Financing Community Development -
Learning from the Past, Looking to the Future

Remarks by Mary Lee Widener
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at the
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(Cover—Slide 1)

I'm pleased to be the luncheon speaker following the tough morning sessions on subprime and predatory lending. The issue is so huge that many are calling it a subprime meltdown, which has the whole nation rising up to address the fallout that we expect.

As we face such a disturbing problem, it is easy to forget that we have faced and met huge challenges in the past. Hopefully a look at the past and lessons learned will help us meet the challenges of the future.

My insight comes from the privilege of heading NHSA since its inception and our role as a laboratory to explore ways to expand the boundaries of conventional lending.

That role is made possible with congressional support through Neighborworks® America. Let me take this opportunity to publicly thank the board members and staff of Neighborworks® America for our partnership with them and to thank NHSA's trustees, directors, and staff for their dedicated service to our mission.

(CAB—Slide 2)

Let me start by saying that if you don't remember anything else that I said today, please remember the word "CAB" as an acronym for collaboration, affordability, and borrower support. Hopefully the importance of these factors in advancing community development financing, as well as solving problems with exotic mortgages, will become clear in my remarks.

Collaboration has been and continues to be essential in solutions for community development financing. It certainly was for the first major community development financing challenge undertaken collectively across all sectors of society—the challenge of eliminating redlining as a practice that starved whole communities of credit opportunity and contributed to neighborhood decline.

(Redlining—Slide 3)

For so many of our young audience, let me explain that redlining was a practice of lenders drawing red lines around lower income neighborhoods on maps to guide loan officers to <u>deny</u> loans in the redlined areas. As shocking as that would be today, it was common practice in the 1960s and 1970s.

I became introduced to the issue as a result of fighting redlining in my own community, specifically in the San Pablo neighborhood of South Berkeley, California. Our struggles led us to the then-federal home loan bank board to express concern and seek help.

To make a long story short, in 1969 and 1970, the honorable Preston Martin as chairman of the Federal Home Loan Bank Board, who later became vice chairman of the Federal Reserve Bank, set up a center to offer <u>lower income lending solutions</u> to thrift industry executives. The center was headed by Wiliam A. Whiteside. In 1971, during our pursuit of the center to help us, I was asked by Mr. Whiteside to join his staff to help them. I did.

The Neighborworks® system grew out of that work, including NHSA, with early guidance to NHSA from Freddie Mac and with a start-up grant by the Department of Housing and Urban Development (HUD). The grant was approved by Michael Moskow, president of the Federal Reserve Bank of Chicago, when he was head of Policy Development and Research at HUD.

What also grew out of that early work was my appointment to the Board of Directors of the Federal Home Loan Bank of San Francisco. In response to my appeal to the board in 1976, a committee was formed that wrote the first anti-redlining policies that were adopted nationally for the thrift industry as regulations.

Prior to the then-new anti-redlining regulations, regulatory policy had actually contributed to redlining. The policy made such items as age of the property and its location next to a blighted property as reasons not to lend.

The policy sought to protect the deposits of a thrifty public that believed in savings. That was a well-intended objective with unfair and unintended consequences for deserving borrowers and older neighborhoods.

The point of this history is, inadvertently, what the regulators did hurt. The point also is to say that what the regulators did started us on a path of solutions and lessons learned.

This was done through a collaborative process with community advocates, members of the Federal Home Loan banks, and the regulators because changing the regulations was not enough to make fair lending happen. Each lender had to learn how to do responsive lending that also was prudent lending. That learning curve benefited from what I consider a pull-push period.

(Collaboration—Slide 4)

The pull came from collaborations and partnerships with the nonprofit sector. The push came from the Anti-redlining Movement and Community Reinvestment Act (CRA).

We are all aware that the case for fair lending was put forth aggressively through the Anti-redlining Movement Led by Gale Cincotta and the National Training and Information Center in Chicago. As a result of that movement, the CRA was passed in 1977.

CRA slowly took root through regulatory oversight and by the mid-1980s stimulated hundreds of local partnerships with nonprofits and local governments. The partnerships started a generous flow of capital into communities throughout America.

Nonprofit organizations worked with lenders individually and through national networks. The national networks included Neighborworks®, LISC, Enterprise, Housing Assistance Council, Acorn, National Council of La Raza, Habitat for Humanity, and others.

They were <u>essential</u> to this new flow of capital into underserved communities.

As one example, in 1986, NHSA was asked to develop an initiative to jumpstart multifamily lending in low- and moderate-income markets in the state of New Jersey. We developed a solid partnership of the state, lenders, nonprofits, and NHSA investors. The initiative achieved more than $200 million in multifamily lending under oversight of NHSA board committees and under management of Ernest Baskette, a senior vice president at NHSA and former executive director of the Newark, N.J., NHS.

This program put people into quality housing previously considered out of reach.

<u>Collaboration</u> made the lending possible. Public and private sector strategies made the <u>affordability</u> possible.

Each participating lender embraced the loan policies and procedures that Mr. Baskette and his team developed and brought them into their own lending programs. <u>That team included our own luncheon host, Dede Myers.</u>

(Of the hundreds of examples I could have chosen, I thought it would be fun to use this one because of Dede.)

After about three years, NHSA was able to exit New Jersey, and the lending activity continued.

The success of the New Jersey initiative was similar to others that CRA spawned.

As happy as we were as a community development field with the anti-redlining successes, a whole new set of challenges emerged in the 1970s and early 1980s.

Legislative change removed the static rate for savings accounts with the result that most of the thrift industry moved to new business models. In general, thrifts no longer found it feasible to hold loans in portfolio because of interest rate risk.

Finally, it became clear that many lenders who were doing a good job of lending needed help to move their responsive loans out of portfolio into the capital markets. They needed:

(Affordability/Borrower Support—Slide 5)

1. A responsive mortgage insurance industry,
2. Responsive secondary markets, and
3. Responsive rating agencies.

In meeting this series of challenges, the importance of collaboration, affordability and borrower support systems kept emerging as the controlling factors in success then and continue so today.

We learned that collaboration knew almost no boundaries when it came to how many people from all walks of life could help.

We learned that affordability had to mean responsible underwriting so that the borrower could, indeed, meet the long-term obligations of his or her mortgages.

We learned that borrower support involved both prepurchase and post-purchase counseling, as well as a solid commitment to forebear and not foreclose when temporary life events interrupted the ability of the borrower to repay the loan.

In working with troubled borrowers an obvious fact was that helping a family keep its home better positioned the family to ride out the temporary waves of challenging life events.

To address these issues, NHSA initiated a series of pilots that used the principles of collaboration, affordability, and borrower support systems.

The first pilot in 1993 addressed mortgage insurance issues. With leadership from world savings, we piloted a co-insurance program with PMI Mortgage Insurance Company, whereby it agreed to accept our underwriting criteria and issue mortgage insurance on loans it otherwise would not have approved.

The agreement called for NHSA putting up a layer of insurance protection that would be tapped if the losses on our PMI portfolio went beyond the losses on PMI's standard book of business. Our unique agreement also made the cost of the mortgage insurance more affordable because of our co-insurance layer.

Also unique to NHSA was the existence of both prepurchase and post-purchase borrower support systems via the Neighborworks® network of local community development organizations.

By this point in time, we had demonstrated to the mortgage insurance industry that its collaboration in creating affordable opportunities for informed borrowers was not only good social policy—it was good economic policy, too.

Today we have similar programs with both MGIC and UGI.

The next pilot tackled the secondary market space. We started to deliver loans to Fannie Mae and Freddie Mac in the late 1990s and tried for years to make more than 10 percent of our loans acceptable to the GSEs, finally getting to about 30 percent in 2003.

We constantly reported the reasons our loans were not clearing their underwriting standards. Early in 2003, we reported to Fannie Mae at a top gun meeting the exceptions to policy that we were approving outside its automated underwriting engine for borrowers we considered to be creditworthy.

Our manual approvals included such items as:

1. High LTV 95 percent loans for under 620 FICO score borrowers,
2. Under 620 FICO score borrowers combined with debt-to-income ratios higher than 41 percent, and
3. High LTV 98 percent loans for mid-range FICO score borrowers slightly above 620.

Finally, most of our manual criteria became available in Fannie Mae's My Community Mortgage EA 1 and EA 2 approval windows.

We now have open-ended contracts that allow as much as 60 percent of our first mortgage activity to be approved by the GSEs on an automated basis.

Of course the result for NHSA is a decrease in origination time and an increase in the number of loans that can be approved.

More important, those same opportunities are now available to others who can qualify to use those GSE products.

In our third pilot we tackled the rating agency issue. In 1999, it was typical for Standard & Poor's to require double digit reserves for pools of loans that fit what they called the "Government Space."

With top flight legal work led by our corporate counsel, Gibson, Dunn, and Crutcher, exceptional trustee work by Union Bank, inspired leadership by Jesse Talens, one of our senior vice presidents, and amazing cooperation from the legal staffs of our investors, NHSA received a AA rating from Standard & Poor's on a $75 million private placement with low single digit reserves.

Let me repeat—a AA rating on loans that had been an enigma wrapped in a mystery to traditional investors.

The rating has held up, as have all our investments, with no defaults over our 25-year history of issuing mortgage backed securities – not because this work is easy but rather because CAB works.

I believe the Standard & Poor's staff assigned to our application were as excited as we were with the rating, but it has been even more excited about the performance of the securities.

We had studied S & P's needs and met them through collaboration with our investors and nonprofit partners.

Our investors were generous in helping us meet affordability targets for the borrowers with below-market investor rates, and our nonprofit customers continued to be the first line of defense for their borrowers when life events created the need for help.

We were able to prove the value of these factors and then leverage them into low single digit reserves.

Our investors were thrilled with the good news of the AA rating. Largely based on the trust we had developed with them, the entire $75 million mortgage backed security had been fully subscribed by members of NHSA's board of trustees before we had the rating.

State Farm, Allstate, USAA, and Nationwide insurance companies had stepped up. The National Press Club announcement was a day we celebrated with representatives from across the community development field. The following year, the national housing conference honored our work by naming me 2000 Housing Person of the Year.

That was a high point for the community development field and our collaborators.

By 1999, we had beaten redlining. Our solutions in the mortgage insurance industry had become a standard product. We had helped to widen the doors of credit opportunity in the secondary markets. And we had proven the credit worthiness of the type of borrowers typically served by nonprofits by receiving a AA rating from Standard & Poor's.

(Median Household Income—Slide 6)

It is important to understand that all of this collaborative work succeeded for a borrower group that consistently was at about two-thirds of national median income or with incomes that ranged from $20,000 per year in 1983 to $30,000 per year in 2006.

(CAB Works—Slide 7)

CAB had proven to be the controlling principles for success in all these victories.

Further, this work succeeded on a portfolio financing level where there were limits on our access to capital to finance our loans—pending a readiness of the capital markets to embrace us.

While the borrowers benefited economically—our borrower support system was doing a good job of keeping unconventional borrowers in their homes.

Individual delinquencies ran slightly higher than conventional loans for our borrowers, but foreclosures ran <u>below</u> conventional loans.

A factor in this success is NHSA's loss mitigation practices, with the help of local nonprofits.

We stick with the borrowers through life events and restructure the loans for as long as there is a good faith effort to resolve the issue. Our investors support the procedures we use for these loss mitigation practices.

Patient money is required to carry out these practices and is an approach that has relevance to the entire mortgage industry, as I will discuss later.

So, the mystery had been solved. We demonstrated that, in general, an educated borrower with a fairly priced and underwritten loan will perform just fine when backed by a good borrower support system.

(Accessing the Capital Markets—Slide 8)

This collaboration, with these results, set up opportunities for us to expand our financing operations into the capital markets.

Standardization, automation, and a more transparent process created better results for borrowers typically served by higher cost loan products.

Now, the lower income populations served by our nonprofit constituents could be financed in the AAA capital markets because our processes were producing conventional loan performance.

(Capital Markets Financing—Slide 9)

Further, our borrower support system and credit enhancement strategies for our capital markets activity were yielding extraordinary results. Delinquencies on loans sold into the capital markets were then and are now almost as low as the conventional market and foreclosures are well below the conventional market.

(Looking to the Future—Slide 10)

Looking to the future, our lessons from the past are excellent tools for taking on new challenges.   Though many challenges lie ahead, there are three overarching ones.

The first new and overarching challenge is actually a long standing and unsolved one—NIMBYism— "the acronym for not in my backyard."

This is the problem of citizens rejecting the development of almost any affordable housing in their communities.

One factor needed in future solutions is evident: We need to learn to give an invisible hand up to bridge affordability gaps rather than have the beneficiaries suffer from being looked upon as receiving a handout.

We need to find a way to assure that the prevailing points of view that impact community development grow out of a shared and enlightened vision.

On the point of advancing enlightened visions, NHSA helped to launch an organization called the social compact.

Social compact does targeted neighborhood profiles that drill down into the hidden economic strength of underserved areas.

The result is hard data and a shared vision of market potential as well as potential community benefits that are going untapped.

One of these drilldowns was enough to convince a major developer to invest in a shopping center in Houston, Texas, creating 750,000 square feet of retail space and 2,000 jobs.

In Chicago, a major retailer had shunned a neighborhood because its market data didn't show adequate buying power. The social compact drilldown showed three times the assumed market strength. This retailer then built one store and three years later built another a few miles away to handle the volume.

Here in Washington, D.C., the drilldown in the Columbia Heights neighborhood was the pivotal piece of information that convinced Target to locate a major department store in the area.

In all three cases, hard data overcame both NIMBYism and investor reluctance. Major collaborative processes have been involved in all the social compact drilldowns into more than 100 neighborhoods across America.

The second overarching challenge and a continuing one for community development financing is sustainability—for all the players in the financing solutions.

At the core of this issue is the fairness question—working out what is sustainable and fair for all the <u>users</u> and <u>providers</u> of mortgage-related products and services.

I want to start with sustainability for the borrowers who do not qualify for conventional loans and would normally end up in high-cost loans.

They normally would be considered by the conventional market to be subprime borrowers.

That is the profile of NHSA's client group. We have purchased and serviced nearly a billion dollars in loans to this group under a policy that has existed since our inception—

namely, the loans we purchase must have been made at the ability of the borrower to repay.

The second part of sustainability is responsive sources of investor funds. If we start with the premise that the borrowers will perform better than conventional wisdom might suggest, it should be possible to lower the cost of funds. The lower cost of funds would contribute to the success of the borrower and, therefore, success of the investment to create a win-win for both.

Our experience in gaining reduced investor pricing, based on our loss mitigation practices, has resulted in substantial borrower savings on our loan products versus high cost subprime loans.

When we ran a loan-by-loan analysis several years ago, borrower savings off market pricing on the loan contracts for our single-family portfolio were in excess of $300 million on about $520 million in loans. Third party review of our numbers found them to be conservative.

We believe this history represents fair play and creates a reasonable expectation of sustainability for the investors and lenders participating in responsive community development financing.

The third part of the sustainability challenge is the nonprofit sector. The nonprofits carry a big part of the load in prepurchase and post-purchase borrower support related to community development financing.

Their work normally is supported by grants. With diminishing grant resources in both the public and private sectors, better solutions than grants are needed for the sustainability of the nonprofit sector. Just as a matter of fair play, nonprofits should be paid for the value of services performed.

To address this issue, NHSA added a feature to many of its loan products that provides an opportunity for the nonprofits to receive a counseling fee and trailing income for a borrower support system on all the qualifying loans they help to achieve.

We are excited about this model and have been trying to promote it for several years. The largest challenge to it has been exotic mortgages with their teaser rates. Many nonprofits are asking us to forego the trailing income to them but keep the lower interest rate to help them compete with exotic mortgages. In return, they pledge to give the required post-purchase borrower support without pay.

These nonprofits are to be commended, but, in my view, they should be paid for work they perform in solving problems that they did not create.

As a society, we must keep working to solve the fairness questions across all aspects of the mortgage industry, including sustainable business models for the nonprofit sector. Many for-profit and nonprofit friends are encouraging us to use the models we have created to promote sustainability.

The bottom line message from the sustainability challenge is that achieving sustainability for borrowers, funders, and nonprofits will add up to sustainable community development financing.

The final overarching challenge that I will address is one that is new—subprime lending. Thirty years ago, the challenge was a lack of financing. Today, it is the terms under which so much financing is provided that demand attention.

Subprime lending at times becomes predatory and is negatively impacting communities across America.

NHSA was asked to help address this issue because local Neighborworks® organizations that we serve were reporting the loss of their borrower pipelines to the speed and ease of subprime loan approvals. Painfully, the subprime loans were being made under more onerous terms than the true credit profiles of the borrowers required.

We took a close look at what was happening and concluded that innovations would be required in both the product and technology aspects of the mortgage delivery process. Responsive community development financing needed work that would complement the automated underwriting engines provided by Fannie Mae and Freddie Mac.

It was clear that even counseled borrowers were accepting exotic mortgages as their perceived path to the American dream of homeownership, as they tried to capture speed and ease in the mortgage loan process. Too often they made these decisions without being prepared for their American dream turning into a nightmare.

To take on the innovation challenges, NHSA launched a new LLC called "Just Price Solutions." Its mission is to develop tools to help nonprofit organizations join with their lending partners to protect their neighborhoods from predatory lending.

This new LLC, referred to as JPS, borrowed start-up funds to do both product and technology development. Its president, Brian Cosgrove, assembled a team, including the NHSA staff and a top flight technology company—Loandna.

On the product side, State Farm Insurance Companies stepped up with a $100 million investment to help us launch an innovative loan product—an emerging markets loan.

This loan is benefiting from a new First American Corporation alternative credit score product—the Anthem Score.

First American stepped up with a $7.5 million equity-like investment as working capital and loan loss reserves.

Both MGIC and PMI stepped up with extraordinary concessions on mortgage insurance premiums based on negotiated credit enhancement strategies.

And Fannie Mae stepped up with a good faith commitment to leverage our $100 million emerging markets loan pools with purchases up to $750 million.

(Just Price Table—Slide 11)

On the processing side, JPS succeeded in building an e-commerce Web portal that includes customized automated underwriting engines attached to third party services for loan fulfillment.

This new digital channel has the capacity to take community development type single-family loans from intake through to closing electronically. Not one piece of paper needs to pass physically ahead of loan approval, with only the requirement that at closing all the representations made electronically and via imaged documents were valid.

This new digital channel was completed in the first quarter of CY 2007 and is being tested with loans from several channels.

The goal of speed and ease in loan approval and processing is being achieved.

This new capacity is opening up the opportunity for the community development field to be an army of partners with the financial industry in serving lower-income borrowers in an efficient, fair, and just manner. Many groups in this room are involved in the test phase with a few loans each and now, already, are serving their clients through the just price e-commerce Web portal, including the Neighborworks® network and the Homefree-USA network.

Manna, a Neighborworks® organization here in the District of Columbia, is among the most expert users of this new technology.

With regard to how the nation solves the exotic mortgage issue as at least $1.5 trillion in mortgages prepare to reset in the next two years, I'm convinced that our small lesson today can help.

The challenge on the resets can be met through collaboration of the mortgage industry with the nonprofit sector, use of workout strategies that achieve affordability, and borrower support systems backed by patient capital that give borrowers a chance to recover from their unfortunate circumstance.

The mortgage industry acknowledges that forbearance is less costly than foreclosure, but, for most of the exotic mortgages, the loan servicer does not have the power to forebear and is required to meet contractual commitments to foreclose.

In my view, that makes no sense, and today, I call on all investors into subprime paper to give their loan servicers the authority to delay foreclosure for all borrowers who are working with them in good faith to develop an alternative path.

Forbearance will require increased pools of capital as patient capital while the workout strategies are put in place or to help support a refinance program.

If patient capital pools are not created by the responsible lending parties and investors, creating such pools of patient capital by others would be in the public interest.

I'm hoping we as a nation can rise to the challenge of creating such pools of capital to help meet the flood of mortgage re-sets that we anticipate.

However, bottom line, if forbearance would cost less than foreclosure, why wouldn't everyone impacted by the foreclosures prefer to avoid foreclosure? One enlightened local community of only about 50,000 people, Euclid, Ohio, already has set up its own fund of nearly $1 million to help protect its citizens and its neighborhoods from foreclosures.

Going forward, clearly subprime lending requires the kind of regulatory intervention that is developing. Further, subprime lending requires suitable borrowers and a borrower support system backed by patient capital.

Hopefully the increasing ability of the nonprofit sector to 1) compete with the speed and ease of subprime lending; 2) properly underwritten borrowers; and 3) backed by good borrower support systems will go a long way toward mitigating further spread of inappropriate high-cost lending.

Finally, in summary, looking to the future, overarching priority challenges are NIMBYism, sustainability, and inappropriate subprime lending. Tools we can bring from the past to tackle these challenges are collaborations built on trust and partnerships, affordability for the borrowers served, and good borrower support systems.

In closing, our journey has transitioned us from hostile conflict to productive partnerships and collaborative solutions, and finally to systemic institutional change. Our successes in community development financing have paralleled our growth as a nation in our determination that fair play will prevail in our society.

Our history shows that <u>always</u> there have been people willing to help and we can trust they are there again. Based on that history, I have total faith that basically we are a nation of <u>good people</u>, that fairness <u>will</u> prevail as, increasingly, this work touches the hearts of the people of America, and that we all can look forward to a brighter and brighter future for financing community development.

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