THE ROLES OF FINANCIAL INSTITUTIONS IN ECONOMIC PLACE-MAKING

LESSONS FROM THE U.S.

A REPORT FOR LLOYD'S BANKING GROUP, IMPACT INVESTING INSTITUTE AND METRO DYNAMICS

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PROJECT TEAM

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INTRODUCTION

Leading financial and development stakeholders in the United Kingdom are exploring how U.K. financial institutions can expand their capacity to effectively make place-based impact investments.[i] This paper aims to synthesize lessons from the United States, where financial institutions have a longer history of engaging in economic place-making, in the hopes it can inform efforts to grow the practice in the U.K.

Over several decades, a robust eco-system has emerged in the U.S. to help address the challenges and opportunities to developing distressed communities. Established piecemeal, the U.S. ecosystem for development can be complicated and imperfect, but it does offer some hard-won insights which may be adaptable to the circumstances and objectives in the U.K. The lessons begin with reconsidering poverty as a separate problem to be solved solely by welfare and charity, to approaching it as a failure of economic activity to be addressed by investing in assets and market activity. Approaching poverty this way requires using the same basic investment principles applicable to investing in other assets—minimize the transaction costs of finding, evaluating, and closing deals; manage risk; and secure collateral. However, applying these principles to less developed assets in "emerging" domestic markets has given rise to specialized development finance practices, community development finance institutions (CDFIs), and an array of government policies to enable and not supplant market investment activity. In conjunction, this ecosystem with synergistic roles for large financial institutions, CDFIs, and policies—that is designed to take a business approach to the assets of distressed communities—has proven that it is not only possible, but better for communities, institutions, and economy to align business and development interests. This approach generates financial as well as social impact returns and leverages much more investment, ultimately restoring healthy market activity.

The paper begins with a discussion of two frameworks—market-based development and development finance—which are the respective principles and specialized approaches that inform the roles of financial institutions in place-based investment. It then dives into each of the three roles for financial institutions in economic place-making: direct provision of financial products, indirect investing through intermediaries, and capacity building. The paper concludes with an examination of governmental programs and policies to support community investments by financial institutions, followed by a discussion of the key insights and potential implications for the U.K.

FRAMEWORKS FOR EXAMINING PLACE-BASED ECONOMIC DEVELOPMENT BY FINANCIAL INSTITUTIONS

Understanding the roles of financial institutions in place-based economic development, and particularly extracting lessons about the most successful practices, requires first briefly summarizing an increasingly prevalent approach to economic place-making: market-based development. Market based development focuses on the assets and market functioning (or not) in distressed communities, creating the framework for financial investment. Flowing from this is a distinct framework – development finance – which provides an approach for understanding how to invest in the assets of these "emerging" domestic markets.

MARKET-BASED DEVELOPMENT AS THE FRAMEWORK FOR PLACE-BASED INVESTMENT

Over the past several decades, the U.S. approach to addressing the problems of distressed communities and populations has undergone a major shift. It has changed from treating poverty as a separate problem to be addressed by charity and welfare to understanding these problems as in large part a failure of economic activity to be addressed by investing in assets and market development.[ii] Not by coincidence, an asset- and market-based approach to development has created more roles and opportunities for financial institutions.

Distressed communities have valuable real estate, human capital, and small business assets, as well as talented entrepreneurs and untapped market opportunities. Poverty can be understood as the failure of these assets and opportunities to be observed, evaluated (without bias), developed, and deployed into markets which are the mechanism to realize their value. These under-invested or emerging markets present several challenges: the assets are often harder to find and assess (at least with existing practices) and are often less conventional or developed.[iii] This in part reflects market failures – from information imperfections to the effects of individual and systemic racism –which cause the assets of disadvantaged communities to be isolated from the larger market systems that define the mainstream economy. These market failures lead to a vicious cycle of disinvestment and further distress.

Market-based development thus begins with a focus on the assets of a particular place and the particular dynamics of the market that enable or prevent developing the assets into wealth creating activity. Through market-based development, economic efficiency is enhanced, and markets are expanded and improved by deploying assets that were previously untapped. Low-income communities benefit, in turn, from the economic growth and wealth creation that ensues. The goal is to restore a virtuous cycle of market activity, as occurs in healthy communities. This often requires place-based development to be at the leading edge of the market, effectively helping "make" markets that can unleash further market activity in the community.

DEVELOPMENT FINANCE AS THE KEY PRACTICE IMPLEMENTING MARKET-BASED DEVELOPMENT

If market-based development is the theory that recognizes poverty as a function of underdeveloped assets and weak markets, then development finance is an approach and set of practices to address the challenges these circumstances create to investing in distressed communities.[vi]

As with any finance, the capacity to invest in an asset depends upon transaction costs (i.e., finding and measurement costs), risk, and collateral. In distressed communities, assets tend to be less developed and not as well-documented.[vii] As a result, the assets may be harder to find and underwrite, making them seem riskier, and often offer less collateral.[viii]

Given these challenges, development finance attempts to find ways to address or offset transaction costs, mitigate risk, and identify collateral substitutes in order to efficiently and effectively find and invest in the assets of distressed communities. Achieving these goals requires distinct and tailored approaches that are attuned to the nuances of the assets and markets of a particular place. [viii]

In effect, the roles and policies for financial institutions in place-based development represent strategies to manage the transaction costs and risks of finding, underwriting and investing in developing assets and emerging markets.

THE ROLES OF FINANCIAL INSTITUTIONS IN PLACE-BASED DEVELOPMENT

Tailoring finance to the challenges and opportunities in distressed markets is delivered via three complementary roles for conventional financial institutions: direct provision of financial products; indirect investment through intermediaries (particularly CDFIs); and capacity building. This section examines all three roles, often using the example of ShoreBank[ix] to demonstrate key functions and lessons learned.

Founded in 1973, ShoreBank was the first comprehensive development bank in the U.S. and served as the model that led to the creation of the CDFI sector. ShoreBank began in the South Shore neighborhood of Chicago and expanded across the country and overseas over 37 years. The bank was eventually forced to close during the Great Recession (along with so many other banks that were not “too big to fail”), as job losses and plunging real estate values undermined its portfolio. The bank was immediately recapitalized and reopened as Urban Partnership Bank by a consortium of major banks and philanthropic groups, continuing its development finance activities (but without its other subsidiaries).

ShoreBank's leadership in crafting development finance as the core of a comprehensive approach to market-based development, and its enormous successes in growth and impact over nearly 40 years, provided the original proof of concept and continues to be a leading model informing place-based investment in the U.S. More information and additional lessons from ShoreBank can be found in a dedicated case study in Annex I.

DIRECT PROVISION OF FINANCIAL PRODUCTS

To address the issues of higher transaction costs, more difficult to evaluate (and in some cases higher) risk, and limited collateral in disadvantaged communities, leading banks have developed a nuanced understanding of emerging markets and have developed practices to reduce these costs and risks.
Below are some key lessons on evaluating assets and investing in distressed communities. These practical "tricks of the trade" for undertaking development finance are essentially tactics that financial institutions can employ to get closer to the ground, find and assess deals, and manage risk in their provision of financial products. The practices allow banks and their customers to achieve profitability and success while also expanding financial inclusion:[x]

Start with "middle" neighborhoods that have some assets and market activity.
Put simply, asset-based development requires assets. If the goal is to unlock market activity, the neighborhoods where this is possible are neither the most distressed neighborhoods nor neighborhoods where revitalization is well underway. The most distressed neighborhoods often initially need primarily non-market interventions to recover while the least-distressed neighborhoods will likely continue to develop without bank focus. In the 1970's, for example, Chicago's South Shore neighborhood was experiencing extreme disinvestment after rapid racial change, but still offered competitive features, including promising housing stock, commercial activity and proximity to downtown Chicago. ShoreBank chose South Shore as its starting target neighborhood exactly because it had under-invested assets. By starting with investing in assets and restoring market activity in South Shore, ShoreBank could build from there to reach and spillover into more distressed nearby communities.

Identify alternative information sources about borrowers.
The information barriers discussed above mean that formulaic or algorithmic approaches are less likely to be effective in distressed communities. While a traditional financial analysis is certainly part of the process, the decision of whether to invest is materially subjective. ShoreBank employed unconventional measures in its credit underwriting. Even with a conventional credit check, rather than simply rely on the overall score, ShoreBank considered factors such as whether the borrower was living within their means and the tenure of the borrower's occupation—the Bank did not want to be an individual's first successful long-term relationship. Similarly, recognizing that tax returns might not accurately reflect the reality of business performance, ShoreBank identified other metrics of business success, such as the level of water usage by a laundromat.

Focusing on a niche market can offer long-term informational advantages.

ShoreBank developed a specialization in multi-family rehabbing, the repair and refurbishment of residential rental properties with more than one housing unit. Focusing on the community's high concentration of multi-family housing, ShoreBank developed deep expertise in the building stock, the common issues and solutions; and extensive relationships with rehab entrepreneurs and contractors. The specialization allowed ShoreBank to tailor and develop "unorthodox" products and protocol for the niche market and cultivate profitable projects. ShoreBank, for example, bundled together financing for acquisition and rehabilitation of multi-family buildings. By leveraging its deep expertise and networks, ShoreBank avoided having to handcraft each deal, and rehabbing eventually became ShoreBank's most successful niche. Revitalizing the private market for multi-family rehab not only was profitable for the bank and the local "mom and pop" developers; rehabbing the dilapidated units also attracted middle class residents to the neighborhood and increased property values (and thereby community wealth).[xii] Similarly, Craft3, a CDFI operating in Oregon and Washington, has developed an investment focus on clean technology, leveraging its expertise of the sector and related public policies to craft loans for clean energy projects that can be more difficult for other banks to value and appreciate.[xiii]

Facilitate and coordinate deals to help lower costs and risks.

Financial institutions can organize and "match-make" across partners and resources to support the success of their deals and promote an upward trajectory for communities. By being "close to the ground" and developing specialized knowledge of the multifamily housing stock, "mom and pop rehabbers" (the local entrepreneurs developing the stock), and rehab challenges and solutions, ShoreBank was able to dramatically reduce costs and risks, and was essentially "market-making" with respect to multi-family rehab. ShoreBank helped facilitate labor and financing for multi-family rehabbers, allowing rehabbers to share labor and obtain serial loans to grow and stabilize their business. Instead of making individual loans building by building, ShoreBank made strategically coordinated loans within sub-neighborhoods, helping expedite redevelopment of the neighborhood, attract middle class tenants without displacing current residents, and grow the market for housing acquisition and rehab. ShoreBank also often negotiated directly with sellers, landlords, and retailers to coordinate deals for its borrowers, saying what the price needed to be before the bank would lend.

Build local development capacity to help identify, develop and "de-risk" assets.

Development deals require a range of expertise, including lenders who know how to source and underwrite deals in distressed communities; technical assistance providers that can provided "linked services" with deals, particularly loans to small business owners; and developers who can execute and shepherd projects, among others. Craft3, for example, has linked services to "de-risk" its deals, including creating a business services program to provide businesses of color with back-office assistance and providing support to first-time landlords. Some financial institutions have bolstered development capacity by establishing units that specialize in development products (such as affordable housing finance) or in particular geographies and markets. U.S. Bancorp Community Development Corporation, for example, is a for-profit arm of U.S. Bank that is dedicated to supporting investments in community development. The development expertise does not necessarily have to be exclusively in-house—it can also be accessed through an intermediary—but should be cultivated and invested in to support engagement in distressed communities.

Expect intensive collection efforts and higher work out costs.

Financial institutions should prepare to be persistent collectors and pursue work outs (meaning renegotiation of loan terms to avoid default) more frequently. This is, throughout, a business approach that respects the borrower as a business, rather than a charitable intervention: neither the bank nor borrower benefit in the long run from failure to firmly manage looming problems. Distressed properties and businesses in underdeveloped neighborhoods can lose value very quickly as demand is already depressed, so handing off a problem to an attorney to handle through typical foreclosure proceedings can turn a modest loss into a disaster.

Create synergies and market momentum through a portfolio of mutually reinforcing investments.

ShoreBank established complementary subsidiaries, going beyond extending credit to eventually include a real estate development company, a venture capital company, and a community organization that ran incubators, offered job training, and provided other community programming. The activities of the subsidiaries were mutually reinforcing and compounded the market forces ShoreBank was unleashing, including growing the demand for housing and the supply of contractors for the multi-family housing rehab market.

Strategically use subsidies where needed to leverage, not supplant, market activity.

Another advantage of the Shorebank subsidiaries is that they were often designed as non-profits able to secure subsidies to enable them to take on the harder projects, the least market-ready assets, or other neighborhood challenges that needed to be addressed to restore market activity. These subsidies may come from a range of sources, both public and philanthropic, and at a range of scales including both contributions from local partners as well as national or international funding programs. In the example of the multi-family rehab market, ShoreBank's real estate development subsidiary used subsidies to tackle the eye-sore corner buildings that were too large and difficult for mom and pop rehabbers to address, while the mom and pop rehabbers focused on the smaller flats that were next to the corner buildings. This allowed the entire block to redevelop. In essence, the subsidies were blended with direct financial products to cover the underwriting gap and enable market activity, rather than to supplant it.

Use government loan guaranty programs to offset risk.
In a related example of using subsidies to enable market activity, ShoreBank frequently used the SBA 7a small business loan guaranty program and the FHA Title I building improvement program, which served not as direct subsidy but as "collateral substitutes." The programs did not improve the business or building's cash flow, but in the event the bank mis-judged the likelihood of success, these programs backstopped the loans, keeping losses to a fraction of the whole loan amount. In developing neighborhoods, few borrowers walk into the bank with adequate collateral. Other ways that banks reduce risk and access collateral substitutes are to participate in a blended "capital stack" that includes philanthropic or government grants, guarantees, subordinate debt, and other features that reduce risk and provide collateral substitutes.

The strategies appropriate for a particular bank will obviously vary by the size, systems, culture, and goals of the institution. While many banks develop a few specialized products for direct financing in distressed communities, the challenges of sourcing and evaluating projects in these communities means that many banks instead or in addition engage in development through intermediaries, as discussed below. A related issue is how to best organize the direct provision of development finance within a larger bank, with some banks preferring specialized units for development and others advocating for understanding and practice of development finance to be embedded throughout the bank and across mainstream banking activities. Leading institutions seem to do a combination of both and at the very least, are sure to elevate the importance of and respect for development finance throughout the bank.

In addition to financing products, there has been considerable progress in the U.S. on expanding provision of retail banking products to "the unbanked," another dimension of promoting financial inclusion. A leading resource in this area is the Financial Health Network,[xv] which has grown into a major center for financial institutions and related stakeholders to collaborate on development of product-driven approaches. The Network helps financial institutions research and develop new retail products to meet the needs of consumers in underserved markets and identify opportunities to make existing retail products more accessible.

INDIRECT INVESTING THROUGH INTERMEDIARIES, PARTICULARLY CDFIs[xvi]

Another way in which financial institutions address the challenges of investing in place-based development is to support and finance deals through intermediaries, such as Community Development Financing Institutions (CDFIs), development authorities, merchant banks, and special purpose vehicles.[xvii] CDFIs and other intermediaries have institutionalized many of the development finance lessons mentioned above, as they are highly specialized by place and/or niche markets; can more easily craft artisanal and higher-risk deals; and possess the development capacity to facilitate and bolster deals, among other features.

Banks can tap into this development finance expertise and mitigate the challenges of distressed markets by enabling and financing these specialized intermediaries, as well as by co-investing in their deals or financing their customers as they scale and "graduate" from needing more niche attention.

The Value-Add of CDFIs for Financial Institutions

As ShoreBank and these other forms of CDFIs demonstrated, critical to the added value of CDFIs is their embeddedness and deep market knowledge of the communities in which they invest. This proximity allows CDFIs to craft targeted development strategies that can build markets, create customer pipelines, and assemble profitable deals that might be missed by less familiar eyes. CDFIs are also often "first-movers" into underserved markets, helping to catalyze and open markets to other investors because of their willingness to accept and capacity to manage greater risk.[xviii] (For an example of how CDFIs mobilize deals for the benefit of financial institutions and other partners, see the case study of the Pullman neighborhood in Chicago in Annex I.)

The primary investors in CDFIs are often mainstream financial institutions, which have come to recognize that the CDFIs are often better suited to identify, underwrite and support certain types of deals because they are so "close to the ground," and that the CDFIs effectively build markets and investable deals, expanding the markets for conventional banks as well. Banks typically provide to CDFIs three types of financing support: equity, which can include grants and equity equivalents;[xix] debt; and deposits (funds placed in CDFI depository institutions that typically earn interest and are insured by a federal governmental agency).[xx] JPMorgan Chase, for example, has developed a "FlexLoan" product that provides long-term, low-cost loans to CDFIs and other development intermediaries (discussed in the Detroit case study in Annex I).[xxi] Other investors in CDFIs include government, foundations, and individuals.

CDFIs intermediate between sources and users of capital, particularly in the instances when larger banks have limited knowledge of a market or transaction costs are prohibitive. For example, some small businesses may require credit counseling or business planning, services that are un-economical for larger banks but that can be provided by CDFIs, which can access subsidies or use capacity subsidies or using capacity building affiliates or partners. The CDFI readies the small business for investment, reducing transaction costs for banks. Banks can also refer deals to CDFIs, particularly deals that are earlier stage and riskier. Chicago Community Loan Fund (CCLF), a loan fund with $104M in assets in Chicago,[xxii] for example, works closely with U.S. Bank on a deal-by-deal basis, often reviewing deals and engaging in co-lending or tandem lending with them. U.S. Bank might engage CCLF to provide a predevelopment loan for a new project, with the understanding that the bank will provide a construction loan or other types of financing once the project is effectively "de-risked" and on its feet.

The most sophisticated CDFIs are strategic in how they leverage mainstream financial institutions, government, and private industry to drive economic growth for their communities. Hope Enterprise, a loan fund with $283M in assets across five southern states,[xxiii] has cleverly established a credit union affiliate (Hope Federal Credit Union) that it partners with to make larger, riskier loans. Hope Enterprise uses its own capital to guarantee the credit union's loans, enabling the credit union to take more risk than traditional depository institutions.

Leading CDFIs are also skilled in using a variety of risk-mitigating programs, such as guarantees, subordinated loans, low-cost funding, and pooled risks to lower costs and increase the chances of success for a borrower.[xxiv] The focus of the CDFI—which can range from place, to market, to market challenges (e.g., underinvested entrepreneurs)—will often inform the programming and subsidy pursued. Some development activities, such as micro-lending, will require permanent subsidy as the levels of financing are too small to support the technical assistance and overhead costs. Other CDFIs might require fewer or different subsidies as the investment area of focus is more profitable or can leverage subsidies more efficiently.

Expanding the Capacity of CDFIs

As discussed below, the CDFI Fund as a government program has been instrumental in increasing the scale and capacity of CDFIs. The CDFI Fund has helped validate CDFIs, provided support for their creation and capital for their growth, and supported bank lending to them (and banks have become major lenders to CDFIs, seeing them as an important market). Other developments that have supported the growth of CDFIs include the Community Reinvestment Act (CRA), which recognized loans and investments in CDFIs as qualified CRA activity (and is also examined below); the establishment of trade associations (e.g., Opportunity Finance); and ratings systems (e.g., Aeris, Standard & Poor's, etc.) which support recognition of CDFIs as investable entities.[xxv] Subsidies, including program-related investment from foundations, have also been critical to the expansion of CDFIs, especially since CDFIs tend to take on more risk and employ more time and cost-intensive approaches to underwriting.

Other Development Intermediaries

Other particularly relevant intermediaries are governmental or quasi-governmental, many of which have successfully raised capital from banks and managed risk for development projects. Exemplar models include Mass Development, Michigan Economic Development Corporation, and Portland Development Commission. Government authorities can access private credit markets by offering bonds and making predevelopment and interim loans with the capital they have accessed. Mass Development, for example, is a quasi-public authority that is governed by a private sector board and raises capital for projects by issuing bonds, loans, and guarantees and managing state grant programs.[xxvi]

CAPACITY BUILDING

Capacity building is the third dimension by which financial institutions (and corporations, generally) increasingly engage in place-based development. Beyond financial investment, corporate social responsibility, and philanthropy, a wide range of companies and financial institutions apply their non-financial business acumen to develop and bolster assets in target communities. In many cases, the development of the asset and/or market aligns with the corporate's business interests.[xxviii]

Examples of capacity-building activities that corporates are coming together to engage in for the benefit of their businesses and key communities include:

- Bolstering the capacity of small businesses to become suppliers, which can allow corporates to diversify and strengthen their supply chains;
- Investing in accelerators, which build regional eco-systems for innovation and entrepreneurship, and generate new businesses and customers;
- Identifying and training hidden labor pools, such as underemployed workers, which can help corporates build a workforce and fill open positions;
- Creating and participating in industry, cluster, and regional development organizations, which allow corporates to collectively address business challenges and strengthen regional industries and the regional economy.

For financial institutions specifically, capacity-building can include supporting or lending expertise to research and analysis, organizing stakeholders, business planning, deal conceptualization, and "predevelopment" activities that are important initial steps to developing assets. Rocket Mortgage, for example, has deployed its real estate and mortgage lending expertise to help stabilize the housing market in Detroit, using its data capabilities to reduce vacancy and blight in low-income neighborhoods. The initiatives enhance and complement the significant real estate holdings, or direct investments, that Rocket Mortgage has in Detroit. Other possibilities for capacity building by financial institutions include having a bank executive sit on a CDFI board or loan committee, loaning an executive to an CDFI or other development organization or providing technical assistance to a community group looking to advance a community development project.

The primary impetus for corporate engagement in capacity building is a dramatically changing economy that is aligning businesses with broader economic development goals, such as strong industries and regional economies. In this next economy, every region needs to figure out what it will be good at and known for – what human capital, business, institutional and other assets it can deliberately build from to become the place where certain targeted industries and populations will be most productive. This shifting context means companies are increasingly invested in the success of their local industry, workforce, research institutions, and region overall. In Hartford, Connecticut, for example, public and private sector partners are collaborating to strengthen Hartford's insurance industry and retain its status as an insurance hub. The partners, which include some of the region's largest insurance companies, are coming together to support innovative insurance-related technology start-ups through hackathons, accelerators, and incubators.

Capacity building often requires new institutional platforms and new leadership from the corporate community. Many corporations pursue development strategies through formal collaboratives in which local corporations, foundations, government, anchor institutions (such as hospitals or universities), community groups or other partners come together to identify and address regional economic development priorities collectively. As discussed in the case study on Newark, New Jersey in Annex I, the Newark Anchor Collaborative is driven by Prudential Financial and engages corporate, public and philanthropic partners to support more local purchasing, hiring, and investing.[xxx] Another institutional platform that can facilitate collaborative, large-scale development activities are development authorities,[xxxi] which financial institutions can partner with to initiate transformative development projects on a regional basis.

POLICIES AND PROGRAMS TO ENABLE PLACE-BASED INVESTMENT

The U.S. government has enacted a broad range of policies and programs to enable and motivate place-based investment by financial institutions. The policies and programs promote development in a few key ways: by making funds available (capital, liquidity, and project finance); ensuring the money enters into the community for targeted types of development effectively; and establishing incentives and reducing risk for financial institutions to support development.[xxxii] The policies and programs, directly or indirectly, have enabled and informed the roles of financial institutions in place-based development.

The Community Reinvestment Act

The most prominent of these policies is the Community Reinvestment Act (CRA), federal legislation that creates the overall framework for banks to lend and invest in distressed communities. CRA was established in response to "red-lining," a practice in which mainstream financial institutions avoided lending to whole geographies—generally home to predominately racial or ethnic minority resident populations—from which they took deposits. It is credited with directing nearly $2 trillion into underserved communities through small business and community development loans.[xxxiii] The CRA framework has evolved substantially over the years, essentially shifting from a narrower focus on lending requirements to a broader focus on varied investment and other ways to support distressed communities. Banks initially treated CRA as a cost-center required for regulatory reasons, but over time larger and more innovative banks have realized CRA investment can be better run as profitable business line(s), for the benefit of the institutions and the community. The more successful banks have developed specialized products, partnerships, and tools to leverage CRA and surface profitable investments in distressed communities.

CRA has proven to be an important framework for establishing the goals and responsibilities of financial institutions and bringing them into the fold of community development. CRA causes banks to pay attention to and begin to recognize opportunities in distressed markets – it brings banks to the table and creates some common obligations for all banks. However, as mentioned above, the most effective place-based investments by financial institutions have gone well beyond meeting minimal CRA obligations, flowing from a sophisticated analysis and appreciation for the market opportunities in undervalued communities, and the use of subsidies, CDFI, partners and other techniques to profitably invest in them. "Carrots" have generally worked better than "sticks" in promoting high-impact place-based investment.

Other Prominent Policies and Programs

Below are additional policies and products to support place-based investment in the U.S., the best of which do not supplant market forces but enable the market to correct or expand.

- The **Community Development Financial Institutions Fund** (CDFI Fund), a federal program that provides capital and other supports to CDFIs, recognizing them as among the most significant and fastest growing means of expanding investment in distressed communities and allowing the CDFIs to finance more development projects. As noted above, the CDFI Fund has been instrumental in growing the number of CDFIs in the U.S, as CDFIs can use the money to build their balance sheets and leverage capital from other sources to grow and expand their operations.[xxxiv] The CDFI Fund has been an efficient way of getting money to the community quickly and providing equity and liquidity to community developers and financiers[xxxv] The CDFI Fund also certifies financial institutions as CDFIs, offers development grants to create CDFIs, administers the New Markets Tax Credit program, and provides technical assistance grants to help CDFIs in their formation stages. In 2020, the CDFI Fund issued nearly $550 million in loans and grant awards to CDFIs and allocated $3.5 billion in New Markets Tax Credits.[xxxvi]

- **Tax credits,** such as the Low-Income Housing Tax Credit, New Markets Tax Credit and Opportunity Zones which incentivize private investors to make equity investments in development projects in distressed communities or that serve distressed populations.[xxxvii] Tax credits can be an effective means of leveraging (and not supplanting) the market and attracting private investment to community projects—as seen with the Low Income Housing and New Markets tax credits in particular—but are also complicated to navigate and lead to high transaction costs. The high transaction costs incentivize larger transactions, making it difficult for smaller deals to be feasible with tax credits.[xxxviii] Opportunity Zones are fairly new, and illustrate the importance of designing these incentive programs carefully to address the market gap (and only the market gap). Early evaluation suggests that many Opportunity Zone funded projects would have proceeded without the tax incentives and that the windfalls for investors are disproportionate to the development impact of the projects. The program is also inaccessible to many investors as it requires deferral of returns for up to 10 years.[xxxix]

Tax Increment Financing (TIF), a public financing mechanism that allows local governments to use projected future increases in property tax revenue to invest in development projects that are anticipated to catalyze the economic growth in the community. TIF proceeds from the theory that certain development projects will increase real estate values, and so property taxes. It is generally advised for development projects that would not have occurred without TIF (and that are reasonably sure to increase property values). While TIF is direct government funding, it is nearly always in projects that leverage a great deal of private investment.[xl]

Many other **project subsidies** outside of tax credits and TIF have also been developed. The subsidies are often provided at state and local government levels and can concern a particular area of focus, such as housing. Example subsidies include grants, state and local tax abatements, and federal and state rental housing subsidies, among others. The best of these subsidize development while also leveraging private investment and are tailored to markets and development goals.

Loan guarantees, such as SBA (Small Business Administration) 7(a) loans, which guarantee the loans made by financial institutions to qualifying small businesses. The guarantee effectively acts as a collateral substitute. Banks make loans targeted to qualified small businesses that might not otherwise obtain funding on reasonable terms and conditions, including particularly businesses that cannot offer sufficient collateral. Guarantee programs have become more sophisticated over time, as exemplified by several states establishing Capital Access Programs that offer cash collateral guarantees from a loan loss reserve fund, enabling banks to make more loans. In response to the Great Recession, the federal government created the State Small Business Credit Initiative (SSBCI), which provided grants to states to establish small business guarantee, loan and investment programs. SSBCI greatly expanded the use and types of government credit enhancement, including in partnership with CDFIs[xli] and was refunded (at $10 billion) under the recent American Rescue Plan Act.

The Small Business Investment Company (SBIC) program, another SBA program that issues debt on very favorable terms to venture capitalists, private equity funds, and other vehicles who in turn provide long-term investment and management assistance to small businesses. The program goes beyond subsidizing financial products to incentivise creation of specialized companies, effectively bringing venture finance to small businesses and underdeveloped markets.

Reflections on U.S. Policy Approaches

Dampening the potential impact of enacted policies and programs is the fact they were developed ad-hoc. The various tax incentives, for example, were not designed as a comprehensive set of tools, making it difficult for developers and other partners to marry incentives and thereby adding to the cost and complexity of deals.[xliii] Similarly, many state and local subsidies are tailored to specific markets and focus areas (e.g., affordable housing) and are insufficient in size for bigger deals, further adding challenges as developers must assemble several different sources to execute larger deals. The complexity can create high transaction and bureaucratic costs to using and maximizing government programs.

Additionally, while the CRA has proven valuable in establishing the goals and duties of financial institutions, it could benefit from being updated to reflect changes in the financial services sector. Over the past 40 years, technology has dramatically changed the nature of banking, with many consumers opting for internet banking, peer-to-peer lending, etc.[xliii] Indeed, some of the largest mortgage lenders in the U.S. are nonbanks.[xliv] The CRA would likely better serve its goals (and be more fair) if reinvestment obligations were expanded to include "fintechs", internet banks, and other relevant corporates, and not just conventional banks.

It should also be noted that there are often tensions between regulatory policies and development finance, as the "safety and soundness" requirements of regulators can penalize financial institutions for taking healthy and necessary amounts of risk in distressed communities.[xlv] Despite its low loan loss rates, it took ShoreBank years to convince regulators that its lending was safe and sound, with the regulators exhibiting many of the same biases against underdeveloped markets as the financial industry at large. Many regulators have limited understanding, or bias against, underdeveloped communities and are not always familiar with how the various specialized programs, subsidies, institutions, and other tools can enable banks to safely engage in development finance.

In general, the policies and programs are most effective when they provide the fewest necessary subsidies to close underwriting gaps for development deals and align the goals of private investment with community development without creating disproportionate windfalls for investors or failing to have development impact. Policies and programs should also be as easy as possible to use and administer and have clear guidelines and protocols to reduce transaction costs and promote certainty of benefits.

CONCLUSION

The U.S. has developed a mature and extensive eco-system for economic development, from which insights can be distilled to inform efforts to bolster the infrastructure for economic-placemaking in the U.K.

A first, obvious, lesson is that the U.K. should consider further developing its own economic development infrastructure, one that is cohesive and tailored to the county's assets, institutions, and goals.

Even in the event where the exact mechanism (e.g., CRA, tax credits, etc.) is missing or not best suited to the circumstances in the U.K., it is likely that the market dynamics are similar enough in the U.K. to warrant consideration of strategies, policies and programs that similarly enable economic activity in underinvested communities. It is likely, for example, that scaling and expanding the capacity of development intermediaries would benefit the U.K. as it has the U.S., by providing financial institutions with a partner through which they can source deals and alleviate barriers to investing in distressed places. It is also possible that a CRA-like requirement that is applied fairly to all financial players would help to organize and add capacity to the eco-system, ensure that the responsibility to reinvest in communities is shared and not put entirely on a few banks, and lead to better recognition of market opportunities in undervalued communities.

The U.S. experience suggests that the eco-system should be a harmonious combination of conventional finance; specialized development intermediaries; and capacity-building activities that work in concert with enabling government policies to develop assets, mitigate transaction costs and risk, and promote profitable investment in distressed communities.
As evidenced by the U.S. model, there are viable returns to be realized in emerging markets, provided that the assets in these communities are effectively identified, developed, and appreciated. Taking an asset- and market-based approach to investing in these markets – aligning business and development interests – has proven a more effective and sustainable approach to achieving both profit and impact.

ANNEX I: CASE STUDIES

Included in this annex are four summary case studies that are intended to complement the paper and illustrate the principles, specialized approaches, and three roles financial institutions play in place-based investment. The case studies were chosen to demonstrate the range of contexts and approaches through which financial institutions can identify and bolster assets and reduce transaction costs and risks to invest in communities. The cases also vary in the types and degree of partnership pursued, as some financial institutions opt to engage in development through large-scale, multi-sector collaborative efforts, while others opt to partner with a development intermediary or leverage their own subsidiaries.

MARKET-MAKING IN SOUTH SHORE, CHICAGO

ShoreBank: Piloting a New Approach to Economic Place Making – a Bank Holding Company

Background on South Shore Neighborhood of Chicago

Located on the South Side of Chicago, along the city's lakefront, the South Shore neighborhood experienced extreme disinvestment after its racial make-up shifted from predominantly white to Black by the early 1970s. The disinvestment was a function of "redlining", a now-illegal practice of denying or limiting financial services in particular neighborhoods where residents are racial minorities or low-income.[xlvi] Commercial corridors were declining, and the housing stock was showing signs of deferred maintenance as conventional financing became unavailable.

Nevertheless, the neighborhood had a mixed income, entrepreneurial new Black population; solid housing stock (75% apartment buildings); major locational amenities (proximity to job centers, the lake, transportation); and investible assets, business opportunities and markets.[xlvii]

Development Strategies: The Business of Development Banking

Four visionary individuals, who had banking, minority business finance and community development expertise and took advantage of recent legislation authorizing bank holding companies to promote community welfare, conceived the idea of using a bank holding company to undertake a different – market based – approach to comprehensive place making. They formed ShoreBank, a regulated bank holding company, with four subsidiaries: a commercial bank, a housing development company, a specialized venture capital firm and a community development non-profit.

Their novel approach was summarized in much later Congressional testimony[xlvii] which informed creation of the Community Development Financial Institutions Act:

> *The failure of the local economy - particularly markets and market driven investment - ranks high among the many complex phenomena characterizing the decline of distressed communities. In deteriorating communities, capital flows out of the area; people cease upgrading their homes and landlords fail to maintain their buildings; property values fall; store owners quit investing in their businesses and close or move; community residents lose hope, stop investing effort in education and developing work skills, and fall into unemployment. Revitalizing such communities requires recognition that disinvestment is itself a market phenomenon and, consequently, will only be reversed by fundamentally reinvigorating community markets. Permanent, self-sustaining community renewal results from creating an environment where private investors inside and outside the community are confident their investments will be reciprocated and rewarded as healthy community dynamics are restored.*

A few key observations concerning this process of community renewal and investment underlie the concept of development banking:

- *Many persons in economically distressed communities desire to improve their own life conditions and, although they may lack conventional credit histories, are fundamentally credit-worthy. Local residents will invest time and money to improve their neighborhood when they are confident about its future.*
- *Local development capacity, be it in the form of "ma-pa " entrepreneurial rehabbers, fledgling business entrepreneurs, or community development corporations, needs to be supported in a disciplined, business-like fashion. Positive community development is a partnership between people who care about their communities and financial institutions with similar motivations.*
- *Market forces can be restored in underinvested communities if the level of institutional capability is sufficient for the task at hand, and if redevelopment is targeted to clearly identified geographical areas with the potential for renewal.*
- *Targeting allows developing the necessary specialized market expertise and assures that investment will be concentrated in order to create the critical mass of activity which shifts resident and investor perceptions and reestablishes healthy functioning markets.*
- *By utilizing a coordinated array of banking, real estate, venture capital, technical assistance, human resource or other community development tools tailored to particular community needs, a community development institution can enhance its market knowledge and impact, control risk, and otherwise undertake complementary activities which create a positive, safer environment for private investment.*

Development banking, based on this relationship between markets, investment, and the health of communities, thus begins with the observation that sustained economic development occurs when local residents invest their savings and talent. The clearest indicator of a permanent community renewal process is active investment by private and institutional investors who believe that an identity exists between their self-interest and that of the current residents. Deliberately accelerating local economic activity requires releasing this local energy by providing access to capital, credit, technical assistance, and market information; and by supporting an entrepreneurial culture that values risk - taking, business discipline and self- reliance. In particularly distressed, disinvested communities, external resources must be attracted to leverage the limited local capacity and allow provision of the necessary credit and capital. Ultimately, development banking seeks to restore healthy market forces by attracting and combining the resources necessary to building a critical mass of permanent development activities sufficient to restore investor confidence in the community.

A community development bank – a bank holding company with a specialized structure and business plan to transform the market dynamics of a target geography – is ideally suited to this approach to revitalizing distressed communities. The bank brings scale, legitimacy, and sustainability. It can continuously develop deep local knowledge of assets and opportunities. As detailed in the main paper, the bank developed a set of lending strategies and skills that built upon and enhanced its local knowledge, networks and role as a financial, institutional and physical anchor for the neighborhood. These strategies enabled it to address the higher transaction costs and risks and limited collateral that were common in its distressed marketplace.

The subsidiaries allow undertaking larger scale or higher risk development, often attracting subsidies; strengthening market conditions for the bank finance; and creating synergies and momentum to strengthen and leverage additional private market investment. Thus, ShoreBank went beyond extending credit to include a real estate development company, a venture capital company, and a community organization that ran incubators, offered job training, and supported low-income housing. For example, in the case of the multi-family rehab market,[xlix] the real estate development company was able to take on large corner buildings that were too difficult for "mom-and-pop" rehabbers to address, while the mom- and pop-rehabbers focused on the smaller flats that were next to the corner buildings. This allowed the entire block to redevelop, thereby attracting better tenants.

The emergence of essentially an entirely new market and industry of mom and pop rehabbers illustrates particularly well the approach and success of ShoreBank. The bank's lenders deeply engaged with and encouraged a growing network of entrepreneurs, initially rehabbing small apartment buildings, but ultimately growing large portfolios. The bank and rehabber network shared detailed information on everything from building conditions to contractors, while the bank helped structure deals, developed a deep specialization in multi-family rehabbing and leveraged the expertise to develop new products and protocols for the niche market, including an acquisition-rehab product tailored and administered to this market opportunity. [l]

ShoreBank's role in driving market development is similarly illustrated, with respect to business lending, by its discovery of and focus on the benefits and opportunities of franchises for minority entrepreneurs. South Shore and its surrounding communities were badly underserved by franchise operations, and franchises provided a business model and support system highly attractive for entrepreneurs who had not grown up in families or networks that provided business networks and expertise. ShoreBank literally bought the rights to whole franchise territories, and then worked with entrepreneurs to open franchise businesses across the South Side. In the process – as with the mom and pop rehabbers – ShoreBank simultaneously contributed to enormous individual wealth creation as these entrepreneurs succeeded in their businesses while also rebuilding the housing stock and providing neighborhood commercial revitalization and amenities.

Outcomes

By 1993, ShoreBank had financed renovation of nearly 10,000 units of rental housing in South Shore, nearly 35 percent of the market. The bank's approach not only enhanced the neighborhood's multifamily housing stock, but also created jobs and a new group of Black entrepreneurs in the housing rehabilitation business. ShoreBank's strategies effectively enhanced the standard of living in South Shore without rendering the neighborhood unaffordable to ordinary people.[liii]

ShoreBank's success in the South Shore allowed the bank to expand its services and impact nationally and globally. By 2008, ShoreBank had made more than $4.1 billion in mission investments and financed over 59,000 units of affordable housing. Its loan loss rates were also consistently lower than its peers.[liv]

ShoreBank was eventually forced to close in 2010 – like many other banks that were not considered "too big to fail" -- as the Great Recession caused extensive unemployment and undermined property values, ultimately leading to rent and mortgage defaults. A large group of major banks and philanthropic investors were prepared to recapitalize the bank, but conservative regulatory judgments (and some say unfortunate politicization), forced the bank to close and reopen with the additional capital as Urban Partnership Bank, continuing its development finance mission but without the subsidiaries. ShoreBank remains among the most successful place-based development finance models to date, serving as the model for the Clinton Administration's CDFI legislation and the subsequent growth of the CDFI sector.

Key Takeaways

ShoreBank took a dramatically different and new approach to poverty alleviation – focusing on assets and market development. It designed a linked set of mutually reinforcing companies, under a bank holding company, to know, engage with, and support the neighborhood and its residents thoroughly and continuously. Its rich, on-the-ground expertise allowed it to find, underwrite, and invest in underdeveloped assets with reduced risk and transaction costs. It also put the bank in the position to develop specialized products that could best serve and grow the market. The case also essentially reflects what was the original proof of concept for the CDFI model's rich capabilities. CDFIs tend to be more highly specialized by place and/or market and have more capacity to craft higher-risk deals and see the deals through by providing hands-on knowledge and expertise.

REVITALIZING DETROIT

A Multi-Pronged Approach of Corporate, Philanthropic, and CDFI Investment

Background on Detroit, MI

Once one of the five largest cities in the U.S., Detroit has experienced persistent population declines since the 1970's, having lost nearly 60% of its residents by the early 2010's. Several factors caused the population decline, including post-war deindustrialization; "white flight", in which white residents fled to the suburbs to avoid racial integration; and the collapse of the auto-industry during the Great Recession, which led to the loss of thousands of jobs. The population loss has led to an increase in housing vacancies, a decrease in property values, and a diminished tax base for the city. In 2013, Detroit filed for bankruptcy. [lvi]

Mechanisms for Redevelopment

Several efforts—some coordinated and some freestanding—have contributed to the revitalization of Detroit. Given the scale of disinvestment, concerted city, philanthropic and anchor institution efforts to reinvest in and re-establish stronger markets in the downtown and midtown neighborhoods occurred in the 2000 and early 2010s. In the early 2010's, the city launched a two-year planning effort to reinvent the city, which culminated in Detroit Future City, a comprehensive framework for Detroit to strengthen its diminished assets. Included in the plan were strategies to strengthen target neighborhoods and corridors and repurpose vacant lots and buildings over 50 years. The city's strategic plan was preceded by The New Economy Initiative, an initiative of ten foundations to support entrepreneurs and small businesses in the region.[lviii]

A wide range of private and philanthropic institutions, sometimes in close coordination and others independently, have been systematically investing to implement these and other plans and begin to restore Detroit markets and neighborhoods. Traditional financial institutions have been key partners in Detroit's redevelopment efforts, particularly JPMorgan Chase (JPMC), which has committed to investing $200M in Detroit's revitalization. Other financial institutions that have been engaged include Goldman Sachs which has made a $7M equity investment to finance the redevelopment of the East River Detroit neighborhood, a formerly blighted industrial area close to the city's downtown, through its GS Social Impact Fund. Goldman has also implemented a 100K Small Business program in Detroit, which provides capital support and technical assistance to small businesses. Similarly, Rocket Mortgage has deployed its real estate and mortgage lending expertise to help stabilize the housing market in Detroit, using its data and specialized lending capabilities to reduce vacancy and blight in low-income neighborhoods.[lxii]

Complementing these activities contributing to Detroit's redevelopment is a growing CDFI presence in the region. Invest Detroit, a local CDFI created in 2011, has leveraged funding from the CDFI Fund and other sources to deploy over $440M into Detroit.

It has developed over 6M square feet of commercial and retail space, produced over 5,000 housing units, created or retained nearly 13,000 jobs, and supported over 700 projects, businesses, and companies since inception. National CDFIs—such as IFF, LISC, and Capital Impact Partners—have also entered the Detroit market, further adding capacity to efforts to revitalize Detroit. Capital Impact Partners, for example, has not only provided financing for development projects but also provided rich market analysis, identifying opportunities to generate a healthy income mix in Detroit neighborhoods and support inclusive growth through mixed use and commercial corridors.[lxiv]

Example Investments by JPMorgan Chase

JPMC has been amongst the most active and invested corporate partners in Detroit. The bank has an 85-year history in the region through its predecessor institutions. JPMC's initial focus was on bringing back businesses into the downtown corridor and attracting larger employers into the region, but later it expanded to neighborhood and community development more broadly upon discussion and engagement with community stakeholders.

JPMC initiated redevelopment efforts in Detroit with two $20M loans to Invest Detroit and Capital Impact Partners, which helped bolster CDFI capacity in Detroit and also helped connect JPMC to specialized, on-the-ground knowledge about Detroit communities. JPMC has since made other investments to support Detroit's redevelopment, many of which are in partnership with CDFIs. Example investments include the Detroit Housing for the Future Fund, a $75M private-sector fund to preserve housing throughout Detroit and support new development in target neighborhoods; Detroit Neighborhoods Fund, a $30M initiative to finance real estate projects in Detroit's near-east side neighborhoods and ensure the residents benefit from nearby redevelopment; Entrepreneurs of Color Fund, a $6.5M lending program for Detroit businesses owned by entrepreneurs of color or business that primarily hire people of color;[lxvi] and Equitable Development Initiative, which provides training and mentorship to support minority real estate developers.[lxvii] The Detroit Neighborhoods Fund, Entrepreneurs of Color Fund, and Equitable Development Initiative are done in partnership with Capital Impact Partners, a CDFI.

In the example of the Detroit Housing for the Future Fund, JPMC has provided a 15-year, $12MM "FlexLoan" – a long-term, low-cost loan—to capitalize the fund. The fund is designed to help developers bridge the funding gap between redevelopment costs and income from tenants, recognizing that the gap limits the developers' ability to preserve and create affordable housing. Products offered through the fund include recoverable grants, low interest mini-permanent loans, and a preferred equity product.[lxviii] The fund is managed by LISC Detroit, a CDFI, which maintains a cash reserve of at least 5% of the dollars deployed. Other investments in the fund include a $10M guarantee from The Kresge Foundation, $25M in grants from 10 corporations, and a combination of senior and subordinated debt from local financial institutions, including $7.5M from PNC Bank. The goal of the fund is to preserve 10,000 units and create 2,000 new units of housing in 5 years.

Outcomes

Detroit's recovery is ongoing and still has a long way to go, but early data suggests that the influx of capital and concerted attention to redevelopment has paid some dividends. Population loss has slowed, though the trend has not fully reversed yet.[lxx] The poverty rate remains high but decreased by nearly 12 percentage points between from 2012 to 2019, going from 42.3% to 30.6%. Private market activity, particularly commercial development downtown, has accelerated. The city has rebounded more quickly than expected during the pandemic, with the unemployment rate for Detroit residents at 3% below its pre-pandemic level.[lxxi]

Key Takeaways

The Detroit case is an example of how banks can leverage the varied expertise and capacities of CDFIs to maximize their community investments. CDFIs in Detroit have helped underwrite and structure financing; raise and manage capital from different sources to support local goals; disseminate specialized, on-the-ground knowledge; and identify and develop new products to address barriers and opportunities in Detroit. Detroit is also an example of how a formal, comprehensive strategy such as Detroit Future City can help to mobilize and direct corporate investments and create momentum for revitalization.

TRANSFORMATIVE DEVELOPMENT IN PULLMAN, CHICAGO

A Non-Profit Developer – Bank Partnership Comprehensively Developing Neighborhood Assets

Background on the Pullman Neighborhood of Chicago, IL

Pullman is a historic neighborhood on the South Side of Chicago, made famous for the row-housing and industrial facilities built by George Pullman and his railroad company in the 1880s. Once a racially diverse, prosperous community, Pullman was devastated by the decline in industrialization after World War II. The neighborhood experienced disinvestment and rapid demographic shifts, resulting in nearly 30% of its population living under the poverty line by 2000.

Mechanisms for Redevelopment

A comprehensive strategy began to emerge in the early 2000's to redevelop Pullman and leverage its underutilized assets, which included strong infrastructure and plentiful land. Of particular focus was redeveloping a 180-acre brownfield site into a mixed-used development with retail, affordable housing, and other facilities. The effort experienced some fits and starts after the Great Recession but eventually came into the hands of Chicago Neighborhoods Initiative (CNI), a newly established non-profit developer and CDFI that understood the potential in Pullman's underutilized assets.[lxxiii]

U.S. Bank similarly committed to Pullman, developed a strong partnership with CNI, initially leveraging $50M in New Markets Tax Credits to undertake the large scale, anchor redevelopment. Much of U.S. Bank's involvement in Pullman was through its community development corporation, U.S. Bancorp Community Development Corporation (USBCDC). USBCDC is a for-profit, mission-driven arm of U.S. Bank that has business lines in affordable housing, tax credits, and renewable energy and syndications. USBCDC's expertise in tax instruments, deal construction and organizational governance brought significant development finance know-how and capacity to the Pullman redevelopment projects. With U.S. Bank's technical assistance, CNI ably passed on the tax credits to investors in exchange for equity financing of the community redevelopment. This equity financing spurred additional third-party lending by establishing to lenders that the project was a viable borrower.

CNI mobilized corporate interest in the brownfield site, working with the city, U.S. Bank, corporates, community partners, and other partners to coordinate, finance, and execute a series of deals to redevelop the site. Corporate partners have included Walmart, Whole Foods, and Amazon, among many others. CNI and U.S. Bank built on this initial investment to continue developing retail, industrial, housing and community amenities, as well as to otherwise promote the Pullman neighborhood (including its designation as a National Monument).

Outcomes

Executed deals in Pullman include a $30M light manufacturing facility that has created 150 jobs; a $20M community center, which was funded in part by an equity investment from U.S. Bank; and a $16.5M commercial facility that exceeded minority business participation goals for trade contractors. In all, CNI has helped coordinate $370M in investments into Pullman assets.

The series of investments in Pullman have helped the neighborhood increase its population while other nearby communities have experienced decline. Unemployment has also declined at twice the rate in Pullman compared to Chicago as a whole.

Key Takeaways

The Pullman case is a classic example of the power of asset- and market-based development targeted and tailored to the opportunities in a specific neighborhood. CNI and its partners effectively identified the 180-acre brownfield plot as an underutilized and potentially anchor asset, and developed it into a series of shopping, light industrial, and recreational space. This reinforced opportunities for continued development, including increasing private market housing and retail activity. The case is also an example of how CDFIs and financial institutions can partner to leverage tax equity, share expertise, surface and bolster assets, and maximize their place-based investments.

REINVESTING IN NEWARK

PFI Undertakes Multiple Roles to Promote Place Based Investment

Background on Newark, New Jersey

Once a booming city, Newark was hit hard by the decline of industrialization after World War II. Racial strife between Black and white communities and the migration of wealthier residents into the suburbs further exacerbated Newark's problems, leading to a diminished middle class and high rates of unemployment and poverty.

While the city is home to several successful corporates, such as US-based Prudential Financial, Inc. (PFI), Mars, Inc., and Audible, its residents have not always shared in the corporates' prosperity. Less than 20 percent of the jobs in the city are filled by Newark residents and most corporate employees do not live in the city. Only three percent of the money spent on goods and services by the city's largest employers goes to Newark vendors.[lxxiv]

Mechanisms for Redevelopment

To promote equitable prosperity, attract and retain residents, and leverage the city's corporates as assets, an anchor institution collaborative was established in 2018. The Newark Anchor Collaborative convenes major employers—including corporates and local hospital and university systems—and organizes them around the mission of growing and establishing a middle class in Newark. One of the Collaborative's core initiatives is a "Hire, Buy, Live Local" effort, which encourages anchors to hire Newark residents, increase local sourcing, and incentivize employees to live locally.[lxxv]

PFI's Investments

PFI seeks to drive inclusive economic growth in its headquarter city of Newark. It has been an especially engaged member of the Collaborative, having catalyzed its establishment, and executes several initiatives to support the Collaborative's mission. PFI has made a series of financial investments to support Newark's redevelopment, many of which are in concert with other anchor institutions and in accordance with the "Hire, Buy, Live Local" framework. PFI, for example, has pursued efforts to address the dilapidated buildings in downtown Newark and the outer wards, including providing a $20M loan to turn a decaying mall into a mixed-used development. It has also helped launch a Residential Pooled Fund, which pulls together resources from local anchor institutions to incentivize employees to own or rent homes in Newark. It has additionally sought to grow and support small businesses, including spending $40M with diverse suppliers to build Prudential Tower and investing $25M in fast-growing businesses that are hiring in Newark.[lxxvi]

In addition, PFI provides philanthropic grants to local nonprofit organizations to accelerate economic mobility and close the financial divide for Newark residents. This includes supporting efforts to improve public education, public safety, workforce development, affordable housing and arts and culture. Other investments by PFI include offering technical assistance and capacity to community efforts by serving and leading committees and donating employee time, which has further enhanced PFI's visibility and credibility in the community. PFI has also partnered with local CDFIs in its efforts to enhance supplier diversity. CDFIs have helped the small businesses increase their capacity to meet higher-volume contracts with PFI and other anchor institutions, providing them with the smaller, riskier loans that can allow them to fulfill the contract and growth their business.

Outcomes

Publicly available data on the impact of efforts to revitalize Newark is limited, but there are indications of some success. The Newark Anchor Collaborative had established a goal of having 2,020 residents hired by Newark companies by 2020, which it reportedly achieved by the end of 2019. According to PFI, $1.7 billion dollars has been invested in new residential and commercial projects in Newark over the last three years. PFI has also reported increasing spending on Newark-based enterprises by 131% between 2014 and 2016.[lxxviii]

Key Takeaways

PFI is an example of a financial institution taking on all three roles for financial institutions in place-based investing by making direct loans to support development projects; providing philanthropic support to local nonprofit organizations; investing and partnering with intermediaries; and engaging in capacity building efforts for small businesses and nonprofit organizations through its core business operations. It is also an example of how financial institutions can deploy financial capital, employee talent and business assets to achieve larger goals, as seen with PFI working with small businesses to enhance the capacity of local diverse suppliers it sought to contract with. Additionally, formal collaboratives like the Newark Anchor Collaborative can help communities leverage corporates as assets and provide infrastructure to organize and maximize corporate investments in community and economic development.

ENDNOTES

[i] Place-based investing and economic place-making are used interchangeably throughout this report to refer to efforts to improve the conditions in distressed communities through investing to improve their economic conditions and outcomes. “Distressed” communities (also known as disadvantaged, disinvested or impoverished) tend to be characterized by more limited economic activity and investment, resulting in higher levels of unemployment, lower income levels, more vacant or underdeveloped buildings and land, fewer and smaller commercial establishments and related economic and social challenges.

[ii] Market Based Community Economic Development, Weissbourd and Bodini (Brookings 2005), <https://www.brookings.edu/wp-content/uploads/2016/06/20050314_communitydev.pdf>; Into the Economic Mainstream, Weissbourd (CFED & OFN 2006), <http://rw-ventures.com/wp-content/uploads/2017/01/Distribution-Draft-IEM-Paper-8-6-06- rw.pdf>. See, Jane Jacobs, The Economy of Cities, p121: “… poverty has no causes. Only prosperity has causes. Analogically, heat is a result of active processes; it has causes. But cold is not the result of any processes; it is only the absence of heat. Just so, the great cold of poverty and economic stagnation is merely the absence of economic development. It can be overcome only if the relevant economic processes are in motion.”

[iii] Worth noting that this dynamic does not appear in conventional markets, where assets are more readily identifiable, easier to evaluate, and more often developed.

[iv] On the role of information in both hindering and potentially enhancing market development in distressed communities, see Using Information Resources to Enhance Urban Markets, Weissbourd and Bodini (Brookings 2005), < https://www.brookings.edu/research/using-information-resources-to-enhance-urban-markets/>.

[v] For more background on the frameworks behind asset-based development, and examples of how those principles are put into practice in place-specific economic growth planning, see The Greater Chatham Initiative Plan, http://rw-ventures.com/wp- content/uploads/2017/01/GreaterChathamInitiative_Plan_1.pdf and ScaleUp Sacramento, https://www.cityofsacramento.org/-/media/Corporate/Files/EDD/IECD/ScaleUp-Sacramento.pdf?la=en; see also, Metropolitan Business Plans, Muro and Weissbourd (Brookings 2011), <https://www.brookings.edu/research/metropolitan-business-plans-a-new-approach-to- economic-growth/>.

[vi] See, e.g., Seidman, Karl, Economic Development Finance (Sage Publications 2005); Shryock, Dave, Financing Neighborhood Businesses (Commercial Lending Review v8#2 1993).

[vii] Small businesses in underinvested communities, for example, may not have conventional financial statements, making it more difficult and costly for financial institutions to assess risk, evaluate profitability, and approve the appropriate investments.

[viii] Consider the example of credit scoring, which ironically makes it much less expensive to lend to people who are conventionally successful, so have more extensive and conventional credit histories. In mainstream financial markets, credit scoring has become increasingly prevalent because it increases the efficiency and productivity of the underwriting process, driving down the costs of lending. However, partly because less data is available, but also because of which data sets are considered (e.g. mortgage payments but not utility payments), credit scoring models under-estimate or are less useful with respect to lower-income consumers. The lack of accurate information on the creditworthiness of lower-income individuals means that financial service providers often cannot reliably evaluate (and so overestimate) the risk of issuing loans to this demographic. As a result, assets that exist in marginalized communities go unrecognized and untapped.

[ix] The bank holding company and its subsidiaries went through a series of name changes over its nearly 40 years. “ShoreBank” is used here throughout to refer to the entire operation.

[x] See also, Dyal-Chand, Rashmi. Collaborative Capitalism in American Cities: Reforming Urban Market Regulations. Cambridge: Cambridge University Press, 2018. https://doi.org/10.1017/9781316459836.

[xi] “About – Middle Neighborhoods,” accessed September 30, 2021, https://middleneighborhoods.org/about-mn/.

[xii] Other niches that ShoreBank developed included franchise lending (restaurant and auto) and non-profit lending (real estate or receivables financing).

[xiii] “Zillah Oakes Inn | Craft3 Clean Energy Loan,” accessed September 28, 2021, https://www.craft3.org/results/StoriesOfChange/story-details/zillah-oakes-inn.

Neighborhood revitalization often provokes fears of gentrification. While neighborhood improvement inherently attracts new residents, it need not displace and can primarily benefit current residents. Revitalizing the multi-family housing market expanded the supply of housing, allowing for improvement without displacement.

[xv] <https://finhealthnetwork.org/>

[xvi] As the original and premier model of a development bank holding company, Shorebank played a leading role in creation of the CDFI industry and legislation. Starting out as an experiment with $800K in capital and $2.2M in debt, ShoreBank grew into a billion dollar institution by focusing on underinvested entrepreneurs and a niche multi-family housing rehabilitation market, establishing complementary subsidiaries to reinforce its investments; and inventing additional strategies to reduce risk and transaction costs. ShoreBank effectively illustrated to traditional banks, policymakers, and others the potential for CDFIs to cultivate assets and expand markets in developing neighborhoods. When public policy makers wanted to enable rapid growth of more development banks, other forms of

development lenders were included – and the phrase "Community Development Financial Institutions" was coined to also encompass community loan funds, credit unions and venture funds. See, United States and United States Congress House Committee on Banking Insurance Finance, and Urban Affairs Subcommittee on Consumer Credit and, New Hope for Old Victims: Hearing Before the Subcommittee on Consumer Credit and Insurance of the Committee on Banking, Finance, and Urban Affairs, House of Representatives, One Hundred Third Congress, First Session, January 27, 1993 (U.S. Government Printing Office, 1994).

[xvii] Merchant banks often specialize in particular industries or types of deals or customers. Special purpose vehicles can span a wide range of models, including real estate investment trusts (REITs), community ownership vehicles, and accelerators, among others.

[xviii] Cristina Garmendia and Annie Olszewski, "IMPACT INVESTING IN DEVELOPMENT FINANCE," n.d., 46.

[xix] Opportunity Finance Network, the national association of CDFIs, working with large banks and regulators, developed an investment product whose features (e.g., longer term, no principle payments for several years, forgivable in special circumstances) allowed the investment to be considered debt for the banks but equity for the CDFIs.

[xx] Federal Deposit Insurance Corporation, "Financing Approaches," accessed September 28, 2021, https://www.fdic.gov/consumers/community/cdfi/cdfis_sectioniii.pdf.

[xxi] "Impact Finance," accessed September 24, 2021, https://www.jpmorganchase.com/impact/our-approach/impact-finance.

[xxii] "Chicago Community Loan Fund – 2020 Annual Report," accessed September 29, 2021, https://2019annualreport.cclfchicago.org/.

[xxiii] "Hope Enterprise Corporation | Hope Credit Union," accessed September 29, 2021, https://hopecu.org/about/hope-enterprise-corporation/.

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