Capital Availability and System Perspectives

- Three frameworks for addressing capital systematically
  - Capital market imperfections
  - Ecosystem approach
  - Capital absorption framework
- Role of class, gender and race in capital markets
- Implications for economic development finance
- Dual practice framework
- Detroit and the three frameworks
Market Imperfections in Theory

- Theory: “perfect” competitive markets allocate capital to the most productive users
- What are the requirements for “perfect” markets?
- Imperfections and capital supply gaps occur when these conditions do not hold
- Political and policy case for development finance is based on perfecting markets
  - Better productivity and economic growth
  - Social benefits
Capital Markets in Practice

- Capital markets: set of institutions that accumulate and channel savings to households, businesses and governments and provide a return to suppliers of capital
- Institutional structure and operation of capital markets shape supply gaps
- “Public” vs. “Private” capital markets
  - What are the difference in how these markets work?
  - What market imperfections result?
Capital Markets: Recent Trends

- Increased role of public markets & fewer assets held or originated by depositories
  - Mortgage banks, brokers, pension funds, mutual funds
  - Global securitization and role of secondary markets
  - Separate origin, ownership & management of assets
- Systemic market and regulatory failures during financial crises
- Bank consolidation and growth in venture capital increased intermediary and transaction sizes
- Automation of business lending (credit scoring)
- Growth of “fringe” & predatory financial services in low-income and minority neighborhoods
Race/class/gender and Capital Availability

- History of disparity in access to capital/exclusionary policies
  - FHA mortgage policies
  - Red-lining of low-income neighborhoods
  - Segregated financial institutions and networks
- Inequality in income, wealth, & education limits access to informal and formal capital
- Institutionalized discrimination in financial institutions & products serving communities
  - Nexus of residential & financial segregation
  - Sub-prime loans 3X more likely in low-income area; 5X more likely in black neighborhoods, independent of income
- Racial disparities in lending decisions and pricing remain after 30 years of legal & regulatory changes
Economic Development Implications

- Common capital supply gaps from market imperfections:
  - Lack of institutional equity for most small businesses
  - Limited availability of small commercial loans
  - Limited availability of long term debt
  - Capital access disparity: geography, wealth, race & gender
  - High level of risk aversion in post-crisis environment
- Private intermediaries are key capital sources for community economic development
- Understand how market, regulatory and financial sector factors shape regional capital supply by private sector
- Expand supply of small amounts and higher risk capital
- Proactive strategies to address class/race/gender biases
Ecosystem View of Capital Markets

- “Ecosystem” of players and environmental forces affect capital markets
- Ecosystems vary across regions & cities
- Tool to gain deeper understanding of the local/regional capital market conditions and to formulate policies and strategies
- Focuses attention on factors beyond capital markets that influence capital supply and using them to change how markets work
Finance Ecosystem

Resource Providers

Financial
- Banks
- Insur Cos.
- CDFI Fund
- Fed. Govt
- Foundations

Human

Knowledge
- Consultants
- Academics/Think Tanks
- OFN, SAHF, HPN
- Federal Reserve

Technology

Financial Intermediaries
- Capital Mkts
- Tax Credit Investors
- Local Govt/RDAs
- CDFIs and SPEs
- Banks
- Local Government
- RE Equity Funds
- SBA Lenders

Environmental Conditions
- Policy and Administration
- Economics and Market
- Geography and Infrastructure
- Cultural and Social Fabric

Complementary Orgs
- Anchor institutions
- Community groups
- Businesses

Borrowers
- Developers
- CDCs
- Non-profits
- Small businesses
- QALICBs

Problem-Makers
- Speculators

Impact: Increase economic opportunity and promote revitalization of low-income communities

Living Cities Adapted from Stanford Social Innovation Review Article “Cultivate Your Ecosystem.”
Capital Absorption Framework

• Living Cities’ response to observed gaps in capital absorption capacity:
  ○ “the ability...to make effective use of different forms of capital to provide needed goods and services to underserved communities”

• Community development investment (CDI) entails many sectors: housing, health, education, arts & culture, economic development, financial services, etc.

• Functional view of finance system:
  ○ Five functions seen as critical to effective CDI
Dual Practice Plus Approach

- Perfect conventional capital markets
  - Risk sharing tools and policies
  - Bank and financial sector regulation
  - Addressing information and transaction costs
- Create alternative financial institutions
  - Revolving loan funds
  - Venture capital funds
  - CDFIs
  - Micro-enterprise Funds
- Address larger system and functional barriers to effective and equitable capital deployment
Detroit through 3 Frameworks

- Capital markets imperfections in Detroit?
- Observations on the economic development finance ecosystem?
- Insights in how effectively the capital absorption functions work?