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SPECIAL ISSUE

This *Bridges* highlights several presentations from the Exploring Innovation conference held May 2-4 in St. Louis.

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Exploring Innovation

Experts Take Conference Attendees on Creative Journey

By Linda Fischer
Editor

A few years back, Paul C. Light was not necessarily a welcome sight to community development organizations. In fact, they would hold their collective breath when they saw him coming. He says, with a grin, that he was known as “The Coroner.”

Light was referring to the days when he visited businesses and organizations that had been deemed innovative to discover what made them so. What he often found were organizations that had at one time been innovative but were unsuccessful at sustaining innovation. Instead of declaring them innovative, Light would report that their culture of innovation was dead.

Light, a professor at NYU Wagner, was one of several keynote speakers at *Exploring*



Core ideas from the conference were captured on art boards.

Innovation: A Conference on Community Development Finance from May 2-4 in St. Louis, sponsored by the Community Affairs Office of the Federal Reserve Bank of St. Louis. More than 200 people attended to learn how to be innovative

and how to apply the process to community development.

There are four important characteristics that high-performing, innovative organizations share, Light said:

- Relevance to the external environment—They know

the future is changeable.

- Agility—There are six or fewer layers between the top and bottom.
- Adaptability—Employees are saturated with information about what is going on and are more likely to offer ideas to generate change.
- Alignment—They realize that changing the social equilibrium requires metrics to see what the situation was in the beginning and anticipating what it becomes.

Andrew Hargadon, another expert on innovation who spoke at the conference, is an associate professor at the University of California, Davis. Innovation is much more than one person with one great idea, he said. In today's technological world, it's more likely to be

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Linking Investors to Economic Revitalization

By Anna Steiger, Senior Research Associate, Federal Reserve Bank of Boston; Tessa Hebb, Senior Research Associate, Labor and Worklife Program, Harvard Law School; and Lisa Hagerman, Doctoral Candidate, University of Oxford

This article is a summary of the information presented during the “Expanding Deal Flow of Community Investments” session at the Exploring Innovation in Community Development Finance conference.

Community-based organizations promote economic development by assembling investments in affordable housing, mixed-use real estate, community facilities and small business in specific geographies. There are calls for the community development sector to have an increased impact on communities by tapping large sources of institutional capital as a new source of funding for these activities. However, these community-based organizations are generally small and limited in their capacity to put together community investments that attract large institutional investors such as national banks, public-sector pension funds, insurance companies and foundation endowments.

Some community-based organizations have found a way

to tap institutional investors for deals by partnering with investment intermediaries who manage the risk of the transactions by pooling assets, spreading risk across investors and pricing the transaction up to the associated risk.

Communities are by definition embedded in location-specific geography. As a result, community investments tend to be small as well as hybrid and individual in nature. In

institutional investors and communities alike.

Such partnerships allow investment intermediaries or “investment vehicles” to use their expertise to structure a deal that delivers high financial returns to institutional investors while ensuring that the investment provides a community benefit. The investment vehicle actively manages investor funds, allocating them to community projects and creating a capital

and nonprofit organizations have begun to track these benefits for the purposes of quantifying the community impact of these projects.

Models of Investment Vehicle and Community Partnership

Our research examines several models such partnerships can take. Two of these models hold the greatest promise for unlocking value for investors and communities because they recognize the role and capacity of the community partner.

The first is the contractual model, where a not-for-profit community partner or fund sponsor organization (e.g., the Bay Area Council in the Bay Area Family of Funds) affiliates with a proven for-profit fund manager in delivery of the community development. The second is the ownership model, where a not-for-profit community organization embeds a for-profit development arm within its own structure.

These two models ensure the diversification, scale and rates of return necessary to attract large institutional investment dollars while simultaneously ensuring the revitalization goals of the existing community.

A good example of a not-for-profit community development financial institution with an embedded for-profit development arm is Coastal Enterprise Inc. (CEI) in Wiscasset, Maine.

Connecting large institutional investors to community-based investments remains a challenge.

contrast, institutional investors seek opportunities to invest large sums of money in easily replicable financial instruments that generate market-based returns with minimum risk.

While institutional investors have significant assets that if deployed in communities would have substantial impact, given the inherent mismatch between these investors and the investment opportunities offered by communities, such investment is unlikely to occur without bridging mechanisms that overcome these problems.

Our research suggests that investment intermediaries with expertise in working with community-based organizations are required to unlock value for

structure for the deal. The community partner, usually a community development corporation, draws on its local knowledge of the community to identify potential deals and work with the investment intermediary to structure the deal so that it has benefits for neighborhood residents. Such benefits include job creation, affordable housing and environmental sustainability through, for example, brownfield redevelopment and investments in clean-tech companies.

Investor benefits are measured first and foremost in market-based financial rates of return and secondarily in the ancillary benefits generated by revitalized communities. Several for-profit

CEI owns several for-profit subsidiaries, including CEI Capital Management LLC (CCML), which manages CEI's \$249 million New Market Tax Credit (NMTC) allocation. CCML is the investment vehicle intermeduating between institutional investors and communities.

In 2003, the Nature Conservancy, a nonprofit conservation organization, approached CCML to be a working partner in an NMTC deal that would tap private-sector capital to help conserve the environment while promoting economic development in a rural region of Maine near Millinocket.

The partnership ultimately attracted equity investment from GE Commercial and Industrial Finance in exchange for the federal tax credits. This equity allowed two recently shuttered paper mills belonging to the Great Northern Paper Co. to reopen, retaining jobs for 650 people. The deal also provided for the Nature Conservancy to purchase 41,000 acres of land from Great Northern and called for a perpetual conservation easement on an additional 200,000 acres of land owned by the paper company.

In this deal, the Nature Conservancy was the community partner, connecting CCML to the investment opportunity and ensuring that the deal provided social returns to the area. CCML was the investment vehicle, connecting the institutional investors to a community-based investment while ensuring that the deal provided

Intermediaries can help community organizations make deals with institutional investors.

the financial returns required by investors.

Building Strong Partnerships

The cases examined in our research provide insight into how investment and community intermediaries partner in a community development transaction. A working relationship between an investment vehicle and community partner becomes a formalized one, and the best partnerships have clearly defined roles. These partnerships can be initiated by either entity. Both investment vehicles and community groups look for partners that have a level of financial sophistication and proven experience with successful community-driven economic revitalization.

Community partners are organizations and businesses rooted in the community with an explicit mission to promote community benefits and work with the investment vehicle to identify and structure community investments. They bring with them various "tools" that help them unlock community benefits.

Financial Tools

Financial tools allow community partners to work with investment intermediaries to structure deals that provide the financial returns required by institutional investors.

These tools include philanthropic grants, below-market-rate funding, and tax credit allocations sponsored by the federal government, such as NMTCS, the SBA's program for Small Business Investment Companies, and the Low Income Housing Tax Credit.

Social/Political Tools

Social/political tools include a community partner's deep knowledge of local conditions and history, ties to key community stakeholders, mission to benefit the community, and track record of contributing to local economic development. These tools engender trust with the community, which can help to get a development project approved, structure the development to meet local market demand that yields high financial and social returns, and leverage additional resources for these community investments.

Material Tools

Material tools include land or a community facility owned or managed by the community partner.

Our research examines several types of community partners, including not-for-profit fund sponsors; not-for-profit organizations such as CDCs and CDFIs; mission-driven lending

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ENDNOTES

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Mixing It Up

Public/Private Partnerships Basis of Finance Fund

By Valerie Heiby
Director of Development
Finance Fund

This article is a summary of the information presented during the “Innovation in Product Development: Creating Value from Value Created” session at the Exploring Innovation in Community Development Finance conference.

Depressed property values, stressed infrastructure and investment flight are just some of the economic issues faced by distressed communities. Potential small business owners or community organizations seeking funding for projects in these areas may have a hard time securing financing through conventional means. And even when financing is available, interest rates may be prohibitively high for borrowers. The Ohio Community Development Finance Fund (“Finance Fund”) is helping organizations in Ohio’s distressed markets access capital more easily through its Linked Deposit Fund.

Who We Are

Finance Fund is a private, nonprofit, 501(c)(3) corporation that supports community partnerships working to revitalize

disadvantaged communities in Ohio. Our partners collaborate to transform emerging rural and urban communities into vibrant, diverse, economically healthy neighborhoods. These public/private partnerships are a combination of financial institutions, foundations, community-based organizations, and federal, state and local governments.

Finance Fund creates partnerships that provide financing resources to locally controlled community-based nonprofit organizations serving low-income communities as well as those for-profit businesses within the communities expressing an interest in revitalization and beneficial development.

What It Is

The Linked Deposit Fund is a financial product used to reduce the interest rate on permanent and construction financing. It provides community-based, nonprofit developers with access to affordable financing from local lenders for housing and economic development projects.

A variety of linked deposit programs exist throughout the country for needs ranging from agricultural waste management to water- and energy-related

projects. The Finance Fund’s Linked Deposit Fund focuses on affordable housing and community development from a mission-driven standpoint.

How It Works

Through the Linked Deposit Fund, Finance Fund places reduced-rate certificates of deposit at local banks participating in specific projects. The lower interest rates paid to the Finance Fund on these deposits allow the banks to provide community-based nonprofits with greatly reduced interest rates for permanent or construction financing. The rates are fixed for these clients for the life of the loan, even though the average linked deposit is seven years.

The Linked Deposit Fund itself is funded through a combination of public monies and benevolent investors. Though there has been strong investment support for this program, liquidity is limited. A lack of liquidity could mean no money for further linked deposits, and thus, no money for vital community development. Finance Fund is able to solve this problem through a unique recapitalization model that offers aggregated portfolios of CDs as collateral for a loan to the Finance Fund—freeing up

cash flow for additional linked deposit projects.

What Makes It Unique?

The linked deposit model is sustainable. Linked deposits perform a programmatic function in that they lower interest rates on mortgages but do not serve as collateral or security for the mortgage. Therefore, the risk of loss is minimal and, upon maturity, capital may be recycled.

The linked deposit model is scalable. This model works for small projects and large projects equally well. The Finance Fund’s Linked Deposit Fund has impacted projects of \$25,000 and projects of \$13 million. The biggest limitation to the model is on the availability of capital for depositing.

The linked deposit model is flexible. The characteristics of a deposit can be adjusted to achieve specific rate objectives by varying the amount, term and rate.

The linked deposit model leverages. Because a lender’s objective is to achieve a yield on a loan over a set term, the linked deposit’s function is to enable a revenue stream that pays for shortfalls incurred when loan rates are lowered. Any shortfall will be funded once the linked

deposit matures—usually many years prior to the loan amortization. Because the lender has received compensation for the reduced loan rate, the loan can continue even after the deposit has matured.

The linked deposit model is a true public/private partnership. Though capital resources for the Linked Deposit Fund initially came from the public sector, substantive private investment also has been attracted. The fund provides a perfect opportunity for many private investors to fulfill socially responsible investing requirements.

The linked deposit model is a valuable tool in distressed markets. Economically distressed markets need varied subsidies to tackle a wide range of development hurdles. Linked deposits are one of the tools adding value to these economies through a “hidden” subsidy strategy.

When borrowers are able to make smaller loan payments because of lowered interest rates, many parties benefit. Money saved by a housing developer, for instance, can translate to lower purchase prices for those homes, making home ownership accessible to more people within the community.

The Program's Success

Since 1989, the Finance Fund's Linked Deposit Fund has provided lower interest rates to clients, leveraging over \$291 million. Investments totaling \$24 million have been made in 125 projects, creating 940 full-time jobs and 3,841 units of new or rehabilitated housing. Two recent success stories are examples of these projects.

The St. Paul AME Wellness Center in Columbus, Ohio, brings needed health-care services back to a blighted

urban community and fills a void left by the departure of a community hospital a decade ago. The wellness center is projected to create 25 full-time jobs and 33 construction jobs and will support the development of 16,075 square feet of commercial space. A linked deposit provided a significant interest rate reduction, from 6.9 percent to 3.94 percent.

The New Straitsville Downtown Revitalization project promotes the historic Main Street districts in two of the “Little Cities of Black Diamonds” within Southern Ohio's Hocking Valley Coal Region. The project is refinancing and rehabilitating five properties in rural downtown areas. The project will lead to the creation of 10 full-time jobs, 13 construction jobs and 10,000 square feet of commercial space. The linked deposit greatly reduced the



One of the buildings that is part of the New Straitsville Downtown Revitalization project in southern Ohio's Hocking Valley Coal Region.

interest rate from 7.75 percent to 5.25 percent.

For more information on the Linked Deposit Fund and other programs, visit www.financefund.org.

Exploring Innovation

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a collaboration of people taking a great idea and improving it.

A perfect example is Bill Gates. The founder of Microsoft didn't invent anything, Hargadon said. Instead, he and his partners took computer products that already existed and made them practical and marketable to the general public. He was innovative.

Hargadon emphasized that innovation alone is not enough. “Success depends on your ability

to mobilize your network around an idea,” he said. The more people you know and connect with, the more likely you are to be successful.

How does one take all this information on innovation and apply it to community development?

The industry is well-positioned to innovate at this point in time, said Sandra Braunstein, director of the Division of Consumer and Community Affairs for the Federal Reserve System.

Although nonprofit lending groups have become innovative

in their approaches to lending, the majority of funding still comes from the federal government. “Are there ways to get better at this while remaining true to the mission?” she asked.

Improving the sustainability of initiatives could open up opportunities for innovation, she said. Processes, from financial counseling to loan servicing, could be improved.

In new marketplaces, companies get the opportunity to test and verify and pilot. The community development field needs to develop funding

sources for this type of research and development.

The private sector connects the dots through consortiums and product development groups. “We could create that type of institution and share our knowledge with one another,” she said.

These are just some of the ideas presented at the conference. For more, read the articles in this special issue of *Bridges* and the proceedings from the conference, which can be found at www.stlouisfed.org/community/innovation.

How Much Subsidy Is Needed for Redevelopment?

Why do developers, lenders, investors and government agencies choose to participate in redevelopment projects? How important are public subsidies? Do redevelopers depend on them to get the job done? On these two pages, a state government official, a banker and a developer share their points of view.

Mike Downing, with the Missouri Department of Economic Development, suggested that the public sector objective for redevelopment is removal of blight to stimulate private investment and to reduce crime and disinvestments. Likewise, local and state government agencies want to increase economic activity by creating jobs, reducing unemployment and increasing the tax base. Redevelopment also may slow urban sprawl.

The public sector may be of assistance with a redevelopment project, but there are considerations, including:

1. Does it conform to an area plan?
2. What is the impact on surrounding property?
3. How many jobs are created and what type?
4. What is the effect on competition (displacement)?
5. How much are public costs for the project?
6. What is the risk if it doesn't work?
7. How much are net new tax revenues?
8. Will the project be successful?
9. Is the developer qualified?
10. Will the project stir up controversy?

Downing said additional considerations come into play when the public sector considers redevelopment incentives. For example, will the existing tax base and property decline continue if the area is not redeveloped? Will there be any net new taxes (new tax revenues from the project less incentives and "displaced" taxes) from the development? Will the developer get involved in the project without public sector incentives?

Public incentives are appropriate when the project passes the "but for" test, Downing said. For example, the project would not get done but for the

Lender/Investor Educates Others on Tax Credits

Walker Gaffney with US Bank indicated that most lenders do not understand the complexities and costs of rehabs or census-tract-eligible subsidy deals involving New Market Tax Credits (NMTCs). They tend to think of them, perhaps understandably, in terms of the market-rate deals they see day in and day out.

For example, the typical lender has a problem with 20 percent developer fees. "Many lenders believe rehabbers are involved in a subsidy grab; and the second they are paid any developer fee, they will run for the hills," Gaffney said.

As US Bank's commercial real estate NMTC program manager nationally, Gaffney's role is to edu-

cate the bank's conventional lenders, introducing them to new markets and encouraging them to lend to projects located in subsidy niches available to real estate developers in various arenas.

Lenders who take the time to understand the disproportionately high upfront and ongoing costs of doing historic rehabs or deals with NMTCs quickly come to understand the importance of layering multiple subsidies. The synergies between the Historic Tax Credit (HTC) and NMTC programs make them very compatible. The recapture periods for the credits are similar—five and seven years for HTCs and NMTCs, respectively. Also, 70 percent to 75 percent

of NMTC deals have been real estate deals.

However, while historic rehab credits are virtually unlimited, there are not enough NMTCs available each year. For developers interested in using NMTCs, Gaffney advises, "Have your deal teed up and ready to go when the next round of tax credits is available."

For the lender or investor, what are some of the considerations when looking at a redevelopment deal?

1. What's the developer's track record and reputation?

- a. Projects completed on time and on budget
- b. Subsidy-promised developer is truly committed

2. Is the entire team experienced and dependable?

- a. Accountants
- b. Legal representation
- c. Other consultants (HTC, NMTC)

3. Do the projections make sense for this product in this market?

- a. Basic underwriting should not get lost in the subsidy shuffle.
- b. Getting it built and taking tax credits is only half the story.
- c. Successful operation over many years is required to avoid recapture.

These articles are a summary of the information presented during the "How Much Subsidy Is Enough (or Too Much)?" session at the Exploring Innovation in Community Development Finance conference. Presentations were given by Steve Trampe, president, Owen Development; Walker Gaffney, vice president, US Bank; and Mike Downing, co-director, division of business and community services, Missouri Department of Economic Development.

incentives, perhaps because: the area has not attracted investment because it's blighted or there are extraordinary project costs associated with things like hazardous waste.

Finally, a big factor in the "but for" test is whether the developer has a gap in project funding.

The method of funding will depend on the type of gap. The gap may be in the developer's return on investment (ROI). For example, the market rate for the ROI on the project is 12 percent and the projected return without incentives is 7 percent, so the gap is 5 percent. Before deciding on whether the funding mechanism will include grants, tax credits, or tax abatement or diversion such as tax increment financing (TIF), several issues need to be addressed. Can costs be reduced? How accurate is the market ROI? How accurate is the developer's projected ROI?

On the other hand, if the gap is due to a lack of funds to cover project costs, the funding method may be a subordinated direct loan, a guarantee of a portion of a bank loan, grants or tax credits.

The best use for diverted taxes, such as TIF, is to fill an ROI gap. There is little risk if the project fails, and upfront cash is not required. However, other taxing entities do not like their taxes diverted, Downing said.

Although tax credits can be used for either an ROI or a lack-of-funds gap, there is no repayment, and tax credits are not as efficient as cash, he said. Formula tax credits do not take into consideration whether there's a gap and, if so, how much the gap is. However, both tax credits and grants have the benefit of being administered more easily than tax abatements and with more consistency.

Direct loans are best used to fill a gap caused by a lack of funds, Downing said. Although there are disadvantages to using loans—high risk of default, funding must be available and less consistency in amounts provided—there are also advantages. Repaid funds can be used for other projects, funds can be deferred in times of inadequate cash flow, and the loan can be repaid after the project is sold.

Downing suggests that government agencies have to decide whether it is more important to fund only the gap or to be more consistent. If they choose to fund only the gap, the public sector must be prepared to develop a consistent process for analysis and monitoring. His final recommendation is for priority projects: Consider providing funds for a portion of the developer's pre-development costs.

Developer Avoids Public Help

Steve Trampe with Owen Development said jokingly that he does developments in St. Louis County so he can afford to do deals in the City of St. Louis. Even though two-thirds of his projects in the city end up close to break-even or lose money, he is committed to historic redevelopment. Why?

"Because it creates a legacy," he said. "I'm thinking more about how good buildings will last. If a building lasts 100 years, there's a good chance it will last another 100. That is not true with most new buildings."

Developers face challenges that run the gamut from time delays and unknown costs to the perception of crime in depreciating areas, the lack of adequate parking and typically higher taxes. On the plus side, redevelopment projects usually have lower acquisition prices, a central location, unique buildings and access to public sector incentives.

Trampe said he does not mess with subsidies if it can be avoided. Every time another project is added, the difficulty of the project goes up exponentially, he said. His advice: Keep it simple! The more subsidy sources, the less chance the project will get done. For example, if New Markets Tax Credits are used, that means the developer is prohibited from selling the property for seven years.

A developer may not get involved if he has to spend too much of his own money for a feasibility study on property he does not own. The level of architectural plans required by the public sector, in many cases before anybody else is even committed to the project, is time-intensive and costly. He indicated that, for some projects, a developer may have to incur \$1 million in due diligence costs before the municipality or other local agencies commit to the deal.

It's difficult to nail down construction costs on a complex historic rehab, he said. "It's much easier to build a Walgreens ... You know the construction costs because you do the same building over and over. But every different

redevelopment project is unique and presents different challenges.

"In the city, there is no such thing as 'virgin land' or vacant property—there's always something underground, even if above ground the building burned or was demolished. Forget about sampling. Get an excavator and see what's there."

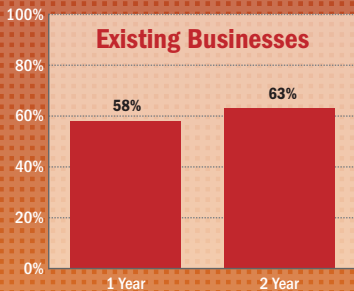
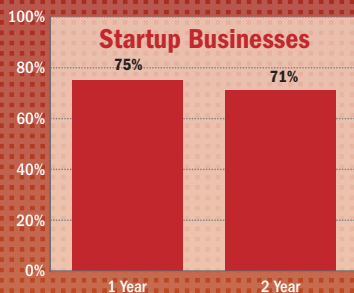
In a city rehab deal, the developer worries about cash flow, equity, completion, personal guarantees and what can go wrong. Fees are needed to cover time, financial risk, losses—most cover a 20 percent flux. "The developer may get a \$1 million fee, but most of it's generally not profit. It needs to cover a lot of office overhead, in many cases from three to seven years of it."

It's all about risk and reward. Redeveloping historic properties is a hugely risky business. So how does a redeveloper judge success? In addition to an above-market-rate ROI that includes cash flow, appreciation at sale and tax benefits, the fewer hassles the better. If the project was done in a decent time period and on budget, if he didn't lose too much sleep worrying about the unknowns and if he didn't lose any friends (lenders, investors, public agencies), that's a success, Trampe said.

The Owen Development Corp. led the rehabilitation of the Continental Building in St. Louis. The financial package for the \$28 million project was extremely complex, with a number of public and private sources.



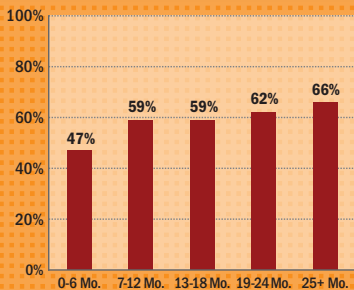
Revenue Increased by at Least 25%



Percentage of businesses that have increased their revenues by at least 25%. Measured at first and second year of participation.

Workforce Goal:

To increase participant incomes by at least 25% in three years.



Real change takes time.

Percentage of participants meeting Workforce Goal by time enrolled in the Initiative.

The first participants will reach their third year in the program in fall 2007.

Portland, Ore., Working to Free Residents from

This article is a summary of information presented by Lyn Knox, program manager for Portland, Ore., during the "New Approaches to Reduce Urban Poverty" session at the Exploring Innovation in Community Development Finance conference.

In 2004, Portland, took a bold step to reduce poverty in its urban neighborhoods. After years of funding community-based organizations to help a lot of people a little bit, the city's Bureau of Housing and Community Development (BHCD) believed it could be more effective by pursuing a focused strategy founded on best practices.

From that belief, Portland launched its Economic Opportunity Initiative in 2004, focusing community development block grant (CDBG) funds on increasing the income of low-income individuals and families. The initiative is a citywide poverty reduction program with a goal of increasing the incomes and assets of low-income residents by a minimum of 25 percent within three years.

Two factors led BHCD to transition from revitalization to income generation as a poverty-reduction strategy—changes in the community and in the city's strategic planning process.

In the late 1990s, Portland experienced a boom. Portland's urban core was revitalized. However, as revitalization and gentrification occurred, low-income people—once concentrated in the inner city—dispersed. Despite the boom, Portland's poverty rate remained constant. Fifty thousand households were living in poverty.

As the Portland landscape changed, BHCD undertook a strategic planning process that included conducting focus groups and meeting with key stakeholders. BHCD responded to the strong messages it received:

- Focus on those most in need: concentrate resources for real impact rather than spreading the money too thinly.
- Move from a geographic to a population focus, and shift the focus from those below 80 percent of the median family income to those at or below 50 percent.
- Concentrate on three initiatives: workforce development for adults; a workforce development program for youth; and microenterprise or entrepreneurship projects that help participants start or expand small businesses.

Other economic development efforts had a trickle-down approach for years (tax incentives, physical revitalization, tax reform, regional assistance to lure companies), and it hadn't worked for low-income residents. BHCD made the decision to change to a bottom-up approach.

BHCD identified best practices from smaller projects throughout the country and implemented them on a citywide scale. Now it invests in a coordinated portfolio of more than 30 projects incorporating these best practices as a foundation:

- Projects serve groups of people united by some common characteristic such as ethnicity, race or entrepreneurial ambition. For example, a project for immigrant Eastern European metal workers builds on their technical experience and trains them to use American equipment.
- Projects provide extensive multifaceted support. Standard components include peer support and help with a range of issues, such as child care, tuition and transportation.
- Real change takes time. The initiative works with participants for three years

to find a permanent way out of poverty.

Portland moved swiftly to change the way scarce financial resources were invested in the city's people. By creating a pool of federal, regional and local funds, including matching grants from the United Way, BHCD provides financial resources to organizations trying to expand successful projects that reduce poverty. BHCD used the scale of the initiative to get additional resources and to develop leverage. The results?

Year 1: 19 projects with \$2.1 million in CDBG and \$650,000 in city general funds;
Year 2: 30 projects with \$2.5 million in CDBG and \$650,000 in city general funds;
Year 3: 34 projects with \$2.3 million in CDBG and \$1.26 million in city general funds.

The Economic Opportunity Initiative has developed an array of leveraged resources for participants:

- Pro bono legal aid: Small businesses receive legal services, including help incorporating and reviewing contracts.
- Health care: Formerly homeless participants receive free health care through a partnership with Kaiser Permanente.
- Free market research: Microenterprises can obtain free customized reports.
- Matched savings accounts: Savings toward education, home ownership or a small business investment are matched \$3 for every \$1 contributed by clients.
- Low-interest business loans: Small-business entrepreneurs are given access to microcredit lenders who can provide low-interest loans.
- Extended Temporary Assistance for Needy Families (TANF) benefits: Oregon has extended TANF benefits for recipients who participate in initiative projects.

Poverty's Grip

- In-depth credit repair: The initiative helps clients repair credit records.
- Clean slate: Participants receive help with cleaning up minor issues with the courts that are barriers to work.

Initial Results

At the end of 2006, there were 1,865 participants in the various projects (389 microenterprises and 1,476 workers on the job or in training). As places become available, new participants are enrolled. By July 2007, the number was expected to exceed 2,000. Seventy-five percent of participants had household incomes at or below 30 percent of the median family income at enrollment. The others were at or below 50 percent.

Return on Investment

The cost per participant ranges anywhere from \$1,000 to \$10,000 per year. The average cost per participant is \$5,500 in Year 1; \$1,000 in Year 2; and \$1,000 in Year 3.

In comparison, the average annualized income gain of workforce participants at six months after placement is \$15,059, far exceeding the cost of the program. In addition, four times the number of workers now have employer-paid health insurance as a result of being placed in jobs.

For existing businesses, revenues have increased an average of 267 percent over two years of participation. Start-up business revenue at two years is 30 percent above the national average of \$34,301 for comparable three-year businesses.

As Portland continues to transform the way it does business, there are many cities nationwide that can learn from their experiences.

Revitalization

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intermediaries—either not-for-profit, for-profit or public intermediaries; local governments and officials, such as mayors; and underserved businesses, including minority- and women-owned businesses. Not-for-profit fund sponsors and not-for-profit affiliates help ensure robust community benefits because of their strong community development mission and role in identifying investments. They also bring with them powerful tools that can make the deal work from a financial point of view.

Community Impacts

There are many social benefits that can be derived from community-based investing. The social metrics are slowly being measured; and, while there is not yet any standardization, various funds are beginning to define and report on the nonfinancial returns.¹ Some of the social returns being tracked include:

- Economic development benefits, such as the creation of livable-wage jobs, affordable rental and ownership housing, and mixed-use real estate developments. These benefits can result in other returns for local areas that are more difficult to measure but are important, such as increases in the tax base due to the growth of

businesses and an increase in property values.

- Community impacts, including the creation of community facilities, such as day care centers; open spaces; job training programs; and technical assistance services for entrepreneurs.
- Environmental sustainability, such as promoting mixed-use and transit orientation; green building construction and operation; energy conservation and waste reduction; and alternative energy utilization.

In addition to these direct benefits, our research demonstrates that community-based organizations that partner with investment vehicles to develop large-scale projects can also benefit organizationally. For many, the experience has been transformative in nature, bolstering the capacity of the community partner, spurring them on to greater innovation and strengthening their overall sustainability.

Conclusion

Challenges remain to connecting institutional capital to community-based investments. They include increasing deal flow, overcoming market prejudice and creating models that can deliver smaller amounts of capital to investment opportunities. Notwithstanding, institutional investors have placed large amounts of capital in economic

development investments, and the numbers are growing.

To date, public pension funds have committed \$11 billion of their capital to targeted investment in underserved capital markets (or emerging domestic markets, as they are sometimes called).² And market-rate, mission-related investments from foundations now stand at \$2.3 billion.³ Increasingly, foundations are using both their program funds and their endowment funds for these investments.⁴

Moreover, lessons learned from public pension funds in California, New York and Massachusetts demonstrate that these investments yield both high financial returns and social returns.⁵ While more research is needed to examine the financial and social returns of these investments, it is clear that this is a growing sector for community development finance.

Inclusive Growth

Strategies for Moving People into the Economic Mainstream

By Robert Weissbourd
RW Ventures, LLC

This article is a summary of information presented during the “Into the Economic Mainstream: Bipartisan Strategies for Inclusive Economic Growth” session at the Exploring Innovation in Community Development Finance conference.

While public debate about economic development seems stuck in an unproductive conflict between supply-side and demand-side economics, private discussions among practitioners and policymakers reveal considerable common ground. It turns out that the poverty alleviation goals of economic development—to move people “into the economic mainstream”—are converging with broader economic growth goals. As a result, more opportunities are arising to align business and development interests toward an emerging common goal of inclusive prosperity.

Ends: Inclusive Economic Growth

If millions of poor people become more economically productive and enter the middle class, net economic growth occurs. This expansion of the economy results in growing markets and production of new goods and services. Economic growth creates a bigger pie with broad benefits. One fundamental goal of economic development must be to create the most productive, efficient, high-growth economy possible. Two ways to improve the economy particularly deserve attention: growth through increasing productivity and growth through inclusion of underutilized assets.

Economic growth primarily occurs by increasing the productivity of individuals, businesses and institutions. Productivity growth, particularly in the knowledge economy, flows from investment in research and development, technological infrastructure, knowledge institutions and networks, and

human capital. Human capital is especially important, as it is the knowledge and skills embedded in the labor force that combine with new technologies to enable growth. Increasing the productivity of individuals and institutions (including government) is a critical point of alignment of business and development goals.

Economic growth can also occur by increasing the resources input to the economy—through inclusiveness of underutilized people, assets and places. Currently, we have wasted assets and eco-



nomics opportunities: underemployed labor, underdeveloped land and underserved markets. Increasing participation and productivity of people in economic activity entails education and skills development, as well as increasing the efficiency of labor markets through addressing inefficiencies such as market bias or higher measurement and other transaction costs, and other transaction costs in lower-income communities. In addition to improving overall productivity, a skilled workforce contributes to the tax base and reduces social and economic costs of poverty.

A growing body of research similarly suggests that reincorporating distressed central cities and communities of concentrated poverty into the economy is not just good for the communities, but good for the economy overall. Generally, places with less inequity prosper more. Inclusionary policies with respect to place seem to increase regional economic efficiencies, leverage market linkages and avoid the costs of concentrated poverty.

Recapturing these assets into the economy is good for business. The experi-

(ones that lay dormant largely because market imperfections have prevented their deployment). However, many people and places are not yet employable or attractive even to efficient markets. It turns out that developing these assets is also good for overall economic growth. Economic arguments on addressing poverty and inequality often presume a trade-off between equity and efficiency—that moving people to the mainstream will require redistributive policies, which arguably reduce efficiency or hinder economic growth. In fact, at least in urban economic development, it appears that inclusiveness and growth tend to go together. Taking steps to move more people and places into the economy, even those requiring some specialized help, makes good economic sense.

Rather than policies that transfer wealth without leading to economic growth, this approach means focusing on asset development and markets whenever possible. Not coincidentally, the economic development field has made great strides in understanding the importance of asset development and ways to achieve it. We have expanded home ownership markets, created new savings products such as Individual Development Accounts, and developed incentives like the Earned Income Tax Credit. We have more targeted programs, particularly with respect to labor force assets, that try to maximize this convergence of asset development and economic growth goals, such as business-led job training programs or regional affordable housing programs to alleviate the jobs/housing mismatch.

In short, to move people “into the economic mainstream,” we can move the stream by growing it overall through increasing productivity; we can move or grow the stream in targeted places through inclusionary growth strategies; or we can move the people to the stream by getting assets ready to participate in the economy.

Means: Market-Based Development

Markets are the primary vehicle for wealth creation in our economy. Undeveloped land, unemployed labor and money in a mattress all become valuable only to the extent they are deployed into markets. Also, markets determine what assets get included or not. If our goal is to expand the economy to be more inclusive, we are talking about enhancing markets.

Markets are shaped by an environment—an institutional context of enabling laws (e.g., property rights), regulations (e.g., Community Reinvestment Act) and extra market incentives (e.g., New Markets Tax Credit). Internal market operations then determine market functioning: who is employed, what real estate is developed, what businesses get financing and what is produced for whom. Internal market operations can be broken into three components—production, consumption and exchange—each with its own levers of change. Growing or moving markets entails changing the conditions of production, exchange or consumption in ways that allow market activity to include new people, assets or places.

The production or supply side of the market is influenced by factors that affect costs and productivity. If we want to expand housing markets toward producing more affordable housing, for example, production can be increased if the costs of materials go down (e.g., manufactured housing), if we can make the land assembly process more efficient or if we reduce regulations limiting productivity.

The consumption component of the market can be influenced through the levers of taste and income. Home ownership counseling or financial literacy programs, for example, affect the market's demand for housing and savings accounts, respectively. Increased employment income increases demand and so affects what goods and services the market produces.

For practical economic development purposes, it is useful to break out a third market component, the exchange function. In basic microeconomic theory, there are no information or transaction costs, so the trading or exchange—where producers meet consumers and demand matches supply—happen automatically. In real life, economists and others are increasingly focused on the ways that information imperfections, measurement and transaction costs heavily influence and often distort market operations. The costs of finding, evaluating and

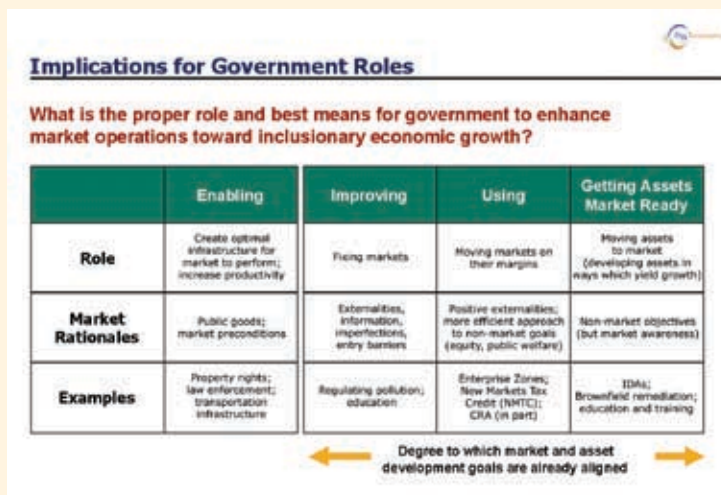
for government to enhance market operations toward inclusive economic growth? Examining the power and limitations of markets suggests four distinct roles for government with respect to markets.

First, government creates the environment that enables markets.

Second, because markets sometimes do not maximize utility, having imperfections, externalities and other failures, government has a role in improving markets.

Third, markets are not designed to achieve some goals, either because of other

through increasing productivity. Improving markets relates to the goal of deploying market-ready assets that have been left out due to internal imperfections. Using markets relates to expanding markets on their margins to include assets further from the mainstream. The last role corresponds to moving assets to market, rather than the other way around. Generally, we are looking for government policies that enable, improve and use market operations, making them more inclusive in ways that increase overall economic growth, as well as policies that develop assets for markets.



closing a transaction heavily influence who is hired, where investment occurs, what is produced for whom and myriad other economic activities. Moody's rating system, or a credit bureau, improve the exchange function, and so significantly expand market activity. Improving information functions and reducing these costs are among the most powerful ways to expand markets to include more people and places.

Policy Implications: The Roles of Government

What is the proper role and best means

kinds of limitations (e.g., public goods) or because they are non-economic goals (e.g., equity). Our recognition of the power of market mechanisms, however, does imply that government often should be using markets to achieve these goals rather than just doing these things itself.

Fourth, in some instances, the non-market goals cannot be achieved by using markets, but we still want to approach them in ways that recognize the importance of markets by getting assets market-ready.

The role of enabling markets is particularly relevant to the goal of growth

Further Exploration

These general principles provide a framework for exploring new approaches to policy and revealing areas where further investigation might be particularly fruitful. That work entails better understanding of how to align inclusiveness with productivity growth in particular industries, markets and places, and with respect to particular assets. It entails exploration of how specific markets are operating and identification of imperfections and opportunities for enhancement. Finally, it entails designing new government programs to enhance productivity and expand markets, addressing imperfections, using markets wisely and moving the most distressed people and places toward the economic mainstream.

This information arises from a project to develop bipartisan economic development policies, sponsored by Opportunity Finance Network and CFED. Special thanks are due to Mark Pinsky and Sandra Kerr of OFN and Andrea Levere and Carol Wayman of CFED, and a diverse group of policymakers, advocates, scholars and practitioners, for making the project possible and for contributing to the ideas summarized here.

A full-length paper providing detailed discussion and extensive examples and citations is available at rw-ventures.com.

CALENDAR

AUGUST

27-30

Governor's Conference on Economic Development—Springfield, Mo.

Sponsors: Women's Council, Division of Workforce Development, DED Business & Community Services, the Missouri Development Finance Board and the Missouri Housing Development Commission
www.mhdc.com/about/housingconference/index.htm

27-31

Nuts & Bolts of Redeveloping Brownfields (and other contaminated properties) for Local Government—Kansas City, Mo.

Sponsor: U.S. Environmental Protection Agency
www.epa.gov/region7/land_revitalization/newsroom/press.htm

SEPTEMBER

13

Neighborhoods in Bloom—Little Rock, Ark.

Sponsor: Federal Reserve Bank of St. Louis
501-324-8296
www.stlouisfed.org

18-19

Economic Development Conference: Access to Community Development Finance—Olive Branch, Miss.

Sponsor: Federal Reserve Bank of St. Louis
901-579-4101
www.stlouisfed.org

18-20

Annual Training Conference—Little Rock, Ark.

Sponsor: Arkansas Coalition of Housing and Neighborhood Growth for Empowerment (ACHANGE)
www.makingachange.net

20

Improving Access to Community Development Capital: The Changing Role of Philanthropy in Community Development—Little Rock, Ark.

Sponsor: Federal Reserve Bank of St. Louis
501-324-8296
www.stlouisfed.org

OCTOBER

18

Strategies for Reaching the Unbanked: Stored Value Cards and Second Chance Checking Accounts—Little Rock, Ark.

Sponsor: Federal Reserve Bank of St. Louis
501-324-8296
www.stlouisfed.org/community

27-27

Community Analysis and Economic Development—Little Rock, Ark.

Sponsor: UALR Institute for Economic Advancement
501-569-8519
www.aiea.ualr.edu/econdev

BRIDGES

Bridges is a publication of the Community Affairs department of the Federal Reserve Bank of St. Louis. It is intended to inform bankers, community development organizations, representatives of state and local government agencies and others in the Eighth District about current issues and initiatives in community and economic development. The Eighth District includes the state of Arkansas and parts of Illinois, Indiana, Kentucky, Mississippi, Missouri and Tennessee.

Glenda Wilson

Community Affairs Officer, Assistant Vice President and Managing Editor
314-444-8317

Linda Fischer

Editor
314-444-8979

Community Affairs staff

St. Louis: Matthew Ashby
314-444-8891
Ellen Eubank
314-444-8650
Jean Morisseau-Kuni
314-444-8646
Eileen Wolfington
314-444-8308

Memphis: Michael Minor
901-579-4106
Dena Owens
901-579-4103

Little Rock: Lyn Haralson
501-324-8240
Amy Simpkins
501-324-8268

Louisville: Lisa Locke
502-568-9292
Faith Weekly
502-568-9216

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Trends in Neighborhood Unemployment

July 24, 2007

8:00 a.m. to 10:30 a.m.

Breakfast will be provided.

J.C. Penney Conference Center
University of Missouri—St. Louis

Sponsor: Federal Reserve Bank of St. Louis

A presentation by
Christopher H. Wheeler,
Research Officer,
Federal Reserve Bank of St. Louis

A panel discussion will follow, featuring
Nancy Box of St. Patrick Center, Gene Gorden
of St. Louis County Workforce Development
and Blair Forlaw of WorkforceStLouis2.0.

They will participate in a
facilitated discussion on:

- how their program(s) are related to the findings in the study;
- challenges they face;
- successes they have experienced; and
- what else is needed to address the issue.

Register online

www.stlouisfed.org/community/conferences.html

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