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CHAPTER 3
COMMUNITY DEVELOPMENT

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This chapter addresses the specific issue of leveraging private financing for community development, primarily in economically disadvantaged urban neighbourhoods that are not generally thriving through the normal working of private market activity.

In the United States, financial leverage is a longstanding concept and practice. In business, it is often called OPM – "other peoples' money." The basic principle of securing ownership of valuable assets via borrowing is well established, whether through a high loan-to-value ratio first mortgage to purchase one's home, or through a leveraged buyout of a corporation. This same principle of leverage applies to attracting shareholders and other equity investors – from venture capitalists to limited partnerships – with an ever-expanding list of innovative financial instruments and intermediaries designed to increase the availability of both debt and equity capital. Public policymakers have generally focused on promoting their own form of leverage due to the longstanding preference in the United States for private market activity, and the fact that private resources are generally much larger than public budgets. In the case of distressed areas of cities and regions, however, one of the main reasons these communities are facing economic and social difficulties is that they have been experiencing a far greater degree of private disinvestment than of capital infusion. Indeed, the term "redlining" was coined to describe just such a withdrawal of capital, and the Community Reinvestment Act was established by the U.S. government in 1977 precisely to address this problem, both requiring and encouraging private lenders to provide more substantial financing for neighbourhood improvement.

In this chapter, I will address the specific issue of leveraging private financing for community development, primarily in economically disadvantaged urban neighbourhoods that are not generally thriving through the normal working of private market activity. These are communities that need some additional public assistance to promote new investment in business growth and job creation, affordable housing and homeownership, transportation and infrastructure, stores and services, schools and safety, environment and amenities, and all of the other features that generate, sustain, and enhance economic prosperity and quality of life. Due to the particular nature of the intergovernmental system in the United States, any discussion of public policy initiatives at the local level will inevitably involve various forms of federal and state government intervention, because much of the budgetary resources, taxation, and regulatory authority for municipal governments is closely interwoven with federal and state laws, grants, and other programs, rules, funding sources, and institutions.

The necessity of economic strategy and public investment for successful private leveraging

Public policies providing a wide variety of incentives and resources to promote private investment in low- and moderate-income neighbourhoods are

intended to address the causes and consequences of insufficient capital devoted to community development. One of the most essential policy approaches is to strengthen the basic conditions that help foster private market activity, such as public investment in transportation and infrastructure improvements to enhance business activity, public funding of education and workforce development to increase employment opportunities, and public support for services, training, and technical assistance that builds the managerial capacity of small and medium-sized enterprises (SMEs) and non-governmental organisations (NGOs). Indeed, it has been repeatedly demonstrated that the direct public investment approach is a necessary precondition for private businesses to thrive, which is why President Clinton's nation-wide Empowerment Zones/Enterprise Communities initiative during the 1990s provided block grants to distressed urban and rural communities for basic physical and social improvements, supplemented by state and local government funds, which were used in conjunction with tax incentives to encourage private investment. The previous wave of state-authorised Enterprise Zones created during the 1980s concentrated almost exclusively on offering tax incentives to private investors. Yet even in the cases of lucrative project-based deals where local governments sacrificed significant future tax revenues to promote private development, most of them have not worked effectively to revitalise an entire neighbourhood, unless they were part of comprehensive economic and community development strategies involving an active and extensive role for the public sector in the redevelopment process.

Indeed, far too often government officials, on the theory that any private business activity or property development project is better than nothing, eagerly subsidise private capital to invest in distressed communities, with very little to show in terms of resulting neighbourhood revitalisation and spin-off economic activity. Thus, leveraging private capital must be recognised as a potentially valuable tool to achieve important public policy objectives, but it must not be treated as its own goal. Leveraging can only be useful if it is well planned in the context of a broader economic strategy.

Such a strategy must recognise the following realities: 1) an individual urban community can only be improved if it is connected to and benefits from the larger economic dynamics of the entire metropolitan region; 2) the key to generating and sustaining economic value is building on strength by investing in the fundamental assets that make a community special and competitive, and the most important asset is the people who live and work in that community; 3) promoting new development must be tied to attracting and retaining businesses and jobs, and to attracting and retaining a mixed-income residential population. Thus quality of life issues such as a safe and attractive environment, good schools and homeownership, good transportation and communications,

may be more important than financial incentives for encouraging private investment; 4) the best way to attract and retain businesses and jobs is by fostering and sustaining the growth of dynamic industry networks or clusters that generate productivity and innovation. Incentives should be expressly targeted to move forward such an agenda, rather than simply subsidising any and all types of business and property development activities.

A good example of a community economic development strategy that used these lessons well is the NoMa initiative in Washington, DC. NoMa, which stands for North of Massachusetts Avenue, is an area near the city's downtown with a large amount of vacant land and abandoned industrial buildings, surrounded by several residential neighbourhoods populated mainly by low- and moderate-income African-American families. At the heart of NoMa is a passenger and freight rail corridor, along with several major traffic streets. Washington, DC's 1998 strategic economic development plan – *The Economic Resurgence of Washington, DC: Citizens Plan for Prosperity in the 21st Century* – targeted NoMa for redevelopment as a technology, media, arts, and housing district, taking advantage of such key assets as centrality of location, transportation accessibility, availability of development sites and loft-style structures, "broad-band" fibre optic cable lines under the railroad tracks, the role of the nation's capital as an international media centre, the 1990s boom in information technology and telecommunications throughout the metropolitan region, and the urban lifestyle that is so attractive to talented and creative young artists, multimedia professionals, and technologists.

A major linchpin of the overall strategy is the construction of a new Metrorail station at New York and Florida Avenues, NE, the first new station added since the regional transit system was planned in the 1960s, and the first-ever "infill" station built on an existing line between two stations while the trains keep running, rather than as an extension to the end of the rail line. As co-ordinator of the city government's economic development strategy during 1997 and 1998, I conceived of an innovative form of private leveraging to finance construction of the New York Avenue Metro Station. What made the necessity for entrepreneurial public sector innovation even more important was the fact that at that time, the city government was facing serious budget problems, and the city's economy was stagnating. Both of them urgently needed a major turnaround.

To help facilitate this economic and fiscal transformation, we turned to the private sector, presenting them with an attractive economic plan that would clearly make their property more valuable for development, as long as it became transit-accessible, which, for example, is a legal prerequisite for obtaining federal government office leases. After more than a year of joint negotiations

during 1997 and 1998, a group of major private property owners agreed collectively to pay $25 million through a 30-year special property tax assessment to build the transit station, and also agreed to donate land to the Washington Metropolitan Area Transit Authority needed for constructing the station.

Armed with this unprecedented large-scale commitment of private leverage, the cash-strapped city government was able to obtain $31 million in federal funds to supplement both the $25 million private sector contribution and the city's own $34 million share of the costs. This $90 million total included a pioneering public-private partnership agreement with environmental advocacy groups to build a pedestrian and bicycle path, part of the regional Metropolitan Branch Trail, as an integral component of the New York Avenue Metro Station project, thus ensuring that transit-oriented development would also be environmentally sustainable development.

There are two key points to highlight about this successful leveraging of private investment in NoMa. First, the private sector invested primarily because the city's economic development strategy for the NoMa area clearly reflected genuine market opportunities for profitable business activity, and because of the demonstrated public sector commitment to making substantial investments in the neighbourhood, which in addition to the New York Avenue Metro Station, also included $100 million in federal funds for the new national headquarters of the U.S. Bureau of Alcohol, Tobacco, and Firearms on vacant city-owned land directly adjacent to the Metro station, and an equivalent amount for a major new office complex nearby anchored by the U.S. Securities and Exchange Commission. The NoMa economic strategy was designed to generate more than one billion dollars of total public-private investment and over 5 000 permanent jobs in NoMa by the time the Metro station opens in late 2004, and these highly ambitious goals now clearly will be surpassed. The NoMa area, home to Cable News Network, Black Entertainment Television, National Public Radio, and Atlantic Video, has recently attracted other major media companies such as XM Satellite Radio and Gannett Publications. Since 1998, NoMa also has begun serving as a magnet for numerous global telecommunications firms, though many of them are suffering from the current market recession.

Second, leveraging private investment in transit and economic activity was closely intertwined with a strong community development strategy designed to involve and empower neighbourhood residents in improving their homes, schools, and amenities, and to enable them to obtain a share of the growing numbers of jobs and business opportunities coming into the NoMa area. This strategy included creation of the McKinley Technology High School and Campus in the heart of the neighbourhood to create career opportunities in

technology fields for African-American youth and adults; the NoMa Community Outreach and Marketing Centre to provide business assistance, job placement, and other important services to neighbourhood residents, and to strengthen the emphasis on grassroots participation and citizen opportunity; the designation of the neighbourhood commercial district along North Capitol Street as a Main Street Corridor for physical improvements, business promotion, and community marketing; and the development of a major shopping centre featuring the first Home Depot in Washington, DC, creating hundreds of new job opportunities and convenient low-priced goods and services for people living and working in NoMa.

In June 2002, the NoMa initiative was recognised as one of the world's 40 most exemplary models of sustainable community economic development and public-private partnerships by the United Nations-Habitat Best Practices Awards Program. Similarly, during November 2002, the NoMa initiative was selected as one of the 99 nation-wide semi-finalists by the Ford Foundation and Harvard University for the prestigious Innovations in American Government Award. The five-year track record of successful accomplishment by the NoMa initiative is definitive proof that when policymakers produce a clear and practical economic plan based on a strategic vision of strengthening the fundamental assets and dynamic industry networks that make their place special, attractive, and competitive, they can successfully leverage hundreds of millions of dollars in private investment and development activity.

Why incentives are needed and when to use them

Simply put, private capital will go where it can get a relatively secure return of acceptable proportions. Private investors and entrepreneurs are not in the business of deliberately losing money. Where they perceive market opportunities to be lacking, or that risks are too great relative to the potential payback, they will go elsewhere with their financial, physical, and human capital. In order to level the playing field and make private investment sufficiently safe and attractive, government agencies and philanthropic organisations with public policy goals that are at variance with current market realities must design and provide financial incentives to lure private capital into distressed communities. If the barrier is high risk, then such risks can be reduced through credit enhancement mechanisms such as loan guarantees or subsidised insurance. The Small Business Administration has made guaranteed loans a standard feature of its portfolio to induce banks to lend to small and medium-sized enterprises (SMEs), and the Federal Housing Administration's pioneering mortgage insurance program – in which the federal government insures private lenders against potential loss from making home mortgage loans

to qualified borrowers – has played a major role in promoting affordable homeownership in urban neighbourhoods since the 1960s.

Similarly, if the barrier is the perceived lack of a market, then guaranteed demand is an appropriate solution. The U.S. government's Section 8 program guarantees that residential property owners will receive monthly "fair market" rental payments on behalf of eligible low-income tenants participating in the program. For two decades the Section 8 New Construction and Substantial Rehabilitation programs provided long-term advance commitment contracts as a means of making it predictably profitable for property developers to build or renovate affordable housing in distressed communities, and as a means of enabling them to obtain private financing from lenders and investors. However, a problem arose after 20 years, when these legal affordability requirements expired, and some building owners decided to substantially raise their rents or convert their buildings to luxury for-sale condominiums, which then forced the U.S. Department of Housing and Urban Development (HUD) to offer these owners substantial additional subsidies simply to prevent the wholesale displacement of low-income renters.

Another example of this type of guaranteed demand-oriented leverage emerged in the mid-1990s, when HUD used specially authorised Section 8 commitments as an incentive to draw pension fund capital into investing in the construction of affordable housing. One hundred million dollars of Section 8 guaranteed rent commitments were reserved for pension funds that then competed for these Section 8 resources by investing millions of dollars to build new housing for lower income tenants. Similarly, the Clinton Administration's Hub Zones initiative provided targeted procurement for small businesses in distressed communities, thus creating a stronger market for them to sell their products and attract private capital to establish and expand their companies. The Hub Zones effort was an outgrowth of court decisions that made it more difficult to engage in targeted federal procurement for groups of people rather than for particular neighbourhoods in need, though numerous state and local governments, depending on the jurisdiction, do not face such constraints either on their people-oriented or place-oriented procurement efforts. Governments at all levels, as well as private employers and foundations, often utilise targeted procurement strategies – purchasing goods and services from small and medium-sized businesses operating within neighbourhoods in need of revitalisation – to strengthen market opportunities and provide a more secure environment for private investment. Generally only a portion, and always not more than half, of any state or local government's total procurement activity is specifically targeted by people or place, and thus the majority of such government procurement is left open for general competition from all qualified bidders.

If the barrier is lack of profitability due to the high costs of doing business in distressed communities, then policymakers can change these cost dynamics by providing subsidies to private firms in the form of below-market interest rate loans; direct grants; subordinated debt, or public loans that take a second or third position behind private lenders; equity investments on especially favourable terms; substantially reduced prices and rents for the sale or lease of land, buildings, and equipment; and tax deductions or credits. Depending on the level of priority, sometimes complex public financing packages involving multiple forms of these and other subsidies are provided. In order to justify such expenditures, public officials occasionally engage in economic analysis to demonstrate that without such government subsidies the private sector clearly would not invest, and thus public incentives are needed to leverage private capital.

For example, during the 1980s HUD's Urban Development Action Grants (UDAG) program, which provided grants to local governments for the express purpose of leveraging private investment for urban economic and community development, required applicants to clearly demonstrate with credible financial numbers the "but for" rationale behind their request for government support, documenting that the project could not be privately financed and would not get developed without the help of partial public funding. The level of subsidy and complexity of financing can become so great that it may require long and difficult negotiations to determine public support and reach an acceptable agreement. Government agencies at all levels – federal, state, and local – need experienced professionals who specialise in this type of financial and economic analysis to serve as members of their team, either as staff or consultants. Increasingly career training is being provided for such skills, both through university degree programs, and professional organisations like the International Economic Development Council, the Urban Land Institute, and the National Development Council.

If the barrier is that financial transactions costs are too high, financing deals are too small for major institutions, and community development loans and investments are too unfamiliar for the comfort level of mainstream firms, then the solution is to create intermediaries that specialise in economic and community development financing to work as advisers to and partners with private investors and financial institutions. These intermediaries can be either government agencies or non-profit private entities. In the U.S., groups such as the Local Initiatives Support Corporation, the Enterprise Foundation, the National Community Development Initiative, and the Neighbourhood Reinvestment Corporation, have effectively served as intermediaries between private capital and community developers. Indeed, they are directly responsible for the successful implementation of numerous targeted government initiatives

and programs, including federal Low Income Housing Tax Credits, which are administered by state and local governments according to an annual federal allocation formula. The above-named groups and other non-profit intermediaries not only work with private investors and financial institutions to lower their costs and reduce their risks by packaging loans and investments for them, but they also do the same for community development groups, providing both financial support and technical assistance.

Indeed, as with government economic development officials, private financiers who specialise in community economic development and non-profit community developers increasingly need highly professionalised training to empower them in their challenging work. To supplement university programs in business management, public policy and administration, and urban and regional planning, community development intermediaries play an important role in providing education and training courses, both for those who provide private financing and for those who need and use these funds to revitalise neighbourhoods. Non-profit community-based economic development in the U.S. is generally much more difficult and challenging than standard market-rate financial deals for business or real estate activity. Instead of one or two sources of financing that characterise a normal deal, investing in distressed communities may require up to a dozen different sources of funding for a development project to be fully financed. Handling such financial obstacles with professionalism and technical expertise is a constant problem for neighbourhood groups, which is why capacity-building activities are an essential element of the overall process, and a necessary prerequisite for leveraging private capital.

I co-ordinated a city-wide competition in Washington, DC for the city government's Department of Housing and Community Development (DHCD) during the first three months of 1998. At that time DHCD was responsible for disbursing a substantial backlog of funds – $70 million to be exact – for economic and community development and affordable housing and homeownership targeted to the city's low- and moderate-income neighbourhoods. My team was given the task of turning around a city government department that had been very poorly managed and was facing severe criticism for its past failures. DHCD's general approach to funding, which had become highly politicised by local elected officials, was to provide loans rather than grants to community development organisations, on the theory that loans were more "business-like" and the repayments could be recycled for further public investment. Unfortunately, the reality was far different than the theory. DHCD had no serious loan underwriting process, and consequently many of the borrowers were unable to complete their projects, their businesses became insolvent, and they defaulted on their government loans. More shocking

was the fact that even many financially solvent borrowers simply refused to repay their DHCD loans, because they believed that the city government would be reluctant to take legal action against them. As a result, in our first few months on the job we were forced to write off as uncollectable more than $50 million in bad loans. But the worst part of this situation is that there was almost no private financing leverage in most of these city government-funded deals. Detailed research we commissioned documented that each dollar DHCD provided leveraged on average only 70 cents in other private funds, which was an abysmal record.

Under DHCD' new city-wide funding competition initiated January of 1998, we designated "leveraging private financing" as one of the three main criteria for obtaining funds, along with "project feasibility" and "visibility/impact/benefit." We required all applicants for funding to demonstrate a minimum of two-to-one leverage (two private dollars to one public dollar), making it clear that higher leverage would make their proposals more competitive and thus more likely to be funded. We also insisted that all applicants demonstrate to us that they had actual money in the bank, or official commitment letters from lenders, grantors, or investors, before any private leverage could be counted on their behalf in the competition for funds. These actions on our part succeeded in generating even more private leverage than we were initially seeking. The $70 million in funding we awarded to the winners of the competition leveraged an additional $230 million in private financing, more than a three-to-one ratio. In addition, we drastically reduced the number of large direct loans made by our department, instead choosing to make smaller grants that leveraged large direct loans made by private financial institutions, on the theory that these lenders would utilise stricter and more market-oriented underwriting criteria, and that the community borrowers would be much more likely to repay a private institution.

Expanding private leverage became the key to generating a total of $300 million in public-private investments for Washington, DC's low- and moderate-income neighbourhoods, the largest single investment of its kind in the city's history. This infusion of substantially leveraged public-private capital produced several thousand new jobs, 2 000 new and renovated affordable homes and apartments, 1 500 affordable homeownership opportunities, 16 revitalised neighbourhood shopping areas and business districts, and over 50 community services centres, including health care and child care, arts and culture, education and counselling, job training and placement, parks and playgrounds. Indeed, the turnaround was so successful that even though at the time we took control of DHCD in the fall of 1997 it was under federal government investigation and subject to considerable media and public scandal for not having spent millions of dollars in federal funds received under the

block grant program for economic and community development (CDBG) and the block grant program for affordable housing and homeownership (HOME), by the spring of 1998 – just six months later – DHCD received special recognition from HUD for having created an excellent national model for fair, effective, and highly leveraged economic and community development funding, with widespread citizen participation both in the decision-making process and producing real results.

To cite just one example of strategic leveraging from the 1998 city-wide local government funding competition in Washington, DC, a solidly established community development group, the United Planning Organisation (UPO), came to DHCD with a request for a $1.25 million loan. This group already had saved $250 000 in equity to spend on building a $1.5 million community services centre in an area of southeast Washington called Anacostia. This centre's purpose was supporting and empowering predominantly African-American low- and moderate income neighbourhoods by providing health care, child care, education, job training and placement, recreation, and other vital services. However, UPO could only obtain a bank loan for $1 million, which left them with a $250 000 funding gap. Under the previous leadership, DHCD would have simply provided UPO with a government loan for $1.25 million. To the UPO leadership's surprise and dismay, however, we rejected their request. Instead, we proposed a very different and much more highly leveraged deal. We told them that they should secure an official commitment from the private bank for the $1 million loan, and having obtained this bank loan commitment, they could come back to us and request a $250 000 grant. Fortunately, this very well managed community development organisation did take our advice, and their proposal succeeded in obtaining the requested $250 000 in grant funding through the city-wide competition. The project got built and is doing very well today. The city government saved $750 000, which then became available to fund other projects, and we effectively leveraged $1.25 million in private capital for strategic community development, ensuring through the loan underwriting process conducted by a reputable bank that the project was solidly feasible. The loan is currently being repaid in a timely fashion to the bank, and the city government's grant money was well and efficiently spent.

Another key challenge for government to promote private leverage is to generate new financial instruments that will induce private investors to put their capital into economic and community development and affordable housing activities that would not normally engage their interest. In this case the barrier is lack of a proper vehicle that provides an attractive risk-adjusted return, and the solution is to create such a targeted vehicle. In the U.S., limited liability partnerships or syndicates, which protect a certain group of private investors from the broader financial risks and exposure faced by general or managing

partners, have been established to enable investment vehicles to attract capital for affordable housing, small business development, brownfields redevelopment, and other challenging public policy priorities. These limited partnerships spread financial benefits to investors through a steady and predictable income stream of government subsidy payments or tax advantages. For example, non-profit groups that pay no federal income taxes engage in "syndication" by selling their allotment of Low Income Housing Tax Credits to high-income corporations and individuals who use these credits to offset their income tax liabilities. By selling the tax credits, the non-profit groups obtain additional financial resources to use as equity to build affordable housing projects, and the purchasers of these tax credits are able to substantially reduce the amount of income taxes that they owe to the federal government. For the past 15 years, syndication of federal Low Income Housing Tax Credits has been the main method of raising private equity capital for building affordable rental housing in the U.S.

The sale of tax-exempt government bonds by state and local government to borrow funds for economic and community development projects, using such debt instruments as Industrial Development Bonds or Tax Increment Financing Bonds, is another means of pooling risk and attracting private capital for targeted economic and community development projects. In these cases private investors obtain significant reductions in their federal, state, and even local income tax liabilities, in exchange for providing vitally needed capital to the public sector for investing in infrastructure and subsidising private development to create jobs. The purchasers of these bonds, in addition to the substantial income tax benefits they receive, also derive a significant stream of income from the state and local government bond issuers through the regular repayment of principal and interest on the debt. Often groups of these loans or investments are packaged together to further reduce risk, and then sold as a bond or other form of security with a predictable stream of payments to private investors seeking a certain level and type of return for their investment portfolios.

Secondary markets, as they are called, can be very effective in expanding the range of institutional and individual investors that will provide private capital for selected activities. In such circumstances, financial institutions purchase large numbers of debt instruments from public and private lenders and borrowers, providing an immediate infusion of funds – enhanced liquidity – to the sellers. They then repackage these loans, which carry a regular stream of loan repayment income, and sell them as securities to individual and institutional investors, thus drawing a larger pool of private capital in support of a particular form of community development or housing finance that would not otherwise attract such capital investment, because the securitisation of the loan packages and bonds have significantly pooled and thereby lowered the risk, as

well as substantially reducing the transaction costs. Fannie Mae and Freddie Mac, two nation-wide secondary mortgage market entities that securitise home mortgage loans by purchasing them from mortgage lenders and selling these securities in institutionalised capital markets, have attracted literally trillions of dollars over the past three decades to increase capital availability and lower the financing costs of homeownership in the U.S. Government agencies, financial institutions, and philanthropic foundations have worked together on a smaller scale to create secondary markets for economic and community development loans and investments in distressed neighbourhoods, such as the nation-wide Community Reinvestment Fund, a non-profit organisation supported mainly by foundations and corporations, which purchases community development loans from state and local government and non-profit community development financial institutions (CDFIs), packages these loans together as securities, and sells them to investors through "private placements" (not through securities brokers or institutionalised capital markets). Establishing a secondary market of community development loans is much more difficult to create and sustain than the huge secondary market in the U.S. for home mortgages, because the latter represent an enormous volume of a highly standardised product that is easily packaged and evaluated by securities rating agencies. However, state and local governments and non-profit groups can work together to establish such secondary markets and successfully identify private or philanthropic investors that will purchase a security consisting of a group of loans, but would not purchase each individual loan separately, due to the increased risks and transaction costs.

One criticism of many of these tax incentives, limited partnerships, and securitisation schemes is that a portion of the government subsidy is going to high-income investors rather than to low-income families and communities. These critics argue that direct grants to non-profit groups would be a more efficient use of funds. The advocates for private leveraging respond that without such incentives, the total amount of capital for economic and community development would be even less, because public budgets are more limited politically in the amount of direct subsidy they can provide in the absence of significant private leveraging. Similarly, tax incentives are popular with policymakers, because even though they are much less efficient as a targeted subsidy for distressed communities, they are more invisible to voters in that they are not generally subject to annual budget debates, which makes them far less politicised and thus more likely to survive as legislation once they have become well established and have cultivated a significant constituency of support from politically influential private investors.

Another type of leverage is on the regulatory side. Governments may require bidders for contracts, leases, deposits, charters, or other valuable public

benefits that, in exchange for such publicly authorised value, the private firm must invest in certain communities or partner with certain organisations to accomplish major public policy objectives. A good example is the federal government's Community Reinvestment Act (CRA), which scrutinises the loan portfolio of depository financial institutions to make sure that they are serving all of the people and communities from which they take checking or savings deposits. The CRA has been responsible for helping generate literally billions of dollars in community investment over the past quarter century. It does not require a bank to make any specific investments or to take any fiscally unsound risks, yet it does require banks to devote a portion of their loan portfolio to serving low- and moderate-income communities both for small business, housing, and consumer lending, and for other financial services such as checking accounts or ATM machines. More importantly, the federal regulators who enforce the CRA and its various companion laws including the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, and the Fair Housing Act, along with the local and state activists and national organisations who fight for full enforcement of the CRA – groups such as the National Community Reinvestment Coalition, the Association of Community Organisations for Reform Now, National People's Action, the National Congress for Community Economic Development, and the National Low Income Housing Coalition – have helped educate numerous private lenders about community development such that many banks now engage in voluntary efforts to expand their lending in distressed neighbourhoods, understanding that what they previously viewed as charity actually represents good and profitable business opportunities. Some private lenders and their associations in turn have become more supportive of community reinvestment activities in recent years, including Bank of America and J.P. MorganChase Bank, the Consumer Bankers Association, and the National Association of Affordable Housing Lenders.

In addition to requiring certain community-oriented private investment behaviour, government officials and programs can also give a preference to certain applicants based on their fulfilling additional public policy purposes, or governments can provide extra incentives to encourage private entrepreneurs to engage in such priority activities. For example, many local governments in the U.S. offer "density bonuses" to permit increased building height, volume, or density for property developers who build market-rate residential real estate projects if they commit to reducing the sales prices and rents of between 10 to 20% of the housing units to make them affordable for low- and moderate-income households, or for developing other desired amenities such as street-level retail stores in office buildings. Governments can also change laws and regulations to permit certain activities, like enabling banks or pension funds to invest in affordable housing and community development projects that meet their fiduciary responsibilities. California State Treasurer Philip Angelides, who

is responsible for investing billions of dollars of public employee pension money as well as other state government funds, has instituted the "double bottom line" (boost the state government's treasury at the same time as helping the state's people and communities) to increase financially sound and safe investment in community economic development and services, along with affordable housing and homeownership, and still achieve a competitive return on these investments. Pension fund managers are often biased against distressed communities due to lack of knowledge about market opportunities, and government regulators frequently need to persuade them to seriously consider such investment options as being both profitable and safe.

Finally, governments can create favourable laws and regulations allowing financial intermediaries to function for specific purposes, such as savings and loans, co-operative banks and insurance entities, community credit unions, community development banks, and community loan funds. President Clinton established the Community Development Financial Institutions Fund in the U.S. Department of the Treasury, to provide millions of federal grant dollars annually for private institutions, generally but not exclusively non-profit organisations, to enable them to substantially increase their investments and lending activities in distressed communities.

In most efforts to revitalise distressed communities in the U.S., intergovernmental relationships are a very significant factor. Often the initiative will come from a local government – city, county, town, village, township, etc. – with additional resources from the state government and the federal government. Most approaches will involve combining direct funding, tax incentives, a variety of targeted programs, and legal and regulatory authority. This mix of incentives will be drawn from multiple levels of government and overlapping jurisdictions, including special public authorities such as regional transportation agencies, and quasi-public entities such as economic development corporations or urban redevelopment authorities. And this thick stew should also include the many private sector institutions, foundations and other non-profit groups, labour unions and civic associations, and faith-based and community-based organisations that must be involved in order for urban community regeneration to truly succeed. In a report recently published by the National Governors Association (NGA) in the U.S. – *State Policy Approaches to Promote Metropolitan Economic Strategy* – I explore many of the intergovernmental issues that are important for local and regional economic and community development. Government policy, programs, and funding are all more centralised in most European countries, which may allow for an easier process of investment, though it might also be less accommodating for grassroots leaders who are attempting to organise community initiatives.

Leveraging private financing for people or places?

Since this chapter is about leveraging private financing for community development in distressed areas, a crucial issue to be addressed is what kind of investment is being encouraged in those neighbourhoods. There are many examples from the 1960s "urban renewal" era in the U.S. and around the world, where the public sector successfully leveraged private investment for commercial or residential development in distressed communities, essentially displacing the low-income population by forcing them to move to other distressed communities, and replacing them with middle to upper income employees, tourists, and residents. This process – now called "gentrification" – can occur solely through private market activity unaided by government, but much more frequently is supported and even encouraged by public policy and substantial government subsidies.

One of the problems with targeting places for development and investment and appealing to the private market to provide the bulk of the financing is that the most likely outcome will be some degree of gentrification and displacement, since market-oriented investors and developers can earn more money at less risk by targeting higher income producers and consumers. The best solution for avoiding this particular outcome while still promoting successful economic, social, and physical regeneration is to work directly with the existing low- and moderate-income population and include them as full stakeholders and partners in the planning and policy-making process that guides all of the subsequent public and private redevelopment actions. At the Prague Institute for Global Urban Development, we call this method of valuing and including everyone in contributing to the process and benefiting from the results "Treating People and Communities as Assets."

In the Clinton Administration we tried to improve distressed communities by making life better for those less fortunate who were already integral members of these communities. Very often such neighbourhood improvement efforts included a focus on attracting and retaining more of a mixed-income population. People that do not have living wage jobs needed to be provided with various forms of assistance in order to obtain the skills and opportunities for gainful employment or entrepreneurship, whether these jobs and businesses are located within their own community or throughout the region. This was the main purpose of HUD's Bridges to Work program. In addition, these low- and moderate-income residents also needed assistance with obtaining good quality affordable housing, and particularly homeownership, that can stabilise the neighbourhood as a liveable environment along the lines of New Urbanism community planning and design principles.

This was the main purpose of HUD's Homeownership Zones and HOPE VI programs. While HOPE VI is currently being downsized, it still continues to be a major federal government program to transform public housing communities. Unfortunately, under the new federal administration both Bridges to Work and Homeownership Zones are not being expanded or renewed. However, many state and local governments and private non-profit organisations at the metropolitan or community level are actively promoting similar initiatives, from the various Nehemiah community rebuilding activities based on large-scale homeownership, to a wide range of regional city-suburban jobs linkage activities.

Creating more of a mixed-income community, even if it involves attracting middle-income homeowners and workers, does not automatically mean displacing large numbers of low-income people. Good, well conceived and carefully implemented economic and community development strategies can raise incomes and increase job opportunities for low-income families; improve schools, safety, stores, services, parks, transportation, infrastructure and housing; expand homeownership and entrepreneurship; and still retain many of the current low-income residents as part of the overall mix and dynamic of neighbourhood upgrading. Achieving such a result is certainly a major public policy challenge, and leveraging private financing to accomplish this vitally important goal is definitely more difficult, requiring economic strategies and financial incentives that are based on a thorough understanding of private market behaviour and a broad view of regional assets. In other words, targeting distressed communities should be tied to a Metropolitan Economic Strategy as described in my NGA report on *State Policy Approaches to Promote Metropolitan Economic Strategy* or my United Nations-Habitat and U.S. Agency for International Development reports (also available from the Prague Institute) on *Productive Cities and Metropolitan Economic Strategy.* Private investment should be shaped by public policies that are genuinely inclusive of low-income families as contributors to, not victims of, neighbourhood revitalisation efforts.

Conclusion: linking private leverage to public policy and economic strategy

Most of this chapter is devoted to section on "Why incentives are needed and when to use them." I will not recapitulate here the pages of detailed analysis and information as to how to design and implement effective public policies that will promote substantial private investment and development activities specifically targeted toward generating increased prosperity and quality of life for lower income families and distressed communities. The key to success is to work closely in partnership with the private sector and understand their needs

and market behaviour, such that incentives will effectively induce them to make investments they would not otherwise make due to excessive risk, insufficient return, lack of institutional support, difficulty engaging in transactions, and inaccurate or incomplete information as to genuine profitable market opportunities.

Two points from earlier in the chapter do need re-emphasising here. The first is that in order to get the private sector to invest, the public sector must make a substantial investment commitment. It goes back to the old adage: "you've got to spend money to make money." In other words, to leverage "other people's money" it is vitally necessary for the public sector to use its own resources quite strategically. If governments invest wisely they will save substantial costs by effectively leveraging private funds and by producing improved economic circumstances that reduce other costs and expand public revenues. Yet all of this can only be accomplished if governments are willing to make their own investments. For example, in London, the Canary Wharf development failed until the U.K. government and London Transport finally built the Docklands Light Railway and the extension of the Jubilee Line in the underground railway system. When public investments were eventually made, private investments followed in record numbers.

Secondly, no incentive package will be worth the public commitment if it is not tied to an overall economic strategy for the community that is well conceived and well executed. Here it is worth repeating the four central points I made much earlier in this chapter: "Indeed, far too often government officials, on the theory that any private business activity or property development project is better than nothing, eagerly subsidise private capital to invest in distressed communities, with very little to show in terms of resulting neighbourhood revitalisation and spin-off economic activity. Thus, leveraging private capital must be recognised as a potentially valuable tool to achieve important public policy objectives, but it must not be treated as its own goal. Leveraging can only be useful if it is well planned in the context of a broader economic strategy. Such a strategy must recognise the following realities: 1) an individual urban community can only be improved if it is connected to and benefits from the larger economic dynamics of the entire metropolitan region; 2) the key to generating and sustaining economic value is building on strength by investing in the fundamental assets that make a community special and competitive, and the most important asset is the people who live and work in that community; 3) promoting new development must be tied to attracting and retaining businesses and jobs, and to attracting and retaining a mixed-income residential population. Thus quality of life issues such as a safe and attractive environment, good schools and homeownership, good transportation and communications, may be more important than financial incentives for encouraging private

investment; 4) the best way to attract and retain businesses and jobs is by fostering and sustaining the growth of dynamic industry networks or clusters that generate productivity and innovation. Incentives should be expressly targeted to move forward such an agenda, rather than simply subsidising any and all types of business and property development activities."

APPENDIX
CONFERENCE PROGRAMME

Leveraging Private Finance for City and Region Economic Development
International seminar, 10.45-17.15, Wednesday 10 July 2002

hosted by
London Development Agency
OECD Local Economic and Employment Development (LEED) Programme
(Forum on Cities and Regions)
Greater London Enterprise
City of London Corporation

Venue
London Development Agency,
Devon House, 58-60 St Katherine's Way London E1

10.45-11.00	Registration *Chair: Greg Clark, Director of Strategy, Communications & Intelligence at the London Development Agency and Chairman of the OECD Forum on Cities and Regions*
11.00-11.15	Opening addresses: - Martin Baker, City of London Corporation - Sergio Arzeni, Head of the OECD LEED Programme
	Session 1: The international context and possibilities for London
11.15-11.30	Private finance for local development: an international perspective - Jonathan Potter, OECD LEED Programme
11.30-11.50	Constraints and possibilities in London - David Walburn, Chief Executive, Greater London Enterprise - Joe Docherty, Assistant Director, Barclays Bank, UK
11.50-12.00	General discussion
	Session 2: Private finance for community building
12.00-12.40	International case studies: - Sandy Braunstein, Federal Reserve Board, Washington DC, USA - Kirsten Moy, Aspen Institute, USA
12.40-13.00	General discussion
13.00-14.00	*Lunch*
	Session 3: Private finance for SME development
14.00-14.40	International case studies: - Ellen Lederman, Shorebank Advisory Services, London - Luigi Vimercati, North Milan Development Agency

14.40-15.00	General discussion
	Session 4: Private finance for brownfields development
15.00-15.40	International case studies: - Colum Halforty, Scottish Enterprise Glasgow, UK - Randy Daniels, New York Secretary of State, created the Metropolitan Revitalization Fund, USA
15.40-16.00	General discussion
16.00-16.20	*Coffee break*
	Session 5: Closing debate and remarks
16.20-17.00	Discussion led by panel from the London Private Investment Commission: - What appear to be the main success factors for public-private partnership in the case studies examined? - What conditions are required so that they can be transferred to other cities and regions? - What do OECD cities and regions need to do now?
17.00-17.15	Concluding remarks by - Sergio Arzeni, Head of the OECD LEED Programme - Greg Clark, Director of Strategy, Communications & Intelligence at the London Development Agency and Chairman of the OECD Forum on Cities and Regions

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