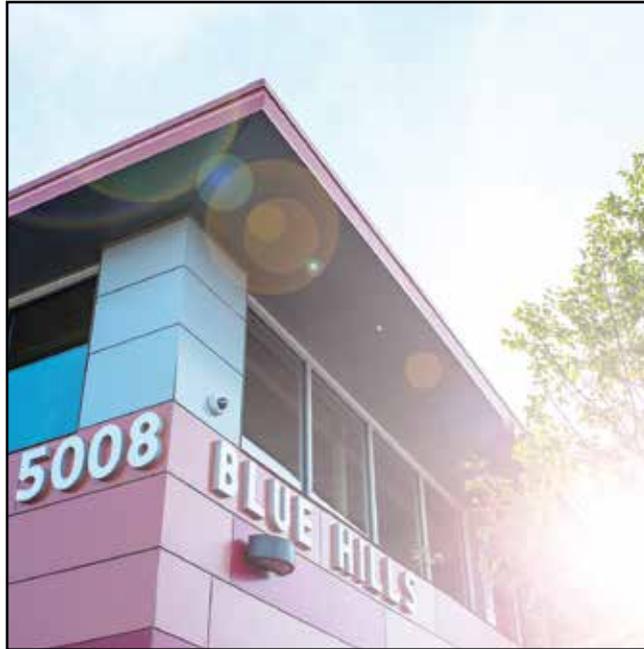


Funding transformations

Loan pools create investment opportunities for the urban core

Ozell Lincoln, an urban rehabber in Kansas City, teaches teenagers about housing rehabilitation.



Existence of large numbers of foreclosed, vacant and abandoned properties in urban neighborhoods poses community challenges of blight, crime and further deterioration, not to mention the loss of tax revenues.

But renovation of these forlorn properties can present fresh opportunities to create affordable housing, revitalize neighborhoods and help low- and moderate-income residents build personal wealth.

One large obstacle, however, is finding capital to finance this transformation, at a time of federal budget cuts and the appearance, at least, of a decrease in lending by banks still feeling the pinch of the housing market collapse.

Some communities are addressing this problem by creating “loan pools,” reservoirs of funding that can provide mortgages to homebuyers and also loans to small-business rehabbers to acquire and renovate vacant properties.

Loan pools are most often funded by a consortium of banks that invest a proportionate

share of money into the pool, thus limiting their individual risks. The pooled money can also be leveraged with funding from city, county and state governments, and from private investors and foundations.

The money is often managed by an underwriting entity that makes loans to borrowers and pays a return to the lenders, in proportion to their investment.

“Loan pools can provide the resources to assist homebuyers who want to live in urban neighborhoods and create a genesis of new homeownership,” said Jerry Dantzler, director of Omaha 100, a nonprofit organization that since 1992 has managed a loan pool for seven Omaha banks, using the money to revitalize neighborhoods.

Dantzler said the Omaha 100 loan pool has provided nearly 1,000 loans amounting to more than \$58 million in funding. The city of Omaha provides additional funding that can be used by the homeowner for renovation and repair.

Loan pools are finding success in cities



PHOTO BY BOB GREENSPAN

Michael Duffy is a senior attorney for Legal Aid of Western Missouri, and he also sits on the board of Kansas City's Economic Development Corporation (EDC). The EDC has offered to manage a loan pool in Kansas City, Duffy said.

ranging in size from Des Moines to Chicago. A loan pool was recently started with three lenders in St. Louis, and proponents are exploring ways to develop one in Kansas City, Mo.

Need for urban investment

"It's a very exciting idea," said Robert Boyle, president and CEO of Justine Petersen, a community development financial institution (CDFI) in St. Louis, which is acting as the underwriter for a new loan pool that three participating banks have already provided funding for 112 loans.

"We know there are homes available," he said, referring to the thousands of vacant properties that mar the urban landscapes of

cities like St. Louis, Kansas City, Omaha, Oklahoma City and Denver.

Justine Petersen, which has an office in Kansas City, Mo., is one of several CDFIs that have been consulted by loan-pool proponents in that city.

"There are rehabbers that want to purchase the homes and individuals that will buy or rent the properties. "If all these things are true, what's the missing ingredient? It's the capital to make it happen," Boyle said.

A study by Kansas City Fed Senior Economist Kelly Edmiston showed that financing renovation on one urban block can result in a positive ripple effect of investment in neighboring blocks.

New contractor incubator is catalyst for change

In addition, a new study conducted in Cleveland, Ohio, for Harvard University, supports the value of loan pools as an option to induce conventional lenders to reinvest in distressed communities.

Frank Ford, a senior policy advisor for the Thriving Communities Institute in Cleveland, and author of the study, said a common theme in interviews with real estate owned (REO) investors was that “traditional bank credit was nearly impossible to obtain to finance home renovation,” partly due in reaction to prior abuses associated with subprime lending.

Now, Ford said, “it’s worth asking the question whether lenders and their underwriters have over-reacted in the other direction.”

He said community leaders “should engage local lenders in a conversation about finding a middle ground: credit that is based on safe and sound lending, but provides fair and reasonable access to credit for responsible borrowers.”

Lenders have reason to be cautious. Bill Dana, president and CEO of Central Bank of Kansas City, which itself is a CDFI that has long been involved in community development, said reinvestment in the wake of the foreclosure crisis is “fraught with peril.”

Homes have lost so much value that lenders have seen their investments plummet by as much as 80 percent. With values dropping, people are leaving the urban core to buy affordable housing in suburban communities, leaving a doughnut hole of abandoned homes and poverty in the central city.

Dana said developing sustainable urban neighborhoods requires diligent planning, solid underwriting and local government support.

“You have to keep talking solutions but it has to be kick started with some funding from government players,” he said.

Still, he said, “I’d love to be at the table.”

Community collaboration

A collaboration of banks, city and county officials, and community leaders is credited for

What once was a disheveled, abandoned building on a weed-infested piece of land in urban Kansas City is now a sleek, energy-efficient small business incubator for contractors. The incubator, which promises to be a catalyst for neighborhood revitalization, is owned and managed by Blue Hills Community Services, a community development corporation (CDC) that has worked for years in the Blue Hills Neighborhood of Kansas City rehabbing homes or building new ones.

“Building the incubator was a natural extension of what we have been doing here for years,” said Joanne Bussinger, executive director of the CDC.

The 14,168-square-foot incubator, built to LEED Gold standards and also houses Blue Hills’ headquarters, is one of several new developments along Prospect Avenue, one of Kansas City’s busiest, and grittiest, urban roadways.

“This development will provide a catalyst for ongoing transformation of the Prospect corridor and bridge existing residential development and community services in the neighborhoods,” Bussinger said.

While the Kansas City metro area has seen a blossoming of business and science incubators in the last decade, this is the first to focus on serving small business contractors—including construction, plumbing, mechanical and energy professionals—in the urban core.

It may be one of the first of its kind in the nation, said Randy Morris, director of member services for the National Business Incubator Association, which has 1,275 members in the United States.

“Incubators serve the entrepreneurial spirit within a community, creating jobs and creating wealth,” Morris said.

The challenge for many small businesses, however, is that their founders may have the professional talent but lack the knowledge that is necessary to make a company sustainable.

That was the reason Dan Garth, owner of Abraham Mechanical, became one of the first five contractors who is getting mentoring, technical support and business training in the new center. While Garth has run a business since 2003, he said his lack of business savvy stood in his way.

“No one ever sat me down and said, ‘This is what you need to do,’” he said. Now, Garth wants to partner with larger companies and become a source of jobs for urban youth.

“We can bring in young people from the inner city that have the heart and want to learn.” “It’s all about learning and applying yourself,” he said.

For information on the Blue Hills incubator, go to: www.5008kc.org

the success of a loan pool in Des Moines. Since its formation in the late 1980s, the loan pool has financed more than 4,000 single-family homes and 700 multi-family centers with \$257 million in grants and loans.

The Neighborhood Finance Corporation (NFC), a non-profit financial institution, manages and underwrites the pool. "It's a great way for banks to participate in community lending while minimizing their risk," said Holly Olson, NFC's executive director, who spoke at a Kansas City Fed roundtable this past spring.

"What the banks like is that if a loan defaults they are only on the hook for the percentage of their investment," she said.

A majority of loans are provided to homebuyers. But the city of Des Moines and Polk

Challenge of getting started

Loan pools used for the purpose of community development are similar to microloan pools, in which CDFIs act as intermediaries for traditional banks in making small-dollar loans to startup businesses.

But they can pose higher risks. Many purchasers of vacant or formerly vacant properties often have less credit than conventional borrowers. And some of the houses can cost more to fix than they are currently worth.

So it is important that the organization that manages the pool, whether another bank, nonprofit or CDFI, have a financial track record, the capacity to handle the funds and strong underwriting skills, Olson said.

Identifying a creditable intermediary

"These neighborhoods need resources. If that doesn't happen they will continue to deteriorate, and you will have more dilapidated houses and all the other symptoms of blight, including poverty and crime." – Jerry Dantzler, Omaha 100

County also invest up to \$10,000 per loan for renovation by licensed contractors. In addition, neighborhoods can qualify for revitalization money for crime prevention, street improvement and curb and sidewalk repairs.

"This isn't a government giveaway," Olson said. "The purpose is to break down the barriers of people not being able to buy a home."

Jennifer Cooper, vice president and manager of commercial real estate for Bankers Trust in Des Moines, said the loan pool has proved popular. Twelve banks now participate, for which they get Community Reinvestment Act (CRA) credit and positive recognition for helping to improve their community neighborhoods.

"The bottom line is that everyone wanted to get on the wagon here and be involved in this," Cooper said.

to manage and underwrite a loan pool has challenged loan-pool proponents in Kansas City, said Michael Duffy, a senior attorney for Legal Aid of Western Missouri, who also sits on the board of Kansas City's Economic Development Corporation.

Duffy said another challenge is keeping acquisition costs low enough so that small-business contractors can afford to rehab the houses and low-income borrowers can buy or rent them, while allowing lenders to still make a return.

"We want to find funders and administrators that are comfortable with low-value homes," Duffy said. "It isn't an apple pie home-buyer model." Many distressed urban homes are valued at less than \$10,000, but may need \$20,000 or more in rehab work.

Ozell Lincoln, an urban rehabber in Kansas

City, said a loan pool is needed “to provide financing and to fill in the gaps where projects won’t qualify for traditional financing.” He said rehabbers now are often limited to funding projects out of their own pockets.

“The key to the loan pool is to be able to have flexible underwriting standards for the rehabbers to allow them to do more projects, so you don’t have to put all your own money into a project,” Lincoln said.

Several CDFIs have stepped forward in the last year with proposals to take on the task of underwriting a loan pool in Kansas City.

Gateway Community Development Fund Inc. has designed a model that would seek an initial threshold of \$1 million in lender funding. Erica Dobreff, president of the fund, said their model would improve properties block-by-block.

“We believe that financial institutions in Kansas City will welcome the opportunity to participate in the success of urban core neighborhoods with the knowledge that the financial risk is spread over a number of properties,” she said.

Kansas City’s Economic Development Corporation (EDC) also has offered to manage a loan pool. Duffy said the EDC has tentative commitments from the city and other sources to fund a \$500,000 loan-loss reserve. He said the EDC hopes the reserve money will entice lenders to kick in another \$500,000, to create a \$1 million fund.

Mark Stallworth, president of Neighborhood Housing Services, which rehabs homes and conducts homebuyer education courses, agrees a loan pool “is one of a few viable tools” to revitalize the urban core.

But he cautioned that any effort would require homebuyer education and a process to ensure quality work by qualified developers and contractors, rather than by vulture investors just out to make a buck. “There is a lot more to rehabbing a house than adding carpet, a roof and new windows,” he said.

Blue Hills Community Services, a Kansas City Community Development Corporation,

recently opened a new business center and contractor incubator in the urban core for the specific purpose of training and encouraging more contractors (See story on Page 17).

Joanne Bussinger, executive director of Blue Hills, said the incubator provides mentoring, support and technical training, including accounting processes contractors can use to obtain lines of credit. “One of the things we want to do with this incubator is create more urban jobs,” she said.

Dantzler of Omaha said investment in jobs, new businesses and affordable housing are urgently needed to revitalize urban neighborhoods.

“These neighborhoods need resources,” Dantzler said.

“If that doesn’t happen they will continue to deteriorate, and you will have more dilapidated houses and all the other symptoms of blight, including poverty and crime. It’s a vicious cycle.”



PAUL WENSKE, CONTRIBUTING WRITER

FURTHER RESOURCES

For more resources on Community Development issues and topics, visit www.KansasCityFed.org/community

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.