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Table of Contents

Rural players network: Explore future of rural West	1
Program development, part III: Building capacity while building programs	6
From Wall Street to Main Street: Understanding how the credit crisis affects you	10
Inclusionary housing: Where do we go from here?	15

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Rural players network:

Explore future of rural West

By Stanley Keasling, RCAC chief executive officer

In February, RCAC brought together nearly 100 advocates who work on behalf of rural communities to discuss the state of rural affairs and how to address housing, infrastructure, economic development, healthcare and leadership issues in rural communities. In this article, Stanley Keasling, RCAC's chief executive officer, discusses different facets of that meeting, including insights gleaned from the interactions that occurred.

Over three rainy days in February, RCAC sponsored a Rural Symposium that brought together rural community development practitioners from across the West to talk about the state of housing, infrastructure, economic development, health care and leadership in rural communities today. Nearly 100 participants gathered to identify the most pressing needs these communities face; brainstorm possible solutions to meet those needs; and help rural communities thrive and survive.

Not surprisingly, much of the discussion centered on the current economic downturn and how it has affected rural areas. However, there was general agreement that the economy eventually will recover, and we did not want to miss the forest for the trees. The discussions centered on surviving today, but planning for the future. There also was much hope that the,

then unpublished, stimulus bill would provide a much-needed lifeline for rural communities.

The symposium genesis predated the current economic crisis and its impact on rural America. It was born out of a belief that RCAC's work, and that of other intermediaries, should respond to the needs and issues that local organizations can identify, but cannot resolve on their own. We also wanted to explore the connections between different community development organizations and to build new partnerships, especially among practitioners in various disciplines.

Fundamentally, the symposium was a first step in changing the nature of communication between RCAC and its clients, both the clients who fund us, and the local clients for whom we work. The symposium initiated a new dialogue between RCAC and its clients, and developing new strategies for continuing that dialog will be

a major strategic goal in the coming years. We are in the last year of our five-year strategic plan. The symposium outcomes will assist us to identify major concerns on which to focus during

Collaboration and partnerships are key, especially in the current economy.

the next three to five years and to draft our new plan. We are committed to listening to local groups as they express their needs. Our role is to partner with our clients

and other rural advocates to solve problems, but the communities must guide the direction of the work. Several common themes evolved from the discussions at the symposium, including:

- There is a need for a communication facilitator — a group that communities can reach out to when they need information.
- We do not need to reinvent the wheel — many good models for community development already exist.
- Collaboration and partnerships are key, especially in the current economy.

We held four three-hour discussions at the symposium. The first two discussions were organized by discipline so that practitioners working in housing could talk to other housing folks. Similarly, practitioners working in environmental infrastructure, economic development, healthcare and leadership development engaged in conversations with people concerned about the same issues. All of the participants joined two issue discussions. Participants also attended two community discussions, which they chose from among four community discussion topics.

“Forums like the symposium discussions help people see that the problems are everywhere, even in urban areas. Bringing people together to dialogue around a problem energizes them to find solutions and take action, just by having a discussion. More than likely, people left the symposium and went and did something different in their community,” said Anita La Ran, RCAC board member in New Mexico and symposium attendee.

Issue/Discipline Discussions

Affordable housing

The housing groups talked about ways to preserve the development capacity of existing rural housing networks. Many rural housing organizations are founded on home ownership and creating new opportunities for low-income people to become homeowners. Many of the rural housing organizations only operate ownership programs, and it was clear that reliance on this development model was creating a crisis. The need to diversify these organizations' operations was evident. In most rural places, there is still a lack of adequate affordable housing, both ownership and rental, but the urban housing crisis is making it nearly impossible for rural groups to make their case or secure financing for much-needed development. The need for financing was a major issue. The need to more effectively engage in the national discussion that is shaping housing policy for the future also was a critical concern.

Infrastructure

The infrastructure discussions focused on the opportunity for new activity created by the economic stimulus money, both in expanded funding for water and wastewater systems and in the opportunities presented for broadband and renewable energy development. The need to preserve and conserve the existing water supply was a major issue, as was dealing with the increasing complexity of federal and state regulations. Most of the solutions to these problems could be addressed by the stimulus package, but the rural utilities did not think that they were in a position to quickly put projects in place. One strategy for overcoming these problems is regionalization of rural systems, and the biggest obstacle for regionalization was seen as a lack of leadership. The need to develop the capacity to access the resources provided by the economic stimulus package was a critical concern. The communities were painfully aware that they lacked project planning that could help quickly access the new resources. The expansion of broadband access for rural communities also was seen as a way to facilitate regionalization;

it could allow one operator to monitor system operations in multiple locations without making unnecessary trips to remote treatment sites except as needed. The “green” focus of a significant per-

The challenges rural economies are facing have never been greater.

centage of the infrastructure funding available in the stimulus package was seen as another opportunity for rural utilities to bring new resources to their communities.

Economic development

The challenges rural economies are facing have never been greater. There was a clear sense that even rural business functions in a global economy, and the dysfunction in the current economic system is adversely impacting rural communities. The “buy local” movement was one of the most intriguing strategies discussed at the symposium. The civic engagement and leadership required to implement this strategy are not usually present in rural communities, and there was a strong sense that the traditional leadership was unprepared to organize a campaign of this type. Rural communities must complete new economic plans based on asset mapping and broad community input. Building a commitment to supporting local entrepreneurs, and focusing on community-owned enterprises were recognized as cornerstones of sustainable economic generators. The need to develop renewable energy in a way that makes rural communities more sustainable rather than simply another instance of resource exploitation was seen as both a challenge and potentially a very significant opportunity.

Healthcare

The health groups recognized regional approaches as a way to provide services; and the increasing role that telemedicine must play in rural service delivery. Because rural communities are often remote, with insufficient medical facilities and care providers, transportation and access to telemedicine could be a significant way to meet rural healthcare needs. However, poor access to broadband was seen as a major obstacle to the expansion of telemedicine in rural communities and as a driver to support expanded Internet access. There was a strong sense that new regional approaches to medical service delivery

are needed in rural communities. Participants’ strategies centered on using existing models and collaboration for future healthcare advances.

Leadership development

Leadership development was a major concern in all of the community discussions. There was a clear sense that the traditional leadership of rural communities is unprepared to deal with current problems. The need to attract and develop new leadership is critical, but there are few resources available for this work. There also are few employment opportunities that would help retain new leaders as they develop, thus the leadership and economic development issues are integrally related. Creating decent employment, and especially promotional opportunities for new leadership, plays a significant role in keeping up-and-coming leaders in rural communities. Developing new, inexpensive programs that can effectively train and mentor these new leaders is a major challenge for sustainability in rural communities.

“I came back with renewed energy and formed new local partnerships in Hawaii with some of the connections I made at the symposium. The symposium helped solidify relationships with other agencies to collaborate and create partnerships. It helped us think more about partnering with other agencies to do various projects that we hadn’t considered before. Helping us better connect was a major service,” said Kamaile M. Sombelon, Lokahi Pacific executive director.

Community Discussions

RCAC leadership went into the symposium with the belief that rural community challenges require comprehensive solutions and that economic development could not happen without adequate housing, which cannot be developed if there are safe drinking water violations or environmental infrastructure is lacking. We wanted to take people out of the comfort zones of their primary fields of work to talk about how their disciplines interconnect with others’ and how through collaborations and partnerships they could more effectively resolve community problems. To facilitate these comprehensive discussions, we looked at the different types of challenges that rural communities face, and asked participants to join

in conversations that relate to the communities they serve. For the symposium community discussions, we identified four types of rural communities: agriculture, timber and mining,

The current economic downturn has the potential to dramatically alter the sustainability of rural communities for the worse.

tourism and retirement, energy impacted and suburban. Participants each attended two of these community discussion sessions.

The agriculture communities historically have provided the commodities that feed us and keep

our factories working. Tourism communities are the growth spots of rural America, the areas where urbanites play and retire and where the cost of living is out of sync with the incomes of year-round residents. Energy impacted communities are subject to the development of U.S. supplies of oil and natural gas, and have seen the boom and bust of energy development in the past as prices have risen and fallen. Suburban communities were impacted by the boom in the early 2000s, and now include many new residents who largely commute to an urban center a good distance away.

We chose these four community types because we believed that they primarily define rural communities in the West, and because most of our clients serve at least one of these community types. We understand that the problems an agricultural community faces are not the same as the challenges tourism communities face or those of one of the other types. We wanted to see how different the challenges might be and what similarities might exist between the community types. We were struck by the similarity of the problems, and even though they played out somewhat differently in the different community types, the economic crisis was a central theme.

“The symposium small group setting was very good. Representatives from different areas of the country attended and shared and we could see that we are all going through the same things,” said Sombelon.

What was painfully clear in our discussions was that rural America is at a crossroads. The current economic downturn has the potential to dramatically alter the sustainability of rural communities for the worse. Retail businesses across the country are having difficulty, and these challenges are exacerbated in rural communities where locally based businesses cannot compete with the prices of low-cost, big-box stores. As rural residents' incomes are squeezed, they are drawn to low-priced necessities, resulting in even less money for the local economy, because the big stores are not located in the rural areas. The dearth of tourists and hard economic times in rural communities only add to the instability of rural retail businesses. Other employers are being hit in similar ways, and the problems simply compound.

Our discussions made it abundantly clear that current leadership structures are inadequate to develop the creative solutions that today's situation requires. Formal structures and opportunities to develop new leadership are significantly lacking in rural communities. The formal power structure is not seen as being open, and the need to engage a broader portion of the community is seen as critical to building a common resolve necessary to address the current problems.

A process for civic engagement in dealing with these issues also is lacking. The formal planning documents that exist do not address the challenges that are now present, and often these plans were developed in a very different environment than what exists today. The correction in the housing market and many other excesses of the economy, including second home development and commuting long distances to work, make the previous planning documents irrelevant. Rural communities need to develop adequate plans to access the resources of the economic stimulus package, so there is a new sense of urgency to tackle and resolve these issues.

Asset mapping was seen as a critical step in this planning process. Communities need to identify and build on their local strengths now more than ever. All sectors of the population need

to be brought into the civic discourse to build consensus from this diversity of viewpoints.

Information gathered at the symposium made it clear that rural community needs are far reaching and require a holistic approach to finding solutions.

Information gathered at the symposium made it clear that rural community needs are far reaching and require a holistic approach to finding solutions. RCAC's new strategic goals must focus on forming partnerships with diverse organizations to advance comprehensive commu-

nity development and ensure the sustainability of rural communities.

"The symposium made us feel welcome and realize the immense potential for partnering with RCAC and to use RCAC technical assistance more. In these tough economic times, staff has been cut and it is good to know that we can call and get RCAC assistance at any time and get quick, excellent assistance," Sombelon said.

Sombelon echoed what several attendees voiced. "It was a worthwhile symposium and we should do it on a regular basis," she said.

Program Development, part III:

Building capacity while building programs

By June Otow, consultant

In this article, June Otow, community and program development expert, wraps up her discussion of ways to build organizational capacity while growing programs. This article was published in three parts. This final segment addresses funding diversification and the advantages of reflecting and learning from actions and accomplishments. Otow sees such reflection as fundamental to enhancing organizational capacity and progress.

In RCAC's *Rural Review*, volume XXVII, number 2, Otow discussed her first three rules of program development.

Rule 1 — Good program development is based on true community need.

Rule 2 — Program development is the intersection between need and opportunity.

Rule 3 — Nonprofit organizations evolve — each evolutionary stage has its capacities, advantages and disadvantages, and strengths and weaknesses.

In the last edition of *RCAC's Rural Review*, Volume XXVII, number 1, she discussed rules four through six:

Rule 4 — Collaboration is essential for success.

Rule 5 — Program development identifies the logical next step for your organization.

Rule 6 — It will cost more than you think, but there is a lot of money out there.

This issue discusses the final two rules:

Rule 7 — Healthy organizations have a diverse funding base.

Rule 8 — Organizations that reflect and learn will grow stronger and wiser.

As Rule 7 explains, it is imperative that non-profit organizations avoid depending solely on one or two funders for their operations.

Rule 7 — Healthy organizations have a diverse funding base.

When assessing other organizations from a program developer's point of view, it is helpful to ask three standard questions:

- How many different funding sources does the organization have?

- If one funding source disappeared, what would happen to this organization?
- What percent of funding comes from each sector: public, private, fee-for-service?

It is important for organizations to take time out to reflect and learn.

In the short time I wore a “grant-maker’s hat,” I was shocked at the number of grantees that had only one or two revenue sources. What would happen to the clients, in this case senior citizens,

who were served by such an organization, if just one funding source disappeared?

As a commitment to your community and your clients, you have a responsibility to diversify your funding sources to ensure long-term sustainability.

For many years, I managed a nonprofit health-care organization. I constantly watched the balance between Medicare/Medicaid, private pay and grant funding and I knew what percent was comfortable and stable for the organization. When I first arrived at RCAC, more than 90 percent of its revenue came from the federal government. RCAC implemented a plan to reduce that to 60 percent — where it remains today. At the same time, RCAC increased its number of funders and annual budget. Organization staff annually review RCAC’s percentages of funding from the federal government, other government entities, private foundations and fee-for-service contracts. They know what percentages will keep the organization stable and make adjustments as needed.

It is important to develop a fundraising and marketing plan to intentionally change the types of funding on which you rely. Set realistic goals and identify specific actions as part of your fundraising and marketing plan.

Another way to diversify your funding base is to add a venture, which is a money-making component. In the nonprofit world, we do not make profit for shareholders, but we can make “excess revenue or unrestricted revenue.” Unrestricted revenue can pay for capacity building expenses, such as staff and board training, awards for staff, proposal writing time, meetings

with partners and strategic planning. RCAC has several ways to generate unrestricted revenue, including loan interest through its loan fund and fees from its conferences.

Obviously, a certain level of capacity is necessary before an organization can take on a venture project. With every venture comes risk and careful business planning is needed to move into this arena. However, many nonprofits operate either for-profit or nonprofit businesses such as thrift stores, restaurants and hotels that generate unrestricted revenue for them. In some cases, the business is related to their mission and is a nonprofit subsidiary. In other cases, the business is a for-profit subsidiary. If you are interested in pursuing a venture for your organization, you will need an attorney to help develop the legal structure that is most appropriate for the venture.

Identifying needs and opportunities, collaborating, diversifying funding sources and all the previous rules are key to building capacity while building programs. However, it is not enough to implement the above rules without evaluating the outcomes of the steps your organization has taken, which brings us to the final rule in this discussion.

Rule 8 — Organizations that reflect and learn will grow stronger and wiser

We have all heard the saying “learn from your mistakes.” Nonprofit organizations that review their accomplishments and their mistakes and change the way they conduct business as a result, tend to become more stable, effective and efficient.

It is important for organizations to take time out to reflect and learn. This increases an organization’s capacity to achieve goals and make greater contributions. As Andrew Mott described in *Evaluation: The Good News for Funders*, the Reflect and Learn methodology is a participatory evaluation method. It allows you to track your achievements, improve performance and prepare for the future as a group. It is an integral part of program development.

Reflect and Learn Evaluation fits into the life of your organization.

Reflect and Learn Method

**5. Make
Midcourse
Corrections**

**1. Develop
Plans**

**4. Evaluate,
Reflect and
Learn**

**2. Raise
Funds**

**3. Act on
Plans**

The Reflect and Learn method provides feedback and learning for your organization. It helps identify weaknesses and errors so corrective action can be taken. It greatly enhances an organization's ability to be creative, learn and try new ideas and approaches, and adapt its work on the basis of what is learned. Reflect and Learn can be used with specific programs, departments or grants/funders and organization-wide.

To plan a Reflect and Learn session within your organization, answer these questions:

- Who should be invited and why?

- What are the three key questions we might ask the group to better understand our experience and move us forward?

Case Example of Reflect and Learn

Eight years ago, RCAC started working in 13 small towns in the West and adopted these towns as "partner communities." The organization wanted to assist these places to identify needs, prioritize projects and develop a work-plan to implement priority projects. Then RCAC provided the technical assistance necessary to accomplish projects. RCAC calls this a "holistic community development approach." RCAC was not there to tell the community

what to do. Rather, RCAC was there to help the community figure out what it wanted to accomplish and then support it through the process. RCAC hoped its technical assistance

Where an organization is in its evolution, determines what it can accomplish.

would build capacity in the community so the community could take on additional projects on its own.

After three years, RCAC staff members involved in this project convened a retreat to reflect and learn. The staff members developed key questions to answer to enhance learning.

- What was the best thing that happened in your partner community over the past three years and why?
- What is success for RCAC?
What is success for the community?
- What have you learned from the successes and failures in the community?

From the answers to these questions, RCAC developed a list of tools that would enhance and improve its work, including an ambitious, yet manageable work-plan for the 12 months that followed, and a new team spirit and dedication to our mission. The team also developed a partner community manual to introduce

the program to new staff, give guidance from our past experiences on how to enter and exit a community, explain expectations and resources and showcase the new, improved program mission statement. As a result, the work became more focused, more effective and more consistent. The partner community program has evolved and RCAC's new strategic plan includes a goal to engage all its communities holistically.

Conclusion

To build capacity while building programs is challenging. One does not precede the other. True community need is the foundation for a mission-based organization. Opportunity will drive your ability to address the needs. Where an organization is in its evolution, determines what it can accomplish. (Organizations can evolve backwards too/devolve).

Build collaborations to increase impact. Choose to grow wisely and logically. Be realistic about cost. Diversify your funding base. Reflect and learn to improve the organization. And remember, there is a lot of money out there!

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From Wall Street to Main Street:

Understanding how the credit crisis affects you

Prepared by The Joint Economic Committee Majority Staff — Senator Charles E. Schumer, Chair; Representative Carolyn B. Maloney, Vice Chair, October 3, 2008. *This is considered a work of the U.S. Government and is not subject to copyright protection in the United States. As such, it is a public document and distribution is permissible.*

The credit crisis is impacting us all. This article gives insight into what created the credit crisis, how it affects individuals, business and government, and what steps might lead to relief.

Overview

We are all familiar with the numerous ways in which we use credit. Credit finances the smaller purchases we make when we use our credit cards, and the larger purchases that are fundamental to our lives — the cars we drive, the homes we live in, the colleges where we send our children. Credit is also crucial for the needs of businesses, and for state and local governments.

At its most basic level, credit is what allows us to make purchases today based on the money we are going to earn in the future. When we purchase a car or a house, few of us have the full cash amount available, so we borrow money from a lender who has confidence in our ability to repay the loan (plus interest) over time. This enables us to turn our future earnings into current spending, and in turn, furthers economic growth by increasing demand for

the goods we are purchasing. If people could only buy cars when they had saved up the full purchase price, there would be many fewer cars sold, and many fewer people employed in every facet of the auto industry.

In the same way, institutional actors also depend on credit. Businesses rely on credit to get off the ground (leasing space, buying start up equipment), to keep their operations running (stocking their shelves, buying new equipment, making payroll, paying the electric bill) and they use credit to expand (opening new stores and factories, and hiring new employees). Government also relies on credit to pay for many of their longer term projects — school improvements, highway repairs, new streetlights — which they finance by issuing bonds against future tax revenues.

In today's economy, all of these forms of credit are part of a much larger global financial web, in which financial institutions around the

world are constantly borrowing and lending to one another, to manufacturers and retailers, and, ultimately, to consumers. In short, while we may not always see it, credit is the lifeblood of the economy.

In short, while we may not always see it, credit is the lifeblood of the economy.

At its most extreme, the availability of credit can dry up, and a credit crisis, such as we are now experiencing, can occur. When a credit crisis does occur, the consequences

for the economy can be devastating. The lack of available credit forces individuals and businesses alike to cut back on spending, reducing business revenues, which then causes wages to drop and unemployment to rise. The resulting economic slowdown causes more individuals and businesses to default on their loans, worsening the credit crisis. In short, this is a vicious circle, in which a credit freeze and economic contraction feed into each other.

The Onset of the Credit Crisis

The securitization of loans

Over the past decade, credit was increasingly “securitized.” Banks would pool together many different loans, and then sell securities, based on the rights to the payments from the loans in the pool, to outside investors. The sales of these securities provided banks with immediate cash, which they could then use to make more mortgages. And investors liked these securities, because they were considered safe investments (frequently, nearly as safe as U.S. Treasury bills, and they typically paid a higher return than equivalent investments).

The most common and well-known of these securitized loans is the “mortgage-backed security” (MBS), based on pools of residential mortgages. But many other types of loans have also increasingly become securitized over the past decade — car loans, student loans, even credit card debt. Over the past decade, this type of securitized credit saw explosive growth, because of the superior returns and perception of safety. By the first quarter of 2006, the total value of all outstanding U.S. MBS totaled approximately \$6.1 trillion.

The deflation of the housing bubble

As is now obvious, the U.S. experienced an unprecedented housing bubble in the earlier part of this decade. The availability of easy, cheap credit with low underwriting standards inflated the demand for housing, which led to increased housing prices. The growing housing market made mortgage-backed securities increasingly attractive, creating more demand among investors for MBS, which then provided even more credit for U.S. homebuyers. This housing bubble has now officially popped. But the repercussions for the U.S. economy have not yet been fully felt.

The deflation of the housing bubble has brought increased mortgage defaults which, coupled with concerns about poor mortgage underwriting standards, and the widespread belief that U.S. housing prices are still overvalued, have led to tremendous declines in the values of MBS. And because MBS — and other forms of securitized debt — were so widely held, some major financial institutions have been forced to take huge writedowns in recent months.

As these writedowns have become recognized, these financial institutions have been forced to raise capital to cover the losses incurred. Those which have been able to raise sufficient capital have so far been able to survive, while those which have been unable to raise sufficient capital have failed, sometimes suddenly and unexpectedly.

Large financial institutions fail overnight

Bear Stearns was one of the first major examples of a big failure of a financial firm, due to its inability to find sufficient capital to cover its mortgage related losses. In March 2008, the Federal Reserve negotiated a deal in which JP Morgan Chase acquired Bear Stearns at an extremely low price (\$10/share), which only happened because of the inclusion of federal guarantees on some \$30 billion in risky Bear Stearns assets. The collapse of Bear Stearns began a steady deterioration in credit conditions, during which time a number of banks failed, which came to a head in September [2008].

The weekend of [Sept. 13-14, 2008] the eminent Wall Street firm Merrill Lynch, concerned about

its ability to survive future MBS losses, agreed to sell itself to Bank of America for considerably less than where its stock price had stood a few months earlier. That same weekend, Lehman

The decline in money market funds has already caused corporate borrowing costs to skyrocket.

Brothers, another iconic Wall Street firm, was unable to obtain any relief, and so was forced to file for bankruptcy on [Sept. 15, 2008].

Both Merrill and Lehman came under heavy pressure because they possessed insufficient capital. As mortgage-related losses mounted, customers began pulling out of brokerage accounts with Merrill and Lehman, concerned about the safety of their assets. Merrill and Lehman thus came under increasing pressure to raise more capital to cover these losses and the outflows of brokerage deposits. When it became apparent that the capital available was insufficient to cover their expected losses, Merrill sold itself to Bank of America, and Lehman entered into bankruptcy.

Around this same time, AIG, the world's largest insurance company, also came under heavy pressure to raise capital. AIG's financial arm, AIG Financial Products, had accrued an enormous amount of exposure to mortgage-related assets, and as a result, it was carrying enormous unrecognized losses on its books.

On [Sept. 15, 2008] the day Lehman announced bankruptcy, AIG's auditors forced AIG to recognize some of these losses. As a result, the next day, September 16, AIG was forced to effectively sell 80 percent of its equity to the Federal Reserve in exchange for an \$85 billion line of credit.

These events were widely considered shocking. Many observers felt that Lehman could survive, and its inability to find any capital to save itself was an eye-opening event. The demises of Merrill and AIG were even more sobering, because they were widely considered to be in sterling shape up until a few days before their dispositions.

Confidence in the health of financial institutions drops, causing credit freeze among banks
Finding credit was already difficult in this

environment, but the sudden and unexpected failures of Lehman Brothers and AIG caused lending to freeze up even more. Lehman in particular caused problems, because many investors which had uninsured accounts with, or other exposure to, Lehman, suddenly lost the ability to access their cash, with no idea of how much, if anything, they would be able to eventually recover.

Confidence in the solvency of financial institutions has plummeted and as a result, banks virtually ceased lending to one another. The most widely-used measure of lending between banks (the London interbank overnight rate or "LIBOR"), reached an all-time high of 6.88 percent [Sept. 30, 2008], an indication that banks are extremely reluctant to lend to each other at any interest rate. This is an indication of the extreme lack of confidence banks have in the financial system.

Other sources of credit also freezing up

In addition to bank lending, other sources of credit have also dried up. Money market mutual funds, which are considered safe alternatives to depository accounts, have also come under serious pressure. Money market funds have historically been an important source of credit for businesses, as they are a major purchaser of short-term corporate debt (also called "commercial paper").

Following the failure of Lehman, two money market funds failed due to their exposure to Lehman debt. This is unprecedented. Money market funds, which are not federally insured, have historically been extremely safe and conservative, with their sole goal being to break even. From 1971 up to September 2008, there was only one money market fund which failed. These failures led to a run on money market funds, which has continued to this time, as investors have withdrawn their money. On [Sept. 29, 2008], money market funds saw a \$10 billion outflow of funds.

The decline in money market funds has already caused corporate borrowing costs to skyrocket. Short-term corporate debt rates jumped from 2 percent [Sept. 29, 2008] to a range between 5.75 percent and 7.75 percent on [Sept. 30, 2008].

The problems in money market funds signal larger problems in the debt markets. Corporate and municipal bond issues are becoming costlier and harder to fulfill. Even such long-time institu-

As credit tightens up, Main Street businesses and consumers are forced to reduce spending.

tions as GE, AT&T, and the State of Massachusetts are finding it difficult to find enough buyers of their bond issues.

How will the credit crisis impact me?

So how will the credit crisis affect ordinary Americans, living outside the confines of Wall Street? It all goes back to the idea of the “vicious circle.” As credit tightens up, Main Street businesses and consumers are forced to reduce spending. This in turn reduces the revenues of businesses, forcing them to cut costs, including lowering wages and cutting staff. As a result, businesses and individuals alike have more trouble paying their bills and are more likely to miss payments on their loans (like mortgages and corporate debt).

As these missed payments turn into loan defaults, the value of mortgage-backed securities and corporate debt is further reduced, which then forces Wall Street firms to cut back even further on their lending activities, causing a further tightening of credit.

In short, what we are seeing now, if uninterrupted is a feedback loop, where tighter credit leads to less economic activity, which leads to a decline in the value of financial assets, which then creates even tighter credit conditions. In an environment like the current one, only those borrowers with the safest credit ratings can find credit, and even this is costly. And without credit, businesses large and small wither and die. Whether it’s the small business owner who cannot expand or the large conglomerate that cannot make payroll, the impact is the same — the economy shrinks and the pie gets smaller.

We are already seeing evidence that the vicious circle is well underway. Unemployment numbers are up again, with 159,000 newly unemployed workers in September [2008]. Auto sales have declined for 11 straight months, due to

more restrictive credit and decreased consumer confidence, and as a result, 18 percent of US car dealerships may close in 2009. Private student lending has become severely restricted, as banks are increasingly unwilling to commit cash to long-term loans. And some colleges have already lost access to funds parked with failed institutions such as Wachovia and Lehman, which may ultimately raise the cost of tuition.

The impacts of the credit crisis are not limited to the private sector, either. Cities and states have become increasingly reliant on the issuance of bonds to finance various projects. Like other credit markets, the markets for “muni bonds” (which have historically been much safer than private bonds and offer significant tax benefits) have also frozen up. In recent weeks [October 2008], a high number of municipalities, including Massachusetts, have been forced to back out of the muni bond market due to insufficient investor interest or overly high costs. One expert recently [October 2008] predicted that muni bond issuances would drop by 25-30 percent in 2009. Even those that are issued will almost certainly be at much higher cost, limiting the amount of new road construction, school maintenance, and other municipal and state projects that can be paid for.

Nonprofit institutions have in recent years also made extensive use of short-term borrowing, and like their for-profit analogues, they are already experiencing problems because of the credit freeze. Blood banks, hospitals, homeless shelters are among the many types of nonprofit institutions that rely on the credit markets to meet their short funding needs. If the availability of credit continues to deteriorate, many of these nonprofit entities will have to cut back, or even shut down.

How will the Emergency Economic Stabilization Act help the credit crisis?

The newly enacted Emergency Economic Stabilization Act (EESA) will help to alleviate the credit crisis by paying a fair price for the MBS that financial firms are currently holding. By adding a massive new buyer to the equation, EESA is expected to improve the market for MBS. Struggling financial firms can then sell some of their

troubled assets, thus improving the condition of their balance sheets, and making it easier for them to attract new capital. More capital and less troubled assets will hopefully stimulate new lending.

Additional policy steps, including more stimulus, may be required in the near future.

However, the effects of EESA will not be known until the Treasury plan has been put into operation. While EESA may help to stabilize the credit markets, banks and other financial institutions may still require significant capital. Moreover, recent signs indi-

cate that the real economy is beginning to slow significantly. Additional policy steps, including more stimulus, may be required in the near future.

Editor's note: Brackets indicate changes based on the reprint timing.

New developments have emerged at the time of this reprinting, since the article's initial publication. For updates on the credit crisis, visit http://www.afponline.org/pub/res/topics/news/news_crisis.html; or http://money.cnn.com/2009/02/06/news/economy/cohan_wallstreetbailout.fortune/index.htm.

Inclusionary housing:

Where do we go from here?

By John Lowry, Burbank Housing executive director

In this article, written December 2008, John Lowry, Burbank Housing executive director and a Sonoma County, California resident, discusses the status of inclusionary housing and explores ideas for improving inclusionary housing policies in the future. Inclusionary housing ordinances generally require a percentage of new residential development be set aside for very-low, low- and moderate income family occupancy. Lowry's comments are his own and do not represent any official positions taken by Burbank Housing or RCAC.

Background and context of inclusionary housing

There is currently considerable discussion of inclusionary housing policy and ways to make it more vigorous and address a wider range of public policy objectives. However, the housing industry is in deep depression. It has ceased to function because production costs exceed market values. In the near term, therefore, inclusionary policy is largely irrelevant, and thoughtful discussion of the issue is really about how inclusionary requirements might figure in a new housing strategy, if and when builders are able to get back to work. It is also worthwhile to consider how inclusionary policies have been combined with and enhanced by other housing policies and how this leveraging might be strengthened in the future.

There seem to be three distinct rationales for inclusionary housing and the emphasis of one over the others will drive policy preferences.

- The first, most convincing argument for inclusionary programs, is that the land available to develop housing is a scarce resource, in part because we have made a public policy decision to limit the areas that can be developed. It is also scarce because of the cost of public infrastructure, including direct hard costs and recently added environmental mitigation.
- A second and widely accepted view, although perhaps not as firmly grounded as the allocation of scarce resources, is that it is the responsibility of the building industry to provide resources to affordable housing either by building it or paying others to do it. While the recent history of insisting the building industry assists affordable housing has created a significant resource, such exaction can only continue as long as home building is financially feasible.
- A third argument is that inclusionary policy is needed to promote social integration

within the community, breaking down the pattern of rich and poor neighborhoods. This may be a worthy policy objective, but it also needs to be seen in the context of

We have experienced a generation-long redistribution of incomes away from lower income people ...

land use policy and the efforts needed to actually obtain this objective on a meaningful scale. Additionally, it is somewhat separate from housing production policy and merits discussion on its own, with a subsequent discussion of

if and how inclusionary policy should be used to further this objective.

Disagreement over the direction of inclusionary policy stems from disagreements about the relative importance of competing policy objectives, concerns about unintended consequences, differing assumptions about the abilities of builders to fund affordable housing and disagreement on the justification of builder exactions.

A perspective on the current debate

It is worthwhile to consider the issues involved in the current debate over inclusionary housing before considering the options available and ways to coordinate inclusionary policy with other housing related policies.

Inclusionary policy should prioritize housing production and focus on creating a range of housing affordability with resources targeted to deeply affordable housing. It also should leverage housing industry financial resources with other funding sources. Toward the goal of social integration, inclusionary policy should be backed by a land use policy that also is predicated on this objective and not a cosmetic patch-over of land use policies intended to preserve exclusivity.

The reasons for this preference are that we see a growing number of people whose incomes are inadequate to pay for low-income housing, given its current cost of production, and that we must address the need for supportive housing for people with disabilities. We have experienced a generation-long redistribution of incomes away from lower income people and toward those with higher incomes. At the same time, we have seen inflation in housing production and opera-

tion costs ahead of changes in income growth. Housing inflation has characterized the past 30 years as well, but has been most dramatic over the past decade. Further, costs have not dropped significantly, even with the collapse of home prices.

For example, if we target a rent of \$600 per month to provide an affordable apartment to a very-low income household and the unit has an operating cost of \$400 per month, then \$200 per month is available for mortgage debt payment. Assuming a 6 percent rate on financing, this unit could support about \$30,000 of borrowing. With current development costs in the range of \$300,000 per unit, \$270,000 would be needed from a source that does not require current debt service. It would take a bold leap of imagination to claim that the housing industry could provide this level of assistance now or at any foreseeable time to come. Therefore, any resources gained from inclusionary requirements must be combined with other sources to create deeply affordable housing. Often, in lieu of providing inclusionary units in residential developments, the developer can pay various fees or donate land to the city for inclusionary housing units.

This type of policy has been widely accepted by Sonoma County, California jurisdictions. Such in lieu fee options are available in both Santa Rosa and Petaluma, both of which have run highly successful affordable housing production programs. Santa Rosa has produced more low-income affordable housing than any other jurisdiction in the Bay Area except San Francisco and San Jose, both much larger cities. Petaluma has demonstrated success in meeting housing goals for many years. Any changes from these policies should demonstrate how they would match the current successful policies for production, depth of affordability, and provision of supportive housing or make a convincing argument that other objectives are demonstrably more important.

Nevertheless, those who find current inclusionary policies objectionable argue that most or all inclusionary housing should be developed on-site and distributed among the homes in every new development. The stated reasons for concern seem to be that the in lieu fee approach

does not ensure that the housing will really be built, that the builders are not really paying their fair share, and most importantly that the current policy concentrates affordable housing and

Zoning continues to set aside some areas for large lots and other areas for multi-family development.

lower income households. Related to the concern about concentration, some critics additionally claim that living in a house or apartment that does not look like the more expensive homes in the neighborhood carries a damaging stigma.

The argument that affordable housing might not be built, or that it will be delayed for an unacceptable time, was a concern in the early days of inclusionary housing and may still be an issue in some locations. In Sonoma County, however, the reverse is true. Affordable housing is running ahead of market rate building. At least five nonprofit and two for-profit developers of affordable rental housing are active in the County at this time. The most significant constraint on their production is the scarcity of local housing funds to supplement state, federal, and private funding. On the home ownership side, nonprofit developers would be eager to expand production, which is constrained currently by costs and market conditions. Additionally, several for-profit start-up builders attempting to serve the low- and moderate income, first-time buyer market and financial conditions too adverse to proceed. If the funding and land are available, affordable housing will come, and in quantities exceeding the requirements of inclusionary policies.

With regard to the issue of the builder's fair share, there are no fully objective criteria for determining the proper level of builder contribution to affordable housing. For many builders, any share in cost of affordable housing is an unjustified exaction. For some advocates, the full cost of producing low- and very-low income units must fall on the builders. I feel the responsibility must be measured and have some relationship to land availability and land cost. The level of builder responsibility, however, can be established more precisely if in lieu fee and land dedication options are offered.

The issue of concentration of affordable housing and more broadly, social integration of people with various incomes in the same neighborhood is important, controversial and worthy of further candid discussion. Land use policy has generally reinforced, rather than diminished, segregation by income level, and even in times prior to formal zoning, patterns of exclusive neighborhoods, middle class areas and poor neighborhoods tended to exist at least in cities and larger towns. The objective of residential integration by income level is a significant break with the past. Since the issue appeared in the context of inclusionary housing, rather than more generally, it makes sense to discuss it in this more general context. Have we, for example, explored it in the context of land use policy? In general, I think the answer is "no." Zoning continues to set aside some areas for large lots and other areas for multifamily development. Some jurisdictions, however, have moved away from this pattern. Santa Rosa, for example, has designated islands of multifamily land within the largely single family Southwest Area, which will provide for greater integration of income levels than exists in some older parts of the city. It seems important that, if income level integration really is a goal we have accepted, land use policy must be consistent with it.

If land use policy is consistent with the social integration purpose, then inclusionary housing will have less of a burden to address this public policy priority. Middle class and low-income people would live in the same neighborhood, attend the same schools, shop at the same stores and develop friendships to the extent that individuals would share common understandings. Wealthier people with discretionary income also might be enticed to live in such neighborhoods, if they included sufficient urban and service amenities. Some people would live in detached houses, others in town homes and others in apartments. I believe it would be a more genuine integration than a policy that would seek to distribute a lucky few low-income families to live in larger single-family homes. This assessment may seem harsh and unfair to those who promote similar style housing for similar income levels to live in the same neighborhoods, exclusive from others as with customary on-site inclusionary policies. However,

I don't think there is any stigma about living in a clean, safe and up-to-date rental apartment or in a modest starter home. A mixture of housing types, including supportive housing, would be a more genuine diversity.

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How can we improve inclusionary housing?

While many Sonoma County jurisdictions have incorporated excellent principles of inclusionary policy into their current

programs, there are ways for all jurisdictions to improve inclusionary programs. The programs should strive to incorporate a number of principles including flexibility, leveraging of funding resources, efficiency, range of affordability, financial realism and incentives to builders. Inclusionary policy should also mesh with both land use and revenue policy. When these policy areas are at odds with each other, each can attempt to address the shortcomings of the other.

- *Flexibility* involves giving builders a number of ways to meet inclusionary requirements including on-site and off-site affordable housing building, land contribution, pooled land contribution and in lieu fee payment. All of these have proven to be effective in the provision of affordable housing. A greater variety of ways to produce affordable housing will increase the likelihood of a wider range of housing types and affordability levels. The ability to leverage builder resources, either through direct partnership with nonprofits or through an in lieu fee program, can increase the amount of affordable housing produced and deepen the level of affordability.
- *Leveraging funding resources* is important to enable the amount of affordable housing produced to exceed the numbers that would be produced under on-site requirements alone and to achieve the provision of deeply affordable housing. As mentioned above, the resources needed to produce a very-low income affordable housing unit are enormous, and seeking to exact them from private builders alone is unrealistic. In today's housing finance environment, they

are produced only through the combination of a variety of funding sources.

- *Efficiency* needs to encompass both the manner in which the housing is produced and the way it is managed and monitored into the future. Again, looking at low- and very-low income housing, most of this type of housing will be rental housing. Most of the financial resources available to produce affordable rental housing are competitive and come with large overhead costs, so that smaller rental developments will be inefficient in both development and operation in relation to larger ones. Very small rental developments as inclusionary portions of each new subdivision or condominium would be a wasteful approach to meeting housing objectives.
- *Range of affordability* is a concern because housing production has become so expensive relative to incomes. Even housing affordable to moderate income, first-time buyers is difficult to produce, although on-site requirements seem realistic to meet moderate income affordability. Local government can, however, make even this unrealistic by imposing onerous resale controls, which make these homes unattractive to potential buyers. To reach low-income homeowners or renters, subsidies are needed, and these subsidies exceed the resources of most private builders. The most realistic way for private builders to participate in low- and very-low income affordable housing production is through in lieu fees or land dedication. In some jurisdictions where on-site production is emphasized, the level of affordability targeted is often moderate income with some homes marginally affordable to low-income households. The real challenge today is providing housing for people whose incomes are lower than this.
- *Financial realism* in housing policy, as in any public policy, should be based on an understanding of costs and a fair consideration of the requirements placed on one segment of the community in relation to others. The development business is more cyclical than most other industries and has experienced greater cost inflation over the

past decade than the economy as a whole. Builders were able to accept higher fees of all kinds during the boom years and profits in the housing development industry reinforced the tendency to add

Financial incentives are very important when seeking to provide low- and very-low income housing.

on more fees and requirements. Presently, however, costs exceed market value and market rate housing development has ceased. Instead of looking for greater financial exactions from the building industry, this is a time to look seriously at reduction of

all fees and other requirements to allow housing production costs to move closer to historic relationships with income. With regard to inclusionary requirements, it is time to provide incentives in return for on-site production, fee payment or land dedication.

- *Incentives to builders* are recognized as an essential part of successful inclusionary programs, but more so in some jurisdictions than in others. Incentives are reasonable and proper because builders are providing a financial resource that should be compensated to the extent possible, but also because incentives make the program more effective.
- **Financial incentives** are very important when seeking to provide low- and very-low income housing. Financial incentives can be drawn from redevelopment housing set aside funds and federal pass through funds, CDBG and HOME. These sources are most often used in partnerships with nonprofits and in combination with other programs such as low-income housing tax credits.
- **Relax development standards** including such items as setbacks, lot coverage and road width can and should be offered to accommodate density bonuses and reduce costs.
- **On-site inclusionary and land dedication housing** should be eligible for density bonuses equal to at least the number of inclusionary units.
- *Other impact fees for the density bonus units should be reduced.* This can be justified in that the parcel being developed is paying the

full payment in relation to infrastructure planning, although the specific amounts of reduction may need to be considered in nexus analysis.

Innovation

Some cities have initiated an innovative approach (graduation of in lieu fees based on unit size), which other jurisdictions should further consider and develop. In Santa Rosa, no fee is charged for units of less than 900 square feet, but fees range up to almost \$40,000 for units of 4,500 square feet. An additional per square foot fee is applied to larger homes. While this formulation does not actually capture the specific affordability of the market rate unit, it does approximate affordability, since there is some correlation between size and affordability. This distinction, in part, addresses the dilemma of adding costs to housing that could be sold at the lowest price, perhaps to first time moderate income buyers. If private builders can create moderate income affordability, it makes sense to reward their effort.

Santa Rosa also charges special fees based on the land density designation. This approach shifts fee burden away for those housing units that would be most likely affordable to low- and moderate income households. Additionally, it is entirely consistent with the most convincing argument underlying inclusionary policy — to ensure that a portion of the scarce resource, developable land, is used for affordable housing. The efficient use of land is rewarded and less efficient utilization brings greater financial responsibility. This principle could also be applied to inclusionary policy.

Without some form of graduated fee system, inclusionary programs can do exactly the opposite. They can reward luxury housing built on large lots and punish, into infeasibility, efforts by private builders to reach as low on the income scale as possible with unsubsidized housing development.

Another area of innovation for inclusionary housing is in its coordination with land use policy. This effort is important in a number of ways. It can answer the concerns of the advocates of on-site inclusionary requirements by

ensuring that all income levels can live in new neighborhoods. It can also maximize flexibility for private-public-nonprofit partnerships that could result in more affordable housing with lower costs to builders.

A more flexible density policy could benefit housing affordability, social integration and private builders as well.

A more flexible density policy could benefit housing affordability, social integration and private builders as well. Under this approach, larger areas of developable land, usually involving multiple

parcels, could exchange prescribed densities for master plans that would incorporate a variety of housing types and densities. In other words, particular densities and housing types could be flexible so long as the total number of units developed in the area fell between some minimum and maximum levels and affordability objectives could be realized. This type of policy would create the opportunity for income diversity and higher proportions of affordable housing. It would allow private builders to choose the most profitable housing types, which would in turn generate resources to support affordable housing. It would also incentivize land contribution in meaningful size parcels as the form of inclusionary participation most advantageous to both builders and affordable housing development. The evolution of such policies would involve further study, but given the potential benefit, it is worth exploration.

Assessment of current times

As mentioned above, it is important to be mindful that current economic times are very unusual. Housing development has essentially ceased. The recession is deepening, and any assessment of the future is speculative. Given these conditions, any changes made to inclusionary policies now will have little immediate effect. It is, therefore, a good time to carefully explore inclusionary policy options going forward to advance our objective of greater opportunity for all. Now also is an ideal time to address the question of how inclusionary policy should be structured to accommodate the recovery of the housing industry, and with it, housing affordability.

Further reading

Non-Profit Housing Association of Northern California, *Affordable by Choice* (2007). This is an easily readable overview of inclusionary housing in California.

Non-Profit Housing Association of Northern California and the Home Builders Association of Northern California, *On Common Ground: Joint Principles on Inclusionary Housing Policy* (2005).

California Coalition for Rural Housing website, www.calruralhousing.org (2008). This is an ambitious effort that catalogues the inclusionary policies of all 156 California jurisdictions which have enacted them, including program descriptions and contact information.

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