To the Graduate Council:

I am submitting herewith a thesis written by Kenneth Duaine Nelson entitled "An Analysis of the Unavailability of Long-Term Mortgage Money in Inner City Areas." I recommend that it be accepted in partial fulfillment of the requirements for the degree of Master of Science in Planning.

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AN ANALYSIS OF THE UNAVAILABILITY OF LONG-TERM MORTGAGE MONEY IN INNER CITY AREAS

A Thesis

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ABSTRACT

The purpose of this investigation was to develop some insights into the shortage of long-term mortgage money in inner city areas. The research indicates that the lack of long-term mortgage money is one of the most critical factors in encouraging an adequate flow of capital into inner city areas.

An initial review of published material on the subject indicated that the orientation of national monetary policy toward new housing construction creates conditions which limit the available buyers for mortgages on existing housing in the secondary market.

In order to gain additional insight into local lending institutions' practices with regard to inner city areas a questionnaire was developed. The questionnaire was sent to FHA and VA approved lending institutions operating in Louisville and Jefferson County, Kentucky. The responses indicated that all of the questions had not been answered. Therefore, local lenders were interviewed to verify responses to questions that appeared significant to the unavailability of long-term mortgage funds for inner city areas. These interviews were conducted in conjunction with attempts by residents of Butchertown, an inner city neighborhood in eastern Louisville, to obtain long-term mortgage money.

The study's most significant finding was that lenders were hesitant to lend money in changing inner city areas because of the difficulty of finding an acceptable buyer for the mortgage in the secondary market. Therefore, one of the study's recommendations is the

creation of a locally operated and funded secondary mortgage market to provide a buyer of mortgages on existing housing stock in inner city areas.

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CHAPTER I

AN ANALYSIS OF PRESENT POLICY

I. INTRODUCTION

A review of published material on housing investment, urban development, and lending practices reveals the disagreement that exists in various levels of government with regard to the proper direction that housing programs should take. In an attempt to present a broad overview of the inner city long-term mortgage inadequacies, this chapter presents the various perspectives that have been able to influence secondary mortgage market orientation. It should be emphasized that it is not the purpose of this chapter to provide an exhaustive critique on the subject. However, a framework should be established through which the reader can conceptualize the dilemma of inner city housing stock with regard to the unavailability of secondary mortgages.

The initial step in analyzing the shortage of long-term mortgage money was to conduct a review of written material on lending practices, housing problems, and urban development. From this review issues such as the subsidization of the consumer or producer; the advantages or disadvantages of owner-built housing or production-built housing; the orientation of state housing corporations toward new housing; and the orientation of the Department of Housing and Urban Development toward housing surfaced as important issues. These topics are discussed in this chapter.

To develop those issues a questionnaire interview process was used to determine lenders' insights with regard to the lack of available long-term mortgage money in inner city areas. Those initial results indicated that location may be a factor in mortgage performance. Therefore, a statistical model was developed to test the relationship certain locational data aggregated by location have upon the performance of the mortgage, as indicated by foreclosures in an area. The test and its conclusions are provided in Chapter III.

In an attempt to provide further insights into the lack of long-term mortgage money in inner city areas, additional interviews were conducted with residents of Butchertown, a neighborhood in eastern Louisville. These residents were interviewed in an attempt to identify specific problems that had been experienced in their attempts to obtain long-term mortgages. Furthermore, Louisville lenders were interviewed to determine their observations with regard to the long-term mortgage shortage in Butchertown. An analysis of these results is provided in Chapter IV.

Chapter V provides the reader with some recommendations that would facilitate a change in the orientation of the secondary market. These recommendations are developed for each level of government.

II. A REVIEW OF LEGISLATIVE PROGRAMS

Before an adequate evaluation of housing policy can be undertaken, it is necessary to review the various legislative programs that have been submitted to Congress since the depression. The Federal Home Loan Bank Act under President Hoover in 1932 was designed as a major weapon

in the fight to recover from the depression. In 1933 the Home Owners Loan Corporation was organized to provide some relief to homeowners whose homes were threatened by mortgage foreclosures.[1]

In 1934 Congress decided to actively enter the housing market to protect mortgage investors and homeowners. The National Housing Act established the Federal Housing Administration which was designed to encourage home building by increasing the flow of mortgage funds available.[2]

A long-range program of public housing for low-income families was initiated in 1937.[3] The debate up to that time had been over two possible solutions to the housing situation. The first of these positions asserted that housing shortages could be reduced by stimulating the production of middle-income homes. The lower income groups could acquire homes from the "filtering down" of used homes as middle-income groups moved into new homes. However, William Grigsby has shown in Housing Markets and Public Policy that the used homes do not "filter down" for there is too much price difference.[4]

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[1]"Programs in Brief," Housing a Nation (Washington, D.C.: Congressional Quarterly Service, 1966), p. 7.

[2]Charles Haar, "Background of Federal Housing Credit," Urban Housing, ed. William Wheaton, Grace Milgram, Margy Meyerson (New York: Free Press, 1966), pp. 347-356.

[3]Haar, p. 7.

[4]William Grigsby, "The Filtering Process," Urban Housing, ed. William Wheaton, Grace Milgram, Margy Meyerson (New York: Free Press, 1966), pp. 191-201.

The second position was designed to encourage the building of massive housing projects for particular groups and income.[5] This position resulted in the public housing projects being built under the control of the Local Public Housing Authority.

During World War II, the government focused its housing efforts on providing assistance for military housing and for workers supporting the war. However, in 1949 the federal government's role was greatly enlarged by the Housing Act of 1949. Consistent with this enlarged role was the national goal of "a decent home and a suitable living environment for every American family."[6] The significance of the 1949 housing program was the broad scope of the national commitment. However, this commitment was confused by many of the housing myths that promised to alleviate social injustices which could not be directly attributed to living conditions.[7] Additional evidence of the many housing myths are explained by Robert Gutman in his article, "A Sociologist Looks At Housing." "Much of the way that the material house is used depends upon how nonmaterial culture prescribes that it should be used. Thus, evidence indicates that standard housing may have had significant impact upon the study habits of low-income children but has not had any impact

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[5]Catherine Wurster, "The Dreary Dead-Lock of Public Housing," Urban Housing, ed. William Wheaton, Grace Milgram, Margy Meyerson (New York: Free Press, 1966), pp. 245-251.

[6]Haar, p. 7.

[7]John P. Dean, "The Myths of Housing Reform," Urban Housing, ed. William Wheaton, Grace Milgram, Margy Meyerson (New York: Free Press, 1966), pp. 255-261.

on occupational success or delinquent behavior."[8] The act was also instrumental in establishing a one-billion dollar Federal Urban Renewal Program to assist localities in clearing and redeveloping the slums. The question of urban renewal and the relocation of displaced households continues to be one of the major topics at local government meetings. The 1949 Act also contained provisions for enlarging the public housing program.

The next housing program that was related specifically to inner city areas was the Housing Act of 1954. Many people concerned with the redevelopment of the inner city were beginning to see the problems associated with the massive clearance efforts. This act was drafted to insure comprehensive federal-local cooperation with regard to slum clearance and community development. Specific to the Housing Act of 1954 were arrangements to help finance community facilities projects.[9]

After much debate between the Democrats and Republicans during the Eisenhower Administration, the Democrats' programs were finally initiated in 1961 with a housing act which increased all federal programs with special attention given to open space and mass transportation. The Housing Act of 1964 continued these programs.[10]

The Johnson Administration made the housing program of 1965 one of the feature provisions of "The Great Society." Consistent with this

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[8]Robert Gutman, "A Sociologist Looks At Housing," in Toward a National Urban Policy by Daniel P. Moynihan (New York: Basic Books, Inc., 1970), pp. 119-132.

[9]"Programs in Brief," p. 7.

[10]"Programs in Brief," p. 7.

policy was a recognition of the massive urban problems and the creation of the Department of Housing and Urban Development.[11]

There has always been much criticism of government's housing ventures. However, one of the more striking arguments came from Robert Kennedy who contended that the Johnson proposal failed to do the following:

> (1) It did not require that new low-income housing be built in urban poverty areas.
> (2) It did not spur employment of low-income residents in rebuilding their housing.
> (3) It did not involve local residents in community planning.
> (4) It did not provide for improved relocation facilities.[12]

Kennedy's comments were countered by the Secretary of Housing and Urban Development, Robert Weaver. Weaver cited Kennedy's criticisms as a rich man's approach to a poor man's housing.[13] It seems that the discrepancies that existed in the various housing proposals were the result of a lack of consistency in the establishment of housing goals and policies.

An evaluation of the performance of the Kennedy-Johnson Administration in housing by quantitive measures did not receive a high score.[14] However, the institutional, administrative, and policy changes that occurred during this period set the stage for a new direction in housing involvement by the federal government. Morton J. Schussheim in

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[11]"Programs in Brief," p. 7.

[12]"News," House and Home (May, 1968), 32:34. [13]"News," p. 34.

[14]Morton J. Schussheim, Toward a New Housing Policy: The Legacy of the Sixties (New York: Committee for Economic Development, 1969), p. 1.

a Committee for Economic Development Supplementary Paper Number 29, entitled Toward a New Housing Policy: The Legacy of the Sixties, reviews policy developments that occurred during the Kennedy-Johnson Administrations. These developments can be summarized as follows:

> (1) The concept that the problems of central cities and the tax base necessary to ameliorate these problems must be reviewed in the larger context of sharing the burden throughout the metropolitan area as well as with unearmarked funds from the states and federal government.
> (2) The development of multicounty and multistate planning jurisdictions to handle the problems of transportation, land development patterns and water and sewer systems.
> (3) The development of housing options to include the below market interest rate formula, the interest reduction program, the used-house approach to public housing, and rent supplements.
> (4) The encouragement of large scale development and proposals for land development to be planned and administered by state agencies.
> (5) The stating of national housing goals and objectives in quantitative terms.
> (6) The passage of the Civil Rights Act of 1968 which prohibits racial discrimination in the sale and rental of most of the nation's housing.
> (7) The reorganization of the federal government to include the creation of the Department of Housing and Urban Development.[15]

Housing programs during the Nixon Administration went through a reevaluation with the impoundment of funds and the development of the federal revenue sharing program. However, even with the freeze on federal funds there are programs on the books that if properly funded can provide some remedy to the housing dilemma. It should be recognized, however, that program regulations oftentimes make it difficult to have a total dollar impact on an inner city neighborhood. This situation

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[15]Schussheim, pp. 3-8.

is the result of each individual circumstance having conditions that are exceptions to guideline limitations. Some of the federal programs presently on the books designed to provide incentives toward the creation of more available housing are listed in Appendix A of this study.

III. A REVIEW OF THE PHILOSOPHICAL DEBATE THAT CHARACTERIZED THE ENACTMENT OF HOUSING LEGISLATION

In characterizing the development of housing reform legislation it is not sufficient to merely provide a chronological history of housing legislation. Some considerations must be given to the reasoning articulated which encouraged or discouraged the enactment of the various housing programs.

A basic part of the housing debate with regard to the unavailability of long-term secondary mortgage money has been the discussion about the relative merits of subsidizing housing production or the housing consumer. The vast majority of legislative programs to date have subsidized the producer of housing.[16] The close association of housing production with economic policy has made it extremely difficult to separate the housing problem from the production of more housing units. The consumption-consumer debate surfaces as an important issue. If monetary policy favors making large amounts of money available for new housing construction rather than an equally sufficient amount for existing housing, the prospects for available buyers for mortgages on existing

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[16]Arthur P. Solomon, Housing the Urban Poor: A Critical Evaluation of Federal Housing Policy (Cambridge, Massachusetts: MIT, 1974), pp. 1-2.

housing stock in the secondary market are seriously curtailed. The lack of available buyers in the secondary markets makes it especially difficult for persons engaged in the rehabilitation of inner city housing to refinance their equity and improvement cost for a longer term. The ramifications of this situation applied throughout the metropolitan area are complex. Some of these can be summarized as follows:

> (1) Those who could best make improvements in the inner city housing stock do not, because the economics of the situation encourage them to make their housing investment in the suburbs.
> (2) When those persons with high potential net income make their housing investment in the suburbs, the economic segregation lines are reinforced.
> (3) Inner cities whose fringe areas are crowded with smaller incorporated entities are left with a majority of low income residences.
> (4) Neighborhood rehabilitation is a long and frustrating process, often marked with personal failure as a result of the short term to maturity loans and the high interest rates, which sometimes are no better than no loan at all.
> (5) Poor people are left in the city to be the beneficiaries of fragmented housing programs which are too slow in accomplishing their objectives and are expected to accomplish results that the programs are not designed to meet.[17]

In addition to the acceptance of housing production subsidy by national elected officials, evidence indicates a persistence within the Department of Housing and Urban Development to encourage developer-built tract housing rather than owner-built housing. John F. C. Turner and Robert Fichter in the book Freedom to Build state the following about owner-built and developer-built houses and the federal government:

> One statistic seems particularly significant since it reflects the role the federal government plays in guiding national

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[17] John F. C. Turner and Robert Fichter, Freedom to Build: Dweller Control of the Housing Process (New York and London: Collier-MacMillan, 1972), pp. 3-22.

> energies. While the Federal Housing Administration (FHA) and the Veterans Administration (VA) assist the purchase of one out of every three developer built homes by offering mortgage insurance, they perform this service for only one out of seventeen owner built homes . . . One is compelled to ask why, if private commercial lending institutions do not consider the owner-builder an inordinate risk, the major public servant of housing need apparently does.[18]

Statistics indicate that owner-builders are economically less well off than home buyers. Of those owner-builders who undertook construction of their own homes in 1968, 23.5 percent had income of less than $6,000 per year. According to estimates made by Turner and Fichter the minimum income necessary to buy a median-priced new single family house in 1968 was $12,500. This assumes the house buyer's ability to afford a house priced two times his annual income.[19] Housing goal conflicts have created a situation in which many low-income families are unable to satisfy their housing needs. Under the present housing delivery system most low-income families can acquire decent shelter only by devoting an excessive portion (30 to 35 percent) of their income to rent and therefore sacrificing much of their budget for other necessities.[20] Housing economist Arthur P. Solomon describes the following situation:

> At least 11 million households paid more than 25 percent of their incomes for shelter—the figure that most housing experts (including the Bureau of Labor Statistics) consider maximum if other necessities are not to be sacrificed. Of these

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[18]Turner and Fichter, Freedom to Build: Dweller Control of the Housing Process, p. 5.

[19]Turner and Fichter, Freedom to Build: Dweller Control of the Housing Process, p. 7.

[20]Solomon, p. 5.

> households, it is not known how many also inhabit substandard or overcrowded units. Roughly 6.9 million households live in physically dilapidated or deteriorated housing in 1970. Some 6 million families had less than one room per person (the U. S. Census criterion for overcrowding) with about one-third of them in substandard housing.[21]

Therefore, rather than pay excessive amounts of their income for housing, many low-income families must resign themselves to living in deteriorated, dilapidated or overcrowded dwellings. From the perspective of the low-income housing investor that purchases rental property, the uncertainties of the investment return do not encourage the investor to make adequate improvements and repairs. Rent defaults, vandalism and other social factors encourage disinvestment in the structure. Arthur P. Solomon states the following:

> Instead of trying to reverse the process of housing disinvestment within the inner cities, national policy has attempted to solve the "bad housing" problem by subsidizing the construction of new housing units. . . . The New York City housing market is something of an anomaly, not as a result of scale alone, but because its unique urbanity and role in the national economy keeps housing demand high in select areas of the city. Nonetheless, while its inventory of sound housing grew by 24 percent during the 1960's, its dilapidated inventory increased by 44 percent and its deteriorated stock by 37 percent.[22]

The proponents of subsidizing new construction contend that an adequate supply of low income housing does not exist. However, the consumer advocates argue that the supply problem has been created by the decline in the quality of existing housing structures and new housing

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[21]Solomon, p. 5.

[22]Solomon, p. 5.

construction has not prevented this rapid decline.[23] New housing on vacant land also is responsible for:

> (1) The creation of more dwelling units at a more rapid pace.
> (2) The consumption of scarce land and resources.
> (3) The extension of public services (i.e., streets, sewers, and water) to areas that previously were without these services.
> (4) The displacement of investment over larger geographic areas that erode tax bases, economically segregate populations and encourages disinvestment in older areas.[24]

Most recent discussions on the role of the national government in housing have supported the concept of subsidization of the consumer. Initial review of such proposals indicate that such a policy would provide greater locational flexibility.[25] This fact in time should be more compatible with other national goals of housing integration, school desegregation, and equal opportunity. Within the national goal of "an adequate home and suitable living environment for every American," is the understanding that most Americans historically have had some choice as to where they desire to live. However, there are some Americans who, as a result of their economic condition, race, or their preference of lifestyle, have been unable to find suitable housing

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[23]Statement by Anthony Downs during the Local Urban Renewal and Neighborhood Preservation Conference conducted in Chicago on June 18-19, 1975.

[24]Lowdon Wingo, Jr., "Urban Renewal: A Strategy for Information and Analysis," Urban Analysis, ed. Alfred N. Page and Warren R. Seyfried (Glenview, Illinois: Scott, Foresman and Company, 1970), p. 402.

[25]Turner and Fichter, Freedom to Build: Dweller Control of the Housing Process, pp. 241-254.

within the context of the national goal.[26] This condition is expected to become more apparent as the group of people listed by the census as "single and unrelated individuals" grows.[27] One of the locations where people desire to live that has been the most neglected and misunderstood is the old inner city neighborhood. These old neighborhoods are going to continue to have difficulty meeting their new role of providing adequate living environments as long as federal financing incentives are heavily oriented toward new housing.

IV. INCENTIVES AT THE FEDERAL LEVEL, ITS EFFECT ON HOUSING INVESTMENT

With regard to the availability of secondary mortgage money, interviews with lenders indicated that the Government National Mortgage Association (GNMA) and the Federal National Mortgage Association (FNMA) purchase such a large volume of secondary mortgages that the terms prescribed by these agencies exercise a monopoly on the market. As long as the government sponsored buyers prescribe loan terms that are oriented toward new housing construction the smaller conventional buyers will not deviate to a great degree and will also prescribe terms oriented toward new construction. Furthermore, there is some evidence that the implementing agencies are oriented toward new housing.

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[26]Nelson Foote, Janet Abu-Lughod, Mary Mix Foley, and Louis Winnick, "The Consumption of Housing and the Urban Community," ed. Nathan Glazer, The Consumer, III (May, 1959), p. 10.

[27]Statement by Anthony Downs during the Local Urban Renewal and Neighborhood Preservation Conference conducted in Chicago on June 18-19, 1975.

In accomplishing local lending institutions' portfolio objectives, decisions are made to loan a set amount of money on real estate with some minimum loan terms and property standards. If the federal incentives are to encourage new housing starts through such agencies as the Federal Housing Administration, Veterans Administration, and Farmers Home Administration, local lending institutions are going to make their money available for loans which are insured through such incentives.[28]

Generally, involvement by the Federal Housing Administration or the Veterans Administration in new housing has been through large tract developers.[29] This is so because of the administrative efficiency the developer is able to offer during the FHA and VA inspection and specification review process. If a developer plans to sell a new house with Federal Housing Administration or Veterans Administration mortgage insurance, the specifications and inspections must be made during the construction process. The result of this procedure serves to discourage the owner-builder (a family that wants to build their own residence) because of the administrative efficiency the developer provides the reviewing agency. While the Federal Housing Administration and Veterans Administration officials will not admit to this situation, evidence on past performance of their agencies supports this contention. Turner and Fichter's evaluation of owner-builder housing points out that

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[28]Interview with lenders in Evansville, Indiana, October, 1974.

[29]John F. C. Turner and Robert Fichter, Freedom to Build, "Owner Builders: Survivors with a Future," ed. William C. Grindley (New York: Macmillan Company, 1972), pp. 3-21.

owner-built units did not always conform to strict requirements of the Federal Housing Administration or Veterans Administration, but provided a dwelling unit that more adequately met the individual family's needs and desires at a lower cost per unit. A recommendation of Turner and Fichter's study was that any national housing program should encourage development of new housing through owner-builders.[30] While most local lenders did not discourage the owner-builder the terms that could be made available to an owner-builder are not as good as those terms made available to a large-scale developer. One mortgage lender explained that the large-scale developer had the track record in building and the insurance provided by the guarantees on the long-term money by the Federal Housing Administration and/or Veterans Administration to lower the lender's risk.[31] The owner-builder and large subdivision developer debate is particularly significant with regard to the number of units that need to be provided to satisfy the housing shortage. Turner and Fichter argue that the owner-builder can provide more units, at a cheaper cost to the consumer, and with a design tailored to meet specific family needs. Many of the advocates of continual subsidization of the housing producer stress the producer's ability to provide a greater volume of units.

In addition to providing a new housing program which broadens the base of builder participants through owner-builders, some attempt must

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[30]Turner and Fichter, Freedom to Build, "Owner Builders: Survivors with a Future," pp. 3-21.

[31]Turner and Fichter, Freedom to Build, "Owner Builders: Survivors with a Future," p. 6.

be made to reduce the cyclical effect of the short run (five year) building cycle. This cycle is largely a result of the performance of the secondary mortgage market. As the interest rate goes up, investors remove their money from the secondary housing mortgage market and place it in other sectors of the economy that are receiving a higher rate of return.[32] Mortgage bankers follow suit by restricting the amount of money their institution makes available for home mortgages. Filtering and new housing starts decline until money is freed in the national economy to be placed back into the secondary housing market.

A variable interest rate is one of the new ideas presently being considered by lending institutions as a method for reducing the cycle effect. Advocates of this method contend that a variable rate would permit the housing industry to better compete in the money market. It is further advocated that the prospective buyers of housing would not be hesitant to buy during periods of high interest rates because the rate would go down with the market fluctuation in the future.[33]

By encouraging large tract subdivision development, through the incentives of federally guaranteed mortgages, investment in older neighborhoods is discouraged as long as other programs are not available to compensate for the economic benefit of developing in the suburbs. Generally, the economic goal in development is to minimize

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[32]Jack M. Guttentag, "The Short Cycle in Residential Construction," Urban Analysis, ed. Alfred N. Page and Warren R. Seyfried (Glenview, Illinois: Scott, Foresman and Company, 1970), pp. 73-88.

[33]Evansville Press, "Floating Mortgages Urged," October 14, 1974, p. 20.

risk and maximize profit. Guaranteed mortgages remove much of the risk, while the speculation on land provides a mechanism to increase profits at a greater rate than could be realized in inner city development.[34]

Federal programs have also influenced the use of existing housing. In an effort to minimize risk the only long-term mortgage money usually available for existing housing is through the federally insured mortgage programs. However, the existing units are often obsolete by design. As a result of the units being obsolete by design, it is difficult to meet the Federal Housing Administration or the Veteran Administration's minimum property standards.[35] During interviews, lenders indicated that investors seldom strayed too far from the minimum property standards when purchasing conventionally financed mortgages in the secondary market.[36]

Local building codes, which are often a mirror of national building codes, were frustrating rehabilitation efforts in Butchertown. The style of the older structures being rehabilitated favored the use of plastic plumbing pipes, and the combining of plastic and cable electrical wiring which were easier to work with than other materials. However, the local

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[34]During the information gathering for this study, the author discovered the rather common practice of "front ending" development money so that a developer could realize a "100 percent borrow out" and the mortgage banker could do a greater volume of lending.

[35]Interview with local lenders and Butchertown residents, March, 1974. The lenders also explained that the unavailability of long-term money seriously slowed the "filtering process" which was one of the reasons that used housing was in such bad condition when it reached the bottom of the "filtering ladder."

[36]Interviews with mortgage bankers and savings and loan lenders in Evansville, Indiana, October, 1974.

code requirements did not facilitate the use of plastic materials, therefore increasing the cost of the project. Often, the cost of rehabilitation became uneconomical. This author contends that this situation exists because the code is oriented toward the new housing industry.

The orientation of federal housing incentives toward the new housing industry has also had some effect on the direction state housing programs have taken to provide assistance. These new state agencies depend upon federal funds; and therefore, it has been natural for them to assume some of the philosophical and policy viewpoints shared by the federal government.

V. THE ROLE OF THE STATE OF KENTUCKY AND THE KENTUCKY HOUSING CORPORATION IN PROVIDING STATE ASSISTANCE TO HOUSING

During the 1950's and the 1960's the state of Kentucky was involved in housing primarily through the establishment of enabling legislation which permitted local government to set up housing authorities and urban renewal agencies. These entities were permitted through this legislation to sell bonds in which the proceeds would be used to match the federal participation or to construct revenue producing projects.

With the encouragement of Ms. Mae Street Kidd, a state representative from the west end of Louisville, and the staff of the Kentucky Program Development Office, plans were developed to place enabling legislation before the 1970 legislature for the establishment

of a housing corporation. The legislation was enacted in 1972 and received operating expenses by 1974. Under the enabling legislation of Kentucky, some of the powers of the Kentucky Housing Corporation are:

> (1) To make or participate in the making of insured construction loans to sponsors of land development of residential housing; provided however, that such loans shall be made only upon the determination by the corporation that construction loans are not otherwise available, wholly or in part, from private lenders upon reasonably equivalent terms and conditions;
>
> (2) To make or participate in the making of mortgage loans to sponsors of residential housing; provided, however, that such loans shall be made only upon the determination by the corporation that mortgage loans are not otherwise available, wholly or in part, from private lenders upon reasonably equivalent terms and conditions;
>
> (3) To purchase or participate in the purchase of insured mortgage loans made to sponsors of residential housing or to persons of lower income for residential housing (where the corporation has given approval prior to the initial making of such a loan); provided, however, that any such purchase shall be made only upon the determination by the corporation that mortgage loans were, at the time such approval was given, not otherwise available, wholly or in part from private lenders upon reasonably equivalent terms and conditions.[37]

This legislation represents a major step at the state level in solving the housing problem. However, one of the shortcomings of this particular piece of legislation is the same deficiency that most other housing legislation has at the national and state level. The legislation limits its flexibility by attempting to provide money for existing and new housing stock through federal mortgage insurance and the purchase of insured mortgages. Basically, new housing stock can be provided by the private sector, and markets are available in the secondary market for

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[37]House Bill 305, as signed by the Governor of Kentucky on April 1, 1974, Kentucky Revised Statutes.

these loans. During periods in which investors are investing in other markets, government involvement in Federal Housing Administration and Veterans Administration programs compared to their willingness to participate in new housing has not been sufficient to remove the cyclical effect of the market.[38]

The private sector has not been as responsive in participating in loans on existing housing stock.[39] To stop housing blight, the public sector should purchase mortgages in the secondary market on existing housing, therefore encouraging investment in the existing housing supply.

A second shortcoming of the state legislation is that its orientation is not toward location and mortgage risk areas, but toward low and moderate income housing production. A program designed to eliminate blight must be flexible and broad-based in order to attract as many participants as possible. Therefore, it is the recommendation of this study to broaden the scope of the Kentucky Housing Corporation.

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[38]Guttentag, pp. 73-88.

[39]Several mortgage bankers who were interviewed by the author on September 23, 1974, Evansville, Indiana, indicated that existing housing was structurally sound, but obsolete by design; and homeowners were not interested in bothering with all of the upkeep, especially when the units were located in areas of change. It is important to note that the only long-term mortgages in depressed areas for existing housing stock are usually guaranteed but there is difficulty in meeting minimum property standards.

VI. SUMMARY

This chapter should have provided an increased awareness of the ramifications that housing policies which are heavily oriented toward new housing have upon the existing housing stock. This chapter does not recommend that incentives at the federal level that encourage new housing construction should be discontinued. The gross number of housing units needed to satisfy the shortage is too great. New units are necessary. However, some changes must occur in the secondary mortgage market to permit an adequate flow of long-term mortgage money to inner city neighborhoods.

Chapter II provides some additional insight into the problems facing many inner city neighborhoods as a result of subjective judgments made about the risk of investing in the inner city. The obstacles experienced by these neighborhoods must be evaluated in context with the orientation of the national housing policy.

CHAPTER II

A PROCEDURE FOR EVALUATION

I. INTRODUCTION

With the completion of this study decision makers should be able to articulate to their constituents the complexity of the unavailability of long-term mortgage money in inner city areas. This study only explores the shortage of long-term mortgage money in inner city areas. It is recognized that other problems exist with regard to inner city housing.

One important factor in the proper utilization of land and land resources is an understanding of the capital delivery system and the allocation of capital investment throughout the planning area. Government has influenced this allocation by the programs it has enacted and the policy decisions that are inherent with each program.

As a result of difficulties in obtaining long-term mortgage money experienced by residents of Butchertown, an inner city neighborhood in Louisville, Kentucky, three basic issues surfaced. Although there may be other issues, this study proposes to analyze these three issues. These issues are:

1. The orientation of the secondary mortgage market toward new housing construction and its affect on the shortage of long-term mortgage money in inner city areas.

2. The relationship between the performance of the mortgage and the location of the mortgage.

3. The affect lenders' evaluation of Butchertown had upon the attempts of residents of that neighborhood to rehabilitate their housing stock.

The issues that have been stated above have had a definite affect on the quality of the housing stock in inner city areas. The purpose of this study is to develop those issues and bring them to the public forum for evaluation. This evaluation should hopefully result in modifications in the capital delivery system to provide long-term mortgage money in inner city areas.

II. AN OVERVIEW

Although the development of the three basic issues is critical to an adequate evaluation of the unavailability of inner city mortgage money, the different nature of each issue necessitates that each issue be evaluated singly. Therefore, a four-step program was developed to evaluate the shortage of long-term mortgage money for inner city areas.

The initial step involved a collection and review of available published information on the subject. As a result of that review a questionnaire was developed to gain information from which to structure a basic framework for further study.

The second phase involved interviews with FHA and VA approved mortgage lenders. Inquiries were made in regard to their loan committee's assessment of financing alternatives for various parcels of property located within Butchertown. Inquiries were also made about the lenders overall operation with regard to servicing and disposition of their firm's mortgages.

The third step in the strategy development was the testing of a model designed to evaluate the relationship certain socioeconomic data aggregated by location had upon risk.

The final phase of the strategy involved the assimilation of all information collected and the development of a local program to ameliorate the inner city mortgage shortage. The development of this program received further input from local lenders, Federal Home Loan Bank Board officials, and program directors from other communities that were experiencing similar problems. This program is provided along with other recommendations and conclusions in Chapter V.

III. STATEMENT OF HYPOTHESES

Based upon the preliminary research done for this study an hypothesis, known as hypothesis A, is proposed to be tested. This research is found in Chapter I. Hypothesis A states the following:

> Monetary policy which heavily favors the construction of new housing creates conditions that restrict the available buyers in the secondary market for existing housing stock.

The methodology which used a questionnaire-interview approach is discussed in the next section.

A separate topic which is related to hypothesis A is the state of the art with regard to judgments that are made about mortgage preference areas. Therefore, a model was developed to test the relationship of foreclosures, as an indication of mortgage performance, with selected socioeconomic data, as an indication of the condition of an area. The hypothesis tested, known as hypothesis B, was:

Selected socioeconomic data aggregated by location, as an indication of the condition of an area, have no affect on foreclosures, as a test for mortgage risk.

Interviews with residents of Butchertown indicated that these residents knew of no owner-occupied property in the neighborhood that was in a foreclosure settlement. However, lenders consistently told these residents that Butchertown was a poor mortgage area. Therefore, the null hypothesis was tested and the independent nature of hypothesis B relative to the other research resulted in the study testing that hypothesis separately. The methodology for that test and its results are found exclusively in Chapter III.

IV. METHODOLOGY

The initial procedure in the development of a methodology to test hypothesis A was to conduct a broad overview of available written material on the subject. As discussed in Chapter I critical topics such as the production-consumer housing debate, the owner-builder issue, the orientation of the Department of Housing and Urban Development's regulatory agencies toward new housing construction, and the affect that state housing assistance with strict income limitations had upon inner city housing investment surfaced for evaluation. Furthermore, it was realized that insights into the operation of lending institutions in general was going to be necessary before a detailed evaluation could take place.

To develop this information a questionnaire was prepared to be sent to all FHA and VA approved lending institutions operating in Louisville and Jefferson County, Kentucky. The questionnaire was structured after a questionnaire used by H. Benjamin Fisher in an unpublished thesis entitled "Financial Intermediaries in the Development Decisions Process." The questionnaire was not sample tested because of its close similarity to the questionnaire used by Fisher.[1] The questionnaire was designed so that the respondent could choose between alternative statements. This method provided a base of common information by which the practices of different lenders could be compared. All of the questions were not answered, which makes valid observations hazardous. However, questions that were answered provided basic information for follow-up interviews with Louisville lenders and for purposes of structuring the remainder of the study. For instance, many lenders suggested that FHA and VA property standards were the minimum that their lending firm would accept. Upon a follow-up interview it was discovered that those were the standards being required by the secondary market. Other responses provided similar insights but required verification through the interview. The questionnaire is provided in Appendix C.

As a result of the information gained from the questionnaire, lenders in Louisville were interviewed with regard to the evaluation they gave a property located in Butchertown.[2] Lenders were specifically asked

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[1]H. Benjamin Fisher, "Financial Intermediaries in the Development Decisions Process," unpublished Master's thesis (University of North Carolina, Chapel Hill, North Carolina, 1966).

[2]Lenders interviewed were assured that the confidentiality of themselves and their firm would be maintained.

questions related to the following topics in an effort to develop a financing strategy to obtain money for long-term mortgages in Butchertown. The topics questioned were:

1. Their firm's ability to warehouse mortgages.
2. Origination fees charged for servicing loans.
3. The adequacy of that fee.
4. Procedure within the lending institution for loan approval.
5. The type of buyers available to that lending institution in the secondary market for mortgages from Butchertown.
6. The level of mortgage performance the institution expected with regard to all of its mortgages.
7. The amount of money that can be loaned for property on an "as is appraisal."
8. Their recommendations for long-term financing strategies in Butchertown.[3]

In addition to the interviews with lenders, residents of Butchertown were interviewed with regard to the long-term mortgage money available to them and the difficulties the lack of long-term money had upon their attempts to rehabilitate the housing stock. Additionally, efforts of the neighborhood as a whole were evaluated with regard to the success a particular strategy may have had on securing necessary financing. The results of this methodology are presented in Chapter IV.

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[3]It should be noted that a few of the lenders continued to participate with this study to develop acceptable financing strategies after the interviews were completed.

CHAPTER III

TOWARD A MODEL FOR EMPIRICALLY EVALUATING MORTGAGE RISK

I. INTRODUCTION

Chapter I concludes that a major problem in inner city areas is the unavailability of long-term mortgage money. There are two basic schools of thought with regard to residential mortgage risk. One theory attributes mortgage risk to imperfections in the capital delivery system. As a result of the secondary market being highly oriented toward new construction, the capital delivery system does not favor mortgages on existing housing stock.

The second theory, which is largely a local phenomenon, characterizes mortgage risk as a result of changes in locational characteristics of neighborhoods. This concept attributes changes in racial composition, density, income, owner occupancy status as well as other characteristics to probable mortgage risk. This chapter proposes to evaluate the relationship certain location data has with foreclosures as an indication of mortgage risk. To encourage an equitable assignment of private mortgage capital within the urban area, public officials, planners, and others interested in urban development must understand fully the ramifications of the present housing capital delivery system.

II. STATEMENT OF HYPOTHESIS

During the research for this thesis, lenders indicated that changes in locational characteristics influenced their decision to lend money in certain areas of the community. The local lenders further agreed that foreclosures represent the best available public record of mortgage performance. However, interviews with residents of inner city areas as well as other empirical research indicate that socioeconomic data aggregated by location does not affect mortgage risk.[1] Therefore, based upon the preliminary research of this study the hypothesis assumes that socioeconomic data aggregated by location has no affect on foreclosures as a test for mortgage risk.

III. METHODOLOGY

In an effort to evaluate locational factors which influence mortgage performance in inner city areas, certain selected socioeconomic data were gathered for the Louisville and Jefferson County area by census tract. Most of the independent variables tested were selected from a list of key variables identified by Real Estate Research Corporation in their manual entitled Evaluating Local Urban Renewal Projects.[2]

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[1] John P. Herzog and James S. Earley, Home Mortgage Delinquency and Foreclosure (New York: National Bureau of Economic Research, 1970), p. 38.

[2] Department of Housing and Urban Development and Real Estate Research Corporation, Evaluating Local Urban Renewal Projects (Washington, D.C., 1975), p. 29.

A few variables were added as a result of the preliminary research conducted for the preparation of this chapter. Most important among these additions was the percent change in nonwhite population within a census tract. This variable always appeared to be a determinant in responses from local lenders, but was never openly discussed as a factor in mortgage risk. Other variables were selected based upon the assumption that they exerted some influence on the economic status of the neighborhood. For the purpose of this analysis the following independent variables were selected:

1. Percent change in nonwhite population, 1960-1970.
2. Percent change in median family income, 1960-1970.
3. Percent change in median value of owner-occupied dwelling units, 1960-1970.
4. Percent change in median contract rent, 1960-1970.
5. Percent change in owner-occupied dwelling units, 1960-1970.
6. Percent change in households with 1.01 or more persons per room (overcrowding).

Foreclosures were selected as the dependent variable in developing a test for mortgage risk. This selection was based upon the assumption that lenders identify readily with foreclosures as an indicator of mortgage performance. Additionally, foreclosure represents a court action in which title of the property is deeded to the mortgagee. Therefore, the information on foreclosures is readily available. The foreclosures utilized in the model were for the years 1967 to 1971 and were obtained from the Jefferson County Court Clerk's office. The

potential for the number of foreclosures to be influenced by the land use and size of a census tract was recognized. Therefore, the rate of foreclosures to dwelling units within a census tract was utilized in the test.

It was assumed that many variables react and interact upon the mortgage investment process. Therefore, a technique for analysis must be chosen that would most closely indicate the type and significance of the relationship among several factors reacting with the dependent variable. Stepwise multiple regression analysis was selected as the appropriate statistical tool to accomplish this objective because it "permits the isolation and holding constant of the effect of all variables included in the analysis and provides measures of the relative influence of these variables upon the phenomena being investigated."[3]

The analysis of the preliminary information for this study indicated that change in neighborhood condition influenced lenders' mortgage preference rather than the absolute condition. Therefore, the independent variables were developed into a time series for the years from 1960 to 1970. However, the program that was used did run some of the variables as absolute values to verify this assumption.

In developing the methodology for analysis of the independent variables, 1960 and 1970 dollar values were divided by the respective increase in the consumer price index for that year. The index as presently constructed measures the average change in prices of goods and

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[3]Herzog and Earley, p. 42.

services purchased by urban wage earners, clerical families, and single persons living alone. It was assumed that this computation equalized the data to a base year.[4]

IV. ANALYSIS OF THE TEST

The program consisted of four basic steps in developing a test for mortgage risk. The mean and the standard deviation were computed for the independent variables with all monetary considerations being adjusted for inflation. A matrix of Pearson's product-moment correlation coefficients was computed in which each variable in the analysis was correlated with each other variable. The independent variable with the highest correlation with risk was entered into the regression equation to explain dependent variable risk, while all other independent variables were held constant. Of the independent variables which were not included in the regression equation, the one with the highest F value was then selected and entered into the regression equation with the first independent variable. Once again all other independent variables that were not in the regression equation were controlled. The process of taking the independent variable with the highest F value and entering it into the equation on the next step continued until the F value of the remaining independent variables becomes too low to explain any appreciable amount of variation "risk." It should be noted that after each step new F

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[4]U. S. Bureau of Census, Statistical Abstract of the United States: 1970 (Washington, D.C.: Government Printing Office, 1970).

values were computed for the independent variables not included in the regression equation.

Of all the independent variables tested, the real median value of owner-occupied dwelling units displayed the strongest relationship with risk. However, at a 5 percent level of significance, the real median value of owner-occupied dwelling units only explained 5.23 percent of the relationship between dependent variables. Only two of the variables had F levels that were not significant at a 5 percent confidence level. They were black population for 1970 and percent of nonwhite change, 1960-1970. However, the total amount of variance explained by all of the significant variables was only 11.19 percent. The null hypothesis that no relationship exists between the dependent and independent variables cannot be accepted; however, the degree of the relationship in terms of the percentage of explained variance is so minimal that the model would be useless if used to predict mortgage risk. Moreover, it shed little light on the theoretical factors causing foreclosures.

V. CONCLUSIONS AND IMPLICATIONS

Despite the fact that very little significant relationship was found to exist between the selected socioeconomic variables and foreclosures as an indication of risk, evaluation of socioeconomic data may still remain as the basis for neighborhood analysis of mortgage performance.

First, in the regression analysis just discussed too much emphasis may have been placed on foreclosures as an indicator of locational

mortgage risk. The overall variance of the foreclosures variable among the 146 census tracts did not appear to be large enough to provide sufficient contrast. As a general rule, foreclosures have been highly related to personal hardship such as divorce, illness of wage earner, borrower occupational skill status, and other borrower characteristics. However, location did not appear to be an important factor in delinquency and foreclosure except where a loan was made to a builder.[5]

Second, investigation indicated that many property transactions within inner city areas utilize a contract for deed. This method of transaction is often not recorded. Therefore, socioeconomic data may indicate that a tract is a poor investment area but the foreclosure rate may be low. This discrepancy may be produced as a result of the use of a contract for deed or by the sheer lack of any mortgage activity in the census tract.

Despite the fact the model tested would be useless if used to predict mortgage risk, evaluation of locational change is important to local economic analysis. Provided a program can be developed that orients the secondary market to local economics, socioeconomic data will continue to be an important part of neighborhood analysis. At the present time, the orientation of the secondary market to a national scale of operation encourages general property standards for which mortgages are sought and deemphasizes detailed evaluation of local neighborhood conditions. The result has been that few long-term mortgages are available for old inner city areas which contributes to their decline.

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[5]Herzog and Earley, p. 38.

CHAPTER IV

AN EXAMINATION OF A LOCAL INNER CITY NEIGHBORHOOD

I. INTRODUCTION

This chapter attempts to relate the operation of the secondary mortgage market with the obstacles an inner city neighborhood experienced in efforts to revitalize its housing stock through the utilization of the private sector investment. To accomplish this objective, methods of reinvestment attempts in Butchertown, a residential neighborhood east of the Louisville, Kentucky, central business district are evaluated. The geographic scope of this study has been limited to Butchertown in order to more effectively evaluate all the variables relative to the lending process.[1]

Butchertown, whose earliest buildings were erected in the 1830's, was once the center of the meat packing industry in Louisville and is located adjacent to the Bourbon Stock Yards. Five packing plants are still operating. The area was once a solid neighborhood of German immigrants

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[1]Lending institutions have various scales of operation from international to local. Their portfolio represents application of risk over a variety of scales of operation. Therefore, it was an assumption of this study that when lending institutions were confined to the Louisville and Jefferson County, Kentucky, area in general, and were specifically evaluated as their policies applied to Butchertown, the diversity of their scale of operation would not overly influence the results of this study.

but began to decline in the 1930's when all of the downtown area was rezoned for industrial use.[2] At the present time residents of the Butchertown area are predominantly low-income whites. Over 75 percent of the housing units in the area are renter-occupied. Unemployment and the families on public assistance are high.[3] Although James Segrest, President of Butchertown, Inc., indicated that the rehabilitation effort is encouraging residents interested in restoration to move back into the neighborhood, it is estimated that the number of residents with incomes over $10,000 is less than 15 percent.[4]

Butchertown, Inc., a neighborhood development corporation that got its start as a neighborhood club, has spearheaded the revitalization drive. This group went to the mayor a few years ago regarding zoning, and the mayor persuaded the planning commission to set up a committee to study zoning in the neighborhood. The result of this action was the rezoning of some areas in Butchertown from industrial to high density residential.[5] Since that time the neighborhood has experienced an

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[2]"Saving Places for People," Progressive Architecture, LIII, John Morris Dixon (November, 1972), pp. 70-84.

[3]U. S. Department of Housing and Urban Development and Real Estate Corporation, Neighborhood Preservation: A Catalog of Local Problems (Washington, D.C.: Government Printing Office, 1974), p. 134.

[4]Interview with James Segrest and Edward Carley, stockholders in Butchertown, Inc., 1976.

[5]"Saving Places for People," p. 50.

immigration of professionals such as planners, architects, interior designers, lawyers and socio-workers.[6] These people have purchased abandoned property and begun to rehabilitate the houses.

The club decided to form a neighborhood development corporation selling stock to neighborhood people and local churches to raise capital for the rehabilitation venture.[7] This set the stage for contact with the local lending institutions. After initial contact with one lending institution, it was discovered that the neighborhood corporation, and more specifically its board members, needed to use their personal influence in a sequence of borrowing strategies to obtain the necessary financing for any substantial rehabilitation effort.[8] These efforts are too numerous to relate here, but they are of sufficient substance that a few are highlighted in the footnote and others are used as examples throughout the study. Of particular significance to this chapter's evaluation is the fact that many of the residents that attempted to rehabilitate their homes had incomes above $15,000. However, these residents were unable to obtain long-term mortgage loans.[9]

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[6]Butchertown, Inc. has rehabilitated 10 to 12 housing units. Proceeds from the sale of these rehabilitated homes are used for further renovations. This has encouraged other residents to rehabilitate their homes.

[7]"Saving Places for People," p. 50.

[8]A local church which supported the rehabilitation effort withdrew funds from a commercial bank until the bank's loan committee gave a more favorable review to the corporation's request for a loan. An attorney invested trust funds that he represented in lending institutions which supported the neighborhood effort through its loan policy.

[9]Interview with Butchertown residents, July, 1971.

II. INITIAL QUESTIONNAIRE AND INTERVIEW RESULTS

In an attempt to relate the information on secondary mortgage market orientation to local lending practices a questionnaire was mailed to each FHA and VA approved lender in the Louisville and Jefferson County areas. Although the return questionnaires revealed that all questions were not answered, which made valid observations particularly hazardous, the questionnaire was useful in developing a framework for later interviews with lenders. For instance, the questionnaire revealed that many lending decisions are made by the "loan committee" within the firm. Therefore, it was important to clarify whether or not the mortgage loan officer being interviewed agreed or disagreed with his loan committee's evaluation of the situation. In general the questionnaire was a useful tool in bridging the gap between the information gained through the review of published material and the lending practices that existed in actuality.

III. THE NEIGHBORHOOD CORPORATION'S EFFORTS

The Butchertown neighborhood recognized the complexity of the rehabilitation process and took action to minimize the difficulty. A design committee was formed through the assistance of interior designers, architects and planners that had moved into the neighborhood. The committee recognized the effects of the "Prisoner's Dilemma" and have sought

to minimize this phenomena by directly encouraging and assisting neighbors to rehabilitate their houses.[10]

The corporation realized that lenders varied the term to maturity of a loan based upon the lender's evaluation of the remaining economic life of the structure. Most units in Butchertown, although obsolete with regard to mechanical installation and design, were structurally sound. Therefore, the corporation sought to make the lenders in the community more aware of the potential of the neighborhood.[11] Several "open houses" were initiated when a house was completely rehabilitated. These open houses were usually billed as a lender's luncheon.

The Butchertown Neighborhood Corporation believes that more interaction with lenders could minimize some of the locational hazards in mortgage consideration.[12] This was a result of several lenders indicating that their firms had no experience with neighborhood organizations and did not understand their function.

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[10]One of the factors most prevalent in blighted areas is what Davis and Whinston refer to as the "Prisoner's Dilemma":

". . . investment by both A and B in their adjoining properties will yield high joint returns, say 7 percent when alternative investments are yielding 4 percent. If A invests in his property and B does not follow suit, B will obtain some benefits from A's investment without any investment of his own while A's return will be depressed because of the blighted condition of B. Each can be assured a minimum return of 4 percent of declining the property investment and will perhaps accrue a considerably greater return, should the other improve his property unilaterally."

Lowdon Wingo, Jr., "Urban Renewal: A Strategy for Information and Analysis," Urban Analysis, ed. Alfred N. Page and Warren R. Seyfried (Glenview, Illinois: Free Press, 1970), pp. 404-405.

[11]Interview with James Segrest, President, Butchertown, Inc., 1975.

[12]Interview with James Segrest, President, Butchertown, Inc., 1973.

Some of the property within any blighted neighborhood is beyond upgrading and must be razed. It has been the philosophy of the Butchertown Corporation that dislocation of low-income residents in the area should not occur as a result of rehabilitation.[13] Therefore, the Corporation purchased two vacant lots and designed three row houses. These units were designed for sale to low-income residents of the neighborhood who were either renting or living in substandard housing. Initially, new construction was to be financed through the Section 235 Subsidy Program. For Butchertown, the Section 235 Subsidy Program was particularly attractive because it provided low-income home ownership and a federally insured mortgage. With the termination of the program, the Corporation must build row houses for rent. The economics of the situation dictate that the row houses will have to be designed for high-middle income rent. Therefore, these units will not entirely satisfy the goals of the Butchertown Neighborhood Corporation.

The housing goals of Butchertown are:

> (1) Provide housing for moderate-income residents through rehabilitation of attractive older residences that have become deteriorated through structural, technical, and environmental obsolescence.
> (2) Maintain the present low-income residents within the neighborhood and discourage dislocation. (This was the objective of the new row houses.)
> (3) Encourage a natural social interaction that would lead to the articulation of desires for other activities (i.e., drug abuse control, police protection, child development, and new housing alternatives).[14]

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[13] Tana Ellis, Louisville Courier Journal, December 9, 1973.

[14] Interviews with James Segrest, President, Butchertown, Inc., 1972.

The impact of the Butchertown Neighborhood Corporation on redevelopment in Butchertown may be too early to evaluate. The Corporation does feel that through its publicity, its present accomplishments, and individual efforts of its own members, the Corporation has gained some political base within the city. The presumption is that a political base in conjunction with the Corporation's other activities will have a positive effect on lending institutions' mortgage risk preference in Butchertown.

IV. A DISCUSSION OF THE "MONEY PROBLEM IN BUTCHERTOWN"

Of particular interest in the discussion of the money problem in Butchertown is the importance of the term to maturity of the loan. A review of past studies on mortgage performance indicated that there was little relationship to the length of the loan and the performance of the loan. Herzog and Earley state that "the behavior of the term to maturity variable was most surprising. It differed significantly from zero only in the National Association of Mutual Savings Bank's equation, but it carried a negative sign in all three versions. This would seem to indicate that longer maturities are associated with a lower rate rather than a high risk of delinquency."[15]

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[15]John P. Herzog and James S. Earley, Home Mortgage Delinquency and Foreclosure (New York: National Bureau of Economic Research, 1970), p. 49.

The major financing obstacle in Butchertown is the term to maturity of the loan.[16] Interviews with property owners in Butchertown revealed that the average term to maturity was five years. In some rare cases, one or two property owners had term to maturity loans of ten years, but this arrangement was on a demand note in which the lender could require full payment with thirty days notice.

Preservation strategies and financing are two tightly woven links in the reinvestment process. Oftentimes, a strategically located building which has code violations will be in danger of being razed. This does not permit the would-be purchaser to go through a prolonged series of negotiations with a lender. The result is that the property is purchased through a contract for deed. A contract for deed is often set up on a five-year term to maturity in which the potential owner pays principle, interest, taxes and insurance. Title remains in the hands of the seller until the provisions of the contract are fulfilled. If the potential purchaser is delinquent in a payment for longer than thirty days, the contract is void.[17] The blighted area is an integral part of

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[16]This was indicated during interviews with Butchertown residents. Although term to maturity does not appear significant as a risk variable, Butchertown residents believed that term to maturity was significant as an institutional disinvestment problem. The residents contend that lenders are loaning less money for fewer years.

[17]An interview with the building inspector of Paducah, Kentucky, revealed that there have been instances where poor people have been victimized by slum landlords through the use of the contract for deed. The seller usually advises the buyer not to record the contract to avoid any increase in taxes. Failure to record the contract enables the seller to take over the use of the property after delinquency without lengthy and costly court proceedings. Generally, the contract does not

the total urban complex which provides social and economic functions.[18] Until some mechanism is developed which encourages the transfer of property in blighted areas and provides longer term loan money for the buyer and security for the seller, this method must remain.

Frequently the dwelling units in Butchertown, as well as other blighted areas, are subject to environmental, technical and structural obsolescence.[19] Therefore, it becomes difficult for otherwise qualified buyers to obtain conventional permanent financing.[20] The

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provide for the buyer to recover any equity that may have occurred. In one instance, a substandard dwelling was sold on a contract for deed. The purchaser had paid on the contract for three years. At the end of the third year, the city's housing enforcement officer condemned the structure and razed the unit. The prospective buyer was no longer able to make the monthly payments on the now vacant lot because it was necessary to reallocate his payment to provide shelter for his family.

[18]Wingo, p. 403.

[19]Ira S. Lowry, "Filtering and Housing Standards," Urban Analysis, ed. Alfred N. Page and Warren R. Seyfried (Glenview, Illinois: Free Press, 1970), pp. 339-346.

[20]Nelson Foote, Janet Abu-Lughod, Mary Mix Foley, and Louis Winnick, "The Consumption of Housing and Urban Community," ed. Nathan Glazer, The Consumer, III (May, 1959). It is stated: "At the present, there are two great areas of deficiency if we look at the American Consumer and what he wants and what is provided to him. One area is that of the low income family--namely the Negro and Puerto Rican city dwellers. They want the houses that other Americans have, but owing to poverty and racial restrictions cannot get them. Then there are those who do not want the housing that Americans are being provided with so lavishly, and who cannot find what they do want except at great expense of money and ingenuity. The solutions to these two great deficiencies are linked: when the low-income city dweller of different races finds it possible to move outside the blighted ghettos of the central city, and those who want an urban life find it possible to move back into the central city, the range of consumer satisfaction with housing will be greater than it is today."

minimum structure standards of FHA-VA eliminate federal government programs as a source of financing and place a strong market factor on conventional financing.[21] This information was obtained as a result of follow-up inquiries on the initial questionnaire. The response on the questionnaire indicated that the minimum property standards acceptable were FHA and VA standards and that these standards were usually required for sale of the mortgages in the secondary market.

A potential buyer of residential property in a blighted area is faced with the obstacle of obtaining clear title to the property and having a reasonable payment to income ratio. In addition to the permanent mortgage, the buyer is confronted with the need to obtain financing for necessary improvements. If the buyer does not have fee simple title, securing improvement money is an extremely difficult task. One lender suggested the following process for obtaining long-term and rehabilitation money:

> Prepare a detailed set of plans and specifications including all technical and structural improvements. Have an appraisal prepared considering the building, the improvements to be made, the location of the property, and comparable sales and improvements in the neighborhood. Go to a lending institution that offers long-term financing and obtain a take out letter. Have the length of term, interest rate, and amount of the loan specified in the letter. Come to a lending firm offering short-term (six months) construction money, and they will loan 75 percent of the appraised value for the improvements specified in the plans on a draw basis.[22]

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[21]This is supported by the questionnaire results and follow-up interviews with lenders in which they indicated that in conventional financing they seldom deviate from the property standards of FHA and VA.

[22]Discussion with other lenders indicated they were unwilling to follow this procedure. These lenders expressed concern as to whether the improvements could actually be represented in the increased appraised value of the rehabilitated property.

This procedure was discovered as a result of inquiries about the possibility of obtaining an "as is appraisal" and borrowing a sufficient amount of money to obtain clear title and make some improvements. The above process is relatively sound and secure for the lender. However, the prospective homeowner must be extremely well qualified financially and adept at negotiating all the necessary procedures.

The structure must be purchased initially through a short-term mortgage or contract for deed unless the take out letter also covers the purchase price. This process generally requires the services of an attorney. A detailed set of plans and specifications must be prepared, which will require the services of an architect. Both of these initial services are an additional expense. An appraisal is prepared which is also costly; and throughout this process, the owner must make the monthly payment on the short-term mortgage. Provided the appraisal is high enough that 75 percent will finance all the improvements, the owner must procure the services of various contractors who are willing to work in older homes and supervise their work closely. When all the work is complete, the owner must refinance the original short-term mortgage and construction loan for a longer term to maturity and a more favorable expense to income ratio. Any unfavorable link in the rehabilitation process, whether on the part of the lenders, contractors, or the financial staying power of the owner can stop the total process.[23]

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[23] Interview with Butchertown residents in Louisville, Kentucky, 1973.

Interviews with Louisville lenders indicated that the obstacle to providing long-term, fifteen years, permanent financing for Butchertown was the lenders' inability to locate an investor.[24] They related that even in easy money periods, their investors preferred FHA-VA insured mortgages or conventional mortgages on new housing stock. Some lenders indicated that warehousing the mortgage was a possible solution, but the term to maturity would not be greater than ten years and the loan to value ratio would be less than normally accepted ratios. The lenders suggested that the individual property owners incorporate so that the interest limits of the Kentucky Usury Law could be minimized.[25] This would facilitate selling the mortgage with a more attractive interest rate in the secondary market. In addition to the difficulty in locating an investor in the secondary market with which to place long-term financing, the market risk of the loan increases with the length of maturity. This risk is created as a result of short-term changes in the money market. However, instead of loaning money in locations of high risk at a greater interest rate, lenders usually maintain the same interest rate and fluctuate the term to maturity. During inquiries

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[24]Most lenders originate loans directly to the home buyer. This market is called the primary market. Some lenders sell a percentage, or all of their mortgages, to investors which frees the lender's money to be placed back in the primary market. The investors are termed the secondary market.

[25]The General Assembly of Kentucky approved a bill during the 1972 legislature, which removed the ceiling on residential mortgages in Kentucky. Prior to this legislation, the ceiling was applicable to all individuals receiving mortgage loans except corporations.

about the term to maturity of the loan and the secondary mortgage market operation, the lenders indicated that the 3/8 origination fee that they receive to service a loan is not profitable. The suggestion was that the City of Louisville may be willing to subsidize that origination fee to 4/8 on long-term loans to qualified buyers in areas considered to be locational risk.[26]

The State of Kentucky and the City of Louisville have not responded adequately to the problem of locating an investor in the secondary market. The present direction that new housing policies by the State of Kentucky and the City of Louisville are following is to provide long-term mortgage money for applicants who wish to purchase homes but have incomes below the guideline limitations of private lending institutions. The problem with such a policy is that there are numerous potential purchasers of homes in the inner city that have incomes above the guideline limitations. These housing buyers are forced to purchase housing away from the inner city.

A case in point is one resident of Butchertown whose situation is not unlike that of other residents. In 1970, a 3,500 square foot brick house was purchased on a contract for deed. The cost of the house was $6,000 and the monthly payment was $133 for five years. During the same year, the owner obtained a $5,000 home improvement loan which was on a term to maturity of five years, with a monthly payment of $108. This enabled the owner to make complete technical improvements including new

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[26]Interview with a Louisville lender, July, 1973.

wiring, heating, and plumbing. A year later, the owner was able to obtain a five-year loan which paid off the contract for deed and left $1,600 for additional improvements. The monthly payment on the new loan was $133 a month. With the additional $1,600 the owner was able to complete a 1,100 square foot apartment which was rented for $125 a month. Although the owner could not obtain an additional home improvement loan, he was able to negotiate another $5,000 loan which cost him $174 a month for three and one-half years. With this amount and an additional $5,000 of his own money, he was able to complete the rehabilitation. The total cost of the rehabilitated 3,500 square foot house was approximately $23,000. However, the extremely peaked monthly payments required that the owner have a high net income, and also be willing to make a substantial investment in an area that lenders termed marginal.[27]

The ramifications of this situation applied throughout the metropolitan area are complex. Some of these can be summarized as follows:

> (1) Those who could best make improvements in the inner city housing stock do not, because the economics of the situation encourage them to make their housing investment in the suburbs.
>
> (2) When those persons with high potential net income make their housing investment in the suburbs, the economic segregation lines are reinforced.
>
> (3) Inner cities whose fringe areas are crowded with smaller incorporated entities are left with a majority of low-income residences.
>
> (4) Neighborhood rehabilitation is a long and frustrating process, often marked with personal failure as a result of the short-term to maturity loans and the high interest rates, which sometimes are no better than no loan at all.

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[27] Interview with a Butchertown resident.

> (5) Poor people are left in the city to be the beneficiaries of fragmented housing programs which are too slow in accomplishing their objectives and expected to accomplish results that the programs are not designed to meet.[28]

With the above conditions affecting the development of the urban physical plant, the direction of this study is toward a strategy to provide long-term mortgage within inner city areas as well as other recommendations and conclusions.

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[28]John F. C. Turner and Robert Fichter, Freedom to Build: Dweller Control of the Housing Process (New York and London: Collier-MacMillan, 1972), pp. 3-22.

CHAPTER V

SOME ALTERNATIVES TO THE PRESENT ORIENTATION OF THE SECONDARY MORTGAGE MARKET

I. INTRODUCTION

Chapter I provides a broad overview of the various governmental housing programs, the philosophical debate which has influenced those programs and the relationship the debate and housing programs have had on the orientation of the secondary mortgage market toward new housing construction. Although it appears unlikely that the orientation of the secondary market will change over the next few years, it is within the scope of this study to recommend some changes.

Any alternatives that are provided must be within the scope of the political jurisdictions authority. This study has addressed the orientation of the secondary mortgage market within the context of that authority with the exception of Chapter III which tested the relationship selected socioeconomic variables had upon foreclosures. The recommendations and conclusions in Chapter III are critical to the interpretation of that chapter but provide no significant findings that assist the overall reorientation of the secondary market. Therefore, the recommendations and conclusions for Chapter III only appear in that chapter. This chapter proposes to provide recommendations on the reorientation of the secondary mortgage market for each level of government.

II. FEDERAL LEVEL OF GOVERNMENT

The recommendations made within this section are made within the context of the present structure of the secondary market and its ability to deliver long-term mortgage money to inner city areas. Should the secondary market's orientation change, then these recommendations may not be applicable.

Chapter I provided an analysis of the affect the Federal Housing Administration's design requirements and the administrative procedures have upon the ability of existing housing stock to qualify for long-term mortgage money. Therefore, it is a recommendation of this study that the Department of Housing and Urban Development review their agency's administrative regulations to provide alternatives for existing housing stock that is structurally sound but fails to meet FHA guidelines.

Evidence has been provided within this study that FNMA and GNMA exercise a commanding influence on the secondary market through the volume of mortgages that are purchased by these agencies. The orientation of these agencies toward new housing construction has greatly affected the unavailability of long-term mortgage money for inner city areas. Therefore, it is a recommendation of this study that the National Commission on Urban Problems reconvene and hold hearings to evaluate this situation and propose alternative measures for providing secondary mortgage money for existing housing stock.

Evidence has been shown in Chapter I that owner-builders can provide a mechanism through which more housing units can be provided for low- and moderate-income families. Therefore, it is a recommendation of this

study that as the regulations that govern the operation of the secondary mortgage market are amended, provisions should be made to encourage owner-builders to enter the development process.

As a result of the disinvestment that has occurred in inner city areas many of the residents of those areas are beginning to lose faith in the ability of the government to effectively solve the problems. Therefore, to increase the visibility of lending institutions' investment in those areas the federal government should implement a disclosure law on all lending institutions which use federal insurance.

III. THE STATE LEVEL

The State of Kentucky has been active in attempts to provide alternatives to the housing problem largely through the efforts of Ms. Mae Street Kidd, a state representative from the west end of Louisville. One of the accomplishments has been the development of the Kentucky Housing Corporation. However, this study has shown evidence that the corporation is not having the impact on inner city housing stock that its proponents anticipated it would. Therefore, it is a recommendation of this study that the scope of the Kentucky Housing Corporation be broadened through amendments to the state enabling legislation. Basic to any amendments should be the corporation's policy of only assisting low- and moderate-income families. The corporation should provide assistance to households that have incomes above guideline limitations but cannot obtain long-term mortgage money in inner city areas.

Although it seems likely that the federal government will enact disclosures legislation, the State of Kentucky could increase its creditability with regard to its housing commitment by enacting a state disclosure law. However, other than the fact that such action would reinforce the state's position on housing, the disclosure bill will probably have little effect on the orientation of the secondary market operation or the lending practices in Kentucky.

IV. LOCAL HOUSING ASSISTANCE

Historically, local governments have had difficulty influencing national housing legislation and the administrative policies that implement this legislation.[1] The direction of housing programs have not been conducive to investment of long-term mortgage money in inner city areas. After considerable analysis of the problem with making long-term mortgage money available to inner city areas, it is the study's recommendation that long-term money can best be provided at the local level.

The following circumstances exist with regard to utilization of the standard existing housing stock:

> (1) Commercial banks and mortgage companies dispose of a large percentage of their mortgages in the secondary market. Their ability to warehouse mortgages is minimal.[2]

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[1]Harold Wolman, Politics of Federal Housing (New York: Dodd, Mead and Company, 1971), pp. 50-71.

[2]Interview with a Jackson, Tennessee, mortgage banker, July, 1973.

(2) Savings and loans have the ability to retain a large percentage of their mortgages within their own portfolio, but are reluctant to do so in areas undergoing socioeconomic change. Savings and loan personnel who were interviewed indicated that in the future they may become more active in the secondary market rather than loan originators.[3]

(3) Investors in the secondary market are oriented primarily toward new housing mortgages or existing housing stock which meet rigid FHA or VA minimum property standards.[4]

(4) The term to maturity of mortgage loans lengthens as one moves outward from the city core, but the interest rate remains constant.

(5) Past studies of mortgage performance indicate that the term to maturity of a loan has no significant relationship with the performance of the mortgage.[5]

(6) Much of the existing housing stock, while structurally sound, does not meet FHA and VA minimum property standards because of room location and technical obsolescence (needed improvements in heating, electrical systems, and plumbing). This situation was discovered in Butchertown as a result of attempts to obtain FHA and VA guaranteed loans.

To assist the utilization of existing housing at the local level an investment strategy has been developed to use the revenue bonding power of local government to develop a trust fund for the purchasing of mortgages from local lenders. This strategy appears to be the more

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[3]Interview with Evansville Savings and Loan Company, September, 1974.

[4]There is some evidence that in Butchertown as well as other inner city areas, part of the difficulty in locating a buyer in the secondary market is the influence that FNMA and GNMA exert on the market orienting investors toward new housing stock and minimum property standards according to interviews with local lenders.

[5]John P. Herzog and James S. Earley, Home Mortgage Delinquency and Foreclosure, National Bureau of Economic Research (New York: Columbia University Press, 1970), p. 37.

successful because of its ability to leverage large amounts of capital and provide a profit for the municipality. Other programs, such as Community Development Funds, were unable to provide the dollar impact and the funds were needed for other community services.

Any decision to develop an investment strategy through the utilization of municipal bonds requires knowledge of investors that purchase bonds, as well as the bond terms. The primary attraction to municipal bonds has been their tax exempt status. This attraction may be facing some obstacles as a result of a recent policy directive from the United States Office of Management and Budget.[6] It does not, however, seem necessary that public authorities need to use their bonding authority to purchase publicly insured mortgages. Provided the mortgages are insured through FHA and VA, the mortgages are going to sell anyway. Therefore, the impact of the A-70 Circular may not be as drastic as suggested. The local public authority should purchase conventional mortgages which are not presently being placed in the secondary market.

Local units of government compete in the capital market against other security offers. Thus, the terms of the local government bond need to be broadly competitive with other security offers. In addition

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[6]The proposal is entitled Circular A-70. This would prohibit "direct or indirect federal guarantees of tax exempt securities issued by state and local governments. The bar on indirect guarantees means that a state agency could not use the proceeds of a tax exempt bond issue to buy federally guaranteed securities, such as mortgages, income from which would be used to pay off the bonds," Barry G. Jacobs, "U. S. Proposal May Hurt State Housing Agency," Louisville Courier Journal, March 10, 1974.

to the possible tax incentive, "a comparison of secondary market yields of twenty year general obligation and revenue bonds sold for 95 qualifying cities showed that for 41 cities, revenue bonds sold at better yields."[7]

A further attraction of revenue bonds is the dependency on income generating projects. This provides a means by which the public sector can guide social capital projects without resorting to the taxation power of local government.[8]

As a general rule, revenue bonds sell at a higher interest rate than general obligation bonds. The result of this situation is that the cost of financing capital projects through the sale of revenue bonds is usually higher than general obligation bonds. Therefore, revenue bonds produce a better yield, making the bonds more attractive to a broader sphere of investors. Of particular importance are the rate stipulations, the order of application of revenue, and the safeguards against competing projects. Before an acceptable program for the purchase of mortgages in the secondary market can be developed, the above considerations must be explored.

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[7]W. H. Tyler, State and Local Finance, "Revenue Bond Financing: Advantages and Disadvantages," Vol. 32, No. 1, August, 1959, p. 76. Reprinted from Manuel Gottlieb, Municipal Finance, "The Revenue Bond and Public Debt," ed. William E. Mitchel and Ingo Walter.

[8]It should be emphasized that the originating institution obtains a mortgage which is sold to the secondary market. This mortgage is protected by the value of the real estate on which the money has been loaned.

Revenue bonds have been a successful tool for financing capital expansions within the public utility sector of the community. This success can largely be attributed to the accuracy with which the utility sector predicted its revenue. Attempts to use revenue bonds issued by local government for the purchasing of mortgages in the secondary market would be difficult initially, as a result of the novelty of the income expectability of these bonds.

When this concept was originally discussed with commercial banks and savings and loan executives, the most common question was "Who would buy the bond issues?" To identify the prospective purchaser of these types of issues, a discussion of the complete operational strategy is necessary.

First, a community could utilize an Econometric model to identify those neighborhoods eligible for mortgage assistance. After the neighborhoods have been identified, the local government could implement land use and housing code enforcement controls to provide additional security for the mortgages it would purchase from the area. The next step in the program would be to prepare the revenue bond statements for placing the bonds on the market. To insure the sale of the issues at an acceptable rate, the local government could pledge funds from the general budget, the revenue sharing budget, or the community development budget to an escrow account would guarantee bonds until an adequate income flow is established with the mortgages. After an adequate income flow is established, the escrow account could be closed and the funds placed back into the general budget. It seems conceivable, provided the bonds are

collateralized, for local commercial banks, nonprofit organizations, and other institutions such as labor unions to purchase the bonds. There has been a recent history of nonprofit organizations and labor unions building low-income housing and housing for the elderly. As a result of these institutions having an inadequate full-time management structure, many of these projects have met with initial failure. Through the purchase of local revenue bond issues, such as the one just described, these organizations could perform a valuable community service, as well as make adequate investments for their clientele.

If the local government sold a million dollars worth of bonds, local lenders would be notified that the local public sector is willing to purchase a million dollars worth of residential mortgages with a twenty-year term to maturity at the market interest rate within the defined neighborhoods. An additional advantage to the community would be the economic benefit provided by maintaining the mortgages locally within the secondary market. The less attractive alternative would be to sell the mortgages to investors outside the community, thereby preventing the possibility of multiplier effect on the mortgage investment.

The local lending institutions would have the responsibility for qualifying the borrower and servicing the mortgages. This process would not be any different than the present method of local lenders qualifying the borrower and servicing the mortgage. It should be recognized that this program is basically a method of providing long-term mortgage money to the otherwise qualified borrowers in locations that have less than market desirability for long-term money.

The most difficult section of this program is the coordination required to develop the bond structure in order for the maturity of the bonds to be in sequence with the maturity of the mortgage. It would seem difficult to obtain a term to maturity on revenue bonds for more than ten years. At the same time, the purpose of the local government participating in the secondary mortgage market is to provide mortgages with a long term to maturity. Initially, the sequence between the maturity of the bonds and the later maturity of the mortgage is the key to a successful operation in the secondary market by local government.

Hypothetically, a loan originated by a local lender would be used by "John Doe" to purchase a $25,000 house. The terms to the loan would be five points, a twenty-year term to maturity, an annual interest of 10 percent. The loan would be serviced by the local lender by 1/2 percent and sold in the secondary market. The terms of the mortgage in the secondary market would be twenty years term to maturity, four points, and a 9 1/2 percent annual interest rate. The difference of one point between the origination of the mortgage and the secondary market would amount to $250 profit for the local lender who originated the mortgage.

For the purpose of discussion, terms have been set for the bonds and for the mortgages. These terms will fluctuate depending upon market conditions and profit expectations of the investors. If ten-year revenue bonds were sold by the local government at an annual interest rate of 6 percent, the annual interest payment from the interest on a $25,000 revenue from the bond sale to purchase a mortgage in the secondary market at an annual interest rate of 9 1/2 percent, four points,

and twenty years for the maturity of the loan. The income to local government from the mortgage follows a direct reduction loan schedule. (See Cash Flow Analysis, Table I.) The direct reduction loan schedule provides local government with the advantage of receiving most of the interest payment on the "front end" of the loan maturity. For example, the total accumulative annual interest payment is $2,356.14 during the first year. However, at the end of the tenth year, the payment is $1,140.29. As a result of this scheduling, the local unit of government should utilize short-term notes as a secure investment to build a sufficient trust fund account to pay the full bond premium at the end of the ten-year period.[9]

This strategy provides two important concepts for inner city economic development. The first concept is the unavailability of long-term mortgage money within the inner city for qualified buyers who might otherwise have chosen to live outside the inner city. Second, the fact that an individual home buyer's payment on his mortgage within the inner city is being retained in the community by the local unit of government provides a multiplier effect on the money. The profits made from participating in the secondary market could be utilized to provide needed capital improvements in the inner city area. This utilization of profits could only be realized after the initial debt structure was

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[9]The terms described above are intended to be used as an example. Various schemes could be utilized by the public sector in participating in the secondary market, but these methods would be dependent upon local market conditions, expectations of local units of government, and participation agreements with local lenders.

TABLE I

CASH FLOW ANALYSIS

Year		Bond Revenue	Bond Payment	Buy Mortgage	Interest Collection	Principal Collection	Service Charge	Total $'s Taken In	Total $'s Taken Out	Yearly Over or Under	Accumulated $'s
1	Bond is sold and mortgage	25,00000	1,50000	24,00000	2,35614	440.34	124.01	27,79648	25,62401	2,17247	+ 2,17247
2	is bought the first year.	-0-	1,50000	-0-	2,31245	484.03	121.71	2,79648	1,62171	1,17477	+ 3,34724
3		-0-	1,50000	-0-	2,26441	532.07	119.18	2,79648	1,61918	1,17730	+ 4,52454
4		-0-	1,50000	-0-	2,21162	584.86	116.40	2,79648	1,61640	1,18008	+ 5,70767
5		-0-	1,50000	-0-	2,15356	649.92	113.35	2,79648	1,61335	1,18313	+ 6,89080
6		-0-	1,50000	-0-	2,08977	706.71	109.99	2,79648	1,60999	1,18649	+ 8,07729
7		-0-	1,50000	-0-	2,01963	776.85	106.30	2,79648	1,60630	1,19018	+ 9,26747
8		-0-	1,50000	-0-	1,94251	853.97	102.24	2,79648	1,60224	1,19424	+10,46617
9	Bond principle is due	-0-	1,50000	-0-	1,85776	938.72	97.78	2,79648	1,59778	1,19870	+11,66487
10	year ten.	-0-	26,50000	-0-	1,76460	1031.88	92.87	2,79648	26,59287	-23,79640	-12,13153*
11		-0-	-0-	-0-	1,66218	1134.30	87.48	2,79648	87.48	2,70900	- 9,42253*
12		-0-	-0-	-0-	1,54960	1246.88	81.56	2,79648	81.56	2,71492	- 6,70761*
13		-0-	-0-	-0-	1,42584	1370.64	75.04	2,79648	75.04	2,12144	- 3,98617*
14		-0-	-0-	-0-	1,28984	1506.64	67.89	2,79648	67.89	2,72859	- 1,25758*
15		-0-	-0-	-0-	1,14029	1656.19	60.02	2,79648	60.02	2,73646	+ 1,47888
16		-0-	-0-	-0-	97591	1820.57	51.36	2,79648	51.36	2,74512	+ 4,22400
17		-0-	-0-	-0-	79524	2001.24	41.85	2,79648	41.85	2,75463	+ 6,97863
18		-0-	-0-	-0-	59661	2199.87	31.40	2,79648	31.40	2,76508	+ 9,74371
19		-0-	-0-	-0-	37828	2418.20	19.91	2,79648	19.91	2,77657	+12,52028
20		-0-	-0-	-0-	13829	2653.12	7.28	2,79648	7.28	2,78920	+15,30948

*This deficit appears at this time due to the principal on the bonds being paid. A deficit may be avoided, however, by investing the surplus money in the first nine years for short terms (30 days, 60 days, 90 days).

Prepared by Ann Schmidt, Evansville-Vanderburgh County Plan Commission, January 31, 1975.

coordinated. At the present time, local market conditions, expectations of local public officials, and participation agreements with local lending institutions indicate that the concept is feasible and profitable.

V. CONCLUSION

There are many other programs that have been initiated by local governments to provide alternatives to more familiar housing delivery mechanisms. The success of these programs depends upon many variables. However, in most cases confidence was reestablished in neighborhoods that had been failing before the programs were initiated. It has not been within the scope of this study to debate the merits or deficiencies of any of these complementary programs. All of these programs have had some affect on how people perceive the neighborhood.[10] This importance can best be demonstrated by a statement made by Mr. Rouse, President of the Rouse Company, in testimony before the National Commission on Urban Problems.

> We are living in this country with a notion that the city is a frightful burden, and that we face a horrible problem of trying to make it work. What we really ought to face in the city is the opportunity for a massive investment. If we could only understand the arithmetic, we would be in a hurry to accomplish this in order to get the city over a great many of its economic humps and make it a fit place to live in. Now, this really isn't just a sloppy-headed notion. There was a time when Nat Keith and I had a job of preparing a workable program for the District of Columbia. This was in the early

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[10] Statement by Anthony Downs during the Local Urban Renewal and Neighborhood Preservation Conference conducted in Chicago on June 18-19, 1975.

years of urban renewal program. The report was called No Slums in Ten Years deliberately because it was the only way we know to attract attention to the fact that slums could be eliminated, that the arithmetic would work. There was absolutely no excuse in 1955 for the city of Washington to have a slum or a blighted area by 1965. It was statistically possible to move the people. It was a more economically prudent thing to do it than not to do it. And it is still true in 1967 that it is a more prudent, economical, easier course to face making Washington a slumless city by 1977 that it is to do the timid, limited, uncertain, skeptical things we now do in temporizing with the problems of the city.[11]

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[11] Hearings before the National Commission on Urban Problems, I (Washington, D. C., January, 1968).

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APPENDIXES

APPENDIX A

HUD-FHA SINGLE-FAMILY PROGRAMS

1. Basic Home Mortgage Insurance: Section 203(b)
2. Property Improvement and Mobile Home Insurance: Title I
3. Home Mortgage Insurance for Low and Moderate Income Families: Section 221(d)(2)
4. Home Mortgage Insurance for Disaster Victims: Section 203(h)
5. Home Mortgage Insurance for Outlying Area Properties: Section 203(i)
6. Loan Insurance for Major Improvements: Section 203(k)
7. Urban Renewal Mortgage Insurance: Section 220
8. Insured Improvement Loans—Urban Renewal Areas: Section 220(h)
9. Mortgage Insurance for Servicemen: Section 222
10. Miscellaneous Housing Insurance: Section 223(e)
11. Mortgage Insurance for Experimental Housing: Section 233
12. Homeownership for Lower Income Families: Section 235
13. Home Mortgage Insurance, Special Credit Risks: Section 237
14. Purchase of Fee Simple Title from Lessors: Section 240.
15. Armed Services Housing—Civilian Employees: Section 809.
16. Armed Services Housing, Individual Sales: Section 810(h)[1]

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[1] Housing and Community Development Reporter, I (Washington, D.C.: The Bureau of National Affairs, Inc., October 6, 1975).

APPENDIX B

GLOSSARY

Amortization: The payment of a debt with interest in comparatively small amounts at regular intervals for a definite period of time, at the end of which the debt is extinguished.

Capital Market: The activities of all lenders and borrowers of equity and long-term debt funds.

Construction Loan: In private home financing, a mortgage loan to be used to pay for labor and materials a construction loan is protected by the general credit of the builder and is usually secured by the incomplete house, delivered materials, and the lot. The construction loan is usually advanced in installments to the builder as construction progresses. It may be repayable upon completion and sale of the house or it may be converted to a permanent loan at that time.

Contract Deed: A method of purchasing property whereby an individual makes payments directly to the property owner. The owner holds title to the property until the purchaser completes all the payments. Contracts of this type usually have a foreclosure provision permitting the owner to declare the contract void and the purchaser loses all money that has been paid toward the purchase of the property and he also loses his contractual right to purchase the property.

Disinvestment: The practice of savings and loan associations, commercial banks and other conventional lenders of reducing or entirely stopping their flow of credit to specific urban neighborhoods and communities. Institutional disinvestment is often called "red-lining."

80 Percent Money: When lending institutions agree to loan 80 percent of the appraised value of the security, requiring a 20 percent down payment, they are said to be making "80 percent money" available.

F.N.M.A.: "Fannie Mae," the Secondary Mortgage Market. It provides a market for mortgages held by primary lenders which permits a greater turnover in loan money.

Fee Simple Title: The most complete form of ownership; all right to the property are possessed by the owner.

Filtering Down: The theory that a unit of housing goes through a gradual decline which makes it available to successively lower income groups until it becomes uninhabitable and is replaced.

Foreclosure: Legal action to take the property ownership away from a person who has failed to make principal and interest payments or debts against the property.

Front End Costs: The initial costs of housing construction or rehabilitation activities. Includes such outlays as architectural fees, site option costs, filing fees, etc.

G.N.M.A.: "Gennie Mae," the Housing and Community Development Act of 1968 established the Government National Mortgage Association. GNMA issues various guarantees of securities that are backed by mortgage loans.

Loan to Value: The amount of a loan to the lender's appraisal of the security at the time when the loan is made.

95 Percent Money. When lending institutions agree to loan 95 percent of the appraised value of the security, requiring a 5 percent down payment, they are said to be making "95 percent money" available.

Originating Lending Institutions: A bank, credit union, savings and loan or other financial concern which directly loans money to individuals, partnerships and corporations.

Owner Built Housing: Houses which are built by the individuals, without the aid of a general contractor, which will reside in the structure upon completion.

Package: Loans of a similar type grouped together in an effort to sell them as a whole to other investors.

Permanent Financing: Most multi-family and speculative housing is constructed with funds advanced by a commercial bank on a temporary basis, secured by the credit of the builder and the value of the work done. Upon completion, these temporary funds are repaid from the proceeds of a long-term mortgage secured by the property itself when purchased. The long-term mortgage is termed permanent financing.

Points: Another term for percentage. Points are used to increase the long-term yield on loans.

Reinvestment: The practice by savings and loan associations, commercial banks and other conventional lenders of increasing the flow of credit to specific urban neighborhoods and communities.

Secondary Market: Loans are originated by financial institutions to individuals and companies in what is termed the primary market (the first phase). These loans are often sold by financial institutions to investors; this is the secondary market (the second phase).

Service Percentage: A specified percentage of an installment payment which the holder of the mortgage (which in most cases was not the originator of the loan) agrees to pay the originator for services such as collecting the installment payment.

Social Capital Projects: A term derived from economics to describe capital projects in society that provide indirect benefits toward industrial development of a political jurisdiction but cannot be directly linked with increase in productivity. Schools, libraries, parks and museums are considered social capital projects.

Subsidy: Any grant or aid furnished by a government to a private commercial enterprise, a charity organization or the like for an undertaking to which a private interest is imputed. The term includes aids to promote private operations in trade, industry, etc., as well as social services and housing production.

Term to Maturity: The length of time for which a loan agreement extends.

Terms of a Mortgage: The conditions set between the mortgagee and the mortgagor in originating a loan (i.e., term to maturity, interest rate, down payment and collateral).

Variable Interest Rate: An interest rate on a loan which increases and decreases periodically according to the changes in the money market.

Warehousing Mortgages: The practice of financial institutions of not selling mortgages, which they originated, to other investors. The originating financial institution maintains possession of the mortgage.

APPENDIX C

SURVEY OF LOCAL FINANCIAL INSTITUTIONS

IN LOUISVILLE-JEFFERSON COUNTY

1. What is the source of your firm's mortgage funds? If there are multiple sources, please indicate the approximate number of each.

a) Life insurance company(ies)	( )
b) Savings and loan institution(s)	( )
c) Commercial bank(s)	( )
d) Corporation	( )
e) Pension fund(s)	( )
f) Foundation(s)	( )
g) Commercial finance companies	( )
h) Individual(s)	( )
i) Syndicate(s)	( )
j) Federal agency(ies)	( )
k) Other (Please explain)	( )

2. What is the geographic scope of your mortgage loan operations?

a) National	( )
b) Regional	( )
c) Statewide	( )
d) Local	( )

3. To what type(s) of investment are your mortgage loans committed?

a) Housing (81-100% of total commitment)	( )
b) Mostly housing, some (20-39% of total commitment) income property	( )
c) Housing and income property (both 40-60% of total commitment)	( )
d) Mostly income property, some (20-39% of total commitment) housing	( )
e) Income property (81-100% of total commitment)	( )
f) Securities (50-75% of total commitment)	( )
g) Other (Please explain)	( )

4. Does your firm provide home improvement loans? ( )
   If yes, to what extent?

   a) Minor repairs (painting & upkeep) ( )
   b) A major technical repair (plumbing, electrical, heating or roofing) ( )
   c) Structural repairs (foundations, walls, chimneys, flashings, gutters) ( )
   d) Other (Please explain) ( )

5. What is the minimum price range of residential property which you would consider? $_____ - $_____

6. What is the price range of residential property which you prefer to consider? $_____ - $_____

7. What is the maximum age your firm will usually allow on a considered residential structure without severe variance of loan terms?
   _____ years maximum age of structure.

8. How would you generally rank the various types of lending institutions with regard to their ability to evaluate individual loan applications? Indicate great ability (G), moderate ability (M), or limited ability (L) beside each institution.

	Residential Property	Income Property
a) Life Insurance Companies	( )	( )
b) Savings and Loan Institutions	( )	( )
c) Commercial Banks	( )	( )
d) Mortgage Companies or Banks	( )	( )
e) Mortgage Brokers	( )	( )
f) Pension Funds	( )	( )
g) Foundations	( )	( )
h) Other (Please Specify)	( )	( )
_____	( )	( )
_____	( )	( )

9. What maximum loan to value ratio will you consider in today's mortgage market for residential property? _____%.

10. What minimal structural standards does your firm require for considered residential loans? _____

11. What maximum loan to value ratio will you consider for residential rehabilitation loans? _____%.

12. What minimal structural standards does your firm require for considered residential rehabilitation loans? _____%.

13. What is your firm's policy with regard to title search and insurance for residential loans?

a) Require title search and insurance	( )
b) Require title search, but no insurance	( )
c) Require title search, but insurance only sometimes	( )
d) Require neither	( )

14. What is your firm's policy with regard to nonowner-occupancy?

Residential

a) Nonowner-occupants allowed	( )
b) Nonowner-occupants not allowed	( )
c) Vary terms of loan for nonowner occupant	( )
d) Investigate nonowner-occupant as if he were the borrower	( )

15. What ratio of "effective" yearly or monthly income (total income less yearly or monthly payments on major nonmortgage debts) to yearly or monthly mortgage payments (payments on principal, interest, and insurance of mortgage) does your firm consider necessary for prospective residential borrowers? _____ : 1

16. How many years do you generally require the borrower to have spent in his current or closely related field of employment? _____ years.

17. How many serious defaults will you allow the borrower to have in the five years prior to his application to your firm?

_____defaults

_____no defaults allowed

18. Relative to the position other lenders in the city would assume, how important do you consider personal problems of the borrower to be (divorce, illness, likelihood of having to move often, etc.)

	Marital Problems	Health Problems	Likelihood to Move
a) Very Important	( )	( )	( )
b) Important	( )	( )	( )
c) Not Very Important	( )	( )	( )
d) Not Considered	( )	( )	( )

19. What is your firm's policy with regard to nonowner-occupancy?

Income Property

a) Nonowner-occupants allowed ( )
b) Nonowner-occupants not allowed ( )
c) Vary terms of loan for nonowner-occupants ( )
d) Investigate nonowner-occupants as if he were the borrower ( )

20. How important does your firm consider the educational level of the borrower to be?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

21. Do you attempt to encourage the loan seekers to comply with the comprehensive plan of Louisville-Jefferson County?

a) Always ( )
b) Almost Always ( )
c) Sometimes ( )
d) Never ( )

22. How important does your firm consider the economic level (based on approximated per capita income of occupants in adjacent residential property) of the neighborhood for which the loan is sought?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

23. Does the frequency of zoning changes in an area affect the locational preference your firm assigns to an area? Yes___ No___

If yes, how frequent:

a) 1 change a year ( )
b) 2 changes a year ( )
c) 3 changes a year ( )
d) 4 changes a year ( )

24. When giving home improvement loans of the technical (plumbing, electrical, heating) or structural (foundation, walls, chimneys and flashings) nature, what importance does your firm attribute to the adjacent land use?

a) Very Important	( )
b) Important	( )
c) Not Important	( )
d) Never Important	( )

25. When considering the locational preference your firm assigns to an area, how much importance does your firm attribute to public expenditures on social capital projects (schools, libraries, parks)?

a) Very Important	( )
b) Important	( )
c) Not Important	( )
d) Never Important	( )

26. When assigning a mortgage preference to a site, how much importance is given to recent private investment within the area of the same nature?

	Home Improvement	New Residential Construction	Business
a) Very Important	( )	( )	( )
b) Important	( )	( )	( )
c) Not Important	( )	( )	( )
d) Never Important	( )	( )	( )

27. When considering a potential mortgage site, how much importance is given to recent private investment within the area of a different nature?

	Home Improvement	New Residential Construction	Business
a) Very Important	( )	( )	( )
b) Important	( )	( )	( )
c) Not Important	( )	( )	( )
d) Never Important	( )	( )	( )

28. What consideration is given to the ethnic composition of the area under consideration?

a) Much Consideration	( )
b) Some Consideration	( )
c) Little Consideration	( )
d) No Consideration	( )

29. How much importance is given to the potential net income of the loan applicant?

a) Much Importance ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

30. When giving rehabilitation loans of the technical or structural nature, how much importance is given to the architectural style of the area?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

31. When giving rehabilitation loans of the technical or structural nature, how much importance is given to local community organizations within the area which encourage rehabilitation (i.e., nonprofit neighborhood groups)?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

32. When your firm is considering the preference of an area for a mortgage loan, how much consideration is given to ownership-turnover through sale?

a) Much Consideration ( )
b) Some Consideration ( )
c) Little Consideration ( )
d) No Consideration ( )

33. When giving rehabilitation loans of the technical or structural nature, how much importance is placed upon social problems (i.e., crime, employment, health) within the mortgage area?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

34. When giving loans for construction of residential property, how much importance is placed upon social problems within the mortgage area?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

35. When giving loans for the purchase of residential property, how much importance is placed upon social problems within the mortgage area?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

36. How much importance is given to the potential net income of the proposed mortgage property?

Residential

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

Business

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

Home Improvement

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

37. What types of collateral does your firm accept for home improvement loans of the technical or structural nature?

a)
b)
c)
d)

38. What effect does federal legislation have upon your firm's consideration of a potential mortgage site?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important

Please Explain:

39. What effect does state legislation have upon the mortgage preference your firm gives to an area?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

Please Explain:

40. What effect does local legislation have upon the mortgage preference your firm gives to an area?

a) Very Important ( )
b) Important ( )
c) Not Important ( )
d) Never Important ( )

Please Explain:

41. Who participates in your firm's evaluation of individual loan applications? (Please check appropriate space)

    a) Office Manager ( )
    b) Real Estate Appraiser ( )
    c) Lending Officer ( )
    d) Other (Please explain) ( )

42. Do you conduct market analyses or have them conducted in considering certain types of loans? Yes_____ No_____. If yes, in what instances is this done?

43. Do you in any way attempt to lead the rehabilitation process or development process within the inner city? Yes_____ No _____. If yes, please explain.

44. What other factors not mentioned in this questionnaire influence your firm's mortgage preference? Please explain.

45. On the enclosed map, please indicate those five (5) census tracts which your firm considers to have the least desirable mortgage preference. (Indicate by lettering those tracts "A" through "E.")

VITA

Kenneth D. Nelson was born in Dayton, Kentucky, on January 29, 1945. In 1961 he moved with his family to Hamilton, Ohio, and graduated from Taft High School in 1963. Mr. Nelson received a Bachelor of Arts degree in Political Science from Eastern Kentucky University, Richmond, Kentucky, in 1967. Upon completion of his undergraduate studies, he served in the United States Army for two years as a Platoon Leader in Viet Nam.

Following military service, Mr. Nelson enrolled in The University of Tennessee's Graduate School of Planning and received his degree in March, 1976. His work experience includes Project Administrator for the Bureau of Outdoor Recreation, Frankfort, Kentucky; Director of Planning for Paducah, Kentucky; and presently holds the position of Executive Director of the Area Plan Commission in Evansville, Indiana.

Mr. Nelson and his wife Eileen have one son, Kristopher.