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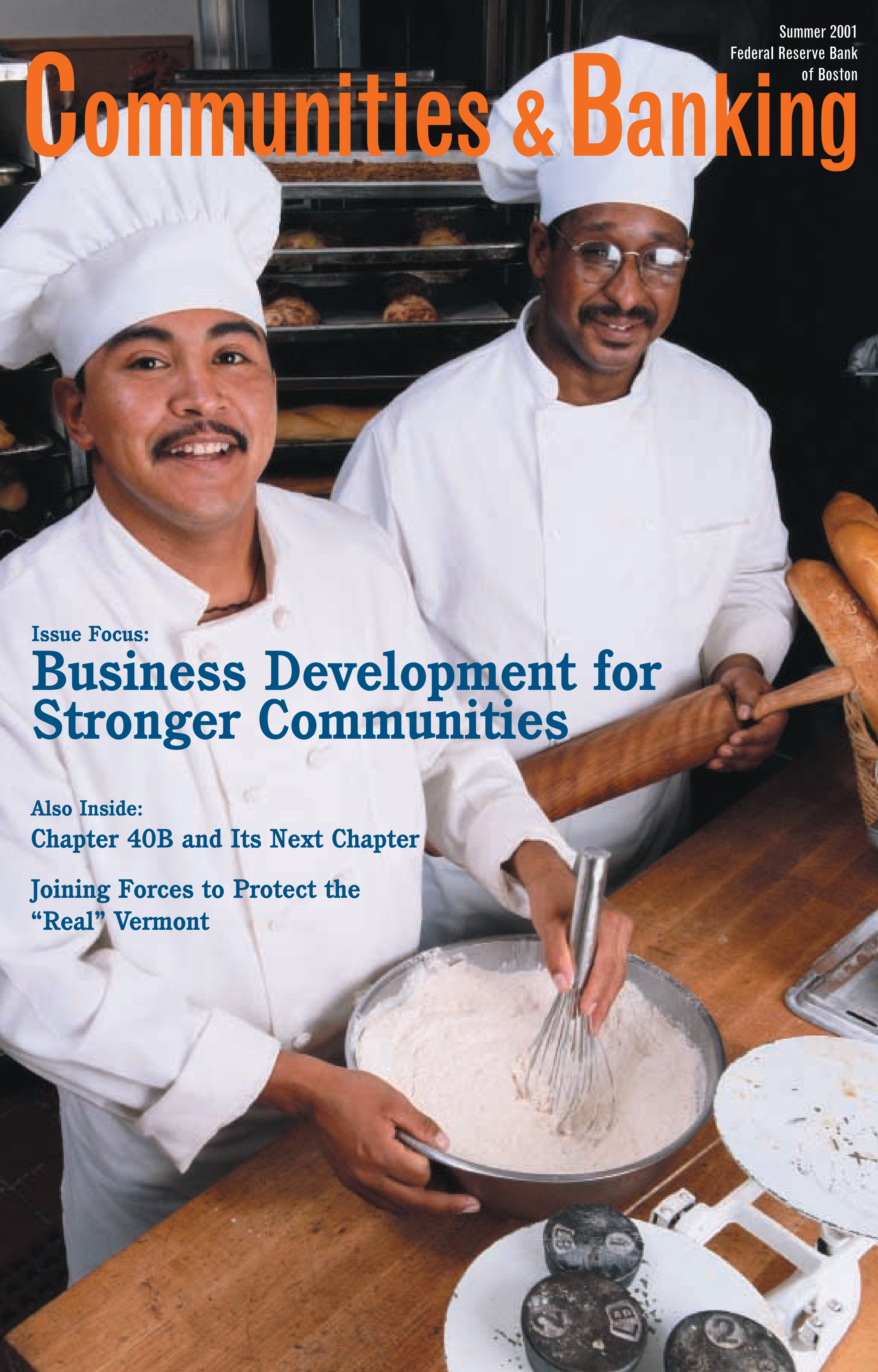
Communities & Banking



Issue Focus:

Business Development for Stronger Communities

Also Inside:

Chapter 40B and Its Next Chapter

Joining Forces to Protect the "Real" Vermont

Communities & Banking

The mission of *Communities & Banking* is to enhance community and economic development by exploring effective ways for lenders to work with public, private, and nonprofit sectors toward proactive compliance with the Community Reinvestment Act.

Kristin Kanders
Editor, *Communities & Banking*
Federal Reserve Bank of Boston
P.O. Box 2076
Boston, MA 02106-2076
(617) 973-3997
kristin.kanders@bos.frb.org

For free subscriptions contact:
Public and Community Affairs
Federal Reserve Bank of Boston
P.O. Box 2076
Boston, MA 02106-2076
1-800-409-1333
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this issue:

Why Microenterprise?

No less than the American ethos is based on the idea that microenterprise activity (starting small but with large reserves of hard work and ingenuity) can lead to improved economic prospects. In addition to the personal rewards that stem from pride of accomplishment and ownership, our capitalistic system relies on entrepreneurship to keep itself thriving.

The Global Entrepreneurship Monitor 2000 study, supported by the Kauffman Foundation, correlates about one-half of a country's rate of economic growth to its level of entrepreneurial activity.[1] Small businesses are dynamic players in the U.S. economy, using innovative approaches to explore markets and test new ideas. Microenterprises, extremely small community-based businesses often run by low- to moderate-income people, have been supported as a means of poverty alleviation. From the global community to the local community, microenterprises play a critical role in America. Their ability to foster a lively business environment is not up for debate. What is up for debate is how best to support them.

The following articles explore issues related to microenterprise activity. In the first article, Kristin Kanders focuses on a study titled "Giving a Leg Up to Bootstrap Entrepreneurship" and asks how regulations influence the level of entrepreneurship and how we can improve the situation. A second article, written by James Carras of Carras Community Investment, Inc. discusses a new federal program, the New Markets Tax Credit, and its prospects for supporting community development. Timothy Bates of Wayne State University then lends a historical perspective to the discussion of financing small businesses, as he compares Community Development Financial Institutions (CDFIs) to the Minority Enterprise Small Business Corporations of the 1960s. Finally, Mark Pinsky and Laura Schwingel of the National Community Capital Association and the CDFI Coalition explain why they believe their industry is different from the MESBICs that began in the 1960s. They present themselves as a new breed of economic developers, ready to take on the challenges of today's marketplace.

Federal Reserve Governor Edward Gramlich on the impact of microenterprises:

It is at the community and neighborhood level that the process of family and community asset-building takes shape and where entrepreneurship leads some, literally, out of poverty. In poorer neighborhoods and communities, small business development provides everyday retail and commercial services and employment opportunities.

The development and growth of small firms at the neighborhood level often contribute to community revitalization, help stabilize real estate values, and provide impetus for additional investments by business, government, homeowners, and homebuyers. Local entrepreneurs often become valued informal community resources or leaders in more formal civic and political organizations. In many communities, they represent the heart of the way that local economic vitality is created and maintained.

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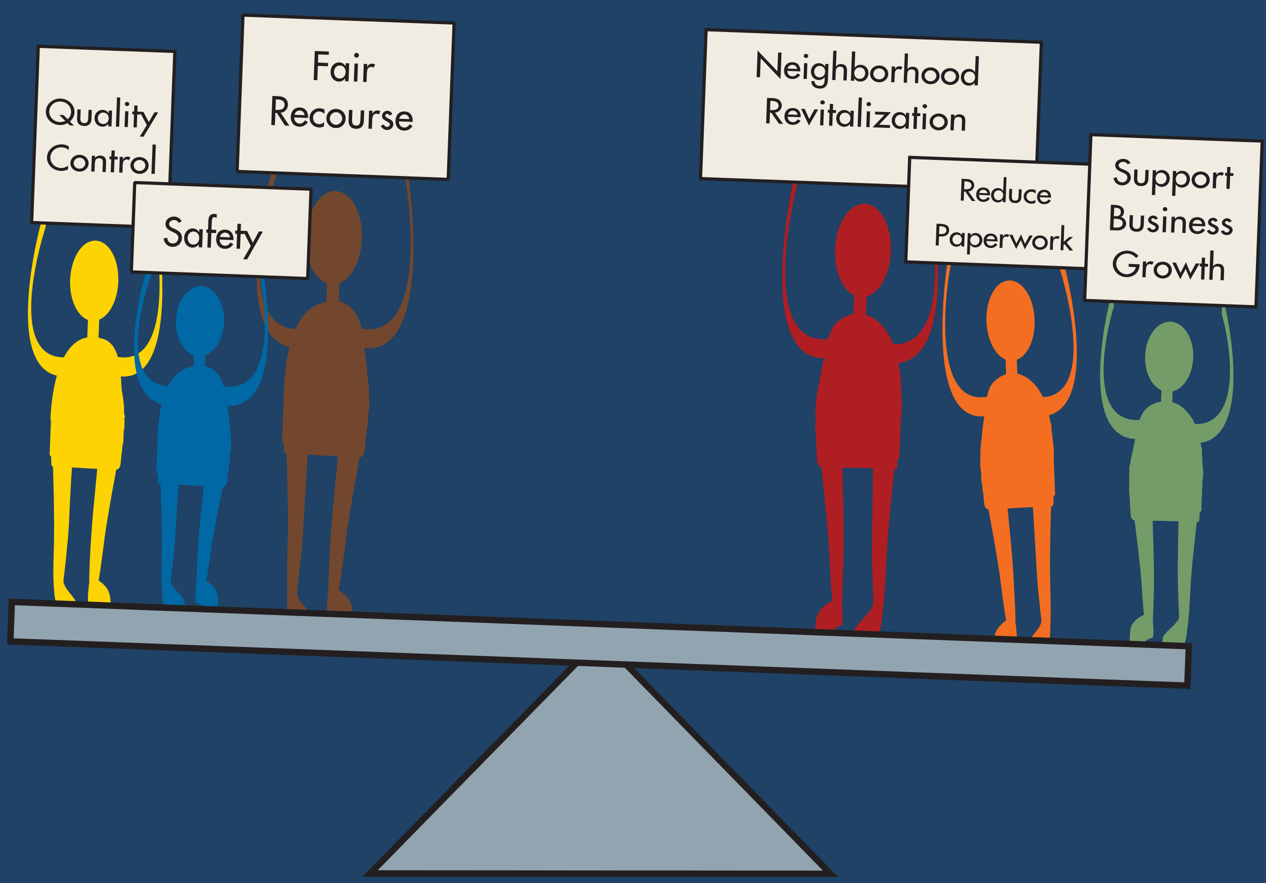
1. The study notes that "despite the high degree of association between entrepreneurship and economic growth, exceptions suggest there is no one catalyst to economic growth. Ireland, for example, has enjoyed rapid economic growth with relatively low levels of entrepreneurial activity. For many countries entrepreneurship may be a key to economic prosperity but it is not always the only key."

Making Microenterprise

For entrepreneurs without much capital, stumbling blocks can mean the difference between starting a business and not trying. Regulations can be one stumbling block to entrepreneurship, but balance, argue advocates for both sides, is what's needed.



Easier

by Kristin Kanders

Ever had the experience of standing in a long line, only to be sent to another long line, only to find out you needed to get an application from somewhere else first? It's enough to frustrate even the most tranquil of us, and when you add in some arcane requirements, can deter would-be entrepreneurs.

To assess whether obstacles inhibit the growth of would-be entrepreneurs, Boston's Pioneer Institute for Public Policy Research conducted a study of the regulatory climate for microenterprises — businesses that employ fewer than five people, require less than $25,000 in start-up capital, and are typically run by low- to moderate-income individuals. Collaborating with other think tanks in Atlanta, Dallas, and Los Angeles, the group compared regulatory burden among cities. The study they produced, "Giving a Leg Up to Bootstrap Entrepreneurship: Expanding Economic Opportunity in America's Urban Centers," highlights cases where the business atmosphere helps and hinders entrepreneurs; it also makes suggestions for regulatory reform.[1]

Burden or Quality Control?

Reducing the number of hoops an entrepreneur must jump through to become legitimate does more than diminish the sweat involved in running a business. Making it easier for entrepreneurs can mean that consumers have more varied and less expensive goods and services. Licensing and other regulations cost the entrepreneur money, directly when he buys a permit or indirectly when he pays for schooling or special equipment to gain accreditation. That cost is transferred to the consumer. While schooling requirements are logical licensing prerequisites for professions such as medicine, is it necessary to go to cosmetology school to open a hair-braiding shop (especially when the skill isn't part of the curriculum)? These are the kinds of questions the report raises.

Onerous regulations encourage microenterprises to maintain an illegal status. And being underground hinders microenterprises from growing into bigger businesses because they cannot obtain bank financing, nor can they fully market themselves for fear of attracting inspection service scrutiny. The bigger cost, however, may be that stringent licensing and permitting requirements limit the market and restrict choices. Rigorous requirements dissuade start-ups from entering business and can slow an economy.

The main reason for regulation of entry-level businesses is to guard quality. However, as the report reveals, regulations "rarely address performance and quality issues" and they tend to "focus on compliance with rules rather than performance." As George Mason University economics professor Walter Williams has argued, high barriers to entry lower the number of practitioners in a field and can result in consumers choosing "do-it-yourself" methods. He has noted that "in jurisdictions where there is a strict licensing of electricians, there is a higher incidence of fires of an electrical origin. Many people can't afford the high-cost services of electricians, so they jury-rig wiring themselves and use extension cords, thereby increasing the risk of fire." Williams believes that a range of quality services, from Tiffany's to Target, is optimal.

Certification is one way to obtain information about quality. If entrepreneurs of the same field were to take a test, the highest-scoring ones could call themselves "Class A" practitioners and the middle-scoring ones could be "Class C" practitioners. This, argues Williams, is more cost-effective and accurate than licensing the profession. Microenterprises, free-market lovers, and economic developers would propose easing regulations. Considering how important small businesses are to the economy, who wouldn't? The answer: current practitioners. Historically, reducing restrictions has been opposed overwhelmingly by those already in the field who fear that losing entitlement will mean losing profits. When former Massachusetts Governor Weld attempted to dissolve 11 boards of registration, the opponents were not concerned citizens but licensed practitioners.

Bill Wood, Director of the Commonwealth's Division of Professional Licensure, is a cautious regulator. His organization oversees licensing and regulation for 36 occupational boards ranging from cosmetologists to nurses, and while he is "not in the business of seeking out more work," he does recognize the value of regulation for consumers. Relating how a car mechanic (an unlicensed professional) performed faulty work on his car, Wood says that he was left with inadequate recourse. His option to solve the dispute was to hire a lawyer to argue his case in small-claims court — "the libertarian way to solve dispute." He adds, "My attorney advised me, however, that the court system is not well-equipped to deal with small consumer complaints because it doesn't have the expertise to determine fault and because it is overwhelmed. As a solution, the courts often decide disputes by ordering each side to pay half the amount in question." If there were a board of regulation for mechanics, Wood could have filed a complaint without wasting his own time or money. His own organization receives about 2,400 complaints per year and takes about 230 actions per year, resulting in between $100,000 to $200,000 being refunded to consumers.

One of the biggest hurdles for microenterprises is towns that don't allow home-based businesses.

Evaluating the Home Market

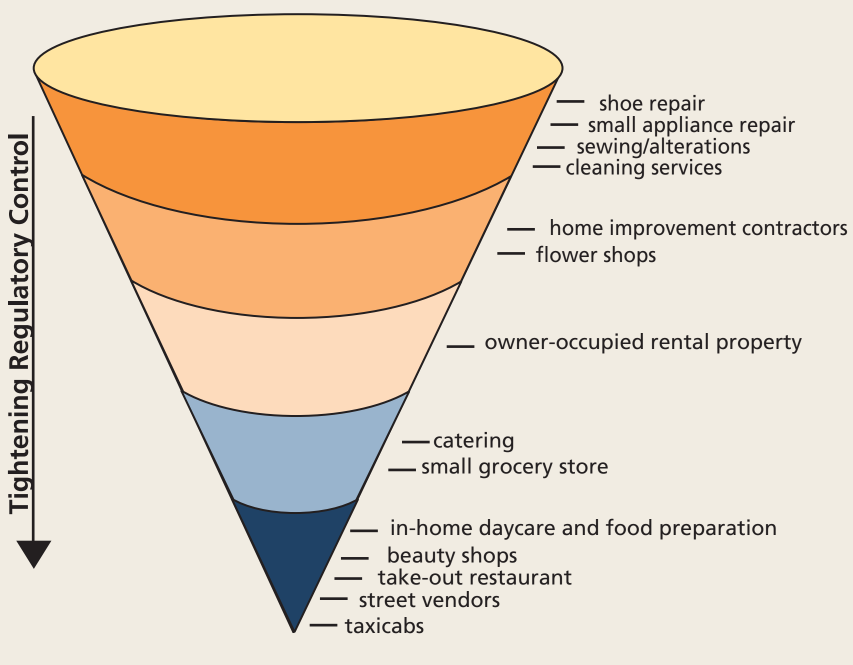
In comparison to the other cities, Boston fared better than micro-managing Atlanta but worse than entrepreneurial-friendly Dallas. The "Bootstrap" report analyzed taxicab regulation among the four cities and highlights Boston as a positive example of keeping licensing requirements in check. It suggests the growth of Boston's livery service (limousines and shuttles) can be attributed to its freedom from a medallion system of regulation. While the industry is licensed — the cost of the special license plate is $40 per year — the start-up capital is minimal compared to what is required to purchase a medallion, about $180,000. This analogy is used to defend one of the Pioneer Institute's main recommendations, "Cities should avoid extending regulatory rules to new occupations and businesses."

The report also analyzes the regulations governing Boston's home-based businesses, such as daycare and catering, street-vending businesses, and cosmetology. Home-based businesses are an inexpensive way to start a microenterprise, yet zoning restrictions are designed to keep residential areas free from visible signs of commercial activity. While many people would prefer that residential and commercial districts be separated, some of the zoning restrictions are not intuitive. For example, a home-based business cannot employ anyone living outside the home, maintain inventory, or use more than 25 percent of the floor area for business purposes. Would allowing these activities necessarily harm the neighborhood's character?

Peg Ryan, Entrepreneurial Training Services Director for the Commonwealth Corporation, a quasi-public nonprofit agency involved in workforce development and economic development initiatives throughout Massachusetts, believes, "One of the biggest hurdles for microenterprises is towns that don't allow home-based businesses. For example, in Quincy, you're not allowed to run a business from your home, and office space is very expensive." Ryan notes that for many microenterprises, starting from home is the most effective way to begin. In the mean-

The figure below, based on surveying of small business fields, compares regulatory burden among occupations.

Index of Regulatory Control in Boston



Adapted from: David J. Dobb, ed., *Economic Opportunity in Boston: An Index of Regulatory Climate for Small Entrepreneurs* (Boston, Massachusetts: Pioneer Institute for Public Policy Research, 1999). hpp://www.pioneerinstitite.org

The paradox of family child care is that although its connection to protecting the public's health and welfare is palpable, regulation and enforcement are not.

time, her organization has developed a small business incubator and will continue to advocate for more incubator space.

Similarly controversial are Massachusetts' restrictions against in-home food preparation. Pioneer reports that health code policies prohibit using residential kitchens to prepare food for sale. A separate commercial-grade kitchen must be used but, says Pioneer, these can be as unsanitary as residential kitchens. And those preparing food illegally are never inspected. The law fails to protect consumers, asserts the report, because "in-home catering is a thriving, if illegal, sector in Boston, serving as an important point of entry for entrepreneurs." A solution to the in-home food preparation situation promoted by the Institute would determine a kitchen's adequacy and cleanliness based on inspection, not an arbitrary rule. A less pervasive change would allow those selling homemade goods to inform customers that their goods were prepared in a noncommercial kitchen. Pioneer also claims that inner-city entrepreneurs who want to sell homemade goods are not allowed to, although farm families often sell homemade items such as jams, cakes, and cookies at farmers' markets.

Beth Altman of the Massachusetts Department of Public Health, Division of Food and Drugs, says "the state is not opposed to in-home businesses, but is opposed to high-risk foods being prepared in non-commercial settings." She disagrees with Pioneer's assertion that a discrepancy exists between what inner-city and farm residents can sell to the public. Massachusetts, which adopted the Federal Food Code in October, has included its own regulation that allows food with low risk of causing illness to be prepared in any residential kitchen — city or country — with a residential kitchen license. This includes baked items and jams and jellies — the foods often seen at farmers' markets — because her organization believes "there are certain things that can safely be made in the home and marketed to the public." Altman adds that although the residential kitchen license can be granted statewide, cities and towns can deny granting the licenses for zoning or other reasons.

Licensing requirements were also shown to be incompatible with the service rendered. For example, Boston's African-hair braiders must complete 1,000 hours of training costing between $5,000 and $8,000 to obtain a cosmetology license. Pioneer contends the training teaches skills unrelated to the braiding technique. In California, a lawsuit resulted in hair braiders' exemption from the license requirement. But Bill Wood of the Division of Professional Licensure believes more care should be taken to develop legislation that is less encompassing. He notes the cosmetology board enforces a statute requiring that anyone "arranging hair for hire" hold a cosmetology license. Helen Peveri, Executive Director of the Massachusetts Cosmetology Board, says her organization did a lot of research to determine if hair braiders fell under the statutory guidelines for hairdressers. The board's affirmative decision was based on research showing that braiders often end up trimming, straightening (with commercial chemicals), and dying hair. Says Peveri, "The most compelling reason for requiring licensure is that the sanitation issues are no different than those raised for any hairdressing procedure."

It's jarring to realize that an aspiring cosmetologist must complete 1,000 hours of training to obtain a license, while the training requirement for family (in-home) daycare providers is a three-hour orientation.[2] Promoted by Pioneer Institute and welfare-to-work advocates as a viable business opportunity for entry-level workers with little education and few special skills, the Institute would like to make the licensing process even less cumbersome. Although daycare licensure in

Massachusetts is not costly, Pioneer alleges the paperwork-intensive process encourages providers to operate without certification. To remedy the paperwork problem, Massachusetts' Office of Child Care Services Communications Director Kate Arsenault says her organization created a Paperwork Committee to look at paperwork issues and it initiated a system allowing potential licensees to submit documents electronically. But Arsenault also believes Massachusetts' licensing requirements "are not minimum standards, but quality standards."

Even in a "strict" state such as Massachusetts, family child care providers operating without a license are not dealt with harshly – so as not to disrupt working families. Arsenault says that those operating without licenses are often unaware of the requirement. Most of these providers are allowed to continue operating while they get licensing assistance from the Office. Ignorance of the law, in this case, seems to keep things running, whereas in the restaurant business, it will result in closed doors.

The paradox of family child care is that although its connection to protecting the public's health and welfare is palpable, regulation and enforcement are not. Why are parents not clamoring for stricter regulation and enforcement of standards? According to Roberta Malavenda of Quality Care for Children, the reason is that "taking care of children is seen as community work" rather than as a profession. But, says Malavenda, "when you start charging – then you are a business" and "when public dollars go for child-care subsidies – then you're required to be accountable." Malavenda points to a recent trend of family child care professionals welcoming inspection checks and accreditation programs as marketing tools for safe programs. Referring to her state of Georgia, Malavenda says that in order to not push providers underground, regulatory enhancement needs to happen slowly, with buy-in from providers and with technical assistance.

What's striking about regulations affecting microenterprises is the incongruity. In-home child care is lightly regulated but in-home catering is totally prohibited. What's also interesting is that regulatory enforcement is scarce, so even though there may be tough regulations, are they tough if consequences are rarely felt? Also notable is the importance of public perception in regulating microenterprises. Are hair braiders just styling hair, or are they just another type of cosmetologist and, therefore, not suitable for special treatment? Is taking care of children community work or is it a business? The irony is that improved public perception (from community work to business) is what microenterprises want, yet it puts them in a position of increased regulation. The goal, of course, is to not make regulation debilitating.

Implementing Change

City Council President Charles Yancey supports working with the Pioneer Institute to enhance Boston's entrepreneurial environment and acknowledges the City has some arcane regulations that deserve evaluation. For example, Yancey thinks it is "unreasonable that in order to operate a radio in a fast-food restaurant you have to come to City Hall to get a specific 'entertainment' license." Noting there may be similar regulations, Yancey believes it would be advantageous to do a study of all existing regulations to determine which ones need to be changed. In general, he believes it is "essential to take a close look at steps the City can take to facilitate the growth of businesses within Boston, particularly small businesses because they are so vital for job creation." Yancey adds that the City is making a "determined effort to put permitting and licensing services online." Moving processes online is expected to help microenterprise owners, 84 percent of whom have access to the web either in their home or place of business.[3]

Lloyd Hart, Nuestra Communidad's Entrepreneur of the Year in 1998, recently added another pushcart to his Black Library operation. He and his co-worker now sell books in Dudley Station and Downtown Crossing.

While the City of Boston works to simplify the regulatory process for microenterprises, Nuestra Communidad Development Corporation (CDC) is implementing its own program to help entrepreneurs get in business. The Village Pushcarts Program began in 1998 with workforce development in mind. Project manager Mike Kerlin says that many of the people in the Roxbury and Dorchester communities that his CDC serves "wanted to start a business, but they didn't have the financial resources, credit history, or business skills to run it successfully."

The Pushcarts Program allows budding entrepreneurs to rent a pushcart from Nuestra for $200 a month with the hassles of securing a permit and a pushcart location taken care of by the CDC. Says Kerlin, "A lot of people will have a business idea and so one of the first things they'll do is go out and buy a pushcart. Then they realize that the most difficult thing by far is getting a pushcart location!" To get a location, Kerlin adds, you must first get a permit from the Department of Public Works (which costs about $270) and then seek permission from the abutting store owner.[4] "If I were to start a business," says Kerlin, "the Pushcart Program is the way I'd go; it's the perfect low-cost, low-risk way to try it out." Currently Nuestra can rent out 15 pushcarts, but using a grant from the Federal Office of Community Services, it plans to increase the number to 40 by 2006.

Apart from giving entrepreneurs an inexpensive, cautious way to start a business or supplement their income, the pushcart program has also been lauded for its neighborhood revitalization. The pushcarts in Dudley Station have been credited with making the station lively, safe, and clean. The program has also created "neighborhood linkages," says Kerlin. He notes that Roxbury residents' selling of Caribbean flags and African-American literature in Boston Common and Downtown Crossing is a positive way to accent the city's diversity.

The next step for Nuestra is to enable its community to sell food from a pushcart. "There's a lot of community demand, and selling food is both more lucrative and recession-resistant than merchandise," notes Kerlin. It's tougher, though, because regulations in Boston prohibit operating a food pushcart unless it has a certified commercial kitchen to rest in each evening. In addition, if a person wants to sell his or her own food, it must be prepared in a commercial-grade kitchen, not one's home kitchen. Says Kerlin, "You may want to sell food, but who has a certified commercial kitchen?" To solve the problem, Nuestra plans to open a commercial-grade kitchen later this summer where the food pushcarts can be stored. Later in the year they plan to expand the kitchen to allow caterers, bakers, and others a place from which they can legally prepare food.

Regulation Approved, Next Step: Financing

Considering the hurdles entrepreneurs face, especially when looking for financing, Nuestra's approach to helping microenterprises get started is vital. In the Opinion Dynamics survey of microenterprise owners in the Greater Boston area, over one-third of 300 respondents either "strongly" or "somewhat" agreed with the statements "I've had real trouble getting the credit I need to make my business a success" and "I underestimated how much it would cost to get me into this business and have been struggling with that since the first day."

Also instructive is the breakdown of how people finance their businesses. When asked to select financing methods used (respondents were instructed to select all that apply), 76 percent said that they used their own savings. The percentage of people who relied on credit from a bank or commercial lending source (20 percent) was less than the percentage of people who either borrowed from friends and relatives (24 percent) or borrowed from credit cards (25 percent).

Borrowing from special small-business or start-up funds was limited; only 5 percent said it applied to their situation. These funds, however, are generating renewed interest since passage of legislation during the Clinton Administration creating the New Markets Tax Credit Program and the Community Development Financial Institution Fund. These financing sources, their role in economic development, and the possible pitfalls they may be able to avoid, are the subject of the following three articles.

Bolstering economic development is the goal of these financing initiatives, just as easing regulatory burden is a Pioneer Institute mission. Obtaining these objectives would allow microenterprises to focus on what matters: the business. After all, standing in line gets tiring, but making products and profits is part of the American Dream.

Endnotes

1. The study was published by Reason Public Policy Institute in Los Angeles, in conjunction with Pioneer Institute, Georgia Public Policy Foundation, and the National Center for Policy Analysis in Dallas. "Giving a Leg Up to Bootstrap Entrepreneurship: Expanding Economic Opportunity in America's Urban Centers" can be found at www.pioneerinstitute.org/entre/legup.cfm.

2. Daycare providers in Massachusetts must also have criminal background checks for themselves and others living in the facility, CPR and First Aid certification, references, and an approved facility.

3. A study of microenterprise owners in the Greater Boston area was conducted by Opinion Dynamics, as commissioned by the Pioneer Institute. All the businesses surveyed employed fewer than four full-time staff, had been in business for a maximum of three years, and were engaged in a nonprofessional trade.

4. Boston areas that accept pushcarts are Faneuil Hall, Downtown Crossing, Boston Common, MBTA stations, Haymarket, the area surrounding Fenway Park, and a few other smaller venues. Nuestra CDC is trying to expand the venues that allow pushcarts.

The New Markets Tax Credit Program:

Moving Mainstream Capital to Developing Communities

by James Carras

Providing capital to low-income urban and rural communities is a key issue for America in the twenty-first century. Problems holding back investment in urban communities include prejudice, crime, and poor public education. Rural areas suffer from additional problems including obsolete industries, population loss, and low educational achievement. Coupled with these social obstacles, vast changes in the financial services industry have resulted in the closing of inner-city and rural branch facilities. Despite these obstacles, successful investment approaches have been identified. In addition, a substantial federal commitment to leverage private capital, known as the New Markets Tax Credit Program, is working its way through the governmental implementation process.

The legislation, signed by President Clinton as part of the Community Renewal Tax Relief Act of 2000, authorizes $15 billion in tax credits for private investments over the next seven years. New Markets Tax Credits (NMTCs) will have the potential to enhance capital flow for economic development in "new market" low- and moderate-income communities – both urban and rural. The credits are valid only for investment in commercial enterprises and businesses such as office buildings or grocery stores; they may not be used for housing, for which the Low-Income Housing Tax Credit is available.

One reason the program is likely to leverage private investment is because the Community Reinvestment Act's investment test prompts banks to be proactive in making debt and investment capital available to low- and moderate-income communities. Often, private investors make investments in community development projects through intermediaries, such as community development financial institutions. In the future, these intermediaries will include a new category of institutions called "community development entities."

NMTCs are available only to private investors in eligible community development entities. Private investors include corporations, banks, insurance companies, and individuals. Banks are the most likely users of these tax credits because they are the predominant investors in community development financial institutions. They provide these institutions with capital and in turn they receive a return on their investment, Community Reinvestment Act investment test "credit," and potentially a Bank Enterprise Act award from the U.S. Treasury Department's Community Development Financial Institution Fund.

A community development entity must have as its primary mission serving or providing investment capital for low- and moderate-income communities. These entities must be certified by the Treasury and must maintain accountability to the community, with either community representatives serving on the entities' board of directors or in an advisory capacity (the regulations are still under construction).

Community Development Financial Institutions (CDFIs) certified by the Treasury's CDFI Fund, or by the Small Business Administration as Specialized Small Business Investment Companies, are automatically community development entities. Community development corporations that establish for-profit subsidiaries or limited-liability companies or partnerships may also qualify. New corporations or partnerships that meet the community development mission and community-accountability requirement may also be eligible.

How does the New Markets Tax Credit Program work? Tax credits will be allocated to community development entities through the Treasury's community development program – the Community Development Financial Institutions Fund (CDFI Fund). The allocation process will be competitive and community development entities with successful track records, either directly or through affiliate organizations, will receive priority. Coastal Enterprises, Inc., a nonprofit community development corporation and certified CFDI with over twenty years of experience serving Maine, was designated a community development entity in early July.

After a community development entity has received its allocation, it may distribute the tax credits to its investors. Investors will receive tax credits based on the amount of their equity investment. Equity investments (either stock or capital interest) must be paid in cash and made within five years of the Treasury's tax-credit allocation to the entity.

Tax credits are claimed by investors during seven years, starting on the date of the investment and on each anniversary; 5 percent is claimed for each of the first three years and 6 percent for each of the next four years. This stream of credits totals 39 percent, with a present value of approximately 30 percent. (Investors may carry back unused credits to years ending after January 1, 2001.) Funding of the program starts at $1 billion in 2001 and rises in increments to an authorized $15 billion in 2006 and 2007.

Community development entities (CDEs) can use tax credit investment proceeds to fund loans or make equity investments in for-profit and nonprofit businesses or other CDEs. For example, a CDE could invest in a community development corporation's project to build a daycare center in a low-income area. The equity provided by the CDE may then enable the community development corporation to persuade other investors to support its project. CDEs may also purchase loans from other CDEs, provide financial counseling and other services, or finance their own eligible activities. For example, an entity could develop and manage commercial real estate, such as an office building or shopping center.

A community development entity must use "substantially all" of the tax credit investment proceeds for the above purposes. When final guidelines are published, the Treasury Department will define the term "substantially all," which will include at a minimum any allowances for administrative expenses, loss reserves, and expenses related to both a start-up period for placing investments and a wind-down period for recovering investments. In addition, a CDE must track how tax credit investments are used if less than 85 percent of its gross assets are so invested.

Two Treasury divisions will administer the New Markets Tax Credit program: the CDFI Fund will certify community development entities and make tax credit allocations and the Internal Revenue Service will develop regulations. Both the Fund and the IRS will monitor program compliance. Applications for community development entity certification and allocations of NMTCs are not expected to take place until late fall 2001; allocations should occur in 2002.

Businesses eligible for investment by community development entities must meet the following four tests:
1. Fifty percent of the business must be derived from conduct within the low-income community;
2. A substantial portion of the services performed by the business' employees must occur within the low-income community;
3. The majority of the facilities must be located within the low-income community; and
4. Less than 5 percent of the business' assets can be held in unrelated investments.

A community is determined to be an eligible low-income community if its census tract has a poverty rate of at least 20 percent or if the median family income does not exceed 80 percent of the statewide median; or, in metropolitan areas, if the median family income does not exceed 80 percent of the greater of the statewide median or the metropolitan area's median. The Treasury Department may also approve a particular area within a census tract as a low-income community.

Community development programs such as the New Markets Tax Credit and the CDFI Fund reflect the current mind-set of utilizing market-driven approaches to revitalize economically distressed communities. Coupled with economic forces turning to low-income urban communities for retail opportunities, these capital resources will enhance the ability of community developers to meet their mission and goals.

What Is the CDFI Fund?

The CDFI Fund provides capital and technical assistance to community development venture capital and loan funds. Through its Core Program, the CDFI Fund provides grants and loans to bolster investment and loan capital. The Fund's technical assistance component (known as the Small and Emerging Community Development Financial Institutions Assistance Program) enables CDFIs to build capacity through training, enhancing technology, and consulting services. The CDFI Fund also provides grants to banks for community development investments through the Bank Enterprise Act Program. Organizations are limited to $5 million in assistance during any three-year period.

What Is the New Markets Venture Capital Program?

The Small Business Administration offers further support to community development through the New Markets Venture Capital Program. Passed in December 2000, the program is providing up to $50 million this year in direct support of community development venture capital companies. Community development entities can apply for both the New Markets Tax Credit and Venture Capital Programs.

For More Information

New Markets Tax Credit Program
www.treas.gov/cdfi/programs/newmarkets/index.html

Community Development Financial Institution Fund
www.treas.gov/cdfi/

New Markets Venture Capital Program
www.sba.gov/INV/venture.html

About the Author

James Carras is Principal of Carras Community Investment, Inc. a consulting firm providing development finance advisory services to regulated and nonregulated financial institutions. Mr. Carras is also conducting a series of community development finance workshops for the Federal Reserve Bank of Boston in 2001; the next are September 26 in Portland, ME and October 24, in Springfield, MA. He can be reached at carras@bellsouth.net.

CDFIs work in niche markets that are underserved by traditional financial institutions. They operate with a "dual bottom line" of development impact and financial return.

FINANCING THE DEVELOPMENT OF URBAN MINORITY COMMUNITIES

LESSONS FROM HISTORY

BY TIMOTHY BATES

Government policies and programs that address economic problems facing inner-city minority communities are often conceived and marketed as vehicles for achieving goals that are difficult to meet. One such program is President Clinton's Community Development Financial Institution (CDFI) initiative, which was launched in 1994. CDFIs are a diverse collection of banks, bank-owned community development corporations, credit unions, microenterprise loan funds, and the like, that have received subsidized funding from government to serve low-income inner-city communities. The common defining trait of CDFIs is their shared mission of filling gaps in the services provided by mainstream financial institutions.

CDFI-like institutions in fact proliferated in the late 1960s, and an understanding of their successes and failures offers rich insights for modern-day proponents of CDFIs who choose not to ignore the lessons of history. Many first-generation CDFIs were rooted in ineffective policies that attempted to produce social-policy fixes. The minority enterprise small business investment company (MESBIC) program, created by President Nixon, was going to make financing more widely available to minority-owned firms, facilitating, as Senator John Tower of Texas, co-sponsor of the legislation creating the program, claimed, "capital formation in the minority community generally." A detailed understanding of the failures and successes of that earlier era offers society the opportunity to replicate the successes and avoid many of the pitfalls of a previous generation of CDFIs.

The MESBIC program typifies an ambitious effort that has generated mixed, often negative, results. Most MESBICs failed long ago and closed their doors. Yet some have grown large and highly profitable by financing minority firms. MESBICs are privately owned, small business investment companies that receive part of their funding at subsidized rates from the U.S. Small Business Administration. These funds are largely invested in immigrant and minority-owned businesses and they provide patient capital, that is, equity capital, as well as long-term subordinated debt.

The uniqueness of MESBICs, renamed Specialized Small Business Investment Companies in the 1990s, lies in their status as equity-capital providers to minority business enterprises. Prior to the mid 1990s, no other federal government small business assistance efforts sought to encourage equity capital (popularly known as "venture" capital) investment in minority business enterprises. What sorts of small businesses do MESBICs invest in? How have the MESBICs performed?

Investments Made by MESBICs

The surviving MESBICs have evolved and adapted over the decades to the circumstances of their marketplace and the constraints imposed on them by their government sponsors. Using data provided by the Small Business Administration, I determined that most of the MESBICs actively investing in minority business enterprises are asset-based lenders. Indeed, most of the CDFIs that survive into the twenty-first century are likely to be asset-based lenders. Asset-based lending is a pragmatic adaptation to the circumstances of financing small businesses in urban America.

The crux of asset-based lending is simple: If the business receiving the loan succeeds, the MESBIC gets repaid, and if the business fails, the MESBIC gets repaid. Asset-based lenders are collateral driven. Taxi medallions, for example, represent outstanding collateral; they have appreciated steadily in value and they are highly liquid. If the taxi owner defaults on the loan, the MESBIC repossesses the cab medallion and sells it for an amount exceeding the outstanding loan balance. Asset-based lenders are less concerned about the viability or the growth prospects of the minority business being financed than they are about the value of the collateral that protects them from loss in the event of loan default.

Beyond taxi medallions, MESBICs have focused upon small-scale, traditional small business industries — restaurants, laundries, and groceries. Loans flow largely to Asian immigrant business owners, and they are concentrated in major urban centers of Asian immigration, particularly Los Angeles and New York.

Although the industries MESBICs invest in are often full of tiny firms, such as restaurants, the typical small business financed by a MESBIC is not a tiny firm. The median minority business enterprise nationwide is a zero-employee operation, but the median enterprise attracting a MESBIC investment is an employer. Likewise, the median minority enterprise nationwide has annual revenues of less than $100,000, but the median enterprise receiving MESBIC funds has annual sales exceeding $500,000. The firms receiving financing also have high collateral value, such as real estate holdings.

Asset-based lenders make no equity-capital investments in small businesses; they provide collaterized loans. MESBICS, however, were encouraged by the Small Business Administration to provide equity capital. The majority of MESBICs that have actively extended venture capital have been unsuccessful. However, while active venture-capital investing has led many MESBICs into bankruptcy, others have thrived by making equity investments in large-scale enterprises operating in wholesaling, manufacturing, communications, and business services.

The MESBIC industry is clearly segmented in terms of its targeted clienteles and the types of investments made in minority business enterprises. Smaller-scale MESBICs (with total assets of under $5 million) focus on asset-based lending to minority enterprises operating in traditional fields such as food stores. They rarely make equity investments. Larger-scale MESBICs are segmented into groups of asset-based lenders with no equity investments, and more broadly based financiers looking to make both debt and equity investments in large-scale minority business enterprises.

Financial Viability Among MESBICs

Small-scale MESBICs are frequently not viable from a cost-of-operations perspective. Examining the consolidated income statement for all active MESBICs operating in 1993 reveals that the industry as a whole is unprofitable. The typical MESBIC generated 7.33 cents in revenues per asset dollar, while incurring expenses of 8.43 cents to generate those revenues. The resultant spread per asset dollar was minus 1.10 cents before taxes and minus 1.18 cents after taxes. Sales of securities added more negative numbers to the bottom line: The mean MESBIC, on balance, lost 2.70 cents per asset dollar in 1993.

For the MESBIC industry, 1993's financial performance was not an atypical year. Examination of industry financial statements for other recent years revealed patterns of recurring losses from operations, frequent losses from the sale and disposal of venture-capital investments, and a high attrition rate.

The smaller MESBICs clearly did worse than the larger ones. Picking an arbitrary cutoff and defining MESBICs with less than $2 million in total assets as "small," and the others as "large," stark differences stand out on the expense side of the aggregate income statements. Over the 1987 to 1993 period, loan losses and labor costs absorbed 38.8 percent of the total revenues of the average large MESBIC, versus 66.5 percent of the total revenues of the typical small MESBIC.

The clearest message emerging from the MESBIC data and the earlier discussion of the MESBIC characteristics is that failure-prone MESBICs are identifiable. Small MESBICs that generate high expenses per dollar of total assets are particularly likely to go out of business. Furthermore, unsuccessful venture-capital investing typifies failure-prone small MESBICs. Survival and profitability, for MESBICs with total assets of under $5 million, is promoted by investing in bank CDs, not minority-owned businesses. Although this finding may explain why money-market investments are much more widespread than venture-capital investments in minority business enterprises in the MESBIC industry, it also suggests that most small MESBICs are not capable of meeting the goals that justified creation of the MESBIC program in the first place.

Lessons for Community Development Financial Institutions

The CDFIs that were so actively promoted by the Clinton Administration began operating in the mid 1990s with funding that partially reflects subsidies from the federal government. Funding small businesses in inner-city, low-income minority communities is a major part of their mandate. The fact that the vast majority of the MESBICs chartered since 1969 had similar missions and went out of business should be noteworthy to CDFI planners. Have we learned the right lessons from the MESBIC experience?

Heeding the lessons of 30 years of MESBIC operating experience is not apparent at one of the premier CDFIs, a financial institution organized in the Atlanta empowerment zone in August 1996 as a Community and Individual Investment Corporation. Identified as a "for-profit" entity, its mandate includes funding for the following:

* Micro loans ranging from $1,000 to $5,000, to finance inventory, working capital, and equipment for home-based businesses and self-employed individuals;
* Start-up loans and "micro-equity" investments ranging from $5,000 to $50,000, to finance inventory, equipment and facilities, and other costs for businesses with fewer than three years of operating or earnings history;
* Expansion loans of up to $500,000 for the acquisition of inventory, equipment, and facilities for established firms whose growth plans exceed internal financing capacity; and
* Commercial mortgage loans of up to $500,000 for the acquisition and improvement of income property within the empowerment zone and linked communities.

All of this broadly resembles an unsuccessful MESBIC strategy to target both small firms operating in the local community and larger-scale firms with growth potential. Of the many scores of MESBICs that pursued such investment strategies in the 1970s, none remain today. Most went broke; the survivors radically changed their investment strategies and became asset-based lenders and high-end venture capital investors of today. CDFIs that pursue a strategy of risky small-business investing will experience similar fates.

The late C. Robert Kemp, CEO of Los Angeles Community Development Bank, headed one of the nation's largest CDFIs. Kemp recognized that his institution must target its loans to the sophisticated, high-end businesses that are located in its market, the Los Angeles Empowerment Zone: "transactions of scale are the ones that will produce jobs for empowerment zone residents and improve general economic conditions within the zone." Yet the Los Angeles Community Development Bank also actively funds microenterprise loans of up to $25,000. These are rationalized as useful for boosting new business start-ups, but the microenterprise program, Kemp noted, is "very expensive" and ultimately sustainable only if it is supported by continuing subsidies.

Absent subsidies, government insistence that CDFIs actively fund high-risk, high-cost loans is a recipe for disaster. Failure can be avoided by permitting CDFIs to operate with sufficient flexibility to minimize financing activities that consistently lose money. Consistent losses destroyed financial institutions such as MESBICs. At this moment we can expect a similar outcome for many of the CDFIs.

About the Author

Timothy Bates is Distinguished Professor of Labor and Urban Affairs at Wayne State University.

Why CDFIs Are Different
An Industry Perspective

Two representatives of Community Development Financial Institutions (CDFIs) explain below why they believe CDFIs' fate will be better than that of the Minority Enterprise Small Business Investment Corporations, described by Timothy Bates.

Mark Pinsky
President and Chief Executive Officer
National Community Capital Association

National Community Capital Association is a nonprofit organization working to promote capital investment in economically disadvantaged communities. The Association solicits funding, technical assistance, and development services for CDFIs and then helps those CDFIs invest resources to better their communities.

On comparing CDFIs to MESBICs:
"The comparison of CDFIs to MESBICS is not apples to apples, it's more like oranges to pears. The problem with the MESBIC model of investing in inner-city minority businesses was that you had strategies that were defined by public-policy objectives. It was a faulty assumption that MESBICS would produce public good just because they were serving the inner-city minority community. CDFIs, and the CDFI Fund, support market-based solutions. No government application determines whether a business gets CDFI funding; it must have a business plan showing a market need for the product or service. So, CDFIs are market-based, not public policy-based, and we are accountable to the market, not the government. This is a fundamental distinction."

On CDFI purpose:
"[CDFIs] bring mainstream financial institutions into the lives of people who are economically disadvantaged, and vice versa – they work best just outside the margins of traditional capital providers. CDFIs should constantly be cultivating, developing, and finding new markets. What we [National Community Capital Association] do is try to strengthen financial intermediaries (CDFIs) to achieve real impact. And we've seen significant progress. Back in the mid to late 1990s, when Bank of America announced they were going to fund over $10 billion in women- and minority-owned businesses, I said that the best thing our industry could do would be to claim victory and move on. If we can convince major financial institutions that investing in these businesses and these communities is not what it seems, then we have accomplished something very significant."

On the importance of size:
"What matters for CDFIs is not overall size but proportionate scale — being proportionate to the market. A few-million-dollar CDFI working in a small rural state could be as effective as a $50 million CDFI in an urban center. Proportionate scale is key. CDFIs do, however, require a subsidy. Our margins aren't sufficient to have the working capital of a traditional bank."

On asset-based lending:
"CDFIs do collateral lending that would not fit the bank standard of 'adequate collateralization.' CDFIs do creative collateralization. For example, in Los Angeles there's a CDFI that does microlending to the Hispanic community and it has realized that the appropriate collateral is not a dollar for dollar match but is putting a lien on the person's car. Because the community really values being able to drive, it is much more effective collateral than taking business inventory. This is what we call 'cultural collateral' and it has to do with understanding the market. Also, I don't agree with taxi-cab funding as a model for us. Taxicabs are an investment that is so mainstream that it doesn't really have any meaning."

On examples of success and failure:
"As a person in the CDFI field, I can say I have never heard of the Atlanta Community Individual Investment Corporation or the Los Angeles Community Development Bank referred to as CDFIs — I believe they operate with a model that is not the CDFI model and, therefore, are not accurate representations of our industry. Bates has a history of excellent research but I think he points here to a few badly chosen anecdotes. Instead, I can point to 15 years of historical data. By year-end 1999, the CDFIs we work with, which is just a subset of the industry but tends to include the higher-performing ones, did $2 billion in financing with a default rate of 1.35 percent overall, and to that point, they had never lost a penny because they're set up right — they are capitalized right, they are structured right, they manage risk right, they do their loss reserves right."

"Are all CDFIs good? They are not. Some are not well run. Are there going to be some that fail? Absolutely. Are some that the CDFI Fund supports going to fail? I think it's possible. But is that a risk you take in trying to build a sector of institutions that is market-based? I think it is."

CDFIs are **market-based**, not **public-policy** based

One interesting thing about CDFIs is they have their feet in two different arenas — community development and financial services.

Laura Schwingel
Director
CDFI Coalition

The CDFI Coalition is the trade association for the approximately 500 CDFIs operating in the United States. Founded in 1992, the CDFI Coalition is managed by the National Community Capital Association.

On misconceptions:
"I think one of the misconceptions of Bates's paper is that CDFIs came after MESBICS. The earliest CDFIs, Community Development Credit Unions, started as long as 60 years ago as part of the self-help credit movement."

On realizing missions:
"CDFIs are very community-based. They serve everything from neighborhoods in urban areas to rural markets, so CDFIs target a broad range of markets. MESBICS were targeted toward inner-city communities. Both have a shared mission of community development. . . but CDFIs have a broad range of strategies for addressing the financial needs of the particular community they're serving."

On challenges:
"This industry has exploded over the past five years and part of that is due to the CDFI Fund which has channeled in a lot of capital and has made for huge growth. Trying to attract people to the field is going to be a critical challenge for the next five years. We need people who have technical knowledge, who can do the financial analysis. But one interesting thing about CDFIs is they have their feet in two different arenas — community development and financial services. We need to get the word out that this is a growing field that has a lot of challenges. . . . Another challenge is that CDFIs operate in a riskier marketplace, mainly because mainstream financial markets have moved into the field when we showed it could be lucrative. But this is our goal."

Chapter 40B

. . . and its next chapter

by Kristin Kanders

Finding an affordable home in Massachusetts, where the average single-family home sells for near $300,000, can be like looking for bargains in Neiman Marcus – most times, they don't exist. The problem is even worse in the Boston metro area, where the average single-family home sells for just under $450,000. Lawmakers in Massachusetts recognized an affordable housing problem in 1969 when they enacted the Comprehensive Permit Law, also known as Chapter 40B. While the need for affordable housing remains dire, this year suburban lawmakers have proposed over 30 bills to amend the law. Some of these amendments have been passed by the House of Representatives, to the woe of urban lawmakers and housing and community advocates. As of the end of July, it is not clear if the amendments will be adopted by the Senate and the governor.

Chapter 40B, dubbed the "anti-snob zoning law," gives developers using a public subsidy an incentive to build affordable housing throughout the Commonwealth by circumventing "exclusionary" zoning laws. The incentive includes a streamlined review process, called the comprehensive permit, exempting developers from local zoning requirements, such as restrictions against multifamily housing, if less than 10 percent of the town's housing stock is affordable for low- and moderate-income earners. In theory, developers can accelerate the approval process (thereby saving money) when they don't have to get approvals from separate local entities, such as building inspectors and boards of health.

The other part of the incentive is an appeal process. If a town rejects a developer's proposal, the developer may appeal the decision to the Massachusetts Housing Appeals Committee. This committee has the right to override local decisions if it believes the need for affordable housing outweighs local objections to the development.

The major changes proposed for 40B are to define more broadly what "counts" as affordable housing, such as manufactured housing, Section 8 vouchers, housing for the mentally ill or even jail inmates; or to lower the percentage of affordable housing called for statewide from 10 percent to 8 percent or less.

Two days before July 4, lawmakers in the House attached some of these amendments to a housing bill, including provisions that manufactured housing, Section 8 vouchers, and long-term housing for the mentally ill or retarded should be included in a town's 10 percent count. The bill passed – making more towns independent from the requirement to build affordable housing. According to a survey done by Citizens Housing and Planning Association, an affordable housing advocate, an additional 67 communities became exempt from Chapter 40B's reach. The housing bill now proceeds to the Senate and Governor Jane Swift's office. Her office says it will adamantly oppose changes that compromise the law.

Why Now?

To understand the debate generated by Chapter 40B, it helps to know why it's raging. The real estate market in Massachusetts is one of the strongest in the nation. Statistics from the Office of Federal Housing Enterprise Oversight show that house prices in Massachusetts have appreciated 364 percent since 1980, more than twice the national average of 156. Prices in the Commonwealth are on track to increase 13.2 percent this year. For the quarter ending in March, Massachusetts ranked fourth in the country for annual house price appreciation (a yearly rate of 13.2 percent), surpassed only by the District of Columbia, California, and New Hampshire. With a hot real estate market, developers want to build, and with increased building — especially building that may violate local zoning ordinances, as 40B allows — comes controversy.

According to Steven Pierce, Massachusetts Housing Finance Agency Executive Director, Chapter 40B is being used actively today because 40B developments are easier to finance in a strong real estate market; with high market-rate prices, it takes less to subsidize a development's one-quarter or more below-market units. As you may have guessed, Chapter 40B was also used frequently, and was a contentious issue, during the real estate boom of the mid to late 1980s.

Another reason why 40B is being actively used and contested today as it was during the mid to late 1980s, says Sharon Krefetz of Clark University and Harvard's Joint Center for Housing Studies, is because a relatively new financing source is helping to make projects more feasible for private developers. The New England Fund, created by the Federal Home Loan Bank, was deemed to qualify as a public subsidy in 1999 by the Housing Appeals Committee. Compared to direct state and federal subsidy programs, says Krefetz, the New England Fund has "few regulatory strings attached." Like the Homeownership Opportunity Program (HOP), a state housing program begun in 1986, this new funding source is attracting some developers who want to build large-scale developments. This is stirring a backlash at 40B.

When Bigger Is Not Better

Increased building stirs emotions, but increased building of large-scale projects in a select number of communities can cause turmoil. Add in a community's feeling of powerlessness to the will of the developer, and you heighten the storm. Lawmakers lobbying for change represent communities that feel they are being besieged by the law, at the mercy of developers who use 40B as a threat if their market-rate developments are not approved by the town. Typically, these towns are not the richest in the Commonwealth (where high land costs tend to make 40B deals uneconomic) but are middle-income towns with housing the town considers to be affordable — but is not, according to the statute. An editorial in the *Eagle-Tribune*, a newspaper representing Northern Massachusetts, expresses the view, "Developers use the law to ramrod through giant projects no sane community would approve."

In Waltham, developers have angered some town residents by filing simultaneously for zoning relief to build a 218-unit non-40B rental unit and, if it's not approved, a 301-unit 40B complex. Representative Donovan of Woburn, in May 16 testimony to the Committee on Housing and Urban Development, stated that developers who were denied permission to build a 400-unit market rate development came back with a 640-unit 40B application. "The law is a hatchet — we need a scalpel," she remarked. Rep. Donovan represents a community that, like others in the Commonwealth, is faced with multiple 40B applications. She is sponsoring bills that would make the determination of a town's 10 percent affordable housing more inclusive by counting Section 8 housing vouchers, or subsidized housing for the mentally ill or retarded. Her bills attempt to compensate for a felt inequity that while Woburn "is definitely not a snob community," it is treated as one by the law. She believes the law needs adjustment since it "never came to fruition in the communities it was meant for."

Housing advocates, however, do not want to tamper with a law that has lasted over 30 years and has produced desperately needed housing. Sharon Krefetz, who has researched 40B, says the number of communities without subsidized housing has fallen from 173 in the early 1970s to 54 in the late 1990s, with most of the 54 being small, rural communities with less than 200 housing units. Jane Gumble, Director of the Massachusetts Department of Housing and Community Development (DHCD),

Chapter 1 of Chapter 40B: Gritty Details

Over the law's 30-year history, the terms "subsidized," "low- and moderate-income," and "affordable," have all been used to describe the housing that Chapter 40B aims to develop. If a developer wants to build a 40B development, then at least 25 percent of the units must be affordable for 15 years. (Buildings that are substantially rehabilitated must remain affordable for at least five years.)

Towns with less than 10 percent of their year-round housing stock considered affordable by the statute, or with affordable housing existing on less than 1.5 percent of the town's residential, commercial, and industrial land, are subject to 40B requests. Housing is "affordable" for households with incomes less than 80 percent of the median area household income, paying not more than 30 percent of income on housing. 40B developments must rely on subsidies from state and federal programs, such as the Massachusetts Housing Finance Agency.

If a 40B development is built in a community, it "counts" toward a town's affordable housing goal of 10 percent. It matters, however, whether the development is rental or ownership. For rental properties, all the units count as affordable, whereas in home-owner developments, only the individual below-market-rate homes count as affordable. Chapter 40B can be used to develop condominiums, single-family homes, housing developments, senior housing, and assisted-living developments.

stated at the legislative hearing that 63 towns would reach the 10 percent threshold by adding 100 or fewer units.

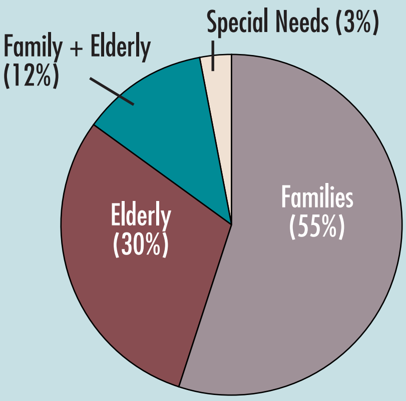
To dissuade lawmakers from changing the law, Housing and Community Development has proposed regulatory reform, not amendments. The Department wants to make 40B a strong and effective law, says Phil Hailer, communications director for the agency. As an advocate of both communities and housing, the Department is suggesting regulatory changes to address community concerns about the law being used as a hammer. “A lot of communities don’t understand their rights and the ramifications of the law,” adds Hailer. “We want them to know that with knowledge, comes power.” Some of the proposed regulations would install a “cooling-off” period between the time a developer is turned down for a market-rate development and initiation of a 40B application for the same site. Other regulations would set parameters for maximum community population increases resulting from a 40B development and would increase the minimum terms of affordability from five to 15 years for rehab projects and from 15 to 30 years for new development.

Chapter 40B makes towns know that they can’t duck the issue of affordable housing.

Facts about Chapter 40B

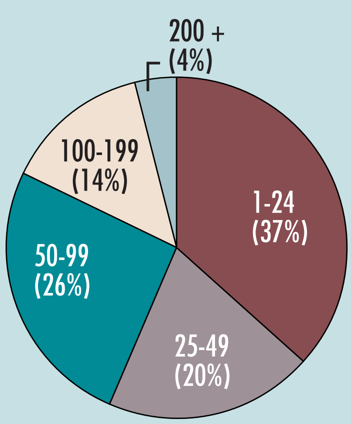
Occupant Characteristics

(of all 40B projects built)



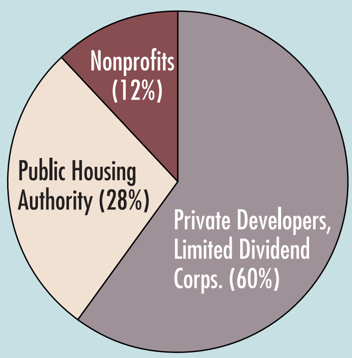
Development Size in Units

(of all 40B projects built)



Developer Diversity

(of all 40B projects proposed 1970-1999)



All statisistics courtesy of Sharon Krefetz

Report Card for 40B

Massachusetts is seen as a leader (and sometimes a maverick) when it comes to housing policy, but has 40B been successful? Is the Commonwealth getting better at providing affordable housing?

The affordable housing situation has improved since the anti-snob zoning law was passed, but not enough that affordable housing is in adequate supply. Estimates from academics and from housing advocates indicate that between 20,000 and 25,000 units of affordable housing have been produced directly by Chapter 40B, and the two sides of the Chapter 40B debate can find fodder in this statistic, citing either that 40B has produced “fewer than 1,000 units per year” or that 40B has enabled “desperately needed units of affordable housing to be constructed when they otherwise wouldn’t in communities that never before had affordable housing.”

While it is true that most towns in Massachusetts have not reached their 10 percent goal (only 24 of the 351 have, according to DHCD), Chapter 40B has had success spreading affordable housing through the Commonwealth. Citizens Housing and Planning Association (CHAPA) cites the fact that Massachusetts’ 15 largest municipalities had 69 percent of the affordable-housing units in 1972, but only 37 percent in 1997, as proof of “opening up the suburbs.”

Proponents of Chapter 40B, such as CHAPA, also stress that the law has been useful in getting affordable housing in general built throughout the Commonwealth. Because Chapter 40B exists, towns know they are subject to 40B propositions unless they increase their affordable housing stock to10 percent. In support, the DHCD notes that from 1970 to 1999, the Massachusetts inventory of affordable housing rose from 85,621 units to 205,000 units. As Clark Ziegler, Executive Director of the Massachusetts Housing Partnership Fund says, “Chapter 40B makes towns know that they can’t duck the issue of affordable housing.”

Other states have also looked to Massachusetts for ideas on how to bolster affordable-housing development. Both Connecticut and Rhode Island enacted 40B-like laws that use the “rule of 10 percent” and provide for state override of local decisions, but according to Krefetz, the impetus for the laws differed from that in Massachusetts. Because the Connecticut and Rhode Island laws were enacted in 1989 and 1991, respectively, when many moderate-income families were being priced out of their communities, they focus more on sustaining the job base than “opening up” the suburbs to low-income families. Accordingly, the laws drummed up more support from the business community than in Massachusetts. In Connecticut the law can be used without a government subsidy as long as at least 30 percent of each development accommodates low- and moderate-income earners; developments have tended to be large-scale and done by private developers. Rhode Island's state housing appeals board has yet to rule on whether the New England Fund counts as a qualified public subsidy.

One of 40B's greatest achievements may also be its most subtle. When suburban towns such as Wilmington can tout the housing they have negotiated with 40B developers as a success, they influence people's perceptions about what affordable housing looks like. This notion of towns becoming more amenable to affordable housing is supported by looking at local-level rejection rates. Whereas from 1970 to 1979, 43 percent of all projects were denied by local boards, only 20 percent were during 1990 to 1999. In 54 percent of all cases from 1970 to 1999, the local board granted permits with conditions such as infrastructure improvements in the town and increases in affordability time limits.

While critics and proponents of 40B iron out its future direction through the fall of this year, it's important to remember that the main complaint levied at the law is also its biggest benefit. Although the law was not intended to be used as a hammer to threaten towns, it was intended to be a construction tool, building more housing in the Commonwealth.

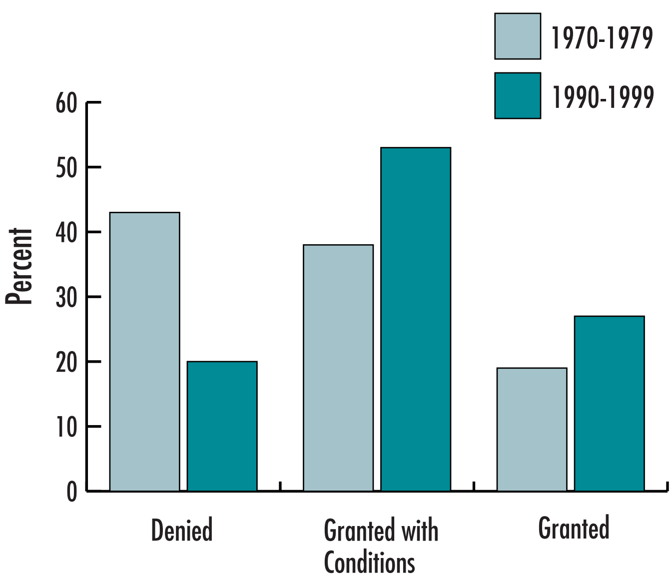
Attempts to Neutralize the Opposition

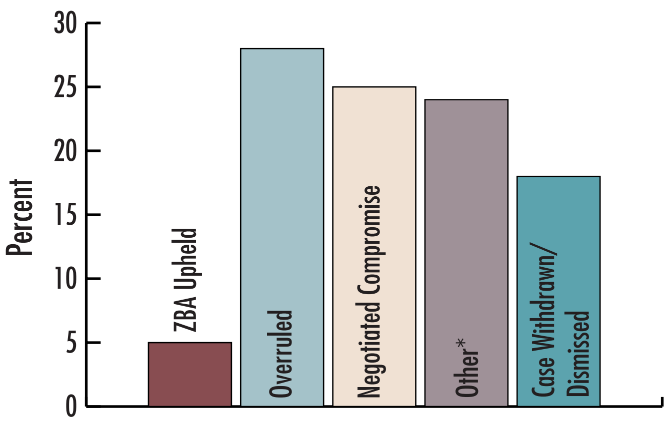
Chapter 40B and affordable housing in general is an issue with tensions. Take the phrase, "It's not affordable housing we're against, it's the ________" and fill in the blank with either burden on schools, density, or traffic for an overview of community concerns.

In an attempt to reduce the obstacles that surround 40B, the Commonwealth has initiated several new housing programs. Executive Order 418, for example, was signed by former Governor Cellucci in January 2000 with the goal of supporting communities as they strive to include affordable housing in their towns. For communities grappling with development plans, it provides up to $30,000 in grants and/or technical assistance to each municipality. It also uses discretion in allocating funding to towns that are actively trying to increase their supply of affordable housing.

The Housing Supply Incentive Program would go a step further to offset the costs associated with residential development, especially schooling. The program would pay the difference between the amount collected from tax revenues from new development and the amount needed to educate the children living in the development. Supported by legislators in theory, the bill has not moved through the House of Representatives Committee on Housing and Urban Development because of controversy about the proposed funding source — Lottery surpluses.

Actions of Local Zoning Boards of Appeal → **Actions of State Housing Appeals Committee** (through 1999)





*Represents cases where one of the parties didn't proceed (but the case was not formally withdrawn) and cases resolved through negotiation that was not moderated by the State Housing Appeals Committee, among others.

Joining Forces to Protect the "Real" Vermont

by Kristin Kanders

Competing for funding and legislative support is nothing new. Bitterness and lost potential, however, sting more when competing groups share a common goal. In the health care field, for example, intense funding disputes occur between advocates of basic research and of research on particular diseases. Ironically, each type of funding can advance the other cause; basic research often leads to specific cures, and focused research often leads to greater general understanding. Likewise, in most states, affordable housing advocates and land conservationists compete for funding, and as with health care, each can greatly help the other's mission when they work together. The state of Vermont offers a case in point. Vermont's Housing and Conservation Board represents the realization that housing and conservation are two sides of an issue, not two issues.

Created in 1987 out of pressure to save Vermont's farms, natural land, historic downtowns, and communities from sprawl development, the Board works to develop affordable housing and conserve historic properties, farmland, and natural land. Conservationists and affordable housing advocates have a lot in common, says Vermont Housing and Conservation Board (VHCB) Executive Director Gus Seelig; a desire to see "smart growth" and a desire to protect the "real" Vermont link both causes. As Tom Slayton, editor of *Vermont Life,* has commented, protecting Vermont from becoming a "theme park" or a "sterile picture postcard" means protecting "a working landscape that really works, farms where farming is more than a rich man's hobby, real neighborhoods instead of trailer parks for the poor and gated housing enclaves for the wealthy."

Overcoming Obstacles

Vermont's affordable housing advocates and land conservationists came together in a citizen entity called the Housing and Conservation Coalition. The Coalition crafted legislation for the Vermont Land Trust and continues to lobby for annual funding. Jim Libby, VHCB's General Counsel and Assistant Director, describes how the two sides gradually began to work together at the first meeting:

"During the first meeting at the Vermont Land Trust, two housing advocates joined a roomful of environmentalists, conservationists, and rural planners who were on a first-name basis. At first, the housing advocates were fearful that affordable housing was being added because of its popular appeal and worried that conservationists, sometimes referred to as the 'green sneaker bunch,' would not be able to understand or address poverty and homelessness. At the same time, the conservationists and farmers were afraid that the housing and low-income advocates would be too radical and too dogmatic to join the coalition. Such opinions and feelings created a lot of tension; however, most of the fears of Coalition members were dispelled after people began to work together, especially after they identified common ground, and began to develop a proposal to chart a course on that common ground."

Dean Christon, Deputy Executive Director of the New Hampshire Housing Finance Authority, wishes affordable-housing and open-space groups could form an alliance in his state but understands that in order for a partnership to work, "both sides have to bring power to the table." Open-space advocates, he says, have greater funding, political support, and fewer detractors than affordable housing advocates.

To get past these discrepancies, Vermont used a "Robin Hood" approach. This is Libby's description of the arrangement: "The Vermont Natural Resources Council, Vermont Land Trust, and the Nature Conservancy — the well-established and financially solid members of the Coalition — paid most of the expenses for the first year. In turn, members like Community Action Program agencies, the Coalition of Vermont Elders, the Low Income Advocacy Council, and the Affordable Housing Coalition made nominal financial contributions but guaranteed active participation by advocates and members with commitment, experience, and expertise. This organizational approach was part of the glue that kept the Coalition together during the early months and helped set the stage for difficult substantive discussions."

Another adhesive the Coalition employed when drafting legislation in 1986 was to value each other's philosophies. Instead of developing affordable housing that would rely on annual payments to maintain a project's viability or affordability, the Coalition proposed that Vermont provide loans and grants to bridge a project's "gap" and require recipients to ensure a project's success. Stewardship, an integral part of the conservation philosophy, became part of affordable housing discussion, Libby observes. As a result, "perpetual affordability" and "no displacement" became synonymous with the trust fund. The trust fund embodies the principle that housing is a right that should be shared with future residents and treated as a community resource.

Putting adaptive reuse to work, the Vermont Arts Exchange restored two nineteenth-century firehouses in Bennington with funding that included VHCB grants. The bottom floors were converted into gallery space and the top floors into housing.

The Coalition's thoughtful legislation was well received in 1987. Governor Madeleine Kunin signed the trust fund into law with $3 million in support, and the Coalition then helped to assemble a board of directors according to guidelines in the statute.[1] A bountiful state budget and strong political support allowed Vermont's 1988 legislature to put an additional $20 million into the trust fund. Since then, says Seelig, "the Coalition has stayed active for 14 years and has resisted being pulled apart."

Measuring Impact

Meting out impact statistics of affordable homes built/rehabilitated and acres of farm and conservation land protected can overlook the significance of an organization that has a social and ecological role as well as a financial one. Some of VHCB's most important work, says Libby, has been to "support compact development in town centers (avoiding sprawl) while at the same time protecting land with significant economic and natural value." Protecting agricultural and conservation land allows the organization to reflect the people, economy, and traditions of Vermont. Farming is the state's third largest economic sector; it protects Vermont's landscape, supports local businesses and community organizations, and attracts visitors who make tourism the largest sector.

Reflecting the people of Vermont has been a mission, but so has engaging them to think about conservation and affordable housing. To do this, VHCB has relied on its partnerships with nonprofit organizations. When the Board started work in the late 1980s, there was "adequate nonprofit coverage for affordable housing in only a couple of parts of the state," says Libby. The Board worked to encourage regional housing development corporations, and by 1994 there was sufficient nonprofit capability to meet VHCB's goal of being able to fund projects in all parts of Vermont. The Board continues to strengthen Vermont's affordable housing nonprofits by providing financial and technical support, and it annually sponsors about eight workshops on topics ranging from "Essentials of Construction Management" to "Principles of Good Design in Affordable Housing." These workshops enable VHCB's nonprofit partners to be more productive and build better housing.

Valuing impact that is measured in nontraditional ways doesn't mean, however, that VHCB's numbers are unimpressive. In fact, they are quite impressive. Since 1987, Vermont's nonprofits have used over $130 million of VHCB grants and loans to develop over 6,000 units of perpetually affordable housing and to conserve over 324,000 acres of land in 205 towns. These funds have leveraged an additional $450 million in private and public funds. Of the housing awards, 26 percent were for projects in buildings eligi-

This 340-acre dairy farm, like the 548-acre one on page 20, has been conserved using VHCB funds. Both farms' development rights were purchased.

ble for, nominated for, or listed on the State or National Register of Historic Places. Of the farms conserved with VHCB funds, 31 percent contain historic barns, farmhouses, or archeological sites. The fund has successfully provided for very low-income Vermonters — roughly half of all the housing units funded by VHCB through 2000 have been for people earning 50 percent or less of median family income.

Today's Challenges

Despite having a workable formula for achieving two goals through the work of a single entity, the road ahead does not look completely smooth for Vermont in continuing to both promote land conservation and meet affordable housing needs. VHCB's Board Chair Deborah Brighton explains the problem: "The need for affordable housing and land conservation has intensified as the state's economy has strengthened. We are now facing the lowest rental housing vacancy rates ever, as the strong job market puts pressure on Vermont's real estate. . . . In many Vermont communities the vacancy rates are below two percent. Homeownership costs are also on the rise, and the values paid for farm and forest land are outpacing any increases in net profits from agriculture or forest management. . . . Vermont's land-based industries and rural heritage will continue to be challenged by a marketplace that values cheap food and quick profitability."

This Shaftsbury building, along with its twin, was rehabilitated into affordable housing apartments according to federal standards for historic preservation.

To tackle the affordable housing supply problem, Vermont's nonprofits are working to construct new housing, especially in Chittenden County. This represents a departure for the many nonprofits using VHCB funds that have focused on rehabilitation by marrying historic preservation and affordable housing development. This experience is clear when looking at the numbers: About 80 percent of all housing units supported by VHCB through 2000 were acquisition and rehabilitation.

Vermont's holistic approach remains unique, which is surprising, considering how successful it has been and how much overlap exists between preserving communities and the landscape. It seems odd to distill housing out from the land, and agriculture out from conservation. To do so, you have to determine if a farm is beautiful, historic, or a mode of sustenance and economic development. You have to ask, is rehabilitating a building in a town's center affordable housing development, historic conservation, or community preservation? As Vermont recognizes, it is often all of these.

The Community Preservation Act

Striving for an encompassing approach that focuses on project perpetuity, Massachusetts passed the Community Preservation Act in September 2000. A local-enactment law, it encourages towns to create individual Community Preservation Funds to finance affordable housing development, open space conservation, and historic preservation.

According to the law, cities and towns may pass a referendum to levy a community-wide surcharge of up to 3 percent based on property taxes. Of the collected funds, at least 10 percent must be allocated for each of three purposes: to preserve open space, protect historic sites, and build affordable housing. The remaining 70 percent (after administrative needs are met) may fund any of the allowed uses or a combination of them. Towns are motivated to pass the act because they will receive matching funds from Massachusetts. So far, over 30 towns have passed the CPA.

What has yet to be seen is how towns will use the 70 percent discretionary funding. Low-income advocates and others worry that the Act might skew toward benefiting wealthy towns and open-space preservation. As a concerned person wrote in the Community Preservation Coalition's on-line discussion forum, "Is this CPA just more snobbism. . . under the disguise of preserving open space?"

For further reading on the VHCB, see Jim Libby's article "The Vermont Housing and Conservation Trust Fund: A Unique Approach to Affordable Housing," *Clearinghouse Review*, Vol. 23, No 10 (February 1990), pp. 1275-1284. It is also available at www.vhcb.org/article.html. A more recent discussion of the Vermont experience co-authored by Libby and Darby Bradley, president of Vermont Land Trust, is "VHCB: A Conspiracy of Good Will among Land Trusts and Housing Trusts," found in the book *Property and Values – Alternatives to Public and Private Ownership*, Island Press, 2000. The Statute enabling the Vermont Housing and Conservation Trust Fund is 10 V.S.A. Chapter 15.

1. According to the statute, the Vermont Housing and Conservation Board must consist of four officials from the state departments of housing, development, agriculture, and natural resources and five public members, appointed by the governor, who are "experienced in creating affordable housing or conserving and protecting Vermont's agricultural land, historic properties, important natural areas, or recreational lands." Additionally, "at least one member shall be a representative of lower income Vermonters and one member shall be a farmer. . . ."

CRA Sunshine Provisions

When Congress passed the Gramm-Leach-Bliley Act, Section 711 of the Act added a new section 48 to the Federal Deposit Insurance Act entitled "CRA Sunshine Requirements."[1] The CRA Sunshine provisions require the reporting and public disclosure of written agreements between insured depository institutions or their affiliates and nongovernmental entities or persons made in connection with fulfillment of the Community Reinvestment Act.

In the wake of the new CRA Sunshine provisions, the Federal Reserve Bank of Boston sponsored three Sunshine Provision training seminars in New England. The following is a list of some of the questions audience members posed to panelists:

Question: What is a covered agreement?

Answer: A covered agreement is one that meets all of the following five criteria:
1. The agreement is in writing;
2. The parties to it are an insured depository institution or affiliate and a non-governmental entity or person (NGEP);
3. The agreement involves payments of more than $10,000 or loans of more than $50,000 in any calendar year;
4. The agreement is made in fulfillment of the CRA; and
5. There has been a prior "CRA Communication" between the parties.

Q: For a prior "CRA Communication" to take place, is it enough if one of the parties to the agreement simply mentions CRA?

A: No. Merely mentioning community needs and opportunities or the CRA eligibility of a loan, investment, or service product is not a CRA communication. A CRA Communication must pertain to the adequacy of a bank's (or an affiliate's) CRA performance.

Q: What agreements are not covered?

A: Individual loans secured by real estate are not covered regardless of the identity of the borrower and regardless of the rate charged on the loan. Specific agreements to make single loans are not covered if the loan is not made at a rate substantially below market and it is not used to relend.

Q: Are parties to the covered agreement required to make the agreement available to the public?

A: Yes. Parties to the covered agreement must make covered agreements entered into after November 12, 1999 available to the public upon request. Any obligation to disclose, however, ends 12 months after the end of the term of the agreement. If the agreement, however, terminated before April 1, 2001, the parties must make the agreement available to the public until April 1, 2002.

Q: What if there is proprietary information in a covered agreement?

A: The parties may withhold from public disclosure confidential or proprietary information that the party believes the relevant supervisory agency could withhold from disclosure under the Freedom of Information Act (FOIA).

Q: What information are parties to the covered agreement required to disclose to the relevant supervisory agency?[2]

A: The NGEP must provide a complete copy of the covered agreement to the relevant supervisory agency (RSA) within 30 days of receiving a request from the supervisory agency. The NGEP must also file a redacted public version should the NGEP choose to exclude certain confidential or proprietary information under the FOIA.

The insured depository institution or affiliate must, within 60 days of the end of each calendar quarter, provide each RSA with a complete copy of each covered agreement entered into during the calendar quarter. If the institution or affiliate seeks to exclude certain information in the public version of the agreement, it must submit the public version with an explanation justifying the exclusions.

Alternatively, the insured depository institution or affiliate can provide a list of all covered agreements entered into during the calendar quarter. The list must contain the following:
1. The names and addresses of the parties to the covered agreements;
2. The agreement date;
3. The estimated total value of all payments, fees, loans and any other consideration to be provided by the institution or the affiliate of the institution under the agreement; and
4. The date the agreement terminates.

All parties to the covered agreement must file a report annually with the appropriate agency concerning the disbursement, the receipt and use of funds or other resources under the agreement.

Q: How does the CRA Sunshine Provision affect the Community Reinvestment Act?

A: The Sunshine provision does not in any way affect the Community Reinvestment Act of 1977, its implementing regulations or the agencies' interpretations or administration of the Act or the regulations.

News Item

An interagency advance notice of proposed rulemaking regarding the Community Reinvestment Act was published in the *Federal Register* on July 19.
Public comments must be received by October 17, 2001.

For further questions about CRA Sunshine, call the Federal Reserve Bank of Boston's Consumer Regulations hotline, (617) 973-3755, or visit the Federal Reserve's web site, www.federalreserve.gov.

Endnotes

1. The federal bank regulatory agencies issued substantially similar regulations implementing the Sunshine provisions of FDIA. The Federal Reserve Board's version, Regulation G, became effective on April 1, 2001.

2. Relevant supervisory agency is defined in the regulation as the appropriate federal banking agency for (1) each insured depository institution (or subsidiary) that is a party to the covered agreement; (2) each insured depository institution (or subsidiary) or CRA affiliate that makes payments or loans or provides services that are subject to the covered agreement; and (3) any company (other than an insured depository institution or subsidiary) that is a party to the covered agreement.

About the Author

Carol Lewis is a contributing writer to *Communities & Banking*. She works for the Federal Reserve Bank of Boston's Supervision and Regulation Department.