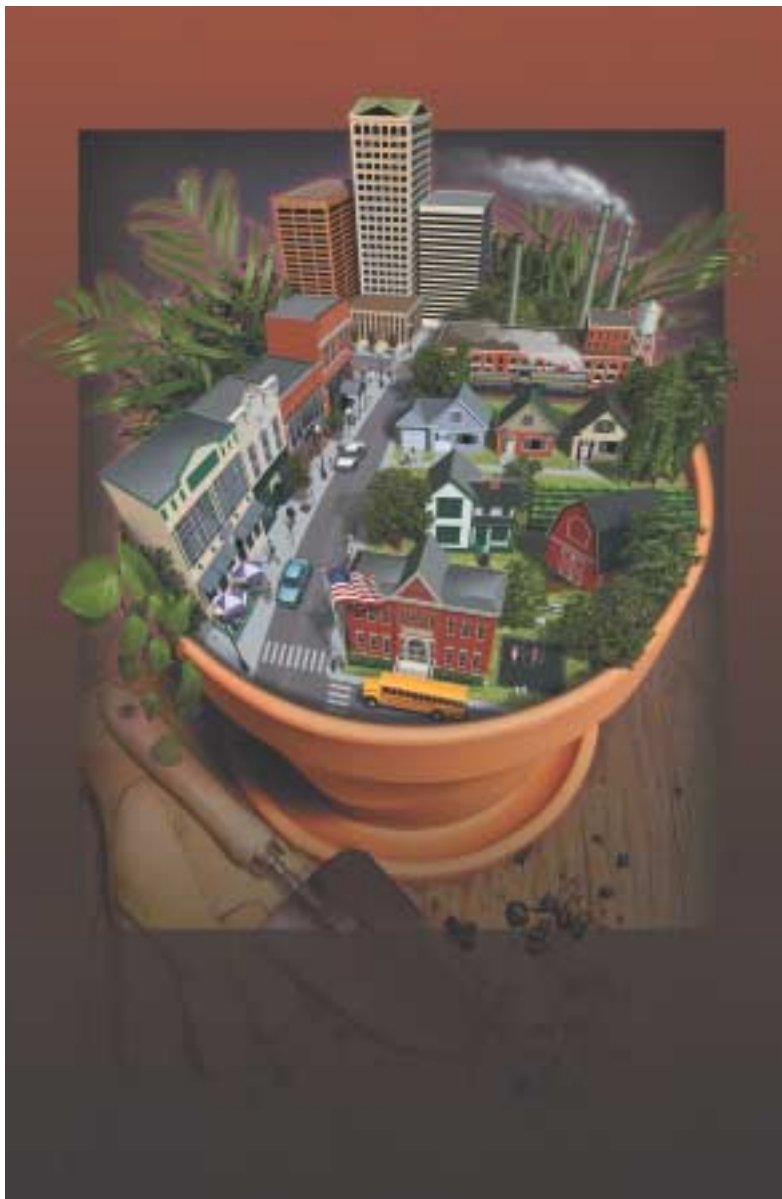


# Profitwise

## News and Views

Published by the Consumer and Community Affairs Division

September 2003



## Seeds of Growth

### Sustainable Community Development: What Works, What Doesn't, and Why

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#### *In this issue:*

*On March 27 and 28, 2003, the Federal Reserve System's Community Affairs and Research Officers held the third biennial Community Development Research Conference. This issue of Profitwise News and Views provides a summary of the Conference sessions and key findings of the papers presented.*

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## Corrections for *Profitwise News and Views 2nd Q*

In the *Profitwise* Winter 2003 edition, the *Financial Institutions and Participation in Individual Development Account Programs* article incorrectly listed the url address for Project Money\$mart on page 17. The correct address is: [www.chicagofed.org/consumerinformation/money\\$mart/agenda421.cfm](http://www.chicagofed.org/consumerinformation/money$mart/agenda421.cfm).

## Profitwise News and Views

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## In Brief

### The Federal Reserve Bank of Chicago Announces a New Research and Information Center

Recognizing the large and growing economic impact of immigrants in the United States, the Consumer and Community Affairs (CCA) division of the Federal Reserve Bank of Chicago announces the launch of the *Center for the Study of Financial Access for Immigrants*.

As defined by the U.S. Census Bureau, the number of foreign-born population in the United States is 32.5 million (March 2002 figures), approximately 11.5 percent of the U.S. population. According to research conducted by the National Academy of Sciences, immigrants add roughly \$10 billion to the U.S. economy each year, an estimate that excludes highly skilled labor and immigrant-owned small businesses. Immigrants contribute to the U.S. economy in tax payments, by most estimates more than they consume in aggregate public services and benefits. Many immigrants, due to barriers such as low English language proficiency and cultural orientation that does not embrace formal banking relationships, remain on the fringes of the U.S. financial system, and thereby limit their prospects for long-term wealth accumulation and economic prosperity.

Community development professionals, government agency representatives and financial institutions lead the research community in the emerging theme of "immigrant financial access." Most research on immigrant access has focused on the labor market, and immigrant participation in formal financial institutions is a critical and largely unstudied dimension of economic integration. A major goal of the Center is to provide a forum where representatives of financial institutions, community development professionals and researchers can interact and learn from one another. A second goal is to focus attention on the issues surrounding immigrant financial access by drawing on the expertise of national researchers. A third goal is to encourage future policy-oriented research that builds on the experience of community development professionals, financial institutions and government agencies. Finally, the Center is designed to identify partnerships and information sharing arrangements that would be mutually beneficial for financial institutions, community development professionals and the research communities in addressing the issues surrounding financial access for new Americans.

Federal Reserve Bank of Chicago CCA staff will also conduct related original research, document and raise awareness of proposals, policies and practices affecting immigrants, and invite noted policy-makers, financial industry representatives, advocates, corporate leaders, government officials, and others to share their views. The Community and Economic Development Research and Information Center (CEDRIC) page on the Federal Reserve Bank of Chicago's website ([www.chicagofed.org/cedric/index.cfm](http://www.chicagofed.org/cedric/index.cfm)) will house the research, articles and other information prepared and collected by the Center. A two-day conference focusing on the research to date and policy-oriented topics will take place April 15 and 16, 2004 at the Chicago Fed.

Visit the website of the Federal Reserve Bank of Chicago at:

 **chicagofed.org**

## Around the District



### Iowa

#### **Iowa Finance Authority and the Iowa Civil Rights Commission to Increase Minority Homeownership**

According to a recent University of Iowa study (Housing and Community Development in Iowa 2000: Meeting Challenges of the Next Decade), the homeownership rate for minority households (in Iowa and nationally) is substantially lower than among White households.

The Iowa Finance Authority and Iowa Civil Rights Commission (ICRC) announced a program to double the number of minority borrowers using FirstHome, the state's affordable mortgage financing program. The ICRC outreach effort, "Owning Your Own Home: Everyone's Dream Should be a Reality," will involve 30 public education sessions on fair housing and home financing in communities throughout Iowa.

*For information about FirstHome, visit [www.ifahome.com](http://www.ifahome.com), or call (800) 432-723. For information about ICRC, visit [www.state.ia.us/government/crc](http://www.state.ia.us/government/crc), or call (800) 457-4416.*

### Michigan

#### **State Housing Authority Announces \$7 Million to Help Homeless in Michigan**

More than 60,000 homeless people in Michigan will benefit from over \$7 million in grants awarded by the Michigan State Housing Development Authority (MSHDA). A total of 204 organizations representing 60 areas serving all 83 Michigan counties will share the 2003 funding, a combination of MSHDA (\$4.4 million) and federal Emergency Shelter Grant (ESG) formula funds (\$2.6 million). The grants were awarded by MSHDA through the "Continuum of Care" planning model. The grants awarded will provide support for ongoing programs, homelessness prevention activities, and supportive services.

*For information, call (517) 373-1974, or visit [www.michigan.gov/mshda](http://www.michigan.gov/mshda).*

### Indiana

#### **\$80,000 Awarded to Nonprofits in Central Indiana**

The Emmis Communications/Radio One Community Fund announced monetary awards to three nonprofit organizations. The fund was created with a joint \$1 million commitment from Emmis and Radio One in January 2001.

This year's recipients are: Fathers and Families Resource Center (\$40,000), which provides financial literacy and planning for young fathers and families; Family Service Association (\$30,000), which provides family asset building services; and Girls Inc. of Indianapolis (\$10,000), which provides economic literacy training.

*Nonprofit organizations interested in submitting requests for funding should download the grant guidelines at [www.network-indiana.com](http://www.network-indiana.com), or [www.agriamerica.com](http://www.agriamerica.com).*

### Illinois

#### **Community Development Entities Receive Tax Credits**

Bethel New Life and the Illinois Facilities Fund, received \$14 million in tax credit allocations under the New Markets Tax Credit (NMTC) Program. The two organizations aim to stimulate economic opportunity and job creation in low-income communities. An additional seven CDEs with national service areas, including Illinois, received over \$200 million in tax credit allocations.

*For information on the NMTC Program, see *Economic Development News & Views, Spring 2001*, at [www.chicagofed.org/publications/economicdevnewsandviews/2001/nvspring01.pdf](http://www.chicagofed.org/publications/economicdevnewsandviews/2001/nvspring01.pdf).*

### Wisconsin

#### **Milwaukee Home Mortgage Lenders: "Mission Accomplished"**

New Opportunities for Homeownership in Milwaukee (NOHIM) disbanded after 12 years of addressing home mortgage lending issues in Milwaukee. NOHIM was originally created to address the racial disparity in loan denial rates in Milwaukee, which has consistently had one of the highest levels of disparity among mortgage applicants nationwide. NOHIM, a coalition of financial institutions and homebuyer counseling agencies, made \$263 million in loans to 4,653 applicants over 12 years, 80 percent of which went to ethnic minorities.

*For information on NOHIM, see Michele Derus' June 4, 2003 article in the *Milwaukee Journal Sentinel* at <http://www.jsonline.com/homes/buy/jun03/145373.asp>.*

# Measuring the Impact of Community Economic Development Programs

Remarks by Chairman Alan Greenspan  
Federal Reserve Board  
Community Affairs Research Conference  
Federal Reserve System  
Washington, DC, March 28, 2003



It is a pleasure to join this group of dedicated researchers, bankers, community leaders, and policymakers interested in the worthwhile and challenging process of program assessment. Meaningful program review can be achieved only through measurement and critical analysis. Systematic research of community economic development programs has been limited. Accordingly, your challenge is to vastly expand the information base.

## Measuring the Impact of Community Economic Development Programs

The overarching objective of community economic development and empowerment is to help underserved populations accumulate assets and improve their economic well-being. Measuring the results of programs dedicated to such goals is essential to maximizing the impact of these programs and managing scarce resources. Meeting the goals, particularly in areas and among populations where biases and negative perceptions may have contributed to market failures, helps people improve their financial standing, regardless of their current economic status.

For nearly four decades, numerous policies and programs have been implemented with the intent of increasing economic opportunity. They have used a variety of management and funding strategies, ranging from federal government appropriations to debt and equity financing from private sources. Nevertheless, despite the broad spectrum of programs, the length of time they have been in place, and the array of funding participants, empirical research quantifying their impact is rare, regardless of whether government agencies, nonprofit organizations, or private entities sponsor the programs. The lack of measurement is particularly regrettable for government-sponsored programs, because quantifying their impact is crucial to the legislative process.

When a bill is proposed in Congress, the nature of the problem and the factors presumed to be contributing to that problem typically are explicitly stated. And generally there is a projection of the outcomes that would indicate success. This process of problem diagnosis, program justification, and projection of results, if fully embraced, provides a cost-benefit structure for assessing a program's value. The program can be judged worthwhile when the data demonstrate that the benefits exceed the costs, including the opportunity costs of any investment.

Even with such a framework, conducting research on community development and economic empowerment programs can be challenging, in part because the effects these programs intend to achieve are often quite difficult to measure and may not become apparent for relatively long periods of time. Initiatives aimed at complex economic and social challenges that were decades in the making require, more than likely, many years to achieve their goals. Unlike the standards for macroeconomic performance, virtually no specifically defined standards exist for monitoring the value of social and economic improvement programs.

For community development researchers, the challenge is to develop parameters that can be used to objectively assess the value of their programs. For example, the measures that affordable housing organizations use could illustrate the extent to which their programs have, or have not, increased homeownership rates and property values, reduced crime, improved school performance, or spurred new private-sector investment in a disadvantaged neighborhood.

Effective research must isolate the variables that best convey the impact of a program, define the specific data that must be collected, and develop a system for maintaining and retrieving the data over time. In other words, the challenge is to quantify the marginal effect of a program. The value of such a system is clear. So too, however, is the complexity of

creating it. Consider, for example, the difficulty of measuring the marginal impact of a financial education program. It requires unique data collection techniques and unconventional tracking systems to gauge the benefit to an individual derived from making informed financial decisions that resulted from that educational program.

### **Socioeconomic Trends in Central Cities**

The relative paucity of data and research on community development programs has limited the ability to fully demonstrate their impact and credibly differentiate those that are successful from those that are ineffective. Undeniably, impressive local community development initiatives have been undertaken, and individual testimonials reveal advances in the economic well-being of many of the beneficiaries. However, the absence of formal data collection and research for the numerous neighborhood revitalization efforts over the past several decades has resulted in a reliance on mostly anecdotal reporting at a neighborhood or individual level. Anecdotal information is not without value. It offers clues to the construction of a more formal statistical analysis. But, as I am sure all of you have experienced, anecdotes can be selective and can convey a false message of the success or failure of a community development program.

Given the lack of data demonstrating outcomes from new initiatives, the inclination is to examine existing data to identify trends in areas where community development organizations have been a consistent presence for some

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time. One hopes that broad positive trends that cannot be understood fully from conventional market forces will suggest the possibility of community development being at least a partial explanation of these trends. Since most community development initiatives focus on urban areas, data on socioeconomic trends in central cities may offer some insight into the influence of local economic and social programs. For example, Census statistics compiled for the State of the Cities database of the Department of Housing and Urban Development (HUD) show that increases in the rates of change in homeownership in central cities slightly exceeded the increases in suburban communities between 1970 and 2000.

The Federal Reserve Board's 2001 Survey of Consumer Finances concluded that between 1998 and 2001, families in the lowest quintile of the income distribution increased their rate of homeownership nearly 5 percent, saw their median income grow more than 14 percent, and realized a 25 percent gain in their median net worth.

Although these gains in homeownership rates in central cities and the economic progress of lower-income families are encouraging, other data covering a longer time frame are less sanguine. In particular, HUD's State of the Cities database indicates that residents in central cities barely increased their real median family income between 1969 and 1999, while families in suburban communities did appreciably better. In addition, the poverty rate in central cities, according to this database, increased 23 percent during this thirty-year period, while it decreased 7 percent in suburban areas.

These seemingly contradictory data undermine efforts to plan an appropriate course of action. The absence of credible data clearly renders researchers unable to attribute the gains to a particular program or the continued challenges to a particular failure.

In weighing the implications of recent trends in data, it is important to factor in the presence of changes in external market influences. For example, advances in mortgage underwriting and delivery systems have resulted in increased availability of funding for homeownership. Community development investors' funding strategies have also changed considerably over this thirty-year span.

At the Federal Reserve, economists strive to identify the appropriate variables for assessing the impact of regulations, in particular the Community Reinvestment Act (CRA). In addition to the research presented at this conference, Federal Reserve economists have undertaken studies to assess whether the CRA causes banks to provide a mortgage subsidy and to determine the performance and profitability of CRA-eligible loans. But the lack of broad data management systems to identify and track the performance and profitability of most CRA-eligible loans presents researchers with a challenge, as does the need to focus on changes that can truly be attributed to the CRA, rather than to changing market forces.

### **Information Gains in Community Development**

While empirical research on specific community development programs is limited, insights nonetheless have been gained from experience over the past several decades. Many community development corporations (CDCs) have modified their strategies and their structures accordingly. Most notably, CDCs have realized the necessity of diversifying their funding sources and reducing their reliance on government funding, which is vulnerable to the vagaries of

shifting political priorities. In seeking to ensure continued financial support for their programs, community development leaders have expanded their range of financing and, in the process, have gained a better understanding of the risk tolerance and return requirements of their various capital providers.

In addition to diversifying funding sources, community developers have also sought to broaden their financing strategies. They once viewed debt as the primary, if not the sole, vehicle available for capitalizing community development efforts, but now recognize the vital role of equity investment in helping communities withstand economic downturns. New sources of equity—community development venture capital funds and secondary markets that securitize community development loan pools—have become available to energize market forces in economically distressed neighborhoods.

Advances in technology have significantly improved the identification and development of new financing strategies. With increased information-processing capacity, loan portfolio managers can better assess risk and monitor credit performance. Additionally, the ever-increasing availability of data facilitates the development of neighborhood profiles that can be useful in understanding and tracking community socioeconomic trends. For example, the cross-referencing of data sets on mortgage lending patterns, business start-ups, and employment figures against crime statistics and property values can provide a valuable perspective.

## Benefits of Research

Many valuable lessons have been learned in community development over the years. And the dissemination and application of such lessons as they emerge are essential to improving program effectiveness. Formal research can accelerate the rate of such learning. Only through a comprehensive understanding of the outcomes of a program can success be emulated and failures reduced.

By consistently and reliably measuring outcomes, and thus helping current and prospective investors better assess their risks and predict their returns, community development organizations can attract more funding. Such accountability is crucial for any organization, regardless of its size.

In addition to increasing funding options, research can also increase the scope and scale of programs. As effective strategies are identified, they can be replicated

and incorporated into efforts in other communities, as well as by organizations seeking to develop programs to address related issues.

## The Process of Measuring Outcomes

As I noted earlier, it is important to establish formal procedures for program assessment. At the start of a program, the nature of the problem should be identified, as well as the presumptions of the various causes of that problem. With a clearer understanding of the issues, policymakers and community leaders are better able to devise a strategy for overcoming the problem. Finally, a well-constructed program must include a projection of its benefits to serve as a benchmark for later evaluation.

In conclusion, I want to emphasize the importance of the role of the interpreter of the research. Analysts must be scrupulously honest in characterizing research results, or their work becomes advocacy and is no longer research. This objectivity is paramount because research findings from previous efforts become the basis for subsequently targeting scarce resources to their highest and best use. Such objectivity requires great discipline and integrity on the part of the researcher; it requires that researchers resist any innate desire to characterize results in the most, or least, favorable light possible. An understanding of the findings, positive or negative, is the greatest contribution of research. The failure of a program is not a research failure; it is a source of information. And acknowledgement of unadulterated research findings, regardless of how disappointing, contributes to a foundation of knowledge upon which future successes can be built. I often say at the end of a day that I learned a great deal. Unfortunately, most of what I learned was that what I thought I knew at the beginning of the day was false.

In the quest to do good for our society's most vulnerable populations and communities — the objective compelling the work of this group — we must embrace the challenge to develop objective and quantifiable standards to assess community development programs. Ultimately, such research is the only means for determining whether we are making advances in overcoming failures in distressed neighborhoods and improving access to economic opportunities for traditionally underserved populations. I applaud your efforts and look forward to learning of your future progress.

# Perspectives on Community Development

Remarks by Michael H. Moskow  
President and CEO, Federal Reserve Bank of Chicago  
Community Affairs Research Conference  
Federal Reserve System  
Washington, DC, March 28, 2003



On behalf of the Federal Reserve Banks and the Board of Governors of the Federal Reserve System, let me welcome you to the second day of our Community Affairs Research Conference. As Alicia mentioned in her introduction, my grounding in the community development arena extends back to the 1970s, when I was the assistant secretary for policy development and research at HUD. So I'm particularly pleased to have the opportunity to discuss this crucial area today.

In reviewing the program for this conference, I thought back to the efforts that we had at HUD 30 years ago and felt that it might be helpful to touch briefly on some of the extensive changes that have taken place in the economy, our institutions and community development programs over this period of time. I make no claims that my list is comprehensive. But perhaps a bit of historical background will be helpful in putting our efforts in perspective and in charting new areas for research.

First, one pervasive trend is the breakneck speed at which technology and telecom capabilities have advanced. E-mail started to get broad acceptance in the '80s and the Internet in the '90s. This has changed everything from how we communicate with family and friends to how we find a mortgage.

Second, the banking industry has gone through tremendous consolidation. There were 13,787 separate charters in 1973, compared with 8,223 today – a 40 percent reduction. The industry also has evolved with regard to community development programs. The Community Reinvestment Act was not enacted until 1977.

Third, our financial markets are much more efficient today. They facilitate greater access to capital internationally and within countries, and specifically in the housing industry Fannie Mae became a for-profit, publicly traded company in the early 1970s. Community development

financial institutions were started during this same period. In addition, over the past 30 years we have seen the establishment of the CDFI Fund and significant growth in bank community development programs throughout the country.

Fourth, our population is much larger, much wealthier, and much more diverse today, and female labor force participation is much higher.

Fifth, homeownership rates are higher – 67.9 percent in 2002, for example, versus 64.5 percent in 1973.

Sixth, government housing assistance programs have made a dramatic shift away from building housing for low-income families to providing vouchers and rental assistance directly to families so that they can seek housing most suitable to their needs.

And finally, there is a much more extensive network of community development organizations to help low-income families. For example, Neighborhood Housing Services was just getting started in the early 1970s.

As you can see from just a quick overview, there have been enormous changes over the past 30 years or so, and most of them have been quite positive. My personal view is that the environment for community development programs is much more favorable today, and we have learned a great deal from our past experience.

Nevertheless, there still is a need for careful research on economic and community development programs, and for objective evaluation of their effectiveness. Along those lines, I'd like to announce that the Chicago Fed is coordinating a System-wide initiative to develop a web page for research on financial education. We believe it will be an important resource for those building or evaluating programs in this area. A press release on the initiative is available here today.

Now I'd like to focus on three of the topics on our agenda today that relate to the changes I discussed earlier: homeownership, community development financial institutions and immigration.

## Homeownership

Let's begin with homeownership, which is now at the highest rate in the nation's history. As we know, homeownership is key to wealth accumulation among lower-income households, where the home is most likely the primary asset. But the confluence of policies to promote homeownership, such as tax incentives, CRA and other consumer regulations designed to ensure wider access to credit, has given rise to new issues. We now have high rates of foreclosure and abandonment in some communities; we have a sub-prime mortgage market, and so-called predatory lending.

High default and foreclosure rates have brought about foreclosure intervention and loss mitigation initiatives, as well as counseling programs to prepare families for the

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**It is encouraging to see renewed efforts by researchers and development oriented organizations and agencies to better capture data relevant to evaluating community development programs and initiatives. Only then can the outcomes be quantified and accurately assessed.**

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rigors of homeownership. Yesterday's presentations included an analysis of FHA's loss mitigation program, which has apparently had positive effects for homeowners, investors and communities.

We also saw compelling evidence of the impact of home-buyer counseling in stemming delinquen-

cies and defaults. It is encouraging to see renewed efforts by researchers and development oriented organizations and agencies to better capture data relevant to evaluating community development programs and initiatives. Only then can the outcomes be quantified and accurately assessed. Still, I think we have room for improvement regarding the quantity and quality of the data collected.

## Community Development Financial Institutions

The second topic I want to address is community development financial institutions (CDFIs).

One area we'll be looking at today is the impact of CDFIs on households and communities. Financial services, especially easy access to financial services by low- and moderate-income households, is an area of keen interest to the Federal Reserve.

The simple transaction account opens an array of opportunities for previously unbanked households to build a banking relationship and access competitive, mainstream financial services. In turn, this can make it easier for households to increase their net worth.

CDFIs provide transaction accounts and other services in low-income communities. But CDFIs also face pressures relating to profitability, and must balance that against their mission to serve inherently higher-risk borrowers while providing vital, ancillary services. We'll hear more about this today.

## Immigration

And finally, we will hear more about a topic that we at the Chicago Fed have a particular interest in: immigration and the financial assimilation of new Americans.

We have a more diverse nation today and immigration to the United States is occurring at an unprecedented pace. Research has shown that, in most cases, immigrants have greatly benefited our nation and economy.

For example:

- They generally have a high labor force participation rate,
- They have a high propensity to start new businesses and be self-employed,
- They use relatively small amounts of public services and transfers, and
- They do not generally cause unemployment among native citizens.

Recent history has shown that we must compete effectively with other developed countries for skilled labor. One implication is that we must take steps to assure the smooth assimilation of immigrants financially, culturally and otherwise, while we simultaneously address complex security issues. As national immigration policy is shaped, we must consider the needs and concerns of local and regional stakeholders as well.

Business and civic leaders in Chicago and the surrounding Midwest region are keenly interested in our immigration policies. So is the Chicago Fed. In fact, we are in the midst of establishing a research and outreach competency center within the Bank to focus on, among other issues, the financial assimilation of immigrants in the region and the nation.

So, some of the questions we intend to address regarding new Americans are:

- What contribution do new immigrants make to our current living standards, worker productivity, and economic growth?

- Who benefits and who is harmed (if any) by the arrival of new immigrants?
- How can we promote the social and economic mobility of immigrants and their families?

We will aggressively pursue these issues and leverage our efforts using a variety of partners and partnerships. So I'm pleased to see that several of the presentations today will touch on issues faced by immigrants seeking to establish new business enterprises.

## **Conclusion**

These issues and many others discussed over the course of this 1-1/2 day conference will continue to drive research and policy in the community development arena. I'd like to thank you all for being here, and also thank those who did so much to create what I think is a compelling conference.

In closing, let me leave with you a few ideas on factors that continue to impact the community development field, underscoring the need for our best thinking and program design:

- As I said earlier, technological advances continue to accelerate. Combined with globalization, they are changing the landscape for community development practitioners.
- And the banking industry will continue to consolidate, impacting banks' relationships with community development organizations.
- Organizations, all with the best intentions, still compete head-on for the same scarce resources; success in future community development may hinge on enhanced sharing of information and other key resources.

In short, we must be vigilant, creative and efficient in the way we conduct community development programs, learn from our mistakes and successes, and be mindful of data needs as an integral part of program development.

Thank you.

# Seeds of Growth

## Sustainable Community Development: What Works, What Doesn't, and Why



### Introduction

The Community Affairs program of the Federal Reserve System is an educational, informational, and technical assistance function focused on community development. The ultimate goal of Community Affairs is to increase the flow of capital and credit to historically underserved communities and ensure fair access to credit and financial services. This goal is consistent with the Federal Reserve's overall mission to promote price stability and sustainable economic growth, as constraints on credit and capital for other than economic reasons work against the Fed's efforts.

On March 27 and 28, 2003, the Federal Reserve System's Community Affairs and Research Officers hosted the third biennial Community Development Research Conference, Seeds of Growth, Sustainable Community Development: What Works, What Doesn't, and Why.

The conference featured a distinguished group of economists and scholars from the Federal Reserve System, academia and major research institutions discussing community economic development tools, programs, and strategies. The conference focused on techniques to foster sustainable economic development within communities and measure the effectiveness of those efforts.

The importance of determining the efficacy of programs is difficult to overstate, particularly in the current economic environment and with budget deficits at every level. Historically, a scarcity of hard data has hindered efforts to analyze the effectiveness of community development programs. This conference shed light on the complex tasks of data collection, variable isolation and connecting cause and effect. The Federal Reserve System is not alone in seeking to quantify program effectiveness – the call for papers elicited 75 proposals and 20 were selected for presentation.

The papers represent the latest work in the field from academia, policy institutions, and the Federal Reserve System. The presentations engendered lively and informed discussions on sustainable community development, insights on various economic consequences and possible policy responses. This article summarizes the researchers' perspectives on what works, what doesn't, and why, and their insights on the elements of sustainable community development. The article is organized by session in the same sequence as the actual conference agenda. The papers in their entirety are available on the Federal Reserve Bank of Chicago's CEDRIC website at: [www.chicagofed.org/cedric/index.cfm](http://www.chicagofed.org/cedric/index.cfm).

# Counseling and Intervention

## Session One

## Seeds of Growth, Sustainable Community Development: What Works, What Doesn't, and Why

The four papers presented in the first session focused on counseling and financial education programs: pre-purchase counseling, credit counseling, retirement planning seminars, and the relationship of financial knowledge to financial behaviors. Each of the papers finds that increasing financial knowledge – whether through counseling, teaching, or experience – improves both financial behaviors and financial performance.

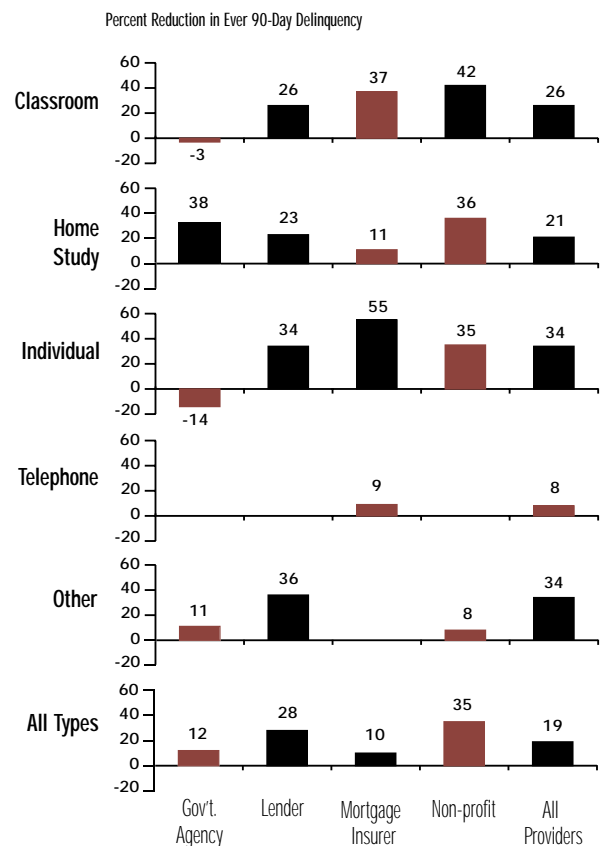
The first paper by Abdighani Hirad and Peter Zorn, Freddie Mac's vice president of Housing Economics, *A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling*, examines data gathered on 40,000 mortgages originated between 1993 and 1998 under Freddie Mac's Affordable Gold program. Recipients of mortgages made under the Affordable Gold program are required to receive counseling, although it is up to the lender to determine the type and source of counseling borrowers receive. When an Affordable Gold loan is submitted to Freddie Mac, the lender must record the organization that provided the counseling (lender, nonprofit, government agency, or "other") and the type of counseling that was provided (classroom, home study, individual counseling, or "other").

The authors present empirical evidence that pre-purchase counseling reduces the likelihood of 90-day delinquency. The reduction in that default risk can be confidently attributed to the counseling. Although there is no significant variation in the rate of risk reduction associated with specific counseling providers,<sup>1</sup> there is a wide variation in the rate of risk reduction among different types of counseling.

On average, borrowers getting counseling are 19 percent less likely to go into 90-day delinquency than borrowers not receiving counseling, regardless of counseling type or counseling provider, Hirad and Zorn find. Individual counseling is the most effective and provides an estimated 34 percent reduction in 90-day delinquency rates. Classroom

and home study provide 26 and 21 percent risk mitigation, respectively. Telephone counseling provides no statistically significant reduction in delinquency rates (Figure 1).

Figure 1  
Estimated Reduction in 90-Day Delinquency Rates from Counseling



Note: Dark-shaded bars indicate delinquency rates that are statistically significant at the 10 percent level

Zorn, who presented the paper, noted that the study ignores the possible effects of timing of delinquency. It may be that counseling simply delays delinquency.

The authors conclude that counseling can play a crucial role in expanding affordable homeownership opportunities. They raise the possibility that counseling might have a larger impact if it were limited to individual- or classroom-type counseling, and they suggest that more recent data may show an even bigger impact of counseling due to the increasing sophistication of the counseling industry.

In *The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior*, authors Gregory Elliehausen, E. Christopher Lundquist, and Michael Staten, director of the Credit Research Center at Georgetown University, find that credit counseling improves clients' credit profile and financial behavior.

Michael Staten's paper begins with an overview of the credit counseling industry. The number of people seeking credit counseling grew from 500,000 in 1991 to 2.5 million in 2001. Some reasons offered for such rapid growth are increased bankruptcy filings (875,000 declared bankruptcies in 1991; 1.5 million in 2001), and the now widely accepted use of counseling as part of the prescription for both bankruptcy reform and anti-predatory lending legislative initiatives.

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**“That all-important risk score that determines not only whether you’re going to get a loan, but . . . the terms on which you’re going to get the loan . . . That credit score improved for the borrowers that received counseling.”**

Michael Staten, Director of Credit Research,  
Georgetown University

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August of 1997 at one of five National Foundation for Credit Counseling (NFCC) member organizations.<sup>3</sup> A random sample of 98,000 borrowers with credit reports in both 1997 and 2000 provided a comparison group of similar borrowers who received no known counseling.<sup>4</sup> The paper documents the short-term and long-term impacts of credit counseling on clients' borrowing and payment behavior. The counseling was provided by nonprofits for people who did not adopt a debt management plan.

Each member of the counseled group had at least one 60- to 90-minute individual session with a certified counselor. Each session included a discussion of the family budget,

financial goals, and spending patterns. Each participant left with a customized, written action plan. Follow-up sessions were held if needed.

Two credit bureau reports, one in June of 1997 and the other in June of 2000, were obtained for each borrower in the counseled group<sup>5</sup> and a random sample of non-counseled borrowers with similar characteristics from the same geographic area. The authors compared the experiences of counseled and non-counseled borrowers to borrowers having similar risk profiles at the beginning of the period.

The study found that borrowers who received financial counseling in 1997 generally improved their overall credit profile – Empirica risk score<sup>6</sup> – over the next three years relative to non-counseled borrowers who had similar credit profiles in 1997. These findings stand, according to the authors, when correcting for self-selection bias and holding constant other factors (job loss, divorce, etc.) that may influence the performance of both groups over time.<sup>7</sup>

The impact was the greatest for borrowers who were least credit-worthy at the start of the observation period. For counseled borrowers in the lowest-scoring 10 percent of initial risk scores, the average score improvement over the subsequent three years for counseled borrowers equated to a 38 percent reduction in the predicted likelihood of a bankruptcy or charge-off. Improvement in the risk scores attributable to counseling diminished for borrowers in higher initial score ranges.

Notably, the researchers observed that counseled borrowers experienced improvements across a range of credit behaviors relative to similar non-counseled buyers even when their risk scores didn't improve relative to the comparison group. The authors note improvements among the counseled group in several categories of credit utilization, including:

- Number of accounts with positive balances (fewer)
- Total debt
- Non-mortgage debt
- Credit card debt
- Percentage utilization of bank card lines
- Number of 30+ and 60+ day delinquencies.

Staten cautioned that the behavioral findings may apply only to one-on-one counseling using the specific counseling protocol used by NFCC member agencies.

In *Financial Education and Retirement Savings*, Robert Clark, Ann McDermed, Kshama Sawant, and Madeleine d'Ambrosio explore the impact of financial education seminars on individuals' financial goals and behaviors. The rise of defined benefit plans and the potentially lower benefits from Social Security mean that individuals will have increasing responsibility for their own retirement savings.

The analysis is based on a standard economic lifecycle model of decision making: individuals start with retirement goals

(when to retire, amount needed to retire) and make decisions based on the present level of wealth and savings rate needed to reach the goal. Individuals pay for retirement through reduced consumption in the course of their working life.

The standard model assumes that individuals have an estimate of their expected lifetime earnings and both a grasp of basic financial mathematics and the risk-return trade-off among investment choices. The authors question the validity of these assumptions across the broad population.

The authors surveyed 633 participants in financial education seminars conducted by the Consulting Services division of Teachers Insurance and Annuity Association – College

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**“The implication, then, is that if a person receives new information or they change their priorities, they might alter their retirement decisions and their behavior. How do individuals process new information and use it to determine their retirement goals and savings behavior?”**

Robert Clark, Professor of Business Management and Economics, North Carolina State University

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Retirement Equities Fund (TIAA-CREF) across the country. The TIAA-CREF consultants asked participants to complete a pre-seminar survey dealing with retirement age and income goals and the likelihood (in their view) of achieving those goals. Participants then took part in a seminar designed to provide financial information that would assist individuals in the retirement planning process.

Following the seminar and before the participants left the room,

another survey asking them to indicate changes in retirement goals or changes in anticipated financial behaviors based on information obtained in the seminar was completed. The findings include:

- Twelve percent of participants changed their retirement age goals.
- Those with relatively low expected retirement ages were more likely to raise their retirement age.
- Twenty-eight percent changed their retirement income goal.
- Thirty-seven percent of those with desired income replacement rates of 65 percent or less raised their target.
- Forty-one percent planned to establish a supplemental pension plan.
- Forty-three percent of those who already had a supplemental retirement plan planned to increase contributions to supplemental plans.
- One-third of participants intend to alter their investment allocation between equities and bonds.

“Financial education does, in fact, cause individuals to rethink

their retirement goals and to change or to plan to alter their savings and investment behavior. Most people making changes in their retirement goals tend to raise their retirement age, increase their desired income level, and increase their savings rates. Women are more likely than men to make changes across all of those dimensions,” stated Clark. A follow-up paper focusing on gender differences in this research will be available on the TIAA-CREF website in the near future.

The analysis indicates that new information provided in the seminar caused participants to alter their retirement age and income goals and behavior, making them more consistent with economic expectations. The authors call for expanded financial education programs based on their analysis and the trend toward more self-directed retirement plans.

Financial education tends to alter investment behavior and increase retirement savings. These changes should enhance retirement income security and potentially influence public policy regarding social security and employee pension plans.

The final paper of the session, *Patterns of Financial Behaviors: Implications for Community Educators and Policy Makers*, by Jeanne Hogarth, Marianne Hilgert, and Sondra Beverly, was “motivated by our desire to help community educators ‘triage’ clients,” according to Hogarth, a Consumer and Community Affairs program director for the Federal Reserve Board.

“You’ve heard that credit counseling is effective, but we all know that it’s very costly to do one-on-one counseling. Seminars are effective and less costly, but some people don’t do as well in the group setting. Some people may benefit from simply giving them a brochure. So the question is: how do we cut those slices – how do we triage clients to make the most effective and optimal use of our resources?” Hogarth stated.

The paper delivers a thorough overview of the literature on financial behavior, financial education, and financial knowledge of individuals and households, summarizing evidence on financial knowledge, the relationship between knowledge and behavior, and the effects of financial education on behavior. Unlike previous research, this study directly tests the assumption that education increases knowledge, which in turn affects behavior.

The study uses data gathered in November and December 2001 through the University of Michigan Survey of Consumers. The consumers in the survey were asked what financial products they own. They were asked about their financial management practices – bill paying, savings, and investing. They were also asked questions designed to determine their financial knowledge, how they learned about financial management, and how they would prefer to learn in the future.

Using the responses to the financial management and financial product ownership questions, the authors sorted the respondents into “high-middle-low” performance categories in each of three financial behavior categories: cash flow management, savings, and investment. The results of that sorting are shown in Table 1.

Table 1

## Patterns of Behaviors by Type of Financial Education (FE) Needed

Financial Behavior Score Levels				
Type of FE Needed	Cash Flow	Saving	Investment	Num. Obs.
<i>Superstars – None</i>				
	High	High	High	104
<i>Back to Basics – Cash flow or Saving</i>				
	Low	High	High	2
	Medium	High	High	22
	High	Low	High	4
	High	Medium	High	43
<i>Kick it up a Notch – Investment</i>				
	High	High	Low	29
	High	High	Medium	140
<i>Cash and Capital – Cash flow &amp; Investment</i>				
	Low	High	Low	2
	Low	High	Medium	4
	Medium	High	Low	3
	Medium	High	Medium	30
<i>Take the Next Step – Saving &amp; Investment</i>				
	High	Low	Low	75
	High	Low	Medium	30
	High	Medium	Low	95
	High	Medium	Medium	141
<i>Need it All – General (all 3 topics)</i>				
	Low	Medium	High	1
	Medium	Low	Low	54
	Medium	Low	Medium	24
	Medium	Low	High	3
	Medium	Medium	Low	33
	Medium	Medium	Medium	45
	Medium	Medium	Medium	10
<i>Need All the Basics – Basic (all 3 topics)</i>				
	Low	Low	Low	63
	Low	Low	Medium	11
	Low	Medium	Low	16
	Low	Medium	Medium	20

Among the findings: about two-thirds of respondents were adept at cash-flow management (88 percent pay their bills on time), about one-third had good savings behaviors, and about one-fifth had good investment behaviors (45 percent said they had a 401(k)). At the low end of the behavior measures, about 2 out of 5 respondents don't invest or save for retirement or long-term goals.

Hogarth highlighted three specific categories:

- Superstars – the 10 percent of respondents who are “high” in every category.
- Take the Next Step – the biggest group at 34 percent who are reasonably adept at cash flow management, but need help in organizing a savings and investment plan.
- Need All the Basics – the 11 percent of respondents who are “low” in everything and who need basic, remedial work.

The study also includes a multivariate analysis to determine what characteristics were shared among those ranked “high” in the financial behavior categories. Variables in the analysis included: financial knowledge, financial learning experiences, measures of economic stability, motivation, and a cross-section of socioeconomic and demographic characteristics.

The analysis revealed that only two variables were consistently significant across the cash management, savings, and investing behaviors: financial knowledge and learning method. The knowledge effect was the largest for cash-flow measures.

Hogarth noted the correlation between certain demographic characteristics and the need for basic financial education. Young, single female heads-of-household who are either Black or Hispanic tend to need basic financial education, are less likely to be homeowners, have credit cards, set goals, or read about money management.

Respondents who said they learned from personal experience and family and friends were more likely to have high scores on cash-flow management, savings, and investment, although the largest effect for these learning experience variables occurred with savings. The authors asked about learning preferences. Households with more financial education needs preferred learning by video. They are less likely to prefer Internet [delivery] and seminars. Households with less financial education needs prefer learning on their own. They like media, brochures, and videos. They are less likely to attend seminars.

The authors conclude that first, financial knowledge and financial learning experiences are significant. One probable way to increase financial knowledge is to gain financial education, although the authors acknowledge that causality may flow either way.

Second, the study concludes that the necessary scope and methods for delivering financial education vary with the recipient. There are various topics for financial education and various learning needs within each topic. Resources and delivery techniques need to be matched with learners. There is no “box of curricula that you can just pick up and use.”

Concluding her remarks, Hogarth emphasized the importance of placing financial education in the highest context: “I think it is worth reiterating that financially secure families are, in fact, an appropriate goal for policymakers, community educators, practitioners, and researchers. Besides contributing to [an] effective, efficient market place...stable, secure families contribute to a stable, secure community, state, and nation.”

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## Notes

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1 "The differentials we see in the marginal effects come from the mix of counseling administered by each provider, not from statistically significant differences in administering any given type of counseling" (A. Hira and P. Zorn, 2003, "A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling" page 15).

2 A Debt Management Plan is an individualized financial consolidation program through sponsoring agencies (either for-profit or nonprofit) established to pay down debt and repair credit histories.

3 The member organizations were Consumer Credit Counseling Services offices in the cities of Atlanta, San Francisco, Phoenix, Dallas, and Farmington Hills, Michigan.

4 Similar borrowers were identified as those borrowers who had credit reports in both 1997 and 2000, resided in the same three-digit zip codes as the counseled group, whose names did not appear on the list of clients counseled by the participating counseling agencies, and whose Empirica score (see endnote v) value fell within the same range as observed in the group of counseling recipients.

5 Each client signed a release consenting to use of his or her de-personalized data for research purposes. The credit bureau matched client names to credit reports and stripped all personally identifiable information prior to releasing data to the research team.

6 The Empirica risk score is a proprietary score used by Trans Union as an overall measure of a borrower's predicted likelihood of delinquency or default (similar to the Fair Issac and Company scores). A lower Empirica score corresponds to a higher predicted frequency of charge off/repossession/bankruptcy; a higher Empirica score corresponds to a lower predicted frequency of charge-off/repossession/bankruptcy over the following 24 months.

7 Borrowers who choose to seek counseling help may be more motivated to take corrective steps to improve their credit profile.

# Housing and Neighborhood Development

## Session Two

## Seeds of Growth, Sustainable Community Development: What Works, What Doesn't, and Why

The four papers in the second session explore the impacts and benefits of housing programs on neighborhood development.

The first paper in this session, by Rex LaMore, Susan Cocciarelli, Jose Gomez, John Melcher, John Metzger, Faron Supanich-Goldner, and Matt Syal, *Organizational Capacity and Housing Production: A Study of Nonprofit Organizations in Michigan*, explores the organizational capacity/productivity link among nonprofit housing development groups in Michigan.

"A critical question in community development is how best to organize, fund, and otherwise support affordable housing development by nonprofit organizations," said John Metzger, Ph.D., assistant professor of geography, Michigan State University, who, along with Jose Gomez, Ph.D., specialist, Center for Urban Affairs, Michigan State University, presented the paper. "The purpose of our research was to identify relationships that might exist between the components of organizational capacity and the efficient production of affordable housing."

The research team developed a questionnaire designed to create an organizational profile of nonprofit housing organizations in five different regions of Michigan.<sup>1</sup> The questionnaire was organized into nine sections: community assessment and participation activities, financial packaging skills, construction management skills, project management skills, homeownership programs, organizational administration and development, professional development activities, linkages to educational institutions, and public policy and housing advocacy skills.

Surveys were obtained from 37 organizations in the 5 regions of Michigan. Nine Habitat for Humanity groups were included (at least one in each region) to permit comparisons by type of organization. All of the groups were

nonprofit housing organizations; many were involved in related community building activities.

The 37 groups in this study produced a total of 4,385 housing units over a 32-year span: 34 percent were multi-family rehabilitation units, 29 percent were multifamily new construction units, 19 percent were single-family rehabilitation units, and the remaining 18 percent single-family were new construction units.

Fifteen of the 37 organizations account for 92 percent of the total production in the survey. Less than half of the organizations reported having produced more than 50 housing units in their entire organizational history. While production from the organizations surveyed averaged ten units per year, the median production per year was three housing units – again, reflecting the concentration of production volume among a small segment of the groups.<sup>2</sup> The organizations involved in multi-unit construction and rehabilitation averaged 241 units each, nearly 10 times the number of units produced by single housing unit developers.

The study also analyzes on-time and on-budget efficiency. The organizations averaged 72 percent on-budget performance and 58 percent on-time performance for a combined overall efficiency score of 64 percent. The 20 organizations reporting above-average performance in both categories are considered "high-proficiency," while the remaining groups, performing at or below the average in one or both categories, are classified as "low-efficiency."

The authors build on the five components of capacity model developed by Glickman and Servon<sup>3</sup> to quantify the organizational capacity of each group and to assign a capacity index score to each group in the survey. The capacity index score is simplified into the following equation:

$$CAP_{\text{overall}} = f \{C_{\text{pol}} + C_{\text{net}} + C_{\text{res}} + C_{\text{prg}} + C_{\text{org}}\} / 5$$

- Resource capacity (CRES) reflects an organization's ability to attract, manage, and maintain funding.
- Organizational capacity (CORG) refers to the capability of a group's internal operations.
- Programmatic capacity (CPRG) measures the types of services offered.
- Networking capacity (CNET) reflects the organization's ability to work with other institutions.
- Political capacity (CPOL) is the ability to credibly represent and advocate for its residents.

The surveys generated index scores for the five components of capacity. The annual average of units produced is calculated as a production measure, and the comparative on-time performance and under-budget performance of each group are calculated as efficiency measures. Comparisons are drawn between high- and low-production organizations, high- and low-capacity organizations, and high- and low-efficiency organizations. Those comparisons are summarized in the following table.

Table 1

**Efficiency Measures**

	Overall Capacity (CAP Overall)	Average Annual Production
High Capacity	.74	8.2
Low Capacity	.53	2.2
High Productivity	7.1	9.5
Low Productivity	.57	1.2
High Efficiency	.63	7.4
Low Efficiency	.67	2.9

The authors conclude that while the characteristics of high-capacity and high-productivity groups are positively correlated, high-efficiency and high-capacity do not coincide. These findings suggest that increasing capacity will increase productivity, but increasing efficiency is likely more dependent on factors such as the funding and regulatory environment.

Based on the survey, increasing capacity requires further technical assistance and training, specifically in construction management, board development, human resource management, and financial management.

The paper concludes that nonprofit producers likely do not have the capacity to meet demand for affordable housing in their communities. The authors suggest the need for further refinement of the Glickman and Sevron model,<sup>4</sup> and they call for further research into both the maximum productivity attainable by nonprofit housing development

groups and communities' sustainable "carrying capacity" for nonprofit housing groups. Finally, further research and analysis needs to balance housing productivity goals with community building goals.

In the next paper, *Neighborhood Externality Risk and the Homeownership Status of Properties*, Christian Hilber, an economist at Fannie Mae, begins with the observation that homeownership rates are extremely low in many inner-city neighborhoods and distressed places. While the overall national homeownership rate is about 68 percent, many inner city neighborhoods' homeownership rates are below 50 percent with extreme cases like West Philadelphia as low as 12 percent.

Research has linked low homeownership rates to lower investment in social capital,<sup>5</sup> bad environments for raising children,<sup>6</sup> low quality schools in densely populated neighborhoods,<sup>7</sup> and decaying housing stock.<sup>8</sup> These are characteristics of many inner-city communities, and many inner-city communities also have low homeownership rates. This research explores the characteristics that affect homeownership rates in inner cities.

Low homeownership rates in inner cities may result from a preference of center-city residents to rent rather than own their dwelling. Other noted characteristics are: "sorting" – elderly households move nearer to services for the elderly, young households move to good school districts, and other logical trends, or location specificity – higher costs and the need for land use efficiencies in densely populated areas may generate demand for more rental units. While noting that the housing literature demonstrates the impact of children on the housing tenure choice, Hilber finds that the sorting and location characteristics fail to fully explain the low homeownership rates in inner cities.

Hilber explains that uncertain neighborhood conditions and, as a consequence, uncertainty about property values negatively affect the likelihood that a housing unit is owner-occupied. His proposition is based on a portfolio diversification argument: "Single owner occupiers have to pay a risk premium that increases with neighborhood uncertainty." Since homebuyers avoid risky neighborhoods, and lenders cannot fully price and thus avoid risky neighborhoods, that uncertainty negatively affects homeownership rates.

Hilber gathered data from the American Housing Study, a panel study including 55,000 repeatedly evaluated housing units, to measure neighborhood externalities including: junk, litter, and trash; street noise; neighborhood noise; and crime. He developed neighborhood externality risk measures based on the standard deviation of the four conditions as perceived by residents or as assessed by interviewers. The purpose was to test the hypothesis that externality risk negatively affects the probability that a specific housing unit is owner-occupied.

Neighborhoods in the study exhibited a random variation in these risk measures rather than a steady improvement or decline. "There are bad neighborhoods that have a high level of externalities but they are pretty much stable," Hilber said. "And there are very good neighborhoods that have some variation in their neighborhood externalities. So it's not uniformly distributed."

The author then analyzes four risk measures to assess the degree to which each measure could shed light on whether or not a housing unit is owner-occupied. The risk measures include: neighborhood externalities risk measures, neighborhood externality levels (to control for the possibility that the level rather than the variation affects the homeownership status of properties), demographic variables, and housing type variables.

All four risk measures have a negative effect on the likelihood that the housing unit is owner-occupied, and they are statistically significant at the 1 percent level. Hilber notes that the results are also quantitatively meaningful. Increasing the measure for junk and litter by one standard deviation reduces the likelihood of homeownership by about 5 percent. The other three quantitative effects are smaller but still quite meaningful. Hilber concludes that one can explain low homeownership rates by demographic factors, location characteristics, the housing structure/composition of these places, and finally by neighborhood uncertainty.

*Estimating the External Effects of Subsidized Housing Investment on Property Values*, by Ingrid Gould Ellen, Michael Schill, Amy Ellen Schwartz, and Ioan Voicu, takes advantage of the unique opportunities presented by the creation of thousands of housing units under New York City's Ten Year Housing Plan. Here, the authors explore whether housing investments generate benefits to the surrounding community as measured by increases in property values.

The authors found that by reducing neighborhood uncertainty – specifically by removing a "disamenity" such as a vacant lot or an abandoned, boarded-up building – subsidized housing development can have positive spillover effects for other neighborhood properties.

In the face of the "conventional wisdom" that subsidized housing accelerates neighborhood decline, these authors have five hypotheses on why subsidized housing investment may generate positive external effects:

1. Creation of new housing often involves the removal of a "disamenity" – a vacant lot or abandoned building.
2. Physical condition effect: "A nice, physically attractive new home might raise the value of surrounding properties."
3. Demonstration effect: "Successful investments in new housing beget more housing investment."
4. Population growth effect: "The increase in population

from the new housing may increase street traffic, improve neighborhood safety levels, and increase demand for other commercial development."

5. Population mix effect: "All of these effects can be heightened by the particular mix of the characteristics of the inhabitants. In particular, higher income residents may be viewed by some as more desirable neighbors. Many people have posited that homeowners have stronger incentives to be 'good' neighbors and invest in their homes, so homeownership properties may deliver more positive spillovers."

Between 1987 and 2000, New York City invested more than \$5 billion to renovate more than 100,000 occupied housing units and create 66,000 new, affordable housing units. Of the 66,000 new units, 22,000 were new construction and the other 44,000 were created through gut rehabilitation of formerly vacant buildings. This study focuses on the 66,000 units of new housing produced under New York City's Ten Year Plan, "The largest municipally supported housing production program in the history of the U.S."

The study uses a host of data including a database of 294,000 property transactions in the city from 1980 to 1999, data on the property characteristics of each of those properties, and data on the location and characteristics of the 66,000 new units created under the Ten Year Plan. The data allowed the research team to estimate a difference-in-difference model, "And we think the results are fairly persuasive," according to Ingrid Gould Ellen, an assistant professor of Urban Planning and Public Policy at New York University's Wagner Graduate School of Public Service.

For every assisted housing unit that was built under the Plan, the research team drew a 2,000-foot ring around that project. They compared the prices of properties that sold within the ring with prices of comparable properties that sold outside the ring. They then compared that difference before and after the construction of the assisted housing, allowing those impacts to vary with both distance (from the project) and time. Finally, the analysis controlled for the structural characteristics of the housing units.

The results of the analysis are striking. For the "average" project – 250 units, 50 percent of which are in multifamily rental buildings – while the initial price differential for properties located adjacent to the project was 28 percent, it fell to about 13 percent after project completion, and the effect gets bigger over time, perhaps as people begin moving into the new units. The impacts are smaller for smaller projects.

The study also reveals larger impacts for projects with fewer units in multifamily rental buildings. "This is not to say that rental housing has the smaller spillover effect," cautioned Ioan Voicu, Furman fellow at the Center for

Real Estate and Urban Policy of New York University. "There is almost a perfect overlap between rental housing and multifamily housing in our data, so we could not separately estimate the impacts of rental and multifamily housing."

In sum, creation of subsidized housing in New York appears to have increased the value of surrounding properties. These effects appear to be larger for larger projects and properties closer to the project site, and they persist over time. The effect for multifamily rental housing is less pronounced.

The next question was whether neighborhood characteristics affected the spillover effects. "The average project (250 units) seems to have a greater impact in more distressed neighborhoods," according to Voicu. "But, it is also true looking at the first row in Table 2, that a small number of units have a smaller impact in more distressed neighbor-

Table 2

### Impact of Average Project in Low-Income and High-Income Neighborhoods

% Change in Value

Project Scale	High-Income Submarket Impact	Low-Income Submarket Impact
50 units	14.3	6.7
250 units	10.6	13.7

Table 3

### Impact of "Average" Project Start and Completion by Number of Units Started and Completed

% Change in Gap Between Prices In Ring and Outside

Project Scale	Start Impact	Completion Impact
50 units	11.7	-1.5
250 units	13.7	2.1
500 units	16.3	5.7

hoods. Building a few units on one block when surrounding blocks are filled with blight will probably make little difference."

Most of the effect is felt at the start of the project, suggesting that much of the effect may be due to the removal of the original "disamenity," or that the market immediately incorporates people's expectations. There are also larger impacts following completion of larger projects.

This research suggests that subsidized housing can significantly benefit low-income neighborhoods, though it is unclear whether housing investment in stable neighborhoods would have similar impact in the absence of some blight being removed. The research also finds that some public costs of housing investments can be recouped through increased property tax revenue. And finally, the authors suggest that, "We might want to steer small projects to neighborhoods that are doing okay, because the smaller projects won't have the desired effects in the more distressed neighborhoods."

In the fourth and final paper of the session, Charles Capone, Jr., a senior analyst in the Microeconomic and Financial Studies division of the Congressional Budget Office (CBO), and Albert Metz, a principal analyst for the CBO, investigate *Mortgage Default and Default Resolutions: Their Impact on Communities*.

Credit flows are vital to community development. An array of programs attest to the federal government's pursuit of community development through increased credit flow: Community Reinvestment Act, Federal Housing Administration (FHA) and Small Business Administration loan guarantees, Federal Home Loan Bank Affordable Housing Program, HUD, Community Development Financial Institution, empowerment zones (EZ), and Section 8 funds.

A home purchase is inherently risky. It involves taking a highly leveraged financial position in an illiquid asset and covering high transaction costs that are only recovered over an extended period of appreciation in the asset. These risks can and do sometimes result in real losses. A foreclosure is more than a loss just to the homeowner; the lender (and/or guarantor) and community location of the home also experience losses.

Capone and Metz raise three "unasked questions:"

- What rate of default and foreclosure is too high? How far can we really push the envelope of homeownership before it truly becomes a net loss rather than a net gain to households?
- What rate of foreclosure destabilizes a neighborhood?
- How much financial risk is appropriate to ask of low- and moderate-income households when we encourage them to become homeowners? Who explains the risks to them?

A number of risk mitigation tools came about in the 1990s. Homebuyer counseling and education programs, automated underwriting, early intervention servicing, and post-default intervention and loss mitigation programs have all helped reduce risk for lenders.

In 1991, Fannie Mae initiated a loss mitigation strategy on the basic premise that it is in everyone's best interest to

avoid foreclosure, so there must be a provision for negotiations between borrowers and lenders. While this strategy was a novel addition to the home mortgage market in 1991, Capone pointed out that, "Actually, these kinds of interventions have always been done in the commercial real estate market because there's always lots of money on the table if one of those loans goes bad."

When lenders' priorities shifted from payment collection to negotiating workouts, foreclosures dropped dramatically. The lenders who engaged in negotiated workouts found that most borrowers in 90-day default only need temporary help. Most have the willingness and ability to continue homeownership. So now, Capone said, "More than half of all [of Fannie Mae's] loans that 12 years ago would have gone to foreclosure, don't."

Capone and Metz analyze data gathered on all FHA-insured borrowers with a 90-day default reported between 1998 and mid-2002, who were unable to cure the default on their own. The FHA loss mitigation program allows three ways<sup>9</sup> for a borrower in default to stay in the home: a special forbearance with extended repayment plan, a loan modification that capitalizes some arrearages and refinances the property, or a partial claim<sup>10</sup> that is unique to the HUD's FHA program. For those borrowers with a 90-day default, the home retention rate rose from 22.5 percent in 1998 to 85 percent in 2002.

The authors explore each of the factors that could influence foreclosure and affect actual outcomes. The research estimated the probability that the home retention outcome would change with each of the following factors:

- Year of default
- Gender of primary borrower
- Marital status
- Race
- Underserved area
- Mortgage type
- Payment-to-income ratio
- House price growth
- Interest rates
- Mortgage age
- Initial loan-to-value ratio
- Unemployment rate
- Loan purpose
- Property value

The study finds that the FHA loss mitigation program itself is the most important influence on the success rate of people keeping their homes. Other than that, house price appreciation has the most significant ongoing influence on success probabilities.

The paper also shows smaller, measurable influences. Blacks, for instance, have a marginally higher probability of success (6 percent) than other non-white homeowners. Factors that portend a marginally lower probability of success include low-valued properties<sup>11</sup> (5 percent), unmarried homeowners (5 percent), graduated payment mortgage (10 percent), and HUD-defined underserved areas (4 percent).

To emphasize the point that having the loss mitigation program itself is fundamental, the researchers, "...threw everything into the mix and asked, 'Who's the least likely to keep their home?'" Capone said that the least likely "person" to get a successful loan workout would be an unmarried or separated white person with a low-priced home in an underserved area and a high payment-to-income ratio (64 percent success probability). "If we gave the same person as above a graduated payment mortgage, we can knock their probability of successfully keeping their home in a workout down under 50 percent to a 49 percent success probability," Capone said.

The discussant, Wyman Winston, deputy director of the Portland Development Commission, argued that, while the Michigan study did an excellent job of describing the contributions of Michigan CDCs, and of answering the questions it poses, his question was more direct: "What will it take to solve America's housing crisis?"

Winston identified five key issues that relate to Glickman and Servon's five components of organizational capacity:

- *The market economy* – Affordable housing is, in part, a function of our economy. There has not been an honest debate as to whether or not affordable housing is valuable in our society.
- *The political, economic disparity* – Winners and losers are inherent in the market economy. Those disparities show up in housing, wages, and income. The housing problems of this nation cannot be solved through housing. The fundamental solution for housing is centered upon issues of wages and incomes.
- *CDC inefficiency* – The private sector is boycotting affordable housing and, by default, CDCs have been left to fill that vacuum. The fact is they simply do not have the ability to achieve the national goals of affordable housing for all American citizens.
- *The CDC cartel* – The CDC cartel is a political alliance among affordable housing practitioners resulting in some of the highest per unit prices and some of the most inefficient operating costs.

■ *The network* – Policymakers, practitioners, and those who finance affordable housing development are not having an honest discussion about solutions. So, what has been created is a segregated market in which the private sector, for the most part, is not involved in the production, management, and maintenance of the affordable housing that's being produced.

Winston noted the relatively small number of housing units being produced by Michigan CDCs, and expressed his concerns over the fundamental weaknesses in the affordable housing development system. Winston drew on his personal experience with the Wisconsin Housing and Economic Development Authority (WHEDA) to confirm Christian Hilber's findings on neighborhood externality

risks. Winston, a former director of Emerging Markets for WHEDA, highlighted the Lindsey Heights project in Milwaukee, a 40-square block, subdivision-type project that tried to address issues of low property values and low homeownership rates in central Milwaukee.

In spite of millions of dollars of investment by WHEDA, the success of the project hinged on organizing block clubs, regular volunteer clean-up campaigns, and a push to get the city to help neighborhoods in clean-up efforts. This approach ultimately led to success at Lindsey Heights, where units are exhibiting price appreciation. Winston's Lindsey Heights experience seemed to affirm the findings of the third paper regarding external effects of subsidized housing.

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## Notes

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1 The Detroit metropolitan area, including Wayne, Oakland, and Macomb counties – a large urban region; the Lansing area, including Clinton, Eden, and Ingham counties – a mid-sized urban region; northern lower Michigan including six counties that comprise a rural region; the Grand Rapids metropolitan area comprised of four counties; and the Flint area, focused on Genesee County.

2 Thirty-six percent of the reported production in this study came from just one organization that produced 1,590 units, nearly all of which were multifamily, new construction. The analysis adjusts for this "statistical outlier" group.

3 N. Glickman and L. Servon, 1998, "More Than Bricks and Sticks: Five Components of Community Development Corporation Capacity," *Housing Policy Debate*, 9:497-540.

4 Ibid

5 D. DiPasquale and E.L. Glaeser, 1999, "Incentives and Social Capital: Are Homeowners Better Citizens?" *Journal of Urban Economics*, 45:354-384.

6 R.K. Green and M.J. White, 1997, "Measuring Benefits of Homeowning: Effects on Children," *Journal of Urban Economics*, 41:441-61.

7 C.A.L. Hilber and C. J. Mayer, 2002, "Why do Households without Children Support Local Public Schools? Linking House Price Capitalization to School Spending," *The Wharton School Working Paper*, June 2002.

8 G.C. Galster, 1983, "Empirical Evidence on Cross-Tenure Differences in Home Maintenance and Conditions," *Land Economics* 59:107-13.

9 The FHA also allows a pre-foreclosure sale in which the FHA will cover the losses on the sale – a loss mitigation option for borrowers who do not wish to (or for some reason cannot) keep the home.

10 In a "partial claim" the FHA will pay all the arrearages to the loan servicer and take on a soft second mortgage lien on the property to get paid back if and when the property is sold.

11 Low-valued properties are defined as those properties in the bottom quartile of any given market.

# Partnerships

## Session Three

## Seeds of Growth, Sustainable Community Development: What Works, What Doesn't, and Why

The papers in this session explore the utility of the partnership model to affect sustainable community development. Although the presenters employed no standard definition of “partnership,” a set of common characteristics runs through their papers, including cooperation between private entities, the public sector, and local residents. Successful partnerships share common goals, decision making, responsibilities, and power. Similarly, the concept of “community development” defines itself in the papers with characteristics that include improving the quality of life for the people who live in communities facing social and economic challenges. The four papers in this section explore various real-world partnership models and their effectiveness in promoting sustainable community development.

The paper by Mark Tranel and Kay Gasen, *Community Partnerships: A Sustainable Resource for Nongovernmental Organizations*, begins with a discussion of a fundamental shift in bringing about community development initiatives. The industry has largely moved from a typical process of confronting public and private organizations to demand redress, to seeking partnerships and cooperation with organizations that can make a difference. A decrease in federal funding for community development over many federal programs has increased the tendency for groups to turn to institutions in a position to serve as active, engaged partners and to precipitate change in partnership with local residents and organizations.

The authors note that community partnership is a term used commonly “by government at all levels,” but that the concept is more recent to the community development field. Further, the term has been used to define a wide cross-section of community activities from physical improvements to social services to web-based information sources. Tranel and Gasen cite several other studies and sources

that emphasize the importance of capacity among all partners in a community development partnership. Not least is community capacity, the active involvement of local groups and individuals to define needs and remedies. Without local participation and decision making, there is not a true partnership, and the local community becomes simply a “recipient of goods and services.”

Capacity is further broken out by the authors as social or community capacity and organizational capacity. The Rockefeller Institute (1997) defines four attributes of social capacity as:

- *Attachment/identification* – stronger identification with the neighborhood than the city as a whole
- *Neighboring* – relationship with neighbors, supportive, friendly, or not
- *Organizational/associational infrastructure* – number and influence of community organizations and degree to which residents perceive them as effective
- *Political/civic engagement* – voter registration, turnout, or membership in lobbying or advocacy organizations.

Organizational capacity refers to the ability to take responsibility and manage key aspects of the partnership's objectives. Without well-defined and meaningful roles for the local partner, the authors maintain, “There is no assurance that [the partnership] is representative of shared interests or that there is any capacity for sustainability.”

The paper outlines community development partnerships in two St. Louis neighborhoods, Forest Park Southeast and Old North St. Louis. The central institutional partner in Forest Park Southeast was the Washington University Medical Center, which had formed a redevelopment corporation (MCRC) in the 1970s to respond to decay in its surrounding

neighborhood and to secure land to expand the facility. The partnership was able to achieve several key goals, but its efforts were hampered due to a fragmented, 30-member neighborhood advisory group. The group was selected entirely by MCRC, an aspect questioned by some local organizations and individuals, and also lacked formal power, serving in an advisory capacity only. Every community partnership has some unique characteristics, but that the key institutional partner inhabits the redevelopment area almost certainly impacted the partnership's achievements despite capacity issues among (other) local partners. The orientation toward goals and away from relationship and capacity building, however, has ramifications for the ability of the community to sustain and replicate its success.

The Old North St. Louis neighborhood has a long history of relationship and capacity building. The Old North St. Louis Restoration Group helped foster two partnerships in the community analyzed by Tranel and Gasen. In response to neighborhood blight, the group became a nonprofit housing developer in the 1990s. In 2001, they formed their first partnership with an outside institution, the Regional Housing and Community Development Alliance (RHCD), to redevelop housing and offer related services. In 2000, the Restoration Group partnered with the University of Missouri, St. Louis, and received a HUD Community Outreach Partnership Center grant to enhance historical assets and address environmental hazards. In essence, both partnerships have focused more on relationship and capacity building than was the case in Forest Park. While there is a strong sense of community involvement, support, and trust, there is also frustration because physical improvements have not proceeded at a pace consistent with early expectations.

The authors contend that the partnerships in Forest Park Southeast and Old North St. Louis highlight challenges "that are likely to be typical of community/institutional partnerships." Among them, when large, well-funded institutions control or appear to control the agenda in a community partnership, and further if they control or are the sole recipient of funding for the initiative, it can impact the partnership's success. Also, ensuring that neighborhood representation is representative of the whole community is a difficult task.

The paper by Jason Bram, Jesse Edgerton, Yigal Gelb, Andrew Haughwout, David Lagakos, Margaret McConnell, and James Orr, *Neighborhood Revitalization in New York City in the 1990s*, uses neighborhood data to characterize the changes in a variety of economic and social categories in New York City over the 1990s, with a special focus on low- to moderate-income neighborhoods. In general, the data shows that conditions improved in New York during the 1990s. These improvements included progress in

housing quality and a reduction in crime. The biggest gains occurred in the poorest ten communities. As a result, by the end of the decade, there was a more uniform distribution of the quality of housing.

The paper then explores the relative roles of economic gains and public policies in driving these social outcomes. Using a variety of statistical techniques, the paper attempts to disentangle the influences of neighborhood resident characteristics, community organizations, local industry trends, and targeted public policies on neighborhood improvement. The paper finds that community development corporations and private lending were key in the implementation of New York's housing program. The crucial aspect to neighborhood revitalization is investment, which occurs in amounts that in part reflect greater anticipated returns resulting from property upgrades. The upgrades include improvements to private property and those brought about by the public sector, such as street and other infrastructure upgrades. The revitalization improved neighborhoods directly, but also had a positive spillover effect by giving rise to further investment.

Elise Bright's paper, *Making Business a Partner in Redeveloping Abandoned Central City Property: Is Profit a Realistic Possibility?*, explores the possibilities of a "win-win" partnership between local governments and the private sector derived from putting vacant abandoned property back into productive use. By undertaking this type of partnership, the operative premise is that local governments gain tax revenue and the private sector profits by bringing unused buildings into productive use.

Bright spent a decade studying the devastating effects of property tax policies on low-income neighborhoods and searching for ways to profitably redevelop abandoned property in central cities and rural America. More than one-half million properties sit vacant nationwide, she discovered. These properties blight neighborhoods and discourage lending and investment. Bright points out that of the more than one-half million tax delinquent properties located in many American central cities, most are owned by local governments. In economic development terms, these parcels have positive aspects: they have a central location, good access to transportation, close proximity to large labor pools, and low cost. They are a government-owned resource and partnering with the private sector to return them to productive use should be a priority. Yet, she finds that successful partnerships are the rare exception.

Bright's work discloses that there is little data kept by local governments on the costs and benefits of redeveloping abandoned property within their jurisdictions. Many local governments contacted did not have good records of property owned.

To determine whether a “win-win” partnership could exist, Bright studied five properties that were redeveloped in Dallas/Ft. Worth. She notes that a lot of public incentives were offered in most of these five projects (e.g., tax abatements, infrastructure cost sharing, development fee rebate incentives, Section 108 loans, historic landmark tax credits, enterprise zone tax exemptions, and brownfields assistance). She also tried to determine whether the projects actually made a profit for private investors. Utilizing mostly public documents, Bright computed the average return on investment for these projects and determined that they ranged from 5.6 percent to 25 percent, with most falling between 15 percent and 25 percent.<sup>1</sup> Bright tried to determine whether the projects were profitable from a tax revenue versus cost standpoint. A fiscal impact analysis showed that for the residential downtown projects, the tax revenues generated equaled or slightly exceeded the public costs before, but not after, tax abatements. The public housing project did show a loss, but the loss was small considering the project pays no property taxes.

Only one project showed a profit from a tax revenue standpoint, mainly because the city didn't provide any incentives to the developer. However, the developer pulled out of the project due to profitability issues on his part. Despite the profit to the city, Bright characterizes it as an unsuccessful project due to the breakdown in the partnership. Finally, the author tried to estimate the nondirect money measures of success, and points to one project that generated significant new employment and sales tax revenues. Due to qualitative and secondary benefits, the overall cost-benefit picture of these projects was better than it first appeared.

Bright's paper makes the following conclusions. First, due to the obvious benefits, development of neighborhood businesses that hire local residents should be strongly encouraged. Second, public sector incentives must be tailored to fit the private sector's needs, without giving too much away. Public officials should analyze the need for incentives closely. Third, the public sector should consider longer-term benefits when formulating partnership proposals, not just tax revenue. Bright asserts that public and private gain is a realistic result of partnerships to redevelop abandoned property, but the structure of the partnership is key to success.

The author made three closing points in her presentation. First, Bright stressed the need to develop better methodology for evaluating project-driven economic impacts, particularly qualitative, employment, and indirect financial impacts from urban redevelopment. Second, she urged creativity and far-sighted thinking by local governments and broader use of tools such as tax waivers, city services, and low-interest financing, plus assistance with brownfields issues and realistic property value assessments.

Finally, Bright concluded that sustainable community development on a large scale will require creativity on the federal level as well. Bright recommended less focus on enterprise zones and tax relief, and more attention to developing incentives to foster public-private redevelopment partnerships. Past federal programs such as loan guarantees, highway funding, and home mortgage deductions have subsidized middle- and upper-income suburban development. More targeted programs, Bright maintained, are needed to level the playing field, reduce lender risk, and increase profit potential for neighborhood redevelopment.

In *Corporate Civic Investment Funds: New Models for Community Development Finance?*, Amy L.W. Hosier, Artem Gonopolskiy, Carolyn McCarthy, Sonya Ravindranath, and Elizabeth Drapa, explore the emerging role of privately funded, often for-profit, community development investment organizations. The authors assert that the community development sector has evolved from a focus on federally funded and managed housing and urban renewal programs to a decentralized system in which numerous entities function alone and in partnerships to address a wide range of community and economic development issues. The authors contend that although a federal funding and oversight role remains for some types of assistance, the federal government is now just one of many stakeholders in the system. Today, each stakeholder brings to the community development field varying foci, investment criteria, processes, and resources. This evolution has generated additional actors to the community development sector, and their operations increasingly provide high-level prototypes and catalysts for expanded community investment.

The authors examine the evolving roles of hybrid for-profit/nonprofit entities and for-profit funds that channel private resources directly to community development initiatives. Specifically, the authors look at the roles and impact of corporate civic investment funds and their subsidiaries, including the spectrum of organizational types investing in community development, and recent investment performance. In examining corporate civic funds, the paper draws on case studies and evidence from other types of corporate civic alliances to provide a preliminary assessment of corporate funds and partnerships and their impact. Because most of these funds are relatively new (established in the mid- to late-1990s), performance information is limited. However, results so far indicate that corporate civic funds can provide financing (debt, equity, and near equity) based on sound investment criteria as well as mainstream perspectives, financial and social criteria, and resources that bridge for-profit and traditionally nonprofit approaches to community development.

They conclude that corporate civic funds and alliances have been most successful in identifying sector-specific

needs and opportunities that support small businesses, helping retain and expand existing businesses, and creating job opportunities with advancement potential for the local labor force. Experience with corporate civic investment funds demonstrates that reliable market information and business assistance are critical in developing successful strategies, maintaining investment performance, and sustaining subsequent rounds of funding. Further, in the case of for-profit funds, financial returns are often below-market, but also offer social returns that are difficult to quantify. Even so, where the funds are building more competitive business environments through their cumulative invest-

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**Experience with corporate civic investment funds demonstrates that reliable market information and business assistance are critical in developing successful strategies, maintaining investment performance, and sustaining subsequent rounds of funding.**

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ments and providing evidence of other social returns, they have sustained themselves and acquired successive rounds of funding. Partnerships are essential to the success of corporate civic strategies, especially in supportive initiatives such as developing business infrastruc-

ture, recruiting employees, and upgrading the environment of distressed areas. Finally, and most importantly, corporate civic funds and alliances provide a level of leadership and visibility that can facilitate the flow of private funds to and management and advisory support for local community development initiatives.

The discussant for this session was Ken Wade, director of the Neighborhood Reinvestment Corporation, Boston. Wade opened by stating that Neighborhood Reinvestment clearly believes in utilizing the partnership model, whereby the private sector, public sector, and local residents are collectively represented in one organization. This model has proved successful over time as an effective way to address community development issues.

Wade agreed with Tranel and Gasen's paper that frequently the challenge in any community process is making that process broad enough to encompass and represent all the stakeholders. Wade offered some insights behind the challenges to involving a broad spectrum of stakeholders and stated that often these challenges are manifested in issues involving race, ethnicity, income, age, and newcomers versus established residents. Regularly, communities are divisively split along these lines. In order to overcome these challenges, it is crucial that a process be designed to include all stakeholders. In doing so, the process will be perceived as valid by the community and one that stakeholders can then invest in to achieve the desired outcome.

Wade found interesting the study by Bram et al. of New York City in the 1990s because the paper documents positive neighborhood changes despite income levels remaining the same. The discussant pointed out that a major challenge to the paper is that the study occurred during one of the most significant economic expansions in New York City in the past four decades. If this economic expansion has now ended, there will be much more difficult times ahead. Additionally, Wade stated that it would have been helpful if the authors had also studied metropolitan areas that were not as robust as New York City. For example, the study could have contrasted its New York City findings with data from upstate New York – an area that hasn't seen such vigorous economic activity.

Concurring with author Bright regarding the positive economic impact derived from putting vacant abandoned property back into productive use, Wade agreed that the proper focus should not just simply be on removing a disamenity/negative value from the community while providing the private sector with a profit. Rather, the proper focus should be on the public sector's broader mission and the common benefits derived from being involved with this effort. Wade pointed out that a significant limitation of Bright's approach is the enormous amount of resources required to purchase abandoned property. Further, the practicality of a costly program is questionable in the current serious deficit environment faced by local and state governments. Wade sees the new markets tax credits as a possible untapped resource that could potentially be brought to bear on the funding problem faced by Bright's approach.

Wade made several points regarding the paper by Hosier et al. that discusses the relatively new phenomena of community development venture capital (CDVC) funds. Wade stated that CDVCs help to address a number of different challenges faced by the community development arena, including: mitigating risk, access to underserved markets, serving as an aggregator by taking smaller transactions and bundling them in a manner that better accesses capital markets, and serving as a provider of gap financing rather than venture capital. Wade sees these roles as very important and ones that CDVCs will end up playing.

As Wade envisions the future of CDVCs, he sees challenges. First and foremost is that CDVCs are focusing on the relatively uncharted economic development sector. Consequently, unlike their affordable housing brethren, CDVCs do not benefit from an existing track record. This makes it more complicated and difficult to achieve the same level of success with CDVC funding as has already been achieved with affordable housing. Further, in their formative years, the CDVC funds have needed to demonstrate early positive results, and henceforth have been fairly restrictive in terms of underwriting criteria.

Such cautious underwriting has caused CDVCs to suffer criticism from community groups that the funds are actually more conservative than mainstream financial institutions. Wade agreed and wondered if the stellar performance of many funds has caused CDVCs to essentially miss the market that many people hope they will serve. He pointed out that if CDVCs end up with risk characteristics that are better than local banks, it begs the question of whether the fund is far enough out on the risk curve. He summed up by saying that if the funds are doing better than the banks, then they are not focused on the right niche – not that the

fund should experience significant losses – but most of these funds were created to serve a niche that banks could not serve.

Wade concluded the session by stating that the partnership model is clearly here to stay, but quickly added that it is not a panacea. The dynamic nature of the partnership model is both its strength and weakness. He cautioned that problems arise when individual partners begin pursuing their own self-interest. In these situations, the partnership model can actually constrain the forward progress of the community.

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## Notes

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1 One was not included in the profitability calculation due to the lack of applicable data; however, the developer stated that the project was not profitable.

# Public Policy – Enterprise Zones and CDFIs

## Session Four

## Seeds of Growth, Sustainable Community Development: What Works, What Doesn't, and Why

**“W**here do community development financial institutions (CDFIs) fit into the idea of development finance, particularly in lower income communities?” That’s the question posed by Lehn Benjamin, Julia Sass Rubin, and Sean Zielenbach in their paper, *Community Development Financial Institutions: Current Issues and Future Prospects*.

The paper begins with a brief survey of the history of community-based financial institutions, from the black-owned banks of the 19th and early 20th centuries to low-income community credit unions and the explosive growth of CDFIs after the 1995 creation of the CDFI Fund. Today, there are 635 CDFIs, most of which are unregulated, nonprofit organizations,<sup>1</sup> including: 71 banks, thrifts, and bank holding companies; 119 credit unions; 20 venture capital funds; and 425 loan funds (includes housing, business, and facility funds).

The whole reason behind the CDFI movement is the historical lack of access to affordable credit and investment capital in lower-income communities. The number of certified CDFIs tripled between 1996 and 2003. This is an increasingly large segment of the development finance industry. “So what exactly is the role of these groups?” asked Sean Zielenbach, research director at the Housing Research Foundation, who presented the paper.

The authors identify and illustrate three general approaches CDFIs take in identifying and serving their markets. Although some CDFIs emphasize one approach more than others, most CDFIs probably have elements of each of these approaches.

The first is a “community-controlled capital” model that developed in response to the practice of redlining.<sup>2</sup> In this model, CDFIs function as an alternative to conventional lenders, keeping money in the community and recycling it in the form of loans.

The second and most prevalent approach is one that complements conventional lenders, helping them reach deeper into underserved, lower-income markets. Zielenbach highlighted multibank CDCs, Neighborhood Housing Services (NHS), Local Initiatives Support Corporation (LISC), and Boston Community Capital to illustrate this approach. In this role, CDFIs both mitigate risks and develop the market for conventional lenders.

The third approach is the niche market model. In this model, CDFIs serve markets that are just too costly for the conventional lenders to serve efficiently. Micro-enterprise funds and unsecured working capital loans for nonprofits are examples.

### CDFIs and Conventional Institutions

The paper asks the questions, “What differentiates CDFIs from conventional institutions?” There is anecdotal evidence of CDFIs serving harder to serve markets or unbankable borrowers. But it’s not really known how much deeper CDFIs go into those markets than conventional institutions do. What really differentiates CDFI products and borrowers from those of conventional banks?

The authors cite two recent studies that try to answer these questions. The Woodstock Institute found that 80 to 90 percent of community development banks’ loans go to lower-income markets, compared to about 40 to 50 percent of similarly-sized community banks. A CDFI Fund study found that CDFI financial performance is worse than that of their conventional peers, perhaps owing to their serving a presumably higher risk market. “But we don’t know how high a risk,” Zielenbach emphasized.

The role of the CDFIs in community revitalization is dictated, at least in part, by what markets banks can realistically serve. Zielenbach and his co-authors assert that the combination of credit scoring and Community Reinvestment Act (CRA) pressures have moved banks deeper into some markets:

"About ten years ago it was difficult for banks to provide mortgages to individuals making 80 percent of area median income. You now have some cases where banks are making loans to individuals making 50 percent of area median income."

Even as banks move deeper into some underserved markets, it is not clear that they serve heretofore underserved individuals as well as or better than CDFIs. It is also not clear if banks' extension into these markets has the "spillover" benefits that CDFIs provide. This all seems to beg two questions: Are there intrinsic benefits to the CDFI model? And what is the real impact of CDFIs, anyway?

In order to better analyze the impact of CDFIs and measure those impacts, CDFIs need to first define their goals and desired impacts better. "Too many organizations are simply saying that their mission is 'to reduce poverty throughout Chicago,' or 'promoting economic development in western Michigan,'" Zielenbach said. He highlighted the Englewood neighborhood on the south side of Chicago, which he called a "basket case," in spite of \$43 million in residential and small business lending by conventional, CRA-regulated financial institutions in 2000 alone. "Clearly," Zielenbach concluded, "there is a lot more to neighborhood development than simple financing."

Another impediment to thorough analysis of CDFI impact is figuring out what's reasonable to measure and being realistic about causality. While most organizations cite numbers of housing units created, jobs created, or jobs

retained, the authors are emphatic that these are really, at best, indirect impacts of CDFI activities. "For the most part, CDFIs have assumed a direct causality between the financing that they provide and the creation of these

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**"CDFIs are a means to an end. We tend to look at them, as with all public policy efforts, as ends in and of themselves"**

Sean Zielenbach, Research Director,  
Housing Research Foundation

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outputs, counting both their own and their borrowers' activities, and ignoring other contributing factors . . . they themselves are not real estate developers or large employers. They do not build projects, but instead help to finance them."

The authors propose a few different ways of assessing impact. First, there is the level where CDFIs directly affect borrowers, projects, and organizational growth and development. How many clients now have any account with a regulated financial institution? Would the project be completed as quickly, efficiently, or cost-effectively without the CDFI? Can the CDFI provide a value added service that

contributes to organizational development beyond the financing? These are important, but micro-level CDFI impacts.

What also needs to be accounted for are the impacts that projects financed by the CDFI have in the broader community. These are important indirect impacts. Zielenbach illustrated the point with a senior center, financed through the CDFI that, in addition to providing housing units, also provides a recreational opportunity for seniors in the community. "This can help build a community; it can help stabilize a community," Zielenbach said. "Is it directly tied to the CDFI's financing? No. Is it an indirect outcome? Yes."

Finally, the authors assert that the "bigger issue" in assessing CDFIs is their role in financial system development. How do CDFIs bring in other lenders? How do they help conventional lenders change the way they serve more customers? Are they helping to attract additional private capital to the market?

The paper concludes with questions about the cost, scale, and capital needed to sustain CDFIs, leading the reader to ponder how sustainable the CDFI model is. Zielenbach summarized those questions: "Probably 85 percent of CDFIs are not self-sufficient because they provide a range of services in addition to their financing. How do we pay for that? Too many CDFIs are tiny. Should we be thinking about mergers and consolidation in the CDFI industry? Can CDFI loans be standardized and securitized?"

The authors also look to the future. It's clear that CDFIs are not going to be able to turn around distressed neighborhoods or ensure adequate access to capital and credit by themselves. "CDFIs are a means to an end. We tend to look at them, as with all public policy efforts, as ends in and of themselves," Zielenbach concluded. "What is the role of conventional lenders and investors? The role of CDFIs? The role of the public sector? Obviously there's some subsidy that's going to be needed to create local infrastructures and make communities something in which financing makes sense. Where's the public sector here; where's the government? These are issues we need to think about."

In the next paper, *Job Creation in California's Enterprise Zones: A Comparison Utilizing A Propensity Score Matching Model*, Susanne O'Keefe, assistant professor of Economics at California State University, Sacramento, finds that California's Enterprise Zone program raised employment 2 to 3 percent per year.

California's Enterprise Zone program, established in 1985 and currently including 39 zones, uses hiring tax credits, machinery tax credits, net operating loss carry-forward, and net interest deductions for lenders to promote employment and economic growth in the distressed areas designated as enterprise zones.

The study focuses on the job creation aspect of the Enterprise Zone program. "What we would like to learn is, what would have happened in those enterprise zones if the program did not exist, which, of course, is an impossible question to answer," O'Keefe pointed out. "The best we can do is to try to control for characteristics of the zone by finding areas that are most similar to enterprise zones before the program began. I used the propensity score matching model to find areas most similar to enterprise zones."

O'Keefe developed a propensity score matching model by which she determined the probability of every census tract in California becoming an enterprise zone based on the observed characteristics of those tracts that did become

Table 1

### Similarity of Zones & Matches

	Enterprise Zone Tracts	Matched Census Tracts	All California Tracts
Median Income	\$26,284	\$22,550	\$38,671
Unemployment	11.1%	9.8%	6.9%
College Grads	13.8%	14%	23.5%

enterprise zones. She then matched zones to tracts with the closest propensity score that lay outside the zone but within the same county. Table 1 shows the results of this matching exercise.

Growth in the enterprise zones was then compared to growth in the matched areas. The study finds employment growth of 22.7 percent in enterprise zones (342,377 new jobs) as compared to 14.6 percent employment growth in "matched" census tracts between 1992 and 1999.

Table 2

### Growth in Employment, Earnings, and Number of Firms Between 1992 & 1999

		1992-1999	Increase
Employment	EZ Match	22.7%	342,377
		14.6%	52,268
Monthly Earnings	EZ Match	21.3%	273
		26.3%	439

Using firm level data from the California Employment Development Department that provided employment and payroll at each firm between 1992 and 1999, the study compares the aggregated data for enterprise zone census

tracts to matched tracts. The study also compared employment growth at firms located within enterprise zones for firms that are observed for two consecutive years – the firm level analysis.

From this analysis, O'Keefe concluded, "Employment in the enterprise zones grew more quickly than the matched areas. Monthly earnings and number of firms grew more quickly in the matched areas than in the enterprise zones. Because there is a tax incentive for hiring workers for around \$8 an hour, there could be an incentive to create more relatively low-wage jobs as compared to high-wage jobs, slowing monthly earnings growth. But, when the regression analysis is done, the earnings and number of firms findings are not statistically significant."

So the study concludes that both the census tract and establishment level analyses support the finding that, while enterprise zone designation does not significantly affect the number of firms or average earnings, zone designation does raise employment by 2 to 3 percent each year.

Julia Sass Rubin and Gregory M. Stankiewicz provide a legislative history of the New Markets initiatives that places the initiatives in the historical context of federal community development initiatives of the last half of the 20th century as well as the philosophical context of the Clinton and Bush administrations. Their paper, *Evaluating the Impact of Federal Community Economic Development Policies on Targeted Populations: The Case of the New Markets Initiatives of 2000* raises concerns about the initiatives' prospects for success.

The Clinton administration created the New Markets programs in 1998, and Congress passed the programs in an agreement between President Bill Clinton and Speaker of the House Dennis Hastert in 2000. In spite of three tours of distressed areas that were reminiscent of the tours taken by Lyndon Johnson and Robert Kennedy 40 years earlier, President Clinton insisted that the New Markets initiatives were not designed for poverty alleviation.

Instead, the program was "sold" as a non-inflationary, pro-growth program. "The program is based on the assumption that investors need a little extra incentive. It's not a question of discrimination or bad deal flow, but these are just deals that need a little extra push," according to Rubin, a post-doctoral fellow at the Taubman Center for Public Policy at Brown University. "That's what the New Markets Tax Credit (NMTC) and the New Markets Venture Capital (NMVC) programs are designed to do."

The NMVC program is modeled on the Small Business Administration's (SBA) previous experiences in community development investments and venture capital programs. Rubin and Stankiewicz detail the elements of the program including the SBA's certification process for NMVC company designation and the matching grants and loans, 80 percent of which must be used to invest in low-income communities.

The authors note that the program was eliminated in the fiscal 2003 budget and that proponents may not be able to revive it in the current political and budgetary climate.

Even if the program could be revived, however, the authors are concerned about the mismatch of sources and uses of funds in the program.

“By utilizing debt to fund mostly equity investments, the NMVC program duplicates the mismatch between sources and uses of capital that had led to financial problems for most of the participants in the federal Small Business and Specialized Small Business Investment Company programs . . . although the five year interest deferment provided by the SBA is helpful, it still is unlikely that a NMVC company could invest its capital in equity and then exit those investments quickly and profitably enough to pay back its loan to the SBA.”

The paper also details the NMTC program. Modeled on the Low-Income Housing Tax Credit program, the NMTC investors in certified community development entities (CDEs) will receive a 39 percent tax credit over seven years for their investments, 85 percent of which must be made in low-income communities.

As with the venture capital initiative, the authors find reasons to be concerned about the efficacy of the tax credit portion of the New Markets programs. First, the program's general economic development objective is ambiguous and the CDE's ability to raise capital quickly is more heavily weighted than community impact in the application process. This leads the authors to wonder whether the resulting investments will supplant rather than supplement investments that would have been made with or without the program's incentives.

Secondly, the NMTC program allows “double-dipping” with most federal and state programs according to the authors.<sup>3</sup> The authors are also concerned that the NMTC program may encourage a “race to the bottom” in raising capital.

The CDEs have used the NMTC selection process to demonstrate their ability to raise capital, using letters of intent from potential investors. These letters are nonbinding, allowing investors to withhold funding until a review of specific deals is conducted. Under these situations, preference would go to the most lucrative deals instead of those that would have the greatest community development impact.

Rubin and Stankiewicz also warn readers about unrealistically high expectations with regard to program impacts. They also believe that, while business equity is what is most needed in new markets, it is the least likely to get funded through the NMTC program while commercial real estate deals are more likely to get funded under the program.

Finally, the program faces the double threat of additional funding cuts due to growing federal budget deficits and a

reduction in demand for credits due to the elimination of “double” taxation of corporate dividends.

In closing her remarks, Rubin proposed potential program modifications that would help address these concerns. Those proposals include allowing more near-equity and debt investing and increasing the weighting for community development objectives in the application processes. She also proposed eliminating “double-dipping” opportunities and encouraging more equity investments by addressing issues related to the seven-year minimum holding period for equity investments. Finally, and perhaps most importantly, she wants the program to encourage investment that supplements rather than supplants investments that likely would have happened anyway, specifically by limiting organizations' ability to invest in related entities.

Paul Pryde, president of Washington, DC-based Capital Access Corporation, was the discussant for this panel. Noting that next year will mark the 40th anniversary of the War on Poverty, Pryde identified two shifts in the way the federal government has attempted to alleviate the effects or causes of unemployment and low incomes. The first shift went from the original direct provision of services by the federal government to an economic development approach – “creating the capacity to produce among low-income residents and making low-income communities more viable places to live and work,” Pryde said.

The second shift was away from economic development to market-oriented solutions, which leads to the present day. Under the market-oriented approach, “we have a variety of ways that government tries to use its taxing, regulatory, and spending authority to change the way that private lenders, investors, and citizens make decisions,” Pryde said. “Each one of the papers we have discussed this morning represents a somewhat different approach to government's use of its powers to influence private decision-making.”

Pryde applauded O'Keefe's paper on the California enterprise zones for showing, in a way that has not been done before, that enterprise zones work to increase employment. But why they work is still not known. “Some data suggest that young, small firms are a large generator of new jobs. Yet, in the early years, these same firms have very little tax liability and have very little capacity to use tax credits or any type of tax incentives. So you would suspect that,” Pryde asserted, “to the extent that these are the firms that are creating jobs in California's enterprise zones, firm-level tax credits and deductions don't work very well.” He suggests that, “perhaps the incentives that work best are those that get money into firms so that they can expand.”

Pryde noted some of the same challenges for CDFIs that were covered in the Benjamin, Rubin, and Zielenbach paper. While highlighting the demographic changes that will be driving more commercial banks toward serving nontraditional

markets, Pryde also noted that competition would come increasingly from nonbank financial service providers. "If you look at trends in the banking industry, in every credit market in which banks compete, they're losing market share – mortgages, consumer credit, and so forth – and they're losing it to specialty lenders – specialty finance companies and diversified financial services companies," he said. "So as CDFIs look out for competition, don't look just at banks. You have to look at other organizations that are increasingly going to look at these markets that CDFIs have historically served."

In addressing questions of scale for CDFIs, Pryde emphasized the need for CDFIs to adopt financial information technologies that have made it possible for commercial lenders to better serve historically underserved markets. As an example, Pryde pointed to securitization. "Securitization has made it possible for anybody to get a credit card and anybody to get a mortgage loan. Those are the most securitized assets in the country," Pryde said. "Securitization means pooling loans and selling bonds backed by those loans to investors. And because of the advances in securitization, mortgage credit and consumer credit is available to almost anybody. My belief is that the same technology can be used to make credit more widely available to low-income communities. There are challenges associated with it, but I think it is definitely a promising technique."

Pryde then turned his attention to the NMTC, agreeing with Rubin and Stankiewicz that not much is known about how the credits will work. But he took issue with the notion that the \$15 billion allocation is a thin incentive. Based on the SBA's highest default rate in the last 20 years of 10 to 12 percent, Pryde believed that if the tax credits were used as a credit support mechanism, they could leverage \$150 billion in new lending.

Pryde concluded his remarks suggesting that the problem of getting capital flowing to underserved markets has been turned on its head. "There seems to be a willingness to invest, but we've got challenges in getting the money to the borrowers who need the money," he said. "We have to ask ourselves, what really are the limits of private markets' ability to serve low-income communities. Because of the advances in financial information and technology," he asserted, "the private sector can serve markets that, 30 years ago, they weren't interested in and couldn't efficiently serve." "So," he concluded, "the problem we face is not a financial problem. It's an intellectual problem. How do we use our creativity to figure out what the solutions are to a challenge that we have faced for the last decade or more?"

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## Notes

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1 "A little less than 30 percent are regulated financial institutions, and probably only 15 percent of all CDFIs are for-profit institutions."

2 "The CRA sought to eliminate the more insidious practice of redlining, in which bankers refused to lend in certain geographic markets because of the perception of high risk in those communities. (The term "redlining" resulted from certain bankers' demarcation of high-risk neighborhoods by stark red lines on city maps.) Contributing factors to high-risk perceptions included large numbers of racial and ethnic minorities and high poverty and unemployment rates" (Benjamin, Rubin, and Zielenbach, 2003, p. 4).

3 "The seventh largest recipient, which received \$110 million is an organization called Advantage Capital, a certified capital company which, in nine states, is eligible to receive 100 percent subsidy for making investments," Rubin said. "So in those states, they would now receive 139 percent subsidy for their investments. It's hard to argue that this money is actually inducing them to make new investments."

# Public Policy – CRA

## Session Five

## Seeds of Growth, Sustainable Community Development: What Works, What Doesn't, and Why

It has been more than 25 years since Congress passed the Community Reinvestment Act (CRA). Since enactment of the CRA, policymakers and community development practitioners have sought to measure the impact of the CRA. The papers presented in this session shed light on the effects of the CRA on lending and credit access.

The paper by Federal Reserve Board economists Robert B. Avery, Paul S. Calem, and Glenn B. Canner, *The Effects of the Community Reinvestment Act on Local Communities*, addresses questions about the effects of the CRA on local communities. To estimate the marginal effects of the CRA, the analysis compares economic circumstances in census tracts with incomes just above and just below the low-income threshold designated by the act. The analysis measures changes in neighborhood outcomes between 1990 and 2000.

Since its inception, the CRA has focused on measuring the activity of lending institutions in the lower-income census tracts of their market areas. Lower-income census tracts are defined by regulators as those with median family income below 80 percent of the median income of a region, such as the Metropolitan Statistical Area (MSA) or the non-metropolitan portion of a state. Importantly, the classification of the census tract by its relative income only occurs once per decade, following the release of census data. At that point, all parties have a clear understanding of which census tracts are going to be the focus of attention when CRA assessments are made. Canner et al. designed their study to rely on this long-standing focus of the CRA.

Canner discussed four additional points regarding the CRA that were directly relevant to the paper's line of research. First, the CRA regulations were overhauled in 1995 to make the process more quantitative and performance-oriented. There are now three specific performance tests for

large banking institutions (lending, investment, and service). Second, the regulations specify four categories for performance ratings (outstanding, satisfactory, needs to improve, and substantial noncompliance) and the analysis makes use of these ratings. Third, since 1995 the regulations broadened the focus of CRA assessments to include lower-income borrowers, not just lower-income neighborhoods, and the research accounts for this broader focus. Finally, the research focuses on home lending activity as a primary measure of CRA activity.

Canner noted previous research on the effects of the CRA primarily focused on performance and profitability of CRA-related lending activities and changes in lending volume as a consequence of the law. The weight of the evidence suggests that CRA-related lending is generally profitable. There also is some limited evidence that the CRA has resulted in the extension of additional credit. Despite previous findings, Canner argued that there has been very little research conducted on the effects of the CRA on local communities.

When the researchers explored ways to test the potential effects of the CRA on local communities, they devised three. The first view is that banking institutions may satisfy CRA provisions through their ordinary course of business. In this case, there is neither a necessary expectation for any change in lending activities associated with the CRA per se nor any effects of the law on local communities. The second view is that banking institutions may respond with intensive marketing and outreach activities to try to acquire more borrowers in lower-income neighborhoods, but not change the pricing or underwriting standards. Here, higher market share may be achieved and the institution's performance may appear better for CRA evaluation purposes; however, these activities will not necessarily result in higher

lending levels or have an effect on the community if the institution hasn't lowered prices or used more flexible underwriting. The third view is that banking institutions may respond by reducing prices and/or adopting more flexible underwriting. Lending increases in targeted neighborhoods and perhaps some positive changes in the neighborhood's circumstances, such as homeownership rates, median home values, and vacancy rates, would be expected.

When designing the tests to determine the effects of the CRA on local communities, Canner et al. faced significant challenges. The first was to assess the marginal effect of the law, which was difficult because there is no way to observe what would have happened in the absence of the law. The second challenge was to distinguish any effects of the CRA on neighborhood outcomes from other market and regulatory driven changes. In particular, technological advances over the last decade affect the ability of lower-

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income families to obtain credit. There has been a substantial growth in sub-prime lending opening up new opportunities for borrowers. Another potential effect on lower-income communities has been the establishment of affordable housing goals for both Fannie Mae and Freddie Mac. And finally, a greater focus

on fair lending may result in regulatory overlap to the extent that predominantly minority neighborhoods tend to be lower-income neighborhoods.

To address these challenges, Canner et al. conducted two empirical tests. Both of the approaches make use of the CRA income threshold definition for lower-income census tracts (i.e., those tracts where the median family income falls below 80 percent of MSA median income). The first test, referred to as the "changes analysis," provided evidence on the potential impact of the CRA on changes in neighborhood outcomes during the 1990s. For this test, the paper compares changes in outcomes for two cohorts of census tracts. The first group, the CRA eligible cohort, is just below the CRA eligibility threshold. The second group, the not-CRA eligible cohort, is just above the threshold. The paper asserts that its test is quite close to a natural experiment, and co-author Avery employs the metaphor of a horse race to put the paper's empirical tests in perspective. The horse race starts with the initial conditions

in each group of census tracts in 1990, and the winner is the cohort that comes out ahead, in terms of changes in neighborhood outcomes, by 2000. For this test, census tracts were placed in one of two groups, based on their 1990 relative income, and this categorization was fixed for the period of the study (i.e., 1990-2000). Lending in any of the census tracts below the income threshold counts toward meeting CRA obligations while lending in the tracts above does not. By design, the authors selected two groups of census tracts that as of 1990 should have been similar by most measures. However, because initial conditions in the two groups of census tracts may have differed slightly, regression techniques were used to adjust for initial differences. The final step in the changes analysis was to determine if any outcome differences observed were related to several different measures of CRA activity employed during the test.

The second test was referred to as the "levels analysis," intended to reveal the cumulative effect of the CRA on conditions in local communities. This test was undertaken out of concern that the CRA may have caused banking institutions to change their behavior in the period shortly after enactment and that the changes analysis, which focuses only on the decade of the 1990s, may not reveal such an effect. The levels analysis used regression techniques to relate the neighborhood outcomes in 2000 to indicators of CRA eligibility for individual tracts as of 1980 or 1990. Here, the sample is census tracts in the 70 percent to 90 percent relative income range as of 2000. This group of census tracts has considerable homogeneity with respect to prior years CRA eligibility.

The measures used for neighborhood outcomes for the changes analysis were: changes in the homeownership rate, number of owner-occupied units, vacancy rate, median home value, and crime index. Canner stated that if the CRA leads to an increase in lending, the first three measures are the most likely to be favorably affected by such lending. However, expectations for positive changes in median home value and crime rates are less clear, and any changes would be considered a secondary effect. The levels analysis employed the same measures, except for the number of owner-occupied units.

The paper concludes that the results of the two tests for the effects of the CRA are mixed and difficult to interpret. On the one hand, CRA eligible tracts had more favorable changes for the decade of the 1990s in terms of homeownership, owner occupied units, and vacancies, than would have been predicted using the not-CRA eligible cohort. Moreover, the market share of institutions rated outstanding was higher in the CRA eligible cohort than in others – suggesting a CRA effect. The paper's findings regarding homeownership and growth in the number of

owner-occupied units are not conclusive. Moreover, CRA-eligible tracts fared worse than would have been predicted with regard to home values and crime.

Canner pointed out that much more study on the effects of the CRA is planned, as it may be that some of the paper's results reflect the nature of the specific tests employed by the study. For example, it is quite possible that banks don't focus only on tracts below 80 percent of the median income, but rather target their activities to a broader area. And this broader area may have some tracts both below and above the 80 percent threshold. Moreover, banks may focus more heavily on lower-income borrowers to facilitate program design and implementation.

Canner stated that several aspects of the paper's research need expansion, as there are different channels through which the CRA may influence communities. Although the current research focused on home lending, further study should assess the effects of the CRA on small business, community development, and purchase mortgage lending.

In *What Makes CRA Agreements Work? A Study of Lender Responses to CRA Agreements*, Raphael W. Bostic and Breck L. Robinson examine whether lenders actually change their behavior after entering into CRA agreements. Bostic began by stating that the CRA has two enforcement mechanisms that provide incentives for lenders to pay attention to the act. The first is the public release of institutions' CRA ratings, and the second is the regulatory application (a formal procedure allowing banks to undertake mergers, expansion, new branch establishment and a variety of other actions) process wherein the regulator must consider a lender's CRA rating. If lenders don't consider the CRA, it can be particularly costly – mostly in terms of lost time regarding applications for mergers. Bankers have a motivation to respond to the incentives and objectives set forth in the CRA. Because of this motivation, bankers have taken affirmative steps to demonstrate their commitment to CRA principles. This research looks at one of these steps, which is the CRA agreement.

Bostic defined a CRA agreement as a pledge that a bank makes to extend financial services to a targeted, typically under-invested community. Usually, financial institutions will enter into a formal agreement with a particular community-based organization (CBO). However, the recent trend has been for banks to proactively and voluntarily extend pledges to lend at certain levels to communities. Here, Bostic referenced Wells Fargo's pledge to invest \$100 billion over the next ten years in low-income communities in California. Although these are types of CRA agreements, they are less formal. The typical agreement contains a commitment not only for lending, but also to provide additional services, such

as mortgage counseling, small business technical assistance, or a pledge to open additional bank branches or extend hours. Further, other types of commitments can include a minority hiring pledge or the establishment of a review committee within a target community. These agreements began showing up almost immediately after the CRA was passed, but real growth in the number of agreements did not come until the late 1980s and early 1990s. Bostic stated that there have been well over 300 agreements since the CRA's enactment.

This research is part of a broader agenda that attempts to measure and quantify the effects of CRA agreements upon lending markets. This paper asks the direct question of whether CRA agreements change the lending behavior of the institutions that actually enter into them. A secondary question is: if changes are observed in lending behavior, what characteristics of the agreements are capable of having the most impact? To answer these two questions, the authors identified institutions that entered into agreements and then tracked the results of those agreements to determine if lending increased or decreased.

In order to conduct the analysis, the authors needed to obtain three types of information. First, the bank's structure needed to be identified and followed through subsequent mergers (as 90 percent of the subject banks underwent at least one merger) to accurately attribute the lending to the source of the agreement. Second, the research required specifics of each agreement, such as commencement dates, time in force, and geography covered. Finally, information on lending activity was also required.

The paper's findings paint a cautiously optimistic picture suggesting that lenders increase their targeted lending when agreements come into force and that the increased lending persists even after the term of the agreement. Additionally, the authors find that mortgage counseling and technical assistance are key components of effective agreements. The authors include a caveat that their results are preliminary and the analysis currently lacks the incorporation of time, which is a particularly important consideration given that overall lending increased during the time period covered by the study.

Jonathan Zinman, a research economist from the Federal Reserve Bank of New York, was the discussant. In addition to formerly having been a community development practitioner, Zinman also has written on the impact of the CRA, focusing on the effects of small business lending.

Zinman highlighted three themes in his comments. First, he felt the research in this session asks the right questions. The marginal value of research on the CRA, financial markets, and access to capital is extraordinarily high. This is true, both from a pure academic as well as a policy

and practitioner perspective, simply because empirically very little is known about these markets, how they really work, and what optimal policies and optimal interventions really look like. Second, the social sciences, and economics in particular, are young sciences and practitioners are just beginning to appreciate and learn to apply methodologies to estimate the causal relationships that are the focus of the research presented. If there is only one take away point for practitioners, it is that they need to adopt a “buyer beware” approach when trying to employ academic or applied policy research to their own operations. Finally, Zinman argued that economists are just beginning to appreciate the most fundamentally important and interesting questions in this area.

Commenting on the papers, Zinman focused on their respective models and methodology – the means to identify the causal effects of the CRA on outcomes of interest – rather than their specific results. He emphasized the need to identify and establish the causal relationships asserted by the papers as being accurate.

In commenting on the paper by Bostic and Robinson, Zinman noted that it precisely documents an association between CRA agreements and increased CRA lending, for a subset of agreements. What the paper does not do, at this stage, is establish a causal link between CRA agreements and the types of lending that the CRA seeks to advance. Zinman's comments focused generally on the role of agreements and trying to estimate the causal link, as opposed to the specific best practices. Zinman also offered comments relative to specific refinements to the model that he believes would produce estimates of the causal role of CRA agreements on the outcomes of interest.

What needs to be known and estimated is whether CRA lending actually responds to CRA agreements per se. What is a concern, as noted by the paper, is that CRA agreements are not randomly assigned and can't be studied in the fashion of a clinical trial. Rather, they occur in the real world and are endogenous – certain banks select or decide to have CRA agreements and what needs to be considered is whether the banks that decide to be a party to an agreement are different from banks that don't elect to sign CRA agreements. A specific item of concern is that banks only make commitments when it is relatively inexpensive for them to do so. If it is believed that banks are profit maximizing and savvy – ideas that economists hold dear – then banks are going to be more likely to enter into CRA agreements for lending that they were going to do anyway. Therefore, the challenge here is to test and control for whether an observed association between CRA agreements and lending is actually the result of the agreements or just lending the banks would have done anyway.

To deal with this selection problem, two different approaches could be taken. First, a researcher could attempt to identify some other reason for forming an agreement, something peculiar to observed communities and banks that makes it more likely to have agreements and where that likelihood is going to be plausibly not related to any underlying conditions of credit supply or demand. The second approach would be to control for the lending that banks that enter into agreements would have done anyway.

Zinman suggested strategies that Bostic and Robinson could follow for identifying causal effects. One is to use statistical matching techniques to compare ex-ante (pre-agreement) lending with post-agreement lending. The other strategy is to measure community capacity to explain the likelihood of there being an agreement in the first place. This approach involves determining why some communities have denser, richer, more capable networks of community groups that are more likely to effectively

**Table 1**  
**Variation that Can/Should Be Used to Estimate the Causal Effects of CRA**

Across Time	Across Banks	Across Targeted Loan Types and Beneficiaries
Late 1970s enactment and implementation	Size	Home mortgages
Late 1980s/early 1990s modifications (include HMDA)	Local examiner behavior	Small business
Mid-1990s rewrite of CRA regulations	Merger and acquisition propensities Ex-ante presence in LMI areas	In LMI areas To LMI borrowers Community capacity •Monitoring •Loan production

broker and monitor an agreement than other communities. Zinman asserted that the entire explanation for differences between communities relates to underlying conditions of supply and demand within credit markets.

Regarding the paper by Canner et al., Zinman characterized the changes analysis as very sensible, comparing outcomes in tracts that are essentially identical, except for falling just above or below the relevant income threshold, but felt the levels analysis needed further thought.

Zinman opined that there is tremendous potential to make strides in analyzing the CRA. In particular, there is much variation and institutional richness in the CRA and complexity breeds opportunity in academic research. Table 1 illustrates the different types of CRA incentives and policy changes in institutions that Zinman argued should be taken into account.

Zinman closed by underscoring the importance of understanding the underlying economics and microstructure of these targeted markets and by providing two cautionary tales from the papers.

First, mitigating market failures does not necessarily imply that bank profits will increase. The CRA could improve the functioning of LMI markets and the welfare of society as a whole, without necessarily improving conditions for banks.

Second, lending behavior and even outcomes can change even if the CRA doesn't induce banks to change the way they do business. If this is true, then contrary to Canner et al., the CRA might well work without banks needing to change the way that they do business. If banks' underwriting policies depend in part on property values or expectations about property values, and on the perceived probability that other lenders will lend in a given neighborhood, then banks could increase their lending without changing policies or practices.

# International and Cultural Dimensions

## Session Six

## Seeds of Growth, Sustainable Community Development: What Works, What Doesn't, and Why

The paper by Maude Toussaint-Comeau and Robin Newberger of the Federal Reserve Bank of Chicago and Art Rolnick, Jason Schmidt, and Ron Feldman of the Federal Reserve Bank of Minneapolis, *Credit Availability in the Minneapolis-St. Paul Hmong Community*, seeks to develop a better understanding of immigrant/refugee small business financing. The Hmong are immigrants from Laos and other Southeast Asian countries who settled in the United States in the late 1970s as political refugees following the Vietnam War. There are approximately 170,000 Hmong living in the United States today. The largest concentration lives in Minnesota, part of the Ninth Federal Reserve District covered by the Federal Reserve Bank of Minneapolis, and Wisconsin, which encompasses part of the Seventh District covered by the Federal Reserve Bank of Chicago, and part of the eastern portion of the Ninth District.

Rolnick provided the introduction to the presentation of this paper. He mentioned the congressional mandate set forth in the CRA for the Federal Reserve System to ensure that commercial banks meet the credit needs of their communities. An economist would question the term "credit needs," and would probably instead ask whether credit markets are working, or whether there is market failure. If there is a market failure, the economist would like to understand it and try to develop corrective policies. Possible reasons for credit market failures include asymmetric information, where borrowers and lenders have unequal information. This is a major issue among small businesses. Discrimination (racial/ethnic, age, etc.) is another major issue that can lead to credit market failure. The motivation for the study was to obtain a better understanding of credit markets, within a community at higher risk for market failure and associated effects.

The authors chose to study the Hmong for two primary reasons. First, being a relatively recent refugee group, the Hmong are more likely to suffer from both cultural and economic disadvantages. Cultural disadvantages include a formerly rustic lifestyle and little familiarity with formal borrowing and lending. Rolnick stated that the Hmong "don't even have words for bank or loan." The Hmong also clearly come with economic disadvantages, arriving in the country as refugees – not as immigrants seeking out the economic advantages of living in the United States. The Hmong are an emerging and growing small business sector in the Twin Cities that have not been studied previously. The authors sought to understand credit markets and how they might work in low-income, distressed areas. As a recent immigrant refugee group making economic progress, evidenced by their growing business sector, the Hmong offered a promising case study.

The methodology for the paper was based on a more elaborate survey instrument developed by the University of Chicago and the Federal Reserve Bank of Chicago for their data collection in Hispanic and Black neighborhoods in Chicago.<sup>1</sup> Aside from the current paper by Toussaint-Comeau et al., Paul Huck, Sherrie Rhine, Robert Townsend, and Philip Bond used the data gathered with this instrument in a previous study, *A Comparison of Small Business Finance in Two Chicago Minority Neighborhoods*, to measure credit access from both formal and informal sources.

For the Hmong study, the original survey tool was translated into Hmong. A Hmong advisory group that provided insights on potential cultural and language problems reviewed the survey. Several issues were identified and worked out through this process. Rolnick stated that "it was very important to work with the community; this was a lesson that came out of the Chicago experience."

The surveyors (the Wilder Institute) compiled a list of all the Hmong businesses they could find, locating 170 establishments, and obtained 121 responses, for a response rate of 71 percent. Rolnick attributed the very high response rate to working closely with Hmong community leaders and promoting the survey on Hmong cable television stations. A comparison group was also established that identified 220 non-Hmong businesses within the same geographic area, namely the central cities of Minneapolis and St. Paul. The latter group provided 131 responses for a 61 percent response rate. Ninety percent of the respondents in the comparison group were White-owned businesses. Therefore, the researchers controlled for geography and race in considering differences regarding the availability of financial resources, especially credit. After obtaining the survey results, the researchers followed up with Hmong community members and local bankers to verify their accuracy. Post-survey focus groups were presented with the results to determine what important aspects, such as experiences and insights, might not have been captured by the survey.

Rolnick stated that the major finding of the study was that "Hmong entrepreneurs in the Twin Cities appear to have well-developed access to the banking sector." He added that the finding was a bit of a surprise, because of all of the factors that the Hmong appeared to have going against them.

Toussaint-Comeau, the lead investigator of the joint Minneapolis/Chicago project, provided more details regarding the paper's analysis. First, she noted the reasons for the focus on access to credit by start-up businesses.

Toussaint-Comeau explained that in the paper, they measure access to credit both in terms of the relative propensity of the Hmong to make use of start-up financing from various sources, in particular from banks, and in terms of the relative size of the loan that they were able to obtain from a bank. The paper also seeks to establish what may have worked to explain the relative success of the Hmong in the Minneapolis/St. Paul market.

According to the survey results, the businesses were concentrated in retail and personal service industries, for both groups. The Hmong, however, were less likely to have capital-intensive businesses, such as construction. Also, Hmong businesses had fewer years in operation. The survey revealed that, on average, Hmong businesses were in operation less than four years, as compared to more than 11 years for the White businesses. She noted that the paper's comparison of Hmong- and (more established, predominantly) White-owned businesses if anything should have biased the results toward finding more disparity in credit access. That no systematic disparity was found in the Hmong use of credit confirms (the paper's assertion of) the Hmong's success in accessing credit at start-up.

The Hmong in the survey were younger and somewhat more educated than the surveyed Whites, and proficient in English. Toussaint-Comeau added that results from national census surveys, as well as results from a local corresponding Hmong household survey that was also conducted in Minneapolis/St. Paul, do not show similarly high levels of educational attainment and English proficiency for the Hmong as a population overall. For example, the corresponding Hmong household survey showed that close to 30 percent of the Hmong had not attended school anywhere. Toussaint-Comeau explained that this finding underscores the fact that the group of Hmong entrepreneurs in Minneapolis/St. Paul may in fact be a very special group of immigrants. In terms of access to credit, the English language skills of the Hmong, she noted, may have made it easier to bridge cultural barriers to formal business credit relationships. Also, the high educational attainment of the Hmong entrepreneurs could have sent positive signals to the credit market as to the potential performance of their firms.

The paper looked to the sources of financing and discussed the initial financial capital structure of the businesses. As expected, the majority of business owners made use of their personal savings. However, the Hmong were more likely to use personal savings and used a higher proportion of their savings. The paper also found that the use of informal, external sources of financing, such as loans and gifts from relatives and friends, were fairly common among both Hmong and White businesses; 46 percent of owners in both groups used informal sources. The focus of the paper was the use of formal bank loans. The authors find that about a quarter of the businesses obtained a formal bank loan. The paper considers the empirical relationship between bank funding and ethnicity, controlling for industry type, human capital, and demographic characteristics, and did not find a significant statistical difference between Hmong and White businesses. Also, both Hmong and Whites had similar self-reported perceptions of reasons for credit denial. In other words, the Hmong were not any more likely than Whites to report perceived discrimination as the reason for having been denied credit.

From a community development perspective, based on the focus group discussion, the authors learned that a proactive approach by banks to serve the Hmong community may also have played a crucial role. For example, feedback from focus groups underscored the importance of banking practices that exhibited cultural sensitivity. All the banks that participated in the focus groups and had a presence in the Hmong community employed a Hmong lending officer. The issue of underwriting flexibility was unanimously viewed as being very important to facilitating a lending process that helped serve the Hmong market. For example, banks modified their traditional underwriting

criteria when calculating loan-to-income ratios by considering the income of the entire family, since many of the Hmong businesses are family-owned and managed. The banks also provided counseling to promote understanding of the lending process.

Overall, understanding how other ethnic groups are assimilating financially is an important subject for future research. The authors caution that their study is time and place specific. For example, they don't know the experience of firms that did not survive. Similarly, the authors outline additional questions regarding the experiences of businesses after the start-up phase for consideration in future studies. However, as Toussaint-Comeau stated, the goal of the research was to develop a better understanding of immigrant small businesses. This research provided insights about some of the factors that may help immigrant ethnic businesses access the credit market.

In *Human Capital and the Development of Financial Institutions: Evidence from Thailand*, Anna Paulson of the Federal Reserve Bank of Chicago discusses some of the

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**So what does this mean for sustainable community development? "In the context of Thailand," Paulson explained, "this means that it is education of everybody that is fundamental. We couldn't make these banks or the financial system more efficient by just educating a few people to run the bank. Here, the village as a whole needs to be educated."**

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challenges and opportunities that confront community development initiatives in developing countries. Paulson's paper focuses on how human capital impacts the development of financial institutions.

Education and financial development have both been identified as key engines of economic growth and progress; however, very little is known about how they interact with one another.

Paulson has attempted to shed light on this interaction and asserts that principles identified and lessons learned from abroad can have utility and application to community development in the United States.

The paper seeks to answer two questions. First, how does education influence locally run financial institutions in a developing country? And second, what are the implications of the findings for sustainable community development? Paulson addresses these questions by looking at how policies of 161 village banks in Thailand are shaped

by the education of the local villagers and the people who run the banks.

Data for the paper was obtained from a survey conducted in Thailand in May 1997, a few months before the Thai financial crisis of July 1997. Data was gathered from 2,880 households in 192 villages. The villages were evenly divided between the poorest part of Thailand in the northeast and the more developed central region, providing the opportunity to explore the impact of village banks in more versus less developed areas. Data was also gathered from all the financial institutions operating in the village. There were 161 financial institutions, and interviews were conducted with the management committee of all of them. Paulson pointed out that these are not always "bricks and mortar" banks, but are organizations centered on people. "They don't necessarily have a physical presence," explained Paulson. "Instead, the people running the bank get together on a monthly basis to conduct business, such as gathering savings deposits, making loans, and sometimes investing in other activities." These are grass-roots indigenous organizations run by and for the villagers. Most are not promoted by a particular aid or other non-government organization. They are developed by and for the villagers.

Household characteristics indicate that villages with a bank tend to have slightly more educated residents than those without a bank. However, median annual income in the villages without a bank is higher (\$2,153) than villages with a bank (\$1,784), and similarly median household wealth is higher in villages without a bank (\$23,585) than villages with a bank (\$19,154). As these are agricultural villages, most wealth is held as land. While it may seem counterintuitive that villages with banks would have lower incomes and wealth than villages without them, village banks are community development tools and would logically be established in relatively poor villages. Characteristics of village banks indicated that 42 percent offered savings accounts and 73 percent make loans. The person who manages the bank tends to be more educated than the typical villager and is usually male (65 percent of bank managers).

The village banks tend to have peculiar policies that make them somewhat inflexible and formulaic. For example, in many banks, all loans originated throughout the year must be repaid on December 31, and the same amount of interest must be repaid – regardless of when the loan was made. For instance, a loan of 1,000 baht (or about \$40) that is made on January 1 will require a repayment of 1,200 baht, as will a loan of 1,000 baht that was made on July 1. Clearly, the person who borrows on July 1 pays a higher interest rate. Additionally, village banks and other financial institutions often have very simple contracts that seem to rule out some transactions on an ad hoc basis. In one

Thai village bank, for example, all loans must be in multiples of 1,000 baht. Likewise, savings transactions often have similarly stringent features, requiring savings amounts, for example, to be a multiple of 100 baht. Further, about 57 percent of banks require their members to save and 33 percent dictate a minimum monthly savings level. Another 45 percent allow for some flexibility in savings levels, however, the savings amount must be evenly divisible by 50. Seventy-seven percent of banks require a single lump-sum repayment of both principal and interest, eschewing any borrower installment payments.

Despite rigid policies, these village banks are associated with some very good outcomes. Other researchers using the same data have found that participation in a village bank increases asset accumulation, reduces credit constraints in agriculture, and reduces the villagers' reliance on money lenders as a source of credit (village banks are a lower cost alternative to money lenders).<sup>2</sup> However, these rigidities still limit the effectiveness of village banks, particularly given the agricultural environment in which they exist. Incomes fluctuate with the vicissitudes of the weather – if the rains come, there is a bountiful rice harvest and lots of money; however, lack of rain will dry up the crops and the income. Accordingly, a mandated monthly savings rate as a condition to bank participation presents a potential challenge to those with a fluctuating income.

The study indicates that the rigid policies are largely unaffected by the education level of the money manager. Therefore, these findings argue against technical assistance and training targeted to money managers as a way to increase the efficiency of village banks. The study indicates that policies are less rigid when villagers have very low or very high levels of education, and policies are more rigid at intermediate levels of education. It is important to realize that these village banks are self-governed and self-policed. The village money manager is in a position of great trust, having access to the accumulated savings of the village, in an environment lacking any governmental oversight, regulation, or insurance. Herein lies a great challenge to the villagers – how do they police the money manager? Paulson argues that the villagers' answer to this challenge is what underlies the rigid policies. In essence, it is much easier for them to determine if the deposit records are accurate when there are only 25 savers and they each must save 100 baht. These unbending policies are the pragmatic response of less educated villagers to the necessity of policing a better educated money manager, in an environment devoid of government oversight.

Another alternative would be to offer governmental legal and regulatory oversight, but for such small banks operating in disbursed villages throughout the country, the infrastructure would be very expensive and impractical. There

are some analogies to issues surrounding predatory lending in the United States. Due to deposit insurance and regulatory oversight, there is no concern that U.S. banks will take deposits; however, with predatory lending, legal and regulatory oversight are sometimes unclear. "It's hard to define predatory lending and difficult to find the culprits," explained Paulson referring to predatory lenders, "so the lesson from this study is that financial education for everyone may be the way to control predatory lending practices."

The final point is that sustainable community development, whether in Thailand or the United States, depends on a careful match of program design with the available educational, organizational, and legal infrastructure. In this case, the Thai village banks offer a nice example of organizations that may look strange at the beginning, but these small banks have confronted their difficult environment and constructed policies to deal with the realities of limited education and limited legal infrastructure.

In her work-in-progress, *Policies Promoting Micro-enterprises: What Works? What Does Not Work? And Why?*, Cecilia Giusti outlines successes and difficulties of some of the programs currently available to promote microenterprises in the Texas/Mexico border region. The paper concentrates on isolated unincorporated areas called colonias in the Laredo area, and will be one of the products of an ongoing research/outreach colonias program developed by the Center for Housing and Urban Development from Texas A&M University. The paper will present the programs designed for disadvantaged minorities and women-owned microbusinesses, and attempt to identify what is and isn't working, and why. Giusti also expects to provide suggestions regarding best practices.

Marty Levine of Shorebank Advisory Services was the discussant. Levine sought out common themes from the papers presented in this session to draw broader inferences about increasing community investment in the United States. Levine stated that he was struck by the degree to which he did find common themes among the papers. He then drew a parallel between the diverse international communities and the domestic themes he hears from practitioners in different local communities, asserting that domestic communities present a distinct, but not so different, set of cultural diversities. The papers illustrate a convergence between research findings and the everyday experience of community investment practitioners.

Levine commented on these common themes. First, he stated that among the challenges in reaching underserved communities is convincing the people that they can take advantage of banking services. Levine was struck in particular by the statistic that 23 percent of all the Hmong small business owners in Minneapolis/St. Paul hadn't even tried to apply for a loan or addressed the issue of a banking

relationship because they expected to be turned down.<sup>3</sup> Levine observed that clearly “[T]here is still an enormous amount of self-selection out of the process.”

Another common theme was the lack, among people who do not have prior banking relationships, of knowledge and understanding needed to foment a successful banking relationship. Levine cited Giusti’s paper on colonias, which noted that many potential entrepreneurs didn’t understand that a business plan was a basic part of beginning a lending relationship.

A third general theme was that lenders’ policies do matter, meaning there are ways to reach out to underserved communities and bring unbanked people into banking relationships. For instance, the successful outreach into the Hmong community stood in stark contrast to the very limited outreach in the colonias, a portrait of a community that had not yet found its way or, alternatively, to which few financial institutions had found their way.

Levine observed in the Thailand example that it seemed as though the banks had moved to potential clients – but in reality, the banks grew from within communities. However, despite being local members of the community, the banks’ managers were operating under a set of practices that, in some cases, discouraged potential customers.

Levine closed with his thoughts on how lenders might develop practices to promote sustainable community development. First a community lending program must be designed with a mandate of profitability. “Any institution that enters a business expecting to lose money will

no doubt succeed [in losing money],” cautioned Levine, “so there needs to be an expectation of profitability and a commitment to stick with that goal, just as would be expected upon entering any other sort of business.” Second, management should be realistic about front-end investments that are necessary to reach under-served communities and at the same time diligent in managing those exceptional costs. A third principle is the critical nature of tailoring a product to the borrower. The small business loan terms needed to serve the colonias might not work in the Hmong community (and certainly would not in Thailand). Likewise, small business lending looks much different from other community lending, and vastly different from micro-lending – where the delivery system, the underwriting, and the monitoring need careful planning.

With outreach is the need for borrower education. Whether it is information about available products, underwriting standards, product suitability, or simply how to become qualified over time, Levine sees education as the key to success. Levine cited the benefits that the movement toward borrower education has brought the housing industry over the past decade and the positive impact that it has had on homeownership in the United States.

Levine’s final point was that getting senior management of financial institutions on board is critical. Entry into a new market is a significant undertaking and must be both consistent with the institution’s overall business strategy and supported by management.

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## Notes

1 These surveys were conducted during the mid-1990s under the direction of Richard Taub, Marta Tienda, and Robert Townsend through the Center for the Study of Urban Inequality, University of Chicago, and were cosponsored by the Federal Reserve Bank of Chicago (Bond and Townsend, 1996; and Huck et al. 1999). See [www.chicagofed.org/cedric/community\\_surveys\\_and\\_data/index.cfm](http://www.chicagofed.org/cedric/community_surveys_and_data/index.cfm) for more information.

2 Joseph P. Kaboski and Robert M. Townsend, 2000, “An Evaluation of Village-level Microfinance Institutions,” University of Chicago, mimeo.

3 Maude Toussaint-Comeau and Robin Newberger, 2003, “Credit Availability in the Minneapolis-St. Paul Hmong Community,” paper presented at *Seeds of Growth, Sustainable Community Development: What Works, What Doesn’t, and Why*, Federal Reserve Bank of Chicago conference, p. 17.

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## Conclusion

This year's research conference made significant inroads into measuring the effectiveness of community development programs, strategies and tools. Authors **Hirad, Zorn, Elliehausen, Lundquist, and Staten** presented results indicating that financial education and counseling has a favorable impact on consumer financial behaviors. Their work shows that after appropriate, targeted counseling, consumers tend to save more, default less and reevaluate their investment goals.

Research into housing issues showed that control of litter, abandoned buildings, and other symptoms of blight positively affects rates of homeownership in communities. Programs such as foreclosure intervention serve to promote neighborhood stability. Housing development similarly improves communities. However, it was noted that community-based organizations cannot meet demand at this time.

On community development partnerships, the paper by **Tranel and Gasen** concludes that partnerships can succeed given well-defined and balanced roles for each partner. Presence of a dominant partner (e.g., as recipient of funds) can undermine the partnership. The research of **Bright** identified an opportunity to redevelop publicly owned but dilapidated buildings obtained through tax foreclosures and other means in partnership with private enterprise.

Some conference papers examined public policy's role in neighborhood development. CDFIs, Enterprise Zones and other government interventions have facilitated community development in low- and moderate-income communities directly and with some ancillary benefits. Questions arise concerning scale, cost and capital needs for sustainability. The design and orientation of government programs may also steer funds away from intended (type) projects or to projects that do not require subsidy.

Research examining the various ways that CRA and CRA agreements impact communities suggested that lending to

underserved communities increases as a result of CRA and CRA agreements. Moreover, technical assistance and credit counseling were found to be key components in making CRA agreements more effective.

In the international and ethnic areas, research revealed that cultural affinity, underwriting flexibility and counseling favorably impacted lending in ethnic communities.

**Toussaint-Comeau and Newberger** explored these ideas in their paper examining Hmong entrepreneurs in St. Paul, Minnesota, and their efforts to finance their businesses. Another important characteristic of effective community development lending, whether in the U.S. or abroad, is program design that takes into account the educational, organizational and legal infrastructure of the country or region where the lending is taking place.

**Paulson** examined community development banks in Thailand, where, at least in remote rural areas, a carefully adapted banking system pervades. The virtual lack of a (bank) regulatory infrastructure in these areas, and no resources to create one, has given rise to a simple, but rigid system of saving and financing. It is a system that all parties understand, however, and as such is sustainable and amenable to oversight by the village as a whole.

The research showed the potential for carefully constructed strategies and tools to increase credit and services to low- and moderate-income populations. While there is no universal model, and some techniques are more labor intensive than others, these findings set the stage for others to build on. Further, carefully orchestrated research, built upon these and similar findings measuring effectiveness of community development programs and strategies, will inform policy makers, lenders, and community development practitioners to help put available resources to their most efficient use.

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### Conference summary written by:

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**Steven W. Kuehl** is the consumer regulations director for the Consumer and Community Affairs division of the Federal Reserve Bank of Chicago. Mr. Kuehl served as a senior examiner with the Federal Reserve Bank of Chicago, and later managed a technical advisory service program targeted to banks in the Seventh Federal Reserve District. Prior to joining the Fed, he was an examiner for the Office of Thrift Supervision. Mr. Kuehl earned a B.S. in Finance and Economics from Carroll College, and a Juris Doctor degree from Chicago Kent College of Law.

4th Quarter 2003

## Calendar of Events



### Wall Street Without Walls

Atlanta, GA  
October 8, 2003

The Federal Reserve Bank of Atlanta, in partnership with Wall Street Without Walls (WSWW), will host a free training session on how community-based development organizations can access capital markets. Financial experts from Wall Street and the institutional marketplace will provide insight, technical expertise, and specific tools to access a broader base of investors.

*For information, contact Jennifer Grier, Federal Reserve Bank of Atlanta, (404) 498-7374, or visit [www.wallstreetwithoutwalls.com/](http://www.wallstreetwithoutwalls.com/).*

### Governor's Housing Conference

Louisville, KY  
October 9-10, 2003

The Kentucky Housing Corp.'s annual conference will feature speakers, Thomas M. Menino, mayor of Boston; Bob Edwards, host of Morning Edition on National Public Radio; and Liz Murray, author and subject of the film *Homeless to Harvard*.

*For information, visit [www.kyhousing.org](http://www.kyhousing.org), or call (502) 564-7630.*

### Brownfields 2003: Growing A Greener America

Portland, OR  
October 27-29, 2003

Brownfields 2003 builds upon past successes and continues to offer up-to-date and stimulating information for brownfields practitioners from throughout the United States and overseas. Every stakeholder involved with brownfields redevelopment—bankers, planners, developers, government officials and community representatives, to name a few—should plan to attend this conference.

*Conference registration is FREE. For information, visit [www.brownfields2003.org](http://www.brownfields2003.org).*

### EDFS Annual Loan Fund "How To" Training Conference

New Orleans, LA  
October 27-28, 2003

The Economic Development Finance Service is the only national organization for small business development loan fund professionals and policy makers with a rural perspective. The "How To" Training Conference will cover a wide range of issues useful for both new and experienced loan fund professionals.

*For information, contact Bill Amt at (202) 624-8467, or at [bamt@nado.org](mailto:bamt@nado.org), or at [www.nado.org/edfs](http://www.nado.org/edfs).*

### An Informed Discussion of the Financial Access for Immigrants

Hilton Milwaukee City Center  
October 30, 2003

A panel of experts will address issues and opportunities surrounding the financial access of immigrants. Topics include: serving the financial needs of immigrant populations, the USA Patriot Act impact on immigrant issues, legal services to immigrants, documentation issues surrounding the IRS, the matricula card, and financial access as a tool to stem poverty and welfare dependence.

*For registration and information visit [www.chicagofed.org/newsandevents/conferences/index.cfm](http://www.chicagofed.org/newsandevents/conferences/index.cfm), or call (312) 322-2832.*

### Big Ideas for Small Business

Cincinnati, OH  
November 7, 2003

A conference for small business owners and entrepreneurs designed to spark new thinking about opportunities for success in a changing economy. Sponsored by the Federal Reserve Bank of Cleveland with additional sponsors TBA.

*For information, contact Jeff Gatica at (513) 455-4281, or at [jgatica@clev.frb.org](mailto:jgatica@clev.frb.org).*

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