

Community Development Financial Expertise Put in Service of Neighborhood Stabilization

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As we began 2009, communities across the United States faced an unprecedented crisis brought about by millions of mortgage foreclosures and chaos in the capital markets. More than one million homes stand vacant and home values have fallen in every major metropolitan area over the past year. Several icons of the capital markets – Lehman Brothers, Merrill Lynch, and Wachovia Bank – no longer exist, and others, including Fannie Mae and Freddie Mac, are deeply wounded.

Yet as communities ponder these massive problems and work to save their neighborhoods in the midst of frozen credit markets, lessons learned over the last 30 years by community development organizations are fostering new tools and solutions. Because there is a rich network of mission-based organizations that are committed to building strong communities across the country and because these organizations have developed savvy and skills in using capital markets tools, community development leaders were able to quickly partner with major financial institutions to set a course for saving neighborhoods ravaged by home mortgage foreclosures.

This article will: (1) briefly explore the history of community development organizations and how they multiplied their impact through the use of sophisticated capital markets tools; (2) describe how community development organizations worked together with major financial institutions to identify key tools that would be needed to dispose of hundreds of thousands of vacant foreclosed properties; (3) describe the National Community Stabilization Trust – a partnership that helps communities effectively bring vacant properties back into productive reuse; and (4) discuss the future of community development organizations working in partnership with financial institutions.

Community Development and Capital Markets – A Rich History

When the term and practice of “community development” came into use in the 1970s, it really marked a change in the way we think about how change happens in communities. The implementation of the federal Community Development Block Grant (CDBG) program in 1975 played a role in cementing a place for the term in our vocabularies as it provided one of the first federal programs that required that cities solicit input from communities in developing plans for how the dollars would be spent. It replaced the Urban Renewal programs of the late 1960s and early 1970s, which were seen by many communities as being “top-down” in their decision making and were seen as emphasizing wholesale demolition and clearance of

blighted neighborhoods as primary tactics. CDBG was part of the Housing and Community Development Act of 1974, which also brought significant dollars to the table for the development of low- and moderate-income housing through the Section 8 housing program.

The Woodstock Institute, an organization committed to the issues of racial justice, economic development, and low- and moderate-income housing, preceded CDBG by two years. Within the next seven years, the Community Reinvestment Act was passed (1977), NeighborWorks was founded (1978), the Local Initiatives Support Corporation (LISC) was formed (1979), and the Enterprise Foundation (Enterprise) was established (1982). In this period, the work of thousands of small community-based organizations began to gain credibility as a powerful “bottoms-up” way for communities to change horrendous local conditions caused by economic disinvestment and racial and economic segregation.

As community development gained credibility, there was a growing realization that community development organizations needed tools to access economic capital directly if they were going to bring about large-scale change in communities. The introduction of the Low Income Housing Tax Credit (LIHTC) program in 1987 provided one of the first tools that enabled community organizations to directly attract private investors to invest in affordable housing. While the Section 8 program had been a powerful tool in developing thousands of affordable housing units, most of the housing was developed by for-profit developers and often was located without much regard to the priorities important to communities. Furthermore, properties developed using the Section 8 program were dependent on continuing federal subsidies in order to keep rents affordable to low-income households. By contrast, the LIHTC builds the federal subsidy into the equity structure of the property rather than using ongoing rent subsidies to generate enough cash flow to pay debt service on large mortgages. In addition, the LIHTC is allocated from the federal level to states and a few cities on a simple per capita basis. The actual direction of LIHTC to projects is managed by state agencies, which must adopt allocation plans that are subject to public review on an annual basis.

Both LISC and Enterprise developed investment entities that used the LIHTC to attract billions of dollars in private capital to develop affordable housing projects. Because they worked directly with investors, they were able to attract this capital to projects located and built with a significant amount of community involvement. This allowed LISC and Enterprise to direct investment to projects developed by nonprofit development organizations whose missions are focused on community development. In addition, community development organizations all over the country were able to influence directly the allocation plans adopted by state agencies.

The 1990s saw a continued flowering of community development organizations that were directly accessing the capital markets to support the redevelopment of communities and the development of affordable housing. The Housing Partnership Network was formed in 1990 by nonprofit affordable housing and community development organizations from across the country that wanted to learn from one another. In 1994, the Community Develop-

ment Financial Institutions (CDFI) Fund was established to provide equity capital directly to banks and loan funds that focused their lending on community development projects. In 1995, the Community Reinvestment Act was significantly modified to require that financial institutions not only lend and maintain branches in low- and moderate-income communities where they collect deposits, but that they also invest in these communities. The decade ended with the creation of the New Markets Tax Credit (NMTC), which allows community development organizations to attract private capital to low-income communities for economic development.

This long history is recounted to underscore the point that community development organizations have produced positive changes in communities across the country because they are mission-based organizations that take their direction from the low- and moderate-income communities they serve and because they have developed successful tools for attracting private investment capital to these communities. They have been able to make the case for investments in projects and in communities that the conventional capital markets often overlooked or shunned. Such projects have often been the vanguard for the subsequent investment of purely private capital in enough volume to turn around whole neighborhoods. The Harlem community in New York City is just one of the best-known of such reinvestment stories. The story has been repeated in hundreds of low-income communities across the country.

A Community Development Response to the Mortgage Foreclosure Crisis

In the past year, community development organizations across the country were quick to realize that the mortgage foreclosure crisis was threatening the health of low-income communities as the number and concentration of vacant and foreclosed properties mushroomed. Communities that they had worked to rebuild for 30 years were being devastated as families lost their homes and their economic situations became perilous. As families left, vacant properties triggered further disinvestment and a sense of hopelessness among the families that remained in the communities. The strong communities that they had worked so hard to build were slipping away.

It should be noted that prominent community development organizations including Self-Help and its Center for Responsible Lending had sounded the alarm in the early 2000s about the dangers of predatory lending and the irresponsible lending products that have now been discredited. The calls of the community development industry for regulation of mortgage lenders went largely unheeded.

In 2007, as foreclosures began to mount in cities like Cleveland and Minneapolis, community development organizations began to convene key players in their communities to figure out how to address the crisis. They looked first to improve and increase foreclosure-prevention strategies.

While there have been and continue to be many successes in the foreclosure-prevention arena, by the end of 2007 it became apparent that bad lending practices and widespread

fraud had resulted in many families having mortgages that they could not afford even with substantial modifications to their terms. Moreover, it became apparent that many single-family homes had been acquired by absentee owners who had purchased properties with the hope of reselling them in rapidly appreciating markets for quick profits. When the credit crisis hit all markets in 2007 and residential property values began to fall, these owners were caught with investments they could not sell and mortgage payments they could not afford. These properties served to quickly balloon the number of vacant and foreclosed properties, which, in turn, added to the downward spiral of property values in communities with high concentrations of these properties.

As the story of foreclosures and vacant properties continued to unfold, community development organizations realized that they had to become engaged in stemming the tide of growing neighborhood devastation. The “we live here” underpinnings of community development stimulated a push for action.

In early 2008, local community development organizations, in addition to their local organizing efforts, began talking to the national community development organizations with which they worked. They realized that some large-scale solutions at a national level would be needed to help them tackle the problems they were seeing at a local level. Two problems emerged as issues that could not be addressed effectively purely at a local level.

- First, the widespread use of securitization for single-family mortgages had resulted in the ownership and decision making about the disposition of vacant and foreclosed properties being spread across the globe.
- Second, the scale of economic losses throughout the financial markets often left local communities holding the bag when it came to dealing with the very real problems of maintaining vacant properties, addressing the neighborhood issues created by vacant properties, and planning for their productive reuse. Local communities needed additional financial resources to deal with these problems.

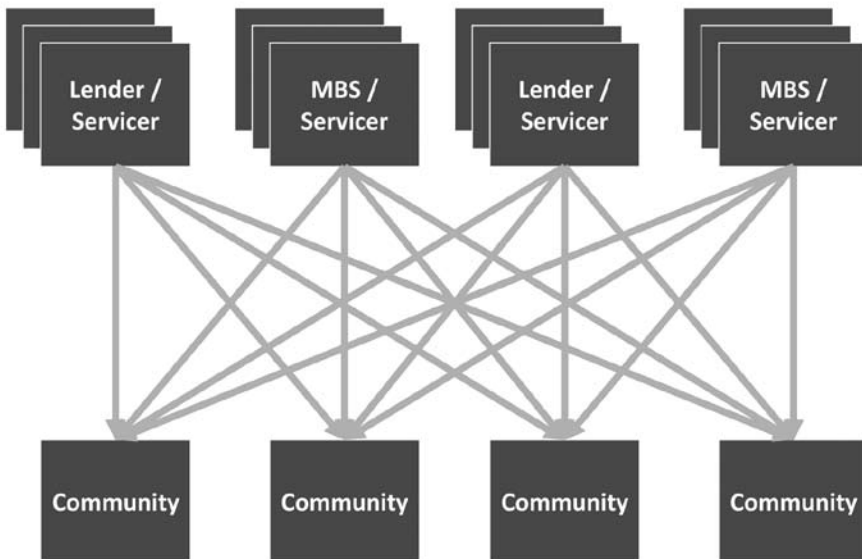
In February 2008, four national community development organizations – Enterprise, the Housing Partnership Network, LISC, and NeighborWorks – came together to explore whether they could help the local and regional community development organizations with which they are affiliated to address these large-scale problems. These four sponsors formed a working collaborative effort called the National Community Stabilization Trust (the Stabilization Trust) to formally frame some solutions.

First, they tackled the issue of financial resources. Working with a broad coalition of community development organizations, they helped form the Save America’s Neighborhoods campaign to advocate for federal resources to help communities acquire and redevelop vacant residential properties. They also began a dialogue with the philanthropic community about directing resources to this issue. They simultaneously engaged in a campaign to heighten awareness of the problems of neighborhood destabilization that were a result of the foreclosure crisis among state, local, and federal government decision makers. As one

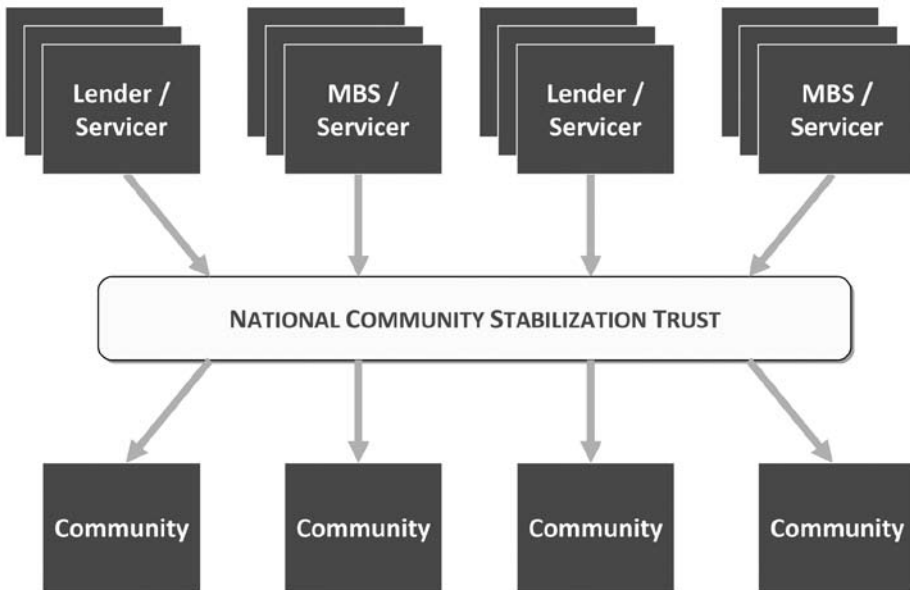
tangible result of these efforts, the Neighborhood Stabilization Program (NSP) was included in the Housing and Economic Recovery Act of 2008, which was enacted in July 2008. The NSP program directs \$3.92 billion through more than 300 state and local government agencies for stabilizing communities by acquiring and redeveloping vacant properties. The NSP program is currently being implemented through the Department of Housing and Urban Development (HUD) and funds will be available for use in communities early in 2009.

Second, they tackled the issue of developing a method by which state and local governments and community development organizations could efficiently and cost-effectively acquire vacant properties from the myriad mortgage loan servicers and investors that make the decisions about the sale and disposition of vacant foreclosed properties. In previous times when neighborhoods faced large numbers of vacant properties, most of these properties were controlled by HUD because the foreclosures occurred under the FHA insurance program. This time, communities would need to make multiple contacts to acquire all the properties even in a small target area. Multiply this by hundreds of communities nationwide and it became clear that an intermediary could potentially serve a useful purpose.

Transfer Foreclosed Properties



Transfer Foreclosed Properties



Using research dollars from the Ford and MacArthur foundations, the Stabilization Trust engaged consultants knowledgeable about both the mortgage banking industry and the community development industry to develop a set of solutions. The four sponsors of the Stabilization Trust quickly realized that this research would best be conducted by working with actual examples of foreclosed properties in communities that were already organizing to tackle the issues of neighborhood stabilization. They also realized that it would be critical to begin working with the major financial institutions that provide mortgage loan servicing for more than half of the country's residential mortgages.

The research had several major components:

- About 20 communities that are affiliated with the four sponsor organizations of the Stabilization Trust were asked to:
 - provide specific information about the neighborhood stabilization efforts that were already under way;
 - identify the zip codes for the areas of their communities that they were targeting for stabilization efforts; and
 - identify the financing gaps that they anticipated as they redevelop vacant properties for effective reuse.

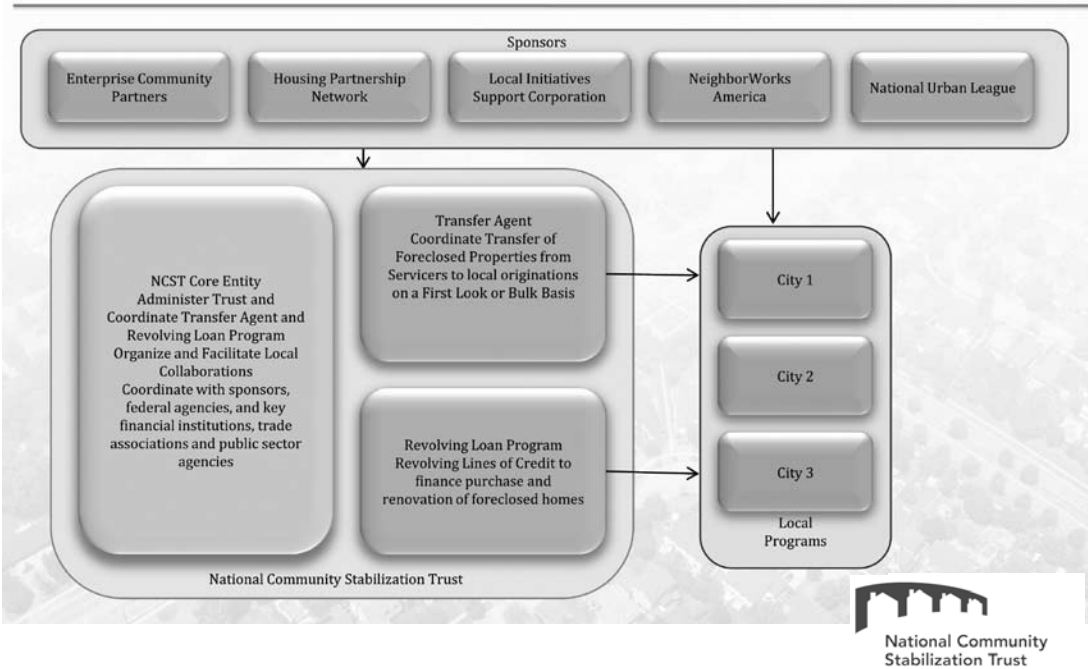
- The Office of the Controller of the Currency (OCC), working with the Stabilization Trust, convened a working group comprised of representatives from the largest mortgage loan servicing operations in the country. Through this working group, the Stabilization Trust gained the commitment of several financial institutions to:
 - provide information to the Stabilization Trust about vacant properties for which they were the loan servicer and which were located in the zip code areas identified by the communities; and
 - arrange for their loan servicing managers to participate in detailed interviews about the processes they use in working with foreclosed properties, particularly when those properties complete the foreclosure process and become “real estate owned” or REO properties.
- The Stabilization Trust developed a methodology for calculating the Net Realizable Value of an REO property that would both:
 - fulfill the fiduciary obligations of the loan servicers to the investor owners of the REO; and
 - take into account the market risks that communities would take on when they acquired REO properties.

This initial research was completed in late July 2008 and a plan was presented to the four sponsoring organizations for implementing an organization that would have two major functions:

- a Transfer Agent entity that would provide an exchange platform for local communities to efficiently and effectively acquire vacant properties from financial institutions; and
- a Capital Corporation that would aggregate capital from philanthropic and capital markets investors to supplement the financial resources available through the NSP program.

The initial four sponsors of the Stabilization Trust, and a fifth sponsor, the National Urban League, subsequently agreed to take the steps necessary to form and capitalize a limited liability company that would implement this plan. They also agreed to engage an executive leader that would direct the work of the Stabilization Trust. The diagram below shows the general business model for the Stabilization Trust.

Functional Structure of NCST



The National Community Stabilization Trust – The Leading Voice for Neighborhood Stabilization

By early October 2008, the National Community Stabilization Trust LLC had been formed and Craig Nickerson, a seasoned executive with extensive experience in both community development and mortgage banking, had been engaged as its executive. When HUD announced the commencement of the new Neighborhood Stabilization Program at a national summit meeting in early October, the Stabilization Trust was featured on the program as an important tool for states and localities to use in implementing the NSP program in their communities. At this same meeting, several major financial institutions announced that they intended to work through the Stabilization Trust to offer REO properties for acquisition by states and localities.

While these activities were unfolding nationally, the Stabilization Trust was beginning to engage specific financial institutions to offer properties to local communities under the terms of a Memorandum of Understanding (MOU). The MOU contains the Net Realizable Value procedure for determining the prices at which properties will be offered to local communities acquiring properties through the Stabilization Trust. The formula for calculating the Net Realizable Value for a property is shown in the diagram below. The Stabilization Trust confirmed with HUD that this Net Realizable Value approach fulfills the requirements for calculating the discount required by the NSP guidelines.

Transfer Agent

Applying the Net Realizable Value Approach to Vacant Property

Net Realizable Value model balances needs of buyers and sellers.

Estimated market value assuming normal market conditions and procedures through a Broker's Price Opinion, an Automated Valuation Model or a full appraisal

Less Saved holding costs of insurance, real estate taxes and maintenance

Less Avoided transaction costs of brokerage and sellers internal supervision and administration

Less Savings in capital costs due to early receipt of proceeds

Less Possible decline in value over the holding period

Less Rehabilitation required for code compliance and marketing

Equals Net Realizable Value



National Community
Stabilization Trust

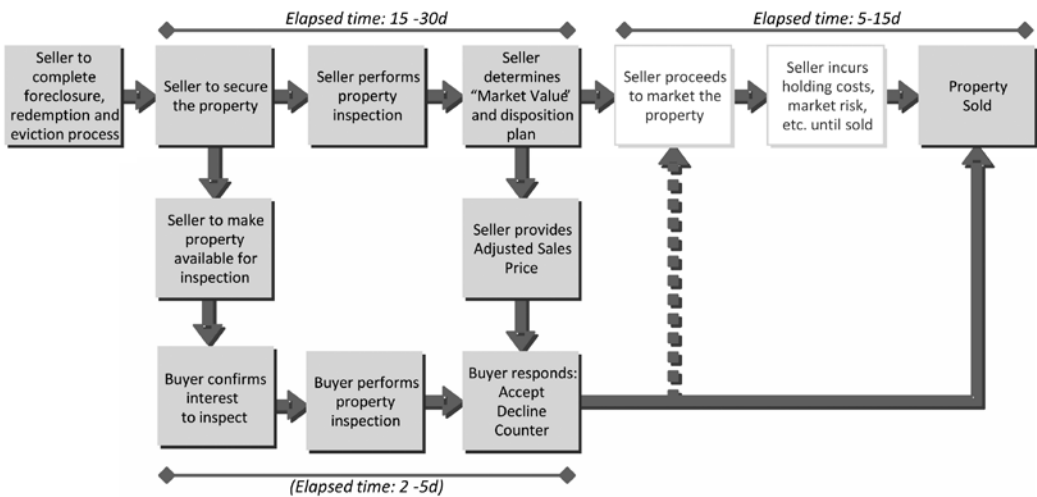
The MOU also outlines two processes for offering properties – a “First Look” process through which financial institutions offer properties in specified target areas as soon as the properties become REO and before they are listed for sale; and a targeted bulk-purchase process through which financial institutions offer properties that have been on the market in designated target areas for an extended period of time.

The responsibilities of the Stabilization Trust under the MOU are to engage local and state organizations to purchase properties through the Stabilization Trust and to ensure that these organizations have addressed a set of five criteria:

- Concentration – The local community stabilization effort should focus on one or more defined geographic areas to increase the likelihood that a significant, visible impact can be achieved.
- Capacity – The local community stabilization effort should include organizations with the ability to assess, acquire, manage, rehabilitate, and convey properties quickly and at scale.
- Capital – The program should have sufficient resources from the HUD NSP fund and other public and private resources to conduct a successful stabilization program.

- Collaboration – The local community stabilization effort involves an established partnership with government agencies, nonprofit organizations, and other local stakeholders that defines the roles and accountabilities of each participant.
- Comprehensive – Bricks-and-mortar activities such as the acquisition and rehabilitation of properties purchased through the Stabilization Trust should be complemented by a broader strategy that leverages related social investments and improvements to infrastructure, incorporates a marketing campaign, and otherwise integrates tangible and intangible community efforts.

Also in early October 2008, the Stabilization Trust Transfer Agent began to test its operations by engaging in a small number of actual transactions, with properties being offered by two loan servicers under the terms of the MOU and properties being reviewed and acquired by two local communities. The initial transactions have yielded offers in the price ranges anticipated by the Net Realizable Value methodology. The first purchases closed in mid-November. The following is a diagram of how the First Look process for acquiring properties works.



The Transfer Agent continued its test implementation with the result that, at year-end 2008, six financial institutions – Wells Fargo, Bank of America/Countrywide, JPMorgan Chase, Citibank, Fannie Mae, and GMAC/RESCAP – were offering properties in five local communities. These communities – Minneapolis, St. Paul, New York City, Memphis, and Rochester, NY – were in a position to acquire properties through the Stabilization Trust. The Transfer Agent became fully operational April, 1, 2009, and funds are available through the NSP program to acquire properties. The Transfer Agent forecasts that it will complete the transfer of more than 4,000 properties during 2009 and that it will engage at least 100 communities and 20 major financial institutions. The Transfer Agent is intended to have a short life span as financial institutions work through the glut of REO properties that are currently flooding the markets, but it is expected to operate at least through 2011.

The Capital Corporation of the Stabilization Trust anticipates receiving a large commitment of philanthropic support early in 2009 and has a goal of having an operating loan fund by July 2009.

The Stabilization Trust is widely seen as a component critical to the success of the Neighborhood Stabilization Program and efforts to turn around neighborhoods ravaged by foreclosures and vacant properties across the country. Congress included an additional \$2 billion for the Neighborhood Stabilization Program in the American Recovery and Reinvestment Act of 2009.

Conclusion

The National Community Stabilization Trust is a clear demonstration of the power of strong relationships between major financial institutions and community development organizations. Years of proven performance by the community development organizations have made it possible to reach agreement with major financial institutions in a very short time-frame that will allow many communities to implement neighborhood stabilization strategies before deterioration becomes severe.

Using these relationships, their detailed knowledge of the capital markets and how they operate, and their deep knowledge about the needs of communities, community development organizations have crafted in the National Community Stabilization Trust a critical capacity to assist those communities in stabilizing neighborhoods that have been ravaged by home mortgage foreclosures. The National Community Stabilization Trust and the Neighborhood Stabilization Program will truly help communities implement strong neighborhood stabilization programs.

As citizens and the new administration wrestle with the severe economic challenges facing the country, this lesson of the National Community Stabilization Trust should not be lost on the country's policy and financial leaders. Healthy communities stand at the heart of the country's economic health. Communities that offer good jobs, safe and affordable places to live, good educational choices for children, and affordable health care are communities that will contribute in a positive way to a bright economic future. Community development organizations now have a 30-year track record of providing support for the jobs, housing, primary health care, and good schools, often in communities that were ignored by conventional capital markets.

At a time when many long-standing institutions have faltered, it is critical that financial institutions and government alike turn to these community development organizations to help keep communities strong. Because community development organizations are grounded in the communities they serve, they are often the first to recognize when things are going wrong. Witness the voice of Self-Help and other community development organizations that early on spoke out against subprime mortgage lending and demonstrated that it was possible to lend to low-income families with loans that those families could afford over the long term. Witness the community development financial institutions that have been in

the vanguard of providing financing for charter schools and primary health-care facilities in communities where traditional schools and clinics were failing. Witness the hundreds of thousands of affordable housing units managed by community development organizations with low vacancy, excellent physical conditions, and social services offered on site.

Community development organizations have clearly earned a place at the table as the country moves forward toward a new era of economic recovery and growth.

Mary Tingerthal joined the Housing Partnership Network as president of the Capital Markets Companies in September of 2007. She coordinates the work of the Housing Partnership Fund, which provides acquisition and predevelopment financing; Housing Partnership Ventures, which serves as the Network's investment vehicle; and the Charter School Financing Partnership, a new conduit for charter school loans. In 2008 she was instrumental in establishing the National Community Stabilization Trust – a new national company dedicated to helping local organizations get vacant and foreclosed properties back into productive reuse.