

# **SCAN OF COMMUNITY DEVELOPMENT REFORMS**



THE ASPEN INSTITUTE

**Economic Opportunities Program**

Funded by:  
The Fannie Mae Foundation

Fred Mendez  
Laura Casoni

Project Director: Kirsten Moy

**May 2004**  
**Review Draft, Not for Distribution**

## **Acknowledgements**

The Aspen Institute would like to recognize and thank the Community Affairs Unit of the Federal Reserve Bank of Chicago for providing extensive assistance by conducting a widespread search for relevant articles and documents using key words relating to evolutionary issues facing the community development industry. Greg Ratliff was an equally valuable asset in starting the search for appropriate and relevant documents for review. The depth and breadth of the documents reviewed are a tribute to their invaluable assistance.



## Background

As it stands today, the community development field is fragmented and has many areas where disconnects exist that stand as obstacles towards achieving the goal of delivering services to the poor with greater impact and efficiency. For example:

- What is Funded versus What needs Funding
- What Products are Delivered versus What Clients Need the Most
- Reality for Practitioners versus the Focus of Research on the Field
- A Locally-Based Industry versus an Industry Desire to Achieve Scale

A range of documents recommending the creation of different types of infrastructure to assist in the field's evolution has been put forward by various leading thinkers and practitioners. As such, the Aspen Institute's Economic Opportunities Program has been asked by the Fannie Mae Foundation to lay out the current landscape by conducting a scan of literature in the field, including activities having impact, proposals and identified constraints inhibiting efficient industry growth with corresponding solutions that can unify the field.

## Purpose

The purpose of this project is to review the full range of documents that consider different strategies to bring the community development finance industry to scale in an efficient way. Many of the documents reviewed in this project call for very different types of intervention to address various shortcomings of the industry. This project categorizes the identified reforms into a usable framework that starts with a static picture of the community development finance industry today and looks forward to a more rational system.

## Scope of Work

The Aspen Institute team, consisting of Fred Mendez and Laura Casoni, employed a relatively simple methodology. In an initial step, the team determined a definition for "reform proposal" in order to systematically qualify documents for review. The team defined an acceptable proposal as:

Any activity captured in writing, either proposed, in process or completed that deals with strategic or tactical issues relating to the evolution of the community development industry.

This definition not only created efficiencies but also allowed the team to use external resources to conduct literature searches and gather material. The Federal Reserve Bank of Chicago assisted the team by conducting an extensive literature search and providing the team with a bibliography and reference information. Simultaneously, the team made formal requests to trade associations, research institutions and foundations for innovative proposals, current research findings and any other relevant documents. To complete the



data gathering phase, the team conducted several web-searches to identify additional publications that had not previously surfaced.

In the end, 59 documents were selected as being the most relevant to the issue of the community development industry's evolution. These documents included trade association strategic plans, research articles, foundation reports and reviews of current initiatives. Members of the team summarized and reviewed each document to ensure that key issues and proposals were accurately captured and categorized, regularly discussed the frequency and relative importance of each identified category and continually reviewed the context of each document to minimize the risk of inaccurate interpretation. Through a facilitated process of review and discussion, the team finalized an aggregate list of recurring issues, which were then clustered into five more general yet topic-specific groupings.

1. Demonstrating Impact, Outcomes and Performance
2. Capitalization and Funding
3. Operational Efficiency
4. Organizational Capacity
5. Integration into the Financial Industry versus a Parallel Industry

## Scan Findings

### **Demonstrating Impact, Outcomes and Performance**

Within the industry, there is growing recognition that future financial support will hinge on the industry's ability to articulate precisely what impact community development organizations strive for and the extent to which they are achieving their goals. Unfortunately, there is no effective or accepted methodology of assessing whether community development organizations are having their intended impact or how efficient they are at achieving their mission.<sup>1</sup> Accordingly, the lack of available information on the efficiency of these organizations complicates attempts to determine the optimal ratio of administrative-to-program expenses.<sup>2</sup> This lack of information also requires each investor to do their own primary research (or take the word of others) when attempting to assess the viability of a given program initiative in the hope of channeling funds to the highest and best use.<sup>3</sup> Adding to this challenge is a funding community that has critically underinvested in the research necessary to measure the real-world impact of reforms intended to improve performance. And, with no way to quantify results or distinguish good from bad, funders are continually awash in "waves of reform" that have little impact on ultimate performance.<sup>4</sup>

---

<sup>1</sup> Metropolitan Policy Harvard University, Joint Center for Housing Studies: *Taking Stock: CDFIs Look Ahead After 25 Years of Community Development Finance*, By Mark Pinsky, December 2001

<sup>2</sup> *Strategic Restructuring for Nonprofit Organizations: Mergers, Integrations and Alliances* (Draft document), By Amelia Kohm and David La Piana

<sup>3</sup> *Money Matters: The Structure, Operation and Challenges of Nonprofit Funding*, By Jed Emerson and Paul Carttar, December 2002

<sup>4</sup> Grantmakers for Effective Organizations In Partnership with Forum of Regional Associations of Grantmakers, Grantmakers Evaluation Network: *Capacity-Building for Impact: The Future of Effectiveness*



The community development industry and its supporting funders need to create consensus on how best to approach the creation and application of a single, commonly endorsed set of metrics by which to assess performance and efficiency. The key elements include: a commonly embraced set of standards and definitions of data; a common understanding with regard to language, terms and concepts; practical data gathering methodology with minimal burden; and funding to build appropriately flexible reporting systems.<sup>5</sup>

### **Capitalization and Funding**

The funding patterns of the community development industry – small grants for short durations, focused on program work – conspire against building strong organizations.<sup>6</sup> Three year grants are not going to build the long-term intellectual capital needed to solve today’s problems. As such, foundations must focus on the importance of experimentation and taking risks. The community development industry needs coordinated packages of money and business expertise over at least five years to strengthen organizational capacity and lead to more efficient and effective delivery of products.<sup>7</sup> This requires overcoming two of the most vexing challenges community development leaders face: dollars seldom follow success; and excess capacity / profit is frowned upon.

At exactly the moment when large amounts of capital would flow to a proven idea in the for-profit sector, the community development sector backs away. There are many reasons – donor fatigue, a belief that equity requires spreading money around, hesitance to make “big bets” – but the consequence is that proven solutions to pressing problems are not replicated and do not spread.<sup>8</sup> The result is a barrier towards increased scale and efficiency, which could be overcome if grants to community development organizations functioned less like revenues that fund direct service provision and more like working capital that can improve the organization’s capacity to grow efficiently and safely.<sup>9</sup> This growth can only be achieved through capital planning and organizational slack, which means encouraging periods of time when capacity exceeds what is required simply to operate current programs. This reversal of the community development industry’s neglect

---

*for Nonprofits and Foundations*, A Report on the 2002 National Conference Made Possible by the W.K. Kellogg Foundation, 2002

<sup>5</sup> *The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation*, By Jed Emerson, Shelia Bonini, and Kim Brehm, Fall, 2003

<sup>6</sup> Stanford Social Innovation Review: *Going to Scale: The Challenge of Replicating Social Programs*, By Jeffrey L. Bradach

<sup>7</sup> Grantmakers for Effective Organizations In Partnership with Forum of Regional Associations of Grantmakers, Grantmakers Evaluation Network: *Capacity-Building for Impact: The Future of Effectiveness for Nonprofits and Foundations*, A Report on the 2002 National Conference Made Possible by the W.K. Kellogg Foundation, 2002

<sup>8</sup> Stanford Social Innovation Review: *Going to Scale: The Challenge of Replicating Social Programs*, By Jeffrey L. Bradach

<sup>9</sup> Rockefeller Foundation and Fannie Mae Foundation: *Nonprofit Capital: A Review of Problems and Strategies*, By William P. Ryan, April, 2001



of capital structure requires both a broad-brush advocacy and education campaign and the changed habits of individual community development organizations and funders.<sup>10</sup>

In addition, research has shown that the vast majority of community development organizations, including smaller ones, are able to generate their own working capital by operating more efficiently, learning to use debt more aggressively and earning unrestricted income in the marketplace<sup>11</sup> by pricing adequately to earn sufficient income for long-term viability and the maximization of grant funding.<sup>12</sup> A key recommendation in achieving this goal is through portfolio and product diversification. For example, a portion of the portfolio can be larger, more standard loans to stronger borrowers, which use relatively low levels of operating subsidy, may even show a profit and help keep up the volume and reach of the organization. The balance of the portfolio would then consist of smaller, less standard loans to more fragile borrowers. These loans should have a much higher level of subsidy per loan available, and so can be made in a sustainable way. In order to maximize the benefits of portfolio diversification, community development organizations will need to engage in a range of activities and offer a range of products, some of which are directly targeted to low-income individual and others that are not. As such, these organizations will need to target a broader market than just low-income individuals (either individually or through strategic alliances) in order to attain the scale and achieve the financial sustainability that will allow them to stay in business for the long run and cross-subsidize their products focused on low- and very-low income individuals.<sup>13</sup>

### **Operational Efficiency**

Three different sources of community development organization strategic value were identified in the various documents: product innovation; operational excellence; and customer intimacy.<sup>14</sup> While product innovation and the ability of the industry to use that innovation to meet specific customer needs are well documented and recognized issues, the goal of increasing efficiency and scale through operational excellence is a more controversial issue that touches the core issues concerning the industry's evolution.

Operational excellence defines the goal of increasing the efficiency and scale of community development organizations so that less subsidy and below-market-rate capital are required per dollar of financing. In order to increase scale, it will be important for community development organizations to “stretch” existing subsidy to cover more deals.

---

<sup>10</sup> The Nonprofit Quarterly: *Hidden in Plain Sight: Understanding Nonprofit Capital Structure*, By Clara Miller, Spring 2003

<sup>11</sup> Rockefeller Foundation and Fannie Mae Foundation: *Nonprofit Capital: A Review of Problems and Strategies*, By William P. Ryan, April, 2001

<sup>12</sup> *Unblocking Obstacles to Capital Markets for Community Development Lenders Working Papers in Community Economic Development*, By Gregory M. Stanton, September 2003

<sup>13</sup> Ford Foundation CDFI Study, Phase II: *Strategies to Increase Community Development Finance*, Brody, Weiser, Burns, January, 2002

<sup>14</sup> CDFI Industry External Environment Scan: *Final Report to National Community Capital Association – PowerPoint Presentation*, By Alex Moss and Andrew Lamas, August 14, 2003



The key strategy for attaining this goal is reducing transaction, servicing and supportive-services costs by creating an efficient credit system.<sup>15</sup>

Efficient credit systems are organized with the following six key characteristics: origination; underwriting; funding; servicing; credit support; and liquidity. In the past, a single organization (usually a bank) performed all of these functions. However, as commercial credit systems have matured, expanded and become more efficient, different institutions now perform different functions. Each takes a piece of the bundle best suited to its abilities and risk / return targets, and the players trade services with one another. Together, these relationships form a credit system that handles high volumes, achieve high levels of efficiency and allows the tapping of a large variety of capital sources. This system maximizes access to capital and minimizes its costs. The community development world has yet to create this type of efficient credit system. Lending by community development organizations tend to be characterized by low volumes, with large numbers of risky loans, organized in a highly fragmented, usually local fashion.<sup>16</sup> The subsequent increase in efficiency obtained through the development of an efficient credit system would allow more investment to be supported with the same level of subsidy. What is needed is increased funding to build the operating capacity of community development organizations and to support the development of a broader infrastructure for the industry.<sup>17</sup>

Nobody believes that the community development world can, or should, bring its costs per transaction down to the level achieved by financial institutions, because that would entail abandoning the very borrowers and investees that community development organizations were created to serve. But there is an overwhelming belief that additional cost efficiencies are possible, even while serving current clients.<sup>18</sup>

An additional barrier to the goal of increasing community development organization efficiency is the challenge of attracting, training and retaining skilled staff. Overcoming this barrier will require increased collaboration for regional training, the development of benchmarking and assessment tools to help manage growth, an increase in mentoring and apprenticeship programs, alliances and partnerships for the joint purchase of employee benefits<sup>19</sup> and the creation of strategies and policies to attract and retain senior management of the highest caliber.<sup>20</sup>

## **Organizational Capacity**

---

<sup>15</sup> Ford Foundation CDFI Study, Phase II: *Strategies to Increase Community Development Finance*, Brody, Weiser, Burns, January, 2002

<sup>16</sup> Touchstone Financial Group: *Velcro Arms, Teflon Heart A Paper about Scale, Scope and Impact*, By Tom Miller and Nancy Andrews, 2002

<sup>17</sup> *The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation*, By Jed Emerson, Shelia Bonini, and Kim Brehm, Fall, 2003

<sup>18</sup> Ford Foundation CDFI Study, Phase II: *Strategies to Increase Community Development Finance*, Brody, Weiser, Burns, January, 2002

<sup>19</sup> Ford Foundation CDFI Study, Phase II: *Strategies to Increase Community Development Finance*, Brody, Weiser, Burns, January, 2002

<sup>20</sup> *The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation*, By Jed Emerson, Shelia Bonini, and Kim Brehm, Fall, 2003



The ability of community development organizations to grow effectively and efficiently is directly related to the operational scope of the organization, its financial capacity, the adaptive nature of its leadership team to assess and respond to macro and external trends.

One of the most pressing challenges facing the leaders of the community development industry is overcoming the disconnect of being a locally-based industry striving for scale. While the industry was created to fill the gap created by a lack of conventional financial services in low- and moderate-income communities, the limited operational scope of many of these organizations translates into diseconomies of scale. Not only can these organizations not capitalize on the economics of increased production, but their scale is limited by the size of their surrounding community or the very specific population they are chartered to serve. Some leaders in the field have tested the affect of diversifying their product mix in order to vertically expand their operational scope. Others espouse the transfer of financial technology to deepen the reach in a cost-effective manner.<sup>21</sup> Still others propose strategic restructuring through mergers, acquisitions and partnerships that not only increase operational scope but reduce redundant functions and organizations.<sup>22</sup> Each strategy has proven successful, but this success is dependent on overcoming the beliefs that by expanding geographic and operational reach the organization is abandoning their immediate community and by expanding the mission of their organization, they are losing the vision of why they were created.

Funding plays a major role as an obstacle in allowing organizations the flexibility to modify its structure to maximize impact through increased geographic and operational reach. Grant capital is typically not as effective as equity or debt in allowing organizations this needed flexibility. As such, funders need to reduce the restrictions placed on grant capital.<sup>23</sup> At the same time, nonprofit organizations have to become more comfortable using debt and equity.<sup>24</sup> Obtaining more flexible capital will liberate good leadership to dictate how they achieve their mission and operationalize their vision.

The ability of an organization to maximize its operational scope and to increase its financial capacity is directly related to the adaptive nature of its leadership. Strong and efficient leaders should be acknowledged, rewarded and supported beyond the norm to promote their value and importance.<sup>25</sup> Strong leadership needs to go beyond substantive knowledge to articulating a vision geared towards expanding the reach and impact of mission-driven products, creating an organization with diverse forms of funding and defining succession strategies that incorporate staff development, retention and recruitment. An indication of good leadership is the presence of a five-year business plan

---

<sup>21</sup> Milken Institute / Ford Foundation: Research Report: *Creating Capital, Jobs and Wealth in Emerging Domestic Markets – Financial Technology Transfer to Low-Income Communities*, By Glenn Yago, Betsy Zeidman, and Bill Schmidt, January, 2003

<sup>22</sup> *Strategic Restructuring for Nonprofit Organizations: Mergers, Integrations and Alliances* (Draft document), By Amelia Kohm and David La Piana

<sup>23</sup> *Money Matters: The Structure, Operation and Challenges of Nonprofit Funding*, By Jed Emerson and Paul Carttar, December 2002

<sup>24</sup> Rockefeller Foundation and Fannie Mae Foundation: *Nonprofit Capital: A Review of Problems and Strategies*, By William P. Ryan, April, 2001

<sup>25</sup> Ford Foundation CDFI Study, Phase II: *Strategies to Increase Community Development Finance*, Brody, Weiser, Burns, January, 2002



which allows leadership to transcend practice and drive impact.<sup>26</sup> Leadership should not be static, but fluid based on skills needed for the future of the organization. An organization's board of directors is an integral influence and often acts as a stabilizing force during periods of transition. At the same time, it is vitally important that leaders recognize when a change is needed. For example, the leadership team and governance structure that is successful in the inception and launch of an organization may not always be the best team to move the organization forward toward scale or through difficult transition periods.<sup>27</sup> Consequently, it has been suggested that grant capital can be stretched if put in the hands of a good and adaptive leadership team that has a comprehensive and long-term vision for achieving scale and impact. The right leadership team can awaken an organization; the wrong leadership team can restrain it.

As such the ability of leaders to assess and respond to macro and external trends is a crucial component to both sustainability and growth.<sup>28</sup> Greater importance and funding should be placed on information gathering and analysis at various levels. The key question is “who is in the best position to collect, analyze and disseminate this information?” There are valid reasons for trade associations and think tanks to play this role. For example, community development financial institution trade associations conducted a “state of the field” analysis to identify strategies that appropriately respond to external and competitive trends.<sup>29</sup>

Understanding macro and external trends is a key for community development organizations to proactively pursue strategic alliances, identify appropriately flexible funding sources and invest in developing products and services that meet constantly changing demand. Continuous and comprehensive market research plays a vital role in allowing community development organizations to compete and evolve by (1) enabling more effective risk management, evaluation and planning through better understanding of the social impact of transactions, (2) more informed product development through the analysis of trends and opportunities, and (3) allowing for market-oriented differentiation through the analysis of economic and social needs.<sup>30</sup> Consistently identifying and reporting the market demand for current and new products will help funders determine the highest and best use of capital.<sup>31</sup>

Underlying the effectiveness of assessing external trends and market demand is the ability of community development organizations to understand the difference between their mission and their vision. Vision is long-term focused and lofty; for example, the Association for Enterprise Opportunity has as their vision that “microlending will one

---

<sup>26</sup> CDFI Industry External Environment Scan: *Final Report to National Community Capital Association – PowerPoint Presentation*, By Alex Moss and Andrew Lamas, August 14, 2003

<sup>27</sup> *Cascadia Revolving Fund: Maximizing Board Performance*, By Shaw Canale

<sup>28</sup> Metropolitan Policy Harvard University, Joint Center for Housing Studies: *Taking Stock: CDFIs Look Ahead After 25 Years of Community Development Finance*, By Mark Pinsky, December 2001

<sup>29</sup> *Promise of Microenterprise Development in the United States*, Prepared by Weinheimer & Associates, Edited by Zulma Bianca and Jason Friedman, Association for Enterprise Opportunity, August, 2002

<sup>30</sup> A Capital Xchange Journal Article Prepared for The Brookings Institution, Center on Urban and Metropolitan Policy, Harvard University, Joint Center for Housing Studies: *Civic Lesson: How CDFIs Can Apply Market Realities to Poverty Alleviation*, By Jeremy Nowak, March, 2001

<sup>31</sup> *Unblocking Obstacles to Capital Markets for Community Development Lenders Working Papers in Community Economic Development*, By Gregory M. Stanton, September 2003



day support itself.”<sup>32</sup> The mission of an organization is the vehicle used to achieve the vision. Given the constantly changing environment in which community development organizations work, the vehicles used to achieve their long-term visions must change in accordance with the environment. It has been proposed that the community development sector “would do a great service for itself and society by focusing with equal or even greater intensity on vision.”<sup>33</sup>

Integrating this industry, market and demand analysis into an organization that can clearly articulate and focus on its mission and vision will define the organization’s strategic position within its industry. The stronger and more clearly defined the strategic position of an organization, the more successful it will be in attracting appropriate capital, both human and financial.

### **Integration into the Financial Industry versus a Parallel Industry**

The future of the community development industry hinges on determining the appropriate relationship with the mainstream financial industry (including capital markets) and the subsequent systems put in place to fortify this relationship.<sup>34</sup> Most authors who wrote on industry-level scale issues believe that for the community development industry to achieve any sense of scale, a structural revamping is necessary. Two legitimate options were identified; either integrate vertically with the mainstream industry or organize a distinct and separate industry. Irrespective of the community development industry’s form, either full integration or creation of a parallel system, infrastructure reforms are needed.<sup>35</sup>

If the industry were to create its own parallel system to the mainstream financial industry, “significant investment in building capabilities” that allow the industry to achieve any sense of scale will be necessary.<sup>36</sup> These include intermediaries that can facilitate reduced transaction costs by aggregating assets and allow for greater volume and the adoption of industry-wide process, procedures and reporting standards.<sup>37</sup>

Conversely, the community development industry can “strengthen structural ties to mainstream financial systems by vertically integrating itself into the financial services

---

<sup>32</sup> Grantmakers for Effective Organizations In Partnership with Forum of Regional Associations of Grantmakers, Grantmakers Evaluation Network: *Capacity-Building for Impact: The Future of Effectiveness for Nonprofits and Foundations*, A Report on the 2002 National Conference Made Possible by the W.K. Kellogg Foundation, 2002

<sup>33</sup> Grantmakers for Effective Organizations In Partnership with Forum of Regional Associations of Grantmakers, Grantmakers Evaluation Network: *Capacity-Building for Impact: The Future of Effectiveness for Nonprofits and Foundations*, A Report on the 2002 National Conference Made Possible by the W.K. Kellogg Foundation, 2002

<sup>34</sup> Final Report to the Ford Foundation: *Community Development Innovation and Infrastructure Initiative*, By Kirsten Moy and Alan Okagaki, July, 2001

<sup>35</sup> Metropolitan Policy Harvard University, Joint Center for Housing Studies: *Taking Stock: CDFIs Look Ahead After 25 Years of Community Development Finance*, By Mark Pinsky, December 2001

<sup>36</sup> Proposal to the Fannie Mae Foundation: *Stating the Business Case for a Capital Markets Integration Investment Fund*, Brody, Weiser, Burns, April 22, 2002

<sup>37</sup> Final Report to the Ford Foundation: *Community Development Innovation and Infrastructure Initiative*, By Kirsten Moy and Alan Okagaki, July, 2001



industry.”<sup>38</sup> In order to maximize the benefits of this integration, the community development industry must determine and clearly articulate their value-added by identifying those activities that make them distinct as well as abandoning duplicative or ineffective functions. The tactical steps necessary for such integration includes:

1. Using the same performance measures as mainstream institutions in order to speak the same language;
2. Adopting capital market standards for underwriting, data collection and performance tracking;
3. Greater discipline with market intelligence, valuation methods for pricing, underwriting, risk assessment and mitigation methods, acceptable collections and back-up service requirements; and
4. Knowing market size and demand.<sup>39</sup>

Such discipline and clarity in the community development industry would facilitate the entry of new investors and allow for the flow of capital based on measurable and consistently defined impact.

---

<sup>38</sup> Metropolitan Policy Harvard University, Joint Center for Housing Studies: *Taking Stock: CDFIs Look Ahead After 25 Years of Community Development Finance*, By Mark Pinsky, December 2001

<sup>39</sup> School of Community Economic Development, Southern New Hampshire University: *Unblocking Obstacles to Capital Markets for Community Development Lenders Working Papers in Community Economic Development*, By Gregory M. Stanton, September 2003

