

USDA RURAL DEVELOPMENT
LEVERAGED LOAN PROGRAM

Quitman Federal Savings Bank
Bay Meadow Corporation

PARTICIPANT PROFILES

Quitman Federal Savings Bank ("Quitman Federal" or "Association") is a federally chartered mutual savings and loan association with assets of approximately \$38.3 million. The Association has only one office, located in Quitman, Georgia, and it has been an integral part of its community since 1936. The Association's strength is residential mortgage lending. As of June 30, 1997, Quitman Federal had a total of \$25.6 million in mortgage loans (\$22.9 million in permanent loans and \$2.7 million in construction loans. The Association also originates a significant number of commercial, real estate, and consumer loans. Recently, the Association has stepped up its community development

lending initiatives, particularly in Quitman's downtown historical district.

Bay Meadow Corporation ("Bay Meadow"), incorporated in 1973, is a for-profit real estate development corporation that created a non-profit subsidiary in 1993, in an effort to expand affordable housing opportunities in rural areas. Bay Meadow develops and builds in six counties in southern Georgia and northern Florida. Residential construction, subdivision development, and mortgage originations are the primary business of Bay Meadow, which builds over 30 homes annually.

COMMUNITY BACKGROUND

The primary lending market of Quitman Federal is the Brooks and Lowndes county area, which is located in extreme South Georgia along the Florida border. 1990 census data indicates the combined population of the two counties was 91,379. This area, Lowndes County in particular, has experienced significant population growth. In 1997, the combined population figure for both counties is estimated to be 100,781. The area

is expected to be classified as an MSA after the 2000 census.

Brooks County

1. Brooks County, which had an estimated 1997 population of 15,868,¹ has grown only modestly since the 1990 census. Brooks County includes the town of Quitman. In 1990, Quitman had a

population of 5,292. Economically, Brooks County couples a mature agricultural industry with a growing commercial and industrial base. Retail trade and service related jobs comprise 60 percent of the county's employment activity. Tourism, primarily hunting and fishing, is beginning to impact the county's economy, which has benefited from the economic growth of nearby Valdosta, Georgia. Brooks County had a median household income of \$19,474 in 1990, with an unemployment rate of 4.1 percent. At the end of 1997, the median household income was estimated to be \$27,323, indicating an increase of more than 40 percent.

Lowndes County

Lowndes County is the most economically diverse county in south Georgia. As of 1997, Lowndes County's population was 84,913, representing a more than 10 percent increase since the 1990 census. Valdosta, which has generated most of the commercial and economic growth in Lowndes County, is the

tenth largest city in Georgia. The service sector has become the county's largest industry, employing approximately 23,312. Manufacturing and farming, while still economically essential to the county, are on the decline. The county's economy has flourished with the recent award of university status to the local four year college, Valdosta State. The university and its more than 9,100 students contribute an estimated \$100 million annually to the local economy. Moody Air Force Base, which is located in Lowndes County, has been a big contributor to the local economy since 1940. According to the 1990 census, the median household income was \$28,541, and unemployment was 3 percent. Federal Home Loan Bank of Atlanta data indicates that by the end of 1997 the income figure had grown a modest 4.4 percent, to \$29,802.

¹ U.S. Census Bureau; "Estimates of the Population of Counties for July 1, 1997, and Population Change: April 1, 1990 to July 1, 1997" published March 17, 1998.



COMMUNITY NEEDS

During the 1990's, Brooks and Lowndes counties experienced an influx of new residents. Many of the people relocating to the area were professionals looking to purchase homes in the high-end sector of the market. Most area lenders focused on this growing market for high-end housing, particularly in Valdosta, and had only marginal interest in making loans for low- and moderate-income single family units. Additionally, because of the demand for high-end housing, the average value of real estate in the area has risen beyond the reach of many low-and moderate-income residents. This was

a bitter pill that forced many low- and moderate-income residents out of the home ownership market.

Quitman Federal, one of the few financial institutions in the community to finance low dollar home mortgage loans, sensed the frustration of many low- and moderate-income residents. As an active leader in the community, the thrift recognized the need to increase the level of affordable credit to qualified families or individuals who could otherwise not afford to buy a home.

BEST PRACTICE PROGRAM OR PRODUCT

Quitman Federal has historically operated as a traditional thrift institution, supplying conventional mortgage products and related services to area residents. Two years ago, the thrift was approached by a local developer to provide affordable mortgage financing through the United States Department of Agriculture's ("USDA") Section 502 Rural Development Leveraged Loan Program ("LLP"). This program was developed by the USDA pursuant to Section 502 of the Housing Act of 1949, 42 U.S.C.A. § 1471-1490 (1994 & Supp. 1997) (the "Housing Act"). Although the thrift's management was aware of the LLP, it was not until a meeting with Harold Hagan, President of Bay Meadow, that an alliance was established to use the program to increase home ownership opportunities for local low- and moderate-income residents.

The LLP is administered by the Rural Housing Service, an agency within the USDA. The regulations governing this program are set

forth at 7 C.F.R. § 3550.51 to 3550.74 (1997). Under the LLP, up to 100 percent of the purchase price of a home can be financed using two separate loans. One loan is made by a private lender and is subject to market rates and conventional underwriting. The financial institution may finance up to 50 percent of the purchase price of the home. A second mortgage is made directly by the USDA at below market interest rates using the Section 502 Direct Loan Program. In some cases, depending upon the income of the borrower, the interest rate on the second mortgage may be as low as 1 percent. The resulting blended interest rate can make the mortgage very affordable for low-and moderate-income rural borrowers. This arrangement also eliminates the need for the first mortgage lender to obtain private mortgage insurance on the loan while still enabling the borrower to obtain financing for the full purchase price.

The loan amounts and terms that the Rural

Housing Service offers vary depending upon the purpose and amount of the loan. Generally, LLP terms are either 30-year fixed-rate mortgages or 15-year balloon products with a 30-year amortization. Lenders may not use adjustable rate products for the program, nor will the Rural Housing Service consider leveraging arrangements where lender participation is less than 20 percent of the loan amount.

The LLP offers advantages for both lenders and borrowers. For participating lenders the LLP offers the following incentives:

- *The USDA shares the risk on the loan.*
- *The participating lender holds the first position on a mortgage with a very low loan-to-value ratio.*
- *The loans may be sold in the secondary market.*
- *The participating lender may receive CRA credit for making the loan in partnership with the USDA.*

For some borrowers, blending lender loans with the LLP financing may be the only way

to make their dream of home ownership a reality. Also, purchasing their home through the LLP may represent their first opportunity to establish a relationship with a private lender. The primary target of the LLP is qualified families in the low- and moderate-income category that do not possess the financial resources required to obtain a conventional residential mortgage. To be eligible for the LLP (i) the borrower's income must be below the median household income for the area; (ii) the borrower must have the intent to purchase and reside in a rural community; and (iii) the borrower must purchase a home that is below the Section 203(b) limits for the area.²

² The Section 203(b) limits for your area can be obtained by visiting the USDA's website or contacting the USDA office closest to you

EXPERIENCES AND OBSTACLES

Until 1996, Bay Meadow had been a customer of Quitman Federal, primarily through construction and commercial borrowing. At that time, utilizing the LLP initiative, Bay Meadow and Quitman developed a mutual commitment to home ownership opportunities for all community residents and forged an alliance to deliver affordable housing to the area. As indicated above, in order to meet the sponsor/developer requirements of the LLP program, Bay Meadow created a non-profit subsidiary to finance and administer its role in

the program, generally consisting of construction and marketing of the homes to low- and moderate-income individuals. To date, all of Bay Meadow's 1998 LLP applicants have been financed by Quitman Federal.

As both the sponsor and developer for the program, the efforts of Bay Meadow are key to its success. Bay Meadow supplies the outreach to and pre-screening of potential home buyers. Outreach generally is achieved

largely by word of mouth with some support from modest community advertising. During the initial screening process, Bay Meadow provides various home ownership counseling services. Potential borrowers are pre-qualified and educated about the mortgage process and the responsibilities of home ownership. Moreover, Bay Meadow works as liaison to help Quitman Federal and the borrower identify the appropriate loan products. For lenders like Quitman Federal, one of the challenges of offering innovative affordable mortgage products is understanding both the implications for the borrower and any program requirements that may be imposed for combining nontraditional sources of financing with more traditional mortgage products. Some of those sources might include state or local government assistance programs, church sponsored assistance, or gifts made to the borrower, all of which may be necessary in order to keep the home affordable to a low-income borrower. Bay Meadow has worked with the borrowers and with Quitman Federal to be certain that all parties understand how and why a particular combination of financing sources will work in a particular situation. Quitman Federal's management has indicated that taking the time to fully understand the LLP and its rules is critical to managing an effective low- and moderate- income housing initiative, while mitigating the thrifts exposure to risk.

The methodology used for educating consumers is one-on-one counseling. Bay Meadow's Sales and Marketing Manager Emily Hagan, has indicated that group seminars are not appropriate for many rural consumers because often there are not enough

potential borrowers at any given time to justify a seminar and the clients and properties are so unique in each case that an individualized approach is necessary.

As the developer, Bay Meadow has targeted the construction of homes typically in the \$65,000 to \$75,000 range. Bay Meadow's strategy has been to target their development efforts in existing low- and moderate-income neighborhoods.

Once a house has been constructed, an applicant is selected based upon his or her ability to qualify for the mortgage. For instance, Bay Meadow is currently working with a family of three to purchase a single



Leveraging the LLP Program a family of three purchased the above property for \$73,900 in Lowndes County, GA

family home in Lowndes County. The family, with a household income of \$18,240, meets the requirements of the program and has been approved for a \$73,900 mortgage. Quitman Federal has agreed to make the first mortgage at 20 percent of the loan amount for 15 years at local market rates. USDA Rural Development will finance up to 80 percent of the mortgage for 30 years at 1 percent interest.

The down payment and most of the closing costs are built into the USDA Rural Development loan. The borrower is only required to fund the prepaid application expenses, i.e., appraisal fee, credit report fee, earnest money, etc., at closing.

For its efforts, Bay Meadow receives the standard general contractor's fee of 3-5 percent of the purchase price of the home. All Bay Meadow's fees are included in the loan amount. However, Bay Meadow does not derive any fee income for loan originations or

its home ownership education program.

Quitman Federal generally takes a 20-25 percent first mortgage position on LLP loans. Additionally, the thrift offers a 15-year mortgage that is amortized over 30 years at local market rates. This product has a 15-year "call feature" that allows the thrift to re-price the loan for the remainder of its term. Quitman Federal management has indicated that this re-pricing feature provides some flexibility for the lender.

CURRENT STATUS

Overall, the LLP has been a very successful initiative for Quitman Federal, Bay Meadow and the community. As of June 30, 1998, the program had made 21 loans totaling \$328,891. In 1996, the program's first year, the Association made two loans, and last year a total of 14 loans. To date in 1998, Quitman Federal has made five LLP loans.

Generally, Quitman Federal's LLP loans have performed as well or better than any conventional mortgage portfolio. To date, there have been no loan defaults charged to the program and no delinquencies in excess of 30 days. However, if a borrower should have difficulty paying the mortgage, the program has a series of checks and balances to avoid loan defaults. Much depends on the response and commitment that the borrower has toward

repaying their debt. Fortunately, the LLP provides some servicing remedies that are available if a borrower encounters difficulty making payments according to the original arrangement.

The LLP policy recognizes that each lender has an independent responsibility to protect its interest. In the event that the lender determines that the borrower cannot or will not continue to make the payments as agreed, the lender may take action to limit its loss exposure. Taking action usually refers to notifying USDA Rural Development of the status of an outstanding account. If the lender decides to foreclose on an account, USDA Rural Development has a "first refusal" option that allows the agency to buy the entire loan from the lender.

PARTNERSHIPS

Bay Meadow Corporation, USDA Rural Development Leveraged Loan Program.

ADDITIONAL INFORMATION CONTACTS

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14th & Independence Ave. SW,
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Phone: (202) 720-2791
Main Web Site: www.usda.gov
USDA Facilities Locator: offices.usda.gov
Rural Development Field Offices:
www.rurdev.usda

U.S. Bureau of the Census
Department of Commerce
The Herbert C. Hoover Building
15th and Constitution Ave., N.W.
Washington, D.C. 20230
Phone: (202) 482-2000
Fax: (202) 482-5270
Internet Homepage: <http://www.census.gov>

ADDITIONAL RESOURCES

The State Data and Research Center
Georgia Institute of Technology
GCATT Building
Room 543
250 14th Street, NW
Atlanta, GA 30318
Phone: (404) 894-9416
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Internet Homepage:
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Projects/gainfo/contents.htm](http://www.cviog.uga.edu/Projects/gainfo/contents.htm)

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