

AN INVESTMENT LETTER FOR MINNESOTA PHILANTHROPISTS

Thursday, April 15, 2004

This issue of the “Investment Letter for Minnesota Philanthropists” is the second in our series dealing with “affordable workforce housing”. In this letter we will demonstrate the enormous savings to philanthropists, business and government from relatively inexpensive programs aimed at mortgage foreclosure prevention.

Northside Residents Redevelopment Council is a non-profit neighborhood organization serving the Near North and Willard Hay neighborhoods of Minneapolis since 1969. As a community development corporation “NRRC” works with residents on housing and economic development projects. “NRRC” is respected nationally for it’s “Mortgage Foreclosure Prevention” program.

The purpose of “An Investment Letter for Minnesota Philanthropists” is to demonstrate how return on investment calculations can be applied to the private and public investments we make in our non-profit organizations. Accounting systems have yet to be developed that make these financial returns transparent to investors.

Based on a four year study completed in 1995 by the “Family Housing Fund at the end of the second year foreclosure experience indicates a 180% return on investment to private “financial sector” investors and a 360% return to “federal, state and local government” investors. Based on the study completed in the 2001 study by Maxfield Research/GVA Marquette Advisors the individual Minnesota taxpayer investor would achieve a 100% ROI at the end of the second year!

WHAT’S THE PROBLEM?

- The Family Housing Fund study shows a loss to private financial corporations of \$18,300 per unit of privately financed and insured conventional foreclosed mortgages after the second year that could have been avoided by a \$6,600 investment in counseling and financial assistance.
- The same study concludes that when both the federal government (FHA&HUD) and state and local (Minnesota & Minneapolis/St.Paul) share as investors in the program each avoid losses by the second year of about \$15,000 and each achieve returns exceeding 300% on their respective investments of \$3,300!
- In the fall of 2001 two private sector real estate research firms (Maxfield Research, Inc. and GVA Marquette Advisors) projected that 31,700 new affordable units would have to be built over the next five years to satisfy the regions workforce housing needs.

- The lack of affordable workforce housing impacts the growth of the Twin Cities labor force (some estimate by as much as \$ 1 billion annually in lost consumer purchasing power and lost income to business) and creates a drag on the economy from concentrations of poverty that makes neighborhood revitalization difficult.

HOW DOES “NRRC” HELP?

- NRRC provides direct counseling and information on options available to homeowners who typically are four to five payments behind on their mortgage after an average of seven years of successful performance.
- Screening is conducted to insure that financial problems result from circumstances beyond the family’s control : health problems, job loss, large extraordinary expenses, divorce or death of a spouse.
- The homeowner’s financial problems must be solvable and the homeowner must be willing to work with the program staff to develop and follow a plan to resolve these problems.
- Emergency financial assistance may be provided to assist the homeowner in becoming current on the mortgage.
- Intervention and advocacy is provided such as negotiation with the mortgage servicer or lender.

WHO BENEFITS?

- Minnesota families benefit because foreclosure results in the loss of a secure place to live, a loss on average of \$7,200 invested in the home, a damaged credit rating and likely higher costs to replace the home through purchase or rental.
- Minnesota taxpayers benefit from avoiding the potential loss of real estate and sales tax revenues and possible increase in social service program expense when families are displaced from their home.
- Minnesota state and local government and therefore taxpayers benefit by avoiding the write off of investments in neighborhoods providing affordable workforce housing. Neighborhoods suffer image and vandalism problems when properties are boarded-up.

- Banks and other mortgage lenders, mortgage servicing companies and mortgage insurance companies benefit from not having to write off direct investments, lose interest payment income and not having to incur expenses related to holding and maintaining properties in default.
- The federal government (HUD) and therefore taxpayers benefit by avoiding costly write offs of FHA and VA insured loans and the attendant processing expenses.

WHAT'S THE RETURN ON INVESTMENT?

Because the Family Housing Fund “Mortgage Foreclosure Study” covered the period from 7/1/91 to 3/31/95 the numbers used in calculating the returns are in 1993-1995 dollars. The foreclosure study surveyed over 800 families in Minneapolis and St.Paul. Nearly 60% of homeowners (487) received counseling and/or emergency assistance had their mortgages reinstated. Fifty percent of the “reinstated” homeowners (244) were current after two years in the program. Total prevention expenditures were \$1.6 million or \$3,300 per homeowner served or \$6,600 per homeowner still current after the second year. While there is a drop off in homeowners surveyed current on their mortgages after the first year experts in the field believe that delinquencies stabilizes at the end of the second year.

In these calculations we have assumed a growing economy with each new housing unit adding about \$14,000 in spending as consumers and \$16,000 as producers for business to the economy each year. Wages are assumed at \$10.00/hour. Business profit margins are assumed at 5% and corporate taxes have not been calculated and are included as part of the return generated by business. We assume 20% of new spending is subject to sales tax (6 1/2%) and that real estate taxes are calculated at 1%. The reduction in social service support and other economic costs (housing/shelter assistance, health care, school performance, day care availability, work performance and criminal justice system) are estimated to be \$3,000/year.

Scenario 1

The combined “Return on Investment” for Federal, State and Local units of government approximates **360%** at the end of the second year after counseling and/or emergency assistance has been given. The return is the same for each level calculated separately (Federal vs State/Local) because of the mutual leveraging impact of each others contribution.

Scenario 2

Because private lenders and mortgage insurers would write the property off after the first year there is little difference between year one and year two calculations other than the present value discount applied at the end of the second year. Year two is taken to show consistency with the returns in Scenario One.

Direct lenders and mortgage insurers would achieve a **180%** return on their investment after the second year by supporting the full cost of a “mortgage foreclosure program”.

Direct Value to Minnesota Taxpayers

Should the Minnesota individual taxpayer assume the full cost the return on investment would exceed **100%** after the second year without even calculating the secondary benefit achieved from Scenarios One or Two!

ROIs are higher than stated since the costs have not been prorated among scenarios.

CALCULATING THE RETURN ON INVESTMENT

Assumptions:

- Individual type = Family of three with Average income of \$22,500.
- Family Housing Fund Study of November 1995 used to measure the cost effectiveness of Mortgage Foreclosure Prevention.
- Maxfield Research/GVA Marquette Advisors Report of September 2001 used to determine the direct value to Minnesota taxpayers from the consumption and production contributions of each new family household.
- Social Service Cost Reductions = Government studies and community experience.

Present Values

(5% discount rate)

<u>Direct Value to Federal & Local Government (Scenario 1)</u>	<u>2years</u>	<u>1year</u>
Benefit to FHA & HUD from “mortgage foreclosure prevention”	\$15,000	\$26,500
Benefit to State &, City from “mortgage foreclosure prevention”	<u>15,200</u>	<u>27,000</u>
<u>Total Benefit</u>	*\$30,200	\$53,500

*Reduction reflects that 56% of mortgages surveyed are current in the second year.

Direct Value to Private Insurer or Mortgage Lender (Scenario 2)

Private mortgage insurance or direct write off of loan	\$15,200	\$16,000
Lender and/or loan servicer expense	<u>3,100</u>	<u>3,300</u>
<u>Total Benefit</u>	*\$18,300	\$19,300

*Foreclosed properties sold in year one. Year two number simply reflects the PV.

Direct Value to Minnesota Taxpayer (Complements both Scenarios 1 & 2)

Gain in consumer spending & business income per unit built	\$56,000	\$30,000
Gain in corporate profits from consumer spending & business		

income per unit built (assume 5% Margin)*	5,200	4,000
Gain from sales tax	750	400
Gain from real estate tax	1,000	600
Gain from reduced social service costs	<u>5,600</u>	<u>3,000</u>
<u>Total Benefit</u>	\$12,550	\$8,000

*includes impact of year one construction spending with \$2,500 profit contribution.

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