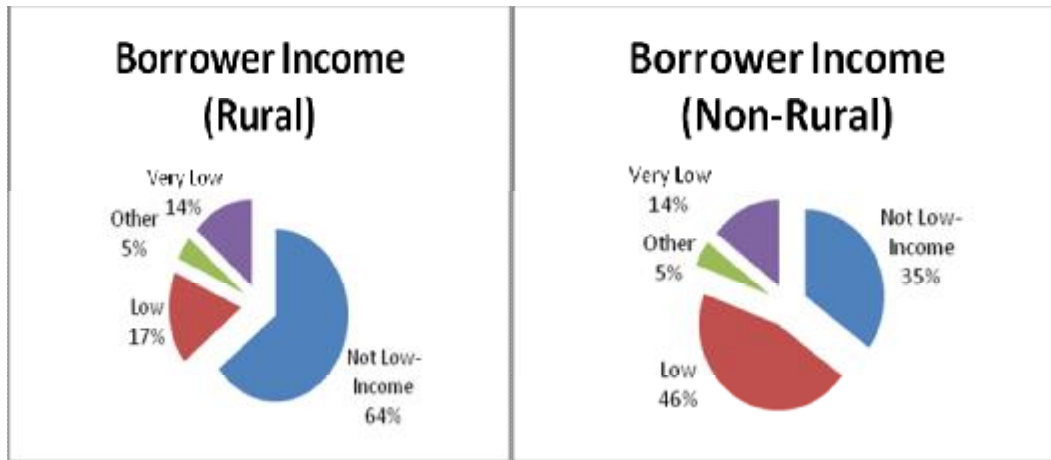
<sup>44</sup> There were 11,194 valid observations for non-rural mortgages and 2,866 for rural mortgages.

Differences in the overall populations living in the census tracts served by CDFIs may offer some explanation for the racial differences found among rural and non-rural borrowers. Whites were the majority in 89 percent of the tracts where rural CDFI mortgage activity was reported, but in only 65 percent of the non-rural tracts. Conversely, blacks were a majority in only 2 percent of the rural tracts served, compared to 25 percent of the non-rural tracts.

**Income**

The CIIS data indicate that rural borrowers were almost twice as likely to be Not Low- Income, as compared to non-rural borrowers (64 percent versus 35 percent, as shown in Figure 12). This finding was not consistent with findings from our case studies. However, low-income categories, as used in the TLR dataset, are defined by AMI, a geographically-relative measurement. AMI does not measure absolute incomes, which are often lower in rural areas.

**Figure 12: CDFI Rural Borrower Income**



Source: Combined CDFI Mortgage data set.

The rural tracts served by CDFIs were more likely to be classified as higher-income than the non-rural tracts. For example, 65 percent of the rural tracts had incomes at or above 80 percent of area median income, compared to only 41 percent of non-rural tracts. Again, however, these are not absolute comparisons of income levels (unlike loan amounts, where absolute figures were reported).

Additionally, census tracts in rural areas are much larger than those in urban areas and, as a result, it is more difficult to pinpoint low-income areas using census tracts in rural areas. Finally, poverty in rural areas is less geographically concentrated than poverty in urban areas (where differences in wealth are often clearly concentrated and segregated). Rural poverty tends to be more widespread. CDFIs could very well be lending in low-income areas within rural census tracts that are not identified as low-income.

**Mortgage Products**

**Table 6: CDFI Rural Mortgage Product Characteristics**

	<b>Rural</b>	<b>Non-Rural</b>
<b>Interest Rates</b>		
<b>Median interest rate</b>	5.62%	4.62%
<b>Mean interest rate</b>	4.94%	3.92%
<b>Percentage adjustable-rate mortgages</b>	17%	11%
<b>Loan Term</b>		
<b>Median loan term</b>	191 months	240 months
<b>Mean loan term</b>	225 months	234 months

Source: Combined CDFI Mortgage data set.

The median interest rate for CDFI mortgages in rural tracts was higher than that for non-rural mortgages in the dataset, as shown in Table 6. In fact, the share of mortgages with a rate of 8 percent or higher was twice as great among rural mortgages compared to non-rural mortgages. Interestingly, adjustable rate mortgages were more common in rural areas.<sup>45</sup> The length of CDFI mortgages made in rural and non-rural tracts was roughly equal, with mortgages having slightly shorter terms.<sup>46</sup>

## Characteristics of CDFI Rural Mortgages—Evidence from Interviews

Through the TLR data, we were able to identify the top three CDFIs by rural mortgage lending. To increase our sample size, we also conducted five additional telephone interviews with CDFIs that we identified through the NFCDCU. For each interview, we asked about the demographic characteristics of their borrowers (race, income, geography), the types of loans offered (mortgage product, terms, rates), loan performance (delinquency and foreclosures), the types of homes purchased (manufactured, stick-built, stock quality, land), the types of services offered (counseling, leveraging of secondary sources of funding), and their competition (banks, predatory lenders). All of the respondents were eager to talk, and all had important experiences and insights into rural CDFI home lending.

### Commonalities in CDFI Rural Mortgage Lending

The first commonality we discovered was that all but one of the eight CDFIs interviewed were credit unions (the last is a bank). A couple of the credit unions were small grassroots organizations that arose to meet the need of the unbanked in remote rural areas. Others were sophisticated financial institutions that have been serving their members for generations. Some CDFIs we interviewed served only rural areas, and others served both rural and urban populations. Regardless of size or status, all of the CDFIs felt that they were able to offer a personal touch and great customer service.

<sup>45</sup> There were 8,247 valid observations for non-rural mortgages and 1,167 for rural mortgages.

<sup>46</sup> There were 7,561 valid observations for non-rural mortgages and 1,200 for rural mortgages.

Second, all of the CDFIs noted that, on average, their rural borrowers were poorer and less educated than their urban borrowers. However, it is important to note that all of the CDFIs said that rural residents were offered the same mortgage products and the same treatment as urban residents. The CDFIs did not offer rural residents different interest rates or terms based solely on location.

The CDFIs felt that they were able to serve a niche population, rural and low-income families, that is often denied loans by traditional banks. All but one interview respondent stated that counseling was a vital part of their lending operations and helped them to improve portfolio performance. Indeed, all of the CDFIs had seen comparable, and overall positive, loan performance for both their urban and rural loans. This positive portfolio performance could also be attributed to overall stable or only slowly increasing home price trends in most of the areas. The interview respondents noted that rural home prices have been more even-keeled, thereby missing the huge appreciation some urban areas experienced, but also avoiding the significant depreciation now plaguing these same areas.

The housing stock in rural areas can be significantly different from that of urban areas. All of the interview respondents noted the lack of available, affordable, quality housing in their areas. Of particular importance was the old age and poor condition of the rural housing stock. The poor quality of the homes, in addition to their remote locations and low demand, created low housing values. Estimating the exact home value can be problematic given the difficulty in finding accurate comparables for appraisals. Therefore, all of the CDFIs noted that they often lend small amounts to homebuyers, sometimes as low as \$17,000. In fact, one lender said that borrowers came to his credit union because they were denied loans by banks due to the exceptionally low value of their homes. Many traditional banks simply will not extend a mortgage for a \$20,000 home because it is not a profitable endeavor. However, rural low-income families continue to demand inexpensive houses, and some CDFIs are there to meet this demand.

The shortage of quality affordable housing units in rural areas has contributed to a high demand for manufactured housing. Manufactured housing, which is much less expensive than stick-built construction, constitutes a significant share of the housing market in rural areas. All of the CDFIs interviewed offer a loan product that covers manufactured housing units, and many noted that they are the only lenders in their area to offer such a product. All but two require that the manufactured housing be on the owner's land, and some of the CDFIs have additional requirements, such as a permanent foundation and connection to sewage and water. Demand for manufactured housing varies by region, so the percentage of manufactured housing home loans in each CDFI's mortgage portfolio varies from 2 percent to 25 percent. However, several of the CDFIs expressed concern about the profitability of manufactured housing loans due to depreciation and higher severity upon foreclosure.

All but two of the CDFIs also noted that they limit the amount of land for their mortgage products. The rationale behind this limit is to ensure that the house constitutes the majority of the overall land/house package. Some of the CDFIs structure their land/house requirements according to Fannie Mae guidelines, and others have developed their own acreage caps.

Finally, the CDFIs noted the challenges inherent in serving a geographically dispersed population. Both borrowers and CDFI personnel must travel great distances to conduct transactions, sign paperwork, and do appraisals. Scattered populations also mean that rural CDFIs sometimes have difficulty generating the loan volume required to sustain the financial health of their organization.

### **Differences in CDFI Rural Mortgage Lending**

All of the CDFIs we interviewed had loan portfolios with significant numbers of rural mortgages, but it was difficult for each CDFI to tell us exactly how many of their loans are rural. This is because each CDFI defines rural differently and has a unique way of tracking its rural loans. For example, some CDFIs code rural loans according to the USDA definition while others code by ZIP code. In addition, there are CDFIs in very rural locations that do not officially record the rurality of their loans because they deem everything in their area as rural.

A second difference between CDFIs was their competition. The most rural CDFIs are often the only financial institutions in their communities. These CDFIs are essentially without direct competition, because local residents have to drive long distances to access other banking institutions. However, this certainly was not the case for all of the CDFIs. In fact, most claimed that there were numerous other banking institutions in their communities. Many of the CDFIs were physically located in metropolitan areas and served both urban and rural populations. However, the mere presence of banks in a community does not constitute competition. As mentioned above, many of the CDFIs serve a low-income population that is unable to access traditional loans from large banks.

Various interview respondents mentioned several other important challenges of rural home lending, though these challenges were not cited by all of the CDFIs in common. For example, one CDFI mentioned that recently the environmental regulations changed to require that all homes meet new sewage runoff standards. This has caused major problems for rural home owners who are unable to spend the thousands of dollars to change from septic systems. As a result, this CDFI has witnessed a trend of homeowners abandoning their old and low-market-value homes rather than meet the environmental regulations.

Another challenge to rural CDFIs is developing unique loan products to meet the needs of specific populations. For example, one of the CDFIs serves a large military population. Therefore, this CDFI deals with a lot of transitory individuals and people whose income consists entirely of transfer payments from the government. Similarly, another CDFI is located in a high-growth location where incomes are rising, and it is therefore learning to create flexible loan products, such as a self-construction loan with which the borrower must construct his or her own home within 18 to 24 months after closing. A third CDFI serves a growing spiritually-focused New Age community which has demanded more sophisticated products than the CDFI's otherwise rural and low-income membership. Therefore, one of this credit union's branches has had to develop services not demanded at the other two branches. Yet a fourth credit union extends loans to non-conforming homes, such as those which are off the main power grid and/or use solar power.

Below we present case study information from two of the CDFIs we identified as active in making rural mortgage loans, one that is in an extremely rural setting in the Southwest, while the other serves both urban and rural markets throughout North Carolina. Case studies on other rurally active CDFIs appear in Appendix D.

### **Case Study—Saguache County Credit Union**

Saguache County Credit Union (SCCU) epitomizes a rural credit union. It is located in an extremely rural and low-income area of south central Colorado (county per capita income in 2003 was \$18,063, and the average population density is two people per square mile). Previous to the opening of SCCU, residents had to drive up to 100 miles round trip to access banking services. However, 12 years after opening, the credit union has 3,090 members, total assets of \$23.5 million, and three branches in the county. SCCU is a certified CDFI and a full-service financial institution offering a wide array of loan products, with competitive rates and terms, such as first and second mortgages, home equity lines of credit, modular home construction loans, vehicle, motorcycle, mobile home, share secured, bill consolidation, and signature loans (Saguache County Credit Union).

SCCU boasts \$18.5 million in loans, of which \$12.6 million are home loans, and 23 percent of outstanding mortgages are to first-time homebuyers. It uses a matrix that analyzes credit history, debt ratio, residency, and employment to determine an overall credit grade, which then determines eligible loan types, rates, and terms. SCCU has a healthy loan portfolio, with a default rate of less than 2 percent and a historical delinquency rate of 2 percent or less. SCCU has not been entirely buffered from the foreclosure crisis, as the delinquency rate rose to 3.60 percent at the end of March 2008 (Saguache County Credit Union). However, the interview respondent felt that the increased delinquency rate was merely a result of cyclical trends, and was confident in the overall strength of the SCCU portfolio.

The demographic constitution of the county also means that SCCU lends to many minorities and low-income individuals. As of the 2000 Census, 45.3 percent of the county was Hispanic and 22.6 percent of county individuals were living below the poverty line (Saguache County Credit Union). Therefore, SCCU helps build the wealth of disadvantaged families while strengthening the local economy.

Given its location, nearly 100 percent of SCCU's home loans are rural. SCCU recognizes that it is the only lender in the area; therefore, it adapts to member demand. For example, the growing spiritually-focused New Age community in nearby Crestone demands more-sophisticated financial services, and SCCU has expanded to meet this demand. Also, manufactured houses are abundant and in great demand in Saguache County, and SCCU has developed a mortgage product to serve this market.

SCCU has successfully met the financial needs of its low-income rural population, a population that was otherwise neglected by large banks. SCCU has been particularly instrumental as a mortgage lender in the area, and has provided thousands of Saguache county residents with the opportunity to be homeowners.

**Case Study— Generations Community Credit Union**

Unlike SCCU, Generations Community Credit Union (GCCU) serves both rural and urban populations. It is a full-service credit union whose mission is “to provide strength and stability to communities statewide by using our financial resources to improve the quality of life for all” (Generations Community Credit Union). Though headquartered in urban Durham, Generations has eight branch locations throughout rural North Carolina.

Generations’ history serves as an ideal example of how mission-driven CDFIs have found creative solutions to serve their target populations. After observing that many small, rural North Carolina credit unions were struggling to meet member needs while managing daily operations, the North Carolina Minority Support Center, an umbrella organization, assumed the back office and administrative tasks, while Generations and its merged credit unions concentrated on customer service. This model has proven very successful, and though only five years old, Generations has over \$19 million in assets, 11,500 members, and nearly \$9 million in mortgage loans (Generations Community Credit Union).

Generations also actively promotes itself as an alternative to predatory lenders. It recognizes that low-income individuals who have been turned away by mainstream financial institutions often seek out predatory lenders to meet their credit needs, especially in rural areas where there are few other options. Therefore, Generations provides members of the community with an affordable way to access credit, while placing emphasis on financial literacy so that members can make responsible, informed decisions.

With regard to rural mortgages, this commitment to fighting predatory lending means that Generations offers reasonable loans to first-time homebuyers and members seeking to purchase or improve a home. In order to fund its commitment to rural borrowers, Generations is actively striving to increase its more profitable urban lending. Yet, the interview respondent from Generations noted that they often have problems informing potential rural homeowners that they are able purchase a home and that GCCU can help. Many rural residents do not realize that they can afford mortgage payments and that there is downpayment assistance available.

GCCU also offers loans for manufactured housing, an acute need in North Carolina where manufactured housing accounts for nearly 20 percent of all housing (U.S. Census 2007). Manufactured homes usually have very low market values, and many traditional banks are not willing to take on the risk nor the expense of small manufactured housing loans. Therefore, without responsible lenders such as GCCU, manufactured housing owners are frequently lured into high-interest personal property loans arranged by manufactured housing dealers.

Despite the fact that every Generations branch location has direct competition from at least one traditional bank, GCCU feels that it is able to service the financial needs of the minority and low-income populations of rural North Carolina. Generations provides the perfect financial solution for individuals with credit needs who have been turned away by banks but want to avoid predatory lenders.

## Conclusions

There are many challenges and opportunities in mortgage lending in rural areas, and CDFIs appear to have discovered ways in which to cater to their particular customers. On the one hand, the data show us that most of the basic tools of CDFI mortgage lending are similarly applied whether in rural or non-rural markets. On the other hand, rural markets feature a number of unique conditions—remoteness, sparse populations, less diverse populations, smaller loan amounts, specialized collateral, and lower-income households—that make them less likely to be served by mainstream banks. In addition, despite the socially-conscious missions of CDFIs, rural residents tend to have higher interest rate loans, and therefore higher-cost loans.

The case studies demonstrate how some CDFIs have responded to adapt mortgage finance tools that meet the needs of a low-income, rural niche market. Though very limited, CIIS delinquency data, confirmed by interviewees, suggests that they are managing to do so without taking greater risk than the non-rural mortgage lending CDFIs. Whether they are the only bank in the area, or simply the only institution willing to extend a small loan on a manufactured home, rural CDFIs are important in places where few other credit options exist.

## V. CDFIs Respond to the Subprime Foreclosure Crisis

CDFIs play an important role in the mortgage market: originating responsible loans to those underserved by traditional lenders. CDFIs, however, do much more than just originate loans. Their dedication to serving the underserved leads them to engage in a host of activities with borrowers before and after loan origination, including providing substantial pre- and post-purchase counseling, offering refinancing opportunities, participating in policy advocacy, and acquiring and developing commercial and residential properties.

Over the last year the mortgage market has been rocked by the repercussions of irresponsible mortgage lending. According to the Mortgage Bankers Association, “the rate of foreclosure starts and the percent of loans in the process of foreclosure are at the highest levels ever” (MBA 2007). Furthermore, foreclosure rates continue to rise, with estimates of between 14 percent and 36 percent of all subprime loans ending in foreclosure, and over 1 million homes lost to foreclosure because of the current crisis (Ernst et al. 2008). In the midst of this crisis, CDFIs have continued to make responsible mortgage loans, and have designed new programs to help troubled homeowners and to mitigate the negative consequences of irresponsible lending for families and communities.

A foreclosure is not purely a personal financial crisis for the family losing their home; it is a blow to the surrounding community because of a foreclosure’s negative spillover effects. Homeowners face a damaged credit rating, which has a detrimental impact on their credit, insurance, and housing in the future. Neighbors living adjacent to a foreclosed home are also affected, as a foreclosure has been shown to lower the price of homes within 1/8 mile by an estimated 0.9 percent (Ernst et al. 2008). This impact is also cumulative in that each foreclosure on a block reduces property values by an additional 0.9 percent (Ernst et al. 2008). Less conservative estimates are that each foreclosure within an eighth of a mile leads to 1.136 percent

decline in property value (Ernst et al. 2008). This reduction in property value is expected to amount to a loss in property value of \$5,000 on average for homeowners who live near foreclosed properties (Ernst et al. 2008). Municipalities are also impacted because each foreclosure can cost local governments up to \$30,000 (Collins 2005, Immergluck and Smith 2006). The Center for Responsible Lending estimates that 40.6 million homes located near homes undergoing foreclosures will lose value and that the cost to neighbors and communities will be \$202 billion (Collins 2005, Immergluck and Smith 2006). An increase in foreclosed properties also leads to higher rates of violent crime (Immergluck 2006, 59)<sup>47</sup> When foreclosed properties remain vacant, blocks with those vacant buildings experience 3.2 times as many calls to police about drug-related matters and twice the number of calls related to violent crime (National Vacant Properties Campaign 2005). Vacant properties are also more likely to be set on fire by arsonists (Community Investing Center 2008).

In the face of mounting foreclosures, CDFIs are developing strategies to prevent foreclosures, to intervene when homeowners face problems, and to help families and communities recover when foreclosures are unavoidable (Community Investing Center 2008). We surveyed CDFIs to learn more about their responses to the mortgage crisis, and discovered a variety of different programs that attempt to mitigate the negative effects on families and communities of predatory and irresponsible lending. We briefly highlight the range of programs we encountered and elaborate on four using a case study approach.

CDFIs have responded in a wide variety of ways to the subprime crisis; however, we broadly group these initiatives into three categories: foreclosure prevention, foreclosure intervention, and foreclosure recovery. We define foreclosure prevention as individual and group counseling, lender mediation and negotiation, and emergency financial assistance. Foreclosure intervention involves originating a loan that refinances the borrower into a sustainable mortgage. Lastly, foreclosure recovery programs are those that recycle foreclosed properties by selling them to new homeowners so that new households experience the benefits of sustainable homeownership and neighborhoods regain stability.

## Foreclosure Prevention

Foreclosure prevention involves multiple strategies aimed at helping borrowers address their financial situation while it is possible to remain in their home. A few example programs are outlined in Table 7. Strategies of foreclosure prevention include telephone counseling, one-on-one counseling in person, workshops on budgeting and financial management, as well as lender negotiation and emergency financial assistance to help borrowers become current on their mortgages. Lender negotiation is when the nonprofit acts on behalf of the borrower to work with the lender in reaching a mutual solution including reinstatement, modification, refinance, or sale. Financial assistance is typically a small short-term loan with the purpose of making the

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<sup>47</sup>“An increase of one standard deviation in the foreclosure rate corresponds to an increase in neighborhood violent crime of approximately 6.7%.”

homeowner current on his or her mortgage. Most of these efforts serve a few hundred borrowers each year.

**Table 7: Foreclosure Prevention Programs**

<b>CDFI</b>	<b>Home Headquarters<sup>48</sup></b>	<b>Self-Help<sup>49</sup></b>	<b>Ohio Foreclosure Prevention Initiative<sup>50</sup></b>	<b>Neighborhood Housing Services of Boise<sup>51</sup></b>	<b>Northeast Florida Housing Partnership<sup>52</sup></b>
<b>Location</b>	Syracuse, NY	Durham, NC	Ohio (statewide)	Boise, Id	Jacksonville, FL
<b>Partners</b>	City of Syracuse, Syracuse United Neighbors(SUN)	Consumer Credit Counseling of San Francisco	12 nonprofits; 3 CDFIs; Neighborworks America; financial institutions	Neighborworks America	Jacksonville Legal Aid, EverBank, and Fannie Mae
<b>Years of Program</b>	Ongoing; began in 2004	Ongoing; began in 2001	Ongoing; began in 2006	Ongoing; began in 2002	Ongoing; began in 2004
<b>Borrower Characteristics</b>	Earning 80% or less of AMI; finances must be stabilized	60 days delinquent	Borrowers facing a mortgage crisis	Earning 120% of AMI or less; delinquent on mortgage payments	Borrowers in a predatory loan who earn 120% AMI or less
<b>Counseling</b>	Yes	Yes; telephone-based	Yes	Yes (homebuyer education only)	Yes; also refinance and preparatory loans
<b>Financial Assistance</b>	Yes; up to \$2000	No	Yes	Yes; \$1500-\$5000	Yes; amount depends on borrower
<b>Borrowers Served</b>	350	638	500 (one-on-one counseling)	7 loans annually	8 loans in portfolio
<b>Other Services</b>	Lender negotiation	N/A <sup>53</sup>	Lender negotiation	N/A <sup>54</sup>	Lender negotiation

<sup>48</sup> Information from Neighborworks Winning Strategies Home Headquarters: <http://www.nw2.org/WinningStrategies/display.asp?strategy=1296> and offset=2 Retrieved 1/16/08; Neighborworks Center for Foreclosure Solutions. "Preserving Homeownership" May 30, 2007 Available: [http://www.nw.org/network/neighborworksProgs/foreclosureresolutions/documents/NWO\\_Preservationfinal.pdf](http://www.nw.org/network/neighborworksProgs/foreclosureresolutions/documents/NWO_Preservationfinal.pdf)

## Self-Help

In 2002, Self-Help created a foreclosure prevention program, partnering with Consumer Credit Counseling Service (CCCS) of San Francisco (Collins and Gorey 2005).<sup>55</sup> Self-Help contracts with CCCS to provide telephone-based delinquency counseling to borrowers involving finances and budgeting (Collins and Gorey 2005). CCCS initiates the counseling and calls borrowers who are 60 days delinquent on their mortgages (Collins and Gorey 2005). Self-Help makes this counseling available to borrowers through its direct home lending and secondary market programs. The counseling focuses on reducing unnecessary expenses, prioritizing the mortgage payment, and curing any default (Collins and Gorey 2005). Counseling is offered in multiple languages, and CCCS requires that all counselors have a college education as well as experience in a financial field, and that they take continuing education courses.

The program began as a pilot program, but once the data showed its success at helping borrowers, Self-Help decided to continue the program long-term. The program targets borrowers most in need of intervention. As of December 2006, the program had been in existence for roughly four and a half years. In that time, CCCS had made efforts to counsel 638 borrowers, and a quarter of those borrowers had participated in a full counseling session with CCCS. When borrowers participate in a counseling session, a summary of their session is sent to Self-Help. Self-Help contacts the servicer with notice for them to contact the borrower for loss mitigation alternatives as warranted. With little variation from year to year, over 80 percent of borrowers who receive counseling avoid foreclosure.

The program has been very successful. Ding, Quercia and Ratcliffe (forthcoming) investigated the impact of Self-Help's proactive default counseling provided by CCCS with a national sample of low- and moderate-income borrowers with community reinvestment loans. This program demonstrated that well-timed, situation-appropriate counseling, even over the telephone, effectively increased the curing probability of delinquent borrowers. The findings hold even

<sup>49</sup> Information from interview with Mary Holder, Servicing and Loss Mitigation Manager.

<sup>50</sup> Neighborhood Housing Services of Cleveland website: <http://www.nhsleveland.org/programs/foreclosure-prevention.htm> Retrieved 1/16/08; Ohio Foreclosure Prevention Initiative. Neighborworks America. Available at: <http://www.nw2.org/WinningStrategies/display.asp?strategy=1323> and offset=2 Retrieved 1/23/08; Neighborhood Development Services Ohio. Press Release. Available at: <http://www.ndsohio.org/CongressmanRyanMayorPolandPress.shtml> Retrieved 1/23/08

<sup>51</sup> Neighborhood Housing Services of Boise Foreclosure Prevention Program <http://www.nw2.org/WinningStrategies/display.asp?strategy=1173> and offset=3 Retrieved 1/16/08

<sup>52</sup> Information from interview with Richard Paige, Vice President of Lending Services

Northeast Florida Housing Partnership is not CDFI, but its lending affiliate, Jacksonville Affordable Mortgages, is a CDFI.

<sup>53</sup> Offers other services, but they are not directly related to homeowners facing mortgage delinquency and/or foreclosure. Self-Help has loss mitigation staff who work with servicers when loans become delinquent to find solutions that work for Self-Help and the borrower.

<sup>54</sup> Information from interview with Richard Paige, Vice President of Lending Services.

Northeast Florida Housing Partnership is not a CDFI, but its lending affiliate, Jacksonville Affordable Mortgages, is a CDFI.

<sup>55</sup> This is a nationwide program, but most of the borrowers are in North Carolina.

after accounting for unobserved heterogeneity among borrowers and the endogeneity problem (Ding, Quercia and Ratcliffe forthcoming).

An additional benefit to borrowers is that they become aware of the other services CCCS offers, such as free workshops on homebuyer education, credit report review, and money management, which could be beneficial for the homeowner.

### **Housing Partnership of Northeast Florida**

Housing Partnership of Northeast Florida (HPNEF) has responded to the mounting foreclosures by working with borrowers in a number of ways: through expanded counseling, developing a relationship with Legal Aid, and targeted lending to help borrowers qualify for refinancing. HPNEF has experienced its greatest success in loan modifications and workouts, especially when lenders are willing to write off a portion of the debt. They have found borrowers have more success in working with their servicer when the CDFI gets involved on the borrower's behalf to help negotiate with the lender. When possible, the Housing Partnership uses its Rescue Loan to help borrowers get current on their mortgage or pay down other debt so they can qualify for programs like FHA Secure or Fannie's Mortgage Recovery Loan. The Housing Partnership serves a five-county area around Jacksonville that has experienced very high foreclosure rates, ranking 15<sup>th</sup> nationally in 2006 (HPNEF). It targets households earning 120 percent AMI or less.

The counseling aspect of The Housing Partnership's program flows from its experience as a HUD Housing Counseling organization. HPNEF offers one-on-one credit and budget counseling to clients as well as homebuyer education workshops. Between 2005 and 2007, over 50 families received homeownership preservation counseling. In 2007 over 500 households received home ownership counseling, and 360 families graduated from homebuyer education classes (HPNEF). HPNEF has also developed a strong partnership with Jacksonville Legal Aid in cases where homeowners are facing imminent foreclosure, and attorneys with Legal Aid help borrowers determine if a legal strategy will prevent foreclosure.

In its lending activities, the Housing Partnership of Northeast Florida works with EverBank, a traditional lender, to place eligible borrowers in a responsible refinance loan—Fannie Mae's Mortgage Recovery Loan. HPNEF holds the loans for six months, during which time they must perform perfectly in order for EverBank to purchase them to sell to Fannie Mae. The Mortgage Recovery Loan product was part of a Fannie Mae pilot program, started in 2004, to provide conventional financing to borrowers who were victims of predatory lending. A predatory loan, defined by this program, is any loan that meets two of six criteria: loan flipping, excessive fees/packing, lending without regard to ability to pay, fraud/abuse, single premium credit insurance, and prepayment penalties. Borrowers who qualify for these loans are refinanced into a mortgage with better terms. The borrowers can use the proceeds from this refinance to pay off an existing mortgage and limited non-mortgage related debt not to exceed \$2,000.00. Financial counseling is required as part of this program.

Finding successful lending responses has been challenging. As of January 2008, HPNEF had offered eight borrowers Mortgage Rescue loans. Two of those have successfully transitioned to EverBank, and two have the potential to transition as well. The other loans have struggled. Due

to the funding sources leveraged to make these loans, they are not designed for HPNEF to hold long-term. HPNEF faces difficulties because it will often be unable to meet with borrowers until they have already been delinquent for several months, thus giving them less viable options. These two constraints make it challenging to offer lending solutions to borrowers with significant financial problems.

Many borrowers most in need of this kind of program fail to qualify for one or more of the following reasons: 1) the loan's debt to income (DTI) ratio exceeds the program limits, 2) they now find themselves "upside-down" in their current mortgages—probably because they had 100 percent (or higher) LTVs on the original mortgage, and 3) many borrowers who could afford their homes at one time cannot now because of a loss of employment or reduction in income. Even for those few borrowers who do qualify for one of the loan products, it is still a difficult process to help them become more financially stable.

HPNEF is hoping to make this loan product more flexible so that it can help more people in the future. It currently has helped few borrowers because of its narrow definitions based on predatory lending. HPNEF does offer another lending product, a small foreclosure prevention loan with a low interest rate and a short-term period of 36 to 60 months. Its purpose is to bring people up to date in their mortgage, and address the reasons for their default so they can qualify for a refinance through the Mortgage Rescue Loan program. This process can last up to a year. Neither of these programs applies to investment properties or second homes. HPNEF also seeks to adapt its lending products so that they remain relevant.

Many of the current lending solutions to foreclosure prevention were developed at a time when the negative effects of predatory lending were still very theoretical, and they were certainly not considered in conjunction with a declining real estate market. The combination of the current real impact of predatory lending in concert with the current declining real estate market results in the equivalent of a "perfect storm," with many homeowners caught in the middle of the tempest. CDFIs need to be innovative, nimble and strategic to appropriately navigate this issue and provide meaningful and impactful solutions.

HPNEF has expanded the programs it provides, while still serving its mission of expanding safe, affordable housing for low and moderate income families. As HPNEF continues to improve these programs, it could provide a great model for smaller-scale CDFIs to use in their response to the mortgage crisis.

### **Lessons Learned –Foreclosure Prevention**

Essentially, foreclosure prevention programs tend to offer a multitude of strategies aimed at helping the borrowers remain in their homes, either by counseling them before they become delinquent or working with homeowners and their lenders when they are delinquent. The benefit of these programs is that they offer a wide variety of services to borrowers, and are often borrowers' first contact once they realize they are in financial trouble. Additionally, they can address the needs of a large number of borrowers. The challenge is that foreclosure prevention counseling and lender negotiations take time and skill and can overburden CDFIs with limited resources.

## Foreclosure Intervention

Foreclosure intervention involves responding to homeowners in crisis by offering lending solutions, typically refinance products. Northwest Ohio Development Agency and ShoreBank offer very similar programs: lending products aimed at refinancing borrowers from their unaffordable mortgages into sustainable mortgages. These programs, described in Table 8, attempt to intervene with homeowners either before they become delinquent or early in their delinquency. The difference between these intervention programs and the prevention programs described above is the recognition that borrowers are in unaffordable loans, and the loans are the component that needs to change in order to reinforce homeownership.

**Table 8: Foreclosure Intervention Programs**

<b>CDFI</b>	<b>NODA<sup>56</sup></b>	<b>ShoreBank<sup>57</sup></b>
<b>Location</b>	Toledo, OH	Chicago, IL
<b>Partners</b>	Toledo Fair Housing Center; Fannie Mae	N/A
<b>Years of Program</b>	Ongoing	Began in fall 2007
<b>Borrower Characteristics</b>	Earning 80% or less of AMI; finances must be stabilized	Borrowers in exploding ARMs earning between 60% and 100% of AMI
<b>Lending Solution</b>	Refinance for victims of predatory loans; refinance for borrowers in unaffordable loans	Yes; refinance
<b>Borrowers Served</b>	71 loans refinanced or adjusted	60 loans closed; over 20 pending
<b>Other Services</b>	Loan mediation and modification	Community outreach program of seminars and workshops

### ShoreBank

In 2007, ShoreBank began a program to reach borrowers in unsustainable, high- cost mortgages. To do so, ShoreBank restructured its mortgage product to refinance borrowers earning between

<sup>56</sup> Northwest Ohio Development Agency website: <http://www.nodatoledo.org/loans/lendingRelief.htm>

Retrieved 1/16/08; "Friends of Fair Housing" Newsletter. 8 4 Fall 2007. [http://www.toledofhc.org/PDF\\_files/FOFHFall2007.pdf](http://www.toledofhc.org/PDF_files/FOFHFall2007.pdf)

<sup>57</sup> Information from interview with Brian Berg, Vice President, Corporate Communications.

60 percent and 100 percent of the area median income (AMI) with an exploding ARM or other high-cost mortgage product. This program is not an “option of last resort,” but rather an alternative for borrowers with fair to good credit who, once refinanced into a 15- or 30-year fixed-rate loan, will be able to make their mortgage payments and build equity. To implement this program, ShoreBank had to make only slight modifications to its underwriting standards: borrowers usually have a credit score of 520 or above and are not more than 90 days delinquent on their mortgage. The average rate for a rescue loan is 7 percent.<sup>58</sup> ShoreBank is targeting this product to 10,000 borrowers in the 25 Chicago neighborhoods that they serve, all of which are minority communities, who face loan resets in the next 12 to 18 months. ShoreBank hopes to refinance at least 2,000 to 2,500 of those borrowers, and plans to hold and service each refinanced loan to provide greater accountability and reduce risk of foreclosure.

The Rescue Loan product is not targeting only borrowers who are in trouble; it is trying to reach borrowers before their loan becomes unaffordable or puts the home at risk of foreclosure. The key piece of this proactive approach is community outreach. ShoreBank holds a series of ongoing free seminars and workshops in the community based on two models—the MoneyWorks or the Knowledge Exchange. MoneyWorks is a program for borrowers on how to find and recognize a responsible mortgage. Knowledge Exchange is a program for realtors, brokers, and developers as a way to build awareness; this program also creates a source for borrower referrals. This community outreach piece is especially important for borrowers who have been the victims of an irresponsible, high-cost, or unaffordable loan and are hesitant to trust another lender. These workshops provide a way for ShoreBank to build and enhance relationships with different community members and Chicago organizations. ShoreBank is also working with local churches, the city of Chicago, and aldermen to promote the program and drive local government and community support.

Currently, ShoreBank has approved 60 loans at a value of over \$10 million and an average loan of approximately \$175,000. Twenty-four more loans are in the pipeline and 16 applicants were ineligible for refinancing. Ineligible borrowers are referred to Neighborhood Housing Services of Chicago or other area nonprofit organizations and agencies. ShoreBank reviews instances of over-appraisal and negative amortization on a case-by-case or homeowner-by-homeowner basis to help borrowers in these situations.<sup>59</sup> The program will continue as long as there are borrowers who need to refinance their ARM and can be helped by a fixed-rate loan. To promote this effort, ShoreBank has an extensive marketing program planned in 2008.

This refinance product is being funded by a new online high-yield savings account at [www.sbk.com](http://www.sbk.com). ShoreBank is hopeful that the Rescue Loan program will significantly grow its loan portfolio, a portfolio that has already witnessed striking growth since the program began in

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<sup>58</sup> As of January 2008.

<sup>59</sup> When deemed best for the lender, loan modifications are also a possible outcome for borrowers.

fall of 2007.. The bank expects the high-yield savings accounts will generate the funds necessary to make over \$200 million in loans in the next 12 to 18 months.<sup>60</sup>

This intervention program is unique from other responses. First, it grew out of ShoreBank's historical mission to serve low-to-moderate income borrowers and make them financially successful. Predatory and irresponsible lending were jeopardizing the work of ShoreBank and all its community partners on the city's South and West Sides, so in response, ShoreBank made a few changes to an existing mortgage loan product and aggressively sought new borrowers through several outreach initiatives. ShoreBank serves low-to-moderate income borrowers with the Rescue Loan program, and by using the online high-yield savings account as its funding source, ShoreBank will attract deposits and customers from across the country who will receive a competitive rate of return on their money and a social return that comes from saving homeowners from foreclosure and building stable communities. The program will help ShoreBank reach its loan origination goals while having a positive impact on communities. ShoreBank has been serving this market and offering innovative, responsible loan products and financial services to minorities since 1973.

### **Lessons Learned—Foreclosure Intervention**

Intervention options are less common than prevention programs because they target a defined set of borrowers. These intervention programs aim to work with borrowers before they even become delinquent in order for a refinance to be feasible. As ShoreBank's model has demonstrated, this option is well-suited for borrowers who are in exploding ARM loans that will be unsustainable when they reset. If they contact ShoreBank before the reset, a refinance can usually be negotiated and the mortgage becomes sustainable. However, for borrowers who are delinquent, finding a lending solution becomes much more difficult if not impossible.

The other element of the intervention option is funding. ShoreBank has structured its refinance product so that it is not a drain on organizational resources; however, for smaller organizations or for products trying to refinance delinquent borrowers, it can be difficult to deal with the potential financial losses over a longer period of time.

## **Foreclosure Recovery**

As foreclosed properties become vacant they negatively affect the surrounding community. As a result of the dramatic increase in foreclosures, organizations are beginning to respond in order to preserve troubled neighborhoods and create programs that redeploy foreclosed properties to homeowners. Neighborhood Housing Services, Enterprise Community Partners, and Self-Help are all pursuing strategies aimed at helping neighborhoods address the negative effects of vacant foreclosed properties, as shown in Table 9.

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<sup>60</sup> Information from interview with Brian Berg, Vice President, Corporate Communications.

**Table 9: Foreclosure Recovery Programs**

<b>CDFI</b>	<b>Neighborhood Housing Services<sup>61</sup></b>	<b>Enterprise Community Partners<sup>62</sup></b>	<b>Self-Help<sup>63</sup></b>
<b>Location</b>	Chicago, IL	Cleveland, OH	Durham, NC
<b>Partners</b>	Lenders, Servicers, City of Chicago	City of Cleveland, Neighborhood Progress, Ohio Finance Agency	City of Charlotte, Fannie Mae
<b>Years of Program</b>	Began in 2003	Beginning in 2008	Beginning in 2008
<b>Disposition Program</b>	Yes; involves HUD ACA program, Real Estate Owned (REO) properties, and abandoned properties	Yes: involves REO properties in six targeted neighborhoods	Yes: pilot acquisition, rehab and lease-purchase financing project in one Charlotte neighborhood
<b>Borrowers Served</b>	121 ACA properties and 22 REO properties have been redeployed to homeowners	Goal: redevelop 150 vacant properties for homeownership or affordable rental	Goal: 25 homes in Charlotte; hope to expand with other nonprofit partners nationally
<b>Other Services</b>	Counseling, financial assistance, and lender negotiation	Foreclosure prevention strategies; demolition of vacant homes	Counseling, lease-purchase financing

**Neighborhood Housing Services of Chicago, Inc.**

Neighborhood Housing Services of Chicago, Inc. (NHS of Chicago) is a leading partner in Chicago's Homeownership Preservation Initiative (HOPI), a city-wide effort that has created a multi-faceted program, including aspects of intervention, prevention, and recovery. The HOPI Partnership provides a counseling hotline (311), one-on-one counseling, workshops with lenders,

<sup>61</sup> Information from interview with Floyd Gardner, Deputy Director of Single Family Programs, NHS Redevelopment Corporation. Neighborhood Housing Services is a CDFI but the Redevelopment Corporation, though closely affiliated with NHS, is not a CDFI.

<sup>62</sup> Koo, Doris. "On Strengthening Our Economy: Foreclosure Prevention and Neighborhood Preservation," Testimony Before the Senate Banking Committee January 31, 2008. Available online at: [http://www.enterprisecommunity.org/public\\_policy/documents/foreclosure\\_testimony.pdf](http://www.enterprisecommunity.org/public_policy/documents/foreclosure_testimony.pdf) Retrieved March 5, 2008. Neighborhood Progress, while not a CDFI, has a partner organization, Village Capital Corporation, which is a CDFI.

<sup>63</sup> Information from discussion with Bob Schall, President of Self-Help Ventures Fund.

emergency loans, lender negotiations, and disposition of vacant and foreclosed homes.<sup>64</sup> Borrowers are referred to the various programs through the 311 hotline, a community-based referral network, and lender referrals. As of February 2008, 1100 homeowners have been counseled through the 311 program (NHS of Chicago 2006). The lender workshops are offered six times a year and are targeted at homeowners who are current or up to 120 days delinquent, and provide an opportunity for homeowners to meet with lenders and servicers (NHS of Chicago 2006). Though emergency and refinance loans are available as part of the program, these loans are becoming less necessary because of working relationships that NHS counselors have established with lenders and servicers (Collins 2005).

The HOPI Partnership, specifically the direct development arm of NHS of Chicago, NHS Redevelopment Corporation (NHSRC), is also leading the effort in Chicago to return the rising number of foreclosed properties back into productive use through rehabilitation. NHSRC obtains foreclosed properties from a number of different sources, including the HUD Asset Control Area (ACA) program. Under the Pilot ACA program (May 2000 – May 2003) 100 FHA foreclosed properties were acquired, rehabilitated, and sold to new homeowners. Under the next round of the ACA program (February 2004 – July 2006), NHSRC acquired and rehabilitated 22 properties, resulting in 19 new homeowners to date. The dramatic decrease in FHA inventory resulted from the shift in the lending industry towards subprime lending practices.

NHSRC also works with loan servicers, asset managers, and REO departments to monitor “low value” Real Estate Owned (REO) properties that could be donated to them or sold for a deep discount. Twenty-two properties have been returned to homeowners through this program, with Chase and Citibank providing the most, at six and five homes respectively. NHSRC also is the lead agency for the City of Chicago’s Troubled Buildings Initiative II (TBI2) Program. The overall purposes of the Program are to:

- Reclaim vacant, abandoned single-family (1-4 unit) housing stock to increase sustainable homeownership opportunities.
- Strengthen blocks and neighborhoods by eliminating the blighting effects of vacant properties.
- Enforce City building code requirements.

NHSRC has been dealing successfully with vacant and foreclosed properties for a number of years. During a period when the HUD ACA program provided a large volume of properties, NHSRC has been able to witness positive neighborhood effects because of the redeployment of vacant properties. As an example, duplexes that sold for \$120,000 in 2000 sold for \$260,000 in 2003.

NHSRC has sold, on average, 36 homes over the past five fiscal years through their Single Family Programs division and, in particular, through the NeighborHomes Programs. *NeighborHomes*® are one- to four-unit buildings that NHSRC acquires, rehabilitates to a high

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<sup>64</sup> Pre-purchase education is also a component, but it will not be discussed in detail here.

quality, and sells to owner-occupants using City and Federal programs to fund development gaps. These homes have achieved an average sales price of \$141,000 while the total development cost per property is \$165,000 on average over the same period. Subsidy available through the TBI2 program helps make the programs possible. The post-ACA experience has resulted in individual block-by-block successes due to the decrease in the volume and concentration of recent acquisitions. These individual successes and newly rehabilitated and occupied properties provide a positive catalyst for neighborhoods and most often spur other development activity in the immediate vicinity.

Until recently Reclaiming REO Property (RRP), while always a critical part of the partnerships agenda, was not the main focus of the HOPI Partnership. HOPI was more focused on successful loss mitigation practices, working to keep homeowners in their homes and best practices in terms of loan originations. Now, as foreclosures have drastically increased and the negative effects of these lost homes on neighborhoods are becoming more and more apparent, the focus is changing.

A collaborative effort is underway to develop a vehicle or limited partnership that has the capacity to acquire volumes of REO properties and place them back into productive use through either direct sales or rental programs. NHSRC has developed strong relationships with lenders and servicers as part of the HOPI program, and hopes to leverage these relationships to develop a shared-risk model that will expand the scope and capacity of RRP under the initiative. The main reason for creating a standalone entity in this crisis is to share the risk and exposure associated with property ownership and management. The crux of this strategy is to control the supply of REO property, rehabilitate these units to a quality standard, and match them with families in need of affordable housing.

### **Lessons Learned—Foreclosure Recovery**

These disposition programs are not very common, because they are difficult to implement. First, negotiating the purchase of REO properties is challenging because it is a losing proposition for the lender. Asking lenders to donate or sell their property cheaply is not appealing, because they have already lost money because of the foreclosure. Additionally, the differing objectives of key players complicate the situation. All of these issues are further exacerbated in strong housing markets. The asset manager wants to recover the bank's investment in the asset, the foreclosed house, while HOPI wants to improve the housing stock. Another obstacle is that once a value is assigned to the property, it becomes difficult to decrease that value. Therefore, the real estate industry, and in particular brokers and appraisers, play a critical role in the valuing the assets.

Sufficient funding for the nonprofit to acquire and finance property is an essential foundation for any disposition program. Ideally, the organization will have a revolving line of credit or a large pool of development capital so that individual loans will not be required on each project. Additionally, multiple projects can be taken on to create an economy of scale instead of completing one house prior to purchasing the next. The benefit of the revolving line of credit is that it allows for a portfolio approach to development activities, and it also provides the necessary flexibility to acquire property quickly and facilitate contractor payouts. The subsequent proceeds from the sale of the property would be used to pay down the outstanding debt on the line of credit.

Organizations must also have an understanding of property management, and be prepared to hold and maintain properties for a period of time. Additionally, these nonprofits need to be clear about what they are trying to achieve with these disposition programs. That is, they need to adequately think through whether they are trying to promote homeownership (either through direct resales or some lease-to-purchase variation), prevent further neighborhood decline, create opportunities for affordable rentals, or some combination thereof. NHSRC's NeighborHomes program is currently strictly focused on homeownership and does not have a single-family home rental component. The program is in the process of completing their due diligence on the addition of other programmatic initiatives to determine the best mix for the clients and neighborhoods they serve.

## Responding to the Foreclosure Crisis: Lessons Learned

CDFIs are responding to the foreclosure crisis in a variety of ways: the number of clients served, programs offered, targeting, and funding differ from program to program. This variety suggests the need for programs to be flexible and tailored to specific communities. Every CDFI response to the mortgage crisis is unique in some way, as each CDFI responds to its clients' needs as well as its capacity to undertake new programs. However, CDFIs are collectively using common strategies like counseling, lender negotiation, financial assistance, and other tools to help borrowers. Their implementation is what creates these differences. Despite this variety, CDFIs implementing these programs have encountered very similar obstacles to launching and sustaining their responses to the current mortgage crisis.

Each of the programs we interviewed highlighted the complexity of the problem and the need for specialized, trained staff. NFHP has found that every foreclosure prevention case is different and that each case can be extraordinarily time- and labor-intensive.<sup>65</sup> Foreclosure prevention counseling is more involved than pre-purchase counseling because of the type of issues that need to be addressed. Face-to-face counseling may take hours, as one program found that the average customer needed five hours of counseling (NeighborWorks 2008). Because of this, organizations need to dedicate enough staff and resources so that borrowers receive adequate help. Organizations also need to have staff skilled in lender negotiation, since loan workouts can be complicated but often essential for many borrowers (NeighborWorks 2008).

Staff members of various organizations have found that helping borrowers avoid foreclosure is easier early in delinquency; once a borrower is more than two months delinquent, finding a solution is more difficult (NeighborWorks 2008). Early intervention, after notification of delinquency/default, "is arguably the most important factor in the ability of counseling programs to help homeowners avoid foreclosure," so programs need referral networks and marketing strategies to reach borrowers quickly (Quercia, Gohram and Rohe 2006). Effective and ongoing

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<sup>65</sup> Interview with NFHP.

marketing helps facilitate early intervention because it raises awareness about the program among borrowers (Collins and Gorey 2005).

Partnerships also contribute to a program's success, especially if a nonprofit can build relationships with lenders and servicers, leading to prompt and timely referrals as well as a greater likelihood of loan modifications when necessary (Collins and Gorey 2005). Some counseling agencies struggled to find access to loss mitigation departments instead of servicing departments. The recent publishing of a list of contact numbers for various lenders' loss mitigation departments should improve access as well as help initiate loan negotiations earlier in the delinquency process.<sup>66</sup> Being able to contact a specific person within each lending organization helps when negotiating workouts and modifications, as it makes the process more efficient.

The other issue is that not every borrower can be saved from foreclosure; refinancing is an option for only a small percentage of borrowers in default. Accordingly, foreclosure response programs need to have an effective exit strategy for those situations.

The greatest and most common struggle many programs face is that they want to create a lasting and sustainable program but lack funding (NeighborWorks 2007). These activities are generally not income generating, therefore CDFIs require additional operating subsidies to carry them out. Post-purchase programs are usually underfunded, and are often funded through multiple sources that can change from year to year. The reality is that many borrowers cannot afford to pay the full price for counseling services, and that there is no dedicated or reliable source of subsidy available to entice CDFIs to undertake these activities. Only those organizations with existing financial resources and the ability to attract additional funding can even consider undertaking foreclosure prevention, intervention, or recovery programs.

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<sup>66</sup> Interview with NFHP. Typically, if a borrower is 90 days delinquent or less, he is put in contact with the collections department, which does not do loan modifications or workouts. Only after 90 days is the borrower put in contact with the loss mitigation department.

## VI. Conclusions and Recommendations

### Findings and Implications

Home mortgage lending has evolved rapidly over the past decade, and has resulted in the creation of two separate and unequal markets for home loans. Demand by home mortgage originators for new sources of customers resulted in the entry of large numbers of home mortgage lenders into traditionally underserved markets. This wave of mortgage lenders initially appeared to be an answer to CDFIs' calls for more financing in underserved communities. But as the current foreclosure crisis plays out, their products appear to have done more harm than good. We are already seeing a counter-reaction by mortgage lenders, GSEs, mortgage insurers, and investors that may dramatically reduce the availability of mortgages for the borrowers and communities served by CDFIs.

Against the background of a broken mortgage market, the biggest issue facing the CDFI industry now is how to reposition itself within the new mortgage market in order to accomplish its goal of providing fairly priced financial products to underserved communities. CDFIs may be needed more than ever to help reestablish the healthy flow of capital for homeownership in low-income and minority communities. Building on our previous analysis, we suggest different CDFI strategies that have the potential to be highly effective in serving low-income and minority homebuyers.

#### Strategy #1: CDFIs as an Alternative Lending Source

As our findings show, CDFIs do not make mortgages available at the scope and scale required to provide a true alternative in the mortgage market. Even in light of the current constriction in the mortgage market, it is the FHA that has moved to fill in this void. Yet we also found that the mortgage capital CDFIs provide is 2.3 times as likely as prime and FHA to serve minority borrowers, 70 percent more likely than prime and 18 percent more likely than FHA to serve low-income borrowers, 70 percent more likely to go to high-minority census tracts, and about three times as likely as prime and FHA to serve low-income areas. The profile of borrowers and areas served by CDFIs was in many ways similar to that served by subprime lenders, yet we find evidence that CDFI financing is more sustainable and less likely to lead to loss of home. Thus, to the extent that CDFIs can distribute mortgage capital in more volume, these are the markets that would benefit the most. But, in order to begin to deliver financing on a greater scale, CDFIs must develop additional capital sources and delivery mechanisms.

Currently, a bill including two promising sources of capital for CDFIs has been moving through Congress. The Capital Magnet Fund, proposed as part of GSE reform, would increase the amount of funds the CDFI Fund would be able to make available to CDFIs as Financial and Technical Awards. There is also a proposal to allow non-depository CDFIs to access funds provided through the Federal Home Loan Bank system. Another proposal, to allow CDFIs to issue government-backed bonds, would also greatly increase CDFIs' access to capital. In

addition to increasing CDFIs' access to capital, industry associations (OFN and NFCDCU) both are working on initiatives to increase the CDFIs' capacity to originate mortgages.

### **Strategy #2: CDFIs as a Complement and Partner to Extend Mainstream Lending to Target Communities**

Our findings suggest that CDFIs serving as complements and partners to mainstream financial institutions is an effective way for CDFIs to maximize their impact with minimized resources. Furthermore, data from the TLR suggest that subsidy/gap loans (non-first lien loans) made by CDFIs perform well, thus making sustainable home lending possible. Such products help establish prime lending in higher-risk markets by enabling CDFIs to take the riskier position. Embracing this approach, however, requires a commitment to providing ongoing subsidy sources to CDFIs, as the CIIS data indicates that many of these subordinate loans are made at low (or even no) interest and feature flexible repayment terms. Subsidies to support such lending activity ought to be fiscally appealing in light of the costs being incurred as a result of the current mortgage market crisis, which include among others \$300 billion in FHA guaranty authority, \$4 billion to address foreclosed and vacant properties, \$6.6 billion in lost tax revenue in just 10 states, and untold billions of potential credit for the housing GSEs (Global Insight 2007).

### **Strategy #3: CDFIs Having an Impact on Market Practice and Policy Through Innovation and Research**

We already see CDFIs innovating in the arena of foreclosure prevention, intervention, and recovery. We identified 10 programs that CDFIs are using to respond to the challenges resulting from the subprime foreclosure crisis. These innovative programs can serve as models as community and policymakers look for larger-scale solutions to this ongoing crisis. In preventing foreclosures, CDFIs work closely with borrowers to avoid foreclosure, practices which could be adopted by other servicers. CDFIs also are building experience intervening when a family faces foreclosure, to provide a responsible loan. The lessons CDFIs learn through this lending experience can inform larger-scale programs with these same goals. As state and local governments begin to look into how to help communities recover from foreclosures, the experience of CDFIs like NHS-Chicago could serve as useful models.

Furthermore, our findings show that CDFI and subprime mortgages served similar populations, but with dramatically different success rates. Therefore, as markets recover, CDFI are positioned to lead the way back into the hardest-hit communities, and prudently assess risk. Case study research, more-structured best practice sharing, good strong market and loan performance data, and continued investment in data and research can provide opportunities for the work of CDFIs to inform market practice.

## **Data Limitations and Recommendations**

Though our research set out to break new ground in presenting data about CDFI mortgage lending—for example, by merging CIIS data with HMDA and by tapping local property records—the data had a number of shortcomings. Because our findings are based on these data, we sound a strong note of caution in interpreting the results. We hope, however, that the

approaches developed in this paper can form the basis of further research and improvement in data provision.

The data sources used in this report were primarily compiled by the US Federal Government: HMDA, CIIS TLR, and Census data. We also purchased data about loan performance from First American Core Logic. Each of these data sets has limitations that should be kept in mind when considering the analysis made in this paper. The HMDA data was limited to only mortgages that were first-lien, home purchase or refinance, owner-occupied, and originated. Also, all HMDA data covers only mortgages made by larger lending organizations.<sup>67</sup> The TLR data used in this report is limited by shifts in which CDFIs are represented from fiscal year to fiscal year, as well as by wide variation in response rates to the many optional data points. The Census data is imperfect because of the changes that have occurred since it was collected in 2000. The detailed records provided by First American Core Logic are limited by the small sample size, and perhaps by some simplifications made in the selection process that may compromise the representativeness of the data.<sup>68</sup>

### Recommendations for Improving the CIIS TLR Dataset

The CDFI Fund has the authority to improve the quality of one of these datasets, the CIIS TLR data. The TLR could be an effective tool for defining the value proposition of CDFIs. Unfortunately, the TLR in its current form is not complete or consistent. First, the TLR cannot be considered a representative picture of the work of CDFIs: far from all CDFIs submit TLR data, so any given year's worth of information will convey information about only a subset of the industry. Also, some key CDFI mortgage lenders (including ShoreBank) did not complete CIIS reports. The TLR data we used in this analysis were drawn from 40 out of 803 certified CDFIs. Additionally, those CDFIs that do report do so only occasionally. They come in and out of the dataset depending on which years they were funded, so longitudinal analysis is impossible.<sup>69</sup> In addition, the TLR contains many optional fields with questionable reliability, and definitions and reporting requirements that change over time. To increase the TLR's usefulness, the CDFI fund should seek to make it more **complete** and **consistent**.

In order to create a more complete and consistent dataset, the CDFI Fund would need to reduce the complexity and burden of the report to ensure that data is represented accurately and consistently. In addition, CIIS needs to collect loan-level data from **all** CDFIs to make the data accurately reflect the industry. We recognize that these recommendations are very difficult for the CDFI Fund to adopt, and that making the TLR a useful dataset for drawing conclusions about CDFIs and their lending is very difficult.

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<sup>67</sup> HMDA reporting is required only for financial institutions that meet a threshold asset size. A more complete discussion on the limitations of HMDA appears in Appendix A.

<sup>68</sup> Appendix A goes into greater detail about the limitations of each data source.

<sup>69</sup> CDFIs are required to submit a TLR for the three-year performance period of their funding award from the CDFI Fund.

***Fewer Fields—All Required***

The report's many fields and complexity make it overly onerous. Non-CDFI financial institutions report much less data about their lending. For example, the report required by the Home Mortgage Disclosure Act (HMDA), which most financial institutions complete with information about home lending, contains only 26 fields for each loan compared to 100 fields in the TLR. The Fund should select a subset of the current fields required in the CIIS TLR report, and require them every year for all CDFIs. This will provide the Fund with a more complete and reliable dataset, and make reporting easier for CDFIs to report. The Fund should focus on a few of the most important fields to collect, and emphasize efforts to improve the robustness and reliability of the dataset. The dataset would be more useful if CIIS included a smaller number of fields about each loan and these fields were reported by all certified CDFIs consistently over time.

***Consistent Definitions and Reporting Requirements***

Inconsistencies in fields, definitions of those fields, and instructions further complicate the CIIS reporting process. Researchers cannot analyze the data in the field over time, since the meaning of responses change from year to year, and CDFIs cannot follow the same procedures for completing CIIS reports from year to year because the requirements change. The CDFI Fund should simplify the report and limit any changes in the reporting requirements from year to year.

***The Solution Is Not Obvious***

As mentioned earlier, CIIS TRL data is currently reported by only a small percentage of the CDFIs, and those that do report this data do so for only a three-year period after receiving a Financial Assistance (FA) or Technical Assistance (TA) award. Since loans must be tracked over their lifetimes to determine performance, and the sample of CDFIs is not representative of the industry, these limitations make it very difficult to draw meaningful conclusions. The alternative, collecting loan-level data from all CDFIs every year (similar to HMDA), would be very difficult for the CDFI Fund, because it has no regulatory function. Thus, it is very difficult to conceive how the CDFI Fund could make the TRL a reliable database to determine the performance of CDFIs or their loans.

## Author Biographies

*Sarah Wolff* is a Research and Impact Associate at Self-Help, a large CDFI based in Durham, NC. At Self-Help, Sarah attempts to articulate the impact of Self-Help programs on the larger community. She received her Masters of City and Regional Planning from the University of North Carolina at Chapel Hill in 2007 with a focus in community and economic development. Prior to joining Self-Help, Sarah worked on research at the UNC Center for Competitive Economies, Regional Technology Strategies and the UNC Department of City and Regional Planning. Sarah also holds a BSE in Mechanical Engineering from Duke University in 2003.

*Janneke Ratcliffe* is Associate Director for the UNC Center for Community Capital, which she joined in 2005, bringing 20 years experience in financial services and community development finance. She has served as executive director of a small business lending nonprofit. She spent ten years in GE Capital's mortgage subsidiary in risk management, product development and strategic planning. She worked for seven years at one of the country's leading community development financial institutions helping to launch a multi-billion dollar secondary market for affordable home loans and developing a new funding source for commercial lending through the New Markets Tax Credit Program. Throughout her career, she has worked to facilitate the flow of financial services to low-income and minority households and under-capitalized communities.

# Appendix A: Methodology and Data Sources

## Methodology

### Loan Originations

The aim of this paper is to provide information about CDFI home mortgage lending. To create the largest data set of CDFI home mortgage loans possible, the 2006 TLR data set was combined with CDFI-originated home mortgages from the 2006 and 2003 HMDA data sets. The value of including HMDA data on CDFI home mortgages in addition to TLR data was made apparent when we discovered that mortgages originated by major CDFIs such as Shore Bank were not present in the TLR but were represented in HMDA. The CDFI Fund's list of registered CDFIs for 2008 was used to identify CDFI home mortgage lenders in the 2003 and 2006 HMDA data sets (CDFI Fund 2008).

To prevent double-counting of CDFI-originated mortgages that were present in the HMDA data sets and in the TLR data set, any mortgage from the HMDA data sets that was originated in the same FIPS code (at the 11-digit level), for the same amount, in the same year as a mortgage in the TLR data set was combined into just one record. This method of matching is far from perfect, but given that HMDA is designed to make the identification of individual loans difficult or impossible, it was a satisfactory solution. The imperfect nature of the method of matching duplicate mortgages may have resulted in some mortgages that were not the same being combined. However, only 190 mortgages were combined, meaning that the net impact is slight. There is also the possibility that some mortgages that were duplicates were not combined; this possibility exists because 1,862 mortgages from the 2006 TLR data set did not have FIPS codes. This is a more serious flaw, but the majority of mortgages without FIPS codes belonged to CDFIs that were too small to show up in HMDA, limiting the potential severity of this flaw.

In total, 2,260 mortgages were added from the 2003 and 2006 HMDA data sets to the TLR data set. While this gives us the largest possible starting point for those years, it is an imperfect match because HMDA records are for all loans made in a given year while CDFI TLR records cover loans that are active in the portfolio at the point of reporting (no matter what year they were originated).

After the mortgages records that were present in both HMDA and TLR were combined, all of the duplicate records for a single mortgage in TLR had to be consolidated. 6,469 mortgage records were removed from the initial 20,321 records in TLR. The high rate of multiple records for a single mortgage occurred because organizations reporting in TLR report all of the mortgages they hold in their portfolio for each year, and TLR is composed of multiple years of reporting by CDFIs. Thus if a loan is held in the portfolio for multiple years in which a CDFI reports to TLR, it will show up once for each year. The "Unique Project ID" variable in the TLR data set was used to identify mortgages that were reported more than once and remove them. When a single mortgage had multiple records the record that was reported to TLR most recently was retained.

After the removal of all duplicate records 15,922 home mortgage records remained in the combined data set, 13,852 from TLR and 2,070 from HMDA, if combined records are excluded. A series of tables describing selected attributes of this combined data set appears in Appendix B.

### **Geographic Context**

The geographical context in which CDFI mortgages occurred was viewed as important to understanding the market CDFIs served, and how their mortgage outcomes compared to other lenders' in similar markets. To provide a geographic context, household and individual data points for the census tract each mortgage was located in, from the 2000 Census, were attached to each mortgage record in the combined data set. The tract-level data from the Census was attached based on the FIPS code for that loan. 1,862 mortgages did not have FIPS codes reported, preventing tract-level data from being assigned to them.

### **Loan Performance**

Comparing the outcome of mortgages originated by different lenders was the next objective after the origination and geographic data had been compiled. Two markets were selected for this comparison, Cook County Illinois and Wake and Durham Counties in North Carolina. We chose to look at loans originated in 2006.

The process of selecting the counties for a market-level analysis began with the selection of appropriate years. The next step was to identify MSAs with sufficient CDFI activity to draw a sample of CDFI mortgages from. A list of the MSAs with the highest number of CDFI-originated loans was generated using HMDA records. The list included Chicago IL, Lexington-Fayette KY, Johnstown PA, New Orleans LA, Waco TX, Raleigh-Durham NC, and Charlotte NC. Lexington-Fayette and Johnstown were eliminated because the home mortgage transaction records were not available online or through First American Core Logic. Waco was removed from the list because of its location along the border and the belief that this would result in the inclusion of trends that are not present in the typical metro mortgage market. New Orleans was removed because the impacts from Hurricane Katrina might confound results. This left the Chicago, Raleigh-Durham, and Charlotte MSAs. Chicago and Raleigh-Durham were selected because they had a higher number of CDFI-originated loans. Charlotte was not included because researching two metro areas in the same state and served by largely the same CDFIs would not be productive.

Selection of specific counties within each MSA was necessary to keep the cost of data purchased from First American Core Logic down. A list of the counties within each MSA that had the greatest number of CDFI mortgage originations was pulled from the HMDA data set. This led to the selection of Cook County and Wake and Durham Counties (with Wake and Durham County results to be combined).

After the locations and geographies were selected the different lender groups that would be compared with CDFI home mortgages had to be created. First American Core Logic provided a market scan for each county and each year. This market scan included the name of different lenders and the number of loans they made. The lenders identified in each scan were classified as

prime, subprime, or CDFI. CDFI lenders were identified first using the CDFI Fund’s list of certified CDFIs. Prime and subprime lenders were classified based on the percentage of loans they originated that met HMDA’s high-priced definition<sup>70</sup>. If over 90 percent of the loans a lender originated were marked as high priced by HMDA and the lender was not a CDFI, then that lender was marked as a subprime lender. If over 90 percent were not marked high-priced, and that lender was not a CDFI, then the lender was marked as a prime lender.

After the lenders from the market scan were classified the list was returned to First American Core Logic, who selected a sample of one hundred loans from each lender type, in each county, originated in 2006. In a few cases there were insufficient subprime or CDFI mortgages to reach the 100-mortgage threshold. For each mortgage numerous data fields were provided by First American Core Logic. This paper uses only a few of them; lender name, mortgage date, outcome type, and outcome date. The number of mortgages for each market, for each year, and for each lender group that reported either pre-foreclosure or foreclosure activity were divided by the total number of mortgages reported for that lender group and market. This provided a default rate for each lender group and market cohort that could be compared with one another and provide insight into the outcomes of mortgages originated by different lenders relative to one another.<sup>71</sup>

## Data Sources

The data sources used in this report were primarily compiled by the US Federal Government: HMDA, CIIS, and Census data. We also purchased two sets of data about loan performance from First American Core Logic.

### HMDA Data

The HMDA data sets used for comparisons, as well as the data that was merged with the TLR data set, were limited to mortgages that met the following criteria; first-lien, home purchase or refinance, owner-occupied, and approved. The data was also limited by HMDA’s limited coverage of the mortgage market, based on lender asset size and whether loans were within MSAs (FFIEC 2006). This is estimated to be about 80 percent of the total mortgage market.

### TLR Data

The TLR data used in this report is a product of the CIIS data collection system operated by the CDFI Fund. “CIIS is the first system to collect standardized transaction-level data on the community development finance industry. CIIS is a comprehensive program designed to be the

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<sup>70</sup> High-price is defined by HMDA as an interest rate 300 basis points above the interest rate of a treasury security with a comparable maturity for first-lien mortgages, and 500 basis points above a treasury security with a comparable maturity for second-lien mortgages.

<sup>71</sup> The outcome data that First American Core Logic provided has serious limitations, which are outlined in the Data Sources Section.

primary data source for the CDFI industry. The transaction-level data (TLR) makes CIIS a unique and highly desirable data set” (Kaplan 2008).

This paper did not use the entire TLR data set. Instead, the CDFI Fund provided a subset of the TLR data set. This subset consists of only those loans that the CDFI Fund identified as home mortgages.

While the TLR data set represents the largest and most comprehensive data set of transaction level records of CDFI mortgages, it contains numerous flaws that diminish the value of the data it contains. Partially these flaws are a result of the youth of the CIIS system and will be eliminated over time. However, we felt it was important to describe how the TLR data set works and what implications this has for the analysis we conducted. Two broad areas limit the effectiveness of the TLR data set: the consistency of the data and the completeness of the dataset.

The TLR data set includes a wealth of data points for each mortgage, with one hundred possible fields per record. However, few data points are consistently reported. Many fields are marked as optional, meaning that CDFIs can choose to include the information or not. This optional nature raises questions about how representative the data that is reported actually is. It is unknown what factors lead CDFIs to fill in or leave them blank, and how this biases those data fields. Numerous fields are rendered useless by their optional nature because the response rate is too low to draw meaningful conclusions. The optional nature can also make it unclear whether a data field was left blank because the mortgage did not fit into any of the categories or because the lender chose not to respond. One example of this is the “low-income status” field. This field does not have a clear category for those borrowers who are not low-income, which makes it difficult to determine whether a CDFI left the field blank because the borrower was not low-income or because they just did not provide the information. Several other data fields are unclear about whether the data field has been omitted or that lender is indicating a negative response. To address these inconsistencies we provided information on the total number of mortgages reporting for each data field analyzed, and attempted to provide a clear explanation when assumptions were made about what a blank field meant.

Another area where the TLR data set presents problems is that it is not representative of all CDFIs’ activity. Only CDFIs that received funding from the CDFI Fund in one of the three previous reporting periods are required to submit data. This is a limited subset of certified CDFIs, and an even smaller subset of all organizations operating as CDFIs. Since the award and allocation processes are competitive, the TLR by design is incomplete. The CDFI Fund has certified 803 CDFIs, but only 40 institutions were represented in our dataset (CDFI Fund 2008).

Furthermore, each year the CDFIs that report in the TLR data set change, as CDFIs’ obligation to report expires. This creates a constantly shifting sample group making it impossible to determine whether changes across fiscal year are a product of trends in CDFI lending or are instead shifts in which CDFIs are reporting in TLR. The entry and exit of a single CDFI can significantly alter the makeup of the TLR data set, particularly if it is one of the larger CDFIs with several thousand home mortgages in its portfolio. There is also a bias toward smaller CDFIs within TLR,

because larger CDFIs are less reliant than smaller CDFIs on funding from the CDFI Fund, and thus less likely to report to TLR.

The other factor that decreases the accuracy with which TLR reflects the entire CDFI home mortgage universe is that TLR includes only loans that were active at the beginning of the fiscal year. This excludes all mortgages that were paid off or defaulted prior to that fiscal year. It is impossible to determine from the TLR data set what portion of a cohort of mortgages made in a given year were paid off or charged off. It is reasonable to suspect that these two outcomes represent a sizeable and increasing portion over time of the mortgages the CDFIs made. Thus it is unreasonable to believe that those borrowers who remain in CDFI mortgages represent an unbiased sample of CDFI mortgages. Because only active mortgages are reported, it is impossible to track a cohort of mortgages made in a given year over time. Tracking such a cohort would provide valuable information about how CDFI mortgage performance compares to other lenders, as well as the net impact of CDFI home mortgage lending, which are two of the stated goals of the CIIS data set.

### **Census Data**

The 2000 Census data included tract-level household and individual data points. 2000 Census data was used because it was readily available, covered the entire geography necessary, and was relatively fine-grained compared to other data sets that could be used to provide demographic information about the area a loan was located in. The drawback to using data from the 2000 Census is that only a small portion of the loans in the combined data set were originated in 2000. The characteristics of neighborhoods obviously change over time, meaning the neighborhood information used in this paper may not be an accurate reflection of the characteristics of that neighborhood when the loan was originated.

### **First American Core Logic Data**

Two data sets were purchased from First American Core Logic for use in this paper. The first was a market scan of Durham and Wake Counties in North Carolina and Cook County in Illinois, for 2006. This market scan provided a record of the number of loans originated by each lender active within the specified time and geography; for loans between the amounts of \$20,000 and \$350,000, and that were owner-occupied. The market scan also provided information about the market share of each lender, the average loan size, the number of conforming and nonconforming loans, the interest rate type, and the average loan size for each lender, among other data points.

The second data set provided detailed information on 100 loans from each lender group, for each county. The information included the interest rate where possible, the interest type, any riders such as adjustable rate or balloon payment, the term of the loan, the amount of the loan, and the outcome of the loan. The outcome of the loan and who it was made by were the two data points central to the analysis in this paper; both of these data points were derived from court records that First American Core Logic compiled electronically. The outcome field had three possible results: nothing, pre-foreclosure, or foreclosure. Pre-foreclosure was assumed when a change of trustee document was filed, and foreclosure was assumed when a foreclosure document was

filed. The name of the lender was pulled from the original mortgage document filed at the local courthouse.

## Alternative Data Sources

We pursued a number of different sources in order to investigate loan performance. In addition to the dataset we purchased from First American Core Logic (described above), we gathered data directly from online courthouse records order to study loan performance. While we did not ultimately analyze data obtained from this source, we think it is a possible approach to investigating loan performance and deserves further consideration.

### Courthouse Record Data—Direct Gathering

Local courthouse records hold information that researchers can use to determine how loans perform over time. In addition to the deed, various legal documents are filed as loans go through the foreclosure process, and these documents can be viewed by searching through public local courthouse records. Each locality has different systems and different requirements. We attempted to gather performance data directly from the Mecklenburg County, NC courthouse online data system for loans made in 2006.

As with the performance dataset we purchased from First American Core Logic, we wanted to put together a dataset describing loan performance by lender type. First, we collected information for all the loans made by three CDFIs in Mecklenburg County in 2006 (identified through our origination data set). We identified loans for prime and subprime lender groups using the same methodology we used for grouping lenders for the First America data, described above. We aimed to gather information for 100 loans in each comparison lender group and assigned numbers (like weights) to each lender, based on the volume of lending the lender did in that year. For example, Bank of America made 30 percent of the prime loans in Mecklenburg County in 2006, so we collected 30 of their loans, randomly sampled, to build our sample group of prime loans. We then used a random number generator to generate random dates, and searched for the combination of lender and date through the Mecklenburg County courthouse online record system to get loan-level information<sup>72</sup>.

- We recorded the following information about each loan:
- From the record: instrument number and date recorded.
- From the record detail: Grantee and Grantor name.
- From the deed: lender name, amount borrowed, maturity date, any riders, address of property, if an adjustable rate rider then the initial rate, the maximum and minimum rates, and the spread.
- And from any related documents: refinance/foreclosure/sale and applicable date.

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<sup>72</sup> The Mecklenburg County courthouse record system can be accessed at:  
<http://www.charmeck.org/Departments/Register+of+Deeds/home.htm>

We identified sale or refinance by a CAN or a satisfaction document; and foreclosure by a foreclosure document. If the loan had a CAN document we preformed another search using the grantor name to see whether a new deed of trust had been issued. If another deed of trust existed for that property then we identified the loan as a refinance; if no such document existed then we identified it as a sale. We matched the property and name when performing this search, since some individuals have many deeds of trust outstanding.

Direct data collection proved to be time-intensive. We estimate eight and a half minutes of search time per record. In addition to the time required the searcher had to be familiar with reading the courthouse documents. We employed a real estate lawyer on a contract basis to collect the data.

Ultimately, we decided not to use this data in our analysis of loan performance. We pursued both the First American data and this data concurrently and felt that First American provided more data fields, more-complete data, and more options for the data than direct collection. We abandoned this method after collecting data for 178 loans, due to time and cost constraints, and concentrated on the data available from First American.

Although we did not use this data in our analysis, the information needed to analyze loan performance is available in courthouse record systems throughout the country. This data is kept in some form (perhaps not easy to access) for all communities, even for places where data aggregators like First American do not collect data. With enough time and skilled researchers, teams of people could search these records to analyze the performance of loans made by all kinds of lenders and for all places (unlike First American Core Logic).

## Further Information About Select Variables

*Rural:* A mortgage was marked as having been made in a rural census tract if the MSA/CMSA code in the 2000 Census was equal to “9999”. “Metropolitan Area code as defined at the time of the 2000 census. A value of 9999 indicates a non-metro area” (Missouri Census Data Center). Some census tracts that were rural in 2000 would have become urban or suburban by the time the loan was made, so there is a bias toward over-marking a loan as rural in this method.

*Interest Rate Spread:* The interest rate spread was calculated by taking the original interest rate reported for the mortgage and subtracting the average interest rate for a 30-year fixed-rate mortgage for the year in which the loan was originated. Thirty-year fixed-rate mortgage values were obtained from Freddie Mac’s PMMS30 data set. Though this is clearly an imperfect measure because of mortgage rate fluctuations over the year, it was a useful starting point for comparing the pricing of CDFI mortgages to the mortgage market as a whole.

## Appendix B: Description of Combined Data Set

Table B.1: Distribution of Mortgages by Originating Institution Type

Financial Institution Type	Number of Mortgages	Percent of Total
Unknown (HMDA)	2,260	14.19%
Bank	139	0.88%
Credit Union	3,984	25.02%
Loan Fund	9,539	59.91%
<b>Total</b>	<b>15,922</b>	<b>100.00%</b>

Loan Funds and Credit Unions dominated the Combined CDFI Mortgage data set. The Credit Union component is itself dominated by Self Help Credit Union, which constitutes 2077 of the Credit Union mortgages.

Table B.2: Distribution of Mortgages by Year of Origination

Year Closed	Number of Mortgages	Percent of Total
1977	1	0.01%
1978	1	0.01%
1981	4	0.03%
1987	8	0.05%
1988	10	0.06%
1989	9	0.06%
1990	37	0.23%
1991	110	0.69%
1992	86	0.54%
1993	99	0.62%
1994	115	0.72%
1995	176	1.11%
1996	244	1.53%
1997	510	3.20%
1998	479	3.01%
1999	560	3.52%
2000	711	4.47%
2001	856	5.38%
2002	1121	7.04%
2003	2685	10.58%
2004	2174	13.65%
2005	2875	18.06%
2006	3032	11.13%
2007	19	0.12%
<b>Total</b>	<b>15922</b>	<b>100.00%</b>

The year of origination spans a considerable amount of time, but is weighted toward 2003-2006. The inclusion of 19 loans from 2007 is interesting, given that the most recent data is suppose to be for 2006.

Table B.3: Distribution of Mortgages by Lending Organizations

Organization ID Number	Number of Mortgages	Percent of Total
1783017	90	0.57%
2793152	139	0.87%
5327444	2,078	13.05%
6466831	1,653	10.38%
14056542	917	5.76%
16614879	330	2.07%
17590158	1	0.01%
21077522	172	1.08%
21410971	64	0.40%
22637396	64	0.40%
24378563	215	1.35%
28680854	527	3.31%
31562223	7	0.04%
32386151	112	0.70%
34016857	400	2.51%
34818885	215	1.35%
36634762	56	0.35%
38739697	10	0.06%
41019286	54	0.34%
45736183	74	0.46%
46803876	299	1.88%
52813916	108	0.68%
53697594	559	3.51%
59879742	90	0.57%
60172014	784	4.92%
61116607	2	0.01%
64065147	641	4.03%
70534030	13	0.08%
71570176	446	2.80%
72333498	12	0.08%
72976071	170	1.07%
73486151	143	0.90%
73910086	1,434	9.01%
74547835	461	2.90%
78480717	578	3.63%
88119475	32	0.20%
94978982	91	0.57%
98375442	266	1.67%
98597393	355	2.23%
HMDA	2,260	14.19%
Total	1,5922	100.00%

## Appendix C: Description of Select Markets

This section provides an overview of the housing and demographic characteristics as well as the home mortgage lending activity occurring in the two markets we selected for closer examinations of the outcomes of CDFI, prime, subprime, and FHA mortgages: Cook County, Illinois, and Wake and Durham Counties, North Carolina. Understanding the demographic and housing characteristics of each market puts the lending activity of each lender group in context. The racial characteristics of the borrowers a lender group serves can be compared with the overall characteristics of the entire market population to determine which portions of the population a lender group serves. The same comparisons can be made for median home value and the size of mortgages made by each lender group; similar comparisons are possible between other variables as well. Other variables such as Mortgage Status and Ratio of Home Value to Income provide an insight into the strength of the housing market.

### Cook County

Cook County was clearly still a hot housing market in 2006; the income to home value ratios show that buyers were leveraging their incomes significantly to purchase homes. Median home value is also roughly six times median household income, making significant leveraging necessary to purchase a home for most households.

When the racial and income characteristics of the county are compared with those of each lender group, Cook County displays the same pattern seen for the nation as a whole, of prime lenders serving whiter, richer segments of the population, and FHA and subprime lenders serving poorer minority segments. Also consistent with the overall national pattern are the differences among lenders in the income and race of the communities that each lender serves.

Table C.1: Profile of Cook County (2006)

<b>Race</b>	
<b>White</b>	54.20%
<b>Black</b>	24.70%
<b>Asian</b>	5.90%
<b>Other</b>	15.20%
<b>Home Ownership</b>	
<b>Rent</b>	38.30%
<b>Own</b>	61.70%
<b>Median home value</b>	\$284,900
<b>Income</b>	
<b>Household median income</b>	\$50,691
<b>Poverty status</b>	9.80%
<b>Mortgage Status</b>	
<b>With either a second mortgage, or home equity loan, but not both</b>	25.10%
<b>Second mortgage only</b>	4.60%
<b>Home equity loan only</b>	20.40%
<b>Both second mortgage and home equity loan</b>	1.10%
<b>No second mortgage and no home equity loan</b>	73.80%
<b>Ratio of Home Value to Income over the Past 12 Months</b>	
<b>Less than 2.0</b>	14.10%
<b>2.0 to 2.9</b>	21.20%
<b>3.0 to 3.9</b>	18.30%
<b>4.0 or more</b>	45.90%
<b>Not computed</b>	0.50%

Source: American Community Survey 2006

As would be expected, prime lenders hold the largest market position. Subprime lenders are hold a smaller position, but their concentration in lower-income and minority communities provides them with a larger portion of lending activity in these communities. The market share of FHA loans is only a tiny sliver of the overall mortgage market for Cook County in 2006.

Table C.2: Home Mortgages Originated in Cook County (2006)

Source: HMDA 2006<sup>73</sup>

	Prime	FHA	Subprime
<b>Number of Mortgages</b>	117,920	3,610	60,315
<b>Borrower</b>			
<b>Gender</b>			
Male	62.50%	56.40%	55.30%
Female	34.30%	42.00%	41.30%
<b>Race</b>			
White	74.00%	45.80%	50.50%
Black	11.20%	47.60%	35.20%
Other	6.90%	1.70%	3.40%
Hispanic	16.30%	17.90%	23.20%
<b>Income</b>			
Median	\$79,000	\$64,000	\$69,000
Mean	\$107,000	\$66,000	\$82,000
( % of AMI)			
<60%	11.60%	15.90%	14.30%
60-80%	14.60%	25.80%	18.90%
80-100%	17.50%	27.70%	22.30%
>100%	56.30%	30.70%	44.60%
<b>Census Tract</b>			
<b>Minority</b>			
0-15%	25.60%	13.50%	12.50%
15-30%	23.50%	13.70%	13.50%
30-50%	17.30%	15.30%	14.40%
>50%	33.70%	57.50%	59.60%
<b>Income Level</b>			
<80%	24.90%	33.50%	43.20%
80-100%	25.20%	35.80%	27.90%
100-120%	18.90%	21.10%	16.50%
>120%	31.00%	9.60%	12.30%
<b>Loan Profile</b>			
<b>Loan Size</b>			
Median	\$216,000	\$167,000	\$192,000
Mean	\$257,000	\$172,000	\$217,000
<\$ 25,000	447	3	246

<sup>73</sup> Only mortgages that were reported in HMDA and met the following qualifications were included: first- lien, owner-occupied, originated not purchased mortgages.

The mortgage performance data is detailed in Table C.3 below. For each lender group we looked at both mortgage activities overall (sale or refinance), and specifically at foreclosure activities, including pre-foreclosure.

**Table C.3: Mortgage Performance in Cook County**

Mortgage Activity	CDFIs		Prime		Subprime		Total	
	#	%	#	%	#	%	#	%
<b>Sale</b>	14	7.0%	17	8.6%	8	4.0%	39	6.5%
<b>Other mortgage activity</b>	100	50.0%	101	51.3%	133	66.5%	334	56.0%
<b>No activity since original mortgage</b>	82	41.0%	78	39.6%	27	13.5%	187	31.3%
<b>Foreclosure Activity</b>								
<b>Pre-foreclosure ( not resulting in foreclosure)</b>	4	2.0%	1	0.5%	20	10.0%	25	4.2%
<b>Pre-foreclosure followed by sale</b>	0	0.0%	0	0.0%	4	2.0%	4	0.7%
<b>Foreclosure</b>	0	0.0%	0	0.0%	8	4.0%	8	1.3%
<b>Total Foreclosure Activity</b>	4	2.0%	1	0.5%	32	16.0%	37	6.2%
<b>Total</b>	200	100.0%	197	100.0%	200	100.0%	597	100.0%

Source: First American Title's Core Logic.

## Wake and Durham Counties

The housing markets in Wake and Durham Counties were not as heated as Cook County in 2006. The ratio of income to home value was only 4 or higher for 21.3 percent of homeowners, and the ratio of median income to median home value was a little under a factor of 4. Homeowners were still leveraging their incomes to purchase homes, but not to the degree that was occurring in Cook County and other super-heated housing markets.

Wake and Durham Counties also resemble Cook County with respect to the racial and income differences between the segments of the population that lenders groups serve and the overall population.

Table C.4: Profile of Wake and Durham Counties (2006)

<b>Race</b>	
<b>White</b>	65.3%
<b>Black</b>	23.3%
<b>Asian</b>	4.5%
<b>Other</b>	6.8%
<b>Home Ownership</b>	
<b>Rent</b>	39.3%
<b>Own</b>	60.7%
<b>Median home value</b>	\$191,550
<b>Income</b>	
<b>Household median income</b>	\$53,769.5
<b>Poverty status</b>	10.4%
<b>Mortgage Status</b>	
<b>With either a second mortgage, or home equity loan, but not both</b>	34.6%
<b>Second mortgage only</b>	6.8%
<b>Home equity loan only</b>	27.8%
<b>Both second mortgage and home equity loan</b>	1.3%
<b>No second mortgage and no home equity loan</b>	64.1%
<b>Ratio of Home Value to Income over the Past 12 Months</b>	
<b>Less than 2.0</b>	31.3%
<b>2.0 to 2.9</b>	31.2%
<b>3.0 to 3.9</b>	16.2%
<b>4.0 or more</b>	21.3%
<b>Not computed</b>	0.2%

Source: American Community Survey 2006).

Wake and Durham Counties constitute a much smaller home mortgage market than Cook County. The order of the relative size of lender groups is the same, though; from largest to smallest: prime, subprime, and FHA. FHA lending is small to the point that its impact on the overall market is questionable. Subprime lenders possess market share equal to or larger than prime lenders among black borrowers, in minority communities, and in low-income communities.

Table C.5: Home Mortgages Originated in Durham and Wake Counties (2006)

	<b>Prime</b>	<b>FHA</b>	<b>Subprime</b>
<b>Number of Mortgages</b>	5,286	398	1,596
<b>Borrower</b>			
<b>Gender</b>			
<b>Male</b>	63.5%	49.0%	52.4%
<b>Female</b>	32.2%	47.7%	41.4%
<b>Race</b>			
<b>White</b>	74.1%	56.1%	44.5%
<b>Black</b>	10.2%	32.6%	37.5%
<b>Other</b>	5.4%	2.3%	2.1%
<b>Hispanic</b>	3.4%	7.7%	7.8%
<b>Income</b>			
<b>&lt;60%</b>	14.7%	35.9%	24.0%
<b>60-80%</b>	15.0%	28.6%	21.0%
<b>80-100%</b>	12.9%	15.4%	16.5%
<b>&gt;100%</b>	57.4%	20.1%	38.5%
<b>Census Tract</b>			
<b>Minority</b>			
<b>0-15%</b>	19.0%	6.9%	10.0%
<b>15-30%</b>	56.5%	39.1%	43.8%
<b>30-50%</b>	19.4%	33.0%	26.6%
<b>&gt;50%</b>	5.2%	21.0%	19.6%
<b>Income level</b>			
<b>&lt;80%</b>	6.5%	19.7%	16.8%
<b>80-100%</b>	18.7%	34.9%	31.2%
<b>100-120%</b>	39.4%	31.9%	34.4%
<b>&gt;120%</b>	35.5%	13.6%	17.7%
<b>Loan Profile</b>			
<b>Loan size</b>			
<b>Median</b>	\$163,500	\$134,500	\$148,000
<b>Mean</b>	\$205,657	\$133,630	\$142,770
<b>&lt;25,000</b>	91	0	66

Source: HMDA 2006<sup>74</sup>.

<sup>74</sup> Only mortgages that were reported in HMDA and met the following qualifications were included: first- lien, owner-occupied, originated not purchased mortgages.

For our loan performance analysis, data for Wake and Durham Counties was collected separately (as described in the tables below) and then combined into one unit of analysis. Table C.6 below describes the data we used to investigate loan performance.

**Table C.6: Mortgage Performance in Durham and Wake Counties**

<b>Mortgage Activity</b>	<b>CDFIs</b>		<b>Prime</b>		<b>Subprime</b>		<b>Total</b>	
	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>	<b>#</b>	<b>%</b>
<b>Sale</b>	10	6.3%	64	16.5%	34	8.5%	108	11.4%
<b>Other mortgage activity</b>	54	34.2%	213	54.9%	271	67.9%	538	56.9%
<b>No activity since original mortgage</b>	91	57.6%	112	28.9%	49	12.3%	252	26.7%
<b>Foreclosure Activity</b>								
<b>Pre-foreclosure ( not resulting in foreclosure)</b>	0	0.0%	0	0.0%	14	3.5%	14	1.5%
<b>Pre-foreclosure followed by sale</b>	0	0.0%	0	0.0%	2	0.5%	2	0.2%
<b>Foreclosure</b>	3	1.9%	1	0.3%	30	7.5%	34	3.6%
<b>Total Foreclosure Activity</b>	3	1.9%	1	0.3%	46	11.5%	50	5.3%
<b>Total</b>	158	100.0%	388	100.0%	399	100.0%	945	100.0%

Source: First American Title's Core Logic

## Appendix D: Rural CDFI Case Studies

In addition to Saguache County Credit Union (SCCU) and Generations Community Credit Union (GCCU), we interviewed six additional rural CDFIs making mortgage loans. More information on some of the CDFIs and their experience with rural mortgage lending follows.

### Alternatives Federal Credit Union

Alternatives Federal Credit Union, which is located in the college town of Ithaca, NY, serves both the urbanites of Ithaca and the rural residents of the neighboring communities. Like most rural CDFIs, Alternatives has difficulty defining and tracking rural loans; loans are coded solely by ZIP code, an imperfect measurement that groups together the city of Ithaca and its surrounding rural areas.

Alternatives uses the same mortgage guidelines for rural and urban borrowers, but rural loans are generally smaller than urban loans. This reflects the higher prices of homes in the city of Ithaca and the generally lower incomes of rural residents. However, the racial demographics of individuals interested in Alternatives' mortgage products do not differ significantly between the rural and urban areas in Alternatives' service area (approximately 83 percent white, 10 percent African-American, and 7 percent Hispanic).

In rural areas, Alternatives carefully analyzes the unimproved land value ratio because, according to Fannie Mae guidelines, this ratio cannot exceed 30 percent of the total land/house appraised value. Alternatives is always the first lender on purchase mortgages, and it works with Neighborhood Housing Services and Better Housing for Tompkins County to piece together affordable loan packages. In addition, it sells loans to SONYMAE (New York State), which provides low-interest loans and closing cost assistance to qualified borrowers.

Manufactured homes are more prevalent in the rural areas served by Alternatives, but they still only account for approximately 2 percent of all home loans. Like other rural CDFIs, Alternatives is more cautious about manufactured housing loans due to depreciation concerns. To guard against such risk, Alternatives avoids thirty-year loans and lends to manufactured housing only when the housing is located on the owner's land. Alternatives also requires that the hitch and wheels be removed and that the home be on a permanent foundation.

Alternatives has maintained an outstanding and self-sustaining mortgage portfolio, even in the midst of the national foreclosure crisis. It attributes this good performance to available and free homeownership counseling and responsible lending in an area with generally stable housing prices. There has also been no difference between rural and urban loan performance.

Despite the presence of many other banks and brokers in the area, as well as internet lenders, Alternatives feels that it is able to create loyalty among its members through better service, homebuyer education, and creative mortgage products to address the underserved.

## Self-Help Credit Union

Headquartered in urban Durham, Self-Help Credit Union has borrowers located throughout rural North Carolina. The mission of the Credit Union, a financing affiliate of the Center for Community Self-Help, is to “Create and protect ownership and economic opportunity for people of color, women, rural residents and low-wealth families and communities” (Self-Help).

Self-Help codes and tracks rural home loans and uses the USDA definitions to determine rurality. In order to serve low-income rural borrowers, Self-Help occasionally leverages USDA and FHA mortgage products, which allow Self-Help to create more affordable mortgage products. Like many of its peers, Self-Help Credit Union also restricts acreage in order to maintain an acceptable land-to-house ratio.

Though housing is generally cheaper in rural areas of North Carolina, there is a shortage of quality units, meaning many rural homebuyers choose manufactured houses. In fact, North Carolina ranks third in the nation for manufactured housing. Self-Help accommodates this demand through its Affordable Alternative Housing Product (AAHP), a product specifically designed to enhance the appreciation of used manufactured homes. Included in the AAHP guidelines are that the manufactured housing must be a double-wide on a permanent foundation that was constructed on or after 1994.

Self-Help provides a great deal of homeowner education, and extends mortgages to only those borrowers that it deems financially and emotionally ready for homeownership. This due diligence has paid off, as Self-Help is not suffering many adverse effects from the subprime crisis. Also, Self-Help has not observed any major differences between the performance of its urban and rural loans.

## USSCO Johnstown FCU

Located about 70 miles East of Pittsburgh, Johnstown is a traditionally rural area that has recently seen substantial business growth. Though the interview respondent estimated that 225,000 people live in the area the credit union serves, the vast majority, approximately 185,000, still live in rural areas. The Johnstown area used to be all low-income individuals, but rapid economic growth has brought a sizable middle class to the area. The area remains predominantly white (96 percent), with an African-American population of about 4 percent and a small presence of Latinos and Asians.

As the area grows, the percentage of rural loans through the USSCO Credit Union has been shrinking. The interview respondent estimated that 35-40 percent of all mortgage loans are in rural areas. Also, due to this growth, housing prices in the area have remained constant or shown slight growth, even after the national housing market has declined. However, this growth has been moderate, and the USSCO has not had problems with fluctuating housing prices. Their mortgage portfolio performs well, and they have not been adversely affected by the foreclosure crisis. However, the interview respondent did note that predatory lenders, especially mortgage brokers, have been a problem in the area.

As is frequently the case in rural areas, Johnstown has many older homes and a substantial demand for manufactured housing loans. The interview respondent noted that they are one of the few financial institutions in the area who will extend manufactured housing loans and that manufactured housing comprises approximately 8 percent of their total mortgage volume. To address the shortage of decent housing, USSCO have developed a unique self-construction product whereby they extend a mortgage loan on undeveloped property with the requirement that construction begin within 24 months. The self-construction product is used frequently and there is no cap on the size of the land plot, although USSCO will only loan up to 80 percent of the land value.

A specific rural problem mentioned by the USSCO interview respondent is that new environmental regulations require that homes pass a sewage run-off test before resale. Many of the older homes in the area are failing the test because they have old plumbing and are not connected to any centralized sewage systems. Repairs can cost upwards of \$10,000, and many people are abandoning their low-cost homes rather than pay the money required for resale.

## **Dakotaland Federal Credit Union**

With five branches throughout southeastern South Dakota, the Dakotaland Federal Credit Union considers itself and its members to be 100 percent rural. The area, which has a very low population density, is overwhelmingly white, although the recent opening of two meat processing plants has brought a moderate Hispanic population (an estimated 10 percent of the area population). The area median family income is an estimated \$45,000-\$50,000 a year and the average house value is about \$70,000-\$80,000.

Given the small housing values, Dakotaland frequently extends mortgages for very small amounts; the average home loan is approximately \$41,000. Dakotaland is the largest lender in a three-county area, and the interview respondent felt that one of the main reasons for this quasi-monopoly status is that big banks do not want to deal with such small mortgage amounts. In addition, Dakotaland is a mission-driven organization that feels its purpose is to serve the community, which builds substantial loyalty among its members.

Dakotaland does consumer, mortgage, and small-business lending, but mortgage lending is its largest activity. It uses Fannie Mae and FHLB products for the Secondary Market, but also keeps unqualifiable loans in-house. Though many of the loans are sold to the secondary market, Dakotaland always retains servicing so as to preserve the personal touch. There is no cap on the size of land, and Dakotaland does a substantial amount of homeowner counseling. Dakotaland extends mortgages to manufactured homes on permanent foundations, and personal property loans to manufactured housing in parks. However, the interview respondent from Dakotaland mentioned that, like most rural CDFIs, Dakotaland is cautious about manufactured housing loans due to problems with appreciation.

The housing stock in South Dakota is old and needs substantial maintenance work. Therefore, Dakotaland frequently extends home improvement financing to its members. In addition, the

opening of the two meat processing plants in the past five years has created a new housing shortage in the area, which further adds to the overall shortage of quality homes.

Dakotaland has not been affected by the foreclosure crisis, and its mortgage portfolio continues to be healthy and well-performing. However, it has felt the effects of the subprime meltdown through bail-outs to members who had accepted bad loans from mortgage brokers. Dakotaland has recently bailed out an estimated 10 members from these bad loans.

## **Mendo Lake Credit Union**

Located in Northern California, the three branches of Mendo Lake Credit Union cover a two-county area with several small towns (15,000 or less) and the rural outlying areas. The region is predominately white, with about 20 percent Hispanic, 5 percent Native American, and 2 percent Asian populations.

The area median income is only about \$36,600, but the median home price is an astounding \$400,000. Such high home prices mean that it is extremely difficult to purchase a home in the region, and Mendo Lake has had to find unique ways to create affordable financing opportunities for its members. For example, Mendo Lake has been facilitating a lot of gifts from older members who want to help their children buy homes. Also, Mendo Lake extends loans to several members of an extended family for joint purchase of a home.

High home prices have also driven a strong demand for manufactured homes (the median manufactured housing price is approximately \$100,000). An estimated 28 percent of homes in the two counties are manufactured housing, and Mendo Lake will loan to manufactured housing on permanent foundations and in parks. Though they charge a 2 percent higher interest rate for manufactured housing on leased land, the interview respondent noted that they are among the few financial institutions that will loan to manufactured housing park members and that this is a market niche for Mendo Lake.

A second Mendo Lake market niche is for nonconforming homes. Mendo Lake loans to homes with large acreage, homes off the power grid (e.g. solar power), and homes built out of nontraditional materials (e.g. earth and mud). Given their location in Northern California, their area attracts many people with alternative lifestyles, and Mendo Lake has attempted to accommodate this. However, the interview respondent did note that the Credit Union has turned down loans to communes.

There are a number of other financial institutions in the area, but Mendo Lake builds loyalty among its members through individual service and counseling. In addition, Mendo Lake loans to people with higher debt-to-income ratios, a population that many commercial banks do not seek out. Like the other rural CDFIs, Mendo Lake has not been adversely affected by the foreclosure crisis. However, it does recognize that predatory lending is a problem in its area (especially from on-line lenders), and is therefore in the process of developing a product that will serve as a responsible alternative to payday lending and that will help the CDFI's low-income members build credit.

## Appendix E: Foreclosure Crisis Response Programs

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