Community Development and Federal Subsidies: A View from 40,000 Feet

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Overview

This paper presents a broad overview of the community development industry and its use of subsidy, examining historic trends and speculating about the future. Its approach is to contextualize community development within federal poverty policy and within a changing economic and financial services world.

One of the conclusions I reach is that community development as it is currently envisioned commands a small fraction of public subsidy and plays a relatively small role in national poverty policy. My observations suggest a set of questions that the community development field will need to answer about its use of public subsidy in light of the changing economic, financial, and fiscal contexts: What should the role of community development be within federal poverty policy? What institutional infrastructure is necessary for community development to be undertaken effectively? And what subsidies are necessary to build this infrastructure?

Historic Connections: Community Development and Federal Anti-Poverty Policy

The modern community development movement originated arguably in the 1960s. The Economic Opportunity Act of 1964—the centerpiece of the War on Poverty–declared:

> [It is] the policy of the United States to eliminate the paradox of poverty in the midst of plenty in this Nation by opening to everyone the opportunity for education and training, the opportunity to work, and the opportunity to live in decency and dignity.

Prior to 1964, the federal government had established programs that addressed the *effects* of poverty. For example, the Housing Act of 1937 provided federal subsidy to construct public housing for low-income families; the Social Security Act of 1935 created Aid to Dependent Children, an income transfer program for poor families; and the Housing Act of 1949 ushered in "urban renewal," efforts to eliminate physical blight and create "a suitable living environment for every American family." With the 1964 Economic Opportunity Act (the Act), however, the federal government took responsibility for eliminating the *root causes* of poverty. The Act, in concert with other legislation, took a four-pronged approach: 1) macroeconomic policy to stimulate economic growth (a tax cut); 2) workforce programs to prepare poor people for the new jobs; 3) civil rights legislation to end discriminatory hiring practices; and 4) bureaucracy reform intended to increase service coordination and political participation by the poor themselves.[1] On paper, these four strands framed a coherent, plausible anti-poverty strategy.

Overseen by the newly-created Office of Economic Opportunity (OEO), the Act funded a number of programs that still exist today such as Head Start, Volunteers in Service to America (now Americorps VISTA), Job Corps, Legal Services (now the Legal Services Corporation), Summer Youth Programs, Adult Basic Education, and others. It also created the Community Action Program (CAP) and by 1966 was funding some 1,600 local community action agencies (CAAs).[2] While some 90 percent of CAP expenditures supported social services, an underlying assumption of the CAP was that poor people should have a stronger voice with the political institutions that affected their lives. Accordingly, the early

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[1] Robert H. Haveman. "Introduction: Poverty and Social Policy in the 1960s and 1970s—An Overview and Some Speculations" in Robert H. Haveman (ed.) *A Decade of Federal Antipoverty Programs: Achievements, Failures, and Lessons.* New York: Academic Press, 1977.

[2] Robert F. Clark. *The War on Poverty: History, Selected Programs and Ongoing Impact.* Lanham, MD: University Press of America, 2002.

community action agencies were largely independent of local governmental control and functioned as platforms for community empowerment and political reform. Mayors and other officials found this activism to be untenable, however, and later drove amendments to the Act that gave local governments more control over the CAAs and dimmed the promise of community participation.[3]

The Emergence of Place-Based Programs

While the CAAs operated in low-income *areas*, they primarily delivered a collection of *people-based* social services, many aimed at preparing the poor for jobs. However, advocates for community development believed that successful *communities* were necessary for poor people to compete economically and integrate into mainstream society. They called for new efforts to build strong communities that would be led by local institutions trusted by local residents. In 1966, Senators Robert Kennedy and Jacob Javits introduced Amendment I-D to the Act, creating the Special Impact Program (SIP) which emphasized the role of economic development in alleviating poverty.[4] The SIP funded community development corporations (CDCs), place-based non-profit organizations that could carry out a wide spectrum of market-oriented activities. The early CDCs were governed by community-controlled boards of directors. These institutions were not “invented” by federal government, but rather their precursors had already formed in certain neighborhoods as local responses to local needs. With federal funding available, these rudimentary CDCs proliferated and by the mid-1970s, they numbered about 100 to 150.

Thus, community development emerged as a place-based complement to the original people-based programs of the Economic Opportunity Act. The practice of community development, as embodied in the CDCs, assumes that poverty is a function of place and environment rather than just the “shortcomings” of particular individuals. It sees poverty as a consequence of interconnected factors that require action on multiple fronts, including economic development, workforce preparation, housing, social services, physical infrastructure, education, and public safety. Unlike social service interventions, community development deploys market-related tools such as real estate development and business development to address the economic roots of poverty. Community development also asserts that residents can and should shape the future of their communities.[5]

The Nixon administration disbanded the OEO in 1974 and direct federal support to CDCs diminished. However, in 1974, Congress merged seven categorical federal funding programs into community development block grants (CDBG), distributed to cities and states on the basis of need, with goals of extinguishing poverty and urban blight. Many cities began funding CDCs out of their CDBG allocations and, thus, the number of CDCs actually grew even though the SIP was being phased out.

In the 1980s and 1990s, more CDCs formed as a result of changes in federal housing policy. Under the Reagan administration, federal support for low-income housing was reduced by 70 percent, and states and localities had to come u0070 with new solutions.[6] A second wave of CDCs was started in the 1980s, generally smaller organizations specialized in building affordable housing. Their growth was aided by three national intermediaries—NeighborWorks America, the Local Initiatives Support Corporation (LISC), and Enterprise Community Partners—who mobilized public, private, and philanthropic resources and created financing and capacity building systems to support affordable housing. The Community

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[3] Lawrence F. Parachini, Jr. *A Political History of the Special Impact Program.* Cambridge, MA: Center for Community Economic Development, 1980.

[4] Julia Sass Rubin. “Chapter 1: Introduction” in Julia Sass Rubin (ed), *Financing Low-Income Communities: Models, Obstacles, Future Directions.* New York: Russell Sage Foundation, 2007.

[5] Neal R. Pierce and Carol F. Steinbach. *Corrective Capitalism: The rise of America’s Community Development Corporations.* New York: Ford Foundation, 1987.

[6] Diane R. Suchman, et al. *Public/Private Housing Partnerships*. Washington, DC: Urban Land Institute, 1990.

Reinvestment Act (CRA) of 1977 incentivized banks to increase their lending in the low- and moderate-income communities where they operate and banks became an important financing partner in affordable housing. The Low Income Housing Tax Credit (Tax Reform Act of 1986) created an incentive for private equity investment in affordable housing.

By 1988, the country had 1500 to 2000 CDCs.[7] In 1990, Congress authorized the HOME Investment Partnership Program, a block grant distributed by the Department of Housing and Urban Development (HUD) subsidizing housing for low and very low-income Americans. The HOME program is the largest federal grant program for low-income housing. It also requires that jurisdictions reserve 15 percent of their funding for projects developed, sponsored, or owned by non-profit community housing development organizations (CHDOs). Thus, the HOME program catalyzed formation of still more CDCs in the 1990s.

Another set of community-based development organizations, community development financial institutions (CDFIs), emerged in the 1960s and 1970s.[8] These mission-driven institutions include non-profit loan funds, microenterprise funds, credit unions, venture capital companies, and banks. They provide loans, investments and other financial services to individuals and organizations inadequately served by conventional financial institutions.

The early CDFIs did not have a dedicated federal funding resource like SIP. Instead, they raised capital and operating subsidy from philanthropy and from diverse programs within HUD, the U.S. Department of Agriculture (USDA), and the Department of Commerce. Like CDCs, CDFIs were affected by CRA and the housing devolution policies of late 1980s. Many CDFIs were started or evolved to meet the financing needs of affordable housing development organizations. The creation of the CDFI Fund within the Treasury Department (1995) further accelerated the industry's growth. Although the program has never been large (the core funding program usually has no more than $100 million available each year), it can provide the core equity capital with which CDFIs can leverage the more readily available debt capital from banks and other sources. The New Markets Tax Credit (NMTC) program, established in 2000, provided an incentive for private investment in job creating projects located in low-income communities. With these federal subsidies, the CDFI industry expanded rapidly in the 1990s and 2000s.

This framework of federal policies and subsidy programs–CDBG, HOME, CRA, CDFI Fund, LIHTC and NMTC—propelled the growth of the community development industry through the 2000s. A 2005 census of CDCs estimated 4,600 CDCs across the country.[9] A more recent study reported community developer production at nearly 100,000 affordable housing units annually with cumulative production over 1.6 million units.[10] CDCs had also developed over 21 million square feet of commercial and industrial space between 2005 and 2007. As of December 2010, the federal CDFI Fund had certified 931

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[7] *Reaching New Heights: Trends and Achievements of Community-Based Development* Organizations. Washington, DC: National Congress for Community Economic Development Census, 2005. http://www.ncced.org/documents/NCCEDCensus2005FINALReport.pdf.

[8] This history of CDFIs is taken from Kirsten Moy and Alan Okagaki, *Changing Capital Markets and Their Implications for Community Development Finance.* Washington, DC: Brookings Institution, 2001; and Julia Ann Parzen and Michael Hall Kieschnick, *Credit Where It's Due: Development Banking for Communities.* Philadelphia: Temple University Press, 1992.

[9] *Ibid*.

[10] *Rising Above: Community Economic Development in a Changing Landscape.* Washington, DC: National Alliance of Community Economic Development Associations, 2010, www.naceda.org.

CDFIs.[11] In 2008, the Opportunity Finance Network reported data from 495 institutions that collectively had total assets of $29.4 billion and total financings outstanding of $20.4 billion.[12]

Evolving Models

The community development industry has morphed in profound ways over 40 years. It shifted strongly towards affordable housing in the 1980s and 1990s. In order to reach scale and become financially self-sustaining, many organizations followed a path of tight financial management, standardized products and services, and more efficient systems based on IT platforms. Often, these organizations chose to become highly specialized rather than working across the multiple dimensions of poverty. Many have also de-emphasized the less tangible aspects of community development such as empowering residents, participating in political alliances, and acting as a nexus point between community and external actors.

As a response to the trend of specialization, a new form of community development, sometimes referred to as "comprehensive community-building initiatives" (CCIs), appeared in the 1990s. While CCIs varied greatly, they generally assessed a community's assets and problems holistically; involved community residents in designing and executing a plan of action, and engaged a diverse array of community, civic, private and public sector partners. Their activities spanned a wide range as they sought economic and social change in the livelihoods of individuals and families, in neighborhoods, and in public and civic systems. In her review of the 20 year history of CCIs, Anne Kubisch lists 43 major community building initiatives, many carried out in multiple neighborhoods.[13] However, many prominent CCIs were time-limited experiments that did not culminate in permanent institutions, programs, or partnerships. While some CCI principles were embedded in federal programs such as HOPE VI, the Empowerment Zones, and Weed and Seed, it is hard to connect the CCI movement to particular federal policies or subsidy sources. More often, foundations and local governments have been the driving force behind CCIs.

Interestingly, the major intermediaries have been shifting towards more holistic conceptions of community development in recent years. The Neighborhood Housing Services network rebranded itself as "NeighborWorks America" to communicate its wider set of community concerns. Living Cities, a major philanthropic intermediary, has rolled out a new funding strategy based on "a general recognition that we need to treat our cities' problems comprehensively—strengthening neighborhood institutions from the bottom up and reengineering, from the top down, the public systems that fail to create adequate opportunities."[14] Similarly, LISC has re-tooled itself around a vision of Sustainable Communities, where "human opportunity and social and economic vitality combine with a continuous process of growth, adaptation, and improvement."[15] NeighborWorks, Living Cities, and LISC are moving back towards the original conception of CDCs: comprehensive approaches to poverty and development, resident engagement, and CDCs acting as a bridge between communities, the public sector, and the market.

There are numerous examples of individual CDCs and CDFIs taking integrated approaches. For example, in 2009, the Ford Foundation's Rural Livelihoods Learning Group studied five organizations serving chronically impoverished rural areas: Enterprise Cascadia in the Pacific Northwest, Southern

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[11] *Certified Community Development Financial Institutions—By Organization Type.* Washington, DC: The CDFI Fund, 2010, http://www.cdfifund.gov/docs/certification/cdfi/CDFIbyOrgType.pdf.

[12] CDFI Data Project. *Providing Capital, Building Communities, Creating Impact. Fiscal Year 2008; 8th Edition,* http://opportunityfinance.net/store/downloads/cdp_fy2008.pdf.

[13] Anne C. Kubisch, Patricia Auspos, Prudence Brown, and Tom Dewar. *Voices from the Field III: Lessons and Challenges from Two Decades of Community Change Efforts*. Washington, DC: Aspen Institute, 2010.

[14] Living Cities Integrative Approach, http://www.livingcities.org/innovation/integrative/.

[15] LISC Annual Report for 2009, http://www.lisc.org/annualreport/2009/pdf/09report.pdf.

Bancorp in the Mississippi Delta, Mountain Association for Community Economic Development and Federation for Appalachian Housing Enterprises in Appalachian Kentucky, and Four Bands Community Fund on the Cheyenne River Reservation in South Dakota. The research was part of an international study of "hybrid organizations," so called because they bring together unusual combinations of poverty strategies. All five organizations are CDFIs, but they view their missions much more expansively than loans or financial services. Each has a deep analysis of poverty that encompasses local economic, political, social, and cultural factors. Their strategies attack poverty at multiple levels, from the individual to broader systemic and policy change. They operate in partnership with other organizations that provide complementary services and institutional strengths. They are actively engaged in their communities and, in different ways, seek to empower residents or cultivate local leadership.

The world of community development today is more complex than it was in the 1960s and 1970s. There are dozens of federal funding sources, and even more philanthropic and private funding sources. There are many types of organizations engaged in community development activities besides CDCs and CDFIs, including social service agencies, civic associations, foundations, local governments, community advocacy groups, and universities. The boundaries of community development activities are murky: A compendium on *Reengineering Community Development for the 21st Century* contains papers on bicycling, smart growth, foster care, crime, and transformational asset building.[16] The complexity and murkiness have made it more difficult to place community development into the broader framework of American anti-poverty policy. This problem arises in part because of the confusing shape of federal poverty policy generally. For all of its failings, one could find policy coherence in the 1960s War on Poverty and one could logically fit community development within that framework. In today's milieu, community development has grown not so much as an intentional result of federal policy, but opportunistically, as community development entrepreneurs have found ways to exploit subsidy sources in the federal budget.

Community Development and its Present Use of Subsidy

So what does the current picture of federal subsidy for community development look like? Cashin, Gerenrot, and Paulson estimated total governmental community development expenditures in 2004 at over $45 billion.[17] Their analysis defines community development as "construction, operation, and support of housing and redevelopment projects and other activities to promote or aid public and private housing and community development" and it includes state and local expenditures in addition to federal support. The Federal Reserve Bank of Boston placed federal community development spending at about $22 billion in Fiscal Year 2004, excluding procurement, wages and salaries, and tax expenditures such as the Low Income Housing Tax Credit (LIHTC).[18] This analysis divided the federal budget into 20 "functional" categories, of which community development is one. However, community development practitioners utilize subsidy programs that are classified in other functional categories, such as business and commerce, housing, education, and employment, labor and training. This estimate also does not include all federal spending that supports key community development activities such as

[16] Donna Fabiani and Terry F. Buss (eds). *Reengineering Community Development for the 21st Century.* Armonk, NY: M.E. Sharpe, 2008.
[17] "Determinants of Federal and State Community Development Spending: 1981–2004," *Profitwise News and Views.* Chicago: Federal Reserve Bank of Chicago, 2007, http://www.chicagofed.org/digital_assets/publications/profitwise_news_and_views/2007/pnv_regedoct07_web_casgerpau.pdf.
[18] "Federal Spending and Incentives: What Does the Data Tell Us?" *Community Affairs Brief* (unpublished). Boston: Federal Reserve Bank of Boston, 2007.

institution building, community mobilization, and connecting local economies and residents to external resources.

A different approach to elucidate federal subsidies for community development is to examine the funding sources for CDCs and CDFIs, two large categories of institutions that self-identify with community development. The 2005 census of CDCs reported that 88 percent of all CDCs received at least $50,000 in grants investments or loans from the federal government, followed by banks (49 percent) and foundations (49 percent).[19] The 2007 CDC census listed the following federal programs as most frequently accessed by CDCs: HUD HOME Program (53 percent of all CDCs), HUD's Community Development Block Grant (CDBG) program (40 percent), HUD's Section 8 program (28 percent), and the LIHTC program (28 percent). However, the most striking finding is the sheer number of federal programs utilized by CDCs. The 2007 Census lists 37 separate federal funding sources, several of which represent multiple funding programs. The total number of distinct federal programs utilized by CDCs might very well exceed 100.

Data of comparable quality has not been collected on the subsidy sources for CDFIs. However, in a 2007 survey by the Aspen Institute Economic Opportunities project, nearly 80 percent of respondents listed the government (not differentiated by federal, state or local) as one of their top three funding sources, followed by foundations (66 percent) and private financial institutions (50 percent).[20] As with CDCs, CDFIs piece their funding together from many different federal programs. The CDFI Fund in the Treasury Department administers several funding programs including the NMTC program. In addition, HUD, USDA, and the SBA have various specialized programs which provide capital or operating subsidy to CDFIs.

Table 1 presents 2009 federal budget data, primarily taken from the *Catalog of Federal Domestic Assistance,* for some of the most important CDC and CDFI funding programs. The data suggests that programs targeted specifically to CDCs and CDFIs (such as the CDFI Fund) are usually small. For the larger subsidy sources, such as the HUD programs, CDCs and CDFIs compete with local government, other non-profits, and for-profit companies and receive only a fraction of the total funds available. For the single biggest funding source, the USDA Section 502 Single Family Loan Program, the subsidy flows directly from USDA to the homebuyer and thus, does not contributes to the financial strength of a CDC or CDFI.

Table 1
Federal Funding Sources for CDCs and CDFIs, $ millions[21]

CDC Funding Sources	2009 Budget	CDFI Funding Source	2009 Budget
HUD HOME Program	$1,825	CDFI Fund, Core Financial Assistance	$102
HUD CDBG	$3,634	CDFI Fund, BEA	$22
HUD Section 202/811 Elderly/Disabled Hsg	$1,086	SBA Microloan Program	$74
HUD McKinney Act Shelter & Care	$593	USDA Intermediary Relending Program	$34

[19] *Reaching New Heights,* 2005
[20] Aspen Institute Economic Opportunity Program. *Approaches to CDFI Sustainability* Aspen Institute, July 2008.
[21] NMTC data from www.cdfifund.gov; data for LIHTC from http://www.novoco.com/low_income_housing/resource_files/research_center/cbo_housingprograms_110309.pdf; and remaining data from the *Catalog of Federal Domestic Assistance,* www.cfda.gov.

USDA Section 502 Single Family	$9,034	USDA Rural Business Enterprise Grants	$38
USDA Section 523 Self Help Housing	$32	Charter School Credit Enhancement	$8
Low Income Housing Tax Credit	$6,000	New Markets Tax Credit	$5,000

How much of these federal community development expenditures are captured by CDFIs and CDCs is largely guesswork. The federal programs that provide the most dollars to CDCs and CDFIs are probably the HUD HOME program, the LIHTC, and the NMTC program. A very rough estimate is that CDCs and CDFIs receive a third of the total allocation from the first two sources and a smaller fraction of the NMTC program. Using these figures as a base, I estimate that the total federal subsidy received by CDCs and CDFIs is likely more than $4 billion but probably less than $8 billion.

Subsidies to CDCs and CDFIs should be viewed in the larger context of the federal budget. According to the Center for Budget Policy and Priorities, in fiscal year 2010, the federal government spent $3.5 trillion, of which $496 billion (14 percent) supported safety net programs.[22] Thus, CDCs and CDFIs capture between 0.1 percent and 0.2 percent of the total federal budget, or about 1 percent to 2 percent of federal expenditures for safety net programs.

Another part of the subsidy picture for community development is the flow of resources from banks and thrifts to low-income communities as a result of CRA.[23] The CRA changed the behavior of banks with respect to lower-income areas both in terms of amount and nature of lending, investment, and services. As a result of CRA, banks provide more money and have also developed innovative products to serve this population. Collectively, banks benefit from the greater information available about these markets as a result of their CRA activities, and now see these neighborhoods as viable places to do business. Banks can receive CRA credit for their support to CDCs and CDFIs, thereby supporting the community development infrastructure in these communities. The aggregate volume of this lending is substantial. In 2008 (before the recession), banks and thrifts made $60 billion of small business loans and $73 billion of community development loans to low- and moderate-income (LMI) census tracts. They originated and held $12 billion of mortgages in LMI census tracts; Fannie Mae, Freddie Mac, and Ginnie MAE originated and held another $98 billion of mortgages. The total volume of CRA-related lending in 2008 was $243 billion.[24]

Table 1 also identifies that community development utilizes subsidies in many different forms other than direct grants, including tax expenditures (LIHTC and NMTC), loans, and loan guarantee or insurance

[22] "Where Do Our Federal Tax Dollars Go?" *Policy Basics* (Washington, DC: Center on Budget and Policy Priorities, updated April 15, 2011), http://www.cbpp.org/files/4-14-08tax.pdf. Safety Net Programs include income security functions such as the refundable portion of the Earned Income and Child Care tax credits, Supplemental Social Security Income for the elderly or disabled, unemployment insurance, food stamps, school meals, low-income housing assistance, child-care assistance, assistance in meeting home energy bills, and various programs for abused and neglected children, but not social security, Medicare or Medicaid.

[23] CRA encourages commercial banks and savings associations to meet the credit needs of borrowers in all segments of their communities, including low- and moderate-income neighborhoods, consistent with safe and sound operation. Regulatory agencies examine banks for CRA compliance and use this information when considering applications for new bank branches or mergers and acquisitions, See http://www.fdic.gov/regulations/laws/rules/6500-2515.html#6500hcda19.

[24] CRA data from the Federal Financial Institutions Examination Council, http://www.ffiec.gov/craadweb/national.aspx. In 2009, banks and thrifts made $43 billion of small business loans and $35 million in community development loans to LMI census tracts. They originated and held $16 billion of mortgages in LMI census tracts; Fannie Mae, Freddie Mac, and Ginnie MAE originated and held another $105 billion of mortgages. The total volume of CRA-related lending in 2009 was $199 billion.

programs. Federal poverty policy since the 1970s has moved beyond the traditional tools of income transfer payments, direct service provision by government, and federal grants to include a larger set of tools such as tax expenditures, regulation, loans, loan guarantees, and insurance. The new policy tools help leverage private investment (as with tax credits and loan guarantees) and recycle capital (as with loans) but require financial sophistication to deploy. These alternative tools are often large compared to the more traditional grant programs. For example, LIHTC, at almost $6 billion, is several times the size of the HUD HOME Investment Partnership Program, at $1.8 billion.

To summarize, the total volume of subsidies to CDCS and CDFIs is small compared to other federal anti-poverty expenditures and the funding is highly fragmented, a patchwork quilt rather than an intentionally designed funding system. Much of the subsidy takes the form of loans, loan guarantees, and tax credits rather than direct grants. About one-half of CDCs and one-half of the CDFIs cite banks and other private financial institutions as significant sources of funding, which suggests the powerful role that CRA has played in the overall funding system. The flow of private sector lending into LMI communities ($242 billion) prompted by CRA is much larger than the federal subsidies for community development as a whole ($45 billion) or to CDCs and CDFIs (estimated between $3 and $6 billion).

Looking to the Future

Thus far I have looked backward at how federal anti-poverty policy and subsidy programs have helped shape the modern community development sector. Below I examine four trends with the potential to significantly alter the shape of the community development sector going forward. Each trend presents an opportunity for community development organizations to leverage their assets to strengthen their value proposition. These trends also pose some opportunities and problems to be addressed by future reform of community development policy and subsidy.

The Significance of Place

Since the 1960s and early 1970s, the fundamentals of our economic geography have been transformed. The "global economy" has become a cliché and nearly all markets evidence a much higher degree of geographic integration. A neighborhood can no longer be plausibly treated as a semi-autonomous economic unit. Instead, it functions within an interconnected metropolitan economy. Rural economic development, which had previously been the province of individual towns and counties, is similarly moving towards regional approaches that encompass many counties and often cross state lines.[25] For everyone, the internet and overnight shipping have disconnected business from place.

The changing economic geography calls into question the continued significance of place. Many have argued that the nation should invest solely in people-based anti-poverty policies—education, training, job and family counseling, relocation assistance—rather than place-based policies. Place-based policies are thought to be economically inefficient because they "trap" poor people in low-income areas and because they distort business and human migration decisions.[26] Community development takes a more nuanced view about the relationship between poor people and poor places, a view which is supported by a recent body of literature. Research on "concentrated poverty" demonstrates that poor people living in very poor communities face a double burden, the challenge of surviving on insufficient income plus the problems associated with poverty-stricken areas. These problems include: 1) fewer local

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[25] Brian Dabson, *Generating Rural Innovation and Regional Partnership,* Keynote Presentation at the 2010 Northeast Rural Summit, Burlington, VT, April 2010. http://www.rupri.org/Forms/Dabson_NortheastRuralSummit_April2010.pdf.

[26] See, for example, David Kraybill and Maureen Kilkenny, "Economic Rationales For and Against Place-Based Policies," *Staff General Research Paper No. 1173*, Department of Economics, Iowa State University, 2003.

job opportunities, limited local amenities, and lack of quality housing options; 2) higher prices for goods and services; 3) lack of networks that help people find jobs and advance in their careers; 4) weaker schools; 5) high crime; and 6) depressed property values.[27]

Areas of concentrated poverty persist over time. Partridge and Rickman found an 84 percent correlation between county-level poverty rates in 1979 and 1999.[28] The USDA's Economic Research Service has identified 340 "persistently poor" non-metropolitan counties which have had poverty rates of 20 percent or greater in every decennial census between 1970 and 2000.[29] Jargowsky found that while the national poverty rate was fairly constant between 1970 and 1990, the number of poor people living in urban high-poverty neighborhoods almost doubled.[30] This pattern reversed somewhat in the 1990s, evidently the product of strong economy.[31] However, as poverty rates increased in the 2000s, the pattern of geographically concentrated poverty reappeared and strengthened. While poverty and unemployment rates broadly track each other at the national level, Partridge and Rickman found this relationship does not necessarily hold within smaller geographies. They write: "poverty varies greatly within broad regions. Even within narrower areas such as states or metropolitan areas, clusters of high and low poverty often exist in relatively close proximity...[A]t the state or more broadly, the regional level, there can be large relative changes in poverty rates over time, but at the disaggregated county level, relative poverty is often quite persistent."

Partridge and Rickman's research offers four insights on the relationship between county-level poverty rates and labor market trends. First, county-level poverty rates respond slowly to economic shocks such as a decrease in the unemployment rate. Job growth does eventually reduce the local poverty rate but only after a long period of time. While a five year period of sustained job creation yielded an impact on poverty rates, job growth over a two year period did not. Second, child poverty rates were more sensitive to changes in local labor market conditions than the overall adult poverty rates. Thus, reducing local unemployment rates had a more powerful impact uplifting families with children than it did on households without children. Third, in metropolitan areas, new job growth had a stronger effect on reducing poverty in the inner city than it did in the suburbs. Fourth, in rural areas, employment growth appeared to have a stronger impact on reducing poverty than it did for the country as a whole.

The Federal Reserve System and the Brookings Institution researched persistent concentrated poverty in 16 communities across the country.[32] The study examined diverse areas: urban and rural geographies and weak and strong markets composed of populations with different ethnic and racial backgrounds. A common theme among the case studies was isolation between the community and the surrounding regional economy. Isolation sometimes took the form of physical barriers such as an Indian Reservations located many miles from metropolitan areas or a freeway separating a neighborhood from the downtown or segregated neighborhoods resulting from exclusionary zoning. In other cases, racial or ethnic discrimination or linguistic barriers produced the isolation. The research also revealed poverty as a problem with multiple and interconnected causes. According to the report, "The high levels of poverty in these communities are the product of long-term, complicated economic and social dynamics, as well

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[27] David Erickson, et al., eds., *The Enduring Challenge of Concentrated Poverty in America: Case Studies from Communities Across the U.S.,* The Federal Reserve System and the Brookings Institution, 2008.
[28] Mark D. Partridge and Dan S. Rickman, *The Geography of American Poverty: Is There a Need for Place-Based Policies?* Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2006.
[29] Rural Income, Poverty, and Welfare: Poverty Geography, USDA Economic Research Service, http://www.ers.usda.gov/Briefing/IncomePovertyWelfare/PovertyGeography.htm.
[30] Paul Jargowsky, *Povery and Place: Ghettos, Barrios, and the American City,* New York: Russell Sage Foundation, 1997.
[31] Erikson et al, 2008.
[32] *Ibid*.

as deliberate public- and private-sector actions." A third theme was the importance of history in persistent poverty. In most of the case studies, communities had experienced high poverty rates for more than three decades and economic decline could be traced to specific events.

The complex interaction of history and social, economic, and cultural variables suggest that neither macroeconomic policy nor people-based policies on their own can effectively impact concentrated, place-based poverty. There is a disconnect between persistently poor communities and the larger economy that can be seen quantitatively through labor market analysis and more qualitatively through history and this theme of isolation. This disconnect suggests the relevance of community development methodologies: targeting a persistently poor community, strengthening internal capacities, and making connections to regional economic strengths. The renewed emphasis on comprehensive and integrated anti-poverty strategies aligns well with this research on the importance of place.

The Changing Financial Services Industry

The transformation of the financial services world continues to shape community development. When the CRA was passed in 1977, banks and other depositories held 57 percent of all financial industry assets, the national personal savings rate fluctuated between 8 percent and 12 percent , predatory lending was largely left to loan sharks rather than publicly traded corporations, the check cashing industry had a minor presence, and workers had pensions rather than 401(k)s and IRAs.[33,34] In 2009, depositories held 27 percent of financial industry assets, the personal savings rate fluctuated between 0 percent and 4 percent (during 2000-2009), predatory financial products flooded many communities, not just low-income ones, and the shift away from defined benefit retirement plans and new, complex financial products has made managing personal finances much more challenging. During the 1970s, banks satisfied most of the average person's financial needs: they provided credit, savings accounts, and transactions products such as checking accounts and credit cards.

Since then, the economics of banking have worked to the disadvantage of low-income communities and people. Low-income consumers, on average, maintain low account balances, have only one or two accounts, make a large number of small transactions, and tend to conduct their business with tellers rather than through low-cost transaction channels such as the Internet and ATMs. Banks have increasingly focused on costumers in the top three income quintiles in order to remain profitable. As such, they have increasingly weeded out low- and moderate-income customer segments through fees and minimum balance requirements.[35]

With banks moving upmarket, check cashers, payday lenders, and other alternative service providers have grown in number and scope. A 2006 study of the industry estimated 13,000 check cashing outlets, cashing over $80 billion of checks annually, of which 80 percent to 90 percent were payroll checks with an average size of $500 to $600.[36] Alternative service providers provide over 100 million payday loans annually, often at annual interest rates equivalent of 261 percent to 913 percent.[37] A 2008 survey by the Center for Financial Services Innovation study found that about one-third of the

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[33] Statistics on the share of financial industry assets held by banks and thrifts are taken from Board of Governors of the Federal Reserve System, *Flow of Funds Accounts of the United States*, Third Quarter 2009.
[34] This and subsequent statistics on personal savings rate are taken from http://en.wikipedia.org/wiki/File:US_personal_saving_rate_1960-2010.jpg.
[35] See *FDIC National Survey of Banked and Underbanked Households.* December 2009, http://www.fdic.gov/householdsurvey/full_report.pdf and John P. Caskey, *Lower-Income Americans, Higher-Cost Financial Services.* Madison, WI: Filene Research Institute, 1997.
[36] Mark S. Gottlieb, *Check Cashing: An Industry Survey.* Great Neck, NY: MSGCPA, 2006, www.msgcpa.com.
[37] *Ibid.*

U.S. population had made at least one non-bank financial transactions in the past 30 days.[38] While the median household income of those making the transactions was low ($26,390 compared to a national median household income of $50,740), most were employed full-time or part-time and of those not employed, more than half were either retired or homemakers.

The economic crisis begun in 2007 has significantly impacted bank lending in lower-income communities. Despite the infusion of hundreds of billions of TARP funds, credit markets remain constricted because of slow demand and tighter underwriting standards.[39] It is also clear that low-income neighborhoods, minority and poor populations, have been hit hardest by contraction of the financial services industry. LISC reported that community development lending—which includes lending for real estate development including multi-family housing and to nonprofits—has substantially decreased and that the only such lending that is going on is a result of CRA.[40] A study by a consortium of CRA and fair lending advocates examined changes in prime conventional mortgage lending in seven major cities between 2006 and 2008. It found that prime mortgage lending declined by 60.3 percent in communities of color as compared to 28.4 percent in predominantly white neighborhoods, and that prime refinance dropped by 6.4 percent in communities of color, compared to 13.9 percent in white areas.[41] In light of factors such as tighter credit markets, the seizing up of securitization markets, and the decline in credit ratings of households and small businesses in lower-income areas, how quickly and how extensively bank lending in these communities will return is an open question.

Similarly, the future of community development institutions within this evolving picture is unclear. Capacity is well-developed in some segments of the financial services market and underdeveloped in others. In the affordable housing industry, CDCs and CDFIs account for at least one third of total federally subsidized housing units produced.[42] Similarly, CDCs and CDFIs have captured a significant share of the low-moderate income mortgage market in certain low-income communities. On the other hand, CDFIs made only 21,000 payday loan alternatives in 2007 which is 1/6000th the number of loans made by the payday lenders.[43] CDFIs financed or assisted about 9,000 small businesses and microenterprises in 2007, whereas banks and thrifts reported making about 310,000 small loans (less than $1 million) to businesses in low-income census tracts. Thus, CDFIs reach at least 3 percent of the total number of businesses served by banks and thrifts. If we allow for the probability that some businesses received multiple loans from banks, this figure might be as high as 5 percent.

While the total volume of lending by CDFIs in low-income communities is small compared to bank lending, these numbers understate their role in those markets. With affordable rental projects, community facilities and even homebuying (where second mortgages or downpayment assistance is involved), CDFIs often serve critical functions in complex systems that leverage private and public sector financing. A paper entitled “Evolving Roles of Mission-Focused and Mainstream Financial Organizations” by Newberger, Berry, Moy and Ratliff explores the role of CDFIs as intermediaries between the financial industry and low-income communities. The study profiles nine CDFIs and the techniques they use to leverage mainstream capital into community development projects or low-income communities. It

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[38] *The CFSI Underbanked Consumer Survey: Underbanked Consumer Overview and Market Segments, Fact Sheet.* Chicago, IL: Center for Financial Service Innovation, 2008.

[39] Binyamin Appelbaum, “Cautious about the Economy, Big Banks Report Slow Lending” *Washington Post*. January 21, 2010. http://www.washingtonpost.com/wp-dyn/content/article/2010/01/20/AR2010012000875_pf.html.

[40] Benson F. Roberts, Local Initiatives Support Corporation. Testimony on Community Reinvestment Act before U.S. House Committee on Financial Services. September 16, 2009.

[41] California Reinvestment Coalition, et al. *Paying More for the American Dream: The Decline of Prime Mortgage Lending in Communities of Color*. May 2010. http://www.woodstockinst.org/publications/research-reports/10/

[42] *Rising Above*, 2010.

[43] Loan origination data obtained from the CDFI Data Project. See http://www.opportunityfinance.net/industry/industry_sub2.aspx?id=236.

shows that even with regulatory pressure from CRA, capital often does not flow easily from the private sector into low and moderate income neighborhoods. CDFIs and CDCs must work hard and creatively to make that financing happen. The paper illustrates the CDFI/CDC role as a nexus between the low-income community and the private sector.

In addition to community development and business lending, low-income communities need access to basic consumer financial services such as checking and savings accounts, debit and credit cards, consumer loans, and credit counseling and financial literacy. Many consumers will want additional products such as loans for automobile purchase, home repair, home purchase and higher education, or other savings products such as mutual funds and retirement accounts. It is unlikely that a single institution such as the neighborhood bank will meet all of these needs. Instead, a more complex infrastructure will emerge consisting of several different types of service providers. The new infrastructure will likely be based heavily on new technology platforms, such as prepaid, reloadable debit cards, and other forms of smart cards. While banks and other depositories will be among the service providers, there are a host of new entrants, from large corporations such as Walmart, which offers prepaid debit cards and walk-in bill-paying service, to mission-driven non-profits such as Community Financial Resources (CFR), which offers a low-fee Visa pre-paid card as part of a suite of services for helping the poor build assets. With the proliferation of funding initiatives around savings Individual Development Accounts (IDAs), credit counseling, first time homebuyers, Volunteers in Tax Assistance (VITA) sites, a whole new infrastructure of community based organizations has also grown up providing financial education.

In sum, a new financial infrastructure for low-income neighborhoods must evolve, replacing the simpler historic role of the full service community bank.

The Intersection with Human Capital

Many of the early CDCs operated employment and training programs, a pattern which still holds today. The 2007 CDC census reported that Education and Training services were offered by 43 percent of community developers, Job Skills training by 22 percent, Job Readiness training by 20 percent, and Job Placement services by 20 percent.[44] However, our understanding of workforce issues has evolved over the last 30 years. In the 1980s and 1990s, workforce development was largely confined to two areas: 1) efforts to bring the chronically unemployed into the workforce through job placement, skills training, adult basic education, and the like; 2) the school-to-work transition, including programs targeted at-risk youth and efforts to better align community colleges with labor market needs.

Over the last ten or fifteen years, the field has shifted to a broader conception of *human capital* development that incorporates cognitive growth in younger children and inter-generational effects. Human capital is cultivated over a long period of time, starting with birth, and continuing through early childhood education and elementary and high school. Rolnick and Grunewald, referencing the evaluation literature on educational preschool, have argued that early childhood development programs should be treated as an economic investment and that they yield a higher return on investment than other economic development programs.[45] Partridge and Rickman emphasize the importance of intergenerational linkage, noting a growing consensus in the literature that the income of a child's family has long-term impacts on that child's health, education, nutrition, and future income and welfare as an adult.[46]

[44] *Rising Above*, 2010.
[45] Art Rolnick and Rob Grunewald. *Early Childhood Development: Economic Development with a High Public Return.* Federal Reserve Bank of Minneapolis, December 2003.
[46] Partridge and Rickman, 2006.

These intergenerational linkages suggest that investments that reduce poverty among families with young children may pay large benefits in the future. In contrast, Carneiro and Heckman (2003) note that later interventions, such as tuition policies for underprivileged college students, likely have smaller marginal effects on improving future earnings. Finally, a paper by Nancy Andrews takes the research on cognitive development and poverty and applies it directly to community development.[47] Research has found that stable housing situations reduces stress and facilitates cognitive development in infants. She argues that our vision cannot be community development alone, but rather community and human development together. A well functioning neighborhood is a place where investments are made in families and children, where they find the support they need to build the skills that secure a better future.

Human capital development is, of course, the quintessential people-based strategy. However, as Andrews writes, "Our field operates at the nexus between people and place."[48] Andrews identifies three major points of intersection between human capital and the built environment: child care, housing affordability, and education. In the last decade, the financing of charter schools and child care centers have become major growth sectors for CDFIs. CDCs have started or supported child care centers and family development programs that teach parenting skills such as techniques that enhance cognitive development. The comprehensive neighborhood development approaches advanced by LISC and Living Cities also reflect this marriage of people and place-based strategies. However, more fundamentally, practitioners must broaden their concept of community development to better incorporate human capital and look for more ways they can add value with their skill set. With their eyes looking to find new possibilities, innovation will follow.

Opportunity as an Overarching Theme

The public debate on federal poverty policy is largely tied up in a values struggle that pits individual self-reliance against the responsibilities of government. Americans place a high value on self-reliance and, consequently have conflicted attitudes towards public expenditures for the poor. A 2007 survey by the Pew Research Center for the People and the Press illustrates the ambivalence. It found 69 percent of respondents agree with the statement "Poor people are too dependent on government programs."[49] However, 69 percent also believed "Government should guarantee food and shelter for all," and "Government is responsible to take care for those unable to care for themselves."

Community development is fundamentally directed towards economic opportunity rather than entitlement. The Special Impact Program was administered by the Office of *Economic Opportunity*. The National Community Capital Association rebranded itself as the Opportunity Finance Network because the major purpose of CDFIs was to promote greater opportunity, not just to make loans. LISC describes community development as "places where human opportunity and social and economic vitality combine." The theme of opportunity resonates with the American public. In the Pew survey, 91 percent agreed that "our society should do what is necessary to make sure that everyone has an equal opportunity to succeed," the highest approval level of all 40 values statements tested by the survey.

This theme of opportunity is embedded deeply within the American psyche. It is synonymous with the American Dream, the notion that anyone can rise above his birth status and achieve a better life through hard work and initiative. As Herbert Croly wrote at the beginning of the 20th century:

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[47] Nancy O. Andrews with Christopher Kramer, "Coming Out as a Human Capitalist: Community Development at the Nexus of People and Place," *Community Investment Review.* San Francisco: Federal Reserve Bank of San Francisco, 2009.
[48] *Ibid.*
[49] As cited in Cliff Zukin, *The American Public and the Next Social Contract: Public Opinion and Political Culture in 2007.* Washington, DC: New America Foundation, 2008.

> “[the native-born American and the alien immigrant] conceive the better future which awaits himself and other men in American as fundamentally a future in which economic prosperity will still be more abundant and still more accessible than it has yet been either here or abroad…The Promise, which bulks so large in their patriotic outlook, is a promise of comfort and prosperity for an ever increasing majority of good Americans.”[50]

American social policy–including federal anti-poverty policy–can be interpreted through the lens of opportunity rather than in terms of entitlement. Michael Lind and David McNamee have re-conceptualized American social policy as a kind of *social contract*, “a system of economic and social arrangements—never permanent, always evolving—that help Americans as they exert themselves in individual efforts to achieve the American Dream.”[51] While America often resists the European-style social welfare state, the nation has nevertheless sought to enlarge opportunity over its 220 year history.

Lind and McNamee argue that this American version of the social contract is consistent with the tradition of limited government and the “deeply rooted belief that individual dependence on public welfare is likely to corrupt dependent individuals and endanger the republic.”[52] Compared to European social democracies, social welfare goals in America are more frequently pursued through publicly-incentivized private spending (tax expenditures) and regulation rather than direct public expenditures and programs. Federal resources are used to leverage state, local, private and philanthropic dollars; the private sector is incentivized to provide social goods rather than having those goods delivered directly by “big government.” Consequently, the American system places the burden of execution more heavily on outside actors, such as private firms and non-profit organizations, rather than government bureaucracies.

Lind and McNamee identify five “pillars” that make up economic opportunity: economic liberty, economic access, economic ability, economic adequacy, and economic security. Within this schema, community development fits primarily within the category of economic access. Economic access “requires a dynamic economy in which concentrations of wealth tend to dissipate rather than endure and in which hard working Americans have access to property, credit and other resources necessary for individual success.”[53] Lind and McNamee root economic access in the Jeffersonian ideal of the yeoman farmer, who was not dependent on an employer for wages or government subsidy or charity. While a republic of yeoman farmers is untenable in today’s world, the value of ownership and its connection to citizenship still hold sway. John Rawls, in his *Theory of Justice*, distinguishes a “property owning democracy” from a welfare state. Consequently, “Americans favor policies that encourage markets where there is widespread asset ownership over policies that simply redistribute income.”[54] The social goals of widespread economic opportunity are best achieved by “helping citizens by regulating land, labor and credit [rather than] after tax distribution of income.” In short, good social policy uses market interventions that level the playing field.

The legacies of the yeoman farmer tradition play out today in several realms. Americans place a high value on independently-owned small businesses, on homeownership, and on the personal ownership of financial assets. These values correspond well to the products and outcomes of community development: jobs, entrepreneurship, homeownership, affordable housing, savings and asset building, and investments in people that enhance their competitiveness in the workplace. While community

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[50] Michael Lind and David McNamee. *The American Social Contract: A Promise to Fulfill.* Washington, DC: New America Foundation, 2008.
[51] *Ibid*.
[52] *Ibid.*
[53] *Ibid.*
[54] *Ibid.*

development advocates have adopted the vocabulary of opportunity, my sense is they have not found the fullness of language or the historic touchstones to fully distinguish it from entitlement strategies. They have not wedded community development with our history of opportunity in a concise, powerful way.

The Shape of a Subsidy System

The fragmented nature of federal subsidies has had positive and negative consequences. On the positive side communities have more flexibility to combine the resources which best meet local needs and opportunities. The negative consequence has been inefficiency: CDCs must structure complicated, layered financing for their projects; CDFIs have multiple funding sources for their lending and investments, each with their own restrictions and requirements. This complexity results in high transaction costs and high compliance/reporting costs which inhibit efficiency and growth. The lack of uniform, rigorous standards has also enabled many low performing organizations to survive that probably should go out of business.

The community development industry would be better served if federal subsidies were aligned into a more rational, intentional system. To a certain extent, the national intermediaries such as LISC, Enterprise, and NeighborWorks have been able to create some order to national and local funding systems. However, these systems would function more effectively if their funding sources were intentionally designed to work together.

In designing a federal subsidy system for community development, one goal should be greater consistency across the country. The CDC movement has always been strongest in the Northeast and the Midwest. Although the 2005 Census revealed more even distribution across all regions of the country, there are still great geographic disparities in capacity. Geographic coverage is probably more uneven for CDFIs.[55] While six states have 33 or more certified CDFIs, 10 have five or fewer. California has 80 certified CDFIs whereas Kansas has one. While some of the differences can be explained by population differences, large parts of the country are inadequately served.

Secondly, subsidy programs have to acknowledge the business models that underpin CDCs and CDFIs and provide them a path to growth. Community development organizations use subsidy in many different ways. CDFIs utilize federal subsidies as lending capital, core equity, operating subsidy, loss reserves, and sources of liquidity. CDCs deploy subsidy for project financing, project operating subsidies, program operating subsidies, and core operations. For both CDFIs and CDCs, subsidies fit into a business model built on combinations of earned revenue and subsidies. The current system of subsidies makes it difficult for CDCs and CDFIs to grow. Without a pathway to growth, CDCs and CDFIs will not reach the scale necessary to significantly affect poverty. Thirdly, the subsidy system has to reward mission performance, productivity and sound financial management. Poor performing organizations should not be allowed to capture subsidy that could be better deployed elsewhere.

This paper has attempted to place community development within the universe of economic and financial industry change and federal poverty policy. Clearly, our current policy has not been satisfactory. Since the mid-1960s, the national poverty rate has been stuck in a band between 11 percent and 15 percent.[56] The optimism of the 1960s has been tempered. Even the most ardent supporter of federal anti-poverty investments is more sanguine today about the effectiveness of our strategies and tools. Christopher Howard opens his book *The Welfare State Nobody Knows: Debunking*

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[55] "Certified Community Development Financial Institutions - Alphabetical By Organization," CDFI Fund, http://www.cdfifund.gov/docs/certification/cdfi/CDFIList-ByName-12-31-10.pdf.
[56] U.S. Poverty Timeline, Wikipedia, http://en.wikipedia.org/wiki/File:US_poverty_rate_timeline.gif.

Myths About U.S. Social Policy by declaring "The American welfare state is known far and wide as a chronic underachiever."[57] While "there has actually been a remarkable amount of activity in the American welfare state," Howard concludes that "all this activity has not had much impact on the core problems of poverty and inequality."[58]

Future federal subsidy for community development will depends on its advocates articulating a distinctive and effective role within the broad question of national policy poverty. Community development offers the value of a more integrative approach to poverty and responsiveness to community needs in a world where funding sources are siloed. It can target places of concentrated and persistent poverty. It can deploy subsidy efficiently and leverage private investment with public expenditure. Community development institutions such as CDCs and CDFIs bring market expertise and financial sophistication to the table on behalf of low-income communities. They operate at the nexus point between persistently poor places and the outside world, including the market economy and public sector systems. While community development commands a small percentage of federal expenditures, it has a potentially compelling niche within American poverty policy.

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[57] Christopher Howard. *The Welfare State Nobody Knows: Debunking Myths About U.S. Social Policy.* Princeton, NJ: Princeton University Press, 2007.
[58] *Ibid.*