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# Community Development Finance

**Plus:**

**The 2009–2010 Assets & Opportunity Scorecard**

**The Housing Policy Revolution**

**Dr. CRA**

# CI Notebook
by Laura Choi, Editor

For the past thirty years, low- and moderate-income communities have been able to draw upon credit and capital made available through a vast network of community development finance organizations. This network includes a broad range of different types of organizations and investors, such as community development finance institutions (CDFIs), banks, venture funds, and socially motivated investors, all dedicated to providing much needed financing for community development efforts. Despite the industry's sound investment practices and strong performance record, it has not been spared from the painful effects of the economic recession. These organizations are faced with troubled portfolios and dwindling capital resources, at the very same time that low- and moderate-income communities are most in need of their services.

In this issue of *Community Investments*, we explore some of the challenges, as well as the opportunities, that lie ahead for the field of community development finance. The articles cover a wide range of issues, including practical strategies community development finance organizations can employ to cope with the current economic environment, ideas for strengthening the Low Income Housing Tax Credit (LIHTC), as well as information on the unique financial structure of nonprofits and its implications for nonprofit sustainability. We'll also take a look at how small businesses are faring in these difficult times and examine a promising new model for community development capital that utilizes individual investors. In our "Eye on Community Development" section, you'll learn about the *2009–2010 Assets and Opportunity Scorecard* and read an excerpt from the new book *The Housing Policy Revolution: Networks and Neighborhoods*. In addition, our quarterly features, which include Dr. CRA, Research Briefs, and Data Snapshot, keep you up to date on the latest community development issues.

There's no doubt that 2009 was a difficult year for community development finance, but I'm confident that the industry will emerge with new solutions as it draws upon the talent, innovation, and passion of those who work in the field. We hope you enjoy this issue of *Community Investments* and as always, we welcome your comments and feedback.

Laura Choi


Community Development Department
Federal Reserve Bank of San Francisco
101 Market Street, Mail Stop 215
San Francisco, CA 94105
www.frbsf.org
(415) 974-2765 / fax: (415)393-1920



**Joy Hoffmann**
Group Vice President
Public Information and
Community Development
joy.k.hoffmann@sf.frb.org

**Scott Turner**
Vice President, Community Development
scott.turner@sf.frb.org

**Brent Minnich**
Administrative Analyst
brent.minnich@sf.frb.org

RESEARCH STAFF

**David Erickson**
Manager, Center for Community
Development Investments
david.erickson@sf.frb.org

**Ian Galloway**
Investment Associate
ian.galloway@sf.frb.org

**Carolina Reid**
Manager, Research Group
carolina.reid@sf.frb.org

**Naomi Cytron**
Senior Research Associate
naomi.cytron@sf.frb.org

**Laura Choi**
Research Associate
laura.choi@sf.frb.org

FIELD STAFF

**John Olson**
District Manager
john.olson@sf.frb.org

**Jan Bontrager**
Regional Manager
Arizona, Nevada, Utah
jan.bontrager@sf.frb.org

**Melody Winter Nava**
Regional Manager
Southern California
melody.nava@sf.frb.org

**Craig Nolte**
Regional Manager
Alaska, Hawaii, Idaho, Oregon, Washington
craig.nolte@sf.frb.org

**Lena Robinson**
Regional Manager
Northern California
lena.robinson@sf.frb.org

**Darryl Rutherford**
Regional Manager
San Joaquin Valley
darryl.rutherford@sf.frb.org



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# Strength in Adversity:
## *Community Capital Faces Up to the Economic Crisis*

By Nancy Andrews[1], Low Income Investment Fund

*Photo Credit: Silke Knebel*

### First Responders—America's Community Development Organizations

This paper reviews the impact of the economic crisis on the community development industry. Specifically, it asks, how are Community Development Financial Institutions (CDFIs) faring? What trends are emerging? What steps are CDFIs taking to respond to the crisis? In addition, the paper offers "best practices" to help all CDFIs manage this difficult climate. To answer these questions and to learn from our CDFI peers, we conducted a series of eleven interviews with leading CDFIs across the country.[2] A number of common themes emerged, from heightened portfolio risk and decreased liquidity, to the need to develop new skills such as how to implement an effective loan workout.

CDFIs can survive this economic crisis and deepen their mission, despite the extraordinary difficulty of the current period. CDFIs are the first responders in neighborhoods across the country and for families hardest hit by the downturn. CDFIs have created an industry joined together by a common mission of providing opportunities for people and places left out of the economic mainstream. The CDFI network can create the strength for CFDIs to help one another through these times, and to ensure not only that the field survives, but that it thrives.

### Avoiding Denial—What Is the Impact of the Economic Crisis on Community Finance?

#### *Heightened Risk*

In general, all CDFIs reported heightened risk in their portfolios and particularly in housing loans, whether they were national, regional, local, large, small, rural or urban. The severity of risk varied considerably by portfolio concentration and by size. Those with high concentrations of housing, particularly homeownership projects, reported far greater risk. Eight of the ten CDFIs with sizable housing portfolios saw homeownership projects as a primary source of increased risk. In particular, respondents reported that unsubsidized homeownership loans were experiencing the greatest weakness.

Heightened risk was evident in increased delinquency rates, or an increase in loan extensions, or increases in loan loss reserves, and occasionally in all three. Two respondents reported no loss reserve increases. The others reported some increase in reserves, generally by 25 percent to 50 percent. One CDFI with a large exposure to homeownership reported a tenfold increase in its annual provision for loan loss reserves.

The second most frequent cause of growing risk was dependency on fundraising or public subsidy (reported by five of eleven CDFIs). One CDFI reported a full stop on new loans that depended on fundraising.

Smaller CDFIs reported less portfolio deterioration than larger CDFIs. Respondents saw short-term acquisition and predevelopment loans as more risky than long-term loans for projects already in service and seasoned, especially community facilities. Portfolios with greater concentrations in Low Income Housing Tax Credit (LIHTC) projects experienced greater risk. One CDFI avoided portfolio deterioration

Photo Credit: Charlotte Fiorito

because of the absence of LIHTC-dependent projects in its portfolio. Projects in weaker markets, such as those in rural or exurban areas, were affected more than in strong markets.

Geographically, western CDFIs saw more trouble than others. Several national and regional CDFIs reported a concentration of problems in California. They reported enduring slow payment on loans and deep financial stresses on community developers. The strains in California CDFI portfolios extended beyond housing and homeownership to health care facilities, charter schools, and other community facilities. One CEO feared that the affordable housing delivery system would be permanently weakened because many community developers would not survive the current economy. One national CDFI reported the weakness in its portfolio was concentrated in Los Angeles, Florida, and in rural locations.

Although community facility portfolios seem to be holding steady at present, many leaders said they were waiting for "the other shoe to drop," and foresaw trouble in this sector in the near future, as well as in their commercial portfolios. One respondent predicted the commercial and facility loans "will be the second wave."

### *Need for Patience*

Most CDFIs (nine of eleven respondents) called for greater patience as borrowers scrambled to put resources together to make deals work. "Everything is taking longer," one respondent said. "Borrowers are going multiple rounds to get financing and subsidy, at the state and city level." Some leaders reported that their delinquencies were stable because they simply extended loans, believing that the borrower would eventually work out the problems. One CDFI reported extending 80 percent of its housing loans (up from 50 percent in more normal times). Another reported that they had always experienced many extensions, but "now it is for bad reasons." In part because of this growing need for patience as projects came together, all but a few CDFIs were anxious about investor renewals and serious liquidity issues that affected their ability to finance new requests.

### *Serious Liquidity Problems*

Liquidity shortages were felt broadly, but large CDFIs were particularly affected. Six of eight large or rural CDFIs reported current and often severe liquidity problems, or concern about future liquidity problems. Smaller CDFIs fared better as well as those located in the Midwest. All but one CDFI expressed concern about a contracting capital environment, even if they were managing well at present. Respondents also noted the need for extensions, the lack of new capital coming into the field, and concern about capital renewals. Indeed, one CDFI leader said, "If

banks don't start lending again at reasonable rates, a lot of us will go out of business." Another said that their capital partners were "really hunkered down. They've begun to understand that this is a structural adjustment and they need to figure out the new normal."

*Nearly all CDFIs reported difficulty in getting new capital and sometimes renewed capital.*

Many of the CDFIs that experienced strong growth in deployment during the past two to three years were more likely tapped out of capital than those with growth in the past year. On the other hand, CDFIs that had not expanded their lending volumes appeared to be faring better than others with respect to liquidity. In the case of faster-growing CDFIs, recent high-volume levels had consumed much of their available capital and the need to extend loans was causing a capital crunch. Nearly all CDFIs reported difficulty in getting new capital and sometimes renewed capital. Most reported "just making it," by saying no to borrower requests. Some indicated that the liquidity problems were being offset by reduced demand. Others reported that demand had increased in recent months, largely from the contraction of lending by banks.

CDFIs reported mixed experiences with investor renewal of capital. In general, they were "holding steady" with capital levels, but new capital was virtually impossible to find. One CDFI reported negotiating with a bank for more than two years and being on the cusp of a capital commitment, only to find the bank taken over by another, and the verbal commitment nullified.

### *Housing Loans Are Hardest Hit*

As noted above, most CDFI leaders reported that increased risk came mainly from the housing portion of their portfolios, particularly from for-sale housing. "Homeownership," said one respondent, "is clearly most severely impacted. It is head and shoulders above the others in weakness. If ten deals are in trouble, seven will be in for sale/homeownership. However, our community facilities are fine."

Community facilities (charter schools, child care centers, health care centers, water and sewer systems, and other community centers) seemed to be performing well, particularly if the financing was long-term and for a facility already in service. That said, a few saw future trouble in their community facilities portfolios, assuming hard times spill over into the next year. CDFIs with loans in California reported more concern about community facilities projects than others.

Three CDFIs continued to experience strong customer demand, particularly when the CDFI was involved in financing community facilities or commercial lending. As one respondent said, "There is a ton of demand right now. Our phones are ringing off the hooks." Her organization, she said, was "moving upstream" and taking on deals previously done by banks. Most leaders, however, and particularly those concentrated in housing, had seen demand slow dramatically during the past few months largely because of the uncertainty of public support, the collapse of the LIHTC market, and state or local budget issues that made new projects too dicey to undertake. The reasons given for slower volume included: housing developers remaining on the sidelines, waiting for property values to bottom out; housing developers are financially weaker, because they are paying the carrying costs of unfinished projects over longer periods of time as total project financing is assembled; lack of capital supply is forcing demand to contract; lack of public subsidy to fund new projects; homeowners remaining on the sidelines because of uncertainty over their employment future, despite the low cost of housing.

## How Are CDFIs Responding?

In general, CDFIs are responding to the need for patience by extending loans (nine of eleven respondents) where an extension did not cover up a credit problem. All CDFIs but one reported notable increases in extended loans. The result is a liquidity crunch that often forces CDFIs to dial down positive responses to new requests.

CDFIs are managing heightened risk through a combination of extra vigilance toward late payments, bulking up loss reserves (nine of eleven respondents) and, in a few cases, performing stress tests on portfolios and corporate budgets. Many CDFIs are scrutinizing deals more closely, along with asset valuations, and occasionally, reappraisals of portfolio collateral. Most reported higher scrutiny of transactions at the front end, in light of the risk environment.

The most common risk management strategy is paying greater attention to late payments. CDFIs are making calls to customers within a few days of the due date, and are escalating if payments are not received. The second and third most widely used approach to mitigating risk is paying extra attention to borrowers' financial condition and scrubbing of asset valuation. CDFIs are also performing stress tests on borrower projections, looking at levels of borrower liquidity to determine size of loans, as well as imposing tighter terms and conditions.

*The community development financial sector's biggest asset is its commitment to a shared vision and an industry structure that does not require competition for vitality.*

## Yes We Can! (Manage Through This)

The community development financial sector's biggest asset is its commitment to a shared vision and an industry structure that does not require competition for vitality. The economic crisis calls on this asset more than ever. The field will need the strength and insights of everyone to pull through this extraordinary time. Several leaders noted that if the crisis goes on for more than a year, it would create serious hardship for the industry. One CDFI leader said, "Philanthropy needs to hear that 2010 is a watershed year for CDFIs and other nonprofits dependent on multi-year grants. 2011 is not survivable without continuing support. We may watch the silent demise of nonprofits."

Many CDFI leaders called for new ways of communicating and sharing, for creating united fronts endorsing common positions on critical issues, especially capital requirements. To get through this crisis, the field will need to pull together more closely than in the past. The watchwords for the next several years will be: learn, share, and help.

## Steps to Weather the Storm

Navigating the worst economy in a century will require that members focus on ensuring that the field is as secure as possible and able to continue to attain its goals and sustain its mission. This requires a number of proactive steps:

### *Batten Down the Hatches*

During any crisis, it is important to identify one's soft underbelly and protect it, rather than waiting for problems to arise. Although some CDFIs are reporting no dramatic increases in delinquency rates, they are anticipating problems and are rescoring their portfolios, increasing their risk reserves, and scrutinizing new requests. These are perfect initial steps.

Now is the time, as well, to begin stress-testing at the organizational level. How much of a revenue decrease can the organization withstand? What would happen if grant support declined by half? What happens if ten percent of the organization's portfolio is nonperforming? The goal is to identify in broad strokes the magnitude of potential problems and to develop responses for the back pocket if bad news is forthcoming. In the end, the actual steps an organization takes may be quite different. But there is nothing quite as reassuring to a leader as thinking through how bad it might get, identifying the soft spots, and developing contingency plans.

### *Workouts and Foreclosures*

For many CDFIs, loan workouts are a rare event. Although projects often hit bumps in the road, the ability to be patient and responsive to borrower requests has often been the main ingredient for a successful workout. However, conditions have changed markedly in the past twelve months. Good workout and restructuring are specialized skills. In the best circumstances, they can be a tool to enhance borrower strength and capacity. Few CDFIs, however, can afford to bring on special asset managers. Yet all CDFI lending staff can learn the special skills of a workout situation. One of the hardest things to balance is when to exercise speedy and decisive action over simple patience. A second difficulty is how to communicate in a manner that helps the customer understand why the workout is the best course, particularly if wishful thinking is at play about the project's future chances.

In any event, it is worth considering whether an industry wide response is warranted. This could take the form of a shared approach to workouts and restructurings, or training for lending staff. At the highest level, an industry response might also include a "bad bank" where CDFIs could create liquidity from their underperforming assets while transferring them to specialized expertise to help customers get through these difficult economic times.

### *Our Borrowers, Ourselves*

Policy matters. CDFIs are frequently lagging indicators of the overall economic environment. Although borrowers are on the frontlines, the field can be shielded from immediate impact by borrowers' coping strategies: they use their own cash to feed projects or fundraising shortfalls, they lower operating expenses to cover debt service payments, and so forth. However, if the economic downturn is both deep and protracted, these coping strategies will be temporary. Ultimately, the health of CDFIs depends on the financial health of its customers.

Many CDFIs are witnessing the deteriorating conditions of community developers and human service organizations. The withdrawal of public safety net services and the contraction of philanthropic support pose a special challenge to the CDFI agenda. Raising a strong voice to advocate for the community development agenda is more important now than ever before, and the message must be about the resources that not only benefit CDFIs, but also their customers. LIHTC, Section 8, and Community Development Block Grants are examples of programs central to the community development agenda, but less

central to the CDFI advocacy agenda. More than anything else, supporting the advocacy agenda of community development will protect borrowers and the CDFI field in the coming years.

### Never Waste a Crisis

Use the basics to grow stronger. It is worth repeating the basics of sound fiscal and organizational management. There is nothing complicated or fancy about these principles. They are rooted in everyday common sense. Ironically, several of the high-flying financial institutions that crashed in the current bust violated these fundamentals.

To keep it simple, there are three financial management principles that matter most: net worth, liquidity, and net operating income margins. Of the three, net worth or equity is most important. There are only two ways to create net worth: through annual surpluses or attracting equity and capital grants, for example from the Financial Assistance program from the CDFI Fund or the Capital Magnet Fund. Sufficient liquidity requires CDFIs to manage cash to cover at least one year of upcoming liabilities (although management textbooks say the ratio should be 2:1, for CDFIs, 1:1 is a must). Keep 90 days of operating expenses in cash as well. In terms of net operating income, always budget a surplus. A four to eight percent net operating margin has proven to be a good range. This is the cushion that allows budget estimation mistakes and revenue reversals to be absorbed without eroding net worth.

### Other Best Practices

Other best practices include full-cost accounting, ongoing forecasts of annual and multiyear performance, and scenario planning. These are techniques that support financial security.

Full-cost accounting: Full-cost accounting aligns the expenses attributable to an activity or program with the revenue the program generates. It requires properly allocating management and general costs (overhead). Full-cost accounting is the basis for understanding which activities cover their costs, which create surpluses, and which require discretionary resources. This allows management to make rational and deliberate decisions about which activities to expand and which to shrink.

Scenario planning: Create high-, medium-, and low-risk scenarios for each annual planning cycle. This can seem like make-work, but it is crucial. If nothing else, scenario planning forces thought about the assumptions beneath annual plans, and programs are stronger for it. Moreover, the financial aspect of scenario planning can reveal weaknesses and assumptions that alert management to issues they must tackle. Using worst-case scenarios in the present climate forces us past our natural denial and disbelief. In the end, worst-case planning can spark new ways of looking at an organization and point to creative solutions to existing problems.

Ongoing projections of fiscal performance: A discipline often overlooked is preparing year-end projections with each financial statement. Similarly, multiyear scenarios (three to five years) should be refreshed annually as part of the planning cycle.

### The Network Solution: Sharing Our Way through This

CDFIs form a national network dedicated to a common vision of community development and poverty alleviation. On a daily basis, however, the field operates separately, with little sharing of services, operations, or expertise across organizations. This isolation causes a "hall

Photo Credit: Ethan Pines

of mirrors," where each CDFI creates independently the systems and expertise needed to run its business. Each enterprise is largely on its own in addressing problems and challenges. The result is increased overhead and inefficiency. The field's survival and future health depends on greater efficiency and cost savings. In these most difficult of times, the field needs everyone's ideas and cooperation.

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CDFI leaders identified five pressing needs for the future:

***(1) Equity support.*** The top priority for CDFI leaders was the need for additional equity and protective capital during the down cycle. This could take the form of equity grants, loan loss reserve grants, possibly even equity equivalent loans. Many equity bases are stretched by credit deterioration at precisely the moment CDFIs need to be patient with customers. Additional equity would mitigate this and permit more mission-driven behavior rather than "hunkering down." As one organization said, "there's no sense of being a CDFI if we can't push mission in a down time."

***(2) Liquidity relief.*** A near tie for first place was the need for additional liquidity. Although the need is for additional liquidity, many also made the point that the price must be reasonable so that CDFIs could earn spread income. The strategy for this may well be joint advocacy for additional resources for the CDFI Fund, for renewed capital commitments from banking partners and foundations, or increased capital commitments through the current regulatory reform discussions. There was interest in innovative new legislation, such as the Opportunity Finance Network sponsored "CDFI bond" program. Likewise, several leaders reflected the concern that foundations with program related investments (PRIs) and banks with loans to CDFIs were not responding flexibly with capital renewals or extension in the face of extraordinary financial circumstances. They pointed to a need to join together to influence investors.

***(3) Workout/troubled asset relief.*** Several organizations asked for a centralized workout service that they could call upon in dealing with the troubled loans in their portfolios. This could take the form of a "bad bank" to purchase troubled loans and recapitalize CDFIs. A second approach would be to provide expertise that CDFIs could call upon for help with their most troubled loans.

***(4) A forum for self-help.*** Every organization interviewed called for additional opportunities to learn from one another. Some were hopeful things will improve soon; others felt there was more darkness to come. Nevertheless, all organizations called for increased communication and sharing of best practices, resources, and information. A few called for new models of shared services to improve operating efficiency. One leader asked for "volunteers from banks who are workout/trouble asset specialists." Another asked for help in developing sophisticated liquidity models and processes. Most called for stronger advocacy within policy circles.

***(5) Policies for new resources.*** Central to CDFI-specific policy work are the CDFI Fund appropriations debate, funding the Capital Magnet Fund – included with an $80 million allocation in President Obama's budget—and funding of the New Markets Tax Credit program.

In addition, the importance of the upcoming Community Reinvestment Act debate cannot be overstated. CDFIs need to be a strong voice in this debate, advocating for increased resources for communities. In fact, the Opportunity Finance Network is developing ideas for building CDFIs directly into the fabric of regulatory reform as a "must do" for financial institutions in meeting their community reinvestment obligations.

Because the future of development finance is intimately linked to its customers, many of the policy issues affecting those customers will provide ultimate support to CDFIs. These include the Low Income Housing Tax Credit market, Section 8 subsidies, National Affordable Housing Trust Fund subsidies, Community Development Block Grant programs, and a range of education, child care, and health care operating subsidies. Providing support to CDFIs without shoring up these underlying programs will be only a temporary solution. CDFIs could lend critical support to their customers when they advocate for increased federal and local support for these safety-net programs. CI

# Small Business Finance and Personal Assets

By John Moon, Federal Reserve Board of Governors

## Introduction

Small business owners have historically relied on personal assets as an important source of support for their enterprises — from the aspiring restaurant owner relying on personal savings to the toy distributor using a line of credit secured by her home. However, the recent bursting of the credit bubble has led to a plunge in values across most asset categories. Consider the following: according to the Case Schiller Index, national housing values have dropped 32% from their peak in 2006 to the first quarter of 2009; the Dow Jones Index has dropped 29% in value since its peak of 14,093 points the week of October 8, 2007. This loss of personal wealth has affected small business owners who rely on their assets to support their enterprises. At a time when many potentially viable businesses are in dire need of credit to keep their struggling businesses alive, owners have fewer personal assets to leverage. These problems are compounded for business owners facing home foreclosures. In this article, I will discuss how small business owners have historically relied on personal assets for credit and how current economic challenges may affect these borrowing patterns. In addition, I will discuss the possible implications for business owners and providers of credit.

## The Need for Healthy Small Businesses

Maintaining healthy small businesses is often cited as an important element to the economic recovery because of their considerable contributions to the overall economy. Small businesses employ more than half of private sector workers and have generated well over half of net new jobs annually over the past decade. They have created more than half of non-farm business gross domestic product. A vibrant small business development strategy is usually an integral part of larger community development strategies within low- and moderate-income (LMI) communities because of the vital local jobs these firms create and the essential products and services they provide to their local communities. Recognizing their importance, the Administration recently reduced fees and increased guaranty levels of the Small Business Administration's (SBA) loan programs to increase access to credit and to encourage small business economic activity. These measures have recently begun to demonstrate improved credit flow to small businesses through the SBA programs. As of August 2009, the monthly SBA loan approval rate of $1.37 billion is now closer to the FY08 monthly average of $1.5 billion.[1]

## Credit Supply and Demand Both Impacted

In spite of this progress, the supply of credit still remains restricted. According to the July 2009 Federal Reserve Board's Senior Loan Officer Survey, banks have slightly tightened (35.2% of all banks) or maintained their previously tightened lending standards (61.1% of all banks).[2] A large percentage (60.4%) of small business owners report using some type of credit to finance their firms[3], and for those who are now seeking credit, they may need to make adjustments. One method for small business owners seeking credit in a more difficult lending environment is to provide credit enhancements namely in the form of personal commitments, which are personal guarantees or pledges of personal collateral such as stocks or real estate. This personal pledge provides lenders additional assurances against risk of loss in the event that the borrower is unable to repay his loan.

Generally, knowing how and when small business owners use personal assets is challenging due to the very limited small business data sources available. Although slightly dated, an informative research paper by Avery,

Bostic and Samolyk, "The Role of Personal Wealth in Small Business Finance,"[4] provides one of the most detailed studies on this topic using data from the Federal Reserve's National Survey of Small Business Finance (NSSBF) and the Survey of Consumer Finance (SCF). The study concludes, "The role of personal wealth in small business financing certainly appears to be significant" and "for firms that rely heavily on loan financing, the use of personal commitments appears to be very important, if not vital."[5] Indeed, loans having a personal guarantee comprise 40.9% of all loans and account for 55.5% of small business credit dollars.[6]

The type of firm also seems to influence the type of commitment it makes. Corporations (i.e. "C" or "S" corporations) are more likely than unincorporated firms to be associated with guarantees, while unincorporated firms (e.g. – sole proprietorships) are more likely to use personal collateral.[7] Generally speaking, sole proprietorships have an implicit personal guarantee due to the way they are organized, which may explain their greater use of personal collateral pledges. For unincorporated firms (e.g. sole proprietorships) the reduction in value of personal assets could have a more dampening effect on their ability to access credit. For very small businesses or micro-businesses in LMI areas, difficulty in accessing credit may be even more difficult as loans have been historically more difficult to obtain in economically distressed communities. In a forum sponsored by the Federal Reserve Bank of San Francisco and the Asian Pacific Islander Small Business Program, some bank lenders had reported reducing the amount of their extended lines of credit as a result of lowered appraisal values on personal homes that secured these small business loans. For other businesses that borrowed directly through a home equity line of credit, notably immigrant micro-businesses, a similar reduction in credit resulted as home values were reassessed.[8]

Further, the Avery, Bostic and Samolyk study finds strong evidence of the pledge of personal guarantees in the use of lines of credit: personal guarantee incidence is twice that of personal collateral among unincorporated firms (39.6% versus 17.9%) and four times that of collateral among corporations (65.5% versus 16.0%).[9] If lines of credit have become relatively more difficult to obtain because of reduced asset values, then an important cash flow management tool may be less accessible for the small business. Like credit cards for individuals, one way small business owners use their lines of credit is to manage the mismatch in timing of cash flow between revenues and expenses. Used this way, lines of credit augment a firm's working capital. However, when owners face credit restrictions on their lines of credit, they lose cash flow flexibility and would likely have to manage their expenses more tightly. Owners who then must manage cash more conservatively are more likely to pull back on their overall use of credit as business confidence wanes and concerns about being overextended on credit become greater. Indeed, the most recent Senior Loan Officer Opinion Survey cited lower business loan demand as one of the most important factors in the reduction of lending activity. Interestingly, lower small business loan demand has also paralleled the recent reduction in demand for consumer credit.

For those business owners who have pledged personal commitments and unfortunately succumb to economic pressures and fail, the loss can have an amplifying effect on their personal finances. For those owners who lack sufficient resources to satisfy their credit obligations, they may need to rely on personal resources to fulfill their credit obligations. In these cases, the owner would likely benefit from professional legal or accounting counsel to minimize the loss of personal assets. Many LMI business owners may have their personal finances co-mingled with their business finances, which makes the unwinding of the business more difficult, and possibly more painful. In more extreme cases, the fear of significant loss or uncertainty has led some of these borrowers to flee their creditors. While this is anecdotal, lenders and small business technical assistance providers have promoted the importance of contacting a delinquent borrower early to minimize losses on both sides of the credit transaction.

## Conclusion

Personal assets are often closely tied to the ability of small business owners to access credit, making them an important factor in the financing of small businesses. The relationship between personal assets and small business financing has presented particular challenges during this economic downturn. On one hand, the pledging of personal commitments can help banks mitigate against greater risk associated with the economic downturn. On the other hand, the drop in asset values as a result of the recession makes it more difficult for small business owners to pledge personal commitments. The net result may be that on the supply side, access to credit is further constrained for small businesses because of this dynamic. On the demand side, a small business owner will be reluctant to pledge his own assets or provide a personal guarantee if he has a pessimistic outlook for his business or the economy. Fundamentally and not surprisingly, to increase credit supply and demand, asset values and business prospects need to improve. Commendable efforts have been made by the Administration through the SBA enhancements to improve access to credit supply. Addressing the demand side for credit by businesses will be the larger challenge as there are fewer "government levers" to affect this part of the economy. CI

Photo Credit: Housing Development Center

*The Mews at Cascadia Village in Vancouver, WA, was financed through a combination of loans, grants, and equity from low-income housing tax credits.*

# Strengthening the Low Income Housing Tax Credit Investment Market

By Buzz Roberts[1], Local Initiatives Support Corporation

The Low Income Housing Tax Credit (LIHTC) has been the federal government's most successful program for producing quality rental housing for low-income families and individuals. It has created jobs, revitalized low-income communities, and expanded low-income families' and individuals' access to geographic areas that offer relatively good employment and educational opportunities. Affordable housing developers receive an allocation of housing tax credits through a competitive process, which they then sell to investors to raise equity for the project. Investors that purchase tax credits are able to reduce their federal tax liability dollar-for-dollar, so the purchase of $1,000 worth of tax credits reduces federal income tax liability by $1,000 (credits are typically sold at a discount, allowing investors to profit from the transaction). As a result of the equity made available through the sale of tax credits, the developer can complete the project with less debt and pass the cost savings on to the tenant in the form of lower rent.

By engaging private capital and imposing financial discipline, the LIHTC has produced over 2 million affordable rental homes[2] while incurring an annualized foreclosure rate of less than 0.1 percent.[3] Historically, the financial services sector has provided 80 to 90 percent of LIHTC investments, a result of its real estate financing expertise and regulatory mandates to address low-income needs. Fannie Mae and Freddie Mac have provided about 40 percent of LIHTC investments, and banks motivated by the Community Reinvestment Act (CRA) have also provided about 40 percent, led by the largest banks. Insurance companies and other investors have provided additional LIHTC investments.

The LIHTC program is now facing significant hurdles, however. Fannie Mae and Freddie Mac had stopped making new investments even before entering federal conservatorship last year. In addition, the substantial losses that many financial institutions have recently incurred have eliminated or reduced their ability to use tax

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credits. Since these credits are generally paid in equal amounts over a 10-year period, and the future tax liability of financial institutions has become more uncertain in the current environment, the risk that the investment will not be profitable because the tax credits cannot be claimed as scheduled is problematic for some financial institutions.

While some banks have kept investing, others have cut back substantially. In 2008, LIHTC-based investment dropped to about $4.5 billion, about one-half of the $9 billion invested in 2007. Many observers expect about the same level of investment or less in 2009. Moreover, current investors that cannot use tax credits are reportedly trying to sell their portfolios, and the mere prospect of such divestment is further destabilizing an already weak investment market.

The investors still in the market can take their pick of projects and command much higher rates of return. From a public policy perspective, however, that means each dollar of tax credit generates less capital for housing. Many high-priority deals are not getting done because they now have financing gaps, are perceived as too complicated or risky, are in locations that get less attention from CRA examiners, or involve potential bank investors that already have enough investments to meet their CRA needs. Although there is a shortage of LIHTC investment in most places, rural areas and smaller cities tend to be especially disadvantaged. As they retrench their portfolios into doing "safe" and "ordinary" deals, most investors are also shying away from complex projects that provide housing for the homeless or other special needs populations, as well as those that would preserve federally assisted housing or otherwise use federal rent subsidies.

The recently enacted American Recovery and Reinvestment Act provides temporary grant funds to jump-start stalled projects, but it does nothing to reactivate the investment market.

I propose three possible ways to attract private investment from both experienced and novice investors:

**1. *Congress could permit investors to "carry back" LIHTCs*** from existing projects for five years from 2009-2011 tax returns, provided the investors make new LIHTC investments of an equal amount. Under current law, an investor without enough tax liability in a given year to use the LIHTCs it has earned can "carry back" the credits one year by amending its tax return for the previous year. However, many current investors face more than one year without profits, so they need a longer carry-back period in order to claim the LIHTCs. This would stimulate new investments immediately and discourage the sale of current portfolios in a weak market. In addition, investors in new projects should generally be permitted to carry back LIHTCs for five years at any time during the 10-year term of the LIHTCs. This policy would address the tax risk for most LIHTC investors. Extending the carry-back to five years would require legislation.

**2. *Regulators could increase the flexibility of Community Reinvestment Act (CRA) policies concerning regional investments.*** Regional and local banks could greatly expand their LIHTC investments, but many of these banks need (and want) to invest with others through large regional or national funds. These large-scale investment funds offer safety, risk diversification, and efficiency, especially for relatively new and small-scale investors. However, current CRA policy guidance limits the recognition of investments made through regional and national multi-investor funds, thus undermining the effectiveness of the CRA to motivate such LIHTC investments. The CRA regulation itself does allow recognition for bank investments in a region that includes a bank's local "assessment area." However, supplemental inter-agency Q&A guidance (revised January 6, 2009) presents two obstacles.

First, Q&A §__.12(h)-6 limits credit for regional investments to banks that are already adequately addressing the community development needs of their major assessment areas. The CRA's desire to prioritize local needs is valid. However, a bank with numerous assessment areas may not be certain at the time it needs to make an investment decision that a subsequent examination will conclude that the bank has met this requirement. For example, after hurricanes Katrina and Rita in 2005, the banking regulators issued special policies encouraging banks nationwide to invest in rebuilding the Gulf Coast. One bank considered investing in the redevelopment of public housing in New Orleans. After checking with its regulator, however, the bank decided not to invest because it was told it had not invested enough in another market—even though the supply of LIHTC capital in that other market already far exceeded demand. As a result, LIHTCs in Louisiana are going unused, even though thousands of units are ready to begin construction. It should be possible to find another standard to encourage banks to meet local needs without discouraging regional investments.

Second, Q&A §__.12(h)-7 gives bank examiners discretion to grant less CRA credit for investments in large regions. However, many funds require regions as large as

a quadrant of the country to be workable and efficient. Many banks are reluctant to invest in such funds because they will not know how much CRA credit they will get until they are examined perhaps a year or more later. A very large bank can avoid these obstacles and target its LIHTC investments to the locations where it will get the most CRA credit by investing directly or by enlisting LIHTC syndicators to set up a fund in which it is the sole investor. Ironically, these approaches divert money from the broader multi-investor funds that regional and local banks prefer. Adding sufficient flexibility should not require a statutory or regulatory change; the four federal banking regulators could jointly modify the Q&A guidance on the CRA.

**3.** ***Fannie Mae and Freddie Mac could guarantee LIHTC investments made by others.*** Because the future status of Fannie Mae and Freddie Mac is uncertain, it may not be practical for them to make new LIHTC investments for their own portfolios. However, they could use their considerable expertise to help restore the LIHTC investment market by guaranteeing investments made by others, including both banks and other less experienced corporate investors. In past years, other financial companies have provided such guarantees but are no longer in a position to do so. Guaranteeing LIHTC investments would provide a source of profit to the GSEs and credit risk protection for investors. The GSEs might also attract new investors by dividing what is normally a 15- to 17-year investment into shorter segments. The Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac as their conservator, could encourage and support this guarantee approach.

The LIHTC has been the linchpin in numerous successful public-private partnerships for over 20 years. As a public policy instrument, it has also helped to rehabilitate the reputation of federal housing production policies and was the model for the New Markets Tax Credit program and other policy innovations.

Problems with home mortgages and commercial real estate have created a financial crisis and touched off a deep recession. LIHTC investments continue to perform well economically, but the financial crisis has curtailed new investments. A few new policies could go a long way to restoring the LIHTC investment market and the housing, economic vitality, and partnerships that depend on it.

## Additional Resources Provided for LIHTC Projects

The American Recovery and Reinvestment Act (ARRA), approved by Congress in February, 2009, provides two resources to states to help start LIHTC projects that stalled because equity investments became less available.

HUD is administering $2.25 billion through the Tax Credit Assistance Program (TCAP), which provides grant funding for capital investment in LIHTC projects to state housing credit allocation agencies. See Table 1 for 12th District state allocations. More information about the TCAP can be found at www.hud.gov/recovery.

Table 1
**12th Tax Credit Assistance Program Formula Grants**

| State Housing Finance Agency | TCAP Recovery Grant Amount |
| --- | --- |
| Alaska | $5,490,631 |
| Arizona | $32,308,066 |
| California | $325,877,114 |
| Hawaii | $9,861,610 |
| Idaho | $8,753,622 |
| Nevada | $15,184,795 |
| Oregon | $27,343,971 |
| Utah | $11,639,074 |
| Washington | $43,010,192 |

*Source: Department of Housing and Urban Development*

In addition, each state can convert into cash a portion of the LIHTC authority the Treasury Department allocates by formula. Each state can exchange up to 40 percent of its 2009 allocation and 100 percent of its unused 2008 allocation. States would use the HUD funds and cash received in exchange for LIHTC authority to fund housing development projects that meet LIHTC requirements. For further information, go to http://www.treas.gov/recovery/LIH-grants.shtml. CI

# Moving beyond Mission:
## *Effectively Funding the Nonprofit Organization*

By Carolina Reid

In his new book, *The Housing Policy Revolution: Networks and Neighborhoods,* David Erickson shows how the construction of affordable housing has moved away from the federal government towards a network of state and local governments, nonprofits and grassroots organizations, the private sector, labor unions, foundations, and churches. Each of the nodes of the network brings its own expertise and resources to the table. Banks, for example, provide loans and capital through their CRA-motivated loans and investments. Foundations often provide funding for research and development, backing pilots and demonstration projects that can help to illuminate what types of housing strategies best support lower-income households.

At the heart of this network, however, is the nonprofit organization. For the most part, it has been nonprofits in the form of grassroots community groups, community development corporations, community development finance organizations, and national intermediaries that have been the ones on the ground pouring the concrete and supporting lower-income tenants with a wide array of services. Indeed, the growth of the nonprofit sector in the United States in the last 40 years has been formidable, and today the nonprofit sector contributes more than $322 billion in wages, with a workforce that outnumbers the combined workforces of the utility, wholesale trade, and construction industries.[1] As Erickson and others have argued, with their small scale, flexibility and capacity to engage grass-roots energies, nonprofit organizations have not only been able to fill the social service gaps that were once the purview of the federal government, but to do so in a way that is more effective and efficient.[2]

Yet Erickson's book also points out two major challenges for this network: adequate funding on the one hand, and capacity on the other. These two challenges are deeply intertwined, and the current recession has placed both of them into stark relief. On the funding side, the recession and financial crisis has hit nonprofits particu-

Figure 1
**Number of Nonprofit Organizations in the United States, 1998 - 2008**

| Type of Organization | 1998 Number of Organizations | 1998 Percent of All Organizations | 2008 Number of Organizations | 2008 Percent of All Organizations | Percent Change |
|---|---|---|---|---|---|
| 501(c)(3) Public Charities | 596,160 | 51.5% | 974,337 | 63.4% | 63.4% |
| 501(c)(3) Private Foundations | 70,480 | 6.1% | 115,340 | 7.5% | 63.6% |
| Other 501(c) Nonprofits | 491,391 | 42.4% | 446,457 | 29.1% | -9.1% |
| All Nonprofit Organizations | 1,158,031 | 100.0% | 1,536,134 | 100.0% | 32.7% |

*Source: National Center for Charitable Statistics*

larly hard, even as demand for their services soars. Paul Light, a professor of public service at New York University, has predicted that "at a minimum" more than 100,000 nonprofit organizations could be wiped out in the next two years.[3] Indeed, even nonprofits with well diversified sources of funding are being squeezed from all sides: foundations are watching their endowments disappear and are limiting their grant making, states across the country are facing massive budget deficits, the demand for tax credits in the private sector has disappeared, and many individual donors are curtailing their giving as their own budgets tighten. In a survey conducted of 800 nonprofits at the end of 2008, 75 percent of nonprofits reported already feeling the effects of the downturn, with 52 percent already experiencing cuts in funding.[4] Few nonprofits are adequately prepared to face an economic downturn of this magnitude: only 54 percent of respondents have three months or less of operating reserves and 74 percent have less than six months of operating reserves.[5]

Equally troubling is the relationship between funding stability and capacity, especially at the local level. Julian Wolpert, an emeritus professor at Princeton University, has long studied nonprofits and has identified that there is a high degree of unevenness and gaps in service provision within the nonprofit field. In particular, nonprofits and the infrastructure, funding, and support networks that help them to function are much weaker in low-income neighborhoods, and in neighborhoods that are experiencing rapid demographic and social change. A recent report released by the Federal Reserve Bank of San Francisco pointed out this dynamic in Fresno, which has the second highest rate of concentrated poverty in the country. As one community advocate pointed out, "Nonprofits here can't compete with [San Francisco] Bay Area organizations on funding proposals—the writing is not as sophisticated, and the applications aren't as strong."[6] Nonprofits that are located in these areas also tend to be newer and smaller, and are therefore at a much greater risk of financial failure. So the regions with the least nonprofit capacity—and the highest need for services—are the ones that are the most likely to see nonprofits close under the strain of the recession.

## Building the Financial Resiliency of the Nonprofit Sector

So how do we address these twin challenges of nonprofit funding and capacity? There is a growing literature on nonprofit finance that shows that funders of all stripes—banks, foundations, government agencies, and individuals—need to recognize the unique financial structure of nonprofits, and that building the financial resiliency of the nonprofit sector requires grants that support not only the nonprofit's mission and programs, but also its capital structure.[7]

At a very fundamental level, nonprofits have a significantly different capital structure than for-profits, and many of the traditional finance rules do not apply. For example, in the for-profit world, the consumer is the one that pays for the good or service. In the nonprofit world, however, this is almost never the case—instead, a third party such as a foundation or government agency is often the one that pays for the service or product on behalf of the consumer.[8] This often leads to a disconnect between the nonprofit and its mission: the nonprofit needs to satisfy the demands of both the funder and the consumer, and often the funder's wishes comes first. This relationship creates a model of program delivery that runs contrary to a nonprofit's strength: their close connection to the communities they serve. While a funder may think they "know" the answer to a problem such as homelessness, it is often

*"Without the development of supporting infrastructure, replication and scale are not possible and promising demonstrations may be little more than isolated efforts."*

the clients themselves who have a better understanding of what they need to get back on their feet. Moreover, a funder's wishes may encourage mission creep, as the nonprofit applies for grants in new program areas just to sustain its existing operations.

Another factor that adds to the complexity of nonprofit finance is that the fee charged for the service or product rarely covers the cost. Efficiencies of scale and volume discounts that are the hallmark of companies such as Walmart do not apply in the nonprofit world. Gregory Ratliffe and Kirsten Moy provide a compelling parallel from the private sector: nonprofit finance is akin to a business that loses money on each widget it produces, and seeks to solve the problem by making more widgets. For nonprofits, which are effective precisely because of their high-touch products and services, a growth in clients is often accompanied by a growth in fixed costs.[9] Instead, nonprofits are more likely to be able to expand their capacity when they make conscious long-term investments in partnerships with other institutions, infrastructure (e.g. standardized procedures; protocols and methodologies; industry-wide databases), and technology. As Ratliffe and Moy note, "Without the development of supporting infrastructure, replication and scale are not possible and promising demonstrations may be little more than isolated efforts." Yet these investments require both capital and human resources, and are rarely the focus of funders who want to see how many clients were served for their dollars.

In fact, research suggests that the current trend that prompts nonprofits to be more business-like, demonstrate low overhead costs, and calculate the return on their investments may actually be undermining the effectiveness and sustainability of nonprofits. According to the Nonprofit Overhead Cost Study[10], many nonprofits are sacrificing organizational infrastructure needs in order to tell funders the ratio they want to hear. Government grants generally specify the percentage that will be allowed for overhead (usually somewhere between zero and eight percent), and nonprofits that submit bids with the lowest overhead costs are often rewarded with additional contracts. Although this trend is driven by a desire to increase efficiency and ensure that public dollars are wisely spent, it has led to a "race to the bottom," in which many nonprofits lack the

Fig. 2

**Registered Nonprofit Organizations in the 12th District Filing Forms 990 in the Past Two Years, 2008**

| State | Total # of Registered Nonprofits | Total Assets Reported by Active Filers | Avg. Assets Reported by Active Filers |
|---|---|---|---|
| Alaska | 5,090 | $7,573,774,042 | $1,845,708 |
| Arizona | 20,714 | $37,359,839,340 | $2,718,939 |
| California | 156,937 | $449,867,596,679 | $3,155,971 |
| Hawaii | 7,465 | $20,632,649,059 | $2,514,499 |
| Idaho | 7,510 | $9,978,482,231 | $1,579,516 |
| Nevada | 7,738 | $17,945,612,356 | $1,793,700 |
| Oregon | 21,944 | $59,004,038,437 | $3,932,841 |
| Utah | 8,712 | $13,850,883,503 | $2,469,212 |
| Washington | 35,092 | $155,303,236,685 | $3,375,894 |

*Source: National Center for Charitable Statistics*

infrastructure they need to be effective. Clara Miller, President of the Nonprofit Finance Fund, likens this trend to going to a restaurant and upon paying the bill, noting that you only want to pay for the talent of the chef who made the meal and not to the lighting, cooking supplies and silverware that are needed to keep the restaurant running.[11] This too may lead to perverse outcomes for the communities being served, since program delivery may shift to those interventions that are most responsive to the market test, as opposed to those most germane to the problems being addressed.

So what is the best way to support nonprofits and help build the capacity of the field? There is a growing consensus that there should be a greater emphasis on unrestricted grants, and that these should be the rule and not the exception.[12] Funders need to realize that they need to support the underlying 'business' that delivers the program, not just the program itself. In contrast, capacity-specific grants—such as a small grant for board development—are not effective without attention to the overall capital structure of the nonprofit. The Nonprofit Overhead Cost Project found that nonprofit weaknesses stem from systemic factors, such as the systematic under-funding of overhead, which can't be addressed "by providing grants to one organization for board development and to another for computer purchases."[13] In fact, the study found that restricted funding is an important contributor to the capacity problem, which questions the wisdom of establishing restricted "capacity-building funds" to solve problems exacerbated by that very practice. As the authors of the study argue, if the systemic underinvestment in nonprofit overhead and infrastructure were addressed, the capacity problem would also disappear. Having an adequate pool of unrestricted funds may in fact help a nonprofit better use restricted dollars, since the financial resiliency and support that comes with unrestricted dollars would translate into the ability to effectively use a pilot grant for a new program that expands the nonprofit's activities. As Jon Pratt, Executive Director of the Minnesota Council of Nonprofits, has argued, paying attention to a nonprofit's capital structure and making sure they have enough flexible funding allows nonprofits to "chart their own course and stay flexible, and have the time and freedom to ask the big questions and make long-term plans."[14]

Still, this shift away from program restricted funding is uncomfortable for most donors, especially for those who are passionate about the nonprofit's mission and want to make sure that their money is spent in a way that helps the most people. Unrestricted funding sounds as though a nonprofit could then spend it on whatever they want, be it service delivery or the staff holiday party. But "unrestricted" should not be viewed as synonymous with wastefulness or a lack of oversight. Funders can and should still be involved in program development and communicate with the staff about their plans for the funds, budget, and program strategy. Funders should continue to scrutinize the impact of their investments, but rather than focusing merely on whether or not the overhead ratio meets their expectations and the "outputs" of the number of clients served per dollar, the conversation should focus on whether or not the nonprofit has what it needs to be effective and whether the organization is effective at delivering better "outcomes" for the communities they serve. CI

# Peer-to-Peer Lending and Community Development Finance

By Ian Galloway[1]

## Introduction

Peer-to-peer (P2P) networks directly connect computer users online. Popular P2P platforms include eBay and Craigslist, for example, which have transformed the market for used consumer goods. Increasingly popular, however, are P2P lending sites that facilitate debt transactions by directly connecting borrowers and lenders on the Internet. In fact, since 2005, P2P lending sites have cropped up all over the world—Kiva, MicroPlace, Lending Club, and Prosper are a few examples. Currently a $647 million industry, online P2P lending is expected to grow to $5.8 billion by 2010.[2] P2P lending has the potential to channel significant capital to the community development industry by efficiently connecting investors to revitalization efforts in low- and moderate-income (LMI) communities. This article explores the potential challenges and benefits of P2P lending in community development finance and addresses some of the changes that need to take place in order to facilitate the growth of this emerging industry.

## The P2P Platform

P2P lending platforms differ dramatically in type and approach. Some connect borrowers and lenders directly; others connect them via a third-party intermediary. Some P2P sites allow lenders to set interest rates; others preset rates based on historical performance and credit score. Many have charitable missions; others are strictly for-profit. Socially-motivated sites tend to promote microenterprise development in developing countries.

For-profit sites tend to focus on domestic borrowers, offering unsecured consumer loans to individuals who either do not want to use mainstream debt products or do not have access to them. For the most part, internet-based P2P lending functions on the basis of trust, albeit trust between people that have only met in cyberspace. P2P lending sites match individual borrowers with individual lenders. Borrowers share information about themselves—both personal and financial—and lenders decide whether or not to contribute to their loan request. Every loan is underwritten by multiple individual lenders,

*P2P finance platforms are naturally well-equipped to support these projects because they function at the intersection of finance and social networking.*

each committing a fraction of the loan until it is funded in full. Once fully funded, the loan is originated and the lenders receive their pro rata share of the principal and interest payments until the loan reaches maturity or the borrower defaults.

It is important to note, however, that P2P "lending" is somewhat of a misnomer. In fact, no platform allows lenders to lend directly to borrowers. Platforms either: (1) broker loan reimbursements through interest-free investments; (2) broker the sale of securities backed by their issuers; or (3) facilitate the origination of loans which are sold as securities to P2P investors who behave like lenders (and who may not even realize the nuance). For clarity's sake, P2P "finance" will be used in this paper to describe all three platforms.

## Capital Markets Challenge: Community Development Assets

The issue of how best to connect community lenders with the capital markets has been a difficult one. Much of the focus thus far has been on securitization. Securitization allows lenders to pool assets of a similar type and sell pieces of the pool to investors. This spreads credit risk across multiple loans and reduces each investor's exposure to discrete defaults. The difficulty with securitization with respect to community development, is that it relies heavily on the homogeneity of the underlying pooled assets. Unlike commonly traded assets such as mortgage-backed securities (MBS), community development loans tend to be unconventional and difficult to pool. The capital markets value standardized, predictable assets and community development loans tend to be neither.[3] The result is unfortunate on two levels: investors undervalue and community development assets and conventional lenders shy away from community development loans because investor demand is depressed. This self-perpetuating liquidity logjam has a severely negative effect on community development activity.

Limited access to the capital markets leads many community lenders, those institutions that finance community development projects, to depend heavily on borrowed funds. Unfortunately, this increases their exposure to down-cycle economic risk. When the economy weakens, bank lending dries up, foundation giving contracts, and community lenders have nowhere to turn for new capital—a scenario that is all too familiar in the current economic environment. This poses a particular challenge to community lenders trying to service struggling LMI borrowers because when workouts, principal reductions, and patience are most needed, these lenders are financially hamstrung to provide them.[4]

## A Potential Solution: P2P Finance Platforms

P2P finance platforms are well suited to both originate and broker the sale of community development loans for a number of reasons. For one, they depend heavily upon transparency. For another, a P2P market for third-party issued loans, should the SEC permit it,[5] would offer community lenders a much-needed source of additional capital. And finally, whether they broker the sale of securities or originate loans on-site, P2P finance platforms would allow investors to evaluate community development loans on a loan-by-loan basis at relatively low cost.

P2P finance platforms could also provide individuals a means, other than charity, to invest in their own neighborhoods or causes that they care about (e.g., Gulf Coast recovery). Instead of waiting for large institutional investors to lead the neighborhood redevelopment charge, individual investors could provide much needed seed financing for a number of community development projects—new community facilities, affordable housing, school rehabilitation, street beautification, playground construction, etc. P2P finance platforms are naturally well-equipped to support these projects because they function at the intersection of finance and social networking.

Institutional investors may find P2P finance platforms useful as well. For example, CRA-regulated institutions invest heavily in community development assets. Because these assets can be difficult to identify, some banks invest in mutual funds composed of loans located in their LMI geographies. While participating in these funds can be less labor-intensive than ad hoc investing, banks pay a premium to farm their underwriting out to a third party. P2P finance platforms could offer a more cost-effective alternative.

## Issues to Consider

### *Loan Size and Terms*

The average P2P loan size is small—$8,626 on Lending Club, $6,172 on Prosper, and even smaller on the microfinance platforms Kiva and MicroPlace. Community development loans, in contrast, tend to be much larger— loans originated by the Low Income Investment Fund, a large national CDFI, average $935,023, for example.[6] The prospect of cobbling together enough individual investors to

fund loans of this magnitude is worrying. As a result, some community development loans seem better suited for P2P finance platforms than others. Predevelopment loans, microloans, small business loans, and working capital loans seem to hold more promise than large affordable housing loans (which constitute the bulk of community lending). Another option is to use P2P finance platforms to raise money for smaller projects that complement larger community developments. A playground on a new charter school site; a computer lab in an employment resource center; a mural on a park wall—P2P investors could augment large projects with targeted, yet appropriately modest, funding commitments.

Loan terms are also a concern. Most P2P finance platforms offer a single product: a three-year fixed, amortizing loan. Designed to simplify the transaction for the lender and borrower, these terms do not mirror those typically offered by community lenders. Community development loans often have longer maturities, variable rates, and balloon payment terms. P2P finance platforms would have to offer a more diverse set of products to meet the unique needs of community development borrowers.

### *Underwriting and Servicing Challenges*

Underwriting community development loans takes special expertise. As discussed earlier, funding community projects is challenging and complying with public program rules can be complex. Lenders need to understand all projects risks, including compliance risk, and the recourses available to them should the project fail. Individual investors may be ill-equipped to evaluate these risks and understand the complexities of community development lending.

Servicing is also a significant concern. It is important to preserve the "high touch" relationship that distinguishes community lending from conventional lending. Community development borrowers require active servicing. While charge-offs and defaults are rare, forbearance and late payments are not. Any P2P finance platform used for community development must retain community-minded servicers to ensure that borrowers have sufficient flexibility to manage their debt payments.

### *Sufficient Lender/Investor Demand*

Small institutions with limited capacity likely have the most to gain from an online community development loan market. Small CRA-motivated banks, foundations, pension funds, and individuals could all benefit from the low search and information costs that P2P platforms provide.

A searchable P2P finance platform would allow CRA-motivated banks to identify investments that meet their CRA requirements. For example, banks could limit their

searches to loans originated by certified community development lenders, such as CDFIs. Banks could easily identify particular types of loans as well: small business, rural development, community facility, etc. This would be particularly powerful if coupled with a tool to search for investments in LMI neighborhoods. A well designed search engine would allow CRA-motivated banks to quickly sort investments by qualified LMI census tract within their regulatory assessment areas. While not all social investments would be CRA-eligible, such a system would allow banks to target investments that meet basic community development and geographic criteria.

Foundations and, in particular, small foundations, could benefit from a community development P2P finance platform as well. Small foundations are often held to strict operating expense limits intended to maximize corpus impact. Potentially, a P2P finance platform could enable small foundations with limited capacity to identify investment opportunities that otherwise may be too costly to search out. Many foundations also have specific social goals: find a cure for cancer, support early childhood education, help the environment, etc. Foundations could use such a platform to find investments that align with their mission. At a minimum, foundations could look to P2P finance platforms for program-related investments (PRIs). PRIs are usually below-market rate investments made by foundations that, unlike grants, involve the potential return of capital within a specific time frame. PRIs count against foundations' annual disbursement requirements (five percent of total endowment) and can be below-market investments.

Pension funds could use P2P finance platforms to find economically targeted investments (ETIs). Pension funds tend to be patient investors. Large pension funds like CalPRS and CalSTRS (the two California public sector pension funds covering state employees and teachers, respectively) have capitalized on this by investing in underdeveloped neighborhoods decades before they are rehabilitated. In some cases, this approach has yielded strong financial returns and positive social outcomes. While it is likely that CalPRS and CalSTRS do not need an online marketplace to identify ETIs, small municipal pension funds may benefit. P2P finance platforms could offer a cost-effective way for smaller funds to identify and fund ETIs that would otherwise be difficult and costly to find.

There may also be significant individual demand for community development investments. International microfinance platforms like Kiva and MicroPlace have demonstrated success in connecting socially motivated individuals with wealth-building projects around the globe. If their success is any indication, asset-backed community development securities may be very popular among individual investors. As discussed earlier, this would provide community lenders an additional funding source beyond CRA-motivated bank borrowing, grants, and subsidized private placement debt offerings.

*Potentially, a P2P finance platform could enable small foundations with limited capacity to identify investment opportunities that otherwise may be too costly to search out.*

### Potential for Fraud

P2P finance platforms rely heavily on borrower- and security issuer-created content. Unfortunately, these disclosures, while revealing useful information, also create an opportunity for fraud. For the most part, P2P finance platforms have no ability to confirm nonfinancial information provided on their sites. This is arguably the biggest weakness of P2P finance—it often places a heavy burden on investors with little formal investment experience to root out fraudulent borrowers and evaluate social and financial criteria accurately.

## Changes P2P Finance Platforms Should Make Going Forward

### Develop a Fractional P2P Market for Third-party Issued Loans

With respect to community development finance, a P2P market for loans issued by third-party lenders would be a significant improvement over existing platforms, which only broker the sale of loans originated on site or securities backed by their issuers. For one, "high touch" intermediation is critical to successful community lending, necessitating the presence of a skilled community lender. For another, contingent upon SEC approval, such a market could offer community lenders a direct route to the capital markets which, heretofore, has proven elusive. Prosper's Chris Larsen, for example, "looks forward to extending the Prosper marketplace to community development organizations and other financial institutions as soon as we complete the securities regulatory process."[7]

Preferably, a P2P market for third-party issued loans would allow for fractional investing as well. In fact, fractional investing—the ability to purchase a piece of a security and not a whole loan—is essential to the P2P finance innovation. As discussed earlier, community development loans are often quite large and the P2P finance market for large community development securities would be small relative to that for fractional investments. Fractional investing is also the key to successful diversification. P2P

finance platforms are an alternative to the conventional diversification strategy—securitization, pooling, and tranching—but only insofar as they allow investors to purchase small pieces of multiple loans. A P2P market for third-party issued loans that does not allow fractional investing will substantially reduce diversification opportunities.

### *Advocate for Regulatory Reform*

The primary obstacle slowing the development of a fractional P2P market for third-party issued loans appears to be regulatory, not technological. This is largely because P2P finance platforms are prohibited from direct lending activities and instead are forced to broker the sale of securities representing shares of consumer loans (triggering state and SEC regulation). P2P finance platforms interested in community development lending would benefit from a regulatory regime better suited to their core function: the facilitation of credit, not securities brokerage.

### *Create a Standalone Community Development Asset Class*

While community development assets are used by some investors to protect against down-cycle economic risk, most community development investing is done for socially motivated reasons. Distinguishing community development assets from other investment types—debt consolidation, auto financing, etc.—is therefore very important. The easiest way for P2P finance platforms to effectively broker the sale of community development securities is to create a standalone community development asset class. This would give investors a clear way to target investments that meet their social criteria. P2P markets for third-party issued loans, if developed, should also carefully vet community lenders to protect against fraud. The most efficient way to vet community lenders is to use a proxy test, such as CDFI certification (granted by the U.S. Treasury). Such a measure would offer a reasonable guarantee to investors that the security being sold by the lender constitutes a legitimate community development product.

### *Offer a Wider Range of Products*

Today, most P2P finance platforms offer a single product: a three-year, fixed, unsecured, amortizing loan capped at $25,000. To be attractive to the community development finance industry, however, they will have to allow for larger, collateralized loans with longer maturities and balloon payment options. Standard P2P finance terms may be sufficient for small working capital loans and other, more modest credit products, but they are not consistent with the bulk of community development finance activity.

*Community development is as much about place as it is about people; P2P finance platforms should provide the tools necessary to invest in both.*

### *Adopt a Social-Impact Ratings System*

Many P2P finance platforms have already developed their own credit ratings to complement borrowers' credit scores. These ratings systems are designed to internalize important borrower information not normally captured by the credit bureaus. Similarly, a social-impact rating system would be a useful way to capture and convey important mission-oriented information to socially motivated investors. In fact, several social impact ratings systems already exist. For example, the CDFI Assessment and Ratings System (CARS), developed by the Opportunity Finance Network evaluates the "impact performance and financial strength and performance" of CDFIs.[8] A ratings system, such as CARS, should be presented alongside financial metrics on P2P finance platforms that broker the sale of community development securities issued by community lenders.

### *Provide a Geographic Search Tool*

Geography is an important consideration for many mission-driven investors. Banks, for example, are motivated by the CRA to invest in LMI neighborhoods. The ability to narrow investment opportunities to those located in LMI census tracts would help attract banks and other CRA-regulated institutions to P2P investing. Other investors, both institutional and individual, could benefit from this tool as well. Investors with a localized focus, such as small family foundations and small municipal pension funds, may want to use P2P finance platforms to target investments in very specific geographies—a task made considerably easier by geocoding the investments. Individual investors may also be motivated to invest in specific geographies, be it their own communities or those communities that have piqued their interest, such as the Rust Belt or California's Central Valley. Community development is as much about place as it is about people; P2P finance platforms should provide the tools necessary to invest in both.

## Changes Community Lenders Should Make Going Forward

### *Issue Smaller Loans with Shorter Maturities*

Community development lenders tend to favor real estate projects over microfinance or small business bor-

rowers. This is largely due to the relatively high transaction costs associated with the latter. Nevertheless, if community lenders want to use P2P finance technology effectively, they need to offer products that meet the needs of P2P investors. This typically means smaller loans with shorter maturities.

### *Originate-to-Distribute*

Most community lenders earn the bulk of their revenue on interest-rate spreads. Very few lenders can generate sufficient loan volume to rely heavily on fee-based income. A P2P market for third-party issued loans would allow community lenders to sell their loans to P2P investors and quickly recoup the borrowed funds. This added liquidity creates an opportunity for community lenders to move away from their typical originate-and-hold model and toward an originate-to-distribute model, which would generate fee-based income. Of course, this need not be an either-or shift. To the contrary, community lenders would be wise to retain a diversified approach, generating a mix of spread-based and fee-based income; P2P finance platforms would simply be a new means of garnering the latter.

### *Compile Loan-specific Social-impact Information*

In general, most investors are reticent to take a below-market financial return without a corresponding "mission return." That investor expectation will only grow in a P2P finance context. There is a good reason that existing P2P finance platforms advertise the social aspect of P2P lending: many investors are nearly as interested in social impact as they are in financial return. It is likely, therefore, that P2P community development investing opportunities will amplify this interest in mission. Should a P2P market for third-party issued loans emerge for community development securities, community lenders will be expected to provide detailed social-impact information on their loans. This high level of loan-specific information will be costly for lenders to compile and communicate effectively. Community lenders interested in selling their loans via P2P should consider this cost before pursuing it as a liquidity option.

### *Partner with Other Community Development Finance Organizations*

Many different types of community development finance organizations work in concert to deliver capital to LMI communities. Several have already been mentioned, including banks, community lenders, credit unions, foundations, pension funds, insurance companies, and wealthy individuals. The use of P2P technology for community development presents new opportunities for collaboration. For example, community lenders may find that P2P investors are unwilling to pay what they perceive to be fair-market value for their community development securities. Instead of selling their loans at a discount—or not at all—community lenders could partner with other community development finance organizations to create a credit enhancement for securities sold via P2P. Specifically, they could form a first loss reserve pool backed by subordinate equity-equivalent investments (EQ2s) or program-related investments (PRIs) as a way to engage investors with differing appetites for risk and impact. This is only one example of potential collaboration; many other partnership opportunities may develop as the technology matures and community lenders grow more comfortable with the technology.

## Conclusion

P2P finance is representative of a growing interest in active, social investing. While online platforms may never replace conventional lending institutions, such as banks, it is important that the community development finance industry be aware of this emerging technology. Moreover, P2P finance platforms will continue to evolve—allowing for third-party issued loan sales, for example—which may fundamentally alter the way credit is allocated in the future. In either case, the potential community development finance implications are too significant to ignore. CI

# The Housing Policy Revolution

By David Erickson

*The following is an excerpt from the Introduction of David Erickson's new book,* The Housing Policy Revolution: Networks and Neighborhoods*, which is available through the Urban Institute Press at www.urban.org/uipress*

## Revolutionary Change in Housing Policy, 1964–2006

In the public imagination, the idea of government-subsidized housing conjures up thoughts of a hopelessly inefficient Department of Housing and Urban Development (HUD) or high-rise "projects" where crime and drugs are rampant. That impression, however, bears little resemblance to subsidized housing today. As a practical matter, HUD has been out of the housing construction business since 1978. While it plays a big role in providing Section 8 housing vouchers, it does not build much housing other than small projects for senior citizens and people living in rural areas.[1] Few people, however, are aware of HUD's current role, even those who care deeply about low-income communities. In a recent op-ed article in the *New York Times* (July 2008), for example, Columbia Professor Sudhir Venkatesh criticized HUD as an ineffective tool for alleviating poverty and advocated its elimination.[2] The reality is that for more than 20 years HUD has taken a back seat to the new network of players now driving affordable housing policy; the network includes HUD but also local advocacy organizations, nonprofits, and for-profit corporations, as well as local, state, and federal government agencies and others. This network builds well-designed, high-quality homes.

## A Flexible, Decentralized, and Well-Integrated System

The recent history of government-subsidized housing should bring to mind architecturally significant apartment buildings that add value to their neighborhoods. These new government-subsidized programs have helped empower thousands of local communities through new institutions such as community development corporations (CDCs) and have helped revitalize many places that seemed hopeless a generation ago. Buzz Roberts, senior vice president for policy and program development for

the Local Initiatives Support Corporation, describes the current state of affordable housing production:

> Over the past 20 years, a cluster of federal policies has supported a flexible, decentralized, and well-integrated production system. The system is distinctively market driven, locally controlled, and performance based. It builds sustainable partnerships among nonprofit and for-profit developers, private lenders and investors, as well as among all levels of government. (Roberts 2008, 36)

While the current approach to housing policy in America is producing better homes for low-income individuals and families than ever before, it is doing more than that: it is in the vanguard of how government delivers social services. This new approach to building housing demonstrates that multiple, disparate groups can form problem-solving networks and deliver high-quality housing and services. This change has contributed significantly to the much-acclaimed "comeback" of the American city. The influence of this model, first developed in the delivery of affordable housing, is even greater, however, because it is now providing an inspiration for policy areas as diverse as economic development, education, health, and the environment.

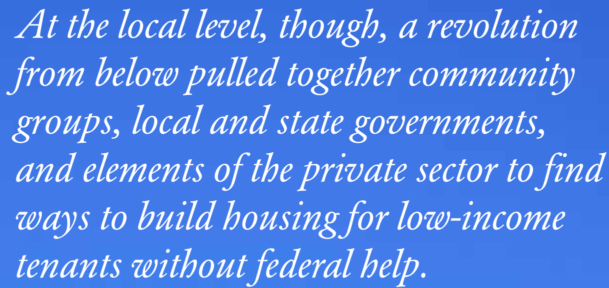
At first glance, this volume might appear to be another book on how public policy today often involves contracting outside of government and relying on public-private partnerships. That approach first captured widespread attention with David Osborne and Ted Gaebler's *Reinventing Government* (1992) and much of the so-called third-way literature that was inspired by the Bill Clinton–era policy changes. This literature also includes more recent works such as Stephen Goldsmith and William Eggers's *Governing by Network* (2004). But what these other books do not do is follow closely the formation of these partnerships—how they operate, cooperate, and execute over time. Brief treatments of public-private partnerships do not capture the complexities of these new policy-implementing structures.

The *Housing Policy Revolution* chronicles, through a historical analysis of political debates and detailed case studies, how a network approach to policy implementation developed in the 1970s, 1980s, and 1990s. It provides an in-depth history of who was involved, how they worked together, and what they built.

## Evolution of Federal Housing Programs

In 1996, the *New York Times Magazine* ran an article that described affordable housing as a political issue that had "evaporated" (DeParle 1996, 52). The *Washington Post* reported that HUD was seen as a "scandal-ridden, regulatory rat's nest."[3] HUD survived calls for its dismantling, but only barely. HUD, which had once spearheaded all production of low-income housing, saw its production programs whither. HUD produced 248,000 housing units in 1977, but by 1996 that number had dropped to 18,000 and has remained low since. Housing scholar and advocate Peter Dreier concluded in 1997 that recent history was a period of political retreat for low-income housing programs: "The political constituency for housing policy is weaker and more fragmented now than it has been in decades." Dreier (1997, 273) lamented the loss of the old housing coalition that pushed access to housing as "part of the broad social contract." Other studies on recent housing policy, including Mara Sidney's *Unfair Housing: How National Policy Shapes Community Action* (2003), were severely critical of the federal government's abdication of responsibility for providing housing for low-income Americans. These critiques were published against the backdrop of significant need for affordable housing. The U.S. Census Bureau's "American Communities Survey" indicates that in 2006, 46 percent of all renters were paying more than 30 percent of their gross income on housing—a level generally considered a severe burden.[4]

The decline of federally built affordable housing closely follows the commonly accepted story about the U.S. welfare state generally—that it developed between the 1930s and the late 1960s and then suffered a series of setbacks during the 1970s, which triggered a political backlash. According to this interpretation, conservative politicians from Richard Nixon to Ronald Reagan successfully harnessed white middle-class anger over government programs to roll back the welfare state. At first glance, the fate of federal programs that subsidize apartments for low-income tenants confirms this narrative: the federal government created housing programs during the New Deal, added to them significantly during the 1960s, and in the 1980s cut them back in the wake of bad press, conservative attacks, and policy mistakes of the late 1960s and 1970s.The problem with this story is that you might have trouble hearing it over the din of construction of the more than 2 million federally subsidized apartments for low-income tenants built between 1986 and 2006 (NCSHA 2008). These units were built by for-profit and nonprofit housing developers and funded largely with tax credits and federal block grants.[5] The number of subsidized apartments met only a fraction of the need, but by 2008 there were nearly 33 percent more homes built under new government low-income housing finance programs (after 1986) than there were subsidized apartments built by all the HUD-sponsored programs dating back to the 1960s.[6] In fact, the number of homes built by the post-1986 programs compares favorably with all the existing subsidized apartments built since the beginning of federal programs in 1937 (2.0 million versus 2.7 million).[7]



*At the local level, though, a revolution from below pulled together community groups, local and state governments, and elements of the private sector to find ways to build housing for low-income tenants without federal help.*

## The Rise of a Stealth Housing Program

Despite the lofty rhetoric of housing programs like the Housing Act of 1949, which promised every American family a "decent home and a suitable living environment," the federal government never built many low-income apartments.[8] In fact, in some years, it destroyed more units than it built. Before the creation of the Department of Housing and Urban Development in 1965, the peak annual production of affordable housing through the public housing program was 71,000 units in 1954 (Orlebeke 2000). During the Great Society, the production numbers skyrocketed for a four-year period to nearly half a million units annually. This pace was short-lived, however.

In 1973, Richard Nixon imposed a moratorium on new construction, in part because there were many complaints that bad design and shoddy workmanship created instant slums. HUD had one more burst of building during the Carter administration, but since then the number of units it builds has remained low.

As HUD building programs fizzled, funding for low-income housing was on the rise. While a new housing finance program, the 1986 Low Income Housing Tax Credit (LIHTC) program, churned out fewer units than the peak HUD production years, it did so at a rate that was higher than the historic average and consistent for over 20 years. By 2005, the program was funding more than 130,000 apartments annually (NCSHA 2008). To say that the federal government has been out of the affordable housing business since the Reagan administration is simply wrong.

During the 1980s two simultaneous policy revolutions took place (or perhaps a revolution and a counterrevolution). Reagan dramatically eliminated funding for low-income housing and cut back the role of the federal government in housing. At the local level, though, a revolution from below pulled together community groups, local and state governments, and elements of the private sector to find ways to build housing for low-income tenants without federal help. In 1988, housing advocate Paul Grogan testified before Congress that:

> The brute force of the federal cutbacks in housing in the last seven or eight years, while doing undeniable harm to many, have produced an unprecedented response in the housing arena at the state and local levels and have activated a staggering array of new involvements on the part of state and local government, the nonprofit sector, the private sector, labor unions, churches, and the list goes on. (U.S. Congress 1988b, 332)

The local effort started small but demonstrated how a decentralized housing network might work. The 1980s were a period of tremendous institution building, although it took place at the local level and often went unnoticed.

In time, the network grew in sophistication, became politically active, and lobbied successfully for more federal resources. The most important new funding programs were the Community Development Block Grant (1974), the Low Income Housing Tax Credit (1986), and HOME funds from the National Affordable Housing Act in 1990.[9]

The housing built through these programs was of higher quality than earlier low-income housing and was politically popular (a significant improvement over the old policies), but these programs did not solve the housing problem. The new network lacked the resources to build what was necessary for most of America's lowest-income families. The units built since 1986 were not for tenants who were as poor as those in projects built during the Great Society but instead targeted to the working poor (tenants who earned less than 50 or 60 percent of the median income in their area).[10] Even so, the new programs managed to serve tenants who were poorer than the statutes required. A 1997 Government Accountability Office (GAO) report that surveyed projects built with funding from the 1986 LIHTC program—the largest of the new programs for subsidizing low-income housing—found that three-quarters of the households earned less than 50 percent of the median income in their area (U.S. GAO 1997).

## What Happened to the Welfare State

While the evolution of the decentralized housing network is important in its own right, it also sheds light on a larger story about recent public policy history, especially the history of the welfare state.[11] Historical scholarship on the welfare state maintains that this institution shrank in the face of deft attack and weak defense (Edsall and Edsall 1991; Katznelson 1989).[12] But what has happened to the welfare state since the 1970s and 1980s is more complicated. In subsidized housing programs, both liberals and conservatives were frustrated with the programs of the Great Society, and while they disagreed on emphasis, both looked to change the delivery of social services.

Some aspects of the welfare state have been weakened since the 1970s, but others innovated and grew. At the same time that the *Washington Post* was reporting that "HUD is about as popular as smallpox," billions of federal dollars began to flow into new subsidized housing programs.[13] Liberals like House Ways and Means Committee Chairman Charles Rangel joined with conservatives to increase block grants and tax expenditures for affordable housing at the same time they were cutting HUD's budget authority. Even more interesting, increased funding to subsidized housing through programs such as tax credits were enormously popular. These political debates lacked the sharp edge of prior eras and appeared to demonstrate a "willingness to walk away from ideology," in the words of Jack Kemp, George H. W. Bush's HUD Secretary (U.S. Congress 1989, 6).

*To illuminate the revolutionary change in housing policy from the 1960s to the present, this book traces the historical events and larger forces that have shaped the options for politicians and activists over the past 40 years.*

This paradox in affordable housing policy illustrates many of the recent changes within the welfare state. The most dramatic change from the 1970s was not scaled back funding—although that certainly affected key programs for the very poor—but a shift in how the federal government delivered welfare state services and who was served.[14] The federal government used an array of new policy tools (tax policy, regulation, loans, and loan guarantees) to induce nongovernment players (nonprofit corporations and for-profit firms) to participate in shaping new programs to deliver social services. Lester Salamon (2002), Steven Rathgeb Smith and Michael Lipsky (1993), Jacob Hacker (2002), Christopher Howard (1999), Julian Zelizer (1998), and Jennifer Klein (2003) have shown that when these other funding mechanisms are taken into account, the U.S. welfare state is larger and more comprehensive than one would conclude by looking only at the bureaucracy-led, and direct expenditure-funded, programs. The government used incentives for social services with increasing frequency in the 1980s and 1990s, challenging the popular conception of a withering welfare state.

## Revolutionary Change in Housing Policy

To illuminate the revolutionary change in housing policy from the 1960s to the present, this book traces the historical events and larger forces that have shaped the options for politicians and activists over the past 40 years. The history is important because it shows that sometimes policymakers had few choices and that larger forces and trends often shaped the terrain on which this battle was fought. The history also demonstrates that many decisions and policies have had unintended consequences. What I lay out here suggests that for many years a current of many streams had been carrying us toward the policy we now have. The current was fed in part by history, in part by ideology, and in part by technology, but in all cases it was brought to life by policy actors—decisions made and not made along the way by individuals. Some of those decisions were made by powerful people on Capitol Hill and in corporate board rooms. Many of them were made by people who were less powerful—local activists and advocates hoping to improve communities. Together, they developed a new approach to building affordable housing. CI

# The 2009-2010 Assets & Opportunity Scorecard

The Corporation for Enterprise Development

## Introduction

*"We cannot rebuild this economy on the same pile of sand. We must build our house upon a rock. We must lay a new foundation for growth and prosperity – a foundation that will move us from an era of borrow and spend to one where we save and invest."*

– President Barack Obama, April 2009

President Obama has spoken on several occasions of the need for America to move from an era of borrow and spend to one where we save and invest. But to do that we need to understand the many factors that contribute to the financial security of U.S. households and the hard choices that individuals and families face when trying to balance short- and long-term term financial needs.

Also required is a clear understanding of the ways in which public policies encourage or discourage families in their efforts to gain a more solid financial foothold in the economy. For more than three decades, CFED has worked to raise awareness about the importance of creating sensible and broadly applicable policies that help Americans build and protect assets and overcome the hurdles that keep us from building real economic security.

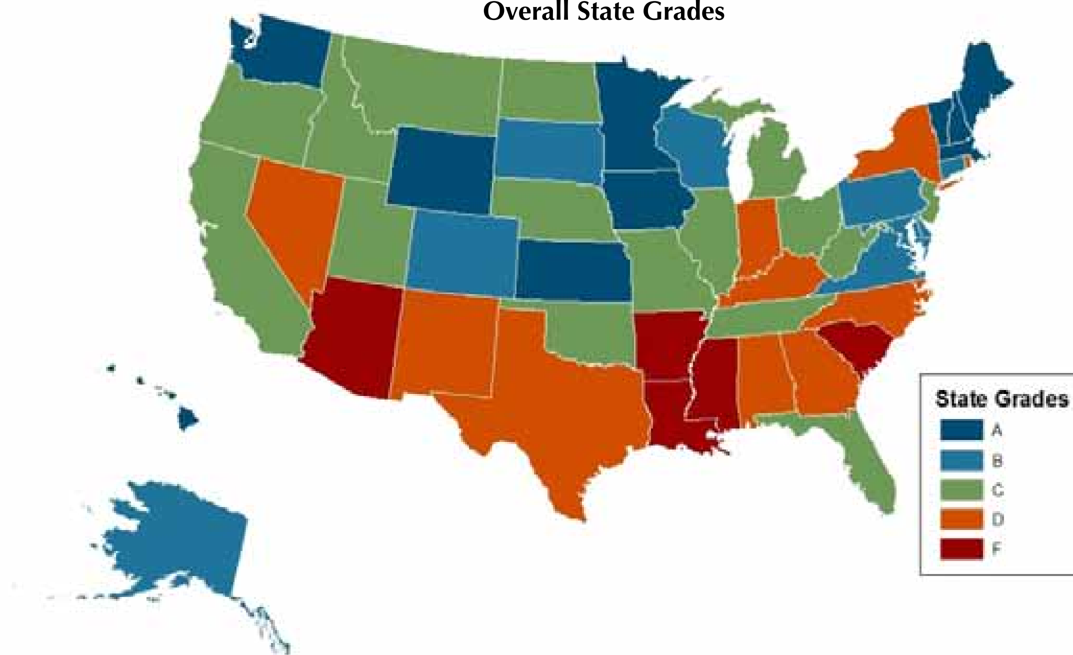
Now in its fourth edition, the *2009-2010 Assets & Opportunity Scorecard* continues this tradition. By assessing 92 distinct performance and policy measures and five interrelated Issue Areas, the Scorecard offers insights that will help policymakers, practitioners, researchers and advocates build a stronger foundation for financial well-being.

## Findings

The *Assets & Opportunity Scorecard* assesses both outcome measures and policies for each of the 50 states and the District of Columbia in five issue areas: (1) Financial Assets & Income, (2) Businesses & Jobs, (3) Housing & Homeownership, (4) Health Care and (5) Education. For

Figure 1

**2009 – 2010 Assests & Opportunity Scorecard**
**Overall State Grades**




a more complete exposition and to find detailed data on each state, go to CFED's *Assets & Opportunity Scorecard* web site at http://scorecard.cfed.org.

## Financial Assets & Income

Owning more assets means having greater economic stability and mobility. Assets enable millions of Americans to plan for the future, buy a home, prepare for retirement, send their children to college and weather unexpected financial storms. And in order to build and maintain assets, particularly in low-income communities, a financial environment must be in place to provide adequate tools and incentives to earn, save and invest. Accumulated assets must also be preserved and protected so that the benefits of holding onto assets may continue. One of the new features of the *2009-2010 Scorecard* is that it includes an assessment not only of household assets, but also income trends at the state level, recognizing that asset ownership and financial security are interconnected. In particular, income poverty is a fundamental indicator of financial instability, which severely limits opportunities for wealth creation and protection.

### *Key Outcomes*

- The highest income households had 45 times the net worth of the lowest, which means that for every dollar owned by a household in the highest income quintile, a household in the lowest income quintile had just 2 cents.
- African-American households had 10 cents and Latino households had 15 cents in wealth for every dollar held by white households.
- The disparity in wealth by race varies considerably across states. For example, in Nevada, minority households had 41 cents for every dollar in white households, while in New York, minority households had only 1 cent for every dollar held by white households.
- Female-headed households had 83 cents for every dollar held by a male-headed household.
- The median borrower in the United States had almost $3,000 in revolving debt, which includes credit card debt.
- Income poverty varies significantly across states, ranging from a low of 7.4 percent in New Hampshire to a high of 19.8 percent in Mississippi.

### *State Policies that Can Increase Financial Assets and Income*

States can adopt a number of policies that can increase the financial assets and income of families. The Scorecard tracks the adoption of these policies across the country.

#### *State EITCs*

The federal Earned Income Tax Credit (EITC) is one of the largest and most effective wage-support programs for low- and moderate-income families. It supplements the earnings of workers by reducing their tax burden. When the EITC is greater than the amount of taxes owned, the taxpayer receives a refund. Every year, millions of Americans use these refunds to get out of debt and start saving for the future. States should enact their own EITCs that build on the federal credit.

### *Lifting Asset Limits in Public Benefit Programs*

Many public benefit programs – such as Temporary Assistance for Needy Families (TANF) or Medicaid – limit eligibility to those with few or no assets. If a family has assets over the state's limit, it must "spend down" longer-term savings in order to receive what is often short-term public assistance. These asset limits, which were originally intended to ensure that public resources did not go to "asset-rich" individuals, are a relic of entitlement policies that in some cases no longer exist. Personal savings and assets are precisely the kinds of resources that allow families to move off of public benefit programs. States should eliminate asset limits from public benefit programs.

### *State IDA Program Support*

One policy that helps low- and moderate-income people build assets is a state-supported Individual Development Account (IDA) program. IDAs are special savings accounts that match the deposits of low- and moderate-income savers, provided that they participate in financial education and use the savings for targeted purposes – most commonly postsecondary education, homeownership or capitalizing a small business. Research demonstrates that these accounts make families more financially secure and communities more stable. States should provide funds and support for local IDA programs.

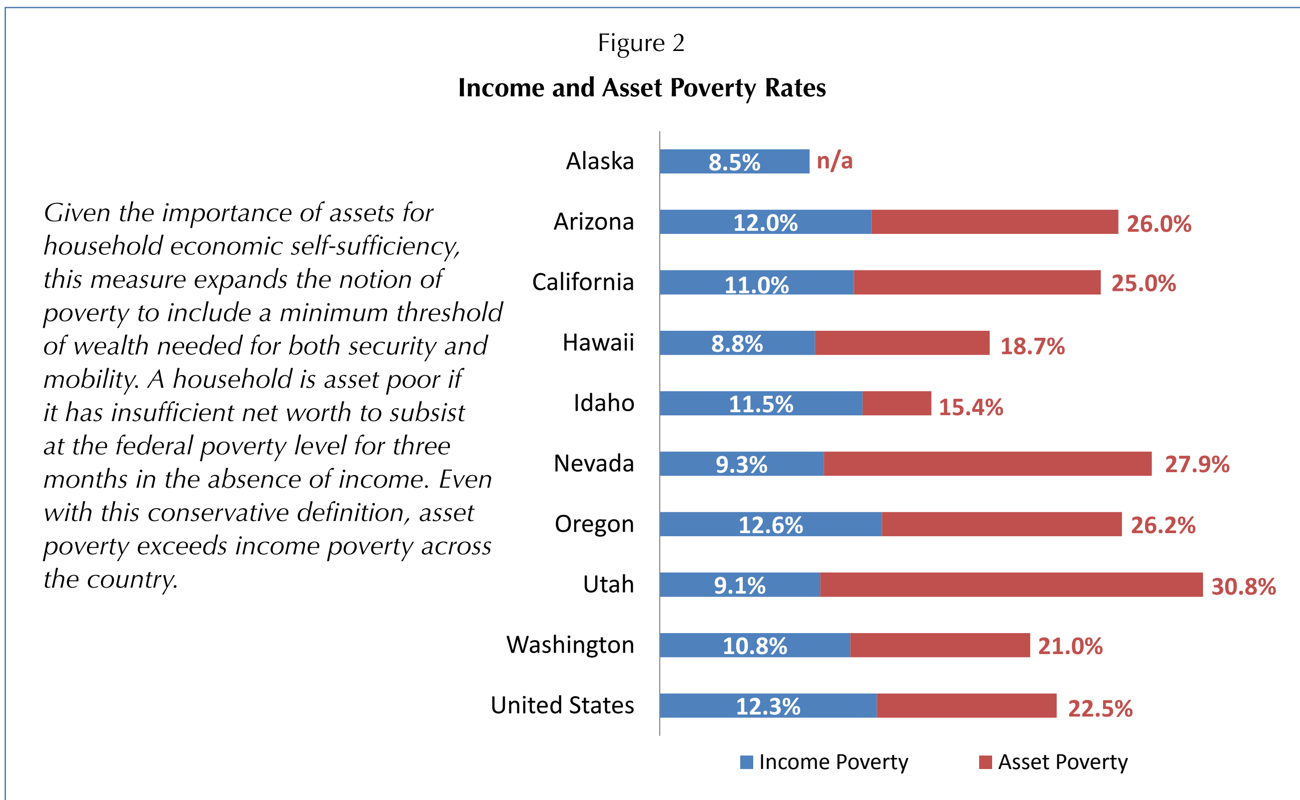
### *Payday Lending Protections*

Predatory payday lending refers to the practice of repeatedly making small, short-term loans at annual interest rates averaging about 400%, trapping borrowers in a cycle of debt. While payday lenders generally locate in urban areas, they are disproportionately concentrated among communities of color.

By far the most important strategy for curbing predatory lending is banning these loans outright or effectively banning them by imposing small-loan interest rate caps of 36% Annual Percentage Rate (APR) or less. States should adopt these caps and help families avoid predatory payday loans in the first place by promoting alternative, safer small-dollar loan products and adopting policies that encourage low- and moderate-income families to save.

## Businesses & Jobs

Business ownership and high-quality wage employment each play an important role in helping families earn income and build wealth over time. Earned income is the single most important contributing factor to a household's ability to save money, access affordable credit and build assets. Business equity is second only to homeownership nationally as a share of household wealth. The *Scorecard's* Businesses & Jobs Issue Area assesses the level of access American households have to business ownership and quality job opportunities.



***Key Outcomes***

- More than 22% of jobs in this country are in occupations that pay a median wage that is insufficient to raise the earner's family above the poverty line.
- Unemployment rates for African Americans are double those of white Americans. More than 10% of African Americans were unemployed in 2008, and that number has risen to 15.3% in the first quarter of 2009.
- 47.4% of workers participate in an employer-sponsored retirement plan.
- 55.8% of private sector establishments offer health care benefits to employees, but there is a great deal of variation among states.
- Small business ownership runs at 17.7 businesses per 100 workers.

***State Policies that Can Increase Opportunities to Start Businesses and Find High-Quality Jobs***

States can adopt a number of policies that can expand business ownership opportunities and improve job quality. Small business creation has consistently been a path to America's middle class–particularly for minorities, immigrants and the economically disadvantaged.

*State Microenterprise Support*

Very small businesses, or microenterprises, are a proving ground for new entrepreneurs and a key income generation and economic revitalization strategy. Microenterprises increase income for the poor, help people move out of poverty and off of public assistance and help poor households build both business and personal assets over time. Many of the estimated 20 million Americans who operate microenterprises face disadvantages in establishing and operating their own businesses–including women, minorities, low-income individuals and people with disabilities. States should provide funding and support to programs that help these individuals succeed as entrepreneurs.

## Housing & Homeownership

Even in today's tough housing market, the home represents the single largest component of household wealth and is a fundamental asset for millions of Americans. For those who are not ready or able to buy a home, access to affordable, high-quality rental housing is essential. Many renters of limited means are forced to accept substandard or unsafe living conditions in order to find housing that they can afford. Whether owning or renting, having a safe, affordable place to live provides physical and financial security. Yet all too often, affordability is out of reach. More than 37% of homeowners and 45% of renters in the United States are "cost-burdened," meaning they spend more than one third of their income on housing costs.

***Key Outcomes***

- 48.2% of minorities own their homes, whereas nearly 71.5% of whites own their homes.
- 89.3% of the highest income households own homes, almost triple the 32.6% homeownership rate among households in the lowest income bracket.
- National foreclosure rates have increased more than 200% since the 2007-2008 Scorecard and continue to rise (The rate rose from .99% in the 2nd quarter of 2006 to 2.93% in the 3rd quarter of 2008).
- The median home in the United States costs 3.5 times the median income.

***State Policies that Can Advance Housing and Homeownership***

States can adopt a number of policies that can increase the ability of families to buy and keep a home and to assure affordable housing for both owners and renters.

*Predatory Mortgage Lending Protections*

Between 1994 and 2005, the subprime mortgage market grew from $34 billion to $665 billion. While some lower-income borrowers benefitted from greater access to credit, many borrowers received high-cost, high-risk subprime loans that they could not afford, especially as house prices started to fall. The current crisis suggests that states should restrict the terms or provisions of mortgage loans, strengthen regulation of mortgage lenders and brokers, require lenders and brokers to engage in sound underwriting practices and ensure that laws can be enforced to protect consumers.

*First-time Homebuyer Assistance*

Low- and moderate-income families face a number of barriers to homeownership, including building up sufficient savings for a lump-sum downpayment and closing costs; accessing affordable and safe mortgage products; and acquiring basic information about what to expect from the home-buying process and how to protect their interests. States can help address these challenges by: providing downpayment assistance; offering competitively-priced mortgage lending products directly to homebuyers; investing in homebuyer education; and providing other programs designed specifically to assist low-income renters who wish to become homeowners. States should offer a comprehensive package of products and services to assist first-time homebuyers.

*Housing Trust Funds*

Housing trust funds are one way that states can help make homeownership affordable for low- and moderate-income families. They use dedicated public monies for

a variety of affordable housing solutions. These include preserving affordable rental housing, addressing homelessness, construction and rehabilitation of affordable housing, helping families become first-time homeowners, emergency repair and foreclosure prevention. States should establish a housing trust fund capitalized through a dedicated and recurring funding source.

## Health Care

There is no greater threat to a family's financial security than the expenses of a major medical emergency or treatment of a chronic illness. Access to health care provides individuals and families with a safety net that complements their asset ownership. Yet today, 45 million Americans do not have health insurance. While federal solutions have been debated for decades, states have and will continue to have a role in widening access to those who have trouble finding coverage.

### *Key Outcomes*

- 17% of non-elderly Americans do not have health insurance, but rates of uninsured vary by geography, race and income. Minorities are twice as likely to lack health insurance as white individuals, while low-income individuals are uninsured at a rate almost 4 times higher than those with incomes above 200% of the federal poverty line.
- The percentage of uninsured children fell slightly since the 2007-2008 Scorecard from 18.5% to 18.3%.
- The number of uninsured low-income parents has risen to 37.2% from 36% in the 2007-2008 Scorecard.
- The percentage of individuals covered by employer-provided health insurance fell significantly since the previous Scorecard, from 63.2% to 60.9%.
- On average, insured employees pay a quarter of the cost of their family's premium.
- In addition to premiums, families paid 19% of medical expenses out-of-pocket.

### *State Policies that Can Improve Health Care Coverage*

States can adopt a range of policies that provide health care coverage to those who are currently uninsured.

#### *Access to Health Insurance*

The majority of Americans receive health insurance coverage through their employers, but given the decrease in employer-sponsored insurance in the last decade, more families are at risk. In the 1960s, Medicaid was created to address the lack of insurance among low-income families, seniors and people with disabilities. In 1997, the federal government created the Children's Health Insurance Program to address the rising incidence of uninsured low-income children. States should expand eligibility for public programs, subsidize the costs of private insurance and mandate coverage extensions for those whose benefits would otherwise be terminated.

## Education

Education is an asset that benefits not only the educated individual, but also his or her family and community. Skills and knowledge are central determinants of earning capacity, but also important drivers of the economy. Education also promotes civic responsibility, advances economic competitiveness and expands economic opportunity. The *Scorecard's* Education Issue Area measures educational opportunity for children born in poverty. It also evaluates basic skills proficiency, and post-secondary educational attainment and affordability.

### *Key Outcomes*

- Education programs targeting children born to low-income and poor households reach only a fraction of their target populations. The federally-funded Head Start program serves only 20.3% of children under six years of age who live below the federal poverty line.
- Only 31% of 8th graders are proficient in math and 29.2% are proficient in reading.
- Math proficiency rates also vary by race. 42% of white 8th graders are proficient, but among African Americans that rate drops to 11%. Only 15% of Latino 8th graders are proficient in math.
- Racial disparities in college attainment rates persist nationally and in every state. 33.5% of whites in the United States have a college degree, compared with only 21.2% of minorities.

### *State Policies that Can Improve Educational Attainment*

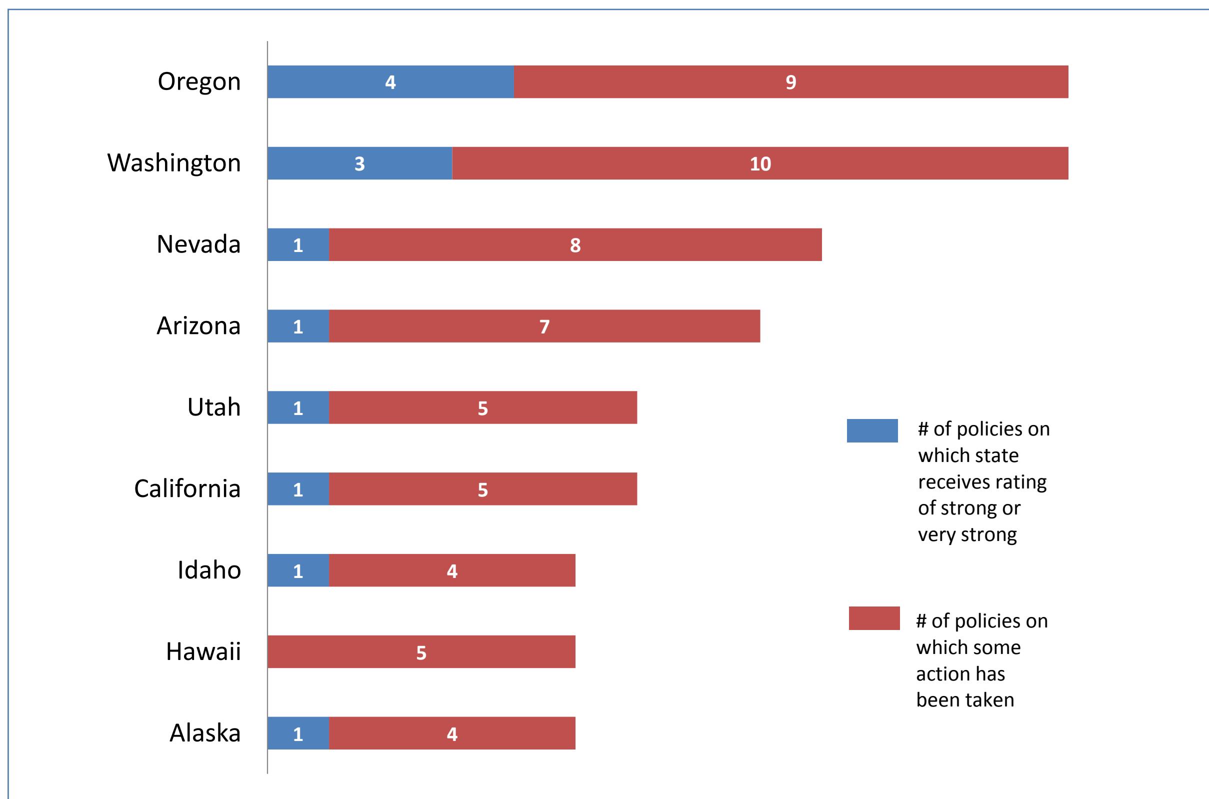
States can adopt a number of policies to improve the educational attainment of residents throughout their lives.

#### *Early Childhood Education*

Early childhood education, including pre-kindergarten, results in higher earnings, higher overall economic growth, a more productive and versatile workforce, better health and lower crime. Early childhood development creates a foundation for later school achievement, workforce productivity, responsible citizenship and successful parenting. Pre-K programs prepare children for learning, both in school and later in the workforce, and are vital to a state's economic prosperity. States should establish and fund high-quality pre-K programs that are accessible to all children.

Figure 3

**Number of Policy Priorities Acted on by 12th District States**




*Access to Quality K-12 Education*

Despite decades of education reforms, inequity persists in education spending and the availability of qualified teachers. Children from disadvantaged backgrounds frequently begin schooling already behind their peers. Yet schools with the highest concentration of students in poverty receive less funding than schools with lower concentrations. Instead of relying on property taxes as the main source of funding, which can disadvantage high-poverty districts, states should defer to statewide sources. States should also target funding to these high-poverty districts while creating and enforcing equity standards in all districts.

States also have enormous authority over ensuring that students are taught by qualified teachers, and can set requirements to help improve the quality of the teaching force across the state. States should implement policies to ensure that teachers are prepared and licensed, that they are evaluated regularly and that ineffective teachers are weeded out of the system.

*College Savings Incentives*

Post-secondary education is one of the best investments an individual can make in his or her economic future. Yet escalating costs discourage many from pursuing higher education. One way to make the cost of post-secondary education more affordable and increase participation by lower-income individuals is to create incentives for families to save for college. States should create programs to match the deposits of individuals into 529 college savings accounts.

## Conclusion

Fundamentally, public policy should create and support an opportunity structure where families and communities can prosper. Looking across the states, the *2009-2010 Scorecard* finds that many have taken positive policy actions to achieve this goal: a majority of states have taken steps to remove barriers to savings, create new incentives to build assets and protect the assets families already have. Yet most states need to take important additional actions to strengthen their policies. We hope the *Scorecard* provides useful data and insightful analysis for policymakers, practitioners, researchers, and all stakeholders committed to improving economic opportunities for all. Please visit http://scorecard.cfed.org to download the full report or learn more about the specific findings for each state. CI

# RESEARCH BRIEFS

## The Impact of Empowerment Zones on Home Prices

The Federal Empowerment Zone (FEZ) program uses a place-based approach to encourage economic development in depressed areas. The program offers tax breaks and other economic incentives to attract companies that provide jobs in designated "empowerment zones." As new jobs are created and local economic conditions improve, theory suggests that housing prices will increase, and neighborhood characteristics, such as demographics and housing stock, will change as well—but does this actually happen in practice?

Douglas Krupka and Douglas Noonan use census block-group level data to examine how housing prices and other aspects of neighborhood quality respond to the FEZ policy intervention. They find that the FEZ leads to fairly large home price gains, even after controlling for metropolitan, neighborhood, and place level characteristics. For example, median home value appreciation was about 25 percent faster in neighborhoods that received the first round of FEZ funding, relative to what would have occurred without the program. The FEZ also generated smaller, positive spillover effects on house prices in neighborhoods surrounding the designated Empowerment Zones. However, the FEZ program had either very small, or even negative, impacts on other measures of neighborhood quality, such as the percentage of families with working adults or the percentage of families in poverty.

The FEZ program was intended to improve neighborhoods across a number of dimensions, not just property values, yet this study suggests positive price effects and mixed results on other measures of neighborhood quality. Further efforts would help policymakers understand how the FEZ and other place-based economic development policies could be designed to improve overall neighborhood quality.

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Krupka, Douglas and Douglas Noonan. (2009). Empowerment Zones, Neighborhood Change and Owner-Occupied Housing. *Regional Science and Urban Economics*. 39: 386–396.

## Assets, Liabilities and Children's Educational Attainment

Completion of a college degree is strongly associated with higher future earnings, but the financial costs of attending college are often prohibitive for many low- and moderate-income families. Past research has focused on factors that support children's educational attainment and college success, such as parental education, employment, and income. However, current income is typically insufficient to cover the costs of college and many parents must rely on household assets to finance their children's higher education. To what extent do assets, and not just income, influence college degree attainment?

To explore this question, Min Zhan and Michael Sherraden explore the relationships among household assets and liabilities, educational expectations of children and parents, and children's college degree attainment, utilizing data from the National Longitudinal Survey of Youth. They find that financial assets, such as savings or retirement accounts, and nonfinancial assets, such as a home or small business, are positively related to children's college completion, even after controlling for family income and other characteristics. Zhan and Sherraden also find that children of parents with higher amounts of secured debt—such as a mortgage loan—are more likely to graduate college, but those from families with higher unsecured debt—such as credit card debt—are less likely to graduate from college. In addition, there is evidence that financial assets are positively associated with the education expectations of parents and children.

The findings suggest that policies and efforts aimed at decreasing unsecured debt and increasing household saving and assets may be desirable for post-secondary educational success. Given the long-term benefits of educational attainment, such efforts could make a significant difference in the economic futures of low- and moderate-income individuals.

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Zhan, Min and Michael Sherraden. (2009). Assets and Liabilities, Educational Expectations, and Children's College Degree Attainment. *Center for Social Development Working Paper,* No. 09-60.

## CRA, Business Development and Job Creation

The Community Reinvestment Act (CRA) was designed to encourage banks and saving institutions to help meet the credit needs of communities in which they are located. One of the ways that the CRA achieves this goal is through the provision of small business loans. The availability of credit to establish, refinance, and improve small businesses should in theory contribute to the well-being of local communities. Yet very little research exists on the relationship between the CRA, new business start-ups, and economic growth in local markets.

Nada Kobeissi explores this question by analyzing establishment and enterprise data from the Center for Economic Studies (from 1997 to 1999), employment data from the Census Bureau, and publicly available CRA lending data on large banks (over $250 million in size). Kobeissi finds a strong positive relationship between CRA lending and new business start-ups at the local metropolitan area level, even after controlling for several potential variables that could have an impact on business start-ups and community developments, such as total bank deposits in an area, economic environment, and market competition. The increase in business start-ups in turn positively impacts the employment rate and job growth in the area.

These findings demonstrate the impact that CRA lending can have on business development and job creation, and suggests that providing access to capital for small businesses has positive spillover effects on economic growth. This is particularly salient given the tight credit markets and limited availability of small business financing.

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Kobeissi, Nada. (2009). Impact of the Community Reinvestment Act on New Business Start-Ups and Economic Growth in Local Markets. *Journal of Small Business Management*. 47(4): 489–513.

## Who Are the "Debt Poor"?

The concept of the poverty threshold was designed in the 1960's to measure the percentage of households that cannot obtain a minimal standard of living based on their annual income. This measurement was created when most low- and moderate-income households didn't have access to credit and therefore had little consumer debt, such as car loans, credit cards, school related debt, or payday loans. But today, many households that are not technically in poverty struggle to purchase necessities because consumer debt-related interest payments significantly reduce their income. Who are these "debt poor" households and how do they differ from low- and middle-income households?

Steven Pressman and Robert H. Scott, III use data from the Survey of Consumer Finances, from 1983-2004, to study this unique population. They find that over four million Americans are not technically in poverty, yet they cannot purchase the goods and services necessary for survival according to the official definition. The debt poor have income levels only 50 percent greater than the poor, but are struggling with consumer debt levels similar to middle class households—nearly three times that of poor households. The debt poor are more likely to be married than the poor, and are less likely to have children than either a poor or a middle-class household. In addition, these households lack private health insurance to a large extent and (unlike poor households) are generally not eligible for Medicaid.

These findings demonstrate an ongoing need for credit counseling and debt management support, and the need for more research attention to be directed to household's full balance sheets, not just income. In addition, financial education can play an important role in encouraging responsible consumerism and keeping debt levels manageable.

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Pressman, Steven and Robert H. Scott, III. (2009). Who are the Debt Poor? *Journal of Economic Issues*. Vol. 43,

# DOCTOR CRA

by John Olson

*Dear Dr. CRA:*

*I received the save-the-date card for the 2010 National Interagency Community Reinvestment Conference in New Orleans. I'm thinking about going now that my training budget is back, but I have a couple of questions. This conference has always been in the West – why the change of venue? And what can I expect from the conference?*

Signed,
Need Opportunities to Learn Again

Dear NOLA,

As you saw on the save-the-date card, the 2010 National Interagency Community Reinvestment Conference will be held at the New Orleans Marriott from March 14 – 18, 2010. The conference itself will take place from Monday, March 15 to Wednesday, March 17, but also mark your calendars for an optional pre-conference lending school session on Sunday the 14th, and two special events on Thursday the 18th: a unique volunteer opportunity to support the local community, and a new, special one-day investments conference.

The move to New Orleans is a big one for us. After many years of holding the conference in the West, the four banking agencies who traditionally sponsor the conference decided to go outside of the Federal Reserve's 12th District. The change was motivated in part by the increasingly national reach of the conference. More and more of our attendees each year come from other parts of the country, and we highlight models and best practices from all over the nation. But another very important part of the reason for the change is New Orleans itself. The story of the region's recovery from Hurricane Katrina will provide us with innovative examples of community reinvestment, public-private partnerships, community organizing, and disaster recovery to learn from. Many communities across the country are suffering from the effects of a different sort of devastation arising from foreclosures, vacant properties, unemployment, and the financial crisis. Our hope is that by bringing together a wide range of community development professionals in New Orleans, we can all learn from one another how best to promote recovery. The move to New Orleans has also given us the opportunity to add two new sponsors to the conference: the Federal Reserve Bank of Atlanta and the Community Development Financial Institutions (CDFI) Fund.

During the conference itself, you'll have the opportunity to learn about community reinvestment from a variety of perspectives. The conference sessions will be of interest to CRA officers, community development lenders, community development investors, nonprofits, CDFIs, and anyone interested in community development.

***The conference will feature four separate tracks:***

1. **CRA Compliance:** The CRA Compliance track will include an A to Z overview of the exam process, and will drill down into specific issues such as data collection, exam preparation, and community development loans, services, and investments. There will also be special sessions for small and intermediate small institutions, and for limited purpose/wholesale institutions.
2. **National Community Development Lending School:** The lending school will offer courses for both new and experienced community development lenders, and will cover the nuts and bolts of underwriting complex community development transactions. The courses are taught by an experienced faculty of veteran practitioners.
3. **Community Development:** The community development track will explore a wide range of topics, from green building to behavioral economics to stimulating economic development in distressed neighborhoods. We've scoured the country to find the most promising practices and models, and speakers will be prepared to share their strategies with conference attendees.

4. **Investments:** The investments track is targeted to both CRA officers and bankers with responsibility for making community development investments. The track will feature the CRA Investment Handbook which summarized the most frequently used investment vehicles and programs. Other sessions will focus on portfolio management and deal structure.

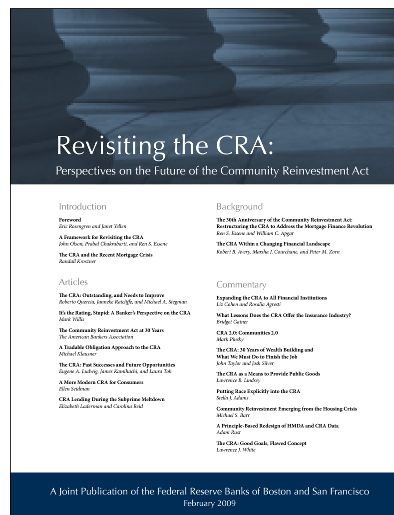
The conference will also have three tours that will explore local projects and organizations to get an up-close look at revitalization efforts taking place in New Orleans. The tours will be organized around the themes of: using mixed-income housing to connect affordable housing to local amenities and services; incorporating green principles into community revitalization; and the role of arts and music in community revitalization.

Also, check out the brand new addition at the conference: a stand-alone day-long conference devoted exclusively to community development investing on March 18, 2010. This all day event will explore the latest innovations in the field, including sessions on new investment tools, green investing, and the latest policy developments affecting the industry.

The complete conference brochure will be available at www.frbsf.org/community/conference2010 in January, 2010. Register early to secure a spot in the break-out sessions of your choice. See you in New Orleans in March! CI

# Revisiting the CRA

As regulatory reform continues apace in Washington, the question of CRA reform still looms. Will the CRA statute be amended? Will the regulations change? Will non-bank institutions be subjected to a CRA-like rule? To inform this debate, the Federal Reserve Banks of Boston and San Francisco jointly published a volume earlier this year entitled "Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act." The aim of the book is to inform the CRA discussion with a set of facts about the state of the financial services industry, and with a range of proposals for how the CRA can be made more effective. The book's contributors include bankers, community advocates, former regulators, and academics.




To further inform the discussion and to spark new ideas, the Board of Governors of the Federal Reserve System partnered with the Boston and San Francisco Reserve Banks to host a policy forum on February 24, 2009. The forum brought together the book's contributors and other commentators to discuss the findings from the book.

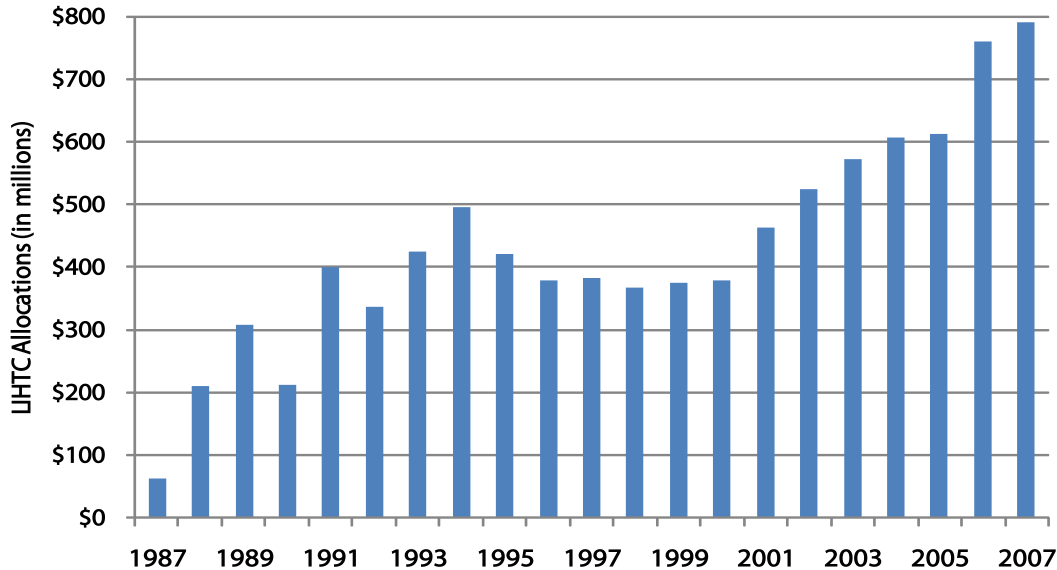
The book is available for download at http://www.frbsf.org/publications/community/cra/index.html. To order hard copies of the book, please e-mail Ian Galloway at Ian.Galloway@sf.frb.org. An audio recording of the February 24 policy forum is available at http://www.frbsf.org/cdinvestments/conferences/0902_2/index.html.

# DATA SNAPSHOT

## The Low Income Housing Tax Credit

The Low Income Housing Tax Credit (LIHTC) program was created in 1986 and has led to the development and rehabilitation of over 1.7 million low-income affordable rental housing units.

**Total LIHTC Allocations (in $millions) – U.S.**
**1987 – 2007**



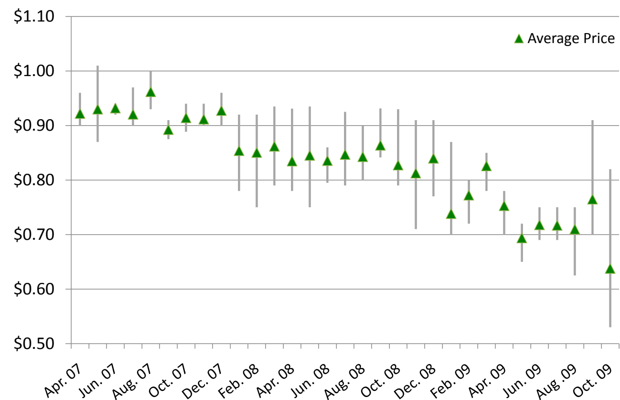

*Source: The Danter Company*

**LIHTC Allocations in the 12th District**
1987 – 2007

| State | Total Amount Allocated ($000s) | Total Units Created |
|---|---|---|
| California | 1,081,122 | 129,627 |
| Washington | 181,078 | 30,120 |
| Arizona | 154,031 | 24,583 |
| Oregon | 101,652 | 20,014 |
| Utah | 71,351 | 14,929 |
| Idaho | 38,900 | 7,999 |
| Hawaii | 37,196 | 4,416 |
| Alaska | 23,115 | 2,816 |

*Source: The Danter Company*

**LIHTC Pricing Trends Chart**
April 2007 – October 2009




*Source: Novogradac & Company LLP*

# Endnotes


### Strength in Adversity: Community Capital Faces Up to the Economic Crisis

1. This article is a condensed excerpt of a Community Development Investment Center Working Paper, entitled "The Economic Crisis and Community Development Finance: An Industry Assessment." For the full article by Nancy Andrews, see http://www.frbsf.org/publications/community/wpapers/2009/wp2009-05.pdf
2. Among the eleven interviews, six were with national or large regional CDFIs; two were rural CDFIs; and three were small and locally targeted CDFIs. Two were in the Midwest, three were headquartered on the West Coast, and six were headquartered on the East Coast.

### Small Business Financing and Personal Assets

1. Small Business Administration presentation, "Economic Recovery and Beyond," Federal Reserve Bank of Dallas, October 14, 2009.
2. Board of Governors of the Federal Reserve System, "Senior Loan Officer Opinion Survey on Bank Lending Practices, July 2009.
3. Board of Governors of the Federal Reserve System, "Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finance," October 2006.
4. Robert B. Avery, Raphael W. Bostic, Katherine A. Samolyk, "The Role of Personal Wealth in Small Business Finance," *Journal of Banking and Finance*, 1998.
5. Avery, Bostic, Samolyk, p. 1052.
6. Ibid, p. 1052
7. Ibid, p. 1059
8. Federal Reserve Bank of San Francisco, "Proceedings From the Impact of the Mortgage Crisis on Asian Small Businesses," July 1, 2008.
9. Ibid, p. 1045.

### Strengthening the Low Income Housing Tax Credit Investment Market

1. This article appears in *Cascade* No. 72, Fall 2009, a publication of the Community Affairs Department of the Federal Reserve Bank of Philadelphia.
2. Source: National Council of State Housing Agencies
3. Ernst & Young, "Understanding the Dynamics IV: Housing Tax Credit Investment Performance," (2007), p. 49.

### Moving beyond Mission: Effectively Funding the Nonprofit Organization

1. John Bridgeland, Mary McNaught, Bruce Reed, and Marc Dunkelman (2009). *The Quiet Crisis: The Impact of the Economic Downturn on the Nonprofit Sector.* W.K. Kellogg Foundation.
2. David J. Erickson (2009). *The Housing Policy Revolution: Networks and Neighborhoods.* Washington, D.C.: The Urban Institute; Lester Salamon (1994). "The Rise of the Nonprofit Sector," *Foreign Affairs,* Jul/Aug, Vol. 73, Issue 4.
3. Eyal Press (2009). "The Perfect Storm," *The Nation,* March 30, 2009.
4. John Bridgeland, Mary McNaught, Bruce Reed, and Marc Dunkelman (2009). *The Quiet Crisis: The Impact of the Economic Downturn on the Nonprofit Sector.* W.K. Kellogg Foundation.
5. Ibid.
6. Naomi Cytron (2009). "The Enduring Challenge of Concentrated Poverty in America: Case Study of Fresno, California," Federal Reserve Bank of San Francisco Community Development Working Paper 2009-04.
7. This article draws heavily from the special edition of *The Nonprofit Quarterly entitled Strange Accounts: Understanding Nonprofit Finance,* published in 2005.
8. Clara Miller (2005). "The Looking-Glass World of Nonprofit Money: Managing in For-Profits' Shadow Universe," Strange Accounts: Understanding Nonprofit Finance, Compiled articles from *The Nonprofit Quarterly,* pp. 5 – 14.
9. Gregory A. Ratliff and Kirsten S. Moy (2004). " New Pathways to Scale for Community Development Finance," The Federal Reserve Bank of Chicago, *Profitwise News and Views,* December 2004.
10. For more information on the Nonprofit Overhead Cost Study and its data and publications, visit http://nccsdataweb.urban.org/FAQ/index.php?category=40.
11. Clara Miller (2005). "The Looking-Glass World of Nonprofit Money: Managing in For-Profits' Shadow Universe," Strange Accounts: Understanding Nonprofit Finance, Compiled articles from *The Nonprofit Quarterly,* pp. 5 – 14.
12. Ibid.
13. Mark Hager, Patrick Rooney, Thomas Pollak and Kennard Wing (2005). "Paying for Not Paying for Overhead," *Foundation News and Commentary,* Vol. 46, No.3. Available online at http://www.foundationnews.org/CME/article.cfm?ID=3313.
14. Jon Pratt (2005). "Analyzing the Dynamics of Funding: Reliability and Autonomy," Strange Accounts: Understanding Nonprofit Finance, Compiled articles from *The Nonprofit Quarterly,* pp. 19 – 25.

### Peer-to-Peer Lending and Community Development Finance

1. This article is a condensed version of the working paper entitled "Peer to Peer Lending and Community Development Finance." The full article can be downloaded from http://www.frbsf.org/publications/community/wpapers/2009/wp2009-06.pdf
2. Interview with Prosper CEO Chris Larsen on July 23, 2009. Source: Celent, a research and consulting firm focused on the application of information technology in the global financial services industry.
3. Laura Choi, "Creating a Marketplace: Information Exchange and the Secondary Market for Community Development Loans." Federal Reserve Bank of San Francisco's Working Paper Series: 2007–01. Available at http://www.frbsf.org/publications/community/wpapers/2007/wp07-01.pdf.
4. Nancy Andrews, "The Economic Crisis and Community Development Finance: An Industry Assessment," Federal Reserve Bank of San Francisco Working Paper Series, June 2009. Available at http://www.frbsf.org/publications/community/wpapers/2009/wp2009-05.pdf.
5. To date, only one platform, MicroPlace, has been granted approval from the Securities and Exchange Commission (SEC) to sell third-party-issued securities to multiple individual investors on its site without triggering a suitability requirement. While this is a key regulatory achievement, it is important to note that securities sold on MicroPlace are backed by their issuer—not the lender or the end borrower. The SEC has yet to allow any P2P finance platforms to sell third-party issued securities backed by assets (loans) online.
6. Low Income Investment Fund Frequently Asked Questions, available at http://www.liifund.org/ABOUTLIIF/FAQ.htm#averageLoanSize.
7. Interview with Chris Larsen on July 17, 2009.
8. Opportunity Finance Network's CARS website available at http://www.opportunityfinance.net/financing/finance_sub4.aspx?id=56.

# Endnotes

## The Housing Policy Revolution

1. Since the late 1970s, HUD's major programs included a small production effort for low-income elderly and rural tenants, a large housing voucher program (Section 8), an effort to undo past design and management disasters (HOPE VI), and a variety of insurance and grant programs.

2. Sudhir Venkatesh, "To Fight Poverty, Tear Down HUD," *The New York Times,* July 25, 2008.

3. Guy Gugliotta, "Report Suggests HUD Be Junked," *The Washington Post*, August 5, 1994, A19.

4. According to HUD's definition of worst-case needs, in 1978, 5.1 percent of all households fell in this category; in 2001, it was also 5.1 percent (HUD 2003, xix, 7). Another examination of how low-income renters were struggling during the economic boom years of the 1990s can be found in Nelson, Treskon, and Pelletiere (2004).

5. The Low Income Housing Tax Credit can be thought of as a tax coupon to corporate investors who put equity capital in apartment buildings rented to low-income tenants. To be considered "low income" one must earn less than 50 or 60 percent of the local area median income as measured by an annual survey by HUD. Since income is tied to local wages, it varies from county to county. The Internal Revenue Service (IRS) distributes the tax credits to state allocating agencies (typically each state's housing finance agency). They are distributed on a per capita basis—$1.25 per person from 1986 to 2001 when they were increased to $1.75 per person and indexed to inflation. In 2008, the credit was $2 per person (http://www.ncsha.org/uploads/Housing_Credit_Fact_Sheet.pdf).

6. I am comparing the two major prior building programs, public housing and HUD-assisted projects (such as 221(d)(3), 236 and Section 8) to Low Income Housing Tax Credits only. There were other subsidized homes built in the later period without tax credits, but it is nearly impossible to track them all.

   Public housing is about 1.2 million units. "Since 1937, the public housing program has been one of the major federal vehicles for improving the housing conditions of low-income house-holds, currently aiding 1.2 million households or about one-third of all those receiving assistance" (U.S. Congress 1983, 1).

   HUD-assisted units total 1.5 million.

   The U.S. Department of Housing and Urban Development's (HUD's) assisted project-based multifamily properties are privately owned properties representing a significant component of federally assisted housing for low-income families. This is in contrast to the public housing stock, which is publicly owned and operated. The HUD-assisted project-based multifamily housing stock includes more than 22,000 properties with more than 1.5 million units. They were developed under programs that were created in the 1960s and 1970s to supplement the public housing program, as part of a policy change that aimed to promote more privately owned development of affordable housing (Finkel et al. 2006, vii).

7. See appendix A in chapter 5.

8. Housing Act PL 81-171. See also U.S. Housing and Home Finance Agency (1950). For a good background on the 1949 Housing Act, see Hoffman (2000).

9. CDBG funds are block grants to localities (counties and cities primarily) and local governments decide how to spend the money; therefore, how CDBG money is spent can vary considerably from locality to locality. CDBG money has been spent on affordable housing since the beginning of the program in 1975, but it has only been tracked as a separate category since 2001. (Reports on national disbursements of CDBG by program area are available at http://www.hud.gov/offices/cpd/communitydevelopment/budget/disbursementreports/.)

   Richardson (2005, 12) notes that "The Housing and Community Development Act of 1974, as amended, established as the primary objective of the CDBG program 'the development of viable urban communities, by providing decent housing and suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.'"

10. To be fair, the old system also lacked the resources to fix the problem of housing low-income Americans, and the focus on very low-income residents was a relatively brief period of the hosing program. "In 1950, the median income of public housing tenants was over 60 percent of the U.S. median; by 1975, it was only 30 percent of the U.S. median" (U.S. Congressional Budget Office 1983, 2).

11. The welfare state is a term that often summarizes the set of social services that provide citizens with a social "safety net" from their governments. Many types of social services can be considered part of the welfare state, including government-sponsored health care, education, unemployment and disability insurance, and retirement benefits. Some welfare states are extensive, such as the "cradle to grave" type we often associate with Scandinavia. Others are less comprehensive. For a good overview of the different types of welfare states, see Esping-Andersen (1990).

12. For the Edsalls, the labor-dominated Democratic Party reached a political high point with the Civil Rights Act of 1964, but the increased focus on minority rights pushed it too far to the political left while the Republicans moved to the political center. However, Arnold Hirsch in *Making the Second Ghetto: Race and Housing in Chicago,* 1940–1960 (1998) and Thomas Sugrue in *The Origins of the Urban Crisis: Race and Inequality in Postwar Detroit* (1996) argue convincingly that the divisions in the liberal ranks were already apparent before the Civil Rights Movement.

    Many authors claim that the welfare state has withered since the 1970s, including Berkowitz and McQuaid (1988), Gilbert (2002), Levine (1988), Katz (1986, 2002), Patterson (1981), Trattner (1989).

13. Guy Gugliotta, "HUD Mans Its Lifeboats," Washington Post National Weekly Edition, February 13–19, 1995.

14. The federal budget numbers also challenge the standard story. Direct expenditure spending did dip in the 1980s (see table I.1) and some programs—especially for the poor—have been eliminated or scaled back since the Great Society. But overall tax expenditures and direct expenditures continued to grow throughout the 1980s, albeit at a slower rate than the preceding 20 years. On this point, see Christopher Howard (1999, 35).

## Get Ready for the 2010 United States Census

The 2010 Census will have an impact on the allocation of federal and state funding for important community development efforts. Census data directly affect how more than $400 billion per year is allocated to communities for neighborhood improvements, public health, education, transportation and much more. An accurate count of all households means your community gets its fair share of federal and state funding.

Make your community count in 2010 and learn more about the upcoming U.S. Census at the new Census Resource Center webpage at www.frbsf.org/community/census

## Call for Nominations!
## The 2010 Community Reinvestment Awards

*Improving Access to Financial Services and Education:*
*Building a Foundation for Inclusive Economic Recovery*

The Community Reinvestment Awards recognize and honor the work of financial institutions that are advancing innovative solutions to the challenges facing lower-income communities. The award will focus on innovations in financial products and financial education. Three awards will be given: 1) Innovation in Financial Education Delivery, 2) Collaborative Approaches to Expanding Access to Financial Services, 3) Product Innovation.

Recipients of the award will be recognized at a special awards luncheon at the 2010 National Interagency Community Reinvestment Conference, to be held in New Orleans, Louisiana, March 15-17, 2010. Winning financial institutions will receive three (3) free conference registrations.

**Nominations are due January 11, 2010.**
Email cra.awards@sf.frb.org for more information.

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