FEDERAL RESERVE BANK OF ATLANTA

VOLUME 14, NUMBER 2, 2004

partners

in community and economic development

Managing the Negative Impact of Gentrifying Neighborhoods

Making Energy Efficiency Affordable

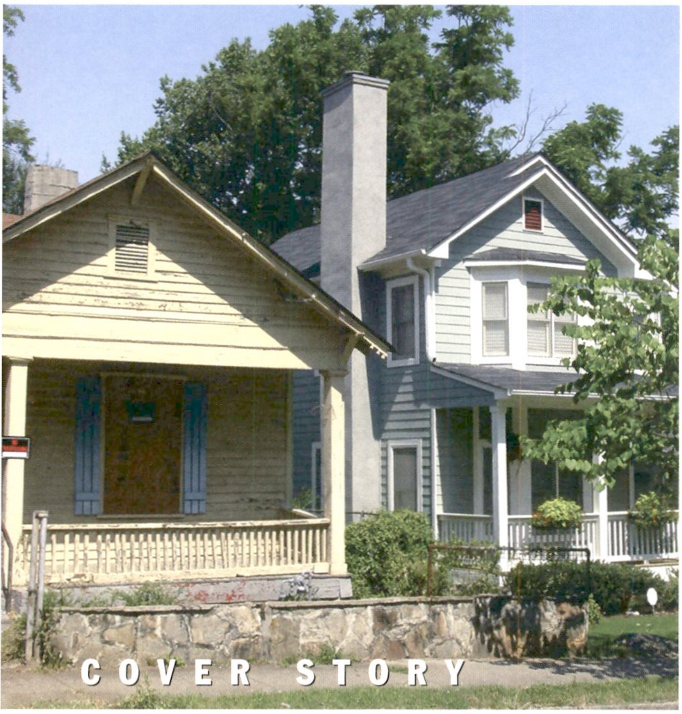
Stemming the Loss of Affordable Housing

Community Development Venture Capital Funds Sow Economic Opportunities

Spotlight on the District—Mississippi and Louisiana

partners

in community and economic development



FEATURES

Partners in Financial Education

Over the past year, I have seen a tremendous increase in interest about financial and economic education, and I can't stress enough how important this topic is to both children and adults. Recently I attended a large economic education summit held here at the Atlanta Fed and learned that, statistically, more kids drop out of college because of financial difficulties than for any other reason.

Let's face it, times have changed dramatically over the past couple of decades. When I attended college, it was not the norm for students to receive pre-approved personal lines of credit. And though many of us struggled to make ends meet, we generally weren't overwhelmed with credit card debt before graduation.

Today, credit cards have taken schools by storm, and students are getting into debt much earlier than ever before. Without proper financial management education, students may be caught in a downward spiral of personal debt before they even start working. Personal bankruptcies have increased dramatically over the past several years, and demand for credit counseling services has risen as well.

As a result of these growing trends, organizations working to provide financial and economic education have multiplied, leading to a host of new programs and initiatives to help students, young people and adults. Although it is encouraging to see so much momentum in addressing these highly important issues, organizations often work in isolation, inventing their own training curricula, instead of partnering with established organizations and making the most of effective resources that already exist.

Rather than creating something new in the area of financial education and putting the Fed seal on it, the Federal Reserve has placed a major emphasis on developing effective partnerships through our Systemwide financial and economic education efforts. Our approach is to foster financial literacy by encouraging synergy among existing programs, forming effective, collaborative partnerships in lieu of creating competition. In many of our Districts we have established strong working relationships with a number of national organizations that provide financial and economic education. We have also created a national website that includes information on our program objectives as well as links to nationally recognized initiatives.

Our work at the Atlanta Reserve Bank is extremely "hands on." With collaboration from our Public Affairs and Human Resources areas, we have established a strong network of educators including Jump$tart Coalition, Junior Achievement, Operation HOPE, Georgia Consortium for Personal Financial Literacy and several other established organizations with proven track records. We have used training programs developed by the FDIC (Money Smart), the National Council on Economic Education and several other organizations to teach both children and adults.

No organization is likely to be able to provide adequate financial and economic education to all people; however, by working together and leveraging existing resources we should be able to make a significant difference in the lives of the many people who need this knowledge.

Juan C. Sanchez
Community Affairs Officer

Managing the Negative Impact of Gentrifying Neighborhoods

THE LAST DECADE HAS BEEN MARKED BY A NATIONWIDE RESURGENCE IN URBAN AREAS. DRIVEN BY A STRONG ECONOMY, STRATEGIC PUBLIC AND PRIVATE INVESTMENTS, AND INCREASING URBAN SPRAWL, COMMUNITIES THAT WERE DESTROYED BY URBAN RENEWAL AND OUT-MIGRATION TO THE SUBURBS ARE ONCE AGAIN BECOMING DESIRABLE.

The benefits of successful urban revitalization are widespread. Local governments can capitalize on renewed interest in urban living to attract higher-income residents, to revitalize the city's tax base and to reduce the concentration of poverty that has plagued many urban communities.

However, such revitalization may also be accompanied by the negative impacts of gentrification—a force that can impose social and economic hardship on the individuals with the fewest resources to adapt to change. The key challenge for local government, business leaders, community activists and residents is to maximize the benefits of the revitalization process while also ensuring that the adverse effects of gentrification are minimized.

What is gentrification?

Gentrification rose to the forefront as a national concern in the 1960s when government-funded urban renewal projects shredded the social fabric of inner-city neighborhoods. In contrast to the engineered gentrification of that time, recent gentrification is driven by a mix of public and private investment and regional economic forces.

The term is often used loosely and can have both positive and negative connotations. It may simply describe urban revitalization in a depressed urban neighborhood. Or it may be framed in the context of the decades of disinvestment and subsequent reinvestment in urban areas, seen as a takeover of a low-income community by wealthier residents and entrepreneurs.

According to a 2001 study by the Local Initiatives Support Corporation (LISC) Center for Home Ownership, gentrification is defined as "the process by which higher-income households displace lower-income residents of a neighborhood, changing the essential character and flavor of that neighborhood." Within this context, gentrification is acknowledged to have been historically associated with displacement of lower-income minority individuals by higher-income white residents.

The causes of gentrification

Gentrification has been a significant concern in a limited number of cities nationwide, and within these cities, only in certain neighborhoods. Neighborhoods with little vacant land or few unoccupied buildings are more likely to experience gentrification.

Regional housing market dynamics appear to play the largest role in determining whether urban revitalization will produce gentrification. LISC research has shown that gentrification is driven by an imbalance in housing supply and demand. In regions of the U.S. where housing prices have risen markedly in the past several years, real estate developers vie for low-cost land to maximize potential profits. In the communities where housing prices have increased dramatically, there is a rapidly growing shortage of affordable housing, particularly for the lowest-income residents.

Job growth in a region also creates the potential for gentrification, putting pressure on housing supply and increasing demand for previously undesirable housing stock. Even when jobs are located throughout the region, gentrification can still occur when other forces create increased demand for urban living.

Traffic congestion created by sprawling development has led to gentrification as individuals look for residential opportunities that will shorten their commutes. Others have been drawn back to the city by the cultural amenities, historic neighborhoods and unique architecture.

Public sector policies to encourage revitalization have also produced gentrification. To increase the tax base and attract higher-income residents, public officials have designed targeted incentives such as tax abatements and below-market financing to draw households and businesses to depressed communities. While incentives attract new investment, they can also change social and economic conditions in a community significantly.

Consequences for new and long-term community stakeholders

Although revitalization benefits many community residents, the costs of gentrification often fall on the lowest-income households. The impacts of gentrification vary according to the stage of the revitalization process. Early in the process, the benefits tend to outweigh the costs for all stakeholders. In the later stages, however, benefits may accrue to new, higher-income residents at the expense of the lower-income, long-term residents unless the adverse effects of gentrification are addressed.

Different stakeholders in community revitalization—new and existing residents and businesses, the city, developers, and others supporting the revitalization process—will experience the revitalization in different ways. Cities, for example, are likely to enjoy the positive impacts of gentrification, including increased tax revenues. New residents and new businesses improve perceptions of a community, as well as attract additional investment.

New business owners also generally benefit from gentrification as new residents create a higher-income market and generate demand for a wider range of goods and services. Escalating property values, higher rents and jumps in housing prices are good for both new and existing property owners. New residents are often active in shaping the future of the community and tend to demand improvements in public schools and other facilities that will benefit long-term residents as well.

Long-term residents and businesses, on the other hand, are most likely to be divided over the impact of revitalization. If they can afford to stay, lower-income residents will probably benefit from appreciation in the value of their homes, improved public services and access to new businesses. However, revitalization can also result in involuntary or voluntary displacement of existing homeowners, renters and businesses. Such displacement is the most significant negative consequence of gentrification.

Involuntary and voluntary displacement

Research has shown that involuntary displacement is most likely among the lowest-income residents. Rising property values may force some residents, especially the elderly and those on fixed incomes, from their homes when they can no longer afford the property taxes. Renters may also be forced to relocate as landlords raise rent, opt to convert affordable rental housing to market rate housing, or sell rental property for conversion to condos.

MANAGING GENTRIFICATION, ESPECIALLY IN THE EARLY STAGES OF REVITALIZATION, CAN HELP TO MAXIMIZE BENEFITS AND MINIMIZE ADVERSE EFFECTS.

Whereas existing businesses may benefit from a higher-income customer base, especially if they provide certain basic services demanded by the new residents, they may also be forced to close due to escalating rents. Expensive specialty stores or restaurants that move into the neighborhood often cater to the new population, leaving existing residents without needed goods and services.

Long-time residents may also voluntarily leave the community. Developers often entice homeowners to sell their homes with offers that far exceed the original home price, but rarely will the seller make enough to purchase another, comparable home. Residents may also leave if they don't feel comfortable with the new demographics of the population or the accompanying changes in community leadership and institutions.

Managing gentrification, especially in the early stages of revitalization, can help to maximize benefits and minimize adverse effects.

Regional approaches to equitable development

Strategies to manage gentrification are most effective within a broad framework of equitable development that considers the role of the community in the larger region. Such strategies aim to create and maintain "economically and socially diverse communities that are stable over the long term, through means that generate a minimum of transition costs that fall unfairly on lower income residents," state researchers Maureen Kennedy and Paul Lenard in the LISC Center for Home Ownership study.

Although community development has traditionally focused on individual neighborhoods, regional strategies offer new paradigms for addressing the negative effects of gentrification. Promoting and preserving affordable housing, creating job opportunities and providing adequate transportation are critical antidotes to the problems of gentrification, and they must be examined in a regional context.

Within these larger frameworks, there are specific strategies that local communities can implement to address gentrification:

Affordable housing production and protection. Preserving and producing affordable housing is the most important component of a gentrification strategy. Public policies can protect affordable rental and owner-occupied housing for existing low-income residents. Some cities, including Atlanta, allow existing residents to defer property tax payments until they sell their homes. This is particularly important for elderly homeowners living on a fixed income who can not afford higher housing costs.

Cities can also protect affordable rental options. For instance, because of limited affordable rental housing, the city of San Francisco restricts when landlords can remove their units from the rental market.

Cities and states can further exercise public policy options to ensure continued production of affordable housing. Housing trust funds, for example, exist in many states and local jurisdictions to provide dedicated funding for affordable housing. The Florida housing trust fund, a national model, has helped over 150,000 families access affordable housing since its creation in 1992.

Another example is the enactment of fair-share housing policies that require communities to plan for both affordable and market rate housing. These policies emphasize location of affordable housing near jobs throughout the region in order to minimize residents' transportation costs.

Inclusionary housing policies that require new housing developments to provide options for lower-income residents represent another public policy tool. Some programs require that developers either designate a percentage of units as affordable or pay fees in lieu of constructing affordable units. Fees go into a local fund to construct affordable housing in other locations. In other programs, developers are encouraged to provide affordable housing through incentives such as density bonuses, streamlined permitting processes, and fee waivers.

Consumer education and protection are equally important for preserving affordable housing. Residents in lower-income communities must know what programs are available to assist them, and they must know their legal rights to stay in their homes. Renters should be protected from eviction in gentrifying neighborhoods and homeowners must be educated about predatory lending to prevent unscrupulous lenders from taking their homes.

Using public assets. In addition to public policies to promote affordable housing, cities and states have other resources available to help manage gentrification. If the city acts in the early stages of the gentrification to secure land and facilities, it can use them later to help those who might be negatively impacted by gentrification. As demand for land in underserved communities increases and prices rise, these public assets can support affordable housing and community facilities that would be otherwise too expensive. Many cities partner with non-profit organizations, providing them with land to develop permanent affordable housing. Cities have developed similar partnerships with for-profit developers, offering land in desirable neighborhoods in return for a commitment of affordable housing. Cities have also given existing public buildings to nonprofits or social service agencies to keep these services in the neighborhood for residents who need them.

Improving employment opportunities. Increasing access to employment is another important component of a gentrification strategy. Although linking regional employment growth to lower-income residents through improved access to jobs has not been widely practiced, such a strategy would improve residents' chances of participating in the benefits of the economic transformation in their community.

Planning and developing a regional vision. Cities can mitigate the adverse impacts of gentrification if they identify early signs that gentrification is a concern. Although communities are unique, characteristics such as distinct architectural style, good transportation access and low housing values make a neighborhood a likely target for gentrification. A shift from rental housing to homeownership, an influx of young or artistic individuals or a change toward services that appeal to higher-income residents may all be indicators that gentrification is already occurring. Anticipating gentrification in advance allows cities to implement policies to manage the change, thus helping to capture the benefits and minimize potential problems.

Finally, a long-term, unified vision for a neighborhood, city and region can help prevent the adverse impacts of gentrification. The process of developing this vision must include all stakeholders in the revitalization process. In addition to creating a shared vision for the community, this process creates the working relationships between new and existing residents needed to implement a plan over time.

Conclusion

The regional forces that produce gentrification show no sign of changing, and affordable housing and urban sprawl are growing concerns in many cities. Since more cities and communities undergoing revitalization are likely to see gentrification, it is critical to develop strategies to maximize the benefits of this revitalization while limiting displacement and the other significant costs. The plans and public policies adopted by states and local jurisdictions must ensure that resources, housing, transportation, and jobs are available and accessible for all residents, regardless of income. ♦

This is part two of a three-part series exploring the issue of communities in transition in the Sixth District.

This article was written by Jessica LeVeen, Regional Community Development Manager in the Atlanta Fed's Nashville Branch.

ANDP Speaks to the Challenge of Gentrification

A prime example of the two-sided nature of gentrification, metro Atlanta is one of the fastest growing regions in the country and is widely regarded as a paradigm of suburban sprawl. Aided by the interstate system, people and jobs fled the city for the suburbs, leaving lower-income minority residents behind.

Growth dynamics in the city have changed dramatically in the past decade, however. Weary of long commutes and high suburban housing prices, people are moving back to the city. Middle- and upper-income homeowners are purchasing homes in poorer urban neighborhoods ripe for revitalization because of their historic character and other attractive amenities.

New interest in these neighborhoods has driven up property values and property taxes. Existing homeowners, particularly the elderly living on fixed-incomes, cannot afford the rising property taxes. Affordable rental housing has been converted to market-rate rental housing or sold for condominium development, forcing the lowest-income renters to compete for a limited supply of affordable rental housing. The displacement of lower-income minority residents by higher-income white households has fueled racial tensions.

Although gentrification has brought some benefits—tax revenues are returning to the city, and landowners are enjoying increased equity in their property—protecting existing residents from displacement remains a challenge. In addition, the shortage of affordable housing is becoming acute, particularly for those with the lowest incomes.

The Atlanta Neighborhood Development Partnership (ANDP) is working to address these challenges. In the past 12 years, ANDP has helped develop or renovate over 7,800 units of affordable housing. Since its inception, ANDP has focused on mixed-income communities in its neighborhood revitalization efforts, and in 1999 it launched the Mixed Income Communities Initiative (MICI), which promotes policies to make metro Atlanta neighborhoods accessible to people of all incomes. "We must push public policy with a mixed-income agenda," said Hattie Dorsey, President and CEO of ANDP.

To that end, MICI is working to inform policy makers and to ensure that there is a voice pushing for mixed-income development. MICI has documented the growing housing shortage in Atlanta and the need for a regional solution. Job accessibility is also a concern. "Affordable housing is removed from jobs," said Ms. Dorsey, and as a result "there is an additional transportation penalty for low-income workers." She notes that people can't afford to live where their jobs are located, that they can't afford to stay in the neighborhoods where they grew up, and that the lowest-income residents are increasingly pushed into the least desirable neighborhoods. "We need neighborhoods of choice that provide a range of housing options from birth to death," said Ms. Dorsey.

MICI brings together community development corporations, government, environmental groups and businesses to build awareness and develop solutions that speak to the systemic problems driving gentrification. This diverse coalition is making the case for an equitable distribution of affordable housing throughout the region and appealing to the interests of the business community, environmentalists, and others focused on social justice. In the future MICI plans to advocate for inclusionary housing, a housing trust fund, expanded protection for seniors and programs to help those with the lowest incomes secure affordable housing. ♦

Making Energy Efficiency Affordable

ENERGY CONSERVATION IS A PERENNIAL SUBJECT. WE ALL KNOW THE INHERENT VALUE IN REDUCING ENERGY CONSUMPTION TO SAVE MONEY WHILE HELPING THE ENVIRONMENT. BUT HOW MANY REALIZE THAT ENERGY EFFICIENCY IS ESPECIALLY IMPORTANT FOR LOW- AND MODERATE-INCOME HOMEOWNERS FACED WITH UTILITY BILLS THAT OFTEN ABSORB A SIGNIFICANT PORTION OF MONTHLY INCOME?

Granted, many builders of affordable housing are aware of the need for energy efficiency, and today's construction generally includes at least some power-conserving features such as insulation materials and energy-rated mechanical systems and appliances. But the effectiveness of builders' choices varies widely, and resulting energy savings tend to be relatively minor.

So why don't builders focus more on constructing affordable houses that use minimal energy— or even generate their own energy through solar technology? The reason is obvious: the incremental cost of achieving this goal tends to exceed low- and moderate-income families' budgets, even with the help of specialized financing products such as "energy efficient mortgages." These mortgages allow a lender to stretch the standard loan qualifications, but the downside is increased financial burden for the homeowner. Although the higher initial costs of major energy-efficiency elements are eventually compensated by savings on power bills, the payback point at which energy savings allow families to get ahead tends to be far in the future. Nevertheless, some builders are finding a way to pursue this goal.

Solar roof panels make the difference on these energy efficient Habitat houses in Lenoir City, Tenn.

Solar technology for affordable housing

Affordable solar homes might seem like an impossible dream to most people, but Jeff Christian thinks otherwise. Jeff is the director of Oak Ridge National Laboratories' Buildings Technology Center, and he's forged a partnership with Habitat for Humanity in Loudon County, Tenn., to build solar Habitat homes in Lenoir City about 20 miles southwest of Knoxville.

Oak Ridge, a division of the U.S. Department of Energy, is also partnering in this project with the Joint Institute for Energy & Environment in Knoxville, Tenn.; the Department of Energy's Building America program; and the Tennessee Valley Authority's (TVA) Energy Right® program. As the region's primary electric supplier, TVA recognizes the need to rein in demand that's likely to outpace production capacity in the long run, if left unchecked.

Five homes have thus far been constructed in Habitat's Harmony Heights subdivision, and more are planned. Each home is its own research project or "living laboratory" in which slight variations in design, materials and construction techniques help determine optimal combinations of features. For example, the first home uses a standard type of structural insulated panel (SIP) for the floor, walls and roof. The next two homes use different combinations of SIP types. Lead carpenters are trained to install the specialty features. As with other

Habitat programs, volunteers contribute labor for the primary construction.

All the homes have solar technology, but they are still tied to the local electric grid. The cost of energy consumption is offset by the home's generation of solar energy, which is contributed back to the power grid. This creates a credit for the homeowner that's applied against the cost of electricity. To date, the average net utility cost of the solar homes has been approximately 50 cents a day or about $15 a month. That's for an all-electric home with central air and heat. The ultimate goal of combining energy-efficient design and solar panels is to achieve "zero-energy" homes— ones that generate sufficient solar power to cover all of the energy needs of a typical family.

Making the numbers work

A major hurdle in affordable, energy-efficient housing is the cost of solar panels and other high-energy construction. In the case of the Lenoir City subdivision, the incremental costs run approximately $15,000 to $20,000 per house. However, extra costs have been mitigated so that homebuyers end up paying the same as for a standard Habitat house.

SUPPORTERS ARE ENTHUSIASTIC ABOUT HOW THESE HOUSES CAN HELP FAMILIES ACHIEVE ONGOING, SUBSTANTIAL SAVINGS.

Donations of energy-efficient material from many manufacturers and suppliers have helped to lower construction costs. While these groups display business acumen in promoting their products, they are also committed to achieving the project's long-range goal—creation of comprehensive whole-house "kits" that can be sold at a reasonable price through mass production, as solar technology continues to improve and manufacturing costs come down. By the year 2010, Jeff anticipates that the "kits" will bring the price of today's energy efficient solar homes in line with that of conventional affordable homes.

Variations in solar features help researchers identify optimal modifications.

Spreading a good idea

Habitat for Humanity has benefited greatly from the interest generated by these solar homes. Supporters are enthusiastic about how these houses can help families achieve ongoing, substantial savings due to "zero-energy" or near-zero energy consumption.

The more units of energy-efficient, affordable homes that are built over time, the more viable the program will become to local housing authorities, nonprofits, developers, funders and other partners interested in affordable housing. Many such partners have a passion for the subject because they understand the significant impact lower power costs will have on their clients. "Eco-friendly" or "green" features can also enhance eligibility for affordable housing tax credits, and this is another reason those concerned with affordable housing find the program appealing. The success of the program also helps educate consumers to understand the benefits, and this leads to increased demand.

Acknowledging the great potential that exists for this market, Jeff notes, "A key part of this project is getting the public and builders to visit the homes and learn about them. We're proving that energy-efficient, affordable housing can be achieved for real families today, and we're poised to be able to help many more families in the near future." ♦

For more information on solar technology for affordable-housing developers, contact Jeffrey E. Christian at christianje@ornl.gov or visit www.ornl.gov/btc.

This article was written by Wayne Smith, Community Affairs Director at the Atlanta Fed.

Photo on p. 8 courtesy of Oak Ridge National Laboratory, U.S. Department of Energy.

New Ideas for Energy Efficient Construction

Omni Innovation, LLC, is a Nashville, Tenn., company on the forefront of creating energy-efficient, affordable housing that costs less than conventional construction. Founded by Larry E. Elliott, Omni is developing the use of Expanded Polystyrene Foam (EPS Foam) as the primary material in home construction. Not only is the material less expensive, but reduced construction time results in lower labor costs. EPS Foam construction generally takes one-fifth to one-third as long as traditional housing construction.

As a home builder and licensed building inspector, Larry felt frustrated with the industry's inability to provide energy efficient, affordable housing to lower-income families, and he began to experiment with alternative approaches. Six years of engineering, testing and prototyping led to a patented technology that allows Omni to build affordable housing in a limitless range of styles and exterior facades. Almost any house plan can be converted into or emulated by Omni's EPS system.

EPS Foam has been approved for strength and durability against fire, heat, cold, rain, wind, hailstorms and earthquakes. The material is of no interest to bugs or termites, and it has sound-reducing qualities. It emits no fumes or gases, has no other adverse health implications, and it can be recycled when a house is torn down.

Because EPS Foam serves as the wall structure, roof and flooring, the homes are highly energy efficient. Traditional housing has insulation factors ranging from R-15 to R-35, whereas the Omni EPS System is rated from R-48 to R-60. In addition to ongoing energy savings, homeowners benefit from lower maintenance. For

Larry Elliott and Chris Urban are the leadership team behind Omni Innovation, LLC.

Omni's prototype of EPS foam construction shows architectural adaptability.

example, standard roofing lasts 50 years versus the typical 20-year roof in most traditional, affordable homes.

Omni's EPS technology should not be confused with homes based on Structural Insulated Panels (SIPs). SIP-based homes also use EPS foam, but require strand board for structural support and a traditional wood truss roof system, neither of which Omni uses.

Prototype homes have been built in Texas and Kentucky. Finished homes look no different than traditional homes either inside or out. Interior walls are finished with fire-resistant sheetrock, and kitchens and baths use traditional cabinetry and fixtures. These homes qualify for conventional financing the same as traditional homes.

Omni's initial focus is on working with both urban and rural community development corporations (CDCs) and economic development corporations (EDCs). The immediate goal is to establish a track record by bringing more homes to market in order to familiarize affordable housing practitioners with Omni's product and its value. To help do this, Larry has assembled a team of professionals including Christopher Urban, Omni's chief executive officer, who has a background in engineering, finance and marketing. Chris shares Larry's enthusiasm with this innovation in energy-efficient, affordable housing.

Only time will tell how this form of construction will affect the nation's housing market. ♦

For more information on foam construction in affordable housing, contact Christopher M. Urban at chris.urban@owen.vanderbilt.edu.

Photo on p. 9, top right, courtesy of Omni Innovation, LLC.

Stemming the Loss of Affordable Housing: The Role of Nonprofits

FOR MANY YEARS THE AFFORDABLE HOUSING INDUSTRY HAS BEEN FOCUSED MAINLY ON PROVIDING ADEQUATE, SAFE HOUSING FOR LOW- AND MODERATE-INCOME HOUSEHOLDS. THE LOW INCOME HOUSING TAX CREDIT, INSTITUTED IN 1986, ALONG WITH OTHER SUBSIDIZED HOUSING PROGRAMS, HAS PAVED THE WAY IN MEETING THIS GOAL.

Now housing advocates are concerned about preserving the existing affordable housing supply, as well, which is at risk of being lost through physical deterioration, expiring affordability restrictions and the need for recapitalization.

Affordable housing preservation not only calls for protecting the number of low rent units in the housing stock, but also for maintaining the quality of units available to low- and moderate-income renters. Each affordable rental property presents different challenges and requires a unique combination of tactics to surmount the barriers to preservation.

When affordability restrictions expire

In 2000, rental affordability restrictions technically began to expire for a fraction of Low Income Housing Tax Credit (LIHTC) units, those with credits allocated between 1987 and 1989. Expiration of the restriction for some units only exacerbated a similar preservation problem in protecting the U.S. Department of Housing and Urban Development's (HUD) portfolio of assisted units developed through the Mark-to-Market Program in the 1990s (see Partners v. 11, n. 2).

According to a Neighborhood Reinvestment Corporation study by Kate Collignon in October 1999, three main challenges threaten the affordability of tax credit developments: (1) conversion to market rents; (2) cessation or reduction of targeting to very low-income households; and (3) a need for capital infusion to ensure continued financial feasibility and prevent physical deterioration. Collignon's research recommends that LIHTC sponsors should be aware of these potential problems as they consider regulatory and partnership agreements, market factors, the physical condition of the property, the financial climate, and owner preferences and their priorities.

The LIHTC program works best when leveraged through combination or layering with other federal programs and private monies to finance affordable rental development. It was not intended to finance the entire development. This approach can enhance the effectiveness and efficiency of the program, which largely depends on its inherent ability to react to market forces, as well as to provide flexibility in targeting, financing and motivating affordable housing production to meet the needs of local communities.

Although administered by the Internal Revenue Service, the practical administration of the LIHTC such as underwriting and allocation falls to state housing finance agencies (HFAs). This system allows states to set specific allocation criteria for awarding credits that target identified affordable rental housing needs, as outlined in the state's Qualified Allocation Plan. Furthermore, HFAs also control how tax credits can be combined with other financing programs they administer. Combined programs can improve the leveraging of the funds either to finance specialized housing development or to boost incentives to developers targeting a specific housing need identified by the state.

For example, the Florida Housing Finance Corporation (the state HFA) has set priorities for funding affordable housing for farm workers, the elderly and the homeless. Projects that develop transitional housing for the homeless, for instance, receive an automatic 9 percent tax credit, which is set aside when they receive funding through the State Apartment Incentive Loan (SAIL). SAIL is also administered by the agency.

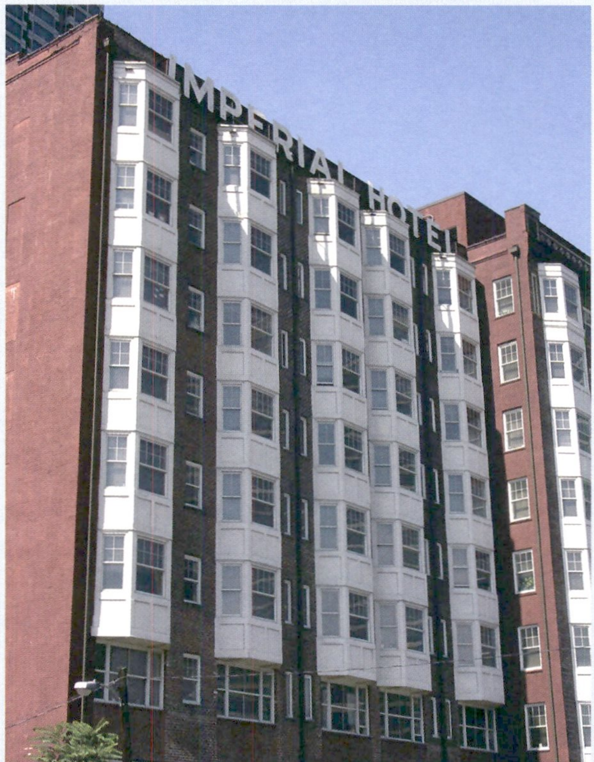
Role of nonprofit developers in housing preservation

The success of preserving tax-credit developments will largely hinge on the involvement of organizations with a social mission that includes protecting existing

Overview of the LIHTC Program

Created by the Tax Reform Act of 1986, the Low Income Housing Tax Credit (LIHTC) is the most important resource today supporting the production of affordable rental housing. The tax credit structure was proposed to offset the 15-year depreciation associated with the production of low-income housing. Acting as equity and typically combined with other funding sources, the tax credit helps to finance the acquisition, rehabilitation or construction of affordable rental housing units.

One condition for a development to be awarded tax credits is that a portion of the units must be set aside for low-income households for a period of 15 years. Shortly after the program was created, legislators were alerted to the threat of expiring HUD affordable housing finance contracts and realized the importance of amending the LIHTC policy to ensure affordable-housing preservation. As a result, the original 15-year rental affordability agreement that supported the tax credit allocation to developers was extended an additional 15 years in 1989. In some states the affordability agreement has been extended well beyond—to 50 years in California and 99 years in Utah.



Atlanta's Imperial on Peachtree, developed by Progressive Redevelopment Inc., was funded with LIHTC and historic rehab tax credits. The property maintains its historic facade.

In return for a commitment to maintain affordable rents, the developer receives a 10-year federal tax credit stream that can be converted into equity by selling or syndicating the tax credits to investors. This creates a cash infusion to finance the project. In the early years of the program, investors in LIHTC ventures were more immediately associated with the projects and purchased the tax credits directly from the developer. At that time the tax credit price averaged 45 cents on the dollar.

As the LIHTC matured and as further legislative actions ensured the continued viability of the credit, syndication through intermediaries gave access to larger corporate investors and to greater economies of scale. Amendments to the Community Reinvestment Act and the growth in socially responsible investment also added value to the tax credit. Today credits are sold at an average of 80 cents on the dollar.

The LIHTC program is managed by the Department of Treasury's Internal Revenue Service, which delegates administration to state housing finance agencies (HFAs). Each state is allocated tax credits based on $1.75 per capita. This figure was set to adjust with inflation beginning in 2003. State HFAs award tax credits each year to multifamily developments as well as monitor compliance with affordable rental agreements. Because demand is well above supply in most states, allocations are awarded to affordable housing projects on a competitive basis. ♦

low- and moderate-income tenants from displacement. Thus preservation is increasingly dependent on nonprofit organizational capacity both to develop and maintain properties.

Although at least 10 percent of tax credits are set aside for nonprofit developers, many nonprofits find the program inaccessible. Less sophisticated nonprofits or those with limited resources are discouraged by a complicated and demanding application process, and some find it difficult to compete against more experienced applicants.

For some time, nonprofits have benefited financially by partnering with for-profit developers eager to improve their applications' competitiveness by incorporating the nonprofit developer factor. This "rent-a-nonprofit" process, as it is referred to by some in the industry, does little to build capacity within the apprentice organization if, as is often the case, they are not allowed to participate in the development process.

Advocates for building nonprofit capacity argue that these development partnerships should not only involve the nonprofit in the application process, but also encourage the nonprofit's active participation in the construction and property management as well.

Florida Housing Finance Corporation assists nonprofits

Stephen Auger, Deputy Director of Multifamily Development at Florida Housing Finance Corporation (FHFC), explains that HFAs are interested in building the capacity of nonprofit developers to finance and undertake projects as well as improving their access to tax credits. Nonprofits, he notes, are socially committed to preserving affordable housing and have the ability to develop and manage supportive housing that serves the lowest-income residents.

The FHFC is hosting a series of dialogues with small nonprofit developers about how to simplify the LIHTC application process and make it more accessible. According to Auger, expiring tax credit affordability periods did not have a substantial impact in Florida since a relatively small number of properties were affected. Nonetheless, since Florida has one of the largest LIHTC portfolios, preservation strategies are a priority as the state faces recapitalization and rehabilitation of properties at risk of conversion to market rents. Even though HFAs often impose a right-of-first-refusal agreement with nonprofits if a developer opts to sell the property at the end of the 15-year affordability period, many nonprofits may not have the resources necessary to finance the acquisition or recapitalization necessary for these aging properties. FHFC seeks to remedy this situation.

Florida nonprofit develops preservation strategies

Several larger nonprofits with adequate capacity and experience competing for tax credits are developing preservation strategies. Greater Miami Neighborhoods (GMN) is one of the largest nonprofit developers in Florida and a frequent sponsor of LIHTC developments. Elena Dominguez-Duran, vice president of development with GMN, says that in its first 10 years of operation, they focused on new construction. Now, using its own portfolio, GMN is developing successful models to recapitalize aging tax credit properties. Specifically, GMN is exploring how existing programs and resources can be used to recapitalize 10- to 15-year old properties that will become available as for-profit developers opt to sell.

"The properties have to be looked at on a deal-by-deal basis," says Dominguez-Duran. "We look at the operating expense and operating income, determine the purchase price and then look at available financing." She says that the nature of layered financing requires that they start looking at properties two or three years in advance to develop a strategy and structure the financing in time to acquire the property in the fifteenth year when it becomes available.

Dominguez-Duran explains that GMN also benefits from having the resources necessary to obtain interim financing to secure acquisition of at-risk properties while working out the permanent financing arrangement. This is not an option available to many smaller or less established nonprofits.

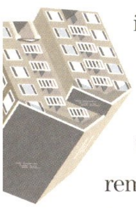
Some HFAs are setting aside a portion of their LIHTC allocations for the preservation of existing tax-credit properties that are at risk. Concern exists that this strategy could spread available resources too thin and dilute the tax credit's impact in meeting growing needs for affordable housing. If the tax credit's soft equity is required to make acquisition and recapitalization

possible, it is critical to begin the process early in order to coordinate the application rounds and varied funding cycles.

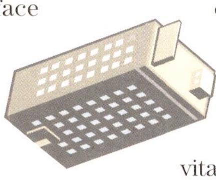
HUD database aids preservation efforts

This strategic approach to preservation has been aided by HUD's creation of a national LIHTC database that provides information on each tax-credit property and thus allows preservation sponsors to identify where best to focus their planning.

The database is also drawing attention to the quantity of affordable rental units threatened by deterioration and expiration of affordability agreements. Like most affordable housing properties, tax-credit deals involve several layers of funding. Often the additional funding sources have longer affordability periods that provide stronger protection. But the pressure to stay financially feasible remains a constant challenge in low-rent development and property management.



The Florida Housing Coalition (FHC), a nonprofit that provides technical assistance and advocates for affordable housing, maintains a list of Florida properties funded by tax credits and other financing that face expiring affordability restrictions. Wight Greger, FHC's Senior Technical Advisor, says that the intermediary organization is trying to find nonprofits interested in adding these properties to their housing portfolios. The first step, however, is to determine whether the nonprofit already has the capacity to acquire and rehabilitate the buildings, or if they will have to develop the capacity.



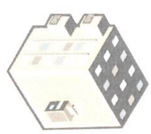
"Capacity," says Greger, "is the biggest barrier to rehab. In-house expertise or access to the necessary expertise is essential to handle the trials of rehab." Particularly in buildings with operating reserves that are inadequate to maintain the property, explains Greger, acquisition and rehabilitation become more demanding on a nonprofit's resources. Intermediaries, like FHC, are focusing on building financial, technical and administrative capacity to manage the more challenging projects.

Greg Melanson, Bank of America's senior vice president of Community Development, says that one of the more effective ways banks can support emerging and growing nonprofits is through intermediaries. "Investments in the intermediaries and loans to their loan funds," he says, "provide predevelopment and gap financing that are not traditionally available from banks." Supporting intermediaries allows banks to fuel nonprofit development effectively by linking funding to technical assistance that ensures greater levels of success for challenging projects.

FHC is also advocating for policy changes to expand the availability of resources applicable to preservation activities. Tax credits, says Greger, seem to be harder to access for rehabilitation. "In markets where funding sources are more abundant," she continues, "many nonprofits have become very good at complicated layering structures to finance preservation." But other communities find that accessible funding sources are less diverse, and they will have to depend more on the flexibility of available resources to meet their needs.

As the discussion surrounding affordable housing preservation grows, nonprofit organizations will emerge as a cornerstone for long-term strategies to protect housing stock for the lowest-income renters. Building capacity and improving the responsiveness of funding program priorities, like the LIHTC, will allow nonprofits to build and maintain quality affordable housing and strengthen the economic vitality of our communities. ♦

This article was written by Ana Cruz-Taura, Regional Community Development Director in the Atlanta Fed's Miami Branch.



Community Development Venture Capital Funds Sow Economic Opportunities

DURING THE 1880s, A SMALL NUMBER OF AFRICAN-AMERICAN-OWNED BANKS ANTICIPATED TODAY'S COMMUNITY INVESTMENT VEHICLES BY PROVIDING AFFORDABLE CAPITAL AND ACCESS TO BASIC FINANCIAL SERVICES IN UNDERSERVED COMMUNITIES.

Now community developers widely recognize that fostering economic revitalization and opportunity is the key to creating sustainable communities. To address this issue, the community development venture capital (CDVC) industry invests in businesses that provide jobs and wealth-building opportunities in distressed communities.

Explaining CDVC funds in terms of traditional venture capital funds is much like comparing apples to oranges. Both are the fruit of well-capitalized plans that stem from a solid business concept, and both are nurtured through infusions of equity and prudent management oversight. Furthermore, both usually reap a significant cash return after several years of investment, as well as nourish the economic health of the communities or industries they support. The flavors, however, are distinctly different.

Comparing traditional and community funds

Traditional venture capital funds aim to produce significant financial returns by offering high yields in exchange for assuming risk. In contrast, CDVC funds expand the definition of reward to include not only interest and dividends to investors but also new jobs and services for low- and moderate-income populations or distressed communities. This investment with a social mission results in a "double-bottom line."

CDVC funds can be structured as for-profit, nonprofit, or "hybrid" organizations in which a for-profit CDVC fund is affiliated with a nonprofit organization. The latter approach has the distinct advantage of enabling access to grant funds, according to a 2001 study by Julia Sass Rubin in *Changing Financial Markets and Community Development*. All CDVC funds strive to engage quality management teams, who bring significant experience in the traditional private equity industry as well as strong relationships with bankers, corporations and other economic development engines.

According to a statement from the Community Development Venture Capital Alliance (CDVCA), an industry group for CDVC organizations, CDVC funds represent one of the "fastest growing sectors of community development finance." The number of CDVC funds in the U.S. has grown from 52 funds managing $300 million in capital at the end of 2000 to over 80 managing $548 million, as of the second quarter of 2003. Research for a San Francisco Fed publication by Kerwin Tesdell and Charity Shumway in 2003 indicates that the CDVC industry grew by 38 percent over that same period, which marked one of the most difficult fundraising environments in the venture capital industry's estimated 30-year history.

Not unlike their traditional counterparts, CDVC funds seek to invest in businesses with solid business concepts, good management teams and high growth potential. However, CDVC funds pursue distinctly different types of investment to achieve this goal compared to traditional venture capital funds.

Characteristics of CDVC investments

Unlike traditional venture capital funds, CDVC funds aren't restricted to high-growth areas or a particular stage of business development. Rather, they are more likely to extend to all businesses in urban and rural low-income communities throughout a geographic region. For example, SJF Ventures in Durham, N.C., is concentrated in the eastern United States and invests in companies at all stages of development (see sidebar).

Another difference is that CDVC fund investments are not likely to be industry-specific. While private venture capital funds in the 1990s invested in technology-related firms, for example, CDVC funds focus on investments that will create quality entry-level jobs with good benefits and livable wages. Like traditional funds, they provide "patient capital": that is, investors don't realize a payment on their investment until the business is well-established, usually several years after the investment is made.

Unlike traditional venture capital funds that seek high returns on higher-risk investments, the financial returns on CDVC funds are usually more modest, with an additional payoff in the form of community benefits such as job creation or neighborhood stabilization. The size of the investment is also smaller than traditional venture capital funds. According to Rubin and others in a study presented to a 2003 Fed conference on Sustainable Community Development, the average investment is $186,000 per round and $393,000 per company as compared with the traditional venture capital industry's average of $8 million per round of investment.

Finally, intensive technical assistance is critical to the success of both the CDVC funds and the businesses in which they invest.

In both types of venture capital funds, providers need to "harvest" or exit the investment to return a profit to investors and re-capitalize funds for new investments. According to Rubin, at the end of 2000, CDVC funds tracked in the study had exited 67 of their 237 total investments. More than half of exits as of 2002 were through acquisition from outside buyers, and 32 percent involved management and owner buy-backs.

Assessing the financial and social performance

Several factors make it difficult to evaluate how successful CDVC funds have been from both financial and community development perspectives. On the financial side, the majority of funds are less than seven years old and not many have exited their investments. The financial evaluation is further complicated because some of the funds received operating subsidies, used a combination of debt and equity instruments, or both.

Although the available data are limited, preliminary assessment of the industry's social impact is encouraging. Rubin tracked the jobs created by businesses financed by three of the oldest funds and found that they created more than 4,000 jobs at an average cost of less than $10,000 equity invested in the company per job. These jobs were in economically distressed rural communities and provided higher than average (for the region) benefits and wages.

To learn more about the community development venture capital industry, visit the Community Development Venture Capital Alliance's website at www.cdvca.org. ♦

This article was written by Nancy Montoya, Regional Community Development Manager in the Atlanta Fed's New Orleans Branch.

Community Development Venture Capital Fund Close-Up: SJF Provides Capital Boost for Community-Minded Atlanta Business

Established in 1999, SJF is comprised of two organizations: SJF Ventures, a community development venture capital fund, and SJF Advisory Services, an affiliated nonprofit that offers workforce development and sustainable business services. SJF's overall mission is to "create quality employment for low wealth citizens and communities by financing and assisting companies that generate social, environmental and financial gains."

SJF Ventures invests in innovative, growing companies that provide high quality, entry-level jobs with good pay and benefits as well as a strong financial return on investment. It has made $10.1 million in equity investments in 18 companies throughout the eastern United States, including the Sixth District states of Georgia, Florida and Tennessee.

One of SJF's successful projects is Ryla Teleservices, Inc., located just outside metro Atlanta. Since 2002, SJF Ventures has invested a total of $700,000 in the company, which provides outsourced customer contact, data verification and validation services for business-to-business interactions. Since SJF's initial investment, Ryla has grown from 20 employees to 280 employees. Benefits for their employees include 100 percent employer-paid health insurance premiums for permanent workers, a 401-K savings plan, extensive training opportunities and opportunities for promotion.

SJF's companies are further supported by SJF Advisory Services, which invests in technical assistance to create, retain and enhance long-term jobs for the residents of economically distressed communities. Its role includes matching these companies with services, such as job placement and training, welfare-to-work, and economic development programs for employees.

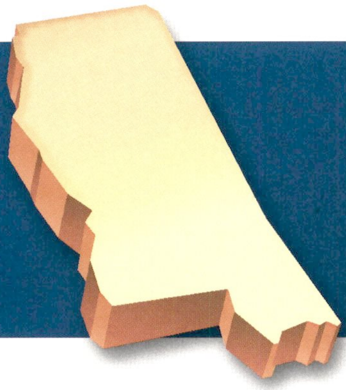
The advisory arm of SJF has assisted Ryla through board involvement, introduction to potential investors, assistance with management recruitment and legal counsel. In keeping with their mission to build wealth for employees, SJF Advisory has also worked with management to launch a multi-tiered stock option plan to provide incentives and rewards for employees at all levels.

Mark Wilson, Ryla's CEO, was featured in the February 2004 issue of *In Focus* as a successful "Innovator of Tomorrow." In 2003, Ryla was named the U.S. Department of Commerce's Minority Business Development Agency's "Local Service Firm of the Year." The company was also featured in a *New York Times* (10/31/2003) article, "Capital for Companies that Aid Communities," and was spotlighted at the annual Community Development Venture Capital Alliance (CDVCA) conference in March 2004.

SJF's 10-member staff maintains offices in Durham, N.C., and Philadelphia, Pa. ♦

For more information, please visit SJF Venture's website at www.sjfund.com or contact Rick Larson, Managing Director, at (919) 530-1177 or rlarson@sjfund.com.

Spotlight on the District



MISSISSIPPI

HOMEBUYERS GET THEIR CREDIT ON TRACK

An impaired or insufficient credit history is a common stumbling block for low- and moderate- income borrowers attempting to buy a home. Thanks to the "Get On Track" (GOT) program, prospective Mississippi homebuyers with impaired credit now have a new option: they can lease the home of their choice for a pre-determined period and work in the meantime to repair credit or establish a qualifying credit score for homeownership.

Mississippi's Get On Track program

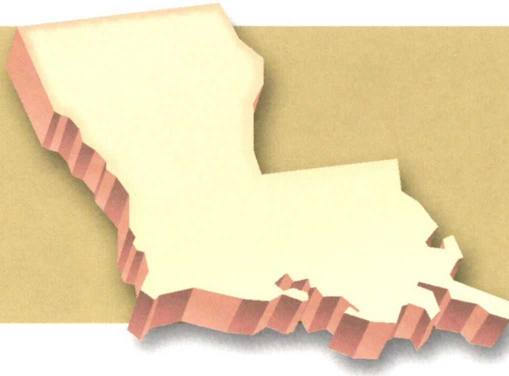
The GOT program, a partnership with the Mississippi Home Corporation (MHC), Freddie Mac, Consumer Credit Counseling Services (CCCS) of New Orleans and local lenders, targets prospective homebuyers with incomes up to 140 percent of area or state median income, whichever is higher. The prospective homeowner works through a local lender and CCCS to determine how much they would qualify to borrow with a credit score of 620. CCCS then helps the client map out a credit repair program for the 39-month lease period. The next step for the applicant is to work with a builder or realtor to select a home to purchase at the end of the lease period.

MHC then purchases the home at closing and leases it back to the prospective homebuyer for a term of 39 months, at which point the program participant can assume the outstanding Freddie Mac loan for a one percent assumption fee. The homebuyer also enjoys the benefit of any appreciation through a forgivable grant from MHC. To assist in the initial loan closing, 7.5 percent of down payment and closing cost assistance is included to avoid depletion of the client's cash flow. The seller may also contribute up to 3 percent.

The loan initially extended to MHC is a 7/1 adjustable-rate mortgage with a 30-year amortization and a current rate of 6.425 percent. Because the lease payment includes rental insurance and other management fees, it is usually about 10 percent higher than the actual mortgage payment. MHC closed 34 loans totaling $2,505,418 between the time of its inception in July 2002 through May 2004. Twenty loans totaling $1,800,000 are currently in the pipeline.

One deterrent to the program is processing time, which has averaged about 102 days, slowed down by the time required for prospective homebuyers to complete credit counseling and establish a workout plan with their creditors. Currently one lender with two branch offices handles loans throughout the state. Loans are eventually sold to Freddie Mac. The program was funded through a bond issue and is set to expire on December 31, 2004. MHC is evaluating the future of GOT, which addresses a significant barrier to homeownership. ♦

For more information, visit MHC's web site at www.mshc.com or call Charles L. "Chuck" Morris, SVP at (601) 718-4624 or Francisco Lara, AVP at (601) 718-4653.



LOUISIANA

A CLOSER LOOK AT LOUISIANA'S TANF IDA INITIATIVE

Individual Development Accounts (IDAs) are matched savings accounts that encourage low-income families to save money, gain financial skills and build wealth through the purchase of assets. Two years ago, in partnership with the Louisiana Department of Social Services, the IDA Collaborative of Louisiana (IDACL) embarked on an ambitious effort to help at least 500 low-income families qualified for benefits from Temporary Assistance for Needy Families (TANF) purchase a home, expand a business or further a post-secondary education.

Felicia Bazille, a graduate of the IDACL program, was able to purchase a home in New Orleans.

At its closing deadline of June 30, 2004, the TANF IDA program reports impressive results: 1,796 households have received credit counseling; 1,101 have enrolled in an IDA program; 1,029 have completed financial education classes, and 895 have completed asset-specific training. To date, 616 participants have purchased assets, including over 343 homebuyers.

Collaborative partners help leverage resources

Growing to this scale required more than just the program's $2 million in funding and the State's progressiveness. Over 42 statewide "service providers," under the oversight and guidance of the Tulane/Xavier National Center for the Urban Community, provided one-on-one intensive credit counseling, case management and coaching, homebuyer training, and financial literacy classes.

Eight financial institutions made savings accounts and mortgages available, as well as offered bank expertise and guidance to the Advisory Board. Several foundations supported the program with operating and matching grants. The program has also reached far and wide both geographically and culturally: graduates come from as far as Lake Charles, La., and the Delta region; they are from both urban and rural communities; they represent diverse populations, including participants from the Vietnamese and faith-based communities.

Working with such diverse partners brings its own challenges: data management and reporting can be an administrative nightmare. To address this issue, Tulane invested its own resources to create a web-based enrollment, tracking and invoicing program. It not only provides necessary forms, but also serves as a source of critical program summary reports for the media, service providers and other interested parties. The state-of-the art system helps IDACL to administer programs efficiently and effectively.

Program meets its goals

The TANF IDA program accomplished what it set out to do: provide an infrastructure for IDAs throughout the state and build the capacity of its partners; demonstrate that IDAs can help low-income workers purchase long-term assets; and bring together various organizations and initiatives to leverage resources for the working poor. Like many other IDA programs across the nation, its next challenge is to ensure the long-term survival of IDA initiatives through policy advocacy, fund development and refinement of its partnerships and programs. ♦

For more information on the IDACL, visit the website at http://idacola.tulane.edu.

This article was written by Nancy Montoya, Regional Community Development Manager in the Atlanta Fed's New Orleans Branch.

Double Bottom Line Investing: An Introduction to the CDVC Approach

A Workshop by the Community Development Venture Capital Alliance

The Federal Reserve Bank of San Francisco Conference Center
San Francisco, CA

Tuesday, September 28, 2004

This workshop is targeted at anyone interested in how equity investing can create social and financial returns: community development practitioners, investors, finance professionals, policy makers and others who are interested in using equity tools in innovative ways to benefit distressed communities and low-income individuals. Participants will get a comprehensive overview of the rapidly growing field of community development venture capital (CDVC) and have an opportunity to engage with some of the most experienced CDVC practitioners.

We are enthusiastically reaching out to new community development and finance professionals who are interested in enhancing their knowledge of the best practices in the CDVC field and using their skills to build viable businesses that contribute to healthy communities.

To register, visit CDVCA's website at www.cdvca.org. If you have any questions, please contact Cynthia Holahan at cholahan@cdvca.org or (212) 594-6747 ext. 25.

FEDERAL RESERVE BANK OF ATLANTA
COMMUNITY AFFAIRS DEPARTMENT
1000 PEACHTREE STREET, N.E.
ATLANTA, GEORGIA 30309-4470

CHANGE SERVICE REQUESTED

PRESORTED
STANDARD
U.S. POSTAGE
PAID
Atlanta, GA
Permit No. 292

STAFF

Free subscription and additional copies are available upon request by mail at the Community Affairs Department address above, or e-mail us at *Partners@atl.frb.org*, or call 404/498-7287; FAX 404/498-7342. The views expressed are not necessarily those of the Federal Reserve Bank of Atlanta or the Federal Reserve System. Material may be reprinted or abstracted provided that Partners is credited and provided with a copy of the publication.

www.frbatlanta.org