

Elizabeth A Duke: Fostering innovation in Community Development Finance

Speech by Ms Elizabeth A Duke, Member of the Board of Governors of the Federal Reserve System, at the 2011 Exploring Innovation Conference on Community Development Finance, St Louis, Missouri, 10 May 2011.

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Good morning. It is a pleasure to be in St. Louis to open the third biennial Exploring Innovation Conference. The first Exploring Innovation conference was opened four years ago by Professor Andrew Hargadon, the Charles J. Soderquist Chair in Entrepreneurship at the University of California, Davis and a senior fellow at the Kauffman Foundation. His remarks established a framework of collaboration for innovation in community development finance. Since then, this conference has served as a forum for sharing ideas and maintaining the networks that are so critical to this work.

Professor Hargadon initially set the stage by explaining that innovation and creativity are not the same. An individual acting alone to solve a problem can be creative, while innovation is the process of adding value by applying a new idea or method to something that is already established. For example, Henry Ford did not contribute the creative energy to invent an automobile. Rather, Ford's innovation was the idea to combine the 100-year-old technology for the automobile with the meat packing industry's assembly line process, resulting in a means to mass produce cars. On the same note, Apple did not invent the MP3 player with the introduction of the iPod. Rather, the company used existing technology and a collaboration with the music industry to develop iTunes software, bringing an affordable application of the MP3 to the public. In each of these examples, improving upon a good idea was as important, if not more important, than the initial idea. The message for community development professionals was the importance of collaboration, sharing ideas, and building upon the ideas of others in order to innovate for the benefit of our communities.

The significance of Professor Hargadon's message should not be lost in today's challenging economic climate. Times are particularly difficult for residents of our low- and moderate-income communities who are struggling more than ever to support their families, obtain affordable housing, and access basic services. We are here this week to develop fresh approaches to address these persistent problems that are even more widespread today than they were four years ago. Throughout the conference, I hope you will contribute your own best ideas and look for ways to use the ideas of others to improve your own communities and enhance your innovation network.

To this end, I would like to talk about efforts underway across the Federal Reserve System and to share some of our ideas and resources. Situated at the intersection of the federal government and private financial institutions, the Federal Reserve System is well-positioned to facilitate collaborative activities among experts in the community development finance industry. Through our network of 12 Reserve Banks across the country, we build relationships with local governments, nonprofits, foundations, academic institutions, and financing entities. We use outreach to connect the creative minds working in community development to generate innovative policy and finance solutions. By adding applied research to the mix, we convene these stakeholders around particular community development topics and disseminate information to low- and moderate-income communities, practitioners, and other interested parties.

I realize that collaboration and innovation can sound abstract, so let me offer some examples of issues that the Fed has championed recently, and where we have seen the results of our efforts.

Housing crisis

I would like to start with the Federal Reserve System's response to the housing crisis as it unfolded over the past three years. Our multifaceted response included guidance to banks, updates to regulations, changes to monetary policy, and analytical research contributions. It also included engagement in national and regional partnerships to inform policy and practices around foreclosure prevention and neighborhood stabilization in communities hard hit by foreclosures.

From the onset of the crisis, we called on the expertise of community development professionals within the Federal Reserve System to respond to concerns from homeowners by crafting strategies to enhance foreclosure mitigation, encourage loan modifications, and stave off the rising number of rescue scams. The Fed also strengthened existing collaborations with fellow regulators, community groups, policy organizations, financial institutions, and public officials to discuss innovative methods for preventing unnecessary foreclosures and the negative impact they have on communities. One valuable product of this effort was the development and dissemination of data tools, heat maps, and detailed analysis to identify neighborhoods most at risk of foreclosures and their damaging effects. Equipped with this information, community leaders can better target limited resources to borrowers and declining communities. In 2008, as interest in market-specific responses to foreclosures grew, the Fed developed a conference series entitled "Recovery, Renewal, Rebuilding"¹ in five cities that represented a variety of housing markets – from older, industrial cities with shrinking populations to boomtowns that grew too quickly.

Meanwhile, we also launched online Foreclosure Resource Centers at each Reserve Bank that continue to provide homeowners, prospective homebuyers, and community groups with information to help prevent foreclosures and lessen their negative influence on neighborhoods. These centers offer a variety of resources, including an enhanced Foreclosure Mitigation Toolkit, which provides detailed steps and information for localities seeking to develop foreclosure prevention activities. The toolkit also includes a new Foreclosure Recovery Resource Guide to help consumers recover from the foreclosure process.

As the foreclosure crisis unfolded and concerns expanded from loss mitigation and loan modifications to worries about housing values, vacant properties, and neighborhood stabilization, the Fed's response evolved as well. For example, starting in 2009, the Board worked with the Federal Reserve Banks of Boston and Cleveland to produce a publication addressing issues related to the acquisition and disposition of real estate owned properties (REO), a term that refers to property owned by a financial institution, typically a bank, after a foreclosure. The publication, "REO and Vacant Properties,"² is a compendium of papers by national experts that highlight their key ideas regarding the disposition of vacant properties. Last November, the papers were presented publicly at a forum at the Federal Reserve Board in Washington, D.C., where more than 100 participants shared ideas and lessons learned about community stabilization.³ In addition, last year, the Federal Reserve worked with other federal regulators to encourage neighborhood stabilization activities through the Community Reinvestment Act. This year, we created video reports that describe specific strategies for managing vacant properties in Cleveland, Phoenix, and Detroit.⁴

Throughout our work on the housing crisis, we have witnessed policy changes and novel responses to the challenges facing our communities. The collaborative efforts and

¹ For more information, see <http://stlouisfed.org/RRRSeries/>.

² This publication (4.6 MB PDF) is available on the Board's website.

³ To learn more about the forum, go to www.federalreserve.gov/events/conferences/2010/reovpsns/default.htm.

⁴ All three video reports are available on the Board's website.

information sharing from national housing and community development experts, including those led by our own staff, helped bring these innovative efforts to fruition. For example, as a result of our neighborhood stabilization work, some Reserve Banks partnered with national groups to help declining cities learn how to use land banks as a potential tool to address high rates of foreclosure and vacant properties. Based on the initial success of the Genesee County Land Bank, established in Michigan in 2002, and resources provided by the National Vacant Properties Campaign, land banking is becoming an integral part of community revitalization efforts for many places across the country. For example, the city of Cleveland has used the Cuyahoga County Land Bank as an important tool to address its vacant property issue. Cuyahoga County works with lenders and servicers, including the government sponsored entities (GSEs), to access properties quickly after they become vacant. This enables the county to make decisions regarding the REO before it becomes dilapidated or a nuisance for neighboring properties.

Because dealing with vacant property is a high profile issue in Cleveland, the Federal Reserve Bank of Cleveland regularly participates in conversations about solutions, such as land banking, and provides research on the neighborhood dynamics of this problem to support communities crafting solutions. The Bank recently released the “Adaptive Policies Needed to Address Changing Foreclosure Landscape”⁵ paper to highlight the changing circumstances driving the foreclosure crisis and the need for comprehensive policy approaches that cater to the specific challenges of diverse neighborhoods.

For its part, the city of Cleveland has responded to the growing number of vacant properties through the innovative use of data that allows the city to provide neighborhood-specific responses. NEO CANDO, or the Northeast Ohio Community and Neighborhood Data for Organizing, is a free and publicly accessible social and economic data system provided by the Center on Urban Poverty and Community Development, a research institute housed at Case Western Reserve University. NEO CANDO developers recognize that limited resources are available to address foreclosure issues, and their data support a systemic methodology for allocating available dollars. Hopefully, others will draw on the experiences with targeted data use in Cleveland just as Cleveland drew on the land banking experience of Genesee County.

Small business credit

Last year, diminishing credit availability for small businesses emerged as a significant stumbling block to the economic recovery. Small businesses are central to creating jobs and to restoring our economic prosperity. In fact, about one-half of all Americans are employed by firms with fewer than 500 employees.⁶ As the challenges facing small business owners surfaced, the Federal Reserve sought to better understand the nuances of the credit tightening.

Together, the Reserve Banks across the System leveraged relationships with lending institutions, small business owners, and community groups to discuss the changes in small business credit and think about potential solutions. Through this initiative, the Federal Reserve sought to deepen its understanding of the dynamics of the supply of and demand for small business credit, to identify specific credit gaps, and to learn of promising practices and suggestions for improvement. In the course of just five months, the Fed hosted more than 40 meetings around the country and finished with a wrap-up forum in Washington, D.C.,

⁵ Federal Reserve Bank of Cleveland (2010), “Containing a Firestorm: Adaptive Policies Needed to Address Changing Foreclosure Landscape (3.36 KB PDF),” Community Reinvestment Forum paper.

⁶ See John C. Haltiwanger, Ron S. Jarmin, and Javier Miranda (2010), “Who Creates Jobs? Small vs. Large vs. Young,” NBER Working Paper Series 16300 (Cambridge, Mass.: National Bureau of Economic Research, August).

designed to summarize what we had heard and to plan next steps.⁷ Some of the meetings took the form of small focus groups or listening sessions. Other meetings were larger in scale, with more formal agendas focusing on a particular aspect of small business financing, such as minority entrepreneurship, the role of Community Development Financial Institutions (CDFIs), or federal guarantee loan programs. Several meetings focused on a specific industry, such as auto suppliers.

Whether small or large, all of the meetings brought together small business owners, small business trade groups, financial institutions and other private lenders, bank supervision officials, CDFIs, and other small business support service providers to discuss ways to improve the flow of credit to viable small businesses. Although the information obtained through these meetings was anecdotal in nature, common themes did emerge. And the ability to obtain real-time information directly from lenders and potential borrowers has proved invaluable to our understanding of the issues affecting credit availability.

Illustrating the importance of small business access to credit, a compilation of the key findings of our outreach effort was included in Chairman Bernanke's semiannual *Monetary Policy Report to the Congress* in July 2010.⁸ Already, a few of the meeting participants' recommendations have become a policy reality for the small business credit market.

Participants in the nationwide meetings recommended improving access for CDFI loan funds to participate as guaranteed lenders in the SBA 7(a) program in order to increase the availability of credit to the underserved markets that depend on CDFIs. Later, the Small Business Administration (SBA) rolled out two pilot programs aimed at increasing the number of loans in these communities. The Community Advantage program will increase the number of lower-dollar loans in underserved communities by allowing CDFIs, and other mission-focused lenders, to originate SBA 7(a) loans up to \$250,000. Also, the Small Loan Advantage program is structured to encourage larger, existing SBA lenders to make lower-dollar loans, which often benefit businesses in underserved markets.⁹

Meeting participants also expressed support for additional low-cost, long-term capital for CDFIs. Such capital would allow CDFIs to price loans to reflect their risk and still offer an affordable rate to small businesses that may not qualify under conventional bank standards and products. One participant recommended that policymakers consider capital models for CDFIs that further leverage private dollars and create innovative incentives for the private sector to partner with experienced CDFI fund managers with strong risk-management capacity. Soon, as part of the Small Business Jobs Act, the U.S. Treasury will provide up to \$1 billion annually in federal guarantees for the next three years for bonds issued by CDFIs for community development purposes. In addition, the act established a \$300 million Small Business Lending Facility for Community Development Loan Funds. The regulations for both of these programs are currently under development.

At this point, I am pleased to tell you that recent anecdotal evidence leads me to believe that conditions are improving for small businesses. Although no definitive data source exists, the combination of a variety of recent survey results paints a picture of increasing optimism about future sales and business conditions and a corresponding easing of credit availability for small businesses.¹⁰ While this upward trend is encouraging, the Fed is continuing to look

⁷ The forum agenda is available on the Board's website.

⁸ See Ben Bernanke (2010), "Semiannual Monetary Policy Report to the Congress," testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Washington, DC, July 21.

⁹ More information on the SBA's Small Loan Advantage program is available at www.sba.gov/advantage.

¹⁰ Governor Elizabeth A. Duke, "Small Business Credit Availability," remarks at the 2011 International Factoring Association Conference, Washington, DC, April 14, 2011.

for ideas that will help small businesses as they work through some of the more subtle issues constraining their overall growth.

Going forward, we will coordinate a series of regional forums for financial institutions and CDFIs on the use and deployment of small business programs authorized in the Small Business Jobs Act and on sharing information about issues and successful practices at a national level. The forums are being organized with participation from the Opportunity Finance Network (OFN), the trade organization for CDFIs; the SBA; the Treasury; the CDFI Fund; and our partner regulatory agencies. In addition to providing information to regional forum participants, we will seek to use these forums to gather information on best practices, trends, and any barriers to the successful implementation of these federal programs. This year's work will culminate with a November conference at the Board of Governors, in partnership with the Federal Reserve Bank of Atlanta, to discuss small business credit and workforce training issues facing entrepreneurs – particularly women and minority entrepreneurs and those living in low- and moderate-income communities. Because jobs and the needs of low- and moderate-income communities remain a priority for us, we will continue to foster collaborative efforts in hopes of additional innovative responses.

Community data initiative

The Federal Reserve has a long history of using anecdotal information gathered from businesses within the Reserve Districts to better understand underlying regional economies and economic conditions. One of the lessons to be learned from the role of subprime lending in the recent crisis is that it is equally important to pay attention to underlying trends in segments of the economy, such as low- to moderate-income communities or small businesses. The anecdotal information we collect from community advocates and development professionals is quite valuable, but it will be even more actionable if we have a framework for systematically collecting, studying, and disseminating the information. To address this need to identify early warning signs of future economic challenges, we are testing several initiatives to collect information from practitioners and others working directly in the communities. This effort, known as the “Community Data Initiative,” is intended to provide a systematic approach to gathering and disseminating on-the-ground intelligence on current conditions and emerging challenges facing low- and moderate-income communities. Insights from the data will inform existing processes at the Fed and provide useful information to low- and moderate-income communities. In order to achieve this new data collection and analysis objective, a number of the Reserve Banks are leveraging their own research resources to survey, poll, or otherwise collect information about communities in their District. At the Board, we are also conducting our own surveys to help validate the District results.

Although the project is in its infant stage, I would like to share some initial findings from two of the Reserve Banks that are already participating in the process. The Federal Reserve Bank of San Francisco's “Community Indicators Project” is a quarterly survey tool that includes a collection of open-ended questions to inform community development policy and practice in a richer way than quantitative data alone. Leaders from banks, nonprofits, community-based organizations, foundations, local government, and the private sector are asked about the conditions and trends affecting low-income households. The lack of jobs was the dominant theme in the first year of data collection, with the majority of respondents identifying unemployment as the primary cause of new distress in the housing sector as increasing numbers of residents struggled to make mortgage or rent payments. One survey participant stated that “prolonged unemployment and underemployment are causing a huge

growth in the number of low-and moderate-income individuals and communities. Unemployment is now the driving force behind most of the other crises we are facing.”¹¹

Similarly, the Federal Reserve Bank of Richmond has been using their Emerging Issues Surveillance Tool (EIST) to identify the most significant current and emerging community development issues in the District’s diverse communities. The top three issues in the spring 2011 data release were employment opportunities, access to housing, and home foreclosures. The jobs issue surfaced again, with a focus on the need for training, when a participant stated: “Employment is the key to sustained self-sufficiency. There are jobs available in the Washington, D.C., market, but mostly high-skilled jobs for which low-income residents are unqualified.” As with the San Francisco survey, the results from this tool provide useful data for Richmond policymakers and District stakeholders.

Virtual collaboration

The growth in survey and other tools is intended to expand the Federal Reserve’s outreach efforts and to ensure that we are responsive to the entire population. As we continue to improve the tools we use, we hope to continue to engage each of you in the conversation.

In the past, collaboration often required outlays of scarce time and financial resources to attend face-to-face meetings. We are increasingly exploring ways to use technology to effectively expand our reach. For example, the System is using live web-streaming to share key conferences through a YouTube channel as well as sharing information through webinars. In addition, the Federal Reserve Bank of Atlanta has introduced a series of podcasts with information on topics from foreclosure responses to perspectives on real estate.¹² Finally, as noted earlier, the Board just released three video reports about strategies for addressing REO and vacant properties.¹³ If I have sparked your interest, I hope you will visit the Board’s website to watch the videos.

Conclusion

It is clear that it will take all of us working together to solve the problems that face communities today. Collaboration among government, nonprofits, and our partners in the private sector should focus on innovative ideas that can address the changing conditions of our communities. As the nature of problems change, we all need to be flexible and modify our responses.

Remember Professor Hargadon and his theory about innovation? Well, he also stated that “social network theory divides the world into nodes and ties. You are a node with ties to other people you know. The people you know have ties to each other.... If you can talk to a wide range of people, you are broadening your entire world, the more people you know, the more likely you are to be successful and happy. This has been proven. ... The more you share and talk to new people about your ideas, the more likely you are to be innovative.”¹⁴ I would like to take this final moment to encourage you to please make the most of your opportunities to share with your colleagues here this week, and to continue to push the envelope on innovation. And I hope the Federal Reserve System continues to be a node of innovation with ties to each of you.

Thank you.

¹¹ For more information, see the Federal Reserve Bank of San Francisco’s Community Indicators Project webpage.

¹² The Federal Reserve Bank of Atlanta’s podcasts.

¹³ The Board’s video reports.

¹⁴ For more information, see <http://www.stlouisfed.org/community/innovation/web/framepages/index.htm>.