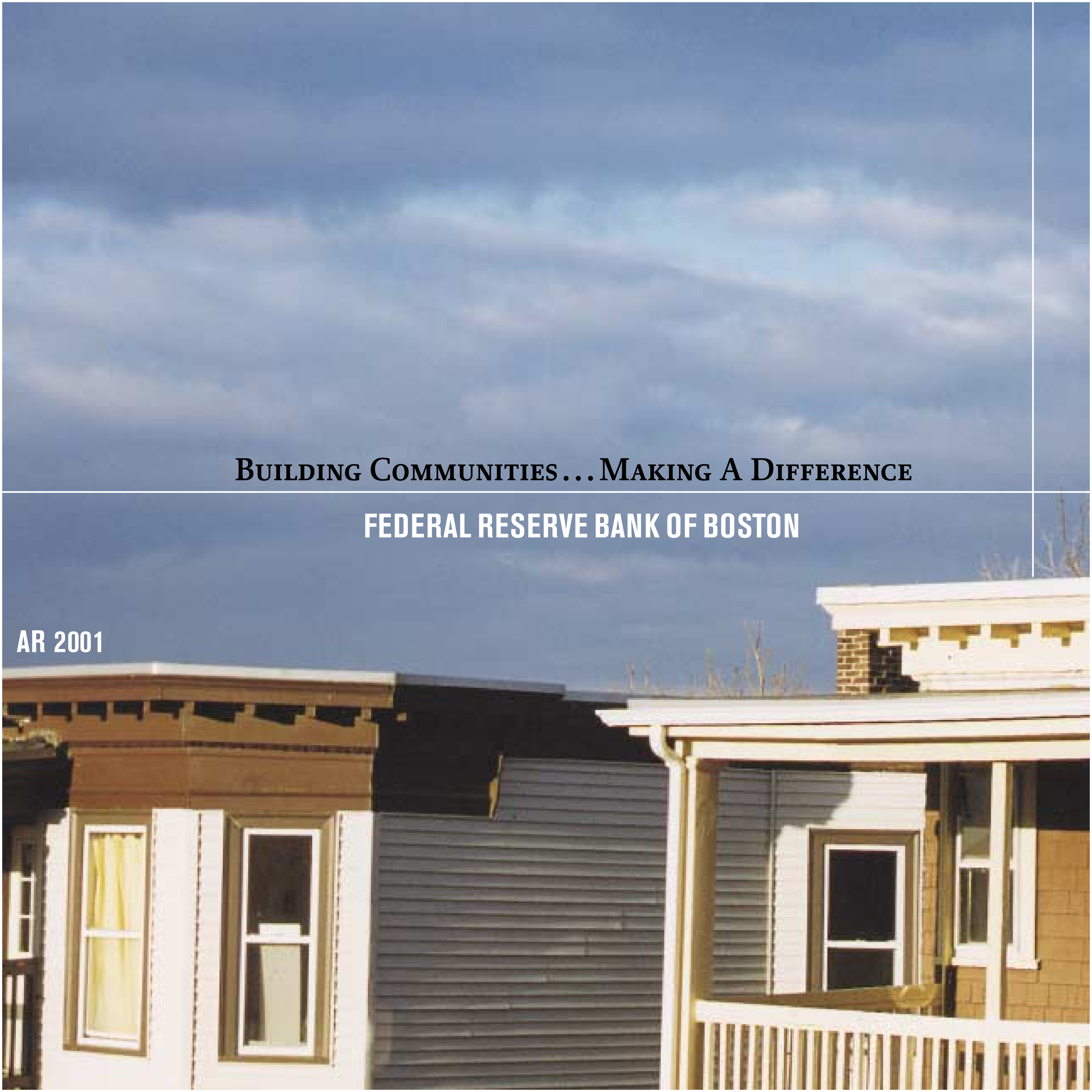


Building Communities . . . Making A Difference

FEDERAL RESERVE BANK OF BOSTON

AR 2001

The Federal Reserve System is responsible for formulating and implementing U.S. monetary policy. It also supervises banks and bank holding companies, and provides financial services to depository institutions and the federal government. The Federal Reserve Bank of Boston is one of 12 regional Reserve Banks in the United States that, together with the Board of Governors in Washington, D.C., make up the Federal Reserve System. The Federal Reserve Bank of Boston serves the First Federal Reserve District. The First District includes all of New England except Fairfield County, Connecticut.

Contents

Cathy E. Minehan, President, with Paul M. Connolly, First Vice President

letter from the president

I have been told that while history is about much more than simply remembering dates, a few dates must be remembered to have any sense of history. Critical dates for the United States start with the July 1776 signing of the Declaration of Independence and include the beginning of the Civil War in 1860, the end of the First World War in 1918, December 7, 1941, and now, in some ways most tragically, September 11, 2001. Like our forefathers who lived through those other dates, we will always remember where we were on September 11, who we might have lost, and what happened to us personally. And most of all, we will remember that the world changed in some ways irrevocably.

Here at the Boston Fed, we joined with the other Reserve Banks and the Board of Governors in responding quickly and forcefully to the disruptions in payments, banking, and securities markets in the days after the terrorist attacks. As the nation's central bank, the Federal Reserve System provided the liquidity that kept the financial markets flowing. I am particularly proud of the role the Boston Fed played in ensuring that the key aspects of the national payments system for which we have responsibility, and our own services, operated without a hitch. Our staff's efforts and dedication were remarkable. Even now, as our attention is focused on improvements that can and should be made to our contingency planning, the ongoing efforts of our Protection staff keep the Bank a safe place for employees, tenants, and visitors alike.

Throughout the region and the nation, resilience in the face of this enormous tragedy was the hallmark of 2001. The year was destined in any event to be a watershed of sorts. After the extraordinary economic expansion of the late 1990s, a slowdown emerged in 2000 and evolved into what now appears to have been a mild recession in 2001. A decline in capital spending after years of rapidly growing investment was the proximate cause of the downturn; our key trading partners weakened as we did, and the first global recession in some time occurred.

Here in New England, high-tech manufacturing and business services shed jobs as a red-hot labor market cooled, and urban and suburban commercial vacancy rates in the Boston area tripled. The aftermath of September 11 had been expected to worsen things considerably, and tourism, hotels, and airlines certainly experienced problems. But the strength of consumers and their unshakable confidence in the future of our region and our country came through. Aided by aggressive monetary policy easing and fiscal stimulus, U.S. consumers kept the economy going, and the productivity of U.S. businesses and workers kept future prospects bright. Everything changed in a fundamental way on September 11, but the strong underpinnings of the U.S. economy remained unchanged.

For some time now, we have used this Annual Report to discuss matters of importance to the Bank and areas in which the Bank is playing a key role. Our essays have looked at key policy issues, like trade and productivity, at matters of Federal Reserve macro policy responsibilities, like bank supervision, and at the payments services in which the System and the Bank play both a policy and an operational role.

The “Bank Highlights” section of this report describes our contributions to System leadership in 2001, as well as key local initiatives. The Boston Fed has a long history of community involvement. Our activities in this arena, including our economic education programs, are highlighted. In addition, this year’s essay focuses on community development and, specifically, on the role played by community development corporations in addressing housing, credit, and social services needs. CDCs have many accomplishments to their credit, but the challenges of inner city and rural development remain formidable.

In addition to the contributions of our officers and staff, the Bank owes a great deal to the many people from around the region who assist us by serving on our various advisory groups. Most important, the Bank’s board of directors provides input and guidance in all aspects of what we do. Three members of the board completed their terms this year. Robert Glauber, President and CEO of the National Association of Securities Dealers, Inc., and Terrence Murray, Chairman and CEO of FleetBoston, brought us valuable insights into financial markets and the banking industry. And we owe special thanks to William Brainard, Arthur Okun Professor of Economics at Yale University, for the insight and common sense he displayed as our chairman from 1997 through 2001. His leadership helped shape the Bank’s continuing evolution to better serve this region and the nation.

Cathy E. Minehan

building COMMUNITIES

MAKING A DIFFERENCE

This essay is authored by Kristin Kanders, Editor, *Communities & Banking*, Federal Reserve Bank of Boston, and Cathy E. Minehan, President and Chief Executive Officer of the Federal Reserve Bank of Boston. The views expressed are those of the authors and do not necessarily reflect official opinions of the Federal Reserve System.

Burlington Community Land Trust, Vermont, has developed 300 rental and 400 homeownership units to date, including this property in Burlington's Old North End.

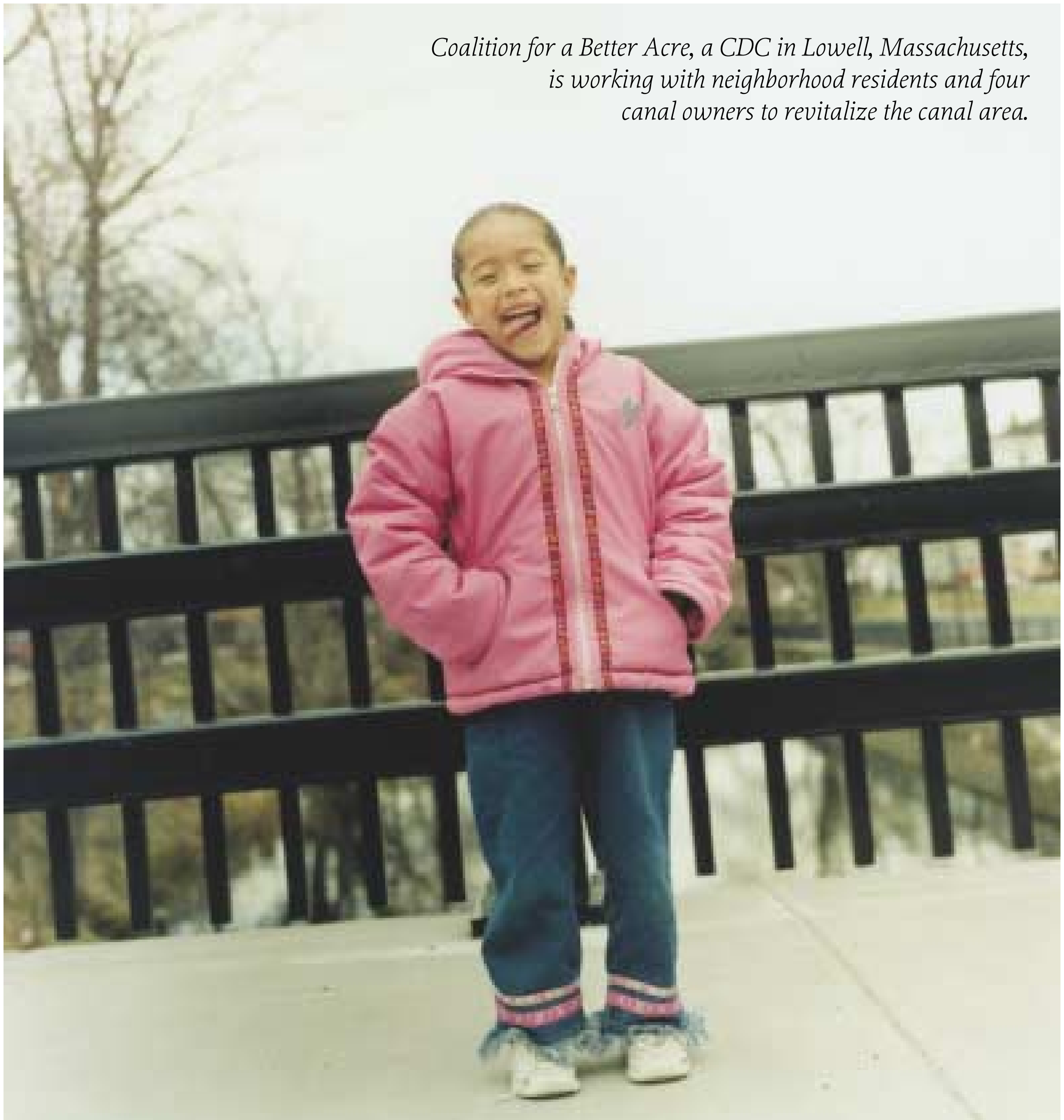
One of the most vexing economic problems facing the United States has been the persistence of pockets of poverty in the midst of prosperity. The reasons for this are many and complex. Prominent among them are economic isolation in the case of rural areas, and language and cultural barriers in the case of many inner-city communities. Discrimination has played a role, but so too has simple ignorance. Resources and opportunities exist in these communities, but getting the recognition from market sources necessary to leverage these assets is difficult. For whatever reason, human and physical resources in these neighborhoods may not be fully utilized. Perhaps even worse, exclusion from the economic mainstream perpetuates and reinforces itself. Lacking jobs, capital, and examples of success, many of these communities have remained mired in poverty.

For the past 30 years, community development corporations (CDCs) have been working to bring such neighborhoods into the economic and social mainstream. Their tactics are varied, from renovating run-down buildings to financing entrepreneurs to improving social services, and they have changed over time in response to changing circumstances. But the aspiration behind the community development movement has not wavered since its beginnings in the 1960s: to strengthen communities by engaging their residents in activities that support economic growth.

Today, thousands of CDCs empower residents and attract public and private investment to resource-poor communities across the country. They are a great example of communities helping themselves get residents up and out of poverty. Their efforts support economic growth and foster opportunity, and they have been especially important in meeting the needs of New England communities since their inception. With the renewed sense of community following the events of September 2001, it is a good time to reflect on the history, goals, and challenges of CDCs. By understanding their strengths and weaknesses, we can perhaps improve their prospects for future success.

Early Roots and Grassroots

Michael Harrington's 1963 book, *The Other America*, awakened the nation to poverty that was "hidden today in a way that it never was before" and was dividing the United States into two nations. In one nation, "millions enjoy the highest standard of life the world has ever known," and in the other, inhabitants "are beyond progress, sunk in a paralyzing, maiming routine." Stirred by the book, President Johnson made reducing poverty a priority of his administration. In the summer of 1964, Congress passed President Johnson's Economic Opportunity Act, the main weapon Johnson would use to fight his War on Poverty. Together with the Civil Rights Act, which was passed a month earlier, it articulated Johnson's vision of a Great Society with



Coalition for a Better Acre, a CDC in Lowell, Massachusetts, is working with neighborhood residents and four canal owners to revitalize the canal area.

"an end to poverty and racial injustice."

The Economic Opportunity Act—which established such programs as Head Start, Jobs Corps, and Adult Basic Education—also launched the precursors to CDCs, community action agencies. Establishing about 1,000 of these agencies was an experiment in self-help; the federal government would finance local leaders to address local poverty, bypassing state and local government. But problems with the structure of community action agencies made them unpopular. Urban mayors, kept out of the federal funding loop, believed their political power was threatened by the agencies. Communities, too, were frustrated because the agencies were funded to develop social services but not employment.[1] In Congress, liberals kept their eyes open for new, more effective programs, while conservatives worked to limit the program's power legislatively.

In the meantime, urban and racial problems were escalating. In 1965, riots in Los Angeles rattled the country. Later that year, New York Senator Robert Kennedy toured Brooklyn's neighborhood of Bedford-Stuyvesant with local leaders who were involved in a community planning process. The neighborhood, like many inner-city areas, was a victim of white flight and economic iso-

Why Is the Fed Involved in Community Development?

The Federal Reserve System, as the nation's central bank, cannot directly lend to or invest in community enterprises generally or community development corporations specifically. But it shows its support in other ways. The Federal Reserve Bank of Boston, along with the 11 other Reserve Banks and the Board of Governors, works to motivate lenders and community development practitioners to work together. The System does this for a simple reason. It has regulatory responsibility for the Community Reinvestment Act (CRA) and must supervise financial institutions to ensure they are working to meet the credit needs of their local communities, including low- and moderate-income neighborhoods. But the "stick" of regulatory power and supervisory oversight may not always be the best approach. The Reserve Banks have found that the "carrot" of providing education, convening meetings, and bringing financial institutions together with community groups helps create the understanding necessary to make markets work. So we, along with our sister Reserve Banks, work at a wide array of efforts aimed at helping communities help themselves and enabling bankers to meet their CRA requirements.

We at the Federal Reserve Bank of Boston encourage public and private organizations to partner and share resources. For example, the Bank frequently hosts gatherings at which bankers and community members discuss communities' credit needs. As a result of these forums, new alliances, such as the Massachusetts Community and Banking Council and the Massachusetts Housing Investment Corporation, have formed. Our Community Development Advisory Council brings together community practitioners from around the District to discuss best practices. The Bank has helped develop a standard homebuyer education curriculum in Massachusetts. It helped leaders in Rhode Island create a statewide homeownership center that assists people with low income to achieve their homeownership dreams. The Boston Fed worked to create multibank lending corporations, known as community reinvestment corporations, in New Hampshire and Maine, following a pattern established by the San Francisco Reserve Bank and emulated by other Banks as well. Most recently, the Bank explored new community development issues in its region by cosponsoring forums on asset development and providing microenterprise training. Readers interested in learning more about community development and available resources may want to subscribe to *Communities & Banking*, a Boston Fed publication.

lation. In 1940, the population had been 75 percent white; by 1960, it was 85 percent black and Latino. Banks had stopped lending in the area, and housing had deteriorated as real estate speculators took advantage of whites' racial fears.[2]

Kennedy was impressed by Bedford-Stuyvesant's activities to unite the community and reverse deterioration. He returned to Washington and, along with fellow New York Senator Jacob Javits, crafted the Special Impact Program amendment of the Economic Opportunity Act. Beginning in 1968, the program provided funding for local organizations to work with residents, nonprofits, and the private sector to foster economic development along with improved social and employment services. The organizations that would receive funding, such as the Bedford-Stuyvesant Restoration Corporation, were called community development corporations. Begun primarily by black leaders, these organizations had been developing in urban centers along with the civil rights movement. With the infusion of federal funding, they focused less on social justice issues and more on tangible inequities in their communities, such as limited job opportunities and inadequate housing.[3]

By 1970, thirty CDCs in urban and rural locations were receiving funding, and each continued to receive nearly $1 million a year through the end of the decade.[4] The total number of CDCs to receive such direct federal funding, which came to be known as Title VII funding, was about 40. In Boston, the Circle Inc. (1971), East Boston CDC (1971), and Chinatown Economic Development Council, Inc. (1974), all received early federal money—the biggest concentration of Title VII CDCs in any single U.S. city. In Maine, Western Maine Community Action, created in the original 1964 Act, continues to this day to provide social services to communities in Franklin, Androscoggin, and Oxford counties.

As the political environment changed, so did CDCs. The first of these shifts came during the Nixon administration. Instead of allocating grants from Wash-

Massachusetts Takes Initiative

Massachusetts is known as a state that is especially supportive of CDCs. The seed was planted during the mid-1970s, when the Commonwealth decided that supplementary funding of CDCs was desirable. In 1975, the state unemployment rate topped 12 percent, and manufacturing facilities, which had traditionally provided job entry for unskilled labor and allowed for upward mobility, were closing down or moving out of central cities. City populations were in decline, with Boston losing nearly 80,000 people from 1970 to 1980. In addition, numerous neighborhoods along Boston's southwest corridor were destroyed in anticipation of an eight-lane highway link to Interstate 95. When the highway project was cancelled in 1972, community activists, led by Representative Mel King, started discussing ways to revitalize the communities.[5]

King's coalition—which also included scholars, urban planners, lawyers, and consultants—met for morning discussions at MIT and came to be known as the Wednesday Morning Breakfast Group. This group proposed that Massachusetts fund a state development "bank" to stimulate businesses in low-income areas. Businesses that couldn't find financing elsewhere would apply for Community Development Finance Corporation funding through local CDCs. The group argued that the Commonwealth should also support CDCs by providing them with operating funds and technical assistance. Legislation to establish the Community Enterprise Economic Development Program and the Community Economic Development Assistance Corporation was passed in 1978. These entities continue to be important sources of operating support for CDCs in Massachusetts.

Coastal Enterprises, Inc.: *Wiscasset, Maine*

Maine's frigid winters are no match for the heat of activity centered at Coastal Enterprises, Inc. (CEI). For 25 years the staff at the headquarters office, in Wiscasset, Maine, and now its eight branch offices, have been churning out financing and assistance for small businesses. Executive Director Ron Phillips guides his nonprofit to provide business support with a social conscience.

Ron Phillips

Over 80 staff members coordinate numerous programs to foster economic development. The CDC promotes job-generation by operating five major funds (two of which provide venture capital) and other loan programs that focus on assisting fisheries, child care services, and businesses caring for the environment. Together, these funds exceed $75 million. Besides funding, Coastal Enterprises provides companies with business assistance; it also provides women and recent immigrants with business counseling designed specifically for them.

A model program to create jobs and access to them is CEI's Targeted Opportunities Program. When businesses obtain CEI financing, they agree to create economic self-sufficiency for Maine's people. This means that a business will train current workers for promotion and create access to new jobs for targeted groups of people, such as those transitioning from welfare, with low incomes, and with disabilities. In return, the business can rely on CEI and its workforce partners to act as a "virtual human resources department," says Kathleen Kearney, senior program officer at CEI. Another benefit, adds Kearney, is that CEI and its partners help businesses access training dollars for current and new employees.

Since 1983, over 200 such Employment and Training Agreements have been formalized, spurring the creation or retention of over 10,000 jobs, 3,000 of them for targeted populations. Agreements are formed with all types of businesses, ranging from metal manufacturers to biotechnology firms. Even as the economy has turned down, says Kearney, the program has had a big impact, with over 1,000 jobs for people with low incomes created in 2001 alone.

What makes the program work is that it is much more than just a contract. Staff at CEI communicate often with business leaders, assuaging concerns and helping them hire people who are motivated to work and are a good fit for the job. Businesses are satisfied because they get help with the hiring process and minimize turnover of current employees through on-the-job training. The process, says Kearney, aims to "bring value—not angst and hoops."

CEI has tracked the program's results over time; it has watched as people "climb the economic ladder," says Kearney. Testament to their results, the Targeted Opportunities Program currently serves as a model for the national Community Development Venture Capital Alliance and Philadelphia's The Reinvestment Fund. Plenty of opportunities for replication remain, though, and Kearney is geared to "spread the idea throughout the field."

ington directly to local communities, the Community Development Block Grant Program (1974) would disburse money from Washington to the states, with the states choosing which community initiatives to fund. The Nixon administration sought to expand the areas served by CDCs. Initially concentrated in the urban and rural Northeast and Midwest, CDCs began to appear in suburban areas and in the South and West.[6] By the end of the decade, hundreds of CDCs are thought to have formed. But overall funding for community development never exceeded one percent of federal expenditures. Thus, CDCs of the 1970s tended to narrow their program activities on a single sector such as housing or employment, rather than support the comprehensive range of activities engaged in by CDCs of the 1960s and early 1970s.[7]

During the 1980s, despite domestic spending cutbacks, CDCs began to flourish. CDC staff were pushed to tap local and state sources of funds and become more technically savvy and professional as they financed projects with a "patchwork" system of funds. State and national trade associations coalesced to help leverage scarce investment dollars and provide CDCs with assistance. These "intermediaries," such as the Local Initiatives Support Collaborative (LISC), strengthened political support for CDCs, spread the risk of investing in CDC projects, and encouraged greater philanthropic investment in community development.[8] (The Ford Foundation was already a major supporter of CDCs, contributing millions to their efforts starting in the 1960s.) By the mid-1980s, LISC offices opened in Boston and Hartford, and the Massachusetts Association of CDCs was formed. As advocates for underserved communities, intermediaries pushed for stronger regulatory enforcement of the 1977 Community Reinvestment Act (CRA), which requires banks to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations.

Into the 1990s, CDCs took on more development work. But as community demographics changed—with new immigrant populations arriving, for example—staying connected to the local population got tougher. Some CDCs could not maintain grassroots involvement and became viewed more as nonprofit developers than community advocates. Community Builders, Inc., for example, is a Boston-based organization that early on shed its community ties to become a larger nonprofit developer working in conjunction with local groups. Some observers, like Randy Stoecker of the University of Toledo, have argued that community development organizations should split into two groups: one to build physical projects and another to focus on community organizing. Others, such as Rachel Bratt of Tufts University, have reasoned that CDCs should not give up their dual role.

CDCs Today

According to the 1998 census of the National Congress for Community Economic Development, roughly 3,600

Where Do CDCs Focus Their Activities?

Source: National Congress for Community Economic Development, *Coming of Age: Trends and Achievements of Community-Based Development Organizations*, 1999.

CDCs in the United States are working to engage residents in local improvement. About one-half serve urban areas, while roughly one-quarter each serve rural and suburban areas. CDCs resemble small businesses in their resources and size. Annual operating budgets range from under $100,000 to over $2 million with a median between $200,000 and $399,000. Sixty percent of all CDCs employ fewer than 10 staff members.

As they did in the 1960s, CDCs continue to serve a population that is overwhelmingly poor. Eighty-four percent of CDCs serve people who have low income, very-low income, or poverty-level income.[9] They continue to serve a specific geographic area and are directed by community representatives. Housing is their single most common activity, with eight out of ten CDCs developing or financing affordable housing.[10] CDCs today are also frequent supporters of small businesses. Over one-half provide technical assistance to local businesses, about 40 percent of urban CDCs own and operate a business, while one-half of rural CDCs operate a loan fund.

What makes CDCs special is not only their shared accomplishments, but also their differences. By molding programs to constituent needs, CDCs are powerful by being distinctive. In individual communities, CDCs venture where private investors don't tread and where governments have not succeeded. Herbert Rubin, in *Renewing Hope within Neighborhoods of Despair: The Community-Based Development Model*, refers to this as "working in the niche." For example, when the Greater Dwight Development Corporation in New Haven, Connecticut, began work six years ago, it hosted meetings to listen to the community and decide priorities. Residents, many of whom were elderly or without transportation, wanted a supermarket within easy walking distance. Greater Dwight, along with its partners, provided the community what it was missing by opening a commercial center in 1997 with a Shaw's supermarket as the anchor. Then, the CDC assumed responsibility for the next community-identified gap: It worked with New Haven's Board of Education to physically improve the local elementary school.

CDCs undertake projects private developers shun for fear of low returns and high risks. For example, CDCs are sometimes the only organizations that will assume the time- and dollar-intensive job of redeveloping environmentally contaminated sites. To do these projects, CDCs often partner with public and private entities. Because CDCs are nonprofits, the government can legally transfer land or buildings to them for a nominal sum. The CDCs then turn the buildings into housing or space for commercial operations or social services.

Housing

One common CDC effort is the development of affordable housing, both rental and owner-occupied. This not only improves the lives of residents but can also attract businesses and other private investments to the community. CDCs encourage homeownership because it is thought to stabilize a neighborhood. With services such as down-payment assistance and homeownership counseling, CDCs also work to reduce the racial gap in homeownership—as of 2000, 74 percent of white households in the United States were homeowners compared with 48 percent of minority households.[11] Beginning in 1990, a portion of federal housing dollars and low-income housing tax credits were allocated specifically for nonprofit housing developers such as CDCs, reinforcing their role as housing producers.[12]

In New England, CDCs are especially prolific housing producers. During the period 1988 to 1990, New England CDCs developed 10 percent of the national stock of CDC-produced housing—almost double New England's share of the U.S. population (5.3 percent).[13]

One organization contributing to these successes is the Burlington Community Land Trust in Burlington, Vermont. When the Burlington Community Land Trust began in 1984, its organizers wanted to increase homeownership throughout Chittenden County and especially in Burlington's Old North End. But constituents stressed that what the neighborhood really needed was good landlords, so the CDC started buying apartment buildings and kept buying, especially as real estate prices fell during the early 1990s. In line with community wishes, the CDC also built housing and gallery space for artists. With 300 rental and 400 homeownership units developed to date, renters and potential homebuyers in Burlington were partly buffered from rising housing prices in the late 1990s.

Easing Economic Isolation

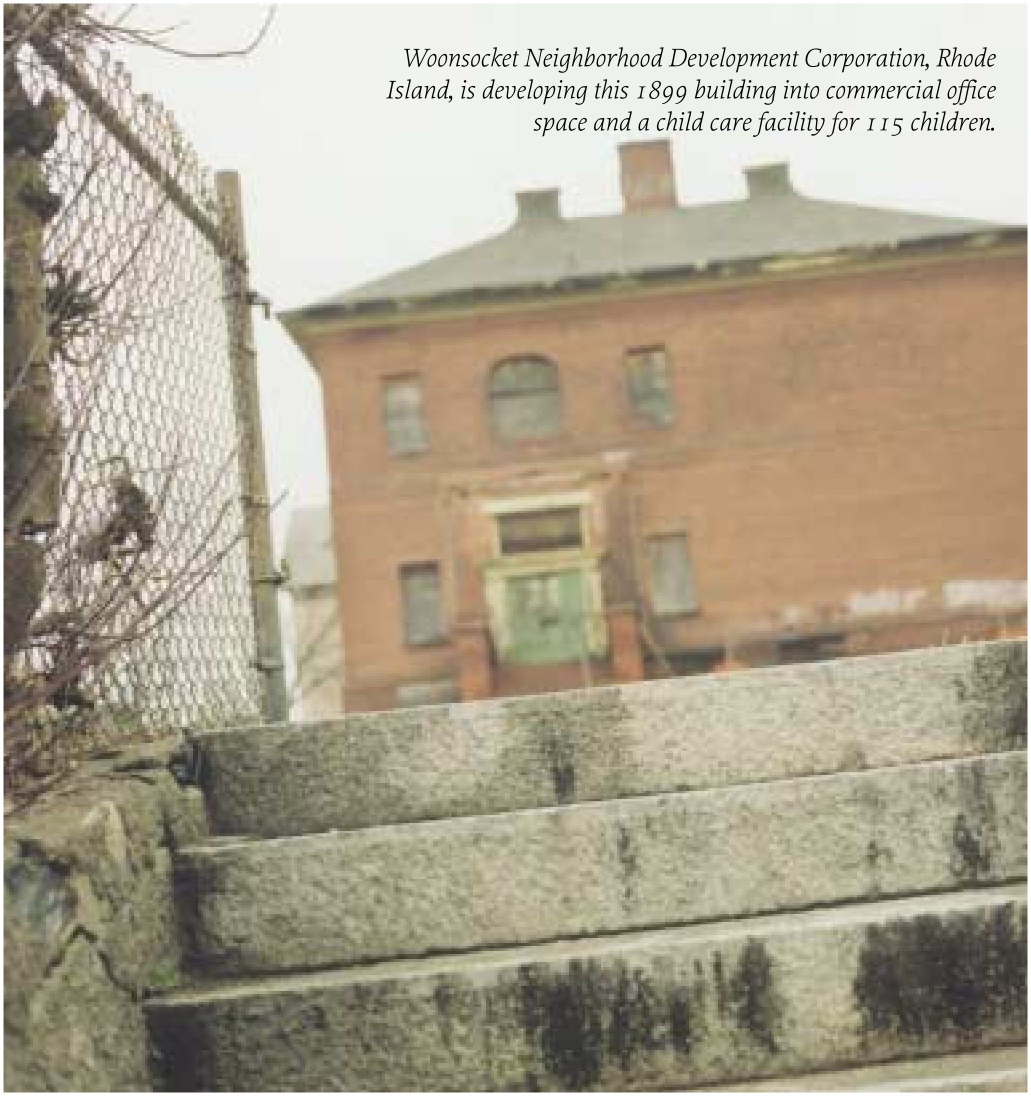
Whether bounded by farmland or pavement, low-income communities often share in economic isolation. Many communities lack employment opportunities because employment centers have moved away or because manufacturing facilities have closed. In rural communities, workers increasingly fill nonagricultural occupations and struggle to move beyond low-wage jobs. According to the Rural Policy Research Institute, low-wage rural workers are 40 percent less likely than their central-city counterparts to advance out of low-wage jobs. In addition, low-income communities, many of them communities of color, struggle to obtain credit.

To reduce this isolation, CDCs provide business loans, offer training and technical assistance, start business incubators, and try to attract outside businesses by developing commercial centers. According to the National Congress for Community Economic Development (NCCED), CDCs have created over

Franklin County CDC, Massachusetts, operates a commercial kitchen to support local entrepreneurs' food enterprises.

247,000 jobs through 1997. NCCED statistics show that about 30 percent of CDCs undertake commercial or industrial projects, and that together they have developed 71 million square feet of commercial and industrial space. The New Markets Tax Credit, established in 2000, is expected to bring new funding for commercial enterprises in low-income communities.

The Franklin County CDC, serving residents of Massachusetts' most rural county and one of its poorest, uses its Venture Center to spark business activity. One unit of the Venture Center, known as an incubator, provides twelve work spaces (six office and six light manufacturing) for local entrepreneurs. Fully occupied since 1989, the incubator shields these entrepreneurs from market rents (and family interference). In the fall of 2001, a 4,000 square foot commercial kitchen was added to support local entrepreneurs' food enterprises. Executive Director John Waite says that competition makes it very difficult for farmers in Franklin County. "A farmer will likely lose money if he sells a bucket of apples because of competition from China and Washington state. But if he brings it to the Center and makes apple pies or applesauce, and sells that, then he can make a profit." In addition to these activities, the Franklin County CDC provides marketing and business assistance to those using the Center. It also runs a $2.5 million business loan program for businesses that do not qualify for traditional bank loans.



Woonsocket Neighborhood Development Corporation, Rhode Island, is developing this 1899 building into commercial office space and a child care facility for 115 children.

Social Services

In tandem with creating job opportunities, CDCs often develop services that support employment. For instance, many working parents have difficulty finding and paying for child care. In Woonsocket, Rhode Island, 21 percent of children live in poverty, and potentially 600 children need child care placement, according to a 2001 estimate by Rhode Island Kids Count.

To help meet this need, Woonsocket Neighborhood Development Corporation (NDC) is developing a child care facility for the Constitution Hill neighborhood, where it focuses its redevelopment activ-

Nuestra Comunidad Development Corporation: *Roxbury, Massachusetts*

When Hector Pina approached Nuestra Comunidad Development Corporation with commercial real estate space on his mind, the situation was serious. He'd been searching the Blue Hill Avenue area of Roxbury, Massachusetts, for somewhere to locate his growing restaurant and catering business, but without luck. Pina figured he would have to move out of the neighborhood. His restaurant, Merengue, was the only sit-down restaurant in the economically struggling community, and it was a symbol of success. It also served terrific Dominican meals. Nuestra Comunidad was sure they would find a solution.

Hector Pina (center) with Evelyn Friedman (right) and Mary Pineda (left)

The solution turned out to be right next door. A vacant building adjacent to Merengue was in poor shape, and the owner was ready to sell. Nuestra Comunidad bought the building, renovated it with restaurant codes in mind, and, for the first time, structured the financing deal so that the CDC would be an equity partner. In five to seven years, Nuestra Comunidad will sell its share of the space to Pina, helping a local resident become a commercial property owner.

Revitalizing commercial real estate is something the CDC has been doing since the 1980s through its work as a redeveloper of mixed-use properties, which have commercial space on the ground floor and housing above. When the CDC became involved in small business support, it realized that businesspeople encounter many obstacles to finding commercial space of appropriate size, use, and condition.

Now Nuestra Comunidad owns 40,000 square feet of occupied commercial space, and in the process, has overcome many financing barriers. "There is no system in the community development world for commercial real estate development," says Evelyn Friedman, executive director of Nuestra Comunidad. In housing finance, she adds, "there is a series of equity resources, and then you get loans, and people know the system. In commercial real estate development, there is no system; it's a new model every time."

Few nonprofit lenders will finance commercial development, and when banks provide financing, they prefer it to be for "credit tenants," such as those who are part of a franchise. "But because we're a CDC, we tend not to seek those tenants—we want the local retailer...and this makes financing harder," says Friedman. Despite the difficulties, Nuestra Comunidad plans to continue redeveloping commercial real estate because the benefits of keeping a place like Merengue in the neighborhood are just too good to give up.

ity. Executive Director Joe Garlick and board members convinced the state to transfer an 1899 brick building and its land to the NDC for one dollar. Woonsocket NDC then obtained listing for the building, which was designed by a Woonsocket resident, on the National Register of Historic Places so it could receive Historic Tax Credits. After cleaning up the asbestos and the underground oil pollution, the CDC arranged for office space within the building to rent to local businesspeople and coordinated with a private child care provider to run a 115-slot child care facility. Woonsocket residents are eagerly awaiting the grand opening of the building, to be named the Hope Street Commercial Center, planned for the spring of 2003.

Community Organizing

Many poor communities need to organize constituents to make their voices heard by the political establishment. This can be an especially difficult task in low-income immigrant communities, where U.S. democratic institutions and rights may not be well understood. Lowell, Massachusetts, is a case in point. Latinos, Cambodians, and others from Southeast Asia (many of them refugees) have been settling in the city, adding to the base of Irish and Greek immigrants. Estimates of the city's foreign-born population range from 16 percent to over one-third.

Residents of the Lowell neighborhood of the Acre, many of whom escaped countries where they were persecuted for the "wrong" political opinion, have overcome their fears of political protest to lobby for their community's well-being and future. Encouraging these residents to join together is a CDC called Coalition for a Better Acre. Established in 1982 to protest a plan to redevelop the neighborhood and displace some low-income residents, the Coalition recently gathered 400 community residents to clean up the neighborhood's canal, eat lunch together, and participate in a cultural festival. After the event, residents began negotiating a memorandum of understanding with the canal's four owners—the city, state, and federal governments, and a hydroelectric company—to ensure its upkeep. Organizing Director Lindolfo Carballo says that area residents are now unofficial "stakeholders" in the canal. By developing a sense of ownership, the community takes a step toward neighborhood improvement.

CDCs' Shared Achievements	Total Products through 1997
Housing units constructed or rehabilitated	550,000
Loans to small and micro businesses	$1.9 billion to 59,000 businesses
Commercial and industrial space developed	71 million square feet
Private-sector jobs created	247,000

Source: National Congress for Community Economic Development, *Coming of Age: Trends and Achievements of Community-Based Development Organizations*, 1999.

An Uphill Battle

Despite the many successes of CDCs, the corrosive effects of poverty and lack of economic opportunity present difficult challenges. Market economies like that of the United States reward success and punish failure. Clearly, it is possible to move out of poverty, and many, if not most, of those who start out at the bottom move up. But a continuing fraction of the U.S. population—about 9 percent, as measured by the U.S. Census—remain in poverty. Moreover, poverty has become more concentrated. Urban-area poverty stands at 11 percent, but within certain cities, poverty rates are much higher. In 1970, metro Hartford had 18 census tracts with poverty rates over 20 percent; by 1990, it had more than twice that number, at 41. In metro Worcester, the number of such poverty tracts also ballooned, jumping from 3 in 1970 to 14 in 1990.

Almost 40 years after Michael Harrington's book, one can still see the

Listening to the Experts

The Federal Reserve Bank of Boston founded the New England Community Development Advisory Council in 1996 to provide the President and community affairs staff with insight into the changing realm of community development in the region's six states. Three other Feds—Richmond, Kansas City, and Cleveland—have since initiated their own councils. With this network of CDC leaders, profit and non-profit lenders, social service providers, academics, and government agency directors, the Boston Fed stays attuned to the challenges of community development and the advances people in the field are making. The Boston Fed works to connect resources with the organizations that need them. It shares the Council's intelligence with its constituents, through activities of the Public and Community Affairs Department, and with others in the nation who are working to enhance the well-being of communities.

The Council's members do outstanding work, as evidenced by the three profiles of CDCs that complement this essay. A photograph of the 2001 New England Community Development Advisory Council and a listing of Council members can be found on page 29.

United States as two nations, one rich and one poor, with minorities generally populating the poorer nation. Income gaps between the races are narrowing, but wealth gaps remain wide. The Federal Reserve's 1998 Survey of Consumer Finances shows that nonwhite and Hispanic families had median incomes that were slightly less than two-thirds of those of whites. Nonwhite and Hispanic median family wealth in 1998, however, was less than one-fifth that of whites.

The need to develop affordable housing is ever more pressing. Three of New England's six states (Connecticut, Massachusetts, and New Hampshire) rank in the nation's top ten most expensive states for renting, as measured by the National Low Income Housing Coalition.[14] Since 1995, over 8,300 housing units in New England have expired from affordability contracts with the U.S. Department of Housing and Urban Development's Section 8 program of subsidized housing. Over 300,000 units disappeared from the national affordable stock between 1997 and 1999. The number of households with severe rent burdens is also on the rise. As of 1999, more that 20 percent of low-income married couples with both spouses working spent more than one-half their incomes on rent.[15]

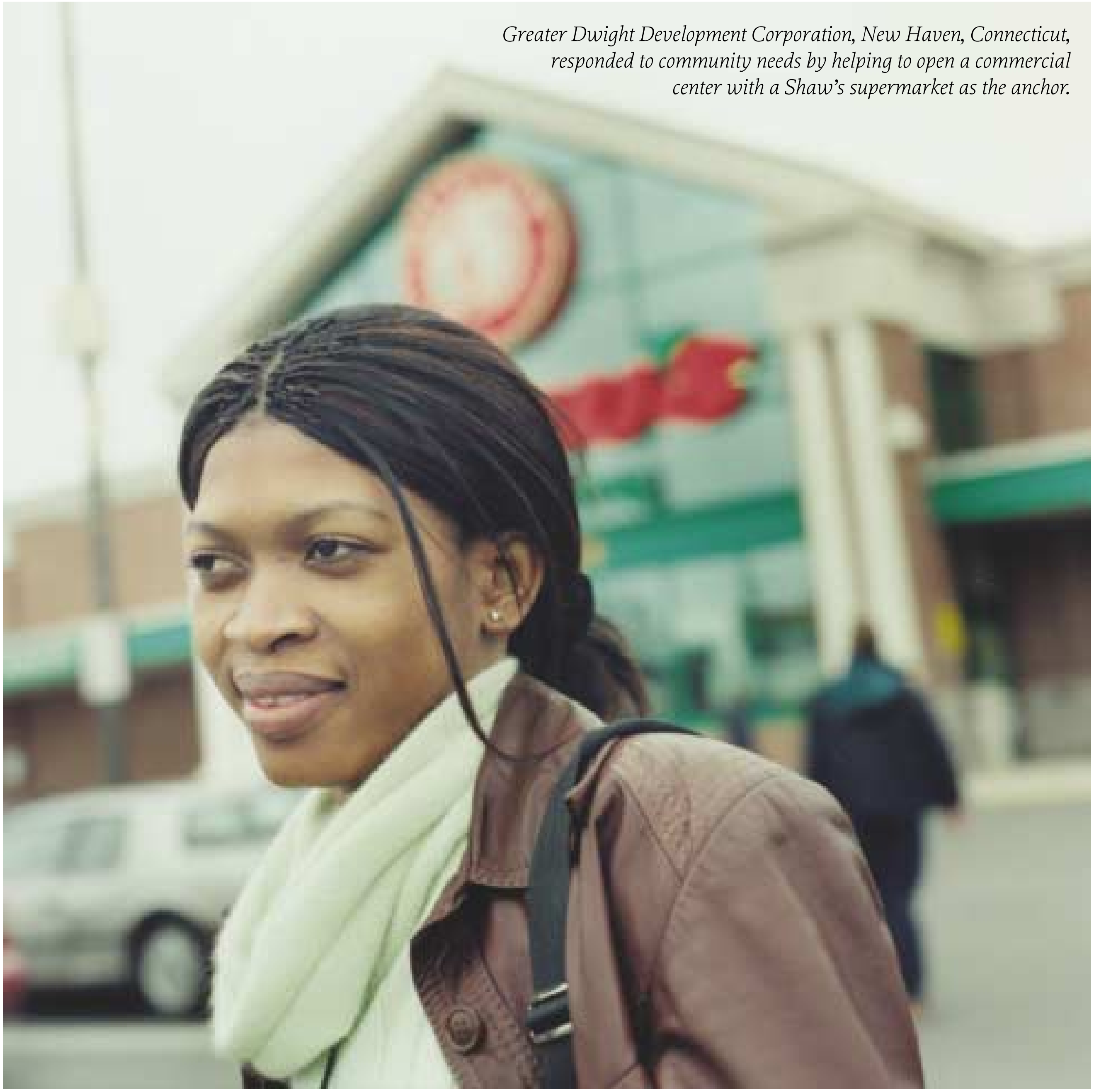
So for many CDCs, it's an uphill battle. David Rusk, in *Inside Game Outside Game: Winning Strategies for Saving Urban America*, analyzes 34 "exemplary" CDCs to see how they affected their neighborhoods. Despite all the good work, Rusk found that areas served by CDCs saw family poverty rates increase, household income fall, and neighborhood buying power either remain flat or decline as metrowide buying power surged through 1990. To explain this result, Rusk notes that CDCs are small organizations—most employ fewer than ten people—and that their impact may not be measurable against giant market and demographic forces. Several issues potentially limit CDC effectiveness: a lack of financial stability, a lack of political power, and operational scale.

Limitations

The first limitation on CDC effectiveness is financial stability. Because CDCs rely on a state's allocation of federal and state monies, they are susceptible to changes in the political winds. CDCs may be in vogue during one administration and out of favor the next. Shifts in the types of projects supported financially, such as workforce development for a few years and then housing, can make it difficult for CDCs to operate strategically. CDCs are also caught between proving to philanthropies that they are in need of money and proving to financial institutions that they are stable enough to deserve investment. It is a constant struggle to both finance projects and support their communities politically.

The second major issue CDCs must grapple with is projecting their voices to the political establishment. While advocating for their communities, CDCs must maintain good relations with the state and local government agencies that supply land or property transfers and provide funding. CDCs work in areas that private markets generally avoid, but they do sometimes have competitors, such as other nonprofits and select developers. Relations with government create natural tension for CDCs. If they lose support in government, they may lose resources. But if they don't challenge government strongly enough on issues of reform, they may sacrifice support within their communities.

The third issue, which builds on financial and political limitations, is scale—whether CDCs are large enough to overcome inefficiencies and maximize impact. A small organization may not have the capacity or experience to undertake large-scale projects. Similarly, it may be unable to take on enough projects to have a major impact on its community. For example, less than 5 percent of all CDCs have produced 40 percent of all CDC-developed housing.[16]



Greater Dwight Development Corporation, New Haven, Connecticut, responded to community needs by helping to open a commercial center with a Shaw's supermarket as the anchor.

Sometimes relying on too few resources leads CDCs to work at a "one project at a time" pace, hindering their ability to obtain new resources and plan strategically. Territoriality is another obstacle. In some markets, such as Boston, nearly 25 CDCs work in a 44-square-mile area. As Avis Vidal of the New School for Social Research notes, "The 'system' cannot attract enough resources to support a comprehensive CDC in every disinvested neighborhood that would benefit from one."[17]

Handling the Limitations

To counteract these limitations, some observers believe consolidated CDCs would be more effective, at least in those areas with a large number of small CDCs. Merging, they argue, would allow smaller CDCs to reach an effective scale so that administrative costs would take a smaller bite out of resources. It would also allow CDCs to combine expertise and reduce the time spent competing for resources. Among nonprofit small business lenders, an industry that similarly stresses the need for a base of community knowledge, merging has begun.

Chuck Grigsby, who heads the Life Initiative, an insurance industry-based community development fund in Massachusetts, believes that overlapping service areas and competition among CDCs are indicators that CDCs could benefit from consolidation. Noting that CDCs in Boston have reached a level of maturity, he believes that their next challenge will be to become "fewer but stronger." He indicates that merging is the step other industries take to ensure long-term strength.

Other observers don't explicitly support merging, but they believe CDCs would be more effective if they specialized, rather than trying to provide a broad array of services. DeWitt Jones, president of Boston Community Loan Fund, thinks there could be a unique role for each of the CDCs in Boston, and that capitalizing on honed expertise might enable the most effective organizations to do what they do best. This would benefit all groups as CDCs could then contract out their particular skills to other CDCs. But Jones acknowledges that if a CDC becomes less politically grounded in its community, developing innovative or specialized projects becomes riskier because the CDC may misjudge community needs. Referring to his own organization's lending activity, he says, "If we're going to push the envelope, we need to have confidence that CDCs understand their own capacity, their constituencies' needs, and the market they want to enter."

The idea of merging or specializing troubles some CDC advocates. Andrea Luquetta, director of housing and community reinvestment at the Massachusetts Association of Community Development Corporations, warns, "It's seductive to say CDCs could merge and have a lot more scale and be more productive—and it's attractive to funders, too, because they could fund one organization that serves a broader area. But when you merge, you develop more of a standard product, and this may not be what the community needs." Luquetta suggests that the current situation, with CDCs partnering on certain projects, allows them to gain efficiencies without losing local connections. Matthew Thall, program director of the Boston office of the Local Initiatives Support Coalition, hopes sophisticated CDCs will begin mentoring and consulting those CDCs with less experience.

Others warn that creating larger scale organizations may be counterproductive, and may actually reduce the political power and effectiveness of CDCs. Mel King, who joined others in organizing communities along Boston's southwest corridor in the 1970s, believes the CDC infrastructure allows communities to develop local leaders—and warns that reducing the number of CDCs will limit the development of neighborhood power. He cautions, "Leadership development doesn't come in one package."

In the end, perhaps this is a question

Manchester Neighborhood Housing Services: *Manchester, New Hampshire*

Executive Director Felix Torres knows his community development corporation, Manchester Neighborhood Housing Services (NHS), is having a positive impact on the community of Manchester, New Hampshire, because when he walks through the city, people stop him and say, "This neighborhood doesn't look like I remember—it looks nice."

The Tree Streets renewal project is one example of the improvements taking place in this former mill town. The dilapidated and vacant complex of four buildings was a disgrace to the neighborhood until board members of Manchester NHS, most of whom are community residents, suggested that the organization buy the properties and renovate them. Two buildings were torn down; one of these was subsequently rebuilt. The other two buildings were renovated with care to preserve. Now the three buildings provide 23 units of affordable housing on the site. An art gallery that employs local youth occupies commercial space on the first floor of one of the buildings.

Felix Torres

Of the nearly 200 units of housing (rental and ownership) Manchester NHS has redeveloped, Torres is especially proud of the Tree Streets project because it provided the opportunity to develop housing while providing services for local youth. During negotiations with the owner to buy the four buildings, Manchester NHS learned that the owner also owned six other properties in the town that were in poor shape. Manchester NHS was able to purchase all ten buildings. It is in the process of transferring some of them to a transitional housing organization, and will be rehabilitating the rest.

Manchester NHS picks development projects to pursue that are large, vacant or mostly vacant, and dilapidated. Many times, board members will say to Torres, "That building on xyz street is such a dump. We need to buy it and fix it up." The challenge of providing affordable housing is becoming more pressing as unemployment rises among the CDC's constituency of low- and moderate-income earners. Unfortunately, Manchester NHS is not always able to purchase buildings because of high real estate prices that have not softened, even as the economy has weakened.

Housing has always been a priority for Manchester NHS because Torres believes housing fits into its broader mission of improving the well-being of its residents. Housing is not "the only answer," says Torres, "but it is a critical piece of a strategy to revitalize a neighborhood. We've taken over houses people used to cross the street to get away from. We've brought in good tenants and gotten rid of criminals. Having a good physical environment makes a real difference in people's lives."

for the community to decide. Mossik Hacobian is executive director of Urban Edge, a large CDC in Boston that shares 80 to 90 percent of its footprint with the Jamaica Plain Neighborhood Development Corporation and has smaller overlaps or is contiguous with five or six other CDCs. Hacobian believes that the question should be posed to community residents. Says Hacobian, “CDCs are created because the community has a need it wants served in a particular way.” He suggests that the community will act as a market and weed out a CDC when it is viewed as ineffective or unnecessary.

Moving Forward

CDCs in mature markets may decide to merge or specialize, or extend their reach by forming alliances with other organizations, such as health care centers or youth organizations. They may become more regional in nature, or they may prefer to stay as they are. But whatever the choice, low-income communities deserve to have the most effective organizations possible serving them. CDCs are not organizations with deep pockets; they cannot afford to use resources inefficiently.

Judging the effectiveness of CDCs is complex, but so is judging how they should transform, or even if they should. With limited resources, CDCs have been restoring communities from within, catalyzing private investment, and giving opportunity to neighborhood residents. Thwarting the pace of neighborhood decline, however, is not an easy task. If CDCs are to continue strengthening communities, we must continue supporting them and seeking ways for them to be more effective.

Endnotes

[1] Alice O’Connor, “Swimming against the Tide: A Brief History of Federal Policy in Poor Communities,” in *Urban Problems and Community Development*, ed. Ronald F. Ferguson and William T. Dickens (Washington, DC: Brookings Institution Press, 1999), 103.

[2] Pratt Institute Center for Community and Environmental Development, “CDC Oral History Project: Bedford Stuyvesant Restoration Corporation,”‹http://www/picced.org/advocacy/bsrc.htm›.

[3] O’Connor, “Swimming against the Tide,” 106.

[4] Matthew Filner, “Community Development Corporations: An Historical Overview,” University of Minnesota, Center for Democracy and Citizenship, Case Study, ‹http://www.publicwork.org/3_2_casestudies.html›.

[5] Ronald Ferguson and Helen Ladd, “Pioneering State Economic Strategy: Massachusetts,” in *New Economic Role of American States: Strategies in a Competitive World Economy*, ed. Scott Fosler (New York: Oxford University Press, 1991).

[6] O’Connor, “Swimming against the Tide,” 110.

[7] Sara E. Stoutland, “Community Development Corporations: Mission, Strategy, and Accomplishments,” in *Urban Problems and Community Development*, ed. Ronald F. Ferguson and William T. Dickens (Washington, DC: Brookings Institution Press, 1999), 197.

[8] Avis Vidal, “Can Community Development Re-Invent Itself? The Challenges of Strengthening Neighborhoods in the Twenty-First Century,” *Journal of the American Planning Association* 63, no. 4 (autumn 1997): 429–438.

[9] According to the National Congress for Community Economic Development (NCCED), low income is defined as 50 to 80 percent of area median income, very-low income is 30 to 50 percent of area median income, and poverty-level income is up to 30 percent of area median income. NCCED, *Coming of Age: Trends and Achievements of Community-Based Development Organizations*, (Washington, DC: NCCED, 1999).

[10] The 8 out of 10 statistic could be a product of the NCCED census because in order to be counted as a CDC, the organization must have completed either a housing, commercial real estate, or business development project. But the statistic is consistent with another academic’s finding that 9 out of 10 CDCs produce housing.

[11] Joint Center on Housing Studies of Harvard University, “The State of the Nation’s Housing: 2001,”‹http://www.jchs.harvard.edu/publications/markets/SON2001.pdf›, 1.

[12] Vidal, “Can Community Development Re-Invent Itself?” 429–438.

[13] Christopher Walker, “Nonprofit Housing Development: Status, Trends, and Prospects,” *Housing Policy Debate* 4, no. 3 (1993), 377.

[14] This ranking excludes Washington, D.C. Including Washington, D.C., New Hampshire ranks as number 11, according to the National Low Income Housing Coalition, ‹http://www.nlihc.org› (11 February 2002).

[15] Joint Center on Housing Studies Harvard University, “The State of the Nation’s Housing: 2001,” 3.

[16] Walker, “Nonprofit Housing Development,” 376.

[17] Vidal, “Can Community Development Re-Invent Itself?” 429–438.

2001 Bank Highlig

Like all Federal Reserve Banks, the Boston Fed has three principal responsibil

- economic research and monetary policy,
- supervision and regulation of banks and bank holding companies, and
- the provision of financial services to depository institutions.

In addition, the Bank offers public and community affairs services related to

Economic Research and Monetary Policy

The year 2001 was a challenging one for monetary policy formulation. The Federal Reserve responded aggressively to a progressively weakening economy and the severe shocks induced by the terrorist attacks of September 11. Altogether, the Federal Open Market Committee (FOMC) voted to reduce interest rates 11 times during 2001, leaving short-term interest rates at yearend at their lowest level since 1961. Virtually all of the Bank's economists contributed to monetary policy deliberations during this extraordinary year. In addition to the focus on monetary policy formulation, major research activities of 2001 included the following:

• Our forty-fifth economic conference, "Seismic Shifts," gathered economists and demographers from around the world to discuss the economic impact of projected demographic changes over the next 50 years. These changes include widespread, rapid population aging, relatively slow population growth, and a marked increase in migration. Policies recommended by conferees to alleviate the pressures induced by these changes included measures to improve labor force participation, reform social security systems, encourage gains in educational attainment, and increase migration.

• Again taking a global perspective, a senior macroeconomist at the Boston Fed led a System study cataloguing monetary policy practices in other industrial countries, focusing especially on the expanding set of assets used by foreign central banks in their open market operations. Other internationally focused research included an exploration of the historical links between international developments and U.S. monetary policy, and a study examining the extent to which movements in exchange rates are passed through

ghts

LITIES:

ITS PRINCIPAL RESPONSIBILITIES.

to prices of manufactured products imported into the United States—a key link in the chain of monetary policy effects. The study suggests that pass-through fell notably between the 1980s and the 1990s.

• Macroeconomists had their hands full analyzing the rapidly evolving conditions in the economy. Developing a better understanding of the cyclical and secular components of productivity, as well as its effects on income and inflation, was a critical task for the first half of the year. In the midst of the economic slowdown, economists continued to study the appropriate way to model the U.S. economy, an ongoing long-term research agenda, and also a center of expertise for the department.

• Regionally focused research included analyses of migration patterns of college graduates, potential obsolescence of state and local revenue systems, factors affecting consumers' choice of payments instruments, and measured disparities in the rise of the educational wage premium. Economists also organized and hosted the New England Study Group, a monthly seminar series attended by area economists and policy analysts.

• Over the course of 2001, economists gave presentations on economic issues at a variety of venues throughout New England. In addition to sharing economists' research and insights in this way, all reasearch publications were made available on the Bank's web site as well as in hard copy. Publications were widely cited in both scholarly and general readership journals. The *Regional Review*, a publication of special appeal to informed readers of nontechnical economics, included articles on education finance in New Hampshire, the modern-day fishing industry, and the impact of estate-tax reforms.

Financial Services

The Boston Fed provided national leadership last year both in ongoing initiatives to improve the development and delivery of financial services and in specific actions to maintain continuity and stability in banking and financial markets after the terrorist attacks of September 11. Highlights of the Bank's national leadership role include the following:

• The System's new national financial services management structure, designed in 2000 under the Boston Fed's leadership and implemented in early 2001, responded effectively to the extraordinary demands placed on the Reserve Banks after the September 11 attacks. Swift and frequent communications and fast, decisive action enabled the Reserve Banks to fulfill their central bank responsibilities and maintain critical payments services in the hours and days immediately after the terrorist attacks.

• The System's commercial check image infrastructure team, based in Boston, overcame several hurdles to complete development of the System's first national check image archive. Installed first at the Cleveland Fed in January 2002, the new archive system will eventually replace incompatible systems in use at more than 30 Reserve offices across the country.

• Under Boston Fed auspices, the industry moved closer to formulating new payments system standards. A workshop organized by the Bank and the Board of Governors brought together Federal Reserve and banking industry participants to explore operating problems associated with the use of universal payments system standards.

• In November, the System started a pilot program to test a new accounting interface that allows depository institutions to use the Internet to access real-time account balances and related information. Developed by a national team based at the Boston Fed, the pilot proved very successful, and all Reserve Banks will offer this new service during 2002.

• 2001 was the first full year of operation at the Boston Fed of one of three national consolidated Treasury Direct call centers, which allow the public to buy and hold U.S. Treasury securities using the Federal Reserve's book-entry system. Boston staff headed the team that established the technical and management processes needed to operate the three centers.

• During 2001, a joint Federal Reserve/banking industry Image Task Force, chaired by a Boston Fed senior officer, published "A Framework for Exchanging Image Returns." This collaborative paper documents the evolving use of image returns in check processing and describes how image returns can facilitate strategic planning by participants in the payments system.

• The Bank and System made significant progress on longer-term issues in 2001. We adopted a plan for e-business; strengthened our joint strategic planning with the Treasury; completed preparations for dialogue with the industry on the long-term direction for cash services; and developed an overall strategy for restructuring customer support. We also completed two major studies: an assessment of Federal Reserve e-payments initiatives, and research on the use of alternative payments instruments.

Locally, growth and new initiatives characterized the Boston Fed's financial services program. Our staff responded effectively to the challenges of September 11. The accompanying table summarizes the growth in check, cash, ACH, and funds transfer services. Highlights of 2001 at the local level include the following:

• The Boston Fed provided uninterrupted delivery of financial services during the September crisis. During the week of September 11, off-line funds and book-entry securities transfers increased dramatically as the Boston Fed served as one of two back-up centers for commercial banks whose electronic funds transfer operations were disrupted.

• First District check processing volume grew at a doubledigit rate in 2001, well above the anticipated level. On average, 4.3 million checks per day were processed. Despite the heavier workload, the Bank was able to increase check processing productivity significantly and lower unit costs by 8 percent.

• The volume of currency processed also increased in 2001, with cash services staff processing 6 percent greater volume than in 2000. Several automation applications were introduced, including a new voice-response cash ordering system. Cash services staff successfully tested a cost-saving innovation that allows more efficient processing of $1 notes. Developed locally, the innovation is being shared with other Reserve Banks.

• In July, the System chose the Boston Fed as the national site for joint custody collateral services and as one of two central providers of customer service and administrative support for on-line funds transfer and book-entry securities transfer services.

• We achieved substantial growth in ECP (electronic check presentment) volume in 2001 through the sustained efforts of account managers, publication of a new ECP marketing brochure, and introduction of a new product that combines ECP with electronic check information. ECP promises to yield significant processing improvements and expedite the collection of checks in the United States.

Bank Supervision and Regulation

Supervisory activities intensified during 2001 as a result of the challenging economic environment faced by the banking industry. At the same time, Supervision and Regulation devoted more resources to the analysis of major policy issues and, in response to the terrorist attacks of September 11, stepped up key monitoring and assessment activities.

2001 Financial Services Activity

	Daily Dollar Value (in thousands)	Daily Average Volume	Volume Growth 2001 versus 2000
Commercial Check Processing			
Processed Volume	$4,100,000	4,300,000 checks	10.5%
Fine Sort Volume	$246,800	300,000 checks	4.1%
Processed Returns	$59,600	48,100 checks	14.1%
Total Volume	$4,406,400	4,648,100 checks	10.0%
Automated Clearing House			
Commercial Items Originated	$1,800,000	985,900 items	10.0%
Government Items Originated	$7,100	1,900 items	2.1%
Funds Transfers[1]	$279,500,000	60,900 transfers	–0.5%
Electronic Book Entry Securities Transfers[1]	$118,300,000	12,500 transfers	13.0%
Cash Operations			
Total Notes Paid[2]	$130,500	8,600,000 notes	4.6%
Total Notes Received[2]	$116,600	8,200,000 notes	–1.7%
High Speed Notes Processed[2]	N/A	8,600,000 notes	9.3%

[1]Includes work performed as a System consolidation site for off-line processing of wholesale payments for the full year.

[2]Comparisons of 2001 with both 2000 and 1999 are affected by unusual activity in the final quarter of 1999 and the first quarter of 2000 related to the century date change. Annualized growth rates for 2001 compared with 1999 are 1.1% for total notes paid, 5.0% for total notes received, and 6.1% for high speed notes processed.

• The weakened economy was evident in the performance of the region's banks, which experienced an aggregate increase in nonperforming assets, pressure on net interest margins, and less robust fee income. While most measures remained relatively strong, Supervision and Regulation will continue to monitor performance trends closely.

• Supervision and Regulation monitored the impact on New England's banking organizations of the September 11 terrorist attacks and worked to ensure that disruptions to normal operations were effectively resolved. The department's Insurance Knowledge Center functioned effectively as a System resource, monitoring and assessing the financial implications of the attacks and distributing advisories regarding potential risk concerns and issues affecting the availability of credit.

• Supervisory staff devoted considerable attention to evaluating the new Basel capital accord. The Boston Fed's work was based on analysis of actual depository institution data coupled with market data. Comments provided by the Boston Fed centered on the analysis of credit and operational risk. Bank staff were invited to participate in two Systemwide work groups related to credit risk.

• In November, we organized and co-hosted with the Board of Governors a two-day international conference, "Capital Allocation for Operational Risk." Attendees, including academics, practitioners, and supervisors, gained a better understanding of best practices in identifying, measuring, and modeling operational risk and in mitigating this risk through capital allocation, insurance, and other tools. In May, the Bank hosted a conference on insurance risk, providing training for staff from the Board and the Reserve Banks on insurance topics ranging from risk management to regulatory perspectives.

• Staffing was significantly strengthened in 2001. A new technical support unit within the department quickly made substantial contributions in a number of areas, including modeling the behavior of LCBOs (large complex banking organizations), assessment of the Basel capital proposal, collaborative work with the Insurance Knowledge Center, and participation in field examinations. Additional expertise was developed in global custody and securities processing; contacts with foreign supervisory authorities were strengthened; and monitoring of troubled foreign economies was intensified.

Public and Community Affairs

In 2001, Community Affairs activities of the Boston Fed centered around issues of fair access to credit and community economic development on both national and regional fronts. The department's overarching aim was to facilitate the efforts of others to educate, inform, create, and change.

• In April, the Boston Fed co-chaired the Federal Reserve System's second Community Affairs Research conference, attended by some 450 community, government, and banking professionals. Research presented at the conference focused on the ways in which ongoing changes in financial markets are affecting low-income and moderate-income communities.

• Over the course of the year, Community Affairs staff assisted in a three-way collaborative effort to develop an on-line information center for faith-based community economic development (www.faithandcommunityatwork.com). Launched in October, this resource has been well received.

• *Protect Yourself: Identity Theft*, a videotape co-produced by the Boston Fed in 2000, gained national acceptance in 2001 as more than 3,200 copies were distributed to individuals and organizations across the country.

• Community Affairs staff contributed significantly to the development of a business plan for a Rhode Island Homeownership Center. An initiative of the Rhode Island

Housing Resources Commission, the Center will promote homeownership through the coordination of resources and agencies providing homeownership services in Rhode Island.

• In partnership with the Center for Hunger and Poverty at Brandeis University, the Boston Fed hosted a Massachusetts asset-development policy forum that focused on asset-development policy options for low- and moderate-income individuals and communities.

• Throughout the year, Community Affairs staff hosted conferences and training sessions in locations across New England. These included three "sunshine provision" training sessions for bankers and community organizations; three community development finance training sessions; and a National Consumer Protection Week conference.

Economic education and work with the Boston public schools were the focus of the Bank's Public Affairs activities in 2001:

• *Fed Challenge*, *Economics Challenge*, and *LifeSmarts*, three economic competitions hosted by the Boston Fed for high school students, were again popular in 2001. From 25 to 30 teams have participated in *Fed Challenge* at the regional level in each of the last several years. *Economics Challenge*, now sponsored by the National Council on Economic Education, attracted 22 teams at the regional level last year, and the regional winner won the national competition.

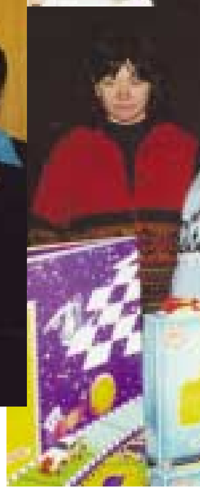
• In early 2001, the Bank officially launched *Peanuts & Crackerjacks*, a web-based baseball game that uses professional team sports to teach economics. Usage continues to grow, and the program has drawn accolades from students, teachers, and the general public.

• The Bank increased its outreach efforts to promote its economic education programs and stimulate ideas for new programs. Presentations were made at regional and national forums. The Boston Fed also worked with System colleagues to develop a marketing plan and stronger identity for all System economic education efforts. The Bank's economic education newsletter, *The Ledger*, was enhanced through new content and format.

• The Boston Fed maintained its close ties with Boston's public schools. In addition to its partnerships with three schools, the Bank continued its *Classroom in the Workplace* reading program for high school summer interns and expanded the program to include mathematics as well as reading. Results were gratifying, as several other companies joined the program and the students' average reading proficiency increased by more than a grade level over the summer.

THE BANK
in the Comm

Federal Reserve Bank of Boston . . .



Boston Private Industry Council
Boston Summer Jobs Program
Boston After School Jobs Program
Classroom at the Workplace (Literacy and Math)
Job Shadow Day

unity

Making a Difference

Project ProTech
Books and Kids Program
United Way
Community Care Day
Toys for Tots
Homeless Children's Holiday Party

School-to-Career Project
Workforce Development
South Boston High School Partnership
Dearborn Middle School Mentoring Program

Board of Directors

Seated: Cathy E. Minehan and Paul M. Connolly
Standing: William C. Brainard and William O. Taylor

William C. Brainard
(Chairman)
Professor of Economics
Yale University

William O. Taylor
(Deputy Chairman)
Chairman Emeritus
The Boston Globe

Orit Gadiesh (1)
Chairman of the Board
Bain & Company, Inc.

Robert R. Glauber (2)
President and
Chief Executive Officer
National Association of Securities Dealers, Inc.

Sherwin Greenblatt (3)
President
Bose Corporation

Terrence Murray (4)
Chairman and
Chief Executive Officer
FleetBoston Financial Corporation

James J. Norton (5)
Vice President
AFL-CIO

David S. Outhouse (6)
President and
Chief Executive Officer
First and Ocean National Bank

Richard C. White (7)
Chairman, President and
Chief Executive Officer
Community National Bank

FEDERAL ADVISORY COUNCIL MEMBER
Lawrence K. Fish
Chairman, President and
Chief Executive Officer
Citizens Financial Group


1


2


3


4


5


6


7

Left to right: S. Whitney, T. Gagnon, W. McDonough, C. Minehan, J. Fuhrer, P. Connolly, R. LaRocca, L. Browne, E. Rosengren, S. Green

Cathy E. Minehan
President and
Chief Executive Officer

Paul M. Connolly
First Vice President and
Chief Operating Officer

Lynn E. Browne
Executive Vice President and
Director of Research

Sarah G. Green
Executive Vice President

William N. McDonough
Executive Vice President and
General Counsel

Thomas E. Cimeno, Jr.
Senior Vice President and
Corporate Policy Advisor
(not pictured)

Jeffrey C. Fuhrer
Senior Vice President and
Monetary Policy Advisor

Thomas E. Gagnon
Senior Vice President

Robert K. LaRocca
Senior Vice President

Eric S. Rosengren
Senior Vice President

Steven M. Whitney
Senior Vice President

New England Advisory Council

Front row, left to right: E. Robert, P. Connolly, M. Brandenburg, C. Minehan, K. Henry
Back row, left to right: P. Chase, B. Silvers, A. Wilson, J. Plotkin, R. Dickinson, A. Dolphin, G. Shuster, T. Hussey, J. Brett, K. Hancock, C. Carlson

Maxine Brandenburg
(Chairman)
President
Vermont Business Roundtable

James Brett (Advisor)
President
The New England Council

Craig D. Carlson
Senior Vice President and
Director of Corporate Development
Arthur D. Little, Inc.

Peter R. Chase
President and
Chief Executive Officer
Chase Corporation

Roger Dickinson
President
Torrington Research Company

Anthony Dolphin
President and
Chief Executive Officer
SpringBoard Technology
Corporation

Kevin Hancock
President and
Chief Executive Officer
Hancock Lumber Company

Kathryn Henry
Vice Chairman
Confluence Holdings

Timothy Hussey
President and
Chief Executive Officer
Hussey Seating Company

John H. Morrison III
President and
Chief Executive Officer
Hitchiner Manufacturing
Company, Inc.

Joyce Plotkin
President
Massachusetts Software
and Internet Council, Inc.

Elisabeth Robert
President
Vermont Teddy Bear Company, Inc.

Brett N. Silvers
Chairman and
Chief Executive Officer
First International Bank

George Shuster
President and
Chief Executive Officer
Cranston Print Works Company

Alan Wilson
President
Wilson Farms, Inc.

Left to right: M. Weekes, H. Flores, G. Lee, C. Minehan, M. Davey, R. Walker, S. Carpenter, F. Fowler, E. Friedman, D. Christon

Richard C. Walker III
(Chairman)
Vice President
Federal Reserve Bank of Boston

Nancy Berliner
Executive Director
New Hampshire Rural
Development Council

Sarah Carpenter
Executive Director
Vermont Housing
Finance Agency

Dean J. Christon
Deputy Executive Director
New Hampshire Housing
Finance Agency

Michael Davey
Commercial Loan Officer
Greenfield Savings Bank

Dr. Marcia Marker Feld
Executive Director
University of Rhode Island
Field Center

Heriberto Flores
Chairman
Partners for Community

Fenwick L. Fowler
Executive Director
Western Maine Community
Action, Inc.

Evelyn Friedman
Executive Director
Nuestra Comunidad
Development Corporation

Michael F. Glavin
Director of Regional Economic
Development
FleetBoston Financial Corporation

Grant Lee
Executive Director
People's Regional
Opportunity Program

Gregory Prince
President
Hampshire College

Carla Weil
Executive Director
Greater New Haven
Community Loan Fund

2001 *financial* STATEMENTS

FEDERAL RESERVE BANK OF BOSTON

P.O. BOX 2076
BOSTON, MASSACHUSETTS 02106-2076

To: Board of Directors

The management of the Federal Reserve Bank of Boston (FRBB) is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 2001 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks, and as such, include amounts, some of which are based on judgments and estimates of management.

The management of the FRBB is responsible for maintaining an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even an effective process of internal controls, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of the FRBB assessed its process of internal controls over financial reporting including the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, the management of FRBB maintained an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements.

Cathy E. Minehan

Cathy E. Minehan, President
February 22, 2002

Paul M. Connolly

Paul M. Connolly, First Vice President

PRICEWATERHOUSECOOPERS

To the Board of Directors of the Federal Reserve Bank of Boston:

We have examined management's assertion that the Federal Reserve Bank of Boston ("FRB of Boston") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the Financial Statements as of December 31, 2001, included in the accompanying Management's Assertion. The assertion is the responsibility of the FRB of Boston management. Our responsibility is to express an opinion on the assertions based on our examination.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants, and accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that the FRB of Boston maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the Financial Statements as of December 31, 2001, is fairly stated, in all material respects, based upon criteria described in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

PricewaterhouseCoopers LLP

March 4, 2002
Boston, Massachusetts

PRICEWATERHOUSECOOPERS

TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND THE
BOARD OF DIRECTORS OF THE FEDERAL RESERVE BANK OF BOSTON:

We have audited the accompanying statements of condition of the Federal Reserve Bank of Boston (the "Bank") as of December 31, 2001 and 2000, and the related statements of income and changes in capital for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3, the financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of the Federal Reserve System, are set forth in the "Financial Accounting Manual for Federal Reserve Banks" and constitute a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2001 and 2000, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

March 4, 2002
Boston, Massachusetts

December 31, 2001 and 2000 (in millions)	**2001**	**2000**
Assets		
Gold certificates	$ 546	$ 535
Special drawing rights certificates	115	115
Coin	54	46
Items in process of collection	317	473
Loans to depository institutions	2	1
U.S. government and federal agency securities, net	33,748	29,766
Investments denominated in foreign currencies	757	703
Accrued interest receivable	343	347
Interdistrict settlement account	–	2,782
Bank premises and equipment, net	112	117
Other assets	33	26
Total assets	$36,027	$34,911
Liabilities and Capital		
Liabilities:		
Federal Reserve notes outstanding, net	$31,806	$31,891
Deposits:		
Depository institutions	626	1,645
Other deposits	5	2
Deferred credit items	283	522
Interest on Federal Reserve notes due U.S. Treasury	37	63
Interdistrict settlement account	2,362	–
Accrued benefit cost	62	59
Other liabilities	10	13
Total liabilities	35,191	34,195
Capital:		
Capital paid-in	418	358
Surplus	418	358
Total capital	836	716
Total liabilities and capital	$36,027	$34,911

The accompanying notes are an integral part of these financial statements.

For the years ended December 31, 2001 and 2000 (in millions)	2001	2000
INTEREST INCOME:		
Interest on U.S. government and federal agency securities	$1,752	$1,757
Interest on investments denominated in foreign currencies	17	12
Interest on loans to depository institutions	1	1
Total interest income	1,770	1,770
OTHER OPERATING INCOME (LOSS):		
Income from services	57	47
Reimbursable services to government agencies	23	19
Foreign currency gains (losses), net	(73)	(63)
U.S. government securities gains (losses), net	18	(5)
Other income	15	12
Total other operating income	40	10
OPERATING EXPENSES:		
Salaries and other benefits	94	86
Occupancy expense	14	13
Equipment expense	13	13
Assessments by Board of Governors	35	34
Other expenses	50	46
Total operating expenses	206	192
NET INCOME PRIOR TO DISTRIBUTION	$1,604	$1,588
DISTRIBUTION OF NET INCOME:		
Dividends paid to member banks	$ 25	$ 19
Transferred to surplus	60	238
Payments to U.S. Treasury as interest on Federal Reserve notes	1,519	1,331
Total distribution	$1,604	$1,588

The accompanying notes are an integral part of these financial statements.

For the years ended December 31, 2001 and 2000 (in millions)	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 2000 (5.7 million shares)	$288	$288	$576
Net income transferred to (from) surplus		238	238
Surplus transfer to the U.S. Treasury		(168)	(168)
Net change in capital stock issued (1.4 million shares)	70	–	70
Balance at December 31, 2000 (7.1 million shares)	358	358	716
Net income transferred to (from) surplus		60	60
Net change in capital stock issued (1.2 million shares)	60	–	60
Balance at December 31, 2001 (8.3 million shares)	$418	$418	$836

The accompanying notes are an integral part of these financial statements.

1. Organization

The Federal Reserve Bank of Boston ("Bank") is part of the Federal Reserve System ("System") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act") which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System ("Board of Governors") and twelve Federal Reserve Banks ("Reserve Banks"). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. Other major elements of the System are the Federal Open Market Committee ("FOMC") and the Federal Advisory Council. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York ("FRBNY") and, on a rotating basis, four other Reserve Bank presidents.

Structure

The Bank serves the First Federal Reserve District, which includes Maine, Massachusetts, New Hampshire, Rhode Island, Vermont and a portion of Connecticut. In accordance with the Federal Reserve Act, supervision and control of the Bank are exercised by a Board of Directors. Banks that are members of the System include all national banks and any state chartered bank that applies and is approved for membership in the System.

Board of Directors

The Federal Reserve Act specifies the composition of the Board of Directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as Chairman and Deputy Chairman, are appointed by the Board of Governors, and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

2. Operations and Services

The System performs a variety of services and operations. Functions include: formulating and conducting monetary policy; participating actively in the payments mechanism, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations and check processing; distributing coin and currency; performing fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government's bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies and state member banks; and administering other regulations of the Board of Governors. The Board of Governors' operating costs are funded through assessments on the Reserve Banks.

The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the FRBNY for its execution of transactions. Authorized transaction types include direct purchase and sale of securities, matched sale-purchase transactions, the purchase of securities under agreements to resell, and the lending of U.S. government securities. The FRBNY is also authorized by the FOMC to hold balances of and to execute spot and forward foreign exchange and securities contracts in nine foreign currencies, maintain reciprocal currency arrangements ("F/X swaps") with various central banks, and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks.

3. Significant Accounting Policies

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared to the private sector. These accounting principles and practices are documented in the Financial Accounting Manual for Federal Reserve Banks ("Financial Accounting Manual"), which is issued by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual.

The financial statements have been prepared in accordance with the Financial Accounting Manual. Differences exist between the accounting principles and practices of the System and accounting principles generally accepted in the United States of America ("GAAP"). The primary differences are the presentation of all security holdings at amortized cost, rather than at the fair value presentation requirements of GAAP, and the accounting for matched sale-purchase transactions as separate sales and purchases, rather than secured borrowings with pledged collateral, as is generally required by GAAP. In addition, the Bank has elected not to present a Statement of Cash Flows. The Statement of Cash Flows has not been included as the liquidity and cash position of the Bank are not of primary concern to the users of these financial statements. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. Therefore, a Statement of Cash Flows would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

Effective January 2001, the System implemented procedures to eliminate the sharing of costs by Reserve Banks for certain services as a Reserve Bank may provide on behalf of the System. Data for 2001 reflects the adoption of this policy. Major services provided for the System by this bank, for which the costs will not be redistributed to the other Reserve Banks, include: Internet and Directory Services, Government Image Archive, Image Services System, Financial Support Office, Financial Services Policy Committee, Integrated Accounting System, Account Management Information System, and System Purchasing Service.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Certain amounts relating to the prior year have been reclassified to the current-year presentation. Unique accounts and significant accounting policies are explained below.

Gold Certificates

The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks to monetize gold held by the U.S. Treasury. Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. These gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time, and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged, and the Reserve Banks' gold certificate accounts are lowered. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based upon average Federal Reserve notes outstanding in each District.

Special Drawing Rights Certificates

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDRs, at the direction of the U.S. Treasury, for the purpose of financing SDR certificate acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, The Board of Governors allocates amounts among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year. There were no SDR transactions in 2001.

Loans to Depository Institutions

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If any loans were deemed to be uncollectible, an appropriate reserve would be established. Interest is accrued using the applicable discount rate established at least every fourteen days by the Board of Directors of the Reserve Banks, subject to review by the Board of Governors. Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

U.S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies

The FOMC has designated the FRBNY to execute open market transactions on its behalf and to hold the resulting securities in the portfolio known as the System Open Market Account ("SOMA"). In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System's central bank responsibilities. Such authorizations are reviewed and approved annually by the FOMC.

Matched sale-purchase transactions are accounted for as separate sale and purchase transactions. Matched sale-purchase transactions are transactions in which the FRBNY sells a security and buys it back at the rate specified at the commencement of the transaction.

The FRBNY has sole authorization by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements on behalf of the System, in order to facilitate the effective functioning of the domestic securities market. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires FRBNY to take possession of collateral in excess of the market values of the securities loaned. The market values of the collateral and the securities loaned are monitored by FRBNY on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA.

Foreign exchange ("F/X") contracts are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. Spot foreign contracts normally settle two days after the trade date, whereas the settlement date on forward contracts is negotiated between the contracting parties, but will extend beyond two days from the trade date. The FRBNY generally enters into spot contracts, with any forward contracts generally limited to the second leg of a swap/warehousing transaction.

The FRBNY, on behalf of the Reserve Banks, maintains renewable, short-term F/X swap arrangements with two authorized foreign central banks. The parties agree to exchange their currencies up to a pre-arranged maximum amount and for an agreed upon period of time (up to twelve months), at an agreed upon interest rate. These arrangements give the FOMC temporary access to foreign currencies that it may need for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the F/X swap arrangements can be initiated by either the FRBNY or the partner foreign central bank, and must be agreed to by the drawee. The F/X swaps are structured so that the party initiating the transaction (the drawer) bears the exchange rate risk upon maturity. The FRBNY will generally invest the foreign currency received under an F/X swap in interest-bearing instruments.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the Treasury, U.S. dollars for foreign currencies held by the Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury and ESF for financing purchases of foreign currencies and related international operations.

In connection with its foreign currency activities, the FRBNY, on behalf of the Reserve Banks, may enter into contracts which contain varying degrees of off-balance sheet market risk, because they represent contractual commitments involving future settlement and counterparty credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio from time to time involve transactions that can result in gains or losses when holdings are sold prior to maturity. However, decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, earnings and any gains or losses resulting from the sale of such currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as "Interest on U.S. government and federal agency securities" or "Interest on investments denominated in foreign currencies," as appropriate. Income earned on securities lending transactions is reported as a component of "Other income." Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as "U.S. government securities gains (losses), net." Foreign-currency-denominated assets are revalued daily at current market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency (losses), net." Foreign currencies held through F/X swaps, when initiated by the counterparty, and warehousing arrangements are revalued daily, with the unrealized gain or loss reported by the FRBNY as a component of "Other assets" or "Other liabilities," as appropriate.

Balances of U.S. government and federal agency securities bought outright, securities loaned, investments denominated in foreign currency, interest income, securities lending fee income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an F/X swap arrangement, are allocated to each Reserve Bank. Income from securities lending transactions undertaken by the FRBNY is also allocated to each Reserve Bank. Securities purchased under agreements to resell and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to the FRBNY and not to other Reserve Banks.

Statement of Financial Accounting Standards No. 133, as amended and interpreted, became effective on January 1, 2001. For the periods presented, the Reserve Banks had no derivative instruments required to be accounted for under the standard.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from 2 to 50 years. New assets, major alterations, renovations and improvements are capitalized at cost as additions to the asset accounts. Maintenance, repairs and minor replacements are charged to operations in the year incurred. Internally developed software is capitalized based on the cost of direct materials and services and those indirect costs associated with developing, implementing, or testing software.

Interdistrict Settlement Account

At the close of business each day, all Reserve Banks and branches assemble the payments due to or from other Reserve Banks and branches as a result of transactions involving accounts residing in other Districts that occurred during the day's operations. Such transactions may include funds settlement, check clearing and ACH operations, and allocations of shared expenses. The cumulative net amount due to or from other Reserve Banks is reported as the "Interdistrict settlement account."

Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve Agents to the Reserve Banks upon deposit with such Agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve Agent must be equal to the sum of the notes applied for by such Reserve Bank. In accordance with the Federal Reserve Act, gold certificates, special drawing rights certificates, U.S. government and federal agency securities, triparty agreements, loans to depository institutions, and investments denominated in foreign currencies are pledged as collateral for net Federal Reserve notes outstanding. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose collateral value is equal to the par value of the securities tendered. The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. The Reserve Banks have entered into an agreement which provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks in order to satisfy their obligation of providing sufficient collateral for outstanding Federal Reserve notes. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the United States government.

The "Federal Reserve notes outstanding, net" account represents Federal Reserve notes reduced by currency held in the vaults of the Bank of $3,808 million, and $4,816 million at December 31, 2001 and 2000, respectively.

Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and surplus of the member bank. As a member bank's capital and surplus changes, its holdings of the Reserve Bank's stock must be adjusted. Member banks are those state-chartered banks that apply and are approved for membership in the System and all national banks. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. These shares are nonvoting with a par value of $100. They may not be transferred or hypothecated. By law, each member bank is entitled to receive an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

Surplus

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in.

The Consolidated Appropriations Act of 2000 (Public Law 106-113, Section 302) directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $3,752 million during the Federal Government's 2000 fiscal year. The Federal Reserve Bank of Boston transferred $168 million to the U.S. Treasury. Reserve Banks were not permitted to replenish surplus for these amounts during fiscal year 2000, which ended September 30, 2000; however, the surplus was replenished by December 31, 2000.

In the event of losses or a substantial increase in capital, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury may vary significantly.

Income and Costs Related to Treasury Services

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. The costs of providing fiscal agency and depository services to the Treasury Department that have been billed but not paid are immaterial and included in "Other expenses."

Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property, which are reported as a component of "Occupancy expense."

4. U.S. Government and Federal Agency Securities

Securities bought outright are held in the SOMA at the FRBNY. An undivided interest in SOMA activity, with the exception of securities held under agreements to resell and the related premiums, discounts and income, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was 6.008 percent and 5.741 percent at December 31, 2001 and 2000, respectively.

The Bank's allocated shares of securities held in the SOMA at December 31, that were bought outright, were as follows (*in millions*):

	2001	2000
Par value:		
Federal agency	$ 1	$ 7
U.S. government:		
Bills	10,939	10,261
Notes	15,978	13,788
Bonds	6,228	5,327
Total par value	33,146	29,383
Unamortized premiums	679	559
Unaccreted discounts	(77)	(176)
Total allocated to Bank	$33,748	$29,766

Total SOMA securities bought outright were $561,701 million and $518,501 million at December 31, 2001 and 2000, respectively.

The maturity distribution of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 2001, was as follows (*in millions*):

	Par Value		
Maturities of securities held	U.S. Government Securities	Federal Agency Obligations	Total
Within 15 days	$ 642	$ –	$ 642
16 days to 90 days	7,483	–	7,483
91 days to 1 year	7,848	–	7,848
Over 1 year to 5 years	9,202	1	9,203
Over 5 years to 10 years	3,205	–	3,205
Over 10 years	4,765	–	4,765
	$33,145	$ 1	$33,146

At December 31, 2001 and 2000, matched sale-purchase transactions involving U.S. government securities with par values of $23,188 million and $21,112 million, respectively, were outstanding, of which $1,393 million and $1,212 million were allocated to the Bank. Matched sale-purchase transactions are generally overnight arrangements.

At December 31, 2001 and 2000, U.S. government securities with par values of $7,345 million and $2,086 million, respectively, were loaned from the SOMA, of which $441 million was allocated to the Bank.

5. Investments Denominated in Foreign Currencies

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and the Bank for International Settlements, and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities held under agreements to resell. These investments are guaranteed as to principal and interest by the foreign governments.

Each Reserve Bank is allocated a share of foreign-currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 5.198 percent and 4.488 percent at December 31, 2001 and 2000, respectively.

The Bank's allocated share of investments denominated in foreign currencies, valued at current exchange rates at December 31, was as follows (*in millions*):

	2001	2000
European Union Euro:		
Foreign currency deposits	$239	$208
Government debt instruments including agreements to resell	140	122
Japanese Yen:		
Foreign currency deposits	99	123
Government debt instruments including agreements to resell	276	247
Accrued interest	3	3
Total	$757	$703

Total investments denominated in foreign currencies were $14,559 million and $15,670 million at December 31, 2001 and 2000, respectively.

The maturity distribution of investments denominated in foreign currencies which were allocated to the Bank at December 31, 2001, was as follows (*in millions*):

Maturities of investments denominated in foreign currencies	
Within 1 year	$713
Over 1 year to 5 years	21
Over 5 years to 10 years	23
Over 10 years	–
Total	$757

At December 31, 2001 and 2000, there were no open foreign exchange contracts or outstanding F/X swaps.

At December 31, 2001 and 2000, the warehousing facility was $5 billion, with zero outstanding.

6. Bank Premises and Equipment

A summary of bank premises and equipment at December 31 is as follows (*in millions*):

	2001	**2000**
Bank premises and equipment:		
Land	$ 22	$ 22
Buildings	98	97
Building machinery and equipment	15	15
Construction in progress	2	2
Furniture and equipment	65	66
	202	202
Accumulated depreciation	(90)	(85)
Bank premises and equipment, net	$ 112	$ 117

Depreciation expense was $11 million for each of the years ended December 31, 2001 and 2000.

The Bank leases unused space to outside tenants. Those leases have terms ranging from 1 to 9 years. Rental income from such leases was $10 million for each of the years ended December 31, 2001 and 2000. Future minimum lease payments under noncancelable agreements in existence at December 31, 2001, were (*in millions*):

2002	$ 9
2003	7
2004	6
2005	5
2006	3
Thereafter	7
	$37

7. Commitments and Contingencies

At December 31, 2001, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from 1 to approximately 2 years. These leases provide for increased rentals based upon increases in real estate taxes, operating costs or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was $1 million for each of the years ended December 31, 2001 and 2000. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases and capital leases, net of sublease rentals, with terms of one year or more, at December 31, 2001, were not material.

Under the Insurance Agreement of the Federal Reserve Banks dated as of March 2, 1999, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 2001 or 2000.

The Bank is involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Bank.

8. Retirement and Thrift Plans

Retirement Plans

The Bank currently offers two defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan") and the Benefit Equalization Retirement Plan ("BEP"). The System Plan is a multi-employer plan with contributions fully funded by participating employers. No separate accounting is maintained of assets contributed by the participating employers. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 2001 and 2000, and for the years then ended, are not material.

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled $3 million for each of the years ended December 31, 2001 and 2000, and are reported as a component of "Salaries and other benefits."

9. Postretirement Benefits other than Pensions and Postemployment Benefits

Postretirement Benefits other than Pensions

In addition to the Bank's retirement plans, employees who have met certain age and length of service requirements are eligible for both medical benefits and life insurance coverage during retirement.

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets. Net postretirement benefit costs are actuarially determined using a January 1 measurement date.

Following is a reconciliation of beginning and ending balances of the benefit obligation (*in millions*):

	2001	2000
Accumulated postretirement benefit obligation at January 1	$49.5	$48.5
Service cost-benefits earned during the period	1.0	1.2
Interest cost of accumulated benefit obligation	2.8	3.3
Actuarial loss /(gain)	(6.6)	(2.4)
Contributions by plan participants	0.3	0.3
Benefits paid	(1.6)	(1.4)
Plan amendments, acquisitions, foreign currency exchange rate changes, business combinations, divestitures, curtailments, settlements, special termination benefits	(5.0)	–
Accumulated postretirement benefit obligation at December 31	$40.4	$49.5

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit costs (*in millions*):

	2001	2000
Fair value of plan assets at January 1	$ –	$ –
Actual return on plan assets	–	–
Contributions by the employer	1.3	1.1
Contributions by plan participants	0.3	0.3
Benefits paid	(1.6)	(1.4)
Fair value of plan assets at December 31	$ –	$ –
Unfunded postretirement benefit obligation	$ 40.4	$ 49.5
Unrecognized initial net transition asset (obligation)	–	–
Unrecognized prior service cost	9.2	4.9
Unrecognized net actuarial (loss)	6.6	0.4
Accrued postretirement benefit cost	$ 56.2	$ 54.8

Accrued postretirement benefit costs are reported as a component of “Accrued benefit costs.”

At December 31, 2001 and 2000, the weighted average discount rate assumptions used in developing the benefit obligation were 7.0 percent and 7.5 percent, respectively.

For measurement purposes, a 10.00 percent annual rate of increase in the cost of covered health care benefits was assumed for 2002. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.00 percent by 2008, and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2001 (*in millions*):

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit cost	$0.7	$(0.6)
Effect on accumulated postretirement benefit obligation	6.6	(5.3)

The following is a summary of the components of net periodic postretirement benefit costs for the years ended December 31 (*in millions*):

	2001	2000
Service cost-benefits earned during the period	$1.0	$1.2
Interest cost of accumulated benefit obligation	2.8	3.2
Amortization of prior service cost	(0.6)	(0.6)
Recognized net actuarial loss	(0.4)	–
Net periodic postretirement benefit cost	$2.8	$3.8

Net periodic postretirement benefit costs are reported as a component of "Salaries and other benefits."

Postemployment Benefits

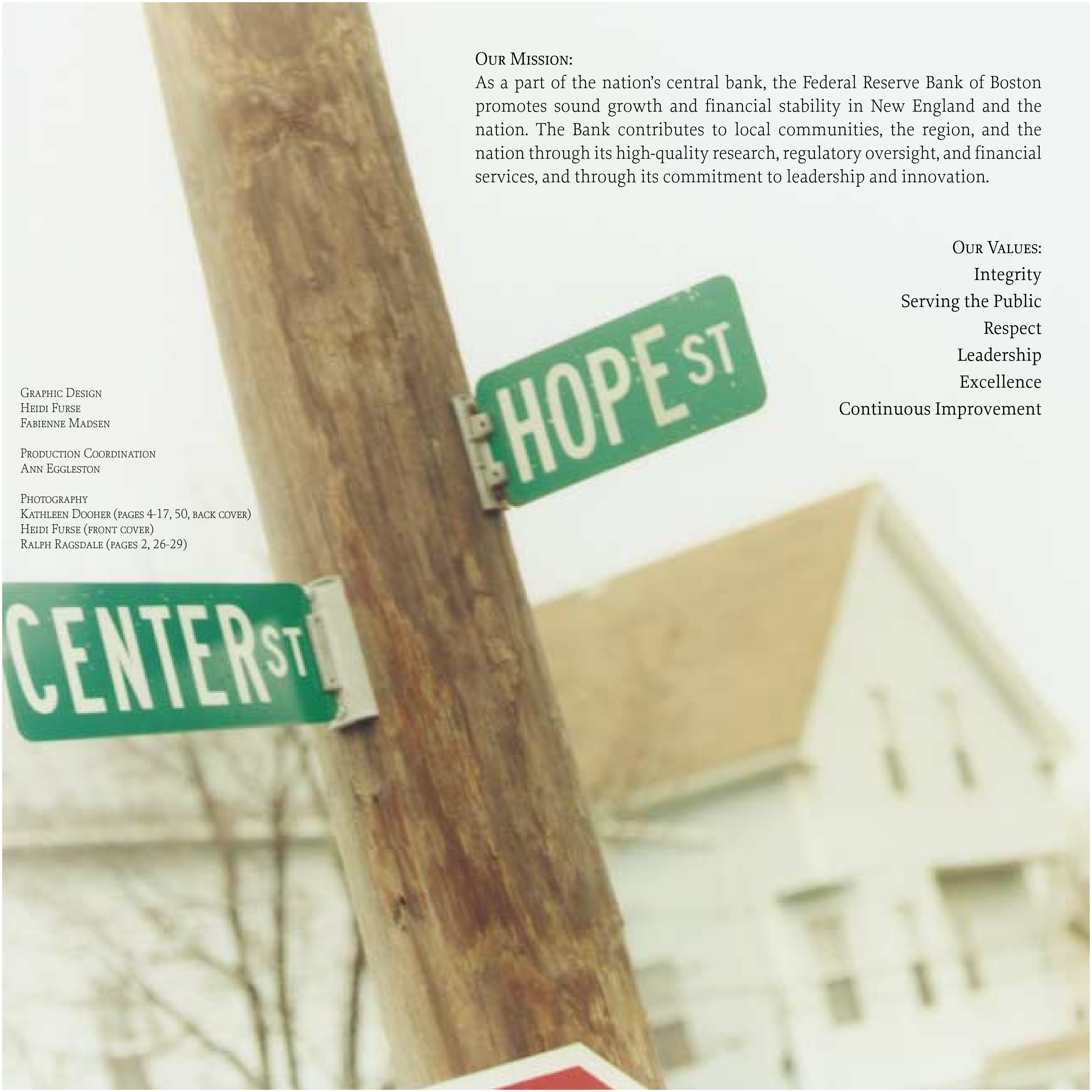
The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 2001 and 2000, were $6 million and $5 million, respectively. This cost is included as a component of "Accrued benefit costs." Net periodic postemployment benefit costs included in 2001 and 2000 operating expenses were $2 million and $1 million, respectively.

Our Mission:

As a part of the nation's central bank, the Federal Reserve Bank of Boston promotes sound growth and financial stability in New England and the nation. The Bank contributes to local communities, the region, and the nation through its high-quality research, regulatory oversight, and financial services, and through its commitment to leadership and innovation.

Our Values:

Integrity
Serving the Public
Respect
Leadership
Excellence
Continuous Improvement



Graphic Design
Heidi Furse
Fabienne Madsen

Production Coordination
Ann Eggleston

Photography
Kathleen Dooher (pages 4-17, 50, back cover)
Heidi Furse (front cover)
Ralph Ragsdale (pages 2, 26-29)

Officers – Federal Reserve Bank of Boston

Executive Office
Cathy E. Minehan
President and Chief Executive Officer

Paul M. Connolly
First Vice President and Chief Operating Officer

Research Group
Lynn E. Browne
Executive Vice President and Director of Research

Jeffrey C. Fuhrer
Senior Vice President and Monetary Policy Advisor

Katharine L. Bradbury
Vice President and Economist

Richard W. Kopcke
Vice President and Economist

William J. Spring
Vice President

Geoffrey M.B. Tootell
Vice President and Economist

Richard C. Walker III
Vice President

Yolanda K. Kodrzycki
Assistant Vice President and Economist

Thomas L. Lavelle
Assistant Vice President and Public Information Officer

Jane Sneddon Little
Assistant Vice President and Economist

Susan E. Rodburg
Assistant Vice President

Robert Tannenwald
Assistant Vice President and Economist

Robert K. Triest
Assistant Vice President and Economist

Marilyn E. Weekes
Assistant Vice President and Community Affairs Officer

Administrative and Legal Services Group
William N. McDonough
Executive Vice President and General Counsel

Mary E. Fothergill
Vice President

John R.H. Kimball
Vice President and Associate General Counsel

Stephen G. Trebino
Vice President and Secretary

Amina P. Derbali
Assistant Vice President

Brian L. Donovan
Assistant Vice President

John J. Kroen
Assistant Vice President and Assistant Secretary

David K. Park
Assistant Vice President and Assistant General Counsel

Colby Rottler
Assistant Vice President

Kristine Van Amsterdam
Assistant Vice President

Bank Supervision and Regulation Group
Eric S. Rosengren
Senior Vice President

Robert M. Brady
Vice President

Claire M. Desjardins
Vice President

James T. Nolan
Vice President

E. Philip A. Simpson, Jr.
Vice President

Jonathan S. Fine
Assistant Vice President

John S. Jordan
Assistant Vice President

Michael P. Malone
Assistant Vice President

Payments and Financial Services Group
Sarah G. Green
Executive Vice President

Katharine Gibson
Vice President

Ronald E. Mitchell, Jr.
Vice President

Krista M. Blair
Assistant Vice President

David F. Tremblay
Assistant Vice President

• Retail Payments Group
Steven M. Whitney
Senior Vice President

James R. Fitzgerald
Vice President

Gerald J. Giaccai
Vice President

Dexter S. Holt
Vice President

Linda K. Kopec
Vice President

James McEneaney
Vice President

Marianne D. Crowe
Assistant Vice President

Paul J. Malloy
Assistant Vice President

Kevin J. McCabe
Assistant Vice President

David L. Plasse
Assistant Vice President

• Treasury Services and Financial Management Group
Robert K. LaRocca
Senior Vice President

Robert Augusta, Jr.
Vice President

Joan M. Gibbons
Vice President

Linda J. Mahon
Vice President

Edward A. Romkey
Vice President

Mary L. Cottman
Assistant Vice President

Carl S. Madsen
Assistant Vice President

Leah Maurer
Assistant Vice President

Amy O. Ross
Assistant Vice President

Information Technologies Group
Thomas E. Gagnon
Senior Vice President

James S. Cunha
Vice President

Marshall F. D'Avanzo
Vice President

Christopher J. Gale
Vice President

Alan W. Bloom
Assistant Vice President

James R. Rigoli
Assistant Vice President

Christopher H. Ritchie
Assistant Vice President

Joyce L. Sandvik
Assistant Vice President

Human Resources and Loan & Credit Group
Thomas E. Cimeno, Jr.
Senior Vice President and Corporate Policy Advisor

Richard M. Burns
Vice President

Cynthia A. Conley
Vice President and Associate General Counsel

Curtis L. Turner
Vice President

Peter F. Genevich
Assistant Vice President

Jane A. Goubeaux
Assistant Vice President

Audit
Roland H. Marx, Jr.
Vice President and General Auditor

Anna M. Wong
Assistant Vice President and Assistant General Auditor