Community Development Finance Research Conference:

A Summary

Marvin M. Smith, Ph.D.
Federal Reserve Bank of Philadelphia

with

Nora Fitzpatrick
Federal Reserve Bank of New York

Conference sponsored by:

FEDERAL RESERVE BANK OF NEW YORK *and the* FEDERAL RESERVE BANK OF PHILADELPHIA
in cooperation with the FEDERAL RESERVE BANK OF CLEVELAND

Community Development Finance Research Conference: A Summary

Marvin M. Smith, Ph.D.
Federal Reserve Bank of Philadelphia

with

Nora Fitzpatrick
Federal Reserve Bank of New York

Acknowledgment: *Special thanks to Julia Sass Rubin, who originated the idea for the conference and whose tireless efforts helped to bring it to fruition.*

Contents

INTRODUCTION 5

OPENING REMARKS 6

SUMMARIES OF PAPERS AND DISCUSSANTS' REMARKS 7

COMMUNITY DEVELOPMENT AND TRADITIONAL FINANCE
"The Relationship Between Community Development Finance and Conventional Capital Markets—Opportunity for Innovation" 8
Michael Swack
Discussion
Mark Pinsky

MEASURING IMPACT
"Measuring Impact of CDFI Activities" 11
Robinson Hollister
Discussion
Carla Dickstein

SUBPRIME MARKETS AND PREDATORY LENDING
"Predatory Lending and Community Development at Loggerheads" 15
Kathleen Engel and Patricia McCoy
Discussion
Alan White

ASSET CREATION
"New Savings from Old Innovations—Asset Building for the Less Affluent" 19
Daniel Schneider and Peter Tufano
Discussion
Ray Boshara

MICROLENDING AND MICROENTERPRISE

"Microenterprise Development in the United States: Current Challenges and New Directions" 22
Lisa Servon
Discussion
Elaine Edgecomb

FINANCIAL EDUCATION

"Financial Education and Community Development Finance" 25
Jeanne M. Hogarth, Marianne Hilbert, and Jane Kolodinsky
Discussion
Jane Schuchardt

FINANCIAL SERVICE PROVISION FOR THE POOR AND FRINGE BANKING

"The Role of Technology in Serving the Unbanked" 28
Michael Stegman, Marta Rocha, and Walter Davis
Discussion
John Caskey

FINANCING THE PRODUCTION OF LMI HOUSING

"Financing Production of Low- and Moderate-Income Housing" 30
Rachel Bratt
Discussion
Susan Wachter

ALTERNATIVE DEPOSITORY INSTITUTIONS

"The Community Development Role and Achievements of Alternative Depository Institutions" 33
Marva E. Williams
Discussion
Ellen Seidman

Contents

FINANCING BUSINESS VIA DEBT AND EQUITY
"Community Development Loan and Venture Capital Funds" 37
Julia Sass Rubin
Discussion
Timothy Bates

COMMUNITY DEVELOPMENT FINANCE AND PUBLIC POLICY
"Community Development Finance and Public Policy:
An Integrated Approach to Financial Services, Saving, Credit, and Insurance" 41
Michael Barr
Discussion
Ellen Brown

CLOSING REMARKS 45

CONCLUDING OBSERVATIONS 46

CONFERENCE CONTRIBUTORS 47

On December 9-10, 2004, the Federal Reserve Bank of Philadelphia and the Federal Reserve Bank of New York with the support of the Federal Reserve Bank of Cleveland hosted the Community Development Finance Research Conference. The conference brought together 60 experts in the field of community development finance to discuss emerging research topics. The forum was also an opportunity to discuss how research in this field can be used to inform community and economic development policy.

To serve as a catalyst for the conference dialogue, papers were prepared by selected participants that summarized various emerging research issues in the field. Discussants were also chosen to review the papers and present their insights.

We have created this summary to disseminate the conference findings to other academics, practitioners, and policymakers in order to stimulate more discussion and research on community development finance issues.

Opening Remarks

Dede Myers, vice president and community affairs officer at the Federal Reserve Bank of Philadelphia, welcomed the conference participants and discussed why the Federal Reserve is involved in forums like this conference. Myers noted that the Federal Reserve System, through its Community Affairs departments, has been active for more than 20 years in facilitating discussions on community and economic development topics.

She also touched on the fact that the community development finance sector provides a supply of capital to finance activities such as building affordable housing, supporting the growth of small businesses, and energizing economic development in distressed neighborhoods.

Finally, Myers explained that a forum on community development finance topics is consistent with the Federal Reserve's commitment to disseminating information on models and strategies aimed at increasing access to credit for low- and moderate-income communities.

Myers was followed by Julia Sass Rubin, who provided an overview of the desired outcomes for the conference. The exchange of opinions and viewpoints, Rubin explained, was intended to increase the amount of research on community development finance topics, facilitate better policy formation, and provide a venue for bringing together academics, practitioners, and policymakers to discuss emerging issues in the field.

The conference was organized around several topics that encompass key issues that confront the field of community development finance. Leading experts in the field were commissioned to present papers in which they discussed the current state of knowledge on the selected topics and suggested the kinds of issues and challenges that lie ahead. Other experts were assigned the task of discussing the papers and providing their insights on the topics at hand. What follows is a summary of the papers and the discussants' remarks.

In the traditional financial markets, innovation is a powerful engine of growth and change. Community development lenders, through partnerships with traditional market institutions, can achieve growth and scale by adopting innovations implemented by capital market institutions. The first session of the conference explored this possibility.

In the paper "The Relationship Between Community Development Finance and Conventional Capital Markets—Opportunity for Innovation," **Michael Swack** documented some of the opportunities for increasing the funding capacity of the community development finance industry by adapting capital market innovations.

Swack noted that the community development finance industry—as represented by community development financial institutions (CDFIs) and other community development lenders—has made significant strides over the years in terms of size and sophistication. Yet the industry is confronted with the major challenge of accessing capital in the face of a decline in the availability of funds from the government and philanthropic organizations. Swack suggested that the industry might look to conventional capital markets as a source of funds. He also suggested some ways to accomplish this. According to Swack, one innovation the community development finance field should adopt is a standardized data collection process. Mainstream financial institutions have recognized the efficiency and the economy of scale achieved through creating standard data collection procedures. Uniform data allow investors to compare investments across portfolios and time. Swack predicted that if the field adopts an "infrastructure around data collection," it will provide community development products with increased "credibility in the capital markets."

One innovation the community development finance field should adopt is a standardized data collection process. Mainstream financial institutions have recognized the efficiency and the economy of scale achieved through creating standard data collection procedures.

Another innovation Swack recommended is the assignment of ratings to securities. Rating securities is a common practice in conventional markets. The ratings enable investors to standardize and price investment risks. If securities have a recognized pricing scheme, they can be sold to a broader range of investors. This would allow investors to use funds from their conventional portfolios rather than their social investment money, which for some is running out. In addition, relying on this tool in accessing capital might be extremely helpful in assisting CDFIs to grow to scale. Swack pointed out that the community development finance industry has already completed transactions in which the underlying securities were rated. He noted that these pioneer deals have "opened up the conventional capital markets to community development lenders."

However, Swack cautioned that seeking funds in conventional capital markets is not without its concerns for CDFIs and other community development lenders. First, once a CDFI has packaged some of its loans and sold them, would the community development lender lose contact with its borrowers? Swack thinks that the choice about whether contact is maintained is up to the community development lender. He cited the case of the Community Reinvestment Fund (CRF), a Minneapolis-based 501(c)3 corporation that created a secondary market for community development loans. He pointed out that CRF will allow the originating lenders to continue to service the loans if the lenders choose to do so.

Another issue on the part of CDFIs and other community development lenders is the requisite pricing of loans. More specifically, Swack questioned whether community development lenders would have to price their loans according to the market price irrespective of the actual risk in their portfolio. The concern is that because the conventional market *perceives* that there is risk associated with community development lenders' portfolios, the lenders would have to discount their loans in order to sell them. Swack noted that those lenders who price their loans at or above the market rate should experience little, if any, discounting. However, the loans of lenders who are highly subsidized would be discounted.

A third issue involved whether community development lenders would have to underwrite according to the standards of the conventional capital markets. Swack acknowledged that some form of underwriting standards must be followed. But lenders who sell to a secondary market or aggregator need to realize that there is more flexibility than they think in negotiating the terms of the standards without forsaking their mission.

Swack stated that the challenge facing CDFIs and other community development lenders is striking a balance. They need to develop the necessary "standards and other practices that allow them to integrate into the financial mainstream and thus scale-up while continuing to focus on their mission," to finance affordable housing initiatives, small businesses, and community facilities in low-income communities.

Discussion

In discussing Swack's paper, **Mark Pinsky** stressed that the environment in which community development finance institutions (CDFIs) operate is changing and now is an opportune time to reevaluate the relationship between conventional finance or capital markets and community development finance. He pointed out that if the CDFI industry is to fulfill the needs of its borrowers and meet the challenge of establishing a more sustainable operation, consideration must be given to introducing scale in the industry. Pinsky pointed out that embracing the notion of scale need not preclude individual CDFIs from developing customized solutions for nonconforming customers in their local communities and maintaining a relationship with them. In fact, he suggested that the focus on scale be shifted from the current view of the size of a CDFI's assets to the volume of financing it does. Pinsky thinks we should strive to create a high-volume financing system that could vastly increase the magnitude of financing activity by CDFIs, something the current system is not equipped to do.

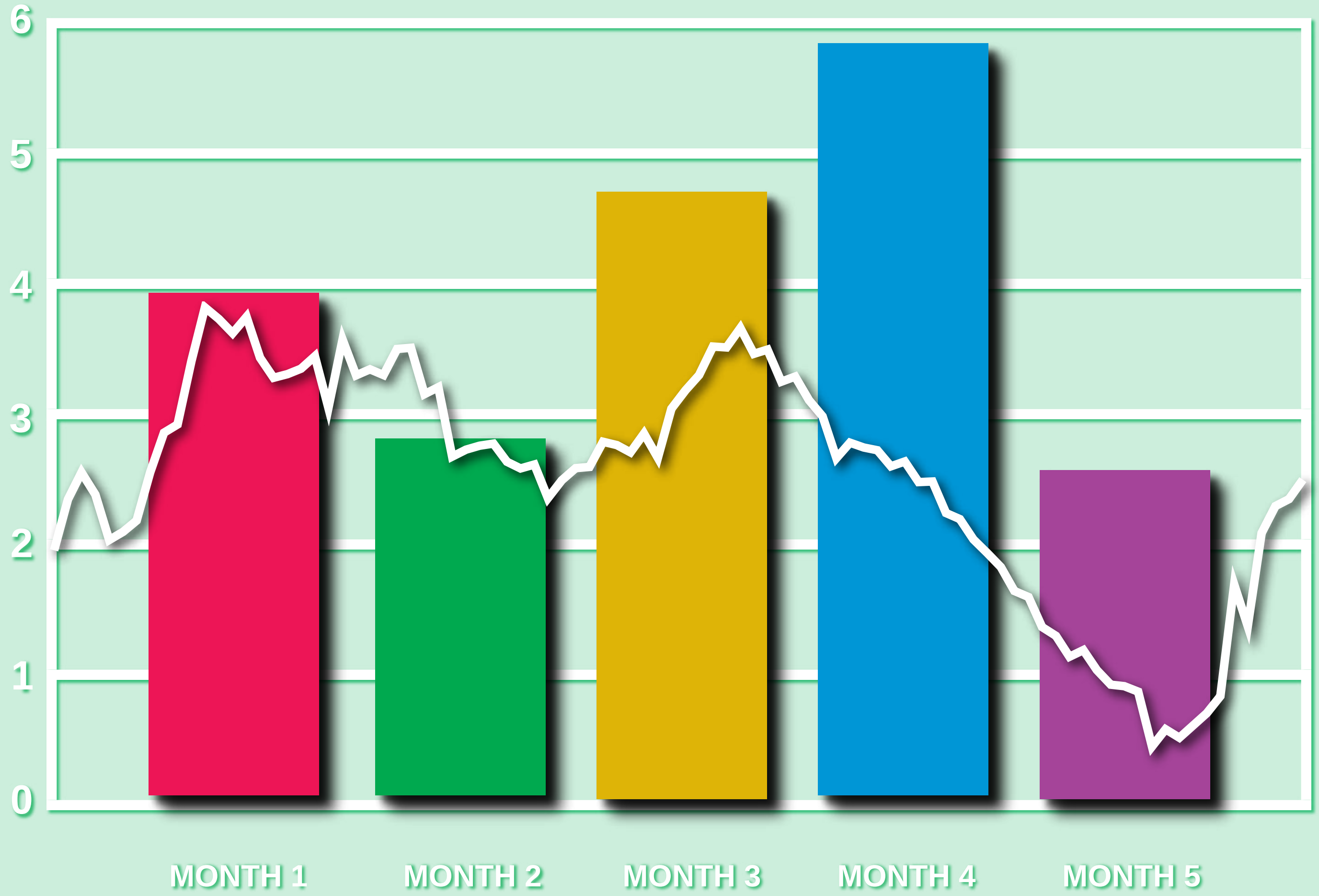
Pinsky noted that several developments have prompted the need to examine financing prospects in the CDFI industry. First, there has been a change in the regulatory environment, and this change might result in the diminishment of the Community Reinvestment Act's influence. Second, CDFIs are facing increased competition from banks of all sizes as banks realize that the perception of risk in CDFI markets is greater than what actually exists. Thus, banks are becoming aware that their participation in CDFI markets can present business opportunities from which the banks can turn modest profits instead of just engaging in philanthropic activities.

Third, he also mentioned that the new-found competition unfortunately opened the door to predatory lenders as well. According to Pinsky, this might have occurred as a result of CDFIs' not being ready to meet the needs for financing with competitive solutions.

In light of the changing environment for CDFIs, Pinsky thinks it is time for the industry to consider securitization as a means to create real liquidity that might generate the volume of financing he thinks the industry will need in the future. He believes that finding a way to leverage Standard and Poor's rating capability would enhance the industry's future financing potential. Pinsky also expressed hope that the new data system of the U.S. Department of Treasury's CDFI Fund will be able to compile transaction-level data that will aid in taking advantage of securitization.

> Several developments have prompted the need to examine financing prospects in the CDFI industry.

Pinsky offered the parting observation that in an atmosphere where operating capital is less available and interest rates are squeezed, CDFI lenders will have to change their mindset with regard to loan servicing and their personal contact with borrowers if the use of securitization is to be successful.



Traditionally, the community development finance field has quantified success through standard measures such as the number of small business loans made and the amount of affordable homes built. In recent years, the trend has been to measure success by analyzing the impact or benefit of community development finance activities on target individuals and communities.

The move to measure success by the level of impact has largely been driven by the providers of community development funds. Foundations, lenders, and governments are increasingly interested in having funding recipients demonstrate the benefit that the activities of community development financial institutions (CDFIs) have on households and communities.

In the paper "Measuring Impact of CDFI Activities," **Robinson Hollister** identified some of the obstacles involved in analyzing the impact of community development finance products and programs. Hollister also cited the circumstances under which impact analysis can be done.

Hollister found that one of the challenges in measuring the impact of CDFIs is the "unrealistic expectations about the degree to which reliable estimates can be obtained." He noted that this challenge is further exacerbated by the difficulty of rigorously establishing causality.

> Under this method (constructing comparison groups), the individuals exposed to the program would constitute the treatment group, while individuals who mirror the characteristics of treatment group participants but were not exposed to the program would make up the comparison group.

According to Hollister, "You may be provided what is called an estimate of the impact of a CDFI activity but to determine that the CDFI actually caused that configuration of events is a very demanding task which…will be achievable in a very limited set of circumstances."

Hollister presented a chronology of the developments in research approaches in response to the "growth in demand for evaluations of the effects of social programs and projects." He pointed out that "prior to the late 1960s, program evaluations had been largely anecdotal." However, the increased pressure to provide more quantitative analyses first led to the counting of a program's inputs and outputs and then to the more formal framework of benefit analysis.

Once the demand called for evaluators to demonstrate that an observed outcome was actually caused by a program, a different approach had to be used. Under this stricture, Hollister noted that "to estimate the ***impact** of a program* one needs to compare the program outcome measures with what would have happened to those measures had the program not existed"— or what is known as a *counterfactual*. To respond to this higher estimation standard, "initially, evaluators resorted to before and after estimates: what was the state of a measure, say, employment of an individual, prior to exposure to the program and how did that compare to the measure after exposure to the program." But this approach raises the issue of causality, since a change in the measure could occur as a result of something besides exposure to the program.

Consequently, as Hollister explained, evaluators turned to the construction of *comparison groups* as a source of a counterfactual. Under this method of evaluation, the individuals exposed to the program would constitute the treatment group, while individuals who mirror the characteristics of treatment group participants but were not exposed to the program would make up the comparison group. An estimate of the program's impact would be represented by the difference in the mean (or average) of the outcome measure between those in the treatment and comparison groups "at a point in time after the treatment group members had completed the program exposure."

However, Hollister noted that using the comparison group approach cannot rule out the possibility that the participants in the treatment group might possess a higher proportion of some key "unmeasured characteristic," such as motivation, than those in the comparison group. This is problematic, since "the estimate of the *impact* [would] contain a positive effect that is really due not to the program but to a concentration of more highly motivated individuals." Consequently, this would give rise to "selection bias." To counter this bias, Hollister recommended using the random assignment method, which gained prominence during the 1980s, and which, since the 1990s, has been regarded as the gold standard for program evaluation. Under this approach, program participants are not allowed to choose to be in either the treatment or comparison group but instead are randomly assigned to one or the other. According to Hollister, "The importance of the random assignment process is that once a reasonably large sample has been randomly assigned, the mean of any characteristic will be the same for both groups with high probability."

Hollister mentioned that other tools, such as logic models, theory of change, and balanced scorecards, might be helpful during the various stages of CDFI activities because they provide clearer connections between theory and practice or they can serve as a strategic planning and measurement feedback tool.[1] But he cautioned that "these methods do not directly address the issue of obtaining reliable estimates of impact"; for that, he urged the use of the random assignment experimental design.

Hollister concluded that although the right circumstances to conduct impact analyses are limited, he encouraged the community development finance field to seize the situations that "would permit such experimental assessment of impacts."

[1] Hollister explained that the most basic logic model is a "picture of how you believe your program will work. It uses words and/or pictures to describe the sequence of activities thought to bring about change and how these activities are linked to the results the program is expected to achieve."

The theory of change approach involves a graphic representation of the change process, which is shown on a map known as a pathway of change. The map is composed of all building blocks necessary to achieve a given long-term goal. Hollister noted this "set of connected building blocks [are] interchangeably referred to as outcomes, results, accomplishments, or preconditions." He further pointed out that the "theory of change describes the types of interventions (a single program or a comprehensive community initiative) that bring about the outcomes depicted in the pathway of a change map. Each outcome in the pathway of change is tied to an intervention, revealing the often complex web of activity that is required to bring about change."

The balanced scorecard approach is basically a management tool for strategic planning but has been recommended as a tool to evaluate impacts. It allows for the continuous improvement of a business's strategic performance and results by offering feedback on the business's internal processes and external outcomes. This is accomplished by viewing an organization from four perspectives: learning and growth; business process; customer; and financial. According to Hollister, a scorecard is developed for each perspective as a matrix of objectives and measures based on metrics developed for and data collected on each perspective.

Discussion

Carla Dickstein discussed Hollister's paper. Dickstein pointed out that the community development financial institution (CDFI) field recognizes the value of measuring its impact both to respond to funders' demands for impact measures and to establish viable measurement standards for the industry. She indicated that the CDFI field has been struggling with measuring impact since its beginnings. Dickstein acknowledged the maximum value of conducting an impact study using random assignment as recommended by Hollister, but she suggested that such a study is usually not feasible for the industry both for methodological reasons and because of the enormous cost involved. She also put her finger on another complicating factor that faces CDFIs that want to implement a random assignment study. Dickstein asked whether a CDFI that was trying to operate a viable financial institution would assign a customer deemed to be qualified for a loan or investment to a control group and risk jeopardizing its ongoing market and customer relationships for the sake of a rigorous impact study.

The community development financial institution (CDFI) field recognizes the value of measuring its impact both to respond to funders' demands for impact measures and to establish viable measurement standards for the industry.

Dickstein noted that Hollister did not offer the CDFI industry the option of using comparison group studies, since research has shown that the results of these studies do not match the actual results from more rigorous random assignment studies. However, she acknowledged that Hollister did point to areas where CDFIs might have opportunities for more rigorous analysis as well as useful studies that monitor outcomes rather than pretending to measure impact. Dickstein stated that both practitioners and funders have become more literate in distinguishing between outcomes and impact but remained challenged to provide evidence that supports the industry. In her capacity as a practitioner, Dickstein offered some insights into how her organization, Coastal Enterprises, Inc. (CEI), and the CDFI field were responding to the measurement challenge, in light of the parameters outlined in Hollister's paper.

Hollister suggested that CDFIs might rely on logic models, theory of change, and balanced scorecards to define impact as a result of a process of developing an organization's strategic direction and interventions. Dickstein observed that over the past few years, these processes have become more common and are becoming more integrated into CDFIs' strategic thinking and planning. While CDFIs might still fall short of mastering how to measure impact versus outcomes, thinking of their work as a social experiment that has inputs, outputs, and outcomes is beneficial. It has helped CDFIs to clarify their assumptions about their desired outcomes, both short term and long term, and the intended impacts they wish to achieve, and to articulate a change process. She also noted that a good, thoughtful process at the outset can help control what outcomes a CDFI might realistically try to achieve and what it monitors. Moreover, she pointed out that the examination of an organization's performance would be enhanced if its ongoing data collection fed into the process.

Dickstein warned, however, that CDFIs must be vigilant when it comes to causal chains of outcomes involving community impacts, particularly if the community goes beyond a small geographic area. She agreed with Hollister that CDFIs are far too small to take credit for most community outcomes. To assist a CDFI in laying claim to its contribution to community change, the CDFI, she suggested, should articulate where and in what ways it had affected larger institutions, systems, or policies that led to change on a wider scale.

As far as particular outcome measures are concerned, Dickstein indicated that CDFIs are typically concerned with providing opportunities for quality jobs, affordable housing, or community facilities targeted particularly to low-income populations or communities. While some of the data needed for measuring outcomes might be relatively easy to collect, such as information on affordable housing, determining other outcomes is more challenging. She mentioned that it isn't easy for a CDFI to determine job outcomes, especially whether low-income individuals had benefited from job opportunities. To make such determinations, a CDFI must know how to count a job as retained or created and how to aggregate full- and part-time jobs into full-time equivalents, a process that lacks consistency throughout the industry. Dickstein cautioned that even reliable measures of outcomes can be problematic unless a CDFI has sufficient resources and institutional support to gather and analyze data. She noted that the funds available to CDFIs typically did not serve this purpose.

While Dickstein recognized the value to a CDFI of using the quantitative approach preferred by Hollister, she pointed out that he did not comment on the role that qualitative methods might play in documenting the results of a CDFI. She noted that her organization and other CDFIs have used qualitative methods, such as interview data, to describe what would have happened to people or businesses *but for* the CDFI. She thought that qualitative methods, if combined with quantitative outcomes, might help in understanding whether a CDFI's strategic investments might have resulted in wider changes in a sector or community. Dickstein realized that qualitative data might not measure impact definitively, but she maintained that they could point us in the direction of impact or further our understanding of how impact is achieved.

Dickstein acknowledged Hollister's point that the best way for CDFIs to justify their existence over the long run is to better understand the impact they could have in changing policy, businesses, and communities. But she cautioned that a CDFI's real impact should be measured over time and not be limited to specific activities or deals, since CDFIs are subject to the ups and downs of the economy and the willingness of banks to take risks. While some CDFIs have managed to leverage their size and financial power to bring about change, they should not think, Dickstein warned, that increasing their scale guarantees that they will affect mainstream businesses and policies in ways that go beyond their individual investments. According to Dickstein, even though CDFIs are gaining stature and are finding new ways to be competitive, their impact still rests on the net social benefits attributable to their activity; it is not simply equated with increased scale.

Consumers have enjoyed significant benefits from improved access to credit. Access to credit has enabled families to obtain goods and services, secure funds to buy houses, and deal with emergencies. Homeownership is at a record high, and the number of home mortgage loans to low- and moderate-income and minority families has risen rapidly over the past decade. Credit cards and installment loans are also available to the vast majority of households.

As access to credit has proliferated among households, there have been concerns about the rise of deceptive and abusive lending practices targeted to low- and moderate-income households. These deceptive lending practices are often referred to as predatory.

In the paper "Predatory Lending and Community Development at Loggerheads," **Kathleen Engel** and **Patricia McCoy** proposed a definition for predatory lending, explored the underlying forces that have led to the rise in predatory lending, and suggested different strategies to correct the adverse impacts of predatory practices.

Engel and McCoy noted that most home loans with predatory terms or interest rates occur in the subprime market. But they hastened to point out that not all subprime home loans are predatory. Nonetheless, Engel and McCoy acknowledged the need to identify those terms or practices that are abusive so that they might be addressed. With this objective in mind, they categorized predatory loans as generally having five underlying problems: The loans are typically structured to result in net harm to the borrower, are rent-seeking,[2] involve fraud and deception, lack transparency, and require borrowers to waive meaningful legal redress.

According to the authors, "An array of market and regulatory forces converged to create an environment where predatory lending could flourish." The growth of the secondary market led to an increase in the supply of mortgage capital. This made it possible for "a steady flow of mortgage capital to borrowers representing almost every level of credit risk," including many with low and moderate incomes (LMI). Some additional market and regulatory forces included the liberalization of government-mandated loan terms and the introduction of federal regulation and laws that created incentives to market to low- and moderate-income households, as reflected in the increase in loans by Fannie Mae and Freddie Mac and the influence of the Community Reinvestment Act, and the low number of conventional bank lenders in low- and moderate-income communities. These developments were accompanied by a marked increase in the securitization of subprime home loans. All told, since "abusive lenders" focus on LMI neighborhoods, the market and regulatory forces provided fertile ground for such lenders to use their "hard sell" tactics to take advantage of eager but uninformed borrowers. According to Engel and McCoy, "The unsuspecting targets cannot believe their good fortune and sign on the line, worried that their opportunity to borrow will vanish if they hesitate."

Engel and McCoy further observed that "as current laws demonstrate, it is not necessary to devise a comprehensive statutory definition in order to regulate predatory lending." Thus, the strategies Engel and McCoy suggested to address the adverse consequences of predatory lending schemes included industry self-regulation, consumer education and counseling, and increased oversight of institutions involved in predatory lending. The authors also recommended the enactment of laws that would allow authorities to criminally prosecute institutions for engaging in predatory lending practices.

Since "abusive lenders" focus on LMI neighborhoods, the market and regulatory forces provided fertile ground for such lenders to use their "hard sell" tactics to take advantage of eager but uninformed borrowers.

An example of a legal strategy proposed by Engel and McCoy is suitability. Suitability, as employed in the securities and insurance industries, is a standard that has been described as the duty to have a reasonable basis for recommending a security or investment strategy. Engel and McCoy called for specific rules defining suitability that will be promulgated by a national oversight authority with regulatory and administrative responsibilities.

In their parting words, Engel and McCoy urged legislators to take action on a national anti-predatory lending bill. They stressed that doing so "will prohibit subprime lenders from making unsuitable loans and reward

[2] Rent-seeking in this context involves loan features that extract more money from borrowers without providing them with anything of value in return. Such features include charging prices above risk-adjusted levels, using double billing, charging fees for phantom services, and assessing pre-paid penalties on top of high interest rates.

loan assignees for refusing to finance predatory loans with damages caps." But they warned that failure to act might result in predatory lending "mushroom[ing] to epidemic proportions."

Discussion

Alan White discussed Engel and McCoy's paper and offered some additional insight into predatory lending and subprime markets. He pointed out that one of the difficulties in assessing predatory lending is coming up with an all-inclusive description of the problem. White acknowledged that Engel and McCoy made an important contribution by proposing to synthesize the various descriptions of predatory lending in the mortgage market and offering a comprehensive solution. He said that their description of predatory lending as a set of market failures, including rent-seeking and information asymmetry, nicely combines many features of the problem and suggests some effective policy responses. White also thought that their use of suitability, a concept borrowed from securities regulation, was a wise choice. However, he pointed out that their desire to synthesize the problem was understandable but their description of it fell somewhat short. According to White, two key elements of the predatory lending problem were missing from the authors' description of market failures: unreasonable risk and wealth stripping. While he recognized that these elements might be implicit in the authors' concept of loans structured to result in seriously disproportionate net harm to borrowers, it was important to make them explicit.

White pointed out that even assuming that subprime mortgages are being made to reasonably well-informed borrowers at an interest rate and with fees that approximate the true risks presented by the loan, there are mortgage loans whose failure rates should not be acceptable. He maintained that these loans are objectionable even if the consumer is perfectly well informed about pricing and pricing is free of any economic "rents."

White further noted that a high-cost (albeit appropriately priced) mortgage loan that creates a significant risk of homelessness is a dangerous product, not unlike an automobile that explodes in a crash 25 percent of the time. As far as he is concerned, the risks involved are not only misunderstood by consumers but create externalities (in the form of risks) for the rest of us.

White observed that the securitization of first mortgages now drives a market in which eventual foreclosures and credit losses are increasingly removed from the underwriting process. Moreover, investors can price risk and create capital structures to avoid or reduce risk, so that the market is not troubled by 25 percent foreclosure rates as long as the returns are sufficiently high. According to White, investors' hunger for returns on capital seems to have outstripped reasonable notions of prudent lending, as far as the subprime mortgage market goes.

Subprime mortgage loans are now made to borrowers with extremely high risks of default. "C" mortgage loans are widely available to consumers with a FICO credit score of 550.

In White's opinion, there is no use in hoping that today's mortgage market will act like a prudent banker and respond to high foreclosure rates on subprime mortgages by tightening underwriting. Subprime mortgage loans are now made to borrowers with extremely high risks of default. White noted that "C" mortgage loans are widely available to consumers with a FICO credit score of 550. According to Fair Issacs, such a consumer has a 52 percent or greater risk of default on his or her credit obligations within a 24-month period. As far as White is concerned, the market does not weed out irresponsible mortgage lending; it simply hedges the risk.

The second element of predatory mortgage lending that White touched on was the systematic stripping of home equity wealth. He observed that for minority groups in particular, home equity is an important if not exclusive form of accumulating intergenerational wealth. This wealth allows the middle class to help the next generation buy homes, fund higher education, and provide retirement security.

White stressed that the ready availability of cash from mortgage refinancing in the current market leads to the phenomenon of low-income homeowners' using their homes as credit cards. Consumers with chronic negative cash flow tap out their unsecured credit (maxing out credit cards, for example), and today's market persistently urges them to replace this unsecured credit with home equity credit. White acknowledged that these home equity loans may have some rationality in the short term for consumers with no better alternatives, but he cautioned that, in the long run, they contribute to the problem that the conference sought to address, namely, the disappearance of savings in the United States, particularly for low- and moderate-income families.

White believes that solving the problems of predatory mortgage lending will require an assortment of policy responses. According to him, a standard of suitability for loan originators, one that could be appropriately applied to lenders in the secondary market, would be salutary. Moreover, among other things, the analogy to securities investments appropriately shines a light on the inherent complexity of mortgage loans as financial products and the inadequacy of a consumer-choice-with-discourse model as a deterrent to abuses. But he warned that policies need to rein in the level of risk we allow homeowners to take with their most vital economic asset. Foreclosure rates of 25 percent should simply not be acceptable. White further observed that while inappropriate risk could be regulated indirectly with a suitability standard, it was historically constrained for hundreds of years simply by setting usury ceilings. He went on to suggest that assuming the market does price risk in a somewhat efficient way, it is also safe to assume that loans made above certain interest rates have unacceptably high failure rates. He recognized that usury rations credit but so does any underwriting standard. However, White underscored that no lender makes loans to all comers.

White concluded his remarks by emphasizing that a suitability standard is essential to recognizing the complexity of mortgage loans, particularly subprime mortgages, and acknowledging the inherent information advantage that sellers and brokers have. He pointed out that along with notions of suitability, fiduciary duty, or responsible lending, we also need more explicit measures to regulate excessively dangerous borrowing and wealth stripping.

Policies need to rein in the level of risk we allow homeowners to take with their most vital economic asset. Foreclosure rates of 25 percent should simply not be acceptable.

What he has in mind are usury limits, particularly on fees and points. However, White counseled that we should not overlook the need for promoting suitable credit—credit that meets consumers' needs for home improvement, credit card debt management, and other cash requirements without relying so heavily on pledging the roof over their heads as collateral. He noted that some European countries rely much more heavily on bank account collateral tied to direct deposit of salary and also on prudent co-signer agreements. White's parting observation was that getting the predatory lending problem under control will require an arsenal of policy responses, not just a silver bullet.

Asset creation is the process whereby individuals build wealth through the accumulation of personal and financial assets. Low-income households often face challenges in building an asset base substantial enough to foster financial stability.

Daniel Schneider and **Peter Tufano** presented findings from their paper, "New Savings from Old Innovations—Asset Building for the Less Affluent," which suggested that increasing the asset base of low-income households requires a series of strategies and approaches. Schneider and Tufano conducted a literature review of the factors that promote savings and asset building. The authors concluded that the consensus from the literature is that income is a dominant factor in determining whether households will save and the level of their asset holdings.

Schneider and Tufano pointed out that "the two primary measures used in discussions of asset building are new savings, as a percent of income, and total wealth, as a dollar amount saved." Moreover, they reported that the literature indicated that "income, perhaps more than any other factor, has been shown to determine both savings and asset holdings." But they noted that relative to those in all income categories, low-income families must deal with credit card debt and other financial situations involving high interest rates and high fees—such as payday loans and refund anticipation loans[3] —that make it especially difficult for them to save or amass assets. Moreover, many low-income homebuyers and homeowners have to deal with predatory mortgage loans that further hamper their ability to save and build assets.

The authors also discussed several measures that might be relied on to indicate a household's financial well-being; this, in turn, would underscore its ability to build assets. Schneider and Tufano indicated that "economists and businesspeople often focus on net worth or wealth, which is defined as assets less liabilities, to provide the clearest picture of a household's financial health." However, the specific definition could vary depending on whether it included all debt and assets or excluded home equity or nonliquid assets. This is particularly noteworthy when assessing the relative net worth between high- and low-income households, since the former definition would hinge primarily on the inequality of asset ownership between the two groups.

In addition to reporting on the important effects that savings can have on the national economy, or the macro view, Schneider and Tufano discussed how wealth and savings might be used as micro benchmarks to measure whether families have sufficient assets. An example of the latter is the definition and measurement of asset poverty. The authors noted that there are two schools of thought regarding asset poverty. One view calls for the incorporation of "household asset holdings into the measurement of income adequacy in order to gauge poverty." Using this approach, researchers have found that "fewer households are classified below the poverty line." The other view "consider[s] both income and assets, but do[es] so separately, calculating the share of households falling below either an income or an asset poverty line." Schneider and Tufano reported that studies have shown that the share of households in poverty increase with this approach.

Schneider and Tufano also detailed ways to increase the savings rate. The authors recommended that policies focus on creating incentives to save, making it easier to save, and heightening awareness about the benefits of savings. According to Schneider and Tufano, initiatives to increase saving should "target asset-building incentives directly at low-income families." One asset-building scheme the authors recommended is to create a national program of savings accounts for low-income households and have the government provide a cash match for any savings deposited into the account. These types of programs, Schneider and Tufano believe, will "create incentives for low- and moderate-income families to save."

The authors also suggested policies to make it easier for low-income households to save. One possibility is to streamline saving plans with the tax refund process. Specifically, during the tax preparation process, low-income tax filers should have the "option of opening savings accounts…and committing their entire refund [to be] directly deposited into the account."

In addition to creating incentives to save and making the process more streamlined, initiatives should be implemented to increase savings awareness and education. Schneider and Tufano identified one innovative education

[3] A refund anticipation loan is a short-term loan of up to $5,000 that cash-strapped taxpayers receive from their tax preparer against their coming refund check.

model: a method that combines "stimulation, decision support tools, and electronic gaming" to teach families about the benefits of savings and financial planning.

Discussion

Ray Boshara was the discussant for Schneider and Tufano's paper. Boshara offered several insights gleaned from individual development accounts (IDAs) and the asset field as they relate to the poor, some of which are reflected in the paper. Boshara's first comment had to do with a statement in the paper that suggested that income is the most dominant factor in determining both savings and asset holdings. While Boshara basically agreed with the claim, he pointed to an interesting finding mentioned by the authors that represented a counterintuitive result, namely, income was not a factor in predicting who among low-income people in the IDA demonstrations saved and who did not. He thought that the authors should give more attention to this novel perspective. Nonetheless, Boshara observed that the poor can save by taking advantage of institutional structures established for low-income individuals by community-based organizations. In fact, the poorest of the poor save a greater percentage of their income than those who are less poor because of institutional structures that facilitate saving. According to Boshara, when these structures are in place, poor people respond just like anybody else.

Boshara's second observation focused on the authors' discussion of asset poverty as a measure of self-sufficiency. This rivals the standard measure of poverty, which is based on income. He noted that since the early 1960s, the problem of poverty has been framed in terms of income and we have sought to solve it by means of income. Thus, if we were to adopt a measure of asset poverty, we would be obliged to solve the problem in terms of assets. Boshara pointed out that a new perspective on asset poverty was emerging from his organization, the New American Foundation. This new perspective urges us to also consider the opportunity costs of not having assets. In other words, what do people forgo by not having a home, not having a college education themselves, or not sending their children to college? While Boshara thinks the opportunity costs are quite high, he acknowledges that they might be somewhat difficult to capture quantitatively. He maintained that wealth begets wealth and that there is a spiraling up effect. Consequently, if one doesn't have assets, there is a spiraling down effect as well, and opportunity costs play a role in the descent.

Boshara's third insight centered on what motivates people to save. Although he acknowledged the traditional reasons for saving, such as for emergencies, family development, retirement, and bequests, he noted that IDAs were developed with the primary goal of affording the poor the means for long-term asset accumulation. Boshara reported that 10 years' experience with IDAs indicates that a high percentage (64 percent) of the poor who have participated in the program had unmatched withdrawals.[4] According to Boshara, the apparent need to address emergencies underscores the notion that the poor save for many reasons other than just long-term asset accumulation. Thus, any savings policy for the poor should be multifaceted. Perhaps the approach should encompass saving for short-term emergencies, buying durable goods, and accumulating assets in the long term.

Boshara concluded his remarks by suggesting that any future strategy to improve the plight of the poor should focus on savings and ownership and that the key challenge is how to generate increases in both. He thought that small changes could be made to existing products (such as the earned income tax credit or saving bonds) and delivery systems that would achieve the goal of increasing savings among the low-income population.

[4] IDAs encourage low-income individuals to save by having their savings matched (1:1, 2:1 or a more generous match) by federal or state governments or private-sector organizations in partnership with a financial institution that holds the deposits. The funds are to be used to purchase a home, pay for post-secondary education, or start a small business. On occasion, participants might need to withdraw funds to take care of emergencies. When these situations arise, the participants withdraw the savings that they contributed to the account or the "unmatched" portion of the savings.

Microenterprise refers to a business with five or fewer employees. Microlending denotes the process by which entrepreneurs seek capital to start and to build up their microenterprises. Providing "seed" capital to these businesses to help them grow is a strategy used by a wide array of community development finance organizations as a means to alleviate poverty, build assets, and foster economic growth.

Recently, the microenterprise field marked its 20th year of lending in the United States. However, the field faces some difficult challenges. Many of the leading minds in the field were at the conference to discuss the next frontier for microlending and microenterprises in the United States.

In the paper "Microenterprise Development in the United States: Current Challenges and New Directions," **Lisa Servon** provided an overview of the emerging issues in the microenterprise industry. She also highlighted the sector's key challenges and proposed innovative strategies to facilitate change.

Servon suggested that the major challenges confronting the microenterprise field are fragmentation, insufficient data, and lack of accreditation and regulation. She also noted that the inconsistent funding streams and narrow product lines are also important issues that need to be addressed. Servon recommended that these industry challenges can be dealt with by pursuing a course of restructuring, innovating, and standardizing.

Restructuring, according to Servon, should be achieved through mergers "between organizations conducting similar or complementary activities." When mergers are not appropriate, she proposed that organizations "enter into mutually beneficial partnerships with other organizations that provide complementary services."

There are exemplary programs that demonstrate that high-quality micro-credit can be efficiently provided to very low-income and disadvantaged microentrepreneurs.

Servon noted that change can also be achieved through innovation. She suggested that the microlending industry can innovate by expanding product lines and adopting new technology. Servon pointed out that new products will enable microenterprise organizations to "approach sustainability and do a better job of serving their target markets." Moreover, the new technology will also bring "greater efficiency and systemic innovation."

Servon also noted that standardization and accreditation are important strategies for the field to embrace. She said that the "first area in which movement toward standardization should be made is data collection."

In addition to standard products and procedures, Servon also recommended that the microfinance field should create a uniform method for assessing performance. She observed that the "field has now matured to a point that we have a solid sense of what are reasonable performance standards." According to Servon's proposal, the performance standards should be compiled to create "an accreditation framework," which will help the microfinance field achieve "industry status."

Discussion

Elaine Edgecomb served as the discussant for Servon's paper. Edgecomb observed that the paper did a good job of capturing the angst expressed by many people in the microenterprise field. But before discussing some of the issues concerning the microlending and microenterprise industry, she touched on some of the accomplishments in the field over the past 15 to 20 years. Edgecomb pointed out that the field now serves between 100,000 and 170,000 people a year with programs in every state. There are exemplary programs that demonstrate that high-quality micro-credit can be efficiently provided to very low-income and disadvantaged microentrepreneurs. In addition, training programs have shown that emerging entrepreneurs can gain business skills and expand their businesses. Furthermore, these clients create employment, increase their income, and increase their empowerment.

However, Edgecomb agreed with Servon that the microenterprise field faces a number of challenges. The marketplace has changed, but unfortunately the field has failed to keep pace. Edgecomb did note that expecting the field to be self-sufficient is misguided. In fact, such a prevailing expectation of total self-sufficiency leaves the field prey to unwarranted changes in policy as well as donor fatigue. She observed that some programs in the industry have developed a range of products and services for emerging microentrepreneurs. But the fact that the number of microentrepreneurs served by current programs relative to the number of microentrepreneurs in the country is rather small raises questions about the relevancy of the products and services being offered. Edgecomb reported that her organization, the Aspen Institute, had conducted a number of interviews with entrepreneurs that resulted in three studies that suggest there is great likelihood of a mismatch between traditional microenterprise services and the types of services sought by many of the entrepreneurs surveyed.

Edgecomb generally supported Servon's recommended changes for the microenterprise field in order to better meet the needs of microentrepreneurs, namely, the field has to continue to become more performance driven, to innovate, and to restructure. However, Edgecomb offered several points that added some perspective for a discussion involving recommendations about the future of the microenterprise field in the U.S. She pointed out that it is important to keep in mind that microenterprise development occurs not only in the CDFI industry but also outside of CDFIs. Edgecomb reported that of the 500 plus programs that exist in the U.S., fewer than half, or about 230, provide any lending at all, and among them, roughly 111 are considered CDFIs. Moreover, 16 organizations account for 45 percent of all the lending that occurs among the 230 lenders. She quickly added that there is anecdotal evidence that banks and alternative lenders are also providing financing to microentrepreneurs.

Edgecomb expressed a different perspective from Servon's on the role of training and technical assistance in developing microenterprise. Servon raised questions about the relevance of this side of the field and suggested that the future might lie in lending. Edgecomb acknowledged that when people are quizzed about the nature of microenterprise development in the U.S., they immediately say micro-credit. However, she said that the field is as much if not more about technical assistance as access to credit. Moreover, she found that the market for training and technical assistance appears to be stronger than the market for lending. To bolster her claim, Edgecomb indicated that the Aspen Institute maintains a directory of programs on which it collects data every couple of years. The institute found that of the nearly 100,000 clients listed in the 2002 directory, only 10,000 are borrowers. In addition, the institute compiles data from 65 institutions in its "micro test" database. Edgecomb noted that of the 24,000 clients of the participating institutions, 21,000 received training and technical assistance, while only about 7,000 reported outstanding loans. Furthermore, the data revealed that over the past five years, the average completion rate for training and business plans was 78 percent. Edgecomb reported that another study found that the number of participants who completed training was statistically correlated with a higher rate of subsequent business development than the number of those who didn't complete training. Although the results did not establish a causal relationship, she felt that successful clients must perceive real value in the training and technical assistance programs; otherwise, they wouldn't enter them nor would they stay.

Finally, Edgecomb echoed Servon's call for restructuring the industry and offered some observations to bear in mind. Edgecomb agreed that the industry would be better served by moving toward new models that centralize capital, standardize underwriting criteria and products, and take advantage of technology. But she thought it would move toward centralizing microenterprise lending within certified institutions and away from the wide variety of human service organizations that offer financing as a small part of their mission. Edgecomb believes that specialization should be extended to training and technical assistance as well. Thus, specialization would enable both the training and financing sides of the industry to increase their self-sufficiency. Edgecomb also commented on the issue of whether microentrepreneurs really need financing, since many of them self-finance or finance from savings. She pointed out that many programs are now offering individual development accounts to accommodate those individuals who prefer to save first and then invest in their enterprises. According to Edgecomb, it's not a matter of whether microentrepreneurs need financing but rather of what the right type of financing is and what the right order of savings versus lending is when it comes to services offered.

Financial education provides individuals with the skills necessary to control their economic independence. In recent years, with the proliferation of different types of financial services and products, there has been a dramatic rise in financial literacy programs focused on helping consumers determine the services and products that best meet their economic needs.

As households become more economically secure, some people assume that the increased stability will also result in improvements in the households' surrounding community. Although such spillovers are often assumed, there is limited research that supports the link between financial literacy and community improvement.

In the paper "Financial Education and Community Development Finance," **Jeanne M. Hogarth, Marianne Hilbert,** and **Jane Kolodinsky** used a case study to investigate the links between financial literacy and improvement in the surrounding community. The authors also identified current gaps in the community development finance research as it relates to financial literacy.

In their study of the Vermont Development Credit Union's educational services, Hogarth and her co-authors found that the benefits of participating in financial literacy training have potentially three levels of impact.

First-level benefits are direct benefits to the individual and include the ability to manage money, get finances on track, and pay off debts. Second-level benefits are "more tangentially related to credit union membership," such as increasing household income. Third-level benefits are "more 'macro' in nature" and involve improving the quality of life and being engaged in the community.

According to the authors, the third-level benefits are the closest proxy for community development outcomes. Hogarth et al. found that the data on third-level benefits "hints at the potential relationships between financial education and community involvement," but the authors indicated that to establish the link more robustly would require more data on community development outcomes.

The authors concluded with recommendations for future research topics on financial literacy. They suggested that research is needed to document the impact of financial education on community development outcomes. They explained that "most studies focused on household-level behaviors." For example, the authors noted that there is growing evidence that financial education has a positive impact on reducing consumer credit, increasing savings, and building assets, "but virtually none of these outcomes have been related to neighborhoods, communities, or economic development more generally." According to the authors, it "may seem logical that these behaviors, in the aggregate, should lead to community improvements, but we really have little data to validate these improvements."

Discussion

Jane Schuchardt discussed the paper by Hogarth, Hilbert, and Kolodinsky. She stressed the need for more national leadership on bringing together the ideas of financial education and community development. This would promote better coordination and understanding of financial education and community development activities across organizations, including her employer, the U.S. Department of Agriculture.

Schuchardt also emphasized that more attention should be paid to the relationship between households' financial stability and community economic development. She suggested that concentrating on various types of assets might provide a critical link between communities and households. She drew on a model that illustrates the connections between community and household assets.

There is growing evidence that financial education has a positive impact on reducing consumer credit, increasing savings, and building assets, "but virtually none of these outcomes have been related to neighborhoods, communities, or economic development more generally."

On the community side, economic assets (in the form of wealth, businesses, natural resources, and the labor force), leadership assets (political, civic, and business leadership skills), and physical assets (environment both natural and built) contribute to the economic viability of the community by providing a solid tax base that can yield quality public services and attract new businesses and residents.

On the household side, individuals accumulate assets and thereby generate wealth through saving, investing, homeownership, and business ownership. These assets, in turn, provide households and the communities they live in with economic and social stability and adaptability that can be manifested in financially sound households, greater educational attainment, less intergenerational poverty, higher property values, and more leadership participation in civic issues.

While Schuchardt thought that the paper began to elucidate some of the links between financial education and community development issues, she felt that it would have been more instructive if the authors had provided more "user friendly" definitions of key terms, explained how people change their financial behavior, and clarified what is meant by community involvement. Schuchardt singled out financial literacy, financial security, and community development as terms that needed clearer definitions.

Schuchardt pointed out that the definition of financial literacy most often used and the one referred to in the paper comes from a paper by Vitt et al., 2000.[5] According to this definition, financial literacy is "the ability to read, analyze, manage, and communicate about the personal financial conditions that affect material well-being. It includes the ability to discern financial choices, discuss money and financial issues without (or despite) discomfort, plan for the future, and respond competently to life events that affect everyday financial decisions, including events in the general economy." She noted that to the layperson, this definition states only what financial literacy is but says nothing about any accompanying action. As a consequence, Schuchardt indicated that the use of the term "financial security" is more descriptive and involves not only meeting the day-to-day financial needs but also saving and investing as a means to building assets for the future.

> The term "financial security" is more descriptive and involves not only meeting the day-to-day financial needs but also saving and investing as a means to building assets for the future.

Schuchardt also suggested that it would have been instructive if the authors had given a basic definition of community development. This would be particularly helpful for those with little familiarity with the area and would provide some context for the discussion.

Another of Schuchardt's concerns was that the authors could have said more about the stages that people go through when making changes in their financial behavior. She offered a variation of the transtheoretical model of change[6] as a possible vehicle to accomplish this. The model involves an individual who starts with the ***contemplation*** *(I know)* of a change in personal financial behavior to the ***preparation*** *(I will)* for making a change, followed by an ***action*** *(I do)* for change, and ending with a continuation or ***maintenance*** *(I do over time)* of the change. An added feature of the model is that it can be used to evaluate the efficacy of financial education programs. The model calls for an action (or change in financial behavior) stemming from an educational program to be sustained in order to consider the program an unqualified success.

Finally, in commenting on the results of the levels of benefits that members of the Vermont Development Credit Union received, Schuchardt thought more should have been said about third-level benefits. More specifically, she believed a further explanation of "being more involved in my neighborhood and/or community" would have been helpful. Schuchardt observed that perhaps an effective form of community involvement would be the development of leaders who would be active in community problem-solving and help confront other public issues.

[5] L.A. Vitt, C. Anderson, J. Kent, D. M. Lyter, J.K. Siegenthaler, and J. Ward, *Personal Finance and the Rush to Competence: Financial Literacy in the U.S.*, Middleburg VA: Institute for Socio-Financial Studies (2000).

[6] The model is contained in J.O. Prochaska and W.F. Velicer, "The Transtheoretical Model of Health Behavior Change," *American Journal of Health Promotion*, 12 (1997), pp. 38-48.

Financial Service Provision for the Poor and Fringe Banking

For numerous reasons, many low-income households are not fully integrated into the financial mainstream. Technological innovations can play an important role in helping low-income populations gain access to financial products and services.

In the paper "The Role of Technology in Serving the Unbanked," **Michael Stegman, Marta Rocha,** and **Walter Davis** examined the role automated teller machines (ATMs) play in providing financial services in low- and moderate-income communities and their prospective application in serving the needs of the unbanked. The paper also presented policy recommendations regarding technology and the unbanked.

To shed some light on the availability of access to ATMs in minority and low-income communities, Stegman and co-authors compiled a national database of ATMs. The study demonstrated that, in general, "low-income and minority populations have good access to ATM locations." Although overall access was determined to be adequate, Stegman et al. found that "there may be some problems with respect to the density of services as defined by ATM locations per capita."

The paper also presented policy recommendations regarding technology and the unbanked. Since access to ATMs is an important way to link low-income consumers to the financial mainstream, the authors thought that policymakers should "consider ways of improving the collection, coverage, standardization, and public dissemination of ATM locations of individual bank-owned and controlled ATMs." Moreover, Stegman et al. advocated that policies should also be implemented in individual states to change licensing or registration rules to "require owners to report the location and features of all their ATMs."

Discussion

John Caskey was the discussant for the paper by Stegman et al. Caskey lauded Stegman and his co-authors for their prodigious data-gathering effort to document the location of ATM machines. However, he raised some concerns that the paper was either unclear on or failed to address.

Notwithstanding the copious information on ATMs, Caskey considered the paper's major weakness to be its failure to define what constitutes adequate access to ATMs. To illustrate his point, he offered the following example: First, if one ATM within a mile of one's home is adequate access, does it matter if residents of poor communities have only three, while residents of rich communities have five? Second, do I need an ATM near my house if one is near my place of work or along my transportation routes?

[It's hard to believe that] most people, including the poor and members of racial and ethnic minorities, do not have access to ATMs now, since ATMs are commonly found in small restaurants, bars, convenience stores, and so forth.

As far as Caskey is concerned, a more important issue than physical access to ATMs is access to a surcharge-free machine. He found it hard to believe that most people, including the poor and members of racial and ethnic minorities, do not have access to ATMs now, since ATMs are commonly found in small restaurants, bars, convenience stores, and so forth. The problem, as he sees it, is that most of these machines impose a surcharge. Caskey thinks that an interesting question that needs answering is whether the poor are more likely to pay surcharges to obtain funds from an ATM than are middle- or upper-income individuals—an issue on which the Stegman paper is silent.

Financing the Production of LMI Housing

In the United States, the production of market-rate housing involves the collaboration of many private-sector participants, including builders, lenders, architects, engineers, and a host of other professionals. However, to finance affordable housing with below-market loans, the process also typically involves the financial assistance of government agencies, foundations, and nonprofit groups.

In the paper "Financing Production of Low- and Moderate-Income Housing," **Rachel Bratt** provided a review of the current public, private, and nonprofit initiatives aimed at increasing the number of affordable housing units. The paper reviewed the initiatives' ability to raise equity, secure debt, and maintain affordability—three key components of the housing finance process.

According to Bratt, buying a house or developing a multifamily housing project requires equity or "up-front money." To assist low-income households in securing the necessary equity to buy homes, the federal government, Bratt pointed out, has numerous down-payment assistance programs.

Congress created the LIHTC in 1986 as "a new investment vehicle aimed at encouraging equity investments in low-income housing."

Bratt also catalogued equity programs that have been created to assist developers in building affordable housing projects. One of the major equity programs, according to Bratt, is the low-income-housing tax credit (LIHTC). She explained that Congress created the LIHTC in 1986 as "a new investment vehicle aimed at encouraging equity investments in low-income housing." Moreover, Bratt noted that another vehicle for raising equity for affordable housing is a real estate investment trust (REIT). REITs, Bratt explained, "enjoy a special tax status that provides exemptions from corporate taxation." In addition to equity, Bratt mentioned that most affordable housing transactions also require debt instruments. According to Bratt, Federal Housing Administration (FHA) mortgage insurance is one of the major programs that has assisted the debt financing of affordable housing. FHA mortgage insurance provides lenders with protection against losses incurred from mortgage default.

Bratt also reported that the secondary market has facilitated debt financing, as well. In its simplest form, the secondary market either buys loans from the originator or provides guarantees that these loans will be purchased by third parties.

Furthermore, Bratt indicated that mortgage revenue bonds are another important debt tool that supports the production of affordable housing. Mortgage revenue bonds are tax-exempt bonds issued by state and local governments. The funds raised by the sale of the bonds are used to finance home mortgages.

Besides equity and debt products, Bratt found that subsidies are also typically necessary to finance the production of affordable housing. She catalogued a host of subsidy programs aimed at ensuring long-term affordability.[7] One of the programs that Bratt cited as a "massive vehicle for promoting long-term affordability for homeowners" is the Internal Revenue Code's provision that allows taxpayers to deduct from gross income the interest portion of mortgages and the amount paid in property taxes.

Discussion

Susan Wachter offered comments on Bratt's paper. She noted that Bratt provided an ambitious and thorough review of housing policies and programs in the U.S. Wachter pointed out that the focus was not on the problems that housing policies address but rather on the programmatic initiatives themselves. She thought that, at the outset, Bratt established the need for intervention by citing the U.S. Department of Housing and Urban Development's (HUD) *Affordable Housing Needs* report of 2003 to demonstrate the severe cost burdens that exist (more than 50 percent of income is spent on housing) and the persistence of physically inadequate housing despite strong economic growth in the U.S.

Wachter also commended Bratt for presenting an exemplary review of the literature of primarily federal housing policy, framing the financing of the produc-

[7] Some of the subsidy programs mentioned by Bratt include the rural Section 502 homeownership program, Section 8 vouchers, the interest deduction provisions in the Internal Revenue Code, the American Dream Down Payment Act, and the Zero Down Payment Act.

tion of housing affordable to low- and moderate-income households by focusing on raising equity, securing debt financing, and maintaining the long-term affordability of the housing stock. Wachter, in turn, provided a succinct summary of the main points raised by Bratt concerning the sources of equity financing for homeownership and rental housing, the role of government entities and special government programs in housing finance, and the promotion of long-term affordability in housing along with some observations of her own.

In regard to homeownership equity, Wachter thought the major issue raised in the paper was the controversy over the trade-off between lowering down payments to make homeownership affordable to low-income households and the consequent increase in risk of foreclosure and loss of equity. On the problems of securing equity finance for rental housing, she noted that the key issue raised was the complexity of the low-income-housing tax credit, the major public initiative in this area. When it came to the role of the Federal Housing Administration (FHA), government-sponsored enterprises (GSEs), the Community Reinvestment Act, and community development financial institutions in encouraging debt finance for low-income homeownership, Wachter suggested that, once again, the concern was the provision of too-lenient loan terms to low-income households and the resulting increased risk. On rental housing, Wachter noted that the primary point made by Bratt was the growing role of GSEs and the diminishing role of the FHA in financing affordable rental housing.

Although the paper made the important point that deep subsidies such as homeownership vouchers, the home mortgage deduction, and the new American Dream Down Payment Act are desirable, Wachter agreed with Bratt that none of these are significant in encouraging long-term affordability of homeownership. Bratt also pointed hopefully to a legislative proposal to provide deep subsidies for low-income homeownership through tax credits. However, Wachter thinks the proposal isn't going anywhere. As far as federal programs involving deep subsidies for housing production are concerned, Wachter indicated that the sole remaining program of importance for rental housing production is the low-income-housing tax credit (LIHTC) program, which has limitations on its use, even though Bratt noted that housing developments that remain affordable in perpetuity were being designed.

Furthermore, while Bratt took an optimistic position on the existence of a new consensus to provide housing support across the political spectrum, Wachter did not envision the necessary legislative initiatives to bring this about. Moreover, she observed that there are proposals to significantly curtail the budget for community development block grants, and if tax reforms are successfully undertaken, the LIHTC would be undermined. Thus, according to Wachter, deep subsidies would be effective in ensuring greater support for both homeownership and rental housing for low-income households, but the current political climate does not appear conducive to such support. Under these circumstances, she challenged the conferees to explore new directions. Wachter stressed that as direct expenditures come under budgetary pressure, the indirect support for housing provided by the FHA/VA and the GSEs becomes more important. She stated that these loan products also *crowd out* the risk-based subprime mortgage market.

Wachter further emphasized that there was a need to go beyond the paper's explicit assumption that housing assistance is fully justified by the improved outcomes it enables. She indicated that it would be increasingly important to make an evidence-based case for the need for housing assistance as competition for discretionary federal budgetary spending increases. Wachter noted that such a case would go beyond assistance to individual households—it would also assist with rebuilding neighborhoods, maintaining access to affordable housing in family-friendly neighborhoods, and supporting the life opportunities that such communities provide.

Financial institutions provide consumers with access to financial services and products. Some financial institutions, such as community development banks and credit unions—sometimes referred to as alternative depository institutions (ADIs)—often have missions aimed at stimulating community development. These institutions are especially important to low-income communities, where they provide basic financial services and access to capital and credit.

In the paper "The Community Development Role and Achievements of Alternative Depository Institutions," **Marva E. Williams** discussed the role that various ADIs play in our financial system, described their characteristics, and recounted their community development achievements. She also indicated some of the emerging research topics on ADIs.

Williams drew on a host of resources that enabled her to chronicle the various characteristics of community development banks (CD banks),[8] mainstream credit unions (MCUs), low-income credit unions (LICUs), and community development credit unions (CDCUs), which, taken together, comprise alternative depository institutions, or ADIs. She pointed out that they vary somewhat in their size and source of funds but share similar involvement in community development and, except for CD banks, are subject to the same regulatory oversight.

By Williams's count using 2004 data, MCUs (9,369) far outnumber the other ADIs, followed by LICUs (1,023), CDCUs (239), and CD banks (40). In addition, the categories varied in the number among their ranks that are also certified community development financial institutions (CDFIs), with CDCUs having the most (84) and MCUs the least (19). She also reported that the total assets for the various categories of ADIs ranged from $3.1 billion to $610 billion. However, it is interesting to note that the total assets of the CD banks ($3.6 billion) were slightly greater than those of the CDCUs, despite the former having a smaller number of institutions.

Williams noted that there is a slight variation in the sources of capital for the ADIs. Both LICUs and CDCUs receive their funds from most of the same sources, namely, member and nonmember deposits and secondary capital investments. But CDCUs receive additional capital from philanthropic donations. Member deposits are the sole source of capital for MCUs, while CD banks rely on deposits and investments from socially responsible investors.

According to Williams, most MCUs, LICUs, and CDCUs share the same insurer for their deposits and are subject to the same regulators. These ADIs are generally insured and regulated by the National Credit Union Administration as well as state credit union regulators. Moreover, they are exempt from the Community Reinvestment Act (CRA). But CD banks are insured by the Federal Deposit Insurance Corporation (FDIC) and, depending on their charter, are regulated by the FDIC, Federal Reserve System, Office of the Comptroller of the Currency, or state banking regulators. They must also comply with CRA as well as the Home Mortgage Disclosure Act, or HMDA. Given that CD banks "are obligated to operate in a safe and sound manner and bring a return to their investors and shareholders," Williams noted that they "have a double bottom line—they must be financially sustainable and foster community renewal."

Williams also discussed the ADIs' primary missions and community development involvement. She indicated that CD banks focus on serving underserved consumers and developing economically distressed communities. She pointed out that "almost 70 percent of the customers of CD banks are minority and over 40 percent are low income." According to Williams, "CD banks channel deposits, investments, and other funding into loans for affordable housing, commercial development and other community development projects." Small businesses or microenterprises are often the recipient of these loans.

Williams disclosed that although the literature suggests that MCUs are certainly equipped to serve low-income households, actual documentation of their community development achievements is thin. They are well positioned to serve the underserved in light of their sense of social responsibility, delivery systems, and products. Williams's review of the literature revealed that MCUs' nonprofit status allows them to concentrate on service, not profit, thus permitting them to offer products and services attractive to low-income consumers: "For instance, they allow members to deposit small amounts to accounts, offer higher than normal interest rates, and may also encourage asset development by imposing a financial penalty for early withdraw-

[8] CD banks operate under the Office of the Comptroller of the Currency (OCC) regulation 12 CFR Part 24. This authority makes it possible for CD banks to make investments that primarily benefit low- and moderate-income individuals or low- and moderate-income communities. The OCC also encourages CD banks to become CDFI certified.

als and making mortgages to consumers with small down payments." Moreover, MCUs have the potential to tailor their products to meet the needs of their fields of membership, which may include church members, residents in a community, or employees of a business. However, Williams reported that the few studies that measure the community development achievements of MCUs seem to suggest that while they serve low-income consumers, those at the lower end of the income scale make up a small percentage of MCUs' business.

Williams pointed out that "LICU is a designation made by the National Credit Union Administration to MCUs that have 50 percent of their members with incomes at or below 80 percent of the median income of the community." When it comes to LICUs' community development achievements, she reported that in addition to serving low-income consumers, one study indicated that they also "appear to serve a higher proportion of modest-income consumers than mainstream CUs."

CDCUs, according to Williams, "are credit unions that focus on revitalizing lower-income and minority communities, often in partnership with other community-based organizations." She further noted that "there is substantial overlap between LICUs and CDCUs. Most CDCUs (86 percent) are LICUs and about one-quarter of LICUs are CDCUs." Williams stressed that "CDCUs play an important role in lower-income communities that have been abandoned by mainstream financial institutions."

She reported on several studies that assessed the lending achievements of selected CDCUs. In general, the studies seemed to verify that CDCUs tended to lend to low-income and minority borrowers as well as small businesses. Furthermore, in some instances, their lending performance appeared to be somewhat efficient. For example, one study found that CDCUs' "loans had a charge-off rate of less than 1 percent," while another reported that "CDCUs had low or declining delinquency rates." Williams also discussed a study in which researchers "found that IDAs [individual development accounts] were being offered with considerable success by CDCUs, which they attribute to the program's compatibility with other CDCU asset-building services, and the ability of the CDCUs to leverage resources through collaborations with other organizations."

Williams closed by suggesting some future research topics on ADIs. She indicated that more research is needed on measuring the community development activities of credit unions and, in general, documenting the services ADIs provide to low-income consumers. In the area of microenterprise finance, she thought that some lessons might be gleaned from the community development finance efforts in other countries. Williams also recommended that research should be conducted on best practices as a means to providing financial services on a larger and more comprehensive scale with increased efficiency.

More research is needed on measuring the community development activities of credit unions and, in general, documenting the services ADIs provide to low-income consumers.

Discussion

Ellen Seidman lauded Williams for bringing together information about a special class of community-oriented institutions, namely, those that are depositories. She thought that the author did a superb job of laying out who these institutions are and what they have accomplished for community development, both in lending and in providing other services, some of which are unique to them. Like all community development financial institutions (CDFIs), they are under financial pressure, but these institutions have some additional challenges. Seidman added one technical note, namely, that credit unions can get a community charter from the National Credit Union Administration (NCUA) as well as a low-income charter. She further noted that these are different charters and both are different from the self-described community development credit union. In particular, while the community charter demands service to a community that includes low-income residents, the basic thrust of the credit union does not have to serve those residents. This, she said, contrasts with a low-income charter in which over half the credit union's members must be low income.

Seidman said that the paper made it clear that the large community development (CD) depositories, in particular, usually have multiple missions. They may have a primary mission of community development, but they also typically serve their communities more broadly, attracting higher income and out-of-neighborhood depositors, members, and borrowers. According to Seidman, this makes it particularly difficult to assess the impact of these institutions, other than by counting their number and the dollar value of development loans. Seidman acknowledged that this is not all that different from other types of CDFIs. She stressed that even if you did figure out exactly how to measure impact, the diffuse nature of the depositories' missions makes their impact more diffuse, as well. Furthermore, she agreed with Williams that even the smallest and most mission-oriented community development credit unions (CDCUs) are challenged by just how to measure their impact in a manner that is convincing and consistent.

Seidman noted that Williams pointed out the need for, and indeed the experience with, partnerships. Seidman thought that for the banks, in particular, this is really important. For both cultural and regulatory reasons, the CD banks are much more effective when they act in partnership with others, including not only community-based organizations (CBOs) but also other CDFIs. She indicated that for the low-income credit unions (LICUs) and CDCUs it's a little different, although they are sometimes partners with banks.

Seidman also mentioned that Williams related the attempts by, for example, the Neighborhood Reinvestment Corporation to partner with credit unions. She was quick to add that while there are some very good examples of success, it has been hard to make a partnership work. This difficulty, she said, arises in part because what the NeighborWorks affiliates are looking for is largely capital—something the credit unions most likely to partner with them have very little of. Nonetheless, credit union partnerships, for example, with CBOs that provide social services and tax preparation, have been quite successful. All of this led Seidman to offer the following lesson: Finding the right partners, ones whose strengths and weaknesses mesh effectively, is critical to leveraging effectiveness.

She echoed Williams's sentiment that while depositories, because of their very nature, have it easier than loan funds with respect to raising capital—and, in the case of banks, even equity—it's still a struggle. Seidman stressed that the limits credit unions face with respect to nonmember deposits, coupled with the fact that the co-op structure limits equity other than through retained earnings, and the quasi-equity nature of secondary capital, all mean that finding sufficient capital to match desired growth can be difficult—notwithstanding their access to grant funds and insured deposits. However, Seidman emphasized that for most banks (other than mutual banks), the challenge is somewhat different. They can basically get all the insured deposits they want just by raising rates, but given tight margins at CD banks, this can be a wolf in sheep's clothing. As far as equity is concerned, Seidman indicated that CD banks—uniquely among the CDFIs—can raise it by selling stock, but the tradeoff might well be a diluted commitment to the mission.

Seidman concurred with Williams that attracting skilled personnel is just as much an issue for the depository CDFIs as it is for others and that more work is needed to understand how these uniquely positioned depository CDFIs serve their target populations and communities and how they can improve.

Seidman also pointed out that not all community development work by depository institutions is done by registered CDFIs. She indicated that a large part of the rationale for enacting the CRA was to encourage non-CD banks to have community development responsibilities that should be defined and measured.

Seidman further noted that many smaller banks and most credit unions remain place-based and serve a wide swath of their communities, although not generally the lower-income parts of those communities. She emphasized that scale is the critical factor in this regard.

Financing Business Via Debt and Equity

All types of community development financial institutions provide business capital. They also share a common goal of promoting economic development in underserved communities. Community development loan funds (CDLFs) and community development venture capital funds (CDVCs) are two such financial institutions that supply debt and equity capital to various businesses and nonprofit entities with the objective of creating jobs and needed infrastructure in underserved areas.

In the paper "Community Development Loan and Venture Capital Funds," **Julia Sass Rubin** presented some background on these two types of financial institutions and discussed the challenges they face in view of the changing economic and political environment as well as their future prospects. She drew on the available data and existing research on CDLFs and CDVCs in addition to a number of interviews with individuals who are knowledgeable in the field.

Rubin indicated that according to data available through the CDFI Data Project (CDP), currently there are approximately 500 CDLFs. She further reported that the CDP data sample contained 159 CDLFs and that "these 159 had $3.2 billion in assets at the end of fiscal year 2003 and had financed $1.7 billion of activities that year." But Rubin cautioned that care should be taken when considering these figures, since the three largest CDLFs are responsible for 42 percent of the total (or $714 million).

According to Rubin, housing and business loans still make up the majority of CDLF financing activities, but CDLFs have broadened their services by "moving into the provision of operating and facility construction loans to nonprofits, such as charter schools, childcare centers, social services agencies, and arts organizations." In addition, the latest venture of CDLFs is in the area of home loans to individuals.

Rubin reported that CDLFs had customarily relied on a "combination of grants and below-market-rate loans to finance their operations. CDLFs re-lent this capital at market rates, using the difference to finance their operations." But owing to the recent limited supply of below-market-rate capital, Rubin indicated that CDLFs have been forced to seek other avenues, such as securitization of loans. Also, CDLFs are exploring new business opportunities "through mergers and partnerships with other CDFIs."

In view of the risk associated with most CDLF loans, Rubin noted that CDLFs have started to provide "extensive pre- and post-investment technical assistance to their portfolio companies." By assisting companies with writing their business plans as well as developing their market strategies and financial systems, CDLFs help companies qualify for capital and improve their prospects of success upon receipt of that capital.

Rubin pointed out that the research on CDLFs thus far has been composed mainly of descriptive statistics. Moreover, the data that have been collected are self-reported. However, she hastened to add that the paucity of research on the CDLF industry might be understandable considering the large number of CDLFs and their diversity. Rubin further noted that given that "CDLFs are unregulated institutions, they do not have unified standards of measurement or performance, as do community development banks and credit unions." Consequently, any resulting measures of job creation or loan loss rates, for example, might be defined differently by various CDLFs, thus compromising any comparative analysis. Similarly, she pointed out that given the diversity of CDLFs, the results from case studies of CDLFs would be difficult to generalize.

The research on CDLFs thus far has been composed mainly of descriptive statistics. Moreover, the data that have been collected are self-reported.

The dearth of research, according to Rubin, has left some questions about CDLFs unanswered. For instance, she suggested that, except for anecdotal information, we do not have any thorough reports "regarding the differences between CDLFs and more conventional financial institutions in terms of their default and delinquency rates or the composition of their customers." Rubin also underscored a point raised by Robinson Hollister in his conference paper that there is "only limited information about the social impact produced by the activities of individual CDLFs."

Rubin then turned her discussion to community development venture capital (CDVC) funds. She reported that "there were 79 CDVC providers either active or in formation as of the end of 2003, with $550 million under management." Rubin also pointed out that while the federal government and foundations were among the initial investors in CDVCs, banks and financial institutions have become an increasingly valuable source of funding. She further noted that CDVCs had benefited from the "important role that the investment requirement of the Community Reinvestment Act has played in encouraging banks to finance equity providers."

Rubin indicated that the activities of many CDVCs were restricted geographically. This limits their potential investment opportunities, which, in turn, might necessitate that they "invest in companies with limited management experience." Thus, like other forms of CDFIs, CDVCs supply intensive technical assistance to the companies in their portfolio.

The acquisition of capital is a concern shared by all types of CDFIs. However, the management behavior of investments by many CDVCs might hamper their ability to raise additional capital. Rubin noted that "like traditional venture capitalists, CDVC providers must exit their investments in order to make a profit and free up new investments." But she pointed out that the "unwillingness of many CDVC managers to force an exit that would be detrimental to the overall survivability of a company" might make it difficult for a CDVC to declare periodic returns to their investors from their profits. Thus, the uncertainty of periodic profit distributions might compromise a CDVC's ability to raise capital.

Rubin also mentioned the emergence of some bifurcation in the CDVC industry, even though it is still young. She noted that it is "between those funds that have smaller capitalizations of $1.5 to $5 million, make investments of $10 to $250 thousand, and target specific distressed rural and urban geographies consisting of a city, several counties or a state, and some of the newer CDVC funds that are more likely to have larger capitalizations of $5 to $20 million, to target broader geographies such as New England or the entire eastern U.S., and to make larger investments of $250 thousand to $1 million." She also indicated that the newer CDVCs were having more success in raising capital, especially from banks and financial institutions.

She observed that the changing economic and political environment since 2000 has made fundraising more difficult for CDLFs, CDVCs, and other types of CDFIs. Specifically, Rubin pointed to the economic slowdown that began in 2001. The decline in the stock market limited the disposable capital for investors in general and, in particular, the amount of capital available from foundations for grants and program-related investments. However, she suggested that the political challenges might be more formidable than the economic ones. According to Rubin, the current federal political environment is less than supportive of community development finance. As examples, she cited the proposed changes to the Community Reinvestment Act that might undermine its overall effectiveness and the cutbacks in the budgets for the CDFI Fund and the new markets venture capital program. Her general concern was that the current national policies and those that are under consideration (such as the privatization of Social Security and the elimination of the "double taxation" of corporate dividends in the tax code) along with the mounting military expenditures and the ballooning federal deficits might lead to dire consequences for the community development finance industry. Rubin wondered whether the current administration's policies would "result in a dramatic increase in individuals struggling to stay afloat financially, thus significantly increasing the populations that CDFIs are serving while the availability of resources with which to serve them are shrinking rapidly."

Discussion

Timothy Bates responded to Rubin's presentation. Bates pointed out that having observed several rounds of political decisions since 1971 to supply funding support to CDFI-type programs and then seeing that support withdrawn, he was convinced that such political funding cycles are simply inherent to the process. Thus, he predicted that there would be another high point for CDFIs followed by another low point.

However, Bates noted that while those in the CDFI industry are concerned about effectiveness, an analysis of many of the state-funded venture capital funds revealed that during the political funding cycles, effectiveness per se was not the major criterion for terminating programs. Therefore, operating a CDFI effectively cannot guarantee continued existence. With this as a backdrop, he suggested that it might be prudent to determine what types of CDFIs might survive in this political environment by drawing upon the qualities of those CDFIs that have endured the up and down phases of political funding over the years. Drawing on his historical perspective, Bates generalized that those CDFIs that hoped to survive the political funding cycles would be well advised to have three traits. First, they should have experienced staffs with a lot of expertise. Second, they should operate at scale—a point at which they would be large enough to manage the necessary paperwork efficiently as well as diversify their portfolio of investments (debt or equity) and realize a reduction in risk stemming from their diversified investments. Third, they should be able to persevere during the down phases by relying on their core operation of lending without subsidies. This might necessitate eliminating certain activities, such as technical assistance.

In light of these suggested traits for a CDFI's survival, Bates challenged the conference participants to consider designing CDFIs with these traits in mind during the next up cycle. He thought that this approach was superior to the status quo of creating a number of CDFIs, only to watch the weaker, very small ones fail when funding priorities change, leading to intense competition for a very small pool of funds.

Bates touched on another concern when evaluating the viability of CDFIs. He referred to this as the truthfulness issue. He cautioned that much of what we hear regarding the performance of CDFIs could be categorized as hype. Bates offered as an example an experience he had when working with the Minority Enterprise Small Business Investment Company (MESBIC) program while at the U.S. Small Business Administration (SBA). Bates was well aware of the SBA's public releases describing MESBIC as a program that predominantly emphasized venture capital investment in minority businesses and also subordinated debt. But as a result of having access to the underlying books, he discovered that there was a category of asset never mentioned, namely, certificates of deposit sitting in commercial banks—i.e., idle cash balances. In fact, these deposits were much greater than the sum of the venture capital invested by the entire industry. Bates noted that there is little talk about idle cash balances, yet it is known that for many CDFIs, idle cash balances are a major, enduring type of investment. He called for an attack on this structural problem by requiring the disclosure of exactly how the funds are being used.

Bates also observed that many CDFIs today are too small to be viable from the point of view of operational efficiency. This includes not only the CDFIs discussed by Rubin but also the lenders mentioned in Lisa Servon's paper. He also suggested that there should be realistic mandates from the government and foundations that allow CDFIs to actually do what they are supposed to do. According to Bates, in some instances, the stated purpose of a CDFI is at odds with its program structure. He gave the example of mandating that a program provide venture capital financing and then funding that program with debt debentures. It would place the program in a position of investing its money in equity investments in small businesses, a situation that would provide very little in the form of an income stream to pay the program's bills, let alone service the debt associated with its source of funds. Such a situation would be a complete mismatch of sources and uses of funds. Bates urged industry participants to take care in setting the operation parameters for CDFIs to avoid this type of mismatch and correct it where it exists.

He concluded on an optimistic note. Bates thinks that even though CDFIs face increased competition with banks in lending venture capital to small businesses, CDFIs had an opportunity to benefit from the competition. Given that banks tend to rely heavily on credit scoring when making loan decisions, some deserving businesses would be denied loans. CDFIs could step in and provide those loans, since they realize that the expertise of the firm's owner or the business's management team is an important component of the loan decision, but one not easily measured by the firm's credit score. Bates also believes that CDFIs could carve out another niche in their competition with banks. Since banks prefer asset-based lending, there might be some young, growing businesses that have pledged all of their collateral to obtain loans but need more money to fund their continued growth. While they would be unable to secure a loan from a bank, CDFIs could move in and fill the lending void.

Michael Barr had the formidable task of examining the connections among the various issues in community development finance that were presented and discussed during the conference as well as expounding on possible policy initiatives that would afford more financial stability for low- and moderate-income households. He accomplished this by investigating the range of issues in the context of four key and interrelated areas: financial services, saving, credit, and insurance.

In his paper "Community Development Finance and Public Policy: An Integrated Approach to Financial Services, Saving, Credit, and Insurance," **Michael Barr** explored the vital elements that would satisfy the financial services and wealth accumulation needs of low-income households.

In discussing the important role that access to financial services plays in one's financial well-being, Barr pointed out that "low-income households in the United States often lack access to bank accounts and face high costs for transacting basic financial services through check cashers and other alternative financial service providers." As a consequence, it is more difficult for these households to save or make future financial plans. Thus, "living paycheck to paycheck leaves them vulnerable to medical or job emergencies that may endanger their financial stability, and lack of longer-term savings undermines their ability to improve skills, purchase a home, or send their children to college."

Barr called attention to five barriers that thwart many low- and moderate-income individuals in using the services of the traditional banking system: difficulty in qualifying for conventional bank accounts (because of prior financial problems); the potential costs in maintaining a checking account (account balance minimums, high charges for bounced checks or overdrafts, and held checks not drawn on "own" bank, causing financial hardship for cash-strapped individuals); paucity of traditional banking services available in the neighborhood; lack of financial education; and lack of necessary documentation to open an account (especially pertinent to immigrants who fear the involvement of the U.S. Immigration and Naturalization Service).

He also noted that "low-income families lack access to institutional savings vehicles." He observed that in addition to many low-income households' lack of a bank account that could be instrumental to their ability to save, they also miss out on potential savings accruing from the tax benefits associated with pension plans, since, according to one study, "two-thirds of tax benefits for pensions go to the top 20 percent of Americans, while the bottom 60 percent gets only 12 percent of the tax benefit." Moreover, Barr cited another study that indicated that "most low-income workers work for firms without savings plans or are not covered by such plans." Thus, according to Barr, "the lack of sufficient income to afford saving and the lack of supply in savings products for the poor, coupled with low rates of return offered to the poor given their low levels of wealth, all contribute to depressing saving among low-income households."

Barr maintained that access to credit could also aid low-income households in their quest for financial security. But he cautioned that "while low- and moderate-income households do need access to credit, there are dangers to these households from assuming too much credit on the wrong terms." In theory, according to Barr, "low-income households would be more risk-averse with respect to credit than higher-income households because their income is likely to be volatile and they have little assets on which to fall back." But he stated that one could argue that "precisely because they have less to lose by going bankrupt," low-income households might be less risk-averse. However, regardless of the behavior of low-income households with regard to credit, Barr reported that "recent evidence suggests that [these] households are unable to access unsecured credit in order to avoid hardships when they suffer a spell of unemployment, suggesting that credit constraints still plague low-income households."

Barr discussed several areas where low-income households can get into financial difficulty when seeking additional funds. One source of extra money might be a short-term (usually two-week) consumer loan from a payday lender. Those who seek these types of loans are generally "low- and moderate-income working people who have bank accounts but lack credit cards, have poor credit history, or are tapped out on credit limits." But Barr indicated that such loans typically have high implicit annual interest rates. They can also result in consumers' getting caught in a "debt trap" when they "take out payday loans repeatedly throughout the year, often because they cannot repay their earlier payday loan by the next payday."

A second form of credit that could financially harm low-income households is a tax refund loan, also known as a refund anticipation loan (RAL). Some earned income tax credit recipients obtain RALs at the time their tax returns are being prepared. Barr noted that both payday loans and RALs can consume a significant amount of a household's income.

A third area where low-income households might become the subject of abuse is the subprime home equity loan market. According to Barr, "Many households turn to subprime home mortgage loans to consolidate other consumer debt, only to find themselves still unable to make ends meet; bankruptcy and foreclosure rates are much higher for subprime borrowers and the choice to convert unsecured debt into a secured (mortgage) loan may end up being a bad choice for many of these households."

Barr also touched on the fact that low- and moderate-income households face risks to their financial security due to a loss of physical health, income, or employment, or damage to the physical structure of their house. In this regard, he noted the important role that insurance of various kinds—federal and state income assistance programs, unemployment insurance, government or private health insurance, and homeowners insurance—can play in mitigating any deleterious effects. He pointed out that "insurance is functionally linked to saving, credit, and income." As a result, "Insurance can help smooth consumption and protect asset accumulation." But, unfortunately, as Barr observed, "It is likely that low- and moderate-income households are underinsured and face steep costs of insurance for most important life risks."

> Low- and moderate-income households face risks to their financial security due to a loss of physical health, income, or employment, or damage to the physical structure of their house.

However, Barr did suggest several policy changes that might help low- and moderate-income households achieve financial stability. Among them was having financial institutions provide low-cost electronic accounts to low-income individuals in exchange for tax incentives. To combat the necessity for an RAL, Barr advised that if tax refunds could be split and deposited into more than one account, the payment for the services of tax preparers could be directly deposited into their account with the remainder going to the client, thus eliminating the need for an RAL. When it comes to saving, Barr suggested that more use should be made of individual development accounts (IDAs) but that such accounts should be connected with large financial institutions. He also argued against altering Social Security by establishing individual retirement accounts funded by Social Security receipts. In response to the exploitation that low- and moderate-income individuals face when seeking a mortgage loan, Barr noted that prohibiting "yield spread premiums as the dominant form of broker compensation and replacing it with flat fees could take some of the sting out of broker abuses." As a further measure in the market for home insurance, he called for required, rather than voluntary, disclosure from all insurers of information about the location, race, gender, and income of applicants and policy holders. This would help firms and regulators better monitor compliance with fair housing laws.

All told, Barr stressed that "public policy is largely geared towards increasing the returns to capital for those who have accumulated assets, rather than towards increasing savings and asset accumulation among those who have been left behind." He concluded by stating that "rather than continuing to shift the tax burden from higher income taxpayers to middle income households and future generations, and rather than moving to private accounts within Social Security, public policy should instead focus on increasing the incomes and assets of low- and moderate-income households, and their access to credit and insurance, in the years to come."

Discussion

Ellen Brown served as the discussant for Barr's presentation. She noted that Barr's paper reflected a comprehensive view of the components that lead to economic security and wealth: credit, savings, insurance, housing/asset development, and tax policy. In fact, in view of the paper's breadth and depth, she regarded it as the basis for a book masquerading as a paper. Brown's remarks were a combination of probing questions and observations prompted by the information on the many topics covered in Barr's paper. She stressed that anyone attempting to address the plight of low-income Americans must understand the realities of being poor in the U.S. Failure to do so might thwart the best of intentions. In pursuing economic and educational remedies to aid the poor, it would be instructive to ask to what extent are policy and product development recommendations informed by real-life options and planning horizons of poor Americans in both urban and rural areas.

While acknowledging the potential benefits of programs such as IDAs and EITC to low-income individuals, she questioned what, if anything, we have learned from the low rates of participation in these programs. Perhaps the programs would be in greater demand and thus more effective if more attention were paid to understanding the financial needs of the prospective participants when formulating the programs.

Similarly, Brown was intrigued with the popularity of check-cashers among low-income individuals and suggested that we ascertain what it is about the services and products they offer (albeit at extremely high rates) that seems to meet the needs of this segment of the population. She further pointed out that it would be valuable to know more about how individuals store value, in particular, whether there are options other than cash savings. Brown was especially interested in this question as it applies to immigrant communities where traditions of saving in gold or jewelry may still persist.

Brown also commented on another topic that Barr dealt with in his paper: the unbanked. She questioned our state of knowledge about banks' and other financial institutions' outreach efforts to the unbanked. Brown observed that banks in their current form are not very welcoming to low-income or immigrant customers. She suggested that this is due, in part, to their intimidating physical plant, multiplicity of forms to complete, expectation that English be spoken, inconvenient hours, and identification requirements. Brown indicated that more attention should be given to how traditional institutions might be more welcoming of these customers.

On the subject of insurance, Brown pointed out that savings and credit might be related to insurance but not substitutes for it. They might be sufficient to handle a rainy day, but they are not replacements for the traditional uses of insurance, such as for health, property, and so forth. Although Brown recognized that some research has shown that low-income individuals and families can save, she thought that their absolute level of potential savings would not cover the cost of a health or property crisis. She noted that Barr had a good illustration of the impact of cascading shocks in the absence of insurance, namely, an accident involving an uninsured car leads to job loss, then to homelessness, then to loss of child custody, then to depression and so on.

> Anyone attempting to address the plight of low-income Americans must understand the realities of being poor in the U.S. Failure to do so might thwart the best of intentions.

Brown's final area for comment was financial education. She observed that usually people are interested in financial knowledge only when they are facing an adverse transaction and then it's often too late. According to Brown, the question remains: How can financial education be offered effectively and efficiently to adults and delivered at scale? She suggested that perhaps financial education should be reintroduced into the secondary school curricula.

Elizabeth Rodriguez, vice president and community affairs officer at the Federal Reserve Bank of New York, closed the conference by thanking the conferees for a stimulating and highly informative discussion of the critical issues in the field of community development finance. She pointed out that the exchange during the conference exceeded the goals set forth at the outset.

Rodriguez especially thanked the authors for providing the conference with a set of papers on the crucial topics in the field; these papers, in turn, served as the basis for the fruitful discussion that transpired. She also acknowledged the insightful comments offered by the discussants. All told, Rodriguez said that the ideas engendered by the conference provided not only some useful guidelines for practitioners and food for thought for policymakers but also some areas for future research.

The conference extolled the virtues and accomplishments of the community development finance industry over the past 20 years. While the conferees agreed that the industry deserved to celebrate its achievements, they cautioned that it cannot afford to rest on its laurels. The changing environment in the financing of community development activities dictates that community development financial institutions (CDFIs) reassess their operations in order to meet the challenges that lie ahead.

CDFIs face a changing landscape influenced by increased competition from banks, the need for alternative funding sources, and changes in regulation and policies. The conferees suggested several areas where the community development finance industry in general and CDFIs in particular might make changes that leverage their talents so the latter can remain a force in the community development field. This is especially germane if CDFIs expect to grow and achieve scale. Among the many suggestions, it was recommended that the community development finance industry consider undergoing a restructuring to take advantage of economies of scale and specialization. Such an undertaking would allow the industry to become more efficient and better able to respond to new developments in market conditions. The community development finance industry was also urged to support strategies that encourage low-income households to increase savings and asset building. In addition, the industry should promote financial literacy and seek links between it and community development outcomes.

The conferees suggested that CDFIs might reconfigure their products to make them more competitive. They should also consider pursuing additional sources of funds other than from the government and philanthropic organizations. By reducing their reliance on government funds, CDFIs could ease the shocks that accompany political funding cycles. One proposed alternative was the conventional capital markets. However, this might entail adopting the necessary standards and other practices—such as assigning ratings to securities and the appropriate pricing of loans—that would allow participation in the mainstream financial markets. Moreover, participants pointed out that CDFIs might better market their services as well as improve their prospects for funding by more accurately measuring their impact in the community.

Perhaps the sentiment of many of the conferees was summed up in the words of one conference participant who remarked that "there are challenges, there are opportunities. This is a down cycle. There will be up cycles in the future and in an up cycle we can apply a lot of the wisdom of the past rounds of CDFIs and set up an industry that doesn't have to worry about perishing every 20 years—rather, there are lots of reasons to think that it might flourish."

...with their affiliations at the time of the conference

Michael Barr
University of Michigan Law School

Timothy Bates
Wayne State University

Ray Boshara
New American Foundation

Rachel Bratt
Tufts University

Ellen Brown
New Jersey Institute for Social Justice

John Caskey
Swarthmore College

Walter Davis
University of North Carolina

Carla Dickstein
Coastal Enterprises

Elaine Edgecomb
Aspen Institute

Kathleen Engel
Cleveland-Marshall College of Law

Nora Fitzpatrick
Federal Reserve Bank of New York

Marianne Hilbert
Board of Governors
of the Federal Reserve System

Jeanne Hogarth
Board of Governors
of the Federal Reserve System

Robinson Hollister
Swarthmore College

Jane Kolodinsky
University of Vermont

Patricia McCoy
University of Connecticut Law School

Dede Myers
Federal Reserve Bank of Philadelphia

Mark Pinsky
National Community Capital Association

Marta Rocha
University of North Carolina

Elizabeth Rodriguez
Federal Reserve Bank of New York

Julia Sass Rubin
Rutgers University

Daniel Schneider
Harvard University

Jane Schuchardt
U.S. Department of Agriculture

Ellen Seidman
ShoreBank Advisory Services

Lisa Servon
New School University

Marvin Smith
Federal Reserve Bank of Philadelphia

Michael Stegman
University of North Carolina

Michael Swack
Southern New Hampshire University

Peter Tufano
Harvard University

Susan Wachter
University of Pennsylvania

Alan White
Community Legal Services, Inc.

Marva Williams
Woodstock Institute

Community Development Finance Research Conference:

A Summary