Community Development

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FEDERAL RESERVE BANK OF SAN FRANCISCO

## 2010 National Interagency Community Reinvestment Conference

One-day Advanced Investments Conference

Co-sponsors:

Center for Community Development Investments
Community Development Financial Institutions Fund

March 18, 2010 | New Orleans, LA

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Federal Reserve Bank of San Francisco
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Federal Reserve Bank of San Francisco
2010 National Interagency Reinvestment Conference
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# One-day Advanced Investments Conference Agenda
## March 18, 2010 | New Orleans, LA

Co-Sponsors:
Center for Community Development Investments
Community Development Financial Institutions Fund

Continental Breakfast and Optional Community Development Investing Networking Breakfast for those Under 35 .......... 8:00 – 8:45 a.m.

Overview Panel: Current State of the Market and Recent Trends .......... 8:45 – 9:45 a.m.

- William Bynum, Enterprise Corporation of the Delta
- John Moon, Federal Reserve Board
- Mark Pinsky, Opportunity Finance Network
- Ellen Seidman, New America Foundation and Shorebank Corporation

Investing from Multiple Perspectives: Know Your Partner .......... 9:45 – 10:45 a.m.

- Calvin Holmes, Chicago Community Loan Fund
- Andrew Mooney, LISC Chicago
- Ellen Sahli, City of Chicago
- Debra Schwartz, MacArthur Foundation

Break .......... 10:45 – 11:00 a.m.

Online Tools for Community Development Investing .......... 11:00a.m. – Noon

- Prabal Chakrabarti, Federal Reserve Bank of Boston
- Ian Galloway, Federal Reserve Bank of San Francisco
- Lisa Hall, Calvert Foundation
- Kirk Inglis, Prosper Marketplace
- Giovanna Masci, Kiva

Lunch Keynote: Donna Gambrell, CDFI Fund .......... Noon – 1:15 p.m.

- Introduction by Mark Pinsky, Opportunity Finance Network

Understanding the "Impact Investing" Trend .......... 1:15 – 2:15 p.m.

- Jackie Khor, Imprint Capital
- Lisa Richter, GPS Capital Partners
- Georgette Wong, Correlation Consulting

Green Investing .......... 2:15 – 3:15 p.m.

- Frank Altman, Community Reinvestment Fund
- John Berdes, ShoreBank Enterprise Cascadia
- Robin Hacke, Living Cities
- Mike Italiano, Capital Markets Partnership

Break .......... 3:15 – 3:30 p.m.

New CRA Investment Opportunities in Retail Finance .......... 3:30 – 4:30 p.m.

- Michael Griffin, KeyBank
- James Gutierrez, Progreso Financiaro
- Dan Nissenbaum, Goldman Sachs USA
- Arjan Schutte, Center for Financial Services Innovation

Investor Idol: Connecting Investors with Investments in New Orleans .......... 4:30 – 5:30 p.m.

- Thomas FitzGibbon, MB Financial
- Gloria Lee, Next Street Capital
- Ed Powers, Bank of America Capital Access Funds
- Arjan Schutte, Center for Financial Services Innovation

Reception .......... 5:30 – 7:00 p.m.

*The Federal Reserve Bank of San Francisco would like to thank the Opportunity Finance Network for their help in organizing this one-day conference.*

# Contents

# Panel 1
# Current State of the Market and Recent Trends

William Bynum
Enterprise Corporation of the Delta

John Moon
Federal Reserve Board

Mark Pinsky
Opportunity Finance Network

Ellen Seidman
New America Foundation and ShoreBank Corporation

## Past Articles from Federal Reserve Bank of San Francisco Publications

# The Economic Crisis and Community Development Finance: An Industry Assessment[1]

## Executive Summary

Ellen Seidman
New America Foundation and ShoreBank

For thirty years, the community development finance industry—banks, credit unions, loan funds, community development corporations, venture funds, microfinance institutions—has quietly provided responsible, well-designed and well-priced credit to lower-income people and communities. These entities have provided this credit with the support of the federal government, through the Community Development Financial Institutions Fund, the Low Income Housing and New Markets Tax Credits, the Small Business Association, the U.S. Department of Agriculture, and various housing and facilities development programs. The industry has also been supported in its efforts by mainstream institutions such as banks and insurance companies, most frequently motivated by the Community Reinvestment Act (CRA) or by concern that CRA-like obligations would be imposed. Philanthropic foundations and supporters and state and local governments have also played their parts. The result: a community development finance industry that has survived and even prospered during recessions and political downdrafts. But the field, and the communities, businesses, and individuals it serves, are hurting now, and fearing bigger hurt. This paper by Mark Pinsky, Nancy Andrews and Paul Weech examines this situation and focuses attention on what needs to be done.

A major theme of the paper is that time is of the essence. Even before the current meltdown, the industry was stressed by years of federal cutbacks and a changing dynamic that made bank funding more difficult to obtain and more expensive. The paper recommends longer-term steps, such as establishing a fiduciary duty for all financial institutions to invest in "opportunity finance." However, the authors agree that capital, liquidity, well-priced debt, and financing partners are needed now. Delay may well mean the infrastructure of community finance, especially for housing and particularly in hard-hit and rural areas, will die before help arrives.

The paper makes three major recommendations, in a variety of contexts and forms.

Policy, particularly at the federal level, is critical on three dimensions: 1) making funds available (capital, liquidity, and project finance), 2) getting that money on the street fast, and 3) establishing and enforcing obligations on the part of all financial institutions to support community finance.

- The effectiveness and efficiency of the CDFI Fund in moving money from appropriation to the street is critical in both the grant programs and the New Markets Tax Credit. Innovative new programs, like the Capital Magnet Fund, should be implemented quickly to provide additional equity and liquidity to community developers and financiers. The Fund's current and future investment in CDFIs can be enhanced, as to both effectiveness and efficiency, with programs that support liquidity and facilitate the workout of troubled institutions and assets. This might be accomplished by, for example, creating a "bad bank" and with technical assistance. The Fund also has a role in establishing an effective regulatory infrastructure that increases the transparency of financial condition and performance of all members of the industry while remaining sensitive to the size and business operations of the institutions involved.
- Increased funding is needed for other federal programs that support projects in lower-income communities, such as those in SBA, the Department of Housing and Urban Development, and USDA. To some extent, these programs might also consider moving to the CDFI model of equity and investment in institutions that are long-term participants in the communities they serve and that can leverage government funds effectively with capital from other sources.

1 This three part article was originally published as a Federal Reserve Bank of San Francisco working paper of the same title, published June 2009, available http://www.frbsf.org/publications/community/wpapers/2009/wp2009-05.pdf.

- The housing programs, particularly the Low Income Housing Tax Credit, the Neighborhood Stabilization Program, and support from Fannie Mae and Freddie Mac, need special attention.
- The Community Reinvestment Act should be expanded, strengthened, and modernized. We now understand that the entire financial system operates in the context of federal support. Institutions that receive this support, whether directly or indirectly, must serve the entire nation; most will not do it directly, but can through support of community development finance intermediaries.

Individual institutions must strengthen their ability to survive and prosper by rigorous self-examination, risk management, and planning ahead. Institutions should focus on the critical elements of a financial intermediary: net worth, liquidity, and net operating income. They should plan for worst-case scenarios, understand where the stresses lie, and plan to meet and overcome them. Restructurings and extensions are to be expected, but institutions should rigorously examine these options and move to workouts and liquidations where recovery cannot be expected within a reasonable period of time. Now is the time for intelligent but hard-headed borrower support, not sentiment. Some institutions are likely to fail, and the industry may be stronger for this "creative destruction," but an orderly process of merger and transfer is needed to avoid leaving communities high and dry when institutions fail.

The industry must come together, strengthen its network, and learn from one another.

- The needed policy changes will only be realized through strong, united action. The industry needs a shared vision of its special role. This shared vision must cross both policy and financing silos. It must unite business, housing, schools, health care, and household asset-building by coordinating funds from government at all levels, the private sector, and philanthropy to strengthen communities the "market" once ignored and then destroyed. If all community finance entities can work together—banks and loan funds, credit unions and community development corporations, venture funds and microfinance—then, as Arlo Guthrie memorably observed, "friends, they may thinks it's a movement."
- Working together also increases the opportunity to share knowledge, understanding, best practices, skill and resources. For example, few community development institutions are large enough to hire workout specialists; working together, they can share and cross-train. Can healthy institutions help others and themselves by taking in and working out troubled assets, particularly where there is a geographic match or a match with the type of asset financed? And by working together, can the industry develop new and more efficient ways to access and deploy capital?
- Finally, by working together, the community finance industry can help rebuild the capacity of institutions not devoted to community finance to be constructive participants in community development. It can help to rebuild the human and financial capital and interest of the large banks, insurance companies, and other corporations who supported communities through the 1990s but whose interest waned during the past decade as pressures built up for short-term profits through financial engineering.

Community finance is at a crossroads. For the first time in almost a decade, financial institutions devoted to serving lower-income communities and those who live and work there have a champion in the White House. Congress, which supported the industry during the lean years, has upped the ante. But time is short. With borrowers and funders in pain, liquidity is tight and capital is scarce. Community development finance needs action now—from the government, from our partners, from ourselves—to do what we've done before: come through the hard times stronger as an industry and for those we serve.

# The New Normal: The Extraordinary Future of Opportunity Markets

## Part I – Overview

Mark Pinsky
Opportunity Finance Network

In Jewish folklore, the mythical village of Chelm is a town of fools, where each person is more foolish than the next. When Chelm's only butcher was convicted of murder and sentenced to die for his crime, the town elders decided to execute one of the town's two bakers instead because Chelm could not survive without a butcher.

Many people who work in community development feel like that baker. They are facing early death or at least a lifetime of operational confinement and reparations for crimes they did not commit. Many people and institutions are responsible for the current economic and financial crisis and none are community development practitioners.

"Since you are being sentenced to death for a crime you did not commit," the town elders asked the baker, "how would you prefer to die?"

The baker thought only briefly before he answered, "If I have a choice, of old age."

### The Context

(Mark Pinsky and Nancy Andrews co-wrote this section)

We are wading through the collapse of what economist Nouriel Roubini calls "the biggest asset and credit bubble in human history." The financial market implosion is global in reach, pervasive across economic sectors in scope, but deeply personal and painful for individuals, families, and communities.

In April 2009, the International Monetary Fund estimated that global losses would reach $4.1 trillion, with $2.7 trillion occurring in the United States, enough to threaten to exhaust the capital base of the entire U.S. financial system. Although the losses will be spread broadly, it is important to remember that every other estimate of damage so far has turned out to be low. Remember when the idea that the global damage might reach $1 trillion seemed almost ridiculous? That was less than one year ago.

The U.S. and global economies are in a state of turbulence that will not settle for years. Global asset values have plunged by one-half in a matter of months. The United States has lost more than 5.1 million jobs since the recession started. Global job losses could exceed 50 million, by some estimates. Unemployment in the United States may rise above 10 percent in the next year. In some locations, such as Los Angeles, unemployment nearly doubled in 12 months. Credit markets remain sluggish, at best, and frozen for most would-be consumers.

The U.S. financial system is barely withstanding the unprecedented stress. The collapse of the mortgage market has toppled the financial house of cards built on faulty assumptions, unrealistic economic theories, and unreliable private and government controls. Anchor institutions—including Bear Stearns, Lehman Brothers, Merrill Lynch, Washington Mutual, Wachovia, AIG, Citigroup, Morgan Stanley, Fannie Mae, Freddie Mac—have failed or likely would have failed but for the infusion of an estimated $14 trillion in U.S. government aid. The federal government now owns most of the housing finance system and holds material stakes in much of the banking system.

Many state and local governments are cutting essential safety net services, exposing children, poor families, and other already vulnerable populations to even greater risk and uncertainty. Institutional and individual philanthropists are stepping in, but at best they can only plug holes while their net assets and giving power decline. Public purpose institutions—

nonprofit service providers, educational institutions, Community Development Financial Institutions[2] (CDFIs), community development corporations, and other community-based organizations—are straining to meet steep increases in need and demand with declining supplies of money and resources. Their strategic management is being put to the test, and choices they made in the past are coming back either to haunt or help them.

Like the baker in Chelm, low-income and low-wealth people and places, and the institutions that serve them, are hoping to outlast the moment even as they struggle to understand it. Unemployment is well into double digits in many of these communities, and housing prices have fallen as much as 40 percent in some. Homelessness is rampant, foreclosures have riddled communities, and safety net services are stretched to the breaking point. Places like Elkhart, Indiana, and Fresno, California, where expansive shantytowns have grown under freeways and across abandoned land, present shocking new images of the human cost of economic and financial systems failures.

## The New Normal

"The new normal" reflects the seismic shift underway that will result in fundamentally and permanently different market practices, rules, and realities than those anyone working in financial services and community development has ever known. The systemic and structural changes of the past two years, and those likely over the next one to two years, create a financial marketplace that is distinctly different from the market of the past thirty years. This new normal also frames a new set of core questions. What will happen to opportunity markets—growth markets of the future that today are populated by people, businesses, and places outside the economic mainstream? How will they survive? Who will serve them?

This paper[3] focuses on the ramifications of "the new normal" for opportunity markets and the financial and community development institutions (CDIs)[4] and systems that serve them. In addition, it suggests for discussion key elements of a strategy to ensure both that effective CDIs emerge stronger from the current crisis than they entered it, and that federal policy and private financial markets work with them, not against them. This presumes that many, but not all, CDIs are effective; that many, but not all, will survive; and that alignment of federal policy, private markets, and CDIs will involve challenging—probably painful—compromises and fundamental changes for all parties.

## The Strategic Framework

The financial market collapse and economic recession is a systemic failure precipitated by structural and systemic financial system flaws and faulty basic economic assumptions. It requires structural and systemic responses and sounder assumptions. Until those responses are in place, however, it also requires urgent, mid-term, and long-term steps. All efforts today in the United States and around the world are focused on containing the problem and mitigating its human toll. They will soon, however, turn to structural and systemic fixes intended to restore economic vitality and foster prosperity—hopefully, this time, for all.

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2 CDFIs are private-sector financial institutions dedicated to community development in ways that create benefits for low-income and low-wealth people and places. They have a range of community development missions—that is, some concentrate on quality affordable housing, others on small businesses and jobs, and still others on community facilities, such as charter schools. Throughout this working paper, "CDFIs" include all entities that meet this definition and is not limited to those that are certified by the CDFI Fund in the U.S. Department of the Treasury. Financing entities that are affiliated with or part of larger organizations—such as bank CDCs—are not CDFIs because their parent organizations do not meet the community development standard.

3 This paper incorporates data from Opportunity Finance Network's quarterly "CDFI Market Conditions Report," the CDFI Data Project, and independent research and ideas by Nancy Andrews and Paul Weech on behalf of the Federal Reserve Bank of San Francisco. In addition, it draws on scores of conversations and e-mail exchanges I have had with CDFI executives, bankers, policy makers, and financial regulators in 2008 and 2009.

4 I am reluctant to introduce another acronym into the alphabet soup that pervades this discussion, but this paper uses "CDI" for community development institutions as shorthand for an inclusive description of a broad range of entities that comprise the infrastructure of community development finance. CDIs is broader than CDFIs and includes, but is not limited to, CDFIs, state housing finance agencies, bank community development lending teams or activities, as well as community development producers and asset managers such as CDCs, for-profit affordable housing developers, and others. Because I work in and represent the CDFI industry, my CDFI-oriented perspective is unavoidable. I hope that my inclusive intent is not compromised by that perspective and that others will find sufficient value in this analysis to apply it to their work. I also hope that the term CDI does not live on; it is so broad in most uses that it blurs important distinctions.

The current crisis is a product of a revolution in the financial marketplace that began quietly decades ago when asset quality was separated from pricing (a structural mistake guaranteed to crash any market eventually).[5] Market fundamentalists—who believe that any transaction that clears is de facto a good transaction—convinced investors that it was not important who the borrowers were and what the underlying assets were worth.[6] The "efficient market hypothesis," now discredited, rationalized this fantasy and fueled the spread of a string of systemic failures: bubble pricing, debauched ratings incentives, unsustainable compensation incentives, inflated assessments, lack of accountability in underwriting, and statutory and regulatory laxity, to name a few. The result is that now we are working to put Humpty Dumpty back together again in a brutally difficult environment.

In this environment, CDIs face significant challenges. Pressures are building on all sides—in portfolios, practices, on balance sheets, in operations, and among customers, funders, investors, staffs, and families. Disheartening first-quarter economic data—a 6.1 percent decline in growth—assures that the pressures will get worse before they get better. If it is true, as many people assume, that CDIs experience the economy roughly two quarters after the mainstream economy does, at least the field will have some advance warning what to expect and when to expect it.

At the same time, CDIs enter this fray with significant strengths and assets, and recognize the need to step up to the challenges. In the right set of circumstances, CDIs in general, and CDFIs in particular, can help manage systemic risks and challenges, bolstering core elements of opportunity markets, and rebuilding the infrastructure when the economy recovers. But they can survive and succeed only if their peer, philanthropic, financial institution, and government partners and allies also grow stronger.

CDFIs are uniquely positioned as bulwarks against the ongoing market trouble because of their capital structures, their relatively low leverage, their market expertise and financing credibility, and their generally respected roles as financial, policy, and civic intermediaries. When the current crisis begins to resolve, CDFIs and CDIs must be ready to play a leadership role in reestablishing and rebuilding an opportunity market infrastructure.

For CDI leaders, perhaps only one thing is certain: The stunning collapse of the modern financial marketplace and its aftermath will transform the way capital flows to, around, and from opportunity markets—the people who live and work just outside the margins of conventional U.S. markets and their communities. It will change forever the daily lives of those people as well as the social fabric and civic culture of those places. It will remake permanently the roles and responsibilities of private and public institutions that serve those markets.

## Stepping Up

For CDFIs and the markets they serve, this crisis can result in either significant decline in our ability to deliver capital or rapid growth in capitalization and production. It could lead to a permanently diminished role or it could make CDFIs pillars of a new financial market foundation that better serves the people and purposes that the field exists to serve. The result will depend, to a significant extent, on four factors, in probable order of urgency (but not necessarily importance):

> 1) How federal policymakers respond, when they respond, and how well federal agencies execute those responses. For example, the CDFI Fund will bolster many CDFIs' balance sheets if it keeps to its schedule of disbursing both 2009 and supplemental stimulus appropriations by October 31, 2009. If it bogs down, the number of CDFIs in serious trouble or failing will increase sharply. The Neighborhood Stabilization Program may help communities

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5 At a March conference on "The Future of Finance" convened by the Wall Street Journal and attended by what the Journal described as "roughly 100 of the brightest minds in finance today," the top policy recommendation was a return to sound underwriting fundamentals. Surprisingly, many participants seemed to be awakening to the fact that the quality of underlying assets was material to the risk in the assets they were creating, buying, and selling. That is, many people at the event seemed to have operated on the assumption that the quality of the underlying assets was not material.

6 Although it is sometimes hard to pin down a moment of inception, there is a good case to be made that this started in 1976 when Merrill Lynch introduced the first Money Market Account (MMA), which allowed savers to purchase full-service banking services without banks. Banks were still subject to strict caps on what they could pay depositors, but MMAs were not. Within years, MMAs set off aggressive competition for deposits (or investments). The higher rates drew consumer capital out of banks and into nonbank financial institutions, spurred the growth of mutual funds and other managers of long-term financing from individuals, and so paired investors with limited knowledge with sellers with ever more clever products. The competition for investments led to money chasing transactions, sparking decades of speculation that seems to have slowly, but inexorably spun out of control.

devastated by foreclosures, but its value will diminish steeply if it is implemented slowly or politicized. The Capital Magnet Fund and the National Affordable Housing Trust Fund, both approved in the Housing and Economic Recovery Act (HERA) of 2009 (PL 110-289), could backstop our nation's affordable housing production system, but Congress has not yet funded them.[7] (The Capital Magnet Fund, much like the CDFI Fund core financing programs, is particularly valuable because it strengthens balance sheets with equity.) In addition, working through the challenges of block grant distributions for the National Affordable Housing Trust Fund could leave a trail of institutional carcasses.

2) Whether CDIs and their partners—investors, funders, civic leaders, and others—join together in organized responses toward a common good or take discordant paths. For example, CDIs and the markets they serve could unwind quickly—within months—if one or a few key investors opt to exercise default provisions based on loan and investment covenants, particularly if the economy gets worse and drags asset values down further. The intertwined fortunes of many are vulnerable to the legitimate concerns of a few. This is a clear case, to borrow from Ben Franklin, where hanging together is preferable to hanging alone.

3) Whether CDIs made disciplined strategic decisions in the past and, assuming so, can maintain their strategic and management discipline during stressful periods. Good to Great author Jim Collins told the Opportunity Finance Network Conference in 2009 that CDFIs benefit from operating in stressed markets that require disciplined thought and action in good times, not just in bad times. This, he argued, gives CDFIs a decided advantage in turbulent conditions such as now.

4) Whether public policy responses to the current crisis target structural and systemic fixes rather than cyclical patches or one-time bandages. There is little hope for progress if comprehensive financial regulatory reform allows or encourages recidivism, and financial institutions return to the same practices and policies that created this mess. If comprehensive reform carries with it an all-inclusive financial industry obligation to support CDIs and opportunity markets, however, there is cause for hope.

The CDI industry has a measure of control over these four factors. Most likely, all four are necessary to ensure a strong opportunity finance role and response during the next decade. Other circumstances, such as the economy, are beyond the field's control.

For example, credit conditions are unlikely to get better for opportunity markets—with minimal exceptions—in the next 24 to 36 months. After that, they are likely to improve gradually and slowly. Many, if not most, conventional lenders and investors shy away from risk they do not understand, which today is almost all risk. This adds to the unknowns that the industry cannot control. In addition, the pervasive, and sometimes malicious, confusion of predatory lending with subprime credit has hurt opportunity markets further, reducing credit and capital supply. Informal credit and capital suppliers, particularly friends and families, are dwindling too, as net worth declined almost universally and often precipitously.

People and places that were low income or low wealth before the recession are less resilient financially and economically during the recession. They lack the ability to absorb the shocks as well as people with greater means. People of color likely will experience a disproportionate share of economic loss because they constituted a disproportionate share of financially and economically vulnerable individuals before the recession.

Philanthropy cannot stopgap all our problems. The crisis is too large, and the field, as a financing system, has outgrown in scale and scope the capacity of all but the largest institutional philanthropists. Although willing, funders have seen their giving power decline along with their net worth. With more demand and fewer resources, donors and philanthropic investors are "choosing" (that is, funding) winners (organizations and strategies they consider both vital and critical) and gently urging mergers.

During at least the next three to five years, however, these trends and issues will produce a new normal in which—if we make good decisions now—CDIs can play a critical role in ways we do not yet understand, intermediating between wholly redefined capital markets and reshaped opportunity markets. The questions for CDIs and their partners are: What is that role? How do we prepare for it? And what do we need to do now to move in the right direction?

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7 Both the Capital Magnet Fund and the National Affordable Housing Trust Fund received generous allocations in President Obama's fiscal 2010 budget. Those proposed budgets are subject, of course, to Congressional action.

## What We Can Do?

### *Policy*

CDIs have long played a small but important role at the fringe of federal policy. By and large, policy work has concentrated on marshaling government resources in support of their work and in support of opportunity markets.

In the current economic and policy environment, CDFIs are pursuing a focused policy agenda to weather the storm, a mid-term agenda for growth, and a broader agenda that aims at structural and systemic change. More broadly, non-CDFI CDIs do not have a well-developed platform yet, although some planks are in place, including the Neighborhood Stabilization Program, the National Affordable Housing Trust Fund, and funding in lieu of Low Income Housing Tax Credits. In related areas, the time may be ripe for asset-building policy expansion, including Children's Savings Accounts, Individual Development Accounts, and community wealth-building strategies.

CDFI federal policy objectives include:

### *In the near-term:*

- Bolstering CDFI balance sheets through CDFI Fund awards programs: This may be the single most important policy objective because it: (a) adds equity directly to CDFI balance sheets; (b) is ready for quick disbursement (in two rounds in 2009: June and September); and (c) is based on a performance-based decision model that will give shape to the CDFI industry going forward.[8]

- Supporting CDFI lending through a Capital Access Program (CAP): The 1994 statute creating the CDFI Fund included authorization for a CAP program for CDFIs. The program has never been used, but today it would support lending by adding a layer of security for investors and CDFIs.

- Restoring liquidity to CDFIs, in several ways:
  - In 2008, Congress gave all CDFIs access to membership in and, potentially, liquidity from the Federal Home Loan Bank (FHLB) system. More than forty nondepository CDFIs are pursuing this possibility. The Federal Housing Finance Agency is working on regulations.[9] Rapid implementation could address $1 billion or more of pent-up demand for FHLB financing.
  - The Troubled Asset Relief Program (TARP) is currently an option for community development banks but not for other CDFIs. Although some restrictions on TARP funding may be a problem for some CDFIs, more public issues such as executive compensation will not be problems. The CDFI Fund's Advisory Board has recommended that the U.S. Treasury use TARP funds to make long-term, low-cost loans to CDFIs. If this is not possible, the Treasury could make equity equivalent (EQ2) investments in loan funds and some equity funds and secondary capital investments in community development credit unions.
  - The Term Asset-Backed Securities Loan Facility (TALF) program might provide liquidity to CDFIs that lend to small businesses if it gains momentum for its original purposes.
  - Congress should enact pending legislation to provide a federal guarantee to certain CDFI bond issues. This bill would authorize up to $1 billion per year for five years in long-term debt at government-backed prices.
  - Emphasizing mission-based results under the New Markets Tax Credit program to ensure that taxpayer-supported financing is reaching the people and places that would benefit from it most.

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8 The President's 2010 budget includes a significant (90%) increase for core CDFI Fund financial and technical assistance programs. The budget includes $80 million more for the Capital Magnet Fund, which also would strengthen CDFI balance sheets, increasing resources that may be available for this purpose.

9 Currently scheduled for publication in the Federal Register in mid-May 2009.

- Reviving the CRA: The Community Reinvestment Act (CRA) has been moved to the sidelines as the financial markets crisis plays out, suggesting incorrectly that it is not key to economic recovery and growth. Bank regulators should ensure full compliance with the CRA as the economy recovers, and they might consider interim, emergency rules that fit the CRA to current market conditions, much as regulators tweaked and transformed policies for multiple purposes during the past year.

- Reinforcing key partners: CDFIs are eager to see at least five policy changes that help key partners succeed, including funding and rapid and efficient implementation of the National Affordable Housing Trust Fund; implementation of short-term remedies to the stupor affecting Low Income Housing Tax Credits; an enhanced mission screen on New Market Tax Credit allocations; and increased resources for Small Business Administration programs ranging from the micro-loan program to the 504 real estate program.

*In the mid-term:*

- Increasing CDFI Fund appropriations: CDFI Fund appropriations flowed through fiscal 2008 despite Bush Administration efforts to eliminate the Fund. This year, through direct appropriations and a supplemental economic recovery appropriation, the Fund will award nearly $150 million, the most ever in a single year.[10] In the current policy environment, with an administration that seems to see CDFIs as key parts of the economic solution and a Congress that has backed the CDFI industry with broad bipartisan support, there is a good chance that CDFI Fund appropriations will continue to rise, despite real constraints on fiscal policy. The CDFI Fund model, unique at the federal level, is a good fit for tough times, relying on demonstrated performance, private-sector leverage, and specialized market expertise to manage risk.
- Building on the CDFI Fund model: Unique today for its focus on general recourse investing in qualified, special-purpose financial intermediaries, the CDFI Fund experience over 13 years makes it a good model for other programs and agencies. Adapting U.S. Department of Agriculture, Small Business Administration, and other agency lending models to the CDFI Fund model (using equity grants and investments instead of debt) could give skilled lenders and investors more flexibility to ply their trade while reducing operating costs related to managing government-restricted financing.
- Revamping the Community Reinvestment Act: With widespread recognition that the time is now to modernize the CRA, the impending comprehensive reform of financial institution regulation is a once-in-a-generation opportunity to also extend the CRA to all financial institutions.[11] Despite pockets of resistance, there is broad general recognition that extending the CRA is all but inevitable now that federal resources have bailed out the full spectrum of financial institution types.

*In the long-term:*

- Make CDFIs and CDIs core to the financial system: CDFIs, CDIs, and opportunity markets are increasingly important to a healthy economy and a robust civic and social environment. No longer fringe players, CDFIs and CDIs are part of the broadcloth of economic and social life. To this end, investing in CDFIs, CDIs, and opportunity markets at appropriate rates and terms should be an affirmative fiduciary obligation of all financial institutions. More than thirty years ago, a similar requirement of pension funds helped the U.S. venture capital industry grow.

10 This figure represents funding in 2009 under core CDFI Fund programs. Total, combined appropriations of $207 million also fund Native CDFI programs, the Bank Enterprise Award Act, other programs and activities, and administration of the Fund.

11 See Federal Reserve Banks of Boston and San Francisco, Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act (San Francisco and Boston: Federal Reserve Banks of Boston and San Francisco, February 2009).

## Performance

Much of the CDFI industry is formed around a commitment to performance that is rooted in its early reliance on investments from Nuns' retirement funds and, later, other faith-based and socially motivated investors. That particular source of capital carried two weighty responsibilities: 1) Make an impact, and 2) Do not lose the Nuns' retirement funds. Performance today carries those same responsibilities—impact and responsible stewardship.

Maintaining discipline is up to practitioners, allowing for problems caused by economic and financial industry factors.[12] Not all institutions will remain disciplined and, in fact, many already are facing serious challenges due to lack of discipline in the past.

The CDFI industry—and I would posit the broader CDI world—needs a strategic intervention strategy to:

- Assess the relative strengths and weaknesses of institutions in distress. Few, if any, boards, CEOs, and senior management teams have experience with the kinds of challenges they are facing today.
- Bring in vital resources for institutions that are viable. Consultant services will come from experienced industry advisors and outside experts. The key is that the intervening entity must be able to make brutally honest decisions about whether the institution can succeed.
- Wind down institutions that are not viable. The CDFI industry has experience with successful wind-downs where investors remained whole and borrowers were served. This might involve acquisitions, mergers, or thoughtful resolution of institutional assets.
- Craft, manage, and deliver public messaging. One institutional failure can harm other, healthy institutions. A single investor fleeing the market could topple scores or more CDFIs or CDIs. Communication among investors, between investors and CDFIs/CDIs, among CDFIs and CDIs, and with the general public through the media is critical in crises.

This strategic intervention strategy would benefit CDFIs, CDIs, investors, funders, Congress and the CDFI Fund, and others.

Particularly in this difficult time, the field must talk openly and honestly about merit and performance in assessing intermediaries that serve low-income and low-wealth people and places. Not all intermediaries are equally effective or valuable.

In 2005, the Bush administration proposed to consolidate all of the federal government's community development and antipoverty efforts into block grants in the "Strengthening America's Communities Initiative." Because it proposed to cut overall funding by more than one-third, severely restrict the use of funds, and end the role of most federal agencies in this work, it was known behind the scenes at the White House as the "Strangling America's Communities Initiative." The stated premise of the initiative was that because some community development programs worked better than others, some were very successful, and some did not work at all, it was time for a national conversation on the future of community development. Because it was such a bad idea, it was relatively easy to defeat. But because it was such a bad idea, it was also a wasted opportunity. We should have an honest, if difficult, conversation about what works and why.

## Collaboration

The most vulnerable aspect of the current situation is also, possibly, its strongest attribute—the trust among a complex set of partners. The greatest systemic risk for CDIs is the potential to lose the confidence and commitment of key partners, on all sides.

Binding the field together, on the other hand, are a shared set of commitments to mission; interwoven economic interests and concerns; and institutional, professional, and personal reputations. Responding to the current crisis can unite the field or pull it apart. The field must ensure that collaboration tightens the ties that bind.

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12 In Part 2 of this paper, Nancy Andrews details operational challenges that CDFIs are facing and some of their responses. My comments are broad and are meant as a complement to hers.

This begins from the recognition that we need each other—that CDCs and housing developers need CDFIs to pull together transactions; CDFIs need banks to participate in transactions and support CDFI financing; banks need philanthropic institutions to inject subsidy that makes the transactions work; philanthropies need government to shape policies and provide resources that leverage grants and program related investments; government needs a viable and effective delivery system to implement policy choices; and round and round.

At the core of the collaboration is a commitment to preserving assets for everyone, from end beneficiaries to developers to financiers. The field needs a balanced and sustainable set of incentives to keep everyone engaged and encouraged. Asset managers, at multiple levels, must act with discipline as well as with an eye on the bigger community development ecosystem.

In practical terms, this collaboration has at least three applications:

1) The field must strengthen and create forums for open and honest communications. The Federal Reserve's upcoming policy discussion based on this report is a foundation for this sort of forum. My organization is advocating for a CDFI Investors' Roundtable so that investors avoid surprising one another and CDFIs. In cases involving distressed CDIs, much like distressed mortgage borrowers, the first, and worst instinct is to avoid contact with sources of financing. CDFIs and other CDIs need to engage in tough conversations about what is working, which institutions are healthy and viable, and what policy solutions are best for the people and places the field serves—rather than what is best for a particular group. Policymakers need to know what is working and what is not. As practitioners, we do not want to surprise our policy champions with unexpected bad news. In addition, the field needs an active media and public communication strategy that is coordinated, to the best of our abilities.

2) The field must find common purpose in managing stressed and distressed assets and institutions. A series of asset or institutional failures can send waves of concern across the industry, but it is equally true that taking extraordinary measures to save assets or institutions that need to be—it sounds harsh—written off is equally damaging to our long-term viability. The current crisis will, and should, reshape the composition, structure, and practices of community development. This is one of the key transformational changes that can, over time, make money and resources flow better in opportunity markets.

3) The field should create a fund or a set of funds to manage the resolution of troubled assets held by otherwise healthy organizations, healthy assets held by troubled organizations, and troubled assets held by troubled organizations. These Resolution Funds would exist to create soft landings for investors, funders, borrowers, and others (assuming a CDFI Resolution Fund for Financial Assets would be separate from a CDC or Developer Resolution Fund for Fixed Assets). The Resolution Funds would assume or purchase assets, warehouse them, and find buyers or takers, as appropriate and as quickly as possible. The Funds would provide interim servicing capacity and would function in close coordination with the strategic intervention services described above. They would require substantial first-loss risk capital, access to revolving credit, and independent management and governance.

## Reasons to Smile and Reasons to Fret

CDIs are accustomed to turbulence, the risk that comes with economic instability, and illiquidity. It is what our customers, clients, borrowers, and beneficiaries live with day in and day out. This grounds us in risk management practices that tend to defy conventional thinking. So far, in good economies and bad (but never in crisis economies), the field has managed successfully.

In this economy and financial marketplace—with current liquidity, capital, and operating challenges—almost everyone is a neophyte. The field is short on capital and powerful relationships to fall back on, dependent on partners and institutions that are less able to help than they once were, and vulnerable to steady erosion of financial, intellectual, and human assets.

The economy may continue to deteriorate, and the worst for CDIs and opportunity markets may come six to nine months after the economy bottoms out. The financial marketplace could leave the field behind as regulatory reform and financial self-interests make community development a burden and opportunity markets a luxury that banks can no longer afford to mine. Policymakers could overlook the field in pursuit of bigger infrastructure solutions to economic malaise, in compassion for individuals who benefit more immediately from direct resources and services, and in the tough triage of decreasing federal resources.

Yet we are more important than ever to economic growth, to the people and places the field serves, and to the ability of the financial marketplace to function well and to grow. It is unclear who other than us can reverse Gresham's Law and drive "bad money" out of the marketplace and ensure that "good money," rooted in prudent and responsible underwriting, takes its place.[13] CDIs seem to me to be key to President Barack Obama's statement, in his inaugural address, that: "The success of our economy has always depended not just on the size of our gross domestic product but on the reach of our prosperity; on our ability to extend opportunity to every willing heart—not out of charity, but because it is the surest route to our common good."

### Issues to Consider for the Upcoming Meeting at the Federal Reserve

One purpose of the conference is to frame and support informal and formal communications and work planning as we try to manage through the crisis and its backwash. With so much happening so fast and with such significant consequences, the challenge is to narrow the set of topics sufficiently to make them manageable but to define each topic in ways that allow dynamic conversations. With those goals in mind, a few ideas seem prominent:

- Policy priorities and strategies: transitional (short-term) and transformational
- Strategic intervention planning: products and services
- Outreach and communications: managing public understanding
- Market data and market conditions: What do we know? How do we know it?
- Capital strategies: meeting needs now and for years to come
- Supporting best practices: from crisis management to viable futures

No doubt the upcoming discussion will influence, enhance, and expand this list.

Overarching these topics is the question, What will the community development finance system look like on the other side of this crisis? And in ten years?

## Conclusion

The future of opportunity markets and CDIs will be extraordinary—that is, they will be different in most ways from what we have known until now. Either they will be extraordinarily bad, involving organizational failures, long-term funding and financing shortfalls for surviving CDIs, and the loss of both jobs and leaders. Or they will be extraordinarily good, involving broad recognition that CDIs play critical roles in economic growth and financial system efficacy, in fostering robust partnerships among CDIs, the private sector, and government; and in rapid increases in CDI production.

The scenario that seems least likely is that CDIs will muddle through the current quagmire and simply continue along the path that has brought them here. That outcome is only possible if policies surrounding financial services and the economy do not change in material ways.

We do not know what will happen in policy or in the financial marketplace. Like the baker in Chelm as he faced the town elders, we know for certain only that life will never be the same as it was not very long ago. Things we thought would never change, things we thought we could always trust, will never feel certain again.

13 Gresham's Law, articulated by Sir Thomas Gresham, states that "bad money" will always drive "good money" out of the marketplace—where "bad money" describes a material difference between the real or stated value of an asset and its trading or commodity value.

# Strength in Adversity: Community Capital Faces Up to the Economic Crisis

## Part II – Operations

Nancy Andrews
Low Income Investment Fund

### First Responders—America's Community Development Organizations

This paper reviews the impact of the economic crisis on the community development industry. Specifically, it asks: How are Community Development Financial Institutions (CDFIs) faring? What trends are emerging? What steps are CDFIs taking to respond to the crisis? In addition, the paper offers "best practices" to help all CDFIs manage this difficult climate.[14]

CDFIs can survive this economic crisis and deepen their mission, despite the extraordinary difficulty of the current period. CDFIs are the first responders in neighborhoods across the country and for families hardest hit by the downturn. CDFIs have created an industry joined together by a common mission of providing opportunities for people and places left out of the economic mainstream. The CDFI network can create the strength for CDFIs to help one another through these times, and to ensure not only that the field survives, but that it thrives.

From a series of eleven interviews with leading CDFIs across the country, we find that the economic crisis has created the following conditions for CDFIs:

- Heightened risk in portfolios: The risk is evident in delinquency rates, extensions of loans, or loss reserves set asides.
- The need for significant patience among community development partners: More time is needed for projects to come together, and lender patience is now crucial for success in struggling neighborhoods.
- Heightened liquidity problems: CDFI liquidity is strained. Many leaders are worried about the availability of new capital, as well as capital renewals from their investors, both private financial institutions and philanthropic partners.
- Severely strained housing portfolios: For-sale housing or early stage loans with Low Income Housing Tax Credits (LIHTC) as part of the project financing plan are particularly hard-hit.
- Increasingly fragile borrowers: The future strength of CDFIs is bound to the future of its customers, and the trends are negative.

### Description of Interviews

Among the eleven interviews, six were with national or large regional CDFIs; two were rural CDFIs; and three were small and locally targeted CDFIs. Two were in the Midwest, three were headquartered on the West Coast, and six were headquartered on the East Coast, in locations stretching from the northern to the southern tip of the Atlantic seaboard.

In all cases, the individuals interviewed were CEOs or senior members of the executive team. In most cases, the relationship with the leader and author was at least a decade long, which generated immediate rapport and a willingness to be candid. The anonymity of the respondent was assured, which added to the candid nature of responses. In all cases, we asked leaders for their judgment and a sense of trends in order of magnitude, rather than data precision. Given the history

14 While this section of the paper is focused on CDFIs, it is our hope the discussion here would be valuable to the wide range of community development finance institutions; what Mark Pinsky refers to as CDI in the preceding section.

and success of these CDFI leaders, their insights are invaluable about the future of the industry and steps needed to protect the community development field during this crisis, perhaps more valuable than detailed data analysis. Indeed, in this fast-paced crisis, even three-month-old data are quickly obsolete, making data analysis less reliable by the time it is published.

## Background

Community developers—the neighborhood builders, investors, and service providers—are on the frontlines of this crisis. They witness daily the impact of the crisis on communities, families, children, and senior citizens. They are the first to get the calls from families in trouble, or from nonprofit service organizations facing state or city funding cuts, or from neighborhood developers scrambling to keep projects alive. For more than three decades, community developers have been quiet but vibrant agents in America's most distressed locations, mitigating the worst effects of an economy that delivered uneven benefits.

The community development finance sector, including CDFIs, community development banks, venture funds, micro funds, and community loan funds (henceforth "the sector"), are the capital side of this network of community support. The sector represents a unique part of the remarkable 30-year experiment America has undertaken in community revitalization and poverty alleviation. Coupling private-sector business discipline with social mission, community development finance organizations draw private capital into places and projects it could not otherwise reach. The sector capitalizes public subsidies, allowing low-cost housing, health care centers, and child care centers to be built, jobs to be created, and commercial enterprises to expand. The CDFI sector finances projects that are financially viable but that fall below the profit requirements of mainstream capital.

Three decades ago, CDFIs emerged from the grass-roots activism of neighborhood organizations. Initially an informal, homegrown response, CDFIs increasingly are large-scale and professionalized. The community development finance sector represents more than $29 billion in capital today, and most of the organizations possess strong internal financial management systems, coupled with investor covenants intended to keep the sector safe and sound. Community capital organizations maintain loss reserve cushions, liquidity cushions, equity cushions, and risk rating systems. With the advent of CDFI Assessment and Rating System (CARS), the community capital industry has created a rating process intended to reward success and spread best practices. These are all signs of a vital industry that is self-reflective, self-correcting, and self-aware.

Nothing in the industry's history—neither investor covenants nor internal models nor scenario planning—could have prepared CDFIs for the stress they now face, either in the communities they serve or within their internal operations. To make matters worse, their primary capital partner—regulated financial institutions—face unprecedented challenges and are pulling back on the throttle of their capital. The financial system can turn to the Troubled Asset Relief Program (TARP) for liquidity aid. Robert Kahn of the World Bank estimates that governments in the industrial world have invested $9 trillion in guarantees, credit extensions, and debt purchases in efforts to put a floor under the market.[15] However, the closest thing to a liquidity infusion that most CDFIs have is the small, but welcome, $100 million emergency appropriation in the national stimulus plan.

Community organizations have faced hard times before. In the early 1970s, the Nixon administration attempted to roll back the signature efforts of the Kennedy-era War on Poverty. It disbanded the Office of Economic Opportunity (OEO) and marginalized its programs. Community activists reeled from this devastation and, in many cases, believed the end of the nation's war on poverty was near.

However, after the first shock wave subsided, community advocacy gave rise to Community Development Corporations (CDCs), and CDCs learned how to generate fees from their activities. They created new partners with philanthropy for support. They attracted religious orders and foundations to the idea of using their capital affirmatively to create community loan funds for the special needs of neighborhoods and people overlooked by banks. In short, out of adversity, community

15 Robert Kahn, Senior Advisor, Financial Systems Unit, Financial and Private Sector Development Vice Presidency of the World Bank, speaking at "The Financial Crisis: Global Dimensions" lecture, sponsored by American University Economics Department, Robert A. Blecker, Chair.

activists hard-scrabbled their way to survival. What sprang from that early devastation is, today, the most robust system of community-based development, services, and finance in the world.

This movement created the Community Reinvestment Act and the Low Income Housing Tax Credit that together delivered billions of dollars to low-income communities. In more recent years, the field created the CDFI Fund, the New Markets Tax Credit program, and the Capital Magnet Fund. In short, the challenges in the 1970s that threatened America's community programs made the sector stronger in the end, and it has subsequently delivered billions of dollars of capital investments to communities.

This history speaks to the spirit of communities and people motivated by a vision of self-improvement. It speaks to the creativity and drive of the professionals working in the community development field, professionals motivated by a social vision, not by profit maximization. Economic reversals spur creativity. Most important, the field is today a strong network that is mutually supporting. The sector's biggest asset is its common mission and collaborative spirit. No private-sector entity possesses this asset, nor does it have colleague organizations to lean on for support. In a very real way, the field's common mission is its greatest asset, and that mission is furthered by continued survival and success. We are not only in this together, but we are in it for each other.

## Avoiding Denial—What Is the Impact on Community Finance?

Community finance organizations feel the impact of the economic downturn at multiple levels. First, the people served are disproportionately affected by hard times; they suffer more and recover more slowly than the mainstream population. Second, a large proportion of the projects CDFIs finance depend on federal, state, or local subsidies, all of which are severely strained. Third, CDFIs finance a mission-driven delivery system, often not-for-profit in both name and reality. Their borrowers operate with thin equity cushions and few shock absorbers to cushion bad times. One East Coast leader described the impact of the economic crisis on the borrower community as "teetering, undercapitalized." Another noted that while at first, weaker entities were experiencing problems, now "even well-run borrowers are having real problems." As a result, the community development sector can expect some serious challenges ahead. One leader estimated that if the current crisis continues for a year or more, the entire delivery system will begin to fail.

As noted above, CDFI leaders see five key trends:

- Heightened risk
- Significantly more patience required by borrowers
- Serious liquidity problems
- Hard-hit housing loans
- Increasingly fragile borrowers

## Heightened Risk

In general, all CDFIs reported heightened risk in their portfolios and particularly in housing loans. It did not matter if the CDFI was national, regional, local, large, small, rural or urban—all saw heightened risk. The severity of risk varied considerably by portfolio concentration and by size. Those with high concentrations of housing, particularly homeownership projects, reported far greater risk. Eight of the ten CDFIs with sizable housing portfolios saw homeownership projects as a primary source of increased risk. In particular, respondents reported that unsubsidized homeownership loans were experiencing the greatest weakness.

Heightened risk was evident in increased delinquency rates, or an increase in loan extensions, or increases in loan loss reserves, and occasionally in all three. Two respondents reported no loss reserve increases. The others reported some increase in reserves, generally by 25 percent to 50 percent. One CDFI with a large exposure to homeownership reported a tenfold increase in its annual provision for loan loss reserves.

The second most frequent cause of growing risk was dependency on fundraising or public subsidy (reported by five of eleven CDFIs). One CDFI reported a full stop on new loans that depended on fundraising.

Smaller CDFIs reported less portfolio deterioration than larger CDFIs. Respondents saw short-term acquisition and predevelopment loans as more risky than long-term loans for projects already in service and seasoned, especially community facilities. Portfolios with greater concentrations in Low Income Housing Tax Credit (LIHTC) projects experienced greater risk. One CDFI avoided portfolio deterioration because of the absence of LIHTC-dependent projects in its portfolio. Projects in weaker markets, such as those in rural or exurban areas, were affected more than in strong markets.

Geographically, western CDFIs saw more trouble than others. Several national and regional CDFIs reported a concentration of problems in California. They reported enduring slow payment on loans and deep financial stresses on community developers. The strains in California CDFI portfolios extended beyond housing and homeownership to health care facilities, charter schools, and other community facilities. One CEO feared that the affordable housing delivery system would be permanently weakened because many community developers would not survive the current economy. Others saw the problems in California beginning to bleed over into Arizona, Washington State, and other western locations. One national CDFI reported the weakness in its portfolio was concentrated in Los Angeles, Florida, and in rural locations.

Although community facility portfolios seem to be holding steady at present, many leaders said they were waiting for "the other shoe to drop," and foresaw trouble in this sector in the near future, as well as in their commercial portfolios. One respondent predicted the commercial and facility loans "will be the second wave."

## Need for Patience

Most CDFIs (nine of eleven respondents) called for greater patience as borrowers scrambled to put resources together to make deals work. "Everything is taking longer," one respondent said. "Borrowers are going multiple rounds to get financing and subsidy, at the state and city level." Some leaders reported that their delinquencies were stable because they simply extended loans, believing that the borrower would eventually work out the problems. One CDFI reported extending 80 percent of its housing loans (up from 50 percent in more normal times). Another reported that they had always experienced many extensions, but "now it is for bad reasons." In part because of this growing need for patience as projects came together, all but a few CDFIs were anxious about investor renewals and serious liquidity issues that affected their ability to finance new requests.

## Serious Liquidity Problems

Liquidity shortages were felt broadly, but large CDFIs were particularly affected. Six of eight large or rural CDFIs reported current and often severe liquidity problems, or concern about future liquidity problems. Smaller CDFIs fared better as well as those located in the Midwest. All but one CDFI expressed concern about a contracting capital environment, even if they were managing well at present. Respondents also noted the need for extensions, the lack of new capital coming into the field, and concern about capital renewals. Indeed, one CDFI leader said, "If banks don't start lending again at reasonable rates, a lot of us will go out of business." Another said that their capital partners were "really hunkered down. They've begun to understand that this is a structural adjustment and they need to figure out the new normal."

More of the CDFIs that experienced strong growth in deployment during the past two to three years were more likely tapped out of capital than those with growth in the past year. On the other hand, CDFIs that had not expanded their lending volumes appeared to be faring better than others with respect to liquidity. In the case of faster-growing CDFIs, recent high-volume levels had consumed much of their available capital and the need to extend loans was causing a capital crunch. Nearly all CDFIs reported difficulty in getting new capital and sometimes renewed capital. Most reported "just making it," by saying no to borrower requests. Some indicated that the liquidity problems were being offset by reduced demand. Others reported that demand had increased in recent months, largely from the contraction of lending by banks.

CDFIs reported mixed experiences with investor renewal of capital. In general, they were "holding steady" with capital levels, but new capital was virtually impossible to find. One CDFI reported negotiating with a bank for more than two years and being on the cusp of a capital commitment, only to find the bank taken over by another, and the verbal commitment nullified.

## Housing Loans Are Hardest Hit

As noted above, most CDFI leaders reported that increased risk came mainly from the housing portion of their portfolios, particularly from for-sale housing. "Homeownership," said one respondent, "is clearly most severely impacted. It is head and shoulders above the others in weakness. If ten deals are in trouble, seven will be in for sale/homeownership. However, our community facilities are fine."

Community facilities (charter schools, child care centers, health care centers, water and sewer systems, and other community centers) seemed to be performing well, particularly if the financing was long-term and for a facility already in service. That said, a few saw future trouble in their community facilities portfolios, assuming hard times spill over into the next year. CDFIs with loans in California reported more concern about community facilities projects than others.

Three CDFIs continued to experience strong customer demand, particularly when the CDFI was involved in financing community facilities or commercial lending. As one respondent said, "There is a ton of demand right now. Our phones are ringing off the hooks." Her organization, she said, was "moving upstream" and taking on deals previously done by banks. She worried, however, that they might become complacent and accustomed to having higher-capacity customers. "My lending team is really happy not to have to hold as many hands," she said. "They are dancing in the aisles when they get a complete loan application."

Most leaders, however, and particularly those concentrated in housing, had seen demand slow dramatically during the past few months largely because of the uncertainty of public support, the collapse of the LIHTC market, and state or local budget issues that made new projects too dicey to undertake. The reasons given for slower volume included:

- Housing developers remaining on the sidelines, waiting for property values to bottom out;
- Housing developers are financially weaker, because they are paying the carrying costs of unfinished projects over longer periods of time as total project financing is assembled;
- Lack of capital supply is forcing demand to contract;
- Lack of public subsidy to fund new projects;
- Homeowners remaining on the sidelines because of uncertainty over their employment future, despite the low cost of housing.

## How Are CDFIs Responding?

In general, CDFIs are responding to the need for patience by extending loans (nine of eleven respondents) where an extension did not cover up a credit problem. All CDFIs but one reported notable increases in extended loans. The result is a liquidity crunch that often forces CDFIs to dial down positive responses to new requests.

CDFIs are managing heightened risk through a combination of extra vigilance toward late payments, bulking up loss reserves (nine of eleven respondents) and, in a few cases, performing stress tests on portfolios and corporate budgets. Many CDFIs are scrutinizing deals more closely, along with asset valuations, and occasionally, reappraisals of portfolio collateral. Most reported higher scrutiny of transactions at the front end, in light of the risk environment.

The most common risk management strategy is paying greater attention to late payments. CDFIs are making calls to customers within a few days of the due date, and are escalating if payments are not received. The second and third most widely used approach to mitigating risk is paying extra attention to borrowers' financial condition and scrubbing of asset valuation. CDFIs are also performing stress tests on borrower projections, looking at levels of borrower liquidity to determine size of loans, as well as imposing tighter terms and conditions.

One CDFI said they believed with enough time and with adequate patience, the problem loans would work themselves out with minor losses. Nearly all others saw growing risk in the future.
At the corporate level, several CDFI leaders mentioned they were stress-testing their budgets in every way they could think of, and continuing to "look around the corner for things I haven't thought of that could kill us."

## Yes We Can! (Manage Through This)

The community development financial sector's biggest asset is its commitment to a shared vision and an industry structure that does not require competition for vitality. The economic crisis calls on this asset more than ever. The field will need the strength and insights of everyone to pull through this extraordinary time. Several leaders noted that if the crisis goes on for more than a year, it would create serious hardship for the industry. One CDFI leader said:

> Philanthropy needs to hear that 2010 is a watershed year for CDFIs and other nonprofits dependent on multi-year grants. 2011 is not survivable without continuing support. We may watch the silent demise of nonprofits.

Many CDFI leaders called for new ways of communicating and sharing, for creating united fronts endorsing common positions on critical issues, especially capital requirements. To get through this crisis, the field will need to pull together more closely than in the past. The watchwords for the next several years will be: learn, share, and help.

## Steps to Weather the Storm

Navigating the worst economy in a century will require that members focus on ensuring that the field is as secure as possible and able to continue to attain its goals and sustain its mission. This requires a number of proactive steps:

1) Batten down the hatches by:
    a. Going to ground; forecast cash flows for the worst-case scenario,
    b. Circling up risk through portfolio stratification,
    c. Instituting stress tests for portfolios and organizations,
    d. Instituting a credit review discipline
2) Learn new skills: workouts and foreclosures.
3) Remember: our borrowers, ourselves. The core of the field's mission is borrowers' well-being. Become active in policy matters that benefit borrowers and the field.
4) Never waste a crisis; Refresh attention on the basics of financial management: net worth, liquidity, and net operating margin.
5) Attend to other best practices, such as full-cost accounting, scenario planning, and multiyear forecasting.
6) Practice the network solution: share your way through this.

### *Batten Down the Hatches*

During any crisis, it is important to identify one's soft underbelly and protect it, rather than waiting for problems to arise. Although some CDFIs are reporting no dramatic increases in delinquency rates, they are anticipating problems and are rescoring their portfolios, increasing their risk reserves, and scrutinizing new requests. These are perfect initial steps.

Now is the time, as well, to begin stress-testing at the organizational level. How much of a revenue decrease can the organization withstand? What would happen if grant support declined by half? What happens if ten percent of the organization's portfolio is nonperforming?

We offer four important steps to batten down the hatches in preparation for a bad storm. For smaller organizations, many of these are back-of-the-envelope calculations. Larger organizations may need to develop simple spreadsheet models. The emphasis is on simple. It is not necessary to develop comprehensive or precise information in undertaking these exercises. In this case, the perfect is very much the enemy of the good. Rather, the goal is to identify in broad strokes the magnitude of potential problems and to develop responses for the back pocket if bad news is forthcoming. In the end, the actual steps an organization takes may be quite different. But there is nothing quite as reassuring to a leader as thinking through how bad it might get, identifying the soft spots, and developing contingency plans.

Step 1: Cash, and forecast the worst-case scenario. In October 2008, the finance committee of Low Income Investment Fund (LIIF) startled both the CEO and CFO by requiring them to come to the October board meeting with a draconian scenario:

> Assuming no customers repaid and no investors renewed their capital commitments, how long would we survive?

Both the CEO and CFO believed their approach to scenario planning was aptly conservative. In their hearts, they felt the finance committee was being overly dramatic. Dutifully, however, they completed the scenario.

*The process was transformative.* They realized, first, they had enough cash to weather a "ground zero" scenario for more than a year. On the other hand, they also realized that three large capital renewals must occur for the organization to sustain a healthy level of investment in its communities. With that, the executive team realized how dependent they were on these events and how tentative their work could become if any one event failed to materialize.

*They began monitoring with great care.* At their weekly executive team meetings, they looked at a multiyear forecast and began managing the lending pipeline far more deliberately. In LIIF's case, one of the three critical renewals has occurred. The remaining two are promised. Thanks to the willingness of the board to push management to "go to ground," LIIF is confident that its capital management disciplines can handle a deteriorating environment.

*Not every CDFI needs to create a special forecast.* For many, the assumptions are so obvious that key events are perfectly well understood. What changed within LIIF was that management foresaw the likely case and began managing more actively to deflect the worst case.

Step 2: Portfolio stratification. Portfolio stratification—examining the layers of risk within a loan portfolio—is useful in highlighting where future risk might reside. It is less useful in highlighting risk already understood. In portfolio stratification, managers create a table that stratifies outstanding capital on the basis of loan-to-value (LTV) ratios to better isolate the proportion of the portfolio with high LTVs. Such an exercise might show, for example, that 15 percent of the portfolio possesses LTVs greater than normal thresholds (say 90 percent), and ten percent carries high-risk LTVs of, say, greater than 100 percent. This makes visible the percentage of capital that could carry higher risk, even if it is currently performing well. By "circling up" the risk, a CDFI can dig into these specific transactions and get ahead of the curve by anticipating future problems.

In addition to LTV stratification, portfolios can be stratified using Debt Service Coverage ratios, second lien positions, unsecured debt or any combination of these factors.

Step 3: Stress-test the portfolio and get ahead of looming problems. CDFI directors intuitively understand that the greatest weakness in their portfolios lies in homeownership, LIHTC deals, and fundraising-dependent projects. Knowing this, it is possible to conduct stress tests of individual loans in a given soft area.

A stress test means varying the key assumptions of the loan repayment to determine how bad things can get before the repayment is threatened. For example, with LIHTC projects, the stress test would involve assuming a lower LIHTC price, say 75 cents on the dollar, rather than the original underwriting assumption of 85 cents on the dollar. What would the borrower do in this circumstance? For homeownership projects, the likely stress point is the break-even sales prices of the homes against current market trends. For small portfolios with only a handful of loans in the most susceptible categories, the stress tests can be done by simply varying critical assumptions. For larger portfolios, it may be necessary to hire consultants. Stress-testing can identify problems before they happen and provoke conversations between lender and borrower that avert the worst outcomes in a deteriorating environment.

Step 4: Credit reviews – hire a "junkyard dog." Once every few years, it may be useful to engage an external expert to conduct a credit review. This generally involves evaluating the underwriting standards, as well as the checks and balances within a lending operation. The review identifies strengths and weaknesses of the system and how accurately current processes have been followed. In general, the outside perspective of a credit review can yield valuable insights, even if the evaluator is unfamiliar with the CDFI environment.

Frequently, a friendly bank or other CDFI capital investor is willing to deploy a credit officer to conduct pro bono portfolio reviews. If not, the expense of hiring a consultant can be controlled depending on how deep the CDFI wants the review to go. However accomplished, the key to a meaningful credit review is using external expertise and external eyes to provide insight.

### *Workouts and Foreclosures*

For many CDFIs, loan workouts are a rare event. Although projects often hit bumps in the road, the ability to be patient and responsive to borrower requests has often been the main ingredient for a successful workout. However, conditions have changed markedly in the past twelve months. More and more hard workouts are rearing their heads.

Good workout and restructuring are specialized skills. In the best circumstances, they can be a tool to enhance borrower strength and capacity. Few CDFIs, however, can afford to bring on special asset managers. Yet all CDFI lending staff can learn the special skills of a workout situation. One of the hardest things to balance is when to exercise speedy and decisive action over simple patience. A second difficulty is how to communicate in a manner that helps the customer understand why the workout is the best course, particularly if wishful thinking is at play about the project's future chances. In any event, it is worth considering whether an industrywide response is warranted. This could take the form of a shared approach to workouts and restructures, or training for lending staff. At the highest level, an industry response might also include a "bad bank" where CDFIs could create liquidity from their underperforming assets while transferring them to specialized expertise to help customers get through these difficult economic times.

### *Our Borrowers, Ourselves*

Policy matters. CDFIs are frequently lagging indicators of the overall economic environment. Although borrowers are on the frontlines, the field can be shielded from immediate impact by borrowers' coping strategies: they use their own cash to feed projects or fundraising shortfalls, they lower operating expenses to cover debt service payments, and so forth. However, if the economic downturn is both deep and protracted, these coping strategies will be temporary. Ultimately, the health of CDFIs depends on the financial health of its customers.

Many CDFIs are witnessing the deteriorating conditions of community developers and human service organizations. The withdrawal of public safety net services and the contraction of philanthropic support pose a special challenge to the CDFI agenda. Raising a strong voice to advocate for the community development agenda is more important now than ever before, and the message must be about the resources that not only benefit CDFIs, but also their customers. LIHTC, Section 8, and Community Development Block Grants are examples of programs central to the community development agenda, but less central to the CDFI advocacy agenda. More than anything else, supporting the advocacy agenda of community development will protect borrowers and the CDFI field in the coming years.

### *Never Waste a Crisis*

Use the basics to grow stronger. It is worth repeating the basics of sound fiscal and organizational managements. There is nothing complicated or fancy about these principles. They are rooted in everyday commonsense. Ironically, several of the high-flying financial institutions that crashed in the current bust violated these fundamentals.

Only three financial management principles really matter: net worth, liquidity, and net operating income margins.

Net worth – Of the three, net worth or equity is most important. It is no accident that, among CDFIs interviewed, additional equity was the single largest desire. There are only two ways to create net worth: through annual surpluses (see net income below) by attracting equity and capital grants, that is, the Financial Assistance program from the CDFI Fund or the Capital Magnet Fund.

The net worth of an organization is what stands between it and insolvency. Equity is a built-in "endowment" that reduces the overall cost of funds, allows CDFIs flexibility in lending tools, and allows patience with our borrowers. It is a revenue source that creates long-term sustainability and the tools to accomplish the organization's mission.

Liquidity – Sufficient liquidity requires CDFIs to manage cash to ensure enough on hand to cover at least one year of upcoming liabilities (although management textbooks say the ratio should be 2:1, for CDFIs, 1:1 is a must). Keep 90 days of operating expenses in cash as well.

Net operating income – Always budget a surplus. A four percent to eight percent net operating margin has proved to be a good range. This is the cushion that allows budget estimation mistakes and revenue reversals to be absorbed without eroding net worth.

### *Other Best Practices*

Other best practices include full-cost accounting, ongoing forecasts of annual and multiyear performance, and scenario planning. These are techniques that support financial security.

Full-cost accounting: Know when to hold 'em, know when to fold 'em. Full-cost accounting aligns the expenses attributable to an activity or program with the revenue the program generates. It requires properly allocating management and general costs (overhead). Full-cost accounting is the basis for understanding which activities cover their costs, which create surpluses, and which require discretionary resources. This allows management to make rational and deliberate decisions about which activities to expand and which to shrink.

Scenario planning. Create high-, medium-, and low-risk scenarios for each annual planning cycle. This can seem like make-work, but it is crucial. If nothing else, scenario planning forces planners to think about the assumptions beneath annual plans, and programs are stronger for it. Moreover, the financial aspect of scenario planning can reveal weaknesses and assumptions that alert management to issues they must tackle. Using worst-case scenarios in the present climate is also a cleansing experience; it forces us past our natural denial and disbelief. In the end, worst-case planning can spark new ways of looking at an organization and point to creative solutions to existing problems. Sometimes it is helpful for an outside force—in the story above, it was LIIF's Finance Committee—to put one through the paces.

Ongoing projections of fiscal performance. A discipline often overlooked is preparing year-end projections with each financial statement. Similarly, multiyear scenarios (three to five years) should be refreshed annually as part of the planning cycle.

### *The Network Solution: Sharing Our Way through This*

CDFIs form a national network dedicated to a common vision of community development and poverty alleviation. On a daily basis, however, the field operates separately, with little sharing of services, operations, or expertise across organizations. This isolation causes a "hall of mirrors," where each CDFI creates independently the systems and expertise needed to run its business. Each enterprise is largely on its own in addressing problems and challenges. The result is increased overhead and inefficiency, as numerous organizations reinvent the same wheel. The field's survival and future health depends on greater efficiency and cost savings. It must break down the hall of mirrors and build in its place a hall of windows. In these most difficult of times, the field needs everyone's ideas and cooperation. We even need one another's emotional support.

CDFI leaders identified five pressing needs for the future.

- Equity support in grants or grants for loan loss reserves;
- Liquidity relief, especially reasonably priced debt;
- Workout/trouble asset expertise;
- A forum for self-help: shared information, best practices, shared services;
- Heightened focus on policy solutions.

Equity support. The top priority for CDFI leaders was the need for additional equity and protective capital during the down cycle. This could take the form of equity grants, loan loss reserve grants, possibly even equity equivalent loans. Many equity bases are stretched by credit deterioration at precisely the moment CDFIs need to be patient with customers. Additional equity would mitigate this and permit more mission-driven behavior rather than "hunkering down." As one organization said, "there's no sense of being a CDFI if we can't push mission in a down time." In this case, the example was to take advantage of low prices to buy up land-bank property. However, the same general point can be made in many program areas.

Liquidity relief. A near tie for first place was the need for additional liquidity. Although the need is for additional liquidity, many also made the point that the price must be reasonable so that CDFIs could earn a spread. The strategy for this may well be joint advocacy for additional resources for the CDFI Fund, for renewed capital commitments from banking partners and foundations, or increased capital commitments through the current regulatory reform discussions. There was interest in innovative new legislation, such as the OFN sponsored "CDFI bond" program. Likewise, several leaders reflected the concern that foundations with program related investments (PRIs) and banks with loans to CDFIs were not responding flexibly with capital renewals or extension in the face of extraordinary financial circumstances. They pointed to a need to join together to influence investors.

Workout/trouble asset relief. Several organizations asked for a centralized workout service that they could call upon in dealing with the troubled loans in their portfolios. This could take the form of a "bad bank" to purchase troubled loans and recapitalize CDFIs. A second approach would be to provide expertise that CDFIs could call upon for help with their most troubled loans.

A forum for self-help. Every organization interviewed called for additional opportunities to learn from one another. Some were hopeful things will improve soon; others felt there was more darkness to come. Nevertheless, all organizations called for increased communication and sharing of best practices, resources, and information. A few called for new models of shared services to improve operating efficiency. One leader asked for "volunteers from banks who are workout/trouble asset specialists." Another asked for help in developing sophisticated liquidity models and processes. Most called for stronger advocacy within policy circles. In addition, a few specific ideas were put on the table:

- Greater sharing of terms and conditions offered by investors to increase transparency of capital terms within the industry;
- Shared services to help organizations improve their cost structures and grow net worth naturally;
- A "bad bank" to aid in liquidity for individual CDFIs, while placing troubled loans into professional hands;
- A federal guarantee of CDFI portfolios;
- A forum to discuss how firms are coping, what works and what doesn't;
- A forum for seeking influence with PRI and bank investors perceived to be unresponsive to the industry in these difficult circumstances;
- A way to discuss and understand that the solutions for small CDFIs may be different from large CDFIs;

- Agreements to stand by one another when shared transactions face risk; it's not cricket to say, "I'm first in line so good luck to you." The field needs more of a system solution for working out troubled credits.

Policies for new resources. Central to CDFI-specific policy work are the CDFI Fund appropriations debate, funding the Capital Magnet Fund – included with an $80 million allocation in President Obama's budget, and funding of the New Markets Tax Credit program.

In addition, the importance of the upcoming Community Reinvestment Act debate cannot be overstated. CDFIs need to be a strong voice in this debate, advocating for increased resources for communities. In fact, the Opportunity Finance Network is developing ideas for building CDFIs directly into the fabric of regulatory reform as a "must do" for financial institutions in meeting their community reinvestment obligations.

Because the future of development finance is intimately linked to its customers, many of the policy issues affecting those customers will provide ultimate support to CDFIs. These include the Low Income Housing Tax Credit market, Section 8 subsidies, National Affordable Housing Trust Fund subsidies, Community Development Block Grant programs, and a range of education, child care, and health care operating subsidies. Providing support to CDFIs without shoring up these underlying programs will be only a temporary solution. CDFIs could lend critical support to their customers when they advocate for increased federal and local support for these safety-net programs.

## Conclusion

Community development and community capital in the United States are facing heightened risk. This is most acutely felt in housing projects and the housing portion of loan portfolios, and particularly in for-sale projects. It is also felt in projects that depend on fundraising or public subsidies. Many leaders fear these problems will very shortly bleed over into community facilities and the commercial sector. CDFIs are responding by exercising patience, giving community-based developers additional time to succeed and to weather the bad economic climate. However, the credit crunch is constricting the flow of new capital coming into the community capital field and push is coming to shove. As a consequence, liquidity problems are emerging, and are most acutely felt by the larger-volume CDFIs. Anxiety is growing that investor commitment, both from banks and foundations, will not match the need of communities for patient, supportive capital. Nearly every CDFI is taking aggressive and prudent steps to shore up risk reserves, to re-score portfolio risk and to manage demand to match capital supply, assuming ongoing constraints. CDFI leaders increasingly recognize the need to pull together as an industry to find pathways through the difficult times, and to help one another navigate rocky economic times. There is also a growing sense that a common agenda must be formed to influence investors and funders in the choices they make for community development in the United States during the next few years.

# Observations on the Effects of the Financial Crisis and Economic Downturn on the Community Development Finance Sector

## Part III – Access to Debt and Equity

Paul Weech
Innovative Housing Strategies, LLC

### Overview

In the almost two years that have passed since the collapse of two Bear Stearns hedge funds in June 2007, the difficulties faced by the financial services sector have continued to dominate the attention of policymakers. Concerns have focused primarily on the troubles at the very large financial institutions and the systemic risks they pose. Policy responses have included infusions of government capital, increases in deposit insurance coverage, government-supported shotgun mergers, conservatorship for the government-sponsored enterprises, purchases of marketable securities to maintain liquidity, and guarantees against losses.

At the same time, policymakers have devoted considerably less focus on the smaller, mission-driven institutions in the financial services marketplace that provide community development finance—critical credit and investment services—to low–income borrowers and communities. These institutions include those certified by the Department of the Treasury as Community Development Financial Institutions (CDFIs), but also other financial institutions with similar missions, which are referred to here as community development institutions (CDIs).[16]

By definition, CDFIs and CDIs were created to meet the lending and investment needs of low-income borrowers and communities that were not well served by mainstream financial institutions. Although many of these institutions have long, meaningful histories, the rise of the community development finance movement is a more recent phenomenon.[17] The industry has grown significantly in number, scale, reach, and impact since Congress created the CDFI Fund program at the Department of the Treasury in 1994. Many of the estimated 800 to 1,000 institutions that qualify as a CDFI or a CDI are adding significant value to the communities they serve.

The CDFIs and CDIs are the institutions best positioned to deliver financial services to the communities hardest hit by the economic challenges. As mission-driven organizations, the CDFIs and CDIs are keenly focused on how the downturn, with its attendant job losses, foreclosures, and bankruptcies, is affecting low-income families and low-income communities (that is, their customers and service areas). Yet an increasingly challenging economic environment is making it difficult for the community development finance industry to respond to these communities' needs. The traditional sources of funding are more constrained as funding partners deal with their own financial challenges. Less access to funds coupled with credit challenges, which are forcing the CDFIs and CDIs to extend outstanding loans and increase loan loss reserves, has meant a liquidity crunch for many institutions in the industry. These strains make it difficult to meet the demand for their investment dollars and other services. And, most in the industry expect the situation to get worse. CDFIs and CDIs are doing the neces-

16 See, "The New Normal" by Mark Pinsky, who coined the term CDI. Like Pinsky, the author regrets introducing yet another acronym to the alphabet soup of federal program names and industry jargon included in this paper. At the risk of adding confusion, the term CDI signals the inclusion of those institutions that do not necessarily identify with the CDFI label. The labels "community development finance industry," "community development finance movement," and "community development financial institutions" include the wide variety of financial institutions serving low-income communities. Where appropriate, "CDFI" is intentionally reserved for specific institutions that identify with this term or that segment of the community development finance movement that is certified by the Treasury Department as eligible for its assistance.

17 The National Development Council, which was founded in 1969, claims it is the oldest nonprofit community development organization in the United States. The Illinois Neighborhood Development Corporation acquired South Shore National Bank in 1973 and with the acquisition launched the community development bank model.

sary contingency planning and adopting other strategies to prepare for an uncertain future environment.

Given the importance of CDFIs and CDIs, policymakers should better understand the impacts of financial crisis on the health and effectiveness of these institutions. This section of the report examines the state of the community development finance sector today, and how the crisis is affecting the funding sources for CDFIs and CDIs and the projects in which they invest.

## Research Methodology and Issues

The material in this paper is derived from conversations with more than twenty-five leaders in the community development finance field. Those interviewed represent many of the most prominent community development financial institutions and some of the leading foundations, lenders, and policy advocates in the industry.[18] The interviews are augmented by available studies from the Department of the Treasury, the Opportunity Finance Network (OFN) survey, several published and unpublished articles, and the other working papers and interview notes. This paper attempts to aggregate the themes that emerged in the conversations with field leaders to paint a picture of the industry today.

However, the project faced a variety of research challenges, which warrant caution in interpreting the results. Some of these challenges include the following:

- The interview sample does not allow statistically valid generalizations about the industry. For the most part, the people interviewed for this project represented larger, more established, nonprofit CDFIs. The information from these interviews, therefore, cannot begin to capture the extraordinary diversity of the community development finance industry. The estimated 800 to 1,000 CDFIs come in all shapes and sizes, with structures ranging from for-profit to nonprofit; from banks to credit unions to loan funds to venture capital funds to microenterprise funds. The institutions that comprise the community development finance movement range in sizes from very small and local (in 2005, the median size was $8.3 million in assets)[19] to relatively large institutions with a national presence, ranging from Self-Help, which has invested more than $5 billion since 1980, to LISC, which has invested more than $9 billion over the same period, to ShoreBank with more than $2 billion in assets.[20]

  The CDFIs and CDIs operate on a wholesale or a retail level, and their funding bases vary considerably, ranging from private financial institutions, to foundations, to other socially motivated investors. Likewise, the types of activities they invest in span a wide spectrum of the financing needs in any given community, including homeownership and rental housing; predevelopment and acquisition loans; rehabilitation, development, and construction lending; commercial real estate, health care, and mixed-used development; small business and microenterprise finance; and public facilities such as charter schools and child care centers.

  As one CDFI leader said, "The CDFI is the ultimate niche business with a unique geography and mission."

- The situation facing the industry is dynamic and changing rapidly. The field is in a period of great uncertainty. The environment is changing daily. Funding partners of CDFIs and CDIs are also facing an uncertain future. Applications for loan or grant renewals are in, but decisions have not been made. Other loan and grant renewals are looming on the horizon. CDFI and CDI efforts to manage their credit books reflect the stresses and uncertainties of a stressed and uncertain economy. Many entities are hopeful that extending repayment terms on their outstanding loans will allow recovery, but this strategy may only work if the downturn is not too prolonged. And, the public policy environment is volatile.

- Available data have limitations for analyzing the current environment. There is no single, readily available data set that captures the current conditions faced by the CDFIs and CDIs. The ideal data set, quarterly financial statements

18 The author is grateful for the time and thoughtfulness of so many people who helped in framing this research. While many have contributed intellectually to this work, the findings and observations are my own.

19 Community Development Financial Institutions Fund, Three-Year Trend Analysis of Community Investment Impact System Institutional Level Report Data FY 2003-2005, Washington, DC, December 2007.

20 Data comes from the websites for these three institutions.

for every institution covered by this project, in a format that allows aggregation, does not exist. In 2004, the CDFI Fund launched the Community Investment Impact System that is providing some very useful information, but there is a lag in its availability and the Treasury Department limits the levels of detail released. Likewise, an ongoing survey by the OFN provides terrific insight. However, only about 118 CDFIs participated in the survey for the end of the fourth quarter of 2008, and, of these, only 35 also responded to the third quarter survey, limiting the value of any longitudinal data. Further, the survey produces an insufficient level of financial detail to precisely describe the changing environment. First quarter 2009 survey results are due out in May and may illuminate what many observers believe has been a markedly negative change in the position of CDFIs during the first quarter.

These and other data limitations mean that the information and findings in this paper are more anecdotal than dispositive, more observation than conclusion. The spirit of the paper is to generate discussion, encourage others to validate (or refute) the findings, and help guide the industry and policymakers through these uncertain times.

## Sources of Funding for the Community Development Finance Industry

The CDFIs and CDIs rely on a wide variety of funding sources. Table 1 categorizes the sources of funds for the CDFIs into: 1) financial institutions and other corporations, 2) government, 3) philanthropy, and 4) internal sources. It shows the considerable differences in funding structures for depository and the non-depository CDFIs. The CDFI depositories, like non–CDFI depositories, generally accumulate funds from the deposits themselves, from shareholder equity, and from the issuance of debt into the capital markets. The non-depositories, on the other hand, rely on a more diverse funding base, with debt and social investments from the mainstream financial institutions comprising the largest shares of their resources.

Table 1. Sources of CDFI Capital under Management, Weighted Averages, 2003-2005

| | Depository CDFIs | Non-Depository CDFIs |
|---|---|---|
| Financial institutions and other corporations | 15% | 54% |
| Government | 3% | 16% |
| Philanthropic | 0% | 12% |
| Internal funds, individuals, and other | 82% | 18% |
| Total | 100% | 100% |

Source: Community Development Financial Institutions Fund, Three Year Trend Analysis of Community Investment Impact System Institutional Level Report Data FY 2003-2005, Washington, DC, December 2007, derived from Table 3-3.

Private financial institutions and other corporate sources. The principal sources of funding for the non-depository participants in the community development finance movement are private financial institutions motivated primarily by Community Reinvestment Act (CRA) obligations. In total, private financial institutions and other corporate sources provided more than 54 percent of the capital under management by non-depository CDFIs. Depository financial institutions provided 29.4 percent of the total capital. Non-depository financial institutions—investment banks, insurance companies, and pension funds (1.9%), CDFI Intermediaries (0.9%), and other corporations (15.7%)—provided an additional 18.5 percent. The government sponsored enterprises (GSEs)—Fannie Mae, Freddie Mac, and the Federal Home Loan Banks—composed the rest of the capital (6.2%) from private financial institutions and corporations. In contrast, 15 percent of capital under management for the depository CDFIs came from private financial institutions or other corporate sources.

Government sources. Approximately 16 percent of the capital under management by non-depository CDFIs comes from government sources, the most prominent being the CDFI Fund. During the fourteen years since it was founded, the CDFI Fund has provided nearly $1 billion in equity investments and grants, loans, and technical assistance funding in support of the CDFIs eligible for its programs. In addition, many CDFIs rely on federal, state, and local government as a source of capital for reinvesting, which the CDFI Fund study estimates to provide approximately five percent of total resources for non-depository CDFIs. For example, the Small Business Administration's (SBA) Section 504 program allows CDFIs organized under this section of the law to borrow money with an SBA guarantee. In contrast, the Treasury study finds that less than three percent of the depository CDFIs' capital comes from government sources. However, for these institutions, the ability to raise low-cost deposits from consumers and business sources relies on federal deposit insurance. In the Treasury study, deposits are included in the funds received from individuals and other sources.

Philanthropic sources. The philanthropic community provides significant levels of support for the non-depository CDFIs, nearly 12 percent of the capital under management according to the Treasury Department study. Certain large foundations, such as the Ford, MacArthur, and Heron foundations, in particular, featured prominently in conversations with the CDFIs as sources of program-related investments (PRIs). Corporate giving, particularly from companies in the financial services sector and their foundations, is another important source of funds for the non-depository CDFIs. Various religious orders are common sources, particularly those looking for investment opportunities for pension monies and operating reserves that provide a return but also reflect the social values of the investing organization. Depository CDFIs reported a minimal amount of capital from philanthropic sources.

Internal funds, individuals, and other sources. The sizable share of capital for the depository CDFIs in this category (82%) is mainly attributable to "individuals" (42% percent), the category in which the deposits are included, and "other" (33%), an unspecified category in the data. In contrast, the bulk of the capital in this category for the non-depositories derives from "internal funds." As financial institutions, all CDFIs and CDIs seek to make a return on their activities. The returns can come in the form of origination, development, and management fees, deal proceeds, and, most notably, from spreads on lending or investment activities. Some CDFIs and CDIs are part of larger organizations that allow them to borrow against the larger organization's balance sheet or take advantage of revenues and proceeds from other entities in a related part of their organization. Most nonprofit CDFIs and CDIs are unable to cover their operating budgets from revenue sources and must raise funds to fill operating gaps.

## Changing Economic Ties between the CDFIs, CDIs, and Their Financial Services Industry Partners

The well-publicized problems facing the nation's largest financial institutions and the financial services sector more broadly have had a spillover effect on the terms and availability of funding for the community development finance sector. Many in the field today are focused on the changing relationship between the mainstream financial institutions and those in the community development finance field.[21] The data suggest that this relationship had begun to change before the meltdown in the financial markets, but the financial crisis has exacerbated the trends. Although the story is not uniformly negative, the emerging sentiment is considerable concern about the level of support from the mainstream financial services sector now and in the future.

The business models of most CDFIs and CDIs rely on low-cost, below-market-rate funding sources. Public and philanthropic funding sources are blended with private funds to provide low-cost investment capital to low-income communities and borrowers. Over the years, many mainstream financial institutions have been willing to provide funds to CDFIs and CDIs at or below the cost of funds to help fulfill their CRA obligations. Insurance companies also participated in social

21 "Mainstream financial services industry" is used throughout this paper to broadly define the non-CDFI/non-CDI financial services industry. In most instances, the term refers broadly to the various different financial services entities, such as banks, thrifts, investment banks, insurance companies, and government-sponsored enterprises that invest in, and partner with, CDFIs and CDIs. Unfortunately, as with efforts to generalize about the community development finance movement, generalizations about the mainstream financial services industry will prove inaccurate for many, if not most, of the players in this broad and diverse industry.

investment strategies in part to respond to anti-redlining lawsuits and to fend off calls for adding CRA-like obligations to their regulatory infrastructure.

In recent years, the community development finance movement has felt the effects of an increasing unwillingness of mainstream financial institutions to provide concessionary funds. The availability of these concessionary resources was often attributed to periods of relatively strong CRA enforcement; it is not too much of a stretch to characterize the last several years, even before the financial crisis, as one of relatively lax CRA enforcement.

The erosion of the concessionary relationship between the mainstream financial services industry and the CDFIs and CDIs is also a function of the growth and success of the CDFI movement. As the CDFIs and CDIs have grown, the demand for low-cost funding from mainstream financial institutions has also grown. When the volumes of concessionary lending were relatively small, the mainstream financial institutions could tolerate lower returns on community development financing in order to meet regulatory obligations. However, as the CDFIs and CDIs grew larger and the demand for low-cost funds grew larger, the levels of internal subsidy required to support these customers grew less sustainable. As one lender said, "You can do LIBOR minus 200 basis points on a $2 million loan, but it becomes tougher within the bank on a $10 million loan."

That said, the financial crisis has instigated other changes in the relationships between CDFIs and their lenders. The change in the financial services landscape over the last two years has been massive, and sometimes abrupt. Self-Help's leadership provides a dramatic example of the financial crisis' effect on liquidity. For about five years, Self-Help had a daily repurchase agreement with a Wall Street investment house that the CDFI used to fund its mortgage portfolio. Self-Help used this overnight facility to manage its daily cash needs, which often varied by tens of millions of dollars. Although the repurchase agreement was only for a 24-hour period, the CDFI had been able to renew the trade consistently during the five-year period on the basis of what had become a routine daily phone call. The day after the fall of Lehman Brothers, the financial institution called Self-Help to inform it that the repurchase agreement had to be paid off that day. Self-Help countered with an offer to pay a temporarily higher rate or to merely reduce the size of the line, but in the end, Self-Help needed to come up with $25 million in a matter of hours to repay the creditor. Fortunately, Self-Help was able to raise the money that morning through another wholesale creditor.

It is clear from the conversations with many community development finance leaders, industry observers, and lenders that the current environment is significantly altering the availability and terms of credit to CDFIs and CDIs. In this, the CDFIs and the CDIs are not alone or even necessarily singled out for unique treatment by stressed mainstream financial institutions. A May 4 front-page story in the Wall Street Journal documents tougher bank credit line provisions for companies such as Verizon and Hewlett-Packard. The article notes that even these strong companies must pay more for revolving lines of credit and that banks were shortening three- to five-year lines of credit to one-year terms.[22] The next day, the Wall Street Journal ran an article, "Lending Practices Remain Tight," highlighting the results of the Federal Reserve's quarterly Senior Loan Officer Opinion Survey on Bank Lending Practices. According to the report, about 40 percent of the respondents said they had tightened standards in the first quarter; 65 percent reported tightened standards for the fourth quarter of 2008 in the January survey.[23]

These press reports echo the interviews with the community development finance leaders interviewed for this project. Those interviewed for this paper attributed the changing economic relationships to growing risk aversion on the part of the mainstream financial institutions, FDIC pressures on banks to tighten up credit, and the banks' desire to increase returns on the community development finance business lines to offset losses in other parts of the business. One observer opined that "many financial institutions had lost their confidence in their ability to understand and underwrite risk in general, not just for CDFIs."

Lenders are terminating or reducing lines of credit to CDFIs and CDIs, increasing the pricing on the lines, and shortening the terms of the lines. One lender confirmed that he was going through an "aggressive" review of his portfolio, terminating lines to borrowers who were in trouble and increasing prices on existing customers. He was particularly focused on raising the prices on below-market rate loans that his institution had acquired in a merger with another institution. From the CDFI

22 Serena Ng, "Banks Get Tougher on Credit Line Provisions," Wall Street Journal, May 4, 2009, 1.

23 Maya Jackson Randall, "Lending Practices Remain Tight," Wall Street Journal, May 5, 2009, 2.

side, one leader said that lines of credit renewals were coming with average price increases of "200 to 250 basis points." The OFN survey for the fourth quarter of 2008 reported that 42 percent of its respondents reported a decline in liquidity, with the most common reason cited as "bank investors not renewing loans."[24] The buzz around the industry is that liquidity has taken a dramatic turn downward in the first quarter of 2009. Most expect OFN's first-quarter survey to highlight an even greater shrinkage.

Several of the community development finance leaders interviewed had not experienced the liquidity challenges yet. Two different respondents reported they were able to raise capital in 2005 and 2006 when it was plentiful and relatively inexpensive, and these lines were still available for draws. However, each expressed concerns about upcoming renewal conversations and were anticipating price increases or losing the line.

Another CDFI leader reported that one of her lenders had asked her organization to reduce its unused line of credit. She had kept the line open because the bank had waived the fees typical in the market for unused lines of credit. For this housing-based loan fund, demand had fallen considerably, and the CDFI agreed to give up some of the line. A lender reflected the other side of the pressures: Banks are required to hold a certain amount of capital against even the unused lines. As banks move to conserve capital one of the first targets is capital that is not earning a return.

Several people interviewed observed that lenders employed renewal strategies that did not terminate the lines of credit, but seemed to reflect an ulterior motive to get the CDFI to withdraw. In testimony before Congress, Bob Davenport of the National Development Council and its Grow America Fund (GAF) described how one of his lenders, despite a successful ten-year relationship, implemented a price increase at the end of last year.[25] In January, the lender came back asking for two new loan covenants that GAF could not meet. GAF is a Small Business Lending Company that originates and services loans on which the SBA provides a 75 percent guarantee. Under the typical structure, a private lender will provide GAF an amount equal to the guaranteed portion of the loan, and a public entity, typically a city's economic development office, will provide the funds for the nonguaranteed portion. The lender requested that GAF cede its interest in the SBA portion of the loan (in violation of SBA rules) and asked GAF to set aside funding to ensure that the lender was paid back, despite the full guarantee on the lender's credit risk by the federal government and the federal government's ultimate responsibility to make the lender whole. GAF terminated the line with the lender, but was able to replace the line with a lender who valued the SBA guarantee.

The tighter credit environment is also evident in the capital markets. The Charter School Financing Partnership that pools charter school loans for its member institutions reported that the securitization of charter school loans was dead in its tracks. Changes to the structure and its pricing were dramatic. Prior to the credit crisis, rating agencies would require a 15 percent credit enhancement on the initial loans into the pool to achieve a BBB rating for the entire transaction. The rating agencies are now requiring a 50 percent credit enhancement to achieve an AA rating, the level needed to obtain reasonable interest rates. Moreover, the interest rates spreads between BBB and AA have widened considerably, to approximately a 500 basis point difference. The new requirements are prohibitive.

One observer counseled caution in generalizing about the reaction of the mainstream financial institutions to the current economic environment. Although he agreed the relationship with large institutions was changing, based on his experience smaller community banks were more willing to work with the CDFI and work to restructure the business deals. A look at this institution's funders shows ties to dozens of national, regional, and community banking institutions.

## Changing Relationships among CDFIs and CDIs and Their Partner Financial Institutions

At a fundamental level, one of the other notable effects of the turmoil in the financial services sector is the quality of the relationships between CDFIs and CDIs and their mainstream financial services partners. Certainly, one implication of the tighter credit environment is that lenders are scrutinizing CDFI and CDI loan portfolios more carefully. Lenders and CDFIs leaders alike reported much closer scrutiny of their customers' portfolios. The manifestations of this are quarterly

24 Opportunity Finance Network, "CDFI Market Conditions Report Fourth Quarter 2008," Philadelphia, PA, April 2009, 8.

25 Testimony of Robert W. Davenport, President of the National Development Council, before the House Financial Services Subcommittee on Financial institutions and Consumer Credit, March 4, 2009.

reviews of each line of credit and a more detailed series of questions for the borrower about their businesses. One person interviewed said that he was experiencing a more rigorous enforcement of loan covenants by the banks, putting loans that were otherwise current into technical default. This presumably creates more work for the CDFI or the CDI and financial risks to the CDFIs, but also adds tension to the relationship.

Some important relationships have gone away overnight. Prominent institutions with relationships to CDFIs and CDIs—those most often mentioned are Wachovia, Washington Mutual (WaMu), National City, and Merrill Lynch—have been acquired by other financial institutions. The CDFIs and CDIs must now establish new relationships and deal with a different culture or philosophy at the acquiring institution.

In one case, the new partner expressed concerns that it is overly exposed to a single CDFI. Another CDFI leader reported that his institution still had a line with Merrill Lynch on which he was drawing funds, but he was unsure when and how to discuss the line with Bank of America when it came up for renewal. Another loan fund executive had five different relationship managers at a single financial institution over an eighteen-month period. In this case, the CDFI leader reported that at one point, her fund had discovered that the financial institution was not calculating the interest owed on the line correctly, to the detriment of the financial institution. They did not know whom to call to correct the error.

In still another case, the acquiring institution brought an entirely different business approach. Several respondents noted that the acquisition of WaMu by Chase had meant important changes in the product offerings for CDFI and CDIs. Specifically, WaMu would provide “near equity” (EQ2) investments to these customers. Chase does not. Also, it was not uncommon for WaMu to provide highly concessionary lines of credit to its CDFI and CDI customers; Chase does not provide debt financing to financial intermediaries at concessionary pricing.

Perhaps a bigger story with longer-term implications has been organizational changes at the mainstream financial institutions with respect to how they handle their CRA responsibilities. During the last several years, many of the large financial institutions reorganized their approaches to community development lending, for reasons not necessarily related to the financial meltdown. At various points in time, many larger, mainstream financial institutions managed their CRA activities through a division dedicated to community development activities. Although the specifics varied at the different institutions, the model was one in which a single, senior executive would oversee investments in community development, lending to intermediaries, tax credit investments, partnerships with nonprofits and special programs, and grant making. Often these divisions managed to a rate of return that was less than that for the rest of the financial institution.

In a trend that began before the current crisis, many banks reorganized their community development functions. The reorganizations dispersed throughout the banks many of the product lines and activities that supported the community development movement. The new executives are managing to different hurdle rates for these products, are less sensitive to the mission, and are less likely to provide concessionary terms. Expertise and institutional knowledge were lost. One CDFI leader noted that the new product line managers did not understand CDFIs and the “funky” deals that characterize community development finance. One lender interviewed for this project acknowledged the change at his institution, but described the change as positive. In the past, he said, the community development divisions were considered backwaters in the banks, where executives and employees went to finish out their careers out of the limelight. Under new structures, the community development business is bigger, profit margins are important, and the rest of the bank takes notice. The division in which he works is now a place for an ambitious executive to build a profile and advance his or her career into other parts of the bank.

## The Economic Crisis and Changes in Government Funding

The trends with respect to public funding streams to support the CDFIs and CDIs are a mixed story. At the federal level, the industry anxiously awaits new CDFI funding and funding for other governmental programs from the stimulus package. The community development finance industry has been encouraged by strong signs of Congressional and administration support over the last 12 months. At the same time, there are concerns that the promised new resources will not materialize in time to save many of the institutions in trouble, and that the CDFIs and CDIs will be unable to realize the full value of the new tools provided. At the state and local levels, the picture is even somewhat less encouraging, although the federal stimulus funds flowing through to these jurisdictions should help.

The federal government has signaled strong support for the community development movement. With the addition of nearly $100 million in new funds for the CDFI Fund, the stimulus package, officially known as the American Recovery and Reinvestment Act of 2009 ("Recovery Act"), raised the 2009 program levels to $145 million for the CDFI Fund program and the Native American CDFI Assistance program. The Recovery Act also included an additional $3 billion in New Markets Tax Credit allocations covering both the 2008 and 2009 program years, in addition to the $3.5 billion already provided for 2009. Further, the stimulus package provided significant levels of new funding for many of the federal programs in which CDFIs participate, including new funds for the U.S. Department of Agriculture's rural development and housing programs, the SBA, the Economic Development Administration at the Department of Commerce, and the Department of Housing and Urban Development (HUD).

The movement also had a big win in the Housing and Economic Recovery Act of 2008, which was signed into law at the end of July 2008. The act included the creation of a Capital Magnet Fund for financial intermediaries using funding based on Fannie Mae and Freddie Mac acquisitions. That legislation also directed the Federal Home Loan Banks to open up their advances to the portion of the CDFI industry that is not currently able to become members.

The industry is particularly encouraged by the new administration's 2010 budget. The budget details released May 7, 2009, call for $243.6 million in appropriations for CDFI Fund programs, an amount more than double the FY 2009 appropriation. The request includes $113 million for the CDFI program (for financial assistance and technical assistance), $80 million for the Capital Magnet Fund, $22 million for the Bank Enterprise Award program, $10 million for the Native American CDFI Assistance program, and $18 million for administration.

However, there is some ambiguity in all of this good news. The amount of funding provided for both the CDFI Fund and the New Markets Tax Credit program in the stimulus package were considerably less than the industry had requested. More important, the money is not yet on the streets. The CDFI Fund has promised funding announcements in July and September and made a commitment to obligate most of the money within thirty days after the announcement. CDFIs have reportedly asked for as much money as they can; the requests for funding mean that the round is oversubscribed. A significant number of CDFIs are looking for funds from this grant round to help fill in holes on their balance sheets and "break even" this year. Yet, several observers worry that given the deteriorating economic conditions the government will not get the funds out in time to save some troubled CDFIs. Of course, the inability of some marginal CDFIs to get funds in this competition will not bode well for the future of those institutions.

Moreover, other important stimulus money is not yet on the streets, although the agencies are working to get it out. HUD published the Notice of Funding Availability for Neighborhood Stabilization competitive grants on May 4 with applications due July 17, 2009. Many CDFIs and CDIs are interested in these new funds and those made available in an earlier allocation. Also on May 4, the Treasury and HUD put out guidance for the Low Income Housing Tax Credit (LIHTC) Assistance Program (TCAP). The Joint HUD/Treasury effort will provide $5 billion to the support LIHTC deals that have stalled. Filling the gaps on these tax credit deals is of critical importance to CDFIs and CDIs who fund pre-development and acquisition loans to LIHTC nonprofit developers. HUD has also allocated the $1 billion provided to the stalwart Community Development Block Grant (CDBG) program in the stimulus package. As a measure of the ambiguity of the "good news," one astute, long-time industry observer commented several times how stunned he was that this classic program of support for the community development movement only got $1 billion out of a $787 billion bill. In many past efforts to address economic challenges, CDBG had served as a flagship program for distributing federal funds.

Another source of ambiguity in the good news is the funding mechanism for the Capital Magnet Fund. That fund has the potential to become an important new tool for the community development finance movement, but its initial reliance on fees based on Fannie Mae and Freddie Mac's mortgage acquisitions makes it an unreliable source of funds given the losses at the housing GSEs. The future status and viability of these institutions is a question policymakers have only begun to consider. The community development finance industry requested resources for the Capital Magnet Fund in the stimulus package, but Congress did not respond. On the positive side, the administration has now requested $80 million for this new program. On the negative side, the future for funding will undoubtedly be uncertain given what is likely to be an oppressive fiscal situation in the future.

Further, when we shared preliminary findings of this paper with a group of industry leaders, many did not foresee access to the Federal Home Loan Bank advances as being a meaningful step forward for the industry. Although the proposed regulations have not yet been released, the group uniformly raised concerns that most CDFIs will find the terms of participation with the Federal Home Loan Banks too onerous for the advances to prove useful.

The picture at the state and local levels is considerably more challenging. The May 13, 2009, Wall Street Journal reported that a Nelson A. Rockefeller Institute of Government survey of 47 states had seen a decline in first quarter 2009 tax revenues of 12.6 percent relative to the same quarter in 2008.[26] Corroborating information from the interview process was limited, but respondents in general supported the view that state and local government budgets were severely constrained and these funding sources would likely decrease. California and Florida stood out as places of significant concern over the declining funds for CDFIs/CDIs and their work.

The negative condition of state and local trust funds that rely on real-estate-related documents or transaction fees was another theme echoed by several respondents. Florida and the District of Columbia were singled out. Many of the nation's more than 600 housing trust funds commonly rely on mortgage-based or home-purchase-based fees as a funding source. It is not unreasonable to assume that the massive decline in for-sale housing across the nation has also constrained available housing trust fund resources in many places.

## Philanthropy, the Economic Crisis, and Community Development Finance

Foundation endowments and other socially motivated investors have taken a huge hit in the economic downturn. Stock market values have dropped precipitously and other highly leveraged investment vehicles have taken a beating. According to a May 2009 survey by the Council on Foundations, foundations responded to the economy by increasing their giving, paying out $45.6 billion in grants in 2008 compared with $44.4 billion in 2007. Yet, the survey also highlighted the bad news in the philanthropic sector: Three out of four foundations saw their assets decline by 25 percent or more in 2008 and a majority (62%) reported they will reduce their grant-making in 2009.[27]

In a December article in ShelterForce, author Rick Cohen underscores the financial services sector's role in philanthropy: "Today's financial meltdown will hit community developers where it hurts, in their financial wherewithal to respond to the challenges they face in urban and rural neighborhoods." Cohen's article is worth the read. He points out that the financial sector was a huge player in corporate giving, and he highlights how the troubles at the banks and other large financial institutions will significantly affect the community development finance movement. Financial institutions that have disappeared, such as WaMu, Wachovia, Countrywide, were providing tens of millions of dollars to institutions serving community development missions. Cohen notes, in particular, the financial troubles at the GSEs and the effects on community development:

> Fannie Mae was the nation's leading corporate grant maker and one of the nation's most generous foundations overall for nonprofits in the field of housing and shelter. Between 1998 and 2004, the Fannie Mae Foundation (not counting what might have been awarded directly by the corporation outside of its foundation) handed out $119 million in grants of $10,000 or more for housing and shelter. For each of those years, Fannie ranked first or second in the nation among all foundations, not just corporate foundations, making grants in the housing arena, often surpassing the totals of independent foundations such as the Ford Foundation, the MacArthur Foundation, and the Lilly Endowment. Among the nation's largest 1,000 or so foundations, it accounted for just about one out of every 10 foundation dollars for nonprofits addressing housing and shelter….Between 2002 and 2006, Fannie put $3.6 million into the Living Cities foundation consortium and millions more directly into an array of national and regional community development intermediaries….For national grant making to housing and community development groups, the new status of the GSEs as money-losing appendages of the federal government means

26 Conor Dougherty, "States' Revenue Sinks Amid Income Tax Drop Off," Wall Street Journal, May 13, 2009, A3.

27 Council on Foundations, "Foundations Respond to the Needs of Families Even as Their Assets Have Declined: Results of a Survey by the Council on Foundations," Arlington, VA, May 6, 2009, 1.

a disappearing philanthropic portfolio.[28]

In interview after interview, the CDFI/CDI leaders anticipated severe tightening by the foundation community, but reports from the front have suggested that this is more of a looming threat than an immediate one. Foundations in general are still in the game, they report, but the CDFIs are girding for a more difficult conversation.

Shrinkage in the philanthropic and socially motivated investment community is likely to have a greater impact on the smaller financial institutions for which this money is a greater share of their capital under management. For the larger CDFIs and CDIs, foundation funds are only a small part of the capital structure; the vast majority of resources flow from private financial institutions.

In general, numerous individuals across the industry reported that foundations were becoming a little choosier. One CDFI executive director reported that his PRI had not been renewed, and most others reported signals from foundation partners that PRI renewals were unlikely. Another respondent said that one foundation was unable to allow a CDFI to roll over a loan; the foundation needed the cash for other commitments. The same individual reported that his CDFI asked for an extension that the foundation apologetically was unable to grant. In any other year, the funder would have approved the extension with little fuss. This is an evolving story.

Donors and recipients also report that the foundations have stepped up their management and oversight of PRI portfolios. Like the private lenders with investments in CDFIs or CDIs, foundation PRI managers are having more frequent conversations with the holders of their funds and asking tougher questions about how the CDFIs and CDIs are managing their portfolios. One foundation respondent discussed the flexibilities the foundation might employ to support these institutions with PRIs, but in the end asserted that the foundation would manage its portfolio like a private financial institution and would pull the plug to get its money back and let a CDFI/CDI fail, if necessary.

Yet foundations still differ in their approach to PRIs than private lenders regarding troubled investments. The MacArthur Foundation, with a large portfolio of CDFI-related PRIs, should announce sometime in advance of this paper's publication that it will waive one year of interest payments on its loans to CDFIs, CDIs, and housing developers, starting July 1, 2009, at a cost of about $2 million, and it will defer for one year the payment of principal due back to it from these PRI recipients during this same period (July 2009 to June 2010). MacArthur is taking this step because it recognizes the extraordinary financial difficulty these organizations face in the ongoing upheaval in the banking sector and amid sharp declines in investor appetite for real estate-related debt and equity. The foundation hopes that this interim relief will help its borrowers maintain their operations and that it will ease the negative impact of rising loss reserves and the need for staff cuts and emergency fund-raising that most of these organizations are undertaking.

Other important changes in the relationships among the foundations to the CDFIs and CDIs were already underway prior to the financial crisis. After an evaluation of its PRI portfolio completed in 2000, the MacArthur Foundation, for example, changed its PRI philosophy with respect to the community development finance movement. In contrast to prior general support for these entities and the field overall, the foundation decided that its PRIs should be used to advance specific program areas. Two examples are its national Window of Opportunity initiative to support the preservation of affordable rental housing, and a new $68 million foreclosure prevention and mitigation project focused on low-income neighborhoods in Chicago. Yet, perhaps also reflecting the strength of the CDFI, the foundation officer noted that many of the recipients of its PRI funding for these and other initiatives were CDFIs, a reflection of the foundation's view that these institutions were important vehicles for delivering on its programmatic objectives. Furthermore, and despite an apparent change in approach, the MacArthur Foundation continues to support the industry as a whole through the NEXT Awards for Opportunity Finance, a $43 million partnership with OFN and the Wachovia Foundation that provides major funding each year to two outstanding CDFIs with significant potential for future growth, innovation, and policy impact.

Perhaps the most dramatic change in the PRI environment for CDFIs and CDIs is the Ford Foundation's decision to shift its PRI investments for the next two years into neighborhood stabilization activities. Ford is a major funder of PRIs, with a portfolio of about 40 CDFI/CDI investments. The foundation typically provides about eight new loans a year, with a total

28 Rick Cohen, "Brave New World for Nonprofits," Shelterforce, December 22, 2008, 4.

annual of investment of $25 million. The investments are typically ten-year, interest-only loans, at 1 percent. This year and next, Ford will make the neighborhood stabilization effort its priority and will provide $50 million in PRI dollars to a grant to the Neighborhood Stabilization Trust. However, as with the MacArthur Foundation story, Ford's new PRI strategy is not entirely unrelated to support for the community development finance movement. Several of the sponsoring organizations of the Neighborhood Stabilization Trust are CDFIs/CDIs, and many of the members of the sponsor organizations' networks are also CDFIs or CDIs. In addition, to a certain extent, with its change in focus to neighborhood stabilization, the Ford Foundation is responding to the priorities of many in the community development finance movement.

One CDFI leader reported that her socially motivated investors, in this case the pension funds of religious orders, had increased their investments in her loan fund. She hypothesized that, ironically, her fund's modest returns to the investors outperformed the other equity investments the pension funds had relied on for yield. These same social investors were increasing the cost of their money invested in the CDFI to offset other losses in their portfolios, but the increases were described as not onerous. At the same time, this respondent reported that one new investor, a religious order health care system, had set aside money for the loan fund, but the organization continues to delay disbursement. She too was nervous about the future. Her organization had several applications out for renewals and new money. Her relatively positive story may change over the next months.

The fourth-quarter 2008 OFN survey of the CDFIs found that many were seeking grant funding from new funders. CDFIs and CDIs, in particular, were seeking additional operating grants to cover rising costs as their credit books show signs of strain. However, it is unclear whether new funds will be forthcoming. Given the strains on funder portfolios, one industry observer felt this was not a good strategy. Most funders are stretched by their current relationships.

## How the Economy Is Changing the Activities of CDFIs and CDIs

Given the troubles in the mainstream financial institutions and the disparate effects of the economic downturn on low-income communities, most observers described a market environment with rising demand for CDFI/CDI resources, although the record on this is less than uniform. Many CDFIs/CDIs, and particularly those in the small business arena such as the Grow America Fund, have reported an uptick in loan applications, which they attribute to the fall-off in lending by the mainstream financial institutions. Demand is also coming from nonprofit CDCs that are experiencing a decline in fundraising and slowing deals and who are looking for cash to keep the organization operating until their deals can close. Many are now looking to the CDFIs/CDIs for assistance and funding.

At the same time, the fourth-quarter OFN survey indicates a slowing in new lending, in part a reflection of a liquidity crunch. Although 48 percent of the OFN respondents expanded their lending in the fourth quarter of 2008, this was less than the 63 percent who reported an increase in new applications. Only 30 percent decreased their lending in the fourth quarter. In the interviews for this paper, several respondents confirmed that in the first two quarters of 2008 their institutions had strong application and lending levels, while in the second two quarters business began to slow. At the same time, some are reporting that the pipeline for 2009 is quite dead. An executive director of a nonprofit loan fund, who described the organization as a "one-trick pony" in housing, reported that its pipeline is down 41 percent for the current year.

In general, CDFIs and CDIs in the housing and real estate areas reported significant slowing in demand and increased difficulties with their deals. This is particularly true of nonprofits in the for-sale, housing/homeownership realm, which are facing borrower concerns about declining home values.

Troubles are also apparent in affordable housing development. The troubles at Fannie Mae and Freddie Mac coupled with the difficult economic climate have created a disaster for the LIHTC program. Fannie Mae and Freddie Mac, the two largest LIHTC investors, exited the markets. Prices have dropped for new credits, and many report that the more complicated deals are going begging for investors. The market is also depressed on fears that Fannie Mae and Freddie Mac will sell their investments into the market and increase oversupply even more. One housing finance expert estimated cumulative LIHTC equity deficits from 2008 and 2009 as large as $10 billion, "virtually threatening to halt production of new affordable rental housing in parts of the country." It is unclear whether the $2.25 billion in gap funds provided by TCAP and the provision in ARRA allowing states to exchange up to 40 percent of unusable 9 percent Tax Credits will close the holes or whether the investor market will improve enough to avoid the need for further interventions. In California, 57 out of the 75 2008 LIHTC transactions were reported to still be seeking equity investors as of April. Two CDFIs with whom I spoke participated in this market as predevelopment and acquisition lenders whose loans get repaid when the tax credit deal closes. One of these was fairly sanguine that new TCAP money in the stimulus bill to close gaps in tax credit deals would eventually get these loans paid back. The other CDFI was not so sanguine. The delays in closing were causing cash flow issues, and the respondent raised concerns that new appraisals were changing the composition of the deals and the proceeds at closing. In one example, the respondent described a deal originally appraised at $12 million. Six months later, it appraised at $9 million.

Of course, the mortgage foreclosure epidemic that has slowed housing originations has also created a huge demand in low-income communities for strategies and resources to stabilize housing prices and deal with vacant properties. Several participants in the community development finance movement have identified this as the number one issue and have shifted their business focus to this problem. One respondent described neighborhood stabilization as the "topic du jour" for the community development finance movement. The availability of neighborhood stabilization funds from HUD has also provided incentives for CDFIs and CDIs to explore this market need and opportunity.

Likewise, housing-focused CDFIs and CDIs are hoping to take advantage of large sums of money in the stimulus bill related to the "greening" and weatherization of the housing stock. The greening of the affordable housing movement began several years before the financial crisis, but the stimulus package has provided incentives for more players to explore this market.

CDFIs and CDIs working on small business lending noted that more of their borrowers were having difficulties in the downturn, but in the conversations on small business lending, the collected stories actually painted this line of business in a more positive light. With the financial crisis and the credit tightening by the large banks, more small businesses have come to the CDFIs and CDIs for credit. In general, CDFI/CDI lenders expressed concerns about having sufficient liquidity for funding the new demand. Several observers also noted that these small businesses, until now able to borrow from the mainstream banks, were generally stronger enterprises than the typical customers of CDFIs or CDIs. In some cases, these community-based lenders were optimistic that the new borrowers had the potential to strengthen their books, but they were still cautious about how to underwrite the loans in an uncertain economic climate.

Several respondents reported strong demand for financing of charter school and community facilities. One CDFI leader noted a shift in his lending business away from "for lease" commercial real estate, whose markets are quite weak, to public facilities lending. In particular, he found that these deals would continue to close because they usually included "soft debt" from a public entity or backed by the public entity in some way.

The New Markets Tax Credit (NMTC) program is an area of focus for the community development finance movement and a tool that many are using to support their missions and raise capital for their activities. One of the surprising findings of this inquiry was that the NMTC investments held up in 2008, practically matching the 2007 program levels. Participants in the market, though, are expressing some concerns. Although there has been only a modest weakening of the price of equity in the deals, down two to three basis points, the debt that allowed leverage in the deals has withdrawn considerably. There is also some emerging concern about the availability of equity at a good price for future deals. Many have watched or suffered from the dramatic changes in the LIHTC market. The additional $3 billion provided in the stimulus package, on top of the 2009 program level of $3.5 billion, raises concerns about an oversupply of the credits in a market in which many of the typical investors are not making a lot of income against which to apply the credits.

There are also several noteworthy stories of CDFIs and CDIs stepping up to fulfill their missions, and provide unique help to communities during the hard times. Perhaps the best example of this mission-driven act occurred during the budget stalemate in California. Unable to come up with the cash to meet its obligations, the state issued IOUs to many of the nonprofits to which it owed money. For many nonprofits, already strapped for cash, the IOUs presented a challenge in meeting their own obligations. The Low Income Investment Fund stepped up to support its customers by providing bridge loans secured by the state IOUs.

## Short-Term and Long-Term Implications for Policymakers and the Industry

This inquiry has highlighted that, as with every other credit provider in the country, CDFIs and CDIs are experiencing difficulties. The economy as a whole is going through a period of deleveraging and risk reduction from the largest capital markets players to the consumer balance sheet. This period will challenge all financial institutions; if prolonged, many more will fail.

Public interventions in the financial services sector so far have been justified not by the challenges that the economy has placed on the financial institutions themselves, but by the impact that troubles in these institutions have on the real economy. This same rationale could apply to the community development finance industry. The CDFIs and CDIs present a unique and discreet case for public intervention.

Although the nature of this research makes it difficult to generalize broadly, the themes that emerged suggest several ways the public sector could support the community development finance industry through this period, and into the future.

## Short-Term Options for Public Support

In the short term, the public sector must recognize the importance of the community development finance industry in serving populations underserved by the mainstream financial institutions. Many of the low-income communities served by CDFIs and CDI are hurting. In fact, the financial crisis is having a disproportionate impact on these people and their neighborhoods. The CDFIs and CDIs are uniquely designed as the delivery vehicle for credit and investment services to these communities in these times. As such, the public sector should focus on the following:

- Implement the Recovery Act quickly. The first and best thing the government can do is to continue to get the stimulus funding on the street as quickly as possible. It is apparent that the timing of federal money already appropriated is important for many institutions. As CDFI and CDI portfolios weaken and other investors consider renewal funds or new grant applications, the ability of these institutions to access federal grant money from the Treasury and get allocations of other stimulus funds will be important in allowing these institutions to fulfill their missions, and survive.
- Identify additional resources to support community development finance. The industry needs more resources, and it would benefit America's low-income communities if the industry had more resources. The funding provided in the stimulus package is likely insufficient to turn around negative developments in many communities, given the economic strains. This is particularly true if mainstream financial institutions continue to withdraw support for small businesses and local nonprofits doing community and economic development work. The policy issue lies in what form the new assistance can take.

  Many voices in the community development finance movement have identified Troubled Asset Relief Program (TARP) funds as a potential source of the needed resources. The government provided TARP funds not only to mitigate systemic risk, but also to remove toxic assets from bank balances and take other steps to increase liquidity and lending across the system. Although the public attention has been on the TARP payments to the large banks and AIG, many relatively small community banks have also benefited from TARP funds.

  It seems that the government's principal concern in providing CDFIs and CDIs access to the TARP funds is the lack of a regulator ensuring safety and soundness for many of these institutions. The concern is that there is no entity able to ensure that the CDFIs or CDIs have the ability to repay the funds to the Treasury and no regulator to ensure that the funds are used in a manner consistent with the law and other public policy considerations affecting TARP funds.

  It may also be that CDFIs or CDIs would find the TARP requirements too onerous or that the funding terms and conditions would not work for the kinds of credits and products they support. CDFIs and CDIs should be careful what they wish for given widespread concerns among TARP recipients that the government's role in their institutions has been difficult.

The CDFI Fund has been tailored to the needs of the diverse institutions that make up the CDFI movement. The cleanest response would provide additional resources to the CDFIs through this vehicle. The administration's proposal to increase funding to $243.6 million in the 2010 budget is very helpful and represents a strong commitment to the industry. However, policymakers should consider the more immediate needs of the CDFIs should a supplemental appropriations vehicle move through Congress.

Likewise, policymakers could consider a supplemental appropriation to the Capital Magnet Fund created in HERA. The President's 2010 budget calls for an appropriation of $80 million for the Capital Magnet Fund, but the process means that these funds will not likely become available until next year. In the shorter term, in advance of the 2010 appropriations process, the administration, through its conservatorship control of Fannie Mae and Freddie Mac, could make the decision to fund the Capital Magnet Fund. The Treasury Department will need to accelerate its process to get the rules for this program in place.

## Longer-Term, Public-Sector Support

Over the longer term, the public sector should consider the following policy options for the community development finance industry and its institutions.

- Revise CRA and strengthen its enforcement. The community development finance model relies on strong CRA environment. As the administration and Congress move to rewrite financial services regulations, they should give significant consideration to modernizing the act. An important rationale for creating the Community Reinvestment Act in 1977 was the quid pro quo for deposit insurance. It is now clear the depth to which the public sector supports the franchises of all large financial institutions, including many financial institutions not currently subject to the CRA. Among the reforms to consider are extending the CRA's coverage to more financial institutions, such as investment banks and insurance companies; deepening the expectations for successful performance by financial institutions; assessing the entire corpus of the financial institution's business, not just for selected assessment areas; and devising an enforcement mechanism that does not rely on rare events like mergers to come into play.
- Extend the NMTC program and make it permanent. The New Markets Tax Credit (NMTC) has become a valuable tool in supporting the work of the community development finance movement. Policymakers should make it a permanent tool for economic and community development. At the same time, Congress and the administration should review the array of tax-advantaged investments in the tax code and rationalize the different rules and features that can cause different energy, housing, and community development credits to compete with one another in the pool of tax-advantaged investment dollars. Changes in the program design that are more advantageous to investors in one program can disadvantage other programs that rely on their tax advantages to raise capital. As an example, the government should consider making the NMTC exempt from the alternative minimum tax similar to the low-income housing and the energy tax credits.
- Consider strengthening the regulatory infrastructure for CDFIs and CDIs. As these institutions continue to grow in sophistication and scale, deliver increasing amounts of public program resources, and attain a place of importance in the credit needs of their communities, the public gains an increasing interest in ensuring their safety, soundness, and compliance with laws and regulations. The reluctance of the federal government to place TARP money in these institutions is indicative of a legitimate concern. A regulatory infrastructure must recognize the unique missions of these organizations, but also ensure a greater level of transparency, provide current data for evaluation purposes, and ensure certain governance standards that seem appropriate. The regulatory regime should also consider better metrics for measuring government-funded community development finance results so the public can evaluate the social return on its investments.

## Implications for the Industry

It is a certainty that the economic downturn will eventually end. What is uncertain is how this economic crisis will reshape the industry. Given the industry trends and expected fallout of the financial crisis, several hypotheses emerge for where the industry will land.

- Industry will benefit from consolidation and economies of scale. To a certain extent, the failures of some CDFIs may benefit the industry as a whole. To the extent that the economic troubles force mergers and consolidations, the resulting larger institutions will have the opportunity to achieve economies of scale and build stronger balance sheets. With stronger balance sheets comes the ability to raise more capital and participate in developments that have a greater impact on their communities. The regulator should seek to support this natural process of creative destruction. At the same time, a thoughtful regulator must consider the effects on the delivery system for community development investments if the failing institutions are unique to a particular geography and no other institution is positioned to step up and meet the needs of that community.
- CDFIs should continue to position themselves as the premier delivery vehicle for federal credit programs. Those institutions that are vertically integrated provide an excellent opportunity to finally break down the silos across the many federal programs that are the tools of local community development efforts. The integrated community investment institutions have taken on not only housing, but small-business lending, commercial real estate, charter schools, and other public facilities. In some communities, the entrepreneurial CDFIs and CDIs are delivering the full range of credit programs from the federal government and other sources. It is possible that these institutions represent a route to achieve what the community development field has as yet been unable to achieve: Bring the integrated and comprehensive credit and development services to bear on the community development challenge.
- Industry will benefit from greater transparency and regulation. Efforts by several groups to devise systems of measuring the strengths and social impacts of the CDFIs and CDIs can only benefit the industry as a whole. This research has indicated a desire by investors in these institutions, both private companies and philanthropies, for a higher standard of care for the resources invested and a better justification for investments' social impacts in these institutions. Investors will continue to push the CDFIs and CDIs to develop quantitative metrics measuring impact and return on investment. The industry should embrace this change. The strength of the community development finance movement is its business-like approach to the social challenges it addresses.
- Market rate environment. It also seems clear that the longer-term trend for the industry is one in which a greater percentage of the capital it raises comes at market rates. Capital is practically unlimited if investors can get a market rate of return on their investment. CDFIs and CDIs that rely on below-market interest will likely limit their ability to grow and limit their effects on communities. Of course, the public and the philanthropic sectors that see the CDFIs and CDIs as a vehicle for delivering a social good will need to provide the subsidy dollars required if lower cost capital is the solution to affordable housing needs, entrepreneurship needs, public facilities needs, or new schools.
- Market to the banks. Many of the large financial institutions may have lost their ability to support community development finance in a broadly meaningful and nuanced way. As the economy emerges from the downturn and the regulatory environment accompanying the CRA returns to normal, many financial institutions will either have to rebuild the capacity to deliver services to low-income communities or they will look for strong partners to deliver these services for them. The strong CDFIs and CDIs with transparency and strong metrics for assessing community impacts per dollar invested should find themselves in a strong position to market to the banks and become even more valued as intermediaries serving these communities.

The future of community development finance is changing, for the better. Although the economic downturn is having important and mostly detrimental effects on many of these institutions, the longer-term trends suggest that the industry has become firmly rooted in the American economy and its growth trajectory will continue. The industry as a whole will benefit from the lessons of tough times and by the emergence of even stronger institutions from among those that weather the storms. Community development financial institutions are well positioned to serve as the delivery system for financial services to low-income communities in partnership with the public sector and other community-based organizations, and they are well positioned to bring meaningful change and economic development to low-income communities.

# Panel 2
# Investing From Multiple Perspectives: Know Your Partner

David Erickson
Federal Reserve Bank of San Francisco

Calvin Holmes
Chicago Community Loan Fund

Andrew Mooney
LISC Chicago

Ellen Sahli
City of Chicago

Debra Schwartz
MacArthur Foundation

## Past Articles from Federal Reserve Bank of San Francisco Publications

# Tackling Neighborhood Poverty: Developing Strategic Approaches to Community Development[1]

Carolina Reid
Federal Reserve Bank of San Francisco

Hurricane Katrina's devastation and its aftermath brought the intertwined problems of poverty, racial discrimination, and neighborhood distress into stark relief. Images of New Orleans' poorest residents trapped in the Superdome and disconnected from rescue efforts provided an apt metaphor for people long isolated and excluded from the economic mainstream. An analysis by the Brookings Institution confirmed the level of visible deprivation in neighborhoods like the Lower Ninth Ward. With one of the highest overall poverty rates in the country, New Orleans ranked second among large cities in the number of poor concentrated in extremely distressed neighborhoods. Nearly 50,000 of New Orleans' poor—mostly African Americans—lived in neighborhoods where the poverty rate exceeded 40 percent.[2]

In Katrina's wake, the question of how to rebuild New Orleans has risen to the top of domestic policy concerns and has reinvigorated a national debate about community development and its effectiveness. Liberals have argued that in rebuilding New Orleans, there is an unprecedented opportunity to use federally funded programs like HOPE VI, Section 8, and CDBG funds to create new and vibrant mixed-income communities. Social conservatives, in contrast, contend that Hurricane Katrina exposed not only great poverty, but also the fundamental failure of community development and anti-poverty policies. Stuart Butler, vice president of the Heritage Foundation, argued, "This is not the time to expand the programs that were failing anyway."[3]

Butler's perspective mirrors a more deep-seated ambivalence about the impact of community development in the United States. Why is it that neighborhoods across the country continue to face problems of poverty, segregation, and disinvestment despite more than three decades of efforts to turn them around? As Charles Buki asked at the Federal Reserve Bank of San Francisco's 2004 Community Reinvestment Conference, "How can it be that we've spent between $300-$325 billion in public dollars on community development activities, and still wind up with West Oakland still like, well, West Oakland?"[4] The field has also increasingly come under attack for focusing on affordable housing at the expense of changing communities for the better. In the words of one community development researcher, "We've become tax credit junkies, building units without stopping to think through why we're doing certain projects." New Orleans is emblematic of this trend: in the 1990s, more than 2,400 units of affordable housing were created under the Low Income Housing Tax Credit program (LIHTC), yet many of these projects were located in poor, African American neighborhoods. Arguably, the 2,400 tax credit units did nothing to connect low-income families to strong neighborhoods with living-wage jobs or good schools; instead, they reinforced their isolation from the rest of the economy.[5]

The lesson from neighborhoods in New Orleans and West Oakland—indeed, from neighborhoods around the country—is that in order to be successful, community development must address the underlying causes of poverty and work to connect poor neighborhoods and families to regional markets. In this article, we share with you an emerging consensus on

1 This article was originally published in Community Investments (Volume 17, Number 14), 2006, available http://www.frbsf.org/publications/community/investments/0602/index.html.

2 Alan Berube and Bruce Katz (2005). Katrina's Window: Confronting Concentrated Poverty Across America. The Brookings Institution: Washington, D.C.

3 Jason DeParle (2005). "Liberal Hopes Ebb in Post-Storm Poverty Debate," The New York Times, October 11, 2005.

4 Charles Buki (2004). Keynote Address at the 2004 Community Reinvestment Conference, sponsored by the Federal Reserve Bank of San Francisco, Los Angeles, California, March 29-April 2, 2004.

5 Lance Freeman (2004). Siting Affordable Housing: Location and Neighborhood Trends of Low Income Housing Tax Credit Developments in the 1990s. The Brookings Institution: Washington, D.C.

the key principles that should guide community development activities and provide tangible examples of how these ideas are being implemented in practice. But first, we take a brief look at the changing dynamics of neighborhood poverty as a way to benchmark our progress and assess what there is still left to do.

## Poverty and Community Development: People and Place

In his State of the Union address on January 8, 1964, Lyndon B. Johnson boldly announced the "War on Poverty," a multi-faceted strategy designed to encourage employment growth and expand the safety net for poor families. These programs contributed to an already declining poverty rate, and while Ronald Reagan argued that in the "war on poverty, poverty won," the next ten years saw the nation make its greatest strides against poverty since the end of the Depression. The poverty rate dropped to a low of 11.1 percent in 1973 (22.9 million people), down from 22.2 percent (40 million) just a decade earlier. Since then, the poverty rate has seesawed up and down, largely following the strength of the national economy.

From a community development perspective, however, the overall poverty rate may be of less significance than where the poor live. Known alternatively as ghettos, barrios, slums, extreme-poverty neighborhoods, blighted areas, distressed communities, and low- and moderate-income census tracts, neighborhoods characterized by high levels of poverty are often host to a wide range of social and economic ills, including violence, drug abuse, bad schools, and little legal commercial activity.

A recent study by Paul Jargowsky, a researcher at the University of Texas, found that between 1970 and 1990, the number of high-poverty neighborhoods more than doubled as the combination of de-industrialization, suburbanization, and "white flight" decimated inner city communities.[6] As with the overall poverty rate, however, this trend reversed during the 1990s, and the population living in high-poverty neighborhoods dropped precipitously. Jargowsky estimates that the number of people living in high-poverty neighborhoods declined by 24 percent, or 2.5 million people, over the course of the decade.

While this decrease in neighborhood poverty is good news, Jargowsky cautions that significant pockets of poverty remain, and that new pockets of poverty are emerging. Many cities including New Orleans, Baltimore, and Detroit have still to overcome the increase in neighborhood poverty during the 1970s and 1980s. The most recent data from the Census also shows that the concentration of poverty is shifting from central cities in the East and Midwest towards rapidly growing Western metropolitan areas. Cities like Fresno, Los Angeles, and Las Vegas all saw large increases in the number of high poverty neighborhoods, reflecting high levels of immigration coupled with local labor markets dominated by low-wage jobs (see Figure 1). In addition, as the national poverty rate has risen since the last Census, there are concerns that the gains made in neighborhood poverty during the 1990s will be eroded.

The challenge for the community development field is to respond to these changing patterns of neighborhood poverty and to continue to work to reverse the effects of decades of disinvestment in low-income and minority communities. Living in high poverty neighborhoods magnifies the problems faced by the poor, and exacts high social and economic costs. Research has shown that:

- Living in extremely poor neighborhoods creates significant barriers to finding and traveling to jobs in other parts of a metropolitan area.[7]
- Children who live in extremely poor urban neighborhoods are more likely to drop out before receiving a high school degree, and are at a greater risk of engaging in criminal behavior and drug use.[8]

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6 Paul A. Jargowsky (2003). *Stunning Progress, Hidden Problems: The Dramatic Decline of Concentrated Poverty in the 1990s.* The Brookings Institution: Washington, D.C.

7 Keith Ihlanfeldt and David Sjoquist (1998). "The Spatial Mismatch Hypothesis: A Review of Recent Studies and their Implications for Welfare Reform," *Housing Policy Debate* 9(4): 849-92.

8 Anne Case and Laurence Katz (1991). "The Company You Keep: The Effects of Family and Neighborhood on Disadvantaged Youth," *NBER Working Paper 3706*, Washington, D.C. and Marjory Austin Turner and Ingrid Gould Ellen (1997). "Location, Location, Location: How Does Neighborhood Environment Affect the Well-Being of Families and Children?" Urban Institute, Washington, D.C.

Figure 1

| Top Ten Cities with the Highest Rate of Concentrated Poverty | |
|---|---|
| Concentrated Poverty Rate | |
| Fresno, CA | 43.5 |
| New Orleans, LA | 37.7 |
| Louisville, KY | 36.7 |
| Miami, FL | 36.4 |
| Atlanta, GA | 35.8 |
| Long Beach, CA | 30.7 |
| Cleveland, OH | 29.8 |
| Philadelphia, PA | 27.9 |
| Milwaukee, WI | 27.0 |
| New York, NY | 25.9 |

Source: The Brookings Institution, Katrina's Window: Confronting Concentrated Poverty Across America, 2005. Concentrated Poverty Rate reflects the proprotion of the poor living in neighborhoods with a poverty rate of over 40 percent in 2000.

- The incidence of depression, asthma, diabetes, and heart disease are all greater in high poverty neighborhoods.[9]
- The lack of competition and market information in high poverty neighborhoods results in poor families paying more for basic needs and services, such as groceries, financial services, auto insurance, and home mortgages, making it even more expensive to be poor.[10]

Revitalizing neighborhoods and reducing concentrated poverty by providing access to quality affordable housing, strong public schools, convenient and comprehensive transportation options, living-wage jobs, and even access to supermarkets and parks and public spaces can therefore help to end the vicious cycle that keeps poor families from moving up the economic ladder.

## Addressing Neighborhood Poverty: Principles of Strategic Community Development

In place of community development work that has been criticized for being overly focused on housing production, CDCs, CDFIs, and other community based organizations are in fact working in a multitude of ways to tackle neighborhood poverty in a comprehensive and strategic way. Increasingly, neighborhoods are being seen as dynamic, unique places where cookie-cutter approaches to solving poverty won't work. Urban renewal—which isolated or divided neighborhoods and removed large numbers of ethnic and minority residents—has given way to empowering local residents and developing mixed-income communities connected to the wider economic region.

In part, this has been made possible through the innovations in both "place-based" and "people-based" programs and policies implemented during the Clinton administration, such as New Markets Tax Credits, HOPE VI, the CDFI Fund, and asset-building efforts like expanding the Earned Income Tax Credit and creating Individual Development Accounts. In addition, the philanthropic community has made a sustained commitment to neighborhoods across the country through a variety of Comprehensive Community Initiatives (CCIs), building leadership among local residents and organizations and

9 Deborah Cohen et al. (2003) "Neighborhood Physical Conditions and Health," Journal of American Public Health 93(3): 467-471.

10 Matthew Fellowes and Bruce Katz (2005), "The Price Is Wrong: Getting the Market Right for Working Families in Philadelphia," The Brookings Institution, Washington, D.C.

investing in both the "soft" and "hard" sides of redevelopment. And innovative partnerships between the public and the private sector, are forming the basis for initiatives that have both a social impact and economic return.

As a result, in cities across the country—from neighborhoods like the South Bronx in New York City to places like South Bend, Indiana–once distressed communities are showing signs of revitalization. While not all of these efforts have been met with universal success, they contribute to a growing understanding of the principles of successful community development. Outlined below, these principles offer important guidelines for financial institutions interested in maximizing the impact of their CRA-related activities, as well as for other organizations working to minimize neighborhood poverty.

## Understanding Neighborhoods, Understanding Needs

Neighborhood poverty is driven by different factors in different places: whereas one neighborhood may be suffering from de-industrialization and the historical legacy of redlining and segregation, another neighborhood may be poor as the result of rapid population growth and the proliferation of temporary, low-wage jobs. One key lesson from past mistakes is that although community development finance tools don't vary, neighborhoods do, and projects should be targeted to meet local community development challenges.

Undertaking a "neighborhood" market analysis can yield important insights into the community development activities that are needed. One successful model has been implemented by The Reinvestment Fund (TRF) as part of Philadelphia's Neighborhood Transformation Initiative, which seeks to tailor community development strategies to the distinct market conditions of disparate neighborhoods. Using a variety of indicators—including vacant land, property values, and residents' credit scores—TRF ranked each of Philadelphia's neighborhoods into six categories, from desirable ''regional choice" areas to distressed "reclamation"neighborhoods. These categories are then used to inform neighborhood strategies. For example, in "regional choice" neighborhoods— those with high, appreciating property values and often only home to the wealthy—it makes sense to support an employer assisted housing initiative that would help to integrate more low-income working families into the community. In contrast, in "reclamation" neighborhoods— those with high levels of deterioration and little commercial presence—the market demand for new housing is low, and it may be better to focus on renovating vacant and derelict properties or providing job training and placement services for local residents. Other groups like Social Compact, MetroEdge, and the Initiative for a Competitive Inner City have also demonstrated that neighborhood-level analyses can identify "hidden" assets and market demand in low-income neighborhoods, which can be capitalized on through neighborhood revitalization efforts.

A second key element to tailoring community development solutions to the neighborhood is involving residents in the planning process. In the words of Angela Glover Blackwell, CEO of PolicyLink, "Don't put the tax incentives in place ahead of genuine community engagement in decision-making about the type of community and city to be built."[11] Involving the community provides a much richer picture of the neighborhood's needs and opportunities, and forms the foundation for successful revitalization efforts. In Baltimore, for example, it was the residents of Patterson Park who identified a growing problem of vacant houses in the community, prompting the local CDC to focus on this issue and develop a strategic rehabilitation program. Since the program's inception, more than 200 homes have been renovated, and the community has benefited from increases in property values and the return of private investment in the neighborhood.

Increasingly, institutional lenders and investors are recognizing the value of engaging residents at the beginning of the planning process, with the understanding that projects that don't are unlikely to achieve the highly sought after 'double bottom line.' The Wachovia Regional Foundation, for example, offers neighborhood planning grants between $25,000 and $100,000 that support the development of resident-driven neighborhood plans that take comprehensive approaches to revitalization. After developing a neighborhood plan, groups can apply for larger implementation grants from the foundation, and "bankable" projects that emerge as a result of these efforts may be referred to Wachovia's community development finance division. William Hannah, CEO of Cedars Bank, similarly noted that the linchpin for the success of Market Creek Plaza in San Diego was the "consistent, sustained effort to find out what residents wanted". Engaging with the community

11 Angela Glover Blackwell in Joan Walsh (2005). "After the Deluge, What Next?" Salon.com, September 28, 2005.

on a regular basis provides Cedars Bank a nuanced understanding of their customers' financial needs, resulting in a more profitable business relationship.

## Building Strong Partnerships for Change

As emphasis has shifted away from top-down, government-led projects, the community development field has increasingly relied on partnerships among neighborhood leaders, CDCs, intermediaries, the private sector, and government to mobilize the financing, technical expertise, and political will needed to revitalize neighborhoods. In some cities, broad coalitions are emerging as a way to share best practices and collectively tackle tough problems. Partnerships are vital to the community development finance industry as well, with loan funds and other collaborative investment vehicles helping to reduce the risk associated with new ventures. There is also a growing belief that collaboration that consolidates back office functions and promotes innovations in accessing capital markets will be necessary for the industry to achieve scale.[12]

While the importance of public-private partnerships in community development is now well established, the strength of those partnerships often depends on the capacity of the different organizations at the table. One of the challenges facing many of the rapidly growing metropolises in California and Nevada—as well as in suburban areas and smaller cities across the country—is that the infrastructure for community development is not yet fully developed. The field must continue to invest in building the capacity of CDCs and other community groups to undertake multi-faceted and complex projects. The need for organizations with effective internal systems and diversified sources of funding—in particular self-sustaining sources of capital—has become even more pressing as community development programs continue to get targeted for cuts at the federal level.

Facilitating this type of capacity building isn't, however, easy. It requires patient capital and patience, as well as project-related technical assistance and support. Where this type of sustained support for CDCs exists, the results are impressive. The National Community Development Initiative (NCDI)—now known as Living Cities—is an innovative partnership among foundations, insurance companies, government agencies, and banks that has invested in a long-term strategy to build the capacity of CDCs in 23 cities across the country. The initiative has provided more than $370 million to over 300 CDCs since 1991, allowing them to diversify their funding bases, build leadership, increase their capacity to build affordable housing, attract, train, and retain more persons of color in professional CDC positions, and expand into other activities such as health care clinics, child care centers, and community facilities. The initiative has more than doubled the number of top-tier CDCs, and 19 of the 23 cities have seen significant improvements in neighborhood quality on the ground.[13]

## Strategic Community Development: Integrating People and Place Based Solutions

With a solid understanding of the neighborhood and strong partnerships in place, it becomes possible to develop a strategic approach to community development, one that addresses underlying problems and develops a range of solutions to tackle them comprehensively. It is here that the mistakes of the past provide the best lesson for what not to do: whether funded by large government public works dollars or nimble private sector tax credits, building low-income housing in low-income communities will only serve to further exacerbate the problems of the poor by segregating them in neighborhoods with weak labor and real estate markets.

Unfortunately, although the lesson of what not to do is abundantly clear, the converse is not; there is no straightforward formula that guarantees success. Still, there is a growing consensus that tackling neighborhood poverty in a sustained fashion will require integrating people-based strategies— efforts that support community residents and link them to quality schools and jobs—with place-based strategies—those that stabilize the neighborhood and connect it to the regional economy. Richard Baron, chairman and CEO of McCormack Baron Salazar, a for-profit housing developer in St. Louis, argues that even though funding for community development flows vertically, interventions have to happen

12 Kirsten Moy and Alan Okagaki (2001). Changing Capital Markets and Their Implications for Community Development Finance. The Brookings Institution: Washington, D.C.

13 Christopher Walker, Jeremy Gustafson, and Christopher Snow (2002). National Support for Local System Change: The Effect of the National Community Development Initiative on Community Development Systems. The Urban Institute: Washington, D.C.

horizontally. "You can't redevelop neighborhoods vertically. The only way these areas will ever function successfully is if we start thinking and solving problems horizontally. The design and the reintegration of housing into a community has to be broad—it has to encompass streets and parks, jobs and education—so that the housing itself can begin to re-knit an area."[14]

While simple on its surface, this principle is actually quite hard to implement in practice. As Jeremy Nowak, CEO of the Reinvestment Fund, has argued, "the community control ideology of neighborhood development often regards locality in strategic isolation from the rest of the economy."[15] Funding requirements often prohibit more integrated approaches, and some programs provide perverse incentives that perpetuate the mistakes of the past. Forced to compete for limited development funds, most CDCs are left with small, undercapitalized projects that are unable to leverage economies of scale or connect poor neighborhoods to regional economies. Building affordable housing in better neighborhoods is often thwarted by NIMBY sentiments and higher land costs. And strategies that try to defy programmatic "silos" often quickly bump up against silo walls.

Nevertheless, where community development has worked, it has done so by increasing market demand in poor neighborhoods. According to Bruce Katz of the Brookings Institution, the goal is to create "neighborhoods of choice and connection." In other words, to be successful, community development must build neighborhoods in which a range of families—including those with higher incomes—choose to live, and where all families have access to the amenities good neighborhoods provide, including high quality education, transportation options, and jobs.[16] The HOPE VI experience shows that building mixed-income developments can serve as an important catalyst for this type of neighborhood revitalization.[17] An early analysis of eight HOPE VI sites found significant improvements in most of the once-distressed neighborhoods, including increased neighborhood income, property values, and private investment.[18] There is also increasing evidence that targeting multiple resources in a community can produce a "tipping point" for revitalization, stimulating enough improvement that the private market takes over. For example, under its Neighborhoods in Bloom program, the city of Richmond, Virginia redirected nearly all of its HOME and CDBG funds into only seven neighborhoods, resulting in dramatic changes in property values and market activity.

However, focusing solely on the "place-based" work of rebuilding the community's bricks and mortar—even if it is through well-designed mixed-income developments that grow market demand—will only result in the creation of new ghettos of the same poor families. Revitalizing neighborhoods without paying attention to the residents already living there turns "revitalization" into a code word for "gentrification." In fact, one of the major criticisms of HOPE VI has been that it rebuilds communities at the expense of existing residents. In some HOPE VI sites, the program forced residents to move out of communities in which they had established important social networks and placed them into new housing situations that were equally or even more precarious.[19]

Successful community development policies therefore also must focus on increasing residents' incomes and connecting them to opportunity. Inclusionary zoning regulations and housing vouchers can help low-income families move to better neighborhoods (and increase their access to opportunity that way), but true "community" development occurs when neighborhood improvements benefit low-income residents and build on the existing social fabric. The best HOPE VI projects have recognized this principle, and have incorporated community building strategies and supportive services that address existing residents' educational and economic needs. In other neighborhoods, CDCs are pursuing innovative approaches

14 Great Cities Institute (1996). Creating Mixed Income Neighborhoods: A Challenge to Chicago's Leadership. University of Illinois at Chicago; and Bruce Katz (2004). Neighborhoods of Choice and Connection: The Evolution of American Neighborhood Policy and What it Means for the United Kingdom. The Brookings Institution: Washington, D.C.

15 Jeremy Nowak, "Neighborhood Initiative and the Regional Economy." Economic Development Quarterly 11 (1): 3–10.

16 Katz (2004). Neighborhoods of Choice and Connection.

17 Valerie Piper and Mindy Turlov (2005). HOPE VI and Mixed-Finance Redevelopments: A Catalyst for Neighborhood Renewal. The Brookings Institution: Washington, D.C.

18 Sean Zielenbach (2003). The Economic Impact of HOPE VI on Neighborhoods. Housing Research Foundation: Washington, D.C.

19 Susan J. Popkin et al. (2004). A Decade of HOPE VI: Research Findings and Policy Challenges. The Urban Institute: Washington, D.C.

that link commercial revitalization and housing redevelopment with small business incubation and workforce training. Still others—like the Annie E. Casey Foundation's Making Connections program—focus on building strong families by encouraging financial security and asset building, and tying these strategies to other community supports like childcare.

## Conclusion

The overarching lesson from community development successes and failures isn't that every organization must tackle every problem, but rather that the integration of efforts through partnerships and the strategic targeting of resources holds much promise for reducing neighborhood poverty. Financial institutions are key partners in this. According to one estimate, financial institutions make more than $100 billion in CRA-related loans and investments each year.[20] These dollars provide perhaps one of the largest and most sustained sources of capital to low-income communities and families, and efforts to target these dollars strategically would have a visible and positive impact on neighborhoods—and on the bottom line. In the words of Mark Willis, executive vice president at JP Morgan Chase, it's time to work harder towards getting the "biggest bang for our CRA buck."[21]

To do this, however, financial institutions will need to stop seeing community development "deals" in isolation of one another. It will require a more targeted approach to CRA-related activities, one that uses data, community input, and research to assess the types of projects that should be financed—and to say no to those that don't meet the criteria set for community impact.[22] It may also mean that financial institutions will have to take a leadership role in establishing partnerships that bring their connections to the wider economy to bear on neighborhood issues. Anne Kubisch, Co-Director of the Aspen Institute's Roundtable on Community Change, noted that "when financial institutions take a leadership role in community development in a neighborhood, it sends a powerful message, one that can bring new partners with real resources to the table."

Even so, financial institutions can't do it alone. While the private sector is a powerful actor in community development, government programs at both the federal and local level are critical, both to "soften" the risk of investing in economically distressed areas and to provide incentives for innovation. Recent efforts to dismantle funding for housing vouchers, the CDBG program, HOPE VI, and the CDFI Fund threaten to undermine the positive impacts these programs are having on low-income communities, and may only further limit the ability of the community development industry to tackle neighborhood poverty in a comprehensive way. Without the concerted efforts of both the public and the private sector, the continued existence of neighborhoods that look like New Orleans' Lower Ninth Ward is a foregone conclusion.

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20 Michael S. Barr (2005). "Credit Where It Counts: The Community Reinvestment Act and Its Critics," New York University Law Review 75: 101-233.

21 Mark Willis (2003). "Building a Sustainable Community Development Business," Speech delivered at Community Reinvestment Act Conference at the Consumer Bankers Association, April 14, 2003.

22 Willis (2003).

# Panel 3
# Online Tools for Community Development Investing

Prabal Chakrabarti
Federal Reserve Bank of Boston

Ian Galloway
Federal Reserve Bank of San Francisco

Lisa Hall
Calvert Foundation

Kirk Inglis
Prosper Marketplace

Giovanna Masci
Kiva.org

## Past Articles from Federal Reserve Bank of San Francisco Publications

# Peer-to-Peer Lending and Community Development Finance[1]

Ian Galloway
Federal Reserve Bank of San Francisco

## Introduction

Peer-to-peer (P2P) networks directly connect computer users online. Popular P2P platforms include eBay and Craigslist, for example, which have transformed the market for used consumer goods. Increasingly popular, however, are P2P lending sites that facilitate debt transactions by directly connecting borrowers and lenders on the Internet. In fact, since 2005, P2P lending sites have cropped up all over the world—Kiva, MicroPlace, Lending Club, and Prosper are a few examples. Currently a $647 million industry, online P2P lending is expected to grow to $5.8 billion by 2010.[2] P2P lending has the potential to channel significant capital to the community development industry by efficiently connecting investors to revitalization efforts in low- and moderate-income (LMI) communities. This article explores the potential challenges and benefits of P2P lending in community development finance and addresses some of the changes that need to take place in order to facilitate the growth of this emerging industry.

### The P2P Platform

P2P lending platforms differ dramatically in type and approach. Some connect borrowers and lenders directly; others connect them via a third-party intermediary. Some P2P sites allow lenders to set interest rates; others preset rates based on historical performance and credit score. Many have charitable missions; others are strictly for-profit. Socially-motivated sites tend to promote microenterprise development in developing countries.

For-profit sites tend to focus on domestic borrowers, offering unsecured consumer loans to individuals who either do not want to use mainstream debt products or do not have access to them. For the most part, internet-based P2P lending functions on the basis of trust, albeit trust between people that have only met in cyberspace. P2P lending sites match individual borrowers with individual lenders. Borrowers share information about themselves—both personal and financial—and lenders decide whether or not to contribute to their loan request. Every loan is underwritten by multiple individual lenders, each committing a fraction of the loan until it is funded in full. Once fully funded, the loan is originated and the lenders receive their pro rata share of the principal and interest payments until the loan reaches maturity or the borrower defaults.

It is important to note, however, that P2P "lending" is somewhat of a misnomer. In fact, no platform allows lenders to lend directly to borrowers. Platforms either: (1) broker loan reimbursements through interest-free investments; (2) broker the sale of securities backed by their issuers; or (3) facilitate the origination of loans which are sold as securities to P2P investors who behave like lenders (and who may not even realize the nuance). For clarity's sake, P2P "finance" will be used in this paper to describe all three platforms.

### Capital Markets Challenge: Community Development Assets

The issue of how best to connect community lenders with the capital markets has been a difficult one. Much of the focus thus far has been on securitization. Securitization allows lenders to pool assets of a similar type and sell pieces of the pool to investors. This spreads credit risk across multiple loans and reduces each investor's exposure to discrete defaults. The difficulty with securitization with respect to community development, is that it relies heavily on the homogeneity of the underlying pooled assets. Unlike commonly traded assets such as mortgage-backed securities (MBS), community

1 This article was originally published in Community Investments (Volume 21, Number 3), 2009, available http://www.frbsf.org/publications/community/investments/0912/index.html.

2 Interview with Prosper CEO Chris Larsen on July 23, 2009. Source: Celent, a research and consulting firm focused on the application of information technology in the global financial services industry.

development loans tend to be unconventional and difficult to pool. The capital markets value standardized, predictable assets and community development loans tend to be neither.[3] The result is unfortunate on two levels: investors undervalue and community development assets and conventional lenders shy away from community development loans because investor demand is depressed. This self-perpetuating liquidity logjam has a severely negative effect on community development activity.

Limited access to the capital markets leads many community lenders, those institutions that finance community development projects, to depend heavily on borrowed funds. Unfortunately, this increases their exposure to down-cycle economic risk. When the economy weakens, bank lending dries up, foundation giving contracts, and community lenders have nowhere to turn for new capital—a scenario that is all too familiar in the current economic environment. This poses a particular challenge to community lenders trying to service struggling LMI borrowers because when workouts, principal reductions, and patience are most needed, these lenders are financially hamstrung to provide them.[4]

### A Potential Solution: P2P Finance Platforms

P2P finance platforms are well suited to both originate and broker the sale of community development loans for a number of reasons. For one, they depend heavily upon transparency. For another, a P2P market for third-party issued loans, should the SEC permit it,[5] would offer community lenders a much-needed source of additional capital. And finally, whether they broker the sale of securities or originate loans on-site, P2P finance platforms would allow investors to evaluate community development loans on a loan-by-loan basis at relatively low cost.

P2P finance platforms could also provide individuals a means, other than charity, to invest in their own neighborhoods or causes that they care about (e.g., Gulf Coast recovery). Instead of waiting for large institutional investors to lead the neighborhood redevelopment charge, individual investors could provide much needed seed financing for a number of community development projects—new community facilities, affordable housing, school rehabilitation, street beautification, playground construction, etc. P2P finance platforms are naturally well-equipped to support these projects because they function at the intersection of finance and social networking.

Institutional investors may find P2P finance platforms useful as well. For example, CRA-regulated institutions invest heavily in community development assets. Because these assets can be difficult to identify, some banks invest in mutual funds composed of loans located in their LMI geographies. While participating in these funds can be less labor-intensive than ad hoc investing, banks pay a premium to farm their underwriting out to a third party. P2P finance platforms could offer a more cost-effective alternative.

## Issues to Consider

### Loan Size and Terms

The average P2P loan size is small—$8,626 on Lending Club, $6,172 on Prosper, and even smaller on the microfinance platforms Kiva and MicroPlace. Community development loans, in contrast, tend to be much larger— loans originated by the Low Income Investment Fund, a large national CDFI, average $935,023, for example.[6] The prospect of cobbling

3 Laura Choi, "Creating a Marketplace: Information Exchange and the Secondary Market for Community Development Loans." Federal Reserve Bank of San Francisco's Working Paper Series: 2007–01. Available at http://www.frbsf.org/publications/community/wpapers/2007/wp07-01.pdf.

4 Nancy Andrews, "The Economic Crisis and Community Development Finance: An Industry Assessment," Federal Reserve Bank of San Francisco Working Paper Series, June 2009. Available at http://www.frbsf.org/publications/community/wpapers/2009/wp2009-05.pdf.

5 To date, only one platform, MicroPlace, has been granted approval from the Securities and Exchange Commission (SEC) to sell third-party-issued securities to multiple individual investors on its site without triggering a suitability requirement. While this is a key regulatory achievement, it is important to note that securities sold on MicroPlace are backed by their issuer—not the lender or the end borrower. The SEC has yet to allow any P2P finance platforms to sell third-party issued securities backed by assets (loans) online.

6 Low Income Investment Fund Frequently Asked Questions, available at http://www.liifund.org/ABOUTLIIF/FAQ.htm#averageLoanSize.

together enough individual investors to fund loans of this magnitude is worrying. As a result, some community development loans seem better suited for P2P finance platforms than others. Predevelopment loans, microloans, small business loans, and working capital loans seem to hold more promise than large affordable housing loans (which constitute the bulk of community lending). Another option is to use P2P finance platforms to raise money for smaller projects that complement larger community developments. A playground on a new charter school site; a computer lab in an employment resource center; a mural on a park wall—P2P investors could augment large projects with targeted, yet appropriately modest, funding commitments.

Loan terms are also a concern. Most P2P finance platforms offer a single product: a three-year fixed, amortizing loan. Designed to simplify the transaction for the lender and borrower, these terms do not mirror those typically offered by community lenders. Community development loans often have longer maturities, variable rates, and balloon payment terms. P2P finance platforms would have to offer a more diverse set of products to meet the unique needs of community development borrowers.

## Underwriting and Servicing Challenges

Underwriting community development loans takes special expertise. As discussed earlier, funding community projects is challenging and complying with public program rules can be complex. Lenders need to understand all projects risks, including compliance risk, and the recourses available to them should the project fail. Individual investors may be ill-equipped to evaluate these risks and understand the complexities of community development lending.

Servicing is also a significant concern. It is important to preserve the "high touch" relationship that distinguishes community lending from conventional lending. Community development borrowers require active servicing. While charge-offs and defaults are rare, forbearance and late payments are not. Any P2P finance platform used for community development must retain community-minded servicers to ensure that borrowers have sufficient flexibility to manage their debt payments.

## Sufficient Lender/Investor Demand

Small institutions with limited capacity likely have the most to gain from an online community development loan market. Small CRA-motivated banks, foundations, pension funds, and individuals could all benefit from the low search and information costs that P2P platforms provide.

A searchable P2P finance platform would allow CRA-motivated banks to identify investments that meet their CRA requirements. For example, banks could limit their searches to loans originated by certified community development lenders, such as CDFIs. Banks could easily identify particular types of loans as well: small business, rural development, community facility, etc. This would be particularly powerful if coupled with a tool to search for investments in LMI neighborhoods. A well designed search engine would allow CRA-motivated banks to quickly sort investments by qualified LMI census tract within their regulatory assessment areas. While not all social investments would be CRA-eligible, such a system would allow banks to target investments that meet basic community development and geographic criteria.

Foundations and, in particular, small foundations, could benefit from a community development P2P finance platform as well. Small foundations are often held to strict operating expense limits intended to maximize corpus impact. Potentially, a P2P finance platform could enable small foundations with limited capacity to identify investment opportunities that otherwise may be too costly to search out. Many foundations also have specific social goals: find a cure for cancer, support early childhood education, help the environment, etc. Foundations could use such a platform to find investments that align with their mission. At a minimum, foundations could look to P2P finance platforms for program-related investments (PRIs). PRIs are usually below-market rate investments made by foundations that, unlike grants, involve the potential return of capital within a specific time frame. PRIs count against foundations' annual disbursement requirements (five percent of total endowment) and can be below-market investments.

Pension funds could use P2P finance platforms to find economically targeted investments (ETIs). Pension funds tend to be patient investors. Large pension funds like CalPRS and CalSTRS (the two California public sector pension funds covering state employees and teachers, respectively) have capitalized on this by investing in underdeveloped neighborhoods decades before they are rehabilitated. In some cases, this approach has yielded strong financial returns and positive social outcomes. While it is likely that CalPRS and CalSTRS do not need an online marketplace to identify ETIs, small municipal pension funds may benefit. P2P finance platforms could offer a cost-effective way for smaller funds to identify and fund ETIs that would otherwise be difficult and costly to find.

There may also be significant individual demand for community development investments. International microfinance platforms like Kiva and MicroPlace have demonstrated success in connecting socially motivated individuals with wealth-building projects around the globe. If their success is any indication, asset-backed community development securities may be very popular among individual investors. As discussed earlier, this would provide community lenders an additional funding source beyond CRA-motivated bank borrowing, grants, and subsidized private placement debt offerings.

### Potential for Fraud

P2P finance platforms rely heavily on borrower- and security issuer-created content. Unfortunately, these disclosures, while revealing useful information, also create an opportunity for fraud. For the most part, P2P finance platforms have no ability to confirm nonfinancial information provided on their sites. This is arguably the biggest weakness of P2P finance—it often places a heavy burden on investors with little formal investment experience to root out fraudulent borrowers and evaluate social and financial criteria accurately.

## Changes P2P Finance Platforms Should Make Going Forward

### Develop a Fractional P2P Market for Third-party Issued Loans

With respect to community development finance, a P2P market for loans issued by third-party lenders would be a significant improvement over existing platforms, which only broker the sale of loans originated on site or securities backed by their issuers. For one, "high touch" intermediation is critical to successful community lending, necessitating the presence of a skilled community lender. For another, contingent upon SEC approval, such a market could offer community lenders a direct route to the capital markets which, heretofore, has proven elusive. Prosper's Chris Larsen, for example, "looks forward to extending the Prosper marketplace to community development organizations and other financial institutions as soon as we complete the securities regulatory process."[7]

Preferably, a P2P market for third-party issued loans would allow for fractional investing as well. In fact, fractional investing—the ability to purchase a piece of a security and not a whole loan—is essential to the P2P finance innovation. As discussed earlier, community development loans are often quite large and the P2P finance market for large community development securities would be small relative to that for fractional investments. Fractional investing is also the key to successful diversification. P2P finance platforms are an alternative to the conventional diversification strategy—securitization, pooling, and tranching—but only insofar as they allow investors to purchase small pieces of multiple loans. A P2P market for third-party issued loans that does not allow fractional investing will substantially reduce diversification opportunities.

### Advocate for Regulatory Reform

The primary obstacle slowing the development of a fractional P2P market for third-party issued loans appears to be regulatory, not technological. This is largely because P2P finance platforms are prohibited from direct lending activities and instead are forced to broker the sale of securities representing shares of consumer loans (triggering state and SEC regulation). P2P finance platforms interested in community development lending would benefit from a regulatory regime better suited to their core function: the facilitation of credit, not securities brokerage.

7 Interview with Chris Larsen on July 17, 2009.

## Create a Standalone Community Development Asset Class

While community development assets are used by some investors to protect against down-cycle economic risk, most community development investing is done for socially motivated reasons. Distinguishing community development assets from other investment types—debt consolidation, auto financing, etc.—is therefore very important. The easiest way for P2P finance platforms to effectively broker the sale of community development securities is to create a standalone community development asset class. This would give investors a clear way to target investments that meet their social criteria. P2P markets for third-party issued loans, if developed, should also carefully vet community lenders to protect against fraud. The most efficient way to vet community lenders is to use a proxy test, such as CDFI certification (granted by the U.S. Treasury). Such a measure would offer a reasonable guarantee to investors that the security being sold by the lender constitutes a legitimate community development product.

## Offer a Wider Range of Products

Today, most P2P finance platforms offer a single product: a three-year, fixed, unsecured, amortizing loan capped at $25,000. To be attractive to the community development finance industry, however, they will have to allow for larger, collateralized loans with longer maturities and balloon payment options. Standard P2P finance terms may be sufficient for small working capital loans and other, more modest credit products, but they are not consistent with the bulk of community development finance activity.

## Adopt a Social-Impact Ratings System

Many P2P finance platforms have already developed their own credit ratings to complement borrowers' credit scores. These ratings systems are designed to internalize important borrower information not normally captured by the credit bureaus. Similarly, a social-impact rating system would be a useful way to capture and convey important mission-oriented information to socially motivated investors. In fact, several social impact ratings systems already exist. For example, the CDFI Assessment and Ratings System (CARS), developed by the Opportunity Finance Network evaluates the "impact performance and financial strength and performance" of CDFIs.[8] A ratings system, such as CARS, should be presented alongside financial metrics on P2P finance platforms that broker the sale of community development securities issued by community lenders.

## Provide a Geographic Search Tool

Geography is an important consideration for many mission-driven investors. Banks, for example, are motivated by the CRA to invest in LMI neighborhoods. The ability to narrow investment opportunities to those located in LMI census tracts would help attract banks and other CRA-regulated institutions to P2P investing. Other investors, both institutional and individual, could benefit from this tool as well. Investors with a localized focus, such as small family foundations and small municipal pension funds, may want to use P2P finance platforms to target investments in very specific geographies—a task made considerably easier by geocoding the investments. Individual investors may also be motivated to invest in specific geographies, be it their own communities or those communities that have piqued their interest, such as the Rust Belt or California's Central Valley. Community development is as much about place as it is about people; P2P finance platforms should provide the tools necessary to invest in both.

8 Opportunity Finance Network's CARS website available at http://www.opportunityfinance.net/financing/finance_sub4.aspx?id=56.

## Changes Community Lenders Should Make Going Forward

### Issue Smaller Loans with Shorter Maturities

Community development lenders tend to favor real estate projects over microfinance or small business borrowers. This is largely due to the relatively high transaction costs associated with the latter. Nevertheless, if community lenders want to use P2P finance technology effectively, they need to offer products that meet the needs of P2P investors. This typically means smaller loans with shorter maturities.

### Originate-to-Distribute

Most community lenders earn the bulk of their revenue on interest-rate spreads. Very few lenders can generate sufficient loan volume to rely heavily on fee-based income. A P2P market for third-party issued loans would allow community lenders to sell their loans to P2P investors and quickly recoup the borrowed funds. This added liquidity creates an opportunity for community lenders to move away from their typical originate-and-hold model and toward an originate-to-distribute model, which would generate fee-based income. Of course, this need not be an either-or shift. To the contrary, community lenders would be wise to retain a diversified approach, generating a mix of spread-based and fee-based income; P2P finance platforms would simply be a new means of garnering the latter.

### Compile Loan-specific Social-impact Information

In general, most investors are reticent to take a below-market financial return without a corresponding "mission return." That investor expectation will only grow in a P2P finance context. There is a good reason that existing P2P finance platforms advertise the social aspect of P2P lending: many investors are nearly as interested in social impact as they are in financial return. It is likely, therefore, that P2P community development investing opportunities will amplify this interest in mission. Should a P2P market for third-party issued loans emerge for community development securities, community lenders will be expected to provide detailed social-impact information on their loans. This high level of loan-specific information will be costly for lenders to compile and communicate effectively. Community lenders interested in selling their loans via P2P should consider this cost before pursuing it as a liquidity option.

### Partner with Other Community Development Finance Organizations

Many different types of community development finance organizations work in concert to deliver capital to LMI communities. Several have already been mentioned, including banks, community lenders, credit unions, foundations, pension funds, insurance companies, and wealthy individuals. The use of P2P technology for community development presents new opportunities for collaboration. For example, community lenders may find that P2P investors are unwilling to pay what they perceive to be fair-market value for their community development securities. Instead of selling their loans at a discount—or not at all—community lenders could partner with other community development finance organizations to create a credit enhancement for securities sold via P2P. Specifically, they could form a first loss reserve pool backed by subordinate equity-equivalent investments (EQ2s) or program-related investments (PRIs) as a way to engage investors with differing appetites for risk and impact. This is only one example of potential collaboration; many other partnership opportunities may develop as the technology matures and community lenders grow more comfortable with the technology.

## Conclusion

P2P finance is representative of a growing interest in active, social investing. While online platforms may never replace conventional lending institutions, such as banks, it is important that the community development finance industry be aware of this emerging technology. Moreover, P2P finance platforms will continue to evolve—allowing for third-party issued loan sales, for example—which may fundamentally alter the way credit is allocated in the future. In either case, the potential community development finance implications are too significant to ignore.

# Creating a Marketplace: Information Exchange and the Secondary Market for Community Development Loans[1]

Laura Choi
Riverside Housing Development Corporation

The lack of information exchange between community development lenders and capital investors limits the growth of a secondary market for community development assets. This obstacle also limits the ability of community development lenders to tap into the virtually endless capital resources of the secondary market, thereby limiting the valuable services these organizations provide to underserved communities. Participants from the Federal Reserve's Conference on the Secondary Market for Community Development Loans in 2006 suggested solutions modeled after popular social networks, such as MySpace, speed dating, and Match.com. The area of social networking may initially appear to be an unexpected source of inspiration for a community development finance model, but the underlying benefits of economic efficiency, widespread visibility, and reduced search cost make these models viable solutions.

Central to the academic discussion on information exchange is the theory of asymmetric information, which George Akerlof introduced in his seminal study on the market for used cars.[2] Another important article in the academic literature of information theory is George Stigler's "The Economics of Information."[3] The article analyzes one of the most important economic considerations of information—ascertaining market price. For buyers and sellers seeking to uncover the appropriate market price for a good, the cost of searching is the time associated with finding a willing counterparty. This is especially pertinent for "unique" goods, or those that exhibit a high degree of heterogeneity, such as community development loan portfolios. A Congressional Budget Office study on the securitization of small business loans finds that "where secondary markets have been slow to develop, the high cost of transactions seems to be a major inhibitor."[4] By reducing the search time associated with identifying buyers and sellers, and by improving the flow of information between parties, finding the optimal market price for a product becomes less costly and more efficient.

Modern applications of information technology make the social-networking models relevant solutions for addressing the information problem. Information systems linking different organizations, also known as interorganizational information systems (IOS), can make use of information technology to increase economic efficiency. The "electronic marketplace" is an IOS that allows participating buyers and sellers to exchange information about market prices and product offerings with a goal to establish buyer-seller relationships.[5] Markets serve a number of functions in an economy, and the increasing role of information technology in these markets facilitates their operation. The introduction of an electronic market system reduces search costs and increases efficiency by reducing the cost of unproductive searches, and it allows buyers to locate products that better match their needs.[6] In the absence of an efficient IOS, high search costs lead to efficiency losses and eventually cause the market to break down or prevent an efficient market from being established at all.

The implication for current research is that while data remain central to the growth of investor activity in community development, a mechanism must be developed that allows lenders and investors to easily share and access these data.

1 This article is a summary of findings from a longer working paper prepared for the Federal Reserve Bank of San Francisco's Center for Community Development Investments. For more in-depth discussion on this topic, see http://www.frbsf.org/publications/community/wpapers/2007/wp07-01.pdf.

2 G. Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," Quarterly Journal of Economics 84, no. 3 (1970).

3 G. Stigler, "The Economics of Information," Journal of Political Economy 69, no. 3 (1961).

4 Congressional Budget Office, "Developing a Secondary Market for Small Business Loans." Inter-Agency Report, 1994, available online at http://www.cbo.gov/showdoc.cfm?index=5013&sequence=0

5 J. Bakos, "Information Links and Electronic Marketplaces: The Role of Interorganizational Information Systems in Vertical Markets," Journal of Management Information Systems 8, no. 2 (1991).

6 Ibid.

Mary Tingerthal, president of the Capital Market Companies, Housing Partnership Network, stated that "any investment is possible only if the investor has the necessary information—the data—to decide whether to make an investment or purchase an asset."[7] It is vital that CD lenders improve their data-collection processes, and it is equally important that they have an efficient mechanism for finding a willing investor with whom to share this data.

A reputable institution could significantly advance the development of such a mechanism by establishing an online information-exchange platform that would allow buyers and sellers of community development loans to: (1) efficiently identify suitable counterparties, and (2) effectively share the appropriate type and amount of data to facilitate a sale.

Most community development lenders borrow the majority of their available capital from mainstream banks through a term loan or line of credit, shown as "lending to the lender" in the diagram below.[8] In contrast, the secondary markets financing model, shown as "purchasing from the lender," allows lenders to replenish their capital supply through the sale of receivables. The characteristics of these two models differ greatly, and the industry needs to change the way it communicates with investors in order to transition from the present model to the secondary market structure.

| Lending to the Lender | | Purchasing from the Lender |
|---|---|---|
| • Full recourse to investor<br>• Investment in the lender<br>• Assets on balance sheet<br>• Institution level data | Development of secondary market structure → | • No recourse to investor<br>• Investment in the assets<br>• Assets off balance sheet<br>• Portfolio/loan level data |

The creation of an online platform would facilitate this transition by allowing parties to share the specific types of data most relevant to the sale of community development loans. Lenders would share organizational data and provide data points related to their individual portfolios available for sale. For example:

- Loan-to-value ratio
- Debt service coverage ratio
- Interest rates
- Expected investor pass-through yield
- Portfolio size (amounts and number of loans)
- Types of loans in the portfolio (for diversification)
- Geography (to meet CRA objectives by reaching certain markets)

This list is only a preliminary estimation of the specific data investors are seeking. The development of an online platform requires a collaborative process that actively engages the investor community, in order to discern what these specific data needs are. The online platform would facilitate only the introductory phase of information sharing, where buyers and sellers identify the potential for transactions. Any actual legal sale of assets would occur through subsequent one-on-one conversations outside the sphere of the platform.

Another consideration for the development of an information-sharing mechanism is the type of secondary market activities that will occur. Whole loan sales and securitization are two distinct types of secondary market transactions. Securitization is better suited for large-volume loan pools (typically in the range of $100 million) because of the significant transaction costs associated with the complicated legal and financial structure.[9] In contrast, the sale of whole loans allows each loan to be sold as a separate investment with buyers often purchasing more than one loan at a time. Whole loan sales

7 Mary Tingerthal, "Turning Uncertainty into Risk: Why Data Are the Key to Greater Investment," Community Development Investment Review (Federal Reserve Bank of San Francisco) 2, no. 2 (2006).

8 An interview with Dan Letendre of Merrill Lynch on January 29, 2007, informed this section on capital financing models.

9 Interview with Frank Wilary and Doug Winn, February 5, 2007.

are often used when the volume of loans to be sold is relatively small or the sales of loans are infrequent.[10] The community development field at present does not originate loans at a sufficient volume to support widespread securitization, but the development of an online platform can facilitate whole loan sales as a precursor to larger-volume transactions.

The platform host can play a significant role in implementing this online information-sharing tool. Some important considerations for implementation include:

- The platform host should be a highly credible and neutral third party.
- Access to the online tool should be limited, requiring that participants be involved in the financing of community development activities.
- The online platform should have a strong educational component.
- The beginning focus should be on whole loan sales as opposed to securitization.
- A mix of strategies should be used to attract participants and encourage continued involvement.
- Enforceable policies must be introduced to keep the data current.

The community development industry can benefit from increased secondary-market activities, but the present landscape of information sharing between lenders and investors remains a significant barrier. The lack of understanding of what investors want in relation to loan purchases is compounded by the lack of an information infrastructure.

Although the limited scale of the industry is a concern, it is valuable to develop the infrastructure to support the ongoing growth of the industry into the future. If the industry waits for lenders to increase their originations to a scale large enough to address the lack of information-sharing infrastructure, a lag will occur between the need for a mechanism and the implementation of that mechanism. The community development industry should seek early-stage solutions that can be modified and adapted as it grows in its lending capacity and becomes comfortable with the capital markets. The other benefit of taking proactive steps to improve market infrastructure is the likelihood that the information-sharing mechanism will act as a catalyst for secondary market growth. Just as eBay created a secondary market for heterogeneous goods (where people were suddenly able to find buyers for their old lamps and used books), the introduction of an efficient electronic marketplace may similarly spur the growth of purchases of community development assets.

The prospective platform host has the opportunity to take a leadership role in supporting community development lenders in their capital financing strategies. The creation and operation of an online information-sharing platform will allow lenders and investors to connect efficiently with one another in order to build trust and professional relationships. The formal implementation of a new platform also signals to the industry that the growth of the secondary markets requires a transition from the status quo—moving from the lending to the lender model to the purchasing from the lender model.

Both community development lenders and capital investors have opportunities for mutual gain in the growth of secondary markets. The ultimate beneficiaries are those communities that depend on this market for scarce financial resources. Strong, healthy communities are the surest sign of this industry's success. Improving information exchange will ensure that a solid infrastructure will be in place to support the community development industry in the future.

10 HUD (1995), Notice: CPD 95-05.

# Cows, Kiva, and Prosper.com: How Disintermediation and the Internet are Changing Microfinance[1]

Tillman Bruett
Alternative Credit Technologies

The international microfinance community has received a considerable amount of attention in the past few years and has captured the imagination of millions. The understanding of microfinance that has permeated popular culture is simple: poor people run businesses, and providing very small loans to these businesses can increase profits and help them lift themselves out of poverty. In fact, microfinance is much more than small loans. Microfinance includes a range of financial products, including savings and insurance and money transfers, and can be delivered by a variety of institutions, such as nonprofits, cooperatives, nonbank financial institutions, and banks. The line between formal finance and microfinance is blurring. What continues to distinguish microfinance from formal finance is the commitment to work with small enterprises and low-income households and a reliance on "social collateral," such as peer pressure, rather than traditional collateral when lending.

The main challenges for international microfinance remain the lack of sound intermediaries to deliver financial services as well as limited funding, although significant advances have been made in both of these areas in the past decade. The microfinance community is moving quickly to tap into local and international capital markets, particularly so-called social investors.

Recent advances in finance and technology are providing new opportunities for individual investors to support and invest in microenterprises, and in some cases bypassing intermediaries altogether. Although these efforts at disintermediation are still new, they present a new way for poor communities to attract capital that has the potential to unleash the entrepreneurial capacity of the poor. They might also hold the key for innovation in other related fields, such as community development finance.

## Putting a Face (or Snout) on Poverty and Opportunity

While most people accept that short-term charity is a necessity in times of acute crisis, a solution to the chronic problem of poverty is harder to "sell." The enormity and ceaselessness of poverty engenders hopelessness and donor fatigue. Relief organizations have had notable success in putting a face on natural disasters by asking donors to sponsor a child or build a house. One of the challenges of supporting economic development is how to put a face on poverty that conveys opportunity and closure. Heifer International is a well-known success story in the development field in part because it has been able to personalize poverty in a way that highlights hard work, self-help, and sustainability. Heifer Projects offers donors the opportunity to provide a cow or other farm animals with the potential for reproduction to needy families to "help people feed themselves." This disintermediation, creating a sense of a direct relationship between a donor and beneficiary, and the promise of a sustainable solution have been key ingredients in the Heifer Projects' success worldwide, even if the faces put forward were not always human.

Microfinance uses messages similar to Heifer Projects, highlighting self-help and sustainability. However, microfinance is not well suited to build direct relationships between donors (or lenders). The essence of microfinance is intermediation—to build microfinance institutions (MFIs) capable of managing the risk and relationships between funders and entrepreneurs. The primary reason for all financial intermediation is to overcome the information gap between lenders

1 This article was originally published in the Community Development Investment Review (Volume 3, Issue 2), 2007, available http://www.frbsf.org/publications/community/review/122007/index.html.

and borrowers. This need is particularly acute in microfinance when clients have no recorded credit history or land title. A lender in New York, however well informed, is unable to measure the borrowing capacity of an entrepreneur in Nairobi. Still, microfinance has long recognized the power of creating the appearance of a direct link between funders and recipients of microloans. Fund-raising efforts for microfinance have followed the disintermediation model by allowing donors to support specific borrowers, village banking groups, or communities and have built relationships with donors by providing repayment information and stories of successes. Unfortunately, the financial costs and time burden of providing this information are fairly high and are at odds with the need to run MFIs efficiently as a business rather than as a charity.

Several recent attempts using the Internet to overcome the information gap and strike a balance between financial intermediation with relationship disintermediation are noteworthy for their successes and challenges. The lessons learned may offer some long-term solutions to attracting capital to creditworthy entrepreneurs.

## Financial Disintermediation, or "Cutting out the Middleman," Goes Small

One of the most profound changes in finance in the past fifteen years has been the spread of financial disintermediation on a global scale. Traditionally, the financial markets centered on banks that acted as a conduit between suppliers of funds (usually deposits) and users of funds (usually borrowers). Banks made their money on the spread between the interest rates paid and charged as their reward for managing the risk of intermediation. Banks now seek to take advantage of their risk-management capabilities to arrange direct deals between lenders and borrowers in the form of private placements, fixed-income securities, and more sophisticated derivative products. The growth in loan syndications (selling participations in loans) and asset securitization in particular (bundling and selling thousands of smaller financial assets to investors) is the most dramatic example of disintermediation. Both have severed the traditional link between underwriting and credit risk: institutions arranging loans or underwriting securities no longer hold them. These securities are assigned credit ratings by rating agencies, sold in the market to the highest bidder, and traded so often that the debtor, issuer, and investor may not know who holds them. A Japanese investor may now own the credit card debt of a Canadian household issued by an American finance company and not even know it.

Prosper.com has sought to bring this financial technology to bear in small loans. Prosper.com is an online auction place for personal loans. It is not microfinance per se, but combines elements of consumer finance, social investing, and microfinance with an online market place. Prosper.com allows individual borrowers to post online their request for a loan with a proposed interest rate. Lenders in turn can shop on Prosper.com and bid to fund loans. As with a loan syndication, lenders may spread their risk by buying small parts of multiple small loans, such that a dozen or more lenders may fund a single loan. Lenders can bid down the offer rates on loans and receive updates to see if they have been outbid. Prosper.com facilitates the transaction for a 1–2 percent fee by providing basic credit information on the potential borrower (for example, credit score, home-ownership status, debt-to-income ratio). It also provides faces to the lenders by giving them space to share a photo and tell their story. Prosper.com has excelled in creating a true "people-to-people lending marketplace" in which the best borrowers get the best rates. The highest-rated borrowers pay slightly less than 10 percent on average, and it is not uncommon to see rates as low as 7 percent.

Prosper.com has been less successful in moving lenders to less qualified, riskier borrowers. The website was not intended to focus primarily on microenterprise or community development. A brief look at the inventory of available loans shows that the majority of lending is done to refinance consumer debt and most borrowers are salaried, although business and home-improvement loans are frequent. Since inception, lenders have been steadfastly risk averse. Only 17 percent of the $91 million in brokered loans have gone to borrowers with a credit score of less than 600 or no credit score. This percentage dropped to 8 percent in the wake of the subprime lending crisis. To its credit, Prosper.com has tried to incorporate some traditional microfinance methods to help lower-rated clients. Borrowers can voluntarily associate themselves with certain groups (professional, ethnic, service, etc.) that act as a character reference and a screening mechanism. Theoretically, borrowers can upgrade their creditworthiness by being associated with a group's collective credit grade. However, group-payment rewards led to group organizers trying indiscriminately to attract as many members as possible, leading Prosper.com to discontinue these rewards and de-emphasize group affiliation on their website.

Kiva is a nonprofit organization that seeks to disintermediate the lending relationship between socially motivated lenders and developing world microentrepreneurs using the Internet. Kiva works with MFIs in developing countries to build Internet profiles of borrowers with a brief biography, loan requested, loan term, and purpose. Rather than wait for individual loans to be funded, Kiva's MFI partners first approve and disburse the loan, which is then refinanced by several Internet lenders. Like Prosper.com, Kiva encourages lenders to diversify risk (and currently limits lenders to $25 participation on any single loan). Kiva's website also includes a detailed summary and rating of the MFI field partner. It is the collection rate and rating of the MFI partner that Internet lenders rely on to make decisions rather than a borrower's credit score. Unlike Prosper.com, Kiva's lending is not market-based; at present, lenders receive 0 percent interest, although Kiva plans to allow lenders to earn a return in the coming year.

Kiva's efforts at true financial disintermediation are complicated by cross-border transactions. Legally, Internet investors are lending to Kiva, not to the microenterprises. Kiva then lends to MFIs or has an agency agreement through which the MFIs manage Kiva's funds. Despite this, Internet lenders agree to assume the full risk of Kiva's loans, including foreign currency risk, mimicking a direct lending relationship with the borrower. Kiva relies on its MFI partners to identify and screen borrowers and approve, disburse, monitor, and collect loans. MFIs are also required to post borrower profiles with occasional updates, which can be time-consuming and outside their daily business routine. In return, MFIs are allowed to keep all the interest earned on the microenterprise loans, usually in excess of 25 percent. Most important, Kiva was created to move lenders to poor households. It deliberately selects some "young and unproven" MFIs that have the potential to reach poorer entrepreneurs overlooked by more established MFIs. Its lending has been constrained by the limited number of qualified and appropriate MFI partners as well as the time and cost required to screen, monitor, and enroll them.

In October 2007, eBay launched Microplace to help link individual investors to purchase a part of institutional investors' microfinance securities. Rather than disintermediation, Microplace is pursuing democratization of investing as an online registered broker-dealer that sells participations in wholesale loans and securities issued by social investors to MFIs. Investment choices are fairly limited at present and will be constrained by the number of credible social investors in microfinance. Returns are fairly low, ranging from 0 percent to 3 percent, reflecting the rates charged by the selected social investors. The potential in Microplace is to offer another option for individual investors to participate in microfinance with the confidence that selected social investors are able to analyze, monitor, and collect from MFIs.

## The Bigger Gap: Information

The Internet is also helping to bridge the information gap between investors and borrowers without resorting to disintermediation. Founded in 1997, the MicroBanking Bulletin (MBB) has become the benchmarking source for the microfinance industry. The industry commentary, analysis, and benchmarks have created more standardization and a better understanding of developments in the microfinance sector. More than 200 MFIs are now included in the MBB. All financial data is provided voluntarily by MFIs (with substantial supporting statements) and then reviewed and adjusted by the MBB staff to provide comparable results for profitability, efficiency, and loan portfolio quality. This led to the founding of the MIX Market, a global, web-based, microfinance information-exchange platform. It provides information on and to a broad variety of microfinance players, such as MFIs, investment funds, MFI networks, raters/external evaluators, and others. With more than 1,000 MFIs self-reporting, the MIX Market seeks to develop a transparent information market to link MFIs worldwide with investors and donors and promote greater investment and information flows. The self-reported data on the MIX Market is not analyzed or adjusted, but participants are ranked according to their level and quality of information disclosure. Neither the MBB nor the MIX intermediate or directly manage lender and borrower relationships. Arguably, the MBB and MIX Market services have done more to foster funding flows to MFIs, and ultimately to their microenterprise clients, than any other mechanism to date by providing a platform for exchanging information and promoting transparency. [For a look on how the MIX Market example may help promote a secondary market for domestic community development loans, see Laura Choi's article in this issue of the Review and her working paper: "Creating a Marketplace: Information Exchange and the Secondary Market for Community Development Loans" (July 2007) at: http://frbsf.org/publications/community/wpapers/2007/wp07-01.pdf].

## Early Lessons Learned

The early experience of Prosper.com, Kiva, Microplace, and the MIX Market is instructive, if not definitive. First, Internet lending is attracting a new class of Internet investors comfortable with person-to-person lending, even across borders. This requires building some semblance of a relationship between the borrower and lender, providing accurate credit information, a mechanism for diversifying and sharing risk, and facilitating contracts and the physical (or electronic) exchange of cash. And yes, it has to be fun and either personally or financially rewarding. The ease with which lenders can browse Prosper.com's website is irresistible, allowing lenders to sort by credit rating or keyword, screen borrowers, and even place standing orders to automatically buy loan participations that meet certain criteria. With Kiva, lenders can sort by country, gender, business, and other categories. While Kiva and Microplace have targeted social investors, Prosper.com's online auction is also appealing to an investor who enjoys the investing process and financial returns.

Second, lenders rely heavily on the personal and financial information provided by the Internet underwriters to make decisions. Similar to rating agencies, the borrower information they gather and share directly supports disclosure and transparency, provides peer comparisons, enhances access to new funds, and, in the case of Prosper.com, enhances the terms of borrowing. The information is also directly linked to a person and their story providing some means to assess the borrowers character and the purpose of the loan. While the basis of Prosper.com's borrower ratings are independent credit scores, borrowers are able to improve their ratings by paying on time. Prosper.com also offers a growing statistical database on loan performance that segments lenders by different categories (credit score, home ownership, etc.) that serious investors rely on to analyze risk. Kiva lacks independent ratings of many of their MFI partners and most do not report to the MBB. As a result, Kiva has resorted to rating partners itself based on a set of standard criteria as well as past performance with Kiva's loans. Although these in-house ratings are certainly efficient, it is too early to tell if this will compromise or enhance the soundness of Kiva's underwriting; ratings and credit scores are supposed to be independent and objective because there is an inherent conflict of interest with rating your own securities.

Third, each of these models shows the importance of the role of the Internet underwriter in managing risk on behalf of the lender. The marketplace of Prosper.com works in part because lenders trust that Prosper.com has the ability to monitor and pursue delinquent loans on their behalf. Kiva and Microplace work because lenders are committed to a cause and trust that they have diligently vetted their partners and monitor them closely.

Finally, reaching lower-income borrowers requires a strategy, structures, and incentives to do so. Prosper.com's marketplace offers a financial incentive to take riskier loans—the rates are often three to four times higher than low-risk loans. Still, investors have not lent much to lower or unrated borrowers. If Prosper.com's business model were to be used to reach low-income communities, it might address this by partnering with organizations such as qualified underwriters, and community and social organizations to identify, screen, and analyze prospective borrowers.

For now, all three have more funds than qualified investments. All three face a similar dilemma—how to increase the quantity and quality of borrowers. This is a reminder that capital is only part of the solution to economic development. With capital must come technology, know-how, and access to markets. To use a popular metaphor, development is no longer about handing out fish, teaching to fish, or even lending fishermen money to build a boat. Rather, development is now focused on providing fishermen with GPS, leasing them refrigeration units and packing warehouses, teaching them ISO standards, sending them market prices on their mobile phones, and linking them to export markets. Still, the advent of Internet person-to-person lending holds great promise for the future of microfinance.

## Additional Information Resources

For information on the organizations discussed:

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|---|---|
| www.heifer.org | www.mixmarket.org |
| www.kiva.org | www.mixmbb.org |
| www.microplace.org | www.prosper.com |

## For More Information on Microfinance:

| | |
|---|---|
| ACCION International | www.accion.org |
| Consultative Group to Assist the Poorest (CGAP) | www.cgap.org |
| Grameen Foundation | www.gfusa.org |
| Imp-Act | www.imp-act.org |
| Microfinance Gateway | www.microfinancegateway.org |
| MicroSave | www.microsave.org |
| PlanetFinance | www.planetfinance.org |
| SEEP Network | www.seepnetwork.org |
| USAID microfinance | www.microlinks.org |
| World Council of Credit Unions | www.woccu.org |

For a good overview of microfinance, see "The Hidden Wealth of the Poor: A Survey of Microfinance", Economist, November 2005. http://www.economist.com/surveys/displaystory.cfm?story_id=5079324.

For a deeper understanding of the financial need of poor households, see Rutherford, Stuart. The Poor and Their Money. Oxford University Press, 2000.

A detailed textbook on microfinance, Ledgerwood, Joanna. The Microfinance Handbook: An Institutional and Financial Perspective. The World Bank, 1999.

A history of the advances in microfinance can be found in Helms, Brigit, Access for All: Building Inclusive Financial Systems. Consultative Group to Assist the Poorest (CGAP), 2006. http://www.cgap.org.

Two articles on Prosper.com and Kiva highlight the business model and intentions of the two organizations. Hof, Robert. "Prosper: The eBay of loans?" BusinessWeek. February 13, 2006. http://www.businessweek.com/technology/content/feb2006/tc20060213_147523.htm.

"A Tale of Two Lenders." BusinessWeek. Winter 2006. http://www.businessweek.com/magazine/content/06_52/b4015451.htm?chan=search.

A brief survey of the level of international funding into microfinance can be found in Latortue, Alexia et. al. Managing the Floodgates. Making the Most of International Flows of Microfinance Funding. CGAP. 2007.

# Panel 4
# Understanding the "Impact Investing" Trend

Jackie Khor
Imprint Capital Advisors

Lisa Richter
GPS Capital Partners, LLC

Georgette Wong
Correlation Consulting

## Past Articles from Federal Reserve Bank of San Francisco Publications

# Impact Investing:
# Harnessing Capital Markets to Solve Problems at Scale[1]

Antony Bugg-Levine[2]
Rockefeller Foundation

John Goldstein
Imprint Capital Advisors

There is not enough charitable and government capital to meet the social and environmental challenges we face. Where, then, will we find the money to complement charity and government to bring solutions to scale? The Rockefeller Foundation launched its Harnessing the Power of Impact Investing initiative in November 2008 because it believes that impact investing can be part of the answer. Imprint Capital was similarly founded in 2007 to help the growing ranks of institutions and high-net-worth individuals create and execute strategies to drive impact with their investments.[3]

However, as the report Investing for Social and Environmental Impact by the Monitor Institute highlights, the ability of this new industry to deliver on its potential is not inevitable. Industry leaders must work together to measure and articulate the industry's successes, build infrastructure to increase its efficiency, and create products that respond to investors' demand for transparency and liquidity.

Impact investing helps solve social or environmental problems while generating financial returns. The pioneering investors are diverse, with a variety of motivations. Despite the current market turmoil, by recognizing they are part of a broader industry, participants can learn from recent innovation and work strategically to improve the efficiency and broaden the capacity of impact investing. These developments present new opportunities for banks in new investments, co-investors, and collaborators. Consider the following examples:

A family in New Jersey is moving into a newly renovated, previously foreclosed home. The home is affordable because the nonprofit organization Housing and Neighborhood Development Services Inc., received timely access to a low-cost loan. That loan enabled it to buy 47 distressed mortgages from JP Morgan Chase from the Washington Mutual portfolio, renovate and sell them for a profit. The capital for the purchase of the loans came from Prudential's Social Investment Fund.

A four-year-old child in Clark County, Nevada, will be ready for kindergarten thanks to Acelero, a for-profit company that takes over failing Head Start programs. Acelero's growth has been fueled by equity investments from Boston Community Ventures (a Community Development Finance Institution), New Schools Venture Fund (a philanthropic investor in high-impact educational enterprises), Ironwood Ventures (a double bottom line private equity firm), and the Kellogg Foundation.

The National Community Stabilization Trust (NCST) is partnering with cities around the United States to augment state and federal funds allocated to combat the foreclosure crisis. With seed funding from the MacArthur Foundation and a $50 million program-related investment from the Ford Foundation, NCST bids on properties on an exclusive basis as they are prepared for auction, stretching scarce grant dollars farther to buy and rehabilitate properties and preserve communities.

1 This article was originally published in the Community Development Investment Review (Volume 5, Issue 2), 2009, available http://www.frbsf.org/publications/community/review/vol5_issue2/index.html.

2 An earlier version of this article appeared in the May/June, 2009 edition of Beyond Profit magazine (www.beyondprofitmag.com).

3 Disclosure: The Rockefeller Foundation currently has investments with Root Capital. As of the writing of this article, Imprint Capital Advisors has client investments in Southern Bancorp, Community Capital Management, Acelero, Habitat for Humanity, and OneCalifornia Bank; is reviewing Root Capital, Revolution Foods, and E & Co on behalf of clients; and has client relationships with the Kellogg Foundation, the Hull Family Foundation, the Annie E. Casey Foundation, the MacArthur Foundation, and RSF Social Finance.

Around Virunga National Park in the Eastern Congo, farmers are receiving premium prices for vanilla and coffee sold to Gourmet Gardens, a Ugandan exporter. Despite the political instability that keeps mainstream lenders away, Gourmet Gardens secured a working capital loan for these purchases from Root Capital, a U.S.-based nonprofit organization that lends to farmers' cooperatives and agriculture aggregators around the world. Its balance sheet is capitalized by corporate investors such as Starbucks, social investors such as Prudential, and various private foundations and investments from high net worth individuals.

In Los Angeles, a six-year old girl gets a healthy lunch and snack every school day made with fresh ingredients thanks to Revolution Foods. Since launching in 2006, Revolution Foods has served more than 2 million healthy school lunches to nearly 25,000 kids, 80 percent of whom qualify for free or reduced lunch. Revolution Foods has been financed by a combination of high net worth individuals, conventional venture capitalists and a double bottom line venture fund backed by banks and foundations.

In Toledo, Ohio, an unemployed factory worker who previously worked for an auto supplier is interviewing for a job with Xunlight at a reopened factory. This former glass factory is located in a neighborhood that is 79 percent minority, with income at 73 percent of the area's median income. It is now manufacturing thin-film solar panels and is generating green jobs with financing provided by a bond issued by the Ohio Enterprise Bond Fund and purchased by Community Capital Management.

In Oakland, California, a family receives financial literacy training and a bank account that offers a savings match via their local Head Start chapter. In Berkeley, an innovative program for financing residential solar power receives bridge financing. In San Francisco, a group of previously unbanked Hispanics build credit histories by having a bank administer and document their previously informal lending circle. OneCalifornia Bank supports all these efforts. OneCalifornia Bank is a financial institution capitalized initially with $22.5 million from Tom Steyer and Kat Taylor, owned by the OneCalifornia Foundation, and supported by mission deposits from organizations like the Annie E. Casey Foundation and the Hull Family Foundation.

Although they may not know it, these people—from the family moving into a new home in New Jersey, the factory workers in Ohio, and residents of Berkeley installing solar panels—are all participating in the rapidly emerging industry of impact investing. Like the individuals and institutions who invested in the New Jersey housing group, impact investors seek for-profit investments that can also provide solutions to social and environmental challenges. In the United States, this field brings together an assortment of players with a range of motivations, from banks investing for Community Reinvestment Act (CRA) purposes, to financial institutions fulfilling their corporate responsibilities and responding to client interest, to foundations engaged in mission-investing, to individuals and family offices expressing their values through their investments.

These impact investors offer a bridge between traditional philanthropy, which incubates innovation and mobilizes attention to exciting solutions, and the private-sector capital markets that ultimately hold the wealth required to advance these solutions to a level proportionate to need.

## Why Impact Investing Now?

The seeds for impact investing were sown in the last quarter of the twentieth century with the socially responsible investment and corporate responsibility movements. In the United States specifically, these included the CRA and the rise of the Community Development Finance sector. These efforts challenged the prevailing attitude that companies' and investors' only responsibility is to maximize financial returns. At the same time, as the community-finance movement and microfinance gained international renown and as advocates of a commercial approach to achieving social objectives gained visibility, the idea spread that investment, rather than pure philanthropy, could generate development outcomes. Innovators from a range of quarters have also led the way, including:

- Faith-based investors (e.g., the United Methodist's General Board of Pensions, which has invested across approaches ranging from shareholder engagement to affordable housing);

- Pension funds (e.g., CALPERS with its California initiative; work supporting emerging minority and women-led managers; and Greenwave initiative);
- Private foundations (e.g., The F.B. Heron Foundation's pioneering work in developing investment tool kits for foundations to make impact investments across asset classes and return profiles);
- Insurance companies (e.g., Prudential, whose social investing unit has invested more than $1 billion across the United States);
- Banks (e.g., Citibank's work in developing the EQ2 structure to capitalize community-based financial institutions more effectively);
- High net worth individuals (e.g., Investor's Circle, an angel network that has since 1992 facilitated the flow of more than $130 million into more than 200 companies and small funds addressing social and environmental issues);
- Hybrid organizations (e.g., Omidyar Network, a distinctive philanthropic investment firm that has committed more than $270 million to for-profit companies and nonprofit organizations in sectors including microfinance, property rights, government transparency, and social media).

The efforts and examples of these and other organizations have, in turn, encouraged other investors to follow their lead and inspired entrepreneurs and fund managers to develop innovative new impact investing offerings and opportunities. These developments have brought us to the point where these different threads, born from different contexts and driven by various factors, are beginning to form the tapestry that is increasingly recognized as the impact-investing industry.

It would be naïve to believe that the wealth destruction and credit market contractions of the past 18 months have not shaken this new industry. Structural changes that spurred its emergence, however, remain in place to drive its growth when the credit markets revive. These include:

- Wealth concentration among the"investment-oriented": Many individuals and families acquired significant discretionary capital in the past decade. This capital has been concentrated among precisely those people—entrepreneurs and financiers—whose personal life experiences primed them to see investment as a potent tool for pursuing social impact. They reject the canard that presence of profit is evidence of exploitation.
- Impatience with traditional approaches: After half a century of both remarkable success and failure, traditional philanthropic options are uninspiring to some. This frustration can be counterproductive when it dismisses the experience and insights of those who have been on the frontlines of addressing key challenges, both in the United States and globally. It can also be counterproductive when the frustration ignores the complexity of the challenges at hand. Such frustration, however, creates an opening for social entrepreneurs who offer a compelling alternative to philanthropy.
- Growing societal interest in addressing social and environmental challenges: An interest in using enterprise, investment, and human capital to address core social and environmental challenges has gone from a niche concern among idealists to a mainstream focus. Business schools report oversubscribed classes on social enterprise; mid-career professionals see attractive employment opportunities in roles that enable them to address key social challenges.
- Perception of social and environmental issues as material to business performance and sources of opportunity: Businesses and financial institutions are increasingly viewing their ability to manage social and environmental issues as material to their financial performance. Financial analysts are regularly publishing reports on the impact of climate change on corporate profits and emerging investment opportunities driven by a green stimulus package. Mainstream hedge funds such as GLG have prominently included impact-oriented issues in their fund management approach for purely commercial reasons. Cleantech investments have become commonplace with some leading venture capital firms (e.g., Kleiner Perkins) setting up dedicated funds in the sector.
- Increased interest in public-private partnerships: With both private and public capital constrained in the wake of the financial crisis, interest from both business and government in creating mutually attractive public-private part-

nerships is moving from a rhetorical assertion to an imperative. Many pressing social challenges—from stabilizing the housing market to addressing climate change—cannot be addressed by governments or private markets alone. The impact-investing industry offers exciting examples of specific deal structures that can enable public and private capital to work together.

## What Will It Take to Harvest the Fruits of Impact Investing?

Despite, and sometimes because of, this proliferation of activity, the impact-investing industry is poised at a delicate moment. Impact investors have already made their mark in a few subsectors, most notably low-income housing in the United States and, more recently, micro-finance and green energy. Yet, impact-investing capital has not yet reached the requisite scale of hundreds of billions of dollars.

The industry remains beset by inefficiencies and distortions that currently limit its impact, even in areas where impact investing should be viable (such as health care delivery, agriculture development, and education). The field's language, analytical tools, capital markets, and legal system do not fully support impact investing, mainly because they are still structured to support the binary poles of either philanthropy or profit maximization. The diverse players who have helped build the field include groups that do not generally collaborate, adding to the complexity and fragmentation of the space.

In this context, impact investing can be frustrating. But these frustrations are not unique. They are the archetypal challenges that confront pioneers in new industries. Fortunately, investors' frustrations are also entrepreneurs' opportunities. Global innovations and collaborations are now pointing to potential solutions to these barriers, including:

Building platforms for industry development: Although various efforts, outlined below, address specific barriers to efficient investing, impact investors need a broader understanding of the contours and structures of this new industry to enable them to work together. Investors need to know how big this industry is, who its participants are, who has capital, who has deals, and how to connect them more efficiently. In response to this need, the concept for a Global Impact Investing Network is gaining momentum, with hubs of activity coming together across the United States and globally. The network is designed to help build the public goods infrastructure that can lead to a more efficient and effective impact-investing industry. Part of its role is to support, connect, and complement existing organizations focused on specific sectors or markets. These include groups in the United States, such as the Opportunity Finance Network, PRI Makers Network, Social Investment Forum, Investor's Circle, Social Venture Network, and More for Mission. They also include more internationally focused groups, such as the Aspen Network of Development Entrepreneurs, the International Association of Microfinance Investors, and the Emerging Markets Private Equity Association.

Creating credible standards for measuring social impact: Commonly understood terms reduce transaction costs for mainstream investors. The profusion of approaches to assessing impact adds complexity and cost for entrepreneurs and investors seeking or deploying capital in this developing marketplace. Research supported by the Rockefeller Foundation and corroborated by Imprint Capital and others indicates that, among wealth advisors and private bankers, developing a credible, independent rating agency to serve as a "Good Housekeeping seal of approval" for impact investments can help unlock capital from this channel. A crucial element of creating these standards is convening leaders within the prominent subsectors of impact investment (e.g., community development, international development, environmental investing, etc.). These leaders can build from existing practice to develop consensus for standards tailored to the specific investing issues in each area. In light of this need, the recent efforts to develop an Impact Ratings and Investment Standards and Global Impact Investing Ratings System is particularly exciting. By mobilizing investors, activists, academics, and entrepreneurs, these initiatives can break through the historic logjam that kept similar efforts fragmented.

Developing capital markets: Intermediation within impact investing is generally subscale and inefficient. Impact investors face high transaction costs in sourcing deals, conducting due diligence, and closing and syndicating investments. Investment funds, investment bankers, and market platforms have not yet achieved the scale and visibility to provide viable conduits for billions of dollars of latent impact investment capital. The intermediation challenge is, however, being addressed by innovators working across a spectrum of segments and business models, including:

- Impact investment banking: An increasing number of organizations and firms are working, in different ways, to provide investors with more efficient deal-sharing capability, more attractive investment structures, and the liquidity that many require. In the United States, organizations such as Wall Street Without Walls, Calvert Investment Partners, GPS Capital Partners, Godeke & Associates, Brody Weiser Burns, Urban Advisors, Aquillian, NextStreet, and others can serve an array of would-be impact investors.
  As investors look abroad, intermediaries with local market knowledge and relationships are proliferating. In London, Social Finance was launched in 2007 as an integrated investment bank serving social-sector clients in structuring and placing impact investment capital. Intellecap in India is expanding its advisory services bouquet to include a range of impact investment services. Yes Bank and Unitus Capital in India are both building up impact investing franchises primarily around sell-side banking services for Indian firms. Similarly, ShoreCap International (an affiliate of Chicago-based ShoreBank) helps connect investors in the United States and Europe with opportunities in Asia and Africa.
- Wealth advising: Money managers are tapping client interest in impact investment to expand their customer base and deepen client loyalties. San Francisco-based RSF Social Finance offers their donor-advised fund clients multi-manager diversified portfolios of impact investments across asset classes. Building on its work with the KL Felicitas Foundation, Guggenheim Partners has begun to develop a suite of impact investment products, including internally developed and third-party managed options. Wealth advisors based in the United States, ranging from the large private banks to independent firms such as Veris, Baydush Simon Weaver, and Baldwin Brothers offer clients impact investments and screened fund options. ResponsAbility, a Zurich-based money manager launched in 2003, manages more than US$650 million in impact investments (with net assets growing at approximately $20 million per month) on behalf of clients of European Union-based private banks. Developed with the support of Credit Suisse, Vontobel, Swiss Re, and other financial players, ResponsAbility demonstrates the potential for specialized managers to partner with mainstream financial players to leverage existing distribution channels and raise assets for impact investing products.
- Fund management: A number of impact-oriented fund managers have achieved reasonable scale. Impact Community Capital manages more than $750 million on behalf of eight large insurers. Bank of America's Capital Access Funds manages or advises on more than $800 million focused on underserved markets in the United States. Community Capital Management and Access Capital Strategies (recently purchased by Voyageur Fixed Income) manage more than $900 million and $600 million, respectively, in community development fixed income on behalf of pension funds, banks, and foundations. Innovators in established fund management companies, such as the managers of impact investing units in TIAA-CREF and Prudential, are building portfolios that total hundreds of millions of dollars across asset classes. Internationally, both Root Capital and E+Co. –US-based non-profits investing in rural businesses and energy services respectively in developing countries--recently launched ambitious scale-up plans. Bridges Ventures in London, the Acumen Fund (an investor in social enterprise in India, Kenya, and Pakistan), GroFin in Africa, and AIsis Funds in Latin America have all increased their balance sheets substantially in recent years.
- Retail client mobilization: Innovators have developed mechanisms to make impact investing accessible to retail investors. The Calvert Community Investment Note can be bought in the United States for $1,000 minimum from brokers ($20 minimum when purchased online via Microplace). It offers up to a 3 percent coupon. Similarly First Affirmative Financial Network supports its members (registered investment advisors serving socially conscious investors) in offering impact-oriented investments to their clients. Efforts to launch "Social Stock Exchanges" for raising public equity for social enterprises are also gaining momentum in London and Singapore. A number of similar efforts, focused on alternative approaches to public offerings for social enterprise, are at very early stages of development in the United States.

Building on structuring innovation: Although the diversity of the social objective and investors' return expectations can make the impact investing marketplace seem chaotic, an increasing range of innovations in structuring transactions and funds are turning these differences into assets.

One approach is to create tranched structures that enable investors focused on social return to leverage their capital while reducing the risk for more commercial investors:

- The New York Acquisition Fund leveraged grant money and subsidized investment capital from foundations with senior debt from banks to create a $230 million pool to finance the purchase of land and buildings for affordable housing. Shaun Donovan, the head of the New York City Department of Housing Preservation and Development and one of the fund's main architects, is now the Secretary of Housing and Urban Development (HUD) in Washington.
- Internationally, the Alliance for a Green Revolution in Africa (AGRA), a Kenya-based private foundation, recently announced a deal with South Africa's Standard Bank in which $100 million of commercial investment in African agriculture will be unlocked by a $10 million loan guarantee from AGRA. AGRA's board is chaired by former United Nation's Secretary General Kofi Annan. In India, the Gates Foundation, Acumen Fund, and ICICI Bank created a similarly structured vendor finance facility for the clean water provider, WaterHealth International.

Innovative fund managers are also becoming increasingly sophisticated in how they provide impact investors the specific investment exposure that meets their social impact goals. For example:

- Community Capital Management and Access Capital Strategies offer investment products that combine the efficiencies of managing a single national fund while allowing different social investors to receive an "allocation" of investments meeting their specific needs (e.g., specific census tracts for banks seeking CRA consideration, specific mission interests for foundations).
- Actis, a prominent global private equity fund with a developmental heritage from the United Kingdom, used a similar approach in raising $2.9 billion for its Actis Emerging Markets 3 Fund. It gives development agencies with specific geographic interests an allocation to specific countries within their global fund.

Investors are also partnering creatively with foundations and nongovernmental organizations (NGOs) to provide impact-investment funds with both strong investing fundamentals and social impact credibility. The Northwest Louisiana Community Development fund is a double-bottom-line real estate fund partnership between the Strategic Action Council (a 38-member coalition of community groups) and Kennedy Wilson, a national real estate manager. Both the fund manager and the council will receive a carried interest tied to the performance of the fund. Kennedy Wilson will take responsibility for investment decisions while SAC will be responsible for impact objectives. This distinctive hybrid approach brings strong community buy-in and support that aids in meeting the fund's financial and social objectives. As a result, it has attracted a range of investors, including the F.B. Heron Foundation, TIAA-CREF, JP Morgan Chase, the Annie E. Casey Foundation, and the Kellogg Foundation.

## Securing Supportive Policy Reform

Despite this proliferation of innovation, for-profit businesses and investors who seek to create social value are still too often left to force-fit their aspirations into existing nonprofit or for-profit legal structures. Legal innovation, however, is also gathering steam. The Dutch government provides capital gains tax breaks to environmentally beneficial investments, which sets a precedent for supportive regulation. The UK government created a new corporate form of for-benefit "Community Investment Corporations" in 2005. In France and South Africa, recent legislation will compel investors to place some of their capital in impact investments.

In the United States, private efforts to create a "B Corporation" (a new classification of company that uses the power of business to solve social and environmental problems) and LC3 legal form are starting to build momentum for a new regulatory regime to meet the interest of impact investors. Clarifying guidance from the Internal Revenue Service could also ameliorate some of the arguably misplaced conservatism that has held many foundations back from engaging in impact investing for fear of legal consequence.

More broadly, the Obama administration's commitment to supporting social innovation coupled with pragmatic partnerships that join government, the social sector, and the investment present the potential for new types of financial and institutional arrangements in sectors ranging from community development, education, to the environment. These arrangements are increasingly crucial to securing the political legitimacy of the Troubled Assets Relief Program (TARP) and other major federal stimulus and bailout expenditures.

## Will Impact Investing Survive the Current Market Turmoil?

Like a butterfly emerging from its cocoon into a hurricane, the impact-investing industry is coalescing just as international credit markets reel. Certain challenges are rooted in the credit crisis, including:

- Lack of tax credit equity: In sectors ranging from renewable energy to affordable housing, the lack of tax credit equity investors, owing to both the broader credit crunch and a lack of value for these credits amid corporate and investment losses, has left a significant gap, making many transactions that were once routine challenging or not viable.
- Lack of access to senior financing: A general lack of available senior finance has sharply curtailed the ability of risk-tolerant impact investors to catalyze substantial senior capital by taking a subordinate position in tiered risk arrangements. This paucity is rooted in the broad de-leveraging across the global financial system, which affects bank lending, bond markets, and nonbank finance. Credit-enhancement mechanisms (such as monoline insurers) to help address these issues have also disappeared or become prohibitively expensive.
- Cut-back in Community Reinvestment Act investments: Many U.S. community development players report a cut-back in investments from CRA groups as banks (appropriately) shore up their balance sheets. In addition, although several new banks have emerged during the prior 12 months, the consolidation among banks has shrunk the field of CRA investors.
- Capital scarcity: Budget cuts in government, foundations, corporations, and among individuals have constrained the financial positions of social enterprises and nonprofit organizations, exacerbating the financing shortfalls.

However, there is good news as well. The financial crisis seems to have created a boon in available talent. Around the world, experienced finance professionals, recent business school graduates, and talented expatriates face much lower opportunity costs to enter this industry. In some cases, they are returning to work in emerging markets of increasing interest to impact investors.

Although impact investors are not immune to the challenges of raising capital and syndicating deals in this credit market, anecdotal evidence shows that many remain committed to this new industry. Many of the impact investment asset management, advisory, and banking organizations have remained solvent, and in many cases are growing during a period that has brought mainstream financial services to their knees. Indeed, initial anecdotal indications are that some impact investment portfolios fared well relative to market benchmarks - while the median foundation corpus declined by 26.1% in 2008 according to the Foundation Financial Officers Group, the program-related investment (PRI) portfolios of a number of foundations delivered positive returns. Some of these PRI portfolios have remained somewhat insulated from recent market volatility and, against that broader backdrop, their modest (< 5%), relatively stable returns have provided a welcome contribution to portfolio diversification and risk management.

Indeed, this environment presents distinctive opportunities. For example, Southern Bancorp, the country's leading rural community development finance institution, is seizing the opportunity to acquire the deposits and selected assets of several institutions in its home state of Arkansas (in one case, at the behest of regulators). These acquisitions, funded primarily with $11 million in TARP funds, give Southern a low-cost way to expand its integrated rural development work in the Delta region of Arkansas and Mississippi. Similarly, various affordable housing groups are stretching their capital with innovative impact investments to acquire land and properties during the current real estate downturn.

Community groups, foundations, and government have discussed a range of areas for prospective collaborations, ranging from the Department of Education's $650 million "Invest in What Works and Innovation" fund, to securing TARP funding for Community Development Financial Institutions (CDFIs), to thinking about how the social sector could partner with the FDIC as it disposes of loans and properties from seized banks.

If we could predict with certainty what effect market conditions will have on this industry, we would be making venture capital investments rather than writing articles. In the end, the interplay of income and substitution effects will determine the medium-term trajectory of the impact-investing industry. Industry participants can do little in the short term to address the wealth destruction that is reducing available capital. We can, however, work strategically to position the industry to absorb a greater share of investment capital when markets inevitably thaw.

The success of this new industry is not certain. The danger remains that "impact investing" will become a mere marketing tool that investment promoters use to raise funds without generating substantial social and environmental benefit. It may also be only a convenient means to meet a regulatory or societal requirement. If leaders in the subsectors—community development, microfinance, education finance, health care finance etc.— do not realize the value of coming together to build a single industry infrastructure, they will suffer from duplication and fragmentation. Their individual voices, capabilities, and potential clout are minor compared with what could be accomplished with constructive cross-sector collaboration.

## Where Does Impact Investing Go From Here?

We know from the success of other innovations, such as the development of the private equity industry, that a small group of leaders must work effectively to accelerate the pace and manner in which an industry matures. The impact-investing industry will reach its potential in the early years of the twenty-first century if the innovation and stamina of entrepreneurial risk-takers can be coupled with industry-building leadership.

Building a mature impact-investing industry will also require brave self-examination by impact investors and the businesses and funds with which they invest. The impact-investment industry must be realistic about the returns it will offer and investment products it must develop to become a viable proposition for the institutional investors, who control most of the world's investable assets but are bound by rules that limit their freedom to invest in unproven and submarket products. The industry also must become more confident and honest about explaining the need for subsidy in many areas, through lower returns and higher risk tolerance.

The Monitor Inclusive Markets report on business models to provide basic services to poor customers provides a new benchmark for a thorough analysis of the opportunities and requirements of a specific subsector of impact investing. The report is built on the willingness of enterprises and investors to expose their business practices to public review. It shows that impact investors must accept that subsidies will be temporarily necessary in some subsectors as social enterprises test and refine applicable business models. Subsidies will be permanently appropriate in subsectors where investment generates substantial positive externalities that cannot be internalized into a company's profit.

The economic crisis has shaken confidence in established investment ideologies and their mainstream proponents. The emergence of the impact-investing industry provides a potentially compelling alternative by offering to imbue investment with social purpose and, ultimately, to increase the scope of solutions to social problems that continue to proliferate even as philanthropy resources dwindle.

# Local Stock Exchanges and National Stimulus[1]

Michael Shuman
Business Alliance for Local Living Economies

Since the global financial system unraveled in 2008, U.S. policymakers have struggled heroically to improve the performance and oversight of global banks and investment firms. But these actions have been largely unresponsive to the growing number of Americans who would like to remove their hard-earned retirement savings from these high financial fliers altogether and invest their nest eggs instead in their community. Might it be time for policymakers to consider the potential stimulus payoffs from nurturing micro-equity investments?

One reason for growing public interest in local investment is the spread of "buy local" campaigns, a movement that is more than just local hucksterism. Consider the title of an article in a recent issue of Time: "Buying Local: How It Boosts the Economy." Cutting-edge economic developers (except at the national level) increasingly recognize the importance of strengthening locally owned, small businesses.

Growing evidence suggests that every dollar spent at a locally owned business generates two to four times more economic benefit—measured in income, wealth, jobs, and tax revenue—than a dollar spent at a globally owned business. That is because locally owned businesses spend much more of their money locally and thereby pump up the so-called economic multiplier. Other studies suggest that local businesses are critical to tourism, walkable communities, entrepreneurship, social equality, civil society, charitable giving, revitalized downtowns, and even political participation.

Despite this overwhelming body of evidence, the national stimulus efforts have proceeded with no specific attention to local businesses. Yet even some very simple reforms that opened up local businesses to local investors could make a huge difference.

Consider two anomalies of the current financial system (even if the latest reforms work exactly as planned). The first is that locally owned, small businesses constitute about one-half of the private economy in terms of output and jobs, but they receive almost no investment from the nation's pension funds or from mutual, hedge, venture, or any other kind of investment funds. In a well-functioning financial system, roughly one-half of the investment should go to roughly one-half of the economy. Today, every American, even the stalwart advocate of community development, is overinvesting in the Fortune 500 companies and underinvesting in local businesses key to local vitality. This is a colossal market failure.

Does this occur because local businesses are less profitable than global ones? Hardly. According to the Statistical Abstract, sole proprietorships (the legal structure chosen by most first-stage small businesses) are nearly three times more profitable than C-corporations (the structure of choice for global businesses).

Moreover, several global economic trends are now making U.S. local businesses increasingly competitive. Rising energy prices make local production for local consumption more competitive against Wal-Mart production in China. The falling dollar revitalizes U.S. manufacturers. As Americans shift their spending from goods to services, a trend that has been occurring for 50 years, local businesses will see more competitive opportunities still, given that most services depend on direct, personal, and ultimately local relationships.

A more plausible explanation for the absence of local business investment is the paucity of market-clearing mechanisms, essentially local stock exchanges, that would allow local investors to find, buy, and sell local securities. Interestingly, smaller stock exchanges, primarily facilitating intrastate transactions, were quite common until the securities reform acts of the New Deal era. Some were poorly designed and fraught with fraud and inefficiency, but others were reasonably successful. Once the national exchanges became reliable and widespread, however, businesses and traders alike gravitated

1 This article was originally published in the Community Development Investment Review (Volume 5, Issue 2), 2009, available http://www.frbsf.org/publications/community/review/vol5_issue2/index.html.

away from the state exchanges. Today, only a half dozen public exchanges still operate in the United States.

Given the fact that market-clearing mechanisms exists on a limited scale, one must ask why local businesses do not use them. Without sacrificing their local character, for example, local businesses could issue nonvoting preferred shares of stock for national investors and trade them over the counter on existing exchanges. There is certainly no technical reason this could not be done. Prosper.com and Kiva.org have demonstrated how small businesses seeking microloans can be vetted, listed, and exchanged efficiently.

The real reason small public offerings and local stock exchanges do not flourish today is that the Securities and Exchange Commission (SEC) has essentially banned them. Existing laws place huge restrictions on the investment choices of small, "unaccredited" investors—a category in SEC vernacular that includes all but the richest two percent of Americans. The regulations prohibit the average American from investing in any small business, unless the firm is willing to spend $50,000 to $100,000 on lawyers to prepare a private placement memorandum or public offering—thick documents with microscopic, ALL CAPS PRINT that no human being has ever been observed actually reading.

Which brings us to the second anomaly of today's financial system. Suppose you wished to play blackjack in one of the more than one thousand casinos operating across the United States. Do you first have to prove that you're an accredited gambler? Must you read a thick disclosure statement letting you know the risks of blackjack before you place your first bet? Everyone understands that these would be silly requirements.

We have two fundamentally contradictory legal regimes operating today. One, called gambling, allows every adult, irrespective of income, to risk everything for a probable loss. Another, called small-stock investing, prohibits 98 percent of us from investing in the local businesses that are essential for the well-being of community, unless businesses pay prohibitively expensive lawyers' fees to prepare the unreadable disclosure statements.

Something is deeply wrong here. Outdated federal securities laws have left Main Street dangerously dependent on Wall Street, and overhauling them may well be a key to economic revitalization.

The good news is the local businesses could get a huge investment boost with some modest securities reforms that would cost little or nothing. One easy reform would be for the SEC to exempt from its usual expensive disclosure requirements any low-risk public ownership of locally owned microbusinesses. By low-risk, I mean that no person can hold more than $100 worth of any one stock—which means that we're freeing up people to engage in the risk equivalent of a nice dinner for two. By local ownership, I mean that only residents within a state can buy, hold, and sell stock shares. And by microbusinesses, I mean any business with a total stock valuation on issuance of less than $250,000.

A related reform would be for the SEC to set simple rules for the setting up of internet platforms for trading the exempt securities above. The few remaining national players, such as the New York Stock Exchange and the NASDAQ, have enough authority now to launch a product that would enable states, regions, or municipalities to set up trading portals. But because they do not see large profit opportunities—a mistaken judgment, in my view—it will probably fall to new entrepreneurs, such as Mission Markets, to redesign local exchanges for smaller, slower transactions. The SEC should streamline its regulations to enable more such exchanges to get off the ground at an affordable regulatory price.

Here are a few other legal reforms that would be helpful:

- Micro-investment funds. Let's allow small investors to pool their money in backyard investment funds (again, up to $100 per person) that in turn invest in diverse portfolios of local stocks. (Only the super rich can invest in such funds now.)
- Co-op investment funds. Let's allow cooperatives, most of which are owned by workers or consumers living in a single community, to set up investment funds empowered to make local investments on behalf of their members. (Currently, they can only invest members' capital in businesses owned and run by the co-op itself.)
- Pension fund participation. Let's allow any pension fund that places as much as 5 percent in local securities, either directly or through microbusiness investment funds, to meet legal standards of "fiduciary responsibility." (Current regulations define the term in a way that directs virtually all such investments must go to global companies.)

New community-based funds, securities, and exchanges, of course, still need oversight to prevent fraud and ensure accountability. However, given that nearly all local investment is, by definition, intrastate, these new rules could be left to the existing securities departments in the 50 states. Once state-level laws are put into practice, many of the absurd requirements of the SEC expensive audits and lengthy legal filings might finally disappear.

Were these reforms enacted nationally, literally trillions of investment dollars could begin to move into the local business economy. Entrepreneurs, hungry for new capital in the post-meltdown credit crunch, would begin to restructure their businesses to receive microcapital. Investors terrified about betting all their money in the global firms with a checkered past would start shifting their investments to local businesses they know, trust, and can visit and "ground-truth" with tough questions. The result will be a nation of stronger local economies, with American investors increasingly placing more of their money into backyard businesses.

Two final points about these ideas. First, the experimentation opened up at the state level will invite other grassroots engagement, invention, and competition that will help demonstrate the viability of simpler, cheaper, more transparent investment regulatory frameworks. Second, and most significantly, all these regulatory reforms will cost almost nothing. Instead of spending billions more in federal taxpayer dollars to prop up dubious big financial institutions, why not create for free a system that is more stable, safe, lucrative, and democratic?

# Who's Counting? Measuring Social Outcomes from Targeted Private Equity[1]

Janneke Ratcliffe
Center for Community Capitalism, University of North Carolina at Chapel Hill

The term "private equity"[2] might invoke images of big buyouts such as Clear Channel Communications and Chrysler. But private equity is also a potential source of capital to fund business growth or innovation for smaller companies. While mainstream venture capital tends to concentrate in particular places and industries, an evolving asset class referred to as "underserved," or emerging domestic markets (EDM), is directing capital to more diverse and traditional business types. The potential of this sector to deliver strong financial returns while also giving rise to public benefits has drawn the attention of both venture and economic development capital, as well as policymakers and researchers.

EDM portfolios tend to feature businesses different from typical venture capital portfolios; they are often largely composed of retailers, financial service entities, makers and distributors of consumer products, business service providers, and computer hardware companies—sectors that, when combined, account for only 10 percent of mainstream venture capital investments.[3] EDM investors seek favorable returns by channeling capital to underserved sectors: minority-run ventures, inner-city companies, rural enterprises, and ventures that hire lower-skilled workers or supply underserved customer groups. In this pursuit, they can have positive indirect benefits in the form of job creation, economic stimulus in disadvantaged communities, and ownership and management opportunities for minorities and women.

The Center for Community Capitalism, with funding from the Kauffman Foundation, is exploring the hypothesis that profit-driven investing can achieve measurable societal benefits in line with mission-targeted investing—but on a larger scale. Further, we seek to understand which particular activities within the private equity arena can deliver high returns to both financial and social bottom lines.

## The EDM Market Opportunity

Private equity can take many forms, from buyouts of large companies to early-stage venture funding of startups, and the sums are substantial. In 2006, venture capital funds and buyout and mezzanine funds raised about $130 billion (NVCA, 2007). In the same year, venture firms reported investing $25.5 billion in 3,416 deals (PricewaterhouseCoopers, 2007).

While this sounds like a lot of capital, it is not a common tool for most businesses. Sixty percent of venture capital goes to just four industries: software, biotech, medical devices, and telecommunications.[4] Previous surveys of small business firms found that less than 1 percent used external equity capital. Although firms that were younger or larger were more likely to have tapped private equity, the percent of either using external equity was still below 3 percent (Ou and Haynes, 2006).

The fact that businesses need to be of a certain scale (actual or potential) to tap private equity limits the universe of candidates for funding. While there are a reported 23 million firms in the United States, less than one-quarter have employees, and of those employer firms only about 20 percent have annual sales above $1 million.[5]

1 This article was originally published in the Community Development Investment Review (Volume 3, Issue 1), 2007, available http://www.frbsf.org/publications/community/review/062007/index.html.

2 We use the term to mean non-publicly-traded equity and near equity investments in enterprises, including venture, mezzanine, and buyout funding, but excluding angel and owner/friends/family investments.

3 Figures for 2006, see PricewaterhouseCoopers and National Venture Capital Alliance 2007, 3.

4 Ibid.

5 U.S. Census Bureau; Statistics about Business Size, 2002.

Venture capital and private equity are even less accessible to certain categories of businesses, such as those that are located far from financial centers and those owned by minority or female entrepreneurs. These underserved markets might offer significant potential for future investment as illustrated by the following facts:

- Eight percent of employer firms in this country are owned by racial minorities, and close to 4 percent are owned by Hispanics.[6] Yet minority-owned companies receive less than 2 percent of Venture Capital (Milken Institute, 2000).
- The IRS predicts that Latinos will soon own one in ten businesses. Growth rates in the number of minority-owned ventures are three to four times higher than for white-owned businesses (Boyd, 2006).
- Population trends put minority purchasing power at one-third the total purchasing power by 2020 (up from one-fifth in 2000) (He and Hobbs, 2000). The dramatic growth in the Hispanic population, projected to grow at three times the overall population rate by 2020 is creating new markets (Pew Hispanic Center, 2005).
- The inner city, home to 8 percent of the U.S. population according to the Initiative for a Competitive Inner City (ICIC), offers retail, hiring, and investment opportunities that are often overlooked. The "Inner city 100" has seized on these advantages: 445 businesses selected since 1999 with average annual sales of $20 million and an impressive 54 percent average annual growth rate (ICIC 2006). Yet these companies and their inner-city peers often struggle to find growth capital.
- Rural enterprises account for 19 percent of all businesses but receive less than 2 percent of venture capital (Schmitt, 2003).

Small and mid-sized businesses have been described as the backbone of the economy. According to the U.S. Small Business Administration, small businesses provide approximately 75 percent of net new jobs added.[7] To put the job-creation potential of the small and mid-sized business sector in perspective, the 5 percent of firms with between $1 million and $50 million in revenues account for 35 percent of U.S. nonfarm, private-sector jobs.[8] Although only 1 percent of black-owned businesses have over $1 million in annual receipts, these firms employ more than half the workforce of all black-owned firms.[9] Thus, this particular slice of the small business universe can be an important component of an area's economic engine. Moreover, there is a compelling case to be made that the economy can benefit from strengthening the number, size, and capital of emerging enterprises. According to a Boston Consulting Group study, "Large minority-owned businesses can create the kind of explosive and transformative growth that is needed to invigorate minority communities, inner-city markets, minority entrepreneurs and business leaders" (Boston Consulting Group, 2005, 1).

The Milken Institute includes the following under the umbrella of EDM: "ethnic- and women-owned firms, urban and rural communities, companies serving low-to-moderate-income populations, and other small- and medium-sized businesses," all of whom face constraints in accessing capital due to "systemic undervaluation." The book Untapped: Creating Value in Underserved Markets describes "a multi-trillion-dollar opportunity that is largely untapped. This market has some of the fastest-growing companies and fastest-growing business opportunities. It is also a market with the fastest-growing workforce and a rapidly expanding supplier base" (Weiser et al., 2006, 1). Additionally, in its case for greater recognition of the value of the asset class, Pacific Community Ventures (PCV) describes the opportunity as "investing in an array of traditional, brick-and-mortar businesses with revenues between $5 and $30 million that are located in distinct, untapped geographies" (Douglas et al., 2006, 1). These sketches suggest a typical company profile: an existing business with a demonstrated market and track record but hemmed in by lack of capital. With a sizable cash infusion from equity investors, often coupled with specialized expertise, the enterprise can grow to the next level, at which point the investor hopes to realize a return.

The business case for EDM private equity is founded on two factors: (1) growth potential, and (2) a lack of competition from other capital sources. These two factors suggest the opportunity to capitalize on a market imperfection. A land-

6 Ibid., 2002 Survey of Business Owners.

7 http://www.census.gov/epcd/www/smallbus.html.

8 U.S. Census Bureau, Statistics about Business Size, 2002.

9 Ibid., U.S. Census Bureau, 2002 Survey of Business Owners.

mark study of the financial performance of minority-focused venture capital funds over a 15-year period by Timothy Bates and William Bradford found that the returns were "certainly no lower—and perhaps higher—than those of mainstream funds" (Bates and Bradford, forthcoming, 14). Despite this performance, the field is projected to remain underserved by mainstream funds due to a lack of relationships, the poor fit between EDM business types and mainstream venture capital preferences, and discrimination.

The public case for EDM investing grows directly out of this business case and the notion that by filling a capital gap EDM investing yields economic benefits for communities, employees, customers, and entrepreneurs. Investors benefit as well, and while each investor comes to the table looking for a particular blend of social and economic returns, very few are willing to give up economic returns for social returns, which are typically regarded as by-products of investing. Conditions giving rise to social returns include:

- Minority-owned employer firms have created more than 4.7 million jobs.[10]
- Black-owned businesses are much more likely to hire minorities than white-owned businesses. While the vast majority of black-owned firms hire workforces that are mostly nonwhite, white-owned firms—even those operating in minority communities—hire predominantly white workforces (Bates, 2006). Emphasizing high-potential black entrepreneurs, Bates suggests: "With increased access to capital, black firms can form, grow, and create jobs, often hiring those who need employment most" (235).
- Minority entrepreneurs tend to enter business with lower levels of personal wealth and face barriers when tapping traditional financing sources, contributing to lower rates of success and growth (Robb and Fairlie, 2006); EDM investing can help overcome the capitalization barrier.
- Urban and inner-city companies create jobs where they are most needed. For example, the 445 Inner City 100 companies recognized from 1999 through 2006 employ 73,000 people, nearly half of whom are inner-city residents. Of these companies, 31 percent are minority-owned, almost three times the national average (ICIC, 2006).

However plausible the theoretical connections between EDM investing and social benefits are, there have been only a handful of attempts to document the connection. In the next sections of this essay, I describe notable sources of targeted private equity and then provide early evidence of favorable social outcomes of three EDM investment vehicles.

## Alternative Sources of Equity Capital: CDVCFs, SBICs, and EDM Investors

Most providers of equity capital do not target mid-sized, traditional enterprises. Exceptions include Small Business Investment Companies (SBICs), Community Development Venture Capital Funds (CDVCFs) and New Markets Venture Capital Funds (NMVCFs), and a cadre of profit-oriented EDM funds. In the overview of these targeted investors and their social returns follows, there will be some overlap between categories.

CDVCFs. These funds are "mission-driven organizations that benefit low-wealth people and communities while working to earn solid financial returns," according to the website of the industry's trade association, the Community Development Venture Capital Alliance (CDVCA). Tracing its roots to Appalachia in the 1970s, the CDVC industry has since grown to more than 80 funds and $900 million under management. Because of the relative youth of the CDVC industry, few funds have existed long enough to mature and report conclusive financial results. The three oldest funds reported a 15.5 percent gross IRR[11] on 31 investments made between 1972 and 1997 that have since been realized, including just seven total write-offs (Tesdell, 2007).

To successfully navigate the implied trade-off between financial and social returns, CDVCFs seek low-cost sources of capital, primarily from banks, government, and foundations. As of 2003, 42 percent of CDVCF capital came from banks, which are motivated by the Community Reinvestment Act. Government and foundations combined constituted another

10 U.S. Census Bureau, 2002 Survey of Business Owners.

11 Caution should be observed when comparing venture IRRs since funds usually report their returns net of fees and may include unrealized investments; see Schmitt 2004.

29 percent of CDVCF capitalization in 2003. Nondepository financial institutions (such as pension funds and insurance companies) are another important, growing source of capital to the industry.

CDVCA developed an impact assessment tool as a template for individual funds to tailor to their own needs. Many individual CDVCFs report detailed results individually as well. For example, the companies in SJF Venture's $13 million investment portfolio added 1,021 jobs from investment through 2005, about one new job per $13,000 invested, 75 percent of which went to LMI individuals (Broughton and Klein, 2006). Pacific Community Ventures (PCV) tracks the number of "designated" employees working for their portfolio companies.[12] As of 2005, PCV reports 1,531 designated employees in its nine-company/$10 million portfolio, two-thirds of whom are minorities (PCV, 2006). To gauge job quality as well as quantity, SJF Ventures, PCV, and other CDVCFs also track such metrics as change in wage levels, benefits provision, wealth-building and profit-sharing programs, and training and promotion opportunities for target employees.

The CDVC industry has historically estimated a social yield of one full-time job added for just under $15,000 invested (CDVCA, 2001). For 2005, sixteen CDVC funds reported a 48 percent increase in employment at portfolio companies since the time of first investment. Data from a subset of CDVCFs indicate that 62 percent of portfolio company employees are low income, that 41 percent of the companies are in low- to-moderate income (LMI) areas and that 32 percent are in rural areas (CDVCA, n.d.).

Certainly CDVCFs have been pioneers in applying "the tools of venture capital…to grow small businesses that create good jobs for low-income people and promote entrepreneurial capacity in economically distressed urban and rural areas" (CDCVA 2002, 2). The industry has amassed a capital pool of nearly $1 billion, more than doubling in size since 2000. However, this model faces constraints because of a lack of scale capital available in the market at that particular risk/return/social impact offering. Additional hindrances include the small scale of the individual funds and attendant lower management fees, coupled with the high costs of making complex but relatively small investments that often require technical assistance (Rubin, 2001). To illustrate, the average CDVC investment is around $350,000 compared to $7 million for mainstream venture capital, and small transactions can require as much work as large ones. The average CDVC fund at just over $10 million is modest compared to $299.5 million for the average venture fund.[13] In short, these funds explicitly invest for social returns and have made an impact, but structural conditions may hamper their ability to carry their results to a more substantial scale.

SBICs. Since 1958, the U.S. Small Business Administration's (SBA) Small Business Investment Company program has fostered venture and mezzanine financing for small business growth. Most of this equity and near equity capital has been channeled through two different programs: the Debenture program and the Participating Securities program. In the former, private, for-profit funds use low-interest ten-year SBA-guaranteed debt to leverage private capital; in the latter, the SBA takes an equity stake in the funds. In 2004, following a period of poor financial performance that mirrored trends in the overall venture capital market, the SBA ceased funding new SBICs under the Participating Securities program. It continues to fund the debenture mechanism. In both models, the subsidization of a substantial portion of capital allows SBICs to generate below-market returns in the aggregate while providing market-level returns to private capital. For example, the Participating Securities program had an overall IRR of 2.5 percent for the 1994 to 2004 vintage years as of September 2004, while the private investors earned a 17.7 percent IRR (SBA, n.d.).

As of the end of 2005, the SBIC industry had capital "resources" of $23 billion[14] in 418 funds, averaging $55 million. In the 2006 fiscal year, SBICs made 3,674 investments in 2,121 companies totaling $2.9 billion. The average investment was $788,580, or $1.4 million per company. The split between debenture and participating securities was roughly 45/55 (SBA, 2006).

For the most part, the SBIC program is not designated for particular geographic places or types of companies but instead

12 Designated employees are those hired below a certain compensation level who either live in an LMI area or were hired through an employment program.

13 Figure for 2005, according to the National Venture Capital Association. http://www.nvca.org/faqs.html. Accessed April 12, 2007.

14 According to http://www.sba.gov/INV/faq.html accessed on March 7, 2008, this includes $6.3 billion of SBA-sourced funds and $5.1 billion of SBA commitments plus $12 billion of private capital.

targets all small businesses because they are viewed as economic growth engines.[15] In fiscal year 2006, nearly one-third of SBIC financing went to manufacturers, followed by "Information" (15.5 percent) and "Professional, Scientific and Technical Services" (12 percent). SBICs reported on 958 companies with a combined workforce of 129,256 and median employment of only 35 prior to receiving financing, and with average pre-financing sales of $16 million (median $5.5 million). Some 23 percent of SBIC-program financing went to low- and moderate-income areas in 2006 (SBA, 2006). Historically, just 5 percent or less of SBIC dollars have been invested in minority-owned companies and 3 percent or less in women-owned companies.[16]

Over the years, SBA has earmarked funding for certain categories. From 1972 to 1996, it offered special terms for funds invested in minority and disadvantaged enterprises through the Minority Enterprise Small Business Investment Company (MESBIC) program, later renamed the Specialized Small Business Investment Company (SSBIC) program. SSBICs accounted for less than 1 percent of SBIC dollars invested in 2006. The New Markets Venture Capital (NMVC) program was enacted in 2001. These special debentures carry no interest for the first five years and are coupled with operational assistance grants to enable the funds to provide technical assistance to companies. Six funds, all CDVCFs, participated in the inaugural round of this program. By March 2006, they had invested $32.2 million in 75 companies with 1,626 jobs "created or maintained." More than 90 percent of the investments were in low-income areas (CDVCA, 2006).

EDM Funds. A third approach to providing patient, high-risk, growth capital to targeted business types represents a growing force due to the interest of larger-scale, profit-oriented investors. This field includes minority-oriented venture funds such as the members of the National Association of Investment Companies, which reports around $5 billion under management altogether. It also includes some SBICs and CDVCFs as well as bank-managed funds. The typical investors—banks, insurance companies, corporations, and public pension funds—are seeking market rates of return without tangible subsidy. Along the spectrum of financial and social return requirements, this group of funds is most closely positioned to mainstream venture capital and private equity. If EDM investments produce sustained returns to these private-sector investors, the pool of capital is potentially enormous.

## Case Studies: Examples of Making Investments in EDMs

Benchmarking financial results using agreed upon metrics such as IRR or the ratio of distributions to investments is relatively straightforward. However, measuring societal benefits is less cut and dried. The data included from these three case studies represent only the starting point of an effort to document the total returns, both financial and social, from EDM private equity. At this stage, the indicators are both basic and preliminary, focusing on employment (number of jobs, changes in employment levels, share of jobs going to disadvantaged workers), community (characteristics of places where business are located), and entrepreneurship (characteristics of business owners and managers). These rough but widely understood indicators can ultimately enable comparison to other development financing activities.

The business model for each of the three examples is summarized below, followed by a side-by-side illustration of the early results of social measurements.

## Banc of America Capital Access Funds (BACAF)

Formed in 1997, Banc of America Capital Access Funds is housed within the bank's primary private equity management division, which manages around $7 billion in private equity capital. Bank of America describes itself as one of the oldest private equity investors in the banking industry and, through BACAF, one of the largest investors in underserved markets.

The "Fund of Funds" approach is enabling Bank of America to consolidate a considerable amount of capital and deliver it to underserved markets through about 15 private equity funds. BACAF combines Bank of America's previous experiences in EDM private equity with sizable investments of $175 million from two of the ten largest pension funds in the world: CalPERS

15 Generally, for purposes of the SBIC Program, "small" means a company whose net worth does not exceed $18 million and whose net income does not exceed $6 million.

16 For example, in FY 2006, 3.6 percent of SBIC dollars were invested in minority-owned companies and 1.3 percent in women-owned; in FY 2004, the shares were 5.2 percent and 2.3 percent, respectively (U.S. SBA: SBIC Program Financing to Small Business-Fiscal Year 2006; ibid., Fiscal Year 2004) .

and CalSTRS (Hebb 2006 and CalSTRS). Combined, these pension funds have more than $378 billion in assets as of January 2007 and combined private equity investments of more than $21 billion.[17] The BACAF represents less than .5 percent of the total private equity funding pool.

Bank of America sums up its investment criteria as seeking to make investments of between $5 million and $15 million—–not to exceed 20 percent of the total private capital raised by each fund. By the third quarter of 2006, BACAF had invested or committed to invest in 13 funds with total expected combined capital of more than $2 billion. At that early stage, these funds had invested in only 44 companies. The funds have an average size of $155 million but range from under $50 million to over $500 million. BACAF's total commitment ranges from $5 million to $15 million (from a 2 to a 20 percent stake). The allocation by asset type is about half buyout funds, 30 percent growth-oriented funds, and the remainder venture and mezzanine.

Among the 13 funds to which BACAF has committed:

- Ten focus on ethnic minority opportunities
- Ten focus on low- to moderate-income geographies
- Eleven have at least one ethnic minority partner
- Three have at least one female partner [18]

Investment strategies of the funds are just as diverse. The funds target a broad spectrum of investment size: some will consider investments as small as $1 million, while others aim to make investments larger than $35 million.

The types of companies and markets represented are also diverse, consistent with the principles of underserved and EDM investing. Less than one-quarter of BACAF companies funded to date are in the mainstream venture-capital sectors of software and biotech. Conversely, 45 percent of the BACAF portfolio companies are in sectors that receive about 10 percent of mainstream venture-capital investments such as financial services, retailing, and business services.[19]

Annual revenues for the portfolio companies are broadly distributed, with 15 percent reporting baseline year revenues of $500,000 or less and 15 percent reporting in excess of $50 million.[20]

Average investment size is comparable to that of mainstream venture capital due to the presence of two very large investments. With the majority of investments falling between $1 and $5 million, the median is just above $3 million, significantly larger than for CDVCs and SBICs.

California is home to the largest share (45 percent) of BACAF's underlying company investments; New York and New Jersey combined account for another 21 percent of the companies; and the remaining 34 percent is distributed in ten other states. Table 1 shows early social outcome measurement results for BACAF.

## The California Public Employees Retirement System (CalPERS)

CalPERS' "California Initiative" has thus far committed close to $1 billion in EDM investments. The initial round of $475 million, launched in 2001, was funded through ten investment firms, including $100 million in BACAF (described above), Garage Technology Bank, Pacific Community Ventures, and Yucaipa Corporate Initiatives Fund, and features investments made through the various partners as well as direct co-investments. As with BACAF, the funds covered the spectrum of investment types, from seed, to venture, growth, middle-market, and corporate. By late 2006, these funds had invested in 130 companies. CalPERS reported a preliminary average annual return of 16.3 percent on those investments as of late 2005 (Hebb, 2006). And, in 2006, CalPERS announced a further $500 million investment through yet another investment partner, Hamilton Lane (Cutland 2006).

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17 Investment portfolio as of January 2007. Private equity figure does not include funds committed but not yet invested. From pension funds' websites www.CalSTRS.com and www.CalPERS.com. Accessed March 1, 2007.

18 Many funds span more than one category and are therefore counted multiple times.

19 44 companies reporting as of June 2006.

20 For 2005; 20 companies reporting revenue figures.

The primary objective of the California Initiative is "to earn attractive risk-adjusted rates of return" (CalPERS, 2007) and to that end CalPERS is reportedly aiming for an annual rate of return in the 15–20 percent range (Hebb, 2006). "Positive impact on underserved markets" is described as an "ancillary benefit" (CalPERS, 2007) that is to be realized as a result of the emphasis on investing activities: "providing capital to areas . . . that have historically had limited access to institutional equity capital, employing workers living in economically disadvantaged areas, and supporting women and minority entrepreneurs and managers" (CalPERS and PCV, 2007).

CalPERS engaged PCV to research, collect, and evaluate these indirect benefits on an annual basis. The launch of the California Initiative predates the inception of the BACAF, thus there are two years of data to report. Findings shared below in Table 1 (as of 2006) are from the report "Impacting California's Underserved Communities: Taking a Second Look."

The nine investment partners (other than BACAF) had invested in 89 companies as of that date. As with BACAF, the portfolio features a diversity of business types, with 38 percent of the investments going to consumer-related companies and service and communications accounting for another 37 percent. Employment size of firms ranges from three to 22,000.

## NewSpring Capital

NewSpring Capital is not a mission-driven investor, but it set out to measure what kind of social benefit it had in EDM communities. NewSpring Capital is a family of targeted private equity funds focused on the Mid-Atlantic region. Since the group's founding in 1999, NewSpring has grown to three funds with more than $340 million of capital under management. The NewSpring Capital family of funds includes:

- NewSpring Ventures, a venture fund providing equity capital to growth- and expansion-stage companies focused on enabling technologies, business services, and information technology.
- Commerce Health Ventures, a diversified health-care private equity fund that invests in biopharmaceutical, health-care services, and medical device companies.
- NewSpring Mezzanine Capital, a mezzanine private equity fund and an SBIC focused on late-stage and buy-out opportunities in business services, information technology, health care, and specialty manufacturing.

Fund management has recognized the growing interest of investors in understanding the potential social benefits of private equity. And in response to the ongoing discussion about the effects of private equity on the larger economy, in early 2007 management took the initiative to gauge the employment and economic outcomes of their own investments. The findings suggest that even though the social implications were considered after the investments were made, they were similar to those realized in the two case studies with stated ancillary benefits objectives and even to outcomes reported by explicitly mission-driven investors.

# Panel 5
# Green Investing

Frank Altman
Community Reinvestment Fund

John Berdes
ShoreBank Enterprise Cascadia

Robin Hacke
Living Cities

Mike Italiano
Market Transformation to Sustainability and Capital Markets Partnership

## Past Articles from Federal Reserve Bank of San Francisco Publications

# It's Getting Easier to be Green: Cultivating the Intersections Between Community Development and Environmental Sustainability[1]

Naomi Cytron
Federal Reserve Bank of San Francisco

## Introduction

It seems like everywhere you turn these days, something is 'going green'— be it a lightbulb, a shopping bag, or an A-list Hollywood celebrity. The community development field is not immune to this shift in hue; the green revolution is prompting community and economic developers to seek ways to dismantle the boundaries between environmental sustainability and community development. And promising intersections between these realms are emerging. In this issue of Community Investments, we explore several of these areas of overlap, including brownfields redevelopment, triple bottom line investing, and retrofitting existing affordable housing developments with green operating systems. In this introductory article, we examine the intersections between traditional community development activities and what it means to go green — from transforming the built environment to reduce environmental hazards and improve health in low-income areas, to reorienting job training and economic development efforts to contribute to both sustainability and wealth creation.

## Greening the Built Environment

The construction and operation of the buildings where we live and conduct business consume over 60 percent of the electricity used in the U.S. and account for one-third of total greenhouse gas emissions.[2] Inefficient heating and cooling systems, lighting, and appliances contribute to the carbon footprint of the built environment; an old or poorly maintained refrigerator, for instance, can emit over 1,500 pounds of CO2 annually—the equivalent of about 75 gallons of gasoline.[3] Building construction, renovations and operations also consume vast amounts of raw materials and generate heaps of waste; while some building materials are recycled, millions of tons of wood, concrete, drywall, and asphalt shingles end up in landfills.[4] Conventional building practices may also have negative impacts on our health; materials and finishes are thought to contribute to poor indoor air quality and resulting respiratory illnesses such as asthma. The negative impacts of conventional building practices on human and environmental health require that we rethink where and how to design, construct, operate, and maintain both residential and commercial buildings in more sustainable ways.

Moreover, it is critical that we recognize the natural intersections between the benefits of greener building practices and the needs and interests of low-income communities. Measures to increase energy efficiency can lower utility costs for residential and commercial properties, and smart growth and transit-oriented development can yield improved health outcomes and access to transportation and jobs. While certainly beneficial to everyone, these kinds of outcomes can have particular significance for lower-income households, who often struggle to stretch earnings to cover basic costs like utilities, health care, and transportation.

1 This article was originally published in Community Investments (Volume 3, Issue 1), 2007, available http://www.frbsf.org/publications/community/review/062007/index.html.

2 Commission for Environmental Cooperation, http://www.cec.org/greenbuilding/.

3 National Geographic $CO_2$ Calculator, http://www.thegreenguide.com/tips_tools/.

4 U.S. Environmental Protection Agency, http://www.epa.gov.

## But What Does it Mean to Go Green?

Green building is intended to yield a variety of environmental, economic, and health benefits, from conserving natural resources, to improving durability and reducing operating costs, to enhancing quality of life and comfort for building occupants. But for many developers—nonprofit and for-profit alike—greening is a new concept, and assistance is needed in determining which types of designs, materials, and technologies truly contribute to the kinds of outcomes noted above. Is it enough to offer recycling bins? Or to use non-toxic paints? Several guides and rating systems and have been created to help developers, architects, and engineers make greener choices throughout the development process. The federal ENERGY STAR labeling program, for instance, identifies energy efficient products across a range of categories, including major appliances, lighting, and office equipment. By providing consumers the opportunity to evaluate the energy efficiency of their appliances and make better choices, in 2007 alone the program reduced greenhouse gas emissions by 40 million metric tons and saved more than $16 billion on utility bills in the US.[5]

Leadership in Energy and Environmental Design (LEED), a green certification program developed by the U.S. Green Building Council, has gained national prominence as a benchmarking tool for green design, construction and operation. LEED rating systems apply to particular types of construction, such as schools, retail sites, and new homes. While there are a number of levels of certification, overall, LEED certified buildings must demonstrate that they are high performing across a number of variables: sustainable site development, water savings, energy efficiency, materials selection and indoor environmental quality. A new LEED rating system—currently in pilot phase—goes even further by rating overall neighborhood design, and examines measures to curb sprawl, reduce automobile dependency, and encourage mixed-use development.

In an effort to encourage the greening of affordable housing and to make the elements involved more understandable, Enterprise Community Partners, through its Green Communities Initiative, has crafted a set of greening criteria that applies specifically for affordable housing development. Developers who meet Green Communities Criteria for affordable housing—using designs and materials that promote health, conserve energy and natural resources, and provide easy access to jobs, schools, and services— are eligible for grants, financing, tax-credit equity and technical assistance through Enterprise.

Local green affordable housing standards have been established by a number of cities and regions as well—the City of Seattle, for example, was an early adopter of environmental standards for greening affordable housing, and since 2002 has encouraged the use of green strategies outlined in its "SeaGreen—Greening Seattle's Affordable Housing" guide (see box 1.1). Local standards can address conditions specific to a given area, including climate issues and sourcing of green materials.

While these types of standards and guidelines are helpful in understanding what going green entails, it can be particularly challenging for nonprofit housing developers to incorporate sustainability measures into their projects, especially given financing constraints and the approvals and restrictions that are often associated with affordable housing construction. While some green elements are low or no-cost, others are more difficult and costly. Low-hanging fruit include paying greater attention to building orientation and landscaping choices, and using recycled materials or installing energy efficient appliances. Those that require more planning include solar panel installation or onsite systems to clean and reuse wastewater. Determining how to finance solar panels that would generate energy for individual housing units can be particularly complicated, as costs may be paid by a developer but savings would flow to tenants.

With all the new choices that need to be weighed, going green can certainly seem daunting. Two approaches, though, can help guide the planning process. The first involves a costing process that takes into account not only the upfront expense of green construction, but also the operating, maintenance, and replacement costs over the life of the building. Called "Life Cycle Cost Analysis," this approach evaluates whether an increased initial investment will generate long term savings for developers by looking at payback time of additional investments and savings per year. This process can be used to determine which combination of green features might generate efficiencies and savings for a project, and ultimately can

5 U.S. Environmental Protection Agency and the U.S. Department of Energy, www.energystar.gov.

guide financial decisions about incorporating sustainable elements into a project.

In addition, an "Integrated Design Process" is held up by advocates as a best practice in helping to manage expectations and costs in greening. This multidisciplinary approach brings together architects, builders, engineers, finance partners and other agents to incorporate sustainable design and green elements into a project from its inception. Through this pre-development process—which often takes shape as a green design brainstorming session, also known as a 'charette'—all involved parties can carefully consider how greener building systems can efficiently operate in conjunction with one another over the life of the building. This process stands in contrast to adding-on green elements after design is complete, which can miss key synergies across the use, construction, operation, and maintenance of a building and thereby reduce efficiencies and savings.

## Remaining Challenges

While green affordable projects have started to spring up in larger cities around the country, the green revolution has not yet reached all corners. "In more sophisticated markets, the momentum will carry green building forward and it will become the standard," said Rose Cade, Senior Program Director at Enterprise Community Partners. "But in smaller markets, nonprofit developers are often inexperienced and have limited capacity to integrate green practices. It's a real challenge to figure out how to deliver the right resources, training, and funding to these places." Access to environmental consultants, or even to green materials, might be limited, and additional work is needed in determining how to expand the capacity for green building in rural areas and smaller cities.

Another limiting factor rests with the financing of green development. Walker Wells, Director of Urban Greening at Global Green—the American arm of Green Cross International that seeks to stem global climate change by working to green the built environment—noted that most large-scale financial institutions have been slow to adjust underwriting standards in ways that might boost the industry. "At the moment of underwriting, lenders are still wondering how green elements influence financial performance and risk exposure," said Wells. In part, this is because there is limited data regarding the savings from energy and related efficiencies—data that can be translated into an argument for a larger loan amount to cover the upfront costs of greening. Lenders also might have concerns simply about the abilities of a developer to succeed in stepping outside of conventional building practices. Increased data about performance and savings of green projects that is collected and reported in a way relevant to lenders would be a significant boost to the industry, noted Wells. Enterprise Community Partners has begun to collect such data on the projects financed through the Green Communities Initiative, but more widespread monitoring of projects will strengthen the case for financing structures geared particularly to green projects. For this to happen, more resources must be devoted to the equipment and staffing necessary to track and analyze the performance of green developments.

## Growing Incentives for Going Green

While the mainstream finance industry has shown limited support for greening through mechanisms like favorable terms and flexible underwriting standards, key shifts have taken place in how states are incentivizing and rewarding affordable projects that put green building ideas into practice. Of significance is the increasing advantage gained by green properties in the competition for Low Income Housing Tax Credits (LIHTC). "More and more states are including green standards in their LIHTC Qualified Allocation Plans (QAPs), and they are becoming much more comprehensive in their criteria for greening," said Wells, who recently completed an analysis of 2007 state tax credit allocation plans. "The progress is pretty amazing." He noted that states are not just rewarding energy efficiency, but also are considering factors like neighborhood connectivity, materials, air quality, and water conservation. This kind of shift is critical, he noted; if allocation mechanisms reward comprehensive approaches to greening, then it creates a powerful lever to generate responsiveness in the industry. There is still considerable variation across geographies in the comprehensiveness of green building requirements, though, and Wells noted that there is great potential for making green building requirements in state QAPs more robust.

Community development intermediaries, along with private foundations, are also working to fill the current financing gaps. Enterprise Community Partners is one of the largest national players in supporting affordable green building, and through its Green Communities Initiative, it has invested more than $570 million in loans, grants, and investments in an effort to mainstream environmentally responsible affordable housing development. This includes loans and grants to nonprofits for critical pre-development design activities. The Green Communities Initiative has succeeded in spurring the development of more than 250 green projects in 28 states—25 percent of these projects are in California.

In addition to Enterprise Community Partners, a number of other community development intermediaries and lenders—including the Local Initiatives Support Corporation (LISC), the Rural Community Assistance Corporation, and NeighborWorks America—have launched green initiatives to provide financial and technical support for community groups looking to green their programs and projects. LISC has directed specific attention to promoting and supporting green practices in rehabbing the existing affordable housing stock of the nation (See article: "Re-build it Green"). The Home Depot Foundation, established in 2002, has also been a significant supporter of green affordable housing and had provided grants for green design and rehab to national organizations including LISC, the National Housing Trust and Habitat for Humanity.

## Green Economic Development

The green revolution is starting to generate ripple effects in the economy at large, creating new industries and expanding or retooling others. Alternative energies—such as wind, solar, biofuel, and fuel cells—for instance, showed significant growth in 2007, and are projected to expand rapidly in the coming years.[6] There are wide-ranging estimates of how many jobs will be created as these and other green sectors expand; some research points to the creation of 5 million jobs in the next 20 years, while more aggressive estimates indicate that the renewable energy and energy efficiency sectors may generate as many as 40 million jobs in the U.S. by 2030.[7] Advocates point out that these "green collar jobs"—including those in the research and development, manufacturing and construction, and maintenance and operations of green systems and products—can be more than just new jobs; rather, they have the potential to offer a career ladder for the working poor.

A number of organizations—such as Oakland, California's Green for All, founded by Van Jones of the Ella Baker Center and Majora Carter of Sustainable South Bronx, and the Apollo Alliance—are calling for increased attention to and investment in "green pathways out of poverty." These groups are working to capitalize on advances in clean energy and green building to create employment opportunities for those who have been trapped in cycles of unemployment or dead-end, low-wage work. In order for this to gain traction, though, new job training, employment and entrepreneurial opportunities in the emerging green economy need to be targeted at those from disadvantaged communities. Not only that, but the opportunities in the green economy must be structured in a way that offers both entry level jobs for transitioning workers and bridges to higher skill and managerial positions that can provide solid wages for working families.

Several new reports outline current green economic development opportunities and strategies for developing equitable green collar jobs initiatives at the local level.[8] Key steps to implementing green collar jobs initiatives include crafting policies that create local demand for green collar jobs, working to identify job growth areas and skill requirements, and building partnerships—among employers, workforce agencies, community organizations, labor unions, and community and technical colleges—that can train and place workers at a variety of rungs on the green career ladder.

Cities around the country are beginning to implement green collar jobs initiatives that are aimed at training and placing low-income workers in green maintenance, installation, and construction jobs. For example, Richmond BUILD, a comprehensive construction skills course for low-income people in Richmond, California, teaches participants how to install solar panels and helps place graduates of the program in jobs. The program is the product of a public/private partnership, and

6 Joel Makower, Ron Pernick, and Clint Wilder (2008). "Clean Energy Trends 2008." Clean Edge : http://www.cleanedge.com/reports/reports-trends2008.php.

7 Roger Bezdek (2007). "Renewable Energy and Energy Efficiency: Economic Drivers for the 21st Century." Management Information Services, Inc. for the American Solar Energy Society. See also: Bryan Walsh (2008). "What Is a Green-Collar Job, Exactly?" Time Magazine, May 26, 2008.

8 Sarah White & Jason Walsh (2008). "Greener Pathways: Jobs and Workforce Development in the Clean Energy Economy." Center on Wisconsin Strategy, The Workforce Alliance, and The Apollo Alliance; Apollo Alliance and Green For All (2008). "Green collar Jobs in America's Cities"; Robert Pollin & Jeannette Wicks-Lim (2008) "Job Opportunities For The Green Economy: A State-By-State Picture of Occupations That Gain From Green Investments. " Political Economy Research Institute, University of Massachusetts, Amherst.

while small in scale, is seeing successes; the program has a 91 percent placement rate, and the average starting salary for graduates is over $18 per hour.[9] In Chicago, GreenCorps Chicago participants—primarily ex-offenders—receive training in landscaping and urban gardening, computer refurbishing and recycling, household hazardous waste handling, and home weatherization. Similar programs are taking root in Washington D.C., Los Angeles, and Oakland.

Attention is being generated at the federal level as well. Signed into law at the end of last year, the Energy Independence and Security Act includes the Green Jobs Act of 2007, which authorizes $125 million in green-collar job training opportunities—enough to train about 30,000 workers a year. A portion of Green Jobs Act funds is earmarked for a Pathways Out of Poverty demonstration program, which will provide targeted green training and career resources to displaced workers, at-risk youth, and other low-income individuals. However, as of this writing, the Act awaits full funding from Congress.

## Conclusion

Rather than muddying the waters, seeking ways to tie together community development ends with environmental outcomes can help streamline the process of addressing not only the health, safety, and financial security issues facing low-income communities, but also looming climate change concerns. It's certainly not simple, but increasingly, public, private, and non-profit organizations are showing that it can be done. Green for All's Van Jones summed up the field's potential in an interview published in the New York Times: "The green economy has the power to deliver new sources of work, wealth and health to low-income people — while honoring the Earth. If you can do that, you just wiped out a whole bunch of problems. We can make what is good for poor black kids good for the polar bears and good for the country."[10]

9 City of Richmond, http://www.ci.richmond.ca.us/DocumentView.asp?DID=3060

10 Thomas L. Friedman (2007). "The Green-Collar Solution." New York Times, October 17, 2007.

## Seeing Green: Spotlight on Seattle

Box 1.1

With numerous awards already under its belt, Seattle's High Point neighborhood may be one you've already heard about. Once the site of over 700 dilapidated public housing units, when complete the neighborhood will be built out to accommodate 1,600 mixed-income housing units in a "New Urbanist" setting that includes a library, a health clinic, and commercial offerings. Even more impressive is that High Point is designed to be a sustainable community, incorporating a host of elements to protect both the environment and the health of community residents. The site design includes a natural drainage system and homes are built to be energy efficient; some units have been designated as "Breathe Easy" homes and include features that reduce or remove allergens. It is estimated that the energy efficiency measures will reduce energy costs by 20 percent annually. And the health benefits are already evident; residents are reporting fewer days with allergy symptoms and an improved quality of life in their new homes as compared to when they lived in their previous residences.

High Point is but one example of the commitment Seattle has made to integrating sustainable practices into its development patterns. Back in 2000, Seattle became the first city in the nation to adopt a Sustainable Building Policy. Two years later, the City's Office of Housing developed a green building guide targeted toward nonprofit housing developers entitled "SeaGreen—Green Seattle's Affordable Housing." The City notes that SeaGreen is "designed to manage the built environment in a socially equitable way so those who can least afford it will benefit from healthy, high quality affordable housing."

Since then, a number of innovative green affordable housing projects have been developed. Traugott Terrace, which opened in 2003 and provides 50 units of housing for extremely low-income recovering addicts and alcoholics, is the first LEED certified affordable housing project of its kind in the nation. In 2007, Broadway Crossing opened—this mixed-use development includes a Walgreens store on the ground level and 44 units of extremely-low and low-income housing on the four stories above. Not only does the project employ smart growth principles by increasing vertical density and employing below-grade parking rather than a surface lot, the units were designed to incorporate green features like ENERGY STAR appliances, low-flow water fixtures, and non-toxic paints and sealants.

## Green Premiums?

Box 1.2

The growing volume of green affordable housing developments offers the opportunity for advocates to capture and disseminate both quantitative data and anecdotal evidence to help make the case that affordable green building is not a contradiction in terms. New Ecology, Inc., a nonprofit organization founded in 1999 to spur sustainable development in distressed urban communities in New England, recently released a study, "The Costs and Benefits of Green Affordable Housing," examining whether or not green affordable housing is financially viable. The authors found that among 16 green affordable housing developments, there was on average a green "premium" of just 2.42 percent of total development costs. The study uncovered substantial benefits, such as decreased operating expenses and reduced replacement costs, as well as other benefits that are harder to capture quantitatively, including improved health and comfort of residents. While the study examined only a small number of projects, the analysis represents a good starting point for understanding the costs and benefits of green affordable housing.

## Greening Small Businesses

Box 1.3

One way to define a green business is that it creates products or offers services that tie directly into energy efficient or otherwise sustainable industries—for instance, building hybrid cars or making parts for wind turbines. But a business can also be green by conserving resources and preventing pollution—e.g. recycling, lowering energy and water use, and using less toxic cleaning products.

These practices can both reduce the fixed costs of operating a business and improve the health of workers. But going green can be hard for small businesses, particularly those owned by first-time entrepreneurs or those located in lower-income areas. Small businesses often operate with tight margins, and owners may be wary of anything that might involve an upfront cost with an uncertain return horizon. As such, it can be difficult for small merchants to think about investing in green infrastructure, like low-flow toilets or more efficient heating and cooling systems. Behavioral changes, like separating recyclables from trash or reducing printing, can also be difficult to achieve in a systematic and sustained way.

However, in a number of California communities, including those in the Bay Area and San Diego, resources are increasingly becoming available to help make greening a less daunting endeavor for small businesses. County level programs have been launched to provide technical assistance and other supports to promote environmental protection. San Francisco's program, for example, which is part of a nine-county Bay Area Green Business Program, offers checklists in a number of languages to help certain types of businesses understand what elements constitute a greening protocol. In addition, the program provides free products and services to help small businesses reduce water and electricity use. Business owners can achieve green certification through the program, which entitles them to marketing and networking events run by the city. While these types of programs are catching on, more work is needed to overcome the challenges that many small businesses face in implementing a full suite of green practices.

# Triple-Bottom Line Investing: Balancing financial, social and environmental returns[1]

Jed Emerson
Uhuru Capital

Tim Freundlich
Calvert Social Investment Foundation, Good Capital, and xigi.net

Shari Berenbach
Calvert Social Investment Foundation

As socially conscious investors have become more aware of environmental concerns there has been an increasing demand for "sustainable" investment opportunities. Building on the double-bottom line vernacular, triple-bottom line investment aims to simultaneously yield financial, social, and environmental returns. Despite this seemingly simple objective, defining and quantifying these returns has proven to be a significant challenge. In large part this is due to a dearth of reliable data. The movement to capture environmental and social impact is relatively new and the process of quantifying returns is still being developed. But it's also worth noting that some confusion stems from the object being measured, namely: "sustainability." What actually constitutes a sustainable investment?

In an effort to establish a common framework for sustainable global investment, the United Nations launched the Principles for Responsible Investment (the Principles) in 2006. The Principles are broad guidelines that encourage institutional investors to "act in the best long-term interests of [their] beneficiaries" by taking environmental, social, and corporate governance (ESG) issues into account.[2] While the Principles are not binding, they "provide a menu of possible actions for incorporating ESG issues into mainstream investment decision making and ownership practices." This attempt to bring sustainability criteria into the mainstream investment process is commendable. Yet, despite such progress, we believe that true sustainability cannot be captured by traditional metrics or explained by clever monikers. Sustainability requires a complete reassessment of value and a reorientation of investment goals. For individual investors, this practice may be thought of as Integrated Wealth Management, while for institutions it is referred to as a Unified Investment Strategy.[3]

Traditionally, financial investing and the creation of economic value have been viewed as activities separate and distinct from efforts to create social value and positive environmental impacts. Perhaps best promoted by Milton Friedman of the University of Chicago,[4] the conventional wisdom has been that the social responsibility of companies and investment managers is fulfilled by simply generating the greatest amount of financial return to investors possible—leaving it to each individual investor to then decide how best to "do good" with wealth thereby created. This notion of economic primacy has served to create vast economic wealth over more than two centuries. But, while frameworks separating the practice of doing well from that of doing good have been effective in creating economic value, they have also failed us in substantial ways. The social and environmental impacts of investment decisions have historically been considered 'externalities,' superfluous to the investment decision equation. In truth, the goal of creating economic wealth is seldom pursued in the abstract. Rather, it is a means to an end. We seek to be "wealthy" in order to have choices with regard to how we live our lives and pursue our goals. We seek wealth to provide for our immediate families and ourselves. We attempt to build thriving

1 This article was originally published in Community Investments (Volume 20, Number 2), 2008, available at http://www.frbsf.org/publications/community/investments/0808/index.html. It is based on a larger report titled: Where Money Meets Mission: Creating a Unified Investment Strategy, published in May 2007 by the same authors. The larger report is available at www.blendedvalue.org.

2 United Nations Environmental Programme Finance Initiative. Principles for Responsible Investment (PRI).

3 The term "Unified Investment Strategy" was first presented in A Capital Idea: The Unified Investment Strategy and Total Foundation Asset Management and explored in related papers the reader may find at www.blendedvalue.org.

4 Friedman, M. 1970, "Social Responsibility of Business is to Increase Its Profits." The New York Times Magazine.

economic systems in order to assure we live in communities and societies that can provide, at a minimum, economic support for all members and, ideally, economic opportunity that will allow each individual to provide for themselves and achieve their greatest potential. And, for some, financial wealth is simply a marker used to measure performance and success in life. In sum, we use economic strategies and financial tools to achieve not simply financial returns and economic vitality, but we use economics and finance as basic means to an end—an end that is fundamentally married to social well being for our community and personal fulfillment for ourselves.

We have, therefore, a significant problem: Oftentimes our use of an economic tool conflicts with the task and ultimate purpose for which that tool is being put to use.

In truth, investors do not just generate financial returns. They participate in a complex system of investing and value creation that generates multiple returns with financial, social and environmental implications. In recognition of this reality, the investor has before them many options. And, indeed, from both a fiduciary and ethical standpoint, increasing numbers of investors are confronting the need to define investment returns as a proposition that blends economic and social value creation. If investors engage in asset management strategies to achieve a variety of outcomes (financial return and maintenance of corpus, social and personal well-being in the future, generation of funds in order to support future "worthy" causes of interest to the investor, and so on), would it not also follow that investors should consider how best to leverage their full assets in pursuit of their ultimate goals?

Many investors have proven that it is, in fact, possible to develop and pursue strategies that balance financial returns with the creation of positive social and environmental value. Such investors understand that portfolio performance is not simply a function of financial return, but multiple returns generated through the effective management of a variety of investment instruments providing a balanced, integrated return over time. When one considers the investments of grant dollars together with equity or debt instruments, financial returns when viewed in isolation from the rest of the portfolio may well be below 'market rate'[5] on a risk-adjusted basis for some portion of their overall portfolio. This is due to the fact that at one end of the continuum we have grant making and, at the other end, investment in pursuit of risk adjusted financial returns. In between is a range of potential investment instruments.

Whether ready to make use of them or not, each and every investor has a large body of financial assets at work in society, with a wide range of potential deployment possibilities. When viewed in aggregate, each instrument of asset management (from equity investments to low-interest loans to grants) generates value in pursuit of investor goals. And each investment should be managed as part of a single, unified whole.

It is clear that what makes sense in concept makes sense in practice to an increasing number of asset owners. Indeed, a growing number of investors are executing strategies that intentionally seek financial and social/environmental value:

- The socially responsible investment (SRI) market has grown from $40 billion in 1984 to over $2.7 trillion in 2007, reaching more than 10 percent of all professionally managed assets, as pension funds, institutional investors and others have taken a more active stance toward shareholder involvement or introduced one or more social screens into their investment selection process;
- Community development investment has increased to $20 billion; and
- Private equity "blended funds" seeking social and environmental value is estimated at more than $2 billion.[6]

While this growth has been impressive, most investors continue to struggle with how best to fulfill responsibilities of financial stewardship while at the same time promoting the social and environmental interests of the investor, whether an individual or institution. To successfully direct a portfolio of investments to achieve its full potential investors must do two things:

5 'Market rate' is defined as a return on investment that matches generally accepted principles of risk and return at any given time for an investment in the financial markets. This is representative of Conventional Wisdom, and is not embraced but duly noted by the authors.

6 2005 Report on Socially Responsible Investing Trends in the United States, Social Investment Forum, January 2006. The private equity figure comes from the RISE Report of 2003.

First, they and their managers must reconceive overall investment strategy to allow for more than simple financial performance consideration. Second, investors need a more comprehensive understanding of, and access to, the array of investment instruments available to them to construct their portfolios.

To be most effective, an investor's strategy must be founded upon the knowledge that the best investment strategy is one which seeks to identify an investor's full array of available assets (both financial and non-financial)[7] and assertively deploy those assets in support of the individual or institution's mission. In this way, investors may simultaneously create the blended value of the financial, social and environmental goals they seeks to achieve.

A Unified Investment Strategy requires fund managers to draw upon a variety of instruments in pursuit of building portfolios capable of generating multiple returns. Rather than allowing investors and their managers to invest capital for simple financial returns, the engaged investor in pursuit of multiple returns will need to be directly involved in working with his or her asset managers to ensure funds are structured in a manner that is reflective of their overall, unified strategy and goals. And managers in their turn will increasingly provide leadership to the field in constructing solutions that meet this emerging client appetite.

Will the creation and application of unified investment strategies soon become the mainstream approach used by a majority of investors? Probably not. However, what is clear is that increasing numbers of investors (both individual and institutional) are building viable, high-performing portfolios capable of generating multiple returns across the financial, social and environmental areas.

7 For an expanded discussion of the array of assets available to organizations, please see both The 21st Century Foundation: Building Upon the Past, Creating for the Future and An Essay in Two Parts: Total Foundation Asset Management—Exploring Elements of Engagement within Philanthropic Practice, both of which are available at www.blendedvalue.org. The reader may also find Blended Value Investing, which provides case examples of alternative investment approaches and was published by the World Economic Forum, of interest. That paper is also available at the Blended Value web site.

# Panel 6
# New CRA Investment Opportunities in Retail Finance

Michael Griffin
KeyBank

James Gutierrez
Progreso Financiero

Daniel Nissenbaum
Goldman Sachs Bank USA

Arjan Schütte
Center for Financial Services Innovation

## Past Articles from Federal Reserve Bank of San Francisco Publications

# From Mattress Money to Checking Accounts: A Profile of Bank on San Francisco[1]

Naomi Cytron and Carolina Reid
Federal Reserve Bank of San Francisco

> "You don't have to worry about somebody snatching money from you when you come out of the check-cashing place – or losing it,"
>
> Virginia Johnson, 71, said of how her life has changed after opening a checking account through Bank on San Francisco.[2]

For individuals without a bank account, the seemingly simple act of cashing a check or paying a bill can be complicated, expensive, and, as voiced above, risky. But few actively choose to stay outside of the financial mainstream—otherwise known as being "unbanked". Many people face barriers to accessing mainstream financial services, and instead turn to alternative providers such as check cashers and payday lenders to pay bills and manage their finances.

Until recently, mainstream financial institutions have done little to tailor their products, policies and outreach efforts to the unbanked market. Increasingly, however, the volume of business conducted through the alternative, or "fringe," financial services industry—an estimated 340 million transactions costing customers $13 billion a year[3]—is being taken as a demonstration of the demand for financial services among the unbanked. Bank on San Francisco, launched in 2006, is a pioneering effort that seeks to tap into this market opportunity and help the unbanked open checking accounts, a first step in participating in the financial mainstream. To date, more than 15,000 new accounts have been opened across the city, surpassing the initial goal of 10,000 new accounts in two years. As word of Bank on San Francisco has gotten out, other cities and organizations across the nation have begun to explore the possibility of launching similar initiatives. To support the replication of this effort, this article reviews the genesis of the program, and looks at some of the lessons learned thus far.

## Why are People Unbanked?

Nationally, as many as 22 million people lack basic checking and savings accounts, and are generally referred to as the "unbanked" or "underbanked". Yet it would be a mistake to see the unbanked as a monolithic group. The unbanked sector is composed of a wide range of individuals who have varied reasons for conducting either some or all of their financial transactions outside the mainstream. Some may not use bank accounts because they live paycheck-to-paycheck and may be fearful of minimum balance requirements or overdraft penalties. In some cases, those who are unbanked had—and perhaps mismanaged—a bank account at some point in the past, and their negative credit histories keep them from opening new accounts. For recent immigrants, identification requirements for opening an account may be a hindrance to bank usage; others may have a cultural distrust of financial institutions. Still others may use fringe outlets instead of banks because they may offer a less intimidating environment than a bank or have more convenient locations or hours of operation.

For households without a bank account, the costs of using fringe financial services are high. Estimates suggest that among households lacking a checking account, 52 percent include at least one full-time worker, and using a non-bank

1 This article was originally published in Community Investments (Volume 20, Number 1), 2008, available at http://www.frbsf.org/publications/community/investments/0805/index.html.

2 Wyatt Buchanan (2007). "Bank accounts put in reach of poor, immigrants; S.F.'s pioneering effort allows residents to avoid high fees at check-cashing outlets." December 4, 2007, The San Francisco Chronicle.

3 Center for Financial Services Innovation (200x). "Fact Sheet: The Unbanked and Underbanked." Center for Financial Services Innovation, Chicago, IL.

check casher costs the household an average of $40 per payroll check.[4] Perhaps more significantly, the unbanked do not have access to the tools necessary for creating savings and building assets, which leaves them particularly vulnerable in times of crisis or emergency. Owning a checking or savings account is the first step in allowing consumers to enhance their financial security and climb the economic ladder—to save and build credit toward covering health care costs, to purchase a car or a home, to send children to college, or to retire.

## Bank on San Francisco

How did Bank on San Francisco get started? Much of the motivation for developing the Bank on San Francisco stemmed from data that came out of the Working Families Credit initiative, a city program that aimed to encourage low-income residents to apply for the federal Earned Income Tax Credit (EITC). This program offered a ten percent local match to the federal EITC for families with children, on average providing an extra $220 to the city's working families. However, city officials were dismayed to discover that many recipients were cashing their Working Families Credit checks at check cashers. "It tore me up that people were taking $100 or $200 checks to check-cashing stores and losing a significant amount to fees," said City Treasurer José Cisneros.[5]

This state of affairs prompted a simple question: if there are clear costs to families who don't have access to banking services, and there are clear financial benefits to banks and credit unions in attracting and retaining new customers, is it possible to bring the public and private sectors together to help unbanked residents overcome the barriers to entering the financial mainstream?

Anne Stuhldreher, then a Fellow at the New America Foundation and one of the early architects of the Working Families Credit, promoted the idea of an initiative to "bank" the unbanked and argued that this type of effort would neatly link to the city's interest in helping working families keep more of their earnings. Stuhldreher, in partnership with the city, approached a number of partners to serve on a steering committee to guide the development of a strategic plan for such an initiative. EARN, a nonprofit that helps low-income San Franciscans build savings and assets, was enlisted to provide perspective on the needs of unbanked consumers and to help establish networks with other nonprofit partners. The Federal Reserve Bank of San Francisco became involved to offer expertise on regulatory issues associated with banking products and services and to help convene financial institution partners.

The discussions that ensued led to the creation of Bank on San Francisco. A partnership between the offices of Mayor Gavin Newsom and Treasurer José Cisneros, the Federal Reserve Bank of San Francisco, EARN, and financial institutions across the city, Bank on San Francisco began in 2006 as an effort to bank the City's unbanked through appropriate products and innovative outreach channels. While the specifics of the initiative have evolved over time, the essential goals of Bank on San Francisco were articulated early on by Mayor Newsom and Treasurer Cisneros. The initiative seeks to:

- Change bank products and policies to increase the supply of low-cost starter account options for the unbanked market.
- Raise awareness among unbanked consumers about the benefits of account ownership.
- Provide quality financial education and equip residents of San Francisco with the tools they need to build assets and achieve financial security.

## First Steps

The first challenge facing the steering committee was to develop an estimate of how many residents in the city lacked a bank account, and to gain a better understanding of how the city's lower-income earners view and use financial service

4 Matt Fellowes and Mia Mabanta (2008). "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential." Brookings Institution, Washington DC.

5 Wyatt Buchanan (2007). "Bank accounts put in reach of poor, immigrants; S.F.'s pioneering effort allows residents to avoid high fees at check-cashing outlets." December 4, 2007, The San Francisco Chronicle.

providers. Developing an accurate count of the number of unbanked at the local level is difficult. The Survey of Consumer Finances, collected by the Federal Reserve Board, is the main data source that includes information about checking and savings account usage, but the sample is designed to paint a national, not local, portrait of consumer finances.

However, it is possible to use these national figures to approximate the size of the unbanked market. Matt Fellowes, then of the Brookings Institution, a public policy think-tank in Washington D.C., used the national data to derive estimates of the unbanked in San Francisco. His research estimated that at least 50,000 households in the city were unbanked, and that many of them were Latino and African American. His research also showed that while many of the unbanked had extremely low incomes, a significant share of unbanked households in San Francisco earn between $20,000 and $40,000, a good target market for the initiative. From these estimates, the initial Bank on San Francisco task force set the Initiative's goal of opening 10,000 accounts. Data from the Working Families Credit program also pointed to the large number of unbanked among African American and Latino households in the city, and showed that many of these households were clustered in the Mission and Bayview Hunters Point neighborhoods.

In addition, the city held several focus groups with unbanked residents in San Francisco to uncover their experiences, aspirations and fears related to financial services. The focus groups offered several insights and take-away lessons about the barriers to accessing the financial mainstream. Focus group participants emphasized the value of "second chance" accounts, and voiced concerns about hidden fees and identification barriers. In addition, participants noted some cultural barriers to using financial institutions—involving both general distrust of financial institutions, and more basic concerns about the lack of culturally and linguistically appropriate service and materials.

## Building the Collaborative

The next challenge? Bringing the financial institutions to the table by making the case that this kind of initiative would benefit not only city residents, but would also help to develop long-term customers for the banks. The Federal Reserve Bank of San Francisco, along with the Mayor and Treasurer, invited bank and credit union executives to come together to discuss the potential of such an initiative, and then asked them to agree to work collaboratively to develop a Bank on San Francisco product.

And then the hard work began. Using the information garnered from the focus groups, participating institutions set upon crafting a product that would address both the hard and soft barriers to banking. This process involved negotiation and compromise; the steering committee had specific ideas for what they wanted banks to develop, and in turn, the banks offered feedback as to what was and was not feasible. During the process of negotiating product features, a few institutions dropped out of the initiative, and others joined. But a year after the first meeting was held, the Bank on San Francisco initiative was defined. While the initial concept was to create a unique "Bank on San Francisco" account, due to concerns about timelines for product roll-out, the steering committee agreed to allow each financial institution to offer its own unique product meeting a set of minimum requirements. Banks and credit unions participating in Bank on San Francisco have agreed to:

- Offer a low- or no-cost product with no minimum balance requirement;
- Adapt internal systems to allow customers on ChexSystems to open an account;
- Accept consular ID cards as primary identification;
- Waive one set of overdraft fees per client; and
- Provide quarterly data to the Federal Reserve Bank of San Francisco on the number of accounts opened, the number of accounts closed, the average monthly balance of the accounts and the zip code of the account holder. As a neutral entity, the San Francisco Fed is able to both collect and guard the privacy of such data.

Nearly all of these elements prompted concerns from banks, and in order to come to agreement, the collaborative had to contend with the different cultures, resources, and internal procedures among the banks and credit unions at the table. First, the issue of no- versus low- cost raised interesting questions: would customers feel accountable if they were offered a free account, or would the accounts be more successful if customers had to put up some of their own money? Would they be willing to pay a small fee? Focus group participants had expressed that cost was a concern, but indicated that they were willing to pay a small fee for an account as long as the pricing was transparent; indeed, some voiced a slight bias against free accounts, as they harbored a distrust for "free" offers that might turn out to have hidden fees. Ultimately, it was agreed that banks could choose whether accounts would be no- or low-cost, but the Steering Committee was firm on its position that the accounts have no minimum balance requirement.

The second key point of discussion was around ChexSystems. ChexSystems is a network of member financial institutions that contribute information on customers who have mishandled checking and savings accounts. Wary of exposure to excess risk, many banks do not offer new accounts to those who appear in the ChexSystems database. But this policy is a major barrier for many of the unbanked. Discussions around this issue resulted in an agreement among banks to revise their policies to offer "second-chance accounts" for those who have mismanaged an account in the past. However, some banks are requiring customers to repay debts on past accounts in order to open a new account at their institution.

Another major sticking point was around the acceptance of alternative IDs such as the Mexican Matricula Card and Guatemalan consular IDs. Some banks were concerned with the reputational and regulatory risks involved in accepting such forms of identification, and were particularly wary of the potential for increased scrutiny under the Patriot Act. In addition, some banks were unwilling to change policies on a local level that would trigger potential risk in other areas of their business footprint. In the end, however, the group determined that if they were truly seeking to reach unbanked residents of the city through this program, participating institutions would have to accept alternative forms of ID.

Finally, there was some back-and-forth on the issue of overdraft fees. At the outset, the Steering Committee wanted up to three instances of overdraft to be forgiven for Bank on San Francisco accountholders, as they felt that there needed to be room for new customers to learn financial management skills before being penalized. Managing a bank account can be particularly confusing for new customers using a debit card at a point-of-sale, as, contrary to at an ATM, there is no indication that one's account has been overdrawn. However, participating institutions argued that waiving three sets of fees was too lenient, and settled on waiving fees for a Bank on San Francisco customer's first instance of overdraft.

## The Marketing Strategy

With the product in place, the next challenge was to develop a marketing campaign that would be effective in reaching the unbanked. Recognizing that various segments of the unbanked face different barriers to opening accounts, two separate marketing campaigns were developed to target the immigrant Central-American market in San Francisco and the African American community in the city's southeastern neighborhoods.

One of the key factors in Bank on San Francisco's success was the partnership with McCann Worldgroup, a renowned advertising firm based in the city. McCann graciously worked pro bono to develop a Bank on San Francisco logo and tagline and all other program materials including brochures, posters, window clings for bank branches, coupons, outdoor advertisements and a website. McCann also developed a media strategy that relied heavily on generating press and pro bono advertising in ethnic and community newspapers, television, and radio and included a citywide outdoor media campaign on buses and billboards. The campaign was aggressive in both promoting the Bank on San Francisco initiative, and in portraying the predatory and wealth stripping features of check cashers and payday lenders. All participating financial institutions were asked to contribute to printing costs of the marketing materials.

In addition, many other partnerships with nonprofits and other local agencies have proved to be important in supporting and getting the word out about Bank on San Francisco. The United Way, for instance, through its 2-1-1 Helplink phone system, is offering referrals to Bank on San Francisco institutions. With one call to 2-1-1, callers can obtain bank and credit union locations and branch manager contact information. One Economy, the leading provider of web-based services to low-income communities, provides on-line referrals to Bank on San Francisco branches. PG&E also helped to get the word out to its 55,000 low- and fixed-income customers enrolled in its CARE program—an income-qualified program that offers discounts on monthly energy costs—through a letter about Bank on San Francisco. In-Home Supportive Services, the Human Services Agency, the Mayor's Office of Community Development and many others have assisted in providing outreach to unbanked city residents.

## Linking Accounts to Asset Building

Another vital element of the program is to make quality money management education more easily available to low-income San Franciscans, as financial education is key to helping residents manage and build assets over the long term. Initially, participating banks aimed to develop a standardized curriculum for financial education classes in the city that would be certified as Bank on San Francisco approved trainings. This proved difficult, as did other efforts to get account openers to attend financial education classes offered at a central location in the city. Now, EARN serves as the primary broker of financial education—both providing classes directly to account openers and offering training through community based organizations.

## Moving Forward

Bank on San Francisco is demonstrating that new products and outreach strategies can help the unbanked succeed in the financial mainstream. Bank on San Francisco's success is reflected not only in the volume of accounts that have been opened, but also in the inquiries the city has received about the program from Atlanta, Denver, Miami, Boston, and many other jurisdictions around the nation. In addition, the National League of Cities has recently launched a "Bank on Cities" campaign that will provide technical assistance to help cities around the nation design and launch efforts modeled on Bank on San Francisco.[6] The Federal Reserve Bank of San Francisco is also working with partners in many of the other cities within its district, such as Los Angeles, Seattle, and Tucson, to replicate this type of program there.

The lessons learned in developing and managing Bank on San Francisco can help these other cities navigate the challenges associated with banking the unbanked. One set of lessons revolves around the collaborative structure of the program. Bank on San Francisco is unique in that large and small banks, as well as credit unions, actively participated in developing all aspects of the program. This collaborative structure has a number of benefits, but building trust among participants and crafting products that suit the needs of all partners does not happen overnight. It took almost a year for Bank on San Francisco partners to develop mutually agreed upon product and systems-change ideas. For cities looking to replicate Bank on San Francisco, it will be important to determine the appropriate partnership structure and plan timelines accordingly.

In a related vein, it is vital to involve a host of partners in such initiatives, including local banks, community organizations, national experts, and banking regulators. But creating and maintaining both the commitment and momentum of such a range of partners is challenging, and ultimately requires dedicated staff to coordinate all aspects of the program. Leigh Phillips, of the Office of the Treasurer, became Bank on San Francisco's full-time program manager, and is responsible for all day-to-day operations including outreach, marketing, fundraising, evaluation and overall program design.

In addition, the rapid uptake of Bank on San Francisco products demonstrates that there is a clear demand for mainstream services among the previously unbanked. But a significant challenge remains in ensuring that opening a bank account is only the first of many steps for city residents to attain financial security. Financial education is critical to helping new banking customers establish savings, reduce debt, build credit and acquire assets, but, as indicated above, it has thus far proven difficult to develop culturally sensitive financial education curriculum and delivery mechanisms that effectively reach clients. Improving financial education efforts, as well as efforts to permanently move people away from fringe financial providers, will go far in making sure that a new bank account is not an end-goal, but rather a springboard toward achieving true financial security.

## Conclusion

Bank on San Francisco has proven to be a welcome addition to the asset building toolkit for the city's working families. "I couldn't be more proud of the work we have done so far with Bank on San Francisco," said Treasurer Cisneros. "Not only are

6 Abby Hughes Holsclaw (2008). "NLC's bank on cities campaign to help city leaders expand access to mainstream financial services." February 4, 2008, Nation's Cities Weekly.

San Franciscans opening accounts in large numbers, but these accounts are staying open, being used and are maintaining healthy monthly balances."[7] It is unique in that it has shown itself to be beneficial for government agencies, financial institutions, community groups and unbanked residents, and has received high-levels of support from the public and the media. There is, however, still much to learn about how to better link the unbanked and newly banked to additional opportunities to learn prudent financial management skills and grow their earnings. Indeed, the financial instability and vulnerability wrought by the subprime mortgage crisis makes a strong case that more resources need to be dedicated to improving and expanding programs like Bank on San Francisco that protect and empower those seeking to climb the economic ladder.

7 Ibid.

# Going "De Novo": Tapping into Emerging Markets at the Branch Level[1]

Vivian Pacheco
Federal Reserve Bank of San Francisco

## Product Innovations

To be successful in an "emerging market," particularly one that caters to low-income and immigrant community members, financial products must be targeted to the needs of the community. Increasingly, banks are providing new products and services that better match the financial needs of low-income households, such as offering remittance products, check cashing services, or small dollar loans. While not all products may be profitable, they can often serve as a "loss leader" and help to create loyalty among customers, encourage repeat visits, and allow customers to grow into more profitable products for the bank.

## Targeting the Unbanked through Check Cashing Services

A recent study showed that in 2005, an estimated 5.2 million Californians used check cashers and paid at least 2 percent of their annual income in check cashing fees—a market of approximately $4.9 billion a year.[2] In addition to the money spent on check cashing fees, relying on these alternative financial services can prohibit low-income families from developing a relationship with a bank and building their assets over time. Focus groups with the unbanked have identified a number of reasons why consumers pay the high fees associated with check cashing. The transparency of check cashers is a key benefit. Customers are often discouraged by the unexpected fees that accompany a bank account, such as the fee for a bounced check or dropping below minimum balance requirements. Check cashers also do not require a clearance period, so the cash is received immediately. Check cashers also offer services that banks may not. For example, some offer remittance products that include a free phone call to the recipient to reassure the customer that the money has arrived. In addition, for those on ChexSystems, there are few options other than to use the services of check cashers in their communities.

KeyBank, in an effort to reach consumers who rely largely on check cashers for their financial transactions, developed a strategy that aims to help check cashing customers build a relationship with and shift toward using mainstream financial services over time.[3] KeyBank has been able to overcome the initial distrust many check cashing customers have of financial institutions by providing services that they are already using and are comfortable with.

To reach those consumers who are solely seeking cash checking services, Key Bank has developed its own check cashing product line available to account-holders and non-account holders alike. The product, KeyBank Plus, costs $5 for enrollment and an additional 1.9% fee for check cashing services. A "checkless" account is also available for those who choose to establish payroll direct deposit-- the enrollment fee is waived but the check cashing fee still applies. This account loads deposits onto a debit card and allows customers to both access their funds through ATMs and use online bill pay. For those who are working to get off of ChexSystems, these products allow a gradual transition back to more traditional bank services.

KeyBank employed several customer service strategies to ensure that check cashing customers have a positive experience and to encourage them to "grow" into customers that use a wider range of products. First, in order to make their

1 This is an excerpt from a working paper of the same name published by the Federal Reserve Bank of San Francisco (May, 2008). The original, full length paper is available at http://www.frbsf.org/publications/community/wpapers/2008/wp08-01.pdf.

2 The Financial Divide: An Uneven Playing Field. March 2005. San Francisco: California Reinvestment Coalition.

3 See Jennifer Tescher, Edna Sawady, and Steven Kutner. "The Power of Understanding the Underbanked Market." Center for Financial Services Innovation, 2007. Nancy Feig. "Key Bank brings the Unbanked into the Bank" Bank Systems & Technology. Jan 01 2007, and Center for Financial Services Innovation. "Success Story: KeyBank Plus." Or contact Michael Griffin at Michael_B_Griffin@KeyBank.com.

branches less intimidating, KeyBank decorated branch buildings targeting immigrant communities with colorful murals and other artwork. KeyBank also retrained their tellers to value and respect check cashing customers who may have had strained relationships with banks.

KeyBank has also created a Financial Literacy Center located adjacent to the Buckeye branch in Cleveland where customers can learn how to manage their accounts and take classes on buying a home or starting a small business. This Center offers both group workshops and individual counseling. They can take the Get Checking classes and qualify for a new checking account. The classes and counseling are provided through a contract with the WECO Fund, Inc, a non-profit financial literacy and education programs provider. KeyBank has found that although the center is a foundation for providing financial education to the community, providing workshops at trusted locations like places of worship and schools remains an important strategy for reaching out to community members.

KeyBank has seen great success through these efforts; in the past 2 years, KeyBank has opened more than 10,000 accounts for former check cashing customers. The product itself has also been successful; in the last two years, KeyBank has cashed 35,000 checks totaling over $24 million dollars.

## Small Dollar Loans

In addition to check cashing and remittances, payday loans are also in high demand among low-income and immigrant consumers. Many consumers turn to high-cost, non-bank lenders because they are accessible and can quickly provide these loans. Yet, the inability to repay these short-term, high-cost credit products often leads to costly renewals and exacerbates a customer's difficulties in meeting cash flow needs. Concern over the costs of payday lending have led some states and municipalities to limit or ban payday lending. Twelve states have moved to eliminate payday lending by enforcing relatively low interest rate caps: Arkansas, Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Vermont, and West Virginia.[4]

Four cities in California—Sacramento, National City, San Francisco, and Baldwin Park—have as of March 2008 placed permanent moratoriums on the establishment of new payday lending outlets (Los Angeles and Chula Vista are considering such moratoriums) and Oakland passed an ordinance limiting the concentration of payday lending outlets in certain neighborhoods. However, as a state, California continues to allow payday lending.[5] As a result, many consumers are still relying on high cost payday lending outlets for short term, unsecured loans.

For banks and credit unions, providing alternatives to the payday loan product can be an effective way of attracting new customers and helping them move up the financial services ladder. Known as "small dollar loans," these loans are generally made available at lower interest rates than at payday lending outlets, and are often coupled with financial education and asset building efforts.

The banks that have been most successful in this regard have taken on a multi-faceted strategy that incorporates small dollar loans as one part of multiple-account relationship, and often includes financial education, workplace financial services, individual development accounts, foreign remittances, and other services.

A number of institutions have developed affordable small-dollar credit programs with annual percentage rates (APRs) that range between 12 percent and 32 percent with no or low fees. The Mission SF Federal Credit Union (MSFFCU), for example, offers 3-6 month term loans of $300-$500 at 15-18 percent APR. The loan is accompanied with a one time fee that is waived if the customer attends a financial education class. In addition, if the customer pays the loan within the timeframe of the term, MSFFCU will deposit $50 into a savings account.

In June of 2007, the FDIC provided guidance that encourages banks to offer an affordable alternative to high-cost small-dollar consumer loans. The FDIC is encouraging lenders to offer products with reasonable interest rates and fees, such as an APR no greater than 36 percent (compared to the 459 percent that is typical for many payday loans), an origination fee no higher than is necessary to cover actual origination costs, and no or low annual fees, membership fees, advance fees,

4 Resource Guide: Curbing Predatory Lending. CFED: Washington, DC. 2007.

5 Ibid.

and prepayment penalties. It also recommends that repayment schedules pay down the principal balance of the loan, and that the product should incorporate a savings component. For example, the borrower could be required to set aside a percentage of the principal amount of the loan in a savings account or deposit a portion of the regular payment into a savings account.

Offering these types of lower cost alternatives to short term dollar loans is viewed favorably under the CRA. To further encourage banks to develop alternatives, the FDIC approved a two-year pilot project, known as the Affordable and Responsible Consumer Credit (ARC) initiative. Some of the key features of the pilot will include loan amounts of up to $1,000, mandatory savings components, payment periods that extend beyond a single pay cycle, interest rates below 36 percent, low or no origination fees, no prepayment penalties, prompt loan application processing, and access to financial education to help with asset building. Participating financial institutions offering these products in a safe and sound manner may receive favorable consideration under the Community Reinvestment Act (CRA). In order to participate, banks would have to be highly rated, well-managed, well-capitalized and confirm that their proposed product meets consumer credit needs at a reasonable cost.

## Bundled Services and Products

The third lesson that banks are learning from alternative financial service providers is the need to "bundle" multiple products and services to attract and retain new low-income and immigrant consumers. Mitchell Bank, a community bank serving a predominately immigrant community in Milwaukee (see below), has developed a suite of products and services to draw in new customers. The range of offerings include:

- Acceptance of the ITIN and alternative forms of ID, such as the Matricula card, for opening accounts. In addition, Mitchell Bank employees can help new customers apply for the ITIN or the Matricula card;
- Five different remittance products, including the very low cost Directo a Mexico product;
- A special loan product—the "New American Loan"--that is intended to be used for citizenship application fees. This product is particularly responsive to the recent increases in the citizenship application fee;
- A short term dollar loan through the FDIC's "Affordable and Responsible Consumer Credit (ARC)" pilot initiative;
- Prepaid debit cards which can be linked to remittance products; and
- Dual ATM bank accounts. This account provides customers with two ATM cards allowing them to give one ATM card to a relative, granting access to the account from another state or country. The cost is 2 dollars per transfer.

## Bank Branch Innovations

Before the recent era of bank consolidation and technological advancements, bank branches were important institutions within the community. While the early 1990s saw a decrease in bank branches—particularly with the proliferation of ATMs and online services—the recent focus on the branch and a wave of de novo branches has returned attention to how to create a welcoming environment at the branch level. Well designed branches can help to create a better customer service experience, and help to overcome trust or discomfort barriers that exist face some customers.

The previously cited Mitchell Bank has tailored all of its products and business lines to cater to the neighborhood's Latino immigrant population. All employees—many of whom are Latino and who live in the neighborhood themselves—are bilingual, branches all have banners in Spanish welcoming customers, and all materials and product advertisements are provided in Spanish as well as English. As we describe below, Mitchell Bank has also taken the innovative step of opening a bank branch in a high school.

Some bank branches, like KeyBank's, have established a resource center approach that provides additional services such as classes on topics such as managing debt, savings, or how to transition from banking paycheck-to-paycheck to accumulating wealth. This approach allows customers to be easily referred to a class or special seminar to address their needs. The center creates the resources to reach into communities to provide education on site, creating a link and point of trust to bring community members into the resource center and then into the branch.

Other banks are looking to focus their physical design, layout, and services to meet the cultural expectations of local communities. This "micromarket alignment" is typically driven by age and income, and incorporates such factors as area population concentration, branch proximity to business centers, and customers' ethnicity. Achieving this alignment drives decisions regarding branch staffing, skills, product configurations, and customer sales/retention targets.

For example, Paramount Bank moved into a known artist's community in Michigan and hoped to add to the community by designing the branch's front end as a gallery space. It hosts monthly exhibits prepared by the gallery's curator. Washington Mutual rethought the use of their branch space and developed the "Occasio" model that incorporates bright colors, comfortable furniture, and most importantly, a children's play area equipped with books and toys as a service to parents who conduct their financial business in-branch. Meanwhile, some bank branches located in communities where pets accompany their owners on their errands have a pet rest area with doggy treats and a water bowl.

Other banks have constructed meeting space in their de novo branches and have offered the site to organizations in their communities for meetings and other trainings. Most have secure, separate entrances so they can be used on nights and weekends. This service is offered free or at a low cost; proceeds are often donated to a non-profit of the organization's choice.

## Reaching Youth through High School Branches

Another emerging strategy—one that is increasingly gaining attention in urban, immigrant settings—is to open a bank branch in a high school. This strategy allows banks to reach young adults and teach them financial management skills, while at the same time attracting new customers. Most of the 'in school' branches have been established by credit unions and community banks looking to stay competitive by attracting more local customers. But some large banks are starting to pursue a similar strategy. Activities within these branches contribute to education and community development efforts, and serve to develop the financial literacy skills not only of young adults, but of their parents as well.

One successful example of this strategy is a partnership between Mitchell Bank, a community bank, and South Division High School in Milwaukee, WI. In the 1990s, the demographic that Mitchell Bank served shifted from a Polish immigrant community to a working class, Latino immigrant community.

After assessing the banking needs of the neighborhood through a community forum, Mitchell Bank partnered with South Division High School and opened a branch— known as Cardinal Bank— on its campus in 2000.[6] In the planning stages of the branch, Mitchell Bank knew that they wanted the branch to be fully functioning rather than just a "play bank." This would enable them to comprehensively educate students about the functions of a financial institution and allow the opportunity for new accounts to originate on campus. As such, Cardinal Bank is a fully-serviced branch that offers loan products, account and remittance transactions, and other standard banking products. Bank business is driven by students, faculty, school maintenance, and other supportive staff.[7] Over Cardinal Bank's 7 years in existence, 800 new accounts have opened.

However, accounts are only one goal. Another important part of Cardinal Bank's mission is to develop financial literacy among students and to help them build a foundation for future financial security and asset building. To this end, Cardinal Bank has become fully integrated into the curriculum of the school's Finance Asset Management Economics (FAME) Academy (South Division High is split into 4 smaller schools, of which FAME is one.) This exposure to finance has given many students the incentive and aspiration to apply to college and further their studies in finance. In addition, students have the opportunity to build their leadership skills. Not only working as tellers and bankers, the 10-12 low-income students who work in the bank also serve on the branch's board of directors or are elected as marketing directors, setting the semester's marketing and activity plan to be carried out on campus. Student bankers also make financial literacy presentations and teach workshops to their peers, including elementary and middle students attending schools that feed into South Division High.

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6 For more information on how to develop an in-school bank branch, see A Guide to Establishing Bank Branches in High Schools, http://www.povertylaw.org/advocacy/publications/bank_branches_guide.pdf Or contact Dory Rand, Sargent Shriver National Center on Poverty Law, 312-263-3830 or James Maloney, Mitchell Bank Chairman, 414-277-9080.

7 South Division High School has over 1800 students and a large staff, providing a ready market for the bank.

Staff from Mitchell Bank's main branch also offer workshops to community members on first-time home buying, financial literacy, and accessing credit. The best attended workshops sponsored by Mitchell Bank are those focused on immigrant rights information facilitated by an immigration lawyer who answers general questions about immigration. The sessions also provide information about how immigrants can access credit, a bank account, and other financial services. Bank representatives are on hand to answer questions and to open accounts for interested community members.

The partnership with South Division high school has enabled greater access to Mitchell Bank's target community, and offers a "trusted" avenue for the bank to disseminate information to parents and students. The student-run branch has provided a hands-on approach to learning, and has provided vocational training for students and developed positive banking relationships with immigrant parents, many of whom were unbanked. By having a branch linked to the daily routine of young people and their families, this site-based approach has bridged the gap between youth and financial services in this community and has also made access to credit and low cost financial services readily available.

## Conclusion

In Los Angeles, there exists a clear opportunity to extend mainstream financial services to new "emerging" markets. As the descriptive analysis in this paper shows, many low-income communities remain underserved by bank branches. This report has identified ways that banks have made progress not only in building de novo branches in LMI communities, but also in developing innovative products and local strategies to reach emerging markets. As the above examples demonstrate, in many LMI areas it is not simply the presence of a bank branch that draws new customers. Rather, active efforts on the part of banks to develop non-traditional opportunities to engage new customers and help them understand the benefits of a banking relationship are needed. These measures can provide both short and long-term benefits to banks and to low-income families and their communities.

# Panel 7
# Investor Idol: Connecting Investors with Investments in New Orleans

Thomas FitzGibbon
MB Financial Bank

Gloria Lee
Next Street Capital

Edward Powers
Bank of America Capital Access Funds

Arjan Schütte
Center for Financial Services Innovation

## Community Development "Investor Idol" Pitch Sheets

# Green Coast Enterprises:
## Community Greens Project

### Problem/Solution

Real estate investment typically focuses on short-term cash flows and time horizons that are out of synch with the lifespan of buildings, leading to spaces that are uninteresting in the best of cases and damaging to civic and environmental capital in the worst. Rather than investing and re-investing in our communities for the long term, we invest for ten years or less and create throw-away spaces that can't address the pressing social and environmental issues of modern life.

The real-life examples of these short horizons are everywhere: the Anyplace, USA strip center that pops up a sea of concrete on what used to be farmland outside of town; the public investment that gets put into a category-killer chain that fattens the developers' pocketbooks, while pushing local retailers out of business; the healthcare center, like the one formerly in New Orleans, shut down because mold is growing in the walls. On the other hand, most places that people love, especially our centers of public life, are old places, worn and cherished by generations. They were built with the expectation of long-term use.

### Product or Service

Green Coast Enterprises' Community Greens concept directly addresses long-term social and environmental challenges by financing buildings so they throw off cash that can become a permanent source of community capital. The concept relies on cultivating a new class of investor that can forego short-term returns for a long-term interest in the project, and financing the projects so that the cash flows accrue to the long-term investors after the market-rate equity and debt claims are retired. Municipalities, other local government entities, community-based foundations, and legacy investors are all attractive prospects for this concept.

We are planning two Community Greens projects now. The first will revitalize a commercial district that has been blighted for 15 years, and place a community-based health center on a crucial corner of the district. Our community partner, the Broadmoor Improvement Association, is the driving force behind the health center and is helping us find guarantors for the health center's rent. In exchange for Broadmoor's support of the project, some guarantors will pass back their guarantee fee to the health center as long-term operating support. As other equity and debt investors are retired from the project, the health center will own its space free and clear. The second Community Green project will support the development of The Building Block, another entrant in this competition. In that project, a below-market master lease passes value to The Building Block that can be recycled into job training, green industry growth, and other local benefits. The site is adjacent to the planned Lafitte Greenway project which will connect Mid-City with the Tremé neighborhood by biking and walking path.

### Target Market/Population Served

On the investor or supply side, the target market is huge. Every program-related investment (PRI) dollar invested in real estate can be invested in this fashion. Every discretionary dollar of public investment in real estate can be invested in this way. These long-term investments allow market-rate investors to make short-term investments that support projects with positive long-term community benefits.

Demand for this model is also vast. Every real estate project that seeks long-term subsidized investment or seeks to reinvest in an underserved area could utilize this structure. Our expectation is that public agencies and their development partners will adopt this type of investment practice across varied situations and geographies.

### Competition and Competitive Advantage

This concept has been successfully applied by Chris Leinberger in Santa Fe, New Mexico and Flint, Michigan, and by the Jacobs Center for Neighborhood Innovation in San Diego, California. To our knowledge, the model has not been attempted in New Orleans or along the Gulf Coast. We are, however, competing with other potential users of public money. Because our expertise in community development and green building allows us to craft projects that hit multiple public targets for investment, we are well-positioned to take the lead on this concept.

For our first two Community Greens, we have committed tenants with strong preferences for our locations. We control over 4.2 acres of space on the North Carrollton corridor in Mid-City that will be the flagship location for The Building Block. We own nearly an acre of property at the intersection of Washington Avenue and South Broad for the health-center Community Green. At this location, we have strategic partnerships with the Broadmoor neighborhood (one of the leading lights of the recovery and a Clinton Global Initiative Partner), and Rhodes Commercial Development (a companion business to the largest and oldest African-American owned funeral home business in Louisiana). In addition, we have a network of local and national relationships that is already building support for the projects. We have half a million dollars of our own equity invested, and tax-credit allocates and leveraged lenders who are interested in that part of the financing. We have discussed the projects with public-sector funds providers who have encouraged us to apply for grant funding. This gives us a lot of momentum, equivalent to first-mover advantage in other contexts.

### Business Model and Financial Projections

Each Community Greens project is structured as a fee-for-service development project where residuals are claimed originally by the equity investors (including ourselves). The two projects together will cost $30 million.

Table 1. Sources and Uses of Funds

**Sources of Funds**

| | |
|---|---|
| Equity | $ 1,667,081 |
| Property sales | $ 1,700,000 |
| Public-sector support | $ 11,000,000 |
| Tax-credit equity | $ 5,701,216 |
| Senior debt | $ 9,991,757 |
| | |
| Total sources | $ 30,060,055 |

**Uses of Funds**

| | |
|---|---|
| Acquisition | $ 7,800,393 |
| Pre-development | $ 223,585 |
| Construction | $ 12,628,605 |
| Overhead and professional fees | $ 5,848,556 |
| Financing | $ 1,676,543 |
| Contingency | $ 1,882,373 |
| Total uses | $ 30,060,055 |

Over the long term, residuals support the civic and environmental goals of the project. In the first two Community Greens, we expect to create $1.5 million in direct operating support to carry out the project, pass through over $6.5 million to our partners through below-market leases during the first ten years of operation, directly invest over $1 million in job training and community-based health care, put at least four blighted buildings back into commerce as LEED-certified renovations (two of which will be historic), pass along over $15 million in building value to our partners, and create $30 million in new real estate assets for tax-paying entities located in the city's existing urban core.

### Management Team

Our management team includes:

- Alexander Kelso, Jr. – a Ph.D. economist who worked as a management consultant for nearly three decades, and one of the founding partners of the Beacon Angels investment group in Boston. Post-Katrina, Lex relocated to New Orleans, where he was born, and embarked on a third career in real estate development.
- Will Bradshaw – a fourth-generation developer who has nearly 11 years experience in development and has won local, regional, and national awards (including a Maxwell Award of Excellence in 2001) for his projects.
- Reuben Teague – a lawyer by training with a background in business and strategy consulting.

Two of our first three hires have significant construction, permitting, and architectural knowledge. The third manages office operations, and has a background in mortgage brokerage and real estate sales. We will continue to expand this core of expertise, adding more people with construction skills, as well as property management expertise.

### Milestones/ Accomplishments

Two of our principals (Reuben and Will) were selected as Echoing Green Fellows in 2008. In addition, we have been named one of America's 25 most promising Social Innovators (Business Week), New Orleans 40 under 40 (Gambit Magazine), Bronze Award Innovators of the Year (City Business Magazine), and one of the 10 Coolest Innovators Rebuilding New Orleans (Fast Company).

Green Coast Enterprises has two businesses: 1) a direct development division that has developed eight new condominium units, and owns or controls over five acres of space in two intersections in New Orleans, and 2) a development services division that focuses on construction management, construction administration, permit expediting, and weatherization. Our biggest service clients have been the New Orleans branch of The Salvation Army and the Project Home Again Foundation, a non-profit development arm of the Riggio Foundation. The Riggio Foundation is a family foundation of Leonard and Louise Riggio. Len is the chairman of Barnes and Noble. We have provided construction management for 45 homes developed by Project Home Again, each of them built to Builder's Challenge specifications, making us the largest developer of Builder's Challenge certified homes in Louisiana. We are the designated developer for 25 houses that the Salvation Army will subsidize in Broadmoor, and will provide quality control services for as many as 100 more. We have weatherized 15 homes for the Salvation Army, with another 110 to follow in 2010-11.

### Use of Funds and Exit Strategy

The build-out of both sites will cost $30 million, of which we need $1.7 million of true equity. (There will also be $5.7 million of tax-credit equity in the deal.) Green Coast has invested about $500,000, so we are looking for equity partners for the remaining $1.2 million equity tranche. This investment will earn returns of 12% to 20% per year, depending on outcomes. We are also seeking guarantors for The Building Block's lease payments. The guarantors will lend their balance sheets in exchange for a guarantee payment and interest at market rates in the event the guarantee is drawn on.

We intend to own and operate the developments through the term of tax credit compliance, after which we will sell the property to our community-based partners at discounted rates. The discounted rates are already factored into the return calculations.

Appendix

Structure of Funds Flows in Community Greens

Green Coast Enterprises finances Community Greens so that cash flows accrue to community uses after the market-rate equity and debt claims are retired.

Figure 1. Investments in projects: Bank funds are leveraged with equity and public funds

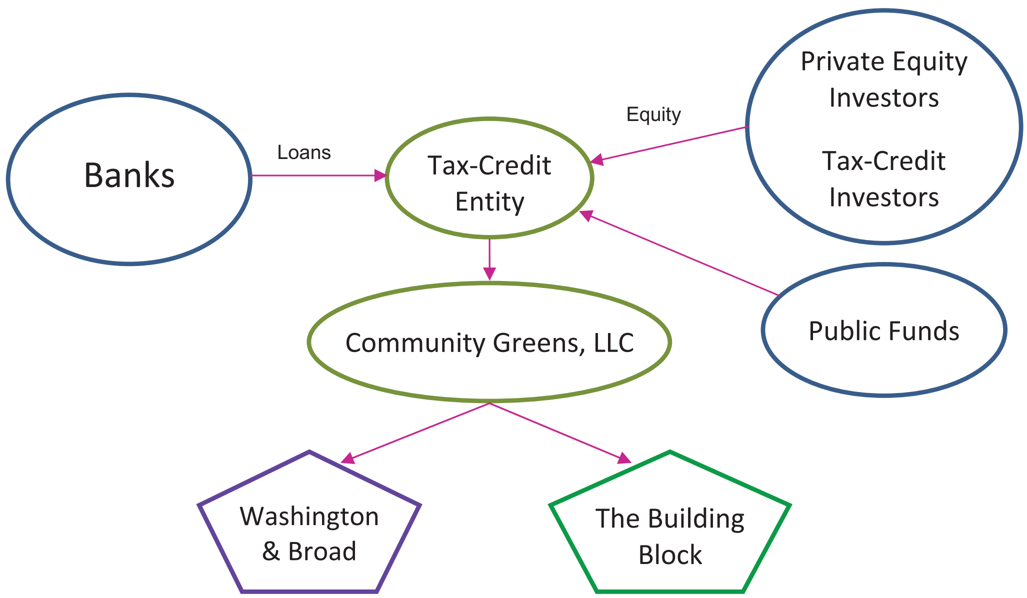
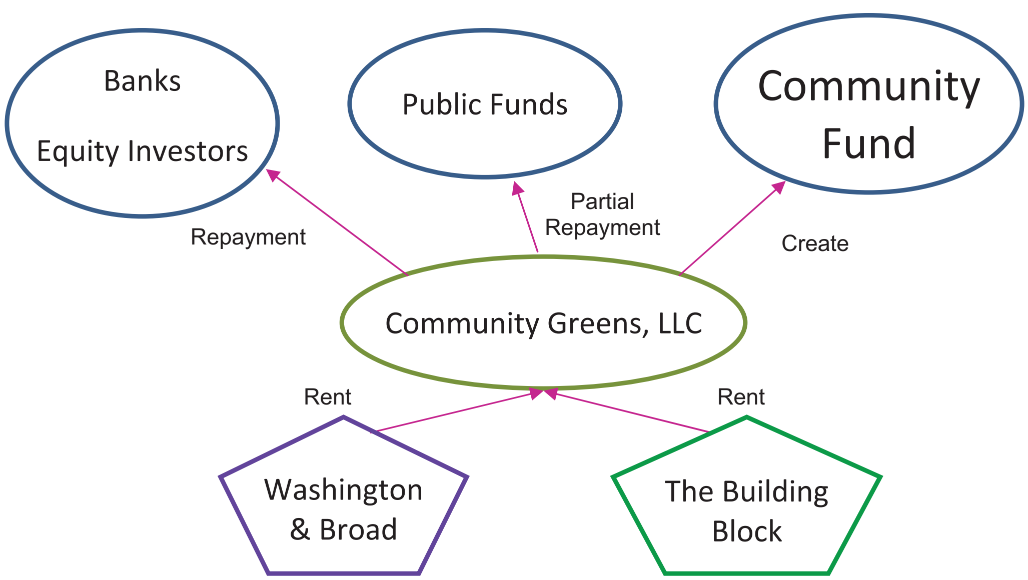



Figure 2. Returns from projects: Community Fund is the residual claimant on cash flows



# Gulf Coast Renaissance Corporation:
## MyHome MyCoast

### Problem/Solution

Hurricane Katrina rolled into the Mississippi Gulf Coast in August 2005, devastating the area and leaving in its wake many challenges. A major roadblock to recovery for the Gulf Coast was soon identified as the lack of safe, attractive, affordable, workforce housing for the area's six counties. Gulf Coast Renaissance Corp.'s (GCRC) MyHome MyCoast (MHMC) program was created to help the coastal counties bridge this specific housing gap by providing down-payment assistance grants, closing costs and prepaid items with a zero-percent second mortgage to qualified individuals with households at 120 percent or less of the area median income.

### REAL EXAMPLE

Mr. and Mrs. Smith are trying to purchase a home in Biloxi, MS (Jackson County). They have two children, 9 and 6 yrs. Both parents are employed, and together their combined income is $35,116.07. This income puts the family of 4 at 64% of Area Median Income (AMI). After qualifying for the MHMC program and completing the various counseling sessions, Mr. and Mrs. Smith obtain the American dream of homeownership, and their mortgage payments total $630.91 per month.

Table 1. Cost and Assistance

| | | | |
|---|---|---|---|
| Contract Price: | $114,000 | **MHMC Assistance:** | |
| DPA assistance: | <u>$22,500</u> | DPA | $22,500 |
| Base Mortgage | $91,500 | Closing costs | $3,500 |
| | | 2nd mortgage | $54,000 |
| 1st mortgage 40% | $36,600 | Total: | <u>$80,900</u> |
| 2nd mortgage 60% | $54,900 | | |

### Product or Service

MyHome MyCoast was launched in April 2009 as an innovative partnership between GCRC and several of Mississippi's largest financial lenders and other housing and leadership groups. The program, which is a perpetual fund created to assist thousands of residents of Mississippi's six coastal counties, is a long-term, stimulus-style housing initiative that provides much-needed homeownership opportunities. Key to the program is the fact that the lenders never have more than a 60 percent loan-to-value position in the home after GCRC's down-payment assistance forgivable grant. GCRC provides the down-payment assistance grant prior to the calculation of the first lender's mortgage amount, and then funds the balance of the second mortgage with a zero percent loan and $3,500 toward closing costs and prepaid items. The forgivable grant is only re-payable if the homeowner sells the home in the first five years of owning the home.

### Target Market/Population Served

The target market size is approximately 2,600 households, with current funding in place to assist 1,000. The MyHome MyCoast program assists applicants with households up to 120 percent of the area median income, and the applicant must qualify for the first mortgage from one of our lending partners. Many MHMC applicants are working families who simply cannot achieve homeownership without assistance, due in part to the high cost of insurance and the increasingly tight credit market.

### Competition and Competitive Advantage

Especially in these challenging economic times, the competition in the homeownership-assistance market is limited. There are other programs that exist; however, none of these programs offer the financial benefits and support that can be found with MHMC. GCRC's designation as a Community Block Development Organization allows GCRC to assist households up to 120 percent of the area median income, which differs from other low to moderate income housing programs, which are often limited to 80 percent of the AMI. By receiving designated Community Development Block Grant Funds (CDBG) from the Mississippi Development Authority, Renaissance Corp. has a solid foundation on which to serve the community though MHMC.

We do find that a challenge for us has been to expand our pool of participating lenders to offset the limited CDBG funds. Our solution to this issue has been to take a proactive stance, including our recent application for the Community Development Financial Institution certification. We were pleased to receive the certification from the U.S. Treasury Department in February of 2010, as the recognition will allow GCRC to apply for special funding. In order to apply for this financial assistance, our organization must show matching funds up to the amount of the award.

### Business Model and Financial Projections

GCRC has the business model in-house with policies, procedures, forms, contracts and internal systems in place to grow the program. The second mortgage payments received by GCRC will be utilized for mortgages to households in our target market. In addition to payments received by GCRC, if a home is sold prior to the end of the fifth year, the down-payment assistance grant must be reimbursed to GCRC. As a nonprofit organization, GCRC is not as concerned with making a profit as we are with maximizing cash flow to continue our programs. The existing model utilizing current funding (not seeking any further funding) results in a 5-year revenue model of approximately $7.8 million dollars with a 5% default rates. However, GCRC remains focused on recruitment of new partner lenders and ensuring that their investment in the MHMC programs are safe and profitable for them, as well as assisting them in earning valuable Community Reinvestment Act (CRA) credits. However, GCRC will need to purchase various external systems in order to bring some of the counseling services in-house.

GCRC plans to use privately raised funds to meet the requirements of the match. We also plan on continually raising additional private funds by applying to other national foundations, governmental programs and income coming back to the organization.

### Management Team

The management team for GCRC is comprised of knowledgeable employees with a wide range of backgrounds and experience, including more than 112 years in finance and management, 59 years in mortgage lending and 32 years of government and CDBG accountability. During the process of launching the MHMC program, the team has evolved into an efficient team that is able to meet the demands of the program today. As some of the external loan processing is brought in-house, additional mortgage professionals will need to be hired, as well as individuals with foreclosure experience.

### Milestones/Accomplishments

Our main accomplishment is fulfilling our goal to provide opportunities for homeownership. As of Feb. 15, GCRC has assisted 443 households in realizing the dream of becoming homeowners. Also in February, GCRC received from the U.S. Treasury Department notification that the organization had been named a CDFI. To date, GCRC has raised approximately $11 million dollars in private donations and $60 million in CDBG funds. Through partnerships with organizations such as NeighborWorks, Enterprise Community Partners, Enterprise Corporation of the Delta, the Mississippi Development Authority and the Gulf Coast Business Council, GCRC will continue to be a leading nonprofit organization on the Mississippi Gulf Coast for many years to come.

### Use of Funds and Exit Strategy

To date, the organization has raised and/or been awarded approximately $71 million dollars. With approximately $5 million remaining in private funding, GCRC plans to apply for a financial assistance awards to match these funds and will utilize this capital to continue the MHMC program. GCRC continues to seek additional funding for other community development projects. At this time, GCRC's five-year strategic plan includes the organization's continued growth of its financial services division and starting a New Market Tax Credit division as early as fall 2010. The strategic plan does not include an exit strategy at this time, but a singular focus on growth. The list of potential acquirers would include large national foundations, regional housing authorities and/or housing advocacy groups.

# Neighborhood Investment Strategies:
## Small Landlord Program

### Problem/Solution

Historically small landlords have been the backbone of housing provision, wealth creation and neighborhood development in New Orleans as well nationally. The flooding following Hurricane Katrina destroyed more than 1/3 of small, often owner occupied, rental properties in New Orleans, that provided affordable rental housing for tens of thousands families. Yet the rebuilding efforts have focused overwhelmingly on large-scale rental developments and owner occupied single-family homes. Existing and potential small landlords are hampered from reentering/entering the market by a lack of capital (both public and private) and technical assistance services. This lack of support and resources for small landlords not only stymies existing and potential new landlord entrepreneurs, but eschews the significant community benefits that their small, community focused developments provide.

Neighborhood Investment Strategies (NIS), a new non-profit venture with seed funding from the Rockefeller Foundation, will establish a reliable small multifamily finance and support program that will serve new and existing small landlords. This program will create new investment opportunities in New Orleans while providing the community benefits of new housing, neighborhoods stabilization though infill development and the creation of wealth in the community.

### Product or Service

NIS will provide existing and potential small landlords with technical assistance for building or rehabilitating housing units, unique direct and indirect financing options, landlord training and support services. The initial program will focus on 1-4 unit structures. Our services, to be provided directly and through strategic partnerships, will include:

- Technical assistance: Work with existing and potential landlords to craft a project that fits their needs and financial capacity. Provide design, construction management and other support for the development process.
- Financing: NIS will develop pools of funds to specifically address the needs of small landlords and provide access to available subsidy programs. Products will include construction financing, first mortgage debt and unique gap financing.
- Training and Operational Support: NIS will provide clients with landlord training and access to support services, such as standardized lease documents, background checks, insurance pools, etc.

This comprehensive program of support and assistance will help to rebuild the stock of small rental properties owned by quality landlords, and assist neighborhood recovery efforts by placing into commerce vacant and abandoned properties.

### Target Market/Population Served

NIS's initial target market for the Small Landlord program is New Orleans, Louisiana with possibility of expansion to nearby parishes. Target neighborhoods will be middle and lower income communities that have shown rebuilding momentum but are in need of additional rehab or infill development to further them on the path to stability.

The program will serve new and existing landlords in owner occupied and non-owner occupied developments. In addition, some developments will have units specifically restricted for low income individuals and families (based on subsidies and program goals). As a result the program will serve a mix of incomes for landlords and tenants.

### Competition and Competitive Advantage

Currently there are few programs in New Orleans, public or private, which support small landlords. There are no organizations that provide the complete range of support and tools proposed by NIS or unique financing products. NIS's competitive advantages include the uniqueness of its products and the ability to build its own market. The specialized financing products to be offered are far more attractive to small landlords that current options in the market. Once a reliable and workable source of financing has been established for small landlords it builds a new market of small landlords seeking to grow and expand, creating repeat business for NIS. This repeat business effect has been seen in other cities with organizations that offer specialized funds for small landlords.

### Business Model and Financial Projections

NIS's business model for the Small Landlord program incorporates a mix of income streams with a focus on financial products. Income is generated from technical assistance fees, financial products and support services. Clients will be able to participate only in the parts of the program that suit their needs, with some exceptions for certain products. Experienced landlords will primarily participate in the financial products portion of the program and inexperienced landlords will be required to use the technical assistance services.

The financial products are the core of the business model and are expected to generate the bulk of revenue over time. NIS will develop a variety of unique loan funds to meet the needs of small landlords. In the first year of the program NIS estimates approximately $185,000 in revenue increasing to over $725,000 in year five. Once the program is established NIS will seek CDFI status either individually or in partnership with another organization and add additional community development programs. Additional programs will utilize the core services and products to build economies of scale and increase revenue.

NIS is a nonprofit venture and does not seek profitability. However, NIS does intended to be aggressive in building the necessary capital reserves to expand and develop new, complementary programs.

### Management Team

NIS was founded and is led by Sarah Olivier and Ian Riekes Trivers. Sarah and Ian are both former Rockefeller Redevelopment Fellows with the University of Pennsylvania's Center For Urban Redevelopment Excellence and residents of New Orleans. There past experience compliments the skill set required for NIS – small-scale rehabilitation and housing finance.

Sarah Olivier has experience in, construction management, property management various government housing programs and urban planning. Sarah's most recent experience is as Project Manager for Neighborhood Housing Services of New Orleans working as a project manager overseeing all phases of development for single family affordable homes.

Ian Riekes Trivers has experience in real estate finance, development, urban planning, and public policy. His most recent experience is as a Program Manager with the AFL-CIO Investment Trust's Gulf Coast Revitalization Initiative, a program to invest over $650 million in Gulf Coast projects for housing, healthcare and economic development. At the Investment Trust Ian works on single and multi-family housing finance and a single family home construction program in conjunction with the New Orleans Redevelopment Authority.

### Milestones/ Accomplishments

NIS received a highly competitive grant from the Rockefeller Foundation (intended to act as venture capital) for entrepreneurial activities to develop new and innovative programs for community redevelopment and housing production in New Orleans. This seed capital enables NIS to complete the program feasibility and establish the necessary organizational and technical infrastructure to launch a successful venture. NIS's immediate goal is to establish loan pools, including possibly seeking CDFI Funds, and establish the proper underwriting guidelines to provide the financing products need by small landlords.

### Use of Funds and Exit Strategy

NIS is seeking investors in loan pools to create unique financial products focused on serving small landlords. Initial products to be offered are:

- Construction Loan Fund – for new construction and rehab. Higher risk, short term funding that fills one of the most needed elements of the progrom.
- First mortgage Debt Fund – a shared risk revolving loan fund for non-conforming loans.
- First Mortgage Debt Origination Fund – for portions of debt on projects that can be made conforming for the secondary market.
- Unique Gap Financing Fund – a higher risk, second position debt financed against non-conforming rental income.
- Soft Seconds and Subsidy Funds – higher risk and or lower return funds to cover gaps or increase feasibility of project.

Mostly philanthropic and governments sources. Funds will be blended with other products when feasible to reduce rate to borrowers or mitigate risk to market rate investors.

These unique funding opportunities provide a vehicle to not only help a mix of lower income owners and/or occupants as well as target low income neighborhoods, but an opportunity to participate in highly innovating community development finance.

Should the program not develop a large enough portfolio to become self sustaining the exit strategy is to offer investors any outstanding loans not deliverable to the secondary market for their own in house portfolios. All services would be ceased and any remaining loans would be transferred to a local non-profit partner or CDFI for ongoing servicing as part of their larger portfolio.

# Pureland, LLC

## Problem to Solve

Pureland, LLC provides interactive solutions and its unique WET™ mark to fill the missing link between consumers and the companies' social conscious brand, while benefiting the wetlands.

Missing Link: Usually, companies that affiliate with good causes come with related labels/certification. Even though these institutes who provide the certification audit the company to make sure the standards are being met, the interactions between label/certification and consumers is usually ignored. This missing link may lead to customers' confusion or even distrust towards the company/institute. Purleland wants to fill this void through our grass root WET™ approach.

Lonely Wetlands: Living through Hurricane Katrina gave Shea Shelton and other New Orleanians a deep concern for New Orleans' future given its fragile environmental condition. Every day, Louisiana loses an area of coastal wetlands the size of 32 football fields. These wetlands are nature's speed bumps and have protected Gulf cities since their existence. Living in and loving the city New Orleans, Jay and Shea could not find a well-recognized brand/certification that devotes itself into this serious yet relatively-unaware social issue.

Given that 34 states in the U.S have declining wetlands, this is a major environmental issue. Therefore, Pureland's mission is to empower customers and corporations to directly engage in raising wetlands awareness and wetlands restoration.

## Products and Solutions

WET™ Messenger: One WET™, One Percent.

We partner with OEMs to whole sale WET™ Messenger. For every WET™ Messenger sold, Pureland donates 1% of the revenue to the WET Foundation. All WET™ Messengers, WET™ TEA, WET™ H2O (water) and WET™ T-shirt, etc, carry WET™ mark as the products' label. However, we are not a beverage or T-shirt company. The main purpose of WET™ products is to raise wetlands awareness while establishing the WET mark through several commonly purchased products.

WET Social Involvement Program (WET SIP) by WET Foundation

Pureland also operates a non-profit subsidiary, WET Foundation. Its mission is to raise the awareness of wetlands restoration and support local non-profit organizations (wetlands-related). WET SIP is an involvement program that aims to directly involve most of the community in to wetlands awareness events (WET™ events) through the partnership with local non-profits and the government. We seek to make WET™ events as interactive and entertaining as possible. They can be wetlands-themed concert, WET-t-shirts design contest and wetlands education tours for school children, etc. These events are sponsored by WET™ products from Pureland and others. Therefore, WET SIP enhances WET™ mark's visibility and affinity with the people by our local event promotion.

Qualified Companies for our WET™ Mark

Ultimately, with the establishment of WET mark, Pureland licenses the mark to qualified companies. In order to meet the community and companies' common interest, Pureland will try its best to ensure that the licensee companies have following attributes:

- The company causes no harm
- The company donates 1% of its products (with WET™) sales to WET Foundation
- The company cares about the wetlands

## Target Market/Population Served

Our potential customers/licensees are corporations who are interested in good causes as well as good marketing investments. Unlike traditional cause-marketing companies, Purland addresses four emerging marketing needs which account for $4.6 billion of the 2010 market share:

- Causes: $1.61 billion, up 6.1%

- Entertainment Tours/Attractions: $1.74 billion, up 5.7%
- Festivals, fairs, annual events: $781 million, up 3.3%
- Associations, membership orgs: $503 million, up 3.4%

Even though sports sponsorship takes $11.68 billion, nearly 68% of the whole market, studies shows that more and more companies, such as PepsiCo, are focusing more on cause marketing. This industry is relatively recession-proof and is still growing by an average growth rate of 20%. In addition, Pureland's founder Jay Zhao comes from Fujian China, one of the largest wetlands areas in China. Thus, the company also aims to tackle the emerging Chinese market as its next stage. We are hoping our initiative towards the environment could benefit the people and the companies in China.

### Competition

The major players in the industry are Barkley, Smartypants Education Marketing, 1st Degree and For Momentum. However, most of them do not specialize in cause marketing; they use brochures, websites, posters, commercials, coaching, focus groups with customers and employees as marketing approaches. They generally charge corporate client by hour and by the content of the project. Since the industry of cause marketing is relatively young, so far we have found only one competitor in the South East. According to our research, large, medium, and small scale marketers are generally located in the Northwest and Northeast, with some Mid-West.

### Competitive Advantages

Innovative business model:

We charge companies annual license fees. Moreover, we utilize the 1% that companies donate to WET Fund to raise the awareness of wetlands while promoting companies' products with WET mark. Meanwhile, companies have tax-shielding from their donation. In a word, our WET™ mark is more grass rooted and more visible to the people.

Public endorsement:

Our innovative approach gained recognition from MTV and NYSE during the Mover and Changers Competition, where we rang the NYSE opening bell and later won the competition's grand prize. MTV televised these events in their Movers and Changers mini-series.WET™ mark has proved its ability to attract free publicity, including stories in Wall Street Journal, Forbes and offBeat, a local magazine. We are hoping WET™ mark will gain the endorsement from celebrities, such as Snoop Dog and Blake Mycoskie (Chief Shoe Givers of TOMS Shoes), who were our judges at the MTV/NYSE competition. Moreover, we will likely get further coverage from MTV as our venture grows.

Our Network and Connections in New Orleans

Locally based, Pureland has already established a network and partnership with local non-profits such as Bayou Rebirth and Common Ground, as well as local community volunteer groups. More importantly, we proactively work with Tulane University, the largest employee in New Orleans, to make the best effort to tackle wetlands issue. However, in the long term, we will also establish branch offices in other major Gulf Cities to designate them as wetland action hubs.

### Business Model

We charge each corporate member $8,000 in the first year and $4,000 after as WET™ mark license fee; at the same time, we utilize 1% donation to visibly promote wetlands issue and WET™ mark, thus enhancing the members' products that are attached to the WET™ mark. At the same time, Pureland also has some small profit from the sales of its own WET™ Messengers. In addition, Pureland will have an online-store in its website that gathers and sells all the WET mark merchandises for our members/licensees, with no additional fees to our licensees.

Pureland's licensing business model is profitable. It has high profit margin of 81%. The annual license fee is $8,000. It might take place some expense up to $1,500 if legal assistance and transportation are needed. As calculated, the breakeven point is 27 licensees.

### Financial Projections

Given the industry growth rate is about 20% and the fact that we are starting as a small company, we make the conservative assumption that Pureland will attract 12 members/licensees in the first year and the number of our licensees will grow by 15% every year in the next 5 years. Based on our current information, the company projects revenues of $96,000 in 2010; $144,000 in 2011; $266,400 in 2012; $492,840 in 2013 and $911,754 in 2014.

### Management Team and Advisors

Jay Zhao- Founder and CEO

Jay is the company's visionary and founder. He was inspired to create the company to reflect his belief that business should benefit humanity. Originally, Jay comes from the Fujian Province, one of China's largest wetlands areas. He has management experience working with a Fortune 500 Company. While he is in A.B Freeman School of Business at Tulane University, he initiates several organizations that involve innovation, social change and international business, etc. Jay's main responsibility is to lead and inspire Pureland, its employees, and its partners.

Shea Kathryne Shelton- VP of Social Causes and Relations

Shea studies Public Health at Tulane University's School of Public Health and Tropic Medicine with a concentration in Global and Community Health. She heads our social causes and initiatives. Shea has spent much her undergraduate career doing research at both Tulane and Emory Universities' School of Public Health.

Advisors

Throughout the development of the company's business planning, we are grateful for the generous time and advice provided by our advisors, some of them may continue to play a role in the company in the future:

- John B. Elstrott, Ph.D: Lead director for Whole Foods Market, Inc. and Chairman for Resource Environmental Solutions, a wetlands mitigation company.
- Lina Alfieri Stern: Director of Levy-Rosenblum Institute for Entrepreneurship of A. B. Freeman School of Business, Tulane University.
- Robert C. Hailey: Professor of Marketing and Associate Vice-President of Tulane University.
- Ralph Maurer: Professor of Management and Entrepreneurship at Tulane University
- Alan DeCorte: Tulane MBA 00' alumni who has professional consulting experience in Beijing for years. He is also an entrepreneur who has strong belief in the opportunities between China and United Stated.

The company is currently under the guidance of Jay, Shea, and the advisors. Considering the scale of the company, Jay and Shea are carefully looking for more qualified candidates to join the management team in the near future. Until then a permanent management team is established, the company is outsourcing some tasks to a consulting team.

### Milestones/ Accomplishments

Jan 2009, the idea of the model was born. Nov 2009, we won the grand prize of $25,000 from first MTV& NYSE "Movers and Changers" competition and rang NYSE opening bell. Dec 2009, we went to China to explore the market while refine the thoughts. During the stay at China, we attracted several Chinese investors who were interested in the project. Currently we are still finalizing the investment terms with potential U.S investors and Chinese investors.

### Use of Funds and Exit Strategy

So far, $35,000 has been invested from personal fund. The company is currently seeking $300,000 in investment financing. These funds will be utilized for initial business operation and WET mark development. As a company that specialized in interactive cause-marketing, our possible exit strategy is to be acquired by large marketing firms such as Red Ventures, Glispa Media and Barkley.

Appendix

Figure 1. Five Year Profit Projection

| | 2010 | % | 2011 | % | 2012 | % | 2013 | % | 2014 | % |
|---|---|---|---|---|---|---|---|---|---|---|
| **Licencing Sales** | $ 96,000 | 100.00% | $ 144,000 | 100.00% | $ 266,400 | 100.00% | $ 492,840 | 100.00% | $ 911,754 | 100.00% |
| Cost/ Goods Sold (COGS) | 18,000 | 18.75% | 20,700 | 14.38% | 38,295 | 14.38% | 70,846 | 14.38% | 131,065 | 14.38% |
| **Gross Profit** | $ 78,000 | 81.25% | $ 123,300 | 85.63% | $ 228,105 | 85.63% | $ 421,994 | 85.63% | $ 780,689 | 85.63% |
| Accum.number of members/licencees | 12 | | 22 | | 41 | | 76 | | 141 | |
| **Operating Expenses** | | | | | | | | | | |
| Salary of owners-managers | $ 72,000 | 75.00% | $ 72,000 | 50.00% | $ 79,200 | 29.73% | $ 87,120 | 17.68% | $ 95,832 | 10.51% |
| All other salaries and wages (intern, etc) | 17,280 | 18.00% | 17,280 | 12.00% | 17,280 | 6.49% | 17,280 | 3.51% | 17,280 | 1.90% |
| Office rent | 12,000 | 12.50% | 12,000 | 8.33% | 12,000 | 4.50% | 12,000 | 2.43% | 12,000 | 1.32% |
| Advertising/promoting brand& logo | 36,000 | 37.50% | 39,600 | 27.50% | 43,560 | 16.35% | 47,916 | 9.72% | 52,708 | 5.78% |
| Sales and Conference (Tabling) Exp | 36,000 | 37.50% | 39,600 | 27.50% | 43,560 | 16.35% | 47,916 | 9.72% | 52,708 | 5.78% |
| Travel (conf.) &auto expense | 18,000 | 18.75% | 18,000 | 12.50% | 18,000 | 6.76% | 18,000 | 3.65% | 18,000 | 1.97% |
| Office supplies | 600 | 0.63% | 660 | 0.46% | 726 | 0.27% | 799 | 0.16% | 878 | 0.10% |
| Telephone | 1,200 | 1.25% | 1,320 | 0.92% | 1,452 | 0.55% | 1,597 | 0.32% | 1,757 | 0.19% |
| Other utilities (Include internet) | 2,400 | 2.50% | 2,640 | 1.83% | 2,904 | 1.09% | 3,194 | 0.65% | 3,514 | 0.39% |
| Insurance | 9,600 | 10.00% | 9,600 | 6.67% | 9,600 | 3.60% | 9,600 | 1.95% | 9,600 | 1.05% |
| Taxes, including social security | 6,830 | 7.11% | 6,830 | 4.74% | 7,513 | 2.82% | 8,264 | 1.68% | 9,091 | 1.00% |
| Interest | - | 0.00% | - | 0.00% | - | 0.00% | - | 0.00% | - | 0.00% |
| Books, software and education | 2,400 | 2.50% | 2,400 | 1.67% | 2,400 | 0.90% | 2,400 | 0.49% | 2,400 | 0.26% |
| Legal, acct and other professional fees | 12,000 | 12.50% | 12,000 | 8.33% | 12,000 | 4.50% | 12,000 | 2.43% | 12,000 | 1.32% |
| Miscellaneous | 1,200 | 1.25% | 1,200 | 0.83% | 1,200 | 0.45% | 1,200 | 0.24% | 1,200 | 0.13% |
| Depreciation | - | 0.00% | - | 0.00% | - | 0.00% | - | 0.00% | - | 0.00% |
| Start-up (one time exp) | 143,300 | 149.27% | - | 0.00% | - | 0.00% | - | 0.00% | - | 0.00% |
| **Total Expenses** | $ 370,810 | 386.26% | $ 235,130 | 163.28% | $ 251,395 | 94.37% | $ 269,286 | 54.64% | $ 288,967 | 31.69% |
| **Net Profit Before Tax** | (292,810) | | (111,830) | | (23,290) | | 152,708 | | 491,722 | |
| **Income Taxes** | - | | - | | (8,151) | | 53,448 | | 172,103 | |
| **Net Profit After Tax** | (292,810) | | (111,830) | | (15,138) | | 99,260 | | 319,620 | |
| **Owner Draw/ Dividends** | - | | - | | - | | - | | - | |
| **Adj. to Retained Earnings** | $ (292,810) | | $ (111,830) | | $ (15,138) | | $ 99,260 | | $ 319,620 | |

# Rebirth Financial

## Problem/Solution

Rebirth Financial, Inc. will serve as an online financial platform to facilitate growth and development in Louisiana. The company's founders created this company to reinvigorate Louisiana's recovery from Hurricanes Katrina and Rita, which has slowed amidst the financial crisis of 2008-2009. We intend to accomplish this objective by connecting individual and small organizational lenders with the businesses that need their loans the most to finance growth in Louisiana's small business sector- a process that we call peer-to-business (P2B™) lending. Rebirth Financial will become a fully self-sustained company. Our mission is nothing short of returning Louisiana, and New Orleans in particular, to the economic powerhouse it was at the dawn of the twentieth century.

Now is a particularly auspicious moment to launch Rebirth Financial. In the last quarter of 2008, our targeted sector of businesses has seen a 57% decrease in access to loans originating from the federally guaranteed Small Business Administration. Venture capital has not been exempt from the recession, as fundraising has decreased by 21.4%. While the lending supply has contracted, the demand for credit has only continued to increase. This combination of circumstances set the stage for the incredible opportunity to launch a new credit model—Rebirth Financial.

We aim to build a network of individual and small organizational lenders that will make small to medium sized loans to small businesses for expansion projects, start up costs, and short-term contract working capital. For example, if one of the many start-up companies headquartered in New Orleans signs a large order contract with Whole-Foods, but does not have the necessary capital to fill that order, Rebirth Financial will provide the mechanism for the company to list and acquire a short-term loan contract.

An example with more immediate community development results may be drawn from New Orleans schools located within impoverished areas, which have been closed because rebuilding funds have not come from the government or large institutional investors. Rebirth Financial could provide a means for a small development company to obtain the necessary funds that would otherwise be out of reach. That development company could then rehabilitate schools in low socioeconomic areas- providing basic education to a community with limited access to institutional credit. This particular project would have important implications for lenders under the Community Reinvestment Act (CRA, see below).

Rebirth Financial will facilitate loans to an underserved market- allowing small companies and organizations which require capital of up to $100,000 the ability to take control of the most pressing needs in their communities, without having to wait for large banks or bureaucratically shackled federal money.

CRA Opportunity: Compliance Officers responsible for CRA at commercial lending institutions may utilize Rebirth Financial as a valuable vehicle to improve their CRA ratings and reports. Rebirth Financial will "flag" particular small business loan requests that have potential CRA qualification. Rebirth Financial will also provide preliminary data collection and geocoding, along with a prepared potential community impact report for those borrowers.

Monetary investment in, or a corporate grant to Rebirth Financial, may also qualify as a CRA loan. Specifically, commercial lending institutions may enhance their CRA performance, because an investment in Rebirth Financial may qualify as a sustaining community development loan. Investing in Rebirth Financial would have a substantial impact on all levels of the New Orleans and broader Louisiana communities.

## Product or Service

Rebirth Financial will facilitate low cost and expedient loans to companies, and high return investments to individual lenders- helping to revitalize and renew the Louisiana economy. With our unique finance process, we will offer best value service across four competitive priorities: speed, cost, quality, and flexibility. Rebirth Financial will resolve the disconnect between individual lenders and loan consumers—inherent in commercial banking—by linking individual lenders' funds directly with the small business borrowers. Our process will ensure that loans funnel to ventures with the highest expected community impact, and spur a sustainable cycle of community driven economic development.

Rebirth Financial will provide a web-based platform to connect small business borrowers directly to individual and small organizational lenders.

I. Borrowers will post a desired loan amount and a desired interest rate. Rebirth Financial will provide initial quality screening of the borrowing small companies that seek financing through the website, but ultimately provide an innovative portal where emerging and growing companies can pitch their ideas to a wide pool of potential funders.

II. Lenders, using our platform, will have the opportunity to see and research all loan requests that meet their qualifications. Rebirth Financial will require certain minimum data from borrowers to ensure that lenders have sufficient information to make lending decisions. This data includes (but is not limited to): financial plans and projections; available credit reports and ratings; existing liens and debts; available assets (plant, property, equipment); debt to income ratio; etc.

III. If a lender is interested, that lender can specify the amount that they are willing to lend at the given interest rate. If their desired investment amount is less than the requested loan amount, funds will be pooled with other investors until the requested loan amount is reached.

IV. Bidding will occur in the event that supply to fund a loan at the borrower's requested interest rate exceeds the amount of capital requested by the borrower. In this situation, lenders will have the opportunity to bid down the loan interest rate, with the resulting marketplace setting the final interest rate.

Loans will be collateralized in accordance with the nature of the borrowing business, and risk tolerance of the lender. Rebirth Financial™ will attempt to collect a delinquent loan on behalf of its lenders for a period of 90 days. In the event that a borrowing company is in default in excess of 90 days, the note will be sold to a third party collection agency partner, for a pre-negotiated percentage of the outstanding principle balance of the loan. This arrangement is expected to provide our investors with a backstop on losses of approximately $0.40 per $1.00.

Rebirth Financial will not operate as a Financial Institution, as defined by the State of Louisiana, and hence will not be regulated by the Louisiana Office of Financial Institutions. Nor will it fall within the ambit of the United States Security and Exchange Commission's regulatory jurisdiction. Rebirth Financial will operate in voluntary compliance with SEC and state regulations pending anticipated future regulatory expansion. Please see the Appendix A for additional legal information.

### Target Market/Population Served

Rebirth Financial will target companies and organizations in Louisiana that require a loan of up to $100,000 (although there is no limit to the amount a company can borrow). Most of these loans will originate from small and medium size businesses. In 2007, there were 146,481 business loans under $100,000 issued in Louisiana, totaling $1.6 billion. The market for loans under $100,000 in the state has been experiencing strong growth in recent years with an increase of 246% since the year 2000, while the dollar value of those loans has increased by 201%.

The Federal Reserve Bank of San Francisco predicts that Peer-to-Peer (P2P) lending will increase to $5.8 billion in 2010. This positive growth in the sector will directly benefit Rebirth Financial because our company will provide an innovative and new service exclusively for small businesses and social entrepreneurs. It shows both a fantastic opportunity, and both lender and borrower willingness to use online lending platforms.

### Competition and Competitive Advantage

Rebirth Financial will face two types of direct competitors:

1. Commercial banks and other depository institutions issuing commercial loans,
2. Other peer-to-peer lending platforms accepting business borrowers, such as Prosper and Lending Club.

The company will also indirectly compete with business credit card suppliers, venture capitalists, angel investment firms, and accounts receivable buyers.

Rebirth Financial will build a sustainable competitive advantage over its competition via cost leadership and differentiation strategies. The firm will have several advantages over commercial lenders. First, Rebirth Financial will create a more efficient marketplace where borrowers and lenders both agree on the loan interest rate, making the lending more financially and socially rewarding for everyone. Second, our platform will offer a lower interest rate for borrowers and a higher return on investment for lenders than traditional banks. Borrowers will also benefit from a faster and easier application process, with loan applications listed online within a few days, as compared with the lengthy process at typical commercial banks. In addition, our process will be more transparent to lenders and borrowers who will have access to information regarding costs, and greater control over their transactions. Rebirth Financial also has a competitive advantage over existing P2P companies- which are legally structured to serve only individual borrowers, as opposed to business borrowers.

Unlike existing P2P companies, Rebirth Financial has taken the appropriate legal steps to stay exempt from SEC regulations. Thus, national P2P companies will face high regulatory barriers to entry if they attempt to compete with Rebirth Financial. Rebirth Financial does not currently have any proprietary assets beyond pending trademarks; however once the firm receives initial funding, it will develop a unique proprietary platform and process to operate the P2B™ transactions.

### Business Model and Financial Projections

Based on our company's five-year pro forma financial statements, our management team feels confident that we can offer investors a 100% return on investment. Rebirth Financial will break even after year three, and projected sales will more than double in year four. Our model is fully self-sustaining.

Rebirth Financial will have three sources of revenue: 1. For the facilitation of services, Rebirth Financial will collect a small percentage based origination fee, and a low percentage spread on all repayments; 2. A listing fee paid by borrowers to list on our platform; and 3. Advertisements placed on our website.

Initially, we will not have a positive cash flow. This is due to the substantial costs needed to gain credibility in the market (marketing, advertising, web development). However, over time those costs increase at a very low rate, and they directly improve performance of our three sources of revenue—which will increase at a much higher rate. Early costs are aimed at increasing all three of our sources of revenue.

Rebirth Financial's™ gross margins reflect the company's strong opportunity for success. We project gross margins ranging from 88% to 97% for years one through four. These margins increase over time between years two and five. This same trend is evident in our projected profit margin, which starts extremely negative, but in year four becomes positive and rapidly increases after year four according to conservative projections.

In the first three years of operations, Rebirth Financial will post a negative cash flow. However, we project that sales will more than double in year four when our upfront investments in marketing and market credibility reach fruition. We project that the company will become profitable in year four, and rapidly double the value of our investors' capital.

### Management Team

The Rebirth Financial management team is a dedicated and diverse cohort of three highly qualified Tulane MBA students. The company is led by CEO Chonchol Gupta, who is also pursuing his Master of Global Management Degree, and has received a Certificate in Latin American Business Studies. As President of Tulane's Graduate Business Council, Tulane Team Leader for IdeaVillage's Entrepreneur Week, a civil engineer, and former intern at the World Trade Center-New Orleans, Chonchol has built a wide professional network—both in the United States, and in emerging markets. COO Xavier Cabo brings 8 years of website project management to Rebirth Financial. Cabo is also the founder and proprietor of XWebConsulting, a web development and online marketing company. General Counsel Alex Owings- a J.D. candidate- acts as legal advisor to the company. Alex has consulted his wide network of legal advisors to ensure that Rebirth Financial operates effectively within the current regulatory and statutory framework. Alex will sit for the Louisiana Bar Exam in July. Jon Atkinson serves as Head Financial Consultant to Rebirth Financial. Atkinson is Commercial Lending Portfolio Manager at a local commercial bank, and brings the necessary expertise regarding loan structuring, and commercial banking underwriting. Atkinson serves as a member of the Student Advisory Committee for the Ashoka Changemaker U Partnership, and is on the steering committee for Social Entrepreneurs New Orleans.

### Milestones/ Accomplishments

Rebirth Financial, Inc. is a startup company in its infancy. We have filed Articles of Incorporation in Louisiana, and have applied for trademarks for both "Rebirth Financial" and our signature mark, "P2B." In addition, we have established the team of individuals who will lead the company to success.

We are currently developing the conceptual platform processes and automated operation that will make the online platform work. The next step is to develop the website and platforms to meet our needs. Our market research has proven that interest in our platform is strong from both investors and borrowers.

### Use of Funds and Exit Strategy

Rebirth Financial is in the process of raising funds through various channels including business plan competitions at the local and national levels. We are also looking into soliciting investment capital from venture capitalists to finance our initial capital expenditures. Our company has calculated use of new funds in the following ways:

- Marketing: a significant portion of our budget will be allocated to promote our service- attracting prospective lenders nationwide; and to build overall brand awareness.

- Technology: a fair amount of the new funds will be spent on technology to develop and maintain a state-of-the-art technological platform

- Management compensation: initially, our team will receive reasonable salaries and benefits based on the industry standards.

Our management team envisions Rebirth Financial's long-term strategies including international expansion to Latin America (where loan interest may be double the rates in the US) and diversification of our offering by providing community development financing, which involves loans averaging over $900,000 .

Acquisition is our most likely exit strategy. Potential acquirers comprise regional and national commercial financial institutions that would like to quickly enter the growing peer-to-Business lending market without developing their own platform internally; existing Peer-to-peer websites who wish to enter the Peer-to-business market; and Accounts Receivable companies. Our anticipated dedicated customer base will hopefully distinguish our peer-to-business lending model as a way to sustainably renew our country's financial system.

### Appendix: SEC Regulations and Compliance

It is the opinion of Rebirth Financial's General Counsel that our company will not fall within the regulatory jurisdiction of the United States Securities and Exchange Commission (SEC), or its state counterparts in the early years of its operations. Our company will work essentially as a passive matching service with a small number of lenders servicing credit demand at any given point in time. In addition, our loans will be made solely to businesses in the state of Louisiana during our initial growth phase. In short, our company does not currently fall within any financial regulatory agency's jurisdiction under current regulatory definitions.

However, given that the sole statutory and constitutional limitation on SEC jurisdiction is that it may regulate only transactions in interstate commerce—and interstate commerce includes nearly every commercial transaction under current Supreme Court jurisprudence—the principals of Rebirth Financial are acutely aware that SEC compliance will become an issue for our business. Once Rebirth grows large enough under one of the various SEC regulatory classes, we will be at risk of SEC regulation even if the SEC does not currently include our business model in the list of models that it can regulate; the SEC has nearly unlimited authority to expand its regulatory jurisdiction over any financial transaction and has done so in the past with respect to peer-to-peer lending companies.

As such, Rebirth Financial will make all of its operations voluntarily compliant with SEC regulations. This will require that Rebirth spend some money annually to pay lawyers to ensure that Rebirth's filings fit within SEC requirements.

Voluntary SEC compliance will keep Rebirth Financial state compliant, when coupled with a few additional filings for state regulatory agencies.

Voluntary compliance makes sense financially. Costs associated with are relatively low. It is substantially less than the cost of finding ourselves suddenly under SEC regulatory jurisdiction with the specter of daily fines for non-compliance.

# St. Bernard Project, Inc.

## Problem

As a result of the events of August 29, 2005 – the day Hurricane Katrina slammed into the southeastern coast of Louisiana – 1,464 Louisianans were dead and 80% of the City of New Orleans was under water. The American Red Cross reported that 850,791 housing units were damaged, destroyed or left inaccessible because of the storm. FEMA estimated that about 330,000 homeowners across hurricane-affected areas in Louisiana suffered anywhere from minor to complete damage of their home and, in St. Bernard Parish and the Lower Ninth Ward, every single home was declared uninhabitable.

In a recent conversation with Lynette Harvey, one of our clients, she poignantly said, "Katrina: she's a long storm." It's "a long storm" because – for so many – the devastation continues four and a half years after that terrible day. Those still affected are represented by the following statistics:

- More than 1,000 households remain packed into unhealthy FEMA trailers, while 9,000 more remain in other forms of temporary housing.
- New Orleans' homeless population has doubled since the storm to more than 12,000 individuals.
- There is currently an unmet demand for 20,019 affordable housing units and this number is projected to increase exponentially over the next 10 years.
- Sixty-six percent of renters in the region are cost-burdened (paying more than 30% of their monthly income on housing-related expenses). New Orleans has the highest rate of cost-burdened households in the country.
- Forty-seven percent of all full-time workers in the New Orleans metro area earn less than $35,000 annually, and more than 70% of these households are unable to find affordable housing.

To date, St. Bernard Project (SBP) has helped return 264 families home by rebuilding their storm-damaged properties (the nonprofits in the Greater New Orleans Area have completed a combined total of approximately 1,000 units). While we are proud of this accomplishment, we also recognize that it is just a "drop in the bucket." With the unmet demand for affordable housing increasing at a rapid pace, we believe that a disaster-relief model that relies predominately on volunteers cannot address the full scale of a problem of this magnitude.

## Solution/Service

SBP's Good Work Good Pay program will allow SBP to provide two services. First, rather than relying exclusively on volunteers, we will create livable, union-level wage construction jobs with full benefits for returned war veterans and other local under- and unemployed populations – two groups that are at-risk of extended unemployment and emotional health challenges. We will provide these employees with training in the growing green construction industry, increasing their likelihood of finding well-paying work throughout their construction careers.

Second, we will be able to utilize this well-trained and consistent workforce (often two pieces lacking with a disaster relief model dependent solely on volunteers) to 1) increase the speed in which we rebuild blighted housing, and 2) provide us with the skill-base we need to build new affordable housing units to be sold or rented to low-income clients.

Our homes are built energy efficiently to LEED standards and are ADA-compliant so they are livable for the elderly and disabled.

## Target Market/Population Served

Nearly four and a half years after Hurricane Katrina devastated southeastern Louisiana, recovery is far from complete. SBP builds/rebuilds affordable housing for low-income homebuyers, renters and homeowners in Orleans and St. Bernard parishes. These clients come from the following populations:

- More than 1,000 households remain packed into unhealthy FEMA trailers, while 9,000 more remain in other forms of temporary housing.
- New Orleans' homeless population has doubled since the storm to more than 12,000 individuals.

- There is currently an unmet demand for 20,019 affordable housing units and this number is projected to increase exponentially over the next ten years.
- Sixty-six percent of renters in the region are cost-burdened (paying more than 30% of their monthly income on housing-related expenses). New Orleans has the highest rate of cost-burdened households in the country.

Table 1. Percent of Low-Income Homeowners that are Cost-Burdened

| Income | Greater New Orleans Area | National |
|---|---|---|
| **< $20,000** | 80.8% | 63.9% |
| **$20,000 to $34,999** | 71.9% | 58.6% |

(47% of all full-time, year-round workers in the New Orleans metro area earn less than $35,000.)

SBP will also serve returned war veterans and other local underemployed populations by creating livable, union-level wage paying jobs with full benefits. There are hundreds of thousands of veterans currently living in Louisiana, with approximately 1,500 currently serving in Iraq and Afghanistan.

While New Orleans' unemployment rate of 7.7% is lower than the national average, it is still far higher than what would be considered a tight labor market. Returned veterans struggle the most, with an unemployment rate that is higher than the national average, and well over 11 percent.

### Competitors and Competitive Advantage

The GWGP program will allow us the flexibility that other construction organizations lack. While most Katrina-related nonprofit organizations focus exclusively on rebuilding housing for those who owned their home before the storm, SBP will be able to expand its owner-occupied rebuilding work while also creating the in-house skilled workforce it needs to build new affordable homes for sale and rent.

By complementing the GWGP program with our Volunteer-Driven model, SBP will be able to keep its costs lower than other nonprofit rebuilders while giving us the capacity to complete more housing units than most for-profit contractors. [Please see Appendix for a comparison with other local housing organizations.]

### Financial Projections

GWGP will generate revenue for SBP by 1) building/rebuilding affordable homes for sale and rent, and 2) receiving reimbursements for rehabilitating owner-occupied storm damaged housing. These reimbursements will come from the homeowner and – in cases when the homeowner cannot afford to reimburse us in full – from third-party payers such as government agencies, foundations, corporations and individual donors. [Please see Appendix for our expected revenue and revenue model.]

### Management Team and Accomplishments

Zack Rosenburg, co-founder and CEO, has 15 years of legal and nonprofit management experience. Liz McCartney, co-founder and Director of Development has eight years of nonprofit experience. Together they grew the St. Bernard Project from two staff members in 2006 to 75 today; and from an operating budget of $165,000 in 2006 to more than $5,000,000 today.

Andrea Bontrager, Director of Development, has served with SBP for two and a half years. She came to SBP after working in a similar position at Habitat for Humanity for three years and brings an extensive background creating and implementing organizational systems.

Jim McQueen, Director of Construction, and John Mueller, Construction Trainer, have a combined 70 years of residential and commercial construction experience and have trained hundreds of new employees in construction-related trades.

Jim will be overseeing all construction at SBP, while John will be training all GWGP staff and maintaining quality control.

SBP has been the proud recipient of several prestigious awards:

- Winner of the State of Louisiana's Social Innovators Institute business plan competition, February 2010
- Highlighted at Service Nation event with the First Lady as one of twenty model civilian-military partnerships, November 2009
- Nominated as Innovator of the Year by City Business, July 2009
- Co-Founders named "New Orleanians of the Year" by Gambit Weekly, January 2009
- Co-Founder selected as CNN Hero of the Year, November 2008
- Co-Founders received a Social Entrepreneurship award from the Manhattan Institute, October 2008
- Awarded Hero of the Storm by Friends of New Orleans, June 2008

## Use of Funds

To launch the GWGP program, SBP will need $497,626, of which we have already raised $325,000. With $147,626 we will launch a program that, in five years, will create a minimum of 882 housing units, nearly 40 jobs and more than $9,000,000 in revenue. This start-up funding will allow the program to be self-sustaining by the end of its first year. We believe the Good Work Good Pay program will become a national model for all cities affected by natural or economic disasters.

## Appendix

Table 2. Competitive Analysis/Advantage Chart

| Organization | Type of Unit | Labor | Scope of Work | Avg # of Projects Completed Annually | Avg. Cost Per Project | Avg. # of Simultaneous Projects |
|---|---|---|---|---|---|---|
| SBP (with GWGP) | Owner Occupied, For Sale, For Rent | Volunteer and GWGP Employees | Rebuild/ New Build | 168+ | $28,444 to $79,679 | 75-85 |
| SBP (without GWGP) | Owner Occupied, For Sale, For Rent | Volunteer | Rebuild | 100 | $28,444 to $34,200 | 50-60 |
| Catholic Charities Operation Helping Hands | Owner Occupied | Volunteer | Rebuild | 100 | $30,000 | 25 |
| Rebuilding Together | Owner Occupied | Volunteer | Rebuild | 100 | $46,800 | 50 |
| Habitat For Humanity – New Orleans | For Sale | Volunteer | New Build | 50 | $110,000 | Not Available |
| Make it Right Foundation | For Sale | Hire Sub-contractors | New Build | 20 | $150,000+ | Not Available |
| For-Profit Contractor | Owner Occupied, For Sale, For Rent | Hire Sub-contractors | Rebuild/ New Build | Varies Greatly | Varies; but not affordable to Low-Income residents | Varies Greatly |

Table 3. Financial Summary

| | Start up | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|---|---|---|---|---|---|
| **Property sales** | | $4,775,155 | $6,323,499 | $8,053,836 | $9,301,227 | $10,410,011 |
| **Rental income** | | $18,645 | $76,027 | $139,194 | $259,702 | $402,093 |
| **Secured Government grants**** | | $5,031,137 | $1,355,000 | | | |
| **Non-government grants and other**** | $472,626 | $1,750,500 | $1,500,000 | $1,200,000 | $1,000,000 | $1,000,000 |
| **Revenue** | $472,626 | $11,575,438 | $9,254,526 | $9,393,030 | $10,560,929 | $11,812,105 |
| **Expenses** | ($472,626) | ($7,312,427) | ($8,083,095) | ($8,689,353) | ($9,356,199) | ($9,805,047) |
| **Debt Service** | | ($42,080) | ($42,080) | ($42,080) | ($42,080) | ($42,080) |
| **Net Cash Flow** | | **$4,220,931** | **$1,129,352** | **$661,597** | **$1,162,650** | **$1,964,978** |
| **Running Cash Flow** | | **$4,220,931** | **$5,350,282** | **$6,011,879** | **$7,174,530** | **$9,139,508** |

** These numbers are conservative and only include government and foundation support that has already been committed at this time. SBP's funds generated from these sources have increased each year since its founding in 2006. This will greatly increase the number of housing units and jobs created. For example, if SBP fundraised at a level equivalent to what was raised in 2009, the program would generate well over 1,000 units of affordable housing over its first five years.

# Sustainable Environmental Enterprises, LLC

Sustainable Environmental Enterprises (SEE) is a mission-driven, triple-bottom line company that believes renewable energy is the new frontier in strengthening historically disinvested communities.

## Problem/Solution

As a condition of the current U.S economy, people are being priced out of their homes as their obligations increase (i.e. home costs, insurance costs, and energy costs), their savings are low to non-existent, and their investments are tied to the same indices that created the slump in the overall economy. Nationally, the picture is bleak and it is thought that by 2018 New Orleans' energy costs will increase ~75% from $2,000-$2,300, annually (with average home size is 1100 sq ft) to $3,500- 4,025 (2008 Policy Link Conference, Dr. Phillip Thompson, MIT). Therefore, New Orleans is especially vulnerable, especially with a majority of New Orleans' homes being low-to moderate-income. The normal costs of living that New Orleans' experiences is compounded with extra costs as we continue to dig out nearly 5 years later from losses incurred by catastrophic weather events of 2005.

Here at Sustainable Environmental Enterprises, LLC (SEE), we have personalized these unique challenges and we are answering back. We lessen the jeopardy these communities face by creating access to solar power for low- to moderate-income customers as a means of reducing the overall costs of living. Traditionally, low wealth communities were unable to access solar power because they could not finance the associated large up-front costs. We borrow from a micro-finance ideology, where we use a small amount of available financing to make big strides in communities who are traditionally unbanked and un-bankable. We are closing this Green Gap TM through this mechanism we call Green EqualityTM.

A solar panel product similar to the typical SEE residential customer system, was installed on a Lower 9th Ward home, it generates 2.7 kilowatts of electricity per hour and the average monthly bills average $35.00*. In our model the homes typically require about 2 kilowatts per hour to power all the lights, appliances and central air conditioning. Which means on sunny days, the homes are returning power to the grid with a monetary benefit to the customer. In addition, all SEE installations provide a fixed electric utility cost and are constructed not lose power during the hurricane events. Hence our customers are better positioned against mortgage default and foreclosure due to lower cost of living; and they are protected from inflation/rising energy cost, and they do not loss their refrigerated food or refrigerated medicines when the power goes out.

* http://www.inhabitat.com/2009/09/28/brad-pitt-receives-award-from-usgbc-for-making-it-right/

## Products

SEE offers two main product lines one is a business-to-business product and the second is a business-to-customer product.

- Business-to-Business: Our product aides Affordable Housing Developers in fashioning a cost effective means of bringing Solar to their properties as a mean of reducing operating costs.
- Business-to-Customer: We sell residential solar panel arrays specifically designed for residential homes. Our expert, licensed and insured installers, installs these systems. The residential arrays can be purchased with our in-house financing. The goal is to create affordable monthly payment as a one-to-one exchange for the customer's current utility bill.

## Target Market

Single-family affordable housing customers:

- Low income / low wealth individuals who have dependable and verifiable income
- Individuals at risk of long-term housing instability due to utility price increases
- Individuals with little exposure to the benefits of renewable energy
- Individuals who are often overlooked and even discriminated against by the conventional lending community

- Individuals who are often excluded from the benefits of regulatory and technological and financial innovation

Multi-family affordable housing developers:

- Developers that serve low income and/or fixed income residents whose incomes are capped in order to remain eligible for tenancy in the developers' units
- Developments that suffer risk from utility price increases and fluctuations because the utility costs are directly tied to the amount of rent that they can charge and the viability of their developments in general
- Affordable housing developers who are not seen as customers for renewable energy because they serve a low-income market
- Affordable housing industry professionals, who, out of all real estate developers, tend to be least expert in innovative regulatory, technological and financial tools

### Population Served

Table 1. Five Year Market Share Projection

| | Total units | % Market capture | SEE customers |
|---|---|---|---|
| **Total Expected New or Rehabbed units coming on-line** | **58,710** | **3%** | **2,019** |
| | | | |
| **Occupied units** | **Total units** | **% Market capture** | **SEE customers** |
| **Total occupied units** | **150,000** | **1%** | **1,500** |
| | | | |
| **Total SEE Customers by 2015** | | | **3,519** |

### Competition and Competitive Advantage

Brad Gentry, director of the Center for Business and the Environment at Yale, says, when speaking of companies that exist in the competitive space where SEE is positioned, that "The innovation [in the renewable energy sector] is not so much the solar panels but the financial structures and business modeling." In New Orleans there are 3 active solar installation companies whose managers come from contractor or environmental backgrounds, but do not have in-house financial products. The value proposition SEE offers with our in-house financing, personalized underwriting, and in-house tax credit processing, separate us from the competition and make us a true end-to-end solution.

All solar installation companies and all finance companies that lend for solar have the same deterrents—our nation's current poor credit market. We instead use the small amount of available financing to make big strides in communities who are traditionally unbanked and un-bankable. To assists us in meeting our goals we created four patent pending proprietary systems: 1) Our Underwriting System, 2) Our panel design system, 3) Our 3-6-4 solar panel & energy efficiency tool, and 4) Our customer-service delivery process; all of which we crafted in consideration of the low to moderate income customer. We finally make it possible for low-wealth customers to enter the market at a price point they can afford. Ultimately we provide a more comprehensive service than our competitors and we are tapping an untapped market.

### Financial Projections

SEE has a scalable business model wherein we generate revenue by selling and installing solar photovoltaic systems to low and moderate-income residents. We have a proprietary underwriting process that evaluates each customer individually to determine how payments for the systems are established based on standard and non-standard credit and collateral measures. Each system sold includes extensive product education to ensure that the customers can be good stewards of the systems. SEE is a one-stop shop that goes step-by-step with the customer from inquiry to post-installation and maintenance. Furthermore, the SEE model works with large-scale multi-family and mixed-use projects that can benefit from the energy efficiencies and money-saving aspects that solar systems provide.

SEE expects to maintain a strong and steady profit margin (17.3%) for the next 5 years by maintaining steady growth during our initial development stage and continuing that level of growth over the next 5 years. SEE understands that there is tremendous opportunity in the next 3 to 5 years in the Gulf Region, as major rehabilitation and new construction continues.

### Management Team

We are all Rockefeller Foundation Fellows and we each received a certificate of recognition for Urban Redevelopment Excellence from the University of Pennsylvania for our work done at various New Orleans firms prior to our beginning SEE. Collectively we have placed 240+ units of housing in-service in Post Katrina New Orleans and structured 110 Million of financing for first time homebuyers and historic renovations. Collectively, we are committed to assisting and making housing affordable and we have in-house legal, environmental, green building technology and financial expertises that make us able to manage SEE unto that end. Presently, our in-house team lacks a CFO and a Solar Systems Design Engineer we currently consult these role out.

Lea Keal, Chief Executive Officer
Bachelors of Science in Urban and Regional Development & Environmental Geography from the Pennsylvania State University. Jurist Doctor from the Pepperdine University.

Rosalind Ross, Chief Operations Officer
Bachelor of Arts in Economics from Spelman College. Master's of Urban Planning from the Robert F. Wagner Graduate School of Public Service at New York University

Stacey Danner, Chief Investment Officer
Bachelor of Arts in Sociology & Justice and Peace Studies from the University of St. Thomas. Masters of Arts in Geography and Urban Studies with a Concentration in Banking and Urban Economic Development from Temple University.

David Lessinger, Director of Residential Sales and Education
Bachelors of Arts in Biology & Environmental Studies from Oberlin College. Master of Arts in City and Regional Planning from Cornell University.

### Milestones/ Accomplishments

- Established the Greenbuild Outreach Center, located in Central City-New Orleans. In Central City between 7.15% - 14.29% of mortgages are sub prime and targeted towards the neighborhoods' predominantly low income, African American population. In a neighborhood that is struggling, even a small percentage of loan failures will have a devastating impact on the community. Therefore we are piloting our outreach-to- education-to-adaptation strategy right in the heart of this community. (Placement of a $12,000 matching grant & $12,000 of Founders' capital).
- Launched our customer process on a beta test of 10 small system placements. (Placement of $100,000 seed funds). Expected completion end of 2nd quarter 2010
- 2nd Quarter 2010–to launch the Business-to-Business Strategy (see above) with a 100 unit single-family development.
- 3rd Quarter 2010—to launch full scale Business-to-Customer product (see above)—PENDING FUNDING

### Use of Funds

Our current funds raised have totaled approximately $266,000. Of which we have Strategically placed $112,000 of those dollars into the community to demonstrate the viability of the products and to promote our brand. Currently we are looking to launch a our Business-to-Customer product full scale by the beginning of the 3rd quarter of 2010. All funding we are seeking would fuel that endeavor providing a ~17% ROI to investors (see above). We are currently seeking a total investment of 25 million (in tranches of 5 million) serving as our entire corpus of lending capital and a small amount in operations (approximately 4%).

Appendix

Table 2. Financial Projections (2010-14)

| Year | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|
| SEE Gross Revenue | $ 24,477,048 | $ 24,721,818 | $ 25,092,646 | $ 25,594,499 | $ 25,850,444 |
| SEE Cost of Sales | 14,248,648 | 14,391,134 | 14,607,001 | 14,899,142 | 15,048,133 |
| *Gross Margin* | *41.8%* | *41.8%* | *41.8%* | *41.8%* | *41.8%* |
| | | | | | |
| **Operating Income** | $10,228,400 | $10,330,684 | $10,485,644 | $10,695,357 | $10,802,311 |
| | | | | | |
| **Operating Costs** | | | | | |
| Loan Loss Reserve | 489,541 | 494,436 | 501,853 | 511,890 | 517,009 |
| Payroll | 1,331,839 | 1,553,102 | 1,599,695 | 1,647,686 | 1,697,117 |
| Marketing Expenses | 20,800 | 21,632 | 21,956 | 22,396 | 22,844 |
| Professional Fees and Licensure | 8,320 | 8,653 | 8,783 | 8,958 | 9,137 |
| Insurance | 104,000 | 108,160 | 109,782 | 111,978 | 114,218 |
| Travel and Vehicle Cost | 12,480 | 12,979 | 13,174 | 13,437 | 13,706 |
| Rent and Utilities | 31,200 | 32,448 | 32,935 | 33,593 | 34,265 |
| Advisory Consulting/ Research & Development | 67,600 | 70,304 | 71,359 | 72,786 | 74,241 |
| Payroll Taxes | 266,368 | 310,620 | 319,939 | 329,537 | 339,423 |
| Legal | 78,000 | 81,120 | 82,337 | 83,984 | 85,663 |
| **Total Operating Costs** | **$ 2,436,148** | **$ 2,720,495** | **$ 2,789,258** | **$ 2,864,240** | **$ 2,936,178** |
| | | | | | |
| **EBITDA** | $ 7,792,252 | $ 7,610,189 | $ 7,696,386 | $ 7,831,117 | $ 7,866,133 |
| Federal Income Tax | 2,556,331 | 2,496,383 | 2,524,971 | 2,569,588 | 2,581,311 |
| State Income Tax | 677,815 | 661,920 | 669,500 | 681,330 | 684,439 |
| Interest Expense | 45,794 | 45,393 | 44,958 | 44,488 | 43,978 |
| Depreciation Expenses | 39,553 | 72,603 | 72,603 | 72,603 | 72,603 |
| | | | | | |
| **Net Profit** | $ 4,472,758 | $ 4,333,891 | $ 4,384,354 | $ 4,463,109 | $ 4,483,802 |
| **EBITDA Margin** | **31.8%** | **30.8%** | **30.7%** | **30.6%** | **30.4%** |
| **Profit Margin** | **18.3%** | **17.5%** | **17.5%** | **17.4%** | **17.3%** |

# The Building Block

## Problem/Solution

The Building Block addresses the problem of poor access - both real and perceived - to sustainable approaches for building and rebuilding in the Greater New Orleans and Gulf Coast marketplace:

- Poor access to knowledge of what is available, and how products / systems work. On-line research is arduous and not a preferred option for all end users.
- Poor access to products and services. Existing green businesses are scattered and hard to find, with no critical mass of commerce to support community outreach and educational marketing tactics.
- Perceived poor access based on price. Life-cycle cost v. installation cost is not widely understood and there is a sense that "exotic" approaches to design and materials are not an option for low and middle-income housing.
- Poor access because of poor distribution. Many products that are available nationally are not manufactured in this market or distributed here due to the real and perceived challenges of entering the marketplace.

## Product or Service

With our flagship location at 401 N. Carrollton Ave, in Mid-City New Orleans, The Building Block will be a value-adding landlord of green businesses, co-locating businesses and organizations dealing in sustainable, energy-efficient approaches to building and lifestyle. By clustering retail, wholesale, and office tenants together, The Building Block will create a density of green commerce in a highly visible, easily accessed, established commercial corridor, bringing green commerce from niche to mainstream. Outreach to building professionals and end-use consumers will be managed via Resource Center programming, including an interactive product showroom, an educational calendar of seminars and product demonstrations, workforce development training, and business incubation services. In addition to the green-building industry, The Building Block will include lifestyle tenants such as a café, a green dry cleaner, green salon, green bank, etc, making the site a dynamic, energized shopping destination, welcoming a wide diversity of consumers.

On the manufacturing and distribution side, we are finalizing a commitment from an insulated, prefabricated building component manufacturer that will use 19,000 square feet of light-industrial space. We will leverage the identity and accessibility of The Building Block to support other manufacturers and distributors who are interested in entering the marketplace. Ample idle property adjacent to our site, zoned for light and heavy industrial use, sets the scene for growing this green hub, attracting industry and manufacturing to New Orleans, and bringing property back into commerce.

## Target Market/Population Served

The Gulf Coast region is still experiencing a disproportionate level of building in response to 2005 Hurricanes Katrina and Rita. Nationally, the USGBC estimated the value of green building at $12 Billion in 2008, and projected the industry to grow to $60B in 2010, driven largely by increased customer demand and an unprecedented level of government initiatives supporting these industries. Our tenants are businesses and organizations that are riding this growth wave and will benefit from greater visibility and adjacency to other industry operators. Our tenants' customers are both building professionals and end-use consumers in the Greater New Orleans and Gulf Coast region.

## Competition and Competitive Advantage

Our competitors are big-box DIY stores, in that they offer a variety of products, some of which are green. However there is no one-stop shopping in this market for the scope of services and products that will be found at The Building Block:

- Professional service providers including designers, architects, consultants, and builders
- Building professionals specializing in alternative energy systems, ductwork, insulation, water management and energy efficient building materials
- Retailers of household furnishings, materials, and appliances

- Environmentally responsible lifestyle services
- Green job training, business incubation, and resource center programming

In several other markets around the country variations on this model exist and are successful: The Green Exchange in Chicago, Green Depot in the northeast, The EcoTrust Building in Portland Oregon, Abercorn Common in Savannah, to name a few.

### Business Model and Financial Projections

The Building Block will make money by leasing approximately 120,000 square feet of office, retail, warehouse and industrial space, and subleasing it to businesses and organizations dealing in sustainable, energy-efficient approaches to building and lifestyle. Together with our real-estate partner Green Coast Enterprises, we have developed a financial model that leverages tax-credit equity and public funds to give The Building Block below-market lease terms. We can fund operations out of the difference between the market-rate rents we charge and our rental payments.

Table 1. Financial Projections (2010-15)

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| Rents, net of vacancy | $81,275 | $240,585 | $1,180,279 | $1,409,147 | $1,626,535 | $1,642,801 |
| Master lease payment | $38,700 | $286,417 | $960,331 | $960,331 | $960,331 | $960,331 |
| Operating expenses | $131,903 | $278,060 | $387,564 | $339,352 | $350,078 | $355,329 |
| Guarantee fee | | $6,402 | $19,207 | $19,207 | $19,207 | $20,217 |
| Real-estate taxes | | $7,770 | $23,310 | $11,205 | $7,107 | $7,107 |
| Net income before income taxes | ($89,328) | ($338,064) | ($210,133) | $79,053 | $289,813 | $299,817 |

As the projections show, we expect about $650,000 of losses during the development and lease-up stages. We plan to spend almost all of this on marketing and tenant acquisition. At stabilization, The Building Block will earn about $300,000 per year from space-leasing activities. We expect to franchise our model or expand into new geographies as the value of The Building Block to the building and construction industries becomes evident.

### Management Team

Mary-jo Webster is the Managing Director of The Building Block. She has 25 years of leadership experience in the retail and food sectors. She spent 12 years in operations and marketing with the New Orleans based, market dominant convenience store chain Time Saver Stores, where she advanced from single unit manager to Director of Marketing. Mary-jo then went into the restaurant business, building and executing the business plan for an upscale café in the New Orleans Warehouse district; The Red Bike Cafe hit profitability in one year and Mary-jo sold her interest after the second year, doubling her initial investment. In 1998 Mary-jo joined Starbucks Coffee where she spent the next 11 years in various capacities including as regional field implementation manager and regional director of operations. She is an energetic business leader who excels at creative problem solving and process improvement, cross-functional project management, and business unit optimization.

Prisca Weems is a co-founder of EcoPark and is principal of the internationally recognized design consultancy firm FutureProof; she also founded a green architecture firm called EcoTecture, which specializes in green affordable housing, and she previously owned a firm in London that specialized in mixed-use development. Prisca is widely regarded as a pre-eminent authority on LEED green building certification and she has an extensive national and international professional network.

Forest Bradley-Wright is a co-founder of EcoPark and the Sustainable Rebuild Director for the New Orleans-based Alliance for Affordable Energy. He launched the La. Green Corp energy efficiency workforce-training program and a major green building expo that now operates year round as the BuildSmart Learning Center. Forest brings a strong understanding of energy policy, workforce development, and non-profit operations.

Industry expertise comes from Prisca and Forest, business acumen and operational experience come from Mary-jo. Our partnership with Green Coast Enterprises has been pivotal for our project's progress, as they bring solid real-estate development experience and an innovative financial model. We have a gap in property and tenant management, that we will fill by engaging an established property management team as the facility comes on line.

### Milestones/ Accomplishments

EcoPark LLC was incubated by The Idea Village and secured funding from the Louisiana Disaster Recovery Foundation ($50,000) and The Blue Moon Fund ($178,200). In January 2010 we opened a proof of concept - The Building Block at the Icehouse - creating a small revenue stream (currently $1,300 monthly), and validating the concept of a value-adding landlord of green businesses. Other key milestones: development of our brand identity; launch of our website; strategic partnership with Green Coast Enterprises; gaining control of our preferred location for flagship development. We are currently in the process of obtaining firm commitments from several established, credit-worthy businesses, including the Make–It-Right Foundation, South Coast Solar, Global Green, and the Tulane University City Center. We are at an earlier stage of negotiations with Neill Corporation, Green Depot, and numerous locally based green sector businesses.

### Use of Funds and Exit Strategy

Funding to-date has been $233,000 from grants. We have opened our temporary location, The Building Block at the Icehouse, to serve tenants with immediate needs. This provides a small revenue stream.

We are seeking $650,000 to cover the next two years of predevelopment and the first two years of building operations. The instrument will be preferred stock or convertible debt that will earn interest and have the right to be bought out or convert to equity in five to seven years.

### Appendix

Integral to the financial viability of The Building Block is the development model that our partner Green Coast Enterprises is using, which they have submitted to Investor Idol as the appendix to their submission. In that model, The Building Block is able to secure a master lease with GCE at approximately 65% of the prevailing market rates. As the master tenant, The Building Block is then able to charge market rates to our subtenants, and utilize the spread as operating funds.

This chart presents the prevailing rent rates as we understand the current market supports, and the corresponding rates which will be applied in our master lease. This illustrates the potential for viability and its direct correlation to leasing up to full occupancy.

Table 2. Current Market Rents

| | | | | **Income to The Building Block** | | | **Expense to The Building Block** |
|---|---|---|---|---|---|---|---|
| | square footage at The Building Block | | Prevailing Market Rent Rate | Rental Income (full capacity) from Subtenants | | Below Market Master Lease Rate | Master Lease paid by TBB to GCE |
| Office | 23,000 | | $15.25 | $350,750 | | $10.00 | $230,000 |
| Retail | 45,000 | | $18.50 | $832,500 | | $12.00 | $540,000 |
| Warehouse | 33,000 | | $4.50 | $148,500 | | $3.00 | $99,000 |
| Industrial | 19,000 | | $6.50 | $123,500 | | $4.00 | $76,000 |
| | | | | | | | |
| avg rent psf | | | **$12.13** | | | **$7.88** | |
| | | | | | | | |
| total | 120,000 | | | $1,455,250 | | | $945,000 |

# Appendix A:
## Executive Summary

# Opportunity Finance Network

## CDFI Market Conditions Report
## Fourth Quarter 2009

Published March 2010

Opportunity Finance Network
Public Ledger Building, Suite 572
620 Chestnut Street
Philadelphia, PA 19106-3413
www.opportunityfinance.net
P 215.923.4754
F 215.923.4755

Full report is available online at:
http://www.opportunityfinance.net/store/downloads/cdfi%20market%20conditions%20report%204thq09.pdf

The Opportunity Finance Network CDFI Market Conditions Report is a quarterly publication based on quarterly surveys of community development financial institutions (CDFIs). Opportunity Finance Network began conducting these surveys in October 2008 to better understand the impacts of tight credit markets and the economic downturn on the opportunity finance industry. Each report provides a near-real-time view of market conditions and CDFI responses, analysis of regional and financing sector differences, and analysis of important trends. This CDFI Market Conditions Report is possible thanks to the generous support of the Ford Foundation.

# CDFI Market Conditions Report
## Fourth Quarter 2009
## Published March 2010

The Opportunity Finance Network CDFI Market Conditions Report is a quarterly publication based on quarterly surveys of community development financial institutions (CDFIs). Opportunity Finance Network began conducting these surveys in October 2008 to better understand the impacts of tight credit markets and the economic downturn on the opportunity finance industry. Each report provides a near-real-time view of market conditions and CDFI responses, analysis of regional and financing sector differences as well as by asset size, and analysis of important trends. These data can assist CDFIs and investors alike to plan for the future.

This report presents the results of the sixth consecutive quarterly CDFI Market Conditions Survey conducted in January and early February 2010 and covering the fourth quarter (October - December) of 2009. One hundred twenty CDFIs responded to the survey.

### Executive Summary

In the fourth quarter of 2009, gross domestic product grew by an estimated 5.7% following 2.2% growth in the third quarter.[1] While the economy grew, the unemployment rate continued to rise, reaching 10% in the fourth quarter.[2] The percentage of FDIC-insured institutions' loans and leases 31 days or more past due increased from 6.86% in the third quarter to 7.30% in the fourth quarter,[3] with the non-current rate rising to 5.37%, once again to the highest it has been in the 26 years these data have been tracked. Mortgages in foreclosure ticked up 11 basis points to 4.58%. For the first time since we began conducting the Market Conditions Survey in the third quarter of 2008, the delinquency rate for loans on one-to-four-unit mortgages fell: the fourth quarter seasonally adjusted rate of 9.47% is 17 basis points lower than the third quarter 2009 and 159 basis points higher than the third quarter 2008. In spite of this overall drop, the percentages of loans 90 days or more past due was the highest ever recorded.[4]

### Key Survey Findings: Fourth Quarter and Trend Analysis

The findings presented below are for the 120 survey respondents and for the trend sample of 42 CDFIs. Results reflect year-end and seasonal factors, with demand and loan originations down or steady for most CDFIs, and portfolio at risk down due primarily to year-end charge-offs. Findings for specific subgroups (asset sizes, primary financing sectors, and regions) are presented in the body of the report. Substantial differences occur among these breakout groups.

Demand continues to increase but for fewer CDFIs: The percentage of respondents reporting an increase in the number of financing applications received over the previous quarter dropped from consistently high levels of 55% or more down to 39%. The percentage reporting an increase in applications over the previous year is 56%. While there is no clear trend in the percentage of CDFIs experiencing increases in applications, there is a four-quarter upward trend in the percentage of CDFIs reporting decreases in applications.

Originations did not keep pace with demand: While 39% of respondents reported an increase in originations over the third quarter -- equal to the percentage of CDFIs that experienced an increase in financing applications -- more than half (53%) of respondents reported that originations did not keep pace with demand. In order of priority, the reasons are capital constraints (43%), tighter lending criteria (35%), weak application quality (32%), and more intensive due diligence (32%).

1 Bureau of Economic Analysis, US Department of Commerce.

2 US Department of Labor, Bureau of Labor Statistics.

3 1.93% of loans and leases were 30 – 89 days past due and 5.37% were noncurrent, defined as 90 or more days past due or in nonaccrual. Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile.

4 Mortgage Bankers Association's (MBA) National Delinquency Survey.

Annual net charge-offs are lower than FDIC-insured institutions: 2009 net charge-offs increased from .93%[5] in 2008 to 1.78% in 2009. Both years compare favorably to all FDIC-insured institutions which had 1.28% net charge-offs in 2008 and 2.49% in 2009.[6]

Portfolio at risk increased at a substantially slower pace than FDIC-insured institutions: Loans more than 30 days past due increased from 11.1% in 2008 to 12.7% in 2009, a 15% increase; FDIC-insured institutions' rate rose steeply by 47%, from 4.9% to 7.3%.[7]

The volumes of workouts and term extensions are up: After a dip in the third quarter, the percentage of respondents reporting increases in the numbers of loans in workout and the number ofloans given term extensions have returned to pre-third quarter levels. Half of respondents reported increases in workouts, higher than any quarter since the fourth quarter 2008. 42% reported increases in terms extensions.

Liquidity constraints persist and in some cases are worsening: Consistent with the previous quarter, half of respondents reported that they were capital-constrained. There is an upward trend in capital constraints.

The average cost of borrowed capital is steady for most respondents, but a growing number experienced decreases: The average cost of borrowed capital did not change for 69% of respondents. At the same time, 19% reported that their average cost fell. With the exception of a third quarter dip, the trend in the number of CDFIs experiencing a decrease in average cost is flat.

Operating challenges have led to personnel actions: Since the start of the economic downturn, 20% of respondents have instituted a hiring freeze, 22% have laid-off staff, and 40% have frozen salaries.

Adaptation and Innovation: More than one-third (35%) of respondents reported developing new products to meet changing market demands. Products include lines of credit, bridge loans to non-profits affected by state budget constraints, debt consolidation loans, and Neighborhood Stabilization Program-related products.

### Key Survey Findings: Outlook

The outlook on portfolio quality trended downward in the fourth quarter, while demand is expected to remain high. Given the year end, many CDFIs reported personnel-related cuts to deal with their operating challenges.

Portfolio Quality: One-third (33%) of respondents expect portfolio quality to improve in the next quarter and 45% expect no change. There is an upward trend in the number of CDFIs expecting deterioration in their portfolios.

Demand: 68% of respondents expect demand for financing to increase in the next quarter. The trend in outlook on demand is declining slightly, with 64% of respondents expecting demand to increase, down from 71% two quarter ago. For both the quarter and the trend analysis, the vast majority of the remainder expect no change in demand, with a minimal number of CDFIs expecting a decrease in demand (7% versus 2%, respectively).

Liquidity and Operating Challenges: Two-thirds (67%) of CDFIs expect to experience new capital liquidity and/or operating difficulties in the next quarter. They are primarily concerned about having insufficient capital to meet growing demand and insufficient operating grants. Twenty-five percent expect to have a decline in unrestricted net assets (an unrestricted loss) in their current fiscal year.

5 OFN 2008 Annual Member Survey.

6 Federal Deposit Insurance Corporation, Quarterly Banking Profile.

7 Ibid.

# Appendix B: Speaker Biographies

Frank Altman is President and CEO of Community Reinvestment Fund, USA (CRF). He pioneered the development of a secondary market for community and economic development loans when he cofounded the organization in 1988. Under Mr. Altman's leadership, CRF has grown from a small Minneapolis firm to a national organization serving community-based lenders across the country. CRF has provided more than $1 billion to more than 750 communities through 154 lending partners across the country. In addition, Mr. Altman is a member of the Executive Committee of the New Markets Tax Credit Coalition. He was a founding member and first president of the organization established to initiate the creation of a federal tax credit to encourage private investment in low-income communities. He is also on the boards of directors of the CDFI Coalition, RAIN Source Capital, The Social Investment Forum and Franklin Bank. In 2008, Mr. Altman and CRF received the Social Capitalist Award ("45 Social Entrepreneurs Who are Changing the World") from FastCompany magazine and Monitor Group. Mr. Altman was named an Aspen Institute Fellow at the 2008 Aspen Ideas Festival. Inc. magazine recognized Frank Altman in its 2004 Entrepreneur of the Year issue as one of the nation's leading social entrepreneurs. He received a BA degree from Brown University and his MA degree from the University of Minnesota's Hubert H. Humphrey Institute of Public Affairs.

John Berdes is President and CEO of ShoreBank Enterprise Cascadia. Prior to joining the ShoreBank Enterprise Cascadia team in 1995, Mr. Berdes held two different positions with the Local Initiatives Support Corporation (LISC), first as Program Director for Puget Sound operations, and subsequently as Senior Program Director for Field Strategies. Before that time, Mr. Berdes was founding Executive Director of Capitol Hill Housing, a community development corporation serving a central city neighborhood of Seattle, WA. Mr. Berdes is a graduate of Oberlin College and resides in Astoria, OR. ShoreBank Enterprise Cascadia (SBEC) is a certified nonprofit Community Development Financial Institution serving urban and rural communities of Oregon and Washington. SBEC strengthens family, ecological and economic resilience through consulting, financial and business assistance. ShoreBank works with entrepreneurs, non-profits and others that deliver economic, social and/or environmental benefits to local communities and the larger region. SBEC is an affiliate of Chicago-based ShoreBank Corporation, the nation's first and leading community development financial institution, and Ilwaco-based ShoreBank Pacific.

William J. (Bill) Bynum is CEO of ECD/HOPE (Enterprise Corporation of the Delta/Hope Community Credit Union), a community development financial institution, intermediary and policy center that addresses development needs confronting low-wealth people and communities in Arkansas, Louisiana, Mississippi and Tennessee. Since 1994 ECD/HOPE has generated over $1 billion in financing and related assistance for entrepreneurs, homebuyers and community development projects in the Delta, areas affected by Hurricane Katrina and other distressed Mid South communities, benefiting more than 70,000 individuals. Bynum is a Henry Crown Fellow of the Aspen Institute and is recipient of the University of North Carolina Distinguished Alumnus Award, Ernst & Young/ Kauffman Foundation National Entrepreneur of the Year Award, National Rural Assembly Rural Hero Award, and National Federation of Community Development Credit Unions Annie Vamper Award. His board/trustee service includes Millsaps College, Jackson State University Development Foundation, Winthrop Rockefeller Foundation, Foundation for the Mid South, Mississippi Children's Museum, Regions Bank Community Development Corporation, and the William Winter Institute for Racial Reconciliation. He also serves as chairman of U.S. Treasury Department's Community Development Advisory Board. Prior to joining ECD/HOPE, Bill helped establish Self-Help, a pioneer in the development banking industry, and directed financing and community development programs at the North Carolina Rural Economic Development Center.

Prabal Chakrabarti is Assistant Vice President and director of Community Affairs at the Federal Reserve Bank of Boston. He has researched, written and presented on a range of topics, including foreclosures, venture capital in smaller cities, the future of the Community Reinvestment Act, and inner city businesses. Previously, at the Initiative for a Competitive Inner City, he managed a project to assess the competitive drivers of inner city economies, directed by Professor Michael Porter. Prabal also served in Economic Policy at the U.S. Treasury and was a delegate to the UN Convention on Climate Change.

He was a manager at Ernst & Young and also consulted to UNDP for its report "Unleashing Entrepreneurship: Making Business Work for the Poor" and on economic development in Armenia and Trinidad. Prabal holds graduate degrees from MIT and Oxford University, where he was a Marshall Scholar, and a BS from the University of Illinois, where he was a Truman Scholar. He serves on the Marshall Selection Committee, on the Board of the Asian Community Development Corporation, and is a member of the Inner City Economic Forum.

David J. Erickson is director of the Center for Community Development Investments at the Federal Reserve Bank of San Francisco and edits the Federal Reserve journal Community Development Investment Review. His research areas in the Community Development Department of the Federal Reserve include community development finance, affordable housing, economic development, and institutional changes that benefit low-income communities. David's book on the history of community development, The Housing Policy Revolution: Networks and Neighborhoods, was recently published by the Urban Institute Press. He has five years of experience in the affordable housing industry working for government, nonprofit, and private sector employers. He has a PhD in history from the University of California, Berkeley, with a focus on economic history and public policy. He also holds a master's degree in public policy from the Goldman School of Public Policy at Berkeley and a BA from Dartmouth College.

Thomas FitzGibbon, Jr. is the former Executive Vice President of the $13 billion Chicago-based MB Financial Bank from 1995-2010. He served as the Chief Retail Banking Officer from 1999-2006. This responsibility included oversight of branches and all other retail delivery platforms including residential mortgage, consumer and small business lending programs. He served as a member of the bank's board of directors. He served as the President of MB Financial Community Development Corporation (MBCDC), the subsidiary of the bank he started in 1995, and President of the MB Financial Bank Charitable Foundation. In community activities he is the former President of Neighborhood Housing Services of Chicago (2004-2008) and has served as a board member since 1996. He is also President of The Rogers Park Business Alliance 1992-present, and Director of the Woodstock Institute since 2002. He served as the Chairman of ACCION-Chicago from 2003 to 2006 and currently serves on the board of directors. He also serves as a board member of ACCION-USA. He served a three-year term on the Federal Reserve Board's Consumer Advisory Council and as a board member of the Illinois Mortgage Bankers Association. In the Chicago region he is the co-chairman of the Regional Home Ownership Preservation Initiative sponsored by the Federal Reserve Bank of Chicago, The Chicago Community Trust and NeighborWorks NHS of Chicago. He is adjunct Professor of Real Estate Finance at the Kellstadt Graduate School of Business at DePaul University since 1995 and chairman of the Advisory Board for the Business School of Kendall College in Chicago.

Ian Galloway is an investment associate at the Federal Reserve Bank of San Francisco. Before joining the bank, Ian worked for O-H Community Partners, a nonprofit management consulting firm in Chicago, and the Chicago Community Loan Fund, a CDFI that serves low-income Chicago neighborhoods. Previously, Ian developed a dog daycare center in Portland, OR that provides homeless youth on-the-job vocational training. The self-sufficient daycare ("Virginia Woof") has since expanded to become the largest in the Portland metropolitan area while graduating dozens of homeless youth to full-time employment and higher education. It was recognized as a "Best Practices" program by the U.S. Department of Labor in 2006. Ian has a BA in political science and philosophy from Colgate University and a master's degree in public policy (MPP) from the University of Chicago. He was recently named a "future industry leader" in community development by the Opportunity Finance Network.

Mike Griffin is a Senior Vice President in the KeyBank Community Development Banking group, with responsibility for Corporate CRA Compliance and Community Development Asset Management. Mike joined Key in April 1998 as Asset Manager for the bank's portfolio of community development investments. The portfolio is currently $1.3 billion of investments targeted to Key's fourteen footprint states. In addition to Asset Management responsibilities he was appointed National CRA Compliance Manager in 2003. Mike has managed Key's two CRA Exams, the most recent resulting in the bank's 7th consecutive Outstanding rating. From 2006-2008 he was responsible for KeyBank Plus, Key's program to reach the unbanked, including the bank's innovative check cashing program. In connection with this program Mike has been featured in the Wall Street Journal, on National Public Radio's Market Place program, and in various trade publications. Prior to coming to KeyBank, Mike was the Asset Manager for Cleveland Housing Network. Mike is a graduate of Cleveland State University with dual degrees in Business Administration and Spanish. He serves on many Cleveland nonprofit boards focused providing affordable housing. In 2010 he was appointed to a three year term on the Federal Reserve Board's Consumer Advisory Council. He sits on the Consumer Bankers Associations Community Reinvestment committee and in 2005 he was named to Crain's Cleveland Business Journal's "40 under 40."

James Gutierrez is the CEO of Progreso Financiero and a leading social entrepreneur and innovator in financial services serving unbanked and lower-income people. In 2005, James co-founded Progreso Financiero to bring micro-lending to the U.S. Hispanic community and help millions of underbanked families build credit, move up the financial ladder, and achieve their lifelong aspirations. Since 2006, Progreso has made over 35,000 loans, grown to over 120 employees and 25 locations in California and Texas, been certified by the U.S. Treasury as a Community Development Financial Institution, and secured over $40 million in venture capital funding. In 2009, James was a featured speaker at the Clinton Global Initiative, Microfinance USA, SOCAP, and the FDIC's Advisory Board Meeting. He has also pioneered new policies on banking reform, helped co-found the Coalition of New Credit Models, and serves on the Pew Trust/New America Foundation's Working Group on Small Dollar Lending. James also serves on the boards of organizations dedicated to strengthening the American middle class from the bottom up, including the Latino Community Foundation, PERC, and Core Innovation Capital. In 2009, James was invited to the White House as a leading young entrepreneur and received the Entrepreneur of the Year Award by Hispanic-Net. James received his MBA from Stanford and a BA in Economics from Yale University.

Robin Hacke is Director of Capital Formation at Living Cities, a pioneering partnership among 22 major foundations and financial institutions that invests in revitalizing America's cities. Members of Living Cities include leading foundations such as Ford, Gates, MacArthur and Rockefeller, as well as banks and insurance companies such as JP Morgan Chase, Bank of America, Prudential, and MetLife. At Living Cities, Ms. Hacke is responsible for developing initiatives to aggregate and deploy investment capital in low-income and underserved urban communities. She manages the Living Cities Catalyst Fund and, together with Green For All, is developing a new energy efficiency opportunity fund. In her previous role as a venture capitalist and entrepreneur, Ms. Hacke raised over $72 million from institutional, corporate and individual investors in two funds and built a portfolio of investments in 20 start-up companies. She founded and ran a strategy consulting firm that worked with 110 clients, and she currently serves as a director and Audit Committee Chair of Alvarion, a wireless communications company traded on Nasdaq. Before entering the tech sector, Robin was a banker in the Public Finance Department at Shearson Lehman Brothers. She earned an MBA from Harvard Business School and a BA magna cum laude in Government from Harvard-Radcliffe College.

Lisa Green Hall is currently the Executive Vice President and Chief Lending Officer at the Calvert Foundation, a private non-profit organization with assets under management of $300 million, whose mission is to maximize the flow of capital to communities in need, in order to foster a more equitable and sustainable society. In this role, Lisa manages a team of 12 investment professionals and a $168 million portfolio of loans and investments with more than 150 organizations including domestic community loan funds, social enterprises and international micro-finance institutions. Lisa previously served as Chief Credit Officer for the American Communities Fund in the Housing and Community Development Division of Fannie Mae Corporation, where she held numerous positions over a 7 year period. Lisa also worked in the Clinton Administration at the National Economic Council as a Senior Policy Advisor covering community development issues. Lisa has also held positions in real estate and community development finance with the Enterprise Foundation, JP Morgan Chase (previously Chemical Bank) and Travelers Insurance. She holds a Bachelor of Science in Economics from the University of Pennsylvania and an MBA from Harvard University. In 2003, Lisa was awarded an American Marshall Memorial Fellowship, a travel study fellowship for emerging leaders from the United States and Europe. She is a 2008 graduate of Leadership Greater Washington. Lisa is a member of the CARS (CDFI Assessment and Rating Systems) Advisory Council and is a non-board member of the Policy and Communications Committee of the Corporation for Enterprise Development. She also serves on the board of Open Door Housing Fund, a CDFI based in Silver Spring, MD and the Fair Mortgage Collaborative, a national initiative to help consumers obtain safe and fairly priced mortgage loans.

Calvin Holmes has served as Chicago Community Loan Fund's Executive Director since 1998. Under his leadership, CCLF's lending has helped attract nearly $1 billion in additional public and private capital into Chicagoland communities and CCLF's capitalization has more than sextupled—from $3.7 million to over $25 million. CCLF has also solidified its position as a leading, early-stage lender for community developers; a primary lender for affordable housing cooperatives; and a forefront promoter of sustainable development in metro Chicago. CCLF is now one of the 10 largest nonprofit CDFIs in Illinois and received the MacArthur Foundation Award for Effective and Creative Institutions in 2009. In 2007, Holmes was honored with community leader awards from the Chicago CRA Coalition and Bank of America. In 2001, Holmes was honored as one of Crain's Chicago Business journal's "40 Under 40" young leaders and was a 2002-2003 Leadership Greater Chicago fellow. He holds a master's degree in urban and regional planning, with a concentration in real estate development, from Cornell University.

Kirk Inglis is the Chief Operating Officer and Chief Financial Officer at Prosper Marketplace. Mr. Inglis brings over 15 years of experience in the financial services industry to Prosper Marketplace. Throughout his career, he has been successful at improving the operating performance of businesses by creating a focus on core variables and improving the productivity of resources. Most recently he consulted Wells Fargo Bank on the effectiveness of their online marketing programs. Prior to that, Mr. Inglis spent nine years with Providian Financial Corporation. While at Providian, he was President of First Select Corporation, the largest purchaser of charged-off credit card debt in the United States. In addition, he served as Chief Financial Officer of GetSmart.com following its acquisition by Providian. Mr. Inglis also developed the financial planning and control infrastructure for Providian Financial Corporation following the spin-off from its parent in 1996. Mr. Inglis earned a MBA in Finance from Memphis State University and a BA in Economics from the University of Texas at Austin. He is a Chartered Financial Analyst (CFA) and a member of the CFA Society of San Francisco.

Mike Italiano is an environmental attorney and scientist and President & Chief Executive Officer for Market Transformation to Sustainability (MTS) and Capital Markets Partnership. He founded the Capital Markets Partnership, MTS, U.S. Green Building Council (USGBC), and American Society of Testing & Materials (ASTM) Committee E50 on Environmental Assessment. Mike has been responsible at over 200 waste sites for expert testimony, litigation, cleanup, settlement, and scientific and technical analysis. He published over 60 articles in the environmental field and authored five environmental books and has over 35 years of environmental experience including as Senior Analyst in the White House Science Office and Assistant to the Director, National Commission on Water Quality where he helped write the Congressional Report on the Clean Water Act.

Jackie Khor is Managing Director of Imprint Capital Advisors. Ms. Khor joined Imprint Capital Advisors in June 2008. Previously, Ms. Khor was an Associate Director at the Rockefeller Foundation, where she co-led the Impact Investing program, a Foundation effort to extend loan guarantees and make program-related and private equity investments to attract private sector capital into underserved sectors and geographies. Prior to joining the Rockefeller Foundation, Ms. Khor was Director of the New York City Partnership's Employment Program. Earlier in her career, she was a Vice President in Lehman Brothers' public finance unit, where she helped structure and complete over $2 billion in tax-exempt bond financings for several state, municipal, and infrastructure projects. Ms. Khor chaired the New York City Acquisition Fund, a fund composed of $40 million in investments from New York City and five foundations (Rockefeller, Ford, MacArthur, F.B. Heron, Starr and Robin Hood) that leverages almost $200 million in bank financing to accelerate affordable housing development. She also serves on the Skoll Foundation's Investment Committee and has served on the Advisory Committee for Pacific Community Ventures I and III. Ms. Khor has a BS in Business Administration from the University of California, Berkeley and a master's degree in Public and Private Management from the Yale School of Management.

Gloria Lee is a Partner at Next Street and head of Next Street Capital. Her primary focus is on managing Next Street's financing and capital formation activities, particularly with a focus on bringing customized capital solutions to growing inner city small businesses. Gloria has been involved in community development and finance for the past 13 years and before joining Next Street was head of Pembrook Community Capital. At Pembrook, she focused on providing debt and equity to projects located in economically distressed areas, typically utilizing a combination of private capital and tax oriented incentives such as New Markets Tax Credits (NMTC). Before joining Pembrook Gloria served as a Director of Citi Community Capital (the community development finance arm of Citigroup) where she led a team dedicated to making debt and equity financings for community development projects throughout the U.S., with a focus on private equity, NMTC and renewable energy investments. She had management responsibilities for a portfolio in excess of $600 million. Prior to joining Citi, Gloria was a Vice President at JPMorgan Chase, specializing in community development private investments. She received a BA with honors from the University of Chicago, and a Masters in Public Administration from Columbia University.

Courtney Anderson Mailey is a Regional Community Development Manager in the Federal Reserve Bank of Richmond's Office of Community Affairs. As part of the outreach team, Courtney conducts fieldwork, outreach and programming for both the community development industry and the financial services industry in Virginia and West Virginia. Her work in the field helps support a number of key Community Affairs Department initiatives by bringing greater awareness about community development investment opportunities, fostering regional and organizational partnerships and encouraging sustainability in the community development industry. Prior to joining the Federal Reserve Bank of Richmond, Courtney worked at the Department of Housing and Community Development as part of the Virginia Main Street program. She came to Virginia Main Street from the International Economic Development Council by way of the Flax Trust in Belfast, Northern Ireland. She received a B.A. in Historic Preservation and in Classical Civilization from Mary Washington College and a Master of Urban and Regional Planning from Virginia Commonwealth University.

Rosa Martinez is an Associate Program Manager for the New Markets Tax Credit (NMTC) Program at the U.S. Department of the Treasury Community Development Financial Institutions Fund. She is responsible for leading the development of NMTC application materials and making award allocations. Ms. Martinez has been with the CDFI Fund since 1998. Prior to accepting her current role, she served as a Program Advisor for the CDFI Financial and Technical Assistance Program. She received a Master of Public Policy degree from the Gerald R. Ford School of Public Policy at the University of Michigan and a Bachelor of Science in Economics from Hunter College of the City University of New York. Ms. Martinez is also a recipient of the Woodrow Wilson Fellowship for Minorities in Public Policy.

Giovanna Masci is Regional Director for the Americas at Kiva. In this capacity, Giovanna is responsible for growing and managing Kiva's portfolio in the region. In particular, Giovanna was responsible for driving Kiva's entry into the U.S. microfinance market in 2009. Prior to Kiva, Giovanna worked as a consultant in the technical assistance department at ACCION New York. In that role she was responsible for growing the department while providing one-on-one technical assistance services to entrepreneurs. Giovanna has been passionate about economic development, microfinance, and Latin America for many years. She has worked on community development projects in Mexico and Paraguay, and has done research on the interplay between eco-tourism and economic development in Costa Rica. Giovanna holds a BA in economics from Yale University and an MBA from the Yale School of Management.

John Moon is a Senior Community Affairs Analyst at the Board of Governors of the Federal Reserve System where he develops programs and policies affecting low-income communities. He also serves on the Advisory Committee of the San Francisco Federal Reserve Bank's Center for Community Development Investments. Prior to joining the Federal Reserve, he worked at the CDFI Fund on the New Markets Tax Credit Program and has advised several successful allocation applications. He has also worked in many other areas within the community/economic development field. These experiences include the District of Columbia's Mayor's Office where he was responsible for many large-scale real estate development projects; the Federal Home Loan Bank of Seattle as a Public Interest Investment Banker; the City of Seattle where he managed its development finance programs; FleetBoston where he was a commercial loan officer; and the Initiative for a Competitive Inner City where he conducted one of its first research case studies. John earned his BA from UCLA Phi Beta Kappa and master's degree in Public Policy from the Kennedy School of Government at Harvard University. He was also a Public Affairs Fellow through the Coro Foundation.

Andrew J. Mooney is the Executive Director of the Chicago office of the Local Initiatives Support Corporation (LISC). Under Mr. Mooney's leadership, LISC/Chicago has become one of the nation's leading community development agencies. He has raised approximately $120 million in grants and loans to invest in the city's neighborhoods, leading in turn to the development of approximately 23,000 units of housing, 2.5 million square feet of commercial space, and numerous community facilities that include health and day care centers, parks and recreational facilities – leveraging over $2.5 billion in total investment. Mr. Mooney and his colleagues are best known, however, for cutting-edge community development strategies that have become national models, including the New Communities Program (NCP), a comprehensive effort at neighborhood development supported by the John D. and Catherine T. MacArthur Foundation, and the Centers for Working Families that provide employment, financial and benefits counseling in 14 neighborhoods. Another initiative, Elev8, is developing a sophisticated model for community schools in several neighborhoods. Mr. Mooney also conceived a community-based, professionally-operated news and communications program, called the Chicago Neighborhood News Bureau. Early in his career, Mr. Mooney was Executive Director and Chairman of the Chicago Housing Authority. He is currently a member of the Knight Foundation's Commission on the Information Needs of Communities in a Democracy and is a member of the Economic Club of Chicago and the Lambda Alpha honor society. Mr. Mooney is a graduate of the University of Notre Dame and the University of Chicago, where he was a Danforth Fellow.

Daniel Nissenbaum is the Chief Operating Officer of the Urban Investment Group, a division of Goldman Sachs Bank USA, which provides community development financing and manages the Bank's Community Reinvestment Act program. Mr. Nissenbaum oversees production, portfolio management, regulatory compliance and operations/finance. He joined the firm in March of 2009. Mr. Nissenbaum has worked in the field of real estate and community development finance for 21 years, with positions at Chemical Bank, Chase Manhattan Bank CDC, JPMorgan CDC, Merrill Lynch CDC and HSBC Bank. In addition to leading transactional teams in those roles, Mr. Nissenbaum also crafted and directed CRA regulatory compliance, philanthropy and community outreach programs. Mr. Nissenbaum leads two national organizations as Board Chair, the National Housing Conference, a national advocacy and policy proponent for affordable housing, and the Low Income Investment Fund, one of the nation's leading CDFI's. In addition, he serves on the board of the Center for Housing Policy and the Center for NYC Neighborhoods. Mr. Nissenbaum earned a BA from Grinnell College, and a Masters of

Business Administration from Columbia Business School. He and his wife Penelope have two daughters and live in New York City.

Mark Pinsky is President and Chief Executive Officer of Opportunity Finance Network, the national network of high-performing community development finance institutions and other opportunity finance institutions. Opportunity Finance Network is leading the industry toward its goal of creating a high-impact, high-volume financing system providing tens of billions of dollars annually benefiting millions of low-income and low-wealth people. Mark joined Opportunity Finance Network in February 1995. During his tenure, the CDFI industry has grown more than ten-fold while Opportunity Finance Network has expanded membership more than 400% and assets more than 1500%. Under his leadership, the organization has introduced several innovative products including the Equity Equivalent investment (EQ2), the CDFI Assessment and Ratings System (CARS), performance-based financing, and the Wachovia NEXT Awards for Opportunity Finance. OFN is leading the industry's on policy, as well. Mark also serves on the Boards of Net Impact, the CDFI Coalition, and New Mexico Community Capital as well as on advisory boards to the Center for Community Development Investments at the Federal Reserve Bank of San Francisco, Bank of America's National Consumer Advisory Council, and several New Market Tax Credit community development entities. He served on the Federal Reserve Board's Consumer Advisory Council from 2003 through 2005, including service as Chair of the Council in 2005. In 2002, President George W. Bush appointed Mark to the CDFI Fund Advisory Board in the U.S. Department of the Treasury, where he served until 2006. Mark was the founding President of Congregation Tzedek v'Shalom, a Reconstructionist synagogue in Newtown, PA. Mark and his family live in Yardley, Pennsylvania.

Edward Powers is a Managing Director, New York, of Bank of America Merrill Lynch Capital Access Funds. Mr. Powers focuses on portfolio management and investor relations. He joined Bank of America in 1994 in community development banking, where he originated investments in a variety of community development equity products. Along with Sanjiv Shah, he co-founded the team in 1997 and continues to manage it. He is one of the founding members and serves as Chairman of the Board of Governors of the Small Business Investment Alliance, a group of institutions focused on private equity funds targeted toward underserved markets. In 1999, Mr. Powers was named one of Crain's Chicago Business Top 40 Business Leaders under 40. He holds bachelor's degrees in English and Economics from the University of Pennsylvania and an MBA and MA in Public Policy from the University of Chicago.

Lisa Richter is principal and co-founder of GPS Capital Partners, LLC, a consultancy that assists foundations, banks and institutional investors in the design and execution of investment strategy that enhances public good. Her work spans asset classes, return expectations and issue areas, frequently incorporating place-based and sector focus to increase equitable access to opportunities, including sustainable community development, education and health. Lisa co-designed and serves as lead trainer for the PRI Institute sponsored by the PRI Makers Network, co-authored "Equity Advancing Equity" (an analysis of impact investing for community foundations) and is preparing a guide to health-focused impact investing with Grantmakers In Health. She brings over two decades of fund management and development finance experience from the National Community Investment Fund and ShoreBank and has served as advisor to the Bank of America National Community Advisory Council, Wall Street Without Walls, 2009 Clinton Global Initiative, and New Frontiers in Philanthropy (a project of the Center for Civil Society Studies at Johns Hopkins University), vice-chair of the Community Development Financial Institutions Coalition, director of the Social Investment Forum, and steering committee member of the New Markets Tax Credit Coalition. She holds a bachelor's degree and an MBA from the University of Chicago.

Ellen Sahli is the First Deputy Commissioner of the City of Chicago's Department of Community Development. Ms. Sahli directs the City's comprehensive housing objectives summarized in the Mayor's fourth Affordable Housing Five-Year Plan including overseeing more than $500 million in annual housing investment; leading the comprehensive strategy to rehabilitate vacant and foreclosed homes; directing a holistic approach to foreclosure prevention; and managing the department's strategic commitments of local resources and aggressive advocacy for state and federal assistance. Ms. Sahli previously served as the Commissioner of the Department of Housing and also served as the Mayor's Liaison on Homelessness and Supportive Housing. A social worker by profession, Ms. Sahli holds a Master of Social Work from the Jane Addams College of Social Work, University of Illinois - Chicago.

Debra D. Schwartz is Director of Program-related Investments (PRIs) for the John D. and Catherine T. MacArthur Foundation, an international, grantmaking institution headquartered in Chicago. PRIs are below-market loans and investments made for charitable purposes. The Foundation is a longtime leader in this innovative form of philanthropy and has allocated $300 million to a PRI portfolio that primarily supports community development and affordable housing organizations across the United States. Before joining MacArthur in 1995, Schwartz was chief financial officer for a child welfare agency in Chicago and an investment banker at John Nuveen & Co. where she helped originate over $1 billion in tax-exempt bonds for municipalities and nonprofit health care institutions. Schwartz is a past presidential appointee to the U.S.Treasury Department Community Development Advisory Board and a founding member of the PRI Makers Network steering committee. Currently a Social Enterprise Fellow at the Yale School of Management and a Lecturer at the University of Chicago, Schwartz graduated from Yale University summa cum laude and holds a Master's degree from the Kellogg School of Management at Northwestern University.

Ellen Seidman is a Senior Fellow in the Asset Building Program of the New America Foundation, where she works on issues relating to financial services and their impact on consumers and communities. In addition to her work at New America, Ms. Seidman serves as Executive Vice President, National Policy and Partnership Development, at ShoreBank Corporation, the nation's first and leading community development and environmental banking corporation. She also chairs the Board of Directors of the Center for Financial Services Innovation. Before joining ShoreBank, Ms. Seidman served as Senior Counsel to the Democratic staff of the Financial Services Committee of the U.S. House of Representatives. From 1997 to 2001, she was Director of the U.S Treasury Department's Office of Thrift Supervision. She was also a director of the Federal Deposit Insurance Corporation and Chairman of the Board of the Neighborhood Reinvestment Corporation. From 1993 to 1997, Ms. Seidman served as Special Assistant for Economic Policy to President Clinton. She has also held senior positions at Fannie Mae, the U.S. Treasury Department, and the U.S. Department of Transportation. She holds a bachelor's degree from Radcliffe College, a law degree from Georgetown University Law Center, and an MBA in finance and investments from George Washington University. Ms. Seidman serves on the boards of the City First Bank of DC, Coastal Enterprises, Inc. and the Low Income Investment Fund, and on the Board of Overseers of the School of Community Economic Development at Southern New Hampshire University.

Arjan Schütte serves as a Senior Advisor for the Center for Financial Services Innovation (CFSI) after acting as an Associate Director for five years. He is the Managing Partner of Core Innovation Capital, launched by CFSI in 2009. Core Innovation Capital (managed by Core Venture Capital) invests in innovative companies serving underbanked consumers in a growing, inefficient and underserved marketplace. As a recognized industry expert and with a background in private equity-funded technology companies, Arjan sources and structures CFSI's investments and builds syndicates of investors and other strategic relationships. He has been cited in the Wall Street Journal, New York Times, BusinessWeek and the American Banker and is regularly invited to speak at conferences and industry events as well as universities such as at MIT, Johns Hopkins and Yale. Prior to joining CFSI in 2004, he led an array of enterprise technology development projects for clients such as Bank of America, Intel, and Target. In 2000, Arjan founded DoTheGood, Inc., a for-profit philanthropy management company, which innovated online workplace giving for clients including 3M, St. Paul Travelers, Lawson Software and Wells Fargo, creating an outsourced donor-advised fund platform for financial services intermediaries. Arjan has founded three technology companies and served in senior technical roles for numerous others. He currently serves on several advisory boards and the board of directors for Indie Energy. He earned an MS from the Media Laboratory at Massachusetts Institute of Technology and a BA in Philosophy and Communication at Lewis & Clark College.

Georgette F. Wong is the Creator & Curator of Take Action! Impact Investing Summit and the president of Correlation Consulting. A multi-disciplinary innovator, Georgette Wong is the President of Correlation Consulting and Curator & Creator of the Take Action! Impact Investing Summit series. The Take Action! Summit is the premier gathering of impact investors focused on premium returns and interested in candid conversations about the evolution of the marketplace. 2010 will be the third year of the Take Action! Summit and the fourth year of Correlation Consulting's work in impact investing. Impact investments generate financial returns while creating social and environmental impact. Over the last eighteen years, Ms. Wong has: advised families, foundations and Fortune 100 businesses on public and private investments; grown and funded early stage companies; and developed organizations focused on more effective philanthropy and partnerships between the business and social sectors. Before starting her own firm in 2006, she worked as the Director for Client Relationships at Sterling Stamos, a multi-billion dollar fund of funds. Previously, Ms. Wong was also a Financial Advisor at Piper Jaffray and the Development Director for the Asian Law Caucus, the nation's oldest legal and civil rights organization for Asian Pacific Americans. She has served on the Boards of The Full Circle Fund, The Foundation Incubator, and Chinese for Affirmative Action. Ms. Wong earned her MBA from the Anderson School of Management at UCLA. She earned her BA magna cum laude from Amherst College.

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