Housing Assistance Council

BEST PRACTICES IN REVOLVING LOAN FUNDS FOR RURAL AFFORDABLE HOUSING

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EXECUTIVE SUMMARY

According to the National Community Capital Association, "best practices" in the community development lending field are the tools and strategies that best enable community development financial institutions (CDFIs) to adapt to the changing context of their work and to perform as resiliently as possible within their mission areas (Lehr 1998, v). However, what constitutes best practices for one CDFI may not necessarily work for another; as a result, it is necessary to examine carefully the impact of the social and economic context of community lending practices.

This study provides case study analyses of four different rural revolving loan funds in order to ascertain which "best practices" are the most salient in different rural contexts. The funds examined include the Kentucky Mountain Housing Development Corporation (KMHDC), Inc. in eastern Kentucky; the Federation of Appalachian Housing Enterprises (FAHE), which serves Kentucky, Virginia, West Virginia, and Tennessee; the Vermont Community Loan Fund (VCLF), serving the state of Vermont; and the Northwest Farmworker Housing (Tri-State) Loan Fund, which covers Washington state, Oregon, and Idaho.

The study first finds that different community lending structures are appropriate to different rural contexts. For example, the KMHDC loan fund – which provides permanent mortgage lending over a two-county area – is suited to a rural context where there are high poverty and unemployment, but low operating costs. Conversely, the VCLF model – which combines a housing and community facilities lending program with a business development program – would be more appropriate to a rural area where there is more robust economic growth, but greater housing affordability problems.

Second, the study outlines best practices that are common to the four case studies. In founding a loan fund, a clearly focused mission, good technical assistance, and solid initial capitalization are key. In structuring loan fund policies and procedures, successful funds start with simple, user-friendly procedures, and then diversify their lending products and practices as their funds encounter competition from other community lending groups.

In the area of risk management, all types of funds must ensure that the collateral for each loan will cover the costs of a possible default, and delinquencies should be monitored as closely and as soon as possible. Familiarity with borrowers through in-house technical assistance (for development groups) and homebuyer education and counseling (for individuals) also helps to prevent delinquencies. Finally, the longevity of a fund can be promoted through investment in information technology and staff capacity, so that the fund is able to handle increasingly complex financing deals and reporting requirements as it grows.

The benefits and drawbacks of obtaining certification and funds from the Community Development Financial Institutions (CDFI) Fund are also analyzed, with the conclusion that CDFI status has been very important to the continued growth of three of the loan funds studied. However, CDFI award recipients also caution that any organization thinking of pursuing CDFI certification should examine its own capacity very carefully to determine if it will be able to handle the CDFI Fund's substantial application and reporting requirements.

INTRODUCTION: TRENDS IN COMMUNITY DEVELOPMENT LENDING

In the past decade, many nonprofit housing developers have begun to form their own community lending institutions. These institutions are increasingly seen as a way to use federal resources more effectively and to leverage private capital that enhances organizations' financial clout. As of April 1, 2001, the Department of the Treasury, Community Development Financial Institutions Fund had certified 421 nonprofit and for-profit organizations as CDFIs.[1] There are countless other non-certified loan funds across the country. According to a CDFI Fund survey of 106 Core Component Grant awardees, from 1996 to 1998 CDFI grant recipients accomplished the following.

- Certified CDFIs were located in 35 states and had service areas covering all 50 states, with 62 percent of all CDFIs serving nonmetropolitan counties.
- They made $3.5 billion in community development loans and business equity investments.
- They financed the construction or rehabilitation of 24,885 units of housing, 94 percent of which were affordable to low-income households.
- In 1999, CDFIs provided one-on-one technical assistance to 11,110 individuals or organizations, and classroom training to 22,876 individuals.

(Fabiani and Benjamin 2001, 1-4)

A 2000 study of the characteristics of 110 CDFIs demonstrates that certified community development financial institutions are active in rural areas; however, rural CDFIs' activities differ in several ways from those of their urban counterparts (Table 1).[2]

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[1] CDFIs are community lending institutions that are certified and funded by the federal CDFI program. The National Community Capital Association (NCCA) is a membership association for certified CDFIs. However, a large number of community lending institutions are neither CDFIs nor members of NCCA.

[2] The study defines rural CDFIs as those serving primarily nonmetropolitan counties, and urban CDFIs as those serving primarily Metropolitan Statistical Areas.

Table 1. Comparative Characteristics of Primarily Rural and Urban CDFIs (2000)

	Rural	Urban
Size		
Number of CDFIs in Sample	31	59
Average Total Capital per CDFI	$8,241,226	$11,353,205
Average Years Since First Loan	13	13
Average Number FTE Employees	16.9	13.7
Average Total Expenses	$1,606,169	$1,848,903
% of CDFI's Direct Financing for:		
Microenterprise Loans/Investments	6.1%	1.5%
Business Loans/Investments	41.1%	11.4%
Community Services/Facilities Loans	13.1%	18.8%
Housing Loans	38.6%	68.3%
Consumer Loans	1.1%	0.0%
Finance Activities		
Average Loans/Investments Outstanding	$5,044,335	$7,853,984
Average Housing Loan Size	$87,803	$117,858
Average # Loans Closed in 1999	49	38
Average Interest Rate on Loans	8.4%	8.3%
Average Term of Loans (months)	78.9	70.5
Financial Performance		
Average % of Equity over Total Capital	47.9%	34.7%
Average Cost of Borrowed Funds	1.5%	2.1%
Average % of Self-Generated Operating Funds	69%	67%
Avg. % Borrowed Capital from Fed. Government	36.9%	3.4%
Average % Borrowed Capital from Banks/Thrifts	7.9%	58.5%
Average % Delinquencies over 90 Days	4.6%	4.3%

Source: Lipson 2000, 33-34.

While rural CDFIs tend to be comparable to urban CDFIs in terms of longevity and staff size, the rural CDFIs tend to do a lower total dollar volume of lending, make more loans, and have a smaller total pool of capital. These facts indicate that, in rural areas, CDFIs tend to do more work to generate a smaller amount of lending business. However, the rural percentage of equity over total capital is 13 percentage points higher than the equity percentage in urban CDFIs, and the rural 90-day delinquency rate (4.6 percent) is almost exactly equal to the urban rate (4.3 percent). Consequently, rural CDFIs are (on average) at least as financially stable as those in urban areas.

While urban CDFI lending activities lean much more toward housing, rural CDFIs tend to fund a combination of housing and business development projects, most likely reflecting the lower access to conventional business development capital in rural areas (USDA ERS 1997). This difference in access to mainstream capital is also reflected in the different sources of rural and urban CDFI lending capital. While urban CDFIs receive the vast majority of their lending capital from banks and thrifts (58.5 percent), rural CDFIs tend to get much of their lending capital from a combination of federal funds (36.9 percent) and foundations (35.4 percent).

As a result, rural CDFIs have many of the same capitalization practices that the "first wave" CDFIs of the 1970s did. In the 1970s, many of the first community development lending organizations (such as the Housing Assistance Council (HAC) and the Kentucky Highlands Investment Corporation) received capitalization either from the Office of Economic Opportunity's "Special Impact Program" or from "socially-minded individuals, churches and local institutions" (Moy and Okagaki 2001, 3-4). Many rural community lending groups have also retained the structure of "first wave" CDFIs, operating as autonomous institutions that perform all their lending functions (such as underwriting and portfolio management) in-house, rather than outsourcing these activities to other firms (Moy and Okagaki 2001, 5).

Moy and Okagaki (2001) point out that, while both rural and urban CDFIs have been slow in evolving, mainstream financial institutions have changed enormously. The small community banks that once dominated in rural areas have given way to large, urban-headquartered, multi-service financial institutions that are highly specialized and technologically proficient. The type of products that are offered by for-profit lending institutions has also changed, with many banks and other institutions offering subprime lending products to consumers with either poor credit histories or no credit histories. Thirty years ago, these same consumers would have been shunned by most financial institutions; now they are often "reverse redlined" by lending institutions that offer easy credit on onerous (and sometimes predatory) terms (Stein 2001). As a result, while first generation community lending institutions dealt with the absence of capital in rural areas, present-day CDFIs now have to deal with competition from subprime lenders.

Finally, Moy and Okagaki (2001) have observed that the missions of most CDFIs tend to lead them toward lending activities that are inherently risky, with lower transaction efficiencies.

> The primary CDFI niches tend to be: 1) products with high transaction costs; 2) customers who require a lot of handholding; and 3) capital needs which are relatively far out on the risk spectrum. These niches drive up CDFI expenses at a time when

CDFI's funders expect them to be financially self-sufficient. (Moy and Okagaki 2001, 10)

The dilemmas of self-sufficiency tend to be more pronounced in poor rural areas, where a large portion of clients are "unbanked" and have low educational attainment, and where community development lenders have long distances to travel to oversee the housing development projects that they are financing.

These considerations ultimately mean that "best practices" for rural community lending institutions will have to take into account the challenges of working in a rural environment. These challenges include the absence of physical infrastructure, large distances between lenders and borrowers, higher costs for personalized, in-house lending services, and lack of access to conventional capitalization sources.

One type of lending structure, the revolving loan fund, has proven popular with rural nonprofit housing providers and regional intermediaries. For this report, HAC staff researched lending programs that recycle federal housing dollars (and other sources of capital) through revolving loan funds – both CDFI-certified and non-CDFI funds. In addition to examining organizational and administrative models, HAC conducted an analysis of the benefits and challenges associated with utilizing federal funds for revolving loans.

Methodology

The research for this report was conducted during federal fiscal year 2001. Using data from the NCCA's annual survey of its 50 member organizations and the recommendation of industry experts, HAC staff selected four rural-serving organizations with revolving loan funds as case studies. Case studies were selected on the basis of performance history and diversity in organization size, target population served, and geographic service area.

HAC staff collected loan fund data on:

- mission and strategy,
- market and programs,
- human resources, and
- finances and management information.

Case study research was conducted through a combination of staff surveys (one per organization) and follow-up interviews with loan fund staff members, borrowers, and other stakeholders. Survey and interview questions were based on the community development financial institution (CDFI) performance principles identified by NCCA (Lehr 1998; Gillette 1994), and included the following questions. For the complete survey instrument, see Appendix A.

- What is the history of the loan fund? How was it originally capitalized? Why was it started? What is the composition of its board of directors and how has that changed?

- What is the structure of the staff and the scope of its current activities? What kinds of loan products does it offer and how have those changed?
- What social and financial performance indicators does the loan fund track over time? What have been the social and financial impacts of the loan fund?
- What are the characteristics of the loan fund's borrowers? Does the loan fund provide education and counseling for borrowers? How often and under what circumstances?
- What is the percentage of loss reserves (capital set aside to cover potential losses on loans) over loan principal outstanding? What is the percentage of delinquent payments and defaults over loan principal outstanding? How diversified is the loan fund's portfolio (i.e., does it have different types of loans with different levels of risk so that the lower risk loans compensate for the higher risk loans)?
- What is the annual growth in fund capitalization? What are the average number of investors and average investment size each year? What are the average rates and terms of investments?
- What percentage of the loan fund's operating budget is self-generated (i.e., funds from fee-for-service income, prior fiscal surpluses, etc., that are not dependent on outside sources)? What is the percentage of equity over total loan capital?

The follow-up interviews focused on the reasons behind each organization's successes and/or challenges and whether these challenges were specific to a particular organizational model, to working within a rural area, or to serving populations with special housing needs. This report concludes with a final section that synthesizes the "best practices" from each case study site.

Case Study Sites

Racially and geographically diverse case studies were difficult to find because there are very few long-lived revolving loan funds in rural areas that specifically fund housing (most specialize in micro-business lending), and most of those funds are concentrated in the Northeast and Central Appalachia. However, the four case studies below provide a picture of the relative strengths and weaknesses of four different loan fund models within a rural context.

The Kentucky Mountain Housing Development Corporation (KMHDC)
Service Area: Clay and Jackson Counties, Southeastern Kentucky

Kentucky Mountain Housing Development Corporation (KMHDC) celebrated the twentieth anniversary of its New Home Loan Fund shortly before HAC conducted this research. The loan fund, which is not CDFI-certified, was first capitalized through contributions from churches and individuals and later by funds from the Appalachian Regional Commission, the U.S. Department of Housing and Urban Development (HUD), and the Kentucky Housing Corporation (the state housing finance agency). Before the New Home fund was established, many of KMHDC's clients with extremely low incomes were unable to qualify for Section 502 mortgage loans from the Rural Housing Service/Rural Development, part of the U.S. Department of Agriculture (USDA).

As of 2001, the loan fund lent over $1 million per year and had 367 active loans in its portfolio. In its 20 plus years of activity, the New Home Loan Fund – in addition to the Home Repair Fund – had financed the construction or rehabilitation of almost 1,000 homes for very low-income families with an average income below $10,000 per year. The average monthly payment for a new home financed through the loan fund is $120.

Although mortgages are written at conventional interest rates, the effective interest rates to borrowers are between 1 and 7 percent using an "interest credit contract." Under the contract, the monthly payments that borrowers make are calculated to be affordable on a sliding scale. The remainder of the monthly payment that would have been made at an 8 percent interest rate is then "credited" to the borrower, under the condition that it will begin to be repaid upon resale of the house.[3] Fundraising by KMHDC provides subsidies that reduce the cost of home loans by an average of $13,000 per house. KMHDC also services all its loans and provides counseling to new homebuyers.

The Kentucky Mountain New Home Loan Fund is an example of a small, yet high-impact lending program that has had tremendous staying power. It is also an interesting comparison case to the Federation of Appalachian Housing Enterprises (FAHE, below), which is a regional loan fund with CDFI certification and an affiliation with the NCCA. While both nonprofits offer similar permanent financing products, it is instructive to examine the comparative advantages and disadvantages of operating a large, regional fund versus a smaller, local fund.

Federation of Appalachian Housing Enterprises (FAHE) Revolving Loan Funds
Service Area: Kentucky, Virginia, West Virginia, and Tennessee

The original FAHE revolving loan fund was a construction loan fund capitalized in 1981 to provide predevelopment, bridge, and construction loans to FAHE member groups. As of 2001, the construction loan fund was capitalized at $5.7 million and had lent a cumulative total of $13.5 million for 235 construction loans. During the 1980s, FAHE also created a regional home loan fund that was eventually split into four state-based loan funds, available to borrowers in Kentucky, Virginia, West Virginia, and Tennessee. The four funds together are capitalized at approximately $17 million.

From 1985 to 1998, the FAHE home loan fund originated, held, and serviced 459 home purchase or rehabilitation loans to individual families at 80 percent of median income and below, focusing on those with incomes below 60 percent of median. FAHE home loan payments are usually calculated to result in the borrower paying 20 percent of his/her income for principal, interest, taxes, and insurance. In 1998, monthly payments for Kentucky home loans were as low as $151. Borrowers must also provide the land on which their homes will be built or a $300 downpayment, and must be able to pay some of the closing costs.

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[3] Under certain conditions, all or part of the interest credit may be forgiven. The KMHDC New Home Loan Fund is also able to write down the principal on its loans using its own capital, rather than relying on Section 502 loan subsidies. This capacity is extremely rare in small, local loan funds.

The FAHE revolving loan funds are very well known to rural housing developers, particularly those familiar with the difficulties of development in Central Appalachia, where both poverty and rocky, mountainous terrain make homebuilding very expensive and financially risky. Their reputation is such that rural housing developers working as far away as the colonias on the Texas-Mexico border have expressed interest in using the FAHE loan funds as a model for revolving loans.

The Vermont Community Loan Fund
Service Area: Vermont

The Vermont Community Loan Fund (VCLF) is a statewide community development financial institution (CDFI) incorporated in 1987. It was one of the first lending organizations to be certified as a CDFI, as well as one of the founding members of the National Community Capital Association. The loan fund recently became the first CDFI to be approved by USDA Rural Development to make guaranteed loans for community facilities throughout the state and, as of 2001, was capitalized at $8.1 million.

Since 1987, VCLF has lent over $14 million to hundreds of community-based organizations and small businesses around the state. A portion of these loans are made to nonprofit housing developers to construct perpetually affordable housing for Vermonters earning 80 percent or less of area median income. Loans may be used for bridge financing, real estate acquisition, or property rehabilitation. Borrowers are eligible for pre- and post-loan technical assistance with credit counseling, information and referrals, business plan development, and proactive problem resolution. Since its inception, VCLF has financed approximately 1,500 units of housing.

VCLF's financial management practices have contributed to its reputation for stability. The loan fund has $2.3 million in equity, which represents 29 percent of the fund's total assets. The equity provides a safeguard against any losses in invested capital. This equity level is extremely high, compared to the average equity in commercial banks (4 percent) or even credit unions (10 percent). Consequently, VCLF illustrates the best practices of a mature, stable loan fund serving a rural state.

The Northwest Farmworker Housing (Tri-State) Loan Fund
Service Area: Oregon, Washington State, and Idaho

The Tri-State Fund was created in 1991 by three Northwest nonprofit organizations in order to further the development of decent, safe, and affordable housing for very low-income migrant farmworkers and their families. The Community and Shelter Assistance Corporation (CASA) of Oregon, the Idaho Migrant Council (IMC), and the Office of Rural and Farmworker Housing

(ORFH) in Washington state cooperatively underwrote all the loans, and the Northwest Regional Facilitators (NRF) served as fiscal agent for the fund.[4]

The fund was originally capitalized by a single $500,000 grant from the Northwest Area Foundation, approximately $406,000 of which is loaned out. By 1998, the Tri-State Fund had financed over 800 housing units for approximately 4,400 very low-income farmworkers (including spouses and dependents) in Washington state, Oregon, and Idaho. Tri-State funds cover predevelopment expenses such as payments on options to purchase property, land-use permit applications, and architectural/engineering costs. Because Tri-State funds are interest-free, they have enabled many housing developments to withstand predevelopment delays and adapt quickly to changing financing requirements without losing viability. These funds have also served as leverage for other financing applications.

Because its beneficiaries are migrant farmworkers, the Tri-State Fund serves to illustrate the lending practices necessary to deal with development obstacles such as delays due to "Not In My Back Yard" opposition (NIMBYism) and the reduction of federal construction financing sources. It also demonstrates the enormous impact that a loan fund with neither CDFI certification nor NCCA affiliation can have.

[4] CASA of Oregon has since withdrawn from the Tri-State Fund, using its share of the fund as a match for a CDFI grant award. In fact, CASA's experience with the Tri-State Fund was a major factor in its designation as a CDFI in 2000.

CASE STUDY 1: KENTUCKY MOUNTAIN HOUSING DEVELOPMENT CORPORATION

Background

In 1999, the Central Appalachian region contained the highest number of Appalachian Regional Commission (ARC)-designated distressed counties, where the 1990 poverty rate (27 percent) was more than twice the national average (13 percent), the 1995 per capita income ($14,417) was less than 62 percent of the national average ($23,196), and the aggregate 1996 unemployment rate (10.4 percent) was nearly double the national rate (5.4 percent).[5] In Eastern Kentucky, on the eastern edge of Central Appalachia, residents have withstood decades of poverty and underdevelopment through a unique culture that emphasizes family ties, individual resiliency, and church involvement (HAC 1999).

In the heart of this region are Clay and Jackson counties, which comprise the service area of the Kentucky Mountain Housing Development Corporation, Inc. (KMHDC). As of 2000, an estimated 57 percent of renters in Clay County and 61 percent of renters in Jackson County were unable to afford a two-bedroom apartment at the U.S. Department of Housing and Urban Development (HUD)-determined fair market rent (NLIHC 2000). In 1990, 15.6 percent of the housing units in Clay County and 14.8 percent of the units in Jackson County were substandard (HAC 1994). Data from the 1990 Census paint a picture of two counties with extremely low median incomes, high poverty rates, and many social challenges (Table 2).

Table 2. Comparative Demographic Data:
Clay and Jackson Counties (1990)

County	Median Househol d Income	% Persons Below Poverty	% Persons on SSI or other Public Assistance	% Persons Age 16-64 with a Disability	% Persons Age 25+ with High School Degree
Clay	$12,732	36%	55%	18%	39%
Jackson	$11,885	35%	54%	14%	38%

Source: U.S. Census Bureau, State and County Quick Facts, www.census.gov.

Until the late 1980s, the primary industries for the two counties were coal processing (Clay County) and tobacco farming (Jackson County). However, nearly all of the coal tipples (processing plants) in Clay County had closed down as of 2001. While an electronics manufacturing plant in Jackson County provides opportunities for high-achieving students and area residents, one KMHDC employee (a life-long resident) related that many young people

[5] Distressed counties are defined as those with any two of the following indicators: unemployment and poverty rates at 150 percent of the respective U.S. rates; per capita incomes under 67 percent of the U.S. per capita income; or poverty rates at 200 percent of the U.S. poverty rate.

drop out of high school early and "draw" (collect social security or other public income support).

Consequently, developers of low-income, affordable housing in these two counties not only must contend with a housing stock that is far more substandard than the national average, but they must also be able to make that housing affordable to residents whose incomes are far lower than average. Much of the housing of choice in this area consists of mobile homes. Analysis of 1990 Census data indicates that 63 percent of owner-occupied mobile homes and 72 percent of renter-occupied mobile homes in Eastern Kentucky were constructed before HUD's 1976 quality control regulations went into effect (George 2000, 4).

In 1973, KMHDC was started as an outgrowth of local and national church ministries. The organization's original goal was simple: to improve the housing situation of Clay and Jackson county residents in any way possible. The executive director commented, "You have to start somewhere and get a track record. . . . The very first house KMHDC built was a 'stack sack' house. You take burlap bags filled with sand and concrete, then you wet them down. . . . That house is still standing today." From 1973 to 1980, KMHDC built and renovated 224 units of housing in Clay County. In the early 1980s, the group's efforts grew into a pilot program – conducted along with other Kentucky nonprofits – to design and build a basic "warm and dry" house for area residents that would provide decent shelter while eschewing amenities required by the USDA Farmers Home Administration (FmHA) lending program to make the houses marketable in the long term.[6]

Fund Evolution, Challenges, and Changes

At the same time that the pilot of the "warm and dry" houses was being conducted, KMHDC staff found that many of the families who were applying for FmHA loans were unable to qualify because the loans generally were not accessible to families with incomes under $10,000 per year. Consequently, in 1980, the executive director of KMHDC began to raise funds for a local revolving loan fund for permanent mortgage lending that would be geared toward families who were unable to qualify for Farmers Home loans. A considerable amount of the original capital came from the United Methodist Red Bird Mission and the Church of the Brethren (Table 3). Funding from the Kentucky Housing Corporation (the state housing finance entity) came after the loan fund's second year of operation. According to KMHDC's executive director, "Kentucky Housing made several low-interest loans to us that have made a huge difference for the fund."

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[6] The housing programs formerly administered by the USDA Farmers Home Administration (FmHA) are now run by the USDA Rural Housing Service (RHS) and USDA Rural Development. The names are used interchangeably in this report, depending on historical context.

Table 3. Original Sources of Capital (1980 to 1986): KMHDC

Source	Amount	Grant or Loan
Churches and Individuals	$221,820	Both
HHS Office of Community Services	$120,000	Grant
Appalachian Regional Commission	$62,500	Grant
Kentucky Housing Corporation	$295,500	Both
HUD Community Development Block Grant	$233,750	Grant
Foundations	$20,000	Grants

Source: Study survey.

For many potential investors, the thought of a small, local nonprofit administering a permanent mortgage loan fund in an extremely poor county seemed infeasible. During HAC's research, KMHDC's executive director commented, "If we had listened to all the naysayers, we never would have started down that road." The former executive director, who presided over the initial capitalization of the fund, elaborated: "Developing a loan fund is a big, long-term commitment. When you're writing mortgages for 30 years, you have to be fiscally responsible in order to be there for 30 years."

The capital raised for the loan fund financed two different programs, the New Home Loan program and the Home Repair program. Table 4 shows the initial distribution of funds within the two programs.

Table 4. Distribution of Funds (1980 to 1981): KMHDC

New Home Loan program		Home Repair program	
Source	**Percentage**	**Source**	**Percentage**
Community Services Admin.	5%	Community Services Admin.	5%
FmHA	64%	FmHA (grant/loan)	42%
ARC (Site Development)	8%	ARC	5%
FmHA (Section 525)	5%	FmHA (Section 525)	7%
Dept. of Labor Trainees	18%	Dept. of Labor Trainees	24%
		Churches/Individuals	16%
		Dept. of Education	1%

Source: KMHDC archival documents.

When the loan fund was set up, most of the original technical assistance came from the local bankers who served on the board of directors. The staff also took the idea of the "interest write-down" contract from the FmHA – while the nominal interest rate charged for an FmHA mortgage loan was 3 percent, the actual interest rate would be computed so that it was affordable to the loan applicant at 20 percent of his or her gross income (as low as 1 percent). The mortgage was written at 3 percent interest, but the remaining interest was "credited" to the borrower until resale of the home. The "interest credit contract" was written on a sliding scale, according to the borrower's income (see Appendix B). KMHDC has continued to work with the state USDA Rural Development office and also received ongoing technical assistance from the Kentucky Housing Corporation.

The fund was structured as a local fund because the size and the ease of access was very important to area clients.

> Our clients have immediate access to us. We can be more responsive. Being localized, we are having a major impact on these communities, and they really need it. A regional fund has a more spread out impact. . . . The close relationship we have with our borrowers [fits] the culture where we're located – like the fact that families often come in here and make their house payments in cash. We're involved with them very closely. (Interview, executive director, KMHDC)

The ability of KMHDC to keep construction funds flowing to projects has also made its local structure an advantage. The KMHDC loan officer observed, "Having that local access, we know the money's going to be there. We don't have to wait six months to get approval for closing and have our construction crews held up."

Establishing a track record was initially a slow process. After two years of fundraising, the KMHDC loan fund finished its first house, financed by churches and individuals, on March 19, 1982. The following year, the organization built two houses, gradually increasing its production until, by 1992, 134 new homes had been built and 105 had been repaired.

In 1992, HUD initiated the HOME Investment Partnership Program (HOME), which was eventually "a huge coup for us," according the executive director. KMHDC applied for and received status as a community housing development organization (CHDO), which made it eligible to compete for the 15 percent CHDO setaside portion of federal HOME funds in 1993. Because Kentucky requires a local match of 5 percent of the HOME funds awarded, KMHDC's loan fund made it a strong applicant. As a HOME-funded mortgage is paid off by the borrower, the monthly payments (known as the "CHDO proceeds") can be used to further capitalize an organization's loan fund, as long as the money is used for low-income housing. In addition, CHDOs that receive HOME awards qualify for operating funds (HAC 1998). After the HOME award, KMHDC also received a $1 million Community Development Block Grant (CDBG) in 1996 through the Clay County fiscal court. The infusion of HOME funds (through the Kentucky Housing Corporation) and CDBG funds allowed the New Home Loan program to diversify its funding sources and decrease its dependence on USDA Rural Housing Service funds.

However, the increased number of funding sources brought a new challenge – keeping up with new and different sets of reporting requirements. Because each house is heavily subsidized (on the order of $12,000 to $13,000 per house), the loan fund must put together a unique financing package from a number of different sources for which each family is able to qualify.

> Originally, we were putting one or two pots of money into a house. Now there's more money, but in smaller amounts. Nobody wants to be a major funder. I know the 1990s were supposed to be the decade of partnerships, but it's made the money really difficult to work with. (Interview, chief financial officer, KMHDC)

The increase in the number and complexity of reporting requirements also led to the hiring of a development director and a loan officer, as well as a change in the fund's recordkeeping practices, with all documents being kept centrally at the Clay County office and duplicates sent to the Jackson County office as needed.

Policies, Procedures, and Indicators

Capitalization

According to the organization's chief financial officer, the loan fund has continued to target federal and state pass-through funds such as HOME/CHDO and USDA RHS Housing Preservation Grant funds. It has also begun to make use of Federal Home Loan Bank Affordable Housing Program funds to write down loan principals, as well as Kentucky's Affordable Housing Trust Fund – which is funded by proceeds from the state lottery and administered by KHC – for principal write-downs and permanent mortgage subsidies.

Table 5. Annual Capital Growth Trends (FY 1996 to FY 2000): KMHDC

Year	$ Increase	% Increase	Average # New Investors	Average Investment Size	Average Rate	Average Term
FY 2000	$991,554	17%	39	$25,424	2%	21
FY 1999	$1,034,449	19%	42	$24,629	3%	23
FY 1998	$1,081,857	23%	45	$24,041	2%	23
FY 1997	$655,755	16%	39	$16,814	2%	21
FY 1996	$489,944	13%	38	$12,893	2%	21

Source: Study survey.

Annual capital growth fluctuated somewhat from FY 1996 to FY 2000, with the cost of funds held at approximately 2 percent (Table 5). The executive director commented that, from 1990 to 1995, the loan fund doubled in size, as projected by its board of directors. In addition to its core capital, KMHDC has been able to secure interim construction loans from the Kentucky Housing Corporation and local banks at 1 to 3 percent interest rates.

Loan Products

The first loan product offered by KMHDC was the New Home Loan product, with an interest rate of 1 to 10 percent (typically 2 percent) and a 20-year term. Shortly after the New Home Loan product came out, KMHDC began to offer Home Repair loans to rehabilitate or replace existing substandard owner-occupied homes. The average rate for these loans is now 1 percent, with terms from five to 25 years. The New Home Loan is still offered, but with interest rates from 1 to 8 percent (typically 3 percent) and terms from 20 to 30 years. In addition, as of 2001, the loan fund offers Rural Development joint financing home purchase loans that feature interest rates from 1 to 6.5 percent (averaging 2.4 percent) and terms of 33 years.

The borrowers served by the three programs tend to mirror the demographics of Clay and Jackson counties (Table 6). Although the percentage of minority borrowers may seem small, the percentage reflects Clay and Jackson counties' small nonwhite populations (6 percent and 1 percent, respectively).[7]

Table 6. Borrower Demographics (FY 2000): KMHDC

Program	Minority Borrowers		Female Borrowers		Low-Income Borrowers	
	#	%	#	%	#	%
New Home Loan	2	1%	96	45%	215	100%
R.D. Joint Financing	1	2%	19	40%	47	100%
Home Repair	2	2%	46	41%	111	100%

Source: Study survey.

KMHDC borrowers tend to be either elderly people or young adults in their early twenties. While there is a very high homeownership rate in KMHDC's service area, the Jackson County office secretary maintained that most of the applicants that she sees are mobile home residents (who may be renters or owners) prior to receiving a New Home Loan.

The two borrowers interviewed for this case study reflect these characteristics. One borrower was a young woman in her early twenties who heard about the New Home Loan program from a relative whose house was rehabilitated by KMHDC. According to the executive director, most of the applicants who come into the office hear about the loan programs through word of mouth. The young woman was able to purchase a newly

Figure 1. The young homeowner's new home, built by KMHDC.

[7] Data from Census 2000 (SF1 files), www.census.gov/Press-Release/www/2001/tables/redist_ky.html.

Figure 2. The converted tool shed where the young homeowner's aunt lives.

built home from KMHDC that is located down the road from her mother, her grandmother, and her aunt (who is also applying for a New Home Loan) (Figure 1). The aunt, who is experiencing financial distress after a divorce, is living at the back of the grandmother's home in a small shelter that was formerly a tool shed (Figure 2). The young woman said that the application process for the Home Loan was very simple, and that the loan officer went through it with her step by step. At the time that she applied, she had no prior credit record, so the New Home Loan helped her to establish a credit rating. As a result, she was recently approved for a $15,000 loan with a local bank to purchase an adjoining 60-acre parcel of land at an 8 percent interest rate over 10 years.

The second borrower family interviewed was an elderly couple with serious, chronic health problems – the husband had emphysema and the wife recently had open-heart surgery after a heart attack. Before they purchased their home, they were renting a trailer that was (according to the Jackson County office secretary) extremely dilapidated and used a coal stove for heating. When the woman was asked if she had applied for a loan from USDA/RHS, she grimaced and said, "Yuck!" "That was a lot of paperwork, wasn't it?" added the executive director, to which the woman nodded emphatically. The woman was very happy about their home purchase, saying that her and her husband's life had improved as a result. "It's a lot better. It makes you feel better when you know where your money's going. . . . There's one payment I don't mind making, and that's my mortgage payment!"

Underwriting and Portfolio Management

The underwriting process begins with the loan officer/counselor examining the application form to answer the following questions.

- Does the individual qualify for a USDA RHS loan? (If so, the applicant is referred there.)
- Is the individual's income at or below 80 percent of area median income? (If the applicant's income too high, he or she is referred elsewhere.)
- Will the individual's projected income and expenses enable him or her to make a monthly mortgage payment, plus insurance and taxes?
- What is the individual's credit history? (Credit records are obtained through Equifax, Inc.)

The underwriting process has changed only in terms of how credit history is assessed. At the beginning of the loan fund's history, applicants were simply asked to provide references of prior lenders. However, staff found that applicants would occasionally leave out references for lenders with whom they had bad debt. As a result, KMHDC began using third party credit verification through Equifax, Inc. According to the chief financial officer, the change did not

affect overall delinquency rates very much, although it did succeed in weeding out "problem" cases. Applicants receive individual homebuyer counseling from KMHDC's loan officer both during the application process and before the loan closing.

Once the application is underwritten by the loan officer, it is sent to a screening committee in the county where the applicant resides for final approval. (Clay and Jackson counties have separate screening committees whose members consist of both residents and bankers.) When the loan is closed, construction begins, and debt servicing is done through both of the county offices. Because 85 to 90 percent of its borrowers do not have bank accounts and bring their mortgage payments directly to the offices in cash, it has not been feasible for KMHDC to centralize debt servicing.

Delinquency tracking follows a four-month timeline, beginning with a letter of notification to the borrower after the first month of delinquency. After the second month, the borrower is requested to come into the office and work out a debt repayment schedule. The young woman interviewed above commented that, when her home was robbed and her mortgage payment stolen, the chief financial officer was very amenable to working out a manageable loan repayment schedule. If a repayment plan is not worked out, the staff will request a deed in lieu of foreclosure from the borrower; however, the chief financial officer commented that they are usually open to working out a repayment plan if the borrower comes into the office. After the fourth month of delinquency, the staff will accept the deed to the house or (if no deed has been offered) begin foreclosure. According to the CFO, the loan fund has only had to foreclose five or six times over the last 20 years, and in each case, the borrower simply had not attempted to contact the office or had moved out of the area entirely. There have also been cases where the homeowner died without a will and there was no clear heir to the property.

From FY 1996 to FY 2000, the delinquency and default rates have held relatively constant (Table 7). KMHDC's close relationship to its borrowers has been largely responsible for maintaining an extremely low delinquency rate (as a percentage of principal outstanding). Consequently, the group has not seen it necessary to establish a loan loss reserve, putting the capital to use in the loan pool that would otherwise be placed in reserve.

Table 7. Loan Delinquency and Default Trends (FY 1996 to FY 2000): KMHDC

Year	Loss Reserves	Delinquencies	Defaults	Principal Outstanding	% Delinquent
FY 2000	0	$4,762	0	$5,917,966	0.08%
FY 1999	0	$2,454	$20,665	$5,474,612	0.04%
FY 1998	0	$3,078	0	$4,783,021	0.06%
FY 1997	0	$2,995	0	$4,201,575	0.07%
FY 1996	0	$4,875	$36,912	$3,967,257	0.12%

Source: Study survey.

Sustainability

The majority of KMHDC's operating funds come from grants (Table 8). However, the pressure on the loan fund to move toward self-sufficiency has become more acute in recent years. Nonetheless, the fund's executive director commented that, while complete self-sufficiency is a good long-term goal, in the short term it would fundamentally damage the fund's effectiveness.

> It's not realistic to expect us to be self-sufficient, expand production, and continue to serve families with incomes as low as we do. If we were to be self-sufficient, we could do it by cutting our program in half and charging the families everything it costs us to do construction and operations – so we would end up serving [families with] much higher incomes.

The director of development added that, regarding their current clients, "We're talking about people making $6,000 a year."

Table 8. Proportion of Self-Generated Operating Funds (FY 1996 to FY 2000): KMHDC

Year	Self-Generated Funds	Grants	Investments	Other
FY 2000	17%	79%	1%	3%
FY 1999	13%	83%	1%	3%
FY 1998	10%	88%	0%	2%
FY 1997	13%	80%	0%	7%
FY 1996	11%	82%	0%	7%

Source: Study survey.

Nonetheless, the high percentage of grant capital in its loan pool has enabled KMHDC to maintain a very robust fund balance from FY 1996 to FY 2000, ranging from 82 to 86 percent of total capital (Table 9).

Table 9. Fund Balance Trends (FY 1996 to FY 2000): KMHDC

Year	Fund Equity	Total Capital	Percentage Equity
FY 2000	$7,158,245	$8,305,505	86%
FY 1999	$6,432,619	$7,549,113	85%
FY 1998	$5,238,041	$6,249,254	84%
FY 1997	$4,160,871	$5,052,443	82%
FY 1996	$3,763,135	$4,566,513	82%

Source: Study survey.

Future Challenges and Lessons Learned

The staff of KMHDC anticipate that continuing to find sufficient funds to write down mortgages to affordable levels will be a difficult task. (The loan officer commented, "We're talking about $500,000 in subsidies a year.") Further complicating the task is increased demand for the loan fund, compounded by increasing construction job costs for the organization. The development director predicted, "We'll probably be seeing an increase in the demand for services because the economy is hitting a low point and we'll probably see more elderly people applying." The CFO added, "We have 200-plus people on the Clay County waiting list right now. We can only serve about 10 to 15 percent of that number this year."

In the past, the fund has occasionally hit "tight spots," according to the executive director, particularly in the early 1990s.

> I remember times when we barely had enough money to finance the next house. There was a greater need for the loans than we were able to meet. The HOME program has really made the difference, plus the Housing Preservation Grant and Federal Home Loan Bank loans to subsidize the houses.

The organization was able to survive these tight spots by hiring a development director and putting a "major effort" into fundraising. The development director now thinks that meeting the challenge of growing demand and rising costs will require continued fundraising efforts along with seeking a different mix of funds.

When asked what advice the organization would have for local practitioners thinking about setting up a revolving loan fund, the executive director replied as follows.

> Don't take no for an answer. . . . Keep knocking on doors and be persistent. We have to credit [our first executive director] for having the insight and persistence to step out there and take a chance. When we had our 25th anniversary [celebration], our major partners were there. Some of them hadn't invested in the initial fund and wanted to leave it to other people. But later, after we got established, they came in.

In his advice, KMHDC's original executive director pointed to the necessity of networking. "The counsel we got in the beginning to establish ourselves and have a financial base was good counsel. A lot of nonprofits have a hard time surviving. We need to help them to be fiscally responsible."

As of 2001, KMHDC had built a new office in Jackson County and was thinking about expanding its service area into Owsley County which, as of the 1990 Census, had a 52 percent poverty rate. The new Jackson County office is off a main road and has handicapped-accessible ramps. The executive director commented, "This will really increase our visibility and our volume of business."

In the 20 years that the KMHDC loan fund has been in operation, it has built or rehabilitated almost 1,000 houses in Clay and Jackson counties. The loan fund has also impacted its region

by serving as the inspiration to establish a regional loan fund based in Berea, Ky. As the next section will demonstrate, the regional fund – the Federation of Appalachian Housing Enterprises – took KMHDC's lending methods and built them into a nationally recognized program that covers four states in Central Appalachia.

CASE STUDY 2: FEDERATION OF APPALACHIAN HOUSING ENTERPRISES

Background

In the late 1970s, the executive director of KMHDC and the directors of other nonprofit housing organizations in Kentucky decided that a state housing advocacy organization was needed to address issues that called for collective action and coalition building. The organization they founded – the Federation of Appalachian Housing Enterprises (FAHE) – was not originally intended to be a community development lender. According to FAHE's executive director, the Federation was structured according to a "classic cooperative model." (A cooperative is an entity that is collectively governed by its member groups, which have one vote per member on its board of directors.) From 1978 to the early 1980s, FAHE member groups addressed issues such as advocacy for low-income housing funding in the state of Kentucky, promotion of building code enforcement, and implementation of the pilot of the "warm and dry" demonstration house (see previous section, p. 11).

The former executive director of FAHE concluded, "So it was not strange [that] in 1980, when interest rates began to move up . . . the groups came to us and said that this was really increasing their costs." Whereas local banks had previously allowed FAHE member groups to carry construction charges on their books for up to 90 days without charging interest, the rise in the federal prime rate forced local lumber and supplies dealers to place member groups on a revolving charge account, charging at least 18 percent interest. Consequently, the groundwork was laid for the establishment of the first of FAHE's two revolving loan funds, the Construction Loan Fund (CLF).[8]

Fund Evolution, Challenges, and Changes

In 1980, FAHE's executive director was approached by a member of the Adrian Dominican Sisters religious order who was doing community work in Central Appalachia. She expressed interest in loaning $30,000 to capitalize a construction loan fund at a 3 percent interest rate for three years, with a balloon payment on the principal at the end of the term. The executive director thought, "We could probably do three $10,000 loans with that money, and it could revolve back in and be used again." During the first three years of the loan fund, FAHE staff began to formulate policies and procedures, mainly using their

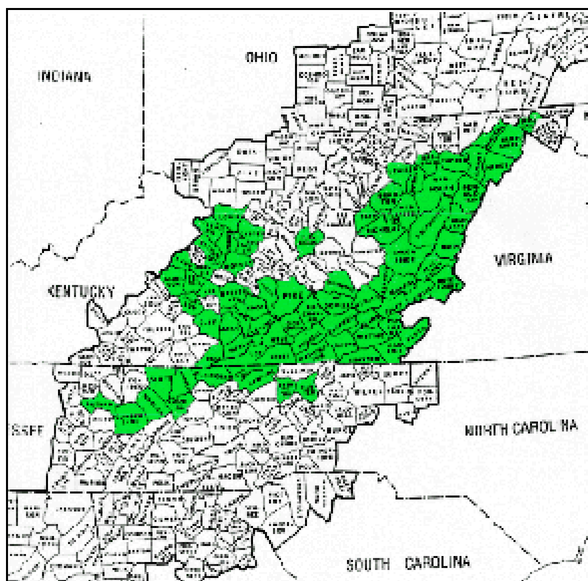

Figure 3. FAHE Service Area. Source: FAHE Web Site, http://www.fahe.org.

[8] The Construction Loan Fund has since changed its name to the FAHE Development Fund; however, since the change occurred in 2001, the original name will be used in this report.

own insights and experience as housing developers. The fund was subsequently offered a $75,000 loan from the Christian Reform Church, which was doing missionary work in Anvil, Ky.

The construction loan fund remained at approximately $100,000 for several years.

> We didn't have any equity – it was all borrowed money. We were loaning it out at 3 percent, so we didn't have any net worth. So if we lost anything, we'd have to just figure out how to take it out of our operating funds to pay it. . . . I was bound and determined not to lose the Sisters' retirement money. (Interview, former executive director of FAHE)

The challenges of keeping a sound investment fund were considerable during the early years. Two loans – both to housing factories – went bad, primarily because the factories were too capital-intensive to feasibly serve families at or below 80 percent of area median income. According to the former executive director of one of FAHE's member groups (Frontier Housing), even a bulldozer purchased with a CLF loan that defaulted "went missing down a hollow somewhere." The same individual also maintained, "There was a time in the early 1980s when Frontier and other member groups would loan FAHE money."

FAHE's second loan fund – the Home Loan Fund (HLF) – was created in 1985. Like the CLF, the Home Loan Fund arose from member groups' requests for help in dealing with federal policy changes that were affecting their ability to do development. By the mid-1980s, there had been a number of cuts in housing programs made by the Reagan administration, and it was becoming much more difficult for FAHE member groups to depend on government programs for take-out financing on their construction projects. The precedent for a regional Appalachian development group had already been set by the Commission on Religion in Appalachia and the Human Economic Appalachian Development Corporation (Figure 4). However, KMHDC's success in fundraising for its permanent mortgage loan fund and completion of several houses prompted FAHE to consider the idea of a regional permanent mortgage loan fund.

> [KMHDC] was seeing the benefits of not having to rely on the federal government for take-out financing. The need [for affordable housing] was there and the capability [to build it] was there, it was just the lack of affordable permanent financing that kept us from building houses. It limited growth and it jeopardized the status quo, because if [the construction crews] didn't have work, you could only keep them on for so long. [KMHDC] always had the goal in mind of creating a nonprofit that could also be a dependable employer. (Interview, former executive director of FAHE)

FAHE has always encouraged its member groups to have their own loan funds for the purposes of "clout and cash flow," according to the Federation's executive director. However, the formation of a regional permanent mortgage loan fund had several advantages.

> Most importantly, a regional loan fund allows the lender and the developer to be two separate entities, which is ideally how it should be. It also allows us to be more

> specialized and efficient in our lending. If I have one person who is paid to do [loan] servicing and nothing else, you know that person is going to have more time to focus on that area. [Finally], we can fundraise better because we have [more] volume. (Interview, executive director, FAHE)

Figure 4. The AppalBanc System: A Regional Community Development Genealogy

AppalBanc is the trade name under which FAHE and its two sister financial institutions – the Central Appalachian People's Federal Credit Union (CAPFCU) and the Central Appalachian Community Loan Fund (CACLF) – operate. The "great-grandmother" of AppalBanc was the Commission on Religion in Appalachia (CORA), which in turn founded the Human Economic Appalachian Development (HEAD) Corporation over 25 years ago as a regional nonprofit community and economic development corporation.

I. When FAHE was incorporated in 1978, it was done as an initiative of HEAD, to serve as a regional low-income housing advocacy group and later, as a low-income housing development loan fund.

II. In 1982, HEAD chartered CAPFCU as a regional credit union and conforming lender. CAPFCU is now a member of the Federal Home Loan Bank system as well as a HUD-approved and SBA-guaranteed lender.

III. In 1987, HEAD created the HEAD Community Loan Fund, which in 2000 was renamed the Central Appalachian Community Loan Fund. Its mission is to provide technical assistance and credit to individuals, cooperatives, and organizations starting or expanding small businesses.

IV. Because each HEAD affiliate had its own board of directors, which created unnecessary confusion, AppalBanc was created in 1995 as a single umbrella organization for the three entities to facilitate governance and marketing.

The initial capitalization of the Home Loan Fund came from a $480,000 loan from the Kentucky Housing Corporation (KHC) – the Kentucky state housing finance agency – which gave the HLF the flexibility it needed at its founding. The way in which KHC financed the loan also enabled FAHE to effectively repay it "from day one."

> At the time, you could buy a zero-coupon bond for a very small amount of money. Our initial loan from [KHC] was something like $480,000 . . . and the first draw of that loan would be [used] to purchase this zero-coupon bond (which was about $40,000). [The financing] was calculated so that, in 20 years, [the bond] would pay back the principal. (Interview, former executive director, FAHE)

After one and a half years, the director of KHC agreed to convert the loan to a grant, due to FAHE's success in building homes and reaching families with very low incomes. According to the executive director at the time, "That was a very important thing, because up until that point, we had very little equity."

Not only did FAHE's success lead KHC to convert its loan to a grant, it also attracted the attention of the Virginia state housing finance agency. Eventually, FAHE signed an agreement with the Virginia Housing Development Agency (VHDA) in 1990 for a $1.5 million, 3 percent loan, amortized over 20 years with a balloon payment at year ten. This arrangement enabled FAHE to begin permanent mortgage lending in the state of Virginia to families with incomes of approximately $12,000 per year. However, the balloon payment nearly sent FAHE into a crisis, because staff had not secured adequate take-out financing to make the sizeable repayment.

> We were making loans to families with incomes of about $12,000 per year with no internal source for take-out. The [balloon payment] came due, and we managed to transition 75 percent of the families to market-rate loans. The rest, we financed internally. That was a multimillion dollar transaction. (Interview, executive director, FAHE)

According to FAHE's former executive director, it was FAHE's good relations with local banks in the region that helped it avert the crisis.

> It occurred to me that we [were] going to have what these banks have always wanted, because these families [were] going to have at least 40 percent equity in their homes. We talked to the banks and they were more than happy to help us take out the [mortgages as the] balloon payments came due. . . . Some of the loans we had problems with, and we had to keep them in our own portfolio.

Because the mortgage capital investments from Kentucky and Virginia were restricted to their respective states, FAHE was not able to do permanent mortgage lending outside of those areas until the early 1990s. Beginning in 1991, the Claude Worthington Benedum Foundation enabled FAHE to expand its mortgage lending into West Virginia through a series of capital grants to the new West Virginia Home Loan Fund, totaling $420,000 over its first two years. At the same time, the advent of federal funding programs without geographic restrictions, such as CDFI grants and the HUD Rural Housing and Economic Development program, enabled FAHE to put much-needed equity into its Construction Loan Fund and expand its mortgage lending program into Tennessee. FAHE staff also cite the HOME program, which began in 1992, as a major breakthrough for the HLF (although the funds were restricted to use in the states that gave FAHE HOME awards – Kentucky and Virginia).

The original technical assistance for creating the two loan funds came from "the experience and insight of the founders," according to FAHE's executive director. He stated that much of the evolution of the organization has been through the hard lessons of trial and error: "We're in a constant state of organized crisis. It might be what management experts these days would call a chaotic environment." In 1992, FAHE underwent a thorough peer review by the National Community Capital Association, which gave the organization insight into what steps were needed to build its capacity and manage its growth. FAHE has also received ongoing technical assistance from KHC and, indirectly, from the Housing Assistance Council. "[Our board president] is on [HAC's] loan committee and after every loan committee meeting, he would bring back the meeting packet, give it to me and say 'Read this.'" (Interview, executive director, FAHE)

One outcome of the technical assistance FAHE has received has been changes in the structure of the organization in response to the changing nature of its activities.

> We're moving to an atmosphere of specialization. It's been partly out of necessity, due to the sheer volume and complexity of the deals that we're doing. You can't let just anybody service mortgages who's read the Cliff Notes one time. There are too many laws and regulations. (Interview, executive director, FAHE)

In addition to adding increasingly specialized staff, FAHE has also been reassessing its information technology needs. Improvised forms and processes were sufficient at the beginning of the two funds. "We did a lot of stuff on jerry-rigged spreadsheets," according to the past executive director. By 2001, however, the organization was investing in higher quality software and customizing its own programs to generate reports and check its work. The changes have enabled FAHE to move to a new stage in its organizational growth. According to the former executive director, "One of the big hurdles that we've gotten over in the past two years is just to increase and improve our management of the fund. If we hadn't done that, the same opportunities would be there, but we wouldn't have been able to manage that growth."

Policies, Procedures, and Indicators

Capitalization

Capitalization strategies differ for the two FAHE funds. For the Construction Loan Fund, FAHE generally asks its member groups what projects they anticipate undertaking in the next fiscal year and how much money they anticipate receiving from the HUD Self-Help Homeownership Opportunities Program (SHOP) and the Appalachian Regional Commission. FAHE then fundraises to cover the remainder of the money needed, approaching the most appropriate sources for each group's projects, depending on the combination of federal or private programs for which each group qualifies.

The capitalization strategy for the Home Loan Fund is generally to seek out heavily subsidized money, wherever available, preferably at a 3 percent interest rate (or lower) over a term of at least 20 years. The money that is loaned out is then marked up by an additional 2 percent (although the effective interest rate to the borrower is brought down by an interest credit contract similar to the one KMHDC uses).

Table 10a. Annual Capital Growth Trends (FY 1996 to FY 2000): FAHE Construction Loan Fund

Year	$ Increase	% Increase	Average # New Investors	Average Investment Size	Average Rate	Average Term
FY 2000	$5,065,840	136.0%	13	$224,005	3.50%	4.0
FY 1999	$2,150,461	12.0%	2	$114,980	3.75%	3.7
FY 1998	$1,920,500	37.6%	4	$131,250	3.80%	3.5
FY 1997	$1,395,500	15.8%	2	$47,500	3.80%	3.5
FY 1996	$1,205,500	NA	3	$32,500	3.80%	3.5

Source: Study survey.

Table 10b. Annual Capital Growth Trends (FY 1996 to FY 2000): FAHE Home Loan Fund[9]

Year	$ Increase	% Increase	Average # New Investors	Average Investment Size	Average Rate	Average Term
FY 2000	$8,078,999	2.5%	1	$192,955	NA	15.1
FY 1999	$7,886,044	12.1%	2	$426,455	NA	14.9
FY 1998	$7,033,134	9.6%	0	$0	NA	14.5
FY 1997	$6,416,771	21.6%	2	$570,192	3.1%	14.5
FY 1996	$5,276,390	NA	0	$0	3.2%	14.0

Source: Study survey.

While the Construction Loan Fund saw robust capital growth between 1996 and 2000 (Table 10a), the Home Loan Fund grew much more unevenly (Table 10b). Not only is the HLF growing more slowly, it is not attracting new investors to the same degree that the CLF is. One possible explanation for this difference lies in the different capital needs of the two funds. The Construction Loan Fund typically seeks out short-term capital, whereas the Home Loan Fund must seek out investments with much longer terms in order to do affordable mortgage lending. While investors may be willing to invest at lower interest rates for shorter terms, it usually much more difficult to find those who are willing to do so for periods of 15 to 20 years.

Another possible explanation, however, could be that the FAHE mortgage loan fund is willing to take more risks to reach lower-income borrowers (see Table 14b). One of the problems of higher risk (and losses) is that skittish investors tend to shy away from high-risk funds and risk-hungry venture capitalists tend to demand high interest rates. FAHE's executive director commented that these are calculated risks that the organization takes to remain true to its mission.

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[9] For FY 1998, FY 1999, and FY 2000, no information was available on the average interest rate of new investments to the Home Loan Fund. For FY 1996, the stated interest rate applies to new investments that were made by past investors.

We could address this [situation] through policies and procedures, but it would inevitably come at the expense of the families. We would basically have to lend only to families making [at least] $20,000 a year. What makes us unique as an organization would no longer exist. But that will be a point of contention for years to come.

Loan Products

The Construction Loan Fund has diversified its loan products considerably since 1981, when it offered a simple 12-month construction loan at a 5 percent interest rate. The infusion of grant funds from the CDFI program in the 1990s enabled FAHE to build some equity in the CLF, establish a loan loss reserve, and offer a much wider range of products. As of 2001, FAHE had made 235 CLF loans to its member groups, totaling $13.5 million, and leveraging an additional $25 million. Its newest product, launched in May 2001, is an Intermediary Relending Program (IRP) to provide permanent financing up to 20 years for rural multifamily projects (Table 11a).

Table 11a. Loan Products, Rates, and Terms (FY 2000): FAHE Construction Loan Fund

Product (CLF)	Purpose	Rate	Term (years)
Construction	Single/multifamily predevelopment	6.25%	1-2
Carryover	Loan on LIHTC for 10 percent carryover requirement	6.25%	1
Working Capital	One-year renewable loans	6.25-7.00%	1
Mark to Market	Expiring use property acquisition	6.00%	5
Bridge Loans	Construction cost bridging	6.25-7.00%	2
IRP	Permanent financing - multifamily housing	3%-market	20

Source: Study survey.

Table 11b. Loan Products, Rates, and Terms (FY 2000): FAHE Home Loan Fund[10]

Product (HLF)	Rate	Term	Notes
FAHE KY HLF	3-8%	20 years	Can extend to 30 years with loan committee approval
FAHE HOME Loan	0-8%	20 years	Can extend up to 40 years
FAHE WV HLF	3-8%	20 years	Can extend to 30 years with loan committee approval
FAHE Virginia HLF	3-8%	20 years	Can extend to 30 years with loan committee approval

Source: Study survey.

Since 1985, the HLF has expanded from a single, 20-year loan product at 1 percent interest to a multi-state product series with more flexible terms (Table 11b). The results of FAHE's mortgage lending program as of 1998 are shown in Table 12.

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[10]All four HLF loan products are for the purpose of home purchase, rehabilitation, or repair.

Table 12. Fund Results (1985 to 1998): FAHE Home Loan Fund

State	Total Lent	Total Loans	Average Borrower Income	Average Monthly Payment
Kentucky	$7,702,685	257	$10,605	$151
Virginia	$7,774,425	163	$14,210	$281
West Virginia	$572,948	39	$13,552	$180
Total	$16,050,058	459		

Source: FAHE Annual Report, FY 1998.

FAHE has also had success in serving borrowers that benefit low-income and female-headed households (Table 13). As with KMHDC's borrower demographics, the percentage of minority borrowers from the Home Loan Fund may seem low, but it is actually much higher than the percentage of minorities in FAHE's service area population (an average of roughly 1 percent, according to the executive director). The single minority borrower group is a nonprofit headed by a group of Catholic nuns that builds housing primarily for Native Americans.

Table 13. Borrower Demographics (FY 2000): FAHE HLF and CLF[11]

	Minority Borrowers		Female Borrowers		Low-Income Borrowers	
Loan Fund	**#**	**%**	**#**	**%**	**#**	**%**
Home Loan Fund	63	8%	503	64%	786	100%
Construction Loan Fund	1	3%	21	64%	33	100%

Source: Study survey.

Underwriting and Portfolio Management

Although FAHE has a large binder detailing the underwriting policies and procedures for its two loan funds, the actual application process for the Construction Loan Fund is fairly simple: "Basically . . . somebody picks up the phone and tells me that they need a loan to do a project" (interview, executive director, FAHE). After the phone conversation, the loan fund director will consider whether the project is in the best interests of both FAHE and the member group and, if the loan is considered appropriate, the group will be sent an application form. Because of the level of familiarity between FAHE staff and its member groups, many of the details of underwriting are already known before a group even submits a request for a loan.

[11] For the HLF, "borrower" indicates a borrower household and "female borrower" indicates a female-headed household. For the CLF, "borrower" indicates a borrower organization, and "female" or "minority" borrowers indicate borrower organizations that either are headed by minorities or women, or primarily benefit minorities or women.

> CLF loans are "family" loans – I don't have to do a skip trace [for bad credit] on these groups because I know them. To be a FAHE member, you have to prove the ability to construct a house and have an audit done. . . . We do all the site visits anyway, so we always know what's going on with a project. (Interview, executive director, FAHE)

Once the application form is returned, the application is evaluated by CLF staff using four general considerations:

- What is the nature of the project and the loan request?
- What loan terms does the group need in order to make the project feasible?
- What will FAHE's security or collateral be? (Is there evidence that take-out funding has been secured?)
- Has the group had experience doing this type of project before?

If additional consideration is needed for an application, FAHE staff will prepare for a meeting of the FAHE loan committee via conference call. Loan committee approval is required for loan requests that are over $75,000 (either individually or cumulatively), for loans to rescue projects that are stalled, for loans to groups that are not in good standing with FAHE, and for loan requests with terms outside those set by FAHE staff. Once a loan is approved, an attorney will prepare a promissory note and other documents for closing, set a date for closing, and issue a commitment letter.

If a loan involves construction, FAHE reserves the right to inspect the project before loan disbursement. Each construction project entails inspections once the frame is erected, when the project is halfway completed, and after final completion. Multifamily project loans entail evidence that projects have been inspected before every draw of money from the loan fund. For loan requests of $500,000 or more, "We'll have someone on site every two weeks, with or without draw, executing inspection contracts. . . . We'll treat it as our project" (interview, executive director, FAHE).

The combination of thorough oversight and familiarity with its member groups has resulted in a default rate close to zero and a delinquency rate that has remained stable at 11 to 13 percent of principal outstanding over the past five fiscal years (Table 14a). The near-perfect default record, however, masks several "close calls."

> The CLF has never been the beneficiary of pure equity investment, so that leaves us a pretty narrow margin for error. Sometimes, a loan will begin to look like it's going bad, so we'll scramble to fix it and spend an inordinate amount of staff time and resources to do so. In the end, the loan will be saved, but there will have been a cost to us. (Interview, executive director, FAHE)

Table 14a. Loan Delinquency and Default Trends (FY 1996 to FY 2000): FAHE Construction Loan Fund

Year	Loss Reserves	Delinquencies	Defaults	Principal Outstanding	% Delinquent
FY 2000	$104,643	$273,812	$0	$2,479,117	11.0%
FY 1999	$65,331	$173,652	$0	$1,409,502	12.3%
FY 1998	$29,362	$174,478	$0	$1,350,978	12.9%
FY 1997	$18,362	$138,931	$7,924	$1,076,985	12.9%
FY 1996	$26,286	$140,395	$0	$1,123,167	12.5%

Source: Study survey.

The application and underwriting process is very different for the Home Loan Fund, primarily because the fund depends on a steady steam of grant money (particularly from HOME) coming into each of the states' accounts for FAHE's service area. When the grant money for a particular state is released, the mortgage loan staff (which consists of two underwriters and two inspector/servicers) reviews the grant regulations for any changes in family qualifications and adjust their underwriting criteria accordingly. The staff then goes through mortgage loan applications that have been sent in by member groups or individually by potential borrowers.

The applications that pass initial underwriting are then referred for counseling, and any problems with each application are addressed. Before a loan application is sent for loan committee review, the applicant must have paid off any outstanding collections, turned in all verification documents, and created a budget with counselors (all FAHE homebuyer counseling is done in-house). FAHE underwriters and loan committee members also need to see evidence from the FAHE member group that will be building the house that they have outside sources in place willing to close on the loan. Loan committee conference calls are held on an ad hoc basis, when a large enough number of borrower families are judged ready to have their applications reviewed.

Once a loan is approved, closing is held either immediately afterward (for FAHE HLF loans) or after construction and site inspections are conducted (for Federal Home Loan Bank and Virginia Housing Development Agency loans). According to FAHE staff, the most common underwriting issues are bad credit and low incomes ("$550 a month [for income] is pretty common," said one underwriter). Underwriting issues tend to be the same across all four states; however, the different area median incomes (AMIs) between states make things more difficult for applicants in West Virginia and Kentucky (which have extremely low AMIs) than in Virginia.

FAHE's familiarity with its member groups has not only helped in its operations of the Construction Loan Fund, it has also helped FAHE to monitor delinquencies in its Home Loan Fund. When a borrower's loan payment does not come in on the due date, FAHE sends out a notice. After 30 days, the borrower's name is placed on a list and distributed to the FAHE member group that serves that area. According to FAHE's executive director, "This helps a lot, because these [groups] know these borrowers really well, and they can say, 'Oh I know him.

He just got laid off at the saw mill yesterday. Let me go talk to him.' That relationship helps bring the borrower in to work things out." After 60 days, FAHE will begin foreclosure procedures; however, FAHE staff will make every effort to work out an agreement with the borrower. "We will carry loans as long as 180 days if there's justifiable cause. In fact, we didn't foreclose on our first house until 1992" (interview, executive director, FAHE).

Table 14b. Loan Delinquency and Default Trends (FY 1996 to FY 2000): FAHE Home Loan Fund

Year	Loss Reserves	Delinquencies	Defaults	Principal Outstanding	% Delinquent
FY 2000	$363,557	$1,758,456	$0	$14,177,544	12.4%
FY 1999	$507,091	$2,031,235	$0	$13,601,770	14.9%
FY 1998	$504,700	$1,694,978	$0	$13,014,341	13.0%
FY 1997	$451,581	$1,640,927	$0	$11,455,682	14.3%
FY 1996	$268,271	$1,508,936	$0	$7,594,003	19.9%

Source: Study survey.

FAHE's willingness to extend itself for its borrowers does, however, show up in its delinquency figures for the loan fund (Table 14b). Delinquencies as a percentage of principal outstanding were as high as 20 percent in FY 1996. In addition, even though the fund has not officially foreclosed on any loans in the past five fiscal years, FAHE staff indicate that problem loans are occasionally written off the books and absorbed by the fund. (Information on how many loans have been written off was not available.) Nonetheless, FAHE's efforts to improve its internal capacity resulted in delinquency rates being brought down to 9.6 percent in FY 2001.

Sustainability

While FAHE is a much larger fund than KMHDC, the issue of its sustainability is just as thorny. Whereas operational funds for the CLF are pure investments, the HLF is much more grant-dependent; however, the HLF has also been able to provide a large portion of operational funds from self-generated sources.

Table 15. Proportion of Self-Generated Operating Funds (FY 1996 to FY 2000): FAHE Construction Loan Fund and Home Loan Fund[12]

Year	Self-Generated		Grants		Investments		Other	
	CLF	HLF	CLF	HLF	CLF	HLF	CLF	HLF
FY 2000	0.0%	35.5%	0.0%	34.5%	100.0%	18.0	0.0%	0.0%
FY 1999	0.0%	23.0%	0.0%	50.0%	100.0%	27.0	0.0%	0.0%
FY 1998	0.0%	49.0%	0.0%	33.0%	100.0%	30.0	0.0%	0.0%
FY 1997	0.0%	NA	0.0%	NA	100.0%	NA	0.0%	NA
FY 1996	0.0%	NA	0.0%	NA	100.0%	NA	0.0%	NA

Source: Study survey.

The predominance of investments in the Construction Loan Fund is also reflected in its fund balance trends from 1996 to 2000. The percentage of equity in the fund has not risen over 5 percent, and in fact hit a five year low in FY 2000 at 2.1 percent. However, the low level of equity fits the profile of the CLF as a “quick and nimble” fund, able to take in substantial investments for relatively short terms, turn projects around, and revolve the money back into the fund.

Table 16a. Fund Balance Trends (FY 1996 to FY 2000): FAHE Construction Loan Fund

Year	Fund Equity	Total Capital	% Equity
FY 2000	$111,186	$5,177,000	2.1%
FY 1999	$97,767	$2,227,000	4.4%
FY 1998	$49,953	$1,970,452	2.5%
FY 1997	$37,362	$1,432,862	2.2%
FY 1996	$38,390	$1,243,890	3.1%

Source: Study survey.

The fund balance trends for the FAHE Home Loan Fund are much more robust, with the percentage of equity steadily increasing from 1996 to 2000, topping 50 percent in FY 2000. These figures reflect the HLF's receipt of a sizeable amount of grant capital over its lifetime, as well as the long-term nature of its investments.

[12] No data for the Home Loan Fund are available for FY 1996 and FY 1997.

Table 16b. Fund Balance Trends (FY 1996 to FY 2000): FAHE Home Loan Fund

Year	Fund Equity	Total Capital	% Equity
FY 2000	$8,333,202	$16,412,201	51%
FY 1999	$7,106,649	$14,992,693	47%
FY 1998	$5,730,633	$12,763,767	45%
FY 1997	$4,567,880	$10,984,651	42%
FY 1996	$2,729,561	$8,005,951	34%

Source: Study survey.

Future Challenges and Lessons Learned

Many of the challenges and changes that past and present FAHE staff see on the horizon pertain to redefining FAHE's role as a membership organization and as a lender in Central Appalachia. After 16 years of success, the FAHE HLF is facing a new challenge – ironically, competition from its own member groups who have their own revolving capital funds.

> We're going to have to deal with the fact that our organizations have their own money. We were founded on an implied system of supply and demand. . . . The groups used to come to us for loans, but that's not necessarily true anymore. Some of it is just as simple as that they have a family come in, and they have a choice of making the loan themselves or bringing [the loans] to us – and there aren't many compelling reasons for them to bring them to us. (Interview, executive director, FAHE)

The executive director also indicated that part of the reason that FAHE was not quite prepared for competition with its member groups was that its activities in the area of lending and community development have tended to be much less proactive than its housing advocacy activities. In order to be more proactive in its lending activities, FAHE's executive director feels that it is necessary to look at more than just housing needs in its service area.

> We're going to have to start taking capital needs of all types seriously and being more proactive in community development. We need to start looking at communities and seeing what enterprises dovetail with housing development. If a community needs a child care center, we should be in a position to help them do that.

In addition to thinking about new types of development, FAHE may also be thinking about expanding its range of development partners. Because many of FAHE's member groups (particularly those in Kentucky) are mature organizations with their own revolving capital, FAHE is beginning to look at development needs that fall outside its member groups' service areas.

> There's a lot of area that's not really served by a housing nonprofit in Appalachia. . . . There could be a spouse-abuse shelter in an area where there isn't a housing program. . . . They don't want to become a housing program, so they might call us. If they're

aware of two clients with housing needs, it doesn't make any sense for this group to go make an application to the HOME program or the Federal Home Loan Bank just to make those two houses. (Interview, former executive director of FAHE)

While FAHE would still retain its ties with and governance by its member groups, it would expand its services by signing memoranda of agreement with local organizations that need small, highly specific projects done. This type of "niche marketing" would not only increase demand for FAHE's products, it would save the group from having to compete with its own members for lending business. In addition, FAHE has indicated a willingness to charge more interest on its CLF loans in order to subsidize the Home Loan Fund. The former executive director observed, "It's the access to capital that is more important to [member] groups, not so much the interest rate. If our groups get a loan from us at 7 percent and the banks are loaning at 9 percent, they're still saving a lot of money. If we're borrowing funds at 4 percent, we're doing pretty well."

Another issue that is becoming acute in FAHE's service area is predatory lending and credit abuse: "Check cashing, credit cards, rent-to-own, subprime lending – we've seen more families with bankruptcies in the past five years than ever before. In fact, 10 year ago, these same families wouldn't have had any credit history at all" (interview, executive director, FAHE). The increase in the activities of "fringe" banking institutions and predatory lenders has fed on an environment of persistent poverty that, in some areas, has not changed substantially for more than 30 years. According to FAHE's executive director, "The 'boom' of the 90s just was not realized in our area. We continued to have double-digit unemployment and had no increase in incomes. We never had an upturn."

Figure 5. "Open for Business" at FAHE's Berea, Ky. office.

In order to deal with the problems associated with easy credit on predatory terms, FAHE is beginning to encourage its member groups to market the services of its affiliate organizations, CAPFCU and HEAD, under the slogan "Open for Business" (Figure 5). One group, Frontier Housing, is planning to open a "hybrid mini-branch" of CAPFCU in its Morehead, Ky. office. The mini-branch would be able to sign people up for membership in the credit union, take deposits, and originate consumer loan applications for Frontier's client families. Because CAPFCU's field of membership was expanded in 2001 to include any individual who is a member of HEAD, all a client has to do is pay a $5 HEAD membership fee to become a member of the credit union. As the former executive director of Frontier commented, "Being able to offer credit union membership would keep new homeowners from being preyed upon by low-life entities who draw them into unfavorable mortgage loans for consumer purchases."

The history and evolution of the FAHE loan funds have stemmed from the enormous personal sacrifice of people who came to Central Appalachia to make a difference. Consequently, the

social process by which FAHE evolved into its present form has been just as important as the official decisions that were made over its lifetime. The former executive director of FAHE likened the process of creating the loan funds to the process of parenting.

> In my experience, there's something about the process that you go through to make the model that gives you the ability to operate the model. If you don't go through that [process] . . . [the model] not only doesn't fit well, [but] you don't have the competencies of having to give birth and rear something for a long time.

When asked whether the FAHE loan funds might be replicable in other regions of the country, the executive director joked, "For the sake of the people who might be trying to do it, I hope not." The fitful process of birthing and rearing the FAHE loan funds – the process of working through conflict to a general consensus – has nonetheless resulted in a general sense of solidarity among its member groups. This solidarity, in turn, makes it possible for the "model building" process to continue.

> We've all been through this together. New groups join because they sense the collegial nature of this process and feel that, even as a new group, they'll be treated fairly. If you can get some of those dynamics, then I think you could replicate what we've done in that sense. But if you've got a lot of people looking [at each other] suspiciously . . . it won't work. (Interview, former executive director, FAHE)

CASE STUDY 3: VERMONT COMMUNITY LOAN FUND

Background

While the state of Vermont conjures up images of quaint, picturesque farm towns and high-end ski villas, the state's nonprofit housing developers also have to consider the housing needs of low-income rural families. According to the Vermont Community Loan Fund (VCLF) executive director, "Our poor are not as poor as the West Virginia or Mississippi poor, but federal guidelines don't take into account the cost of living here. Consequently, Vermont doesn't compete well for federal money." The VCLF director of lending for its Housing and Community Facilities (HCF) fund elaborated, "In spite of high incomes, New England has experienced the slowest income growth rate in the country. The Central Vermont Community Land Trust . . . has found that the fastest growing category of homeless people is now working families."

In addition to high housing costs, Vermont also has to contend with an aging rental housing stock and an extremely fragmented regulatory system.

> The state doesn't have a registry or inspection process for the state's rental housing stock. There are few local zoning codes that are enforced. The state agency that code enforcement might fall under – the Department of Labor and Industry – focuses on residential care facilities, rather than rental housing. (Interview, director of VCLF Housing and Community Facilities Fund)

A recent study found that, out of 500 rental units inspected in Vermont, two-thirds had significant code violations. St. Johnsbury, located in the highly rural northeast part of the state, had five housing fires from 2000 to 2001 alone. However, the state has never put into place a regulatory body to register and inspect properties, or to fund building code enforcement.

The problem of affordability was beginning to surface in the state in the mid-1980s, when a group of housing development practitioners convened a conference in Plainfield, Vt. on the topic of socially responsible investment. There were a few community development land trusts scattered around the state; however, there was no state finance infrastructure to sustain them. At the time, the New Hampshire Community Loan Fund had been in existence for ten years, and conference planners thought that the New Hampshire model might be replicable in Vermont. Several of the conference attendees went on to incorporate the Vermont Community Loan Fund in 1987, and many of the original incorporators continue to influence state housing policy and programs.

Fund Evolution, Challenges, and Changes

The Vermont Community Loan Fund has the advantage of being specifically structured as a loan fund from its inception, with its mission "to build and strengthen Vermont communities by promoting more equitable access to capital." Consequently, the organization has not had to undergo the major identity shift from nonprofit housing developer to community development

lender that KHMDC and FAHE did. The seed money for VCLF came from several foundation grants, including a $5,000 grant from the Jacowski Family Foundation. After hiring its first executive director, VCLF began fundraising and succeeded in securing a commitment from the Episcopal Diocese of Vermont to match investments to the loan fund from its parishes or parishioners with money from a $50,000 challenge grant. According to VCLF's chief financial officer (CFO), "That gave us instant credibility." The first executive director then toured the state's Episcopal churches to promote the loan fund and, at the end of three years, had succeeded in raising $200,000 from Episcopal parishes and individuals. The profile of VCLF's initial capital sources reflects the importance of churches and individuals (Table 17).

Table 17. Original Sources of Capital (1988 to 1990): VCLF

Source	Amount	Grant or Loan
Board Investments	$10,000	Loans
Corporate Investments	$30,000	Loans
Foundation Grants	$170,000	Grants
Individuals	$605,600	Both
Religious	$126,605	Both

Source: Study survey and VCLF archival records.

According to VCLF's executive director, "We started off as a housing organization. Then we got involved in community facilities. Then we got into the business arena." The housing, community facilities, and business funds were, at first, three separate corporations with their own boards of directors (VCLF served as the umbrella organization). However, the executive director observed, "It insulated the funds, but it got very unwieldy." Consequently, from 1999 to 2001, the three corporations were consolidated into one corporation (VCLF) with two housing funds (the Housing and Community Facilities Fund and the Enterprise Fund).

The Housing and Community Facilities Fund (HCF) provides loans for the acquisition or rehabilitation of property that will provide affordable housing or essential services for low-income state residents. The HCF's primary borrowers are a group of 13 nonprofit community land trusts with service areas covering two to three counties each (although the Gilman Housing Trust's three-county service area spans 2,000 miles of Vermont's "Northeast Kingdom" – see Figure 6). The Enterprise Fund (EF) provides access to capital for small businesses, with an emphasis on agriculture and women- and minority-owned businesses. Its two latest initiatives – the Agrotourism Loan Program and the Child Care Initiative – recently closed loans on five on-farm tourist enterprises and nine private child-care businesses.

In June 1987, at approximately the same time that VCLF was incorporated, Vermont's state government enacted the Vermont Housing and Conservation Trust Fund Act, which created the nine-member Vermont Housing and Conservation Board (VHCB) and capitalized the Vermont Housing and Conservation Trust Fund at $3 million. The VHCB was structured to include five citizen members appointed by the governor, including one representative for low-

income Vermonters and one for farmers. Its mission was to "encourage and assist in creating affordable housing and in preserving the state's agricultural land, historic properties, important natural areas and recreational lands" (Vt. Stat. Ann. tit. 10, § 15). According to VHCB staff, the most important activities of the Housing and Conservation Board are to administer the state-funded housing program that covers multifamily and single-family housing, mobile home parks, and accessibility modifications, and to provide operating grants and technical assistance.

VCLF and VHCB both have development missions; however, VCLF was structured purely as a loan fund, whereas VHCB is able to offer both loans and grants. The program director for VHCB commented, "Since the VHCB was founded, it's been sort of a '500-pound gorilla' to VCLF because it has substantially more money from the state. . . . VCLF was a struggling nonprofit from the beginning." Although the two organizations have an extensive working relationship collaborating on housing projects throughout the state, the existence of VHCB has posed a perpetual challenge to VCLF to find its own "niche" in Vermont low-income housing development. VCLF has met this challenge by diversifying its lending activities, focusing more on construction and gap financing for development projects ("more of an in-and-out role," according to its executive director) and on specialized lending initiatives.

According to the CFO, the original technical assistance for setting up the fund came simply from "the caliber of the people putting this all together – people who were in and around the [community development] industry." Later, VCLF received ongoing technical assistance from the National Community Capital Association (NCCA), including a one-week peer review after the fund's third year of operation which was, according to the CFO, "one of the best things it did." As a result of NCCA's recommendations, VCLF created a loan

Figure 6. Life in the Northeast Kingdom

According to local sources, state Senator George Aiken was visiting the far northeastern corner of Vermont on the campaign trail in the 1940s when he said, "You know, this is such beautiful country up here. It should be called the Northeast Kingdom." The Kingdom is comprised of three counties spanning a total of 2,000 square miles, holding one-tenth of the state's population.

According to the executive director of the Gilman Housing Trust, the Kingdom's natural beauty is matched by its economic distress: "The dairy farms are imploding. . . . The major employer – a maple syrup processing plant – closed down and now the major [economic] sector is medical. There's a lot of outmigration of the young and a general population decline."

The rental housing stock in the area is particularly old and vulnerable to fire. However, affordable rental housing development is often stymied by the low rents that the market will bear. The executive director elaborated, "Our median rent is low enough to where we can have absolutely no debt in a project and it's still hard to make it work."

Finally, Gilman has to deal with the impact of harsh, snowy Vermont winters – "How many other areas do you know where you have to rake your roof or you lose it?" In addition, most of the rural communities of the Northeast Kingdom do not have access to natural gas lines, so Gilman has to use more expensive propane fuel to heat the 500 units of rental property it manages.

In spite of these challenges, Gilman Housing Trust is one of VCLF's most successful borrower groups. The "fast track" development process was instituted specifically with Gilman in mind, and the group will be participating in the rental rehabilitation loan pilot for private landlords.

monitoring committee on its board of directors and upgraded its portfolio management practices.

VCLF has since undergone several additional changes aimed at improving the fund's operational capacity. The organization is hiring new staff at the paraprofessional level to assist with the day-to-day work of loan underwriting, so that the HCF director has more time to generate and monitor innovative development financing deals. The fund is also investing in new computer software to replace its old investment-tracking software (4D for Macintosh systems) and integrate it with its new loan portfolio-tracking software (Nortridge for Windows system). VCLF staff hope that the new software will greatly ease the process of loan monitoring and reporting for a range of government and private funders, all with different reporting requirements (which one staff member compared to "being nibbled to death by ducks.")

While the organizational capacity of VCLF has been changing, the state development agencies of Vermont have likewise changed. Since 1987, the state's housing and community development system has evolved into four entities comprising a "crazy housing system that works," according to the program director of VHCB. The Department of Housing and Community Affairs is charged with housing policy formulation, which also includes administering the state's Community Development Block Grants (CDBG) funds. The Vermont Housing Finance Agency, which allocates the state's Low Income Housing Tax Credit program, also does low-income homeowner mortgage lending. The Vermont Housing Authority administers the state's tenant-based voucher program; however, it does not own or operate any public housing in the state. The Vermont Housing and Conservation Board administers the state's HOME, Lead Paint, AmeriCorps, and Housing Opportunities for Persons with AIDS programs.

While the state's housing practitioners maintain that the state's housing finance system has been more than able to meet their needs, the fiscal picture for the future may not be as optimistic. According to the program director for VHCB, "We have a public with a short attention span. They think that just because the state allocated all this money to housing a few years ago that the housing crisis is over."

Policies, Procedures, and Indicators

Capitalization

While the main component of VCLF's initial capitalization was investments from individuals, its capitalization strategy has since shifted to individual corporate investments, which VCLF's executive director calls "our bread and butter. . . . It's the largest dollar component of the fund with the fewest strings attached." Additional sources of capital have included three CDFI grants (beginning in 1996), which have enhanced VCLF's fund equity, as well as increased its loan loss and equity reserves. VHCB has served as a steady source of equity matching funds for CDFI grants and has also provided operating grants.

Table 18. Annual Capital Growth Trends (FY 1996 to FY 2000): VCLF[13]

Year	$ Growth	% Growth	# New Investors	Average Investment Size	Average Rate	Average Term (years)
FY 2000	$2,617,930	47%	35	$50,000	3.00%	3
FY 1999	$252,147	5%	27	$28,000	2.00%	4
FY 1998	$1,020,603	24%	50	$11,000	2.25%	3
FY 1997	$756,851	21%	32	$17,500	3.00%	3
FY 1996	NA	NA	46	$20,000	3.00%	2.5

Source: Study survey.

VCLF's capital growth has been fairly steady throughout the past five fiscal years, with the exception of FY 1999 (Table 18). It was during that year that the organization's original executive director resigned from the fund. According to the CFO, "That transition was very difficult. Our production went flat for a year. I think it was a case of 'leaving the founder.'" However, after a new executive director was hired in FY 2000, the fund more than made up for any lost progress with a growth rate over nine times that of the previous fiscal year. The CFO commented on recent capital growth trends, "We've had exponential growth, and I expect that to continue."

Loan Products

As stated above, VCLF is in the process of diversifying its loan products in order to pursue lending niches not being tapped by other community development lenders. One of the products VCLF is preparing to launch is a pilot program in collaboration with the Gilman Housing Trust. The program will use USDA Intermediary Relending Program (IRP) funds to provide 30-year, fixed-rate loans to private landlords at 1 percent interest, in order to upgrade the state's rental housing stock. Landlords will be eligible for the loans under the condition that IRP funds do not constitute over 75 percent of the total funds in the project. The program will target landlords located in the highly rural Northeast Kingdom.

Table 19. Loan Products, Rates, and Terms (FY 2000): VCLF

Product	Purpose	Rate	Term	Limit
HCF Loans	Nonprofit Housing and Community Facilities Development	7%	20 years	5-year balloon
Small Business Loans	Term Loans/Lines of Credit	Prime +2%	Variable	
Development Capital	Subordinated Business Debt	10%	Variable	

[13] No dollar growth data are available for FY 1996.

Source: Study survey.

Figure 7. A six-bedroom rehabilitation in Gilman, Vt.

In addition to the landlord lending initiative, VCLF is increasingly specializing in what the HCF director calls "turnaround jump-shot rehab deals" in the Northeast Kingdom. These deals involve the Gilman Housing Trust purchasing a house that has been foreclosed on or sold at auction, rehabilitating it, and quickly reselling the property to a low-income buyer. As of 2001, VCLF and the Gilman Housing Trust had completed six such rehabilitation deals.

One project, in the town of Gilman, is a six-bedroom house that has been rehabilitated and will be rented to a family for one year, with rental payments going toward a downpayment to purchase the house (financed with a USDA RHS Section 502 mortgage) (Figure 7). VCLF is providing the bridge financing. A construction crew member on the site commented, "To appreciate the job we did, you'd really have to have seen this place before we took it over. You wouldn't have believed it. It was an abandoned crack house – utterly disgusting." In spite of the extensive rehabilitation, the house was kept affordable through the use of minimum-risk Department of Corrections labor, who received two days of credit off their jail sentences for every day spent working on the Gilman Housing Trust crew. One Gilman staff member stated that the program works extremely well, because most of the laborers they get are highly skilled tradesmen who have been sentenced for driving while intoxicated. There is very little training involved, and participants are relieved to have their jail sentences halved.

Another rehabilitation project in Ryegate, Vt. involved a row of historical houses originally used to house local mill workers at the turn of the twentieth century. The Gilman Housing Trust purchased the houses and rehabilitated them with the goal of using them as rent-to-own units (Figure 8). The original financing for the project came from the Vermont Housing Finance Agency, USDA RHS, and the Neighborhood Reinvestment Corporation. (Gilman is a NeighborWorks® Network affiliate.) However, in the middle of the rehabilitation process, Gilman discovered lead paint and asbestos in the units. The organization also discovered that, contrary to the word of the previous owner, the site had no access to local sewer lines. Gilman applied for a $180,000 loan from VCLF to cover the additional lead and asbestos abatement costs, as well as the cost of putting in a septic tank. VCLF approved the loan and, in return, was granted first position on the mortgage.

Figure 8. Historic row houses, Ryegate, Vt.

Table 20. Borrower Demographics (FY 2000): VCLF

Product (FY 2000)	Minorities		Female		Low-Income	
	#	%	#	%	#	%
HCF and EF Loans	0	0%	2	13%	16	100%

Source: Study survey.

All of the borrowers or borrower groups to which VCLF lends must serve low-income Vermonters. Out of 16 total borrowers, 13 are VCLF's nonprofit community development land trust borrowers, and the remaining three are business loan borrowers (Table 20). Two of the business loans are to women-owned businesses, one of which is a Mexican food restaurant and the other a food manufacturing operation.[14] Although VCLF did not have any minority borrower groups or business owners at the time of this study, the state as a whole has a 96.8 percent white population, with most of the racial and ethnic minorities concentrated around the Burlington metropolitan area.

Figure 9. Future elder home-care facility, Vergennes, Vt.

Many of VCLF's projects are housing developments for elderly Vermonters, who are particularly vulnerable to the housing price shocks that the state has undergone. In one of the loan fund's more innovative loans, a married couple in the town of Vergennes submitted an application to build a six-unit house designed as a level three elderly home care facility for mixed-income residents (Figure 9). The couple, who already had extensive experience in caring for elders in their own home, would live on-site in the upstairs part of the house and the residents would live on the ground floor. Completion was expected in October 2001 and the couple was applying for a home care license from the Vermont Department of Aging and Disability.

Underwriting and Portfolio Management

According to the director of the HCF, the lending process begins at the start of each fiscal year, when the loan fund staff draws up a schedule of seven to eight loan committee meetings for the following year, with loan applications due three weeks prior to each meeting. The loan committee schedule and application deadlines are then published and distributed to all the Housing and Community Facilities Fund's current borrowers. It usually takes approximately three weeks to underwrite, present to the loan committee, and render credit decisions on new applications from current borrowers, which comprise most of the loan fund's portfolio.

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[14] Business loan information is current as of FY 2000, and does not include the five farm-tourist enterprises and nine child-care business loans closed in 2001 (see p. 35).

Loan applications for the Housing and Community Facilities Fund are first reviewed for any missing critical elements. "Most people don't send the fee up front," commented the director. "The application fee is $350, or 1 percent of the total loan, but people think that means that they can wait until the loan is disbursed to pay the fee. We ask for the $350 up front, and then we credit the difference to their account if 1 percent of their total loan would be less." Groups with missing materials from their application packets are then sent follow-up e-mail messages requesting the missing information. VCLF is also willing to accept completed VHCB loan application forms.

The HCF director then begins the process of underwriting and verifying all aspects of the loan packet, assisted by a loan coordinator whose time is divided between the HCF and the EF. The three most important questions that the director focuses on during this process are as follows.

- What is the borrower's mission and usage for the loan?
- What are the debt, cash flow, and take-out financing source on the project?
- What is the collateral?

Loan write-ups are circulated to four other staff members for proofing, after which they are edited, re-typed, and sent to the loan committee on the Thursday prior to the Wednesday loan committee meeting. Once the loan committee meets and renders a decision, the director typically notifies the borrower within 24 hours and sends two copies of the commitment letter within 48 hours, asking the borrower to sign and return one copy within 15 days of receipt.

According to the HCF director, the standard loan commitment period is 90 days. The commitment period can be extended by an additional 60 days at the cost of 0.5 percent of the loan amount, which is refundable on closing. The borrower can extend the commitment period an additional subsequent 60 days (120 days total) for an additional 0.5 percent of the loan amount, which is not refundable. If the borrower does not close after commitment, half of the loan application fee is refundable.

When the process moves to closing, VCLF prepares closing documents, drafts a pre-closing letter, and works with the borrower's attorney to set up the closing. After closing, a check is usually issued to the borrower within two weeks. The loan continues to be monitored by the loan coordinator until all outstanding loan documents are received. At that point, the documents are recorded into standard bank file format and the loan is placed in the active, permanent loan file.

Technical assistance (TA) for VCLF HCF borrowers often comes from sources other than VCLF itself, due mainly to the level of experience that the Vermont community land trusts already have. ("They know the drill," said the HCF director.) The TA that the loan fund does provide its cadre of land trusts is usually limited to guiding a group through specific types of projects that it is not experienced in doing (such as tax credit deals), or trouble-shooting projects that show early signs of distress. The land trusts receive ongoing TA from a number of other sources, with VHCB being the primary provider. One group, the Addison County Community Land Trust (ACCT), receives most of its TA and training from VHCB, in addition to the Vermont Housing Managers' Association. (ACCT owns and manages several renovated mobile home

parks.) The Gilman Housing Trust receives ongoing TA from the Neighborhood Reinvestment Corporation and VHCB, and recently received a capacity building grant from the Housing Assistance Council.

After loan disbursement, VCLF borrowers are required to submit monthly reports of each project's income-to-expense flow and quarterly reports on the status of the organization. VCLF also requests copies of any audits or fiscal reviews that the organization has done. The CFO stated, "We're pretty close to our borrowers. Communication is critically important. . . . We try to go out and visit our borrowers once every one to two years." Loan payments are monitored very closely, and if a payment goes even 10 days past due, the borrower group will receive a phone call from the loan coordinator. If the payment runs 30 days past due, the borrower receives a call from the HCF director. According to the director, there is only one delinquency in the portfolio at present. "Technically they're 60 days late, but we're working on a six-month deferral for their loan."

Table 21. Loan Delinquency and Default Trends (FY 1996 to FY 2000): VCLF (HCF and EF)

Year	Loss Reserves	Delinquencies	Defaults	Principal Outstanding	% Delinquent
FY 2000	$518,860	$413,571	$37,499	$6,104,421	6.77%
FY 1999	$395,900	$97,738	$38,948	$4,177,693	2.34%
FY 1998	$279,000	$42,340	$0	$3,151,858	1.34%
FY 1997	$222,500	$23,747	$0	$2,718,920	0.87%
FY 1996	$200,000	$711	$132,823	$2,755,670	0.03%

Source: Study survey.

The loan fund's delinquency and default record from 1996 to 2000 reflects far more on the Enterprise Fund than on the Housing and Community Facilities Fund (Table 21). The EF has much higher delinquency and default rates than its sister fund because the business loans are riskier and more susceptible to economic downturns than the housing loans (although the business loans also earn greater returns). According to the HCF director, there has only been one foreclosure in the Housing and Community Facilities portfolio in its 14-year history. "It was a rough deal," the director related, "You never want to go through that process, but once you have to, you need to go in there like you mean business."

Sustainability

In 1998, VCLF asked the NCCA to do another peer review in order to look at ways of becoming more self-sustaining because, as the CFO stated, "For a long time, we were spending a lot of time trying to raise operating funds." The NCCA studied the methods that other loan funds were using to increase their self-generated income and made the following recommendations to VCLF.

- Charge higher interest rates on housing loans to borrower groups.
- Obtain more income from CDFI program grants.
- Increase growth in the Enterprise Fund.
- Decrease personnel expenses.

As Table 22 demonstrates, VCLF has since raised its percentage of self-generated operating funds from a low of 50 percent in FY 1997 to 77 percent in FY 2000.

Table 22. Proportion of Self-Generated Operating Funds (FY 1996 to FY 2000): VCLF

Year	Self-Generated	Grants	Investments	Other
FY 2000	77%	23%	0%	0%
FY 1999	67%	33%	0%	0%
FY 1998	56%	44%	0%	0%
FY 1997	50%	50%	0%	0%
FY 1996	59%	41%	0%	0%

Source: Study survey.

VCLF's success at generating its own operating funds has provoked a new question, however: "Since then, we've had the discussion of 'Are we being *too* self-sufficient? Are we not taking enough risk?' That's a good discussion to be having, because if we're too self-sufficient and we're not taking risks, then we're not reaching the people we need to be reaching" (interview, CFO, VCLF). This concern was echoed by the fund's executive director: "We're now in the 70 to 75 percent range [of self-generated funds]. I don't think we want to get much beyond that, because then we'll be a bank."

Table 23. Fund Balance Trends (FY 1996 to FY 2000): VCLF

Year	Fund Equity	Total Capital	% Equity
FY 2000	$2,340,880	$8,176,158	29%
FY 1999	$1,594,297	$5,558,228	29%
FY 1998	$1,584,625	$5,306,081	30%
FY 1997	$1,132,884	$4,285,478	26%
FY 1996	$801,175	$3,528,627	23%

Source: Study survey.

From FY 1996 to FY 2000, the rate of equity growth in the fund gradually increased, leveling out at 29 to 30 percent per year (Table 23). The solid growth in equity has been partly attributed to the fund's redoubling its efforts to build its Housing and Community Facilities

portfolio, which has served as the anchor for the organization and enabled it to withstand any losses from the Enterprise Fund portfolio. The other factor in equity growth has been the fund's CDFI status.

> The biggest benefit of becoming a CDFI is money, hands down. It's the biggest source of capital out there and it's the best type of capital – unrestricted. Its sole purpose is to increase the capacity of a CDFI in any way. They're not segregated funds, they're for the whole organization. (Interview, CFO, VCLF)

However, applying for the CDFI grant and administering it have been extremely taxing. The CFO commented, "You have to have the capacity to go through that process. It's a big application with big planning elements. But if you are ready to take that step, I'd say jump on it."

Future Challenges and Lessons Learned

When asked what challenges he anticipated in the future for VCLF, the loan fund's executive director replied, "The first big challenge will be attracting lending capital, because our projects are getting bigger. We tend to be better at getting money out the door than we are at getting it in." This challenge is compounded by the fact that VCLF has never been the recipient of substantial state budget allocations, and state Community Development Block Grant money is distributed first to individual communities, and then to individual projects – "So where's that new $2 to $3 million of lending capital going to come from?" the executive director asked. However, once lending capital has been secured, tracking and retaining it is also a challenge.

> Usually, about 80 percent of [our investors] will renew with us. But it only takes a couple pulling out to upset the apple cart. We always have to look carefully at the availability of lending capital. We tend to run lean and put that money to work, which is what your investors want to see. (Interview, executive director, VCLF)

At the other end of the fiscal cycle, the balance between increasing capacity and maintaining operational self-sufficiency may be impacted by staffing changes. The CFO commented in 2001, "This year, we're adding two new staff, which will increase our staff size by 25 percent, so we need to watch our expenses." Sustainability was also impacted by the 2001 economic recession, which the CFO predicted would directly impact the earnings of VCLF's Enterprise Fund portfolio.

Last, the above challenges take place within the context of a housing affordability crisis that shows no immediate signs of abating, in spite of the recession. According to the CFO, "Nonprofit developers can't develop fast enough to keep up with the demand. We're losing ground by about 2,500 units a year. Housing prices average about $185,000 to $225,000 for new houses, but [households earning] the median income in Vermont can only afford $130,000." Affordability problems are even worse for renters. As of 2000, 48 percent of all Vermont renters were unable to afford a two-bedroom unit at fair market rents (NLIHC 2000, 346).

When asked what advice they would have for housing practitioners thinking of setting up a state community loan fund, VCLF staff emphasized the importance of technical assistance and the state political context. The CFO stressed the importance of the National Community Capital Association as a resource. "They've got the technical assistance, whether it's in the form of a consultant or best practices." The executive director advised examining what loan funds already exist in the area.

> There are tons of loan funds and CDFIs out there. Look hard at what's out there already. Is there any way to piggyback or join organizations? Then look at . . . what part of community development you're going to do. Don't try to do everything.

The second consideration in setting up a loan fund pertains to the political and fiscal structure of the state in which it will be located. According to the CFO, "The state has to have a central pivot point for [supporting] affordable housing, and if it's not there, then you have to think about how and whether you can establish it." For example, the state of New Hampshire does not have an entity like the Vermont Housing and Conservation Board that does extensive technical assistance and operational support for state nonprofit developers. Consequently, the New Hampshire Community Loan Fund provides much more technical assistance to its borrower groups than VCLF does.

The CFO also pointed out that Vermont is fortunate to have a cadre of highly experienced nonprofit developers to make up its housing delivery system, including five of the largest community land trusts in the country. "What happens if you don't have that cadre in your state?"

CASE STUDY 4: THE NORTHWEST FARMWORKER HOUSING (TRI-STATE) LOAN FUND

Background

The farm fields, orchards, and plant nurseries of Washington and Oregon are home to many of America's favorite harvests. Red apples, strawberries, raspberries, and cucumbers are only a few of the crops that make their way from these two states to supermarkets around the country. However, these crops are also very labor intensive with typically short harvest seasons, resulting in extremely low incomes and irregular work for the migrant farmworkers who harvest them.

Prior to 2001, there have been few national surveys addressing the quality of life and housing conditions of America's migrant farmworkers. The data available up until that year paint the following picture.

- In 1994, 670,000 out of a total 2.5 million farmworkers were migrant workers. When counted along with their dependents living in the U.S., the migrant farmworker population totaled 1,080,000.
- Eighty-five percent of all migrant farmworkers were born abroad, with the majority of them (90 percent) coming from Latin America.
- Foreign-based migrants made up 71 percent of the migrant labor force, representing 480,000 workers.
- U.S.-based migrants made up 29 percent of the migrant labor force, comprising 190,000 workers.
- The median income for migrant farmworkers was $5,000 per year.
- Two-thirds of migrant farmworkers lived below the poverty line as a result of inadequate full-time and year-round work, combined with low wages.

(U.S. Department of Labor 1994)

In 2001, the Housing Assistance Council released *No Refuge from the Fields*, the first national survey to focus explicitly on the housing conditions of migrant farmworkers. The study found the following conditions in the Western migrant stream, which includes California, Washington State, Oregon, and Idaho.

- Of the three migrant streams examined, the Western stream had the highest percentage of cost-burdened households, with 42.9 percent of surveyed households in California and 45.8 percent of surveyed households in Washington, Oregon, and Idaho paying 30 percent or more of their monthly incomes for housing-related expenses (HAC 2001, 31).
- Among states included in the study, Washington and Oregon had (respectively) the third and fourth highest percentages of substandard migrant farmworker housing units with children present. In Washington state, 30.5 percent of all units surveyed (N=129) were severely substandard and 94.9 percent of those units had children present. In

Oregon, 34.5 percent of all units surveyed (N=209) were severely substandard, and 86.6 percent of those had children present (HAC 2001, 46).[15]

There are many challenges to providing decent and affordable housing for migrant farmworkers. Low farmworker incomes and brief occupancy periods during the harvest season prevent many farmworkers and their families from obtaining off-farm rental housing that is not employer-owned – and only 32 percent of farmworkers surveyed in 1994 and 1995 were able to obtain employer-owned housing. Additional obstacles to farmworker housing development include:

- difficulty packaging financially viable projects to serve renters with especially low incomes and short occupancy periods;
- lack of subsidized funds for farm labor housing projects;
- difficulty finding and securing land with appropriate zoning and access to roads, water, sewer, and other utilities in agricultural areas;
- community opposition to new construction of farm labor housing (NIMBYism) and widespread discrimination against farmworkers and their families based on race/ethnicity and national origin.

(HAC 1997, 35)

In 1991, staff from the nonprofit Office of Rural and Farmworker Housing (ORFH) in Washington state, the Community and Shelter Assistance Corporation (CASA) of Oregon, and the Idaho Migrant Council (IMC) met to discuss the chronic shortage of decent and affordable farmworker housing in their states. They eventually decided to apply for a grant from the Northwest Area Foundation (NWAF) to set up a three-state regional fund for predevelopment and bridge financing for migrant farmworker housing developments. All three grant applicants were, themselves, successful nonprofit farmworker housing developers in their respective states.

The concept of a regional fund appealed to the founders for several reasons. The collaboration across states of organizations involved in similar work was appealing to the NWAF because the three partners could share their experiences and reinforce each others' efforts. A regional fund would also provide for greater development production volume, because the three organizations could more efficiently reach more project sponsors together than they could if acting separately. The executive director of CASA also pointed out that the very nature of migrant farm work itself was conducive to a regional approach, "since migrant farmworkers will often work their way through Oregon, Washington, and Idaho, following different crop harvests."

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[15] The study classified units as "severely substandard" that lacked complete indoor plumbing and/or had a substantial number of interior and exterior problems.

Fund Evolution, Challenges, and Changes

The three organizations were awarded a $500,000 grant from the NWAF, which covered capitalization ($450,000) and administration ($50,000) of the Northwest Farmworker Housing Loan Fund, more commonly known as the Tri-State Fund. In addition, ORFH had $90,000 in received capital of its own that it had already been using for predevelopment lending in Washington state.

Relying on their own extensive experience in the area of farmworker housing development, the founding partners created a very simple – yet highly unorthodox – lending model (there was no outside technical assistance in either setting up the fund or, later, in administering it). The fund is structured as an unincorporated partnership between the three groups, with no staff of its own. Fiscal management for the fund is provided by Northwest Regional Facilitators (NRF), a nonprofit organization supporting housing and community services throughout the Northwest. However, all underwriting and general management of the fund is provided collaboratively by the staff of ORFH, CASA, and IMC. During its lifetime, the fund has never hired any staff for specialized lending positions. Borrower organizations face minimal application paperwork and no application fees. There has also been no change in the Tri-State Fund's overall structure, policies, and procedures since its inception.

However, the fund has been impacted by congressional budget trends in the USDA RHS Section 514/516 program, on which area nonprofits had previously relied for take-out financing. From 1991 to 1998, the Section 514/516 program experienced a surge in demand from farmworker housing developers across the country (particularly in the tri-state area), combined with insufficient appropriations to meet the demand. According to the Tri-State Fund's final report, this shortage of funding resulted in a national backlog that was eventually "equal to about six years' appropriations" (Tri-State 1998, 2). Although the Tri-State Fund was initially conceived as a predevelopment fund, the backlog in Section 514/516 processing meant that farmworker housing developers in the region had to shift to other sources of take-out financing for their projects to survive. Consequently, the Tri-State Fund began to offer bridge financing to organizations that were applying for funds such as the Low Income Housing Tax Credit, so that borrower groups would be able to retain options on development property while they were waiting to secure alternative take-out sources.

Policies, Procedures, and Indicators

Fund Capitalization

Throughout its history, the Tri-State Loan Fund has – surprisingly – not pursued any additional capitalization other than its organizing grant from the Northwest Area Foundation. While pursuing additional capital was originally one of the goals of the founders, two main considerations led them to focus their energies elsewhere. The primary reason was that the "collapse" of the Section 514/516 pipeline meant that staff in the three organizations had to refocus their time on complex restructuring of development deals that had previously relied on Section 514/516 funding. According to the executive director of ORFH, "The Tri-State partners

decided to prioritize their housing development work to keep these projects viable, rather than devote valuable staff time of their developers to seek loan fund investments."

A second consideration was that, even if the Tri-State partners had decided to pursue additional investments, the level of competition for community development capital had grown. "Shortly after the Tri-State [Fund] was established, other predevelopment loan funds for affordable housing became available," according to ORFH's executive director. Because of the level of competition, the partners decided that it would not be worth the additional staff time and energy to put together competitive applications. In addition, the executive director added, "the Tri-State [Fund], as it was constituted, more than met the needs of the partner groups."

<u>Loan Products</u>

The $450,000 in capitalization funds are split into three different accounts, with $150,000 available to each participating agency (ORFH, CASA, and IMC) to lend out to farmworker housing development projects. The loans are all available at zero percent interest financing, with no set terms and repayment due upon receipt of take-out financing from a permanent source. This kind of flexibility, while highly unusual, has been critical to the types of projects that Tri-State has funded.

Flexibility of loan terms has been important to Tri-State borrowers in part because of the obstacles posed by NIMBY opposition. Some farmworker developments have had to withstand multiple legal and regulatory challenges by neighbors before they were able to begin construction. In one instance, the sponsors of the Plaza del Sol complex in Sunnyside, Wash. had to weather two months of public hearings over a challenge to the Conditional Use Permit (CUP) application that would have enabled the developer to build fourplexes, rather than duplexes, on the site. The developer finally withdrew the CUP application, hoping to begin construction; however, the neighbors then challenged the project's environmental review. The zero interest, flexible term Tri-State funds enabled the developer to maintain site control during this entire process and eventually finish the project (Figure 10).

Figure 10. Plaza del Sol, Sunnydale, Wash.

Since the Tri-State Fund exclusively loans to farmworker housing development projects, every one of its loans has gone to borrower groups whose beneficiaries are all low-income, racial/ethnic minorities (typically Hispanic). Almost exactly 50 percent of the tenants at the complexes are women, with virtually no female-headed households. Table 24 lists the number of farmworker housing units that had been completed and that were in development as of 1998.

Table 24. Tri-State Borrower Development Output (1991 to 1998)[16]

	Units Completed	Tri-State Funds Revolved Back	Units in Development	Tri-State Funds in Use
ORFH Borrower Groups	119	$372,318	195	$298,965
CASA Borrower Groups	266	$480,431	139	$65,920
IMC	72	NA	30	NA

Sources: Tri-State 1998, 9-11; interview, executive director, ORFH.

Not only do Tri-State funded development projects reach a minority population that is among the most poorly housed in the nation, they also create living environments that are child-friendly, enabling farmworkers to travel with their families. For example, the ORFH-funded Linda Vista housing complex includes a day-care center, and all other complexes (like Mariposa Park, Figure 11, and Abbey Heights, Figure 12) include safe playground areas. Farmworker family amenities such as these are highly unusual in an industry where housing arrangements have historically been limited to "bullpen" or "horse-stall" dormitories for unaccompanied men (Bell 1997).

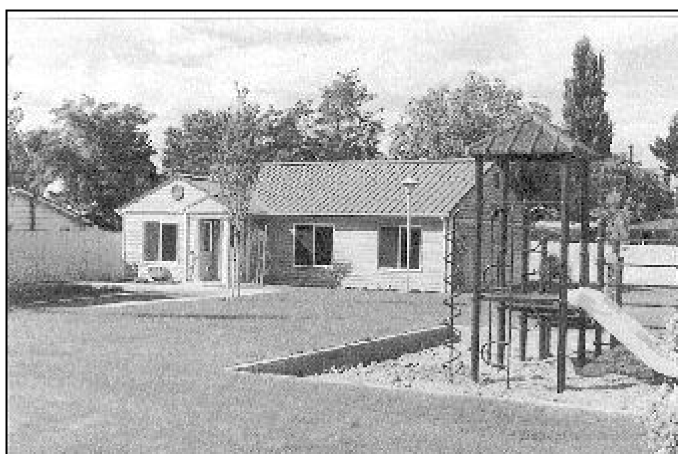

Figure 11. Mariposa Park, Yakima, Wash.

Underwriting and Portfolio Management

The Tri-State Fund's structure has proven remarkably easy for borrower groups to use. There are no application fees for the fund and the application forms are very simple and direct. ORFH, CASA, and IMC created a collaborative underwriting process whereby the partnering groups review, underwrite, and approve each loan application. If there are any questions concerning an application, the underwriters simply ask the applicants directly for clarification or additional documentation. The staff of ORFH, CASA, and IMC involved in the underwriting process remained generalists throughout the life of the Tri-State Fund. No specialized staff positions have ever been created for underwriting, closing, or servicing.

[16] ORFH-funded units completed include a day care center at the Linda Vista complex in Toppenish, Wash. ORFH-funded units in development include a community building at the Redwood Plaza site in Pasco, Wash. The Idaho Migrant Council serves as its own project developer. Information was not available about the amount of Tri-State funds used in IMC's projects.

The policies and procedures established for the fund serve several functions:

- identification of allowable uses that could reasonably be expected to be reimbursed by permanent financing;
- risk assessment by analyzing potential obstacles and the project's progress toward permanent financing approval; and
- provision of flexible, quick responses to any development obstacles through consultations among the founding partners (Tri-State 1998, 1).

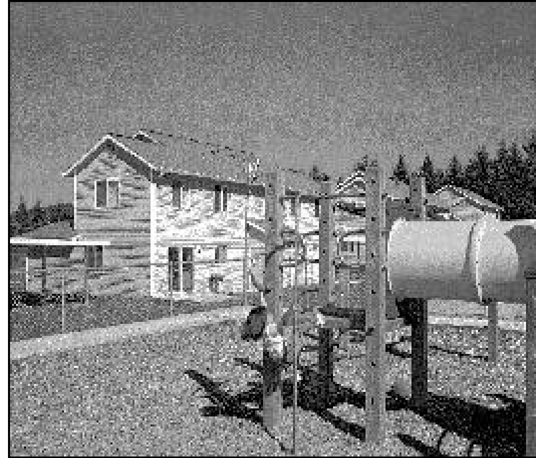

Figure 12. Abbey Heights, Ore.

Project risks are also assessed by judging whether each applicant has secured site control, whether the group conducted a market study or needs assessment, and how the proposed permanent funders have reviewed the project. After the loan is approved, the project is carefully monitored. "Before funds are drawn down, there is a lot of investigation to confirm project feasibility, and this continues with each subsequent drawdown on the project" (interview, executive director, CASA).

The terms of its loans also gave the Tri-State fund a highly unusual risk profile (Table 25).

Table 25. Loan Delinquency and Default Trends (FY 1996 to FY 2000): Tri-State Fund

Year	Loss Reserves	Delinquencie s	Defaults	Principal Outstanding
FY 2000	$0	$0	$0	$406,340
FY 1999	$0	$0	$0	$343,428
FY 1998	$0	$0	$0	$343,428
FY 1997	$0	$0	$0	$305,000
FY 1996	$0	$0	$0	$320,000

Source: Study survey.

While many Tri-State projects were delayed for long periods during the predevelopment stage, the fund had taken this risk into account by structuring its loans without pre-set terms. Consequently, there were never any delinquent payments or defaults, because there were never any deadlines for payment in the first place (other than upon receipt of permanent financing). If a project experiences significant delays, the Tri-State partners meet and work out a solution collaboratively. The risk that a borrower might not receive permanent financing is covered through a lien on the project by the Tri-State partner making the loan. According to the executive director of CASA, these provisions have had to be used in only a few circumstances.

> With troubled or derailed projects, loans are paid out from the sale of the property, and any excess [has] to be covered by the [Tri-State] partner that got the loan. CASA had two projects where the property sale didn't cover their costs, so they put money from their own operating funds into the Tri-State Fund to "make it whole."

In addition to the risk of project nonperformance, the Tri-State Fund has also dealt with the risk of partner nonperformance. One of the partners, the Idaho Migrant Council, successfully constructed three developments of 24 units each in DuBois, Blackfoot, and Heyburn, Idaho. After these initial victories, however, the organization experienced heavy staff and managerial turnover, and subsequently had to scale back its development objectives to "[maintain] the same level of quality rental management services to our existing housing projects" (Tri-State 1998, 8). Even though the IMC has not requested any additional loans from the Tri-State Fund, the fiscal agent for the fund has invested all of IMC's idle funds, providing a substantial amount of interest income while maintaining the fund's liquidity.

Sustainability

Another benefit of IMC's idle funds is that the investment income earned has funded a portion of the loan fund's administrative costs, as well as supporting the cost of the Tri-State partners' annual retreat. As a result, the Tri-State Fund has been 100 percent self-supporting since 1995, without having to seek any outside grants or investments for administrative expenses.

The annual retreat is an important element of the Fund, because it is an opportunity for the Tri-State partners, their fiscal agent, and invited rural and farmworker affordable housing practitioners to gather and work out solutions to ongoing development problems encountered by borrower groups. In addition, many innovative approaches to development have been generated during the retreat, including the use of LIHTC for farmworker housing development.

> CASA was the first organization in the country to [develop farmworker housing] using a state-funded housing tax credit, and their experience with this credit has served as a model for other states looking to adopt a state tax credit. CASA is also working to be one of the first groups in the nation to use Low Income Housing Tax Credits in conjunction with the USDA Rural Development 514/516 program. (Interview, executive director, CASA)

Because the Tri-State Fund has not needed to seek outside investments to build its capital, it has also maintained 100 percent fund equity (Table 26).

Table 26. Fund Balance Trends (FY 1996 to FY 2000): Tri-State Fund

Year	Fund Equity	Total Capital	% Equity
FY 2000	$545,200	$545,200	100%
FY 1999	$538,000	$538,000	100%
FY 1998	$532,380	$532,380	100%
FY 1997	$528,000	$528,000	100%
FY 1996	$512,000	$512,000	100%

Source: Study survey.

Future Challenges and Lessons Learned

Although the Tri-State Loan Fund has been in existence for ten years, it may be on the brink of dissolution. Ironically, its success may be the reason for its possible breakup.

In 1999, CASA of Oregon began the application process for a CDFI grant and certification. According to CASA's executive director, "We initially saw CDFI as funding to support the organization's homeownership initiatives as a source of long-term financing." CASA's record with the Tri-State Fund was a key element in its winning CDFI certification and grant money in 2000. The CDFI examiners looked at (among other things) the number of units produced through the Tri-State Fund and how well the Tri-State partners were able to cycle money through the fund ("ten times over!" exclaimed CASA's executive director). During the application process, CASA also expanded its vision of the potential uses for the CDFI grant to include property purchases rather than the funding of property options.

Although CASA's CDFI will have a regional service area that includes Washington state, it will be administered solely by CASA. ORFH's executive director commented on the impact of CASA's decision.

> CASA's decision to use its Tri-State share for its CDFI may signal the dissolution of the Tri-State Fund. [However], this might not necessarily be a bad thing, in that all the partners have matured in their own ways – i.e., the fund may have served its purpose.

While the transition to CDFI status was fairly easy for CASA, receiving the actual funds has proven difficult. Although the organization was approved for CDFI funding in 2000, CASA had not received any funds as of September 2001. CASA's executive director noted that contingency planning is critical for any organization thinking of becoming a CDFI.

> Being a neophyte with the CDFI process, it's essential to secure your first year's operating funds for the CDFI to accommodate these kinds of delays, and even more importantly so that the staff can set up strong financial and monitoring systems, loan evaluation procedures, and internal controls in the interim. (Interview, executive director, CASA)

When asked what advice he would give to practitioners contemplating starting a loan fund similar to the Tri-State Fund, the executive director of CASA emphasized solid underwriting criteria and a sharp mission focus. One of the key considerations for a Tri-State-type fund is ensuring that the project costs being funded by the predevelopment loans will be eligible for the type of permanent financing proposed by the project sponsor (which can be verified by the permanent financing source). Another underwriting practice that Tri-State developed was requiring each partner in the fund to secure a lien on their borrower groups' property for which they had received a predevelopment loan. This practice ensured that the fund would have collateral in case of permanent default.

The executive director of CASA also stated that Tri-State's specific mission focus – predevelopment funds for farmworker housing – was a key part of its success. He maintained, "It's very important not to stray too far from the primary purposes of your fund, or it can become over-committed and/or tied up in nonperforming projects." He added that the fund's mission and activities should reinforce the core missions of its partner organizations, because "the transformation from developer to lender can be a pretty serious step."

The executive director of ORFH emphasized the centrality of trust among the founding partners in a Tri-State-type fund. "The groups have to have some base level of trust or willingness to jump off the deep end with the other organizations." When asked how disagreements had been resolved between Fund partners, ORFH's executive director initially joked, "by bare knuckles – no Marquess of Queensberry stuff." He added, though, that the reality of the Tri-State partnership was one of close working relationships where the partner groups have not been hesitant to challenge each others' proposals and assumptions. Once that level of trust is cultivated, it is possible to have the benefits of both autonomy and risk-sharing. "You have control of your own funds, but with valuable peer support and review" (interview, executive director, ORFH).

CONCLUSION AND BEST PRACTICES

In his forward to the National Community Capital Association's *Best Practices for CDFIs*, NCCA Executive Director Mark Pinsky asserts that the main function of best practices is related to institutional change.

> To be effective, CDFIs must be strong and adaptable institutions. CDFIs need to know what works and what does not work in the communities they serve. Change requires institutional courage. (Lehr 1998, v)

While not all of the revolving loan funds profiled in this study are certified CDFIs, the same principal holds true in evaluating their structures and investment outcomes. In order for rural revolving loan funds to help alleviate the housing problems within their service areas, they must be resilient in the face of change and effective within their missions.

However, Pinsky also points out that "what works for one CDFI may not work for another" (Lehr 1998, v). Consequently, while it is possible to derive some commonalities from the four case studies presented here, the outcomes of each loan fund's practices are highly context-specific. Best practices, in the final analysis, are tools to help community lending institutions carefully monitor both the external political, economic, and social context within which they work, as well as the changing internal nature of the organization itself. When external and internal change is observed over time, appropriate changes in lending policy and procedures are formulated by the institution.

With these considerations in mind, a brief summary follows of the characteristics, strengths, and challenges for each of the four loan funds studied.

Kentucky Mountain Housing Development Corporation: The Little Fund That Could

Even though its loan fund was capitalized seven years after the corporation itself was founded in 1973, KMHDC's New Home Loan program and Home Repair program are among the longest-lived of the four revolving loan funds studied. This loan fund has distinguished itself not only through its longevity, but also through its creation of a permanent mortgage lending product that has resulted in nearly 1,000 houses built or rehabilitated in two extremely poor counties.

The strengths of the fund lie in its simplicity and its attunement to the culture of its service area. In order to make homeownership possible for residents with incomes of $10,000 or less, KMHDC pared down its housing design to a basic "warm and dry house" and adjusted its interest rates according to the monthly payment a borrower could afford at 20 percent of his or her income. In order to keep its services accessible to its rural residents, KMHDC has one office in each of its service area counties, accepts mortgage payments in cash, and walks borrowers through the application process – in person, step by step. Because KMHDC does its own housing construction, it is able not only to gear its designs toward affordability but also to be a reliable area employer.

The challenges for the fund will be adjusting to the changing nature of the community development lending industry without losing its simplicity and its commitment to serving low-income residents. Because grant money for operating funds is increasingly scarce, and because federal housing programs have become increasingly fragmented into several different "pots," community development lenders are increasingly pressured to become more self-sustaining – while simultaneously developing enough internal capacity to handle complex reporting requirements. The most common method for dealing with these pressures is to increase service charges and interest rates for lending products and to centralize and automate loan processing, underwriting, and servicing. As KMHDC's executive director pointed out, these are changes that would pull its lending services out of reach for many of their existing clients.

Consequently, a KMHDC-type fund would be most appropriate for a remote rural area with persistent poverty and high unemployment – but with low construction and administrative costs. The higher the cost of materials and the more complex the lending environment becomes, the more likely it is that this type of fund will have to either diversify its products or change its lending focus to higher income borrowers.

Federation of Appalachian Housing Enterprises: Strength Through Cooperation

Within rural housing development circles FAHE's Construction Loan Fund and Home Loan Fund are likely the best known of the four case studies. As of 1998, the Construction Loan Fund has made possible the construction of 1,851 new homes, the rehabilitation of 4,086 existing homes, and the repair and weatherization of 22,473 homes within its four-state service area. From 1985 to 1998, the Home Loan Fund lent a total of over $16 million for 459 permanent mortgages. The combined total assets of the Federation and its member groups in 2000 were a staggering $161 million. FAHE has also used its lending reputation to enhance its clout as a national housing policy advocate: "We decide what conversations need to take place on a state and national level, and then we go and make sure that they happen" (interview, executive director, FAHE).

FAHE's key strength lies in its structure as a cooperative, member-controlled enterprise. Because its membership is comprised of a wide range of local nonprofit housing developers, FAHE's impact is far larger than that of a single community development lending institution. The money that goes into its Construction Loan Fund builds the experience and capacity of its member groups as housing developers, who can claim their "piece" of the loan fund as part of their assets. These groups, in turn, expand the influence of FAHE as a regional housing advocate and its reputation as a lender, making it easier for FAHE to fundraise on their behalf. Not only does FAHE have a cooperative relationship with its member groups, it is enhancing its cooperative relationship with its parent organization (HEAD) and its sister institution, the Central Appalachian People's Federal Credit Union (CAPFCU). By encouraging its member groups to market CAPFCU membership to their clients, FAHE will have another tool to promote asset accumulation and economic stabilization in poor Appalachian communities.

FAHE is beginning to work through the challenge of reassessing its role as a permanent mortgage lender. The cooperative model begins to fray when competition enters the picture. Likewise, the Home Loan Fund is unable to operate as efficiently or have as much impact as the Construction Loan Fund, because it is operated in competition with FAHE member groups' local revolving loan funds. Not only does the HLF have the challenge of making permanent mortgages affordable to families with $10,000 to $14,000 incomes, it has to market its lending product over a four-state region – often through its member groups who have competing mortgage products. When member groups have the choice of originating their own mortgages or referring a borrower to FAHE, they will typically choose the former. FAHE is beginning to meet this challenge by lending to organizations who are not member groups, but who need permanent financing for small, highly specific projects. The challenge at that point will be marketing this kind of a "niche" product outside the sphere of influence of its member groups, which will involve time and labor-intensive deal-making – in addition to servicing its already existing permanent mortgage portfolio. However, because FAHE has completed an upgrade of its information technology systems, the organization may well be in a position to launch such an initiative.

Another critical factor in FAHE's evolution has been the presence of two state governments (Kentucky and Virginia) that were willing to capitalize permanent mortgage funds for their states and to allocate HOME dollars to that fund. In West Virginia, a foundation (the Benedum Foundation) provided the necessary initial capital. The FAHE model also depends on the existence of a network of experienced housing development practitioners and groups. In the case of FAHE, this network was the result of many decades of evolution and struggle, both individually and collectively.

Cooperative financial complexes have historically thrived in areas where there is a common culture and a common threat (in Mondragon, Spain under the dictator Franco and in Nova Scotia, Canada during the Depression). In FAHE's four-state service area, the common culture is the resilient mountain folk culture of Appalachia, and the common threat is persistent poverty. Consequently, a FAHE-type cooperative lending model would be most likely to take root in a region where there is a high degree of social commonality and a similar set of economic challenges. As a model, FAHE is not easily replicable in any context; however, the example of its history and the long labor of its member groups and staff can serve to demonstrate the importance of solidarity and commitment to groups who would want to follow its example.

Vermont Community Loan Fund:
Lending Like Clockwork

The Vermont Community Loan Fund, incorporated in 1987, was the only case study loan fund that was an attempt to directly replicate an existing model (in this case, the New Hampshire Community Loan Fund). Because it began its life as a loan fund, VCLF has not had to shift its corporate identity and activities significantly over its existence. Also, because it is a state fund, it has to deal with the regulatory and fiscal constraints of only one state – rather than four different states. As a result, VCLF's lending activities – particularly in its Housing and Community Facilities portfolio – work like a well-oiled machine. It has a cadre of 13 highly

experienced community land trusts, and its delinquency and default record is very low (with only one housing loan default in 14 years of operation). If a borrower group goes even ten days past due on a loan payment, they promptly receive a phone call from loan fund staff. VCLF's level of self-sufficiency is also unusually high among the four case studies; it is the product of deliberate self-assessment (with the assistance of NCCA) and careful monitoring of income and expenses. Consequently, VCLF's major strength lies in its careful planning and operational efficiency.

Major challenges for VCLF lie along two fronts. The first challenge is the constant necessity for VCLF (like FAHE) to explore new niche lending products and aggressively market them in order to compete effectively with the products of the state-funded Vermont Housing and Conservation Board. However, these new initiatives will also entail new sets of risks, as well as different lending criteria and monitoring practices. One example is the rental rehabilitation loan pilot targeting private landlords in the Northeast Kingdom. Not only does the pilot offer a new lending product (a 30-year, fixed-rate mortgage through the USDA Intermediary Relending Program), but VCLF is offering it to a completely new market of borrowers outside its customary group of community development land trusts.

The second challenge for VCLF could be termed "institutional overreach." While the projects VCLF funds are getting larger (and the affordability crisis in the state continues unabated), eventually there may not be enough loanable funds for it to accomplish its goals. While its status as a CDFI (and a founding member of NCCA) gives VCLF a tremendous edge in courting investments, large investment "chunks" at a low cost of funds are difficult to find – particularly for a loan fund that does not receive any significant state budget allocations.

A VCLF-type loan fund would work well in a rural environment where there are lower overall poverty levels, but much greater housing affordability problems. Because VCLF is located in a high-growth state, it can take calculated risks such as establishing a loan fund for small businesses, and use the higher earnings to subsidize its Housing and Community Facilities portfolio. Likewise, the state's ever-rising property values should keep the HCF portfolio on a stable, robust growth path, enabling it to serve as the fund's "anchor."

The Northwest Farmworker Housing (Tri-State) Loan Fund: The Stealth Fund

The Tri-State Fund is at once the most anomalous and most ingenious of the four case studies. It violates virtually every "rule" governing best practices in community development lending: it has no loan loss reserves, no capital growth strategy, no set terms for its loans, and no fee-for-service income (such as application fees). However, it is precisely this unorthodoxy that has enabled it to succeed in an area of community lending that is extremely difficult under the best of circumstances: migrant farmworker housing. Its flexibility of terms and zero-interest predevelopment loans have enabled its borrower groups to retain development site options through regulatory obstacles and community opposition that would derail virtually any other project. Consequently, it has succeeded in quietly laying the groundwork for a three-state network of farmworker housing organizations to build and maintain 457 units of farmworker

housing, with 364 additional units in the development pipeline. It has also provided at least one of its founding organizations, CASA, the lending experience to attain CDFI status.

The context of farmworker housing development renders moot virtually every argument against a Tri-State-type fund.

- The absence of a capital growth strategy for the fund was a conscious decision to use the staff time and resources that it would have taken to court investments (in a highly competitive environment) to focus on making difficult development deals work. The initial capitalization grant was more than sufficient for the founding partners (ORFH, CASA, and IMC), and the presence of Tri-State as the "first-in" lender resulted in the leveraging of countless additional dollars into individual projects.

- The Tri-State partners' collaborative management and underwriting practices eliminated the need to create and fund a separate loan fund staff. ORFH, CASA, and IMC staff processed, underwrote, and serviced the loans, while the Northwest Regional Facilitators served as the fund's fiscal agent. This collaborative arrangement also built the capacity of the three organizations through the sharing of insights and best practices.

- The absence of a loan loss reserve posed no risk to Tri-State, because it had no fixed terms for its loans other than payment upon receipt of take-out financing. The risk of a borrower failing to secure take-out funding was covered by a lien on the property by the sponsoring partner agency (ORFH, CASA, or IMC) and a pledge by that agency to pay any costs not covered by sale of the property.

- The risk of non-performance by any of the partnering agencies was covered by investment of that agency's idle funds by the fiscal agent. In addition, the use of interest from those investments covered a portion of the fund's operational expenses, as well as an annual retreat.

- Finally, while the Tri-State Fund may not ultimately be as long-lived as the other loan funds studied (as CASA's exit has demonstrated), the fund has served as the launch pad for a comprehensive regional farmworker housing development effort and garnered political support and visibility for farmworker housing as an issue.

As a result, a Tri-State-type fund may be ideal for "hard-to-reach" rural regions and populations, such as the colonias and the Native American trust lands, where orthodox lending practices are not always feasible.

Best Practices for Rural Revolving Loan Funds

- Founding a Loan Fund

First, examine carefully what loan funds are already in existence within the service area that the new loan fund would cover, in order to avoid duplicating services. When structuring the

loan fund's mission, focus on one specific aspect of the housing development needs in the area, rather than attempting to do everything. Secure technical assistance either from already existing loan funds with a similar structure or from national community lending trade associations (such as the National Community Capital Association). Look to the faith community in the new loan fund's service area for initial capitalization (churches played a critical role in the capitalization of three out of the four case study loan funds).

- Planning for Change to Meet Potential Challenges

When structuring policies and procedures for a new loan fund, the advice of the executive director of KMHDC is particularly salient: "I like to operate by the KISS principle: Keep It Simple, Stupid." The more simple the loan fund's policies and procedures are, the more usable they will be by its borrower groups or individuals. When facing competition from the loan products of other community lending organizations, the most successful loan funds diversify their lending products, targeting new borrowers that are outside their traditional market – but still within their mission area. Successful funds also tend to seek out technical assistance and peer review after several years of operation, with the National Community Capital Association serving as a key provider.

- Risk Management through Underwriting and Portfolio Monitoring Practices

For predevelopment and gap financing loans, a key practice in underwriting is obtaining proof that the borrower will be able to secure permanent take-out financing for the project. Beware of trends in federal mortgage programs – sudden changes in congressional budget allocations can leave projects stranded in the predevelopment phase. For permanent mortgage products, solid pre- and post-purchase homebuyer education and counseling is paramount. Borrowers should be able to formulate a budget with counselors that will enable them to make their mortgage payments and demonstrate an ability to stay within that budget. In-house counseling for individuals by the lending institution will make delinquency monitoring much easier, due to familiarity with the borrowers. For both predevelopment and permanent mortgage products, adequate collateral must be secured.

For all loan products, successful loan funds monitor delinquencies closely, intervening as early as possible. The more delinquent a loan, the lower the chance that the borrower (whether an individual or group) will come in to work out a repayment plan. In the event of foreclosure, the value of the collateral must be able to cover the cost of the defaulted loan. However, a loan fund's familiarity with its borrowers and borrower groups is a key factor in preventing delinquencies in the first place.

- Ensuring Sustainability through Investment in Capacity

For many rural revolving loan funds, the issue of self-generating operating funds is particularly difficult. There is an inherent tension between fulfilling a low-income housing development mission and increasing fees and interest rates to support operations without relying on outside grants. Whether a loan fund leans toward self-sustainability or affordability, the decision is best made with as much information as possible. An informal poll

of similar loan funds may reveal ways that additional income can be generated without sacrificing loan product affordability. For example, both FAHE and VCLF found that they could charge more for their predevelopment loan products, because their borrower groups value the ease of access to the loan fund more than low interest rates. As a result, higher interest rates on these loans can be used to subsidize operating expenses.

Fund sustainability can also be improved through investments in new, better integrated information technology systems. A software program that enables a loan fund to link its accounting spreadsheets to its loan application database will save time and enable staff to more easily generate different kinds of reports for different investors. Organizational capacity can also be improved by investing in training for existing staff and hiring new paraprofessional staff to support them.

Several loan funds have benefitted from capacity building grant programs, such as the HUD Rural Housing and Economic Development program and the U.S. Treasury Department CDFI program. Two out of the four case study loan funds applied for and obtained CDFI certification and grants (FAHE and VCLF), as did CASA of Oregon, a former partner in the Tri-State Fund. The CDFI application and grant administration process, however, is not for the faint of heart. All three CDFIs studied in this report emphasized that any loan fund thinking about CDFI certification needs to make sure that it has sufficient staff and information technology to fulfill substantial planning and grant reporting requirements (which often change from year to year). CASA's executive director noted that CDFI applicants should also make sure that they have sufficient operating funds on hand for their CDFI's first year of operation (CASA was approved as a CDFI in 2000, but still had not received funding as of September 2001).

In the final analysis, a successful community development loan fund is made up of committed, competent staff and successful borrowers. People matter. The longer an individual stays with a loan fund, the more experience he or she will have in lending and in navigating the challenges specific to the fund's service area. Long-time staff members can cultivate strong working relationships with borrowers, as well as the trust and commitment necessary to work with partnering organizations. The executive director of FAHE commented, "When you lose a staff member, you lose years of capacity and you can't instantly build that up again. . . . You can't create experience and capacity overnight, even if the money is there."

He then added, "Of course, the upside to that [fact] is that you can't kill [capacity] overnight either. We're an institution. We're going to be around for a long time."

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APPENDIX A. RURAL REVOLVING LOAN FUND SURVEY INSTRUMENT

Organization Name:____

SURVEY: BEST PRACTICES IN REVOLVING LOAN FUNDS

1. *Loan Fund History*

Year loan fund was started: _________

Original sources of capitalization:

Source	Amount	Grant or Loan?

2. *Staff Structure and Current Activities*

Position Title	# Full-Time Staff	# Part-Time Staff	# Volunteers

At the time the loan fund was incorporated, it offered:

Loan Product Name	Loan Product Description (including rates and terms)

The loan fund offers:

Loan Product Name	Loan Product Description (including rates and terms)

Please indicate, using the table below, the number and percentage of borrowers from the following demographic groups for each of your loan products.

Loan Fund Products (current FY)	Minority Borrowers/ Beneficiaries		Female Borrowers/ Beneficiaries		Low-Income Borrowers/ Beneficiaries	
	#	% of total	#	% of total	#	% of total
		%		%		%
		%		%		%
		%		%		%
		%		%		%
		%		%		%

3. *Social and Financial Performance Indicators*

What measures of financial performance (such as fund growth, default rates, etc.) does the loan fund track?

1. ______________________________
2. ______________________________
3. ______________________________
4. ______________________________
5. ______________________________

What indicators of social performance (such as increases in borrower income, neighborhood stability, etc.) does the loan fund track?

1. ______________________________
2. ______________________________
3. ______________________________
4. ______________________________
5. ______________________________

Please attach any annual reports or other compiled information that indicate how your loan fund has performed on each of these measures up to the last five years.

4. *Financial Risk Management*

Please complete the following table regarding loan fund risk management activities.

Year	Loss Reserves	Delinquencies	Defaults	Loan Principal Outstanding
FY 2000	$	$	$	$
FY 1999	$	$	$	$
FY 1998	$	$	$	$
FY 1997	$	$	$	$
FY 1996	$	$	$	$

What criteria does the loan fund use to measure borrower risk?

1. ____

2. ____

3. ____

4. ____

5. ____

Based on your criteria, estimate the percentage of the loan fund's current portfolio that falls into the following risk categories.

High	Medium	Low
%	%	%

Based on your criteria, estimate the percentage of the loan fund's current portfolio that falls into the following investment return categories.

High	Medium	Low
%	%	%

5. *Fund Capitalization*

Year	Annual Capital Growth[17]		Average # of New Investors	Average New Investment Size	Avg. Rate	Avg. Term (years)
	$	%				
FY 2000	$	%		$	%	
FY 1999	$	%		$	%	
FY 1998	$	%		$	%	
FY 1997	$	%		$	%	
FY 1996	$	%		$	%	

6. *Fund Sustainability*

Year	Percentage of Operating Budget Coming From ...			
	Self-Generated Funds[18]	Grants	Investments	Other
FY 2000	%	%	%	%
FY 1999	%	%	%	%
FY 1998	%	%	%	%
FY 1997	%	%	%	%
FY 1996	%	%	%	%

Year	Fund Equity	Total Capital
FY 2000	$	$
FY 1999	$	$
FY 1998	$	$
FY 1997	$	$
FY 1996	$	$

[17] Defined as growth in new investments, rather than cumulative growth.

[18] Defined as revenue that is not dependent on outside sources, such as fee-for-service revenue, etc.

APPENDIX B. INTEREST CREDIT CONTRACT CHART, KMHDC

ALLOWABLE INTEREST CREDIT

Each borrower may enter into an interest credit contract, which will charge a part of their interest. This unpaid interest will become a credit which the borrower still owes on the mortgage. The amount of allowable interest credit shall be based on total household income.

Adjusted Income	Interest Credit	Interest Paid	Amortization Rate per $1,000 Loaned
$8,999	7 percent	1 percent	4.60
$9,000	6 percent	2 percent	5.06
$10,000	5 percent	3 percent	5.55
$11,000	4 percent	4 percent	6.06
$12,000	3 percent	5 percent	6.60
$13,000	2 percent	6 percent	7.17
$14,000	1 percent	7 percent	7.76
$15,000	0 percent	8 percent	8.37

ADJUSTED INCOME = Gross Household Income Less:

- 7.65 percent of income subject to Social Security
- $480 per dependent preschool or student in household
- 11 cents per mile for those driving more than 30 miles round trip
- Cost of child care; actual amount to be paid
- Deduct all medical expenses over 3 percent gross income for elderly, handicapped or disabled households [sic].
- $400 per each elderly family [sic], 62 or older
- Exclude income for household members that are completely incapacitated

(Reprinted from KMHDC document)

This report provides case study analyses of four different housing-related rural revolving loan funds in order to examine what best practices apply in different rural contexts. Some best practices are common to all the funds studied, and others vary considerably. The report details these variations and provides specific advice for rural-serving organizations seeking to establish revolving loan funds.

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