

WHY LOW-INCOME COMMUNITIES NEED THEIR OWN DEVELOPMENT
FINANCIAL INSTITUTIONS: A CASE STUDY OF UPHAM'S CORNER,
DORCHESTER, MASSACHUSETTS

by

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Why Low Income Communities Need Their Own Development Financial Institutions:
A Case Study Of Upham's Corner, Dorchester, Massachusetts

by

Joseph D. Sternlieb

ABSTRACT

This thesis explores whether conventional financial institutions serve the needs of low-income communities. If not, it seeks to determine how alternative community development financial institutions (CDFIs) can better meet their capital and service needs.

The analysis in this thesis is based on the results of two inquiries. The first is a three part survey which assesses the capital and financial service needs of the Upham's Corner neighborhood in the Dorchester section of Boston, Massachusetts. The second is an inventory of the capital and financial services currently provided by local banks, check cashing stores, and other non-conventional financial service providers. Public, quasi-public, and private not-for-profit organizations are also included in this inventory.

The results of these two investigations are compared to define a set of public and private capital gaps between the communities needs and available financial services. These gaps are considered in light of changes in the way conventional lending institutions serve communities, and efforts to compensate for the negative impacts of these changes.

I find that conventional financial institutions--which are heavily regulated and profit-driven--are not structured to provide many of the services Upham's Corner's residents and businesses most need. I conclude that this creates capital and institutional gaps that can best be filled by alternative (CDFIs) with development missions.

Criteria for creating new CDFIs are outlined, and the strengths and weaknesses of five different CDFI models are described including, community development banks, community development credit unions, community development loan funds, microenterprise loan funds, venture capital funds, and check cashing stores.

Based the findings of this study, I recommend the creation of a multi-service CDFI in Upham's Corner that aggressively creates new businesses, jobs housing and commercial projects for the community's low-income residents and small businesses.

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INTRODUCTION

There is clearly a problem in urban America. While it may have taken the Los Angeles riots to stir some people to this conclusion, for those who live in distressed inner city-neighborhoods, the problems of persistent poverty, joblessness, violence and urban blight take a daily toll.

Decades in the making, these problems have been caused by enormous economic, sociological, and demographic changes that have effected much of the world. Thirty years of stop and go efforts to revitalize American inner-city neighborhoods have yielded mixed results for these neighborhoods, but a wealth of information about appropriate interventions to create healthier communities.

The question of what constitutes a healthy community is central to figuring out how best to address community problems. Residents of a low-income community might list solving crime problems, increasing after school programs for youth, and improving schools as the elements that would make their community healthy.¹ Urban planners are more likely to say that creating a stable economy that provides jobs for residents and enables them to accumulate assets, will give them a long-term stake in, and are the necessary elements of, a healthy community (Abrams xxvi).

In trying to build healthier communities, one of the most discussed factors in the community economic development literature is the role that capital, and the institutions that provide capital, play in low-income communities (References). Bringing capital and financial institutions back into inner-city neighborhoods is a key component of any solution to these problems.

¹ These were the top three answers recorded by the Upham's Corner Healthy Boston Survey which will be discussed more fully in chapter two.

Communities need more than just capital to support housing, commercial revitalization, businesses that create the jobs, and economic multipliers that enable people to put down roots and have a stake in their community. They also need development institutions that can do strategic planning and can see the social benefits of projects that conventional bankers might never recognize. Lack of sufficient capital and development institutions inhibits community revitalization from occurring and condemns neighborhoods to stagnation and decline.

Capital for business and housing development has traditionally come from financial intermediaries, such as banks and thrifts. Capital has traditionally been used by local developers and entrepreneurs who have developed real estate and businesses to serve their communities.

In recent years, banking institutions have changed the way they address the needs of communities in general, and low-income communities in particular. Banking institutions have either ignored low-income communities, or they have attempted to provide limited services to the few people and businesses who meet their qualification standards. In both cases, low-income communities have not received the private capital or institutional support they have needed to become economically or socially healthy. Moreover, these communities have suffered from a dearth of good developers and entrepreneurs who can put available capital to good use. The capital problem that communities face, therefore, is not just of supply, but of demand as well (Henze, Nye and Schramm. Litvak and Daniels).

This thesis argues that low-income communities are not only generally under-served by conventional financial institutions, but that these institutions, as currently structured and oriented, may never be able to meet low-income community's real financial or development needs.

Although many projects in these communities, when taken on an individual basis, may

not yield the private returns that banks require, they may provide high social benefits that justify their receipt of capital, and justify local development finance institutions to both identify these projects, and provide them with capital.

This conclusion is based on an examination of the nature of unmet financial and development needs in low-income communities and an assessment of whether or not existing institutional models are the best able to meet them. If not, it suggests that alternative institutions must be created to meet these needs, and describes what alternative institutional models look like and the criteria used to determine if and how they should be designed.

Many of the arguments in this thesis are based on the concepts of public and private capital gaps, and institutional gaps. Public and private capital gaps were first described by Stephan Michelson, Belden Daniels, Lawrence Litvak and others in the late 1970's. Private capital gaps occur when investments that have normal risk and can pay a normal (private) return are not being made by existing--private--institutions. Public capital gaps occur when investments with high social returns/public benefits are not made because they have higher risks and/or lower private returns than required or sought by private investors.

In addition to capital gaps there are gaps between the institutional needs of low-income communities and the capacity of existing institutions to meet these needs, which I have called "institutional gaps." Because low-income communities are often missing many of the ingredients needed for economic development to occur, including capital, entrepreneurs, developers, and planners, institutions are needed that can bring leadership to the community and coordinate many of these tasks.

This thesis begins by describing in chapter one how changes in the American banking industry over the last twenty years have negatively impacted low-income communities.

In order to ground this thesis in the realities of a low-income community, chapter two looks at the specific needs of one community, Upham's Corner in the Dorchester section of Boston, Massachusetts, so that the lessons here might be applied to other similar areas. Upham's Corner provides an excellent case to study the capital and development needs of low-income communities that are not (and possibly cannot be) met by conventional banks. It is unusual because it is home to several conventional banks, but is among Boston's lowest-income communities and greatly needs redevelopment.

Chapters three, four and five examine specific "gaps" between demand and supply of capital and financial services in three areas: consumer retail banking, business lending and home mortgages. In each area I found private, public, and quasi-public institutions that have and have not met Upham's Corner's needs, and the existence of different types of capital gaps.

My study of Upham's Corner's consumer, business, and mortgage needs found both capital and institutional gaps that conventional institutions are not, despite their good intentions, best suited to fill. Many of the capital gaps I identified are public in nature, and the missions of conventional institutions are incompatible with filling public gaps. Further, because of the way they are regulated and operated, conventional banks incur higher costs to provide some services than do other types of financial institutions. They probably cannot, therefore, be structured to serve every segment of a low-income community. This is not to say that most banks cannot do a better job of designing programs specifically for low-income people. They can. However, I found that there is a floor beneath which even better designed bank programs cannot provide services, but where a large number of Upham's Corner's residents and businesses have needs.

Chapter six discusses this conclusion and suggests a set of criteria to be used in deciding whether or not to create an alternative community development financial

institution (CDFI) to fill these gaps, and how a CDFI should be designed to best meet its community's needs. Chapter seven describes the strengths and weaknesses of various CDFI models that are now being used to close financial and institutional gaps in low-income communities. And chapter eight suggests a possible model that the Dorchester Bay Economic Development Corporation (DBEDC)--the Community Development Corporation in Upham's Corner that asked me to explore the possibility of their starting a CDFI--can create to meet Upham's Corner's particular needs.

I conclude that there are fundamental differences between conventional financial institutions that may lend to community development projects, and community development institutions that have the financial resources to stimulate, create, and invest in strategically planned community projects. Despite the growing number of alternative lenders and service providers in and around Upham's Corner, the strategic economic development that is needed to make this a healthier community is unlikely to occur until an organization or institution is established that links needed strategic development programming with the provision of financial services and capital.

The findings of this thesis support this conclusion and suggest appropriate actions to provide the capital and services low-income neighborhoods need to address many of their problems.

1 FINANCIAL INSTITUTIONS AND LOW-INCOME NEIGHBORHOODS

In 1982, Daniels, Barbe and Kwass warned that the foundation of the American economy was being threatened by changes in the financial and banking system that (in 1982) would have, (and in retrospect had), major implications for communities across the country.

we are seeing the undermining of the very structure of the economy that made possible the individual enterprise, the diverse and independent small communities, and the self reliant people who have characterized the United States. This social and economic structure has been painfully hammered out over generations, and once gone, it can never be recreated (Daniels et al. 1982, 1).

Capital and financial institutions are among the most important ingredients of successful community development. Communities that lack capital are unable to invest in any of the job or wealth-creating activities that can lead them from poverty to good health.

This chapter examines the structural and regulatory changes that have taken place in the American banking industry over the last generation, including banking consolidation, which has created fewer and larger institutions, and changes in household savings and investment behavior. Starting with the regulation of financial institutions in the 1930's and ending with their deregulation and then re-regulation in the 1980's, these changes have worked together to make it more difficult for small community financial institutions to raise and invest long-term capital, and to serve the capital and financial service needs of the communities in which they are located.

BANKING IN AMERICA

Money was invented to facilitate the exchange of goods and services in the marketplace. When some people had a surplus of money while others had a temporary shortage, the idea of banking was born.

A bank is a financial intermediary. In its simplest terms an intermediary is an institution that borrows money from people who have an excess, and lends to (or invests with) people who need money and have the ability to pay it back in the future. The act of borrowing money in order to lend it is called intermediation. Intermediaries earn money on the interest rate spread between what it costs them to borrow money from people and what they charge to lend it.

Over the last two hundred years intermediation has evolved into a complex system of both specialized and multi-purpose institutions. In this century dramatic changes took place in banking laws with the creation of the Federal Reserve in 1913, during the Great Depression in the 1930's, and again in the 1970's and 1980's. In the long period between the 1940's and 1970's there were relatively few banking crises and little remedial banking legislation.²

In the 1930's Congress passed banking reforms in response to the massive bank failures of the Great Depression. Among these reforms, the Glass-Steagall Act of 1933 set the maximum interest rates that banks could pay to borrow funds. Interest rate caps were imposed in order to decrease interest rate competition which was believed to have driven up the speculative lending that led to the banking crisis.³ In order to encourage deposits in institutions that lent primarily for home mortgages, Congress set the maximum rate for Savings and Loans at 1/4 percent above the rate commercial banks could pay.

Depression-era reforms also separated intermediary's functions. Regulatory walls were

² This period was marked first by increasing numbers of thrift institutions (including credit unions) and then a decrease. At the same time, "year after year, no more than a handful of the nation's fourteen thousand banks failed, usually six or eight a year and sometimes none" (Greider, 1987). See charts 1-3.

³ The cap on interest rates was known as Regulation Q and was on the books in various forms until the mid 1980's. (Ritter and Silber)

erected between the services that could be provided by banks, savings and loans, securities brokers, and other financial service providers. Each type of institution was assigned its own niche and protected (and prevented) from competing with other types of institutions. It was also during this period that the federal government created the deposit insurance program for banks and Savings and Loans (Ritter and Silber).

Government regulation of intermediation was initially designed to stabilize the industry and protect depositors, but it also sought to ensure that desirable banking functions, such as investment in home mortgages, took place. Regulations required all banks to acquire a state or federal charter to operate, and charters required depository institutions to serve the needs of the communities in which they were located.

In the 1970s Congress passed the Community Reinvestment Act (CRA) as well as monitoring legislation,⁴ in order to press banks to fill private gaps in low-income communities. The extent to which Congress intended to force banks to fill public as well as private capital gaps can be debated. However, the Community Reinvestment Act of 1977 states that "every commercial bank and thrift institution has an affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods" (Bradbury et al. 1989). Some community bankers, such as South Shore Bank Vice President Joan Shapiro, believe that "the concept of community banking is at the core of our banking laws and industry" (Shapiro speech).⁵ Congressional efforts to ensure that banks did not abandon low-income communities, enabled some community-minded bankers to acquire bank charters, and other activists to challenge banks to be better

⁴ Such as the Home Mortgage Disclosure Act (HMDA) of 1977.

⁵ In fact, in its decision not to allow the original South Shore Bank to move in 1972, the Comptroller of the Currency said that the bank had "failed to show a persuasive reason for abandoning its service area." This enabled the current bank owners to come to terms with the original owners.

community service providers.⁶

Regardless of Congress' intent, most of the reforms of the mid 1970's through 1980's did not cause banks to be more community or civic-minded. In fact, deregulation had quite the opposite. During this period the walls between the different type of institutions were lowered or eliminated and the maximum interest rate caps for banks and thrifts were relaxed. Deposit insurance was increased from \$40,000 and \$100,000 per account, and the Reagan Administration reduced the number (and rigor) of bank and thrift regulators (Ritter & Silber 89).

These changes set off a wave of disintermediation.⁷ In order to counter this wave, banks and thrifts began aggressively competing with money market and mutual funds for deposits. In order to compete they raised the rates they were willing to pay to depositors and made riskier loans and investments--that would yield higher returns to cover their higher borrowing costs. Community-based thrifts that had once received long-term deposits (savings accounts) and made long-term loans in their communities were now borrowing short-term money in the form of certificate of deposits (CDs), and looking outside of their communities to make short-term, high return, high risk loans.

⁶ According to Ron Gryzwinski, a founder of the South Shore Bank in Chicago, "the 1970 amendments to the Bank Holding Company Act directed the board of governors of the Federal Reserve Bank (FED) to define permissible activities for bank holding companies. Among the interpretations of its own regulations the FED issued an opinion that banks possessed a unique combination of financial and managerial resources, making them particularly suited for a meaningful and substantial role in remedying [the nation's] social ills" (FED opinion quoted by Grzywinski).

⁷ Disintermediation is what happens when depositors take their money out of intermediaries and invest them directly in stocks, bonds, mutual funds, and the money markets which pay higher returns. Disintermediation significantly changed the way American households saved money, and decreased the financial stake households had in their own communities (Ritter and Silber).

Because thrifts and S&Ls no longer held most of their portfolio loans in local home mortgages, they no longer had the same economic stake in their own communities and no longer played the stabilizing roles they were originally chartered to play.

It was the highly speculative, highly risky lending and investing by banks and thrifts in the early and mid-1980s that first supported the incredible bonanza and inflation in Boston's (and many other US city's) real estate market. When the real estate market crashed in the late 1980's so did the banking and thrift industries that had pumped in all the money.

The Savings and Loan crisis, at a cost of over \$500 billion to the taxpayer, and the banking crisis, the full cost of which has yet to be tallied, were caused largely by banks, thrifts, and S&Ls making high-risk loans at high interest rates that could not be repaid (Waldman, Greider, 1989).

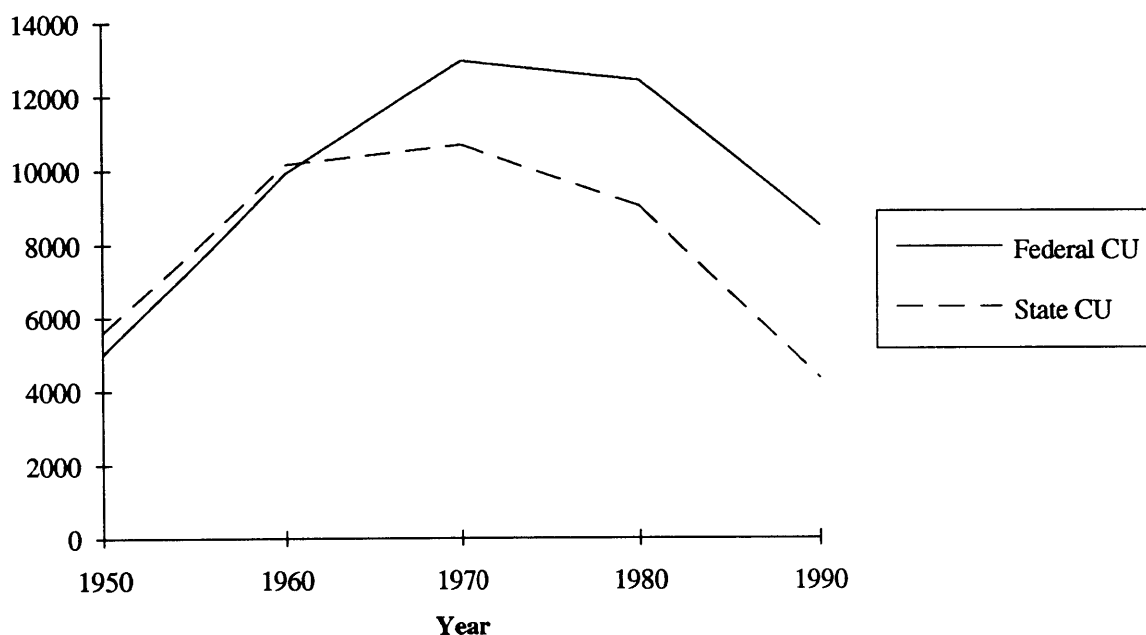
In 1982 both the Counsel For Community Development and Wharton Econometric Forecasting predicted the coming bank and thrift failures and offered regulatory prescriptions to minimize their impact while providing for the credit needs of their traditional markets. Congress, unable or unwilling to see the coming crisis, did not pass legislation to address the underlying problems in the banking system. Instead, they allowed regulators to pursue a course of consolidating failing banks. This consolidation, which continues today, has made banks bigger, more bureaucratic, and less connected to the communities in which their branches are located.

This trend is directly at odds with the concept of serving a primary service area and has had negative impacts on the way communities access capital for development. As Bendick and Egan point out "...as smaller banks are merged in the ongoing process of bank consolidation, discretionary loan decisions are often taken away from local bank managers and centralized and depersonalized in a system of "formula lending" (27).

The regulations passed by Congress in the late 1980's and early 1990's have been in response to the damage that was done to and by the banking and thrift industries. Stuck with an unprecedented bill to bail out failed institutions--once their insurance funds became insolvent--Congress moved to re-regulate. Regulators were told to ensure that every bank loan made had low-risk and was well-secured. Banks retrenched and stopped lending money not only to real estate projects but to businesses as well.⁸ The credit crunch, as it has come to be called, is the latest consequence of what has happened in the intermediation industry over the last 15 years.

Chart 1-1

Number of Federal and State Credit Unions in US 1950-1990



⁸ Part of the phenomenon of a credit crunch for businesses and real estate is cyclical. "Traditionally, banks buy government securities during recessions, when private loan demand is slack, and then sell them off during business recoveries, when private loan demand is vigorous. Thus bank holdings of government securities show a counter cyclical pattern..." (Ritter and Silber, 1986) The fact that bank holdings of government securities continues to be high in April, 1993 despite the recession's end, indicates that the high degree of regulation may play a significant part in the credit crunch (Zuckoff, Boston Globe, 2/9/93 57).

Source for charts 1-1 - 1-3: Statistical Abstract of the US, 1970, 1972, 1980, 1982, 1992.
U.S. Census Bureau, Washington, DC.

Chart 1-2 Number of S&Ls in the US 1950-1990

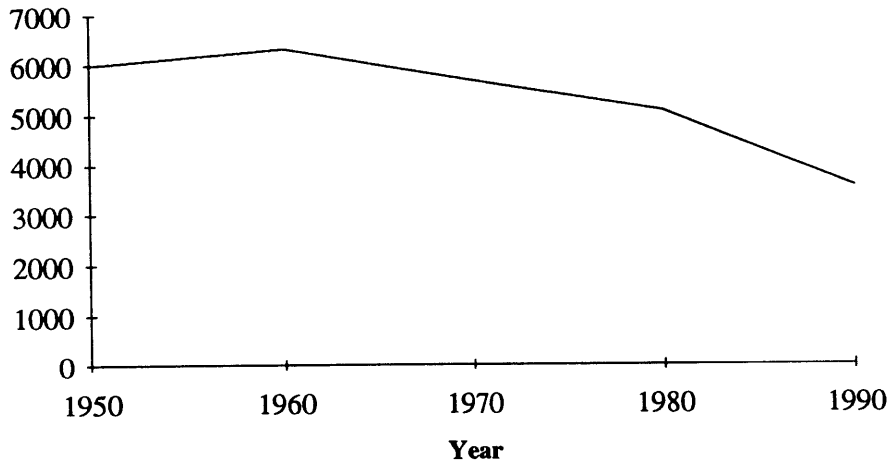
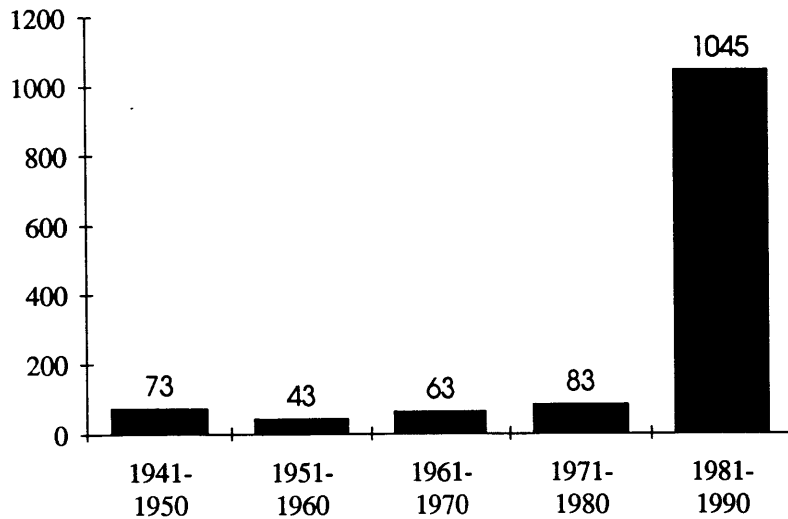


Chart 1-3

**1950-1970 "Banks Closed due to Financial Difficulties.
1971-1990 "FDIC Insured Banks Closed or Assisted Due to Difficulties and Problem
Banks.**



BANKING IN NEIGHBORHOODS

The evolutionary changes in intermediation have probably been felt most heavily in low-income neighborhoods. Prior to the 1960's some low-income communities were served by small thrifts, credit unions, and neighborhood oriented banks. Other communities, particularly minority communities, may not have been served at all.

The changes in neighborhood demographics in many American cities, coupled with changes in the national capital markets and rising sensitivity to anti-minority bias in lending, has made it increasingly clear that many low-income communities--especially minority communities--are under-served by banking institutions. Moreover, recent studies by the Federal Reserve Banks in Boston and Atlanta have identified discrepancies between white and minority access to home mortgages from existing institutions (Bradbury 1992, FED Report, 1989).

The real estate bonanza of the 1970's and 1980's was partially catalyzed by the regulatory reforms, and banking response that preceded it. The boom, however, was not equally distributed throughout the region or the city of Boston. Many poor neighborhoods experienced increased real estate prices but no significant reinvestment to improve physical or social conditions.

The banks and thrifts that served low-income communities in the mid 1980's were caught up in the frenzy to make high yielding loans--increasingly found outside of the communities where their branches were located. The lending that took place in low-income neighborhoods was often in the form of first mortgages on price-inflated homes or second mortgages. For the most part however, mortgage lending remained outside the reach of low-income people.

COMMUNITY DEVELOPMENT RESPONSES

Community development-oriented people and groups have responded to the changes in intermediation in two ways, by pressuring banks to be better community lenders and by starting their own community development financial institutions (CDFIs). In the late 1970s groups like the Massachusetts Urban Reinvestment Action Group (MURAG) used the newly passed Community Reinvestment Act of 1977 and the Home Mortgage Disclosure Act of 1975⁹ to challenge existing banks to live up to their community responsibilities. In many respects, several Boston banks have responded positively to these challenges.

1. PRESSURING CONVENTIONAL BANKS

According to Kevin Winn, the former Shawmut Bank branch manager in Uphams' Corner and now the bank's community outreach officer, the commitment of banks to low-income communities is cyclical. "CRA was hot in the mid-70's and dead in the late '70's, hot in '84-'85 (due in part to the Atlanta FED study) and dead by '89." Winn thinks that the banking industry's attitude towards CRA has also changed over the years. "In the mid-70's it was the cost of doing business. Today, bankers are more sensitive and many believe that this is what should be done to make communities stronger" (Winn interview).

The two commercial banks with branches in the case study area of Upham's Corner have both taken up the challenge of the CRA. Bank of Boston has created the First Community Bank--a bank within a bank--which operates 12 branches in low-income areas and offers services to meet the needs of low and moderate-income customers. Shawmut has created a special Community Investment Unit and has designed a number of programs to serve low-income customers.

⁹ HMDA was strengthened by Congress in 1989.

It is important to note that these innovations have occurred during a deep recession while banks have been receiving contradictory directions from regulators. On the one hand banks have been told to be cautious and increase their loan loss reserves and minimize risk in their portfolio's. On the other hand, they are supposed to be doing more aggressive community development lending, which they have traditionally considered risky.

Despite new commitments to community investment, a commercial bank's vision of community lending does not reach all who need access to capital. Commercial banks tend not to make business start-up loans, loans below \$50,000, or any type of un-collateralized loan. When individuals or businesses need such loans they have gone to non-traditional lenders such as family, friends, or possibly quasi-public institutions.¹⁰ In some cases, needed loans have simply not been available.

2. CREATING COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

When banks have been unwilling or unable to meet the challenges posed by low-income communities, community-oriented people and organizations in some areas have created new, independent financial institutions that are dedicated to doing community development. Some of these groups believe that the CRA can only get conventional banks to fill private gaps, and that they are inappropriate institutions to fill public gaps (Jones interview).

The idea of community-based financial institutions (CDFIs) is neither new nor radical. The fictitious Bailey Building and Loan in Frank Capra's movie It's A Wonderful Life exemplified the best of what a community-based lender could accomplish through local home and business loans. Community development lending is what thousands of small thrifts and commercial banks did for generations, even if this is not what they

¹⁰ In their 1985 study of small business finance, Dunkelberg and Scott found that only 7 percent of businesses got start-up funds from institutional lenders.

called it. The social and economic problems that communities have faced over the last generation, coupled with the globalization of capital markets, and consolidation of the banking industry, have created a new need for community development financial institutions. These new CDFIs have approached lending as part of a development strategy to improve the economic and social conditions of communities.

The South Shore Bank in Chicago was purchased and reconfigured in 1973 specifically to stabilize and redevelop one community. Today it is the largest and most famous success story in community development banking, but has few peers.¹¹ The only de- novo community development bank in the nation is the Community Capital Bank in Brooklyn, New York, which opened in January, 1991. It took six years to create Community Capital Bank, and although it is growing, it is among the smallest banks in the nation with deposits of just over 10 million dollars and outstanding loans of approximately \$7 million as of October, 1992. Moreover, unlike the South Shore Bank which is focused on redeveloping one neighborhood, Community Capital is a citywide bank whose impact will be harder to measure than if it had a smaller geographic service area.

Because of the difficulty and high expense of starting a chartered community development bank, many groups have opted to create credit unions or revolving loan funds rather than banks. The National Federation of Community Development Credit Unions (NFCDCUs) in New York and the National Association of Community Development Loan Funds (NACDLFs) in Philadelphia are two of the more prominent community development finance trade associations.

¹¹ In many ways South Shore Bank is more like an S&L than a commercial bank. It concentrates on lending in one small market, and mostly to housing. Although it has only about \$250 million, this is a perfectly efficient size for a local bank and, as I will discuss in later chapters, the maximum size for a bank to best serve local communities is no more than \$500 million which is also considered small by industry standards.

The NFCDCU works with regulated and insured institutions. The NACDLF, by contrast, works with unregulated and uninsured intermediaries to support and professionalize emerging loan funds. Both organizations are dedicated to helping expand the number of alternative financial intermediaries and to the democratization of capital (NFCDCU and NACDLF publications).

In addition to these associations many other groups and individuals are working at the local, state, and national levels to expand opportunities to create community-based development financial institutions. Peer lending models based on the Grameen bank of Bangladesh and micro-credit programs started by municipal governments, are popping up around the country.¹² Many of these groups and organizations are also actively lobbying Congress to rewrite banking laws so that community groups have greater ability and flexibility to open their own financial institutions.

SUMMARY

Low-income communities across the nation have been adversely affected by changes in the intermediation process. During the 1980's household savings that might once have remained in community financial institutions to support local development were circulated into a system that looked for high risk, high return investments, that were most often found outside of these communities.

In addition to these changes, for much of this century, federal banking policy favored Thrift and Savings and Loan institutions that collected long-term savings from depositors and reinvested that money back into mostly long-term loans in the same community. This "result based" policy gave way to market based policies of

¹² Examples include Working Capital in Massachusetts, The Good Faith Fund in Arkansas, the Women's Self-Employment Project in Chicago and Coastal Enterprises in Maine, which will be discussed in chapter seven.

deregulation which no longer favored long-term community investment.

The Savings and Loan and banking crises of the last decade and the consolidation of the banking industry have further cut off low-income communities from the capital they need to develop housing, businesses, jobs, and commercial centers.

In response, the government has passed laws and pressured banks to become more involved in community investment. There is some question about the ability of traditional conventional financial institutions to provide low-income communities with all of the services and products they need. Their structures and motivations can be stretched to reach further down the economic ladder than they have been comfortable doing, and they can certainly fill private capital gaps, but it is doubtful they can reach those people and businesses at the bottom of the economic ladder who are most in need of assistance. This belief has led to the creation of community development financial institutions, which over the last several years have provided communities across the country with both the capital and the strategic development institutional support they need for development.

2 THE UPHAM'S CORNER NEIGHBORHOOD

In order to study the role financial institutions play in meeting the capital and service needs of low-income communities, it is necessary to understand what those needs are, the resources that are available, and the types of strategic and institutional responses that can fill the gaps between the two.

In order to make this study both relevant and useful to potential community development bankers, I have decided to look at one low-income neighborhood in detail and to draw lessons from that community to guide decisions in similar areas.

This chapter explores the history and characteristics of the Upham's Corner neighborhood and the surrounding North Dorchester community in Boston, Massachusetts, and describes why it is well-suited to support a Community Development Financial Institution.

I chose Upham's Corner for my case study after learning that David Knowles, the director of the Dorchester Bay Economic Development Corporation (DBEDC)¹³ was exploring the possibility of starting a community development financial institution in this community. I wanted to investigate the issues surrounding the financial needs of a low-income community and the opportunities to start new development financial institutions.

Because there are three bank branches located in the center of Upham's Corner, I believed it offered an excellent opportunity to assess how well banks met the needs of this mostly non-white and low-income community. The presence of so many

¹³ The Dorchester Bay Economic Development Corporation is a community development corporation that was created in 1979 to strengthen and stabilize neighborhoods in North Dorchester through the creation and rehabilitation of housing and commercial real estate.

financial institutions in a low-income community is a unique situation, thus caution must be taken in directly applying my conclusions about Upham's Corner to other communities. However, many of the lessons I have learned from Upham's Corner should be very helpful in discussing the financial services that all low-income communities need.

I found Upham's Corner to be a study in contrasts and hard to define succinctly. On the one hand it is a very low-income community with a large number of urban problems. On the other hand it is served by a wealth of organizations and institutions that are committed to making it better, and has a fairly stable, if dilapidated looking, commercial district.

The opportunities for developing successful community-based institutions in any location seem to rest on the existence of a stable and committed population base. Here Upham's Corner is stronger than other, similar, communities in the Boston area that have weathered tough times over the last few decades. It has a good multi-ethnic distribution of home owners and about the same resident turnover rate as the Boston average. Many local residents are actively involved in improving the health of the community which makes this a suitable environment to support new community development institutions.

HISTORY

North Dorchester, and the Upham's Corner neighborhood at its center, is a diverse low-income community. Over the past forty years it has gone through significant changes but has weathered these changes more favorably than other Boston neighborhoods.

Upham's Corner is named for Amos Upham who owned a store at a rural crossroads in Dorchester around 1800. Over the course of the 19th century the area first

developed as the home of many of the Boston area's wealthy new families and later as a major commercial center. It is considered to be the site of the first supermarket in the United States and at one time was the intersection for five different street car lines which made it accessible to people from all over the area.

For the first half of the 20th century--the days before suburban shopping centers and the ubiquitous private automobile--Upham's Corner was the largest neighborhood regional shopping district in the area, serving residents from surrounding Roxbury, Mattapan, Dorchester, and other Boston neighborhoods. Local residents lived within walking distance (or a short street car ride) of over 300 commercial establishments (Telesis 1981).

The factors which helped make Upham's Corner the region's largest shopping district in the 1920's and 1930's--its centrality and access to public transportation (first horse drawn trolleys, then street cars)--meant that the commercial district benefitted from serving far more shoppers than actually lived in the immediate community. This was not the case for most other Boston neighborhoods, whose commercial districts served only local residents (Levine, 1988).

Today, Upham's Corner is a far different place. While in 1930 it was home to over 300 businesses, by 1970 this number had fallen to 180, and today, it is about half that number.¹⁴ A 1981 Telesis Report for DBEDC points out,

Comparisons with other neighborhood commercial centers, described in the next section [of their report], indicate that Upham's Corner may have contracted to a size suited to its current role of a neighborhood commercial district. In 1950 Upham's Corner had 40-90% more commercial establishments than the four neighborhood commercial centers we have chosen for comparison [West

¹⁴1991 Mt. Auburn Study for PFD, pg. 9 cites the 1981 Telesis study for DBEDC as its source. As further evidence of decline it also mentions that "in 1950 there were 92 establishments on Dudley between Columbia and the train tracks; today there are 25."

Roxbury, Mattapan Square, Jamaica Plain, Dudley Station]. Not until 1970 had Upham's Corner contracted to a comparable size (16).

No single event or set of related events can account for the great changes in Upham's Corner over the last 35 years. Rather, a wide variety of social, economic, structural, and political events came together to transform the community and continue to affect it today. These factors included the introduction of federally guaranteed home mortgages, changes in transportation modes, changes in shopping behavior, red lining, green lining,¹⁵ and block busting.

After World War II the government's Veterans Administration (VA) and Federal Housing Administration (FHA) mortgage guarantee programs enabled and encouraged tract housing developments outside of center cities. When large numbers of middle class whites left the City of Boston for inexpensive single family homes in the suburbs, new shopping centers followed them. The loss of customers with the greatest disposable income to spend in Upham's Corner marked the beginning of the significant decline in the commercial district.

At the same time, families of modest means were acquiring their first cars. This increased access to the wide variety of goods offered at the new suburban shopping centers surrounded by vast parking lots. Even had none of the people in Upham's Corner chosen to shop elsewhere, many traditional Upham's Corner shoppers from other areas now had a choice of--and way to get to--other retail centers.

It was also during the 1950's that the last portions of the street car system in this part

¹⁵ Redlining is the practice of refusing to provide a product or service (such as a mortgage or insurance) to a specific geographic area. Green-lining is the practice of making a service available only within a specific geographic area. This has the effect of steering certain groups to designated neighborhoods.

of Boston were dismantled and replaced by new, modern, busses (Sanborn interview).¹⁶

The social upheaval of the 1960's also had a profound effect on Upham's Corner and surrounding Boston neighborhoods. The national call of the civil rights movement to end discrimination in housing and public accommodation, engaged the federal government, local political leaders, and bankers, and caught the residents of many Boston neighborhoods in the middle of a short but painful urban disaster.

In response to the creation of federal government mortgage guarantees that were part of the Model Cities program, local bankers created B-BURG, the Boston Bankers Urban Renewal Group. Some of these local bankers, with the best of intentions, created a set of programs that would, for the first time, enable black families to get home mortgages.

B-BURG partially opened the doors to home mortgages to black customers, but did so in a way that brought far more harm than good. The B-BURG bankers green lined an area in Dorchester, Roxbury and Mattapan where, and only where, they would underwrite government guaranteed mortgages for blacks.¹⁷ Although Upham's Corner fell outside of the B-BURG lines in an "adjacent area," the consequences of what

¹⁶ There is a popular notion that the street cars kept neighborhoods, like Upham's Corner, vibrant. "Once the trolleys were gone it [Upham's Corner] was no longer anything special" (Haas interview). The decisions that led to their elimination, however were mostly economic and practical. They were very expensive to maintain and ridership began to decline in the 1920's and continued to decline as private automobile use increased. It is unclear, therefore, if Upham's Corner's fate would have been any different had the street cars remained.

¹⁷ For a full description of the work of the Boston Banks Urban Renewal Group (B-BURG), and the history of block busting in this area see Levine and Harmon, The Death of an American Jewish Community.

happened within the B-BURG lines had major effects there as well. The B-BURG green-lining tapped a tidal wave of middle class black demand for homes and mortgages, but focused all the demand on a very confined area. The green-lining also encouraged "block busting" by local realtors. Block busting took many forms, but usually relied on realtors scaring white home owners with the fear that blacks moving into their neighborhood meant the value of their homes would plummet or that their wife and children would be molested if they did not sell right away. Frightened whites fled quickly.

Ostensibly, B-BURG mortgages were designed to help qualified minorities who had been traditionally discriminated against. In fact, blacks who were unqualified for mortgages were used in a game of selling inflated priced homes to families who could not afford them. Soon after the family moved in, they fell behind in their payments, the bank foreclosed, the realtor resold the house to another black family, and the bank wrote another mortgage. Houses and whole neighborhoods quickly deteriorated as their new owners could not afford to maintain them. Arson too, was often used to take a final profit from a badly deteriorated house.

Although a significant portion of the DBEDC service area fell within the B-BURG area, Upham's Corner was in an adjacent area, outside of the B-BURG red line. The proximity to the quickly changing B-BURG neighborhoods made the adjacent areas attractive targets for block busters. However, since realtors in Upham's Corner could not rely on the federally backed mortgages being offered by B-BURG, they had to attract better qualified buyers who were able to repay mortgages and maintain their homes. This led to greater stability in Upham's Corner, despite the white flight.¹⁸

¹⁸ Today, about 31% of Upham's Corner residents are owners and 69% are renters (about the same as citywide percentages), however, elsewhere in the DBEDC service area, (much of which is in the former B-BURG area) only 25% are owners while 75% are renters (1990 US Census data).

Although many new owners were middle class blacks, block busters continued to operate in the community. They scared blacks with the threat of being overrun by hispanics, and hispanics with the threat of being overrun by Cape Verdeans. While some from each ethnic group left, others did not. This may be one of the reasons why Upham's Corner became more ethnically mixed than did areas within the B-BURG boundaries (Haas interview). Although it continues to be very low income, Upham's Corner has a more stable base of multi-ethnic home owners than many surrounding neighborhoods.

The upheaval that occurred in communities around Upham's Corner (Roxbury, Mattapan, and Dorchester) caused such profound instability that it has taken, and likely will continue to take, decades of work to repair. When the people who had lived in those communities all fled at once, the institutions that they had built to serve and stabilize their communities also left. The dramatic and continual turnover of new residents who did not know each other made it difficult to create or support a sense of community or new community institutions. By comparison, the situation in Upham's Corner was less tumultuous, and the neighborhood is in a stronger position to overcome difficulties and thrive.

**Table 2-1
Population changes by race in Upham's Corner tracts 912, 913, 914, 915.**

Census	1970	Percent	1980	Percent	1990	Percent
Population	15,346		12,541		12,424	
White	12,885	84%	5,703	45.5%	3,891	31.3%
Black	2,224	14.5%	3,467	27.6%	4,599	37.0%
Hispanic	1,011	6.6%	2,948	23.5%	3,207	25.8%
Other	278	1.8%	3,371	26.9%	3,934	31.7%

Source: Upham's Corner Healthy Boston Report (5).

CURRENT CHARACTERISTICS

Today, Upham's Corner is a place of contrasts. There are fewer gap-tooth streets, boarded up stores, or litter-strewn lots than in other low-income parts of the city. Most of the houses are fairly well kept; most of the streets are clean and cared for. Many of the businesses on Columbia road and Dudley street appear to be doing well. There is also visible community spirit supporting a variety of neighborhood affirming projects.

At the same time, Upham's Corner has a reputation of crime and violence that is foremost in resident's minds. The 1993 Healthy Boston study of Upham's Corner found that over 50% of residents believe that public safety is the most important issue facing the community. The second most important issue listed was youth. Although crime rates have been decreasing recently, press attention of celebrated cases has, in some people's opinions, kept the community's reputation worse than reality.

Upham's Corner is also among the poorest neighborhoods in the region. "A review of health status indicators produced by the Department of Health and Hospitals compared sixteen neighborhoods... North Dorchester, with a per capita income of \$11,038 was the second lowest of the sixteen and only Roxbury, with a per capita income of \$9,521 was lower."¹⁹ Over 25 percent of families live below the poverty level compared to 19 percent city-wide. There is a higher unemployment level than in most Boston neighborhoods and Upham's Corner's residents in every racial group have lower per capita incomes than their group does city-wide. Part of this can certainly be attributed

¹⁹ Uphams Corner Healthy Boston Report, March, 1993, taken from Massachusetts Department of Public Health, Bureau of Health Statistics, Research and Evaluation and Boston Department of Health and Hospitals, Office of Health and Vital Statistics, (February, 1993).

to the fact that only 65.8 percent of Upham's Corner adults have completed high school, compared to 88 percent city-wide (Sources: 1990 Census data).

The remedies to Upham's Corner's problems are complex and will take years to implement. Residents need the economic stability that comes from secure jobs--so they can better support themselves and their families--and asset ownership so they can have greater economic stakes in their community. Young people need the promise of jobs, and an economic future to encourage them to finish school. Some of this can certainly be supported through efforts to revitalize the Upham's Corner commercial district, bring new businesses to the community, and create stable jobs.

The obstacles to the commercial revitalization of Upham's Corner are also complicated. It will never again be the type of regional commercial center that it was 50 years ago. But it can be a healthier local shopping and service district. The 1981 Telesis report notes that "because low-income consumers tend to be less mobile, they tend to spend a larger portion of their income locally than do high-income consumers" (3). However, in the long-term, the economics of this community will not support a significant increase in the number and type of businesses without increases in the number of people who will patronize them and the amount of disposable income they have to spend.

Availability of capital for new and existing businesses is another element necessary to expand commercial activity in the neighborhood. The success of any economic development program rests on its ability to strategically get capital into the hands of business people who will invest it in businesses that create jobs and revitalize the community as part of a comprehensive development program.

Many good efforts are now underway to address a number of Upham's Corner's most pressing needs. There are many community organizations, including the Bird Street Youth Center, the Strand Theater, Upham's Corner Board of Trade, and Upham's

Corner Healthy Boston Coalition, that are all working on projects to address the community's needs. Their efforts, along with economic development efforts now being discussed by the DBEDC, City of Boston and others, create a supportive environment for economic development programs to take place.

SUMMARY

Upham's Corner has a rich history as one of Boston's oldest and largest neighborhood commercial centers. Inner-city demographic and economic changes of the last half century has sharply reduced its commercial activity and changed the profile of community residents and neighborhood conditions.

Although it is small and poor, Upham's Corner has more of Boston's bank branches than any similar community. It also has a large number of community development organizations. All are concerned with the state of the community and willing to take action to help improve it. The fact that Upham's Corner has a more stable population of home owners than other communities with similar demographic profiles means that greater opportunities exist to build community institutions that can work to improve the physical, social and economic conditions of the community.

Keeping this in mind it is important to caution against drawing too many lessons for other communities from the conditions and opportunities I will describe in later chapters without appropriately factoring in the resources and circumstances that are particular to Upham's Corner.

In the next three chapters I will explore how the existing financial institutions serving Upham's Corner are meeting its specific financial and capital needs. Based on the consumer, business, and housing needs I find in these chapters, and the community characteristics outlined here, I will be able to suggest possible institutional interventions to make Upham's Corner an economically healthier community.

3 CONSUMER BANKING NEEDS AND SERVICES IN UPHAM'S CORNER

In order to understand whether or not Upham's Corner needs an alternative financial institution it is necessary to explore whether or not its residents and businesses have capital and financial service needs that are going unmet. Capital services are loans and investments made by a financial institution, while financial services are other retail banking services such as savings and checking accounts, money transfers, and ATM transactions.

This chapter describes how Upham's Corner's financial institutions meet the consumer banking needs of its residents. In the two following chapters I explore how well local financial institutions meet Upham's Corner's business and home mortgage needs. Taken together, these chapters provide a profile of this community that can be used to assess how well needs are being met, whether services can be improved, and whether new institutions should be created to fill gaps between what the community needs, and what existing institutions can provide.

ASSUMPTIONS

In order to test my belief that banks were not offering services to low-income people, and therefore low-income people were not using banks, I conducted a four-part survey of Upham's Corner residents and financial service providers.

In thinking about community economic development opportunities, I believed it was important for low-income people to have access to financial services that could help them build banking relationships, accumulate savings and establish credit histories. I also believed it was important for financial institutions to capture and leverage some of the money flowing through low-income communities to support local development activities. If existing financial institutions were not providing services to low-income

people, I believed that the likelihood for successful economic development to take place was diminished.

SURVEY

In November, 1992 I began conducting a five part survey of Upham's Corner financial needs and services described below.

Part 1) In order to learn how consumers use financial services, I spent two afternoons sitting in the waiting room of the Upham's Corner Health Center where I interviewed 12 people at length about how they managed their own finances and how they used local financial services and institutions. I chose to interview people at the Health Center because it serves a large cross section of the low-income people in North Dorchester and it gave me an opportunity to speak with white, black, Hispanic, and Cape Verdean residents. Interviews lasted approximately 15 minutes each (interviews that were conducted with the help of an interpreter in Spanish and Portuguese took slightly longer) and I found remarkable similarities of behavior in everyone with whom I spoke.

- 2) I conducted a small focus group with four social workers from the Upham's Corner Health Center in order to find out how they, and their friends and families, managed their money, and whether this was different from their clients' behavior.²⁰
- 3) I interviewed several professional people who work in Upham's Corner who confirmed what I already believed about how professionals, like myself and my colleagues, manage personal finances and use financial services and institutions.
- 4) In order to determine what services are available to people living and working in

²⁰ Appendix A contains the survey instrument I used to conduct both the interviews at the Health Center and the focus group.

the Upham's Corner area, I surveyed each of the three banks located in Upham's Corner, and interviewed all the branch managers and several other bankers who have been active in Boston's low-income communities. I also interviewed the managers of Boston Check Cashers, and the Purity Supreme and Bradlees in Fields Corner (both of which offer limited financial services).

- 5) In addition to the field research described above, I interviewed several people who have studied the financial service needs of low-income people and are designing new models to better meet the financial service needs of low-income people.

HOW UPHAM'S CORNER RESIDENTS MANAGE THEIR FINANCES

I found at least three different financial worlds in Upham's Corner that probably exist in most low-income communities. The first is made up of both employed and unemployed low-income people. These people own few if any assets--sometimes a car--have no investments, little or no savings, and live from one check (work or public assistance) to the next. They live entirely in a cash economy. They pay bills with cash or money orders that they buy from a variety of local outlets. They have no access to conventional credit nor any relationship with a bank. When they want to purchase something that costs more than they have in cash, they rely on store credit or lay away--such as that extended by some furniture stores, pawn shops, or loan sharks. They often know very little about banks or how they operate.

The second group is comprised mostly of moderate-income people who receive wages (and/or possibly self-employment income). Some of these people own assets such as a car or even a home. Few have investments but may have some savings.

Relationships with a bank are usually limited to cashing pay checks and possibly making small deposits into savings accounts. People in this group are unlikely to use direct deposit services or have an ATM card. They might have a credit card, but it is

more likely that they have one or more charge cards from their favorite stores. When they want to purchase something that costs more than they have, they use a charge card, purchase it on lay away or store credit, or borrow money from friends or family. They are more likely to pay for monthly bills with money orders than to have checking accounts--although some do. They are often not knowledgeable about the different services offered by banks. They complain about the length of lines at banks and say that they don't trust banks, viewing them as an obstacle between themselves and their money.

The third group is comprised of middle- and upper middle-income people with steady jobs and incomes. They can afford to own assets such as cars and homes. They have savings, and possibly investments, and they have a regular relationship with at least one bank. People in this group have checking accounts and credit cards and are likely to use direct deposit services and ATM machines. When they need to purchase something on time, they use some form of conventional credit such as a credit card, loan or mortgage. They avail themselves of many of the services offered by a bank including linked accounts that eliminate banking fees. These people feel comfortable using banks to facilitate all their financial transactions. People in this group need more complicated banking services that allow them to convert what I will call "markers" for other markers,²¹ credit or cash. People in the other two groups are less likely to need or use markers.

One finding that surprised me was how easily some middle-income people moved between the cash and marker economies. People told me of losing jobs and closing up all of their accounts and moving, at least temporarily, into the 100% cash economy. Others related stories of their poor experience managing accounts, or their mistrust of banks, leading to a deliberate decision to return to the cash economy.

²¹ A "marker" is a check, charge, promissory note or other form of recognized currency other than cash.

BANKING SERVICES IN UPHAM'S CORNER

These interviews confirmed part of my initial beliefs that a great many Upham's Corner residents, including those with jobs and steady incomes, were not receiving most of their financial services from local banks. I cannot, however, explain this entirely by pointing to a dearth of banking services available to lower income people.

There are three bank branches in Upham's Corner: Shawmut, Bank of Boston, and the Boston Five Cent Savings Bank. Shawmut and Bank of Boston are full service commercial banks. The Boston Five-- which took over the failed First American branch at this location --is a savings bank and makes no commercial loans. All three branches are located on Columbia Road close to the corner of Dudley Street. There are automatic teller machines at all three branches as well as BayBank ATMs on Columbia Road and in Edward Everett Square. There are several other bank branches and cash machine locations in North Dorchester, including the U.S. Trust branch on Mass. Avenue, and another Bank of Boston branch near the JFK library.

In recent years the banks with branches in Upham's Corner have made the decision to improve their service to low- and moderate-income communities in Massachusetts. These decisions were prompted, in part, by the 1989 Federal Reserve Bank of Boston (FED) study on Home Mortgage Lending in the Boston Area²² and Congressional passage of the Financial Institution Reform and Recovery Enforcement Act (FIRREA) of 1989, along with new Community Reinvestment Act (CRA) guidelines. The banks that serve Upham's Corner have all introduced new programs to serve community needs in an effort to comply with new regulations and, they claim, to compete in markets with future profit potential.

²² This study found that blacks and hispanics are more likely to be rejected for a mortgage than whites, all other factors of qualification being essentially equal.

NEW CONVENTIONAL BANK STRUCTURES

In 1990 the Bank of Boston has created the First Community Bank (FCB) which is a "bank within a bank." FCB has a special mission to serve the needs of low and moderate-income communities. It has 12 branches in Massachusetts and Rhode Island and has done targeted community needs assessments in order to improve the products and services it offers. First Community Bank has created a line of banking products that have low (or no) fees and fit the needs of both new, and low-income, banking customers. These include both retail and credit products. Among the credit products are "first step" home mortgages and consumer loans that are available to middle-income people who have not previously used this type of credit. In addition, FCB is hiring multi-lingual branch staff to meet the special language needs of its clients, conducting community training programs and setting up both commercial and mortgage lending offices in community branches (rather than just downtown). It is important to stress that FCB is a relatively new program and none of its new services or products have been heavily tested.

Shawmut Bank, by contrast has chosen to maintain its structure of segmented divisions that offer different banking products. In order to address needs--in low-income communities--that are outside of the expertise of their conventional divisions, they have created specialty units within some of these divisions that concentrate on lending to development projects considered too risky under conventional criteria. In 1992 Shawmut created a "Community Investment Unit" in their real estate business line. This unit lends to community development commercial real estate projects throughout New England that need more massaging (than the average real estate projects) to make them bankable. Like FCB, Shawmut offers a wide variety of loan products.

Shawmut has also created a bank information center which operates out of the Freedom House Community Center in Grove Hall, Roxbury. This is not a branch. Rather, it is a teaching, credit counseling, and advocacy center. In addition, Kevin

Winn, the former Upham's Corner branch manager, is now a full-time outreach and education coordinator working in low-income communities throughout the Boston area.²³ In 1992 Winn conducted over 250 seminars for existing groups serving low-income clients. He teaches a range of subjects including what a bank does, how to manage a checking account and how to apply for a mortgage.

Shawmut, like FCB, has also created a line of products designed specifically for low-income customers such as no-fee checking and no-minimum-balance accounts. It, too, has multi-lingual tellers and branch staff, and can serve the needs of several language communities. The largest base of Shawmut customers at the Upham's Corner branch are African-American and Hispanic.

The Boston Five has not introduced as many new products because, according to branch manager Carolina Correia, "as a savings bank, our products have been designed to meet many consumer retail banking needs" (Correia interview). The Boston Five took over the failed First American Bank in 1990 and retained Ms. Correia, who had been with First American since 1974, as their manager. Ms. Correia is of Cape Verdean descent and mentioned that the majority of Cape Verdeans in the area are Boston Five patrons.²⁴

The Boston Five, like FCB and Shawmut, offers no fee/no minimum balance checking and savings accounts and multi-lingual branch staff. It, too, offers a wide variety of consumer loan products and, like the area's other banks, its staff conducts training sessions for local schools and businesses in several languages. It is also studying its products to determine how well they meet its community's needs.

²³ Winn is an advocate of community banking and has been active on a number of local boards working on community development projects.

²⁴ This claim was substantiated by other area bankers with whom I spoke.

CONSUMER LENDING

The final thing that all these banks have in common is the way they provide loans and credit to consumers. Credit in the form of credit cards, home equity loans, personal loans, car loans, school loans, and passbook loans (loans made against a savings account balance) are all available from at least one of the local bank branches. However, none are easily available to low-income people. Most low-income people have little or no savings, no credit histories, no prior relationship with a bank, and no collateral to cover a loan. None of these banks any longer makes straight "character loans."²⁵

Shawmut and Boston Five have consumer underwriters in their branches who have the authority to make loans of up to \$50,000. First Community Bank forwards applications to a central office in Rhode Island where they are approved or denied within 72 hours by Bank of Boston's conventional consumer lending division (with no special consideration). Diedre Lockhart, Shawmut's branch manager, explained to me--and her statement was representative of what I heard from other bankers--"it's difficult for low-income people to get consumer credit of any kind, there is no low-income credit card and therefore it's difficult to establish any credit history."

As of September, 1992, Shawmut had approximately \$1 million in outstanding consumer loans, and had made \$11 million in home equity loans from the Upham's Corner branch in 1991. (Winn and Lockhart interviews). Almost all these loans were made to middle-class home owners who used their homes as collateral. No one with whom I spoke knows of an area bank that will make un-collateralized loans for any purpose.

²⁵ Character loans--which require little information gathering or collateral--were commonly made by S&L and Credit Unions whose lenders often had personal knowledge of their borrowers and based the soundness of loan on their character.

Chart 3-1 Comparison of consumer services offered by the 3 Upham's Corner bank branches

SERVICE	Boston Five	Bank of Boston	Shawmut
Fee for savings account with ATM card and minimum balance	Free with Direct Deposit, or \$500min/bal	\$1/mo service charge No Min. Balance	\$1/month service if below \$100 balance
Free Checking	8 free Chks./ month	10 free chks./mo w/DD ²⁶ or \$2.50/mo.	7 free chks/mo. or \$2.50
Minimum balance checking account and fee for ATM card	\$1000 & greater of \$3/ month or \$.35/ check	\$1000 min., for no fee, or \$8-\$10/mo. service fee	10 chks/mo. and \$2.50 fee
Low-income Credit Card	No credit cards	No credit cards	No low inc. cards
Direct Deposit of Pay	Yes	Yes	Yes
DD of Social Security	Yes	Yes	Yes w/account
DD of Welfare benefits	Yes	Yes	Yes
Cost of money order (MO)	First MO is free w/withdrawal then \$2 each.	First MO is free w/withdrawal then \$3 each.	\$2.50/ MO
Free bill payment	no bills paid	no bills paid	no bills paid
Cost to cash a check with an account	No charge	No charge	No charge
Cost to cash a check without an account	\$.50 for welfare/ \$5 for a perm. SSI card	No Charge	No Charge
Max. consumer loan underwritten at branch	\$7500 w/ \$2500 unsecured & \$5000 secured	All underwriting done from BKB Rhode Island office	\$50,000 limit for on site underwriter
Branch Deposits	\$41 million	\$25 million	\$24 million
Language Availability ²⁷	E,P,C,S,F	E,F,Ch,V,S	E,C,S

Source: Interviews with branch managers.

In spite of efforts to attract and serve low-income customers, according to both the

²⁶ Direct Deposit

²⁷ E=English; F=French; P=Portuguese; C=Creole; V=Vietnamese; S=Spanish; Ch=Chinese;

branch managers and the low-income people I interviewed, very few low-income people actually use these specially tailored products or the banks. The fact that consumer credit is unavailable to low-income people probably creates a disincentive to their using banks, however, other reasons can be explored by looking at the financial services and institutions that Upham's Corner's low-income people are using, and describing why they prefer these service providers to the conventional banks.²⁸

ALTERNATIVE FINANCIAL SERVICES USED BY UPHAM'S CORNER RESIDENTS

The low-income people with whom I spoke informed me of a network of non-depository financial service providers that they were more likely to patronize than banks. The check cashing stores at the corner of Columbia Road and Dudley Street, and in Edward Everett Square, offer low-cost money orders, money wiring, and a utility bill payment service. They will also cash almost any type of check, including out-of-state checks, which the banks will not. The local Christy's Convenience Store sells money orders for \$.59. The Purity Supreme Supermarket and Bradlees discount store in Fields Corner both offer check cashing and money orders, and Purity offers bill paying for the phone, gas, and electric companies. Beneath this level of easily identifiable services are informal service providers. Some of the corner groceries, discount, and liquor stores that serve particular ethnic groups cash checks and occasionally extend credit to regular customers. Several of the clothing and furniture stores offer lay away financing and easy credit terms.

²⁸ Errol Lewis of the National Federation of Community Development Credit Unions believes that one of the primary reasons why people use community development credit unions is because they offer the only affordable credit in the community. According to Lewis, other services such as "share deposit and draft accounts do not motivate people to join the union anywhere near as much as loan availability" (Lewis interview).

While some community residents believe that local furniture stores prey upon people by luring them into easy credit deals and sticking them with very low quality merchandise at inflated prices, others contend that furniture store credit is the only type available to many local residents. To my mind, both are correct.

The fact that these financial services cost more than at the banks does not dissuade low-income people from using them. In an effort to ascertain why low-income people prefer check cashing stores to banks, the First Community Bank had Sabrina Gee, a graduate student at the Kennedy School of Government, interview low-income women who use check cashing stores in Roxbury. Gee concluded that low-income women prefer to conduct their financial transactions at check cashing stores because of convenience of location, cost of services, length of wait for service, availability of multiple services at one location, fewer ID requirements than banks, anonymity of transactions, and ignorance of alternative, conventional, banking services.²⁹

It became apparent during my interviews that banks had created programs for low-income people based on the needs and experiences of middle- and upper-income people. Low-income people, who live almost entirely in a cash economy, mostly need and want the services provided by the check cashing stores, and other alternative institutions. The non-cash-oriented products offered by banks are either outside of their experience, or more expensive and less convenient to use than those offered by alternative institutions.

Table 3-2 Services offered by non-bank financial service providers

²⁹ These reasons were also listed in a December 1, 1992 New York Times article on the popularity and proliferation of check cashing stores.

Service	Boston Check Cashers	Purity Supreme Supermarket	Bradlees Discount Store	Christy's Convenience Store
Cost to Cash a Check	2.25% for Govt.Chks. or 1.4%-2.7%	\$.50 under \$100 or \$1 over \$100	\$1 for Govt. or corporate checks only	No Check Cashing
Cost of Money Order	\$.59 Western Union	\$.50 AmEx Money Order	\$1 AmEx Money Order	\$.50 AmEx Money Order
Cost to Pay Utility Bill	\$.59 for M.O. or free with your check	No Charge	No Bill Paying	No Bill Paying
Cost to Pay Phone bill	No Charge	No Charge	No Bill Paying	No Bill Paying

Source: interviews with managers at each of the Upham's Corner or Fields Corner outlets

WHY LOW-INCOME PEOPLE DO NOT USE BANKS

I found two recurring sets of problems that low-income people had with banks. The first concerned the banks, which they viewed as places that served other people's needs but not their own. They felt that the banks--with their long lines and paper work--placed barriers between themselves and their money. They also believed that banks were expensive to use. Even people with steady jobs believed that it would be more expensive to have a checking account than to cash their checks and buy money orders. Few of the people with whom I spoke knew about direct deposit of pay, welfare, or social security checks. Only one woman who knew about direct deposit actually used it. Others who knew about it did not trust that their checks would automatically make it into their bank accounts.

The second set of issues revolved around low-income people's confidence in their own abilities. Most believed that they didn't have the requisite skills to manage a check book and that they would get into trouble bouncing checks or getting overextended if they had a checking account or ATM card. Finally, many believed that they did not

have enough money or income to make it worth having a banking relationship.

In contrast to the way that low-income people described their own reluctance to use banks, the bankers and community leaders with whom I spoke said only that low-income people had a cultural mistrust of banking and that bank use was outside of their realm of experience. In the future, this may lead bankers to view education rather than new product development as a solution to attracting both low- and middle-income people.

CONCLUSION

Despite the extensive, multi-cultural and multi-lingual outreach and education that banks are doing to encourage low-income people to use their specially tailored banking products, they are not being used by most low-income people.

Through interviews and conversations with Upham's Corner residents I found that low-income people need safe, inexpensive, and convenient places to cash their checks, pay their bills, borrow relatively small amounts of money, and establish credit histories. Many would also likely open small deposit accounts if they were offered easy accessibility in a comfortable, familiar environment.

There is clearly a difference between the perceptions and motivations of these people, who live in a cash economy, and higher income people, who live in an economy where cash is used for only a fraction of transactions. The fact that banks make little distinction between these two groups when designing their consumer services and credit products means that services and products are available to all, but used by only middle- and upper-income people. The services and products that low-income people need, can afford, or would likely use, by contrast, are not offered by conventional banks. Moreover, since banks are regulated, they must keep accurate records of each transaction they complete, so they incur much higher transaction costs for services and

lending than do non-regulated institutions. This fact alone lowers a banks incentive to look for the differences between these groups or to provide many of the services that low-income people would use.

The various institutions that have sprung up to fill the gap between what low-income people want and what banks provide, such as check cashing stores, are not financial intermediaries. Although much of the money that is converted to cash at these outlets is likely spent in the local economy, it also likely flows quickly out of the community once it is spent.³⁰ Unlike intermediaries, check cashing stores, furniture stores, and loan sharks do not collect money in order to reinvest it. Nor are they likely to invest their profits in institutions that support local community economic development.

As an alternative to the way many local residents are receiving financial service, low-income people could be organized and educated to use new, or improved, institutions and products designed to provide low-cost, convenient, financial services and loans. Such institutions could capture some of the money flowing quickly through these institutions and reinvest it in community and individual development (Minsky).

Understanding consumer capital and financial service gaps explains only one piece a community's capital and financial needs. When combined with the business and home mortgage gaps identified in the next two chapters, a picture of Upham's Corner's overall needs should become clear.

³⁰ Carl Sussman of CEDAC related to me that the economic multiplier for cash transactions in low-income neighborhoods is less than 1.

4 BUSINESS CREDIT IN UPHAM'S CORNER

A community's capital and institutional needs go well beyond its consumer credit and service needs. Capital and services for business development is particularly needed to support commercial revitalization and job creation that create the economic multipliers required to create a healthy local economy.

This chapter describes how local financial institutions meet the capital needs of Upham's Corner's businesses. I researched this topic by surveying local business owners, private financial institutions, and private, public, and quasi-public business finance programs that offer products to the types of businesses likely to locate in Upham's Corner.

I found similarities between these issues and the consumer service gaps I identified in the previous chapter. As with consumer services, alternative business lending programs have been created by non-intermediaries to fill the capital needs of businesses that cannot use established banking products. In addition, I found an institutional gap between the community's need for a strategic business development organization and the abilities of existing institutions to fill this role.

SURVEY

In December, 1992 and January 1993 I conducted a survey of business banking needs and services in Upham's Corner. In order to learn about the ways that local small businesses think about their financial needs and use financial institutions, I surveyed 18 storefront retail and service businesses.³¹ In order to learn more about the services

³¹ I used a 40 question survey form to collect information from each of the 18 businesses. In addition, I conducted face to face interviews with five of the 18 business owners or managers. A copy of the survey form which is attached in Appendix 1.

that are available to small businesses, I interviewed business lenders from three local banks as well as 8 program managers from many of the federal, state, city, quasi-public, and private non-bank institutions that do small business lending in the Boston area. Finally, I interviewed the president of the Upham's Corner Board of Trade, three staff people from Boston's Public Facilities Department and three staff people from the Dorchester Bay Economic Development Corporation, all of whom are working on projects to improve the business climate and develop small businesses in Upham's Corner.

I conducted these surveys and interviews in order to test my belief that small- and micro-businesses in low-income communities have little or no access to the financing they need to start up, operate, or expand. I believed that this lack of access to capital has stunted business development, prevented jobs from being created, and therefore, has impeded community economic development.

Many of the people I interviewed insisted that capital was only one of the elements needed to support community-based businesses. Most stressed that technical and management assistance were also critical to helping businesses successfully develop and qualify for loans. I was therefore curious to ascertain the difference between the level of assistance that people believed was necessary and the level that was available to local businesses from different institutions.

I made a concerted effort to collect information from a wide cross-section of local businesses in order to learn something about businesses of different ages, sizes, and ownership. Of the 18 businesses I surveyed, (over 25% of local businesses) I collected data from white, black, Hispanic, Cape Verdean, and Asian business owners who employed between one and 14 people and had been in business, in Upham's Corner, between 6 months and 60 years.

HOW LOCAL BUSINESSES MANAGE THEIR FINANCES AND USE FINANCING

There are basically three sizes of businesses in Upham's Corner, small business with over \$1 million in sales, small storefront businesses which range in size from 1 to 15 employees and do less than \$1 million a year in sales, and micro-enterprises which range from a single, part-time, self-employed person to a few employees and do less than \$250,000 in annual sales.³²

Both the bankers and local business people agreed that different types and sized businesses have different financial service and credit needs.

Except for the micro-enterprises, all of the businesses I spoke with used some business banking services. Most had businesses checking accounts with a local bank and a few had savings and payroll accounts as well as a business credit card.

All of the businesses I surveyed earned most of their income through cash transactions and had to deposit cash in person--or through night deposit boxes--at their bank branch.

FINANCING LARGER LOCAL BUSINESSES

America's Food Basket³³, which required over \$450,000 in equity and debt capital is a good case study in the type of financing required by larger Upham's Corner

³² These are my own designations. I created them based on the types and sizes of business that I found and what appeared to me to be differences between business needs and management structures.

³³ America's Food Basket, which opened in December, 1992, is the first modern full service supermarket to exist in Upham's Corner for a number of years. Upon opening it was the largest retail business and employer in the Upham's Corner commercial district.

businesses. It needed financing to renovate its store, to purchase assets (such as refrigeration bins, grocery shelves, and check out stations), and working capital for inventory. The owners, who had significant experience running successful supermarkets, had great difficulty finding financing for this project. They took on considerable personal financial risk while piecing together a variety of public and private financing sources to raise the capital they needed to open.³⁴

FINANCING STOREFRONT BUSINESSES

Upham's Corner's smaller storefront businesses also have had difficulty finding financing in recent years. Of the smaller storefront business that I surveyed, eight had applied for a bank loan in the last three years and four had been turned down. An additional three reported having loans from either a finance company or family. All four of the businesses that were rejected for loans (or lines of credit) sought between \$10,000 and \$30,000. Of the four who received loans two were for building mortgages and two were for lines of credit.

Mt. Auburn Associates 1992 study of Upham's Corner for Boston's Public Facilities Department recorded similar, but not exactly the same rejection rates.

For business owners who are motivated, lack of access to financing seems to be

³⁴ There is no evidence that this project would have been any easier to finance in a higher-income community. However, the fact that the owners had a good track record and credit history, that there was no competition, and that the local banks--which want to do more community lending--turned them down for loans, points to the extreme difficulty in getting even the larger loans that banks want to make, in this community. The financing package that was finally put together by the State Street Bank included \$100,000 in equity from the owners, a \$125,000 loan from the Massachusetts Industrial Finance Agency, \$125,000 loan from the Minority Enterprise Investment Corporation, \$100,000 from the State Street Bank, and a \$250,000 guarantee deposit in the State Street Bank from the Public Facilities Department to make up for a collateral gap and to secure the loans.

a problem. Twenty-one percent of our sample said they have been denied financing in the past two years. Of the 7 businesses who said they want to expand, only 2 were confident of obtaining needed financing (16).

Steve Tromp of First Community Bank told me that "the approval rate for small business loans runs between 30 and 40 percent. Some people come in for start-ups and haven't adequately prepared themselves to borrow money." Although Upham's Corner businesses are denied no more frequently than FCB's average (similar to other bankers with whom I spoke) without knowing the reasons why any of the Upham's Corner businesses were denied loans, or how these rates compare to rates in similar communities, it is impossible to draw firm conclusions about discrimination or redlining.³⁵

Both business owners and bankers told me that many business people in the area take out home equity loans or second mortgages on their homes in order to raise capital for their businesses. Most of those surveyed said they raised working capital from personal savings, and family members. Only three raised working capital from a bank or finance company and only two from business profits.

Of the 11 businesses that had no loans, 7 believe they would be more profitable if they had access to loans. About half of these business people would like to be able to do one or more of the following in the next one to two years: expand their inventory, expand their product line, renovate the business, or buy new equipment. Only two would like to be able to expand the physical size of their businesses (about half the interest cited in the 1992 Mt. Auburn study). None of the storefront businesses I

³⁵ This is a much lower overall approval rate than was found in the Dunkelberg and Scott survey of small businesses in 1985. "Credit is available in desired amounts to most operating small businesses most of the time. More than 85 percent had their latest loan request accepted, a figure which has not changed for all practical purposes over the past few years. Over 70% received the terms requested on their latest loan and 90% received the amount requested " (2).

interviewed needed working capital or asset based loans in excess of \$50,000.³⁶

A March 1993 study of minority businesses for Boston's EDIC concluded that

Accessibility to capital and financing are among the major barriers to growth and expansion which face Boston's minority and area businesses. Easy access to financing for ongoing operations or expansion are not available to a majority of these businesses. Sixty eight percent of respondents indicated that financing for ongoing operations was either difficult to obtain, even at high cost, or not available at all. Seventy four percent of respondents indicated that financing for expansion was either difficult to obtain, even at high cost of, or not available at all. Liability insurance, employee training, and technical assistance were available to a majority of firms either at reasonable cost or high cost (page #).

FINANCING MICRO-ENTERPRISES

In addition to the storefront businesses, there were approximately 300 people in the four Upham's Corner census tracts--and 1200 people in the DBEDC service area--who received self-employment income in 1989. (1990 Census)

According to Jeffrey Ashe, founder of Working Capital, a significant fraction of the people who are recognized by the census as self-employed are micro-entrepreneurs.³⁷ He believes that if appropriate loans were available, many of these people would be interested in establishing business credit and taking out loans to expand their businesses.

³⁶ I did not specifically question these businesses about their desire to purchase their own buildings, or their ability to qualify for commercial mortgages.

³⁷ Ashe spent many years working with Accion and is the founder and director of Working Capital. He has written extensively on small business development finance in less developed countries and has studied market potential for microenterprise development in the United States.

Among the micro-enterprise consultants and entrepreneurs I interviewed, most said that micro-entrepreneurs do not use available banking services to their full potential. Many conduct their businesses entirely on a cash basis, use their personal checking account (if they have one) for all their business needs, and do not distinguish between personal and business finances or accounting. Few receive financing from a formal institution, relying instead on other income and family money to purchase materials or pay bills.

An MIT student studying businesses in Chinatown found that some micro-entrepreneurs--especially street vendors--are using multiple credit cards to meet their businesses' cash needs (Yang). Some are paying as much as 17-22 percent interest, because it is the easiest way for them to get start-up and operating cash.³⁸

OTHER BUSINESS NEEDS

Business consultants and successful district business owners say that many other owners lack basic business skills in cash management, inventory management, marketing, business planning, and so forth. Observers are concerned that some owners are not motivated to improve their businesses, and that others do not see the potential payoffs from investing more money and effort in expansion (Mt. Auburn Study, page 16).

This statement suggests that many local business people may be reluctant to admit that they need technical and management assistance to improve their businesses. Both business people and lenders with whom I spoke agreed that many small business people do not know how to keep the types of records that banks require from potential borrowers. They further agree that good financial statements are among the most important prerequisites for a loan.

³⁸ In most cases interest rates are not considered to be a critical factor of very small business loans. Since the difference between 10 and 20 percent on a thousand dollar loan is less than \$100 per month, the other terms of the loan and technical assistance are often considered to be more important factors.

As Joan Shapiro of the South Shore bank told me "the one truism of small business lending is that the technical assistance that comes with a very small business loan is at least as important as the money itself" (Shapiro interview).

I will describe the availability of technical and management assistance later in this chapter.

GAUGING FUTURE CREDIT DEMAND AND ENCOURAGING ENTREPRENEURSHIP

Among other things, the Mt. Auburn study looked at potential future demand for financing of local businesses. "Over a third of the interviewees said they hoped to expand or renovate in the future"(15). They also reported that the owners of the major anchor buildings in the business district, the Columbia Square Building, The Buckley Building and 600 Columbia Road, were actively working to improve their buildings and find new tenants. By contrast, only two of 18 respondents I surveyed knew of business people who would like to open operations in Upham's Corner. Neither of these believed access to financing was the foremost stumbling block to their starting up.

In interviews conducted with Ed Grimes, President of the Board of Trade (and director of the Upham's Corner Health Clinic), Carlos Arcos, the Public Facilities Department business development agent, and Angel Bermudez, DBEDCs director of business and commercial development, I found that none of them knew of any businesses that were planning to open in Upham's Corner. All expressed hope that the new America's Food Basket on Dudley street would stimulate commercial activity and attract new businesses.³⁹

³⁹ All of these people have been integrally involved in improving business conditions in the community by working with the board of trade, encouraging small business development, and improving the physical condition of the commercial district.

The conclusions of both the Mt. Auburn study, and Nanette Robicheau's MIT thesis for the DBEDC, recommend an Upham's Corner commercial development strategy that will require significant capital investment in real estate and businesses.⁴⁰ Both point to an existing market demand and the potential to expand this demand through a variety of marketing, organizing and development efforts.

To accomplish the goal of bringing more and better businesses to Upham's Corner and North Dorchester, entrepreneurs who have the skills needed to open and operate businesses will have to be located or trained. Once ready to launch new ventures, these entrepreneurs will need access to capital.

PERCEPTIONS OF THE UPHAM'S CORNER BUSINESS CLIMATE

Over half of the business owners I interviewed believed that their business would be more profitable if they were able to obtain more financing, but half of these people had not applied for any type of financing in the last three years.

The perception that business financing is not available to Upham's Corner businesses is an important factor in local development. Regardless of how they feel about their own ability to get credit, almost everyone I surveyed said that it is difficult for other Upham's Corner businesses to get financing. Most believed that other business people don't know how to properly approach a bank for a loan, that they lack credit history and that the Upham's Corner neighborhood has been redlined by local lending institutions.

⁴⁰ These conclusions were based in part on a 1990 Melvin F. Levine study for the BRA of the potential business market in Upham's Corner found that the population and location could support more food, clothing, furniture, restaurant and service outlets.

Despite this perception, of the seventeen local retail and service businesses I surveyed (about 20 percent of the local businesses) most said that crime, shortage of customers, and cost of rent were bigger problems than access to credit or lack of working capital.

Few business people with whom I spoke had complaints about the types of service products they were offered by the banks--checking, savings, and payroll accounts, but several complained about the length of lines and time it took to transact business or get information from their local branches.

The perception that it is difficult for Upham's Corner small businesses to get financing, points to a need for either better communication between financial institutions and potential borrowers, or for loan products that are designed to meet the needs of these types of business people.

The next section explores the credit services that exist for small businesses, and whether they meet the needs described above.

MEETING THE MARKET DEMAND

There is a wide range of financial capital products available to local businesses. These are offered by various private for-profit, private not-for-profit, public, and quasi-public institutions. The institutions listed in table 4-1 are:

Banks: First Community Bank, Shawmut, BayBank.

PFD: City of Boston Public Facilities Department.

EDIC: City of Boston Economic Development and Industrial Corp.

CDFC: Massachusetts Community Development Finance Corporation.

WEJ: Women for Economic Justice.

CEDAC: Community Economic Development Assistance Corporation

Table 4-1 Comparative products offered by various funders:

Size of Loans	Banks	PFD	EDIC	CDFC	State Prgms	WEJ	Working Capital	CEDAC
Loans less than \$5000	No	Yes	No	No	No	Yes	Yes	Funds
\$5000-\$20,000	No	Yes	Yes	No	No	No	No	Only
\$20,000-\$50,000	No	Yes	No	UIF ⁴¹	No	No	No	Day
\$50,000-\$100,000	Some	Yes	No	UIF	No	No	No	Care
Loans over \$100,000	Yes	Yes	No	Yes	Yes	No	No	Centers
Uncollateralized loans	No	Yes	No	No	No	Yes	Yes	No
Real Estate loans	Yes	Some	No	Yes	No	No	No	Yes
Working Capital Loans	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Loan Guarantees	No	Yes	No	Some	No	No	No	Some
Technical Assistance	Some	No	No	Some	No	Yes	Some	Yes
Funds Start-ups	No	Some	No	MEIC	No	Yes	Yes	No
Equity Investments	No	No	No	Yes	No	No	No	No

Source: interviews with branch managers, loan officers and fund administrators. Key:

INVENTORY OF LOAN PRODUCTS AVAILABLE FROM DIFFERENT INSTITUTIONS

Loans for less than \$5,000

The PFD loan program, Working capital and Women For Economic Justice are the only institutions that help fund micro businesses. The PFD program is the most flexible of all the lending programs in the Boston area, but works city-wide and has only a small staff and small amount of money to lend. Working Capital requires

⁴¹ UIF is the Urban Investment Fund administered by the CEDAC. For a full description see the section on CEDAC below.

borrowers to be part of a peer group that trains members, approves, and services loans. Women for Economic Justice is primarily a training organization, and only lends small amounts of money to women who have come out of its program and started their own cooperative businesses.

The fact that there are both public and private sources of capital in this range is important, since public programs often change or end.

Loans between \$5,000 and \$20,000

Only the city of Boston's PFD and EDIC (Boston Small Business Loan Fund) programs make loans between \$5,000 and \$20,000. This loan size can be helpful to both micro-enterprises and to small storefront businesses. As I will discuss below, the PFD program is flexible but relatively small given its service area, and the EDIC program requires burdensome paper work. There is no permanent--private--institution that lends in this range.

Loans between \$20,000 and \$50,000

Although local banks may be willing to make loans in the \$20,000 to \$50,000 range (First Community Bank advertises commercial loan availability as low as \$15,000 to \$20,000) the actual number of loans they make is very small. PFD has made some loans and loan guarantees in this range. The newly created Urban Investment Fund administered by Community Development Finance Corporation (CDFC) will lend in this range once it puts together its lending guidelines.

Loans between \$50,000 and \$100,000

Area banks are more willing to make loans in the \$50,000 to \$100,000 range than in the smaller ranges. However, they are usually only looking to lend this little amount of money to businesses with significant growth potential. PFD has made some loans in this range and, as in the previous range, CDFC will administer UIF loans in this range once the program is started.

Loans over \$100,000

The over \$100,000 range is where banks can most profitably and efficiently offer full service loans. Many government programs, too, are set up to lend larger sums of money. CDFC programs used to include smaller loans and guarantees but now concentrate on lending between \$100,000 and \$300,000. Similarly, other state programs are targeted at assisting fewer larger businesses--that generate more jobs--rather than more, smaller, businesses.

BANK LOAN PRODUCTS, PROGRAMS AND MOTIVATIONS

All of the commercial banks in the Boston area offer business loan products. First Community Bank, Shawmut Bank, and BayBank all have commercial loan customers in North Dorchester (as I assume is the case for other commercial banks in the region). The degree to which bank loans are available in North Dorchester, as in the rest of the country, however, depends on the size of the business, amount of money needed, purpose of the loan, credit history of the borrower, amount of collateral that can be offered, and the (sometimes) subjective decision of the loan officer and loan committee.

Most of the businesses I interviewed do their banking with either the First Community Bank or Shawmut, and since both these banks claim to be highly responsive to community needs, I will use them as "best cases" for product availability.

Anthony Amoah, a business lender at Shawmut for the last seven years, summed up the reason why banks tend not to lend to very small businesses when he told me that "it costs as much for the bank to make a loan for a million dollars as it does to make one for \$10,000... the bank earns far more money on the million dollar loan, so there is a great deal of pressure to concentrate on making big loans." Mr. Amoah has personal authority to underwrite loans of up to \$50,000, and is occasionally willing to lend to smaller businesses, however, he is mostly looking to lend large sums of

money--over \$200,000--to existing, successful companies.

The costs Mr. Amoah referred to are information and transaction costs. Prior to making any loan, the bank's loan officer must do a thorough analysis of the business, including its financial history, capacity, market, and prospects for success. Gathering this information and walking a potential borrower through the loan application process are time consuming, and therefore expensive, tasks. Once the loan is made it must be serviced. The lender must make time to monitor the business to ensure that the loan will be repaid.

First Community Bank's policies are similar to Shawmut's. The bank announced in November, 1992 that it is "back in the lending business" with a commitment to lend \$3 billion in the New England region. In January, 1993 it upped the amount to six billion dollars.⁴² The FCB business lending unit is located in the Upham's Corner branch and has increased its loan staff from 2 to 5 since July 1992. The bank is now aggressively going after new banking customers particularly from recent immigrant communities (especially Asian communities) by approaching existing businesses looking to expand. Despite these efforts, almost no small loans under \$40,000 are being made to small businesses (although the bank has recently started advertising that it will lend as little as \$15,000-\$20,000). As I mentioned earlier, no local bank makes loans to start-up small businesses.⁴³

Both Shawmut and FCB lenders told me that their banks are going to introduce new small business loan products in 1993. Both will be designed to lend smaller amounts

⁴² Bailey, Doug. Bank of Boston Doubles Loan Pledge to \$6 Billion. Boston Globe. January, 9, 1993. 19.

⁴³ Start-up businesses can only raise capital from banks though their owners taking out second mortgages or home equity loans, or to deposit as much collateral in the bank as they wish to borrow. Although used for business purposes, the bank considers these to be personal loans.

of money-- down to \$10,000--to existing businesses by using a standardized loan application that is, as FCB's Steve Tromp described it, "easy and fast and not too bureaucratic...underwriting criteria would be strictly defined." Tromp went on to say, "If I could design any product for very small businesses, it would be a small business credit card with a \$20,000 limit similar to a line of credit." He added that he would insist on getting collateral before issuing such a card. Both he and Shawmut's Kevin Winn believe that risk and profitability questions have prevented local banks from offering such a product in the past.

Banks seem to provide technical assistance in proportion to the size of the loan they are making. The bigger the loan, the more assistance that is offered. Banks provide assistance in order to reduce their risk and to encourage more borrowing by their largest, most profitable, customers.

The loan officers with whom I spoke appeared willing to educate and work with potentially profitable business borrowers. The banks also sponsor outreach programs and seminars for small businesses that are interested in learning how to apply for a loan or work with a public program through a bank. However, unlike the work they do with low-income consumers, banks are not designing these programs specifically for very small businesses. Further, the banks must be able to make a profit from each new small business product they offer. This means that underwriting and servicing costs must be reduced, often through the elimination of expensive technical assistance that might have come with a loan. As I stated earlier, there is a widespread belief that small businesses need technical assistance from financial institutions and that capital provision without this assistance can get small businesses into trouble. Although the bank tries to protect itself by taking collateral and a personal loan guarantee, it is in no one's best interest to see a business struggle or fail due to lack of technical or

management assistance.⁴⁴

PUBLIC LOAN PRODUCTS AND PROGRAMS

Public Facilities Department

The City of Boston's Public Facilities Department (PFD) runs a neighborhood business development loan fund and a loan guarantee program that it funds with an annual \$3 million Community Development Block Grant (CDBG). What makes the PFD program unique is its flexibility. PFD will underwrite everything from fairly large loan guarantees to small unsecured loans, as well as facade, renovation, and construction loans. When the new supermarket Americas' Food Basket had insufficient collateral to secure its loans, PFD placed a \$250,000 guarantee with the State Street Bank--the primary lender--to secure the financing. When a hair stylist in another targeted neighborhood was unable to get conventional financing, PFD lent him \$20,000 at 5% for 10 years. This type of flexibly designed loan might be very attractive to many storefront businesses in Upham's Corner.

Upham's Corner businesses are among those in eight city neighborhoods that have access to this program. Business people are made aware of the PFD funding program through Carlos Arcos, the PFD neighborhood business development agent. Mark Yagerlaner, who runs the program out of the Housing and Neighborhood Development Division told me that "I can be much more flexible than a bank in looking at a

⁴⁴ I should note that there is some dispute over the amount of technical assistance needed to launch small and micro enterprises and get them to a point where they can repay loans. The Grameen bank model that has been replicated by the Full Circle Fund in Chicago (and others), uses peer groups rather than formal technical assistance to encourage loan repayment. Working Capital, a New England based micro-lending program requires peer groups to participate in technical assistance exercises before they qualify to receive loans and then encourages group members to set up their own education program to get the assistance they need.

potential borrower... and this program requires far less paper work or bureaucratic decision making than the EDIC loan program" (Yagerlaner interview). According to Yagerlaner, the only two criteria a business must meet to be eligible for CDBG funds is that at least 51 percent of the project--either population served or jobs created--must go to low- and moderate-income people, and that construction projects of over \$2000 must pay prevailing wages.

Commonwealth of Massachusetts

The Commonwealth of Massachusetts has a variety of state programs designed to help small and medium-sized businesses (as defined by the SBA). The Massachusetts Business Development Corporation, Massachusetts Certified Development Corporation, and Massachusetts Capital Resource Company's programs, all target lending, guarantees, or other services to otherwise unbankable businesses. However, these programs are designed for businesses that are significantly larger than any located, or likely to locate, in Upham's Corner.

The Massachusetts Industrial Finance Agency (MIFA) has two programs that could conceivably be approached by Upham's Corner businesses. However, both the Seafood Loan Fund and Child Care Facilities Loan Fund tend to lend to larger companies than locate in Upham's Corner.

The Thrift Fund is a state sponsored lending pool set up with resources from a large number of thrift institutions to help and encourage them to do community-based, development-oriented, lending. The Thrift Fund has three programs, the Participation Loan Program, the CRA Initiative, and the Direct Loan Program. All concentrate on lending in the \$200,000 range. All these programs are designed to lend to bankable businesses with collateral.

Other programs administered by the Commonwealth of Massachusetts target larger and more specialized businesses than typically locate in urban neighborhood commercial

districts. Lending targeted for high tech ventures, and large manufacturing companies is designed primarily to create a large number of jobs.

Federal government

The Small Business Administration (SBA) has a loan guarantee program that is used widely by many banks in underwriting conventional business loans. In addition the SBA offers a limited direct loan program to Vietnam Veterans and disabled entrepreneurs.

QUASI-PUBLIC LOAN PRODUCTS AND PROGRAMS

Economic Development and Industrial Corporation

The Boston Economic Development and Industrial Corporation (EDIC) administers the Boston Small Business Loan Fund (BSBLF) that was started in 1991. The BSBLF lends between \$5,000 and \$15,000 from a \$1 million loan pool set up by several large banks. It lends only to existing businesses that are able to put up sufficient collateral. Six Community Development Corporations (CDC) from around the city act as the intake agencies for loan applicants. The lending rate is 2 percent above prime and the maximum repayment/ amortization period is five years. Several people with whom I spoke said that the idea for the program was sound but that burdensome paper work required of applicants discourages many potential borrowers.⁴⁵

As with bank lending, many businesses that qualify for loans in this range are more needy of technical assistance than the capital provided. This program offers no technical assistance. EDIC and the CDCs working with this program are processing relatively few loan applications at this time. Several local activists expressed hope

⁴⁵ The two development officers (who are administering this program for different CDC's) with whom I spoke think it's too bureaucratic. Applications are first taken and processed by CDC staff, then by the CDC loan committee, then by the EDIC staff, and finally by the EDIC loan committee which makes a final loan decision.

that the program will become less bureaucratic in the near future so that more small businesses will apply for and receive loans.

Community Development Finance Corporation

The Community Development Finance Corporation (CDFC) is a state-endowed quasi-public agency (\$15 million in capital) that lends short-term construction money to CDC's and makes medium-term debt and equity investments in businesses (with CDC sponsorship) in order to expand employment in low-income communities.

CDFC makes small business loans (primarily to mature businesses looking to expand) of between \$100,000 and 300,000 in targeted areas of the state. It also makes equity investments in companies with high profit potential (or high social returns), also in targeted areas of the state.

In addition to these programs, CDFC administers the Urban Initiative Fund (UIF) on behalf of the State which gave it a \$5 million appropriation, and the Minority Enterprise Investment Corporation (MEIC) on behalf of the Commonwealth Investment Fund. The UIF was created by the legislature to encourage minority entrepreneurship. UIF will make loans, in targeted cities, to small minority businesses with annual sales under \$500,000 (no CDC presence is required). Although at the time of our interview CDFC was still writing lending guidelines for the UIF, it will likely have a primary lending range between \$10,000 and \$30,000, but will be able to make some loans in a wider range between \$5,000 and \$200,000. Collateral requirements and policies on lending to start-up businesses had not been decided.

The Commonwealth Investment Fund is a 3-program group which was founded by seven banks to overcome historic anti-minority bias in lending. It has contracted CDFC to administer a Minority Enterprise Investment Corporation (MEIC) which operates under SBA guidelines and is eligible for SBA guarantees. This program provides both debt and equity financing to qualified minority businesses including

start-up companies.⁴⁶ The MEIC puts greater emphasis on financing businesses that can create jobs, so it lends larger amounts of money--over \$100,000--than the UIF program.

Finally, CDFC runs a minority and women bonding program to assist contractors who might have difficulty getting insurance bonding for their projects. CDFC has set aside \$1 million to provide technical assistance, prepare companies to apply for bonding, and provide letters of credit for minority or women-owned companies that have insufficient capital to receive bonding.

Up until 1992 CDFC ran a loan guarantee program for very small businesses (but not micro's) intended to help CDCs stabilize their commercial districts. Guarantees of up to 50% of a loan--of \$50,000 or less--were made for mature businesses that lacked sufficient collateral to secure the full amount of a needed loan. This program was cancelled because as Margaret Summer Small told me, "excessive staff time and energy was being spent doing financial work-ups on the borrowers and companies, and monitoring the guarantees...when commercial interest rates fell and we [CDFC] were getting only 3-4 percent on the bank CDs we began losing too much money and were forced to terminate the program."

CDFC is willing to assume more risk than the average bank. However, almost all of its lending and investing is done to manufacturing- based companies that are larger than those likely to locate in the Upham's Corner commercial district. Further, CDFC no longer offers as much direct technical assistance to its borrowers.

Community Economic Development Assistance Corporation

The Community Economic Development Assistance Corporation (CEDAC) lends money--and provides technical assistance--to existing day care centers that are either

⁴⁶ This depends on several factors including the track record of the entrepreneur.

not bankable or require loans that are too small for conventional banks to consider. CEDAC is funded through foundation grants, the United Way, private contributions and government contracts. Its current mission is primarily to help low-income communities expand day care services in order to free-up single parents to enter the job market.

At one time CEDAC also had a small business lending program which it has phased out.

PRIVATE NON-PROFITS

Working Capital

The DBEDC has recently become an affiliate of Working Capital, a micro-enterprise peer lending program that facilitates the creation of peer borrowing groups of micro-entrepreneurs and provides individual borrowers with loans in the \$300-\$5,000 range. Organizing costs for the program are assumed by the local affiliates and loans are made from banks (on a line of credit). Anyone willing to join and be an active member of a peer group is eligible to become a borrower.

Women For Economic Justice

Women For Economic Justice (WEJ) is a non-profit, small business development organization that teaches and assists low-income women to start and run cooperative businesses. WEJ has a small loan fund that is available only to those cooperatives it has established. When a cooperative business is ready to incorporate and start production and sales of a product, it becomes eligible to be a peer borrowing group in a stepped program with a maximum loan size of \$5000. The organization and loan fund are capitalized by foundations and private donations. WEJ is currently working with about eight different groups of women in Roxbury and Dorchester including one affiliated with the Bird Street Community Center in Upham's Corner.

OTHER SOURCES OF CAPITAL AND SERVICES

There is no venture capital fund that has been set up to assist the types of businesses likely to locate in North Dorchester. Businesses in need of equity investments must find their own sources and compete with other ventures from around the region.⁴⁷

In addition to the technical assistance provided by some of the lenders listed above, one of the state sponsored small business development centers is located at Boston College and services area business people needing assistance. There is also a Minority Business Development Center located at Boston University and a Service Corps of Retired Executives (SCORE) sponsored by the SBA.

PROBLEMS AND ISSUES

Despite the variety of small business lenders and programs available to Upham's Corner businesses, many of these capital products are either difficult to access, or they are not offered as part of a strategic business development effort to improve specific conditions in this community. In the first case, demand for business capital exists, but the way that businesses are prepared to borrow money and the way that financial institutions are prepared to lend it, do not mesh.⁴⁸ In the second case there may be no

⁴⁷ The State office of Business and Economic Development publishes a partial list of known venture capitalists and venture capital firms.

⁴⁸ Anthony Amoah from Shawmut Bank told me that the biggest problem he sees with loan applications from very small businesses is that their records or financial statements are poorly kept. In his opinion, many small businesses do not know how to keep their books during their start-up and early years of operation, and therefore cannot prove that they qualify for loans when they are ready to expand. He believes that proper presentation of financial statements is a key to qualifying for business loans.

DeWitt Jones of the Boston Community Development Loan Fund has a slightly

lack of capital, but there is a shortage of community-based entrepreneurs who have the interest and ability to seek capital to start or expand businesses in Upham's Corner, and no institution exists to recruit, develop, coordinate and assist entrepreneurs.

The recent introduction of Working Capital, and the PFD and EDIC loan programs have begun to fill the need for small business debt financing below \$50,000 and are very positive additions to the lending community. However, EDICs lending criteria and paper work are considered by many to be more bureaucratic than a bank's. Although capital is available from this program, it is not necessarily accessible. The PFD program is less bureaucratic, and may be the most flexible source of money for the types of businesses likely to locate or expand in Upham's Corner. However, because it is city-wide in scope, it alone cannot support the level of lending that will be necessary to revitalize the Upham's Corner and North Dorchester commercial districts.

CONCLUSION

As I stated in chapter two, the obstacles to the commercial revitalization of Upham's Corner are numerous and complex. The availability of capital for new and existing businesses, while important, is but one necessary element of a successful strategy to expand neighborhood commercial activity, support business development, and create jobs.

different perspective. As a board member of the Tortilla Factory (a small business) and a tenant at the Neighborhood Development Corporations' business incubator in Jamaica Plain, he agrees that very small businesses should do a better job of keeping their books. But he also believes that banks and other financial institutions must do a better job of understanding how small businesses keep their books and do their planning. He believes that banks should understand what small businesses are good at, and figure out ways to get capital into business people's hands without making them jump through onerous hoops.

In many ways, the gaps between what small business people in a community like Upham's Corner need, and what conventional financial institutions provide, is similar to the gap between consumer needs and services. Like consumer products, most loan products seem to be designed for large corporate clients with the experience and facilities to keep required records and offer particular types of collateral. These programs are then scaled down, labeled as community development products, and offered to smaller businesses. Also like consumer products, the costs incurred by conventional banks when they provide very small business loans is so high that they cannot profitably make most loans, and do not attempt to do so.

Again, capital gap occurs because financial programs are designed to meet the needs of the financial institution, rather than the needs of small business consumers. In the case of larger loans that could be profitably made, the banks may be behaving too cautiously to assist business development in Upham's Corner and should be pressed to make certain loans. In the case of very small capital provision, this is a public and not a private gap.

Public and quasi-public agencies, as well as private non-profit groups, have developed programs to fill some of these public gaps and some of these programs are well-designed and will meet many of Upham's Corner's business needs. Other programs display the same shortcomings of bank programs, and will have little impact in the community.

As with the provision of consumer financial services, local institutions have made good efforts to provide capital and technical assistance to Upham's Corner's small businesses. Despite these efforts there remains an institutional and organizational gap between the strategic targeting and development assistance needs of Upham's Corner, and what existing organizations are capable of providing.

A compelling case can be made, therefore, for the creation of a CDFI to meet this

need. Its ultimate design, however, must be based on all of Upham's Corner's unmet needs, including consumer financial needs and those discussed in the next chapter on home mortgage financing.

5 THE HOUSING MARKET IN THE DBEDC SERVICE AREA

A final critical capital need in low-income communities is for residential and commercial mortgages. It is outside the scope of this thesis to do original research comparing mortgage demand with availability from existing institutions. This would be a thesis topic in itself. Rather, this chapter frames some of the questions that need to be answered to determine if there are unmet home mortgage needs in North Dorchester, and draws on some existing studies to reach some tentative conclusions. Due to lack of time and resources I have chosen not to investigate the demand or provision of commercial mortgages and will leave this topic for others to pursue.

Based on interviews with four local mortgage lenders, the 1989 and 1992 Federal Reserve Bank of Boston studies on discrimination in Boston's mortgage lending market, and information taken from Kristi Cunningham's 1992 report for the DBEDC on sales and mortgage volume in Upham's Corner, I will describe the mortgage products being offered by existing institutions as well as where some of the gaps in mortgage lending might be found.

RESEARCH QUESTIONS

There is a great deal of raw data that can be compiled to determine mortgage demand. The number of home sales in an area in a given period compared with the number of saleable housing units yields a sales friction percentage that can be compared to other areas. But, since no two areas are the same, local economic factors, sales prices compared to income levels, and comparative demographic information must all be factored into determining if there is high, low, average or abnormal mortgage demand.

The most discussed research on mortgage availability in Boston has been the 1989 and 1992 Federal Reserve Bank studies to determine if there is racial discrimination in Boston's mortgage lending market. Although both the 1989 and 1992 FED studies concluded that area banks discriminate against minorities in the home mortgage lending market, these studies did not account for non-bank mortgage lending which accounted for over 65 percent of mortgages made between 1987 and mid-1992 in the DBEDC service area (Cunningham). To conclude if there really is a lending gap, it must be determined if mortgage companies, credit unions and private lenders also discriminate, or if they are meeting the mortgage lending needs in markets (such as North Dorchester) where banks are discriminating.

Table 5-1 Home Mortgage loans made in DBEDC Service area 1987-5/1992. Note large number of lenders active in area.⁴⁹

Year	Total number sales in DBEDC service area	Total number of lenders	# of loans made by biggest lender	% of loans made by biggest lender	Institution that made most loans
1987	455	83	40	10%	Dime Real Estate ⁵⁰
1988	456	87	40	10%	Progressive Consumers CU ⁵¹
1989	430	74	59	17%	Northeastern Mtg.
1990	279	64	46	20%	Northeastern Mtg.
1991	241	56	22	15%	Boston Bank of Commerce
5 mos.	194	33	8	9%	BBC, FNMA, Shawmut ⁵²

Source: Cunningham, from Banker and Tradesman

⁴⁹ The number of lenders is based on the number of loans made, which is less than the number of sales listed in column one. Also, in the later years, a larger percentage of the transactions were foreclosures which did not include mortgages.

⁵⁰ The Dime Savings Bank is no longer making any residential loans in Massachusetts.

⁵¹ The Progressive Consumers Federal Credit Union has left the mortgage lending market.

⁵² BBC=Boston Bank of Commerce, FNMA=Federal National Mortgage Association.

The fact that so many lenders have been active in the DBEDC market is positive. This data can be most useful, however, when compared with well served communities to determine if there is adequate sales volume (based on the number of saleable housing units in the community), and adequate mortgage availability based on the percentage of mortgageable sales.

As I stated above, it is difficult to gauge normal sales volume in a market. The 1989 FED study set an average level of market activity finding,

About 8.6 percent of all properties in neighborhoods with a majority white population were sold in an average year between 1982 and 1987. The corresponding figure for majority black neighborhoods was 5.2 percent. Mortgages were originated on 6.9 percent of properties in majority white neighborhoods during an average year, but on only 3.5 percent of properties in majority black neighborhoods (13).

Cunningham's study of Banker and Tradesman data found that in both 1987 and 1988 approximately 5 percent of properties in the DBEDC service area were sold. In later years not only did this percentage decrease, but a large proportion of sales were actually foreclosures. It is probably unwise to put too much stock in comparing numbers from these different time periods, but since market conditions were fairly similar between 1985 and 1988 a case might be made that sales friction in North Dorchester was similar to other minority communities and less than in white or higher income communities.

The high price-inflation of the mid-1980's coupled with the recession that hit Boston and the entire Northeast in 1989 must also be factored into the discussion of drops in sales and mortgages.

WHO USES MORTGAGES

Any discussion of mortgage availability must include the fact that mortgages

represent much larger loans than any other credit demand of a household. They are based on the price of a home which is usually well outside the reach of a low-income person, regardless of the interest rate and mortgage terms offered by conventional banks. In recent years various non-profit groups have worked to devise ways to lower the cost of home ownership through price subsidies and mortgages held by social investors.⁵³

The mortgage market studied by the FED never considers the issue surrounding making home ownership more possible for very low-income people. Below I describe how the banking industry is attempting to close the bottom end of private capital gaps in the home lending market. After this is done there will remain a public gap preventing low-income people from becoming home owners. Closing this gap will require alternative public and private efforts that the DBEDC should consider adding to a list of activities for a CDFI.

MORTGAGE PROGRAMS

The recession and the heavy losses sustained by some mortgage lenders in the last several years have caused the number of institutions in the mortgage market to decrease. Progressive Consumers Federal Credit Union of Revere was among the biggest mortgage lenders in the DBEDC service area between 1987 and 1989. By mid-1990, however, they decided to get out of the mortgage lending business. Still, there are a large number of mortgage lenders operating in North Dorchester and over the last few years, the banks in Upham's Corner (Bank of Boston's FCB, Shawmut and the Boston Five) have all become more active mortgage lenders in this community. All these banks have introduced mortgage products specifically to help

⁵³ Groups like the Federation of Appalachian Housing Enterprises in Kentucky, and the Self Help Credit Union in North Carolina have been successfully able to make mortgage loans to people earning below the poverty level.

people in lower income communities.

Bank of Boston has introduced a "First Step" mortgage program for first time home buyers.⁵⁴ First Step offers lower application fees, lower closing costs, reduced interest rates on 30 year fixed mortgages, and more flexible qualifying criteria than for conventional mortgages. Bank of Boston also holds these mortgages in its portfolio. This means that they do not have to worry about meeting secondary market standards and can lend on more unusual properties to buyers who do not qualify for a guaranteed mortgage. This is a case of banks designing products to meet customers special needs.

Shawmut and BayBank are also using flexible mortgage programs, including "soft second" programs, to increase access to home ownership in neighborhoods like Upham's Corner.

The Boston Five, whose primary business is mortgage lending, is going to be starting a "purchase lease" program with the DBEDC. This program allows the DBEDC to purchase a house and then lease it to a family who will eventually buy it from the DBEDC and take over the assumable mortgage. This program will be insured through Fannie Mae.

In addition to these bank products, there are a number of private, public, and quasi-public programs that assist home buyers with financing. These include the Home Ownership Program (HOP) administered by the Massachusetts Housing Finance Agency, and a soft second program through the Mass Housing Partnership (MHP). In response to the FED studies, the Massachusetts Bankers Association created several new programs that made mortgages more available to minority borrowers. Finally, the

⁵⁴ The First Step mortgage is available throughout the Bank of Boston system and is not unique to the First Community Bank.

Federal HOME funds (available through the National Affordable Housing Act) which are funnelled into the states and local government agencies, can be used to subsidize home ownership. Participating towns and cities can apply for funds to be used for a variety of programs including home purchase assistance.

CONCLUSION

I have no conclusive evidence that a great demand for home mortgages in Upham's Corner is going unmet. Further study is necessary before such a conclusion can be drawn or dismissed. Because there are so many different lenders and different types of lenders active in the DBEDC service area, a broader study of market opportunities should be undertaken to ascertain:

- 1) if there is the same level of racial discrimination among non-bank lenders operating in the area as among banks.
- 2) if most loans being made in North Dorchester are using government guarantee programs or sold in the secondary markets, and whether the qualification requirements of these programs excludes otherwise qualified borrowers or properties.
- 3) if there is a way to think about mortgage lending from the perspective of people who have traditionally not qualified for mortgages, and if there are opportunities to create affordable housing and mortgage products for low-income people (such as exists in some rural areas). These are the types of projects that cannot be undertaken by conventional financial institutions, but might be appropriate for a CDFI.

CONCLUSION TO CHAPTERS THREE, FOUR AND FIVE

In chapters three, four and five I outlined many of the issues surrounding financial services and capital provision in the Upham's Corner community. At the retail

banking level I found a number of gaps between services needed by, and available to, low-income consumers. I found another gap between the needs and provision of services for very small businesses. Finally, I recommended further study to determine whether there are gaps in the home mortgage market and how they can best be filled.

Although there are private and public capital gaps in both consumer and business service provision, I believe that the more serious gap I have identified is institutional, that is, between the community's need for a strategic development institution and the abilities of existing institutions to adequately meet this need. I found that conventional banks and other credit providers in Upham's Corner sincerely want to provide services and products to all who need them. However, the mission, size, structure, risk profile, and financial objectives of these institutions prevent them from reaching all those who need capital and service.

6 THE NEED AND CRITERIA FOR CREATING CDFIs

The decision of whether, and how, to respond to the capital and institutional gaps described in the previous three chapters should be largely based on the nature of these gaps, and on a set of objective criteria. This chapter defines community development financial institutions and describes some of the assumptions, criteria, and issues used in their design and operation. This, along with an understanding of different CDFI models described in the next chapter, will enable me to suggest whether and how the Dorchester Bay Economic Development Corporation can best meet Upham's Corner's unmet capital and institutional needs.

There are many different ways to respond to the consumer retail, small business, and institutional gaps I have identified. Policy analysts, and state and local governments spent much of the 1970's formulating policies to create new public institutions to fill what Daniels and others identified as public capital gaps (Bingham et al. 25). Although they were not community-based, these new public institutions played, and continue to play, an important role filling the capital needs of individuals, businesses, and non-profits in low-income communities.

In the 1980s many private groups recognized that the CRA had limitations, and was only able to press banks to fill certain types of private capital gaps. They also recognized that the public and quasi-public financial programs created to fill public gaps had limited abilities to fill specific and strategic development needs in low-income communities. In response these groups created alternative community development financial institutions (CDFIs) to meet the types of capital and institutional gaps I have identified.

DEFINITION

The term "community development financial institution" is used to describe a wide variety of organizations and programs. It may refer to anything from a community development bank, which is a state or federally chartered depository institution, to a small loan fund run by a community groups.

For the purpose of this thesis, CDFIs are community-based institutions and programs with community development missions. They usually serve narrowly defined markets--either geographic or sectoral--to assist people and businesses who are under-served by conventional financial institutions. CDFIs provide capital and services for community economic development projects in these markets. Their mission, therefore, is primarily developmental--to improve the conditions of a specific geographic area or segment of society--and secondarily financial--to be profitable. This is the biggest difference between the mission of community development financial institutions, and conventional financial institutions.⁵⁵

DIFFERENCES BETWEEN MODELS

Community development financial institution models include--but are not limited to--commercial banks and thrifts, credit unions, various types of loan funds, micro-enterprise loan programs, and royalty and venture investment funds. Although conventional check cashing stores do not meet the definition of a CDFI, they can be redesigned to both provide needed financial services and support community economic development in low-income communities (Minsky).

Each of these models fills a specific market niche and has a unique way of interacting

⁵⁵ This definition is my own, but is compiled from the works of Parzan and Kieschnick, Daniels, the NACDLFs, Schramm and others.

with the public, raising capital, lending money, and conducting operations. Each model also carries different risks and returns to investors and the community. All of these differences are defined by the institution's mission and the opportunities and restrictions of its legal structure.

The structure of a CDFI should be determined by the community needs it seeks to address. The mission of a CDFI can be narrow or broad, as specific as stabilizing the land values of trailer parks in the state of New Hampshire,⁵⁶ or as general as reversing the physical and social deterioration of a low-income community.

Similarly, the services offered by a CDFI can be narrow or broad. There are community development loan funds that offer no consumer services while there are community development banks that offer every depository service and loan program available from a conventional commercial bank.

CDFIs may have different organizational forms. A CDFI may be a single entity addressing a narrowly defined community need. Another may be a multi-service organization made up of many subsidiaries and a broad mission.

Because CDFIs are designed to serve the unique needs of specific communities, it is difficult to make definitive statements about what general structures will, and will not, succeed. Community development financial institutions are not like McDonald's franchises, the same model cannot be placed in every market and be expected to succeed. Henry Morgan of the South Shore Bank board has cautioned the Clinton administration against designing a single type of institution that can be replicated across the country. Instead, he and others are urging that the program allow for

⁵⁶ The New Hampshire Community Loan Fund was started primarily to lend to groups of mobile home park residents so they could buy the land under their trailers cooperatively.

individual structures to be created to address the needs of individual communities and the capacities of sponsoring organizations.⁵⁷

ISSUES AND CRITERIA

Community development financial institutions are created to address both capital market failures, and under-development. There is little need to create CDFIs in communities where there is a healthy level of development and sufficient capital to finance projects.

As I have described in earlier chapters, capital gaps occur for two reasons. When investments with returns and risks that private investors normally find acceptable, are not made, private capital gaps occur. When investments deserve to be made because they have high social return,⁵⁸ but are not made because they have unsatisfactory private returns, public capital gaps occur. Communities suffer from under-development because they lack the entrepreneurs and institutions with the skills and interest to complete development projects, and because of private and public capital gaps.

Organizations that decide to start CDFIs seek to address capital market failures and under-development either by uncovering profitable markets, or by committing to serve unprofitable markets where high social benefits exist. It is vital for CDFI sponsors to know which of these tasks they are undertaking and to design their institution and programs accordingly. The strategies and tactics necessary to fill private and public

⁵⁷ Henry Morgan made these comments at the Boston College, State Street Bank Forum, 2/24/93. Similar advice to the Clinton administration has come from a consortium of community lenders organized by the National Association of Community Development Loan Funds.

⁵⁸ A social return is a desired public benefit, exclusive of financial returns or risks associated with the market.

capital gaps are quite different, and the consequences of attempting to fill public gaps with a private gap-oriented institution may be disastrous.

CRITERIA

CDFIs are designed to respond to community needs in a different way than conventional financial institutions. Therefore, the decision of how to respond to the gaps I have outlined must be based on different, but no less stringent, objective criteria than those used by conventional institutions. The following criteria can be used to decide whether to create, and how to design, a CDFI:

- 1) There must be clear community needs that are going unmet, and will continue to go unmet, by existing institutions.
- 2) The CDFI must have measurable and achievable goals that are related to the community's unmet needs.
- 3) The CDFI must be sustainable either through its own income, stable subsidies, or a combination of the two.
- 4) The CDFI must use its resources efficiently.
- 5) The CDFI structure must be flexible enough to respond to opportunities in its target area.

ASSUMPTIONS FOR DESIGN OF STRUCTURE:

1) Targeted Population

CDFIs deal with customers who are largely missed or ignored by conventional financial institutions. These are usually low-income customers who may be non-white, have limited formal education, and may not know how to use conventional financial

institutions.⁵⁹ Institutions dedicated to addressing the needs of this population must offer products and services designed specifically for them. They must be able to meet special needs while recognizing the limitations of their abilities.⁶⁰

2) Risks

Conventional bankers often view community development lending as being riskier than lending to established businesses and upper middle-class people. In most cases risk perception is based on the lenders' experience and familiarity with particular types of projects and people, as well as objective assessments of collateral and income.⁶¹ Nascent CDFIs must explicitly decide how they will deal with the issues of assessing, managing, minimizing, and accepting risk when designing their structure and programs. They must, therefore, balance their desire to provide services to unconventional borrowers with caution not to mistake overly risky requests for acceptable loans.

3) Capital Sources

Most money that is used by conventional financial intermediaries comes from households. Corporations, pension funds, insurance companies, governments, and charitable organizations also invest in intermediaries (Ritter and Silber). Community development financial institutions, like all financial institutions, must raise both equity (money that is invested by stock holders or donated by individuals, foundations or public agencies) and debt (money that is loaned to the institution and must be repaid). CDFIs have many potential sources of funds in national and local capital markets and

⁵⁹ This is only one profile of a CDFIs target population, and most accurately describes the population likely to use a CDFI in Upham's Corner. There are also CDFIs that serve middle-income whites with relatively high levels of formal education.

⁶⁰ Some low-income people will never be able to qualify for a home mortgage just as some businesses will always be too risky to be bankable, even by a CDFI.

⁶¹ David Rockwell talk at MIT, 11/92

each CDFI model has access to different sources of funds depending on its structure, legal status, and mission.

Private capital comes from investors who are motivated by either financial or social returns. Financial return-oriented investors represent over 99% of all investors, while social return investors are a very small but growing group. Return-oriented investors are most concerned with five aspects of an investment: the financial return (amount of money earned on the investment), risk (chances that the institution will lose some or all of the investment), term (the length of time their money will be used in exchange for the promised return), liquidity (the ease of turning the investment back into cash), and reversibility (the cost of turning the investment back into cash) (Modigliani).

Social investors (who may be concerned with many of these same things) are most concerned with how their money will be invested by the intermediary. Some social investors are passive, choosing to place their money in "socially responsible" investment funds. Others are active, choosing to invest in specific, socially beneficial projects.

A CDFI must identify its potential sources of funds. It must understand what motivates depositors and investors to choose one institution over all the others in the market. It must decide where it will concentrate getting its two different kinds of capital; equity and debt. And, finally, it must determine the impact its fund raising will have on other community development financial institutions in its area and nationally.⁶²

⁶² Many development bankers believe that the pool of social investors is so small that new ventures that target this pool for deposits and investments simply take money away from existing community development institutions (Ronald Homer, Henry Morgan, at Boston College/State Street Bank Forum; DeWitt Jones interview).

CONTROL AND LOCATION OF CDFIs

Based on the criteria outlined above, organizations that are interested in sponsoring community development financial institutions may start and operate new institutions or work with existing CDFIs.

The advantages of working with an existing CDFI include cost savings, increased leverage ability, access to broader staff expertise, and limiting competition for scarce subsidies and investments.

Because there are minimum fixed costs to operating any type of CDFI, two separate CDFIs operating in the same market will both be spending money for base staff, space, and materials that could be spent more efficiently by a single, larger, organization. In its 1987 report for the EDA, Mt. Auburn Associates lists several useful findings about the efficiency and effectiveness of revolving loan funds (RLFs).

Larger organizations, with greater financial resources, are able to support a more specialized staff, more intensive marketing, more comprehensive planning and more sophisticated loan administration. These funds also have more lending flexibility and are able to maintain more consistent deal flow. The effect is that larger funds tend to perform better.

The skills and experience of RLF staff are key variables in performance. Financial analysis skills are the most important, and RLFs with the strongest performance records tend to have staffs with substantial experience in banking and finance.

Loan review committees composed of finance professionals can play a key role for smaller RLFs which need to supplement the financial analysis skills of the staff.

These findings suggest that there are real advantages to running larger CDFIs which have larger operating budgets and are more likely to attract highly skilled staff who can make more complicated investments and build the fund's reputation and power in the community. Moreover, CDFIs that are intermediaries for investors must limit the

size of any one investment to a fraction of their total capital pool.⁶³ Therefore, the larger the pool, the larger the size of the loans, guarantees, and leverage positions CDFIs can take. Taken together, these issues suggest great advantages to expanding existing CDFIs to serve new communities rather than creating new CDFIs and duplicating efforts.

The disadvantages of one organization joining another's CDFI, however, should not be minimized. By joining an existing CDFI there is less focus on the needs of the single community. There is also a loss of control over how and where money is invested, and foregone political influence, and capacity building of the sponsoring organization.

TECHNICAL ASSISTANCE

Funds that choose to provide technical and management assistance to businesses face another set of issues over where to place these activities. Bendick and Eagan describe much of what technical assistance providers now do.

A traditional business assistance approach might provide a loan, perhaps at a below-market interest rate, from a special minority loan fund. A contemporary assistance organization might instead first suggest that the firm modernize its accounts receivable system to reduce its need for working capital. Then it might assist the firm to obtain supplier credit rather than obtaining its inventory on a cash and carry basis. And finally it might advise the firm to change their debt structure so that a market-rate loan can be obtained from a commercial bank operating under conventional rules. In many cases, this counseling is similar to what has traditionally been provided informally by local branch banks to small firms in their market areas. However, many banks are increasingly reluctant to engage in informal counseling. Under an emerging legal doctrine called "lender liability," they now fear being sued for giving bad advice (Bendick and Eagan 26).

Mt. Auburn Associates' Study notes that there can be conflicts of interest when TA providers represent the interests of borrowers before other lending groups. This is

⁶³ The National Association of Community Development Loan Funds guidelines call for no more than 10% of funds to be lent to any one project.

especially the case when the loan fund TA providers are trying to leverage conventional financing and are helping the business owner assemble a complex loan package.⁶⁴

SUMMARY

When markets fail and capital and institutional gaps occur, and when communities suffer from under-development due to lack of entrepreneurs, developers and good strategic development planning, alternative community development financial institutions may be required to fill these gaps and create needed development programs.

A CDFI sponsoring organization must decide what it most wants to accomplish based on the unmet needs of its community. It must set measurable and achievable goals, be able to raise capital, attract staff, and design a program that can provide appropriate services while minimizing and managing risk. It must be efficient and flexible and it must be able to exercise political power in the local development process. The criteria and issues outlined in this chapter just scratch the surface of the issues that must be faced when developing a CDFI. Although some smaller loan funds have taken as little as six months to launch, more complicated ventures, such as the Community Capital Bank in Brooklyn took six years to organize before making its first loan.

The criteria outlined here should be considered when reading the next chapter where I describe what some of the new CDFI models look like, how they are structured, and the strengths and weaknesses they bring to the task of community development.

⁶⁴ They too note that the Fund can be sued by a client if a business person believes that the TA provider has given poor advice that damaged the business (Mt. Auburn Assoc. 1987, 46). However, none of the community development lenders I interviewed, who give extensive technical assistance, mentioned a fear of being sued by a client. I am not sure that this is as important an issue as the literature suggests.

7 COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

In earlier chapters I have made the case that there are capital and institutional gaps in Upham's Corner that may best be filled by creating new community development financial institutions with special service and development missions. Simply pointing out the need for a different type of institution does little to recommend what it should look like and how it should function. The criteria outlined in the previous chapter describe some of the issues surrounding whether and how to create a CDFI, but it is also necessary to consider what different existing CDFIs look like, and how each meets its community's needs.

This chapter describes five different types of CDFI models that have been created to address the needs of low-income communities, and one model (check cashing stores) that has been proposed to provide limited community services while contributing to a larger CDFI mission. Using the criteria outlined in the previous chapter, I describe and evaluate each model's relative strengths.

ISSUES SURROUNDING STRENGTHS AND WEAKNESSES

There are relative strengths to each type of CDFI model. The most appropriate model for an organization is determined by community needs, market opportunities, and its goals and capacity. There is no clear advantage of one model over another. Therefore, comparing and contrasting the models in a vacuum is useful only to the extent that it allows one to describe what each is best suited to accomplish. The issues by which I measure the relative strengths of the various models I will describe are:

- 1) ability of CDFI to raise both debt and equity.
- 2) ability to lend money to consumers and businesses.

- 3) ability to invest equity in businesses and projects.
- 4) ability to be self-sustaining and profitable by earning financial returns without subsidies. This is based on,
 - a) cost of transactions.
 - b) cost and efficiency of providing services.
 - c) cost of physical space.
 - d) number, expertise, and cost of staff needed to operate.
- 5) ability to stimulate business, commercial and residential real estate markets.
- 6) ability to leverage other sources of money through government guarantees and secondary markets.
- 7) ability to lend money to affiliated organizations.
- 8) ability to provide consumer financial services to community.
- 9) ability to serve the neediest members of the community.
- 10) ability to exercise political power in development process.
- 11) ability to accomplish mission in light of regulatory control over institution's operations.
- 12) ability to accomplish mission in light of level of internal bureaucracy.

CDFI MODELS:

COMMUNITY DEVELOPMENT BANKS AND THRIFTS

Commercial banks, Thrift institutions, and Savings and Loans' are all chartered depository institutions. They are usually either privately owned or publicly held corporations. Their primary business is done through the taking of deposits (e.g. savings and checking accounts, certificates of deposit, and individual retirement

account investments), and making loans to businesses, households, and governments.

Any institution that wants to take demand deposits must, by law, receive a federal or state charter to be a regulated depository institution. The charter requires that the bank conduct business in a particular fashion and in a defined area. Chartered banks belong to federally backed deposit insurance pools that guarantee individual deposits up to \$100,000. In order to ensure that banks do not take advantage of their deposit insurance by making very risky loans, the government regulates their activities. Banks are required to keep a certain portion of their deposits in cash, lend or invest no more than a certain percentage of their capital to any one project, keep a certain percentage of their outstanding loan balance in a reserve fund to cover loan losses, and make only those loans deemed, by the regulators, to be acceptably risky.

As explained in chapter one, banks earn their money on the interest rate spread between what they pay to borrow money from depositors (e.g. the interest paid on a savings account) and what they charge to lend money to borrowers (e.g. the interest rate borrowers pay on a home mortgage).

In order to attract sufficient funds to make loans, banks compete with each other (and with other institutions) in the capital market. Almost all banks offer a full range of consumer financial services and loan products. They compete with one another over the interest rates they pay and charge, the fees they charge, and the quality of the service they provide. Smaller banks often cannot afford to offer as many kinds of services and products as larger banks, and must find other ways to attract depositors.

Regulation forces banks to be very careful about their activities. Unlike unregulated institutions, they must maintain detailed records of all transactions, including all retail consumer services and loan applications. They must seek a great deal of information on borrowers to prove the soundness of their lending decisions to regulators. All these activities carry very high costs for banks.

STRENGTHS OF THE BANK MODEL

- 1) Banks have the ability to attract significant deposits due to the services and products they alone can offer, and the fact that deposits are federally insured. This also makes banks attractive to potential equity investors who can buy stock in banks.
- 2) Banks can lend money to be used for almost any legal purpose as long as it is lent within the bank's service area. Loans can be for personal use, mortgages, businesses, or government projects.
- 3) Depending on their success at attracting deposits, making sound loans, and managing their overhead and operations efficiently, banks can be very profitable. These are the factors that also make them self-sustaining in the long run.
- 4) Because banks have the flexibility to make different types and sizes of loans, they have the power to stimulate markets by aggressively lending in particular sectors and areas.
- 5) Almost all banks are large enough and sufficiently skilled to participate in federal loan guarantee programs and to sell loans in secondary markets. This enables banks to keep small portfolios of loans, to loan out significantly more than they have in deposits, and to reduce the amount of reserves they are required to keep.
- 6) Banks can provide the widest array of consumer financial services to a community.
- 7) Banks of sufficient scale can exercise significant power in the local development process. They can bring tangible assets to the bargaining table, and leverage their assets to create development deals.
- 8) Banks and bank holding companies can own community development corporations (CDCs) and affiliates that support community development work.

WEAKNESSES OF THE BANK MODEL

- 1) Banks are highly regulated. They do not have the freedom to do highly creative borrowing or lending. Bank regulators (who may be unfamiliar with community development lending) can require banks to increase reserves based on a perception of risk in a CDFI's portfolio. This diminishes the bank's willingness to make development loans it might otherwise desire to make.

- 2) Banks cannot lend money to affiliated organizations or companies owned by the same holding company above a very small percentage of their capital. Usually, the only way money flows between affiliates is through grants made by the holding company from profits earned by affiliates.
- 3) Banks are restricted in the amount of corporate stocks they can buy, or direct equity investments they can make.⁶⁵ Regulators consider equity investing to be very risky. Banks can also own some real estate and government securities.
- 4) Most banks have very high fixed (overhead) costs. They must maintain a safe and accessible place of business, and pay for the high level of staff expertise needed for operation.
- 5) Very few banks can profitably provide services to the neediest members of the community. Those banks that do provide services to the neediest cover their costs with fees or profits from other bank products.
- 6) Banks tend to have high levels of internal bureaucracy which often inhibit the flexibility that community development groups seek in their ventures.

THE SOUTH SHORE BANK EXAMPLE

The best known community development bank in the United States is the South Shore Bank in Chicago. In 1973 four young Chicago bankers believed that they could develop a new model for a bank that was dedicated to serving, stabilizing, and redeveloping poor neighborhoods. They purchased a small commercial bank (\$40 million in deposits) that was trying to leave a poor neighborhood, and began to reorganize it around a new mission. Although their original hope was to create a successful community development bank model that could be replicated around the country, despite 20 years of success, no independent group has been able to replicate their model. This is testament to the difficulty of starting and running a successful community development bank.

⁶⁵ The amount of "leeway" a bank has to purchase stocks or make equity investments, depends on the state. In Massachusetts, bank leeway allows 3 percent of bank assets to be invested in any way the bank desires. If this 3 percent is invested in housing, the bank is allowed to invest an additional 2 percent of assets.

South Shore bank is different from conventional commercial banks. Its mission required it to creatively leverage its money and clout to address a wide spectrum of community problems that most conventional depository institutions are neither inclined nor suited to address. South Shore Bank's owner, the Shorebank Holding Company, is a multi-subsidary corporation of for-profit and not-for profit companies that develop real estate, train, and organize, in addition to providing conventional banking services. One key to Shorebank's success has been its ability to address both private and public capital gaps through both separate, and coordinated, action of its subsidiaries.

The bank takes both market rate and subsidized rate (from social investors) deposits and lends to fill both private and public capital gaps. It also generates profits for the holding company. Shorebank's non-profit subsidiaries--which raise almost all of their funds from outside sources, are designed to fill public capital (and social) gaps. Their for-profit development and investment companies use market rate, subsidized and government monies, and programs to stimulate and support local economic development.

Shorebank uses all of its subsidiaries to addresses its community's needs. Over the years they have found that in order to create demand for certain bank products, such as their successful multi-family purchase and renovation loans, they have had to prove the financial viability of the market by developing some of the toughest projects themselves.⁶⁶ In addition, they have realized that capital and financial services address only a fraction of the problems in a poor and under-served community. The functions of their subsidiary organizations including housing creation, tenant organizing, and economic development, contribute to improving the entire community.

According to Julia Vindasius--who worked briefly at the South Shore Bank before

⁶⁶ Joan Shapiro talk at MIT, 11/30/92

becoming the director of the Good Faith Fund in Arkansas⁶⁷--Shorebank's organizers understood which community problems they wanted to address and had a design for their subsidiary structure before they knew what lending programs were likely to be successful. This was also the case in the design of the Southern Bankshare's structure.

In its initial conception, the Shorebank Holding company was created to stimulate and support community development and stabilization. The bank was and is a tool to support this goal.

COMMUNITY DEVELOPMENT CREDIT UNIONS

Community development credit unions (CDCUs) are dedicated to providing traditional financial services and to promoting local community development "through small loans made directly to people--home buyers and improvers, students, workers, and small business people" (Tholin, 3). They are most often found in communities that are not being served by mainstream banks or financial institutions.

All credit unions are mutually held organizations owned by depositors and borrowers who are called members. Members must come from a defined geographic area or constituency. In order to become a member of a credit union, one must open a "share account" which is similar to a savings or checking account, but which designates the member as a share holder of the credit union. Some credit unions offer an array of banking services, while others offer just one or two. Unlike banks, which can take deposits from any person or entity, credit unions can take no more than 20% of deposits from non-members, and, for the most part, can only lend money to members. Some larger credit unions have related organizations that provide services to support

⁶⁷ The Good Faith Fund is a subsidiary of the Southern Bankshares Corporation, a holding company modeled after and set up with the help of Shorebank Corporation and Shorebank Advisory Services. The Elk Horn Bank of Pine Bluffs, Arkansas is the commercial bank affiliate of Southern Bankshares.

their lending, similar to those provided by Shorebank's subsidiaries.

While some conventional credit unions are very large--in 1990 credit unions averaged around \$13 million in deposits--CDCUs range in size from around \$500,000 to \$5 million, with outlier's as small as \$200,000 and as large as \$30 million. (Tholin, 1991) Like banks, credit unions are chartered and regulated by either the federal or state government, and their deposits are insured for up to \$100,000 by the National Credit Union Administration (which is also the federal regulator).

Because the mission of most CDCUs is to provide basic banking services to communities where few other services exist, they tend to offer basic depository and exchange services and make mostly small personal loans. Many CDCUs are located in very poor communities where the average share deposit account is less than \$500 and has a large number of transactions per month. This makes operating a CDCU very expensive on a cost per account basis. Only the larger CDCUs have the capacity to make mortgage or business loans.

CREDIT UNION STRENGTHS

- 1) CDCU deposits are federally insured up to \$100,000. This helps encourage membership and deposits.
- 2) CDCUs are mutually held by their members which encourages a high level of community (member) participation and control.
- 3) Very large CDCUs have the ability to make loans in concentrated areas and to stimulate development activity, improve a community's housing stock, or enable businesses to save and create jobs.
- 4) CDCUs are able to leverage funds for development projects from other institutions. Some, of sufficient size, are able to access secondary markets and government guarantee programs.
- 5) CDCUs can offer services to the neediest members of the community, often at lower cost than banks.

- 6) CDCU's of sufficient size can use the strength of their resources and membership constituency to exercise political power in development process.
- 7) CDCUs do not need to operate out of a bank-like space. Since they are membership-based, they can operate out of a second floor office which will lower their physical space and security costs.
- 8) CDCUs can have a bureaucracy level that allows the flexibility sought by community development organizations.

CREDIT UNION WEAKNESSES

- 1) CDCU (and all credit union) regulations are more restrictive than bank regulations. CDCUs must raise 80 percent of their deposits from members who come from a defined group of people (often low-income). Further, they can only lend money to members and can lend no more than a small portion of their deposits to any one member.
- 2) CDCUs cannot own stock or invest equity in businesses.
- 3) CDCUs tend to attract very small deposit accounts. If account owners make more than a couple of transactions per month, transaction and operating costs can be very high. For this reason, CDCU's are often very weak financially and generate few surpluses. Many CDCUs require subsidies from sponsoring organizations in order to be able to provide basic services.
- 4) CDCUs cannot lend money to affiliated organizations.
- 5) CDCUs that make complicated loans and sell loans in secondary markets, incur relatively high salary costs for required staff expertise. Many credit unions have had difficulty retaining qualified staff because salaries tend to be lower than in competing banks.

THE SELF HELP CREDIT UNION EXAMPLE

The most successful and creative community development credit union in the United States is the Self Help Credit Union in Durham, North Carolina. The Self Help Credit Union is structured more like Shorebank than most other community development credit unions. It has several subsidiaries and a very broadly defined constituency so that it is able to take deposits and make loans throughout the state. Anyone who joins

the Community for Creative Self Help (\$5 membership fee) is eligible to join the credit union. Today the Self Help Credit Union and affiliated organizations have approximately \$44 million in assets.

The Self Help Credit Union offers almost no depository services and relies primarily on development deposits⁶⁸ in share accounts for its capital. The credit union makes consumer, real estate development, and home mortgage loans. It acts as both an agent bank⁶⁹ for other banks in North Carolina and puts together mortgage packages which it then sells to the secondary markets.

In order to lend to small businesses and to assume greater risk than a regulated credit union can, there is also a Self Help Ventures Fund that is a separate legal entity from the credit union, but shares its mission, some board members, staff, and office space. The ventures fund makes both debt and equity investments in companies throughout the state and focuses on job retention and creation.

COMMUNITY DEVELOPMENT LOAN FUNDS

Community development loan funds (CDLFs) are dedicated to providing capital to projects or programs in a given lending niche. CDLFs are intermediaries that take loans and grants from individuals, religious organizations, foundations, municipal and state governments, and other financial institutions, and lend to many different types of community development programs. CDLFs come in a range of sizes and structures. Some, such as the Institute for Community Economics (ICE) in Springfield, Massachusetts, lend to cooperative housing ventures nation-wide. Others, such as the

⁶⁸ A development deposit is a deposit made by a social investor to support general development programs of the intermediary or a specific development project.

⁶⁹ An agent bank is a bank that originates loans for other, larger banks. These larger banks are better able to hold mortgages in their own portfolios.

Good Faith Fund in Pine Bluffs, Arkansas, lend to local small businesses in one rural section of the state.

Although they take money from various sources, CDLFs do not offer banking services and they are not "depository institutions." This means that they are not chartered nor regulated like a bank or credit union, nor are the investments they receive insured. Because almost all CDLFs are non-profit organizations, they do not have to register with the Securities and Exchange Commission or adhere to any regulatory guidelines.⁷⁰

Although they are not regulated by a state or federal agency, many CDLFs belong to the National Association of Community Development Loan Funds (NACDLFs) which is trying to get member organizations to follow a set of self-regulating guidelines, and subject themselves to a peer review process.

CDLFs are not required to keep the same level of reserves as banks or credit unions, and do not pay deposit insurance premiums. They are able to make riskier loans than banks or credit unions and they often have lower overhead because they do not have to maintain small accounts or offer any depository services. Most CDLFs are unwilling to take investments below \$500 to \$1000, but the average investment at most CDLFs is significantly higher. The average equity base of a CDLF is about 10 percent of capital, while loan to capital ratios range from 50 to 90 percent.⁷¹

CDLFs (that are members of the NACDLFs in Philadelphia, Pennsylvania) range in size from about \$30,000 to \$12 million in capital. Most seek niches within their communities to leverage capital for projects that could not be developed without their assistance.

⁷⁰ Some state securities laws do require CDLFs to report some of their activities.

⁷¹ Gregg Ramm, ICE; Dick Jones, BCLF; Stevens, Woodstock Institute

Most CDLFs are run by a few staff people and a very active, unpaid, board of directors. Boards are responsible for setting policy, fundraising, reviewing loan applications, and overseeing loan repayments (Stevens, 1991).

A CDLF can be created to provide capital for almost any use its community needs and its founders want to provide.⁷² However, flexibility in using funds can be offset by the difficulty in attracting equity capital and investment deposits. The combined capital from all of the members of the NACDLFs is less than that of the South Shore Bank.

Some people in the CDLF community now view CDLFs as interim financial institutions that, once mature, will have the capacity to purchase commercial bank or S&L charters and run much larger operations.⁷³

LOAN FUND STRENGTHS

- 1) CDLFs have great flexibility in lending. Since they are not regulated, they are left to their own sense of prudence in making lending, and investment decisions. These include the percentage of capital they will lend (and the percent they will keep in reserve), the maximum amount they will lend to any one project, the types of projects they will lend to, whether or not they will make equity investments, and the terms of each individual loan. Much of the money CDLFs raise is from socially motivated investors who expect a lower financial return than market-oriented investors. This enables some CDLFs to lend money to socially beneficial projects at below market interest rates.
- 2) CDLFs have the ability to leverage money from other sources including banks,

⁷² This statement is based on the tax status of the CDLF. Some, like the Boston Community Loan Fund, are 501(c)3 organizations which means that they can only lend to other not-for-profit organizations. Loan funds can also have affiliated 501(c)3 organizations that do training and receive grants while still being profit making corporations that are allowed to lend to for-profit ventures.

⁷³ Focus of panel discussion at NACDLF annual conference, Boston, Massachusetts, November, 1992.

credit unions and government agencies. They are often able to provide bridge financing to make up the difference between what a project needs and what a bank is willing to lend. They can also offer short-term loans that they can "season"⁷⁴ for a borrower, pre-development financing, and loan guarantees. Since CDLFs tend to be much smaller than banks or credit unions, their lending has higher leverage ratios⁷⁵, but leverages fewer total dollars. Further, they are usually forced to take subordinated positions which raise the risk of their participation in multi-lender deals.

- 3) CDLFs are usually quite small, so have limited ability to stimulate local markets (business or real estate). In order to have noticeable impact, they must concentrate on very small areas.
- 4) CDLFs are free to lend money to affiliated organizations. Some CDLFs are connected to Community Development Corporations (CDC) and lend primarily to their CDC's projects. It should be noted that this practice is highly discouraged by the NACDLFs which believes there is great danger and risk in breaking "arms length" financial relationships between borrowers and lenders.
- 5) CDLFs often lend to projects that are designed to assist the neediest members of the community.
- 6) CDLFs tend to have relatively low costs for account management. This is because they usually have far fewer investor/depositors than banks or credit unions, have no reporting requirements, and each account has a relatively large deposit that is not liquid for an agreed upon period.
- 7) CDLFs tend to have low overhead for office space since they offer no banking services and need not maintain a conveniently located branch space.
- 8) Staff expertise and cost depend entirely on the mission and size of the fund. Larger funds that do complicated lending require more experienced staff who demand higher salaries. Some smaller funds operate with one or two staff

⁷⁴ Banks seldom make community development loans that they view as being high risk. However, if another institution is willing to make and hold a loan in its portfolio long enough to show that it is a reasonable investment--to "season" it--a bank will often be willing to buy or remake the loan.

⁷⁵ CDLF participation in a \$3,000,000 construction project might be as little as \$30,000--a 100 to 1 ratio. By contrast, a bank might be able to participate in a \$20,000,000 dollar deal with a \$2,000,000 loan. This is only a 10 to 1 leverage ratio, but a much larger amount of money has been leveraged.

people and an active Board of Directors.

- 9) CDLFs can choose to operate under any level of bureaucracy they desire.
- 10) Most CDLFs offer a great deal of technical assistance to their borrowers.

CDLF WEAKNESSES

- 1) CDLFs must spend a great deal of time looking for social investors who are willing to make medium- and long-term unsecured and below market investments in the fund. Social and public investments tend to be the only funding sources for CDLFs.
- 2) Most CDLFs are not large enough to be profitable.⁷⁶ Most depend on operating subsidies above and beyond the money they earn on the spread between their borrowing and lending rates. In addition to raising investments, CDLFs must raise grants from individuals, foundations, church groups, government and other financial institutions for their operating expenses and equity base. This means they compete with other community-based projects for funding.
- 3) Very few CDLFs are large or expert enough to access federal or state loan guarantee programs or secondary markets.
- 4) Although CDLFs tend to offer more technical assistance to their borrowers than banks or credit unions, this service is very expensive and raises the transaction costs for lending--which usually must be subsidized by an outside source.
- 5) Although CDLFs are able to participate in deals with other lenders--and leverage money--they are usually forced to take a subordinated position and assume the highest risk in the deal.
- 6) CDLFs provide no consumer financial services to their communities.

MICRO-ENTERPRISE LOAN FUNDS and PEER LENDING PROGRAMS

Community development micro-enterprise loan funds (MELFs) make very small,

⁷⁶ Some believe that the break even point for a CDLF can come with as little as \$5,000,000 in investments and equity (Stevens, 1991). Most others with whom I spoke agreed that at this size a fund would still require some outside subsidies.

(\$300-\$5,000) short-term loans to existing "micro" businesses⁷⁷ or to entrepreneurs who are trying to start up new small businesses.

Many of the micro-enterprise loan funds in the United States are modeled after successful programs and institutions in less developed countries--such as the Grameen Bank in Bangladesh, and the FINCA program in Bolivia. They address capital, educational, social, and organizational needs of micro-enterprises and the people who own them. MELFs rely on the formation of peer lending groups--made up of 4-10 entrepreneurs--that meet regularly to review and approve each others loans, and collectively guarantee repayment. Peer group members also teach and learn from each other about running small businesses.

The MELF model is significantly different from the others in both its goals and approach. It is the only model that addresses very small business capital needs and the only one designed to develop very small businesses by organizing and training entrepreneurs to be more effective business people. The philosophy behind MELFs is that capital is just a small portion of what micro-entrepreneurs need to launch and run successful small businesses. MELFs emphasize training, and giving technical support to micro-entrepreneurs so they become better at keeping records, and establishing good business practices, and credit records. Most MELFs are first and foremost community development programs and secondarily lending programs.

It is unclear whether MELFs can be as effective in a "developed world" urban setting as they are in rural settings of less-developed-countries. Some in this country believe that regardless of the intentions of a domestic micro-credit program, its impact can only be marginal. Loans do not go towards bricks and mortar projects that improve

⁷⁷ A micro business, as opposed to other small businesses, is often a part-time or home-based activity run by an entrepreneur or family to supplement another source of income, or to grow into a sustainable small business.

the physical landscape, and relatively few people benefit directly from the peer group activities.

MICRO-ENTERPRISE LOAN FUND STRENGTHS

- 1) MELFs are not regulated so they can raise, lend, and invest money however they desire. There is, however, a newly formed national association of MELFs that may publish lending guidelines similar to those used by the NACDLFs. At this point, MELFs can structure their programs and make loans in whatever way they deem best.
- 2) Unlike CDLFs, MELFs are so small that they can rely on a very limited number of sources for their capital pool.
- 3) MELFs provide capital and training to business that are so small they are usually completely ignored by conventional lending institutions.
- 4) MELFs are free to make equity investments in small businesses (this is not a goal of, nor done by, any of the MELFs I have studied.)
- 5) MELFs can be very inexpensive to set up. They require no special office space, offer no consumer services, and can structure their account management to be very efficient.
- 6) The number and expertise and cost of staff are a function of the size of the MELF and its mission. Some MELFs operate with few, relatively unspecialized, staff. Those that do a great deal of training pay higher salaries to more highly skilled staff.
- 7) Peer group MELFs have very low lending transaction costs because loan review and risk assumption are done by the group members.
- 8) There need not be a high level of bureaucracy associated with operating a MELF, (although there are exceptions such as the EDIC loan fund which is public) however, most of the funds I have studied have very clear rules and procedures that must be followed in order to ensure stability of operations.
- 9) Peer group pressure on borrowers, and collective responsibility to repay loans, lowers the default rate well below what lenders to very small businesses expect.

MICRO-ENTERPRISE LOAN FUND WEAKNESSES

- 1) MELFs loans are usually too small to leverage money from other sources.
- 2) MELFs in the United States are usually too small to have any significant or noticeable impact on any one market or in any one community.
- 3) MELFs do not create many new jobs or economic multipliers in a community.
- 4) The cost of providing technical assistance to micro-enterprises is very high, and comprises a large share of many MELF budgets.⁷⁸

OTHER CHARACTERISTICS PARTICULAR TO THE MELF PROGRAM

- 1) Relies on community members to organize themselves.
- 2) Defaults on loans are easier to prevent than with other models because collective responsibility to repay loans puts peer group pressure on borrowers.
- 3) MELFs encourage the professionalization of small business record keeping so that borrowers can some day qualify for conventional bank loans.
- 4) MELFs help borrowers mature and develop credit histories that they can go on to use with conventional lenders.
- 5) MELFs help micro businesses network with one another.
- 6) MELFs help to develop new community business leaders and mentors for other potential entrepreneurs.
- 7) MELFs help micro-entrepreneurs grow their businesses into larger storefront businesses capable of creating jobs for the community.

EXAMPLES OF MELFs

Over the last decade the Grameen Bank in Bangladesh has grown into a significant institution. It is self-sustaining and provides micro-credit to thousands of people

⁷⁸ This may be due to the fact that MELFs are a relatively new development finance model for the US. This may change as the industry grows and matures.

across Bangladesh.⁷⁹ The Grameen bank lends from its own capital base, and charges 16 percent interest on loans. The Grameen Bank is able to sustain itself (it was initially capitalized by the government of Bangladesh and the World Bank) because it operates at a very large scale and it does not provide technical assistance which is the most expensive part of American MELF programs. Even among domestic MELFs that provide no technical assistance, economies of scale have yet to reduce costs in any domestic program to the point where the MELF does not need significant operating subsidies.

U.S. adaptations of this model, such as the Good Faith Fund in Pine Bluffs, Arkansas, and Working Capital in New England rely on subsidies from foundations to cover operating costs and take their lending pools either from commercial banks or from the government's SBA program.⁸⁰ Jeff Ashe, the founder of Working Capital, believes that an annual volume of \$2 million in loans would enable Working Capital to be self-sustaining.⁸¹ Today, with significantly less volume, Working Capital has a two year budget which requires just over \$300,000 in subsidies. Julia Vindasius, the director of the Good Faith Fund, believes that "micro-lending cannot be profitable and self-sufficient in this country." She believes that there is so much educational and technical assistance work that needs to be done to make potential borrowers into successful borrowers and business people, that regardless of the scale of operations, MELFs will always need subsidies.⁸² The Good Faith Fund has a \$400,000 annual

⁷⁹ Although the Grameen Bank claims to be profitable, its profits are unable to cover the cost of its expansion, and it has received a great deal of money over the years from various government and international sources.

⁸⁰ Working Capital also relies on community-based groups to organize its peer groups and provide ongoing management and technical assistance.

⁸¹ Interview with Jeffrey Ashe, 2/5/93

⁸² Interview with Julia Vindasius, 3/5/93

budget of which only 20 percent is internally generated from returns on its loans.

COMMUNITY DEVELOPMENT VENTURE AND ROYALTY INVESTMENT FUNDS

Unlike the other models described here, royalty and venture investment funds (RIFs) provide equity, rather than debt, to businesses. Many small and new businesses need long term "patient" money until their companies have generated enough cash flow to begin to repay investors. Businesses that are saddled with debt, often find they cannot cover their operating costs and reinvest returns into the business and still cover their monthly payments. Too much debt severely hampers their ability to become more efficient and profitable.

Venture investing is the riskiest of all capital investment models. Since investors take an ownership position in businesses, there is no agreement that they will ever be repaid, or that a return on their investment will be paid within any specified time frame. Most venture capitalists look to invest money in companies that have very great potential for a large financial return.

Royalty investment funds (RIFs) are venture capital funds that invest in a particular product or innovation that a company is developing. When the product is marketed, the investor receives a royalty from that product alone, and not other profits of the company.

Most venture investing is done on a large scale by very knowledgeable investors in sums exceeding \$250,000. This type of investing is done by individuals, state and municipal venture funds, and even some corporate investment divisions. People with very high levels of expertise are required to do this type of investing.

Smaller scale venture investing has been done by community groups and CDC's as well. TELACU in Los Angeles is a CDC that owns a for-profit business holding

company. Among other activities, the holding company has invested in and purchased small businesses that met its financial or social goals. This type of investing enables TELACU to support the types of businesses are needed in the community, and the types that should be retained.

VIFs can also be subsidiaries or affiliates of other institutions. Both the Shorebank Holding Company and Southern Bankshares Holding Company own VIFs that invest equity in businesses that serve their communities. These funds were capitalized by investors who were willing to place large sums of money in a long-term, low liquidity, high risk investment pool in hopes of earning very high future returns.

COMMUNITY DEVELOPMENT VENTURE INVESTMENT FUND STRENGTHS

- 1) VIFs are free from regulation and can invest in any type of company or project they choose.⁸³
- 2) The primary cost of operating a VIF is paying a highly skilled staff to gather and analyze information on companies. This includes oversight, consulting, and intervening in the operations of companies in which they invest. VIFs offer no retail services and need no special office space or equipment.
- 3) VIFs can have the greatest impact on attracting businesses to a community and on helping businesses stay in a community by leveraging other funds on behalf of businesses they support.
- 4) Although VIFs tend not to have much direct political power in the development process, their participation can reassure government financial and political entities that a project is worth supporting.
- 5) If the venture proves to be successful, the investment return is usually very high.
- 6) VIFs need very little bureaucracy to operate.

⁸³ This is not true of VIFs that sell securities to investors, which must register with the SEC.

COMMUNITY DEVELOPMENT VENTURE INVESTMENT FUND WEAKNESSES

- 1) VIFs have a harder time raising capital than any of the other models. They usually require very large investments that are not insured, offer no return for long periods of time, and are not liquid.
- 2) There is a higher risk of losing an entire--large--investment than with any of the other models.
- 3) Staff expertise to run a VIF is very high and therefore staff costs are very high.
- 4) Because of the nature of the investment and the high level of risk, VIFs must spend more time on oversight, consulting and intervening in the operations of companies they invest in, than any of the other models.
- 5) VIFs do almost nothing directly to serve the needs of the lowest income people in a community. However, the companies in which they invest do create jobs and economic multipliers that help these people.

CHECK CASHING STORES

Although they are not CDFIs, conventional check cashing stores provide many of the basic consumer retail banking services used by low-income people. They cash checks, write money orders, pay utility bills, and wire money.⁸⁴ They do not take deposits or hold money for customers, and therefore, are not regulated as depository institutions.⁸⁵

In communities that are well served by banks, or where there is competition between check cashing stores, fees and rates can be quite reasonable and service can be as good or better than at a bank. Even the check cashing stores that charge relatively small fees for services can be very profitable. Average fees for services run

⁸⁴ Some check cashing stores also provide cash advances--for a high fee--for income tax returns and other assured payments.

⁸⁵ Today there are efforts in Massachusetts to regulate the rates check cashing stores charge, and maximum amounts of cash that can be exchanged before triggering a reporting requirement.

approximately 2.5 percent to cash a government check, \$.50-\$1.00 for a money order, and no charge to pay some bills.

Since there are no regulatory controls over check cashing store activities, their primary costs include the set up of the outlet, security, staff, and the cost of borrowing money from a bank.⁸⁶ Check cashing stores are profit-oriented service centers. While there is much dispute over their desirability in a neighborhood, there is no question that they provide a convenient and needed service that would not be available in their absence.

To date, I know of no community development group that runs its own check cashing store.⁸⁷ Hyman Minsky, an economist at the Jerome Levy Institute at Bard College, has written that community groups should get into this business in order to provide better service to their communities than do the existing check cashing stores, and to use profits from operations to fund local economic development activities.⁸⁸

CHECK CASHING STORE STRENGTHS

- 1) Check cashing stores can be very profitable and self-sustaining almost immediately after opening.
- 2) The costs associated with running a check cashing store are quite low. There is no need for staff expertise, no reporting requirements associated with regulation,

⁸⁶ Most check cashing operations borrow money on a daily line of credit from a commercial bank and pay it back as soon as the checks they have cashed clear (usually just 2 or 3 days).

⁸⁷ The South Middlesex Opportunities Council (SMOC) in Framingham, Massachusetts has plans to become a non-profit provider of check cashing/bill paying services in low-income neighborhoods. They are doing this in order to establish relationships with people in these communities, and to help them grow into conventional banking customers. This is one part of a larger SMOC undertaking which include purchasing and running a bank.

⁸⁸ Hyman Minsky interview, 1/15/93

and almost no internal transaction costs to provide services (fees more than cover costs).

- 3) Check cashing stores provide needed services to the lowest income members of the community.
- 4) Profits from the operation of check cashing stores can be reinvested in community development activities.
- 5) Check cashing stores that are operated by community development groups have the ability to undercut disreputable check cashing stores and drive them from the community.

CHECK CASHING STORE WEAKNESSES

- 1) Check cashing stores do not directly address non-retail financial needs of low-income communities nor encourage or facilitate savings.
- 2) Many check cashing stores are used by people engaged in illegal activities and thus have poor reputations. Further, those that charge high rates and fees are viewed as predatory by community activists.

CONCLUSION

There is probably no one "best" model for a CDFI. Each model has particular strengths that may or may not serve the unique needs of a community. Community Development Banks and Credit Unions clearly provide the widest range of products and services, but to be efficient, they must operate at a minimum scale of 20-50 million dollars, which is not appropriate for all communities. Community development loan funds and micro-enterprise loan funds are incapable of offering consumer retail banking services, but since they are not regulated, are usually less bureaucratic than banks or credit unions, and can more flexibly meet the needs of certain kinds of customers. Community development venture investment funds are also able to fill niches that banks and credit unions cannot. Finally, check cashing stores have been filling financial service gaps in low-income communities for many years. They are able to provide needed services in an accessible manner at a lower cost than can be provided by banks. If check cashing stores can be reconfigured to

support a community development mission, they too can be incorporated into CDFIs.

The most important concept to be gleaned from this discussion, therefore, is that there are a wide variety of tasks that can be completed by many different types of corporate models. Once an organization has clearly identified its community's needs, as well as the scope and size of the institution needed to meet them, any combination of these models can be assembled to carry out the CDFIs mission.

8 A CDFI FOR UPHAM'S CORNER

In previous chapters I described how changes in the banking industry, coupled with economic and demographic changes in the Upham's Corner community, have prevented it from receiving all of the financial and organizational services it needs. I identified specific capital and institutional gaps that cannot be efficiently filled by existing institutions, and I suggested that alternative community development financial institutions should be created to fill them. I also described the criteria for designing new CDFIs, and what several CDFI models look like.

This chapter ties all these findings together, and recommends a CDFI model for Upham's Corner that meets both the community's needs, and the criteria for creating a new institution. As noted in chapter two, I hope that by grounding this study in the realities of a specific community, the lessons I have learned can be applied to other similar communities. The methods used to arrive at the recommendations in this chapter may be applicable to other communities, but the specific conclusions are probably not.

DBEDC'S MISSION AND UPHAM'S CORNER'S NEED FOR A CDFI

DBEDC's mission is to take actions to improve the physical, social and economic environment of its service area. It seeks to create housing and stabilize residential neighborhoods; to help create jobs and support small business development and expansion; to revitalize local commercial districts; and to improve the quality of services provided to residents.

Ultimately, the DBEDC's ability to complete this mission successfully is less dependent on capital than on the development of solid businesses, real estate projects,

and social programs. Capital cannot make non-viable projects viable. But, "lack of capital on appropriate terms can prevent viable projects from succeeding and stunt economic development" (Parzan and Kieschnick, 6).

The DBEDC must, therefore, work to stimulate and catalyze viable economic development and job-creating projects in its community, and be committed to filling capital gaps that cannot be filled by existing institutions.

DEBATE OVER RESPONSES TO GAPS

There is a healthy debate in the community development field over the proper way to respond to the capital gaps I have described. Some believe that it is far more efficient to pressure existing banks to invest the money that low-income communities need than it is to try raising this money to start a new CDFI.⁸⁹ Others believe that regardless of the existence of conventional financial institutions in a community, unique markets for community-based, development-oriented financial institutions exist as well.⁹⁰

I am convinced that the participants in this debate are arguing about two separate things. The former group seeks the most efficient way to address capital gaps while the latter group seeks the most viable structure to address development needs. Low-income communities need both capital and development institutions that can properly use that capital.

Despite the existence of many banks and financial programs serving Upham's Corner,

⁸⁹ Beth Seigal and Peter Kwass of Mt Auburn Associates made this point in a 1992 talk at MIT. South Shore Advisory Services emphasizes the importance of using financial institutions to fill private gaps and to leave public gaps to non-financial institutions.

⁹⁰ This position was expressed to me in interviews with both Errol Lewis of the NFCDCUs and by Martin Trimble of the NACDLFs.

I have identified both private and public (service and product) gaps. These gaps exist despite efforts of existing institutions to be more responsive to community needs.

Based on my findings in chapters three and four, I have concluded that these gaps can be better filled--and the missing pieces of Upham's Corner's development agenda can be better met--by new, or radically altered organizational forms, than by existing institutional structures.

THE CRITERIA FOR CREATING A CDFI AND UPHAM'S CORNER'S NEEDS

Based on the needs I have identified for Upham's Corner and the criteria outlined in chapter six, I conclude that:

- 1) there are clear community needs that are going unmet and will continue to go unmet by existing financial institutions. The four primary needs I identified in Upham's Corner are low-income consumer and credit services, very small (and micro-) business lending, small business equity investing, and technical and management assistance. All of these activities are either outside of the missions of conventional financial institutions, or cannot profitably be provided within existing institutional structures.
- 2) that a CDFI in Upham's Corner can set measurable and achievable goals for projects and programs to build a healthier community. These include small business and entrepreneur development, and commercial revitalization strategies such as those recommended by the 1992 Mt. Auburn study and Nanette Robicheau's 1992 MIT Thesis.
- 3) that a CDFI in Upham's Corner can be structured to be self- sustaining through both profitable and subsidizable activities. Financial services such as check cashing and bill paying for low-income people can be run profitably, as can

mortgage origination and some of the larger-project lending and investing that a CDFI can do. Technical assistance provision, consumer, micro- and very small-business lending will need to be subsidized by both internal (profits and fees)⁹¹ and external sources. I believe subsidy sources will continue to be available for well-managed organizations supporting comprehensive community development programs.

- 4) that a CDFI can be structured and managed to use its resources efficiently. The CDFI can manage and contain its costs by creating separate for- and not-for-profit legal entities that raise debt and equity capital most efficiently for each given task. At the same time, entities can minimize their costs by sharing space, staff, and resources.
- 5) that a CDFI can be structured to respond to development opportunities in Upham's Corner by creating multiple-entities that perform specialized tasks. This will enable the CDFI to respond quickly to opportunities with the most appropriate entity or combination of entities.

In addition to the strengths and weaknesses of the models that I outlined in the previous chapter, the following four questions are among the most important for an organization to answer when deciding which model best fills each gap.

- 1) What is the nature of the need going unmet, and what is the best institutional model to fill it?

⁹¹ Shorebank uses profits generated by South Shore Bank's home mortgage lending to subsidize some of the work of its non-profit development company and technical assistance provider. The East Los Angeles Community Union (TELACU) owns several profit making companies that help subsidize its non-profit development activities and scholarship fund.

- 2) Where will the CDFIs capital come from?
- 3) How can the CDFI most flexibly and efficiently lend and invest its capital?
- 4) How will the CDFIs structure help build a stronger institution and increase its political clout?

THE BEST MODELS TO FILL EACH GAP

CONSUMER FINANCIAL SERVICES

Retail Services

Upham's Corner's three bank branches, with over 90 million dollars in deposits, offer a full range of traditional consumer banking services and do a good job of meeting the needs of the communities middle- and upper-income people. I identified a gap between low-income consumer financial needs (check cashing and bill paying services, small consumer loans, and possibly specialized mortgage products) and service provision. I found that low-income consumers are not interested in using many bank services, and that banks are not the best institutions to provide the services these people are most likely to use. Regulated banks sustain the highest costs of all the models in providing consumer services. This is especially true in low-income service provision, which only yields a payback if costs are minimized. This makes banks the least efficient institutions to address low-income consumer service needs.

I found that low-income people are most likely to use the least regulated institutions (which happen to have the lowest operating costs). These include check cashing stores and other informal institutions that offer financial services. Check cashing stores have very low start-up and operating costs and easy access to capital. Although many check cashing stores have poor reputations, it may be possible to integrate them into larger CDFIs to efficiently meet the needs I have outlined.

Consumer loans and mortgages

Check cashing stores cannot perform intermediary functions such as taking deposits or making consumer loans or mortgages. These tasks are best performed by banks or credit unions.

Local banks do a reasonably good job of providing loans to middle- and upper-income people, and they are making good headway in providing mortgage products to lower-income and first-time home buyers. As with consumer services, however, they are not structured to make character, or very small consumer loans, and their size and high level of bureaucracy makes them unlikely candidates to offer these services in the future.

A community development credit union, by contrast, can make very small consumer loans more efficiently and less expensively than other models. CDCUs can raise insured capital, develop flexible loan products for low-income people, access government guarantee and secondary market programs, and build political clout.

The combination of a check cashing store with a community development credit union can efficiently meet Upham's Corner's consumer financial service needs. On a sufficient scale, a CDFI offering these services could break-even or generate a surplus.

SMALL-BUSINESS DEBT AND SERVICES

Despite my efforts to find a capital gap in small business debt provision, it remains unclear whether there is either a private or public capital gap in this area. While the local banks do not--and will not be able to efficiently--lend small amounts of money to businesses, public agencies such as PFD and EDIC can. The more important question for Upham's Corner, however, is whether there are any institutions that strategically coordinate and create economic development programs. Here, I found that Upham's Corner needs an organization that does aggressive business development,

helps local entrepreneurs start and grow companies, and flexibly provides them with both debt and equity capital between \$500 and \$50,000. I believe these needs present a significant institutional gap that can be filled by a CDFI.

Community development banks cannot efficiently provide very small amounts of debt to businesses because their overhead and information and transaction costs are too high. Further, their structure makes them more bureaucratic and less flexible than very small businesses need their lenders to be. They do, however, have unique capacities to fill institutional gaps. Credit unions can only lend to businesses whose owners are members, and they are prevented by regulators from being too flexible or creative in their lending policies.

A community development loan fund that is capitalized with money from social investors is probably the most efficient model to lend small amounts of money to Upham's Corner businesses. However, a CDLF will require operating subsidies in addition to its capital pool. An unregulated CDLF can develop the most flexible lending criteria, and make the most creative loans. Moreover, its investors (who are targeted to support specific types of lending) will be more interested in supporting small business lending than depositors in other types of models. A CDLF has lower operating costs than either a bank or credit union and its less bureaucratic structure compliments its small business development lending mission.

Micro-business debt and services

Micro-business loans are now available in Upham's Corner through the DBEDCs affiliation with Working Capital. It makes great sense to continue this program and to study the systems that Working Capital has set up, and continually evaluate the program's success. Some Working Capital techniques may also be appropriate for a larger CDLF.

Working Capital's most visible shortcoming is that its lending does not fit into a larger

strategic community economic development agenda.⁹² Other micro-enterprise loan fund models, such as the Good Faith Fund (GFF) in Arkansas and Coastal Enterprises Inc. (CEI) in Maine, spend a great deal of money giving technical assistance to their borrowers. They view themselves as full service institutions dedicated to developing businesses, rather than just helping micro-businesses get funding. DBEDC should evaluate Working Capital's success to determine if an MELF structure more like GFF's or CEI's is more appropriate.

EQUITY CAPITAL FOR SMALL BUSINESSES

"Banks cite undercapitalization as a primary reason for turning down loan requests by small businesses" (Mt. Auburn Assoc. 1987, 39).

In contrast to debt financing, there is no institutional source of venture or royalty equity available to Upham's Corner (or any local community's) small businesses. Many potential small businesses and business expansions do not have the collateral to support more debt and cannot afford to repay debt in the short-term. Some of these businesses are sound risks for a community development venture fund. Venture and royalty investments for Upham's Corner small businesses can fall into \$5,000-\$100,000 range (similar to the small business debt range).

⁹² Working Capital has perfected the technical side of peer group lending. It tries to help micro-entrepreneurs teach themselves more about running small businesses and it sets up systems to increase repayment rates. It is internally strategic and targeted, but does not have a development strategy for any particular community or sector. This does not preclude the local affiliate from imposing an agenda on itself as it works to form peer groups. Working Capital, in contrast to many other microenterprise loan funds, makes no attempt to indoctrinate its clients in a particular way of looking at business or community economic development. It subscribes to no political school of thought other than that providing capital to small businesses helps them develop and helps build communities.

It makes great sense, therefore, for an Upham’s Corner CDFI to invest directly in local businesses as part of a targeted development strategy. Venture investing sends a signal to businesses that they are wanted in the community. Venture investments leverage debt from banks and other financial institutions, and ensure the creation of new jobs in the community.

Since providing venture capital to businesses is the riskiest form of investment, special investors must be located who are willing to participate in venture deals. Because banks and credit unions raise money through insured deposits, regulatory restrictions prevent them from being active venture investors.

These realities argue for the creation of a specialized venture investment fund for Upham’s Corner that raises capital from venture investors and has highly skilled staff who can work closely with business owners and other equity investors. This too can be part of a larger CDFI.

Table 8-1 The relative initial start-up costs of the various CDFI models described above.

Fixed	Banks	Credit Unions	Loan/Micro Funds	Venture Funds	Check Cashers
Start up costs	\$85,000- \$190,000	\$1,500- \$20,000	\$1,500- \$20,000	\$30,000	\$5,000 \$10,000
Minimum Capital	\$2 million	\$500,000	\$100,000	\$500,000	\$50,000

Sources: Parzan and Kieschnick, Mt. Auburn Associates, 1987, interviews with Jeffrey Ashe, Edward Shea and DeWitt Jones.

PROVIDING TECHNICAL ASSISTANCE TO SMALL BUSINESSES

As I noted in chapter four, many community development lenders and investors believe that providing small business technical and management assistance (TA) is just as important as providing them with capital. Both for- and not-for-profit lenders are

motivated to provide TA in order to decrease default risk and to increase the capacity of borrowers.⁹³

Although most local lenders provide some form of TA to their borrowers, and there are a variety of public TA providers in the Boston area, no local organization uses TA as a tool to organize business activity, recruit and train new businesses, and identify and solve problems before they become life threatening for local businesses. TA, therefore, should be a key component of an Upham's Corner CDFI.⁹⁴

Ideally, a TA provider would be able to generate its own funds through fees charged to clients. This is how business consultants earn their living. When the primary mission is to serve the needs of very small, unsophisticated, and under-capitalized businesses, however, this is not possible. The TA provider will have to work with a large number of community businesses that cannot afford to pay for assistance, and most of the businesses they work with will probably never be borrowers, and will never generate income for the CDFI loan fund.

⁹³ Banks want borrowers to increase capacity and grow so they will be able to borrow more money, while non-profits want them to increase capacity so they will create more jobs and economic multipliers.

⁹⁴ Many loan fund administrators consider TA to be the most expensive component of their programs. The Good Faith Fund, which is still in its initial growing phase, spends approximately \$400,000 per year to loan out only \$200,000. According to fund director Julia Vindasius "we spend most of our time making borrowers more smart [about the borrowing process and small business management] so they understand the implications of taking on debt." They also are working hard in rural Arkansas to teach people who have traditionally relied on low-wage labor how to think about and become small business owners. A large portion of their \$400,000 budget, therefore, is spent providing training and technical assistance to both their borrowers and to their target community. Ron Phillips of Coastal Enterprises Incorporated (CEI) told me that 11 of his 24 staff people work in their TA area. The budget for TA is \$400,000 (of an annual \$1.6 million CEI budget), and covers individual consulting, clinics on how to start a business, and aggressive organizing in the community to locate and help businesses.

The most efficient way to provide TA to businesses is by running the effort through a separate 501(c) 3 entity.⁹⁵ Operating costs can be raised through government and charitable grants as well as through profits generated by other CDFI affiliates. Operating costs can also be minimized by working with--or contracting out to--the local small business development center, Service Corps of Retired Executives (SCORE), and other community organizations that already provide TA to small businesses.

OTHER ISSUES TO CONSIDER

Generating cash flows for operations

CDFIs need to generate income streams to fund their programs and operations. The Shorebank holding company model relies on the bank to be the profit engine for all the other entities. In cases where opening a commercial bank is not appropriate, the CDFI holding company can become a local business owner. This has the effect of directly creating jobs, and controlling the location and operations of local companies, so that profits can be recirculated back into the CDFIs development work.⁹⁶ The

⁹⁵ This is an IRS tax exempt designation that allows the organization to receive charitable, tax deductible, contributions.

⁹⁶ TELACU, a Los Angeles CDC has approached this issue in an interesting way. Founded in 1968, their primary mission has always been job creation and retention, so they have focused on attracting, creating and purchasing businesses. Today TELACU has a \$100 million cash flow and \$250 million in assets. Their non-profit parent company is just a shell corporation through which only their non-profit activities take place. The CDC owns TELACU Industries, a for-profit holding company, which in turn owns a number of for-profit businesses. The profits from these businesses support a wide array of community development activities including a revolving loan fund (originally set up through the EDA), a low-income housing developer, and a scholarship fund. These for-profit businesses range from a restaurant to an underground cable company to a bank.

TELACU's great strength is its ability to generate and reinvest a significant stream of cash flows back into its community. While many of the circumstances of TELACU's

CDFI can approach business ownership three different ways. It can purchase existing businesses that might leave the area or close due to retirement, it can work to create new start-up businesses, or it can entice business franchises to locate in Upham's Corner through partnership agreements and financial backing.

UNIQUE CIRCUMSTANCES TO DBEDC

Unlike most start-up CDFIs, which are heavily dependent on external funding and are under-capitalized with equity, the DBEDC has the ability to self-capitalize a CDFI with equity. This means it can assess and assume risk differently, need not hold external funds in a loan loss reserve, has lower liquidity requirements, and can set its own standard of prudence for the maximum loan size it will make.⁹⁷

This strong equity position means that the CDFI can leverage more money from other investors and funders because it can assume more risk. It can more easily subordinate its own debt position, and guarantee some portion of its investments to its own funders and to participating banks (even though it has no deposit insurance).

TIMING and CAPACITY

success cannot be replicated in North Dorchester, this general principle can be. If DBEDC finds market opportunities to own and operate for-profit businesses that can support other development work, it will not be dependent on outside subsidies to carry out its development mission. One of the possibilities, as outlined in the previous chapter, is starting a string of high quality, community service-oriented check cashing stores. Other options include starting businesses that may provide privatized community services such as recycling, street and sidewalk repair and cleaning, sign maintenance, or real estate management and maintenance.

⁹⁷ Many loan funds members of the National Association of Community Development Loan Funds will not loan more than 10% of their funds to any one project. This seems a wise level of risk, even for funds that are primarily self-funded.

I have recommended what development lenders call a "multi-service model"⁹⁸ of community development financial institutions. In a proposal to the newly elected Clinton Administration, a consortium of CDFIs and professional associations identified only four such institutions nationally. They went on to point out that "at the second tier, the number of CDFIs that have the capacity to step immediately into the multi-service model is limited to some 25-30 institutions. Indeed, significant support for capacity building will be needed to achieve President Clinton's goal of 100 multi-service CDFIs" (5).

The issues of capacity and growth schedules should not be minimized. Although the Upham's Corner community needs, and can support, a multi-service CDFI, it will have to be created in stages, as capacity grows, over a number of years. Indeed, many of the "second tier" CDFIs referred to in the consortium's memo to the President have been building capacity for many years, and are only now approaching the ability to become multi-service organizations.

SUMMARY

In earlier chapters I found that Upham's Corner's low-income residents and small businesses have at least four financial needs that are going unmet by existing institutions and could be better met by an alternative CDFI. In addition, I found that this community needs a strategic development institution that can create and fund development projects.

Based on the five criteria outlined in chapter six, (finding unmet needs, meeting achievable goals, being sustainable, operating efficiently, and being flexible enough to

⁹⁸ This term was put forward by a consortium of community development lenders in "Principles of Community Development Lending & Proposal for Key Federal Support."

respond to opportunities) I concluded that Upham's Corner should create a multi-service CDFI. This CDFI should consist of a check cashing store and credit union to provide basic retail banking services, including small consumer loans. It should also include a community development loan fund, to make small business loans of between \$500 and \$50,000, a venture capital fund, to investments equity in local businesses, and a technical and management assistance provider, to recruit, train, and consult with small- and micro-businesses.

These entities can work together under the umbrella of a single CDFI that plans, stimulates and coordinates strategic community development. Structurally, the entities can share staff, boards, space, and resources, but should be separately incorporated in order to most efficiently raise capital and operating funds.

9 CONCLUDING THOUGHTS AND COMMENTS

This thesis set out to study if and how low-income communities are under-served by conventional financial institutions, and to suggest how alternative institutions might be created to better meet their needs.

It starts from the premise that America's inner-city neighborhoods face great problems. Moreover, many ingredients go into making communities healthy, including creating jobs, retaining and creating housing, revitalizing commercial areas, reducing crime, improving schools, and ensuring that even low-income residents can accumulate savings and assets that stake them in their communities.

Capital, and the institutions that can both provide capital and support strategic development, are among the key ingredients to creating healthy communities.

UPHAM'S CORNER

I chose Upham's Corner as my case study because it is a multi-ethnic, very low-income community that has many problems along with many opportunities. Most low-income communities are not well-served by conventional banks, and blame many of their problems on the absence of capital and capital providing institutions. Since Upham's Corner is home to three banks, it presented me with a unique opportunity to study how well conventional banks--that are located in low-income communities, and are committed to helping them develop--meet the actual needs of low-income residents and small businesses.

LOOKING FOR GAPS

I designed this study to look for specific gaps between what Upham's Corner residents

and businesses need (in the way of capital and development assistance), and what conventional lending institutions, public, quasi-public, and non-profit organizations provide.

In order to get a comprehensive picture of Upham's Corner's capital and development needs, I broke this study into three parts: consumer retail banking services and credit, small business credit (and technical assistance), and home mortgage financing.

In each part I assessed community needs and inventoried the various programs and institutions that tried to address these needs. In areas where I found no overlap, I described either a public or private capital gap, or an institutional gap.

EXPECTED FINDINGS

I initially expected to find that the local banks collected deposits from Upham's Corner residents and businesses, but made little attempt to put anything back into the community. I therefore expected to find several public and private capital gaps that stunted local development. I expected to find that the check cashing stores in Upham's Corner preyed upon their customers and that there were few alternative affordable ways for low-income people to convert their checks, save money, or use other banking products.

FINDINGS

FINANCIAL SERVICE AND PRODUCT GAPS

In the consumer service area, I found similarities in the broad needs of low- and higher-income individuals, but the specific needs of these two groups are quite different. While both need safe, inexpensive, and convenient ways to convert their checks, pay their bills, and deposit and access their money, higher-income people are more likely to exchange markers for other markers (such as checks to pay credit card

bills, or credit cards to make mortgage payments), and lower-income people are more likely to live entirely in the cash economy.

I found that the primary consumer services offered by banks are checking and deposit accounts, and ATM services (markers). Although good efforts have been made to make these products available to low-income people, they are designed to meet the needs of the upper-income people, and are not what low-income people most need, or are likely to use.

Check cashing stores, and some department stores and supermarkets have recognized this gap and offer many of the cash-based services that low-income people want. Although some of these services are reasonably priced and convenient, these alternative institutions do nothing to help low-income people accumulate savings or develop banking relationships. Nor do they invest money back into the community.

Low-income people also need inexpensive and accessible credit as well as ways to establish credit histories. All of the local banks provide extensive credit services including consumer, auto, education, home equity, and mortgage loans. None, however, provide the types of loans that low-income people can get or use.⁹⁹ Low-income people have difficulty putting up collateral, or proving that they are good credit risks. They are more likely, therefore, to use loan sharks, furniture stores, and pawn shops to get the credit they need.

The alternative institutions that offer services and credit to low-income people in Upham's Corner fill mostly private gaps (since they are able to profitably provide

⁹⁹ These might include very small uncollateralized consumer loans such as those offered by community credit unions. No local institution offers anything like a low-income credit card to help people establish credit.

services) that banks cannot.

Upham's Corner needs an institution that provides consumer banking services to low-income people that benefit both these individuals and the community. Such an institution should fill both service gaps and private and public capital gaps that impact low-income people.

SMALL BUSINESS DEBT PROVISION GAPS

I found that small storefront businesses in Upham's Corner often have little collateral, unique financial records, and need loans between \$500 to \$50,000 (which is less than most banks are able or willing to lend).¹⁰⁰ I found that banks almost never lend to start-up businesses. They also require loan guarantees or high amounts of collateral. I also found a mismatch between how banks require small businesses to keep financial records, and how records are often actually kept. Unconventional record keeping seems to prevent otherwise credit-worthy businesses from accessing capital.

Like consumer banking services, business debt products appear to be designed for larger businesses with the experience and ability to meet bank requirements. The minimum loan size is reduced, and the product is offered to smaller businesses which may still not be able to meet the bank's other loan requirement. These requirements too, are usually designed to meet the bank's needs, rather than the consumer's.

A number of programs run by public, quasi-public, and non-profit organizations have

¹⁰⁰ Although commercial banks may advertise that they make loans as low as \$15,000, for all practical purposes, they make very few business loans for less than \$50,000 and prefer to make loans of over \$100,000. These qualities are not unique to Upham's Corner banks. Notwithstanding the difficulty the Americas' Food Basket Supermarket had getting financing, the local banks seem to make a greater effort than most to reach out to small businesses.

recognized this gap and provide business loans in the \$500-\$50,000 range on terms that are sensitive to the abilities and needs of borrowers. This is especially true of Boston's Public Facilities Department loan fund and the Working Capital MELF. Both are very flexible and, I believe, have the potential to meet much of Upham's Corner's business capital needs. The EDIC Small Business Loan Fund, by contrast, is reputed to be just as bureaucratic as a bank. Despite its goal to lend small amounts of capital, few Upham's Corner businesses are able to meet its lending criteria.

I was interested to find that the supply of capital is less of a problem for Upham's Corner than the lack of demand. Few businesses I surveyed believe that lack of available capital is a major local development problem. Despite the growing availability of debt capital for very small businesses, few new businesses are growing out of, or into, this community. I conclude, therefore, that Upham's Corner needs an institution that can stimulate demand through strategic targeting of resources and by creating programs that develop new businesses.

EQUITY FOR SMALL BUSINESSES GAPS

At least three types of business people in low-income communities need outside sources of equity capital. These include entrepreneurs who are unwilling to bear all of the financial risks of opening new businesses in neighborhoods like Uphams' Corner; low-income entrepreneurs who have insufficient savings or family resources to fully capitalize a business; and existing business-people who want to expand but cannot afford to assume more debt.¹⁰¹

¹⁰¹ I should note that in my survey of local businesses I did not find an identifiable demand for equity financing. I would like to have had the time to do a more extensive study of potential equity demand. Instead, I am relying on the work of Daniels, Bendick and Egan, and others who have written about the general equity needs of businesses in low-income areas.

The Community Development Finance Corporation was the only group I found that has a local equity investing program for small businesses. This program is designed to invest in high tech businesses that have great profit potential, and not the types of businesses likely to locate in Upham's Corner.

There are many reasons why small business equity funders are rare in low-income communities. Venture investors face high information and management costs, very high risk, and because of the types of businesses likely to open in Upham's Corner, have only limited potential for returns.

The dearth of venture capitalists investing money in Upham's Corner can be viewed as both a private and public capital gap. Some potential investments may carry similar risks and returns to investments in other communities. In most cases, however, conventional venture investors financial objectives probably cannot be met by local opportunities.

Upham's Corner needs to attract new businesses to the area, and help existing businesses expand. It needs an institutional "angel" that can assess and provide for these equity needs as part of a community business development strategy.

TECHNICAL ASSISTANCE GAPS

In addition to capital, small- and micro-businesses need technical and management assistance (TA) to help them become better at planning, marketing, and keeping records in ways that will enable them to access conventional financing.

Conventional banks provide TA to their borrowers, and several different SBA and state sponsored organizations provide TA to any business that requests it. These programs are all passive service providers and are located outside of the community. None of these programs focus on providing TA to the types of very small businesses

that are likely to locate in Upham's Corner.

Technical and management assistance is very expensive to provide and has no direct financial return. The absence of easily accessible TA for very small businesses, therefore, constitutes a public gap that requires subsidies to close.

The financial institutions and programs currently serving Upham's Corner are not designed to provide the types of services, products, or programs that its lower-income residents and small businesses most need. Nor are they structured to be comprehensive community developers with missions to make this a healthier community. The most serious gaps facing Upham's Corner, therefore, are institutional. These are gaps between the types of institutions that the community needs to create and support effective community economic development, and the structure and goals of its existing financial institutions.¹⁰²

DIFFERENCES BETWEEN INSTITUTIONAL CORE VALUES

I believe that the institutional gaps that I found in this community can be explained, in part, by what I found to be significant differences between the core values of conventional institutions and CDFIs, and the way each approaches the market. Conventional banks look at a community's current capacity to support banking activities. Most banks offer boiler plate services and loan products and they do not open branches where demand is not established. CDFIs, by contrast, assume that low-income communities need development, and know that capital is needed to carry this

¹⁰² This conclusion is remarkably similar to one stated 12 years ago by Telesis. "The DBEDC should endeavor to provide technical and financial assistance to, and community support for those small businesses which serve the community's interests. Joint venture or other cooperative arrangements, involving the DBEDC, may be appropriate for their commercial viability" (5).

out. The question they seek to answer, therefore, is not whether to serve a market, but how.¹⁰³

Under this framework, the services and products provided by both conventional (and alternative) financial institutions are only tactical responses to community needs, while CDFIs are strategic entities that catalyze good community planning and can create programs that stimulate demand for development capital.

I base this conclusion on my findings that the conventional banking institutions located in Upham's Corner truly desire to serve low-income communities and make a good attempt to do so. All three local banks have made great attempts to look at and address the needs of low-income people and very small businesses.¹⁰⁴ Their structure and profit-making constraints prevent them from filling the community development role that Upham's Corner needs. They remain part of larger institutions that are, at their core, banks and not strategic development institutions.

¹⁰³ Many of the community development bank and loan fund founders with whom I spoke admit that they did not do extensive market demand surveys before opening their doors. Most had a strong desire to support strategic economic development, and a strong belief, but little empirical evidence, that a capital need was going unmet. The South Shore Bank, Self Help Credit Union, and Boston Community Loan Fund, all experimented with offering different loan products in order to locate, stimulate, or create demand. These lenders recognized both financial and institutional gaps and set out to create institutions that did far more than just provide capital or services to under-served communities.

¹⁰⁴ A good example of this is the Sabrina Gee study that First Community Bank commissioned to look at reasons why low-income people use check cashing stores.

Unfortunately, the CRA expects little more of them. Bank of Boston has received an "outstanding" rating from the Comptroller of the Currency, for the work of its First Community Bank. This is despite that fact that the First Community Bank remains a net exporter of money from low-income communities.

DEBATE OVER RESPONSES TO GAPS

The debate over whether to pressure existing conventional institutions to meet community needs, or to create new CDFIs, does not account for specific community needs, nor the strengths of each institutional model.

Existing banks are well-suited to fill private capital gaps, while CDFIs are better suited to create community development opportunities. Upham's Corner's low-income residents and businesses face greater institutional gaps than capital gaps, and therefore, simply pressuring local banks to lend to more local projects will do little to improve community conditions.

BANKING IN THE 1990s AND THE NEEDS OF LOW-INCOME COMMUNITIES

Inner-city neighborhoods across the country are crying out for investment to create businesses and jobs, build housing, and revitalize their physical environment. Moreover, individuals living in these communities need affordable and convenient services that are designed to meet their needs. The market has done an uneven job of providing banking services and investment to America's communities. In response, the Community Reinvestment Act was designed to pressure banks to seek out and fill private capital gaps in their service areas. However, even if banks did all they could under the CRA, there would still be significant public and private capital gaps such as those I found in Upham's Corner. Attempts by community groups to get banks to fill public gaps as well, will continue to meet with understandable resistance.

The CRA is a necessary tool to force banks to overcome income and race discrimination, and serve those segments of low-income communities where profits can be made within regulatory and structural constraints.

Since 1970 the number of savings and loans and credit unions have significantly declined. For decades these local financial institutions best met individual community needs. In the last 10 years the banking industry, too, has consolidated. Taken together these trends have created fewer, but larger institutions, that are more bureaucratic and flexible to address the unique needs of individual communities. They are also less able to develop personal relationships with their customers.¹⁰⁵

The Bank of Boston First Community Bank model is a welcome effort to compensate for this trend. However, even FCB is a net exporter of funds from low-income communities.¹⁰⁶ It remains to be seen how successful the FCB experiment will be, or if other banks will replicate it. The Boston Five Cent Savings Bank--which serves a number of Boston's low-income communities, will soon be taken over by Citizens Bank of Connecticut. Despite the new owner's assurances to the contrary, the Boston Five is unlikely to be a more responsive community lender--as part of a bigger bank--than The Boston Five is today (or than the First American was prior to the Boston Five taking it over several years ago).

There are clearly economies of scale to improve the efficiency of banks. The minimum size for a bank to be efficient is between \$50 and \$100 million. However, there are also diseconomies of scale where banks larger than approximately \$500 million start to

¹⁰⁵ These trends run counter to the efforts of some segments of the banking industry to adjust the scope of their products to the needs of communities, and serve new markets. Shawmut Bank has recently started making soft second loans to home owners in a low-income community at below market rates and terms in order to develop a new market. Although banks should be encouraged to continue implementing such positive programs, this may just be a short-term trend and cannot be counted on to meet all the future needs of low-income communities.

¹⁰⁶ Gail Snowden, President of FCB confirmed this in a talk at the Kennedy School of Government, April 27, 1993. She explained that the bank is attempting to become a net importer of money into low-income communities in the near future. However, she was unsure how long this process would take.

lose touch with the needs of their community.¹⁰⁷ CDFIs can be efficient at smaller scales, and are never likely to reach a size where they lose touch with their neighborhood constituents.

Several trends in financial intermediation seem likely for the 1990s. First, smaller banks will continue to be taken over by larger banks leaving communities with fewer locally controlled banks. This will occur while regulators and citizen's groups continue to pressure them to better serve their community's. Depending on the success of experiments like the First Community Bank, more conventional banks may create subsidiaries or "banks within banks" to meet these demands.

The Clinton administration will also likely be pressed to support the creation of a two-tier banking system. This system would recognize that banks cannot meet all the needs of low-income communities. Special provisions for CDFIs could be made to fill these needs (under separate regulations). Such a system would enable many existing multi-service CDFIs to expand, and new CDFIs to be created in low-income communities (Principles 6).

CONCLUSION

Addressing the problems of pervasive poverty and deterioration in urban America's low-income communities will take concerted efforts by development and financial institutions.

The extent to which this occurs in the 1990's depends on recognizing the fundamental differences between financial institutions that lend money in low-income communities,

¹⁰⁷ Henry Morgan of the South Shore Bank Board and Ronald Homer of The Boston Bank of Commerce believe the minimum size for efficiency is \$50-100 million, Parzan and Kieschnick say it is \$20 million (). Edward Shea and Morgan agreed that banks over \$500 million begin to lose touch with their communities.

and CDFIs that create, and invest in strategically planned community development projects.

Despite the growing number of alternative service providers in low-income communities, the strategic economic development needed to make them healthier is not taking place. New CDFIs, with activist missions, must be created by and for people who are dedicated to meeting needs that cannot be met by traditional banking approaches or institutions.

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Appendix A

English and Spanish Questionnaires used for Upham's Corner Business Survey

UPHAM'S CORNER/NORTH DORCHESTER LOCAL BUSINESS SURVEY

Please take 5 minutes to complete this survey. Thanks in advance for your assistance.

- 1) Name of Business _____
- 2) Location of Business _____
- 3) Your Position in the Business (Circle One) **Owner** **Manager**
- 4) Type of Business (Circle one) **Food**
Clothing/Shoes **Furniture** **Professional Service**
Restaurant **Personal Care Service** **Retail Goods**
Convenience/Liquor **Other** _____
- 5) Length of time at current location _____ **years**
- 6) Length of time in Neighborhood (if different) _____ **years**
- 7) How many people work at your business
 Full time _____ **Part time** _____

How do you view each of the following as a pressing problems facing your business today? 1 is no problem and 5 is a big problem.

	No Problem	Some Problem	Big Problem	
8) Too few customers	1	2	3	4 5
9) Cost of supplies	1	2	3	4 5
10) Cost of rent	1	2	3	4 5 NA
11) Neighborhood crime	1	2	3	4 5
12) Access to long term loans	1	2	3	4 5
13) Problems with employees	1	2	3	4 5
14) Problems getting credit	1	2	3	4 5
15) Condition of building	1	2	3	4 5
16) Neighborhood reputation	1	2	3	4 5
17) Competition from other Businesses	1	2	3	4 5

(turn to next page please)

- | | No
Problem | Some
Problem | Big
Problem | | |
|------------------------------|---------------|-----------------|----------------|---|---|
| 18) Short term financing | 1 | 2 | 3 | 4 | 5 |
| 19) Shoplifting | 1 | 2 | 3 | 4 | 5 |
| 20) Location of the business | 1 | 2 | 3 | 4 | 5 |
| 21) Parking | 1 | 2 | 3 | 4 | 5 |
- 22) Where do most of your customers come from? (Circle answer(s))
- Live in the neighborhood** **Work in the neighborhood**
- Drive through the area on way to or from work**
- Make a special trip to this business** **All of Above**
- 23) How do most of your customers get to your business?
- Walk** **Drive** **Take bus** **Other**_____
- 24) Is your business doing better, worse or the same as it was 1 year ago? (Circle one)
- Better** **Worse** **Same**
- 25) Is your business doing better, worse or the same as it was 4 years ago? (circle one)
- Better** **Worse** **Same**
- 26) Would you like to expand your product line in the next 1-2 years?
- Yes** **No** **Not applicable**
- 27) Would you like to expand your inventory in the next 1-2 years?
- Yes** **No** **Not applicable**
- 28) Are you considering expanding the size of your business in the next 1-2 years?
- Yes** **No**
- 29) Are you considering renovating your store or business space in the next 1-2 years?
- Yes** **No**
- 30) Are you considering the purchase of new equipment in the next 1-2 years?
- Yes** **No**

(turn to next page please)

31) What business problems do you need to solve in the next year?

32) Do you do regular business with one of the area banks?

Yes No

33) If you answered yes to 32, please circle the Bank name

Shawmut BayBank Bank of Boston Fleet

The Boston Five Other _____

34) What type of accounts do you have with the bank? (circle all that apply)

Checking Payroll Time Deposit

Business Credit Card Other _____

35) Do you think that it is difficult for businesses in the neighborhood to get financing?

Yes No

36) If you answered yes to 35, do you think that the reason is: (circle all that apply)

Lack of credit history Location of business The Economy

Lack of collateral Don't know how to get a bank loan

Other _____

37) Do you know people who would like to open a business in the area?

Yes No

38) If you answered yes to 37, why are haven't they started their business?

Lack of space Lack of Credit Lack of Experience

Other _____

39) Do you currently have any business loans from a bank?

Yes No

(turn to next page please)

40) If you answered yes to 39, please circle all the types of loans that apply

Line of Credit Long term business loan Building Mortgage
Equipment loan Second Mortgage Credit Card
Accounts Receivable Loan Other _____

41) Do you have any business loans from a different source?
Yes No

42) If you answered yes to 41, please circle all that apply

Friend or Family Finance Company Government Program
Loan Fund Personal Savings Other _____

43) Could your business be more profitable if you had more financing?
Yes No

44) If yes, what type of financing does your business need?

45) Have you been turned down for a loan or line of credit in the last 3 years?
Yes No

46) When you want to expand your inventory or product line, how do you finance this expansion?

Business Cash Bank Finance Company Family
Personal Savings Other _____

47) When you need more working capital to run your business where do you get it?

Business Cash Bank Finance Company Family
Personal Savings Other _____

48) How did you acquire your business?

Started it new Bought existing business
Took over family business Other _____

ESTUDIO DE NEGOCIO

Por favor, coja 5 minutos para completar el estudio. Gracias por su asistencia.

- 1) Nombre de su negocio. _____
- 2) Lugar de su negocio. _____
- 3) Su posicion en el negocio. Dueño _____ Administrador _____
- 4) Tipo de negocio. Restaurante _____ Muebleria _____ Bodega _____
Ropas/Zapatos _____ Servicios _____ Tienda _____
- 5) Cuanto tiempo lleva en el negocio. _____ Años
- 6) Cuanto tiempo lleva en el vecindario. _____ Años
- 7) Cuantas personas trabajan en su negocio. Tiempo completo _____
Tiempo parcial _____

Como Usted ve cada uno de los siguientes problemas. Numero uno (#1) es ningun problema y numero (#5) es un gran problema.

	Ningun Problema	Algunos Problemas	Grandes Problemas		
8) Muy pocos clientes	1	2	3	4	5
9) Costo de su productos	1	2	3	4	5
10) Costo de su renta	1	2	3	4	5
11) Crimen en el vecindario	1	2	3	4	5
12) Acceso a prestamos con fines largos	1	2	3	4	5
13) Problemas con empleados	1	2	3	4	5
14) Problemas con acceso a credito	1	2	3	4	5
15) Condiciones del edificio	1	2	3	4	5
16) La reputacion del vecindario	1	2	3	4	5
17) Competicion con otros negocios	1	2	3	4	5

	Ningun Problema	2	Algunos Problemas	3	4	Grandes Problemas	5
18) Finanza con fines cortos	1	2	3	4	5		
19) Robo	1	2	3	4	5		
20) Lugar del negocio	1	2	3	4	5		
21) Parqueos	1	2	3	4	5		
22) De donde viene la mayoría de su clientes (marque uno de lo siguiente)							
	Viven en el vecindario__ Trabajan en el vecindario__						
	Manejan a través del área en camino a su trabajo__						
	Hacen un viaje especial para negociar__ Todo lo anterior__						
23) Como llegan la mayoría de su clientes a su negocio.							
	Andan__ Manejan__ Toman autobus(guaguas)___						
24) Esta su negocio mejor, peor o igual que el año pasado.							
	Mejor__ Peor__ Igual__						
25) Esta su negocio mejor, peor o igual que 4 año atrás.							
	Mejor__ Peor__ Igual__						
26) Quiere expandir la línea de sus productos en el próximo año.							
	Si__ No __ No aplica__						
27) Quiere expandir su inventoria en los próximos años.							
	Si__ No__ No aplica__						
28) Piensa expandir su negocio en los próximos años.							
	Si__ No__ No aplica__						
29) Esta pensando renovar su tienda o negocio en los próximos años.							
	Si__ No__ No aplica__						
30) Esta pensando en la compra de algún equipo para su negocio en los próximos años.							
	Si__ No__ No aplica__						

- 31) Que problemas de negocios tiene usted que resolver en el proximo año. _____

- 32) Hace usted negocio con los bancos del area.
 Si___ No___
- 33) Si su contesta es Si en el numero #32 (marque todos lo que apliquen)
- Shawmut___ Baybank___ Bank of Boston___ Fleet___
 El Boston Five___ Otro_____
- 34) Que tipo de cuentas tiene Usted en su banco. (marque todo que aplique)
- Cambio de Cheque___ Pago de empleo___
 Deposito de tiempo___ Tarjeta de credito___
 La economia___ Otro___
- 35) Cree Usted que es dificil para los negocios del vecindario conseguir financiamiento.
 Si___ No___
- 36) Si su contesta es Si al numero #35, cree Usted que la razon es porque(marque lo que aplique)
- Falta de credito___ Lugar del negocio___ Falta de garantia___
 No sabe como conseguir un prestamo___
- 37) Sabe Usted de personas que quieren abrir un negocio en la area.
 Si___ No___
- 38) Si su contesta es Si a la pregunta numero #37, diga porque no han abierto el negocio.
- Falta de espacio___ Falta de credito___
 Falto de experiencia___ Otras razones_____
- _____
- _____
- 39) Tiene Usted un prestamos con un banco.
 Si___ No___

40) Si su contesta es SI en la pregunta numero #39, marque el tipo de prestamos.

Linia de Credito__ Prestamos con fines largos__
Hipoteca de edificio__ Prestamo de equipo__
Hipoteca de segundo lugar__ Tarjeta de Credito__
Prestamos de Ventas__

41) Tiene Usted un prestamo en otro lugar. Si__ No__

42) Si su contesta en la pregunta numero #41 es SI, entonces marque lo que aplique en lo siguiente.

Amigos/Familia__ Compania de Financiamiento__ Programa de
Gobierno__ Programa de prestamos__ Ahorro Personal__

43) Pudierá su negocio tener mas ganancias con financiamiento.
Si__ No__

44) Si su contesta es SI en la pregunta anterior, entonces que tipo de financiamiento necesita.

45) Ha sido rechazado por un prestamo o una linea de credito en los ultimos tres anos. Si__ No__

46) Cuando quiera Usted expandir su inventoria o linea de productos, como vas a financiar esta expansion.

Capital del Negocio__ Banco__ Compania de Finan-
ciamiento__ Familia__ Ahorro Personal__ Otra__

47) Cuando necesita Usted mas capital para su negocio, donde lo consigue.

Capital del Negocio__ Banco__ Compania de Finan-
ciamiento__ Familia__ Ahorro Personal__ Otra__

48) Como conseguí su negocio.

Lo empese nuevo__ Lo compre__ Lo conseguí a traves
de la familia__ Otra manera__

Appendix B

DISCUSSION QUESTIONS FOR INTERVIEWS OF LOW-INCOME PEOPLE AT UPHAM'S CORNER HEALTH CENTER, AND FOCUS GROUP(focus group only has a *).

November, 12, 1992

What do you do when you get a check, either from work or the government?

Where do you cash it?

How much do you spend the first week?

How much of it do you have left over at the end of a week?

How about at the end of two weeks?

Do you sometimes have to borrow money to get to the next pay period?

How often do you receive checks?

Do you go to the banks?

Have you ever used a check cashing store? Do you know people who do?

Do you like the check cashing store?

What do you like about the Check Cashing store?

Do they treat you better or worse than the banks?

Why don't you use the Check Cashing Stores?

What do you like about the bank (s)?

What don't you like about the bank(s)?

Why don't you leave some money in a bank during the month?

When I first had a cash card for the ATM machines, I didn't trust myself not to use it.
Do you feel that way (anyone else feel that way)?

Do you have an ATM card?

Have you ever had a checking account? Do you still?

Who doesn't have one? *

Why don't you have one?

How many pieces of picture ID do you have?

What are they? A drivers license, a passport, what else do you have?

Is this enough to use the banks?

Does anyone have a credit card? *

Have you ever had a credit card?

Would you want one?

Why?

Money:

Where do you spend most of your money? At the Supermarket, on clothes, on what else?

Do you shop here in Upham's corner?

Do you know any of the people who run the businesses here?

What do you think of their businesses?

Do you know people who are running businesses out of their homes?

What kind of businesses are these?

Do any of you want to start your own businesses?

What kind of business would you like to start?

What would you need to start it?

Where would you get these things?

FOCUS GROUPS SET UP:

ROOM DESIGN:

- 1) Name Plates on Desk
- 2) Tape Recorder
- 3) A round table in a room with no distractions
- 4) Refreshments (orange juice, apple juice and some cookies is fine).

DESIGN OF THE GROUPS:

- 1) group members should be somewhat homogeneous in terms of language skills. All should understand and speak english and none should be shy about speaking in front of others.
- 2) age range from 25 - 60
- 3) income levels: working class (lower/middle-income)

INTRODUCTION:

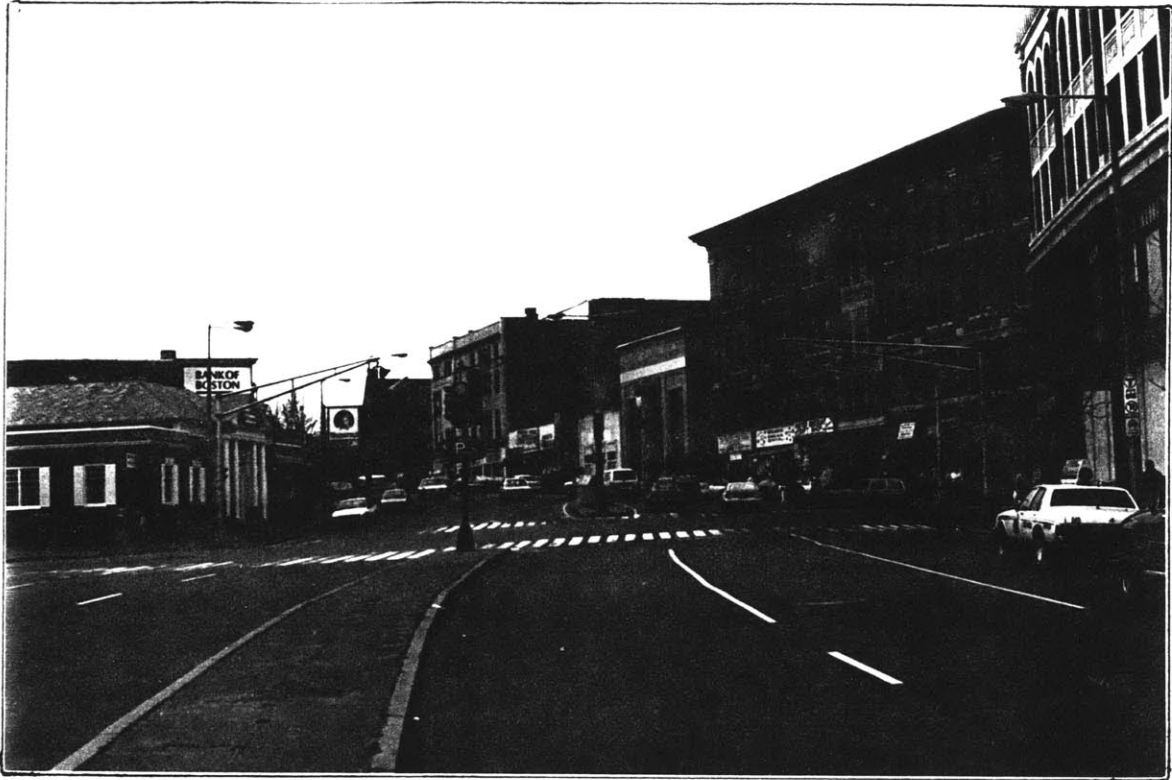
Warm up the group with some simple questions about how things are going in the city, and in the neighborhood and what types of things they think are the best and worst things about this community.

Go around the table and ask everyone to throw out a few words to describe how they feel. This is a loosening up exercise. After they are done going through all of this stuff, I should get back to a couple of people and ask them to elaborate.

APPENDIX C
Locus Map, Upham's Corner

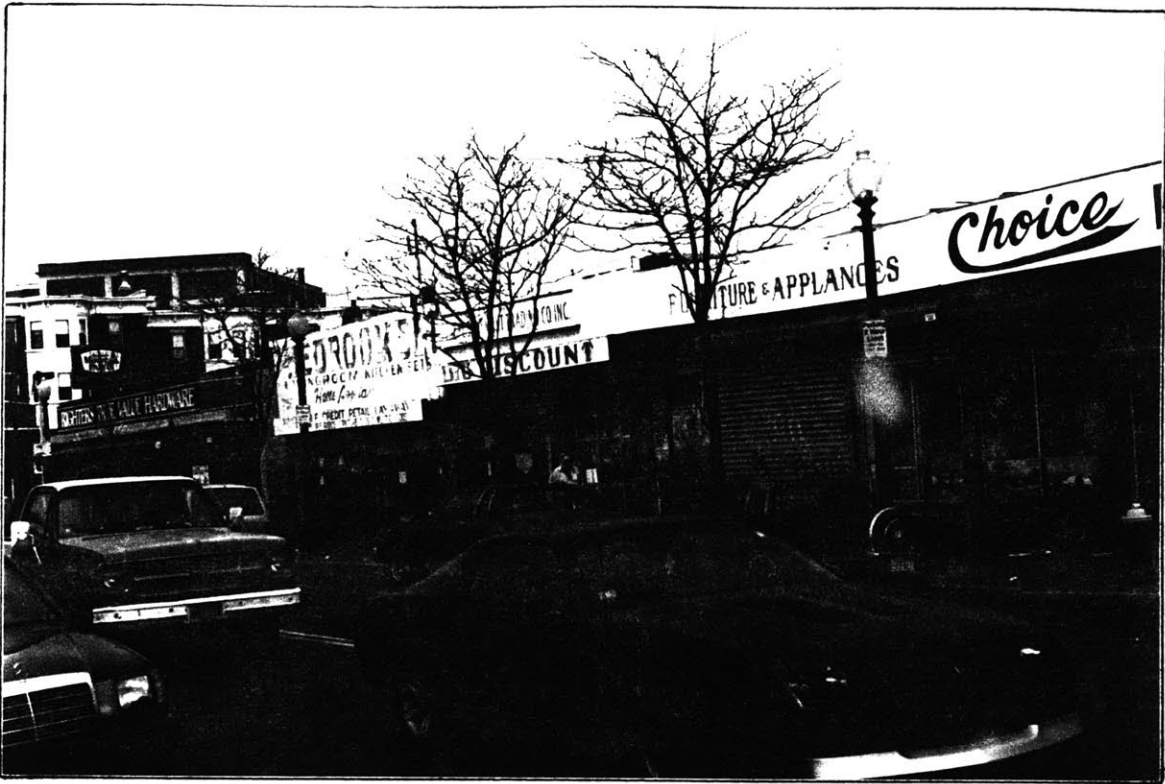


Appendix D Pictures of Upham's Corner Commercial District

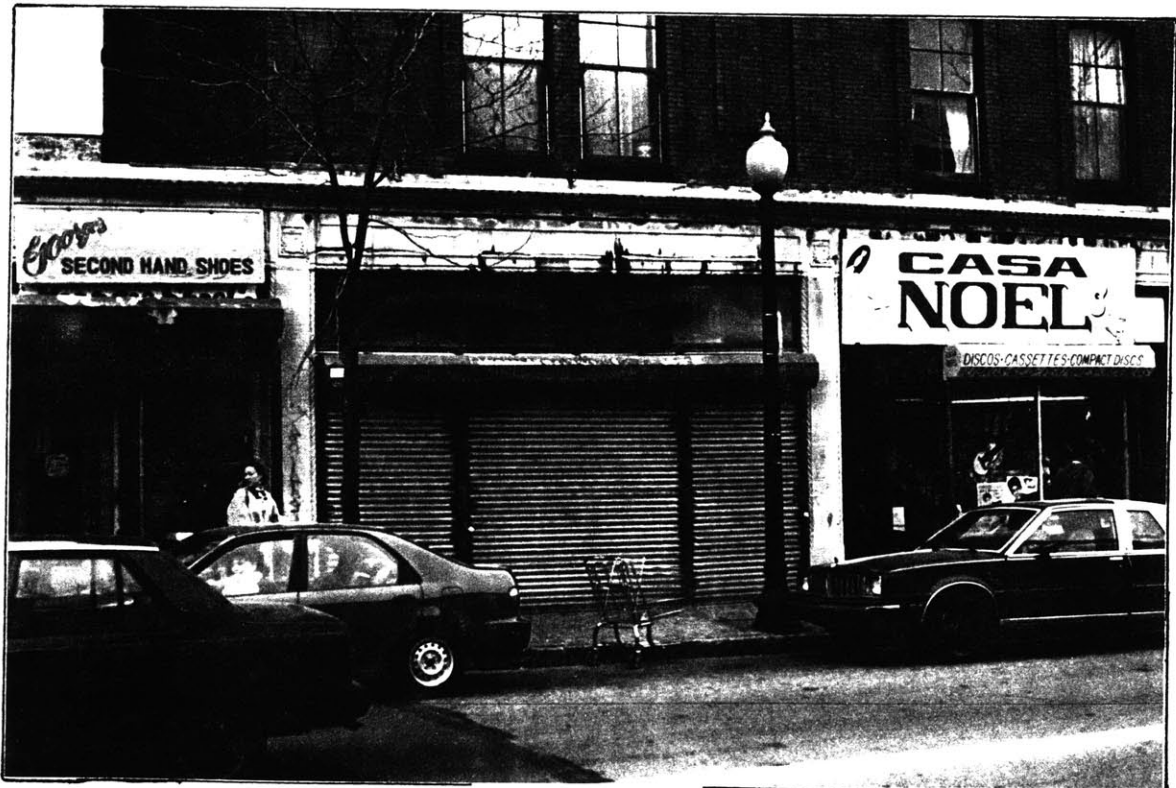


2 views of the corner of Columbia Road and Dudley Street, Upham's Corner.





Dudley Street, Upham's Corner



Street Car on Columbia Road
(Pre-1950)

