

SUMMER 1998



AN EXCHANGE OF
COMMUNITY DEVELOPMENT ISSUES AND

KENTUCKY TOWN'S RENAISSANCE BECOMES MODEL FOR STATE

Mt. Sterling, population 5,362, is a county seat on the grow in eastern Kentucky. Since the late '80s, its city-county industrial authority has used tax abatements to lure light manufacturers to a new industrial park, replacing industrial jobs lost a few years earlier. Its developers are building housing subdivisions. A restaurant tax financed a new 68-acre recreation area. Tourism has attracted a new hotel, a new golf course is underway, and a cycle of prosperity is in motion.

Mayor Bert May attributes the town's success to cooperation among local bankers, real-estate interests, and government. "Some towns have divergent interests," he said. "We put aside our personal agendas." He felt that one piece was still missing, however:

The new development was all on the edges of town, doing little to revitalize Mt. Sterling's downtown. Once-beautiful, turn-of-the-century buildings were sitting vacant, while the decrepit Mattie Lee neighborhood nearby was a growing eyesore. It was a prime opportunity for adaptive reuse.

The city's first step was to restore the streetscape downtown. A community development block grant paid for new sidewalks, landscaping, and burial of utility lines. The stage was thus set for the city to convert downtown office buildings into architecturally significant low-income housing.

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It took \$6 million and an array of funding mechanisms, including tax credits for historic preservation and for low-income housing, but the Main Cross project is now the centerpiece of Mt. Sterling's recovering downtown and a model for Renaissance Kentucky, a statewide program. On a Main Street corner, the city bought

Main Cross is reserved for low-income elderly tenants. "We found that elderly people, although they don't have a lot of money, spend nearly all they have within walking distance," Linder pointed out.

"Federal regulations require that five percent of the units in these buildings be totally handicapped-accessible," May

"This is what we're hoping to do," said Penny Young, director of Renaissance Kentucky, which seeks to revitalize Kentucky's downtowns. "Main Cross gave us the idea, and we're looking for proposals to mix market-rate and low-income housing."

Meanwhile, Mt. Sterling's renaissance continues on other fronts. Across the street from

The Main Cross Project
Elderly Housing/Commercial Incubator
Mt. Sterling, Kentucky
(see also front page photo)



10 nearly empty adjoining buildings, cut through the outer walls to add a common hallway, and built a complex of 51 apartments. Decorated in an airy, contemporary style, they retain much of the buildings' character in architectural details. A restaurant recently opened in retail space on the ground floor.

"The owner of nine of the buildings was about to retire, facing terrible capital gains," said Will Linder, a consultant to the city. "The appraisals came in at \$710,000. We only had \$450,000, so we offered him that plus a tax loss to the city in the amount of the difference. It was the only way we could make the numbers work, but it was a win-win situation."

said, "but we turned the numbers around. Here, 95 percent are totally accessible. And we contracted with the local housing authority to provide maintenance and technical assistance, because they know the regulations.

"If I had it to do over again, I'd do a building like this as market-rate housing. We had a waiting list of 85 people a full year before this project was ready, but when we started qualifying them, only six of them qualified under the income limits." May said he now sees the possibility of a market-rate apartment complex on another street.

Main Cross is a corner park, once the site of a burned-out drugstore, now graced by a gazebo and a mural depicting architectural elevations of other local buildings. A few blocks away, an affordable housing program is transforming the Mattie Lee neighborhood. Here the city bought 23 lots, most containing dilapidated houses, to start an affordable housing program for first-time home buyers.

"People won't change their lifestyles just because welfare is ending," Linder said. "But they will change for home-ownership."

"And we've had no problems with paybacks," May said. "Our loan approvals are safe, because our borrowers' neighbors are on the loan committees." ■

4th district

PROFILE

DAVID LOLLIS

**Executive Director
Appalbank
Berea, Kentucky**



David Lollis heads Appalbank, a financial institution established last year as an umbrella organization for three

nonprofits that have served Appalachian Kentucky, Tennessee, West Virginia, and Virginia since the 1970s. They include a credit union, a housing service, and an economic development

corporation. Lollis has worked in Appalachia for most of his career, except for 10 years spent in Manhattan, and is glad to be back in Berea, Kentucky.

Poverty in Appalachia has been so widespread for so many generations that many Americans, including some finance professionals, consider it a given. A different breed operates Appalbank, certified and funded as a Community Development Finance Institution by the U.S. Treasury. The bank grew organically from what are now its vertical partners in housing, credit, and economic development. All of

those operations, in turn, grew from the conviction that if local people could own and control the region's resources, they could eventually end the region's poverty.

Appalbank works through the financial products of its components:

The Federation of Appalachian Housing Enterprises, Inc. (FAHE), an association of 27 local nonprofit housing organizations, offers 30-year mortgages at one to three percent to low-income homebuyers,

and cash-flow financing to its member groups in the pre-development and construction phases. Each year, FAHE serves as the lender of last resort to finance 170 new homes, 170 rehabs, and 900 repairs. One of its recent projects is the Main Cross apartment complex in Mt. Sterling, Kentucky (see page 1). FAHE also counsels homeowners and provides technical assistance, fundraising, and advocacy for its member groups.

The Central Appalachian People's Federal Credit Union (CAPFCU) gives its members an alternative to usurious finance companies, rent-to-own stores, and check-cashing outlets. Since 1980, CAPFCU has loaned more than \$17 million to 8,400 low-income borrowers for essential needs—a used car to drive to work, for example.

The Human/Economic Appalachian Development Corporation (HEAD), formed in 1974 by a network of churches, promotes sustainable, human-scale economic development. One of its projects is the HEAD Community Loan Fund, which offers credit and technical assistance to small businesses. Many of these small businesses are local artists and craftspeople who attract a growing tourist trade to their towns.

"I could tell you horror stories," says David Lollis about the need for quality financial services credit in his region. He understands how expensive credit drags poor people into a downward spiral of debt and hopelessness, how they can be completely uninformed in the ways of mortgages, and how they can manage their income when given the right tools.

The challenge, he says, is working within the geographically fractured politics of financing. When decisions affecting Appalachia are funneled through Cleveland, the politics of and beyond either place can affect the decisions. The strengths of organizations like his are that they are based in the communities they serve, and the regulatory climate currently favors low-income credit unions.

"There's a danger in franchising housing groups," Lollis says. He questions whether a major grantmaker needs to select a national organization—or even establish a new local branch of a national organization—to oversee a local, rural project being financed through Appalbanc. This practice is not cost-effective, he says, when Appalbanc's board brings together locals of various backgrounds (e.g., banker, welfare

director, minister, retailer, low-income homeowner) who may not have talked together before. The sparring perspectives raise questions and solutions that may never occur to outside agencies. One of those questions is who to serve first in areas where even the median income is low.

"The goal in rural housing," Lollis says, "is to get debt service down so low that you can rent units without rental supports while serving people making 60 percent of median income or less and while doing gut rehab downtown (as in Renaissance Kentucky; see page 7). Those on the cusp—below median but above 60 percent—are the ones who are hurt."

Debt service is a fine line to walk, he emphasizes. "If you have no debt, you get fewer tax credits. If you have too much debt, even deferred, it can be crippling."

Locals should be the origin of economic development, too, Lollis believes.

"HEAD was never for industrial recruiting," he says. "It's always been economic development with a human interest in what happens to people. In industries like mining, you have to give away so much, is it worth it? Our approach is to involve locals in the process, to create things that are sustainable."

For example, he points out, local nonprofit housing developers bring in construction businesses that achieve a multiplier of eight to 12 times, compared to a McDonald's restaurant turning the money over once or twice. Other sustainable businesses that he recommends are day care centers, education programs, mom-and-pop retail, and crafts. He cites Simple Gifts, a maker of Shaker-style furniture. The owner, whose previous building was destroyed by a tornado, was "unbankable" when he approached HEAD. Now he employs staff.

Appalbanc's know-how has come at some cost, Lollis concedes, recalling an early seven-percent spike in delinquencies. "We prided ourselves on never foreclosing, until we realized we needed some foreclosures for the safety of our depositors," he says. Delinquencies are now only one to two percent a year, thanks in part to a policy of voluntary conveyance, in which a house is reconveyed to the bank until the owner becomes solvent.

"We know how to do this lending," Lollis says, "even though, just like our clients, we have no cushion." ■



in my opinion

KAREN MOCKER PATTON

Executive Director
Enterprise Development
Corporation

MICROLENDING IS THE MOST COST-EFFECTIVE SOURCE OF NEW JOBS

Karen Mocker Patton is executive director of the nonprofit Enterprise Development Corporation in The Plains, Ohio. She directs a dynamic team of professionals who provide loans, training, and consulting services that enable low-income residents of the 30 counties of Appalachian Ohio to establish and manage small businesses. Over the past 10 years, Patton has administered \$3 million in loans to more than 200 businesses, some of which now employ dozens of local residents full-time. Currently, she is working with the Ohio CDC Association to write a guide to microlending for other organizations, and to offer classes in microlending this fall.

Microlending is such a versatile endeavor, it's inherently risky to "standardize" your approach to it. By the nature of the work, each microlending program thrives best in its own entrepreneurial mode, as does each microenterprise. Nevertheless, potential microlenders can learn much from the experience of longstanding microenterprises and their finance institutions.

Twenty years ago, Enterprise Development Corporation became one of the first agencies to use microloans, and our experience has taught us some principles for microlending. First, however, agencies must weigh the reasons why they should become involved in microenterprise financing.

The first and most pragmatic reason is that microlending is the most cost-effective means to create jobs. Our borrowers create their own jobs, and they eventually create jobs for their neighbors. This kind of employment base doesn't rely on a costly economic development program to market our region to existing companies. It happens without municipalities being forced to offer costly perks to persuade current employers to stay or expand.

It does, however, require the innovative use of government and private resources, applied in a refreshingly direct manner: teach budding entrepreneurs basic business practices, lend them a moderate amount of seed money, coach them to clear predictable hurdles, and allow them to learn from on-the-job self-training.

Our favorite success story involves a woman, formerly a welfare recipient, who borrowed \$3,200 to start a home health-care business. Three years later, she employs 50 full-time workers in an industry that's essential to our aging population. Last December, she shared a podium with U.S. Treasury Secretary Robert Rubin to speak on "In-Your-Face Economic Development." She's been asked to speak on her experience often since then.

“We have found that many traditionally underserved borrowers are the most conscientious and driven to succeed.”

Second, microlending allows low-income people to take possession of their own problems and their own solutions. This self-sufficiency develops on several levels, beginning with the experience of dealing with a financial institution. Many of our borrowers have no savings and little credit history. Their “banking” experience at Enterprise prepares them to work effectively with conventional banks later.

We offer technical assistance, including classes funded by the Department of Education. This is a major consideration; we found that most borrowers need help not only to start a business, but also to manage it as it developed. Our watchword became, “Run your business, don’t let it run you.”

Peer pressure can be used constructively, also. We sometimes arrange peer lending, in which several borrowers agree to borrow a pool of money,

make loans to each other, and make group decisions about their businesses. They succeed or fail together, so they’re tough on each other; but they also share the work when necessary. Their businesses become a community effort.

Third, microlending will grow in importance because of welfare-to-work legislation. As welfare benefits end over the next three years, a vast pool of semiskilled workers will enter a market that offers few correspondingly skilled jobs paying a living wage. Some welfare recipients may benefit from time-consuming retraining, but they and the region stand to gain more if they can grow businesses of their own.

The principles that drive microlending stem from the realities of our market. Most of our borrowers lack the traditional collateral of home equity. They also face the stereotypical regulations of traditional banks that often rule out poor,

female, or minority borrowers. They live in an underdeveloped region with relatively few resources.

From the disenfranchised borrowers’ standpoint, then, microloans are the first tool toward economic stability. The operative term here is “tool.” We may be a lender of last resort, but our borrowers use their loans as tools, not band-aids. We have found that many traditionally underserved borrowers are the most conscientious and driven to succeed. Given our mission in a predominantly rural area with a growing tourist trade, Enterprise has accepted some very offbeat collateral from unusual entrepreneurs—for example, the inventory of a bait wholesaler, and a magician’s props, called “illusions” (we found that one rather ironic). As their businesses succeed, however, homeownership can follow naturally for such borrowers. Their home equity gives them a greater tool—one of their own making—with which to grow their businesses. Most importantly, they gain the confidence that comes from acquiring and operating a business, making it possible for them to negotiate in the mainstream economy.

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and suggestions.*

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RENAISSANCE KENTUCKY BRINGS BACK MAIN STREET

Kentucky's downtowns speak of a time past when commerce, government, and domestic life centered on a town square, each small town's architectural gem. Renaissance Kentucky is the state government's initiative to bring that time back to life, enhancing tourism, job creation, cultural growth, housing opportunities, and a "sense of place" in keeping with Kentucky's heritage.



Although downtowns have been neglected during 50 years of suburban sprawl, they comprise an investment in infrastructure that should be a basis for growth, say Renaissance Kentucky officials. The key is to coordinate the available funding among agencies and apply it cost-effectively. To do that, Renaissance Kentucky links governor-appointed staff from the Kentucky Housing Corporation with the Kentucky Department for Local Government, Kentucky Heritage Council, and Kentucky League of Cities, along with representatives from federal and local government and from the private sector.

At each legislative session, Renaissance Kentucky grants incentives to applicant cities at three levels, based on each city's previous commitment to its central business district. Among the incentives are matching grants for pedestrian streetscapes and façade restoration, tax credits to utilities to

bury their service lines, tax credits for building improvements for desired uses, and low-income housing tax credits to convert downtown space to modern apartments. A city's eligibility depends on a detailed set of criteria, including its financial support, leadership, goals and objectives, possible impediments (logistic, regulatory, or political), building occupancy, historic integrity, appearance, safety, and market considerations.

Officials expect Renaissance Kentucky to operate in about 50 cities in the near future. When introducing the program last fall, Governor Patton said, "We'll continue to look for ways to be a better partner as we strive to restore the heart of our cities. We can't make our downtowns something that goes against our economic and social desires, but we can keep them a safe and efficient part of our constantly evolving society." ■

SOCIAL COMPACT ANNOUNCES CALL FOR NOMINATIONS

Nominations are being accepted for the 6th Social Compact Awards recognizing innovative and successful industry and neighborhood partnerships that are strengthening and rebuilding America's lower-income communities.

Each award-winning business and non-profit community development group partnership receives a \$10,000 grant and is the focus of a national recognition program launched at the National Press Club in Washington, D.C.

Partnerships are judged based on the non-profit community development group's and local business's joint achievements strengthening their community; and, the business's track record of success in a lower-income community. Applications must be filled out by a neighborhood partner and a business partner. **Both portions of the application must be submitted together as a joint application no later than September 30, 1998.**

All applicants are profiled in a publication distributed to Congress, the media and business. Judging will occur throughout the fall and a group of finalist partnerships will be invited to Washington for the competition, which will take place before a panel of national public and private sector leaders at the National Press Club on May 5, 1999.

Award program activities also include a Congressional Symposium, Federal Reserve Leadership Celebration and briefings with Administration leaders. For more information or to request an application contact Social Compact at the following address and phone number or download an application from our website. Contact: Amy Whittle, Social Compact Awards Program Director, 5225 Wisconsin Avenue, N.W., Suite 204, Washington, D.C. 20015; (202) 686-5161. World Wide Web <http://www.socialcompact.org>. ■

100 FASTEST GROWING INNER-CITY COMPANIES IN AMERICA

The Initiative for a Competitive Inner City (ICIC), a Boston-based advocacy organization, and *Inc. Magazine* have established a new program to recognize the 100 fastest growing businesses based in core urban areas in the United States. Harvard Business School Professor Michael E. Porter, Founder, Chairman and CEO of ICIC and George Gendron, Editor-in-Chief of *Inc. Magazine* anticipate that The Inner City 100 will highlight the magnitude and breadth of inner-city entrepreneurship and business growth.

“The Inner City 100 is a great opportunity to showcase the growing dynamism of inner-city economies and the new frontier of entrepreneurship in core urban areas. For the past four years ICIC has been identifying successful inner-city companies and market opportunities, the competitive advantages of inner-city locations, and the best practices for operating in these locations,” said Porter. “By uncovering the most exciting growth companies in the inner cities we hope to promote further entrepreneurship and business growth and accelerate corporate America’s recognition of the urban business opportunity.”

“Given the extraordinary success of the Inc. 500 at demonstrating the importance of privately-held growth companies on the overall American economy, we believe that The Inner City 100 will have a similar effect on how we see inner cities,” stated Gendron. “The list will show that the inner city is not only a viable, but a compelling and attractive place to build a company.”

The inaugural Inner City 100 list will be published in the May 1999 issue of *Inc. Magazine*. Companies will be ranked according to their compound rate of revenue growth over the past five years. To qualify for the list, businesses must be independent, privately held, for-profit corporations, partnerships or proprietorships (not subsidiaries or divisions) that have:

- 51% or more of their physical operations in inner-city areas (Inner cities are defined as core urban areas that currently have household income and employment levels that are lower than their surrounding metropolitan areas.)
- Sales of at least \$1 million in 1997
- A five year operating history that includes an increase in 1997 sales over 1996 sales
- 10 or more employees

The top three Inner City 100 companies will be honored at the Inner-City Entrepreneurship Dinner, a national awards ceremony to be held in Boston on April 22, 1999.

For information on applying contact Inner City 100 by phone (617-292-2367) or E-mail (HYPERLINK mail to: initiative_InnerCity100@icic.org) initiative_InnerCity100@icic.org). Or visit the Web site (HYPERLINK <http://www.inc.com.inner100> www.inc.com.inner100) for more details. The deadline for entry is October 31.

ICIC’s mission is to transform thinking, reinvigorate market forces and engage the private sector in fostering healthy economies in America’s inner cities that create jobs, income, wealth and economic opportunities for local residents. By partnering with *Inc. Magazine*, ICIC hopes to elevate the awareness of viable and promising inner-city businesses that yield competitive rates of return. ■

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From the region’s standpoint, microlending works well because the community helps it to happen. The community starts with the board. Ours is an eclectic group, including two bankers. We’re fortunate to gain the input of talented human-service and academic professionals because we are located near the region’s hub for human services and a university.

The community also includes our staff. We spend a great deal of time raising funds for our loan pool and for our operations, so we rely on the confidence of the community at large that we are a sound investment.

Our regional community partners include vocational schools, colleges, chambers, and small-business development centers that offer classes and technical assistance. These operations coordinate their work with ours to benefit entrepreneurs located far beyond commuting distance from our offices.

Judging by the calls we receive from would-be microlenders, the politics and lack of understanding of the power of microenterprise in some regions make microlending inordinately difficult. Even in Enterprise’s case, it took years to build the relationships that motivate our partners to work with us. The effort has been well worth it to be an effective player in an emerging field, though, when you see the difference that microenterprise ownership makes in people’s lives. ■