Federal Reserve Bank Comments – Charles Buki
March 29, 2004

Good afternoon. And thank you for having me here today.

I am glad to be here, to have the opportunity to learn from you all. It is quite an honor for me to be here, speaking at the invitation of the Federal Reserve Bank, and to you lenders.

I want to thank the Federal Reserve Bank for sponsoring a conference where a central element is the work of thinking about where we are as a field, and where the field of community development is going.

Many people have been very generous to me regarding me being here this afternoon. Scott Turner and Jack Richards and Melody Nava and others from the SF Office of the Fed. Ralph Lippman and Glenn Sanada from CCEDA. I want to express my gratitude to them for their professional kindnesses.

Before I begin I'd like to ask you to tell me a little about your own level of experience and backgrounds. My comments today are designed to add a considerable degree of distress into the room, and I need to gauge where you all are.

I need to know how many of you have more than 15 years total experience in community development.

The way I've organized my talk this afternoon is straightforward.

Here's my thesis, up front, so there's no misunderstanding: **The project IS the Neighborhood. Our field is dominated by an unhealthy housing production emphasis where housing has become a proxy for neighborhoods and good intent a surrogate for outcomes.**

To explain myself, first I want to talk a little about a powerful personal experience I had more than ten years ago in a room with bankers who had just recently formed the National Association of Affordable Housing Lenders. I'll try to tie some of this story to our larger purpose of not just making loans, not just complying with regulations (especially ones that are woefully outdated), but **making neighborhoods healthy urban markets again.**

Next, I'll interject a few quick vignettes about certain cities whose problems I believe are representative of the state of our field; this as my way of trying to convince you that more is not always better.

Further, I'll try to describe a community development industry hamstrung by what Hume described as the "is-ought" problem, that is, the philosophical error of confusing what exists with its right to exist; because we can finance and build affordable housing we should.

Then I want to give you some personal views on how to think about our work. I'll assert that all the units and lending in the world don't matter if the neighborhood isn't getting better. The question is whether you make loans to make loans or make loans to improve neighborhoods. Is lending your goal? Is producing another housing unit your goal? Are healthy urban markets your goal? **Are you underwriting good intentions or good market interventions? And most critically, is lending a tool to some other end, or is lending your goal?**

Last, I'll try to give you a sense of both what's positive on the horizon to look out for plus some encouragement in midst of a lot of bad news.

If this seems to be a doom and gloom assessment, let me correct that impression. Though harsh, and direct, I'd ask you to permit me to function today as a sort of cardiologist. Suspend disbelief and think of me as the doctor who has just seen your overweight, potato eating, TV watching, Camel smoking, cheeseburger smuggling, Coors drinking spouse. The one you love no matter.

We can get your spouse's heart and lungs back to where they need to be. It won't be pretty. It won't be easy. But consider the alternatives. What I am going to try to do is something akin to that, with one exception.

Let's suppose actually your spouse has been trying to quit smoking. Been trying to eat better. Been trying to exercise. Yet the weight has remained. The high blood pressure persists.

Do we praise your spouse for attempts that have not changed actual fitness? Do we keep up the current regimen? What do we change if anything?

Let us agree that our cities are like our overweight spouses – in need of

attention. Let us agree that our community development industry has tried. But still our spouse isn't exactly running five miles a day. Let us agree that something needs to change. In front of us is a lot of work. Not technical work as how to manage collateral risk. But work as in the effort to change. Not gimmickry in the form of the new market tax credit, but real change that takes us in a different direction than the one we're headed in.

So…Where is the field going?

The impoverished, blighted neighborhoods of inner ring Baltimore are as broken as ever. How can that be?

The Anne E. Casey Foundation has put millions of dollars into Baltimore.

The Enterprise Foundation has been there for 20 years; heck it started there.

DTI has been there for two decades. The NHS of Baltimore has been there for 25 years.

Bank of America has pumped tens of millions of dollars into Baltimore. Mayors Schaffer and Schmoke and O'Malley have sold bond after bond after bond to finance new housing. Fifty million dollars in HOPE VI monies have gone into Baltimore.

Baltimore is an Empowerment Zone. Baltimore has Senators Mikulski and Sarbanes. But inner ring Baltimore is just as distressed as ever.

You tell me. Where is the field going? How is such distress amid so much investment possible?

It was not too long after the riots following the Rodney King verdict that I was in Atlanta to attend a conference of the National Association of Affordable Housing Lenders. It was 1992. First week of May. Daffodils. Spring. Dogwoods.

Think about that. Twelve years ago. 1992 George Bush the Elder was President. Clinton was not yet the nominee.

And that April the acquittal of four white policemen from criminal assault in the beating of Rodney King unleashed a fury of looting, arson, and killing strikingly reminiscent of the 1960s.

Troops helped to restore order, though not before more than 50 people died and more than a billion dollars worth of property was destroyed.

How many of you today in your most honest moments think the root causes of that fury have been addressed?

When you make loans in Trenton, or near 7th Avenue in Salt Lake City on the west side, or in East Austin, are you underwriting market interventions that restore economic health to the community and trigger private sector investment, or are you underwriting affordable housing deals disconnected to the demand-based work of revitalization?

So it's a week later and we're in Atlanta – affordable housing lenders and others, like me, interested in community banking. At that meeting there were some serious people saying important things. Lenders who had been making a difference. And I mean a real difference. George Surgeon from Arkansas. Carol Parry. Mike Mantel.

We're there, taking about the tax credit. CDCs. HOME monies. But there's something beneath the surface.

Just the day before, President Bush on national television focused on the immediate sources of distress, condemning the violence and promising swift restoration of order. Bush promised federal action to ensure justice for Rodney King. But he did not use his authority to mobilize commitment to the larger questions that underlay the riots – racism and chronic economic disparity.

I was then, as now, in awe of lenders pushing the envelope. Making us clarify. Making the field make a difference.

Which brings me to the purpose of your conference. Asking hard questions. Probing. "What is the future of the Community Development Industry? The State of Community Reinvestment? The relevance of CRA today? Where is the field headed?

These are questions you as lenders have yourselves posed. Since the work of

community lending in my view has been on autopilot for the better part of the last ten years, these are appropriate questions to ask and it is a good sign that you lenders are doing the asking. Which takes me back again to 1992.

Back then, in the spring of that year a country punk music electrorocker named Michelle Shocked, from East Texas, released an album titled Arkansas Traveler. The album was influenced by part minstrel, part punk, part country. And on this album is a song that gets airtime on the alternative stations just days before the riots, a song titled **Come a Long Way**. But have we come a long way?

So worried about the affordable housing shortage in the SF Bay Area, we have completely forgotten that whole sections of Richmond and Oakland are not communities of choice. So worried are we of gentrification occurring in neighborhoods with no such prayer on the horizon that we tend towards keeping neighborhoods crappy as our de facto affordable housing policy.

There we were, in a basement hotel conference room in Atlanta. The presentations are pretty good. Debt coverage ratios. Loan committees. Bank CDCs.

Now about this time a woman from American Security Bank gets up to speak. ASB was a small half billion dollar bank in Washington, DC, and this woman was a force there, and because ASB was involved in the neighborhoods, she was a force in those communities.

This woman eventually would go work for NationsBank and then move on. Incredible person, focused lender, utterly unafraid to speak her mind.

So we're there, in this staid environment, and this woman struts to the stage.

She is dressed loudly. She was wearing a hot pink suit with a bright yellow and black polka dotted men's tie, cherry colored cat's-eye glasses, striped stockings. Black patent leather shoes. Hugh McColl and those Charlotte boys certainly didn't know whom they were hiring, that's for sure.

Anyway, people are paying attention. They're focused.

And she comes to the podium. And she pauses. She holds her audience. And she pauses once again.

The room is by this time focused on her.

She delves not into loan committee process and due diligence, which everyone anticipated. Instead she reminds everyone in the room of the undertow, the hidden issue both holding together and tearing apart the room.

Telling us she's just returned from a three-week trip to Mexico, she talks of going away on her first vacation in ten years. And learning that while gone LA fell apart. "I can't even take a vacation," she says, "without all hell breaking

loose."

She is on the verge of tears, because she really means what she says. You can see it. She is embodying the commitment we community developers make. It's why we stay late, and come in early, and don't take enough vacations.

We all know that the riots would have occurred regardless of whether Karen had been on vacation. Duh. But we get the point and we feel it. She makes the room feel it.

And I am sitting there thinking of that new song by Michelle Shocked titled Come a Long Way, where she sings "I've come a long way and never even left LA" I'm recalling the images of the riots and I am asking myself if we're mobilized to respond just to the riots. Or maybe instead to the festering issues of unemployment, poverty, inequity, and prejudice.

In my head Michelle Shocked continues singing while Karen Kollias continues talking.

"And then I crossed the river into East L.A.
Pescado mojado me encontre …
A train, she cries on the midnight hour All along the Watts Tower"

We're all there just days after the Rodney King verdict.

Everyone in the room is working on after tax cash flow. But we're all thinking South Central. Karen Kollias took that room to the intersection of Vermont and Slausen, and for a moment at least, even far away in a sterile Atlanta conference room, I witnessed a roomful of talent mobilized not to symptom but cause, not to the near and short, but the long. If not in product, then in spirit.

Such are the seeds of my deep respect for you community lenders, pushing capital across the red line, building value. Such is my abiding admiration.

And it is because of my respect for you that I am here, humbled and flattered at the same instant, and must therefore ask you to cross the river into East LA, pescado mojado me encontre.

Our field needs to change; bankers can help provide orientation. Lenders can and should only partner with the community development industry when the industry shows a capacity to adapt. **Unit production, long the mantra of the field, must be subordinated like soft money to the more vital investment strategy of triggering market confidence**. If your CDC partners don' get this, they shouldn't be your partners.

Out of respect for what you do, I have to tell you that our field is aimless and the lending community is part of that drift. **With very few exceptions, we are not tackling the underlying problems of why some neighborhoods don't work.** We have fooled ourselves into lending to housing construction instead of neighborhoods. We have taken the wrong path and it is time to refocus.

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No more cheeseburgers. No more smoking.

Frog Hollow, a neighborhood in central Hartford, Connecticut is as poor and deracinated as ever.

How is that possible?

The Hartford Foundation and the Surdna Foundation and the Ford Foundation have put millions into Hartford.

Aetna and the Travelers and Mass Mutual and the United Way have underwritten the creation of a CDC system there.

LISC has developed tax credit after credit after tax credit project there. There is a Mutual Housing Association there, a support collaborative, and a strong community foundation.

There has been a huge home ownership push there. The state of Connecticut has a very sophisticated tax credit system that is supported by a wide array of very creative programs and a substantial volume of thoughtful direct grants.

But Frog Hollow and Asylum Hill and Clay Arsenal are as distressed as ever.

You tell me. Where is the field going?

How is such distress amid so much investment possible? The issue is not what's going on in Hartford, or Indianapolis into which Lilly has pumped millions. The issue is the pattern. You are lenders and investors and services. You base your living on the patterns that are there. **The issue is the pattern**.

We are putting more money in Anacostia but it is still is a slum. There is loan capital available in West Oakland but the corner of 24th and San Leandro remains as bad as ever. Yes there's a Home Depot in South Central. Urban Edge is repaying all its loans for all their work in Dorchester and Roxbury but those places still are as uncompetitive as ever. East Central Ogden Utah is a dump, ineptly creeping along. Strawberry Mansion and Swamp Poodle in North Philadelphia remain neighborhoods in name only, surrounded as they are by roughly 22,000 vacant houses.

You might not think these places are slums, but the market does, and the data show that the last thing these places need is more housing and more lending.

These are not places with housing supply problems, but rather whole swaths of cities for which there is zero healthy market demand. **Yet the field is forever on the more is better trajectory, and if you lenders don't resist, you're very apt to add capital where and in a form least useful.**

More of the same won't get us closer to systemically addressing chronic housing shortages in the Marin Counties and West Hartfords and Fairfaxes of the world, yet how helpful are we if all we're doing is avoiding adding affordable housing where it is most needed – where it is missing.

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More of the same won't fix Cleveland, the last resting stop for steel pipe manufacturing prior to relocating in Chonburi Thailand. More of the same won't restore East Baltimore to market health. Yet this is precisely where we are. And where we're headed. **The motto for our industry has for too long been "we care, we try, give us more money**".

You think I'm exaggerating? Want a canary in the coalmine for continued delusion?

Watch the emerging faith-based movement. No decent logic model. No articulated empirical basis. Feel good and look the other way politics at is worst.

We have worked our way into a corner born of working at the wrong scale with the wrong tools, and as a result of too infrequently asking the right questions.

In our Camdens we have whole sections of the city where nothing works, where there is no confidence, where there is no shortage of affordable housing, yet our entire community development system, such as it is, is structured towards subsidy and process and is not at all geared to be genuinely responsive to the underlying problems about which we can do something.

We know this yet with our tail between our legs fearful of having the current administration cut off the little support that remains for our CDCs, we are ready to watch the syllogism of faith based community development take off.

The problem is not religious. It's that the CDC model on which the coming rise of faith-based development is based is a house of cards regularly confusing regional shortages of first choice affordable housing with neighborhood surpluses of third rate units no one would rent.

Ten years after the Lebanese rebuilt war-torn Beirut, whole blocks of North Philadelphia continue to resemble an urban combat zone but LISC in Philadelphia continues to build.

Why? Ostensibly because the region is an expensive one to live in and the CDC engine runs on one type of tax credit fuel processed at the same refinery that never really understood that the enemy isn't capitalism and competition, but economic and social segregation.

What's that about? Its like the party host who says to his guests, "would you like a drink?" They respond, "sure, what do you have." And the host replies, "whatever you want as long as its gin." The guest says, "great, thanks. I'll have gin." And the host concludes, "excellent, that's all we've got."

Understand the host and his gin and you begin to see more clearly into the national community development intermediary one-size-fits-all way of doing business. You got a housing problem, whoa let me show you how the tax credit works. You got an abandoned building, hey lookie here at this nifty tax credit thing. When the only tool you have is the low-income housing tax credit, and you compound your tool shortage with the view that unit production is the goal

instead of a means, then every neighborhood revitalization challenge looks like a housing project in search of subsidy.

You get the point.

See into this and you begin to understand why more of the same is what the industry clamors for. Hear this clamoring and you begin to see why so many of our urban markets are as uncompetitive and problem-riddled as ever.

See the near broken system and its detritus for what it is and you can see what Michele Shocked was talking about when she wailed "I've come a long way, and never even left LA". We need different tools, different data sources, different approaches. Not more of the same.

Think about the decaying neighborhoods of San Bernadino and how much housing our system is poised to put in there, even though what those neighborhoods need is not more of the same, and you begin to understand the feelings expressed by that rebel banker ten years ago in Atlanta, as she herself surely hummed the rest of the those lyrics, "the sun was sinking into the sea, but a ball of fire inside of me, was burning my motor and diving me hard, down across the boulevard."

We lost our way the moment we permitted good intentions to become a proxy for measurable meaningful results.

So my question to you on this point is:

Do bankers care whether the community development leaders -- your partners -- are addressing the right problem and is that your corporate responsibility?

The way you think about due diligence needs to be expanded. Don't be offended when I paraphrase James Carville and say, "it's the neighborhood, stupid".

If you just want to make loans or get a good grade from the OCC, keep doing what you're doing. If you want to put units in the ground, I know two national groups – one in New York founded with monies from the Ford Foundation and the other in Columbia, MD started by Jim Rouse – that are delighted to hear that.

On the other hand, if you want to make a difference, if you want to make neighborhoods more livable and healthy and competitive and worthy of market risk, **then you have to help change the way we do things.**

Why should you care about disinvested commercial strips and ungodly bad housing? Because it serves no one and is beneath us, and blighted conditions cement the underlying problem of segregation.

Why should you change what you do? Because the strip redevelopment you are likely lending to is apt to wind up as abysmally performing tomorrow as it was yesterday, unless its redevelopment is designed not to unblight the area but instead to foster confidence.

Because the housing you underwrite is very likely to still be in a blighted neighborhood not fundamentally better tomorrow than today, no matter how good the housing, unless the objective is not to add supply but spur confidence.

Just because you can pencil out a project some CDC brings you doesn't mean that its development is good for the neighborhood. **Is it good short-term business to underwrite a project? No question.**

But that's not the direction we should be going in; that's what we want to stop doing. Our criteria for development and your criteria for partnership should be when our deals make economic sense for the neighborhood and the project pencils out. Only in this way can we be true to the core purpose of community development which is to grow individual and community wealth. This is not now nor has it ever been about housing. But along the way housing has become a proxy for community development and our focus on production has hijacked our larger purpose.

The project IS the neighborhood.

The community development field cannot change without the leadership of lenders. You are vastly more important to our cities than you may think and it is not that you have money.

It is that you have the potential to use that money wisely. **Using your resources wisely, not merely using them, is what this is all about.**

Where to start?

Let's start by acknowledging that the community development field, in its pluralism and energy, is a central ingredient to the work of restoring neighborhood health to the urban marketplace.

The field helps bridge information failures. It facilitates partnerships. It moves subsidy efficiently. It is part of an essential feedback loop connecting regulators and planners and investors.

But the field that successfully fought redlining still clings to the Charlotte Garden model of community development. The field that learned how to build housing still forgets that neighborhoods are what families look for. The field that built alliances on outputs hasn't yet evolved to the ruthlessly outcomeoriented industry it needs to be. The field is headed in the direction of obsolescence. The banking industry has changed enormously since the days of Gale Cincotta and Mike Sverdoff but our field has yet to adapt.

We have automated underwriting. Risk-based pricing.

We have seen the decoupling of mortgage lending from branch based deposit taking. We've seen the mortgage delivery system become dominated by brokers and national banking.

We've seen the private sector selling off servicing rights and we've seen the rise of principal agent risk.

All this has given us one of the world's most efficient capital markets. Consider that banks and CDCs have partnered on nearly $1T of activity, and in the last ten years there's been at least an 80 percent increase in home purchase loans to low income borrowers.

But also consider this.

The rise of bank consolidation and risk based pricing has also ushered in a two-tiered mortgage system. Low income neighborhood lending is characterized by concentrated sub-prime activity, government backed loans, manufactured housing lending, and abusive lending in general.

As Bill Apgar and Allen Fishbein have noted in their groundbreaking and recent study of the changing role of CBOs, "many communities once constrained by a decided lack of mortgage lending [are] now awash with lenders seeking to provide capital.

So the issue is not that we're short of resources, though it is true we can use more. The issue is we rarely deploy them wisely, with an uncompromising eye towards triggering market confidence in the neighborhoods where we work.

My test is simple. Not as in easy. As in not complex. Simple and very hard.

It doesn't measure number of groundbreaking partnerships. It doesn't measure ten year commitments made at a fancy reception by big national banks.

It doesn't measure the foundation titillation factor when another program officer stumbles across another "innovation" with sex appeal. Far simpler.

Are neighborhoods getting better? What does your loan do to make the neighborhood better?

Are the people in the neighborhoods becoming connected to the economic mainstream?

Are people moving into a neighborhood bringing higher standards? What is your loan's role in this?

Are neighborhoods places where healthy market activity predominates and investment and reinvestment are continual? What healthy market activity can you legitimately point to as a likely – dare I say bankable – consequence of your lending?

I don't believe it matters how many units we've put in if housing values continue to fall. It doesn't matter how many after school programs are created if the strongest households continue to flee.

Are standards slipping or improving? Have you underwritten ten more

affordable units on Elm Street while being developed three stable owners on the next block grew frustrated and left the neighborhood?

Is investor confidence on the rise or wane? How are you taking this into account at loan committee?

Is the low-income neighborhood becoming better able to retain and attract the strong households into living there? Are upper income communities shouldering their fair share?

Why these questions?

Because the one thing that was true in our red-lining genesis that remains true in the risk-based-pricing-FICO-algorithm-world we live in today: economic segregation facilitated by lending activity.

If community development lending doesn't economically desegregate, just whose lending might?

If the community development work done by CBOs doesn't economically desegregate, I do not believe the housing they build is worth doing.

What is it about our industry that produces systemic misreadings of data that lead to systemically biased interpretations of the wrong data collected at the wrong scale, which get into the hands of city agencies and their community development partners and lead to systemically anemic, ill-conceived actions by community development corporations, housing departments, housing finance agencies, lending institutions, and private foundations?

How can it be that as we are all interested in tackling distress and ensuring that our regions have ample supplies of housing affordable to lowincome households, we continue to see so little positive change?

How can it be that we've spent between $300-$325 billion public dollars on community development activities, and still wind up with West Oakland still like, well, West Oakland?

How come when seasoned objective community developers get together they readily agree that it's not for lack of money, it's for lack of the right approach that our neighborhoods remain distressed?

How come seasoned program officers from the nation's most influential philanthropic foundations support questionable proposals and then in private all but sneer at the concepts they've just underwritten?

What we have is a community development version of the so-called Abilene Paradox.

I think the answer to his comes to us in the form of a series of questions.

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What problem are you trying to solve? How do you know it is the right problem? What data are you mining to give what information to whom for what purpose? Are you in the housing business or are you trying to develop healthy communities? Are you in the neighborhood business or the housing business? Let's get this ironed out already.

Is lending your goal or your tool? If it's your tool is it your means of underwriting intentions or genuine market interventions? What tools are we using and are they the right tools for the right problem?

I also think the answer this dilemma is contained in the revealing mantra of our field – "we care, we try hard, give us more money"

So to you lenders, who are invariably the centerpieces of any local activity, I ask you to ask yourselves at loan committee every time a loan has reached the point of making sense in terms of risk and return.

What problem is this loan solving or measurably helping to solve? It cannot be sufficient for the problem you are solving merely to be that the borrower has a project that needs capital.

Has the underwriting included a series of pointed questions about whether this form of bank activity is necessary and will lead – even if micro incrementally – to an economically more diverse neighborhood?

Has the conversation between borrowing CDC and lending institution included hard questions about how exactly the loan is being used as a tool to increase neighborhood standards and trigger private sector market activity?

If all we end up with is a large increase in lending to low-income communities that remain perpetually poor and suffer from perpetually slipping standards, then it's hard to argue that the dual mortgage system that replaced redlining has really improved anything.

"We care, we try hard, give us more money" has been good enough for too long, and cannot be good enough any more.

First step to fixing our communities? Seek dialogue, and speak the truth.

Second? Honor the lender in garish clothing with garish things to say; make it possible to take a vacation with a clear conscience. Focus on the right problem.

Third, harness the ball of fire burning your motor and driving you hard, and cross on over to the boulevard.

Relentless adaptation. Relentless focus on whether you are trying to make a loan to solve a problem or make a loan to make a loan. You know what to do.

Lend not to projects but to demand-based interventions in markets that stimulate economic integration and the reconnection of low-income people to

the economic mainstream. Lend not to housing for its own sake but to housing surgically conceived to be part of a process of raising neighborhood standards.

To move us forward, don't look to the South Bronx or to Sandtown Winchester for models.

Be wary of the charlatans promoting such efforts under tacky titles like "comeback cities" selling feel good snake oil.

Lend in neighborhoods where there are assets that can be grown
and when grown will attract the middle class and bring and end to economic isolation. Lend to projects in those neighborhoods that are mixed use projects. Do the harder projects. Not the ones harder to pencil out. The ones that harness neighborhood strengths, the ones that uncover hidden assets, the ones that stem disinvestment.

The ones that give you more borrowers worth banking on tomorrow. Make loans for low income projects in middle and upper income communities and ask your borrowers why they are building where housing isn't useful and not building where it would be.

The outcomes of the last 30 years are not in doubt. If you want different results, the inputs have to change. There is perhaps no more important set of inputs than are contained in what you lenders do in your lending and in your investing and in your servicing. I say again, if you want different outcomes, change the inputs.

Don't gripe about these kinds of projects not coming into your office. Go help make them. You know what to do.

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