[8679]

DRAFT REPORT OF

THE MAYOR'S REINVESTMENT TASK FORCE

"We can no longer afford the luxury of allowing our housing to decay to the point that we must completely rebuild neighborhoods every forty years. We must develop public policies and private lending practices which allow for the continual renewal and rehabilitation of our housing and neighborhoods."

M. Todd Cooke, President, Philadelphia Savings Fund Society, in a presentation to the Mayor's Reinvestment Task Force, February 10, 1976

A televised hearing on this draft report will be held Monday, April 12, 8:00 p.m. at the studios of KCTS-TV-Channel 9, Drama-TV Building, University of Washington Campus. The Reinvestment Task Force seeks your comments on this preliminary report.

CHAPTER 1

INTRODUCTION

In July of 1975, the Central Seattle Community Federation published a report entitled "Redlining and Disinvestment in Central Seattle: How the Banks are Destroying Our Neighborhoods." This report prompted a major public debate in Seattle. As a result of this debate, Mayor Uhlman, after consulting with Councilmen Paul Kraabel and John Miller, appointed a Reinvestment Task Force in August, 1975. The Mayor defined the mission of the Task force in this proclamation:

> I, Wes Uhlman, Mayor of the City of Seattle, hereby proclaim the establishment of a Reinvestment Task Force.
>
> The Reinvestment Task Force is established in response to the growing recognition of the widespread impact that the investment policies of local financial institutions and governmental bodies have on our city. The purpose of this Task Force is to develop recommended policies and actions, based upon problem identification and analysis, that will help insure the continued economic strength of the entire city. Specifically the recommendations are to be directed at reinvestment policies by both private and public bodies as they affect the quality of Seattle's housing stock and the economic health of neighborhoods and downtown business.
>
> Therefore, the Task Force is charged with the following responsibilities:
>
> 1. Determine the current status of investment policies regarding housing and businesses in Seattle;
>
> 2. Document the nature and extent of any problems therewith;
>
> 3. Evaluate private and public policies in other cities that differ substantially from those operating in Seattle; and
>
> 4. Recommend responsible public and private actions to encourage investment policies which are in the best interest of local financial institutions, the City of Seattle, and individual citizens.
>
> Further, be it known that the Reinvestment Task Force consists of citizens of Seattle whose viewpoints and skills are representative of a broad range of concerns and interests and that:
>
> Municipal Court Judge T. Patrick Corbett is appointed chairperson for the duration of this Task Force's existence and that:
>
> The Task Force will receive the complete cooperation of City Departments and offices to accomplish its purpose as set forth herein.
>
> August 21, 1975

The members of the Task Force are:

T. Patrick Corbett
Russell Kelleran
John Teutsch
Carsten Lien
David Thompson
Chalmers Ekness
Glover Barnes
Luther Carr
Margaret Ceis
Karen Morgan
Nancy Silberg
Stuart Weiss
James M. Young
Charles Jones
David Sucher

The Mayor appointed three staff persons from the Housing Policy Office, Office of Policy Planning to assist the Task Force. The City Council provided additional resources by approving a budget request for $14,000.

After completing its initial investigation, the Task Force began meeting twice each week and has maintained this schedule for nearly six months. All meetings have been open to the public.

Early in its deliberations, the Task Force determined that de facto redlining or disinvestment (the terms are interchangeable) has been occurring in many Seattle neighborhoods. It also determined that such practices are a consequence of the traditional appraisal and underwriting standards used by lenders and other public and private actors involved in residential lending. Redlining or disinvestment is the refusal to make real estate loans in certain neighborhoods. It is also the practice of requiring higher interest rates, larger down payments and shorter repayment periods. These decisions are not based on an evaluation of the creditworthiness of borrowers or the physical condition of the properties. Instead, redlining decisions are based on a consideration of the neighborhood characteristics in which the properties are located. Traditional appraisal and underwriting standards have tended to place considerable emphasis on these neighborhood factors: Racial and ethnic characteristics of the residents, age of the housing, and the degree to which land uses are mixed. These traditional standards have been informed by an assumption that neighborhoods eventually deteriorate. So new housing located in developing communities is generally considered to be less of a risk than housing situated in older communities.

The Task Force made its top priority the development of policies which would eliminate the use of these standards by local lenders and appraisers, mortgage insurers, federal and state regulatory agencies and secondary mortgage markets. The Task Force also concluded that the revision of underwriting standards must be complemented by the development of incentives for private investment in the maintenance and rehabilitation of our existing housing stock. Recognizing that often one of the tragic consequences of neighborhood rehabilitation is the dislocation of poor people, the Task Force decided to address this issue as well.

In order to better inform itself about the exact nature and scope of the disinvestment problem in Seattle, the Task Force and its staff conducted three types of investigations. First, it interviewed representatives of local lending institutions, federal and state regulatory agencies which supervise banks and savings and loan associations, secondary mortgage markets, City departments, real estate brokers, builders, private mortgage insurers, HUD-FHA, and real estate appraisers. Second, the Task Force conducted two hearings, taking more than six hours of testimony from Seattle citizens and public officials. Third, the staff and individual members of the Task Force provided a number of documents on various aspects of the redlining problem.

During February, the Task Force invited to Seattle, seven resource persons who have been involved in developign solutions to disinvestment in other sections of the country. These resource persons included bankers, a community activist, lawyers, an academic researcher and a United States Senate staff person. Because the Task Force felt it was critical to provide assistance to a number of the parties who are interested in resolving this problem, it arranged for the out-of-town resource people to meet with a wide range of individuals and groups. These included community organizations, federal and state regulatory officials, secondary mortgage market officials, the Mayor and City Council, lenders, appraisers, the Young Lawyers Division of the Seattle-King County Bar Association, and the Senate and House Financial Institutions Committees of the Washington State legislature. In addition, the Task Force sponsored evening public meetings when each resource person was in Seattle.

The Task Force spent the latter part of February, March and the first week of April in the preparation of this draft report. The Task Force is publishing this draft report in order to obtain public comment before it completes its final report. A hearing will be conducted on the draft report on Monday, April 12. It will be broadcast live on KCTS-Channel 9 at 8:00 p.m. You are invited to attend the hearing at the Channel 9 studios in the Drama-TV Building on the campus of the University of Washington. If you are unable to attend the hearing, but wish to comment on this draft report, please send your comments to:

Darel Grothaus, Staff Director
Reinvestment Task Force
Office of Policy Planning
Arctic Building
Third and Cherry
Seattle, Washington 98104

Comments must be received by Tuesday, April 12. If you have any questions, call Mr. Grothaus at 583-6843.

CHAPTER 2

SUMMARY OF TASK FORCE DRAFT RECOMMENDATIONS

This chapter summarizes the draft recommendations of the Task Force which are developed in subsequent chapters.

Summary of Chapter 3

I. Appraisal and Underwriting Standards and Practices for Residential Loans in Seattle

Appraisal and underwriting standards determine which Seattle neighborhoods are eligible for loans. They also determine which properties and borrowers are eligible for residential loans. Many of the traditional appraisal and underwriting standards discourage lending in Seattle neighborhoods. Therefore, these standards must be changed, if residential loans are to be made available throughout the city. These standards should be:

A. The degree of Housing Vacancy should be the only indicator of current neighborhood risk for residential lending throughout the Seattle metropolitan area.

Lenders should make residential loans on any block throughout the Seattle metropolitan area, except where the vacancy rate for residential structures has exceeded 20% of those structures on the block for a period of one year.

Although more than 20% of the units on a block have been vacant for a year, lenders should consider lending on that block, if one or more of these mitigating conditions exist on that block.

1. Presence of a local community organization which includes that block in its service area.

2. Evidence that the municipality or county where the block is located is providing that block with basic housekeeping services.

3. Vacancy rates which can be attributed directly to a major economic disaster such as the Boeing layoffs.

B. When estimating the future economic life of a block in the Seattle metropolitan area, only the following factors should be considered:

1. Geologic conditions (Example: Slides)

2. Atmospheric conditions (Example: Airport noise)

3. Impending public acquisition of property (Example: Land acquisition for freeways)

4. Vacancy rates

5. City policies for maintaining the quality of the housing stock

6. City policies for providing basic housekeeping services

Unless lenders shall present documented evidence to borrowers based on one or more of these six factors, it shall be presumed that any block has a remaining economic life of at least 30 years.

C. Appraisers should select comparable properties from blocks anywhere in the city or suburbs which are similar in the following legitimate respects:

1. Number of abandoned houses

2. Number of single-family, multi-family, commercial, industrial and institutional units on the block

3. Distance to neighborhood commercial centers which include a grocery, drug store and cleaners

4. Distance to nearest bus stop

5. Distance to nearest public elementary school

6. View

Appraisers should not select comparables based on the racial, ethnic and economic composition of neighborhood residents, age of neighborhood housing, or quality of neighborhood schools.

D. The remaining physical life of a residential structure should be the standard by which the remaining economic life of that property is to be calculated.

E. Lenders should maintain credit standards that provide reasonable assurances borrowers will repay the loans.

F. Credit standards shall be applied equally to all applicants regardless of race, sex or marital status in accordance with Title VIII, Equal Opportunity in Housing Act of 1968, Title VI, the Fair Credit Reporting Act of 1970, and Title V, Equal Credit Opportunity Act of 1974.

1. Lending institutions should develop affirmative marketing programs targeted toward women and minorities.

2. Lenders should publish and distribute their credit guidelines for residential loans.

3. Loan rejections should be in writing and cite the specific reasons for the rejection.

G. The City should adopt an ordinance requiring that a permit of occupancy be the sale of all residential structures. This permit is to insure the property is in compliance with elemental health and safety standards. These standards are to be separate from and significantly less than the City's present Housing Code standards.

H. Rejected residential loan applications should be reviewed to determine whether the revised appraisal and underwriting standards were used in rejecting the loans. The review shall be done by a lenders review board, which shall be monitored by a public review board.

Summary of Chapter 4

II. Housing Rehabilitation

A. Lenders should develop the capacity to monitor the progress and quality of major rehabilitation projects. This would assure both borrowers and lenders that the contractors are doing quality work within a reasonable period of time.

B. Homeowners should be permitted to do their own rehabilitation work, if lenders are satisfied that they have the skills required to do such work.

C. Lenders, material suppliers, community organizations and the City should develop and publicize home repair and maintenance education programs. Such education efforts should be aimed at three distinct categories of people:

1. Prospective homeowners

2. Existing homeowners

3. Tenants

D. Financing techniques should be developed for home repairs that are less expensive than home improvement loans. This problem should be on the work program of the Rehabilitation Policy Group to be converted by the City's Office of Policy Planning.

Summary of Chapter 5

III. Dislocation of the Poor

A. Seattle lending institutions, the City, the Seattle Housing Authority and community organizations should give their highest priority to the development of strategies which will avoid the displacement of poor people from neighborhoods as a consequence of neighborhood reinvestment strategies.

B. A rehabilitation policy group should be convened by the City's Office of Policy Planning which will include representatives from lending institutions, the Seattle Housing Authority and community organizations. This policy group should immediately begin developing solutions to the problems of dislocation of the poor.

Summary of Chapter 6

IV. Federal and State Action Required for Neighborhood Reinvestment

A. Federal and state regulatory agencies should promulgate regulations and adopt administrative procedures to monitor whether financial institutions are meeting their charter obligations to communities. The Washington legislature should amend the statutes governing the chartering of commercial and mutual savings banks and savings and loan associations so the obligation of these institutions to serve community needs for credit and deposit services are clearly specified.

B. Federal and Washington State regulatory agencies should review their appraisal and underwriting standards and eliminate any which are based on the racial and ethnic composition of neighborhoods and any which presume the inevitable deterioration of neighborhoods.

C. Federal and Washington State regulatory agencies should insist that the Society of Real Estate Appraisers and the American Institute of Real Estate Appraisers eliminate the use of those standards and training materials which incorporate biases concerning the current or anticipated racial and ethnic composition of neighborhoods and any standards which presume the inevitable deterioration of neighborhoods.

D. Local lenders, the City and interested community groups should immediately make a joint request to the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association to bring their formal and informal property underwriting standards into conformity with those proposed by the Reinvestment Task Force. These requests should emphasize the cooperative efforts of Seattle community groups, lenders and the City to improve our neighborhoods.

E. Federal and State tax incentives should be modified to provide incentives for the rehabilitation and maintenance of existing houses, apartment buildings, commercial, and industrial buildings.

F. Congress should pass legislation eliminating the administrative determination of interest rates for FHA-insured loans. These rates should be determined by the same market forces which control interest rates on conventional mortgage loans, thereby eliminating the need to pay discount points.

Summary of Chapter 7

V. Disclosure in Seattle

All Task Force members recognize the merits of some form of disclosure. There are some differences of opinion as to the type and extent of retroactive and prospective disclosure. The chapter on disclosure includes a presentation of the proposed types of disclosure. Where there are differing views, alternative proposals and the pros and cons of each alternative are presented.

Points of Agreement

A. Some form of disclosure is needed and should include the following: residential loan information, marketing programs undertaken by lending institutions to generate demand for loans, and City expenditures for capital improvements.

B. The City should adopt an ordinance which requires City depositories to disclose information in a uniform and timely fashion.

C. The City's Office of Policy Planning should be the agency to receive, compile and analyze disclosure information.

Points of Disagreement

A. The extent of prospective disclosure related to residential loans and loan applications.

B. Disclosure of loans to neighborhood businesses and not-for-profit organizations and institutions which serve communities, such as churches, social service agencies and community organizations.

C. Disclosure of deposits.

D. The need for retroactive disclosure of lending information to document past lending patterns.

CHAPTER 3

APPRAISAL AND UNDERWRITING STANDARDS AND PRACTICES FOR RESIDENTIAL LOANS IN SEATTLE

Appraisal and underwriting standards and practices determine which Seattle neighborhoods are eligible for loans. They also determine which properties and borrowers are eligible for residential loans. Many of the traditional appraisal and underwriting standards discourage lending in Seattle neighborhoods. Therefore, these standards must be changed, if residential loans are to be made available throughout the city. This section of the report is divided into three parts:

I. Appraisal and Underwriting Standards and Practices Used to Evaluate the Risk of Lending in Seattle Neighborhoods

II. Appraisal and Underwriting Standards Used to Evaluate the Soundness of Residential Properties Securing Loans in Seattle.

III. Underwriting Standards Used to Evaluate the Credit-worthiness of Residential Borrowing in Seattle

IV. Commitments Needed to Support and Monitor Revisions in Appraisal and Underwriting Standards

I. Appraisal and Underwriting Standards and Practices Used to Evaluate the Risk of Lending in Seattle Neighborhoods

The appraisal and underwriting standards referred to in this section are documented in the Reinvestment Task Force discussion paper, "Appraisal and Underwriting Standards in Seattle Neighborhoods." The professional publications on which the discussion paper is based are listed in Appendix A of this report. Copies of the discussion paper are available at the City's Office of Policy Planning.

A. Appraisal-Underwriting Standards

Problems

1. Inevitable Deterioration of Neighborhoods

These standards assume that all neighborhoods go through an irreversible life cycle of growth, maturity and deterioration. The stages in this life cycle vary only in intensity and duration. Once the stage of maturity, i.e., complete development, is reached, it is only a matter of time before deterioration sets in. In this context, deterioration means the following changes may occur: Higher-income neighborhood residents who own their homes are replaced by lower-income renters. Housing decays physically. City services and capital improvements are neglected. Land uses change from predominantly single-family homes to apartments, commercial or industrial buildings. Or the neighborhood is virtually abandoned.

Given this assumption of impending deterioration, lenders may become increasingly cautious in their lending policies as the neighborhood ages. This caution is expressed as a reduction in the "remaining economic life" of the neighborhood and its homes. "Remaining economic life" is an appraiser and loan underwriter's guess about the number of years that owners and tenants with the same social and economic characteristics will want to live in the neighborhood.

Remaining economic life of a house is sometimes confused with the remaining physical life. Remaining physical life refers to estimates of the number of years a house will provide safe and sanitary shelter given its current physical condition. It can also be adjusted to include the future usefulness of a house if it were repaired or rehabilitated to some level of health and safety. By comparison, remaining economic life focuses on the potential future demand for a house and its surrounding neighborhood. It is based on the guesses of appraisers and underwriters about the future decisions both of persons currently living in the neighborhood and of other types of people who might move in at a later date: Will current residents stay or move out of the neighborhood? What types of people will want to move into the neighborhood in the future?

Lenders may translate assumptions about reductions in economic life into conservative lending policies for older neighborhoods: Repayment periods may be shortened, so that loans will be repaid faster than the anticipated decline in the values of the houses. Additional financ-

ing fees and increases in the interest rates may be required to compensate lenders for what they assume to be the higher risks of lending in older neighborhoods.

Increases in the required down payments and smaller loan amounts may be required. This is done so lenders will have less money to recover if they must foreclose on houses and sell them after the expected declines in property values set in.

To the extent that first mortgage loans are available at all in older neighborhoods, lenders may require FHA mortgage insurance. Consequently, such neighborhoods may become stigmatized as "high risk neighborhoods. This stigma is not necessarily associated with the concentration of FHA insured mortgage loans per se. But rather it may be associated with the refusal of some lenders to make conventional loans, i.e., non-federally insured loans, in those neighborhoods. Lenders may refuse to lend without such federal insurance, because they believe the aging neighborhood is facing a shortened economic life.

Rehabilitation loans may be refused if lenders believe they will result in the "over-improvement" of some houses relative to other houses in the neighborhood. Similarly, loans for the construction of new houses may be refused. Both of these refusals are grounded in lenders' assumptions about the reduced economic life of aging neighborhoods.

Traditional appraisal and underwriting standards assume that persons whose incomes and personal values make them the most likely purchasers of substantially remodeled or new homes will not want to buy such homes in predominantly older neighborhoods. Instead, they will choose to purchase houses in newer communities.

An important assumption undergirds this traditional standard that neighborhoods always deteriorate: New houses built in developing areas are more attractive than houses located in older neighborhoods. It is believed that new housing will, in time, "pull" middle and upper income residents away from those older neighborhoods. As the former, more affluent and white residents move away from older neighborhoods, they will be replaced by lower-income persons who usually are members of racial minorities. The lower-income persons move into the older neighborhoods, because they cannot afford the higher priced new construction. In doing so, they either abandon their former residences and neighborhoods or pass them on to even poorer persons. This process is often referred to as the "trickle down" theory, because it assumes that as housing and neighborhoods pass from one user group to another, they decline in value and quality.

Appraisal and underwriting standards do acknowledge that older neighborhoods can occasionally be renewed; however, the examples which are cited are areas which had once been occupied by poor people, but subsequently became "chic", in-town places for affluent persons to live, e.g., Society Hill in Philadelphia, Old Town in Chicago. There is no presumption that older housing and neighborhoods can be perpetually renewed without first suffering serious deterioration.

The traditional appraisal-underwriting standard that neighborhoods always deteriorate is based partially on this implicit assumption: Each actor who has some control over the future of neighborhoods will do those things which result in neighborhood decay rather than contribute to neighborhood improvement. To illustrate: There is the presumption that city governments will reduce the levels of basic services and capital improvements to older neighborhoods. It presumes most middle- and upper-income buyers, if given a choice, will prefer newer houses located in the suburbs or in more recently developed sections of cities. They will not choose to buy houses in older neighborhoods. It presumes all other lenders will stop lending in older neighborhoods thereby increasing the risk for any individual lender going it alone. Since individual lending institutions may be guided by the assumption that everyone else will eventually do things which undermine older neighborhoods, each lender may begin to feel victimized by the other parties. Consequently, each lender will curtail its investments as neighborhoods age before all the other actors do things that make conditions worse. This withdrawal may, in turn, reinforce similar apprehensions in other lenders, potential home buyers, real estate agents, city officials, etc., leading to further disinvestment by all concerned.

2. Assignment of Higher Lending Risks to Neighborhoods Whose Current or Future Residents will Differ in Race, Ethnicity, Income and Life Style

A primary appraisal-underwriting criterion is to assign higher risks to neighborhoods whose residents differ in race, income, ethnic background and life style. This means the appraisers and underwriters may reduce the estimated future economic life of neighborhoods with diverse residents.

A collateral appraisal-underwriting standard assigns higher lending risks to neighborhoods whose residents have similar characteristics but are located next to neighborhoods whose residents differ in race, ethnicity, income and life style. Another variation of this basic principle is to assign higher risks to neighborhoods whose population characteristics are changing from homogeneity to diversity.

Shortened economic life of a neighborhood is related to racial and ethnic changes by this presumption: When one racial or ethnic group replaces another in a neighborhood, the newer group will have lower incomes, and the newer group will have less concern for the maintenance of property than the previous residents. So the newly arrived racial or ethnic group will cause a decline in property values and contribute to overall neighborhood deterioration.

This set of traditional appraisal-underwriting standards penalizes neighborhoods because of the diversity of their residents or because of concentrations of racial and ethnic minorities. These standards stand in patent contradiction to the pluralistic tradition of our nation. Traditional American values cherish the diversity of our people and celebrate the uniqueness of their various contributions to our entire society.

That element of appraisal-underwriting standards which regards racial diversity and minority concentrations in neighborhoods as grounds for restrictive residential lending stands in categorical defiance of Title VIII of the 1968 Federal Equal Opportunity in Housing Act and the Revised Code of Washington, 49.60, which prohibits consideration of race, ethnic heritage, national origin and religion in residential lending.

3. Assignment of Higher Lending Risks on Single-Family Loans to Neighborhoods Where Mixed Land Uses Exist or Are Anticipated

Traditional appraisal and underwriting standards assign higher risks to single-family loans in neighborhoods where the single-family homes are mixed with multi-family, commercial, institutional or industrial uses. Collateral versions of this principle are to assign higher risks when the neighborhood usage is uniformly single-family, but the zoning has been changed or different nearby land uses are perceived to be encroaching on the single-family home neighborhood.

Many neighborhoods in Seattle are characterized by single-family dwellings mixed with apartments, stores, offices, institutions and occasionally even industries. There appears to be strong demand by persons who wish to buy and occupy single-family homes in many mixed neibhborhoods, but financing for the purchase and rehabilitation of such homes does not seem to be available. If strong market demand can be documented for single-family homes in the same and other mixed use neighborhoods, it is unclear why lenders should object to lending on these homes.

4. Methods Used by Appraisers to Select Comparable Properties

There are no uniform, publicly disclosed standards which determine the comparability of neighborhoods from which appraisers select the comparables. Appraisers should be comparing market values of similar properties located in similar neighborhoods, e.g., same distance from public transportation, same mix of multi-family and single-family structures, etc. But there are no objective appraisal techniques, available for public review, which insure such comparability. When pressed on this question, appraisers who met with the Task Force said the public has to trust the professional judgment of appraisers.

Recommended Remedies

1. Degree of Housing Vacancy the Only Indicator of Current Neighborhood Risk for Residential Lending Throughout the Seattle Metropolitan Area

Lenders should make residential loans on any block throughout the Seattle metropolitan area, except where the vacancy rate of residential structures has exceeded 20% of the structures on the block for a period of one year.

Although more than 20% of the units on a block have been vacant for a year, lenders should consider lending on that block, if one or more of these mitigating conditions exist on that block.

a. Presence of a local community organization which includes that block in its service area.

b. Evidence that the municipality or county where the block is located is providing that block with basic housekeeping services.

c. Vacancy rates which can be attributed directly to a major economic disaster such as the Boeing layoffs.

Definition of Terms

Residential Loans: First mortgage, repair, home improvement and rehabilitation loans on single-family or multi-family structures.

Block: Twenty houses on each side of a street shall constitute a block. Because of the topography of Seattle, flexibility must be used in applying this standard. For example, if there are no homes on one side of a street, but there are twenty homes on the other, this shall constitute a block. Or, it may be necessary to count houses on both sides of an intersection to arrive at twenty homes for each side of the street.

Vacancy: The residential structures shall have been unoccupied by owners or tenants. Seventy-five percent (75%) of the apartments in a multi-unit structure must have been unoccupied for the building to be considered vacant.

Rationale

The basic assumption underlying this recommendation is: Market choices of buyers are the best indicators of neighborhood lending risks. If potential buyers or tenants think the risk of neighborhood deterioration is excessive, they will not move into the neighborhood. Current residents will not support the efforts of a local community organization to improve the neighborhood. There will be no pressure on the City to maintain services, because neighborhood residents no longer care. Some residents will move out. Over time, this market assessment of neighborhood deterioration will result in vacant units.

This market approach to determining neighborhood risk stands in contrast to the imposition on the market of traditional appraisal and underwriting criteria. Appraisers and underwriters who use these standards prejudge the market: They assume potential buyers and tenants will make market decisions based on those traditional criteria. The Reinvestment Task Force believes that appraisers' and underwriters' use of these traditional standards interfere in the free workings of the market place and should be discontinued.

2. Geologic and Atmospheric Conditions, Vacancy Rates and Impending Public Acquisition of Property, City Policies for Maintaining Housing and Basic Services Are the Only Appropriate Indicators to Be Used In Estimating the Future Economic Life of a Block

When estimating the future economic life of a block in the Seattle metropolitan area, only the following factors should be considered:

a. Geologic conditions (Example: Slides)

b. Atmospheric conditions (Example: Airport noise)

c. Impending public acquisition of property (Example: Land acquisition for freeways)

d. Vacancy rates (Example: See previous discussion on neighborhood risk),

e. City policies for maintaining the quality of the housing stock

f. City policies for providing basic housekeeping services

Unless lenders shall present documented evidence to borrowers based on one or more of these six factors, it shall be presumed that any block has a remaining economic life of at least 30 years.

Rationale

At best, estimates which appraisers and underwriters make about future economic and social conditions in neighborhoods are guesses. Appraisers and underwriters do not have sufficient information on the complex social, economic and political factors at work in urban neighborhoods to make reliable estimates about neighborhood futures. (It should also be noted that city planners and academic researchers who study urban neighborhoods are also limited in their capacity to predict future neighborhood social and economic conditions. They too must contend with limited information and research techniques.)

Many such guesses about remaining economic life may be influenced by the traditional appraisal standard that older neighborhoods inevitably deteriorate. These guesses are also influenced by the appraisers' and underwriters' subjective judgments: They must speculate about the number of years remaining until neighborhood deterioration reaches unacceptable levels; they make judgments about the desires of buyers and tenants to live in neighborhoods whose residents are different socially and economically.

As a practical matter, these guesses and subjective judgments about neighborhood futures are incorporated into lending policy. If they predict future deterioration, lending policies may be formulated which contribute to such future deterioration.

In searching for an alternative way to determine realistic risks that may influence future property values in neighborhoods, the Reinvestment Task Force has sought to avoid the two basic problems inherent in traditional methods for estimating remaining economic life: The presumption of inevitable neighborhood deterioration and the potential for appraisers and underwriters to inject their personal biases into their estimates. The Task Force recommends the following alternative approach for assessing realistic future risks to lending in neighborhoods: Blocks in Seattle neighborhoods should be presumed to have a sound future unless objective evidence can be presented of the existence of any of six conditions. The existence of such condition raises reasonable doubts about the future housing values of those blocks. Geologic and atmospheric conditions such as slides, noise and air pollution have adverse influences on future property values in neighborhoods. Decisions by public agencies to acquire privately owned land create uncertainty about future values, since new owners will not want to buy in such impacted neighborhoods and existing owners have no incentive to maintain their properties. Vacancy rates indicate how potential buyers and tenants view the future of neighborhoods. The absence of City policies for maintaining basic housing standards and services will contribute to the deterioration of housing and neighborhoods. Each of these six adverse conditions can be objectively identified. Also, it is possible to determine objectively when changes occur in each of the six conditions.

3. <u>Objective Standards To Be Used for Determing Blocks from Which Appraisers Select Comparables</u>

In selecting comparables, appraisers should select them from blocks anywhere in the city or suburbs which emphasize the following legitimate characteristics:

a. Number of vacant houses

b. Number of single-family, multi-family, commercial, industrial and institutional units on the block

c. Distance to neighborhood commercial centers which include a grocery, drug store and cleaners

d. Distance to nearest bus stop

e. Distance to nearest public elementary school

f. View

Appraisers should not select comparables based on the racial, ethnic and economic composition of neighborhood residents, age of neighborhood housing, or quality of neighborhood schools.

II. Appraisal and Underwriting Standards Used to Evaluate the Soundness of Residential Properties Securing Loans in Seattle

Determination of the Remaining Useful Life of a Residential Structure

Problem

The concept of remaining economic life has been applied to individual houses and apartment buildings as well as neighborhoods. The appraiser and underwriter focus on the future demand for a residence based on their guesses about the future decisions both of people who are currently living there and those who might move in during the future. As noted in the discussion on the economic life of neighborhoods, it is virtually impossible for anyone to make reliable estimates about future market demands in neighborhoods. It is equally impossible for appraisers and underwriters to make such a determination of future demand for individual houses and apartments within neighborhoods.

Recommended Remedy

The remaining physical life of the residential structures should be the standard by which the remaining useful life of the property is to be calculated. This calculation should be made on the basis of the current physical condition of the property. If the current physical condition of the property is below that required by the City standards for occupancy certification (see Section IV of the chapter for a discussion of housing standards recommended for use in certifying residences for occupancy.), an additional estimate of remaining useful life should be made. This estimate should be based on the useful life which would remain if the residence were repaired to the standard required for occupancy certification.

III. Credit Underwriting Standards Used to Evaluate the Creditworthiness of Residential Loan Applicants

A. Maintaining High Standards of Creditworthiness

Problems

Relaxed credit standards may result in borrower defaults, foreclosures, housing vacancies and even abandonment. None of these outcomes serves the best interests of the borrowers, neighborhoods, lending institutions and consumers: The credit records of borrowers are stigmatized by defaults and foreclosures. Vacant and abandoned properties blight the surrounding neighborhoods and depress nearby property values. Costs that lenders incur when collecting delinquent mortgage payments and administering foreclosures are passed on to other borrowers through higher interest charges.

Recommended Remedies

1. Lenders should maintain credit standards that provide reasonable assurances borrowers will repay the loans.

2. Lenders should be encouraged to use the following guidelines in establishing such credit standards:

   a. The borrower(s) must have established a credit record which reflects proper regard for repayment of obligations.

   b. Adverse ratings should be reviewed to determine whether they were caused by valid and verified reasons with a minimal probability of recurrence.

   b. The borrower(s) must have clearly established a verified source of funds sufficient to make the down payment and pay all other costs incidental to closing a loan.

   c. The monthly payment for the loan, taxes and insurance should not exceed 25% of gross income.

   d. The borrower(s) income should be adequate to cover operations and normal repair in addition to the monthly payment for the loan, taxes and insurance. The monthly outlays for operations and maintenance will vary depending on the age and condition of the house and the type and use of utilities.

   e. The total of the mortgage payment and any other installment obligations extending beyond 10 months should not exceed 33% of verified gross monthly income.

B. Equal Opportunity in Provision of Residential Credit

Problems

Past institutional practices have contributed to the unequal application of credit standards for racial minorities and women. This discrimination has taken different forms. The salaries of working women have often been discounted without regard to the professional status, seniority or stability of employment; lenders have sometimes required statements indicating women's future childbearing intentions; credit agencies have refused to give women credit ratings separate from their current or former husbands. Lenders have sometimes refused to acknowledge incomes from second jobs which the applicants have held for long periods. This practice has placed minorities at a particular disadvantage because second jobs have been an important means for them to save enough money to buy houses.

Recommended Remedies

1. Credit standards shall be applied equally to all applicants regardless of race, sex or marital status in accordance with Title VIII, Equal Opportunity in Housing Act of 1968, Title VI, the Fair Credit Reporting Act of 1970, and Title V, Equal Credit Opportunity Act of 1974.

2. Seattle lending institutions should be encouraged to take the following affirmative steps as they develop and implement programs for equal access to residential credit.

   a. Consultation with the City of Seattle, Human Rights Commission and the Women's Commission in the development of sexism and racism awareness programs for lending personnel and in the preparation of affirmative marketing programs targeted to women and minorities. Such consultation can include technical assistance in program development and advice on the potential effectiveness of the programs.

   b. Publication and distribution of lenders' credit guidelines for residential loans should become routine practices. These guidelines should be written in non-technical language, and lenders should be encouraged to distribute them widely throughout their service areas. Such guidelines should be posted in the lobbies of lending institutions.

   c. Written notification should be sent to each loan applicant who does not meet the credit standards. The letter should identify the specific reasons for the loan rejection and include an offer to discuss remedial steps the applicant can take to qualify for a loan.

IV. Commitments Needed to Support and Monitor Revisions in Appraisal and Underwriting Standards

The City and Seattle lending institutions must make certain commitments if the proposed revisions in appraisal and underwriting standards are to be effectively implemented on a long-term basis: The City should commit itself to a policy requiring that housing be maintained in accordance with elemental health and safety standards. These standards should differ somewhat from those contained in the current Housing Code, because many of its requirements exceed those needed to protect the health and safety of housing occupants. The comprehensive implementation of such a policy would give residents and lenders needed confidence that the City is striving to maintain the housing stock in a sound condition throughout all the neighborhoods. The lending institutions should commit themselves to participating with the public in the monitoring of appraisal and underwriting decisions. Such monitoring is essential if Seattle citizens and the City are to have confidence that local lenders are actually using the revised appraisal and underwriting standards.

The following discussion describes the Reinvestment Task Force recommendations for implementing the commitments by the City and the lending institutions.

A. A City-Wide Policy to Maintain the Housing Stock in a Safe and Sanitary Condition:

Problems

The maintenance of the housing stock in a safe and sanitary condition is one of the basic challenges facing Seattle residents, lenders, real estate brokers, property insurers and City officials. The Building Department estimates that 4% of the residential buildings have serious health and safety hazards, 34% of the residential buildings in the city have at least one housing code violation, and 17% of the structures have visible signs of deferred maintenance. Our housing stock is aging--more than 50% of the housing units were constructed before 1940.

The City has a legitimate and important obligation to maintain the housing stock in a safe and sanitary condition. Housing Code enforcement is usually considered the principal means for the City to carry out this responsibility. However, there are problems involved in the City's past administration policy. In addition, there are problems inherent in a policy of Housing Code enforcement regardless of its administration. (See Appendix B for an extensive analysis of the problems and possibilities associated with alternative methods of Housing Code enforcement.) The following summary describes the essential difficulties of using Housing Code enforcement as a major policy tool for maintaining the housing stock in a sound condition on a city-wide basis. This summary incorporates those problems associated with the City's past efforts in code enforcement as well as those difficulties inherent in alternative methods:

1. Housing Code Standards and the Application of Those Standards

The City's current Housing Code contains standards which exceed those necessary to assure the basic health and safety of housing occupants. The enforcement of all these standards increases the costs of housing repairs unnecessarily. (Currently, the City Council is revising the Housing Code.)

Since Housing Code standards are, by their very nature somewhat general and vague, they must be interpreted and applied in specific situations by a number of different actors involved in Housing Code enforcement--City inspectors, contractors, hearing examiners, judges, etc. It is inevitable these actors will disagree from time to time about each other's application of the code. The more standards contained in the Housing Code, the more opportunity there is for disagreement over the application of those standards, and greater is the likelihood of administrative delays and confusion.

2. Impacts of Housing Code Enforcement on Low-Income Owners and Tenants

Systematic code enforcement throughout each neighborhood may force low-income owners to abandon their homes, unless public subsidies are available to help pay for a portion or all of the repairs. Similarly, systematic enforcement may force owners of housing rented to low-income tenants to abandon their buildings, unless the tenants subsidized to a level that will allow the owners to finance the required repairs. The abandonment of low-income housing will diminish this housing supply, causing an increase in rentals for low-income tenants.

Some local and federal subsidies are currently available to facilitate code enforcement programs involving low-income tenants and owners. However, these subsidies are extremely limited and could not support a systematic code enforcement policy in more than a few neighborhoods.

Housing Code enforcement at time of sale is one strategy that partially overcomes the hardship to low-income owners inherent in systematic neighborhood enforcement of the housing code. Since the low-income owner is moving out by choice, the enforcement of the code would not be forcing that owner out of the house. The buyer and the seller could negotiate a price that was discounted to reflect the costs of required code repairs. However, if the sale falls through, the low-income owners will still be legally required to make the repairs. This is because the City is legally obligated to follow through with its enforcement proceedings, once the violations are officially cited.

3. Lack of Financing for Code-Related Repairs

Since many lending institutions have not made loans available for housing code repairs in some neighborhoods, the City has been reluctant to institute systematic code compliance programs.

After reviewing alternative methods for city-wide enforcement of the housing code, the Task Force concluded there were too many problems inherent in each method and decided against recommending any of them.

Recommended Remedy

The Reinvestment Task Force recommends that any policy the City adopts throughout the city should be judged by these criteria:

1. The standards of housing quality should not exceed those needed to assure the basic health and safety of the occupants. Standards which exceed this level will require more costly repairs and diminish the supply of low-income housing.

2. The policy should encompass as many units as possible in the shortest period of time. This criterion must be qualified by considerations of the limitations of subsidies for low-income property owners and tenants.

3. The housing quality standards and administrative procedures for implementing the standards should be kept simple to avoid the bureaucratic confusion and delay.

4. The policy should be funded by user fees, so it is not a drain on the City's general fund.

5. Financing must be available for any repairs required by the policy.

The Task Force finds that a policy which requires an occupancy permit for residential structures at the time of sale comes closer to satisfying these criteria than any of the other policies it examined. Therefore, the Reinvestment Task Force makes the following recommendations:

1. The City Council should enact an ordinance requiring a certificate of occupancy at the time of sale for every residential structure in the city. This would require City certification that each residential structure meets specified elemental health and safety conditions. If a property is sold within a year of its certification, its new owners should not be required to obtain a new certificate. Owners of residential structures at the time the ordinance is enacted should not be required to secure an occupancy certificate. A reasonable period of time shall be given for any deficiencies to be repaired.

   Because of the large number of residential structures sold each year in Seattle (8,800 single-family and 1,200 multi-family in 1975), a pervasive city-wide impact can be made in a fairly short period of time.

2. The standards of housing quality to be used for certification must not exceed the most elemental standards necessary to assure the health and safety of the occupants. Because some of the requirements in the City's Housing Code surpass such elemental standards, the Housing Code

should not be used for implementing this policy. Instead, another set of criteria should be developed which are limited to basic health and safety factors. In developing the elemental health and safety standards, the City shall consult with housing consumer groups, especially those representing low-income tenants and owners, real estate brokers, apartment owners and lenders.

3. The certificate of occupancy should be understood as a consumer protection policy to protect buyers from purchasing residential structures with hazardous conditions and to protect tenants from living in such conditions. Therefore, the ordinance establishing the certificate of occupancy should require that a copy of the inspection report be made available to all potential buyers, real estate agents, appraisers and lenders, and tenants occupying the building at time of sale.

4. The certificate of occupancy shall be administered by the City's Department of Licenses and Consumer Affairs.

5. Owners who do not make the repairs required for certificatation and occupy the residences or allow tenants to occupy them shall be referred to the Building Department for enforcement of the Housing Code.

6. The cost of administering the program should be recovered from an inspection fee charged to the sellers.

7. The availability of financing for the required repairs and the mortgage loans is an indispensable element in the certificate of occupancy policy. To assure the City that sufficient funds will be available to finance the mortgage and repair loans, the City Council should not adopt the certificate of occupancy ordinance until the Mayor's Office has received letters of agreement from a majority of the lending institutions within each of the three categories of lending institutions: commercial banks, mutual savings banks and savings and loan associations. The letters of agreement should indicate the adoption by each lending institution of the underwriting and appraisal standards for neighborhood evaluation, property and creditworthiness as recommended by the Reinvestment Task Force.

8. The City will need more time to adopt and implement a certificate of occupancy ordinance than lending institutions will need to revise and implement their appraisal and underwriting standards. Therefore, lending institutions should implement the new standards 90 days after the submission of the Reinvestment Task Force final report to the Mayor. If the City Council has not adopted an ordinance requiring an occupancy certificate within 18 months of the submission of the final report, the Reinvestment Task Force should reconvene and reconsider the continued use of the appraisal and underwriting standards.

B. A Monitoring System to Assure that Seattle Lending Institutions Are Using The Revised Appraisal and Underwriting Standards

The proposed monitoring system calls for reviews by both lenders and the public of rejected applications.

1. Lenders Review Board

a. Purpose

The purposes of the Lenders Review Board are:

i. Review rejected loan applications to determine whether the rejections are based on unfair applications of the revised appraisal and underwriting standards.

ii. Review approved residential loan applications when the approved borrowers believe that required interest rates and finance charges, down payments and repayment periods or other conditions are not based on the revised appraisal and underwriting standards.

iii. Attempt to persuade lending institutions to grant the loans and establish terms consistent with the revised appraisal and underwriting standards whenever the Board determines that such standards are not being used.

iv. Place loans with other lenders after the Board has determined that lending institutions have not used the revised appraisal and underwriting standards, and such lending institutions will not make the loans or alter the terms in accordance with the Board's request.

b. Organization

i. The Lenders Review Board shall be composed of nine members.

ii. The Board shall be established initially as follows:

- Each financial institution serving Seattle through real estate lending shall be invited to designate one person to represent it on this program.

- At a meeting of such representatives, 15 individuals who are representative of the composition of the financial community shall be nominated to the Board and submitted for appointment by the Mayor. The Mayor shall appoint nine to overlapping terms.

- The Mayor shall appoint the Board within 30 days of receipt of the initial nominees. Appointments shall be for terms of not less than one nor more than three years.

- Vacant and expired terms shall be filled in the same manner.

- The Board shall be responsible for its own organization.

c. Operations

i. The Board shall have a quorum when the chairperson or vice-chairperson and two additional members are present.

ii. The Board shall meet at least quarterly, or as called by the chairperson.

iii. The Board shall have minutes describing the considerations and actions of the Board prepared for each meeting and distributed to the Mayor, the City Council and all designated representatives of the participating financial institutions, and to the Public Review Board.

iv. The Board shall be empowered to make all of its rulings binding on the financial institutions, individually or collectively as appropriate to the circumstances.

v. The Board shall advertise its role and function as necessary. Seattle financial institutions which have adopted the new appraisal and underwriting standards and subscribe to the monitoring program shall publicize widely the application review program. These institutions shall provide all loan applicants with materials describing the loan review process for rejected applicants.

d. Procedures

i. The Board shall direct all requests for review of rejected loan applications to the Secretary of the Board, who shall prepare and distribute an agenda prior to each meeting.

ii. The Board shall review each rejected application and make its determination within 21 days of the request for review.

iii. The Board shall consider only matters involving written application to a lending institution.

iv. At the written request of the Board and the persons whose applications were rejected, lenders shall provide a copy of the rejected application and related documents such as credit reports and appraisals to the Board. These documents shall be treated confidentially.

v. Rejected applicants shall make a request for Board review within 30 days of receiving written notice of their rejection.

vi. Persons requesting a review must provide a signed statement of the facts, circumstances or acts to be reviewed and the ruling which is sought.

vii. The Board shall make all of its rulings in writing and shall provide a copy of the ruling to the person requesting the review.

viii. The Board shall develop and communicate such additional procedures as are deemed appropriate and necessary to its function.

e. Financial Support

i. The Board shall prepare and approve an annual budget.

ii. The Board shall obtain the required revenues through an annual assessment of financial institutions in proportion to their real estate loan portfolios in such a formula as may be adopted by the Board.

iii. The Board shall provide an annual accounting to all participating financial institutions.

iv. The Board shall, as it deems necessary, have the authority to establish an office, publish and distribute related materials and to hire, set salary, and dismiss employees.

2. Public Review Board

a. Purpose

The purpose of this Board is to monitor the activities of the Lenders Review Board and to review matters:

i. Referred by the Lenders Review Board.

ii. Appealed by a party not satisfied by the determination of the Lenders Review Board.

iii. Concerning real estate financing.

b. Organization

The Public Review Board shall be composed of eleven members with the following qualifications:

i. Four representatives from community organizations.

ii. Chairman, Lenders Review Board.

iii. One representative each from:

Realtors
Contractors
City Government

iv. Three citizens chosen at large and not associated with any interest otherwise represented.

v. The Board shall be established initially as follows:

- Thirty days prior to the initial appointment, the Mayor shall make a public announcement that appointments to the Board will be made. The announcement shall solicit nominations for Board memberships from the public at large and from the interest groups to be represented on the Board.

- The Board members shall be appointed by the Mayor within 30 days of the receipt of the list of nominees.

- The Board shall elect its own chairperson. The Chairperson of the Lenders Review Board shall be ineligible for election to this position.

- Appointments to the Board shall be for overlapping terms of not less than one nor more than three years.

- The City's representative shall serve as Board Secretary.

c. Operation

i. The Board shall have a quorum when a majority of members are present.

ii. The Board shall hold meetings at least quarterly or as called by the chairperson.

iii. The Board shall have minutes describing the considerations, recommendations and actions of the Board prepared and distributed to Board members, the Lenders Review Board, the Mayor, and City Council. The minutes will become public information.

iv. The Board shall issue reports at regular intervals to the Mayor and City Council.

v. The Board shall have the right to express its collective opinion publicly on any matter appropriately brought to its attention. The role of the Board is to hear such matters and attempt to mediate the differences among the parties. While it lacks the authority to require the parties to act, the Public Review Board will have the capacity to exercise significant persuasion with the parties to encourage them to reconsider their positions.

d. Procedures

i. The Board shall review such complaints or appeals regarding the financing of the purchase or improvement of real estate as may

be brought before it, provided that the case has first received the review of the Lenders Review Board. The Board shall review any request, suggestion, complaint or reference to the purchase, improvement or sale of real estate in the area.

ii. The Board shall direct all written requests for review to the Secretary of the Board, who shall prepare and distribute an agenda prior to each meeting.

iii. Referrals to the Board must be made within 30 days of the occurrence of the Lenders Board decision.

iv. The Board shall review and make its determination within 21 days of the request for review.

v. All matters and information coming before the Board shall be deemed public information unless identified as confidential. All confidential documents shall be destroyed when no longer needed.

vi. The Board shall make all reasonable efforts to verify the completeness and accuracy of information and testimony given, and shall cause such investigations to be conducted as it deems necessary and productive.

vii. The Corporation Counsel of the City of Seattle shall serve as the Board's legal counsel.

viii. The Board shall develop and communicate such additional procedures as are deemed necessary and appropriate to its function.

e. Financial Support

i. The City of Seattle shall provide any staffing and financial support needed to support the activities of the Public Review Board.

CHAPTER 4

HOUSING REHABILITATION IN SEATTLE*

The maintenance and preservation of the City's housing stock has been acknowledged by lenders, citizens and City officials to be a critical determinant of the City's future. By contrast, traditional appraisal and underwriting standards, federal state and local policies and the values of many individual citizehs have promoted the view that housing and neighborhoods should be consumed and discarded. Fortunately, there is a growing awareness in Seattle and across the nation that we can no longer indulge in such wasteful practices. M. Todd Cooke, President of the Philadelphia Savings Fund Society, expressed this view forcefully to the Reinvestment Task Force:

> "We can no longer afford the luxury of allowing our housing to decay to the point we must completely rebuild our neighbhoods every forty years. We must develop public policies and private lending practices which allow for the continual renewal and rehabilitation of our housing and neighborhoods."

A. Monitoring the Quality of Work Performed by Contractors

Problem

Often lenders, homeowners and apartment owners are reluctant to invest in substantial rehabilitation projects because they are afraid of being cheated by contractors. Most lenders and borrowers do not have the technical background to monitor contractors to insure that work is being done in a quality and timely fashion.

Recommended Remedy

Lenders should develop the technical capacity to monitor the progress and quality of contractors' work on major rehabilitation projects which involve any of the main mechanical systems or structural alternatives of the property. Lenders who generate a substantial volume of rehabilitation lending may find it most efficient to develop an in-house staff with these skills. Otherwise, lending institutions can contract for these services with individuals or organizations who have the requisite skills and experience.

B. Rehabilitation Work Performed by Property Owners

Some property owners who want to do their own work may not have the technical capacity to complete the rehabilitation work in a quality and timely fashion. Lenders need assurances that their loans will be well-used for the rehabilitation projects.

* Chapter 6 contains a recommendation for changes in federal and state tax policies which are needed to stimulate private investment in housing rehabilitation. Chapter 3 contains a recommendation for an occupancy permit as a policy the City can use to maintain the quality of its housing stock.

Recommended Remedy

A homeowner should be encouraged to do his or her own rehabilitation work, provided the lender is satisfied that the owner has the technical capability to do the work.

C. Do-It-Yourself Home Maintenance

Problem

A continuous effort is necessary to maintain houses and apartments in sound condition. Much of this work can be done by the property owners and tenants themselves. However, many are inexperienced and need training.

Recommended Remedy

Lenders, material suppliers, community organizations and the City should develop and publicize home repair and maintenance programs. Such education efforts should be aimed at prospective and existing homeowners, apartment owners and tenants.

D. Cost of Financing Rehabilitation

Problem

Financing for housing rehabilitation and repair is most often done through home improvement loans. Home improvement loans are a relatively expensive way to finance such work, since they are consumer loans and carry a consumer loan interest rate. (Currently, consumer loan rates are about 12%.) The repayment periods are ten years or less. This means the monthly loan payment is greater than if the repayment period were longer. By contrast, mortgage loans carry a lower interest rate (current conventional rates are slightly below 9%) and the repayment periods often exceed 20 years. It is very difficult for a family to carry both a first mortgage loan for an older house requiring rehabilitation work and the more costly home improvement loan.

Recommended Remedy

Financing techniques for housing rehabilitation which are less costly than home improvement loans should be developed. The Rehabilitation Policy Group to be convened by the City's Office of Policy Planning should include this problem as a priority item on its work program.

CHAPTER 5

DISLOCATION OF POOR PEOPLE FROM NEIGHBORHOODS

Problem

One of the tragedies that has haunted most public and private efforts to rehabilitate neighborhood housing is that low-income residents of those neighborhoods are usually forced out. There are several reasons for this dislocation: First, public and private reinvestment often results in increases in housing values. Owners of rental units will often evict poor tenants so the buildings can be rehabilitated and rented to people with higher incomes. Low-income owners of residential properties may sell in order to take advantage of higher prices, but their limited incomes make it impossible to buy or rent housing in the same neighborhoods. Code enforcement policies designed to improve the housing stock have sometimes forced low-income owners and tenants to abandon buildings, because their incomes were too limited to finance the required repairs.

There is a pervasive suspicion that the City and local lending institutions would like to pursue neighborhood reinvestment policies that will eventually force low-income persons, particularly minorities, out of neighborhoods which are strategically located close to the downtown.

Recommended Remedies

The Reinvestment Task Force believes that public and private reinvestment strategies should be designed so that low-income persons are not forced out of their neighborhoods. To that end, Seattle lending institutions, the City, the Seattle Housing Authority and community organizations should give their highest priority to the development of strategies which will avoid the displacement of poor people from the neighborhoods, as a consequence of public and private reinvestment strategies. The Rehabilitations Policy Group, which will soon be convened by the Office of Policy Planning, should immediately begin the development of solutions to this vexing problem.

In its work, the Rehabilitation Policy Group should give special attention to several financing techniques which may have particular promise: The Section 8 program administered by the Department of Housing and Urban Development can be used for the rehabilitation of existing rental housing. If Congress decides to continue Section 167(k) of the Internal Revenue Code, there will be tax incentives for private investment in the rehabilitation of low-income housing.

CHAPTER 6

FEDERAL AND STATE ACTION REQUIRED FOR NEIGHBORHOOD REINVESTMENT

Federal and state policies have a significant impact on lenders' investment decisions regarding neighborhoods. These policies create a network of "public channels" which can direct private credit toward some communities and away from others. This chapter presents a discussion on several of these federal and state policies which influence quite directly neighborhood lending decisions of banks, savings and loan associations and mortgage banking companies:

I. Federal and State Regulatory Policy for Savings and Loan Associations, Commercial and Mutual Savings Banks

II. Federally Related Secondary Mortgage Markets: Federal National Mortgage Associations and Federal Home Loan Mortgage Corporation

III. Federal, State and Local Tax Policy

IV. FHA Mortgage Insurance

I. Federal and State Regulatory Policy for Commercial and Mutual Savings Banks and Savings and Loan Associations

A. Responsibility of Federal Regulatory Agencies to Assure that Lending Institutions Fulfill Their Obligations to Communities

Problems

Federal regulatory agencies have not made clear the nature of institutions' obligations to serve the credit needs of local communities. Each of the federal agencies which regulate banks and savings and loan associations has a general requirement that the institutions they supervise serve community needs. But the agencies do not define what is meant by community needs. Such lack of regulatory focus has contributed to lenders' disinvestment from portions of communities. In the past, agencies have been concerned primarily with the protection of depositors, and have focused regulatory policy on the solvency of banks and savings and loan associations. This emphasis has resulted in the regulation of interest rates, mandatory deposit insurance, establishment of reserve and capital requirements and limitations on competition by requiring institutions to be publicly chartered as a condition for entering the business. These same regulatory policies increase the profit potential of banks and savings and loan associations.

Federal Reserve System* - This agency regulates certain activities of national banks and those state-chartered commercial banks which choose to join the Federal Reserve System.

> *"The convenience and needs of the community to be served by the bank" is one of four criteria the Federal Reserve uses to evaluate an application for membership.*
>
> (12 C.F.R. 1 § 4.2)

The present Chairman of the Federal Reserve, Arthur Burns, has noted that member banks should give the credit needs in their local service areas priority over other demands for credit:

> *"While funds should normally flow to the uses offering the greater returns, I believe that it is important that each banker realizes that continued availability of credit to local activities may well, in the longer run, yield the greater total return to the economy of the community and thus to his bank as well. Taking due account of relative credit risks, the first obligation of bankers is to the credit requirements of their service area."*
>
> (Letter from Arthur Burns, Chairman of the Board of Governors, Federal Reserve System, to the Presidents of the Federal Reserve Banks of Chicago, Dallas and Kansas City.)

Federal Deposit Insurance Corporation - This Agency insures the deposits of commercial and mutual savings banks, and has some regulatory oversight for the insured banks.

* The Comptroller of the Currency is inserted on p. 35a.

Comptroller of the Currency - This agency charters and regulates the national banks.

> *"The convenience and need of the community to be served by the bank" is one of the criteria the Comptroller uses to evaluate an applicant for a charter.*
>
> (12 C.F.R. 1 § 4.2)

"Convenience and needs of the community to be served by the bank" is one of the six criteria the FDIC uses to evaluate applications for deposit insurance.

(12 U.S.C. 1816)

Federal Home Loan Bank Board - This agency charters and regulates federal savings and loan associations. Through its subsidiary, the Federal Savings and Loan Insurance Corporation, the FHLBB regulates both federal and state-chartered associations whose deposits are insured by FSLIC.

The Congress authorized the FHLBB to charter and regulate savings and loan associations so they would provide home financing to local communities:

"In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation of associations to be known as 'Federal Savings and Loan Associations,' and to issue charters therefore, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.

(12 U.S.C. 1465(a) (1933 as amended))

The FHLBB has issued regulations and administrative procedures requiring charter applicants to furnish detailed information and showing *"There is a necessity for the proposed association in the community to be served by it. . ."* (C.F.R. Chapter V (C), Title 12 § 543.2 (b))

Regulatory agencies' formal requirements that lending institutions serve community needs have not been implemented through the issuance of regulations, adoption of administrative procedures and examination practices. Traditional regulatory policy has focused almost exclusively on assuring the solvency and profitability of lending institutions. The Reinvestment Task Force acknowledges that the agencies' concern with solvency and profitability serves an important public purpose. But the federal regulatory agencies have not adopted policies to assure that lending institutions are fulfilling an equally important public purpose--the provision of credit and deposit services to local communities.

Recommended Remedies

1. Federal regulatory agencies should adopt the following policies:

   a. Develop criteria to evaluate whether applicants for charters and branch offices will adequately serve the needs of communities for credit deposit services.

   b. Applications for new branch offices should not be approved until applicants have demonstrated that they have satisfactory records of community service in other areas where they have home and branch offices. As an aid to the public's participation in this review, regulatory agencies should require each branch applicant to answer these questions:

i. What has the applicant done to determine and document the various needs for credit and deposit services in the community where it proposes to establish a branch?

ii. What is the applicant's track record in the provision of credit and deposit services in the community where it proposes to establish a branch?

iii. What specific commitments is the applicant willing to make to meet the reasonable needs for credit and deposit services in the community where it proposes to establish a branch?

c. Applicants for charters and branches should be required to consult with local community interests (e.g., community organizations, private community serving institutions, local governments, businesses) about their needs for credit and deposit services and submit such information as part of the application.

d. As part of the regulatory agencies' field investigation of branch and charter applications, agency examiners should consult with community interests about local needs for credit and deposit services and the adequacy of the applicants' proposals to meet those needs.

e. Regulatory agencies should periodically review whether institutions are adequately meeting the deposit and credit needs of communities. The public should be given legal standing to comment during this review. (Under current regulations, the public has legal standing to comment on charter and branch applications. This recommendation would extend this legal right to the periodic review.)

2. If the Congress approves the federal chartering of mutual savings banks, the enabling legislation should spell out clearly that the granting of federal charters carries an obligation to meet reasonable community needs for credit and deposit services in exchange for the benefits of such charters.

B. Information Federal Regulatory Agencies Need to Investigate Racial and Sexual Discrimination in Lending

Problem

The Equal Opportunity in Housing Act of 1968 prohibited lenders from discriminating in the provision of housing credit on the basis of race, color, religion, or national origin. (A 1974 Amendment added "sex" to the list of unlawful actions.) Included in the 1968 Act is a congressional mandate to the federal regulatory agencies *"to administer their programs and activities relating to housing and urban development in a manner affirmatively to further the purposes of this subchapter. . ."* (Sec. 808 of Title VIII (42 U.S.C. 3609)

It is reasonable to assume that part of the regulatory agencies' affirmative responsibility is to determine whether discrimination is occurring. This

would include the investigation of specific complaints and the examination of actual lending patterns to ascertain whether institutions are systematically practicing discrimination. Factual information is essential, if the agencies are to carry out both types of investigation. However, the four federal regulatory agencies do not require lenders under their supervision to record the race and sex of loan applicants, although eight years have elapsed since this Act was passed. Nor do they require lenders to maintain copies of rejected applications. Consequently, it is virtually impossible for the agency examiners to review the facts of specific complaints alleging racial and sexual discrimination. Further, the absence of such information makes it impossible for examiners to review loan rejection patterns according to race and sex to detect any patterns in lending decisions which warrant further investigation.

Recommended Remedies

1. Federal regulatory agencies should require institutions under their supervision to record on each application form for residential loans, the sex and race of all loan applicants and to keep all rejected applications in their files for a minimum of three years.

2. Federal regulatory agencies should require field examiners to review the rejected loan applications during the periodic examinations for each lending institution.

C. Appraisal Standards Used by Federal and State of Washington Regulatory Agencies

Problem

Federal and state regulatory agencies use appraisal principles and practices in their supervision of lending institutions. For example, these agencies require lenders to make appraisals on properties secured by first mortgage loans. Some regulatory agencies employ staff appraisers who review appraisals made by lending institutions.

Reinvestment Task Force research on the training materials and professional standards published by both professional organizations identified two major problems: First, the standards and training materials generally discourage lending in older city neighborhoods. Second, these educational materials and standards promote the use of racial and ethnic considerations in real estate appraisals.

Recommended Remedies

1. Federal and Washington State regulatory agencies should review their appraisal standards and eliminate any which are based on the racial and ethnic composition of neighborhoods and any which presume the inevitable deterioration of neighborhoods.

2. Federal and Washington State regulatory agencies should insist that the Society of Real Estate Appraisers and the American Institute of Real Estate Appraisers eliminate the use of those standards and training materials which are based on racial and ethnic biases.

D. State of Washington Legislative Requirements for Institutions to Serve Credit Needs of Communities

Problems

Commercial banks and savings and loan associations can be chartered either by the federal or state governments. Currently, mutual savings banks are chartered only by state governments, although federal legislation has been proposed to provide federal charters for such institutions.

The Washington state legislature has not provided language which clearly specifies the obligation of state-chartered institutions to serve community needs:

State-Chartered Savings and Loan Associations

"The (state) supervisor shall proceed to determine . . . whether the public convenience and advantage will be promoted by allowing such association to be incorporated and engage in business in the community indicated, and whether the population and industry of the neighborhood and the surrounding country afford reasonable promises of adequate support for the proposed association."

(RCW 30.08.030)

State-Chartered Commercial Banks and Trust Companies

"The (state) supervisor shall ascertain whether the character, responsibility and general fitness of the persons named in such articles are such as to command confidence and warrant belief that the business of the proposed bank or trust company will be honestly and efficiently conducted in accordance with the intent and purpose of this title, whether the resources in the neighborhood of such place and in the surrounding country afford a reasonable promise of adequate support for the proposed bank and whether the proposed bank or trust company is being formed for other than the legitimate objects covered by this title."

(RCW 30.08.030)

State-Chartered Mutual Savings Banks

"The (state) supervisor shall ascertain . . . whether the public convenience and advantage will be promoted by allowing such proposed bank to be incorporated and engage in business, and whether greater convenience and access to a savings bank would be afforded to any considerable number of depositors by opening a mutual savings bank in the place designated, whether the population in the neighborhood of such place, and in the surrounding country, affords a reasonable promise of adequate support for the proposed bank."

(RCW 32.08.010)

Recommended Remedy

The legislature should revise the statutes authorizing the state chartering of commercial banks, mutual savings banks and savings and loan associations. The language should conform to the language in federal statutes and administrative regulations which specifies the obligation of lending institutions to serve the credit and deposit needs of communities.

II. Federally Related Secondary Mortgage Markets: Federal National Mortgage Association and Federal Home Loan Mortgage Corporation

A. Property Appraisal and Underwriting Standards of Secondary Mortgage Markets

Problems

Conventional mortgage loans, originated by Seattle lenders, are frequently sold directly to secondary mortgage markets related to the federal government. Those federal markets are the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA). These secondary markets use appraisal and underwriting standards to determine which mortgage loans they will buy. Since most local residential lenders expect to sell a substantial portion of their loans, it is in their interest to originate loans which satisfy those secondary market standards.

Seattle is a "capital short" area. This means, in part, that there are not enough deposits generated locally to provide all of the funds lenders need to meet local mortgage needs. Therefore, Seattle lenders acquire needed "outside" capital by originating mortgages and then selling them to the secondary markets. The proceeds from these sales are used to originate local mortgages.

If Seattle lenders revise their property underwriting standards, they will be limited in the number of mortgages they can originate--unless secondary market purchasers also revise their standards accordingly. When the Philadelphia bankers met with the Reinvestment Task Force, they noted their recent changes in underwriting standards differ from those used by FHLMC and FNMA. This makes loans originated under the "Philadelphia Mortgage Plan" ineligible for sale to these two markets. The new Philadelphia underwriting standards are similar to those proposed by the Reinvestment Task Force for use in Seattle. (See Chapter II of this report for a discussion of the recommended appraisal-underwriting standards.)

1. Federal Home Loan Mortgage Corporation

The Federal Home Loan Mortgage Corporation is a subsidiary of the Federal Home Loan Bank Board. This federal agency regulates federal savings and loan associations and state-chartered associations whose deposits are federally insured.

The published underwriting standards of the FHLMC assign higher risks to older properties that are "overimproved" relative to other homes in the neighborhood. FHLMC bases this standard on the asumption that most buyers in a given neighborhood will conform in their values and tastes. FHLMC underwriting standards also assign higher risks to new houses built in older neighborhoods. This standard is based on the assumption that older neighborhoods will be more likely to deteriorate than to maintain or improve their quality.

The Seattle housing market generally contradicts each of the FHLMC standards. Seattle housing is diverse: Housing varies greatly in architectural style, amenities, level of improvements, age and cost on

many blocks and throughout many neighborhoods. There is a very strong demand for this housing. There is also a vigorous demand for new houses in older neighborhoods throughout the city. But these FHLMC underwriting standards are penalizing Seattle home buyers, lending institutions and Seattle taxpayers who have supported City programs to encourage the rehabilitation and new construction of housing in older neighborhoods.

2. Federal National Mortgage Association

The Federal National Mortgage Association is a privately held corporation with public purposes and subject to certain public controls. The President of the United States appoints one-third of its directors, and the Secretary of the Department of Housing and Urban Development exercises some policy direction over FNMA.

FNMA underwriting standards for conventional loans do not contain explicit standards which indicate that conventional lending in older neighborhoods represent higher risks. The property underwriting guidelines say, *"FNMA has not and will not designate certain areas as being acceptable or unacceptable to FNMA, i.e., it will not 'redline.'"* (FNMA Conventional Selling Contract Supplement, p. 27)

On January 13, 1976, the Reinvestment Task Force met with Norman Reid, Regional Vice President for FNMA. Mr. Reid was asked whether FNMA published underwriting guidelines similar to those contained in the FHLMC document. Mr. Reid reported that FNMA depends on the underwriting judgment of local lenders who originate and sell conventional loans to FNMA, and cited the following statement in the published FNMA underwriting standards:

> *(FNMA) will rely upon the seller's judgment as to the market value of a given security and the general acceptability of that type of security to private institutional investors. . ."*
>
> (FNMA Conventional Selling Contract Supplement, 1974, p. 27)

However, local lenders have told the Reinvestment Task Force that FNMA's informal underwriting standards do discourage purchase of conventional loans originated in older neighborhoods. This Seattle experience was corroborated by the Philadelphia bankers when they met with the Task Force.

Recommended Remedies

1. Local lenders, the City and interested community groups should immediately make a joint request to FHLMC and FNMA to bring their formal and informal property underwriting standards into conformity with those proposed by the Reinvestment Task Force. These requests should emphasize the cooperative efforts of the three local interests to improve Seattle neighborhoods.

   Further, these requests should emphasize two collateral principles:

a. Local lenders, who have daily contact with neighborhoods, are better qualified to evaluate the risk of lending in neighborhoods than are secondary market officials.

b. FNMA and FHLMC should not impose their property underwriting standards on local lenders unless default and foreclosure rates reach levels which have been determined previously to be unacceptable.

2. If FHLMC and FNMA do not make satisfactory revisions in their property underwriting standards, local lenders, the City and community groups should jointly request the Federal Home Loan Bank Board and the Secretary of the Department of Housing and Urban Development to require FHLMC and FNMA respectively to make such changes.

3. Alternatively, local lenders, the City and community groups should jointly request the congressional delegation from the State of Washington to introduce legislation incorporating these principles:

   a. At the joint request of local lenders, municipalities and community groups, FHLMC and FNMA shall bring their property underwriting standards into conformity with those proposed by the local interests.

   b. As a condition for approving such property underwriting changes, FHLMC and FNMA should require local interests to present a plan of joint action for neighborhood improvement which is mutually satisfactory to the local lenders, municipality and community groups. The secondary markets shall have no power to veto this plan, relying rather on the local interests' knowledge and judgment about neighborhood conditions.

   c. The only grounds for FNMA and FHLMC to make local lenders' use of the revised property underwriting standards shall be an increase in default and foreclosure rates to unacceptable levels. The standard which determines unacceptable default and foreclosure rates shall be the same standard which FHLMC and FNMA apply to lenders operating under their traditional property underwriting standards.

B. Secondary Mortgage Market Purchases of Rehabilitation and Repair Loans

Problem

Currently, there is not a source of funds in "capital short" areas to support a major shift in local lending policies toward the conservation and rehabilitation of existing housing. Over time, Seattle lenders may require a secondary market for the purchase of repair and rehabilitation loans. Local lenders will need this secondary market in order to meet the potential consumer demand for this type of financing. FHLMC and FNMA have not yet developed programs to purchase such loans.

Recommended Remedy

FHLMC and FNMA should be encouraged to develop secondary market programs for the purchase of housing repair and rehabilitation loans.

III. Federal, State and Local Tax Policy

A. Federal Tax Policy

Problems

Channeling of Private Credit Primarily Toward New Construction Instead of the Maintenance and Rehabilitation of Existing Structures

Current federal tax policy provides incentives to private investors which tend to channel private capital toward the construction of new residential commercial and industrial buildings instead of the conservation and rehabilitation of existing properties. Two tax incentives which illustrate this basic orientation are the current allowances for the accelerated depreciation of income-producing properties and the 1975 tax credit for purchasers of new homes.

1. Accelerated Depreciation Allowances for Income Producing Properties

An income producing property is one which the investor holds primarily for the rental income. Principally, income producing properties are apartments, offices, stores and industrial-manufacturing buildings.

Tax shelters based on depreciation allowances are predicated on this somewhat fictitious assumption: As property is used, it wears out, loses its value and eventually must be replaced. The owner should be compensated for this loss in value, in order to have replacement funds available when the property finally wears out. This replacement fund is created by a depreciation allowance. The depreciation allowance permits the owner of an income-producing property to make an annual deduction from his or her taxable income The deduction is equal to the loss in value attributable to the depreciation. So the owner's annual taxable income and consequently the tax bill, is reduced or "sheltered" by the amount of the annual depreciation allowance. For example, assume the owner of a large new apartment building is permitted an annual depreciation allowance of $10,000. This depreciation allowance can be deducted from his or her annual taxable income. If the owner's marginal tax rate is 40%, e.g., the top $10,000 of taxable income is taxed at a rate of 40%, then this tax shelter saves the owner $4,000 in federal income taxes for that year.

There are basically two approaches to the calculation of the depreciation allowance. The first approach assumes that property wears out and depreciates in value at a uniform rate over a fixed number of years. This method based on this assumption is called the "straight-line" technique of depreciation. It is derived by dividing the depreciable value of the property by the number of years of allowable economic life. For example, if the depreciable value of a new apartment building is $400,000 and the allowable economic life is 40 years, then the annual straightline depreciation deduction is $10,000.

The second approach to the calculation of depreciation is based on the assumption that the decline in value is much faster when the property is new. It allows the investor to deduct a greater proportion of the total depreciable value of the property in the early years of ownership.

There are several different methods which can be used to calculate accelerated depreciation, e.g., double-declining balance, sum-of-the-years, etc. For example, if the owner of the new apartment building whose depreciable value is $400,000 elects the double-declining balance method, $20,000 can be deducted from his or her taxable income in the first year of ownership. This is in contract to the $10,000 first year deduction available to the owner under the straightline method.

The important principle is: The more accelerated the depreciation, the greater the tax shelter. With one exception, the most accelerated forms of depreciation are available for the construction of new properties. This exception is an accelerated depreciation allowance for the substantial rehabilitation of rental units for low and moderate income tenants.

The following charts portray the various forms of accelerated rates of depreciation on income producing properties which are available for new construction, existing properties and the rehabilitation of properties:

Chart 1

Rental Residential Properties	Accelerated Depreciation Allowances
New Construction	Double-declining balance. (200% of straightline depreciation.) 150% declining balance. (150% of straightline depreciation.) Sum of the years.
Existing Properties	125% declining balance for used residential units with a useful life of at least 20 years. (125% of straightline depreciation.)
Rehabilitation of Existing Properties for Low and Moderate Income Residents Only	5 year straightline depreciation for total rehabilitation expenditures over two consecutive tax years. (Minimal rehab expenditure is $3,000 and maximum is $15,000.)
Rehabilitation of Existing Properties for Residents Who Do Not Qualify as Low and Moderate Income	None.

Chart 2

Commercial-Industrial Rental Properties	Accelerated Depreciation Allowances
New Construction	150% declining balance.
Existing Properties	None.
Rehabilitation of Existing Properties	None.

2. 1975 Tax Credit for Purchasers of New Homes

In 1975, the Congress passed a tax bill that provided a one-time tax credit for purchasers of new homes (Tax Reduction Act of 1975, Section 208). Congress gave an income tax credit to purchasers of new homes whose construction had begun on or before March 31, 1975. The tax credit was 5% of the purchase price up to $2,000. Since a tax credit is applied to a tax liability, a home buyer who qualified for a tax credit of $2,000 and had a tax liability of $2,000 was able to eliminate completely the federal income tax liability.

The purpose of this legislation was to help home builders sell off a rather large inventory of new homes. This inventory had accumulated during the recession when new home sales had dropped dramatically. As a practical matter, the tax credit did not stimulate the number of sales its sponsors had hoped to produce.

However, this Act illustrates that federal tax policy tends to encourage private investment in new construction rather than investment in the maintenance and rehabilitation of existing properties. Congress has not legislated any tax incentives explicitly designed to stimulate private investment in the rehabilitation and conservation of existing single-family homes.

Recommended Remedy

Policy Options

The Reinvestment Task Force recognizes that an important national debate is occurring on the use of federal tax incentives to stimulate private investment in activities the Congress believes to be desirable. Some argue that tax policy should not create incentives for private investment. They prefer to fund such programs directly through the budgetary process and eliminate most or all of the tax shelters. Others argue that the current provision of tax incentives should continue.

Because of time limitations, the Task Force has not investigated this important but complex question. However, the Task Force has identified the broad policy choices facing Congress, if it decides that federal tax incentives should be used to stimulate private investment for the rehabilitation and conservation of existing structures in existing neighborhoods:

1. Equalize the federal tax incentives for private investment in both new construction and rehabilitation and maintenance of existing residential commercial and manufacturing properties.

2. Eliminate federal tax incentives for investment in new construction, but allow incentives for private investment in the maintenance and rehabilitation of existing structures.

3. Create federal tax incentives for private investment to rehabilitate and maintain existing structures. Combine this policy with the elimination of federal tax incentives for private investment in new

construction--except for "in-fill" construction on vacant land located in existing communities already serviced by public improvements such as schools, streets and highways, sewer and water systems, parks and recreation areas. (Much of the new construction occurs on suburban peripheries which do not have these public improvements. Taxpayers are than called upon to finance these improvements through local, state and federal expenditures. Such public investments are often made in suburban fringes while similar and serviceable public facilities are abandoned or underutilized in older cities and suburbs.

E. State and Local Tax Policy

Problems

Under current state law governing local real estate tax assessments, any improvements to property require the county assessor to reassess the entire property. This serves as a disincentive to the rehabilitation of property, since owners do not want to pay the higher taxes that will likely result from such reassessment.

Recommended Remedy

State property tax laws should be modified to provide incentives for the rehabilitation of property.

IV. Federal Housing Administration Mortgage Insurance: FHA Interest Rates and Discount Points

Problem

In the past, FHA mortgage insurance has been instrumental in allowing many middle-income families to purchase homes. The basic mortgage insurance program, known as Section 203(b), has low down payment requirements and long repayment periods. However, the use of FHA mortgage insurance is curtailed because sellers must pay discount points if such mortgage insurance is used in the sale.

Interest rates on FHA-insured mortgages are determined by the administrative action of the Secretary of the Department of Housing and Urban Development. Typically, the Secretary sets the rates slightly lower than those prevailing for conventional mortgage loans. Since lenders will invest in conventional mortgage loans yielding higher interest rates, FHA-insured mortgages are at a competitive disadvantage. The payment of discount points on FHA insured loans is the financing device which compensates for this competitive disadvantage. (A discount point in mortgage lending is one percentage point of the loan amount.) Put simply, an FHA-insured lender will calculate the number of discount points needed to make up the difference between the interest rate available on a conventional mortgage loan and the maximum interest rate allowable on the FHA-insured loan. The lender then charges the seller of the house the required number of points. The seller pays the "points", because FHA regulations prohibit the buyer from paying such charges. The seller usually pays the points out of the proceeds of the sale. Since sellers must pay the discount points, they do not like to use FHA mortgage insurance in their transactions.

Recommended Remedy

The Congress should pass legislation eliminating the administrative determination of interest rates for FHA-insured loans. These rates should be determined by the same market forces which control interest rates on conventional mortgage loans, thereby eliminating the need to pay discount points.

CHAPTER 7

DISCLOSURE IN SEATTLE

Cities have adopted ordinances, states have passed laws, and Congress has recently enacted legislation requiring lending institutions to disclose certain types of non-confidential information.

The adoption of these regulations has been advocated for several purposes: Documentation of past lending practices, evaluation of current lending policies, and provision of planning data related to private and public investment.

Retroactive disclosure may provide documentation of past lending practices, savings/deposit patterns, defaults and foreclosures. Pressure for retroactive disclosure seems to be strongest when lenders and regulatory agencies deny that the practice of redlining occurs or assert that higher risks and lower returns on investment justify the denials of conventional mortgage credit in certain neighborhoods.

Prospective disclosure may provide a monitoring tool to evaluate the effect of future lending practices, savings/deposit patterns, defaults and foreclosures. Proponents of prospective disclosure believe that such data can be used to determine whether lenders are fulfilling reinvestment commitments and to evaluate the levels of risk associated with lending in various areas across metropolitan regions.

Disclosure information provides data for private and public institutions which are involved in policy making, planning and research in cities and suburbs. Policy makers, economists, planners, regulatory agencies, and academic researchers have noted that virtually no publicly available data exists on the geographic sources of private capital, i.e., deposits, pension and insurance premiums, and the geographic distribution of that private capital through loans and equity investments. These private investment decisions have considerable effects on the future of communities, both urban and rural. But the virtual absence of data about the private capital flows across communities has seriously limited researchers and policy makers in understanding and coping with these investment impacts.

Governmental disclosure of public investment on a geographic basis provides a measure of accountability to taxpayers. Although governmental expenditures are a matter of public record, it is difficult to determine actual investments in capital improvements and services for small geographic areas.

All Task Force members recognize the merits of some form of disclosure. Acknowledgement of de facto redlining/disinvestment practices by lenders may have reduced the need for extensive retroactive disclosure. There are some differences of opinion as to the type and extent of retroactive and prospective disclosure. This chapter includes a discussion of the proposed types of disclosure. Where there are differing views, alternative proposals and the pros and cons of each alternative are presented.

I. Loan Disclosure

II. Deposit Disclosure

III. Disclosure of City Investments

IV. Retroactive Disclosure

V. Geographic Areas for Comparison

VI. Means of Enforcement

I. Loan Disclosure

A. Lending Policies

Problems

Appraisal and underwriting criteria determine loan eligibility. Therefore, loan applicants have a right to know precisely what standards will be used to evaluate their applications. City and School District policy makers and taxpayers must make fiscal and program decisions based on the social and physical conditions in neighborhood and commercial areas. These local conditions are created, in part, by private lending decisions. Therefore, policy makers and taxpayers have a right to know exactly what appraisal and loan underwriting standards are being used to evaluate applications for residential and commercial loans.

Recommended Remedy

Copies of appraisal and underwriting standards and policies used by each lending institution should be available to the public. Standards and policies of other public and private institutions which influence local lending policy such as mortgage insurers, secondary mortgage markets and regulatory agencies should also be made available to the public.

B. Risk Experience

Problem

Some lenders assert that lending in older communities is subject to higher risk than in newly developing areas. Lenders should provide the data necessary to justify appraisal and underwriting criteria which describe certain areas, types of persons, property and businesses as being higher risks than other types.

Recommended Remedy

Data should be provided which documents each institution's risk experience measured by default and foreclosure rates.

C. Lending Patterns

Problem

Private credit is essential for the construction, rehabilitation and orderly transfer of residential and commercial properties. Home buyers are dependent upon the availability of mortgage loans for financing. Without the lending of private credit for inventory, equipment replacement and expansion, local businesses cannot provide employment, goods and services and basic tax support for local government. Community-serving private institutions such as churches, hospitals and social service agencies need credit for property acquisition, repair and maintenance as well as for operating expenses. Therefore, the extent to which private credit is being made available to the residential, commercial, and community service segments of cities is significant information.

Recommended Remedy

Alternative A: Disclosure by census tract of real estate loan activity for limited but significant categories of information. (See Appendix C for Alternative A.)

Pro: This form is concise and could be completed more readily than one requesting more comprehensive data. This would decrease the expense for disclosing institutions. Types of loans disclosed provide essential information for comparing the number and dollar amounts of loans closed, loan terms and the number of defaults and foreclosures. Analysis of the data would be facilitated by its brevity.

Con: The data disclosed by this form is insufficient to evaluate the lending patterns for neighborhood business and private community-serving institutions and organizations.

Alternative B: Disclosure by census tract of a full range of lending data organized by four broad categories of community credit needs (See Alternative B, Tables 1-5 in Appendix D):

a. Single-family residential

b. Multi-family residential

c. Small business real estate and commercial loans

d. Community-serving private non-profit institutions and organizations.

Pro: Information required is comprehensive and includes categories of several types of loans vital to maintenance of communities. Most of the data is already reported by individual institutions to regulatory agencies and/or secondary mortgage markets. It would be impractical to retrieve unreported information that later may be needed for complete analysis of lending patterns or that may be required by state law.

Con: Alternative B requires the reporting of information that is not essential to monitoring residential lending activity. More data may be generated than is practical to analyze. Extensive reporting of data is an added expense which will be passed on to the customer.

D. Community Marketing of Loan Availability

Problem

Lenders have not adequately addressed the credit needs of older communities for residential rehabilitation loans, neighborhood business loans, short-term revolving credit for day care agencies on voucher systems, etc. Correspondingly, real estate agents, local property owners, businesses, private community-serving institutions have not believed that credit will be made available to them, nor have they understood some of the practical problems lenders may have in administering such loans. Therefore, lenders should disclose the practical steps they have taken to bridge this lack of understanding of community credit needs.

Information on lenders' efforts to market the availability of credit to communities is essential for an accurate understanding of the loan demand underlying the disclosed loan patterns. Ironically, both opponents of redlining and lenders fear that each other will misunderstand this very issue. Opponents of redlining argue that both the reality and perception of redlining have discouraged home and apartment owners, businesses, and private community-serving institutions from seeking loans. They feel that unless changes in lending policy are accompanied by aggressive efforts to market the availability of credit, loan demand may not pick up. Disclosure statistics will then pick up this limited demand, and lenders will back away from continuing reinvestment programs because "the demand is not there." Some lenders, however, argue that redlining opponents will establish arbitrary and artificial reinvestment quotas for neighborhoods that may exceed the real demand for loans in those neighborhoods. Such lenders feel that in spite of good faith efforts to change lending policies, they will be held up for public attack if these unrealistic quotas are not satisfied because of insufficient demand.

If lenders document and disclose their marketing programs, this information can be used, in part, to assess the extent of lenders' commitment to reinvest in older communities. In turn, the disclosure of marketing efforts can protect lenders against reinvestment quotas which exceed real demand. By documenting the extent of their marketing efforts to generate demand for loans, lenders can blunt criticisms that they are not doing enough.

Remedies

1. An institution's efforts to determine local needs for various kinds of credit, particularly residential, commercial, industrial, and private institutions serving communities, e.g., churches, hospitals, day care centers, etc. should be routinely disclosed.

2. Lenders should describe the marketing programs used to generate demand for different types of loans. This description should include dollar amounts committed to such marketing programs, geographic scope of the marketing, and samples of informational materials.

II. Deposit Disclosure

A. Deposit Patterns

There are two viewpoints related to disclosure of deposit information:

Pro:

Disclosure of the total dollar amounts of private and public deposits will emphasize the obligation of lenders to be accountable in the investment of these funds to the residents, businesses, private community-serving institutions and taxpayers who own these deposits. Advocates of deposit disclosure argue that lenders must give first priority in the investment of these funds to the reasonable credit needs of the communities which have generated the deposits. The disclosure of the total privately and publicly owned local deposits will provide dramatic evidence of the large amounts of local capital which lenders take out of older communities. This evidence will build support for reinvestment policies which give priority to local needs. If those needs exceed local deposits, then other sources of credit should be secured from secondary mortgage markets, etc. But if total credit needs are less than local depsits, then lenders may invest local deposits elsewhere. People of this persuasion believe that an analysis of loan-to-deposit ratios and neighborhood needs will indicate disinvestment/reinvestment trends.

Proponents contend that it is necessary to know the extent of net changes in deposits for each reporting period if they are to gauge the overall availability of funds to lenders. During periods of disintermediation, i.e., withdrawal of funds from savings accounts for direct investment in government securities offering higher returns, the availability of funds for lending is diminished. During other periods, total savings balances will increase. An awareness of the ebb and flow of savings provides a necessary perspective for interpreting changes in loan volume.

Remedy Suggested by Proponents of Deposit Disclosure Information

Disclosure by census tract of a full range of deposit data in two categories: (See Tables 6-7 in Appendix D)

Demand deposits (non-interest bearing)
Time deposits (interest bearing)

Con:

Lenders and regulatory agencies object to the disclosure of deposits for several reasons: First, no conclusions about disinvestment/reinvestment in certain neighborhoods can be drawn from comparisons of lending and deposit information. The disclosure of both loan and deposit data will encourage the creation of arbitrary loan/deposit reinvestment ratios which may exceed or fall below the real credit needs of communities. Lenders and regulators point out that lower income communities with relatively smaller total deposits may have needs for credit that far exceed the deposits generated from those neighborhoods. A reinvestment

ratio that limits loans to some percent of existing deposits will penalize poorer communities from receiving "outside" credit from secondary markets or other sources. Second, the priority given to reinvesting local deposits in the communities of origin reduces the prerogatives of lenders to invest money at higher yields and/or lower risks outside those areas.

III. Disclosure of City Investments

A. City Expenditure for Capital Improvements and Services

Problem

Seattle residents, who are both depositors in local lending institutions and taxpayers, need information to determine whether both the lenders and the City are investing their money in ways which will help revitalize the city's neighborhoods. The withdrawal or substantial reduction of essential public services and maintenance of capital improvements, over time, contribute to the deterioration of neighborhoods as inevitably as does the withdrawal of private credit. Although the City routinely discloses information on amounts spent for services and capital improvements, it does not report the data by census tract. Therefore, it is difficult to determine the precise amounts of public expenditures which are made in given neighborhoods.

Recommended Remedy

The Task Force recommends that City expenditures for capital improvements and services be broken out for each census tract in the city. Such disclosure by census tract would be prospective in nature.

B. City Investments in Lending Institutions

Problem

The City of Seattle has approximately $140,000,000 in its employees' pension fund and millions of dollars more in time and demand deposit accounts and investments of various types. Although this information is a matter of public record, the City does not publicize this data.

Recommended Remedy

The Task Force recommends that the City publicize widely the type and dollar amounts of employees' pension fund investments, the dollar amounts held in demand and time deposits, and the identities of lending institutions holding those deposits.

IV. Retroactive Disclosure

Problem

In order to determine whether Seattle lending institutions have changed their lending policies, it is necessary to have a historical data base as a bench mark for evaluating future lending performance.

Remedy Suggested by Some Members of the Task Force

Disclosure of residential loans and deposits specified in Tables 1, 2, 6 and 7 of Disclosure Alternative B. The geographic reporting unit should be postal zip code rather than census tract. The data should be reported in twelve month periods, beginning July 1, 1973 and concluding June 30, 1976.

Pro

Advocates of retroactive disclosure argue that historical data for loans and deposits must be made available in order to avoid a long delay before an evaluation can be made of future loan and deposit patterns. In the absence of historical bench marks, future patterns will not emerge until a number of reporting periods have passed, and it will be difficult to determine whether lending policies are changing. Proponents believe that the establishment of past patterns is particularly important for neighborhoods which have undergone racial transition or have concentrations of minority residents. There have been denials that racial and ethnic considerations have been major influences in past lending practices, and proponents of retroactive disclosure want data to determine past patterns in such neighborhoods.

Information on past deposit trends is necessary to determine whether changes in the volume of lending were related to decreases or increases in savings deposits. These deposits are a major source of lendable funds for mortgage loans.

Proponents of retroactive disclosure recognize that few, if any, Seattle lending institutions have in the past organized loan and deposit information by census tract. However, many may have the historical data coded by postal zip code. To reduce the cost of retrieving the information, proponents recommend the use of postal zip codes rather than census tract.

Con

Opponents of retroactive disclosure argue it is unnecessary to document previous lending patterns since lenders have acknowledged that de facto redlining has occurred in Seattle. They believe the important issue is the development of remedies which will assure that residential loans are made available on a fair and equal basis throughout the city. They also believe that the review process proposed by the Task Force for rejected applications and the future disclosure of rejected applications by census tract will be adequate for determining whether individual lending institutions are discriminating.

Opponents of retroactive disclosure maintain the costs of producing retroactive disclosure far exceed the benefits. Few, if any, lending institutions have their loan files computerized. The loan files themselves are not organized by zip

code, so these would have to be sorted manually. All of the detailed information on individual loans contained in Alternative B would have to be retrieved manually.

It is argued that there is no causal relationship between the amount of deposits generated by a given neighborhood and the number of loans made there. Loan demand may be greater or less than the deposits in a neighborhood, so that any conclusions about neighborhood investment policies which are drawn from loan-to-depisit ratios will be misleading.

V. Geographic Areas for Comparison

A. Geographic Units of Analysis

Problems

Comparison of lending practices between communities and among neighborhoods within communities cannot be made unless data is disclosed by specific geographic areas. Geographic comparisons can be made for the following areas:

1. Neighborhoods within the city.

2. City with the suburbs and unincorporated areas in its metropolitan region.

3. City with the entire state, excluding its own metropolitan region.

4. City and home state with other states.

Recommended Remedies

Alternative A: Use of a Title Insurance Company for Retrieval of Real Estate Loan Information

Title insurance companies maintain records of all real estate transactions legally recorded in the county in which they take place. Title companies also perform title searches to make sure properties are free and clear of liens at the time of sale. Recordings of properties involved in each transaction are by legal description, not street address. Depending upon each company's computer capability, they would be able to aggregate information and retrieve some specific loan information. At least one title company publishes a monthly report of all real estate mortgages recorded at the King County Court House. Information is organized by individual financial institutions and reported for Seattle and the rest of King County. Information is broken out monthly by number and dollar amounts of conventional, FHA, VA mortgage loans and deeds of trust. If a title company were used to organize disclosure data, census tract numbers would have to be assigned to each property by the institution making the loan.

Pro

Real estate loan data that is routinely recorded for legal purposes is also recorded by title companies. This would eliminate duplication of recording some information and possibly reduce the cost of disclosure. At least one title company has the computer capability to aggregate and sort out data by census tract if each transaction is pre-coded by census tract.

Con

The information recorded by title companies is not complete. Data related to deposits, defaults, some loan characteristics, applicant characteristics, and some types of loans could not be disclosed using a title company. Lending institutions would have to develop an efficient and accurate method of determining and recording census tract designations on recorded documents. The importance of this point is emphasized by the findings of the Federal Home Loan Bank Board. The FHLBB conducted an experiment requiring savings and loan associations to code loan applications by census tract. The analysis revealed that the largest source of errors in its data was census tract designations. "A manual check for the accuracy of census tract numbers on randomly selected addresses showed that substantially less than half of the census tract designations were correct (46% in Washington, D.C.; 38% in Chicago) . . . The high degree of inaccuracy in this information appears to be a result of the difficulties encountered in determining census tracts as well as normal carelessness. (Fair Housing Information Survey, Form A Approach, Federal Home Loan Bank Board, August 18, 1975, pp. 2 and 4)

All of the transactions recorded at the county are by the legal description of the property; few include street addresses. Title companies currently do not have access to the street addresses of most properties, nor do they have reason to record these addresses. Consequently, there is no way the accuracy of census tract designations can be checked.

Alternative B. Use of GEOBASYS (Geographic Base System) for retrieval of information by any of the following geographic units:

1. Inside Corporate Limits of Seattle:
   * Census Tract: Contains approximately 4000 residents within its boundaries.
   * Census Block: Roughly equivalent to a city block.
   * Census Block Groups: A census block group consists of about 1,000 people--approximately one-fourth of the population of a Census Tract.
   * Kroll Maps by map number: Each Kroll Map displays one square mile, usually divided into an east section and a west section of one-half square mile each.
   * Quarter Sections: A quarter section is one-fourth of a square mile.

2. Outside Seattle Corporate Limits

   The following areas currently are geo-coded completely by census tract, Kroll Map, and quarter section:

   King County
   - Bellevue
   - Des Moines

Kirkland
Lake Forest Park
Mercer Island
Normandy Park
Renton
Tukwila
145th - 205th (North Seattle)

Snohomish County
Alderwood Manor
Brier
Edmonds
Everett & surrounding area (Unincorporated areas between
Alderwood Manor (these communities are included.
Lynnwood

The following population centers are partially geo-coded.

Auburn	(Unincorporated areas
Federal Way	(between these communities
Kent	(are included.
Bothell	
Redmond	

GEOBASYS is a non-profit consortium of technical management officials in Seattle area public agencies who have developed a computerized capability of sorting street addresses by various common geographic areas. Present members of the system are the University of Washington and the Seattle Public Schools. The utility is managed through the Urban Data Center at the University of Washington. Geoprocessing services are provided to members and other users on a cost or support reimbursable basis.

GEOBASYS actively encourages and assists local and private agencies to utilize geoprocessing technology. The goals are as follows: To provide economies to members and users through the maintenance and operation of data files that are costly to build, maintain, and use; to provide the private sector with marketing related services; to provide spatially identified data for use in analyzing, planning and administering public functions and services; to integrate and advance knowledge and capability of geoprocessing and related systems.

Pro

GEOBASYS is a sophisticated computer utility. The personnel that have developed the system are highly skilled computer technicians with expertise in the possibilities and limitations of computer programming and data processing technology.

Accuracy of the basic data is an important element in analyzing any aggregated information. GEOBASYS has the advantage of 95-98% accuracy.

It estimates that within Seattle, its file of street addresses coded to the various geographic units of analysis, e.g., census tract, Kroll Maps, etc. has less than a 2% error factor. The error factor for the urbanized portions of King and Snohomish Counties is less than 5%. These errors are corrected with each update of the computer file system. The current file was updated in February, 1976.

In addition, GEOBASYS has the capabiltiy to display Geo-Coded Loan/ Deposit Data in the following formats:

Tables
Bar charts
Lists
Maps
Spatial statistics

These displays would aid in the analysis and understanding of the processed data.

Con

Lenders are more accustomed to working with title companies. Their unfamiliarity with the technical capabilities and costs of utilizing GEOBASYS may discourage them from participating in disclosure.

Small lending institutions which originate few loans may find it less costly to hand record the data requested.

VI. Means of Enforcement

A. The Task Force recommends that the City Council adopt a disclosure ordinance for depositories of City funds. At the present time, the Task Force has not agreed on the extent of the loan and deposit data it should recommend for incorporation into the disclosure ordinance.

B. The Task Force recommends that the Mayor and City Council request the Washington State Legislature to pass disclosure legislation. At the present time, the Task Force has not agreed to the extent of the loan and deposit data it should recommend for incorporation into the legislation.

C. The Task Force recommends that the City's Office of Policy Planning be assigned the following tasks related to local, state and federal disclosure:

1. Monitor lenders' compliance with reporting required by local ordinance, and report regularly on such compliance to the Mayor, City Council, lenders/review board, public review board, and other interested parties.

2. Collect, analyze, and summarize the data generated by any local, state and federal disclosure requirements.

3. Report findings to the Mayor, City Council, lenders review board, public review board, and other interested parties.

4. Review periodically the effectiveness of any local, state and federal disclosure requirements and make recommendations for modifications to the Mayor, City Council, lenders review board, public review board, and other appropriate parties.

APPENDIX A

READING LIST FOR APPRAISAL AND UNDERWRITING

The sources are the current, official publications of the American Institute of Real Estate Appraisers, the Society of Real Estate Appraisers, Federal Home Loan Mortgage Corporation, and Washington Mutual Savings Bank. Those publications are listed below along with chapter and page citations for further reading on these topics. Specific quotations from these sources appear in an earlier Task Force discussion paper, "Appraisal and Underwriting of Residential Loans in Seattle Neighborhoods." Several other publications are also listed below. All documents are available for review at the Mayor's Office of Policy Planning, 3rd Floor, 306 Cherry Street.

American Institute of Real Estate Appraisers

The Appraisal of Real Estate, American Institute of Real Estate Appraisers, 6th Edition, 1974, Chapter 6, "Neighborhood Analysis" pp. 87-108.

Single Family Residential Appraisal Manual, Jerome Knowles, Jr., American Institute of Real Estate Appraisers, 1974.

Society of Real Estate Appraisers

An Introduction to Appraising Real Property, Society of Real Estate Appraisers, Revised, 1975, Chapter 6, "Area and Neighborhood Analysis," especially Section III (Neighborhood Analysis) and Section V (Uses and Applications of Area and Neighborhood Analysis).

Federal Home Loan Mortgage Corporation

FHLMC Single Family Underwriting Guidelines and Use of the Computer in Underwriting Loans, Federal Home Loan Mortgage Corp., Revised 1974.

Washington Mutual Savings Bank

Underwriting Policy Manual

Other Publications

Examination Objectives and Procedures, Federal Home Loan Bank Board, Office of Examinations and Supervision, 1971.

The Valuation of Real Estate, Alfred A. Ring, S.R.A., M.A.I., Ph.D., 2nd Edition, 1970

a) Chapter 6, "Impact of Urban Forces Upon Property Value," pp. 68-77

b) Chapter 7, "Value Analysis of Neighborhood Characteristics," pp. 78-92

Valuation Analysis for Home Mortgage Insurance, a HUD Handbook, Housing Production and Mortgage Credit - Federal Housing Administration.

Miscellaneous Type Home Mortgage Insurance Section 223(a), (e), and (d), a HUD Handbook, Housing Production and Mortgage Credit - Federal Housing Administration

Selling Agreement Supplement, Federal National Mortgage Association, January, 1975 (and recent changes)

Servicer's Guide, Federal National Mortgage Association, October 1974 (and recent changes).

APPENDIX B

HOUSING CODE ENFORCEMENT:

AN ANALYSIS OF THE ALTERNATIVES

I. What Purposes Are Served by a Policy of Housing Code Enforcement?

There are several purposes which a policy of housing code enforcement can serve. Some of these purposes may be in conflict. A City Task Force on City Codes and Building Rehabilitation notes these factors in its 1974 report:

> *One of the major reasons for controversy surrounding the Housing Code is the difference of opinion among various parties concerned as to the purpose of the Code. The purposes which have been attributed to the Housing Code include forcing the demolition of obsolete structures and opening the way to new development, stopping the spread of blight, forcing the maintenance and conservation of existing buildings, protecting the health and safety of the public, and even protecting the morals of building occupants. Each interested group promotes its purpose for the code as the only legitimate purpose. Tenants may view the Code as a device to ensure that their living units are satisfactorily maintained; neighborhood homeowners may view the Code as a tool to maintain the appearance of the community and thus provide a more pleasant place to reside; owners of rental property may view the sole legitimate fundtion of the Code as the protection of the health and safety of the public; mortgage firms, banks and the Department of Housing and Urban Development may view the Code as the proper mechanism for requiring housing to include features which will facilitate the resale process. In fact, the Housing Code does function, at least to a limited extent, in many of these capacities mentioned above. However, this multiplicity of purposes results in conflicting judgments as to the adequacy of Code provisions, as well as to the desirable application of enforcement resources.*

II. What Housing Code Standards Shall Be Used?

There seem to be two qualitative types of standards which can be used in housing code enforcement:

A. Minimal standards for structural and mechanical systems which assure safe and sanitary living conditions.

B. Standards which assure not only basic safety and sanitation, but also some degree of modernization and cosmetic improvement.

There are problems in distinguishing between minimal health and safety standards and standards for more extensive degrees of rehabilitation.

III. Alternative Policies of Housing Code Enforcement: An Overview

A. Mandatory Housing Code Compliance at the Time of Sale

B. Advisory Housing Code Inspections at the Time of Sale

C. Concentrated Code Enforcement on a Neighborhood by Neighborhood Basis

D. Ad Hoc Code Enforcement, Based on Complaints

A. Mandatory Housing Code Compliance at the Time of Sale

A Housing Code inspection at time of sale is required. All housing code violations found as a result of this inspection are required to be corrected by either the buyer or the seller.

1. Pro

Because of the large number of units which are sold each year (8,800 single-family and 1,200 multi-family in 1975), a pervasive city-wide impact can be made in a fairly short period of time. It is more efficient to handle the financing of such repairs at time of sale, because such financing can be worked into the mortgage loan.

2. Con

If the sale falls through, the "seller" must still make the required repairs, because the City is legally obligated to follow through in its enforcement once the violations are cited. This may be a hardship for low-income owners who cannot secure financing to make the repairs.

If code compliance at time of sale becomes the sole Housing Code enforcement policy, there may be certain neighborhoods, or pockets within neighborhoods, which do not turn over rapidly but have houses with code violations that need attention.

Code compliance at time of sale may increase the number of housing units which are abandoned. This can occur if owner-occupants cannot afford to repay loans for the repairs. Abandonment of rental units can occur if low-income tenants cannot pay the rent increases necessary to repay the repair loans.

The City's administrative costs for this program may be quite high. Also, the compliance process may slow down real estate sales.

B. Advisory Housing Code Inspections at the Time of Sale

No enforcement of standards is required except where violations are discovered which pose severe and immediate threats to the health and safety of the occupants. The results of the inspection are required to be made available to all sellers, potential buyers, their real estate agents, appraisers and mortgagees.

1. Pro

This alternative is primarily a consumer protection service which will make buyers and lenders aware of needed repairs. It can be used to negotiate the purchase price downward to compensate for the cost of the needed repairs.

If lenders make first mortgage financing contingent on either the seller doing the repairs or the buyer making the repairs, such a requirement may encourage widespread compliance with codes as a means of securing institutional mortgage financing.

The administrative costs to the City under this option may be less than those incurred through mandatory compliance at time of sale, because there will not be as many follow-up inspections as there are under mandatory compliance.

2. Con

Enforcement is uneven, especially if banks require compliance, but the City doesn't. Many house sales are not financed through financial institutions; therefore, compliance would be uneven. There may be an increase in the number of private contract sales as a way to avoid meeting the Housing Code standards imposed by institutional lenders.

3. Additional Comments

This concept would require legislative changes regarding the responsibilities of the Superintendent of Buildings. At present, the Superintendent of Buildings is required to issue a formal notice of violation, if, after an investigation (inspection), he determines that a building is in violation of the standards as set forth in the Housing Code. The issuance of this notice triggers the legal enforcement machinery. The legislative change would have to be applicable to all buildings, or to a class of buildings, e.g., multi-family or single-family.

C. Concentrated Code Enforcement for Selected Neighborhoods

A geographic area, usually a neighborhood, is designated for this program. Every structure is inspected within a prescribed time period, typically one to five years. Violations, if found, are cited and the owner is required to make all repairs within 90 days. Extensions are granted on the basis of mitigating circumstances, such as lack of funds, a large number of repairs that require more than 90 days to make, exterior repairs which can only be done during the summer, etc., but extensions generally do not exceed 60 days. This alternative is not in any way tied to the time of sale.

This code enforcement strategy can operate in conjunction with a special repair loan program offering both subsidized and market rate interest rates similar to the Mt. Baker Neighborhood Housing Rehabilitation Program. Or, concentrated code enforcement can be used without providing any special repair loan programs.

1. Pro

This code enforcement strategy may have the greatest concentrated impact on given neighborhoods of any alternative approaches. If the enforcement program is coupled with the availability of repair loans that reach all income levels, all homeowners and tenants may benefit by living in units which are upgraded.

2. Con

There are not sufficient public funds available from federal and local sources to subsidize more than a small proportion of the city's low-income residents living in substandard housing; therefore, only a relatively few neighborhoods can be served. Without such subsidies, low-income homeowners or owners renting to low-income tenants may be forced to sell or abandon their units.

Concentrated code enforcement without low-income subsidies is viewed by many as a policy designed to displace the poor and minorities from neighborhoods located close to the downtown, expediting the redevelopment of these areas.

Because housing codes are a relatively new phenomenon (most cities adopted such codes in the early 1960'a, including Seattle), there is not sufficient historical data to determine whether concentrated code enforcement programs have a pervasive and long lasting effect on the quality of the housing stock. Seattle's experience with federal urban renewal programs, such as Federally Assisted Code Enforcement (FACE) and Neighborhood Development Programs (NDP), indicates that such programs are expensive to administer. Completion of a neighborhood with such a program takes a minimum of five years; such neighborhoods commonly consist of between 600 and 700 structures.

The major reason for the high administrative costs is that code enforcement is only one element of such programs. The additional elements are financial counseling, preparing cost estimates, preparing and reviewing bid packages, contractor selection and the monitoring of contractor's work, information dissemination, citizen participation, land acquisition and disposal, preparation of comprehensive neighborhood plans, etc. It is impossible to separate out the actual cost of code enforcement activities from the other tasks.

D. Ad Hoc Code Enforcement, Based on Complaints

Code inspection and compliance initiated on a complaint only basis.

1. Pro

This may be the least costly administratively of all code enforcement strategies, because it relies on complaint-initiated inspections. Since no programs are initiated by the City, fewer field and support staff are required.

2. Con

While an ad hoc approach may be less expensive administratively, it may be detrimental to preserving the existing housing stock and, in the long run, prove to be more expensive to a municipality. If the housing stock is not maintained, the tax base erodes while public demand increases for expensive remedial housing programs.

IV. Legal, Budgetary and Administrative Issues Involved in a Policy of Housing Code Enforcement at Time of Sale

A. Legal Problems Involved in a Policy of Mandatory Code Enforcement at Time of Sale

Housing Code enforcement entails the municipality's use of the police power. Therefore, it may be unconstitutional to require an inspection at time of sale. Such a requirement may abrogate an individual's right, under the Fifth Amendment of the U.S. Constitution, to refrain from incriminating himself. Such mandatory inspections may be illegal unless search warrants are obtained which describe the conditions under which it is reasonable to assume the property is not in compliance with the code.

The experience in Cincinnati illustrates this legal problem:

A Cincinnati ordinance required sellers of one-family residences to provide buyers with certification that the homes had been inspected by Cincinnati building inspectors.

The inspectors would have listed any deficiencies on the certificate, thereby informing buyers about code violations. The inspections would have been made within 180 days of entering into the contracts for sale. There was a $35 inspection fee.

The ordinance provided that sellers could "warrant"--make a sworn statement--that the structures were in compliance with codes, making the sellers liable for deficiencies which were discovered later.

Failure to comply with the law would have been punishable by a fine of up to $500.

A suit contesting the ordinance was brought by the Cincinnati Board of Realtors. The case was heard on June 6, 1974 by Judge Black of the Hamilton County Common Pleas Court.

Black ruled the "warrant" section was unconstitutional because it was too vague, indefinite and confusing to be a valid enactment.

He ruled many other provisions of the ordinance unconstitutional as well. They were:

1. Penalizing the seller for failure to tender the certificate before entering into a contract is too many steps removed from direct enforcement of the building code to be a valid exercise of the City's police power.

2. Imposing strict liability for failure to obtain and tender the certificate is arbitrary and unreasonable.

3. Forcing owners to permit City officials to enter and inspect their premises would place them in criminal jeopardy by reason of the other penalties for housing violations--a form of self-incrimination.

4. The penalty clause which disallows a defense based on the absence of deficiencies or the buyer's ignorance of deficiencies is unreasonable and arbitrary.

The case was appealed by Cincinnati's City Council, but Judge Black's decision was upheld by the First Appellate Court of Hamilton County, Ohio. Cincinnati plans no further appeals.

Ordinances similar to the one in Cincinnati were enacted in Wilmington, Delaware and Tampa, Florida.

In Wilmington, a suit was filed and the ordinance was amended before the case went to court. The case was then dropped.

In Tampa, real estate brokers brought a suit against the City. the ordinance was amended to exclude all owner-occupied residences from compliance at time of sale, except those on which code complaints had been pending prior to sale. The ordinance does require a certificate of compliance at sale for all rental properties. This was upheld by the court.

It has been suggested that the legal problems may be overcome by licensing residential properties for occupancy. Basic health and safety standards can be promulgated. These standards establish the minimal conditions for human occupancy, and all residential structures are licensed for such habitability. The new owner cannot occupy the residence, nor can a new owner allow a tenant to occupy a unit until habitability standards are satisfied and the license issued. No criminal penalties are a part of such an ordinance.

B. Administrative and Budgetary Issues Involved in a Policy of Code Enforcement at Time of Sale

The Reinvestment Task Force asked the City's Building Department for assistance in evaluating some of the administrative and budgetary issues involved in this type of policy. The Building Department response is attached to this background paper.

Seattle
Department of Buildings

Alfred Petty, P.E. Superintendent
Wes Uhlman, Mayor

March 23, 1976

The Honorable T. Patrick Corbett, Chairperson
Mayor's Reinvestment Task Force
c/o Office of Housing Policy, OPP
Arctic Building
City of Seattle

Dear Sir:

The City's Office of Policy Planning, in compiling a discussion paper on the possibility of Housing Code inspection prior to home-sales, has asked the Building Department to respond to certain questions. We are submitting for your reference those questions and our responses. Our statistical information is based on our experience with single family dwellings inspected for FHA certification. Please keep in mind that the owners of buildings to be sold under FHA terms are desirous of bringing their homes into compliance as quickly as possible because of the financial incentives involved. This means that we do not have to spend much time explaining the necessity for compliance with the Code, nor need we make repeated reinspections as we might in the event of noncooperative owners. The statistics, below, represent Building Department involvement with owners in the most hospitable environment possible for enforcing the Code.

1. In the case of pre-sale inspections, what is the average number of violations noted?
   This may vary from 2 to perhaps 30. An estimated average would be 12. Types of violations commonly found include light and ventilation, weather protection, electrical systems and sanitation.

2. What is the average cost of repairs?
   There are too many variables to predict costs, and our records do not include this information.

3. What is the average number of reinspections before compliance is reached?
   Our records for 1975 show 898 initial inspections and 1488 reinspections with an average of 1.66 reinspections for each initial inspection.

4. What is the average length of time allowed by the Building Department to comply with required corrections?
   Four months, within a range of one to six months.

Seattle Department of Buildings, 503 Municipal Building, Seattle, Washington 98104.

5. What is the average length of time taken by the owner to achieve compliance?
   One month, within a range of a few days to six months.

6. What is the approximate cost to the Department of the original inspection?
   During 1975, our cost for each property visit averaged $19.70 with a total cost per case of $52.40. Actual time spent per visit will vary with the size and condition of the building.

7. How many original inspections and reinspections per day can be expected of one person?
   Our 1975 records indicate that one trained and knowledgeable inspector averaged 1.87 original inspections and 3.09 reinspections per day.

8. How many staff are needed to inspect an assumed annual number of 8800 single family structures?
   Based on past experience, 20 inspectors would be required, along with support services and staff equivalent to 56% of the cost incurred in salaries for the 20 inspectors.

9. What would be the staff requirement to inspect an assumed annual figure of 1200 multi-family structures?
   We estimate that 11 inspectors with support services and staff would be needed.

10. What would be the cost of such a program?
    Based upon the above figures, the annual cost for single family structures would be $460,000. Multi-family structures would cost an estimated $250,000. The latter figure is obtained by assuming that inspections of multi-unit buildings will require approximately four times as much time as single-family structures.

Very truly yours,

ALFRED PETTY, P.E.
Superintendent of Buildings

Zoltán Szigethy

by
ZOLTAN SZIGETHY
Assistant Superintendent of Buildings

CFH:dy

TABLE 1

Total Number of Residential Units	217,780		
Total Number of Residential Structures	151,876		
Total Number of Single Family Structures	141,245 = 93% of all residential structures = 65% of all residential un		
Total Number of Multi-Family Structures (2 or more units)	10,631 = 7% of all residential structures		
Total Number of Multi-Family Units	76,535 = 35% of all residential units		

(Above information obtained from 73-74 R. L. Polk data)

Approximate number of Residential Sales in 1975 in Seattle King County Assessor's Office Estimate*	10,000	8,800 single-family	1,200 multi-family
Approximate Average Sales Price for Single Family King County Assessor's Office Estimate*	$28,000		

APPENDIX C

ALTERNATIVE A
REAL ESTATE LOAN ACTIVITY

Census Tract Number _____

Reporting Period _____

Branch or Home Office _____

**All averages are to be computed as arithmetic means by the dollar amounts of the loans.

TYPE OF LOANS	OWNED				SERVICED				APPLICATIONS PROCESSED	APPLICATIONS REJECTED	LOANS CLOSED DURING REPORTING PERIOD				NO. OF FORECLOSURES FOR REPORTING PERIOD	NO. OF LOANS IN DEFAULT FOR REPORTING PERIOD	
	Beginning of Period		End of Period		Beginning of Period		End of Period										
	Number	$ Amt. Outstanding Balance	Number	$ Amt. Outstanding Balance	Number	$ Amt. Outstanding Balance	Number	$ Amt Outstanding Balance			Number	$ Amt.	Average Maturity**	APR**			
First Mortgage for Purchase Conventional (80% L/V or less)																	
Private Mortgage Insurance																	
VA																	
FHA																	
Multi-Family																	
Other																	
Home Improvement																	
Refinancing First Mortgage																	
For Rehabilitation																	
No Rehabilitation																	

ALTERNATIVE B
TABLE 1
SINGLE FAMILY LOANS*

Census Tract Number _____

Reporting Period _____

Branch or Home Office _____

TYPE OF LOANS	Beginning of Period		End of Period		Loans in Default/ Foreclosure During Reporting Period		Loans Closed During Reporting Period						Loans Closed to Absentee Owners During Reporting Period	
	Number	$ Amt. Outstanding Balance	Number	$ Amt. Outstanding Balance	Number of Loans in Default	Number of Foreclosures	Number	$ Amt.	Average % Down Payment	Average Repayment Period Stated in Months***	A.P.R.**	Average Age of Structure***	Number	$ Amt.
First Mortgage for Purchase														
Conventional														
VA														
FHA														
Construction														
Home Improvement														
Refinancing First Mortgage														
For Rehabilitation														
No Rehabilitation														
Forward Commitments														

*Single family refers to a structure containing one to four units. It also refers to five or more units within a single structure in which each unit is owned as a condominium or cooperative.

**The Annual Percentage Rate (A.P.R.) does not include a mortgage insurance premium.

***All averages are to be computed as arithmetic means.

ALTERNATIVE B
TABLE 1
SINGLE FAMILY LOANS SOLD
Page 2

Census Tract Number _____
Reporting Period _____
Branch or Home Office _____

TYPE OF LOANS	LOANS SOLD DURING REPORTING PERIOD							
	FNMA		FHLMC		GNMA		OTHER*	
	Number	$ Amount	Number	$ Amount	Number	$ Amount	Number	$ Amount
First Mortgage for Purchase								
Conventional								
VA								
FHA								
Construction								

*Other private institutional investors.

ALTERNATIVE B
TABLE 2
MULTI-FAMILY LOANS*

Census Tract Number _____
Reporting Period _____
Branch or Home Office _____

	Beginning of Period		End of Period		Loans in Default/Foreclosure During Reporting Period		Loans Closed During Reporting Period			Average Age of Structure**
	Number	$ Amt. Outstanding Balance	Number	$ Amt. Outstanding Balance	Number of Loans in Default	Number of Foreclosures	Number	$ Amt.	A.P.R.**	
TYPE OF LOANS										
First Mortgage for Purchase										
Conventional										
FHA										
Construction										
Refinancing First Mortgage										
For Rehabilitation										
No Rehabilitation										
Rehabilitation (with no refinancing)										
Forward Commitments										

*Multi-family refers to structures containing 5 or more rental units.

**All averages are to be computed as arithmetic means.

ALTERNATIVE B

TABLE 2

MULTI-FAMILY LOANS SOLD

Page 2

Census Tract Number _____

Reporting Period _____

Branch or Home Office _____

	Loans Sold During Reporting Period							
	FNMA		FHLMC		GNMA		Other*	
TYPE OF LOANS	Number	$ Amount	Number	$ Amount	Number	$ Amount	Number	$ Amount
First Mortgage for Purchase								
Conventional								
FHA								

*Other private institutional investors.

ALTERNATIVE B
TABLE 3
SMALL BUSINESS REAL ESTATE LOANS*

Census Tract Number
Reporting Period
Branch or Home Office

	Beginning of Period		End of Period		Loans in Default/Foreclosure During Reporting Period		Loans Closed During Reporting Period		
	Number	$ Amt. Outstanding Balance	Number	$ Amt. Outstanding Balance	Number of Loans in Default	Number of Foreclosures	Number	$ Amt.	A.P.R.**
TYPE OF LOANS									
Commercial									
First Mortgage for Purchase									
Construction									
Refinancing First Mortgage									
For Rehabilitation									
No Rehabilitation									
Rehabilitation (with no refinancing)									

ALTERNATIVE B
TABLE 4
SMALL BUSINESS NON-REAL ESTATE LOANS

	Beginning of Period		End of Period		Loans Closed/Originated During Reporting Period	
	Number	$ Amount Outstanding Balance	Number	$ Amount Outstanding Balance	Number	$ Amount
Small Business Administration Guaranteed						
Non-SBA Guaranteed						

*"Small Businesses" are defined by the Small Business Administration as having under 100 employees and less than $1,000,000 in assets.
**All averages are to be computed as arithmetic means, by the dollar amount of the loans.

TABLE 5
LOANS TO PRIVATE NON-PROFIT COMMUNITY-SERVING INSTITUTIONS AND ORGANIZATIONS

Census Tract _____

Reporting Period _____

Branch or Home Office _____

	Beginning of Period		End of Period		Loans Closed During Reporting Period		Loans in Default/Foreclosure During Reporting Period	
	Number	$ Amount	Number	$ Amount	Number	$ Amount	Number of Loans in Default	Number of Foreclosures
TYPE OF LOANS								
Real Estate								
Construction								
First Mortgage								
Rehabilitation								
Other								

ALTERNATIVE B
TABLE 6
DEMAND DEPOSIT INFORMATION

Census Tract Number _____
Reporting Period _____
Branch or Home Office _____

	Beginning of Reporting Period			End of Reporting Period		
	Number of Accounts	Total $ Amount	Average $ Amount per Account	Number of Accounts	Total $ Amount	Average $ Amount per Account
Household and Individual						
Business and Industry						
Private not-for-Profit Institutions						
Public						
City						
Board of Education						
Metro						
County						
State						
Federal Agency						
Federal Tax and Loan						

ALTERNATIVE B

TABLE 7

TIME DEPOSIT INFORMATION

Census Tract Number _____

Reporting Period _____

Branch or Home Office _____

	Beginning of Reporting Period				End of Reporting Period			
	Number of Accounts	Total $ Amount	Average $ Amount per Account	Average Interest Rate*	Number of Accounts	Total $ Amount	Average $ Amount per Account	Average Interest Rate*
Household and Individual								
Business and Industry								
Private not-for-Profit Institutions								
Public								
City								
Board of Education								
Metro								
County								
State								
Federal Agency								
Federal Tax and Loan								

*The Average interest rate is to be weighted by the dollar amounts held at various interest rates.

ALTERNATIVE B

TABLE 8
LOAN APPLICATIONS

Census Tract _____
Reporting Period _____
Branch or Home Office _____

	Applications Accepted									Applications Rejected								
	Number of Applications Accepted During Reporting Period	Race *					Sex			Number of Applications Rejected During Reporting Period	Race *					Sex		
		Black	White	Oriental	Spanish American	Native American	Female	Male	Joint Loan		Black	White	Oriental	Spanish-American	Native American	Female	Male	Joint Loan
TYPE OF LOAN																		
First Mortgage for Purchase																		
Conventional																		
VA																		
FHA																		
Home Improvement																		
Refinancing First Mortgage																		
For Rehabilitation																		
No Rehabilitation																		

* *Due to a composition error, the category of "Other" was omitted from the race section.*