

Building a Strong Rural Finance Network – What Do We Need to Change?

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Rural areas more often lack access to credit and capital than urban areas in the United States.¹ The reasons revolve around the higher information and transaction costs that financial institutions and investors face in rural areas (on both the equity and debt side). Lack of access also stems from the more limited deal flows, limited supporting infrastructure, and long distances between places that make oversight difficult. Furthermore, rural investments are often characterized by the small scale of individual transactions and the perception of a high degree of risk. Finally, rural community development lenders, including community development financial institutions (CDFIs), are typically small, vertically integrated institutions that do everything themselves, from underwriting, originating, and servicing loans.

It is this last issue that is the focus of this paper. To serve more people, access more funds, and have greater impact, rural CDFIs and other rural community development lenders must change the way they operate. Rural CDFIs should operate as national or regional networks rather than individual, unaffiliated lenders. Although many rural CDFIs identify with a particular form of CDFI (e.g., loan fund, credit union, or micro-enterprise lender) and often belong to a trade association, these affiliations are of limited use when addressing operational issues related to growth, efficiency, and scale. New models of networked community development lenders are necessary if rural areas are to access the capital necessary to grow their local economies.

Rural Areas Need New Development Strategies

A recent Carsey Institute report on rural economic development states that, “In the volatility of today’s economy, rural communities across the country are clamoring for development strategies that create jobs, businesses, and community wealth. Although nearly every town and village, county and countryside is hitching its future to the notion that it can compete in the new global economy, few are clear on the pathway to that success.”²

The report goes on to note that rural areas still face particular challenges that require special attention from policymakers. First, employment opportunities in primary industries (largely wood products/forestry, mining and agriculture) are declining. Second, young people are leaving and retirees are moving to some locales, which has grayed the population. Finally, most rural areas have difficulty establishing the necessary critical mass of facilities, producer services, and investments to support economic development, and thus entrepreneurs have difficulty starting up or expanding enterprises in the area.

¹ N. Seymour, *Entrepreneurship in Rural America* (Kansas City, MO: CELCEE Kauffman Center for Entrepreneurial Leadership Clearinghouse on Entrepreneurship Education, December 2001).

² A. Graham-Brown and William Lambe, *Measures and Methods: Four Tenets for Rural Economic Development in the New Economy*. Policy Brief no. 9 (Durham, NH: Carsey Institute, fall 2008).

The Carsey Institute report further states that, “In the past, much of rural economic development relied on exploiting natural resources or recruiting industry, often marketing cheap land and labor as community assets. In an era of global competition, those old approaches no longer yield sustainable results.”³ Clearly, rural communities are defined in part by a unique relationship with the natural world that surrounds them, and both capitalizing on and serving as good stewards of their natural resources are critical to their success. It also is becoming clear that these areas must see themselves as part of larger networks in order to attract private capital and also to leverage government support (public capital.)

Globalization Increases Pressures to Evolve

Globalization, which both loosens national ties and enforces international competition, confronts rural areas both with development opportunities and with threats not previously encountered. Globalization may bring gains to economies in their totality, but it will nonetheless pose severe problems of adjustment to a good number of rural regions. On the other hand, there may be a series of new opportunities opening up, requiring appropriate policy support. These include increased demand from urban dwellers for rural amenities, stemming from improved transportation links. Sustained local development has also begun reversing patterns of economic decline and population exodus. The sources of economic success include dynamic small business clusters and networks, diversified agro/ food sector industries, and rural tourism.

To date, however, rural policy is still considered by many to be synonymous with agricultural policy, such as the Farm Bill. Yet even among the most rural regions of the United States, only one in five jobs is in the agricultural sector (including forestry and fishing). A development approach that extends beyond agriculture is now required, given that the majority of rural citizens increasingly depend on employment and income generated from a complex mix of interacting economic activities.

Across northern New Hampshire, Maine, Vermont and New York, two-thirds of the land base has changed in the past dozen years as the industrial landowners who once dominated the region have sold their lands. Paper mill closures in Groveton and Berlin, New Hampshire, and Millinocket, Maine, are recent examples of a changing regional manufacturing sector, which lost 35,000 jobs since the mid-1970s. The *Boston Globe* tracks declines in the forest products industry and manufacturing industries and the shrinking supply of qualified workers. These jobs are often replaced by lower-paid tourism jobs.

These regional challenges are combining with global trends to create a perfect storm of community decline in many rural areas. In places where living-wage jobs have declined, communities struggle to maintain their civic structure and community and social infrastructure. Many indicators of personal well-being such as education and health are stagnant and lag behind urban areas. A report released in Spring 2008 by the Carsey Institute revealed that 78 percent of

³ Ibid., p.1

respondents to a 2007 survey of residents in rural northern New England said they would tell local teenagers to move away when they grow up.⁴

A Possible Solution: Creating Networks, Attracting Resources, Building Scale

For the past 30 years, thousands of nonprofit community development organizations (CDOs) and CDFIs have demonstrated effective strategies for addressing poverty and underdevelopment in the United States. These organizations have developed a variety of successful community programs, all designed to improve the quality of life in their local communities.

Despite this important work and, in many cases, impressive results, these organizations generally have been unable to scale up their operations—that is, to make a meaningful and sustainable impact by serving a larger percentage of those in need—to meet demand. Such is the case for organizations working in a broad range of antipoverty program areas, including community development finance, micro-enterprise, workforce development, affordable housing, individual development accounts, youth initiatives, early child care services, social services, and low-income tax preparation. In short, the need for scale in the nonprofit community development world has long overshadowed the individual achievements of these organizations. The result is high levels of frustration among practitioners *and* funders, as well as within the low-income communities they serve.

Yet scale has been successfully achieved in the private sector. In one example, what was 20 years ago a 13-store retail operation, today is CCA Global Partners, with 15 affiliated companies offering a range of support and training services to more than 3,700 independent retailers in a variety of for-profit industries across the United States, including many rural areas and small towns. The result is more than \$10 billion in aggregate annual sales and 85 consecutive quarters of profitability. There have also been some early successes in the nonprofit sector both inside and outside the United States (more on this later)

The extent of the long-standing challenges of poverty and economic insecurity in our nation's poorest communities and the demand for related community economic development (CED) programs overwhelms what nonprofits can currently offer as solutions. In fact, across a range of CED program areas, the insignificant impact of CED organizations threatens to render them irrelevant. Below are a few examples of this anemic impact:

- *Affordable Housing*: Every year since at least 1993, there has been a shortage of about 5.2 million affordable units for low-income renters.⁵ In 2007, CDFIs built or renovated only 57,274 units of affordable housing,⁶ or just 1 percent of the 5.2 million needed. And need has only grown since. After gradually rising between 1980 and 2000, the share of

⁴ Chris Colocousis, *The State of Coos County: Local Perspectives on Community and Change*, (Durham, NH: The Carsey Institute, Issue Brief #7, Spring 2008), p. 7.

⁵ Joint Center for Housing Studies, *The State of the Nation's Housing 2005* (Cambridge, MA: Joint Center for Housing Studies, Harvard University, 2005), p. 23.

⁶ CDFI Data Project, *Providing Capital, Building Communities, Creating Impact.*, 7th ed. (CITY: publisher, date), p. 12.

households whose rents or mortgages strained their budgets shot up between 2001 and 2007. As a result, the number of households spending more than half their incomes on housing (considered severely burdened) jumped by an unprecedented 30 percent to 17.9 million in 2007. Another 21.6 million had moderate burdens, paying 30–50 percent of income for housing. By 2007, fully 30 percent of all homeowners were at least moderately burdened and 12 percent were severely burdened. Renters and low-income families were particularly stressed. The share of renters with severe burdens remained nearly twice as high as that of owners. Indeed, fully 51 percent of low-income renters and 43 percent of low-income owners paid more than half their incomes for housing.⁷ CDFI's efforts are a drop in the bucket of this growing need.

- *Financial Services:* The number of payday lenders has exploded from a few hundred in the mid-1990s to more than 15,000 today, providing about \$25 billion in short-term credit to millions of customers each year. In contrast, community development credit unions (CDCUs) in 2003 made only 21,000 personal development loans (the CDCUs' alternative to payday loans) worth \$11 million.⁸ This amounts to only 0.04 percent of the amount provided by payday lenders.
- *Micro-enterprise:* The estimated potential market for micro-enterprise development services in the United States is 10 million individuals.⁹ Yet the micro-enterprise development industry (over 500 nonprofit programs to date) serves approximately 200,000 individuals per year, or 2 percent of its market.

In short, despite the efforts of thousands of community development organizations across the country, the results are often disappointing in relation to the need.

What Does Scale Mean?

For community development practitioners, scale is one of six principles needed to create excellence in the field. Scale means:

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- Providing services to a large number of people,
 - Providing services to a significant percentage of those in need,
 - Being able to leverage size to improve results,
 - Having enough capital to develop new products and services,
 - Getting beyond year-to-year funding concerns,
 - Capturing enough market share to influence for-profit providers, and
 - Being significant enough to have a voice with legislators and regulators.

The concept of scale is also shorthand for the related goals of scope, sustainability, and impact. To get a product or service to scale, organizations must move well beyond marginal hand-to-mouth and year-to-year community development efforts. Serving more people (scope), being

⁷ Joint Center for Housing Studies, *The State of the Nation's Housing 2009* (Cambridge, MA: Joint Center for Housing Studies, Harvard University, 2009), p. 26.

⁸ CDFI Data Project, *Providing Capital*, p. 29.

⁹ Elaine Edgcomb and Joyce Klein, *Opening Opportunities, Building Ownership: Fulfilling the Promise of Micro-enterprise in the United States*. (Washington D.C.: Aspen Institute, February 2005), p. 16.

able to maintain operations over time (sustainability), and making a real difference in communities (impact)—taken together— define the concept of successfully achieving scale.

Why Scale Matters

When it comes to making a difference, larger organizations have many advantages. First, they often have critical capacities that smaller organizations do not. For example, large organizations have access to capital, market research, the ability to develop and test new products and services, and the infrastructure to deliver products and services efficiently and with consistent quality. These capacities make larger organizations more effective in meeting their mission. Perhaps most important, once at scale, larger nonprofits can afford to attract and retain a higher quality of staff, including experienced specialists.

Larger organizations are also better able to leverage both the public and private sectors. Simply stated, they have more clout. To public officials and policymakers, scale communicates a constituency. In the case presented here, scale could give rural nonprofits a voice in shaping public policies. Similarly, large organizations have more ability to influence mainstream practices, persuading for-profit players to serve the underserved, go down-market, or develop more affordable products. A large customer base can attract private-sector partners, who may be more willing to reduce fees or tailor products and services in return for access to more volume. And to attract Wall Street and other investors who think in terms of millions of dollars, organizations must be able to put that kind of money to work and have the organizational capacity to inspire investor confidence.

Finally, scale matters because it is in play everywhere—shaping our economy and our society. Small businesses often fail because they cannot compete with organizations of scale. In the retail sector, for example, giant retailers control suppliers. In their attempt to reduce costs, these retailers drive wages and benefits lower and push jobs off-shore.

By developing models for scale in the CED nonprofit housing and community finance sectors, networks aim to create an antidote to inefficiency, strengthen small organizations, and develop the blueprint that will promote thriving models of CED in rural areas.

What Can Be Done to Achieve Scale and Promote Capital Flows in Rural Areas?

There are several models of networked organizations that are beginning to address issues of scale and scope in rural areas. Three such models are described below.

Lenders One

Lenders One is a national alliance of leading mortgage originators that uses the combined strength of its members to negotiate favorable terms on products and services for its members.

Lenders One is a national alliance of independent mortgage bankers that provides its member companies with revenue-enhancing, cost-reducing, and market-share-expanding opportunities.

Lenders One examines every aspect of the traditional mortgage process to create revenue enhancement and cost savings programs and delivers these programs to its members. Members of Lenders One become a shareholder in the organization that operates on their behalf. The organization leverages the buying power of its members to negotiate favorable terms on mortgage delivery in the secondary market. As one of the largest aggregators of mortgage money in the United States, Lenders One members receive favorable mortgage delivery terms typically reserved only for national originators. In addition, Lenders One negotiates cost-savings programs on products and services. These programs include discounted rates on office products, insurance, office equipment, furnishings, long-distance, wireless technology and payroll services as well as credit reports, appraisals, title insurance, homeowners' insurance, and flood letters.

Lenders One has developed LendersOne.com as the virtual headquarters of the organization. The members of Lenders One can use this site as an operating platform to access mortgage product and pricing information, training resources, advertising material, and standard documentation for every step of the lending process. Lenders One has also developed Loan Finder, an interest rate search engine that allows members to search a proprietary database of products and provides information on the best product and price for a specific loan request. The Lenders One platform also provides access to training through LOANMax, which provides unlimited use of the tools of MTI, a leading source of education and continuing education in the mortgage business. LOANMax provides workbook, instructor-led seminars and online courses for member companies. From LendersOne.com, members can access training resources for managers, loan officers, and associated mortgage staff.

Lenders One provides members with multi-faceted advertising programs that include informational flyers, interest rate flyers, postcards, newspaper advertisements, magazine advertisements, recruiting material, and radio announcements. All collateral material is available through LendersOne.com at no cost to members. Members also access discounts on products and services through their affiliation with Lenders One.

Lenders One member benefits include:

- **Lower Expenses:** Reduce annual expenses by an estimated 5 to 10 percent.
- **Strength in Numbers:** Members will receive favorable mortgage delivery terms typically reserved only for national originators.
- **Customer Service Solutions:** Customer One programs generate repeat business and referrals.
- **Increased Volume:** Buying power generates product and service advantages over competition.

- **Training and Education:** Access to industrywide training at favorable prices.
- **National Programs:** Products and services (all available through an online platform at reduced prices) include appraisals services, credit card processing, credit reports, packages of closing documents, human resource manuals, insurance products, loan origination systems, office supplies, and more.
- **Secondary Marketing Partners:** Lenders One has relationships with a number of secondary marketing companies including Fannie Mae, CitiMortgage, Chase, GMAC Bank, Comerica, MetLife and others.
- **Advertising and Marketing:** Lenders One offers members an abundance of free resources to help drive more business to their companies. The Lenders One Ad Planner offers a variety of advertising campaigns for members, all of which are customizable with members' own photo, logo, and contact information. Also included is a database of over 50 marketing letters to assist loan officers in all stages of the loan process, campaigns for recruitment, and a selection of Lenders One logos.

ROC USA

ROC USA, LLC helps resident corporations buy their manufactured home communities (also known as mobile home parks) from private community owners. ROC USA is a nonprofit organization with a mission of making resident ownership of manufactured housing parks possible nationwide. ROC accomplishes this by first focusing on communities that are for sale and in which homeowners have a strong likelihood of success if they choose to work as a group and buy the park. Second, ROC has assembled local and regional nonprofits that they have trained and certified to assist resident corporations with the purchase process and beyond. Third, ROC has developed a specialized source of financing for resident corporations that wish to buy their communities.

ROC's goal is to provide homeowners with the opportunity, when viable, to secure the community beneath their homes. ROC does this through two wholly owned subsidiaries and affiliations with local nonprofits:

- **Resident Ownership Network, LLC** (or ROC USA Network) trains and certifies local nonprofit organizations to provide technical assistance to resident corporations. They assist both during the purchase process and afterwards because communities succeed if they are continually improving and linked with other similar communities.

ROC USA Network's Certified Technical Assistance Providers are experienced, affordable housing developers and/or co-op trainers. They help find local legal counsel, develop budgets, and help secure a purchase contract, financing proposals, and funding for studies. They help with all of the steps necessary for a group to make an informed

choice about buying their community. Buying the community is entirely the choice of the association.

Resident Ownership Capital, LLC (or ROC USA Capital) was formed to provide community purchase financing to resident corporations that are supported by a Certified Technical Assistance Provider. ROC USA Capital specifically is designed for resident corporations that have minimal cash for a down payment. Because some commercial banks will lend 75 or 80 percent of the purchase price, the problem historically for resident corporations has been the down payment gap (from 80 to 100 percent). The result is:

1. The group fails owing to a lack of sufficient financing;
2. The homeowners who can afford it raise the funds through large membership share values, creating two classes of homeowners: members and nonmembers. (We have seen too many divided communities to think this is a good idea.); or
3. The resident corporation finds a nonprofit or government agency willing to lend the down payment.

ROC USA Capital falls into the third category, a nonprofit lender, but one that can provide the whole loan, not just the down payment. That way, ROC USA Capital is both appropriate and timely, because most sellers do not want to wait for resident corporations.

Essentially, ROC has established a national network that links residents to technical assistance, management education, and financing. ROC is in the process of building a network, similar in scope to LendersOne, that will provide education, training, access to capital, and discounted purchasing to all members of the ROC network, from technical assistance providers to manufactured park managers to park residents.

The Federation of Appalachian Housing Enterprises

The Federation of Appalachian Housing Enterprises (FAHE) is a network delivering housing in the Appalachian region. Their service area is characterized by substandard housing, economic hardship, and inadequate infrastructure. In the region they serve, there are more than 100,000 substandard homes, which are overcrowded and lack essentials such as electricity and plumbing. FAHE addresses the problem on three levels: for the family, the community and the region. In 2009, FAHE deployed approximately \$40 million, reaching 4,000 families. This volume of direct financing is quadruple that of 2004. Additional accomplishments in 2009 include:

- **JustChoice Lending:** The mortgage and homeownership division made more than \$18 million in mortgage loans to 225 families in the region, an increase of 40 percent over the previous year
- **Resources for nonprofits:** \$5.6 million in pass-through funds and set-asides.

- Total capital under management: \$71.7 million.
- Membership grew to 47 members across the region.
- Impact: in 2009, the FAHE network provided housing solutions to 4,000 families.

Collaboration: Performance Compacts

As a membership-based organization, FAHE facilitates partnerships among organizations, corporations, and individuals. In 2005, FAHE started the Berea Performance Compacts to build on these strengths to serve more families. With this move, FAHE and its members committed to capitalizing on individual strengths united to accomplish more together as a network. Members can go beyond learning lessons from others' success and directly tap into another member's expertise. This series of collaborative initiatives works cooperatively to provide competitive, standardized, professional services designed around existing expertise. Through the Compacts, FAHE members share core competencies to develop models that can be replicated, allowing other members to divest administrative functions and focus on their strengths, therefore decreasing costs and increasing efficiency while continuing to provide necessary services to their communities. This model allows members to work collectively across the region while still tailoring their programs to meet the needs of local communities. By aggregating the demand of multiple organizations across the network, the Compact leaders create a marketplace for the entire region.

The five active performance compacts and goals are:

- Loan Servicing: To double the number of contracts to 14 in 24 months.
- Green Building: To double the production of units that meet a green standard in 24 months.
- Mortgage Lending: To triple the number of originators to 15 in 18 months.
- Manufactured Housing: To double the number of participating organizations to six, and triple number of units to 15 in 18 months.
- Multi-family Development: To double the number of projects from to four in 24 months.

Each initiative moves through a pilot, standardization, and rollout phase.

What Can We Learn from These Examples?

Incipient networks such as Lenders One, ROC USA, and FAHE are demonstrating the power of network solutions to promote efficiency, scale, and impact. A rural finance network could combine several hundred rural lending institutions into a powerful, effective force that could build scale, increase the flow of public and private capital, and promote more effective rural development. A rural finance network could:

- Develop a common operating platform similar to the Lenders One model to share information, enhance purchasing power, and access capital;
- Standardize certain products to attract capital market investors;
- Promote supportive federal and state policies, including tax incentives, credit enhancements, and regulations;
- Access private capital markets using federal and state credit enhancements and tax credits.

Only a *consistent, coordinated, and intentional effort* can break community development from its wall of small volume and moderate results. The end goal of these efforts is a transformed community development field that is more efficient and effective, that is secure in continuing its work, and most important, that can achieve real, positive community change.