

**Credit Unions and Communities:
Breaking New Ground In Affordable
Mortgage Lending**

**by
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**A Project for the
Credit Union Foundation, Inc.**

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Credit Union Foundation, Inc.

The Credit Union Foundation, Inc., established in 1980, is the U.S. credit union movement's primary charitable and fundraising organization for worldwide credit union development.

The Foundation provides grants for projects that help strengthen the credit union movement throughout the world. More than \$5 million has been disbursed for domestic and international credit union projects. The Foundation works closely with state credit union leagues and the National Federation of Community Development Credit Unions to strengthen credit unions and establish financial services in needy communities. Areas of focus include youth development, education and training, small credit union development, and special projects.

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The Woodstock Institute is a not-for-profit organization based in Chicago. For the past 23 years, the Institute has carried out applied research and development and implemented programs that increase private sector investment and promote economic development in modest-income and minority communities for the benefit of those who live there. It designs programs that bridge the gap between the needs of communities and the resources of banks, savings and loan associations, foundations, and others. The Institute also analyzes and disseminates information about best practices in reinvestment and community development.

The Institute provides a variety of services to community-based organizations, community development financial institutions, banks, foundations, and government agencies, including applied research, policy analysis, program design, and evaluation.

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CUNA is the primary national trade association serving the country's 12,250 credit unions through leagues in the 50 states and the District of Columbia.

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Preface

In June 1993 the Credit Union Foundation hosted a historic meeting in Madison, Wisconsin to discuss the creation of a project to promote affordable mortgage lending in credit unions.

Attending that meeting were representatives of CUNA's Washington Office, the national Federation of Community Development Credit Unions, Self-Help Credit Union in North Carolina, CUNA Mortgage, the Credit Union Foundation, and the Vermont Development Credit Union.

Resulting from that initial meeting was an Affordable Mortgage Lending Program at the Vermont Development Credit Union, which the Foundation has funded since October 1993.

The Program's primary results have shown that the greatest challenge to making affordable mortgage loans is not a lack of capital or access to secondary markets, but instead the existence of a "counseling gap" which cannot be closed by conventional mortgage income practices. Without closing that gap, credit unions (low-income and mainstream alike) would have to redefine the types of borrowers they are able to work with, focusing on those that require relatively less assistance.

A component of creating an Affordable Mortgage Program at Vermont Development Credit Union was the requirement that their experiences be documented so that other credit unions might learn and implement their own programs. Vermont Development Credit Union's program has achieved success in effectively bringing borrowers through the "counseling gap" to successfully closed mortgage loans. The Program has increased the number of home owners in Burlington, Vermont as well as the credit union's operating revenues. Their experiences, challenges and lessons learned are chronicled in this report which provides a replicable model for all credit unions to use.

Executive Summary

Homeownership has been a central path to wealth creation, family economic stability, and community vitality for large numbers of American families. But many modest-income families have been unable to access that path. Today credit unions across the country--both community development credit unions serving low-income members and mainstream credit unions with lower-income members--are looking at affordable mortgage lending. As membership-focused and nonprofit institutions, credit unions have a particular role to play in the mortgage market.

Vermont Development Credit Union, a small credit union serving low-income residents of Vermont, began an affordable mortgage program in February 1994. This publication looks at their experience in starting up a specialized program--the challenges they faced, their successes and shortfalls, and the lessons learned in the process. While credit unions face different circumstances and market conditions, VDCU's experience should provide useful lessons to any credit union considering an affordable mortgage program.

Vermont Development Credit Union (VDCU) is a six-year old credit union with 1,700 members and \$2 million in assets. Its affordable mortgage program was launched in February, 1994 with startup assistance from the Credit Union Foundation. The bulk of VDCU's prospective mortgage borrowers are individuals and families who don't readily qualify for mortgage loans from conventional institutions, or are uncomfortable with or intimidated by the mortgage process. They have little savings, non-typical work histories, prior credit problems, high levels of debt, and /or little experience with financial issues. They typically have household incomes between \$20,000 and \$28,000, although the credit union has worked successfully with borrowers with incomes as low as \$13,500.

VDCU discovered early in its mortgage lending program that its targeted clients could not be served simply through offering mortgage loan products. VDCU's mortgage lending program has three key components: financial counseling, mortgage-related consumer lending, and mortgage lending.

All prospective borrowers receive one-on-one financial counseling which includes review of an applicant's credit reports, financial situation, and assistance in establishing a budget, reducing existing debts, resolving credit issues, and understanding the financial obligations of homeownership. Those with more extensive credit and financial planning issues receive more extensive assistance over a longer period.

One of the unique components of the VDCU affordable mortgage program is the development of two consumer loan products designed to work in tandem with the mortgage loan. VDCU assists its more long-term applicants with Mortgage Tracker loans which can consolidate debt, reduce debt service costs, pay off old obligations, and establish a positive credit record. Once a positive payment record is established for these loans, VDCU can consider a mortgage loan application. VDCU also offers Mortgage Closer loans to assist borrowers who have insufficient funds for down

payments or closing costs. These loan products are used by the majority of VDCU borrowers, and are critical factors in many applicants' ability to qualify for a mortgage loan.

VDCU has developed an in-house mortgage product. It also makes loans for sale to other entities, primarily the Vermont Housing Finance Agency. In addition, the credit union also works with local non-profit organizations and public agencies to provide available housing subsidies to its members who qualify.

VDCU made 13 mortgage loans, 11 Mortgage Tracker loans, and seven Mortgage Closer loans in its first program year. It made 12 mortgage loans and nine Mortgage Tracker loans in its second year. Despite inconsistent staffing and high staff turnover in this program in its second year, VDCU's mortgage program broke even in its second year. Other credit unions would find a different level of activity necessary for self-sufficiency, depending on circumstances, particularly the number of mortgages held in portfolio. The credit union projects a volume of 27 mortgage loans in its third year of the program and expects that the program will be a significant source of net income.

Lessons learned by VDCU in the development of their program are detailed in Chapter II. Key lessons include:

- **The program needs to be planned around the “appropriate scale” for sustainability.** This may require a volume necessary to sustain a full-time staff person.
- **Specific products developed and offered must meet the needs of the credit union's members.** This includes developing products in addition to the mortgage loan itself.
- **Attracting and training qualified staff is essential to the success of the program.** VDCU believes that taking the time necessary to bring on a person with mortgage lending experience is important to their long term success.
- **Credit union staff must be skilled at assessing members' readiness for a mortgage and assisting them accordingly.**
- **Utilizing outside sources of subsidy and available housing programs is necessary to extend the credit union's reach to more of its members.**
- **The credit union must be able to determine its costs and develop an appropriate fees structure.**

Successful operation of these and other credit union affordable mortgage programs over the long term will require VDCU and other credit unions to address a number of continuing challenges. These include: finding additional ways to fund the more extensive financial planning and counseling assistance needed by many potential applicants; achieving scale through the development of further partnerships; weathering future shifts in the mortgage market; and increasing access to the secondary market.

The kind of affordable mortgage lending program initiated by VDCU is not appropriate for every credit union. The program, however, can bring a range of benefits to both the credit union and its members--building the economic opportunity of borrowers, the health of their communities, and the financial strength of the credit union.

Introduction

Joanne Young needed a house. She needed space for her grandmother, who couldn't climb the stairs into her apartment. She needed space for her mother and she felt her eight-year-old son needed a neighborhood where he had a place to play and was not exposed to gangs and drug activity. But with her income--from two jobs--and her mother's disability income she couldn't afford the rent on a four-bedroom house.

Joanne never thought she could buy her own house. She had never had a bank account, and dreaded the thought of even entering a bank to inquire about a mortgage.

Then she found a house she really wanted. The realtor referred her to Vermont Development Credit Union (VDCU). "They sat down with me and went over my credit reports," she said. "They didn't look at it and say 'no way'. They explained what I would have to do."

But before the process was over, she hit a major snag. Her credit report showed defaulted student loans. Though she had been paying regularly for three years according to an agreement with a collection agency, the agency refused to provide information about her payment record or their agreement. In fact, a collection agency employee told her he'd do everything possible to keep her from getting a mortgage. "I was totally stressed out and ready to give up," says Joanne. "but Susan (Susan Fortune, a loan officer at VDCU) just took over and said, 'we'll take care of it.'" Working closely with a local credit agency, Susan was able to coach them to get more information from the collection agency, which they noted on the credit report. The process was time-consuming, and Susan believes that a bank wouldn't have taken on the advocate's role she did to make the loan.

Today Joanne, her son, mother, and grandmother live in their dream house. Her son loves their new neighborhood, and Joanne has the security of knowing she can continue to provide for the needs of her family. Their mortgage and related expenses cost them only \$45/month more than their rent on a much smaller apartment. Joanne also has a savings account, at VDCU, for the first time in her life. "I truly believe that if not for the credit union, I could never have gotten a mortgage," she says. "But this has made an enormous difference in my life."

For Vietnamese families resettling in Burlington, a home of their own is an aspiration, but the process is a mystery. Vietnam has neither mortgages nor an established banking system. In Vietnam, a family saves its money, buys materials, and builds a house. Suspicious of and intimidated by financial institutions, most immigrant families have no banking relationships. Many, however, have a strong commitment to saving.

The Nguyen family came to Burlington in 1991. Both Mr. and Mrs. Nguyen work for a private cleaning company that services IBM, a major employer in Burlington. Their

three children work summers and after school to earn additional money for the family. In three years, the family was able to save \$15,000 for a down payment.

The Nguyens were brought to the Vermont Development Credit Union by a board member and local restaurant owner who is a leader in Burlington's Vietnamese community. For the Nguyens, and for other newer immigrant families, only a personal relationship could establish trust in a financial institution.

While the Nguyens had demonstrated their ability to save for a home, making a mortgage required flexibility in conventional standards. To qualify for a mortgage which could be purchased by the local housing finance agency, the children's income could not be included. Because they had worked for several successive IBM cleaning contractors, continuity of employment, rather than employer, had to be accepted. Most important, the \$15,000 cash which the family had saved had to be structured as a gift because outside underwriters could not believe that the family had saved that much.

In addition to helping them to qualify for the mortgage, the credit union oriented the Nguyens to every aspect of homeownership--from how a mortgage works and the kind of bills they would have to pay to how to operate a heating system. "There's a tremendous amount of education needed," says Phi Doane, the VDCU board member who brought the Nguyens to the credit union and worked closely with them. "Everything is so much different than what they had in Vietnam. The credit union is the only place where they are comfortable asking all the questions they have and where they can get the information and help they need."

With the Nguyens' success in buying a house, there are now ten Vietnamese families interested in homeownership. The credit union plans to do a homebuyer seminar for these families, and expects to see its work with the Vietnamese community expand.

Homeownership has been a central path to wealth creation, family economic stability, and community vitality for large numbers of American families. But many modest-income families have been unable to access that path.

Today, homeownership rates for people earning more than \$50,000 approach 90 percent. At \$50,000 or less, fewer than 60 percent own homes, and rates decline much further for lower-income families. At the same time, more than 20 percent of households spend at least one-half of their income for housing. Many of these households don't qualify for a mortgage because of prior credit problems or lack of savings. Many require assistance in overcoming personal and institutional barriers to getting a mortgage or owning a home.

Today credit unions across the country--both community development credit unions serving low-income memberships and mainstream credit unions with lower-income members--are looking at affordable mortgage lending. As membership-focused and nonprofit institutions, credit unions have a particular role to play in the mortgage market. More CDCUs are looking to add mortgage lending to programs they already offer members. Increasingly, mainstream credit unions are thinking about how they can

expand their existing mortgage programs to members who don't qualify for more conventional products.

This is the story of one credit union which embarked on a mortgage program designed to provide affordable homeownership to its low- and moderate-income members. This account looks at their experience in starting up a specialized affordable mortgage program---how they approached it, the challenges they faced, their successes and shortfalls, and the lessons learned in the process.

There is no magic formula to launch this kind of program successfully, and Vermont Development Credit Union has not solved all the problems and challenges it has encountered. VDCU is a small and relatively new community development credit union which has aggressively developed an affordable mortgage program and has discovered and addressed many of the challenges facing a credit union engaged in this work.

Every credit union faces a particular set of circumstances which it must take into account in developing any new program. Its membership base, membership needs, organizational capacity, financial strength, and housing market are all critical factors which influence whether and how a credit union should embark on affordable mortgage lending. The experience of Vermont Development Credit Union, however, should be helpful to any credit union considering an affordable mortgage program.

I. The VDCU Affordable Mortgage Program

Background

Vermont Development Credit Union, a community development credit union, opened its doors in 1989 with a mission “to make capital available for prudent needs to low-income Vermonters”. As a community development credit union (CDCU), it was particularly interested in strengthening its targeted communities by increasing opportunities for homeownership and by enabling families to build assets and financial security.

Interested from the outset in making mortgage loans, VDCU developed a relationship with the Vermont Housing Development Agency (VHFA), a state-financed mortgage agency. VDCU processed its first mortgage loan for VHFA in 1991. Over the next two years, the credit union processed several such mortgages responding to member demand.

However, the credit union discovered mortgage lending to be a complex process for its staff size and member needs. Low-income borrowers posed a challenge to meeting secondary market requirements and placed heavy demands on a staff to help them qualify. Doing a few mortgages here and there, they were unable to develop the expertise and systems to manage the process efficiently. On the other hand, it was clear that there was a need for this type of mortgage lending and that it required the appropriate products and a counseling-based lending process.

The credit union concluded that being serious about mortgage lending required a full-scale program with in-house expertise and appropriate systems to enable their members to qualify for homeownership.

VDCU recognized that they would need assistance to develop and launch such a program. VDCU sought and received support from the Credit Union Foundation to launch the program, learn about what worked and what didn't, determine how best to make the program sustainable, and document their experience so that it would be helpful to other credit unions interested in doing the same thing. It began its affordable mortgage program in February, 1994.

VDCU and its Market

Vermont Development Credit Union was established in a low- and moderate-income central city neighborhood in Burlington. Increasingly, it serves members throughout Vermont through developing partnership relationships with other organizations serving those areas. While those relationships are developing, most of the credit union's 1,710 members live in Chittendon County, the only metropolitan area in an otherwise rural state. In 1995, VDCU had about \$2 million in assets.

Income levels in Vermont as a whole parallel those of the nation, with 1994 median incomes of about \$32,000. With a statewide population of 580,000, Vermont does not face the same types of housing and poverty issues as urbanized areas. Its lower-income residents are scattered throughout the state. The credit union's neighborhood, however, which was designated as a federal Enterprise Community, has a poverty level of 32 percent in a population of 11,000. About 88,000 Vermont households have incomes of \$25,000 a year or less.

Property values are generally high in Vermont, particularly in comparison to the incomes of residents. Values rose steeply in the 1970s when Chittenden County was one of the fastest growing areas in the country. While the recession of 1990-91 reduced home values significantly in many areas, they remain high in comparison to resident's incomes. With high property values come high rents, making it difficult for people of modest incomes to save for a down payment. High rents also mean many people are paying a large proportion of their income for rent and could afford to make monthly mortgage payments.

In recent years, affordable mortgage products have increased not only in Vermont, but across the country. More flexible underwriting standards for loans purchased by the secondary market and targeted programs by conventional financial institutions have increased the reach of mortgage programs to more homebuyers.

At the same time, many people still find it difficult to qualify for mortgages offered by conventional financial institutions. Past credit problems, high debt, or lack of experience with financing and financial institutions mean some potential borrowers need more assistance to prepare them for a mortgage and take them through the mortgage process. Others have circumstances that require specialized loan products that aren't available from other sources. VDCU's affordable mortgage program is designed to serve both types of potential borrowers.

VDCU's Members and Prospective Borrowers

The bulk of VDCU's prospective affordable mortgage borrowers are individuals and families who don't readily qualify for mortgage loans from conventional institutions, or are uncomfortable with or intimidated by the mortgage process. Many are single heads of households. Many have non-typical work histories and sources of income. For example, they may be self-employed, with difficult-to-document income, or earn income from several sources. They may have had prior credit problems, a past bankruptcy, or high levels of current debt from credit cards, medical bills, or student loans. They have little savings that can be applied to down payments.

In addition to financial issues, VDCU's prospective borrowers often have done little financial planning. They don't have experience dealing with banks and have little experience with homeownership. A small but growing number are new Americans.

The typical mortgage applicant at VDCU is of moderate-income (50-80 percent of area median income), but capable of buying and maintaining a house (though often with

outside financial assistance or subsidies) if they can work with a flexible lender, get appropriate advice, and establish a sound financial plan. The majority have household incomes from \$20,000 to \$28,000, although the credit union has successfully worked with borrowers with incomes as low as \$13,500.

Developing the Loan Products

Two types of loan products are integral to VDCU's mortgage program: mortgage loans and consumer loans.

Mortgage Loans

As a small credit union, VDCU had to begin its program with a mortgage product it could sell to a secondary market or other buyer. VDCU began as a participating lender with the Vermont Housing Finance Authority.

The credit union's relationship with VHFA has been one of the most important partnerships in its mortgage program (see Partnerships, p. 15). The credit union chose to work initially with VHFA because its loan products had the most advantages for the credit union's members. They had flexible underwriting standards, including higher debt-to-income ratios than other affordable mortgage programs, and accepted loans or grants for some or all of the required 5 percent down payment. In addition, the agency provided its own mortgage insurance at a much lower-rate than traditional private mortgage insurance.

While the credit union began with VHFA loans, its ultimate goal was to be able to offer every potential homebuyer an appropriate mortgage product. Although VHFA loans offered the best terms for lower-income buyers with little down payment, the program had several restrictions (e.g., it was available only to first time homebuyers within specific income limits) which disqualified some potential borrowers. In addition, from the perspective of credit union operations, VDCU wanted to develop its own mortgage product. The credit union had available funds to lend, and selling all their loans deprived them of interest income to help support the program.

For its portfolio loans, the credit union developed an adjustable rate mortgage (ARM). To protect its borrowers from the shock of large increases in interest rates in future years, the credit union designed its product to be less aggressive than standard formula ARMs. Interest adjustments for these loans are limited to 1 percent per year, to a maximum of a 6 percent increase or 2 percent decrease from the original loan rate. The interest rate is set at 1 and 7/8 percent above one-year Treasury bill rates, with no points.

While the VDCU loan carries a somewhat higher initial interest rate than area banks, the lack of points and the smaller adjustments in future years make it a good overall

value for credit union members. Many area banks also offer lower-rates in the first year as a promotional device.

VDCU designed its ARM about midway through the first year of its affordable mortgage program year, but did not receive regulatory approval until the second year. The product is used selectively for borrowers who can adapt to rate adjustments. Once it was available, the loan accounted for about half of VDCU's closed loans. The National Credit Union Administration initially limited these loans to no more than 25 percent of the credit union's deposits. Though the credit union has not yet reached that limit, it expects that it will within the next year. VDCU plans to request an increase in that limit, and is also exploring the potential for selling its seasoned loans to local banks.

While the ARMs enabled the credit union to serve more members, they still faced significant limits. Because the credit union used VHFA mortgage insurance, buyers with less than a 25 percent down payment had to meet VHFA income standards. To address the needs of more borrowers, the credit union added CUNA Mortgage products to its offerings as well. To further increase its flexibility, the credit union is now establishing a relationship with a private mortgage insurer and is working to establish a better pipeline to more products which meet established secondary market guidelines.

Consumer Loans

It quickly became apparent to VDCU staff that many prospective mortgage borrowers were not yet ready for a mortgage loan. One of the unique aspects of the VDCU affordable mortgage program is the development of two consumer loan products designed to work in tandem with the mortgage loan--enabling applicants to qualify for a mortgage loan or build their qualifications for a future mortgage. Some applicants needed additional assistance for down payments; others needed to reduce their debt levels and costs and/or establish a positive payment record.

Mortgage Closer Loans were designed for borrowers who qualified for a mortgage except that they lacked sufficient down payment or needed to reduce overall debt. The Debt Consolidation Mortgage Closer restructures a borrower's debt, enabling them to pay off high interest obligations and reduce monthly payments. The Down Payment Mortgage Closer loan addresses a lack of accumulated savings to cover mortgage down payment and associated fees. Used singly or together as the final piece of a mortgage loan, a Mortgage Closer can make the difference in the credit union's ability to make a loan. Mortgage Closer loans cannot exceed a total of \$5,000 and are used only when all other factors are positive for homeownership and when total debt ratios remain inside lending standards.

Mortgage Tracker loans are designed for borrowers who need a longer-term process to become qualified borrowers. These are consumer loans specifically designed to consolidate and reduce debt and/or establish a positive credit record so that members can get "on a track" to qualify for mortgage (a process which takes six months or more). With a Mortgage Tracker loan, a loan officer can help a member determine the achievements necessary to qualify for a mortgage, and design a loan and financial plan to

achieve them. Unsecured Mortgage Tracker loans are also limited to \$5,000; higher loan amounts can be made with appropriate security. (See Getting on the Mortgage Tracker, p. 12, for examples of credit union loans).

Mortgage Tracker and Mortgage Closer loans are typically made for a five-year term (less for smaller loans) at 12 percent interest. When making one of these loans, VDCU calculates the debt service for a projected mortgage to determine the mortgage amount for which the borrower will qualify.

While the need for these credit products was not anticipated at the outset of the affordable mortgage program, VDCU leadership believes that they have been essential to the success of the mortgage program, and one of the primary factors that distinguishes them from other lenders in their market. These products enable the credit union to provide concrete assistance to those who would not otherwise qualify for mortgages and who the credit union most wanted to reach.

"We don't just advise people on strategies to improve their credit record or get out of debt; we can give them the tools to implement those strategies," says Caryl Stewart, president of VDCU. "That's a real strength of credit unions, that we have the flexibility to do that--and it makes this program work for our members."

Staffing

Developing an effective staff has been a major challenge for VDCU. The credit union knew that a serious program would require a full-time mortgage loan officer who could manage the technical aspects of the program and also be committed to the mission of working with low-income borrowers.

Timing was a problem. A strong housing market, though winding down, priced experienced lenders out of reach so the credit union chose someone with strong people skills and strong commitment but no lending experience. This required the credit union to devote substantial effort to training both internally (VDCU's assistant manager had mortgage lending experience) and externally via CUNA lending seminars. Because of this compromise, the program took longer than anticipated to develop and put unexpected demands on other credit union staff.

Soon after the end of its first year, the program's mortgage loan officer left the credit union. The credit union felt it could not afford to invest in training a new mortgage officer, and decided to search for an experienced lender. An interim replacement had good experience in counseling but not in rigorous loan underwriting. Finding the right person took a total of eight months, cut into production goals for 1995, and strained relationships with external partners.

VDCU leadership learned from this experience the critical role of program staff. They now believe that to build a self-sustaining program within a year requires them to hire staff with preexisting skills and experience in mortgage lending. While not all credit unions have the same opportunities, taking the time at the outset to find the best mix of skills and commitment is essential.

The Mortgage Process

At VDCU, the process of working with prospective mortgage borrowers goes through three main stages: assessment, planning, and mortgage origination (which includes the mortgage process through closing). Depending on the readiness of the borrower for a mortgage, this process may take from several weeks to well over a year.

When a prospective borrower comes to the credit union, the assessment process begins. Generally, the applicant is given the information to enable him or her to obtain a copy of their credit report. This report, along with other financial information, is brought to a prequalification meeting. This meeting, generally one to two hours long, is an opportunity for the prospective applicant and the loan officer to review the credit reports, applicant's income, and other relevant information. The interview is designed to determine "how much mortgage" the applicant can afford and spot the major barriers to success. It identifies those who appear qualified and those who face barriers that will put them on a longer track to homeownership. For the credit union's planning purposes, these latter applicants are divided into two categories, the Near-term Qualifieds (those who can be expected to resolve their barriers to obtaining a mortgage within six months), and Long-term Qualifieds (those for whom the process will take more than six months).

As the credit union has gained experience in working with prospective borrowers, it has developed a more systematic assessment process, in order to target its assistance to applicants more effectively. The Assessment checklist on page 10 is a tool VDCU is refining to assist in that process. It is completed by the loan officer after the initial assessment meeting.

Those applicants who move beyond the assessment phase into the mortgage program pay a \$175 origination fee. This mortgage application fee, which the credit union instituted during the middle of its initial program year, not only provides necessary revenue to the credit union, but also helps ensure the commitment of the prospective borrower to the complete process.

Applicants who require a Planning Phase with more extensive assistance and counseling to qualify for a mortgage now are now assessed a \$325 counseling fee, paid at closing, to partially compensate the credit union for the professional time this process requires.

The planning/counseling process includes assisting the applicant in establishing a budget and determining how much existing debts need to be reduced or current spending needs to be held in check. Where there are disputes with existing creditors, or errors in the credit reports, the lending staff provide instructions on how to communicate with creditors and resolve problems. The credit union has developed form letters to assist applicants in writing to credit bureaus, creditors, and others. Planning issues include the need to deal with combinations of credit repair, debt reduction,

special documentation, budgeting, and education about the financial obligations of homeownership.

**Member Readiness for an Affordable Mortgage
Time Assessment Criteria
In Affordable Mortgage Lending
At Vermont Development Credit Union**

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Where needed, the credit union's consumer loan officer may also make a Mortgage Tracker loan to consolidate debt or establish a stronger credit history. In more complicated cases, the loan officer may work with the borrower to negotiate settlements for long-standing debts.

Often this planning process represent the first budgeting or financial planning the applicants have done. It also helps them understand the importance of credit records. Mortgage Tracker loans are often a critical part of the financing package; without them, borrowers cannot reduce their debt or their monthly payments enough to afford a mortgage. About one-half of VDCU's mortgage borrowers get a Mortgage Tracker loan first.

Once a Mortgage Tracker loan is made, the credit union requires six months of on-time payments before the member can advance to the next mortgage steps. VDCU has made 20 Mortgage Tracker loans since April, 1994; there have been no late payments. "Our members have a great incentive to pay these loans," says Susan Fortune, VDCU Assistant Manager.

Once the borrower has addressed all the issues identified in the planning process (and has made at least six monthly payments on any Mortgage Tracker loan), the credit union begins the loan origination process. This involves identifying the appropriate loan product, sometimes referring a borrower to other sources for subsidies, (see p. 16), and preparing documentation, including substantiating nontraditional income or other compensating factors. Staff also lead the applicant through the mortgage closing process, spell out the ongoing obligations of the mortgage loan and handle any other complicating conditions.

Getting on the Mortgage Tracker: Three Examples

Denise needed a debt consolidation loan to clean up her credit record. She had seven old debts, totalling more than \$4,000. VDCU contacted each of the creditors, determining the amount that would pay off the account in full. In February, 1995, VDCU loaned Denise \$4,000, and paid off the creditors. With the payment, VDCU also requested that the creditor notify the local credit bureau that the account had been paid in full, and that they not solicit Denise for further credit for five years.

While Denise's payment record on the \$87/month loan was perfect, six months later the credit union discovered a new blemish on her record. She had co-signed her daughter's credit card, and her daughter's unpaid bill showed up on her record. The credit union helped her resolve that debt, which was small, and remove herself as a co-signer, but another six months of clean credit was required before a mortgage loan could be processed.

In February, 1996, VDCU is processing Denise's mortgage. With the assistance of a subsidy to reduce the mortgage amount through the Burlington Community Land Trust, Denise is now purchasing the condominium she had been renting.

Steven and Martha posed a particular challenge to the credit union. In October, 1994, when they came in, their credit report showed 24 creditors--including credit cards, doctor bills, utilities, state and federal taxes--going back several years. Their total debts of about \$9,000 were too high to consolidate in one loan. VDCU staff contacted and negotiated with each creditor to determine the payment they would accept to clear the debt. The credit union won't make a debt consolidation loan unless all accounts can be paid off. In February, 1995, the credit union completed negotiations to pay off all creditors with a \$6,100 loan; \$4,000 of this was an unsecured personal loan, and the balance was secured by the borrower's car. Steven and Martha cut up their credit cards, and are now paying off the loan and keeping all other accounts current. Steven has a new job at a higher salary, and they hope to be applying for a mortgage in the near future.

Peter came in to the credit union wanting to buy a house. He had outstanding debts totalling about \$1,000, and very little savings. The credit union sat down with him to review his situation and his options for obtaining a mortgage loan. Peter decided to take responsibility for contacting his creditors and negotiating repayment terms. He paid them off with a Mortgage Tracker loan of less than \$1,000, and paid off his one year credit union loan in only seven months.

While Peter could qualify for a mortgage, he didn't have the necessary down payment. With the successful record of the Mortgage Tracker loan, the credit union made a five-year Mortgage Closer loan of \$4,200 to cover closing costs and part of the down payment.

Peter contributed \$1,000 of his savings to the down payment, and closed on his home in December, 1995.

Managing a program like VDCU's is considerably more complicated than managing a conventional mortgage program. Because of the length of the process needed to qualify borrowers, the credit union juggles more loan applications at any one time. The longer pipeline means that the credit union must pay particular attention to the constant generation of new business to ensure a mortgage stream as much as a year in the future. And the complications of working with borrowers who need extra assistance make it important for the credit union to streamline as many parts of the process as possible.

Managing this program was a particular challenge for VDCU, a young credit union which was still trying to grow rapidly and solidify its basic operations. With limited staff and leadership time it was and is difficult to devote sufficient attention to developing each component of the credit union. (see Chapter III, Lessons Learned).

In the first year of the program, VDCU estimates that they spent up to 25-30 hours per borrower before a mortgage loan was made. Reducing that number was a high priority, as VDCU could not increase its capacity and achieve sustainability at that level. With more efficient procedures, more experience with the underwriting and documentation process, and better ability to screen applicants and target assistance, the credit union estimates that it now spends an average of 15 hours per applicant.

VDCU has found that 20 percent of its prospective borrowers are immediately qualified to begin a mortgage application, 30 percent are near-term qualified (requiring a six-month process or less), and 50 percent are long-term qualified (requiring one year or more before qualifying for a mortgage). About 20 percent of their applicants drop out of the program after the initial assessment; another 20 percent drop out after the planning phase. This customer profile increased the lag time before the credit union began generating significant numbers of mortgages (and therefore income), but it means that after two years, VDCU has a substantial number of loans in its pipeline.

VDCU also tried to increase its efficiencies through the use of software products to help automate its system. Initially, they purchased mortgage origination software, but found that it was difficult for mortgage staff to use it until they were more experienced with the mortgage process. In the second year of the program, VDCU has found the software to be an important tool, and is now considering the purchase of additional underwriting software.

One of the key components of successful affordable mortgage lending is monitoring of loans after they are made. VDCU has had no delinquencies in its mortgage loan portfolio to date, an achievement they attribute to their relationship with their borrowers and careful monitoring. Where possible, VDCU sets up payroll deduction arrangements for mortgage payments. Mortgage borrowers are contacted within a few days of a late payment.

Marketing the Program

The credit union began its initial project year by sending an information piece to 500 respondents of VHFA public service announcements on affordable housing. Almost 100 responses were received, demonstrating to the credit union a large potential market for affordable homeownership. Most of the mortgage clients and prospective clients that the credit union worked with during its first program year came from that initial mailing.

The credit union uses a brochure describing its program, and makes particular efforts to reach out to the realtor community and nonprofit housing organizations. VDCU sees both of these types of relationships as important sources of referrals.

Realtors are accustomed to refer their clients to conventional financial institutions. We have to establish credibility with them, as well as demonstrate that we can offer particular service to clients who need more assistance and attention," says Susan Fortune. As time permits, the credit union loan officer tries to meet with realtors, and has sometimes invited them to sit in on a client meeting. While it has taken time to establish good relationships, the credit union's efforts have resulted in increasing numbers of referrals from realtors.

Nonprofit organizations, particularly the Burlington Community Land Trust have also been an important source of referrals. The Community Land Trust gives all their clients a list of area financial institutions, including VDCU.

Recently, the credit union has focused on informing area banks about their lending program. VDCU staff have found that some banks' loan officers have been very willing to refer clients that they could not serve themselves.

To date, the credit union has not had problems attracting applicants for the mortgage program. The challenge has been taking their applicants through the mortgage process to a successful closing.

Developing Effective Partnerships

Developing effective partnerships has been critical to VDCU's mortgage program. VDCU must make good use of public and private programs designed to assist lower-income borrowers. There are two key partnerships which have had the greatest impact on VDCU's program.

1. Vermont Housing Finance Agency

The Vermont Housing Finance Agency (VHFA) is VDCU's most important external partner. VHFA is a state-supported agency which finances mortgages to lower-

income Vermont residents who cannot qualify for conventional financing (in Vermont, first time homebuyers with incomes less than \$41,500 for a family of three, or \$45,100 in the Burlington area, are eligible for VHFA financing). VHFA loans have more flexible underwriting criteria, lower down payments, and more flexible terms than conventional loans. Their standards are also more flexible in key ways than Fannie Mae and Freddie Mac targeted affordable mortgage programs. In addition, VHFA offers a state-sponsored mortgage insurance program which is less expensive and more flexible than conventional mortgage insurance. VHFA loans are made through participating lenders, which can be banks, savings and loans, credit unions, or mortgage companies. These loans are then sold to VHFA, which acts much like a secondary market purchaser.

VDCU began working with VHFA in 1991, when it first became a participating lender. While VHFA participating lenders are usually larger and more established financial institutions, VHFA understood the potential advantages of working with VDCU. “We know there’s a range of people not being served by conventional lenders,” says Allen Hunt, VHFA Executive Director. “Working with a community-based lender like VDCU made it possible to reach that group of borrowers--people who need additional attention to get them ready to be borrowers and homeowners, or special groups of people, like Vietnamese refugees, who need more targeted assistance. These markets aren’t large enough to attract the interest of most banks, but they represent people who need to be served.”

Concerned with expanding the number of its lower-income borrowers, VFHA has made a special effort to work with the credit union. It has provided training to credit union staff, and waived a normal \$1,000 annual fee for participating lenders. In addition, the credit union is allowed to hold its VHFA mortgages for one year, rather than sell them immediately, increasing the credit union’s income from the Nuoyensaction.

Today, though the credit union is VHFA’s smallest participating lender, VDCU’s loan production through VHFA is higher than many participating banks. The program’s relevance and overall responsiveness to VDCU’s borrowers means that VHFA has been its primary resource for non-portfolio loans.

2. Burlington Community Land Trust

Working with nonprofit organizations that provide housing services and subsidies is a necessary part of serving many lower-income borrowers. VDCU’s primary nonprofit relationship has been with the Burlington Community Land Trust, one of a network of land trust organizations across the state. They are primary conduits for state funds to subsidize housing purchases for low-income Vermonters. The Land Trust is able to provide a subsidy of up to \$12,500 for households with incomes less than about \$38,000 for a family of four (with other limits for larger or smaller households). In exchange for the subsidy, the Land Trust has the first option to purchase the home, when and if it is sold, at a price which shares the increase in value between

BCLT and the owner. While the Land Trust provides the initial subsidy, a mortgage lending institution must finance each project.

VDCU refers qualified members to the Land Trust if they want to use its program. The Land Trust refers its clients to local financial institutions, including VDCU. According to Amy Dimetrowitz, project coordinator for BCLT, the organization has appreciated the credit union's willingness to work through more difficult loans that the local banks have not been willing to consider.

In its two years of mortgage lending, close to one-half of VDCU's mortgage loans have included Land Trust participation. The credit union has begun to establish relationships with land trust organizations in other parts of the state, so that it can increase its capacity to serve other areas. VDCU is also beginning to work with other nonprofit organizations in the state, including several affiliated with Neighborhood Housing Services.

While the specific structure of the land trust organizations is particular to Vermont, nonprofit groups that provide home purchase assistance serve many cities and rural areas. Their assistance may include subsidies, loan guarantee funds, homeowner-ship counseling, or other services. In some areas, local governments have taken on such roles directly. Developing relationships with all such sources of assistance is an indispensable feature of affordable mortgage lending.

Financing the Program

VDCU began its affordable mortgage program recognizing that it would not be able to recover its costs from lending income in its first year. The grant support VDCU received from the Credit Union Foundation enabled it to cover its planning costs and its operating deficit during its startup phase. The credit union's goal was to achieve a self-sustaining operation during the program's second year.

Part of the credit union's task is to determine the number of mortgage loans required for the credit union program to break even from operations. This number depends on a range of factors, including: how many loans are sold and how many remain in portfolio; the income received from selling or keeping them (which itself depends on the fees charged, the average mortgage size, the alternative uses of credit union assets, and other factors); and the staffing and program costs (which can vary considerably by credit union). The single most important factor is whether a credit union keeps or sells its loans.

A credit union can receive substantially more income from making portfolio loans than it does from selling them to a third party (see Table 2 for illustration). However, most credit unions would rapidly exhaust their funds if they made only portfolio loans. VDCU needs to find the optimal balance of in-house and sold mortgages.

VDCU receives a substantial benefit from the fact that it is allowed to hold its VHFA loans for a year before it sells them to the Agency. This means VDCU can retain some of the benefits of making the loans themselves (the interest income), as well as the benefits of selling them (ability to make more mortgages and avoid the interest rate risk of long term loans). To date, VDCU's growth in deposits and its overall loan-to-deposit rate have allowed it to hold its VHFA loans. As its portfolio grows, it may need to sell its VHFA loans more quickly.

Credit unions which lack this kind of relationship would have to make considerably more nonportfolio mortgages to gain the same amount of income. Alternatively, they could develop arrangements with other potential purchasers (e.g., a bank) to purchase loans which have been seasoned and have good payment records. VDCU is exploring such a relationship to recycle its adjustable rate mortgage portfolio when it reaches its portfolio limits.

VDCU has taken other steps to increase its income and to reduce its operating expenses. As previously discussed, additional application fees were introduced during the first year, and counseling fees during the second. VDCU is working to provide assistance to borrowers more efficiently, and to streamline its in-house procedures. Achieving sustainability may also require attracting a larger number of borrowers who qualify as "immediate" borrowers, and require less assistance from the credit union.

VDCU planned to expand the program and reach sustainability in 1995, the second year of the project. The credit union's staffing reductions during its second year, however, had a substantial impact on its productivity and its costs. Both mortgage production, and therefore income, were below projections. Despite inconsistent staffing, however, VDCU closed 12 mortgage loans and nine Mortgage Tracker loans in 1995. Because its staffing expenses were also reduced, VDCU estimates that the program broke even in 1995 (see Table 2).

In 1996, VDCU projects a total of 27 closed mortgages, 50 percent in portfolio, 50 percent through third parties and sold to secondary markets, and expects that the program will be a significant source of net income for the credit union. They project that this level of lending will require them to hire additional loan processing staff (50 percent) in mid-year.

Another credit union would find a different level of activity to be necessary for self-sufficiency, depending on circumstances, particularly the number of mortgages it holds in portfolio. Alternatives Federal Credit Union in Ithaca, New York, for example, projects about 45-50 loans per year to fully support a mortgage department of one and one-half persons. To illustrate this range, the last column of Table 2 estimates the income the credit union mortgage program would receive in 1996 if it made all its loans for sale to third parties. The deficit of approximately \$17,000 that would result would have to be made up through increased income (more mortgage loans, holding some mortgages in portfolio, etc.) or lower expenses.

Table 1
Initial Project Year
Income and Expenses

Income	
Mortgage Interest	24,609
Servicing fees	1,000
Application fees	5,115
Points/other fees	8,627
Total	29,025
Expenses	
Mortgage interest	10,326
Affordable Mortgage specialist	25,671
Occupancy (16 percent)	1,194
General Supplies	1,630
Support staff (10 percent)	7,994
Other (5 percent)	2,036
Computer costs	2,706
Marketing	358
Education	125
Professional fees	430
Total	42,144
Profit/Loss	(13,119)

Notes:

1. Initial program year began 2/1/94 and ended 1/30/95.
2. Income reflects actual income from 13 mortgage loans, of which 12 were VHFA loans and one was sold to CUNA mortgage.
3. VHFA loans are held by the credit union for one year before sale.
4. Income from tracker and closer loans were not included.
5. Expenses reflect cost of mortgage loan officer, and related overall office operations, including shares of other operating expense items. Expenses do not include staff time for program development. Expenses also do not include staff time from consumer loan department for tracker and closer loans.

**Table 2
Income and Expense (1995-1996)**

Loans	1995	1996	Estimated 1996 Income If All
	Actual	Projected	Sold
Number of Mortgage Loans closed	12	27	27
Loans sold to others (VHFA)	5	14	27
ARMs held in portfolio	7	13	0
Total loan originations	\$ 769,000	\$ 1,750,000	\$ 1,750,000
Income			
Mortgage Interest	61,634	93,661	----
Servicing fees	5,945	10,807	20,000
Application fees	6,385	10,803	10,800
Points and fees	5,628	5,460	10,920
Total income	\$79,592	\$ 120,731	\$ 41,720
Expenses			
Interest Expense	26,285	44,154	----
Personnel	31,610	41,690	41,690
Operating Expenses	20,500	16,841	16,841
Total Expense	\$78,395	\$91,245	\$58,531
Net Income	\$ 1,197	\$29,486	(\$16,811)

Notes:

1. VHFA loans are held 12 months before selling to VHFA.
2. Servicing income equals 3/8 percent of outstanding portfolio per year (non- portfolio loans only).
3. One point charged on non-portfolio loans only.
4. Average mortgage interest rate equals 7 percent for 1995 and 1996.
5. Average cost of funds (interest expense) equals 2.9 percent for 1995, 3.3 percent for 1996.
6. Personnel cost for 1995 and 1996 equals one full time mortgage loan officer and 15 percent of balance of staff; personnel cost for 1996 includes an additional 1/2 time loan processor added in mid-year.
7. Operating expenses equal 15 percent of credit union total operating expenses for 1995 and 1996.
8. Estimated 1996 Income if All Loans Sold assumes: no loans are held in portfolio; credit union earns no interest income; points and servicing fees are collected on all loans.

II. Lessons Learned

The credit union's first year experience taught its board and staff many key lessons. These included:

1. **It's important to determine the "appropriate scale" for this program and to plan activities accordingly.** VDCU determined that in order to work with members who can't qualify for conventional mortgages, it needed a full time mortgage loan officer with the necessary expertise. This meant developing a mortgage program with a significant scale. VDCU believes that because of the complexity of affordable mortgage lending, it cannot be done just as an add-on to consumer lending.

With a broad potential membership base, VDCU knew that its program could reach a scale that would support this level of staffing. A credit union without that membership base would need to consider other options, including perhaps a partnership lending arrangement through a consortium of credit unions.

2. **Launching a successful program requires a realistic assessment of your mortgage market.** This assessment includes the needs of your members for mortgage loans and the products and assistance you can offer. Doing this well requires tapping the expertise of people who understand the affordable mortgage market, not simply the more conventional market.

In its initial projections, VDCU relied on assessments based on the mainstream mortgage market and did not fully take into account the 'non-conventional' financing needs of their members. As a result, they underestimated the complexity of the lending process and overestimated their initial loan volume.

3. **The products and program offered must meet the needs of members.** VDCU began its program with a focus only on mortgage loans. They soon learned that their members needed additional types of loan assistance in order to qualify or get ready for a mortgage loan. VDCU's mortgage program encompasses mortgage lending, consumer lending, credit repair, and financial planning. Meeting the needs of members who challenge traditional lending criteria requires understanding the provisions and the flexibility of available loan programs.

VDCU also learned that it is important to offer a range of products and services to a wide range of its members. While their first priority is to address the credit needs of those who need the most assistance, these loans are also the most labor intensive and expensive. A credit union which has the ability to lend to borrowers who meet more conventional criteria can bring in additional income to support the program, and better serve those who need more assistance.

VDCU initially put its emphasis on developing approaches to make the most difficult mortgage loans. Now it is looking for ways to broaden its product offerings.

4. **A secondary market source which is geared towards your market is essential.** Any small credit union will need to work with a secondary market purchaser in order to embark on a significant affordable mortgage program. Even a large credit union or a credit union which plans to hold a mortgage portfolio will need a secondary market source in order to offer long-term, fixed rate loans, an important product for lower-income borrowers. VDCU estimates that over the long-term it needs a secondary market outlet for about 75 percent of its mortgages.

VDCU was fortunate to partner with a responsive state housing finance agency. Other community development credit unions have successfully worked with other financing entities. Several have established relationships with area banks or other mortgage conduits that purchase loans meeting secondary market affordable mortgage program standards (e.g., Fannie Mae Community Homebuyers program).

Credit unions investigating an affordable mortgage program should look for the most appropriate partners for their circumstances. Many states have active state housing finance agencies or other public programs which may be valuable resources. Like the Vermont agency, they may be particularly interested in working with a financial institution strongly committed to mortgages for lower-income borrowers. Local financial institutions interested in increasing their community reinvestment loan portfolio may also be sources of mortgage purchases.

5. **Plan thoroughly before beginning the program.** Knowing your market, the needs of your members, and potential partners are all part of the planning process. Once you understand these, it's possible to make initial financial projections and implementation plans. The plan should also be realistic about the time and effort it will take to develop the credit union's capacity (hiring the right person and/or training existing staff, setting up institutional systems, developing effective relationships with other entities).

Financial projections should include realistic estimates of the startup costs and the time required to achieve a self-sustaining program, and identify the sources of funds (whether external or credit union internal reserves) to cover those costs. Because there are a wide range of market and organizational factors that determine startup costs, it's difficult to determine precise numbers for any individual credit union. The most important startup costs are planning, training staff, developing the necessary systems and procedures, and covering staff costs while the program is gearing up. Planning, developing, and implementing a program similar to VDCU's, for example, could be expected to require \$10,000 to \$20,000 in startup costs, much of which might be able to be recouped over time.

Any small community development credit union will need some outside assistance in starting up a full-scale off-mortgage program. VDCU's outside funder, the Credit Union Foundation, was committed to the project and able to be flexible in providing support. Finding appropriate funders and supporters is a key part of the planning process.

While VDCU developed projections and raised up-front support, much of their knowledge was gained through experience. A better initial understanding of member needs would have enabled them to design more appropriate products and procedures initially. More realistic estimates of the planning and preparation process for borrowers would have produced very different time estimates and financial projections. As credit union build a broader base of experience in affordable mortgage lending, better planning is possible.

At the same time, it is also impossible for a credit union to know exactly what it is getting into until it actually begins. A credit union program has to be flexible, so that it can be refined or even dramatically altered its program to meet emerging circumstances.

6. **Quality staffing is essential.** After good planning, getting and keeping good program staff is the most important single factor in a credit union's ability to develop and sustain a quality program. This is especially important for a small credit union like VDCU where there is no backup staffing for the program. VDCU's program started slowly because its initial staff person had no previous mortgage lending experience and had to learn on the job. Second year turnover and difficulties finding and developing new staff meant that the credit union was able to close fewer loans. It also made it difficult to maintain effective relationships with external partners who need to be able to count on the credit union to consistently serve their clients and constituents.

Other credit unions address these staffing issues in different ways. Some look to staff with previous experience; others make a point of hiring from within the organization and providing necessary training. Alternatives Federal Credit Union, for example, believes that its internally-trained lending staff are more likely to understand the mission of the credit union and remain with the credit union for a longer time.

The best hiring and staff development strategy depends on a credit union's particular circumstances--but its plans and projections need to take into account the availability and capabilities of staff. VDCU finally was able to bring on someone with strong mortgage lending experience. A credit union needs to be prepared to spend the necessary time, effort, and money to attract, provide training for, and retain quality staff.

7. **To be effective, the credit union must learn to assess members' readiness for a mortgage and assist them accordingly.** Because the credit union expects that at least 50 percent of its applicants are "long-term" qualified, it is particularly important to understand how to assess these members' needs and assist them in becoming qualified. Over the initial year, staff spent up to 30 hours working with each of these members; today the credit union expects that it will spend about 15 hours with each.

The credit union has learned that it is most effective with members who require longer term assistance if they: are highly motivated; have barriers to ownership that are primarily financial; have sufficient income (for conventional or subsidized

programs) but a more complex work and income history; or have negatives in their history (e.g., bankruptcies) that may be justifiable with sufficient understanding.

The effective use of skills and resources means giving prospective borrowers the appropriate guidance and tools up-front (including Mortgage Tracker loans or other financial assistance), helping them work through the issues that are preventing access to financing, and then working with them more intensively again when they are ready to apply for a mortgage.

8. **Serving members well requires using available outside resources and programs.** Working with other programs, a credit union can extend its ability to assist its members and build its own capacity. Many areas already have public and private programs designed to assist lower-income families purchase homes. Some local governments offer financial assistance (e.g., grants, soft second mortgages, funds for repairs or rehabilitation) to reduce mortgage payments or down payment costs for borrowers and reduce the risk to lenders. In Vermont, subsidies provided by the Community Land Trusts (supported by a state program) enabled the credit union to assist many more lower-income families. In some areas nonprofit organizations have developed homeownership counseling or training programs. A credit union should investigate all local sources of assistance to their potential borrowers. Some of these programs will be eager to work with a financial institution with a strong commitment to affordable homeownership.

In addition to the partnerships established by VDCU, other types of institutions may be useful resources to credit unions building a mortgage lending capacity. State credit union leagues, large credit unions with mortgage programs, and even local banks can be important resources. They may be able to assist with training, setting up administrative systems, management assistance, or startup operational support.

9. **Starting an affordable mortgage is a major commitment.** As a young credit union, VDCU's affordable mortgage program placed a lot of additional stress on the credit union while it was still trying to stabilize other parts of its operation. Without grant funds to develop it, the affordable mortgage program would have put substantial financial pressures on credit union general operations. The priority placed on this program necessarily affected the progress of other components of the credit union program. For an older or larger credit union, such a program would be somewhat easier to launch. A small or new credit union which makes this type of program a high priority will need some startup help to become successful, and must be prepared to devote the resources (financial and otherwise) necessary to make it work.
10. **Know your costs and charge accordingly.** The credit union must assess its program costs realistically and find ways to cover them. For VDCU, this has included moving from no application fee in the first months of its program to a \$175 application fee for all applicants and a \$325 counseling fee for those who aren't immediately ready for a mortgage. In practice, the counseling fee does not prevent members from obtaining mortgages because it is rolled into closing costs which the credit union can, if appropriate, finance. A sustainable program, however, means not

only developing efficiencies and identifying available subsidy programs, but also fees that recover costs of service.

III. Continuing Challenges

While VDCU has worked to address many challenges, maintaining a self-sustaining program over time will be a continuing challenge. Key areas include funding borrower counseling and assistance, achieving and maintaining appropriate scale of operation, weathering market shifts, and increasing secondary market access.

1. Funding the borrower assistance

One of the biggest challenges VDCU faces in developing a self-sustaining program is figuring out how to cover the costs of providing the level of assistance that many of their borrowers need to become successful homeowners. The credit union's first year experience made clear that they had a "counseling gap" which could not be closed by conventional mortgage income. Without closing that gap, the credit union will have to redefine the types of borrowers it is able to work with, focusing on those that require relatively less assistance.

Since its initial program year, the credit union has implemented a range of ways to close the counseling gap. The additional counseling fees charged to borrowers are designed to offset much of the cost. The credit union is exploring with its regional Federal Home Loan Bank ways to utilize subsidy funds to further reduce the gap and lower costs to low-income borrowers.

Another strategy is increased efficiency. With the expansion of its mortgage program, the credit union hopes to offer seminars on homeownership and financing issues, reducing one-to-one counseling. VDCU will be seeking to raise funds specifically for this purpose. Funders could include foundations, banks, or local government programs. In addition, VDCU is supporting plans by the Vermont Housing Finance Agency to establish and fund several nonprofit counseling centers in the state to assist lower-income prospective homebuyers. Once established, these centers would be able to provide counseling to VDCU applicants, and could assist in expanding the market for VDCU loans.

2. Achieving scale through further partnerships

As a relatively small credit union which can hold a limited portfolio of loans, VDCU's loan growth, over the long run, depends on expanding its non-portfolio loan activities. Because developing and implementing an effective affordable mortgage program requires acquiring and maintaining specialized expertise, not all credit unions are in a position to develop an in-house capacity. VDCU is exploring whether

it can share its experience with other credit unions. One option would be a Credit Union Service Corporation (CUSO), operated by VDCU, which could assist other Vermont credit unions with their mortgage loans. A pooled effort of this sort might be successful in other areas where there are multiple credit unions, but few have the market to attract enough mortgage borrowers for an in-house operation.

VDCU has also joined the Boston Federal Home Loan Bank, making it eligible for long term funds from the bank system. As the credit union grows in size and sophistication, it may be in a position to utilize Home Loan Bank funds to expand its in-house mortgage lending capacity.

3. Weathering shifts in the mortgage market.

Mortgage lending is a volatile business. Shifts in interest rates, housing markets, the local economy, or government regulation, all impact the demand for mortgages and families' ability to borrow. The overall market also affects the level of competition VDCU must contend with in its affordable mortgage program. Financial institutions that all but ignored lower-income or more challenging borrowers during the refinancing boom are competing for some of that business now that the overall market has softened.

Long-term success requires VDCU to develop its expertise, solidify its lending niche, market itself effectively, and broaden its ability to serve its members well. It also requires developing the flexibility and creativity to shift its efforts as conditions change.

4. Increasing access to the secondary market

To date, VDCU, due to an active and responsive state housing finance agency and to the availability of internal loan funds, has been able to make affordable housing loans to almost all of its qualified applicants. Over time, however, VDCU will need more secondary market access for its loans which don't qualify for housing finance agency purchase. Existing secondary market products (with low downpayments and flexible underwriting) may meet some of this need, but other outlets are necessary as well. VDCU hopes to sell its seasoned adjustable loans to local banks. CUNA Mortgage has also developed an affordability program that was launched in 1995. The National Federation of Community Development Credit Unions is exploring whether a specialized credit union secondary market is necessary and feasible as credit union affordable mortgage lending grows.

Conclusion

The kind of affordable mortgage lending program VDCU initiated is not for every credit union. Going beyond standard mortgage products and programs requires substantial effort and development of capacity to deal with the complexities of lending and counseling. A cost-effective program requires building scale and the ability to hold some loans in the credit union's portfolio.

Despite all the challenges it faced, some expected and many unexpected, VDCU's affordable mortgage program still became profitable in its second year. VDCU expects mortgage lending to be its greatest growth vehicle over the next five years, and to generate significant income to support other credit union programs.

Affordable mortgage lending brings a new set of benefits to credit union members. VDCU and several other credit unions have shown that they can enable people to purchase homes who could not have done it without their extra assistance. Mortgage lending also builds the loyalty of members and the credit union's visibility and reputation.

Credit unions engaged in affordable housing lending are showing that it can be an important component of their program--building the economic opportunity of their borrowers, the health of their communities, and the financial strength of their institutions.