



Building Personal Wealth

A Conversation with Bob McTeer

President, Federal Reserve Bank of Dallas



Perspectives asked Bob McTeer to talk about building personal wealth and expand on a speech he recently gave on the importance of saving and taking advantage of compound interest.

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Why should a person learn about building personal wealth?

The most common reasons people aren't able to buy a house or start a business are a lack of personal financial wealth and poor credit. Even people of modest means can build wealth by setting goals, budgeting, saving and investing, and controlling debt. But if they don't know these basic steps—or their importance—they won't be able to take full advantage of our growing economy and the opportunities it offers.

What should a person know about building personal wealth?

If I were talking to someone interested

in financial security, I would emphasize that the most important thing is to get used to living below your means. Open a savings account, and start saving as early in life as possible. As your income rises, keep increasing the percentage you save. Never spend all you earn. Maintain discipline by having savings automatically deducted from your paycheck or checking account. Purchasing savings bonds through payroll deductions is one good way to start socking away money. If you are eligible for an individual retirement account, take full advantage of its favorable tax features. Similarly, if your employer has a 401(k) plan, take advantage of all the matching features as well as its tax advantages.

Also, never withdraw interest. Leave it invested to compound. Compound interest, over time, is like magic. And it is more magical the earlier a person begins to save and take advantage of it. People who don't understand the magic of compound interest until later in life never stop regretting their missed opportunities.

Do people know enough about creating personal wealth?

For some of us, saving and managing our personal finances are a lot like exercising and dieting to lose weight. We have a pretty good idea what we should be doing; execution is the problem. Lack of knowledge may be a problem, but lack of discipline is the real enemy.

Saving doesn't seem to be a high priority with most Americans. Our personal saving rate remains very low

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despite the economic growth of recent years. One study by the Consumer Federation of America and Primerica found that one-half of American households have accumulated less than \$1,000 in net financial assets.

The same study also found that many people could be more knowledgeable. A substantial percentage of those surveyed think their best shot at accumulating \$500,000 or more over a lifetime is buying a lottery ticket—not saving. Pretty scary, isn't it? This implies that many Americans grossly underestimate the impact of compound interest on accumulating wealth.

How would you explain compound interest to someone who hasn't saved?

When I speak to groups unfamiliar with its magic, I use this example: If you invest \$100 at 10 percent interest, you will earn \$10 interest in a year and have \$110 at year-end. If you take the \$10 in interest out of the account and leave the \$100 invested, you will earn another \$10 the next year. If you take that interest, you'll earn another \$10 in the third year, for a total of \$30 over the three years.

On the other hand, if you keep the interest invested, you will earn \$10 the first year on \$100, \$11 the second year on the \$110 and \$12.10 the third year on the \$121. The extra dollars come from earning interest on your interest as well as on your original investment. Compounding annually at 10 percent adds an extra \$3.10 in three years—not a huge deal. But in just over seven years, your \$100 investment would double, to \$200. In another seven years, the \$200 would double again to \$400—a pretty big deal.

Also, it's important to let people know they don't need to be rich to have compound interest work for them. The chart to the right shows how saving just \$500 a year and earning 5 percent interest on it can produce almost \$3,000 in five years, more than \$17,000 in 20

years and almost \$35,000 in 30 years. And just think what would happen if the amount saved were doubled to \$1,000 a year—in 30 years it would grow to a nest egg of almost \$70,000.

In addition to beginning to save today, what other wealth-building steps can people take?

People need to know how important it is to use debt wisely. A few years back, I read about a long-term experiment involving Twinkies. A group of 4-year-olds was assembled in a room, and each was given a Twinkie. The youngsters were told they could eat the snack whenever they wanted, but if they didn't eat it right away, they'd get another one when the researcher returned. Those who held out—those who deferred their gratification—were more successful later in life than those who couldn't resist downing their Twinkie right away. The same goes for adults. Deferring the instant gratification of using credit cards to buy something that isn't budgeted pays long-term benefits of lower debt, higher savings and ultimately, more wealth.

The power of compound interest works both ways. If you are a saver and investor, it works for you. It multiplies your money. If you are a debtor, it

works against you. If you owe a large credit card debt and don't pay it all off, you pay interest on interest rather than earn interest on interest. You have to run hard just to stand still, sort of like running up a down escalator. Earning with compound interest is like climbing an up escalator.

I also tell people it's important to have a financial plan. As with anything, when you have a plan, you are more likely to accomplish your goals. A financial plan should include a budget, a monthly saving or investing strategy, and ways to take advantage of tax-deferred savings. Plus, you have to stick with the plan. As I mentioned earlier, the best way to stay disciplined is to have money directly deposited into a savings or investment account. It's easier to stick to a long-term plan if the money you earmarked for saving never passes through your hands. Get on automatic pilot and stay there.

And finally, finding good information is important. This issue of *Perspectives* includes a list of resources for learning more about financial planning, budgeting, saving, investing, borrowing and controlling debt. Being financially literate and building wealth takes lifelong learning, as well as lifelong saving and investing. It means learning about the best financial products and using them effectively.

What can community leaders do to increase the understanding of building personal wealth?

Community leaders can share information with their constituencies and customers about the magic of compound interest and the steps people can take to build personal wealth. If these leaders emphasize the importance of knowing more about personal finance, maybe more people will be encouraged to save and invest and use credit wisely. There's a lot of information available that can be used as teaching tools, in discussion groups or just to pass along to someone who needs it. ▀



Personal Wealth Primers

Building Wealth: A Beginner's Guide to Securing Your Financial Future, a new publication from the Dallas Fed, is designed to help boost financial literacy. This easy-to-read workbook will help individuals better understand the basic steps for building personal wealth. It explains how to budget to save, save to invest and control debt in order to reach short- and long-term wealth creation goals.

To order your copy, go to www.dallasfed.org under Publications or call (800) 333-4460, ext. 5254, or (214) 922-5254.

Here are some other resources that organizations and individuals can use to expand financial literacy:

Choose to Save® Education Program—www.choosetosave.org.

The program offers online financial calculators to help people determine how much they need to save to have enough money for retirement.

Jump\$tart—www.jumpstartcoalition.org. The Jump\$tart Coalition for Personal Financial Literacy encourages curriculum enrichment in grades K–12 to ensure basic personal financial management skills are taught.

National Endowment for Financial Education (NEFE)—www.nefe.org. The NEFE offers free materials to schools and nonprofit organizations. Through games, simulations, case studies and interactive exercises, students test and apply financial principles and concepts.

National Community Reinvestment Coalition (NCRC) Financial Literacy Campaign—www.ncrc.org. The NCRC offers train-the-trainer courses, teaching guides and workbooks to help community-based organizations use the curriculum. For additional information, call (713) 224-7772.

National Partners for Financial Empowerment (NPFE)—www.npfe.org. NPFE is a coalition of government agencies, private organizations and nonprofit groups working to increase public awareness of the importance of financial education and bring greater visibility to financial literacy projects. ▀

Lyons Village



A residential/commercial redevelopment project in the Fifth Ward is helping reverse decline in Houston's poorest neighborhood.

Mixed Use Revitalizes Historic Houston Neighborhood

During the 1920s, Lyons Avenue in inner-city Houston bustled with black-owned businesses, including dental practices, barbershops, theaters, restaurants and pharmacies. Through the years, Duke Ellington, B. B. King and Ella Fitzgerald enthralled crowds at the Fifth Ward neighborhood's famous Club Matinee.

In the 1960s, antidiscrimination laws and school desegregation began giving black Americans more choices about where they worked and lived. Fifth Ward began a precipitous decline as many residents took their disposable incomes to new suburban homes and shopping centers. Today, the Lyons Avenue neighborhood is Houston's poorest. The average income is \$8,900, and 62 percent of its residents live below the poverty line.

Working to change that are those who formed Fifth Ward Community Redevelopment Corp. (CRC) in 1989 to build affordable single- and multi-family housing and commercial space

in the area. In June 1995, the group launched its most ambitious project by developing a plan to revitalize the Lyons Avenue corridor. The CRC picked a symbolic tract of land for the project—the very spot where Club Matinee once stood.

Today, Lyons Village is a unique blend of residential and commercial space located between Highway 59 and Gregg Street on Lyons Avenue, Fifth Ward's main thoroughfare. More than 33,000 square feet of flats and townhouses mix with 10,500 square feet of commercial space that houses social service agencies as well as businesses.

"We're trying to make capitalism work in the lowest income neighborhood in the South's largest city," says Stephan Fairfield, Fifth Ward CRC's president. "To make capitalism work, communities must have access to capital, which we have done by having long-term, mutually beneficial relationships with banks. We help achieve their business objectives,

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Lyons Village

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and they help us achieve our social objectives.”

Such residential/commercial ventures are a “more urban way of doing things, bringing more life to the neighborhood,” says Jeff Baloutine, senior vice president of community reinvestment at Bank United, a major player in Lyons Village. “This kind of project is one that should be considered as a real model and one that can work in all communities, not just in low- and moderate-income areas.”

Mixed-Use Development

The development mix is the result of feasibility studies, town meetings and discussions with city planners. Although some Fifth Ward residents and civic groups wanted commercial development and others favored only residential, leaders surveyed the area’s business and housing needs and in September 1995 determined the two could coexist.

The financial package included pre-development, equity, construction and permanent funds. Local Initiatives Support Corp. (LISC), which helps community development corporations with loans and technical assistance, provided nearly \$160,000 to conduct a market and feasibility study, acquire some of the land and complete environmental studies.

Equity financing for multifamily housing came from the 1996 sale of \$1.4 million in low-income housing tax credits to the National Equity Fund (NEF). A LISC affiliate, NEF is the limited partner and Fifth Ward the general partner in Lyons Village. NEF will receive tax credits over the next 10 years. After the 15-year affordability period, Fifth Ward will purchase the property from the partnership for a price already negotiated with NEF.

In addition, a \$240,000 grant from the Federal Home Loan Bank of Dallas, awarded in October 1997 through Bank United, helps lower residents’ rents.

IDs a Good Idea

Covenant Community Capital Corp., located in a commercial space in Lyons Village, encourages residents to enroll in its individual development account (IDA) program. Covenant is a social-service provider and community development financial institution serving low-income residents in the Houston area.

IDs are savings accounts designed to encourage low-income families to save regularly and build assets. Reagan Swank, Covenant program manager, says that for every dollar saved, \$2 to \$4 is added to participants’ accounts. The additional money is provided through the McAuley Institute, Department of Housing and Urban Development, Office of Community Services of the Department of Health and Human Services, and United Way of the Texas Gulf Coast. Compass Bank holds the IDA accounts for the savers.

Swank says residents may apply their IDA funds toward buying a home, starting a small business or paying for postsecondary education.

For more information on Covenant Community Capital Corp.’s IDA program, call (713) 223-1864.

Many Partners

Lyons Village represents another step in the Fifth Ward CRC and Bank United relationship, which goes back more than 10 years to a \$1 million loan for housing construction in the area. In fact, according to Fairfield, Baloutine has been involved in the conceptual stages of all the CRC’s projects.

Fairfield says CDCs must have strong, long-term relationships with banks and other financial institutions. “We have never approached a bank about making a CRA loan,” he says. “We tell them we have a business opportunity in our

community. If we attract financial institutions on the basis of the CRA, then their interest will only be sustained as long as the CRA exists. The barometer is not if you do one deal—it’s if you do your second, third and fourth deals with the same lender.”

Bank United provided \$1.6 million in interim construction financing for Lyons Village. Southwest Bank of Texas furnished \$340,000 in a bridge second lien, and Wells Fargo provided \$130,000 for tenant finish-out. Other funding sources are a \$275,000 grant from the Office of Community Services of the Department of Health and Human Services and a \$497,566 loan from Christus Health, a large charitable-hospital organization. There also is a deferred developer fee of \$262,500. Fifth Ward is currently structuring the permanent financing.

Navigating a Rough Road

The road to building Lyons Village was anything but smooth. During 1997 and part of 1998, Houston’s building boom made it impossible for Fifth Ward Community Builders—the general contractor and an arm of Fifth Ward CRC—to hire subcontractors it could afford.

When construction did begin in May 1998, it ran afoul of the weather. First a drought meant foundations had to be watered daily to keep them from cracking. Then excessive rain caused flooding and halted all work. Because the tax credits required that residential construction be completed by the end of 1998, work on the units forged on through weekends and year-end holidays. Fairfield remembers being on site Christmas Day.

Finally, on December 31, 1998, the residential units were completed and people began moving in. Today, all 24 units are leased, and there’s a waiting list of 300. In spring 1999, commercial construction wrapped up.

Located above the commercial space are residential units of eight flats, each with four bedrooms and two baths.

Behind the buildings are 16 townhouses, each with four bedrooms and 2½ baths, ceiling fans, high-efficiency air conditioners, brick exteriors and masonry-type siding. Eight units are accessible to handicapped and elderly people.

Because it receives low-income housing tax credits, 20 percent of the Lyons Village units must be set aside for families making less than 50 percent of the median area income. Fifth Ward CRC decided to go further to address housing needs and set aside 33 percent of the units for families making less than 30 percent of the median income, with the balance of the units for families under 50 percent of the median.

Meeting Service Needs

Lyons Village gives area residents easy access to a host of social services in the commercial space, including the Fifth Ward Enrichment Teen Enterprise Center, Young Fathers in Families, Career and Recovery Resources, Community Partners, McAuley Institute, Covenant Community Capital and National Community Reinvestment Coalition. Services are more available to the community than in the past because of the storefront locations and providers willing to set hours convenient for their clientele.

In addition to Lyons Village and other ongoing projects, Fifth Ward CRC plans to restore the historic Deluxe Theatre, create a Fifth Ward arts district, introduce an acquisition rehab program, develop 20,000 square feet of additional commercial space and start a child development center. **D**

Fast Facts

Lyons Village, Houston

Developers and their partners have leveraged grants and other financing sources to create Lyons Village, a mixed-use development that helps meet both housing and social service needs for an inner-city community. Through innovative structuring, Fifth Ward Community Redevelopment Corp. has created a model for other developers.

Predevelopment Financing

Local Initiatives Support Corp. loan, at 6 percent	\$ 157,500
LISC grant	\$ 2,500

Equity

Low-income housing tax credits sold to National Equity Fund	\$1,428,140
Federal Home Loan Bank of Dallas grant	\$ 240,000

Interim Construction Financing

Bank United, first lien, at prime plus 1 percent	\$1,626,752
Southwest Bank of Texas, bridge second lien, at prime plus 1 percent	\$ 340,000
Wells Fargo, tenant finish-out	\$ 130,000
Fifth Ward CRC third-lien loan (using Office of Community Services grant), at 5.98 percent	\$ 275,000
Fifth Ward CRC loan (using Christus Health loan), at 4.98 percent	\$ 497,566
Deferred developer fee	\$ 262,500

Permanent Financing

Fifth Ward CRC is structuring the permanent financing.

For more information:

Stephan Fairfield
Fifth Ward Community Redevelopment Corp.
(713) 674-0175



Oak Cliff Gateway TIF District

Unique financing encourages revitalization in southern Dallas

As part of a long-range community development plan for Dallas, city leaders created the 360-acre Oak Cliff Gateway Tax Increment Finance (TIF) district in 1992 to encourage investment and development in the city's southern sector. City officials envision the TIF district as a place where people work, live, shop and enjoy parks, dining, entertainment and the district's historical flavor.

City officials want to use the TIF district to build on successful developments in neighboring downtown, create jobs, find productive uses for vacant land and provide an attractive location on the banks of the Trinity River for new residential and commercial development.

Local governments create TIF districts to help promote development in blighted areas or to stimulate additional development in areas where it otherwise wouldn't happen.

In the Oak Cliff Gateway TIF district, city leaders hope private developers will build:

- 500 market-rate apartments;
- 150 housing units for the elderly, including assisted-living facilities;
- 100 single-family homes;
- 90,000 square feet of additional industrial space;
- 140,000 square feet of additional retail space; and
- 40,000 square feet of office development.

When the TIF district was established in 1992, the city council set its base tax value. At that time, a designated fund was created to hold the additional tax revenues derived from the increased property values as development occurs. Revenue from the fund will finance public improvements in the TIF district. City officials estimate the cost at \$5.2 million. The TIF district expires in 2012.

To date, \$1.5 million has been used for streetscape, pedestrian walkways,

educational and training facilities, street reconstruction, curbs and gutters, intersection improvements, utility burial or relocation, and other public-use improvements. To spur further development, city officials designated \$500,000 of a 1995 bond program as seed money to finance additional public improvements in the TIF district.

Planned improvements will focus on three major corridors—Zang Boulevard, Colorado Boulevard and Beckley Avenue.

Unique Financing

Under the TIF district's pay-as-you-go financing, private developers desiring city participation in cost sharing can get either 30 percent or all infrastructure costs plus city fees reimbursed out of the TIF fund.

If developers choose to pay for infrastructure, the city will reimburse 30 percent of the costs, including city fees, without interest. Developers will get full reimbursement, plus interest, if they advance money to the city for public infrastructure improvements and allow the city to bid the contracts (*see table*).

Developers who have tight construction schedules would likely opt for the 30 percent reimbursement method rather than the 100 percent method because of the city's approval process.

Improvements Taking Shape

Since 1992, public improvements and private development have ranged from new and expanded businesses to private housing.

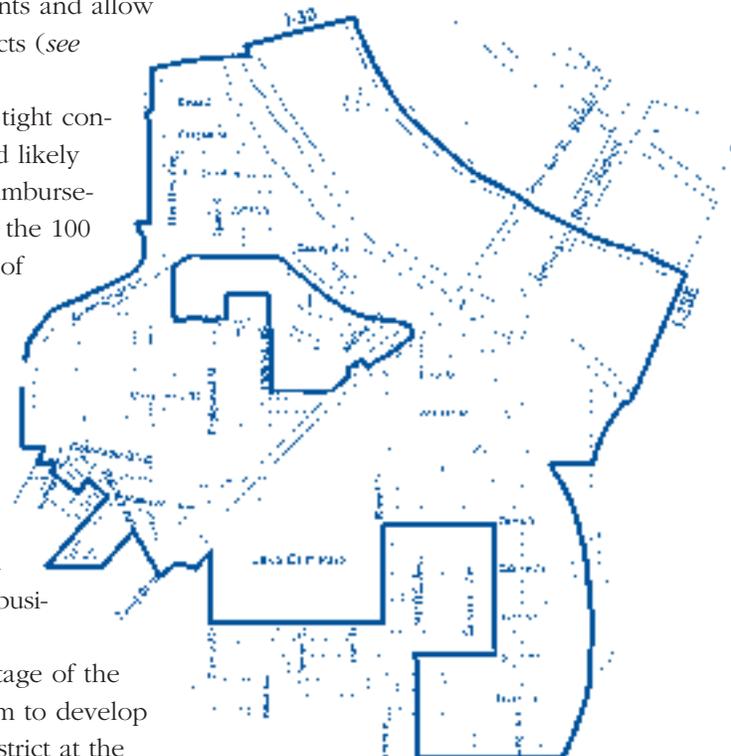
Walgreens took advantage of the city's cost-sharing program to develop a pharmacy in the TIF district at the

major intersection of Colorado and Beckley. Because of a tight time frame on construction, Walgreens financed its own infrastructure improvements. From the TIF fund, the city reimbursed Walgreens 30 percent—\$38,000—of the fees and infrastructure costs. The pharmacy opened in June 1999, representing a \$3.2 million investment in the TIF district.

City officials hope private lenders will finance projects to the extent the lenders are confident that future cash flows to the TIF fund will bring a return on their investments. Washington Mutual, based in Irvine, Calif., has already shown that confidence.

Washington Mutual loaned \$1.5 million to the TIF district in 2000 for infrastructure improvement for a private development. JPI Properties Inc., a major apartment developer in Las Colinas near Dallas, expressed an interest in develop-

Oak Cliff Gateway TIF District Boundaries



ing a 644-unit multifamily complex on 27 acres of the TIF property—a \$44.7 million investment—but first wanted public improvements completed. Washington Mutual agreed to finance the public improvements, with JPI guaranteeing the loan to the district. The loan will provide lights, street improvements and water lines for a portion of the TIF development and adjacent areas.

JPI began constructing the apartment complex in late 2000 and is scheduled to complete the project in August 2004.

Washington Mutual loan officers had prior experience in financing projects in TIF districts and were familiar with the intricate details of finalizing the agreement. Unlike traditional commercial loans, this loan's repayment comes from future tax revenue from the TIF district.

"We like finding innovative deals and being on the cutting edge where we can help redevelop communities we serve," says Art Porter, first vice president of community lending and investments in

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What's a TIF?

Local governments create tax increment finance districts, or TIFs, as an economic development tool to stimulate the redevelopment of blighted areas or to entice investment that would not occur without the TIF. Tax increment finance is considered a viable option for revitalization because the increase in private investment pays for the operation of the TIF district.

TIF districts are created at the direction of a local government, usually a municipality. This approach is often used for downtown districts perceived to be stagnant or areas with declining property values. In an effort to revitalize the area, city officials propose a redevelopment plan to other local taxing entities, usually the county and school districts, for their approval and participation. If all entities agree, a boundary is drawn around the area to be revitalized and the taxing entities are limited to revenues from the existing tax base for the life of the TIF.

The TIF authority—often the municipi-

ality or a newly created entity—uses tax increment revenues or sells bonds to finance public improvements inside the district. Improvements are generally to infrastructure associated with development like streets, lighting, water lines and sidewalks. The TIF is then attractive to private investment because costs associated with development are reduced. Taxes on the base property values continue to go to local entities. Taxes on increased property values resulting from improvements, or the tax increment, go to the TIF authority to retire the bonds.

TIFs are generally regarded as beneficial to local governments because they spur development at no cost to the taxpayers. Developers benefit because they receive a subsidy in the form of infrastructure for a project. However, it is important to note that the realized increment is not necessarily as large as projected and that local governments are obligated to make bond payments even if the district does not perform as expected.

Financing Public Improvements in a TIF District

Traditional method	Cost-sharing program 30 percent reimbursement	Cost-sharing program 100 percent reimbursement
City creates TIF.	City creates TIF.	City creates TIF.
City issues bonds.	Developer finances and makes public improvements.	Developer/bank makes an advance to the city for public improvements. City places proceeds in a designated fund for development of the project.
		Public works and transportation department puts the public improvement projects out for public bid and constructs improvements.
Developer builds project, which creates increases in tax revenues.	Developer builds project, which creates increases in tax revenues.	Developer builds project, which creates increases in tax revenues.
Tax revenue increase goes to TIF fund.	Tax revenue increase goes to TIF fund.	Tax revenue increase goes to TIF fund.
Increased revenues pay off the bonds.	City pays back developer 30 percent of the cost of public improvements and city fees from TIF fund, without interest. Developer will receive the entire 30 percent reimbursement if funds are available in the TIF fund. Otherwise, the developer must wait until funds accrue.	City pays back the advance for the cost of public improvements and city fees, including principal and interest. Advance will be paid back as funds are available in the TIF fund. Otherwise, the developer must wait until funds accrue.

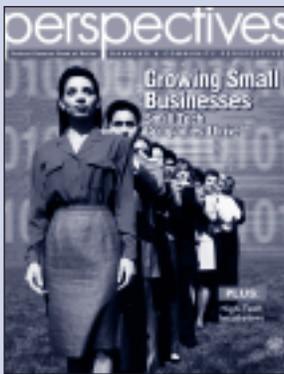
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Oak Cliff Gateway TIF District

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Washington Mutual's Irvine headquarters. “This is a unique deal and involves risk, but that's what we do every day—take risks and make loans. We first had to make sure it was a good business deal and matched our strategic goals.”

In addition, K-Clinic, a chain of metroplex medical clinics, in 1998 constructed an office building on Colorado Boulevard. The development is valued by the Dallas Central Appraisal District at \$420,930.

In 1999, Oak Farms Dairy, one of Oak Cliff's largest employers, completed construction on its main site on Zang

Boulevard and expanded to the south as part of an \$8 million project. Oak Farms built a milk refrigeration facility on the existing site and a parking lot for dairy vehicles and employees on the expansion site. The facility is lighted, fenced and landscaped.

Dallas Advantage Charter Schools has built a K–12 facility at Ewing Street and Colorado Boulevard. The development, valued at more than \$1.2 million, includes five buildings and totals more than 41,000 square feet.

Uptown Realtors relocated to a Beckley Avenue office that the owner had renovated, increasing its value to about \$200,000. Eight years ago, Methodist

Medical Center built medical buildings and doctors' offices in the TIF district. Since then, the complex has provided approximately \$5 million in tax valuation annually to the TIF fund.

The city continues to encourage development in the district and hopes it will enhance the revitalization of the southern sector. ▀

For more information on the Oak Cliff Gateway TIF District, contact:

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