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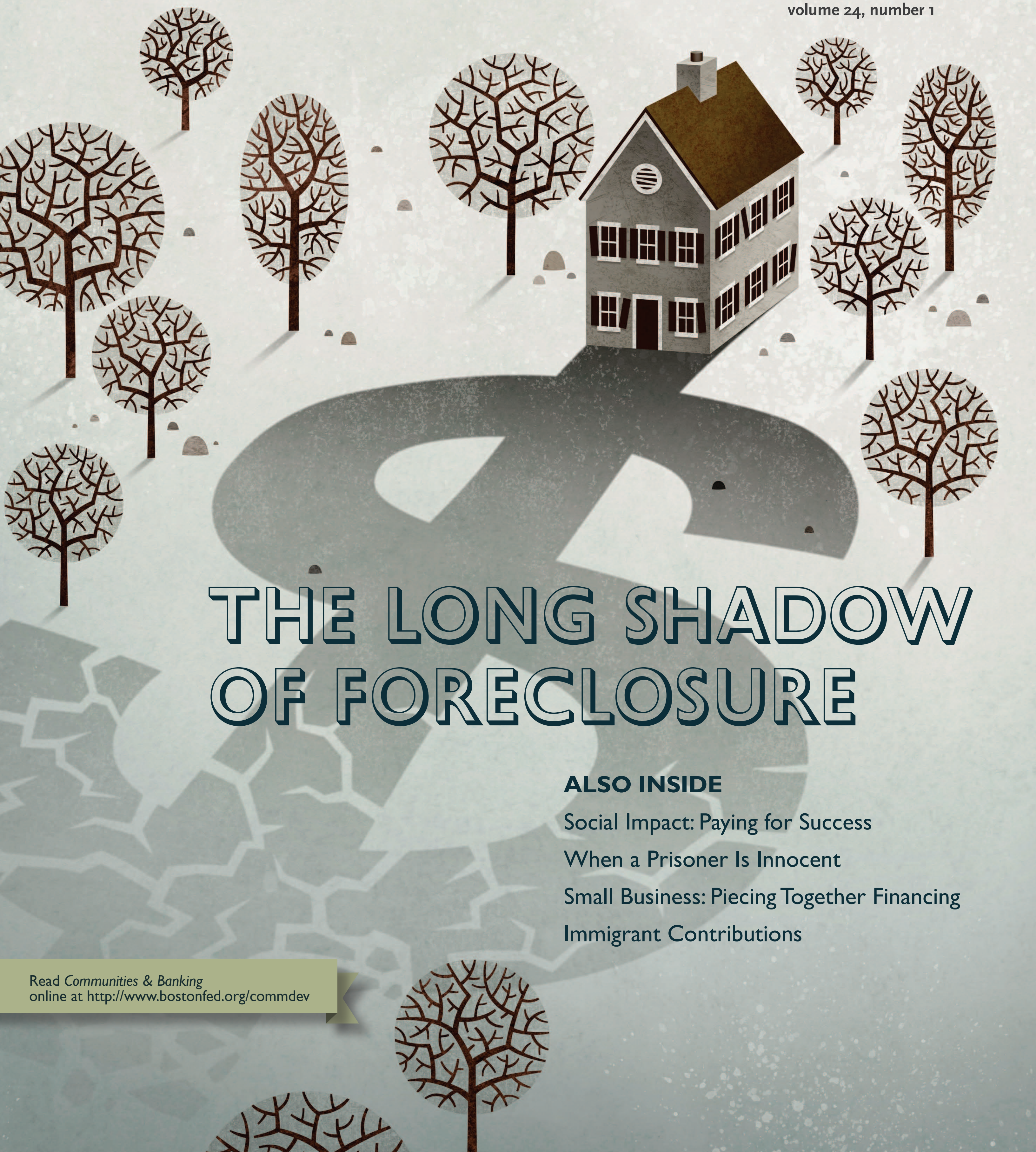

THE LONG SHADOW OF FORECLOSURE

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Communities & Banking

Communities & Banking magazine aims to be the central forum for the sharing of information about low- and moderate-income issues in New England.

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Letter from the Editor

Photo Rachel Bissett

Foreclosure casts a long shadow over the lives of individuals, families, and communities. That's a concern not only for the Federal Reserve departments focusing on the economic strength of lower-income communities, but for regulators.

Indeed, as a result of irregularities that regulators found in the mortgage-foreclosure process in 2009 and 2010, the Federal Reserve and the Office of the Comptroller of the Currency initiated an agreement with lenders to compensate homeowners found to have been financially harmed by lender error in 2009 or 2010 foreclosure actions. An independent reviewer will determine eligibility. Tell people you know to apply at https://independentforeclosurereview.com by December 31, 2012.

Three angles on the topic of foreclosure are featured in the winter issue of *Communities & Banking*: one by Nellie Gorbea of HousingWorks Rhode Island, a second by Chris Hannifan on what foreclosure has done to the rental market, and a third by Emily Anderson on the increased risk of homelessness in Connecticut.

And as you know, we routinely address an array of topics in economic and community development. This time we highlight how a small business in Vermont financed an expansion, what immigrants are contributing to Maine's economy, why role playing can get competing stakeholders to "yes," where you can turn if you are convicted but innocent, and how the arts are benefiting a postindustrial city.

The Boston Fed's Kristin Kanders, a former editor of *Communities & Banking*, introduces the concept of social impact bonds that pay only for success. Elizabeth Glynn of the Local Initiatives Support Corporation describes assistance to owners of multifamily properties who want to retrofit buildings for energy savings. MIT Sloan's Juanjuan Zhang explains her crowdfunding research and why many Prosper.com lenders have followed the "herd" to success.

Check out the data that went into Kaili Mauricio's map at http://www.bostonfed.org/commdev/c&b—and also a video about the Vermont small business, in which photogenic barnyard animals make cameo appearances.

Let me know what you think,

Caroline Ellis
caroline.ellis@bos.frb.org
Managing Editor

Contents

THE FORECLOSURE Legacy

NELLIE M. GORBEA
HOUSINGWORKS RHODE ISLAND

Rhode Island, the smallest state in the Union, with 39 municipalities and only 1 million residents, became New England's poster child for the residential foreclosure crisis. How that came about and what can be done to prevent it in the future is a critical public policy question for the Ocean State.

Over the past several years, HousingWorks RI has monitored Rhode Island's troubling surge in foreclosures. In 2010, the first *Special Report on Foreclosures* examined how having a critical shortage of long-term affordable homes for more than a decade made Rhode Island vulnerable.

It all started with the run-up on home prices. Rhode Island's home prices began to increase dramatically after 2000. Between the first quarter of 2000 and the first quarter of 2006, home prices increased at the steepest rate in the state's history, with an average increase of almost 21 percent in 2003 alone—the highest in the United States that year.[1] At the same time, the supply of new housing stock was not keeping pace with that of other New England states. In fact, according to statistics from the U.S. Census Bureau, Rhode Island ranked as the state with the lowest rate of housing production in the nation between 2000 and 2008.

The lagging supply of homes further fueled housing-price appreciation and made rentals less affordable.

A Perfect Storm

Meanwhile, the amount of money working families could borrow increased dramatically even though the median wage in Rhode Island was receding. The lack of affordable housing and the availability of easy credit conspired to create a perfect storm. Despite high prices for homes, subprime mortgage financing gave homes an "illusion of affordability."[2] (See "Median Income and Housing Costs.")

The fertile subprime market was one key factor in Rhode Island's foreclosure crisis. The protracted economic downturn and the high unemployment rate exacerbated the problem. As of December 2009, Rhode Island had the second-highest unemployment rate in the nation (11.8 percent).[3] In 2009 alone, there were 2,852 residential foreclosure deeds filed in the state, averaging 238 per month. In 2010, the number of completed residential foreclosures dropped to 1,891 but increased again in 2011 to more than 2,000. In all, between 2009 and 2011, 3.6 percent of all mortgaged properties in Rhode Island experienced foreclosure.[4]

No town in the state has been immune to the volatile housing market, but communities have been affected differently depending on the location of the foreclosures. For example, in smaller, nonurban municipalities, foreclosures tend to be scattered and less visible. But in the state's urban communities, high concentrations of foreclosures have blighted entire neighborhoods with boarded-up buildings.

Nearly one-third of residential foreclosure deeds filed from 2009 through 2011 were multifamily homes, significantly affecting renters. The cities of Central Falls, Pawtucket, Providence, and Woonsocket had the highest number of multifamily foreclosures, accounting for 76 percent of the state's total multifamily foreclosures over the 36-month period. Most multifamily foreclosed homes were three- to five-apartment triple-deckers, or old millworker residential buildings.

Each multifamily foreclosure affects multiple rental homes, which in turn threatens tenants with possible eviction. For every multifamily property foreclosed, approximately two to three families could find themselves without shelter. HousingWorks RI estimates that more than 6,300 apartments were lost as a result of the 2,178 multifamily foreclosures from 2009 through 2011.[5] (See "Estimated Loss of Housing Units Due to Foreclosures in Rhode Island.")

Public Investment

It is tempting to assume that the glut of foreclosures and resulting depressed prices effectively solved Rhode Island's lack of affordable

Median Income and Housing Costs

Year	Avg monthly rent for 1-bedrm apt	Avg rent for 2-bedrm apt	Avg rent for 3-bedrm apt	Median annual salary	Median single family sale price	Median wages in 2010 dollars
2001	642	775	875	31,727	156,000	16.27
2002	694	863	1,017	32,897	188,150	16.87
2003	796	1,032	1,195	32,565	230,000	16.70
2004	880	1,121	1,377	32,370	264,700	16.60
2005	911	1,147	1,418	32,409	282,900	16.62
2006	903	1,172	1,423	32,253	282,500	16.54
2007	905	1,142	1,350	31,356	275,000	16.08
2008	944	1,232	1,406	32,136	234,900	16.48
2009	956	1,170	1,533	33,365	199,900	17.11
2010	943	1,165	1,531	33,111	210,000	16.98

Sources: Year-End Rent Survey, 2001-2011, Rhode Island Housing; Median Wage and Household Income Fact Sheet, Economic Policy Institute analysis of Current Population Survey data as used by Economic Progress Institute; and Rhode Island Association of Realtors and Statewide Multiple Listing Service.

Estimated Loss of Housing Units Due to Foreclosures in Rhode Island (2009-2011)

Type of Home	Number of foreclosures	Average number of units per home	Total units lost
Multifamily	2,178	2.9	6,325
2 units	1,031	2.0	2,062
2-5 units	65	3.5	228
3 units	823	3.0	2,469
4-8 units	248	6.0	1,488
9+ units	5	9.0	45
Apartment buildings	6	5.5	33
Single-family	4,011	1.0	4,011
Condo	551	1.0	551
Total	**6,740**	**1.6**	**10,887**

Source: HousingWorks RI estimates

homes. However, the increased demand for rental homes was coupled with decreased supply, and that helped sustain high rental prices, particularly in urban areas. The average cost for a three-bedroom apartment in 2010 was $1,531, 75 percent higher than in 2001, when it was $875; for a two-bedroom apartment, it was 50 percent higher; for a one-bedroom apartment, 47 percent higher.[6]

Rhode Island lacks the consistent state policies and investment in affordable housing seen in neighboring Connecticut and Massachusetts, but some temporary Rhode Island programs have had excellent results.

At the federal level, the Neighborhood Stabilization Program (NSP) has had a significant impact on lives of countless families. In the first distribution from NSP, the Rhode Island Office of Housing and Community Development, in partnership with Rhode Island Housing, received a total of $19.6 million to target 11 communities that had been designated "hardest hit" by foreclosures. Another $5 million was received in the third round of NSP funding, which was targeted to hardest-hit areas in Providence, Pawtucket, and Central Falls. Those funds were rapidly distributed to rehabilitate foreclosed properties into affordable housing and stem the tide of blight in specific urban neighborhoods.

A temporary state program, Building Homes Rhode Island, was also important. It was funded by $50 million in proceeds from the state's first affordable housing bond, approved in 2006. Building Homes Rhode Island is the only state program focused on providing capital investments for affordable housing development. About $19 million of Building Homes Rhode Island funds were used to create 530-plus long-term affordable rental and 40 ownership homes out of what were once foreclosed units.

An economic impact study by HousingWorks RI found that for every dollar the program invested in affordable housing production, $16 went back into the Rhode Island economy.[7]

A great example of the opportunities created by public investment in affordable housing can be seen in Providence's Smith Hill neighborhood, where Smith Hill Community Development Corporation is using $1.22 million in NSP funds and $2.5 million of Building Homes Rhode Island funds as part of a $12.4 million neighborhood stabilization project. The Smith Hill CDC is working to convert 19 empty houses, 18 of which were previously foreclosed, into 52 two-, three-, and four-bedroom apartments. Some of the properties will be owner-occupied multifamily homes, offering eligible buyers the opportunity to earn rental income to supplement their earned income. To date, 31 homes have been completed and are currently occupied. Significantly, the $12.4 million project has provided employment for between 175 and 200 workers.

Although there are many examples of proven success in the development of affordable housing, Rhode Island remains one of the few states that does not have a consistent investment strategy for building homes designed to remain affordable in the long term. High cost burdens have resulted in the rental housing market becoming one of the most damaged segments of Rhode Island's economy. Likewise, persistent foreclosures remain a significant factor in the state's recovery.

For Rhode Island to be truly competitive in attracting and retaining businesses, it must address the lack of a consistent funding policy and elevate the development and operation of long-term affordable housing into its overall economic development strategy. Rhode Island's economic stability and health requires safe, affordable homes for all its residents.

Nellie M. Gorbea *is executive director of Providence-based HousingWorks Rhode Island, a coalition of business and community organizations that promote stable, affordable homes. Contact her at nmgorbea@HousingWorksRI.org.*

Endnotes

1 See Federal Housing Finance Agency, Home Price Index, http://www.fhfa.gov/.

2 J.Carr, "Responding to the Foreclosure Crisis" (National Community Reinvestment Coalition testimony to the United States House of Representatives, January 29, 2008).

3 See www.census.gov/mcd and www.bls.gov/lau.

4 HousingWorks RI analysis of the Warren Group data, 2009 through 2011, www.thewarrengroup.com.

5 In the HousingWorks RI analysis of the Warren Group data, apartment buildings were individually researched using property addresses to determine available realtor information regarding total square footage, number of bedrooms, and number of bathrooms. One unit was assumed for every bathroom listed, with the majority of units assumed as two bedrooms. Two- to five-family residential properties were assumed to have an average of three and one-half units each. Four- to eight-unit apartment properties were assumed to have an average of six units each. Nine-plus properties were assumed to have nine units each.

6 See http://www.rhodeislandhousing.org/filelibrary/RentSurvey_YE2010.pdf.

7 "Measuring the Economic Impact of Affordable Housing in Rhode Island" (report, HousingWorks RI, Providence, spring 2010), http://www.housingworksri.org/news-events/special-report-measuring-economic-impact-affordable-housing-rhode-island.

Mapping New England

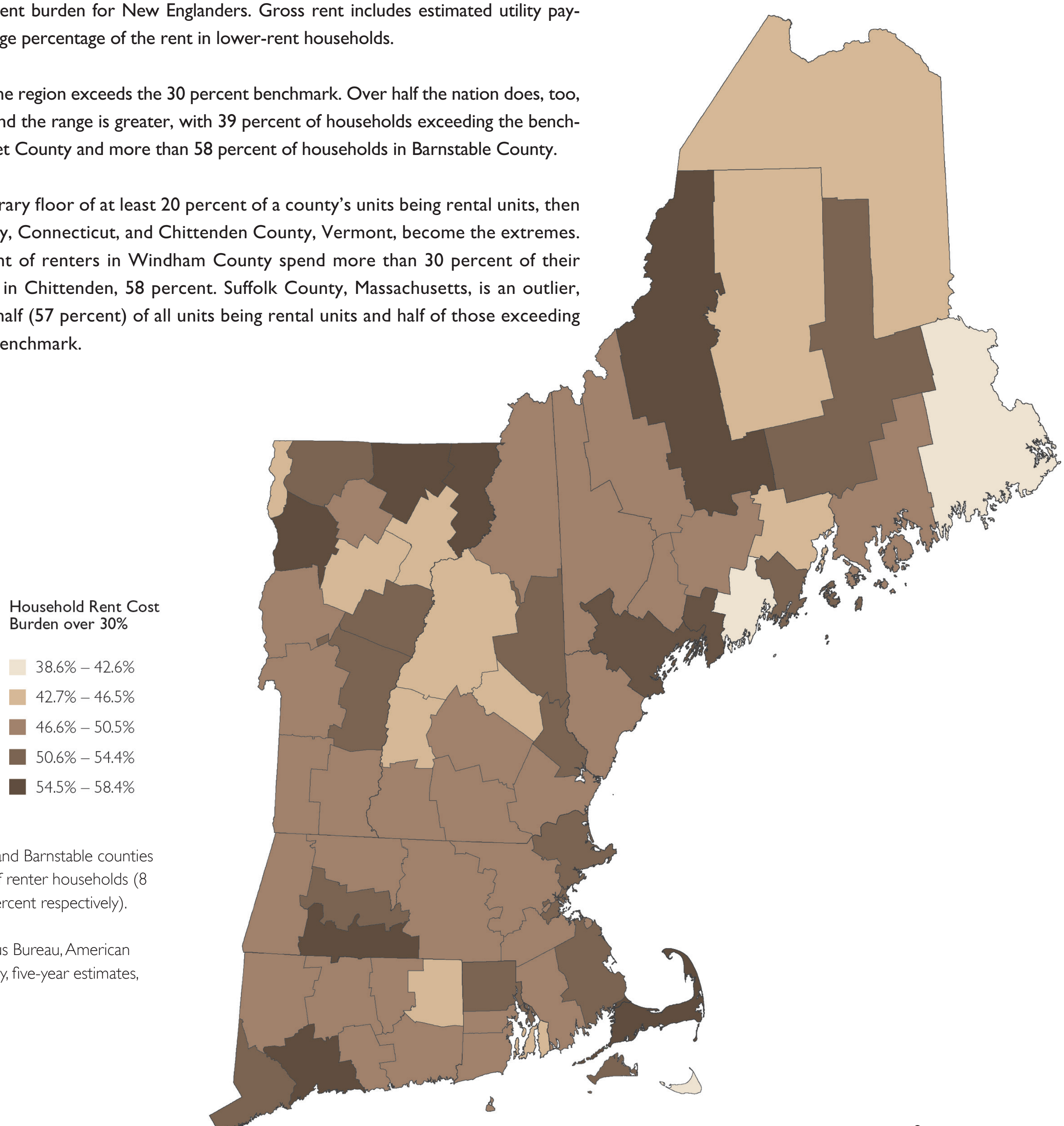
Rent Cost Burden over 30 Percent, by County

KAILI MAURICIO
FEDERAL RESERVE BANK OF BOSTON

The maximum rent in public housing, established by the 1981 Housing and Community Development Act, is 30 percent of family income. Using that as a benchmark for all renters—and looking at the American Community Survey's data on gross rent as a percentage of income—can suggest the rent burden for New Englanders. Gross rent includes estimated utility payments, often a large percentage of the rent in lower-rent households.

Just over half of the region exceeds the 30 percent benchmark. Over half the nation does, too, but in New England the range is greater, with 39 percent of households exceeding the benchmark in Nantucket County and more than 58 percent of households in Barnstable County.

If we set an arbitrary floor of at least 20 percent of a county's units being rental units, then Windham County, Connecticut, and Chittenden County, Vermont, become the extremes. Forty-five percent of renters in Windham County spend more than 30 percent of their income on rent; in Chittenden, 58 percent. Suffolk County, Massachusetts, is an outlier, with more than half (57 percent) of all units being rental units and half of those exceeding the 30 percent benchmark.



Note: Nantucket and Barnstable counties have low shares of renter households (8 percent and 11 percent respectively).

Source: U.S. Census Bureau, American Community Survey, five-year estimates, 2006 to 2010.

RENTAL HOUSING
IN RHODE ISLAND

CHRIS HANNIFAN
HOUSING NETWORK OF RHODE ISLAND

If asked what they want in life, most Rhode Islanders would probably say a decent income, the ability to send their children to good schools, and a good home in a safe place. Unfortunately, for many Rhode Islanders who want to rent, a good home is out of reach.

Although the recession may have temporarily slowed the rising cost of housing across the country, on a local level housing affordability has not gotten better. Moreover, Rhode Island has some of the highest rental costs in the nation and some of the greatest gaps between what housing costs and what local wages can cover.

Out of Reach 2012, a report released by the National Low Income Housing Coalition, a Washington-based housing advocacy group, has the details.[1] Hawaii has the highest rental costs in the country and Puerto Rico the lowest. Rhode Island has the 17th-highest rental cost, and four other New England states—Massachusetts, Connecticut, Vermont, and New Hampshire—are among the 15 least affordable.

Parsing the Data

The national ranking is just one measure of affordability. Perhaps even more important is the increasing gap between the cost of housing and the income to pay for it. The gap is the difference between the Housing Wage—the hourly wage one needs in order to afford a two-bedroom apartment at the fair market rent—and the average wage for a renter. Rhode Island may rank 17th for highest cost of rental housing, but it ranks 8th for the highest gap between income and housing cost.

This year's report demonstrates that the recession has worsened an already severe housing crisis. The persistence of high rates of unemployment and underemployment, translating into diminished household income, makes it more difficult than ever for families of modest means to secure decent living arrangements. Low-income renters face an array of housing challenges at a time when prevailing incomes and wages are simply not enough to allow people to pay for a decent home in their community.

In Rhode Island, the fair market rent for a two-bedroom apartment is $924. In order to afford rent and utilities without paying more than 30 percent of income on housing, a household must earn $3,081 monthly, or $36,974 annually. Assuming a 40-hour work week, 52 weeks per year, that level of income translates into a Housing Wage of $17.78 per hour.

Unfortunately, in Rhode Island, a minimum-wage worker earns an hourly wage of $7.40. This means that, in order to afford the fair market rent for a two-bedroom apartment, a minimum-wage earner must work 96 hours per week, 52 weeks per year. A household must include 2.4 minimum wage earners working 40 hours per week year-round in order to make the two-bedroom apartment affordable.

Currently, Rhode Island's estimated average wage for a renter is $11.64. In order to afford the fair market rent for a two-bedroom apartment at that wage, a renter must work 61 hours per week, 52 weeks per year. For 40 hours per week year-round, a household must include

Photo Corbis

1.5 workers earning the average renter wage in order to make the two-bedroom fair market rent affordable.

The gap between the Housing Wage of $17.78 and average wage for a renter earning an hourly wage of $11.64 is $6.14. This works out to a gap of $319 per month between the cost of housing and 30 percent of the average renter income. The gap for the minimum-wage worker in Rhode Island is even bigger.

Addressing the Gaps

Local advocates have seen firsthand how the unemployment and foreclosure crises have increased the barriers low-income renters encounter in their search for safe, good-quality, affordable housing. Rhode Island's foreclosure rate continues to be one of the worst in the country and is the highest in New England. Moreover, as people lose their homes, many become renters, and that has put tremendous pressure on the market.

Not only does foreclosure often push a former homeowner into the rental market, but in a state where much of the affordable housing stock is the "triple-decker," a foreclosure on the owner may mean three families are put out on the street.[2] At the same time, those rental units are removed from the stock available to people seeking apartments. That presents a challenge, especially when the dispossessed are from low-income households or are suffering from unemployment or other serious shocks to their income. They seldom have emergency savings or the resilience to make deposits for rent and utilities on short notice, let alone to pay higher rent.

The unemployment crisis continues to affect all Rhode Islanders, but the cost of housing and the wage gap are of even greater concern for the affordable-housing community. Rhode Island has one of the highest unemployment rates in the nation, hovering above 11 percent as of this writing, even though the national climate is improving. Meanwhile, the number of extremely low-income households is growing. In fact, one out of four Rhode Island renter households is in the lowest-income category.[3]

With a decrease in the number of available units and an increase in the number of low-income households, the competition for a shrinking pool of rental units is intense. But despite the growing need, housing-assistance programs that could be used to bridge the housing-cost gap are at risk under proposed budget cuts at the federal level (with no new dollars or housing programs anticipated) and also at the level of the state and cities and towns. The nation is in the midst of a deepening crisis in which full-time wage earners cannot afford fair market rents in almost any state.

Affordable-housing and homeless-prevention advocates in Rhode Island are working to garner support for strategies that will ensure a long-term supply of affordable housing. Rhode Island is one of a very few states that lack a dedicated affordable-housing funding stream. That is why groups such as the Housing Network of Rhode Island and the Homeownership Connection are actively promoting ways to generate revenue for the state's Housing Trust Fund, which although enabled by legislation, remains unfunded.

As federal housing resources shrink, state investments in affordable-housing programs, such as the Rhode Island Neighborhood Opportunities Program and Building Homes RI (a voter-backed bond of $50 million passed in 2006), are becoming even more important. Those two programs together produced 2,462 units of affordable homeownership and rental housing between 2006 and 2011.

Why Care?

Housing is a cornerstone of the state's economic growth, and investing in affordable-housing production will help get Rhode Island back on the path to economic recovery. The good news for housing advocates is that Governor Lincoln Chafee included a $25 million housing bond in his 2012-2013 budget, and the Rhode Island General Assembly included the bond in the budget passed in early June. By the time this article appears, Rhode Islanders will know whether a voter referendum on the bond passed.[4]

If approved, the bond would be a good first step for the production of more affordable housing for working Rhode Island residents and a more constructive way to make the state attractive to companies than the failed economic development strategies that made headlines in the state this year. The ultimate goal of a permanent funding stream for affordable housing in Rhode Island remains to be tackled.

Clearly, there is a glaring mismatch between the cost of housing, the wages people earn day to day, and the availability of housing assistance in Rhode Island. An affordable home, providing stability and shelter, is a basic human need, and workforce housing is essential for economic growth. Expanding the availability of affordable housing to address the unmet needs should be a top public policy priority. Until it is, a good home will continue to be out of reach for many families in our communities.

Chris Hannifan *is the executive director of the Pawtucket-based Housing Network of Rhode Island, an association of 20 nonprofit community development corporations working in neighborhoods across Rhode Island. Contact her at channifan@housingnetworkri.org.*

Acknowledgments

The author would like to thank Karen Jeffreys of the RI Coalition for the Homeless and Elizabeth Debs of the Housing Network for their invaluable assistance.

Endnotes

1 See www.nlihc.org/oor/2012.

2 A triple-decker is a three-level multifamily structure occupied by the homeowner and offering additional rental units.

3 According to the National Low Income Housing Coalition, "extremely low income" is 30 percent of area median income.

4 The bond passed. See http://www.wpri.com/dpp/elections/rhode-island-voters-approve-all-ballot-questions.

Homelessness Prevention

An Inexpensive Solution to a Costly Social Problem

EMILY S. ANDERSON
JOURNEY HOME INC.

The nonprofit Journey Home Inc. recently concluded a three-year Homelessness Prevention and Rapid Re-Housing Program (HPRP) pilot as part of its role in implementing Greater Hartford's plan to end homelessness. The prevention measures were for low-income individuals and families at risk of losing their housing, and rapid rehousing assistance was provided to those already experiencing homelessness. Serving more than 2,000 people, the program provided case management, credit counseling, legal services, and temporary financial assistance such as security deposits and rental assistance. Evaluation of the long-term results is forthcoming, but already Journey Home has gained a greater understanding of housing-affordability issues and the value of temporary financial assistance.

Photo Heidi Furse

Although thousands of insurance professionals work daily in downtown Hartford, the vast majority head back to the suburbs in the evening. In the sea of suits milling around downtown, it is easy to forget that on any single night more than 700 people in the capital region are homeless.

As the country's income disparity continues to widen, Hartford provides a poignant example of inequality: well-off workers in insurance and finance dominate downtown, minutes away from impoverished minority neighborhoods. Connecticut's homelessness is especially troubling considering that the state is one of the nation's wealthiest. That is actually part of the problem because it makes housing expensive. For rental housing, Connecticut is the sixth-most-expensive state and the third-most-expensive in non-metropolitan areas.[1]

Historically, the response to homelessness has been to shelter people after they have become homeless. New prevention programs acknowledge the housing-affordability problem and aim to keep people in their homes with temporary financial assistance and case management.

Lack of Affordable Housing

Ending homelessness depends on housing being affordable. It is most people's single largest expenditure. Households are generally considered "cost burdened" if they spend more than 30 percent of income on housing, often the case for renters. In fact, one in four renter households spends 50 percent or more of its monthly income on housing.[2] This means that even a small change in prices can have a large impact. According to 2012 data from the National Low Income Housing Coalition, the fair market rent for a two-bedroom apartment in Connecticut is $1,226. But in order to spend no more than 30 percent of household income on a unit at that price, one would have to earn $23.58 per hour, 40 hours per week. Two working adults would each have to earn almost $12 per hour. Connecticut's current minimum wage is $8.25 per hour.

As employment continues to stagnate, many residents have even more difficulty paying for housing. To make matters worse, the foreclosure crisis increased the number of households competing for affordable rentals. Temporary financial assistance, combined with case management and financial literacy assistance, provides one solution for individuals facing a crisis.

Once families become homeless, they are more likely to become homeless again, and the longer homelessness continues, the less likely people are to escape.[3] Preventing homelessness disrupts that cycle and decreases side effects such as victimization and earlier mortality.[4] It reduces medical costs such as emergency hospital admissions and delayed hospital discharge, and cuts demands on the police and criminal justice system.[5] At the same time, it protects housing providers from financial losses associated with eviction and unpaid rent. Homelessness places unnecessary financial burdens on communities and calls into question the values of a society that allows such poverty to persist.

In the Hartford area, anyone facing a housing crisis can call

2-1-1 for a centralized community referral line.[6] Using this point of contact to reach those at risk of homelessness, the HPRP pilot sought to provide fast financial support to households at risk and to rehouse persons actually becoming homeless. Journey Home received funding through the American Recovery and Reinvestment Act to implement the program for 35 towns surrounding Hartford. In collaboration with the Chrysalis Center Inc., Connecticut AIDS Resource Coalition, Salvation Army Marshall House, Co-Opportunity Inc., and Greater Hartford Legal Aid, it served more than 800 households in the region.

Households receiving prevention assistance were either unstably housed or at imminent risk of losing housing. Rapid rehousing participants generally came from emergency shelters or transitional housing. Both sets of participants received temporary financial assistance and case management. The program was able to house all eligible participants in their own apartments.

A preliminary evaluation of the program indicates that participants in the prevention group were generally younger, female, African American, single, and living with at least one child. As for cost, program participants did not require exorbitant financial assistance and services in order to stabilize their housing, and most did not require the full amount of funding for which they were eligible. The average amount of financial assistance needed to stabilize the household in their own apartment—typically rental assistance or security deposit funding—was $2,200. Additionally, local partnerships with Co-Opportunity and Greater Hartford Legal Aid enabled participants to access budgeting, credit repair, and legal assistance for which they otherwise might not have qualified.[7]

Targeting the Resources

With the federal stimulus funding exhausted, prevention programs across the country confront difficult choices about how to target scarce resources. Homelessness prevention requires identifying households most at risk, but that is no easy task.

According to Journey Home Executive Director Matt Morgan, evictions alone may not be predictive of homelessness. Eviction may be the first step, but lack of a support network is often the deciding factor in someone resorting to a shelter. Only when no family or friends are available or willing to provide a place to stay do most people turn to shelters.

Preliminary findings indicate that people targeted for prevention might not have ended up in a homeless shelter right away. Data from the Hartford region demonstrates that the majority of those entering shelters do not come directly from their own place. Rather, over half had been with friends or family the night before entering a shelter. There also was a large number coming from institutions such as prisons and hospitals. Only 10 percent of those entering shelter in Hartford came from their own place. Therefore, it seems less likely that HPRP participants living in their own rental units would have directly entered an emergency shelter without the assistance.

Despite both practical and philosophical difficulties of targeting those most at risk of homelessness, the capital region program unquestionably helped many households who were in dire need. Although they may never have entered a shelter, thousands of local families were at risk of losing their current housing.

As groups plan for future HPRP programs with new funding, they face a troublesome question: Should clients be screened more rigorously in order to target those who are more likely to *actually* end up on the streets or in shelter? Organizations may need to turn to their stated mission to determine their target audience, their capacity to serve that population with the resources they have, and whether they could turn away someone with serious needs who might not meet more rigorous screening criteria. The questions themselves shed light on the overwhelming scope of the housing-affordability problem.

Morgan acknowledges that the pilot program showed him that the demand for short-term housing assistance and the number of people living at risk is much higher than he thought. A small injection of cash assistance made a huge difference for hundreds of families. Participants who contributed to a follow-up focus group were enthusiastic about the program and described their housing outcomes with emotional statements such as, "I have control of my space, no chaos, my routine—that helps my PTSD," and "I had to learn to live again. I was lying in my bed in my clothes, with my coat on, and I forgot: this is my apartment and I can turn on the heat!"

Emily Anderson *is a public policy intern at Journey Home Inc. in Hartford. Contact Journey Home at info@journeyhomect.org.*

Endnotes

1 Elina Bravve, Megan Bolton, Linda Couch, and Sheila Crowley, *Out of Reach 2012: America's Forgotten Housing Crisis* (Washington, DC: National Low Income Housing Coalition, 2012), http://nlihc.org/sites/default/files/oor/2012-OOR.pdf.

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5 Maureen Crane, Anthony M. Warnes, and Ruby Fu, "Developing Homelessness Prevention Practice: Combining Research Evidence and Professional Knowledge," *Health & Social Care in the Community* 14, no. 2 (2006).

6 J. Porth and Maria Dynia, "Dialing 211 in Connecticut," *Communities & Banking* 21, no. 3 (summer 2010), http://www.bos.frb.org/commdev/c&b/2010/summer/Porth_Dynia_211_United%20Way.pdf.

7 Abt Associates, "Capitol Region Homelessness Prevention and Rapid Re-housing Program" (report, Cambridge, Massachusetts, June 27, 2012).

Hussein Ahmed at his store in Lewiston, Maine

Photo Amber Waterman/*Sun Journal*

Maine Communities Foster Immigrants' Small Businesses

ALEXANDRA ALVAREZ AND JODY HARRIS
MAINE CENTER FOR ECONOMIC POLICY

"Businesses are vital for this community," says Hussein Ahmed, the owner of Barwaqo, a convenience store in Lewiston, Maine.[1] A native of Somalia, Ahmed arrived in town in 2003 and set up shop within the year.

Lewiston, a destination for immigrants since French-Canadian millworkers arrived in the 19th century, has in the most recent decade absorbed 8,000 Somali refugees.[2] Ahmed was one who quickly became active in the Lewiston community and encouraged other Somalis to do the same. Today the head of the county's Chamber of Commerce praises Ahmed as a "leader in the community."[3]

Maine is the whitest state in the country (95.4 percent, according to 2010 census data), but its minority population is growing. A combination of migrant workers and refugee settlers, who began to arrive in the 1990s, nearly doubled Maine's black population between 2000 and 2010. Over the same period, Maine's Latino population, largely of Mexican and Puerto Rican heritage, grew by more than 80 percent.[4]

Contributions

According to the Fiscal Policy Institute, immigrants are investing in Maine's economy through entrepreneurship, small business ownership, and employment of other Mainers.[5] Research by the Maine Center for Economic Policy also demonstrates that immigrants are making contributions.

Hispanics are Maine's largest minority group and account for a small, albeit significant, portion of entrepreneurs. In 2002, Maine's 731 Hispanic-owned businesses generated $113 million in revenue.[6] The number of Hispanic businesses grew to 979 in 2010. The award-winning Thistles is one, a Bangor restaurant owned by Maria and Alejandro Rave and their son. The Raves emigrated from Colombia in 1985 when Santiago was entering first grade. Like most new immigrants, they spoke little English, so they took jobs bagging groceries and making donuts.

Today, Maria is a professor of Spanish at the University of Maine at Orono and at Husson College. Alejandro is the chef at Thistles. They volunteer in the community, contribute to charities, and provide needed jobs to university students. They have contributed to Bangor's downtown renaissance, one of dozens of new restaurants bringing the city back from economic stagnation.[7]

Asian entrepreneurs have also been important. In 2007 alone, the state's 1,043 Asian-owned businesses generated receipts of $284 million and employed 2,543 people.[8] Moreover, because schools in Asia often emphasize math and science, many Asian immigrants offer local employers highly sought-after skills. Today Asian immigrants are valued employees in high-tech industries, government, health care, and biomedical research, among other sectors.

The education and skill of immigrants is especially crucial now that Maine has tens of thousands of residents aging out of the workforce and not enough young, trained workers coming along. Sixteen percent of Maine's population is 65 and older, compared with the national average of 13.3 percent. At the same time, the percentage of Mainers under 18 (20.3 percent) is below the national average (23.7 percent).[9] Recent immigrants, however, are mostly working age.[10] Encouraging immigration through economic development strategies can bring urgently needed skills to jobs left vacant by retiring baby boomers.

For Economic Development

Local governments and organizations are beginning to see the potential of immigrant-owned businesses.

Coastal Enterprises Inc. definitely does. CEI, a private, nonprofit community development corporation and community development financial institution based in Wiscasset, specializes in rural business financing. A key tenet of its triple-bottom-line mission (economy, equity, and environment) is serving disadvantaged populations, including developing immigrant entrepreneurs. Every year, CEI works with about 150 immigrants and refugees who want to finance or develop businesses. Its StartSmart program, founded in 1997, provides free business counseling. So far it has worked with 1,000 immigrants and refugees starting 301 businesses in southern Maine.[11]

John Scribner, StartSmart's director, says, "StartSmart empowers immigrants who want to achieve success in small business. It's like that saying: 'you can give a man a fish or you can teach him how to fish.' "

Ahmed was one of the people that StartSmart helped. It enabled him to acquire building space in Lewiston and offered him start-up advice. StartSmart also has a fee-for-service loan program for Muslim business owners whose religious beliefs preclude paying interest on loans.[12]

Maine's largest city, Portland, sees immigrants as a boon. Gregory Mitchell, the city's economic development director, says, "Our economic development plan recognizes the value of the immigrant community and fosters immigrant entrepreneurship to grow Portland's economy."[13] The city works with CEI to foster immigrant business start-ups like Tandoor Bread, a Middle Eastern bakery, and Boda, a Thai restaurant, whose chefs were both nominated for a 2012 James Beard award.

Like CEI, Portland offers immigrant businesses commercial lending and technical assistance. It also helps them navigate permitting and licensing and hosts networking events to help local businesses tap immigrant talent and to encourage immigrants to establish business roots Maine's port city.

But although there is broadening support for immigrant entrepreneurship, challenges remain. Among them: gaining the trust of lenders, understanding licensing and permitting requirements, and for professionals like doctors and teachers, getting their credentials transferred. Immigrant businesses must also learn to appeal to a broad market since a small ethnic population alone usually cannot sustain a business.[14]

Investing in People and Communities

In a state known for its potatoes and blueberries, fresh food appears to be a good niche for immigrant business growth.

One group of Lewiston's Somali residents, the Bantu, comes from southern Somalia, where most were subsistence farmers. The New American Sustainable Agriculture Project (NASAP), run by Portland nonprofit Cultivating Community, helps Somali Bantu, especially women, to start small vegetable gardens, drawing on skills they already possess. NASAP trains the farmers and helps to market their products to local restaurants, farmers' markets—even Bates College.[15]

Hoping to exploit this niche, the Western Mountains Alliance (WMA) in Farmington has received grant money to pilot a local food-buying club in Lewiston. Tanya Swain, executive director of the WMA, says, "The easiest, most cost-effective way to support the economics of local farming is direct selling to the consumer." She sees great potential for the pilot project to expand Somali-owned farms that contribute to the region's economy and improve access to fresh food, especially for immigrants and seniors.

Immigrants also actively participate in the broader community. Ahmed is a success not only because of his business achievements, but also because of his deep involvement in Lewiston. In addition to offering Halal foods, Ahmed hires translators to work with businesses and social service agencies, provides tax services, and operates a kind of wire-transfer service. Always eager to learn, he is currently a master's degree candidate.[16]


Monire Child (owner of Uno, Dos y Tres Daycare Center in Portland, Maine) with her son


Organic farmer Poonsri Sawangjaeng and family

Photos Victor Damian

Of his role reaching out to other immigrants, Ahmed says, "I encourage people to start their own businesses because it keeps the community growing, and there are single mothers and elders who are able to provide for their families."

With immigrants bringing new ideas and new business to Maine, local leaders are beginning to take notice and to explore new ways to work with recent arrivals to take advantage of the economic opportunities.

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INNOCENT BUT INCARCERATED

10,000 LOST YEARS

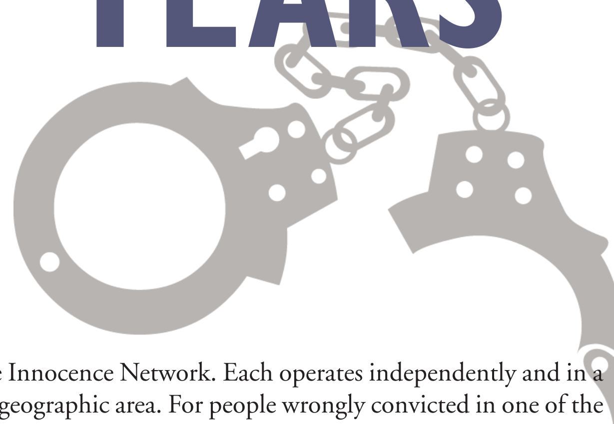

Illustration iStockPhoto

GRETCHEN BENNETT
THE NEW ENGLAND INNOCENCE PROJECT

The United States criminal justice system provides for two stages of review for people accused of a crime—the trial stage, where facts are presented and evaluated by a judge or jury, and the appellate stage, where the way the law was applied to those facts may be questioned. The facts themselves are typically not reexamined.

After the appellate stage, there is no guaranteed right to counsel. But what happens when the system gets it wrong and facts are missed or misinterpreted? When someone is convicted of a crime he or she did not commit, the system does not guarantee any recourse. If the innocent do not have private resources to hire lawyers or investigators, they may spend years, decades, and even life in prison, while the guilty person remains free to commit more crimes.

Mounting a Defense

Consider what happened in the case of Kenny Waters, wrongly convicted in Massachusetts in 1983 of a murder he did not commit. The 2010 film *Conviction* tells the story of Kenny's sister Betty Anne, a 29-year-old mother of two small boys with a high school general equivalency degree who, when all available resources were exhausted, dedicated more than 18 years of her life to proving her brother's innocence.

Betty Anne did what most people in her situation would think impossible. While raising her sons, she graduated from college and then law school. She passed the bar in Rhode Island and Massachusetts. She then hunted down the DNA evidence authorities repeatedly told her had been destroyed, fought to have it tested, and ultimately won her brother's freedom. Most people don't have a sister like Betty Anne.

For most people in Kenny's situation, organizations like The New England Innocence Project (NEIP) offer their only chance at freedom. There are currently 65 organizations worldwide affiliated with the Innocence Network. Each operates independently and in a specific geographic area. For people wrongly convicted in one of the six New England states, NEIP provides a final hope.[1]

The causes of wrongful conviction vary, but it is undeniable that economically disadvantaged people are more vulnerable to being convicted of a crime they did not commit. Insufficient access to investigative resources and inability to hire experts to challenge unreliable evidence are just two of the many ways the justice system may fail a factually innocent defendant who does not have sufficient private resources.

This is a nationwide problem. A 2011 report by the Justice Policy Institute in Washington, DC, found that "only 7 percent of all county-based public defender offices have enough investigators to meet national guidelines; 87 percent of small, county-based public defender offices do not have a single full-time investigator; and only 27 percent of county-based public defender offices and 21 percent of reporting state public defender systems have enough attorneys to meet caseload guidelines."[2]

Tackling the Challenge

Earlier this year, the University of Michigan Law School and Northwestern Law School joined forces to compile national data on all exonerations. The project produced startling numbers. Nationwide, between 1989 and the report's release in March 2012, 891 people were proved innocent of crimes for which they were convicted. As a group, they had served an almost unimaginable 10,000 years behind bars while the actual criminals went free.

DNA evidence is the most compelling means for proving innocence and is most often found in homicide or sexual assault cases. Because of that, 83 percent of those proved innocent by DNA evidence were serving time for those types of violent felonies.[3] An additional 1,170 people were released following "major police scandals." Although these people are not included as official exonerees in the report, the researchers concluded that many of them are innocent. Meanwhile, there is no way to accurately estimate the number of people who are currently serving time for crimes they did not commit, but it is apparent that the problem is significant.

With 27 verified exonerations, Massachusetts ranks fifth in the country for exonerations per capita. Three additional exonerations were achieved in Massachusetts at the federal level, including the 2011 exoneration of Jimmy Hebshie, who was convicted in 2006 of setting fire to his small newsstand, a fire that experts now say was most likely an electrical fire that could not have started in Hebshie's store.

While an innocent person was serving time for those crimes, the real criminals went on to commit 123 violent crimes.

The fire science that ultimately helped to free him existed at the time of his trial and could have been discovered and produced by his attorney. In 2009, when his case came to the attention of The New England Innocence Project, Jimmy Hebshie had exhausted his appeals. He was freed only when a federal judge found that his counsel was legally ineffective for failing to adequately challenge the scientific evidence (never validated) that was brought against him at trial.

Ten other people have been exonerated so far across the New England states since 1990, bringing the total to 40 people. Reinvestigating, locating evidence, and finding ways to bring these cases back into the court system often takes many years and enormous resources. Altogether, the 40 New England exonerees served 565 years of prison time, with an average of more than 14 years each.

Reentry

If and when innocent people are finally freed, they are often ill-equipped to reenter a society that has moved on without them. Many are unfamiliar with things that the average person today takes for granted. Cell phones and the Internet did not exist when some of these people were incarcerated.

Ironically, although reentry programs are available to guilty inmates who are released after serving their sentence, people who are released because they are found innocent may not be eligible for the same programs. Even though a conviction is overturned, the stigma may follow an exoneree for years as he tries to rebuild his life. Jimmy Hebshie, for example, has now been deemed ineligible for the housing assistance he previously received simply because he served time in prison. He is now forced to prove his innocence all over again to the housing authority.

When the wrong person is convicted of a crime, the community suffers, too. The innocent person and his or her family have to endure the horror of incarceration. The victim is made an unwitting party to a terrible injustice. Valuable law enforcement and court resources are wasted, and the community at large remains in danger from the real perpetrator remaining free to commit more crimes. In 142 of the first 292 DNA-based exonerations, the real perpetrator was identified. While an innocent person was serving time for those crimes, the real criminals went on to commit 123 violent crimes, including 32 homicides and 68 sexual assaults.[4]

The New England Innocence Project provides pro bono assistance to inmates who have claims of actual innocence. The nonprofit does not do criminal defense work. If during the course of an investigation, NEIP discovers evidence tending to prove guilt rather than innocence, the organization will no longer represent that individual.

As a nonprofit, the organization is dependent on donations and grants and the assistance of volunteer attorneys and law students. Its mission is to assist persons wrongly convicted in Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, or Vermont—and to advocate for the reform of our criminal justice system. It considers cases in which a conviction is final and in which scientific testing or other investigative leads could establish a strong likelihood that the individual is factually innocent. NEIP also seeks to aid exonerated persons by helping to connect them to educational, health, and other services to improve their chances of a successful reentry into society.

In addition to its work on behalf of individual inmates, NEIP seeks to raise public awareness of the prevalence, causes, and costs of wrongful convictions, and it advocates for legal reforms that will hasten the identification and release of innocent prisoners.

It is the New England Innocence Project's vision that no one in New England will ever go to prison for a crime he or she did not commit.

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BUILDING COMMUNITY THROUGH THE ARTS

The North Adams Story

Illustration iStockPhoto

JAYE FOX
STUDIO21SOUTH

In North Adams, the walls of the Massachusetts Museum of Contemporary Art (Mass MoCA) form a dividing line between the high-minded art within and the struggling postindustrial city without.

But outside the 13-acre complex, the erstwhile mill town boasts its own arts community, comprising artists who arrived after MoCA and institutions and residents who predate it. Creative placemaking (shaping the character of a geographic area around the arts and culture) provides a useful paradigm for exploring the synergy between the two creative spheres.[1] By framing North Adams as a prototypical "creative place," we can consider the ways in which major arts-development projects intersect with preexisting community assets. This approach replaces the superhero fallacy of arts-oriented development with models that respect community institutions and affect the lives of low-income residents in a more meaningful way.

The symbolic value of Mass MoCA has been huge. The Sprague electric plant, which houses the museum, was once the largest employer in North Adams. After it closed, its empty hulk weighed on the city's spirit. Opened in 1999, Mass MoCA created 77 jobs by 2002 and influenced the creation of 150 jobs by other businesses. So says Center for Creative Communities (C3), a collaboration of Williams College and Mass MoCA, which also documented a net growth of over $9.4 million annually in the county economy. Counting tourists, the economic impact is closer to $14 million. All good. However, creative placemaking emphasizes the value of locales being able to retain a higher share of income that is generated by residents (as opposed to tourists). Keeping the money in circulation at home results in greater community benefits.

Another consideration is that, according to data from the Berkshire regional planning commission, the average weekly wage in the sector most improved by Mass MoCA—that of "arts, entertainment, food services, and accommodation"—actually has the lowest average weekly wage of any employment sector in North Adams by far. At only $253 per week, wages in this sector are about half of the next lowest, retail.

Meanwhile, home affordability has declined with the increase in home values. New artist-oriented loft developments, the North Adams dot-com boomlet, and the draw of Mass MoCA's year-round art, cinema, music, and performance offerings (which help local companies retain employees) have all contributed to the increase in property values.

New Investment

Today as MoCA enters its teens, several long-term development projects are beginning to take root.

The Partnership for North Adams, a joint effort of the city, Mass MoCA, and the Massachusetts College of Liberal Arts (MCLA) is spurring community development projects through public-private partnerships. For example, it has intervened in the threatened destruction of one of the city's iconic churches and has collaborated on an RFP (request for proposal) to redevelop Heritage State Park. The successful proposal, approved by the City in June 2012, removes the park's maintenance from the city's budget and rebrands the site as a retail center integrated with the state's new gateway to Mount Greylock. Investment on such a scale would not happen if not for Mass MoCA.

Also capitalizing on the presence of Mass MoCA, MCLA's Downstreet Art (DSA), a public art project designed to revitalize downtown, was launched five years ago, in 2007. Downstreet Art fills underused public and private spaces with pop-up galleries, performances, public art projects, and the like throughout the summer and fall.

Since the Mass MoCA campus is physically separated from downtown North Adams, Downstreet Art is important in defining the city as a cultural haven, rather than simply an empty vessel where Mass MoCA is located. Downstreet Art brings people downtown, into the restaurants and shops and the (largely noncommercial) art venues. And although new commercial tenants might not hold Downstreet Art directly responsible for their decision to open up shop, it does deserve credit for creating a sense that "something's happening," a sense of potential that makes investment appear reasonable. Suzy Helme, co-owner of Shima, an upscale natural parenting and baby goods store on Main Street, concurs and adds: "DSA has been a vital part of our summers! We almost always do enough sales to make it worthwhile, and you can't beat the sense of community that happens on those monthly openings."

New Networks

Stephen Hannock is a painter with an international reputation. He also maintains a studio in Beaver Mill (developed in North Adams by artist Eric Rudd).

For the past two years, Hannock has organized a show of artwork from the local schools in Mass MoCA galleries between installations. A reception and prizes are part of the excitement. The experience teaches students to prepare their work for sharing with the public, and it lets them see their work in a greater context. The combination of a significant art institution, the commitment of a renowned artist, and support from school administrators and art teachers makes it possible.

Northern Berkshire Community Coalition (NBCC), a community-organizing nonprofit, also uses the arts to work with youth. A writing workshop helps teens discover the power of the written word through their own investigations, outside of school. The workshop might have existed without Mass MoCA, but some opportunities would probably have been missed.

Kate Merrigan, director of the program, describes an example of the connections that form when larger institutions are engaged in the community. An internationally recognized artist, Pepon Osorio, was brought to the area by the Williams College Museum of Art (WCMA) and set up an art installation in a vacated car dealership under the auspices of Downstreet Art. Since the subject of the installation was a provocative interpretation of the divergent character of North Adams and Williamstown, it became that semester's subject matter for the teen writing workshop's project. They also made valuable connections with adult mentors.

The Williams staff member who coordinated with the NBCC later became an admissions officer at MCLA. When MCLA denied admission to one of the teens, Merrigan reminded the admissions officer about how hard-working and energetic the teen was. Her application was reconsidered, and she was accepted.

NBCC youth are also engaged in a long-term effort to bring a skate park to North Adams. Teens rapidly age out of programs, so youth leadership programs are generally not conducive to development projects. However, several "generations" of North Adams youth have identified a skate park and gathering place as a top priority, and even teens who don't skateboard are enthusiastic. One generation identified Community Development Block Grant funds from the U.S. Department of Housing and Urban Development as a likely funding source and made a proposal to the mayor. Another carried the work forward with engineers and design professionals.

Ultimately, a Mass MoCA curator was drawn into the project and is connecting the youth with yet another conceptual installation artist, this one specializing in urban design projects including public skate parks. The involvement of a major artist not only raises the level of discourse among the teens, but also elevates the project from a perfunctory concrete structure to a destination of wider interest.

Community theater has also been important in the arts scene. When Main Street Stage lost the lease on its location, it reinvented itself as a traveling theater company. Summer 2012's family-friendly production incorporated puppetry and performance, and many of the free shows were held adjacent to low-income and public housing, drawing the attention of neighborhood families who would likely not otherwise attend live theater.

In one case, community members and NBCC organized a bike parade from a housing development to the show as a part of the state's "Mass in Motion" initiative.[2] Main Street Stage's creative company and board are made up of both long-term residents and recent transplants. The imprimatur of MoCA and North Adams as a creative center has been a benefit to the troupe.

Creative placemaking is the right model for contemporary initiatives using the arts to make a positive impact on low-income communities. Efforts to measure outcomes are elusive, but several organizations are productively engaged in the attempt. Notably, the ArtPlace Foundation is developing indicators of "vibrancy and diversity" that should assist communities in the future. In the meantime, ArtPlace has developed 10 questions to help identify whether or not a locale is moving in the right direction.

Questions such as "Is there a new indoor/outdoor gathering place?" and "Are there more people on the streets?" can help people think about whether the creative networks are developing in such a way as to improve the quality of community life. Efforts to define precisely how creative placemaking can contribute to community development are expected to continue and to serve as an intelligent guide to planning.

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Role-Playing Our Way to Solutions

MIRIAM AXEL-LUTE
NATIONAL HOUSING INSTITUTE

Photo iStockphoto

Many community development challenges are intractable because it's hard to convene all the relevant stakeholders to work on real solutions with real consequences. Now a few organizations are trying out multiplayer scenarios as a way to give serious thought to opposing views. Scenarios feel safe because they are pretend, but the great thing about pretend is that it can open minds and lead to unexpectedly collaborative innovations.

A Simulation in Connecticut

Connecticut is a state of old houses and rapidly rising energy costs. Even though it has a good ranking from the American Council for an Energy-Efficient Economy and shrank its per capita energy use 10.3 percent between 2005 and 2009, it still uses more energy than neighboring states.[1]

Concerned, several Connecticut nonprofits, utilities, and agencies got together to tackle energy efficiency in residential properties, starting with the residences of people most in need of savings, lower-income homeowners and seniors. Under the leadership of the Stamford-based Housing Development Fund (HDF), they embarked on a two-day exercise in problem solving with the ambitious goal of reducing Connecticut's residential energy use by 25 percent by 2030.

Seventy-eight people met up in Hartford in March 2012 for "Energy Smart Solutions," a *megacommunity simulation.*[2] Participants came prepared to role play and negotiate as part of teams focused on increasing the efficiency of Connecticut homes. The teams represented energy suppliers, vendors (of energy efficiency audits and retrofits), state government, nonprofits, private financing, and residents.

Joan Carty, HDF president and chief executive officer, had previously encountered a megacommunity simulation at a NeighborWorks America Achieving Excellence training led by Booz Allen Hamilton, a consulting company. Impressed, she got HDF to submit a proposal to a NeighborWorks competition and won a grant.

HDF proceeded to work with Booz Allen to prepare a residential-energy-efficiency simulation. On opening day, the teams huddled with a facilitator to come up with preliminary ideas for reducing energy use by 25 percent. To encourage creativity, innovation, and risk taking, participants were told not to assume that anyone was speaking on behalf of their actual organization.

Most teams were composed of people familiar with that sector (for example, utility employees were on the utilities team) with a few individuals from other sectors mixed in. Logistical challenges kept actual low-income residents from attending and being on the residents team, however, so participants assigned to that team threw themselves into role playing.

When report-outs from the first "move" suggested that participants were struggling to get the hang of the process, Booz Allen Vice President Gary Rahl explained that was normal. "Typically, teams will [first] try to solve the problems in the way that is most personally and professionally convenient to them."

The residents team gave strong feedback that the other teams should think more about lower-income homeowners' concerns, particularly how to address a lack of trust.

In the next two rounds, everyone went back to the drawing board, visiting other teams, explaining their views, asking questions, negotiating. Even when a team was not persuaded to take the action that another team wanted (if the state agencies team rejected a policy change, for example), the cross-pollination helped people think differently. Hearing a vendor describe real-life energy-efficiency programs spurred the residents team to focus on uptake of efficiency programs rather than on program design. In a second case, conversations between utilities and nonprofits changed assumptions about nonprofits being the best suited for taking the lead in program management. Maybe utilities or a completely new entity would have better capacity for the job. In a third case, participants suggested that requiring contractor certification could lessen the trust gap.

Results

Specific proposals, new relationships—and an understanding of the need for continued collaboration—emerged in the end.[3] Convening people who don't usually sit down together so that they might interact in a safe environment was powerful. Individuals could see that although they might have familiarity with their own pieces of the puzzle, a different take from someone in a different sector can produce breakthroughs.

Says Annie Harper, Yale Community Carbon Fund coordinator, "I met really interesting people, have kept in touch with them—*and* have been introduced to other useful contacts."

"It made me realize that there are a lot more players out there than I thought," adds Connecticut Consumer Protection division director Frank Greene.

But to hold a megacommunity together, Rahl recommends identifying a coordinating organization. After the Energy Smart simulation, HDF launched a working group, and as of this writing, the state was considering assuming the coordinator role for a convening.

The simulation generated other recommendations, too:

- standardized marketing and outreach, with an emphasis on educating and selling consumers on easy-to-understand upgrades;
- easy financing, including adding retrofit loan payments to utility bills and linking repayment to a meter rather than a person;
- independent certification of contractors;
- training of a larger workforce;
- using a third-party administrator—possibly a utility—to bring an efficiency program to scale; and
- considering payment to energy suppliers for increasing efficiency.

Although there is no blueprint after a simulation, says Rahl, it is important to come out of a game with actionable items, even if that just means setting up meetings that wouldn't have happened otherwise. "You don't need to get all the way to an action plan," he says. "The question is, Do you have forward momentum?"

Energy Smart Connecticut was an experiment for HDF. "We're learners in this space," says Carty. "It was an advantage to be a learner because we had no preconceived notion about what the outcomes should be. … You want people there who know something, are open-minded, and able to put aside their own agenda."

Figuring out who should be represented can be hard. Although HDF and Booz Allen spent the bulk of the planning process on that aspect, participants identified gaps. Landlords were not present, for example, though their incentives and challenges differ from those of homeowners and renters. And there was discussion about how best to represent the low-income residents. Booz Allen had recommended against involving individuals who might not be able to see beyond their particular situation, but those who were called on to play the role of residents felt ill equipped to do so.

Annie Harper, a member of that team, said she "worked in development overseas for many years and was really shocked that there is not yet a recognition in this country that low-income people are in fact more expert than anyone else in dealing with the problems of poverty. Overall I found the set-up of the event fantastic, but the absence of this group of people made it ultimately much less valuable." Possibly increased participation from community organizers, financial counselors, or neighborhood leaders might have bridged the gap.

Another challenge was that both the composition of the teams and the decision to base proposal development on the feedback of "residents" limited the range of solutions to energy-efficiency products. Other possible solutions—policy proposals such as removing the link between increased consumption and increased utility profits, and ideas about requiring Energy Star ratings for homes or energy audits that could be shared with potential buyers or renters—got less scrutiny than programs that were similar to existing programs.

Says Rahl, "We ended up with solutions that were more compromise oriented than they were innovation oriented"—an unusual outcome. But since the simulation was just a beginning point, innovation may still be in the offing.

The simulation led to an Energy Efficiency Workshop on July 24, 2012, with more than 50 state officials, academics, advocates, energy-solutions vendors, and utility representatives generating input on Connecticut's Energy Efficiency plans for 2012-2013. In August, HDF, with state agencies, convened a series of working groups that met weekly to draft official recommendations for the state's Conservation Load and Management Plan. "It's an ongoing dialogue," says Carty.

The Potential

Rahl describes the sorts of challenges suited to the megacommunity format this way: "You never want to pick a goal that can simply be met by an analytical solution—figure out who needs to do what. You need a goal where, to meet it, there will be tensions between participants and no single way of getting there."

Many topics in community development—abandoned properties, neighborhood change, education reform, foreclosure prevention—could benefit from a megacommunity simulation. If the field could develop skill with the approach and include all the important stakeholders, simulation could be a powerful tool for creating innovative solutions to some of our thorniest problems.

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Endnotes

1 See http://aceee.org/sector/state-policy/connecticut.

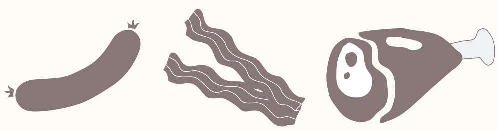
2 *Energy Smart Solutions: A Strategic Simulation* (briefing book prepared by i2 Community Consulting for Housing Development Fund and Booz Allen Hamilton, March 2012), http://hdf-ct.org/PDFs/StrategicSimulationBriefingBook.pdf.

3 *Energy Smart Solutions: A Megacommunity Strategic Simulation* (report prepared by Booz Allen Hamilton for Housing Development Fund, April 2012), http://hdf-ct.org/PDFs/HDF-EnergySmartSolutionsSimulationFinalReport.pdf.

THE STORY OF A SAUSAGE BUSINESS

By mixing together funding sources, a fast-growing smokehouse tripled its space, creating jobs and opportunity for Vermont farmers.

CLAIRE GREENE
THE FEDERAL RESERVE BANK OF BOSTON



Vermont Smoke and Cure makes sausage, bacon, and ham using traditional methods and local ingredients.

FENNEL

VERMONT TOWN WINS GRANT TO CREATE JOBS

In 2008, a fire destroyed the Saputo cheese-processing plant in Hinesburg, Vermont. Eighty jobs were lost. Hinesburg, 14 miles south of Burlington, population 4,500, won a U.S. Department of Housing and Urban Development Community Development Block Grant to fund a low-interest loan to help Vermont Smoke and Cure move into the abandoned space.

"CDBGs are used to create or retain jobs."
– Josh Hanford, Vermont Department of Housing and Community Affairs

CASING

SMALL BUSINESS OPPORTUNITY CONSTRAINED BY TIGHT SPACE

A darling of locavore food culture, Vermont Smoke and Cure not only produces its own products but also provides smokehouse services for 600 farmers in Vermont. In five years, revenue increased from $300,000 to $3 million, and the smokehouse was bursting out of its old facility.

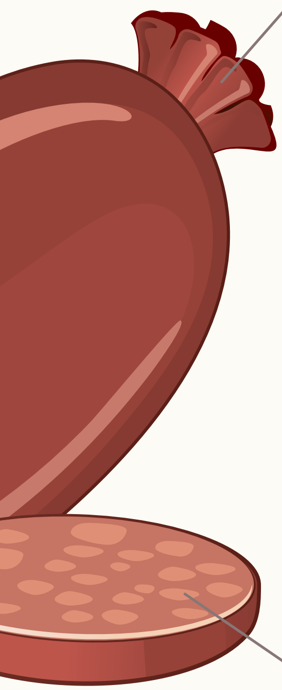
"It takes all kinds of money for small businesses to grow and stay in Vermont. It takes angels and venture capitalists and foundations and tax incentives and community lenders. Often you need to mix and match to make the right package."
– Janice St. Onge, VSJF Flexible Capital Fund

x3

The borrower, lenders, and credit guarantors cooked up a collaboration that brought jobs to Hinesburg, increased smokehouse capacity for local farmers, and enabled Vermont Smoke and Cure to modernize its equipment while **tripling** its space.

SUCCESS

- Creates local jobs (15 now, 25 in the future)
- Supports 600 farmers
- Redevelops an unused resource
- Preserves Vermont's farm landscape



PACKAGING

37,000 SQUARE FEET BOOSTS LOCAL ECONOMY

Vemont Economic Development Authority (VEDA) also made a loan to the real estate developer of the building and to the dairy that shares the building with Vermont Smoke and Cure. The 50-year-old meat processor opened its new facility in May 2012.

USDA

In addition to the USDA-guaranteed portion of the term loan to Vermont Smoke and Cure, an SBA guarantee supports a working capital line of credit that gives the growing business needed liquidity.

MEAT

SEVEN+ PARTIES HAD A PIECE

Everyone met around the table at the VEDA office in Montpelier to hash out the structure.

"Each participant had different require-ments and timelines and needed to understand the structures of the other lenders that were going to be involved."
– Marie Dussault, VEDA

WANT TO LEARN MORE?
Check out the faces behind the story.
Go to http://www.bostonfed.org/commdev to watch the video!

The Green Retrofit Initiative

ELIZABETH GLYNN
LOCAL INITIATIVES SUPPORT CORPORATION

Prior to 2008, when the Green Communities Act became law in Massachusetts, low-income multifamily properties (five-plus units) were not well served by the utility-ratepayer-funded energy-saving or weatherization programs. Multifamily properties simply didn't fit neatly into either the commercial or the residential program.

But in early 2009, NStar convened a meeting of owners of affordable multifamily housing and other stakeholders to get feedback about their needs. The working group that grew from the initial meeting made a proposal to the Energy Efficiency Advisory Council of the Massachusetts Department of Utilities for a program that would provide incentives for energy upgrades in low-income multifamily housing. As many as 78,000 previously unserved housing units were thought to meet the program's requirements.

In mid-2009, the Barr Foundation provided a grant to the Boston office of the Local Initiatives Support Corporation (LISC) to catalyze retrofits and energy conservation in affordable multifamily housing by harnessing the new opportunity for energy-retrofit funding. The goal of the grant was to develop an understanding of the unique challenges and opportunities for increasing efficiency in the sector and to gain knowledge about the types of retrofit measures that are the most effective and practical.

LISC created a program supporting the efforts of Boston community development corporations (CDCs) to make their affordable housing more "green" and energy efficient. LISC's CDC Green Retrofit Initiative assisted 11 CDCs in Boston, Cambridge, and Chelsea for two years, with significant savings results. Today, through a grant from the Energy Innovation Fund of the U.S. Department of Housing and Urban Development to Boston LISC's building-science partner, New Ecology Inc.—and with additional support from the Barr Foundation—the program is to be expanded statewide and cover low-income multifamily rental property owned by both for-profit and nonprofit owners.[1]

Collaborations

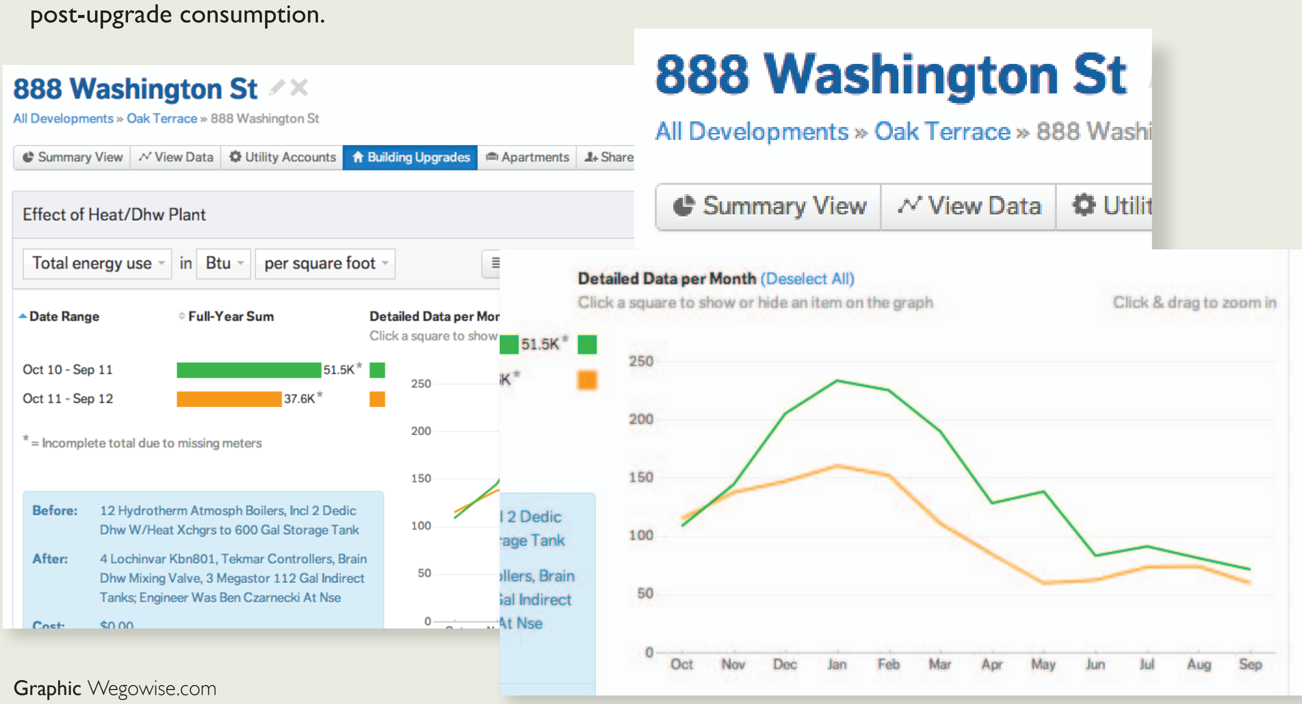
The CDC Green Retrofit Initiative helped build the capacity of 11 CDCs to understand energy use and implement upgrades in their existing affordable housing stock. That was done either through a direct grant to the CDC to pay for staff time to focus on retrofits or through access to a shared "energy manager" housed at New Ecology. The initiative did not provide funding for retrofit construction costs. The CDC staff and the energy manager would collaborate to analyze the energy use of the buildings, identify opportunities for energy efficiency, and with the help of LISC, find the appropriate funding for their projects. Boston LISC also provided technical assistance on an ad hoc basis and fostered a community of practice among the profes-

Photo Darlene DeVita Photography

The community room at Oak Terrace

What Is Wegowise?

Wegowise is an online energy- and water-benchmarking tool designed for multifamily buildings. Owners need to complete a one-time input of data, including utility account numbers and building information such as square feet and building type. Wegowise automatically downloads energy-use information from the utility providers and manipulates the data to provide the owner with trends, anomalies, and comparisons. Owners can track upgrades and monitor post-upgrade consumption.



Graphic Wegowise.com

sionals at participating CDCs.

The CDCs used Wegowise, an online tool designed for multifamily housing owners, to benchmark the energy and water use of the properties by inputting building information and utility accounts. (See "What Is Wegowise?")

Next, each CDC submitted applications to the state's utility-ratepayer-funded multifamily efficiency program for free energy assessments. Many of those assessments led to fully funded energy-efficiency upgrades. With LISC's help, the CDCs continued searching for other funding to address retrofit needs and eventually leveraged more than $4 million in construction money.

Altogether, the 11 CDCs own about 5,900 units of affordable housing, of which about 5,000 are fully benchmarked in Wegowise. In the first two years of the program (2010 and 2011), the CDCs implemented retrofits in 2,020 units of affordable housing.

Of 1,206 units (102 buildings) that have undergone retrofits and have weather-normalized postretrofit data available, the average targeted energy savings is 17 percent, ranging from a few projects with increased consumption (water and lighting retrofits) to 61 percent savings (new boilers). There was one retrofit that saved 43 percent on water use.

Statewide Expansion

The CDC Green Retrofit Initiative's third-party evaluation by community development consultancy Sussman Associates showed that a primary barrier to widespread energy upgrades in affordable multifamily housing is cost-effective expertise in building science, energy efficiency, and knowledge of the range of options for energy-conservation funding and financing.

Armed with insights from the evaluation, Boston LISC worked with New Ecology to leverage the most successful components of the Boston-area program and offer enhanced services to affordable-housing owners in an expansion called the Massachusetts Green Retrofit Initiative.

In May 2012, New Ecology was awarded a large HUD grant for the statewide initiative, nearly a million dollars. Boston LISC is providing comparable matching funding, primarily from a new $675,000 Barr Foundation grant.

The activities of the two-year Massachusetts Green Retrofit Initiative currently under way are as follows:

- benchmark utility use for at least 10,000 units
- identify energy hogs
- conduct energy assessments
- propose recommended conservation strategies
- work with owners to match funding to the recommendations

- manage installation of retrofits to at least 3,000 units
- monitor postcompletion building performance
- host periodic retrofit peer-group network meetings

A Case in Point

Tim Doherty started working at Asian CDC in 2007 as a project manager to help identify opportunities to develop and preserve affordable housing for Greater Boston's Asian American community. Now director of real estate, he has a portfolio that has grown significantly, most recently with the development of a new green affordable rental development in Quincy Center.

In late 2009, Asian CDC was actively searching for a new executive director. The staff was stretched thin with a new development under way and ongoing programs in housing counseling, youth engagement, and community organizing. The organization needed to forge another of the innovative partnerships for which it is known—this time with the Green Retrofit Initiative.

Asian CDC tapped Marty Davey of New Ecology, the shared energy manager provided through the Initiative, to input the group's building data in Wegowise and identify opportunities for savings. She zeroed in on Oak Terrace, an 88-unit development with family-sized, three- and four-bedroom apartments housing more than 300 residents in four adjoined buildings. One of the first developments in the country to utilize the Low-Income Housing Tax Credit (LIHTC), Oak Terrace was completed in 1995, but it was not performing efficiently in the 2000s.

"It wasn't exactly an energy hog, but it wasn't great," Davey says. According to Wegowise, the property performed slightly worse than similar buildings, but much worse than efficient buildings. "We could see there was an opportunity to increase efficiency."

Davey helped Asian CDC submit an application for the state's utility-ratepayer-funded multifamily efficiency program. It turned out to qualify for free electrical upgrades. Then Asian CDC was awarded a $10,000 green-planning grant from LISC's Green Development Center and The Home Depot Foundation to perform technical engineering studies on the domestic hot water system and cooling tower. In addition, the potential for a solar thermal installation was assessed, but given plans for a neighboring tower that would shade the roof, solar power was deemed impractical. Davey worked with Asian CDC to refocus the engineering study on the heating and hot water system and a plan for lowering utility costs.

Meanwhile, the City of Boston's Department of Neighborhood Development (DND) announced a limited amount of funding for energy-efficiency measures at affordable multifamily properties through the American Recovery and Reinvestment Act's Energy Efficiency and Conservation Block Grant program. The city would fund only those projects that had nowhere else to turn for retrofit funding. After a thorough analysis of the Oak Terrace reserves, Davey and Doherty developed a proposal to use a portion of the reserves in combination with the DND's energy-efficiency fund to replace 12 aging atmospheric boilers with four high-efficiency, condensing models, and a single, 600-gallon hot water storage tank with three 100-gallon indirect water tanks.

So far, the boiler replacement has resulted in a 27 percent reduction in natural gas usage and a projected annual cost savings of $22,000. Oak Terrace is now performing about 40 percent better than similar buildings and about 20 percent better than other efficient buildings in the Wegowise dataset. Not only have operating costs gone down thanks to decreased demand for energy, but the management company has to maintain and service only four boilers rather than 12, so maintenance costs will be lower for the long term.

Tim Doherty, director of real estate, and Janelle Chan, executive director of Asian Community Development Corporation, with the new boilers and hot water tanks at Oak Terrace.

Photo Darlene DeVita Photography

"We could never have accomplished this retrofit without the help of the Green Retrofit Initiative," says a grateful Doherty.

Elizabeth Glynn *is program officer at Local Initiatives Support Corporation in Boston. Contact her at eglynn@lisc.org.*

Endnote

[1] For an explanation of how New Ecology works, see Edward F. Connelly and Jessica Miller, "Making Affordable Housing Greener," *Communities & Banking* 20, no. 2 (spring 2009), http://www.bos.frb.org/commdev/c&b/2009/spring/Connelly_Miller_New_Ecology.pdf.

WHEN HIGH FINANCE MEETS AGE-OLD PROBLEMS

KRISTIN KANDERS
FEDERAL RESERVE BANK OF BOSTON

Preventing problems rather than trying to fix them afterward makes sense, yet even when prevention has been shown to work and save money, it often doesn't get supported or funded. That is why people are getting excited about an innovative approach to reshaping how government and nonprofits work together to deliver better social outcomes.

In a short amount of time, a pilot study under way at a prison 75 miles north of London has generated interest across the globe and will likely be getting its next test in Massachusetts. The experiment is to use a new financing tool—a "social impact bond," also called a "pay-for-success contract"—to bring market solutions to society's problems.

The way it works is the government contracts with nonprofits to deliver certain social outcomes, such as fewer incarcerations or reduced homelessness. If the nonprofit achieves those outcomes, which reduce government spending over time, the government reimburses the nonprofit and pays a return. If the nonprofit does not achieve the outcomes, then it is not repaid. For example, in the United Kingdom case, if the nonprofits can reduce reincarcerations of criminals by a target amount, the government will pay for the program costs.

The bond aspect comes into play if intermediaries are used as part of the model to raise funds from the private sector to provide working capital to the nonprofits. But given that there's the chance that government won't pay if the outcomes aren't achieved, the word "bond" is a misnomer. The investment is more like venture capital.

"Times are tight for everyone," says Alex Zaroulis, spokeswoman for the Massachusetts Department of Administration and Finance, which has requested proposals from nonprofits and intermediaries on pay-for-success contracts. "We don't want to put taxpayer dollars at risk for unproven programs." She and others within the Commonwealth are hoping to use social-innovation financing to learn faster about what works and to pay only for success, rather than the promise of success.

Show Me

Social programs are frequently under pressure to prove their value. Some, such as food banks, do not return savings to taxpayers and so are judged based on their civic and social benefit. Others however, such as those that reduce criminal behavior or reduce reliance on high-cost emergency care and services, can yield economic as well as social benefits. Even among these double-bottom-line programs, however, it is not always clear which programs are delivering results. What exactly are those results? Are they as good as they can be? If so, how can the program be replicated or scaled to provide still greater value? At a time when states remain leery of spending, given the damage from the recession, the stakes for nonprofits and program providers remain high. Want government funding for your program? Then show me the results, and by the way, show me the money.

You can't blame states for focusing on results. Just the opposite. Many on both sides of the political spectrum in the United States and abroad have praised impact investing as a responsible approach to better understanding and supporting social programs that work. And to put it mildly, the upside is significant. According to the Coalition for Evidence-Based Policy, which reviewed 10 major federal social programs for effectiveness, nine of the 10 major social programs were found to be ineffective.

The review authors warn, "It would be a mistake to jump to the conclusion that nothing works in social policy" since many components within these large social programs (for example, nurse-family partnerships within the early childhood program) do in fact work. It's just that when small pieces that work well get mixed together with those that don't work so well, the outcomes overall turn out to be pretty dismal. All the more reason to find out where the successes are and replicate those. Moreover, say the authors, citing a poverty rate of one in six Americans and poor U.S. progress on issues such as K-12 education, "the problems that these programs are designed to address have not gone away."

Social impact bonds, which move financial risk from taxpayers to service providers and focus on outcomes over outputs, seem well suited to address these problems. Andrew Wolk, founder and CEO of Root Cause—a nonprofit based in Cambridge, Massachusetts, that focuses on advancing innovation for social impact—sees the most potential in the bonds' ability to "force conversation among government agencies and between government agencies and nonprofits about outcomes." He believes that the contractual arrangements, although complex, represent an easier alternative than re-aligning all of the sometimes overlapping government programs that have touch points with at-risk or vulnerable groups of people. Citing a study on how Texas was investing $8 billion with 87 different nonprofits, he argues that the beauty of social impact bonds is that they will help to "change the rules of the game" about how public and private sectors can partner and assess performance.

Giving It a Try

Roughly 30 states and local governments are looking into social impact bonds, many spurred by federal pilot programs announced by the Obama Administration in early 2012. Massachusetts is the frontrunner in testing out the approach. The Commonwealth reached out to nonprofits and intermediaries in two issue areas: chronic homelessness and youth at risk of reentering the corrections system.

For the youth focus, Massachusetts is interested in providing services that can help to reduce recidivism among the roughly 750 youth who age out of the juvenile justice system each year. That rate, at 30 percent arrested and ultimately convicted for new offenses within one year of release, leads to high costs for the state: approximately $45,000 per inmate per year.

Molly Baldwin, executive director of ROCA, a nonprofit based in Chelsea, Massachusetts (with a replicated effort in Springfield providing intervention services to high-risk young people), says ROCA did "a lot of homework on scaling" their program and assessing different scenarios in preparing their proposal for the youth-justice issue. "It's great and really important for the state to say what they are doing, who they are serving, how they are making a difference, and moving financing in that direction."[1]

Mark Hinderlie, president and CEO of Hearth, a Boston-based nonprofit focused on ending elder homelessness, thinks social impact bonds are a brilliant idea for overcoming the lack of comprehensive and stable funding that constrains progress in his field. Having seen his organization's budget cut by $400,000 since 2008 because of state fiscal constraints, Hinderlie is hopeful that the bonds will help to provide needed services with fewer bureaucratic funding limitations. Referring to a Boston Health Care for the Homeless study, Hinderlie says health care costs the public two to three times what it would if a homeless person were in a stable housing arrangement. Providing stable housing "is a way to save money, get better outcomes, and help vulnerable people."

Hype and Skepticism

There is a lot of excitement around social impact bonds, but also skepticism. It's not clear yet how many programs will be able to demonstrate a return on investment to the taxpayer or how many have success metrics that can withstand rigorous third-party evaluation. Perhaps early childhood intervention effects, college completions, or hospital readmissions will be the next areas?

Time will tell how quickly the approach expands and also whether investors reliably recoup their capital. The latter will influence whether social impact bonds come to been seen as predictable instruments like municipal bonds or remain a niche product similar to venture philanthropy. If social impact bonds do find a footing among investors, they will have to overcome the perception some people hold that "financial innovation" is harmful sleight of hand. Top-rated tranches of early childhood intervention, anyone?

No one denies that social impact bonds are complex. And with that complexity, comes cost. The consulting firm McKinsey conducted a pro-forma analysis showing that the same program directly funded by government would take eight years to break even, but that through the social impact bond structure it would take 12 years. So why not just skip the middleman and fund programs directly? The answer from Tracy Palandjian—CEO and cofounder of the Boston office of Social Finance, a leading intermediary whose parent organization is involved in the UK pilot—is that political cycles, annual budget calendars, and short-term thinking have been barriers to government action on important social problems. By moving risk from the government to the private sector, proponents of social financing hope they will be able to bring innovative programs to scale in a way that the current system doesn't facilitate.

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Endnote

1 For background on ROCA, see John Ward, "Giving At-Risk Youth a Chance," *Communities & Banking* 22, no. 4 (fall 2011), http://www.bostonfed.org/commdev/c&b/2011/fall/Ward_Roca_at-risk_youth.pdf.

The Wisdom of Crowdfunding

JUANJUAN ZHANG
MIT SLOAN SCHOOL OF MANAGEMENT

Photo iStockphoto

Microloans, also known as microfinancing, peer-to-peer lending, and crowdfunding, started out as a means for individuals, such as impoverished borrowers who lack collateral and underprivileged women in third world countries, to provide for themselves. The way microloan markets operate is quite straightforward. There are no banks. Interested individuals come together on a microloan platform and directly borrow and lend with each other.

During the recent global slowdown, the application of microloans expanded to fill the void created by banks' increased fiscal conservatism. In its current form, microfinance not only provides borrowers with access to capital, but also serves as an investment vehicle for individuals without substantial means.

New research into one large microloan market demonstrates that disadvantaged people can be quite successful in obtaining loans this way, and that a behavior known as *herding* can help lenders identify which borrowers are the best risks.

From Lun Hui to Prosper.com

Concepts relating to microloans can be traced back to the 4th century, when the first private credit union, called "lun hui," was founded in China.[1] In the West, the idea surfaced in the 18th century, when Jonathan Swift created the Irish Loan Funds.

In fact, microlending has been practiced for centuries all over the world, as demonstrated by "susus" in Ghana, "chit funds" in India, "tandas" in Mexico, and "pansanaku" in Bolivia. Modern applications emerged in the 1970s, the Grameen Bank in Bangladesh being the most prominent example.[2]

As with much else, microlending truly blossomed when the Internet connected people in ways never before possible. Many websites now exist to match lenders with all sorts of borrowers, whether they be businesses, charities, artists, or just individuals who need liquidity.[3] In fact, with the help of the Internet, microloans are projected to reach $5 billion by 2013.[4]

Such growth calls for more research on how efficiently microloan markets allocate capital. After all, individual lenders may lack access to the same credit-screening machinery available to institutional lenders, and borrowers seeking alternative funding sources may be at higher risk for default. The question becomes, are individuals able to make wise lending decisions in a microloan market?

To help answer that question, I conducted a long-term field study with Peng Liu of Cornell University on one version of microlending, using data from a web company called Prosper.com.

The company opened to the public in February 2006 and quickly grew to become the largest microloan market in the United States. By September 2011, Prosper.com had registered 1.13 million members and posted more than $256 million in loans. The study tracked a random sample of 49,693 borrower listings. For each listing, the borrower's characteristics were recorded and funding progress was monitored.

Whenever a borrower requests a loan on Prosper.com, she must create a listing that specifies the amount requested, the maximum interest rate she is willing to pay, the purpose of the loan, and her credit profile, including an official credit grade assigned by Prosper based on her Experian Scorex PLUS credit score. Additionally, the borrower may list any endorsements from other Prosper members, may provide her Prosper group membership, and may upload a personal photo. A lender then decides whether, and by what amount, to fund a listing. Only a fully funded listing is regarded as a loan. The loan is unsecured and is to be paid back over 36 months.

The functioning of Prosper differs from traditional bank-mediated financial markets in three important ways. First, Prosper represents a high-risk, high-return investment platform. In our sample, on average, borrowers are willing to pay an interest rate of 17.7 percent. Fifty-two percent of borrowers are associated with a high-risk credit grade (which corresponds to an Experian Scorex PLUS credit score lower than 560).

Second, some lenders may have private information about a borrower's creditworthiness. For example, a Prosper borrower claimed in her statement that she was "still making payments every month," yet there was a past judgment on her credit report. She requested lenders to contact her "because of some of what is going on." By calling this borrower or acquiring information about her through Prosper user groups, a Prosper lender might find out that she received a poor credit grade because of nonrecurring circumstances, or that she had made solid plans on how to pay her debt back on time. The lender could thus gain some private information about how much trust to give the borrower.

A final difference from traditional bank lending is that a Prosper borrower is typically funded by multiple lenders, with each lender's decisions (including the timing and amount) publicized on the website.

Herding among Lenders

Interestingly, those features of Prosper give rise to imitative lending behaviors among the lenders—herding. Potential lenders consider that predecessors' lending decisions are justified by private information—gleaned, for example, from a phone call to the woman with the past judgment to assess her creditworthiness. So they decide that imitating predecessors' decisions would be a wise investment strategy. This herding effect is so prominent that a powerful indicator of a borrower's funding success is her first-day funding outcome—borrowers who ended up being fully funded would have raised $2,095 on day one on average, whereas those who failed to be fully funded would raise only $44.

The most striking finding, however, is that lenders seem to be savvy enough to know *when* to follow the herd. Here is how it works. Suppose two borrowers both raised $1,000 on day one. The first borrower has an AA credit grade, and the second a high-risk credit grade, but they are otherwise similar. From a subsequent lender's perspective, first-day lenders do not need to rely on favorable private information to justify funding an AA borrower. However, if first-day lenders are willing to fund a high-risk borrower, it is likely that someone studied the borrower and discovered the particulars of her high-risk situation and determined that she is actually trustworthy. The same $1,000 would then carry more information, which leads to a more influential herd that subsequent borrowers are likely to follow.

Indeed, we find that Prosper lenders are more inclined to herd on well-funded listings with obvious defects like poor credit grades and higher debt-to-income ratios.

Assessing Funding Outcomes

The findings are reassuring. Although individual lenders do not have the credit-assessment capability of banks, they do have a powerful investment tool they can resort to—observations of others' lending decisions. They wisely choose when to follow the herd and, in doing so, incorporate others' private information into their actions. Most significantly, this decision strategy actually leads to good investment outcomes. Tracking the performance of loans in our sample, we find that a higher herding momentum on a loan is associated with a lower default rate, after controlling for other loan characteristics.

On top of the question we set out to answer, an interesting fact that arose from this research is that disadvantaged borrowers fared well on Prosper. Intuition would suggest that borrowers with poor credit histories or higher debt ratios would not get funded, as crowds would flock to the safer options and riskier listings would struggle to gain traction.

However, our research demonstrates that individual investors are able to analyze each borrower's situation separately and take the time to investigate the reasons that have led to the borrower's current predicament. An institutional lender is unlikely to allocate resources for such personal analysis. Once early lenders make an investment in a listing, subsequent lenders are able to read a sign of trust into that action. In short, when lenders invest time up front, they in effect lend more than money to a disadvantaged borrower: they lend credibility.

As a financial tool, microlending is still relatively young, but there are indications that it will have a significant influence in the development of important sectors within both developed and underdeveloped nations. If harnessed properly, microlending is likely to pick up some of the slack from conventional banks postrecession and become a powerful tool to spur growth and eliminate inequality.

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