

Enhancing Access to Community Development Capital

STRATEGIES FOR STRENGTHENING LOW- AND MODERATE-INCOME COMMUNITIES

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Preface

Across the country, there is growing recognition of the impact that communities have on children's development and their pathways to productive adulthood. This knowledge has spurred an array of initiatives to revitalize neighborhoods and make them better and safer places for families to live and raise their children. While these initiatives often differ in scale, scope and design, developing and sustaining these efforts requires significant investments over time.

Community development initiative leaders often focus on the availability of public and private grant funds for financing community development activities in low- and moderate-income communities. However, state budgetary shortfalls and tight fiscal markets severely constrain initiative leaders' ability to access public and private grant dollars and have made it particularly challenging to renew the economic and physical assets of the most disadvantaged neighborhoods and improve the accessibility and quality of services and supports for families. To address this challenge, state and local policymakers and community leaders need to look to a wide array of strategies to finance community development activities and improve the health and wealth of their communities.

One important, though often overlooked, set of strategies for financing community development initiatives includes accessing a variety of sources of capital. This brief, *Enhancing Access to Community Development Capital: Strategies for Strengthening Low- and Moderate-Income Communities*, describes five strategies available to policymakers and community leaders seeking to finance community development strategies and activities in financially distressed neighborhoods and provides an overview of key issues to consider when implementing these strategies.

This brief is part of a series of tools and technical assistance resources on financing and sustaining the Making Connections and other community development initiatives developed by The Finance Project with support from the Annie E. Casey Foundation. These tools and resources are intended to assist policymakers, program developers and community leaders in developing financing and sustainability strategies to revitalize neighborhoods and improve outcomes for children and families in low- and moderate-income neighborhoods.



Cheryl D. Hayes

Executive Director



Introduction

Strengthening the social, physical, and economic infrastructures of low-income neighborhoods is essential to transform them into supportive communities for children and families. Initiatives designed to create jobs, expand housing opportunities, and improve the quality of human services are underway in many U.S. communities. The success of these community development initiatives depends on many factors, including resident engagement, political support, strong community leadership, and, of course, financial resources.

Community development initiative leaders often focus on public or private grants as critical elements of a community development financing strategy. Yet with budget deficits threatening public funding for community development programs and poor market performance constraining the availability of private grants, it is imperative these leaders craft more diversified financing plans. In particular, community leaders must increasingly look to private capital markets to support their community development efforts.

This strategy brief aims to help state and local policymakers and community leaders understand the capital market sources that can support their initiatives and develop strategies for accessing those resources. The brief is divided into two parts. Section I provides an overview of sources of community development capital and information on the types and characteristics of financing instruments available to support community development initiatives. Section II outlines strategies that state and local policymakers and community leaders can use to enhance access to public and private capital investments in low- and moderate-income communities.



Introduction to Community Development Capital

The term “community development” means different things to different people. In some arenas, community development is synonymous with economic development and refers to activities designed to attract and expand businesses in disadvantaged neighborhoods. In other arenas, the phrase refers to policies or programs designed to enhance affordable housing opportunities. Still other arenas include human services in their definition of community development. For the purposes of this strategy brief, community development refers to initiatives designed to:

- increase the income and/or assets of residents of low- and moderate-income (LMI) communities;
- reduce the cost of living for residents in LMI communities and expand access to affordable goods and services; and/or
- prevent or reduce community blight.

This definition of community development includes various policies, programs, and activities to strengthen and enhance the social, physical, and economic infrastructures of LMI communities. These efforts seek to create jobs, increase the stock of quality and affordable rental housing, expand the availability and reduce the costs of retail goods and services, improve the accessibility and affordability of child care and health care services, and enhance opportunities for LMI families to build and protect assets such as homes, businesses, and financial savings.

Types of Community Development Capital

Although community development initiatives reflect the varying objectives, priorities, and needs of different neighborhoods and communities, they all require capital. **Capital refers to the financial resources needed to pay for property or activities.** In general, community development initiative leaders need three types of capital: real estate capital, working capital, and risk capital.

REAL ESTATE CAPITAL

Real estate capital refers to financial resources for the construction, acquisition, or rehabilitation of land or buildings. A community’s need for real estate capital could include capital for housing, capital for business property, and/or capital for community facilities.

Capital for Housing. The demand for decent, affordable housing is high in many low-income communities. Capital is critical not only to acquire, construct, and rehabilitate affordable rental housing, but also to increase homeownership in LMI communities (e.g., by extending affordable mortgage products to families that want to purchase or renovate homes).

Capital for Business Property. Creating jobs and expanding access to goods and services in low-income communities requires attracting new businesses and/or expanding existing businesses. Supporting business development often means securing capital to acquire or renovate existing property or to develop new, commercial space.

Capital for Community Facilities. To expand or improve the availability of human services, LMI communities need access to facilities. Poorly designed facilities, or an inadequate number of them, limit the type of services that can be offered in a community and the number of individuals who a provider can serve. By improving the type, number, and location of community human service providers, capital investments in facilities significantly affect the quality and availability of services to LMI families.

WORKING CAPITAL

Working capital refers to assets available to an organization, in excess of its liabilities, that can be applied to current operations. In general, working capital finances routine expenses when other funding sources are temporarily

unavailable. Because small businesses and community organizations often operate with little or no financial cushion, lags in revenue streams cause serious cash flow problems. This results in insufficient working capital and, in some cases, disruption or cessation of business or program activities. These lags are not uncommon for businesses awaiting payment from clients or for nonprofit organizations awaiting grant payments or government reimbursements. Consequently, organizations operating with limited financial reserves need to access working capital from external sources, such as loans and other investments, to help even out their cash flow.

RISK CAPITAL

While working capital allows organizations to maintain current operation levels, risk capital finances the expansion of program operations and/or the development and marketing of new products or services. This form of capital is also essential for new business startups. For example, risk capital can finance the development of a resident-owned business or the development of a new bilingual service program in a community family resource center.



Sources of Community Development Capital

Recognizing the role of capital in stabilizing and strengthening economically disadvantaged neighborhoods, federal, state, and local government agencies have infused billions of dollars into community development initiatives in LMI communities. Private foundations have also been vital supporters of community development activities through their grant-making efforts. Yet while the poor performance of the U.S. economy has increased the demand for community development services, state budgetary shortfalls have reduced the availability of public funds to support these activities.¹ At the same time, the sluggish performance of the stock market has hindered the flow of private grants to these communities, as foundations face shrinking asset bases.² More and more, financing community development depends on the ability of state and local policymakers and community development initiative leaders to access capital.

Community leaders can integrate various investment instruments into their initiative's financing plan to meet the demand for capital. In addition, a strong and growing network of financial institutions and other entities invest in, and provide needed capital to, LMI communities.

INVESTMENT INSTRUMENTS

Capital market investors expect a positive return on their investments. The type of return an investment will generate is determined by the structure of the investment. Typically, capital market instruments take one of two forms: debt or equity.

Debt. Debt capital is capital raised through loans. It is loaned to a borrower for a specified period and requires the borrower to repay the principal plus interest on the loan. Common debt investments in community development include home mortgages, small business loans, and facility loans for human service organizations. Community development debt instruments include nonconventional mortgages, construction and preconstruction loans, bridge loans, working capital loans, and low-cost lines of credit.

- **Nonconventional Mortgages.** A mortgage is a loan for the purchase of real estate. Nonconventional mortgages are government loans that typically have below-market fees and interest rates and other underwriting standards that make the mortgage more flexible or affordable.
- **Construction and Preconstruction Loans.** A preconstruction loan finances the purchase of permits, property, and architectural and other necessary services before construction of a new

¹ For example, the combination of plunging state revenue and exploding health care costs led almost every state to implement across-the-board program cuts in fiscal 2003, restricting the flow of state dollars to economically disadvantaged communities. The National Governors Association reports that while the national economy shows signs of improvement, states still face an uphill battle to recover from the worst fiscal crisis in the past 60 years.

² Foundation giving decreased by 2.5 percent between 2002 and 2003, from \$30.4 billion to an estimated \$29.7 billion. Loren Renz and Steven Lawrence, "Foundation Growth and Giving Estimates ~ 2003 Preview," *Foundations Today Series* (New York, N.Y.: The Foundation Center, 2004), at http://fdncenter.org/research/trends_analysis/pdf/fgge04.pdf.

building or facility can begin. A construction loan finances construction of a new building or facility.

- **Bridge Loans.** A bridge loan is secured by funds from a contract or grant that has been signed but for which the money has not been received. It is often used to provide working capital to organizations experiencing cash flow problems.
- **Working Capital Loans.** A working capital loan is similar to a bridge loan. However, instead of being secured by signed grants or contracts, this loan is secured by other types of evidence that funds will be available in the future to repay the loan.
- **Low-Cost Lines of Credit.** Low-cost lines of credit are financial arrangements in which a lender extends credit to a borrower for a limited period and for a low cost.

Equity. Equity capital is capital obtained in exchange for a share of business or project ownership. Equity investments generally do not have a fixed term or predetermined financial return. The equity investor, as a partial owner, shares in the profits or losses of a business or project. Common types of community development equity investments include stocks in for-profit community enterprises, venture capital investments in startup businesses, and ownership of affordable rental housing in LMI neighborhoods.

Debt financing is most common when the organization seeking financing, or the activity being financed, has a fairly stable and predictable future revenue stream with which to repay the loan and when there are financial

assets to secure the loan. In contrast, equity investments are most common when there is greater risk but better potential for a higher return on the investment, as is generally the case with startup, for-profit businesses.

PUBLIC AND PRIVATE SOURCES OF CAPITAL

Although community development activities tend to offer relatively high-risk and low-return profiles compared with more conventional investment opportunities, many institutions are willing to invest their capital in these activities. These institutions vary in size, mission, and capacity. Some are small, specialized institutions with a specific community development agenda, such as the development of affordable rental housing. Others are mainstream financial institutions that invest hundreds of millions of dollars in affordable housing, commercial development, and social services activities. These institutions also differ in the types of capital offered and the eligibility requirements associated with their investments. Therefore, when considering a specific source of capital, it is essential state and local policymakers and community initiative leaders fully understand how each source can be accessed and develop strategies that maximize their ability to acquire needed capital. For example, while community development nonprofit organizations are eligible to apply for some sources of capital, accessing other sources will require influencing or encouraging organizations or individuals to invest in specific activities and/or apply for specific financing sources. There are several sources of capital, both public and private (see Sources of Community Development Capital on pages 16-17).

Community Development Financial Institutions. Perhaps the most important source of capital for community development activities is the large and growing industry of community development financial institutions (CDFIs). These institutions structure and provide financing instruments to meet the capital needs of small businesses, affordable housing agencies, and nonprofit community-based organizations in communities underserved by traditional financial institutions. Between 800 and 1,000 CDFIs exist nationwide, including community development banks, community development credit unions, community development loan funds, community development venture capital funds, and microenterprise development loan funds. A survey of 512 CDFIs found that in fiscal 2001, these institutions financed approximately 7,500 businesses, 43,400 housing units, and 501 community service organizations for a total investment of \$8.2 billion.³

- **Community Development Banks.** Community development banks are for-profit, depository institutions that use targeted lending and investments to support the development of housing, businesses, and nonprofit organizations in low- and moderate-income communities. These institutions are federally regulated and insured by the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency, and state banking agencies.

- **Community Development Credit Unions.** Community development credit unions are financial cooperatives that focus on providing capital to rebuild low-income communities. These institutions provide affordable credit and retail banking services, including check cashing and savings account programs that promote savings and asset ownership. Some community development credit unions also offer financial services, such as credit counseling or business planning.
- **Community Development Loan Funds.** Community development loan funds are financial intermediaries that provide below-market-rate financing for community development activities in underserved communities. In addition, they provide technical assistance and other services, such as guidance to borrowers during the loan application process.
- **Community Development Venture Capital Funds.** Community development venture capital funds provide debt, equity, and equity-like investments in new businesses to create job opportunities and build wealth in LMI communities. In general, these institutions do not invest in housing development or social services activities.
- **Microenterprise Development Loan Funds.** Microenterprise development loan funds provide business loans, usually of

³ See www.communitycapital.org/community_development/finance/statistics.html. The CDFI Data Project, a joint project of the Corporation for Enterprise Development and several community development trade associations and funders, conducted the survey. The CDFIs participating in the survey included 18 community development banks, 238 loan funds, 230 credit unions, and 26 venture capital funds.

less than \$25,000, and technical assistance to very small businesses, generally with fewer than five employees, that lack access to conventional financing.

Small Business Administration. The federal Small Business Administration (SBA) offers numerous loan programs to help small businesses meet their capital needs. Although SBA does not directly provide loan services, the agency guarantees loans made available to small businesses through private and nonprofit organizations. SBA has several loan programs for small businesses—the Basic 7(a) Loan Guarantee, the Microloan (7m) Program, and the Loan Prequalification.

- **Basic 7(a) Loan Guarantee.** This program enables small businesses, such as startup and existing small businesses, to obtain financing when they might not be eligible for business loans through normal lending channels. Loans provide funds for working capital, debt refinancing, machinery and equipment, and land and building acquisition or renovation.
- **Microloan (7m) Loan Program.** This program provides short-term loans to small businesses and nonprofit child care centers for working capital or for the purchase of supplies, furniture, and machinery and equipment. Loans are guaranteed to intermediary organizations that disburse the microloans and provide management and technical assistance to eligible applicants.

- **Loan Prequalification.** This program enables small businesses to have their loan application \$250,000 or less analyzed before it is submitted to a lender for consideration. These services are available through nonprofit intermediaries that review the applicant's credit and business history and the reliability of the applicant's assets.

Other Sources of Public and Private Capital.

Another important federal source of capital is the Community Facilities Loan and Grant Program Fund that supports the construction, expansion, or improvement of community facilities. Several grant programs from the U.S. Departments of Agriculture, Health and Human Services, and Housing and Urban Development are available to support the construction of public facilities such as neighborhood centers, the redevelopment of public housing, and the remodeling of child care facilities.⁴

In addition to CDFIs and the Small Business Administration, several other sources of community development capital are made available by both for-profit and nonprofit entities. These entities often accept lower financial returns on their investments in exchange for the social benefits resulting from community development activities. Among the more common private, non-CDFI sources of community development capital are traditional financial institutions and foundations.

- **Traditional Financial Institutions.** Commercial banks and other mainstream financial institutions invest billions of

⁴ For more information on sources of facilities loan funds and grants, see Margaret Flynn and Amy Kershaw, *Financing Facility Improvements for Out-of-School Time and Community School Programs* (Washington, D.C.: The Finance Project, August 2000).

dollars in community development projects each year. Banks invest in these projects for several reasons. Many community development loans are secured by significant and stable revenue streams, such as public entitlement funds (e.g., Medicare) or block grants (e.g., the Community Development Block Grant) that have a fairly low risk profile and can be profitable to the lender even with their relatively low interest rates. Many financial institutions also support community development projects because these activities enhance their visibility and promote positive relations with the communities in which they operate. Consequently, even if a community development investment does not generate an immediate return on investment, it may nonetheless result in longer-term financial benefits for the investor.

Financial institutions often support community development activities because of the incentives created by the Community Reinvestment Act (CRA). The CRA is a federal initiative to increase the availability of credit and financial services to lower-income and minority communities. The legislation requires regulated financial institutions to use their private-sector resources to meet the financing needs of the communities in which the lenders conduct business. Under CRA regulations, financial institutions receive credit for such community development activities as providing debt or equity investments in businesses, community facilities, or housing

in low-income areas.⁵ Although CRA is not a direct source of funding, it can be a valuable financing tool for community development initiatives in need of capital.

- **Foundations.** In addition to their grant-making programs, many foundations extend loans or provide equity for community development projects. Federal statute requires foundations to spend at least five percent of their assets for charitable purposes each year. In 1969 Congress enacted legislation that allows certain types of investments, known as program-related investments (PRIs), to count toward this requirement. The Internal Revenue Service defines a program-related investment as one that is made primarily to accomplish a charitable purpose and no substantial purpose of which is to produce investment income or a capital gain from the sale of the investment. PRIs are designed to fill existing financing gaps by offering more flexible underwriting criteria, reduced fees, and interest rates below those offered by mainstream financial institutions. These investments are often combined with, and complement, more traditional foundation grant-making activities.

Other private sources of community development capital include institutional investors (e.g., corporations, insurance companies, and utility companies), faith-based organizations, and individual investors motivated by philanthropic and/or public relations incentives.

⁵ For more information on the uses of the Community Reinvestment Act, see Debbie Gruenstein, *Using the Community Reinvestment Act to Help Finance Initiatives for Children, Families, and Communities* (Washington, D.C.: The Finance Project, April 2002).

Sources of Community Development Capital

	Purpose	Typical Products
Community Development Financial Institutions		
Community Development Banks	Provide capital to revitalize economically low-income communities through targeted lending and investing	Mortgage financing, home improvement loans, commercial business loans, and loans to students and nonprofit organizations
Community Development Credit Unions	Promote ownership of assets and provide affordable credit and financial services to low-income people	Personal loans and home rehabilitation loans
Community Development Loan Funds	Aggregate capital from individual and institutional social investors at below-market rates and lend this money primarily to nonprofit housing and business developers	Housing construction, predevelopment, and business startup, expansion, and facilities loans
Community Development Venture Capital Funds	Provide equity and equity-like debt instruments for community real estate and business projects	Commercial equity investments and equity-like debt instruments
Microenterprise Development Loan Funds	Foster social and business development through loans and technical assistance to low-income owners of very small businesses	Microbusiness startup and expansion loans
Small Business Administration Programs		
Basic 7(a) Loan Guarantee	Enables small businesses to obtain financing when they may not be eligible for business loans through normal lending channels	Loans can be used as working capital for machinery and equipment, land and building acquisition or renovation, and debt refinancing
Microloan (7m) Loan Program	Provides short-term loans	Loans can be used for working capital or for the purchase of supplies, furniture, and machinery and equipment
Loan Prequalification	Provides loan application analysis prior to submission to lender	Not Applicable
Other Public and Private Sources of Capital		
Facilities Loan Funds	Supports the construction, expansion, or improvement of community facilities	Grants and tax incentives
Traditional Financial Institutions	Supports community development activities	Loans and other products
Foundations	Promotes community development capital investments with flexible underwriting criteria, reduced fees, and below-market interest rates	Grants and other investments

Source: Adapted from information from the National Community Capital Association at www.communitycapital.org

Primary Sources of Capital	Customers	Governance and Ownership
Deposits from individuals and institutions, usually with below-market rates; and government	Nonprofit community organizations, individual entrepreneurs, small businesses, and housing developers	For-profit corporation; community representatives on board
Member deposits and limited nonmember deposits from social investors; and government	Members of credit unions, usually individuals	Nonprofit financial cooperatives owned and operated by low-income people
Foundations, banks, religious organizations, corporations, government, insurance companies, and individuals	Nonprofit community organizations, social service providers, facilities, and small businesses	Nonprofit entity; community investors, borrowers, and technical experts on board and loan committees
Foundations, corporations, individuals, and government	Small businesses	For-profit or nonprofit entity; varied community representatives
Substantial training and technical assistance in social and business development	Foundations and government	Nonprofit entity
Small Business Administration	Small businesses	Private and nonprofit entities and Small Business Administration
Small Business Administration	Small businesses and nonprofit child care centers	Small Business Administration
Small Business Administration	Small businesses	Nonprofit entity or Small Business Administration intermediaries
Government	State and localities, public housing authorities, and community organizations	State agency and nonprofit organizations
Commercial bank or other mainstream institution	Community development projects	Private entity
Private donor/ endowment	Community development projects	Private and nonprofit entities



Strategies for Enhancing Access to Community Development Capital

State and local policymakers and community leaders increasingly need capital to maintain and augment the supports and services necessary to revitalize their communities. Many leaders also recognize that rebuilding low-income communities requires more than simply accessing short-term public grants. A more proactive approach is to identify multiple sources of capital and develop an action plan for how to access those resources most effectively.

State and local policymakers and community leaders can pursue five general strategies to enhance access to community development capital—improve market conditions, leverage capital, reduce risk, use tax strategies, and build cooperative systems. The outlined approaches are intended to provide policymakers and community leaders with useful ideas, examples of strategies in practice, and considerations on ways to encourage the flow of private capital to disadvantaged communities.

Strategy 1. Improve Market Conditions

One strategy to encourage capital investment in financially distressed neighborhoods is to remove the market barriers that prevent private investors from committing capital in these communities. State and local policymakers and community leaders have an opportunity to remove or lessen the impact of these investment barriers by engaging in several activities.

IMPROVING THE QUALITY, QUANTITY, AND ACCESSIBILITY OF INFORMATION
Dispelling fallacies about the economic strength of low- and moderate-income neighborhoods is critical to encourage private investment in these areas.⁶ For example, an often-cited misconception is that the purchasing power of poor urban communities is too low to sustain profitable businesses. Most national market research companies use data such as average household income and unemployment rates to advise clients on where to locate businesses. Many private investors tend to disregard low- and moderate-income neighborhoods, perceiving the risks to be too high and the potential returns too low. Yet while average household income and employment levels are relatively low in disadvantaged communities, the household density and proportion of income spent on goods and services tend to be quite high. Therefore, the total spending power in these communities is often comparable to higher-income, lower-density neighborhoods.⁷ In addition, conventional data sources for evaluating market demand such as Census data are generally insufficient to analyze most low-income areas. These sources tend to undercount the number of low-income people and do not take

⁶ See John Pawasarat and Lois M. Quinn, “Exposing Urban Legends: the Real Purchasing Power of Central City Neighborhoods” (discussion paper prepared for The Brookings Institution, Washington, D.C., June 2001).

⁷ Michael Porter, “The Competitive Advantage of Inner Cities,” *Harvard Business Review* (May-June 1995).

Estimating Market Power in Harlem

In 1990 a group of business leaders founded Social Compact, an initiative to attract private business capital to low-income communities, particularly inner-city neighborhoods, by revealing the true purchasing power of these communities. Social Compact developed a new method of market analysis, called “Neighborhood Market DrillDown,” to reveal the real market power of communities undervalued by conventional market data sources, such as Census data. The Neighborhood Market DrillDown uses more than 30 commercial and public data sources (e.g., building permits and commercial credit data) to capture populations and economic activity missed by more traditional data sources.

In 2000 Social Compact worked with Fleet’s Community Investment Group to perform a Neighborhood Market DrillDown of Harlem, New York. Through its analysis, Social Compact discovered Harlem had a larger population and higher aggregate income than were estimated by Census data. Specifically, Social Compact estimated Harlem’s population to be 417,000 residents, compared with 317,000 residents estimated through the Census data, and its aggregate income to be \$6.2 billion, compared with \$5.0 billion estimated through the Census data. Furthermore, Social Compact estimated that about \$1 billion out of \$2.6 billion in local purchasing power was being spent outside of the Harlem market, representing enormous opportunities for retail businesses willing to locate in the community. After seeing Social Compact’s work, Fleet Bank decided to open two branches and expand its small business lending in Harlem. Social Compact has also undertaken Neighborhood DrillDowns in Chicago, Ill.; Cleveland, Ohio; Houston, Texas; Jacksonville, Florida; Oakland, California; and Washington, D.C.

Contact: Karin Ottesen, chief executive, Social Compact, 301.961.4982

Website: www.socialcompact.org/harlem_dd.pdf

into account strong informal cash economies in many of these neighborhoods (see Estimating Market Power in Harlem above). However, these are the very data sources on which business decisions are usually made.

In addition to misconceptions about distressed communities’ purchasing power, the lack of comprehensive, standardized, available data on the performance of community development investments in these communities makes it difficult to develop credit-scoring models or

other automated processes to analyze investment decisions.⁸ Without such processes, originating and managing community development investments is often expensive and time consuming.

State and local policymakers and community leaders can significantly affect investment decisions by collecting data and/or commissioning studies to assess a neighborhood’s true market potential as well as investment performance in the community.

⁸ Glenn Yago, Betsy Zeidman, and Bill Schmidt, *Creating Capital, Jobs, and Wealth in Emerging Domestic Markets* (Santa Monica, Calif.: The Milken Institute, January 2003).

Helping Develop Commercial Sites in Pennsylvania

According to the Southwestern Pennsylvania Growth Alliance, a 10-county, public-private partnership that lobbies for policies to stimulate economic development in the region, southwestern Pennsylvania lost almost 5,000 jobs between January 2000 and May 2002 because of the poor condition of potential commercial sites. In March 2003, Pennsylvania Governor Edward G. Rendell released plans for New Pennsylvania, a comprehensive economic stimulus initiative to attract and grow businesses in the state. As part of the initiative, the state will run a revolving loan fund to help municipalities prepare sites for commercial use. Funds accessed through the site preparation program, Business In Our Sites, will be used for site acquisition, environmental assessment, and, if necessary, remediation, engineering costs, legal services, and other activities necessary to facilitate commercial development. The \$300-million fund is expected to leverage an additional \$200 million in private capital.

Contact: Brian Eckert, director of site development, Business In Our Sites, 717.787.7120 or 866.466.3972

E-mail: ReadysetInvest@newPA.com

FACILITATING REAL ESTATE DEVELOPMENT

Developing real estate in economically distressed neighborhoods, particularly urban neighborhoods, is often more expensive and time consuming than developing real estate in less-dense, more-affluent areas. Factors such as restrictive zoning ordinances, environmental hazards, problems in aggregating small land lots, and long waiting periods for needed permits contribute to the difficulty and expense of real estate development in these communities.⁹ However, policymakers can counteract these disadvantages and increase the attractiveness of low-income neighborhoods to private investors. They can eliminate unnecessary restrictive zoning policies, improve the ease with which developers can access needed permits, enact clean-up programs to clean up

environmentally hazardous properties called “brownfields,” or create other mechanisms to facilitate real estate development for housing and/or commercial purposes¹⁰ (see Helping Develop Commercial Sites in Pennsylvania above).

ENSURING EQUAL OPPORTUNITY

In response to discriminatory lending practices rampant in the 1970s, Congress enacted two pieces of legislation, the Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA). HMDA requires lenders to disclose information about mortgage applications and their dispositions. The CRA requires regulated financial institutions to meet the needs of their communities, including the needs of low- and moderate-income neighborhoods and residents.¹¹ These two laws

⁹ Michael Porter, “The Competitive Advantage of Inner Cities,” *Harvard Business Review* (May-June 1995).

¹⁰ The U.S. Department of Housing and Urban Development has an excellent database of strategies to identify and remove regulatory barriers to the development of affordable housing. Visit the “Regulatory Barriers Clearinghouse” at www.huduser.org/rbc

State Legislation to Address Discrimination in Lending

Many state and local governments have passed legislation to encourage financial institutions to invest in low-income communities. Some states have established laws similar to the federal Community Reinvestment Act. For example, the Massachusetts Community Reinvestment Act establishes criteria the state must use to assess how well Massachusetts-based banks and other financial institutions are serving low- and moderate-income communities and evaluate their fair-lending records. The state takes these evaluations into account when considering whether to approve a financial institution's application for new branch openings, mergers, and acquisitions. Other states, including New York, and cities, including North Chicago, have passed legislation requiring financial institutions to receive federal CRA ratings of "outstanding" or "satisfactory" to be eligible to receive public deposits.

For more information on CRA legislation, as well as CRA ratings of financial institutions in local communities, visit the website of the National Community Reinvestment Coalition at www.ncrc.org

have encouraged financial institutions to lend, invest in, and serve low-income communities. Nonetheless, because racial and ethnic discriminatory practices continue to persist within the mainstream financial industry, many communities and several states have passed legislation to further combat unfair and discriminatory lending practices (see State Legislation to Address Discrimination in Lending above).

CONSIDERATIONS

- Improving the availability and quality of information on purchasing power is a relatively low-cost way to encourage capital investments in low- and moderate-income communities. Nevertheless, this strategy requires access to specific resources, such as technical expertise and various local data

(e.g., income tax records, crime statistics, and property assessments). Community leaders can partner with a local university or contract with a data management and analysis firm to conduct a market analysis and develop strategies for accessing data and disseminating information on the community's market power to potential investors.

- By demonstrating an unmet need for goods and services and encouraging new businesses to locate and develop in financially distressed neighborhoods, community leaders can increase access to two types of capital—real estate capital and risk capital. In considering this strategy, however, policymakers and community leaders need to understand the types of

¹¹ For an extensive discussion of the evolution of the Community Reinvestment Act and an exhaustive summary of related research, see Susan White Haag, *Community Reinvestment and Cities: A Literature Review of CRA's Impact and Future* (Washington, D.C.: Center on Urban and Metropolitan Policy, The Brookings Institution, March 2000), at <http://www.brook.edu/es/urban/haagexsum.htm>

investments this approach is likely to generate. Although information on a community's purchasing power could generate capital investments in retail and specific consumer services, such as laundry and dry cleaning and financial services, this information is unlikely to encourage investments in other types of commercial development activities, such as manufacturing, that are less affected by local purchasing power.

- Eliminating barriers to real estate development is likely to be a long-term strategy that requires significant political resources. For example, to eliminate restrictive zoning policies, policymakers and community leaders will need to secure the support of numerous stakeholders at the state, county, and city levels. However, encouraging and increasing real estate development can also yield significant longer-term benefits. Real estate development enables communities to leverage additional investments by improving a community's infrastructure, attracting economically viable businesses, and generating private capital investments. Some of these strategies are more costly

and time consuming than others, for example, revamping the permit process is less resource-intensive than is eliminating restrictive zoning policies. Policymakers and community leaders may want to pursue less resource-intensive approaches in the short term while taking steps to accrue the resources needed to implement longer-term strategies.

- Discrimination can adversely affect the availability of all types of capital. Efforts to enact legislation to combat discrimination, such as the Community Reinvestment Act, can increase access to real estate capital, working capital, and risk capital. Enacting this type of legislation, however, requires a concerted effort at the state level. To be successful, policymakers and community leaders will need to build coalitions of support and identify key champions within their community, state legislature, and financial industry. In addition, it is critical policymakers and community leaders understand the limitations of legislative efforts and work directly with lenders to ensure practices are implemented to guarantee equal opportunity.

Strategy 2. Leverage Capital

The amount of resources that can be raised through capital markets for community development projects often falls short of the total cost. In these cases, using existing resources to leverage other capital enables program developers and project leaders to move their projects forward. Leveraging entails putting capital, in such forms as grants, equity, debt, or land, into a project to attract additional investors. Developing partnerships with a variety of investors, both public and private, is also critical to leverage needed capital (see Public-Sector Debt Subsidies in San Francisco below). The underlying concept is that shared funding and a mutual commitment among contributing investors not only will facilitate, but also help ensure the success of a community development activity.

One of the most effective ways to leverage capital for community development is to create a revolving loan fund. A revolving loan fund is a fund from which loans are made to replenish a business or organization's capital. As loan repayments are made, funds become available for new loans to other businesses. These funds often fill a financing gap in a community development project or activity. Many states and municipalities leverage their resources for community development through "gap financing" (see Leveraging for Affordable Housing through the Chicago Community Loan Fund on page 25). Gap financing refers to the difference between the capital needs of a project and the maximum amount of capital that can be accessed through available sources. Providing gap financing enables a project to continue when all other sources of financing fall short of what is needed. Although the revolving loan fund is not the primary source of capital, the combination of financing instruments reduces risk and encourages investment.

Public Sector Debt Subsidies in San Francisco

Recognizing that many nonprofit child care programs could not afford to repay loans for capital expansion and improvements, the city and county of San Francisco helped secure public- and private-sector funding for a new child care facilities loan program. The two jurisdictions pledged up to \$1 million annually in general funds to subsidize up to 80 percent of the cost of the loan principal and interest for the providers receiving loans through the new program. This means programs are required to pay as little as 20 percent of the principal and interest over the life of the loan while the public sector pays for up to 80 percent of the cost of the loan. They can also receive grants for predevelopment and for equipment and working capital. A subsidy of this size makes facility improvement projects considerably more affordable for child care programs while also helping the city and county use debt financing to address their immediate need for additional high-quality child care spaces. In this case, the funding for the loans also came from the public sector— the Section 108 Housing and Community Development Loan Program administered by the U.S. Department of Housing and Urban Development— but a bank or a philanthropic partner would be an appropriate entity to make the loans available to child care programs.

Contact: September Jarrett, Low Income Housing Fund, 415.772.9094, ext. 302

Website: www.liifund.org

Leveraging for Affordable Housing Through The Chicago Community Loan Fund

The Chicago Community Loan Fund (CCLF) provides capital to nonprofit entities for affordable housing, economic development, and social services organizations in low- and moderate-income communities throughout the greater Chicago area. Through its loan program, CCLF often provides the gap financing necessary to acquire additional capital for community development projects. CCLF loan products may be used for various community development capital needs, including:

- acquiring, constructing, or rehabilitating affordable housing units;
- acquiring or rehabilitating community facilities and commercial real estate; and
- working capital for social enterprises and worker-owned cooperatives.

Since its inception in 1991, CCLF has made 101 loans worth more than \$15.3 million to community development initiatives. This money has leveraged nearly \$213 million in additional capital from the public and private sectors, helping to create or retain 1,500 affordable housing units and 700 jobs.

CCLF has become a leader in providing predevelopment financing for real estate projects across metropolitan Chicago, having extended 40 of them since its inception. Predevelopment activities can include feasibility studies, environmental reviews, and fees for architects, engineers, and lawyers. Predevelopment can be costly and, because there is no guarantee that a project will transpire until after much of the predevelopment work is done, it is fairly risky compared with other types of real estate development. Recognizing the difficulty of securing predevelopment financing, CCLF provided an \$80,000 predevelopment loan to help the Woodlawn East Community and Neighbors Association (WECAN) assess the possibility of rehabilitating an abandoned residential building in the Woodlawn Community on Chicago's south side. Once WECAN received financing for its predevelopment activities, the association was able to secure the \$4.7 million needed for the actual renovations from other investors. Now renovated, the rental housing development contains 42 units for low-income seniors and families and has 24-hour security services. In addition, the development provides supportive services, including full-time day care.

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Website: www.cclfchicago.org



CONSIDERATIONS

- As a first step, policymakers and community leaders need to carefully assess the type of community development activity with the greatest leveraging potential and identify investors with the greatest stake in the project. In addition to leveraging capital for a specific community development project, community leaders can also leverage capital for activities that are *related* to, but separate from, a community development project. For example, leveraging capital for street repairs, parking facilities, or telecommunications systems is likely to attract business investors to the community as well as increase residential property values.
- To successfully leverage capital for community development projects, community leaders must have a clear sense of the start-up costs associated with the project. Evaluating project start-up costs includes not only calculating the amount of capital needed to operate the business or project, but also the initial cash flow or assets available. Being realistic about a project's start-up costs provides a basis for determining how much capital to leverage. Yet while some investors are willing to provide the capital necessary to meet a project's start-up costs, others will only invest in business ventures that have sufficient resources to cover their start-up costs and can assume the risk of the business venture.
- To develop a revolving loan fund, policymakers and community leaders need to assess the need for or "gap" in capital to support a community development project or activity. They also need to identify barriers to accessing existing capital sources. This information will help determine the type of organization or activity the loan fund will support, eligible use of funds (e.g., working capital and real estate capital), loan terms, and underwriting criteria. By understanding what capital is already available and the challenges associated with these sources, policymakers can create effective and efficient ways to fill financing gaps, rather than compete with existing capital.
- Leveraging strategies, especially revolving loan funds, are likely to be more successful when they include technical support. Technical assistance on basic elements of finance, budgets, start-up cost evaluation, feasibility analysis, and financial structuring is an important way to support businesses and nonprofit organizations that are seeking to leverage capital for community development projects and can help ensure a positive return on the initial investment.

Strategy 3. Reduce Risk

When individuals or institutions invest capital in a community development project, they assume a certain risk and recognize they may lose some or all of their investment. In return for taking on such risk, they expect a return on their investment. However, many private investors shy away from investing in low- and moderate-income neighborhoods because they consider these projects too risky, the costs too high, and the potential returns too low. Credit enhancements can reduce the credit risk of an investment transaction. By developing credit enhancements, policymakers and community leaders can enhance the attractiveness of investments in financially underserved communities and investors' willingness to finance community development projects. Credit enhancement mechanisms include collateral and loan guarantees.

Collateral. Collateral is a specific asset a borrower pledges to sell, if necessary, to repay an investor. Assets include equipment or real estate, in the case of a business, or a home or car, in the case of an individual. For example, banks could require borrowers to commit assets as security for loans, which is known as “secured lending.” Collateral can be obtained from multiple parties, and collateral levels can be fixed or can change over time to reflect the value of the investment.

Loan Guarantees. A loan guarantee is essentially insurance in which a third party, known as a guarantor, agrees to pay some or all of an outstanding loan in the event that a borrower cannot repay (i.e., defaults) on the loan. Loan guarantees can originate from private or public sources. For example, several states have developed loan guarantee programs to increase the amount of private capital invested in human services that support community development, such as child care and health care (see Loan Guarantees for Child Care Facilities, below, and Loan Guarantees for Health Care Facilities on page 28).

In addition to developing local or state credit enhancements, policymakers and community leaders can encourage private investments by disseminating information on the availability of federal credit enhancement programs for community development activities. The Small Business Administration programs described in this brief are only a few of the public credit enhancement resources available

Loan Guarantees for Child Care Facilities

The Tennessee Child Care Facilities Corporation (TCCFC) is a quasi-state, nonprofit financial agency that helps meet the financial needs of the state's child care providers. The agency offers technical assistance and financial products, including loan guarantees, direct loans, and corporate partnership grants, to child care centers. In addition to its grants and direct loans, TCCFC guarantees up to 80 percent of child care facilities and working capital loans of \$250,000 or less.

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to small businesses. The Federal Housing Administration (FHA) provides mortgage insurance for low- and moderate-income homeowners, and the U.S. Department of Housing and Urban Development's Section 108 program allows communities to use their current and future Community Development Block Grant funds as collateral to secure loan guarantees for community development projects. Finally, the U.S. Department of Agriculture, through its Business and Industry Guaranteed Loan Program, provides guarantees for real estate, working capital, and startup loans made by private lenders to nonfarm businesses in rural areas and small cities.

CONSIDERATIONS

- Community leaders may want to obtain collateral from one or more parties to increase their ability to access loans for community development projects. When deciding whether to spread collateral among multiple parties, community leaders should consider the relative value of the collateral pledged by each party vis-à-vis the overall

loan amount, how related are the various sources of collateral, and each party's risk tolerance in pledging collateral for a loan.

- Community leaders who are seeking to obtain collateral to access loans should work directly with the financial lender to develop lending agreements that most appropriately meet their needs. For example, they may find it easier to identify parties that are willing to post collateral when collateral levels are fixed rather than variable.
- Community leaders should consider establishing a relationship with a community development bank that is willing to post collateral and/or loan guarantees for small businesses and nonprofit community-based organizations. However, private loan guarantees may not always be the most appropriate financing strategy for community development projects. They typically last only one year, which requires the borrower to raise the

Loan Guarantees for Health Care Facilities

The California Mortgage Loan Guarantee Plan, known as the Cal-Mortgage Program, helps health care facilities obtain private capital to expand health care services in communities across the state. The state office of statewide health planning and development runs the program, which guarantees up to 100 percent of the cost of constructing, acquiring, or renovating health care facilities. Cal-Mortgage also offers insurance instruments to help secure financing for equipment. It defines "health care facilities" broadly, and eligible institutions include hospitals, laboratories, health clinics, nursing homes, public health centers, mental health centers, adult day health centers, and drug treatment centers. All applicants must demonstrate that they are filling a community need. The program backs these loans with the "full faith and credit" of the state, a guarantee that permits borrowers to obtain lower interest rates.

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equity capital to pay off the original loan in a short period. A private loan guarantee also forces the borrower to apply for and obtain a loan based on the borrower's worth. Finally, the fees and interest on a loan guarantee can be costly compared with a traditional loan. Businesses or organizations that can put the borrowed

funds to use and show an immediate return on the investment best use loan guarantees. On the other hand, loan guarantees are easier to negotiate than pure equity investments because unless the business or project does not perform as expected, the investor guaranteeing the loan does not turn over any funds.



Strategy 4. Tax Strategies

Federal, state, and local governments use tax strategies to encourage certain behaviors or activities, including private investments in disadvantaged communities. Many federal and state tax incentives aim specifically to encourage private capital investments in poor communities (see Federal Tax Incentives for Community Development on page 32). These tax incentives subsidize the financial return on capital investments in specific types of community development activities. Although tax strategies are a less direct public mechanism for infusing capital into communities, these incentives can be instrumental in bringing private dollars to low-income neighborhoods. Tax incentives for community development activities include tax credits, tax deductions, tax exemptions, and tax increment financing.

Tax Credits. Tax credits are dollar-for-dollar reductions in the tax obligations of individuals or businesses. The Low-Income Housing Tax Credit, the Historic Preservation Tax Credit, and the New Markets Tax Credit are federal tax credits that serve as incentives to investors providing capital for community development. States and localities have also developed their own tax credits to encourage community development investments (see California’s Low-Income Housing Tax Credit on page 31).

Tax Deductions. Tax deductions decrease the amount of income subject to taxation. By lowering taxable income, tax deductions decrease tax obligations. For example, businesses located in federal empowerment zones or renewal communities deduct the costs of certain depreciable equipment from their taxable income the year the equipment is placed in service.

Tax Exemptions. Tax exemptions, also known as tax exclusions, allow taxpayers to disregard certain types of income when calculating their taxable income. Certain types of bonds provide tax-exempt interest. For example, the federal government allows state and local governments to issue tax-exempt bonds. The interest earned on these bonds is exempt from federal income tax.¹²

Tax Increment Financing. Tax increment financing (TIF) is an increasingly common way for municipalities to encourage private investments in development projects that stimulate private-sector investments and serve a public purpose (e.g., redeveloping blighted areas, constructing affordable housing, and providing employment opportunities). Under this form of financing, a county or municipality creates an authority within a specific geographic area and an authority board that has responsibility for developing a tax increment financing plan for the redevelopment of the geographic area, also known as a TIF district. When a TIF plan is adopted, the assessed value of real property in

¹² For a more detailed discussion of tax incentives, see Paul Pryde, *Tax Strategies for Community Economic Development* (Washington, D.C.: The Finance Project, June 1998); and Debbie Gruenstein Bocian, *Encouraging Investment: Using Federal Tax Credits for Community and Economic Development* (Washington, D.C.: The Finance Project, June 2003). Both publications are available at www.financeproject.org

the district is frozen at the current base level prior to the construction of improvements. The projected property tax revenue stream created by the development project in the TIF district is captured and invested into improvements associated with the project. For example, if the base year value for the plan is \$1,000,000 and the value in the second year is \$1,250,000, the authority gets to “capture” the property taxes on the increase in value (i.e., the tax increment) of \$250,000. The taxing unit only receives the taxes on the base value. The revenue generated by the tax increment financing can be used to repay a bond that was used to develop the property, construct

additional parking, or pay for infrastructure improvements in the TIF district.

In addition to developing tax credits and other incentives, policymakers can engage in other less-intensive strategies, such as developing marketing campaigns to disseminate information about existing state and federal tax incentives for community development projects. This strategy can be particularly effective because information about the availability of tax credits and about how best to use these resources is not often made available to potential investors. The Missouri Tax Credit Clearinghouse, a subsidiary of U.S.

California's Low-Income Housing Credit

The Tax Reform Act of 1986 created the federal Low-Income Housing Tax Credit (LIHTC) to increase the availability of affordable rental housing for low-income households. The credit provides a dollar-for-dollar reduction in the federal tax obligation of owners of newly constructed or substantially rehabilitated affordable rental properties. Communities in need of decent, affordable housing can benefit significantly from LIHTC. Since its inception, the credit has encouraged an estimated \$10 billion in private investments for the development of nearly 800,000 units of low-income housing.

Recognizing the exceptionally high cost of housing in California, in 1987 the state legislature enacted a state low-income housing tax credit to complement the federal LIHTC. The state credit further reduces the state tax liability of investors in low-income rental housing in California. Only projects that have received or are receiving federal credits are eligible to receive the state credits. However, neither the federal LIHTC nor the state credit are entitlements; both have annual limits on the total dollar amount of credits that can be allocated and, therefore, credits are awarded through a competitive bidding process. There were \$79 million worth of California state low-income housing tax credits available in 2004. Several other states, including Massachusetts, New York, and North Carolina, have also enacted state low-income housing tax credit programs (visit www.novoco.com/2003_State_LIHCS.shtml).

Contact: Lynn Wehrli, executive director, California Tax Credit Allocation Committee, 916.654.6340

Website: www.treasurer.ca.gov/CTCAC

Federal Tax Incentives for Community Development

Low-Income Housing Tax Credit (LIHTC). LIHTC encourages private investment in the development and rehabilitation of affordable rental housing by providing a reduction in the federal tax obligation of owners of newly constructed or substantially rehabilitated affordable rental properties.

Historic Preservation Tax Credit (HPTC). HPTC encourages investment in the renovation of historically significant properties for commercial use. Although the credit's primary purpose is to protect culturally and historically significant buildings and, not necessarily to support the revitalization of distressed neighborhoods, it is nonetheless useful to encourage private investment in the physical infrastructure of older inner-city neighborhoods.

New Markets Tax Credit (NMTC). NMTC reduces the tax obligations of investors who provide equity to community development intermediaries that provide loans, grants, and equity to businesses located in low-income areas. By reducing the tax obligations of investors, the credit increases the private capital available to these intermediaries and, consequently, to the businesses and communities they serve.

Commercial Revitalization Deduction. This incentive permits businesses that develop or rehabilitate commercial properties in renewal communities to deduct 50 percent of qualified expenditures, up to \$10 million, in the first year the building is in service, or all qualified expenditures over 10 years.

Special Treatment of Capital Gains. Taxpayers who sell qualified enterprise zone (EZ) or renewal community (RC) business assets may be able to exclude part or all of the capital gains from the sale of those assets. This essentially increases the potential return on these investments, encouraging taxpayers to invest in EZ and RC business assets.

Tax-Exempt Enterprise Zone Facility Bonds. The federal government allows state and local governments to issue tax-exempt bonds to provide low-interest rate loans to qualified businesses in EZs and RCs. The interest on these bonds is exempt from federal taxes, so bond purchasers realize a higher return on their investment.

50 Percent Exclusion of Gain from Sale of Small Business Stock. To encourage investment in small businesses and specialized small-business investment companies, the federal government allows noncorporate investors to exclude up to 50 percent of the gain realized on the sale of qualified small-business stock issued after August 10, 1993, and held for more than five years from federal income taxes.

Tax-Exempt Municipal Bonds. Tax-exempt municipal bonds fall into two categories: government bonds and qualified private activity bonds. A state or local government, or a nongovernmental entity with bonding authority issues government bonds to finance activities the government owns or operates. A state or local government (or an authorized entity) issues qualified private activity bonds and loans them to nongovernment entities for qualified activities; many community development activities qualify. Interest on these bonds is exempt from federal income tax, which increases the effective return to investors.

For more information on these and other tax incentives, see U.S. Department of Housing and Urban Development, *Tax Incentive Guide for Businesses in the Renewal Communities, Empowerment Zones and Enterprise Communities* (Washington, D.C., fiscal 2003), at <http://www.hud.gov/offices/cpd/economicdevelopment/library/taxguide2003.pdf>



Bancorp, is an effort to address this challenge. The clearinghouse brokers, provides information on, and facilitates the sale and use of Missouri's state community development tax credits.¹³

CONSIDERATIONS

- Developing tax incentives at the state and local level requires building coalitions, accessing political resources, influencing state budget allocation processes, and demonstrating the applicability and benefits of tax incentives. Tax incentives cost the government money, because they represent money that the government would have collected absent the incentives. Yet, because tax incentives do not require an outlay of funds, policymakers are often more willing to support them than they are to appropriate funds for other community development purposes. In addition, because repealing a tax incentive is commonly perceived as a *de facto* tax increase, once an incentive is written into a state's tax code, it is very difficult to repeal.¹⁴
- The two most important characteristics of tax incentives are *effectiveness* and *efficiency*. Tax incentives for community development are *effective* if they encourage investments that would not have taken place absent the tax benefits. Tax incentives are *efficient* if they maximize the “bang for the buck” (i.e., if they maximize the impact per dollar spent). Therefore, when creating tax strategies to support community development, community leaders and state policymakers should conduct two types of analyses. First, they need to evaluate the degree to which different tax strategies will increase private investment, rather than simply create tax benefits for investments that would otherwise occur. This is frequently called a “but for” analysis; “but for” the tax incentive, the community development investments would not happen. Second, community leaders and state policymakers should develop cost-benefit analyses comparing the estimated net monetary loss to the government for given tax incentives with the additional dollars invested in the desired community development activities.¹⁵

¹³ U.S. Bank Corp, *2001 Community Annual Report* (Minneapolis, Minn.: U.S. Bank Corp, 2001), 7, at http://www.usbank.com/about/community_relations/pdf/114130_USBancorp.pdf

¹⁴ Paul Pryde, *Tax Strategies for Community Economic Development* (Washington, D.C.: The Finance Project, June 1998).

¹⁵ Because tax incentives for community development may lead to economic growth, the amount of revenue that a government loses may be partially or entirely offset by increases in individual and/or business income tax revenue.

Strategy 5. Build Cooperative Systems

A final strategy for enhancing access to community development capital is to build or strengthen systems that expand the number of market stakeholders in community development activities. Increasing the number of stakeholders beyond a single investor and investee enhances market efficiency and distributes risk more widely, increasing the capital available for community development projects.

Intermediaries. Community development financial intermediaries pool capital from multiple external investors and use that capital to provide specialized loans and/or equity products for community development initiatives. The risk to investors depends on the performance of pool investments and, therefore, is spread over multiple community development projects. In addition, intermediaries often specialize in originating investments in certain types of communities and offer technical and/or financial support to investees that external investors may find too difficult or time consuming to provide. As a result, intermediaries can attract and invest private capital that would otherwise not be available for community development initiatives.

Secondary Markets. Traditionally, lenders originated, serviced, and held loans to maturity. As a result, after a certain amount of lending, all of their capital became tied up in existing investments and they could no longer meet their community's capital needs. Secondary markets disaggregate the origination and/or servicing from loan holding. In their simplest form, secondary markets allow loans to be bought from originating lenders by outside investors.¹⁶ By allowing for the sale of loans after

Secondary Market Activity for Community Development Loans

The Community Reinvestment Fund (CRF), located in Minneapolis, Minnesota, is a national leader in the secondary market for community development loans. Among its activities, CRF purchases loans from community development financial institutions to help replenish the originating lender's capital. For example, when the Region 9 Development Commission, which operates a community development revolving loan fund in Minnesota, depleted its funds for future projects, CRF purchased 16 of its loans for \$689,000. With new capital to lend, Region 9's loan fund made a \$100,000 loan to an injections molding plant that wanted to expand its operations in the area. By providing the loan an estimated 27 jobs will be added in the next two years.

In addition, CRF pools the loans that it buys and packages them into securities, which are sold to outside investors. For example, in 2000 the fund pooled 174 community development loans, which were purchased from 27 sellers in 14 states. CRF then packaged these loans into securities, which it sold for \$11.75 to multiple investors, including commercial banks, insurance companies, pension funds, and a private foundation.

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Website: www.crfusa.com

origination, secondary markets enable investors who are unable or unwilling to originate or service loans to contribute to the community development financial market by replenishing the originating lender's capital. This promotes additional lending activity. More complex secondary market activities include securitization; investors pool purchased loans and issue securities backed by these loan pools. Securitization helps spread risk across multiple projects and investors, encouraging additional capital into the system.

Secondary markets have been very successful in conventional mortgage lending. Fannie Mae and Freddie Mac, the nation's largest home loan purchasers, have injected billions of dollars in capital into the home mortgage market by purchasing mortgages and selling securities backed by pools of these mortgages. This infusion has made homeownership possible for families that might otherwise not have been able to secure mortgages. Although there is far less secondary market activity for community development loans, including small business loans, community facility loans, or home loans that do not meet Fannie Mae and Freddie Mac's standards, some opportunities exist (see Secondary Market Activity for Community Development Loans on page 34).

The Center for Community Self-Help (Self-Help) in Durham, North Carolina, and the Community Reinvestment Fund (CRF) in

Minneapolis, Minnesota, are two organizations engaged in secondary markets for these types of loans. Self-Help purchases packages of nonconforming mortgages for low-income homeowners from financial institutions. CRF purchases a wider range of community development loans, including asset-secured business loans, commercial and residential real-estate loans, and community facilities loans.¹⁷

Business Improvement Districts. A business improvement district (BID)¹⁸ is a designated district that receives financing for commercial area improvements to restore or promote business activity.¹⁹ Community businesses band together to impose additional taxes on businesses or properties that are located within their geographic area. Once collected, these taxes are used to enhance the safety, cleanliness, and image of the local business environment. In general, BID revenue may be used to improve parking, recruit businesses, develop and implement marketing campaigns, and support street cleaning or public safety services. By establishing a system for multiple stakeholders to share the cost of improving the local business environment, BIDs support the provision and management of services for the entire community that independent businesses could not afford individually. As a result, BIDs help improve business competitiveness and economic activity, which encourages private capital investment in community businesses and other development projects.

¹⁶ However, the originating lenders may continue to service the loans.

¹⁷ CRF gets most of its capital for purchasing loans by selling the loans that it purchases, or the securities backed by the cash flow from the loans, to institutional investors.

¹⁸ Other names for BIDs include business improvement zones, parking and business improvement areas, special services areas, special improvement districts, and self-supported municipal improvement districts.

¹⁹ Massachusetts Department of Housing and Community Development, Division of Community Services, *Business Improvement Districts: A Guide to Establishing a BID in Massachusetts* (Boston, Mass.: Division of Community Services, Massachusetts Department of Housing and Community Development, at www.state.ma.us/dhcd/publications/bid398.pdf)

CONSIDERATIONS

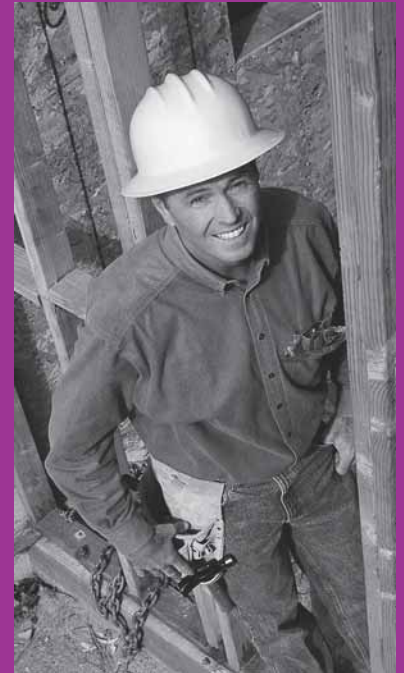
- The current level of secondary market activity for community development loans is fairly low. However, the enactment of the New Markets Tax Credit (NMTC) is likely to increase the selling and purchasing of such loans. Enacted as part of the Community Renewal Tax Relief Act of 2000, NMTC aims to promote economic growth and job creation in low-income communities. The credit reduces tax obligations of investors who provide equity to community development intermediaries. Intermediaries are required to use at least 85 percent of the cash provided by investors to make qualified low-income community investments (QLICIs). Because the purchase of loans made by community development intermediaries to qualified low-income businesses is considered a QLICI, NMTC may increase secondary market activity for these loans.²⁰
- Specific laws governing the establishment and operation of BIDs differ from state to state. Before developing plans, community and project leaders should learn more about BID laws in their state by contacting their state's economic development agency. In addition, the International Downtown Association offers resources and consulting services to property and business owners, local government officials, and community leaders hoping to establish BIDs.²¹
- Intermediaries and other organizations that provide technical assistance can be an important source of support for businesses and organizations seeking to access capital for community development projects. These organizations engage in numerous activities, including financial counseling, assistance in packaging loan proposals, support for the development of public-private partnerships and strategies to raise capital from public and private sources, and seminars, workshops, and other education activities that can support the implementation of the different financing strategies discussed throughout this brief.

²⁰ For more information on the New Markets Tax Credit and other federal tax credits for community development, see Deborah Bocian and Cheryl D. Hayes, *Encouraging Investments: Using Federal Tax Credits for Community Development* (Washington, D.C.: The Finance Project, June 2003).

²¹ The website for the International Downtown Association is www.ida-downtown.org



Accessing public and private investments will provide low- and moderate-income communities with access to the real estate capital, working capital, and risk capital needed to make these communities thrive.





Conclusion

Policymakers and community leaders nationwide are developing initiatives to enhance the social, economic, and physical conditions of low- and moderate-income communities and improve the lives of the children and families that live there. Such initiatives involve various policies and programs, from workforce development to commercial development to housing development. Although these initiatives often differ in scale, scope, and design, they share one critical challenge—they all need capital.

The decisions about which strategy to use to enhance access to private capital will likely depend on the design and objectives of the community development activities, the support and resources required to implement the selected strategy, and the timeframe for implementation. Every good financing plan begins by answering the fundamental question, “Financing for what?” Then the plan aligns specific financing instruments with the fiscal requirements of the development activity. Public and private grants are important funding sources for community development projects. However, even when these types of grants are plentiful, they cannot substitute for the private capital market. Accessing public and private investments will provide low- and moderate-income communities with access to the real estate capital, working capital, and risk capital needed to make these communities thrive.



Additional Resources

Related Finance Project Publications

Encouraging Investments: Using Federal Tax Credits for Community and Economic Development by Deborah Bocian and Cheryl D. Hayes, June 2003.

Encouraging Savings: Financing Individual Development Account Programs by Michele Miller and Deborah Gruenstein, October 2002.

Financing Facility Improvements for Out-of-School Time and Community School Programs by Margaret Flynn and Amy Kershaw, August 2000.

Health Insurance for Small Businesses: State and Local Financing Strategies by Elisabeth Wright and David Kass, May 2002.

Sustaining Comprehensive Community Initiatives: Key Elements for Success by The Finance Project, April 2002.

Thinking Broadly: Financing Strategies for Community, Child, and Family Initiatives by Cheri Hayes, March 2002.

Using the Community Reinvestment Act to Help Finance Initiatives for Children, Families and Communities by Deborah Gruenstein, April 2002.

Organizations

Association for Enterprise Opportunity, www.microenterpriseworks.org

The Brookings Institution, www.brookings.edu

Enterprise Foundation, www.enterprisefoundation.org

Fannie Mae Foundation, www.fanniemaefoundation.org

Knowledgeplex, www.knowledgeplex.org

LISC (Local Initiatives Support Corp.), www.liscnet.org

National Community Capital Association, www.communitycapital.org

National Community Reinvestment Coalition, www.ncrc.org

National Congress for Community Economic Development, www.nccd.org

National Reinvestment Coalition, www.nw.org

Small Business Administration, www.sba.gov

Wall Street Without Walls, www.wallstreetwithoutwalls.org

The Urban Institute, www.urban.org

U.S. Department of Housing and Urban Development, www.hud.gov

Additional Publications

Baxter, Christie I. "A Basic Guide to Program-Related Investments." *The Grantsmanship Center Magazine* (Fall 1997). Available at www.tgci.com/magazine/97fall/basic1.asp.

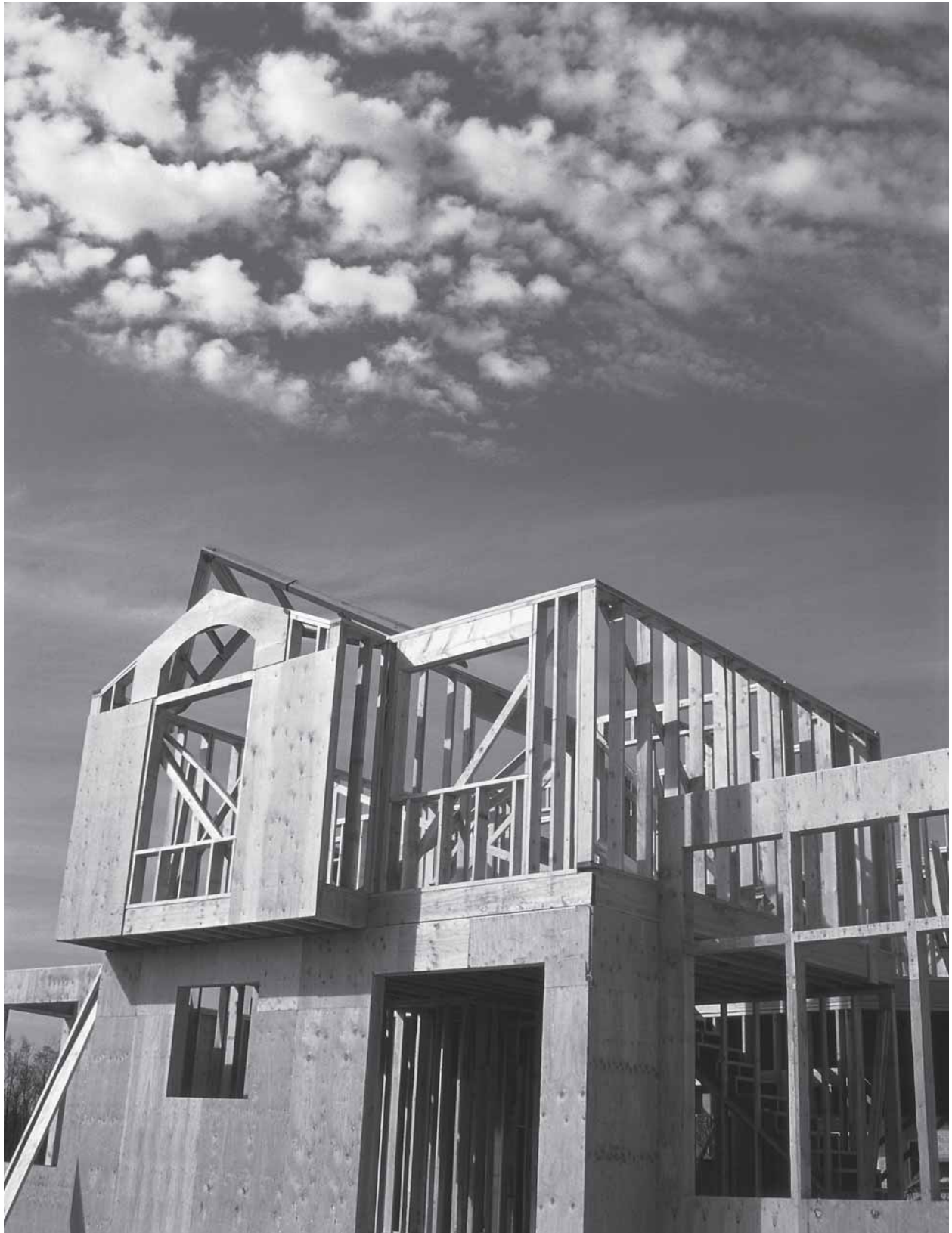
California Community Economic Development Association. *Dictionary of Community Economic Development Terms: A Resource Book for Practitioners and Funders*. 2nd. ed. Los Angeles and Oakland, Calif.: California Community Economic Development Association, 2002.

National Congress for Community Economic Development. *2003 Practitioner's Guide to Federal Resources for Community Economic Development*. Washington, D.C.: National Congress for Community Economic Development, March 2003.

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Acknowledgments

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About The Finance Project

To support decisionmaking that produces and sustains good results for children, families, and communities, The Finance Project develops and disseminates information, knowledge, tools, and technical assistance for improved policies, programs, and financing strategies.

Overview

The Finance Project, an independent nonprofit organization based in Washington, D.C., provides high-quality information, knowledge, policy tools, technical assistance and training to support decision making. As a result of self-initiated projects and work commissioned by public and private sector clients, The Finance Project has emerged as a respected and authoritative resource on social policies, programs, and systems reforms, especially their financing. The Finance Project's work is concentrated in several practice areas:

- **Education** — strengthens the capacity of schools, school districts and states to promote student learning by providing the field with tools, frameworks and information to determine the cost-effectiveness of investments in education and to support improvements in financing strategies to sustain effective education initiatives, including professional development for educators.
- **Family and Children's Services** — improves the capacity of federal, state and local organizations to strengthen families and communities and support children's healthy development by building and sustaining community supports and services that reach across categorical boundaries and across the public and private sectors to effectively link health care, education, income security, economic development and family supports.
- **Vulnerable Children and Youth** — strengthens the capacity of states and communities to promote positive outcomes for vulnerable children and youth, including those in child welfare, juvenile justice, and health and mental health care systems.
- **Family Economic Security** — strengthens the capacity of state and local governments and the private sector to make families more economically secure and communities more economically viable places to raise children, by improving workforce development, employer supports for working families, community economic development, asset building and cash assistance.

Established in 1994, The Finance Project is a valuable intellectual and technical resource to policymakers, program developers, and community leaders, including state and local officials, foundation executives, academic researchers, service providers, and advocates who:

- Seek creative ideas for policies, programs and system reforms, and effective policy tools to implement them;
- Need information about what is occurring elsewhere, how it is working, and why; and
- Want practical, hands-on assistance to advance their reform agendas.

Products and Services

The Finance Project’s products and services span a broad continuum from general foundation knowledge about issues and strategies to customized resources and intensive, hands-on technical assistance. They encompass efforts to cumulate knowledge and build the field over time as well as time-sensitive projects to address immediate challenges and opportunities, including:

- **Research and Analysis** — gathering and analyzing information and data to identify promising practices and evaluate policy and program options and to improve the financing, management, and implementation of programs and services.
- **Policy Tool Development** — developing tools and “how to” materials to support implementation and sustainability of promising practices and systems reforms, including financing strategies.
- **Technical Assistance** — providing and coordinating assistance to decisionmakers on the design and implementation of policies, programs, and system reforms.
- **Development of Web-Based Clearinghouses** — organizing and presenting research findings, technical assistance tools and other information on the Internet.
- **Management of Major, Multi-Site Initiatives** — helping funders manage collaborative efforts and large, multi-site initiatives by providing technical assistance to the sites, monitoring their progress, and serving as liaison between sites and funders.
- **Peer and Organizational Networks** — creating and managing networks of professionals and organizations to assist in the development and dissemination of information and resources to implement policy, program, and system reforms.

Staff

The Finance Project's capacity to take up wide-ranging research, development, and technical assistance challenges with great success is due to its highly qualified professional staff that has substantial experience in public policy research and development, state and local government, public- and private-sector finance, and social program management and design. A small group of core consultants with specialized knowledge and expertise extend the staff capacity. The Finance Project also participates in strategic partnerships with other national and regional organizations that provide complementary expertise and direct ties to key audiences.

Publications

The Finance Project develops and disseminates an array of published resources:

- **Working Papers** — occasional papers that examine issues related to financing, governance, and management in education, family and children's services, and community building.
- **Reports and Monographs** — studies of federal, state, and local financing, governance, and management issues and strategies.
- **Strategy Briefs** — “how to” briefs that outline innovative financing strategies and considerations for implementing them.
- **Issue Notes and Resources** — short notes on policy choices related to welfare reform, workforce development, and other issues that summarize relevant research findings and highlight promising practices.
- **Resource Guides** — guides to the design and implementation of financing strategies and available funding sources.
- **Toolkits and Workbooks** — step-by-step guides to help users design and implement policy, program, and systems reforms that are tailored to their needs and priorities.
- **Email Newsletters and Updates** — electronic publications highlighting recent developments, publications, and other resources.

Websites

The Finance Project maintains several major websites.

- **Financeproject.org** — a website that provides up-to-date information on The Finance Project and its work, including project descriptions, descriptions of available services and access to publications, tools, and other resources it has developed.
- **Financeprojectinfo.org** — a comprehensive web-based clearinghouse of policy information, research and evaluation findings, state and local initiatives, and technical assistance resources in a broad array of policy areas, including welfare reform, workforce development, out-of-school time, and sustainability and financing. Other clearinghouse topics in development are early care and education, youth development, family and children's services, and vulnerable children and youth.
- **Financingpd.org** — provides a wide array of information regarding professional development in education useful to practitioners, policy makers, and researchers, including information on: funding, cost frameworks, and spending analyses; federal, state, and local control over decision making; and evaluating the effectiveness of professional development for principals and superintendents.