



COMMUNITY DEVELOPMENT LENDING

Patience,
Collaboration,
and Tolerance
for Risk

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FEDERAL RESERVE BANK
OF BOSTON

A Boston Fed initiative shows how mutually beneficial opportunities can result when community banks, nonprofits, and municipal leaders get to know one another face to face.

Throughout the financial crisis, small business owners and community development leaders complained that tightened credit standards at local financial institutions were having a negative effect on lending for mortgages and small businesses. Some even accused banks of preferring to sit on their reserves during the economy's sluggish recovery.

For their part, financial institutions contended that tighter credit standards were a response to regulators and the somewhat relaxed standards of the past. They held that the risks associated with lending for community development had increased and that many small businesses lacked the working capital, equity, or sales to offset the higher risk they represent.

The Federal Reserve Bank of Boston saw a need for a forum where all parties could openly discuss their viewpoints and busi-

ness models and learn about win-win strategies for community development lending and investment. In conjunction with its regulatory peers and the Federal Home Loan Bank of Boston, the Boston Fed developed the Business Opportunities in Community Development Lending forums. From forums hosted throughout New England, a key insight has emerged: It's never too early to bring together private- and public-sector partners. Participants routinely confirm that early engagement is the key to helping small businesses and affordable-housing providers be ready to tap innovative financing structures.

Getting People Together

Since late 2011, the Boston Fed forums have convened traditional and nontraditional lenders, municipal and state governments, planning organizations, and numerous community development organizations throughout New England, including in Springfield (Massachusetts), Manchester (New Hampshire), Burlington (Vermont), Meriden (Connecticut), Providence (Rhode Island), and Augusta (Maine).¹ Regardless of urban or rural orientation or the mix of public and private entities, common lessons have arisen. Successful deals require patience, creativity, broad cross-sector participation, risk-mitigation strategies, and trust.

Most important, everyone needs to be at the table: for-profit financial institutions, community development financial institutions,

economic development agencies, government organizations, angel investors, venture capitalists, regulatory experts, and the public.

Connecticut

Highwood Square is a project of NeighborWorks New Horizon that includes retail space and residential housing for artisans as part of the repurposing of a dilapidated industrial site. It is a happy result of innovative financing structures but illustrates why they require enhanced patience and creativity.

The Highwood Square effort was launched in 2004 when the City of Hamden, Connecticut, acquired the Johnson Building. Pre-development work, including brownfield remediation, was tackled, and the abutting property was leased from the owner in case the land might be needed later. The next step was to pursue a grant to involve the community in a visioning process. Once the community completed the concept plan, Hamden engaged NeighborWorks New Horizon, an organization with a broad community development strategy and a track record as a developer.



NeighborWorks New Horizon created a plan that included multiple sources of funds—among them, state and federal tax credits. Although the tax credit market collapsed in 2009, the Connecticut Housing Finance Authority was able to help the partners leverage federal stimulus dollars. And by June 2011, NeighborWorks New Horizon welcomed the community to a 27-unit artist colony.

New Hampshire

Balancing organizational priorities and market opportunities requires private and public development professionals to work together in new ways. CATCH Neighborhood Housing's Mennino Place in Concord, New Hampshire, and Vermont Smoke & Cure in Hinesburg, Vermont, demonstrate how public and private developers are collaborating early and often throughout the development process.

For Concord's deputy city manager, Carlos Baia, the keys to success of projects like Mennino Place, a 45-unit affordable rental community developed for local artisans, include developers who can demonstrate a successful record of completed projects, proposals that fit the community's long-term economic development plan, and likely benefits to the broader community.

As Baia puts it, "You don't want to have one building that kills everything else around it. Get the abutters on board and encourage them to engage in the process." Baia also advises developers to build

Promising Practices in Community Development Lending

Takeaways from Boston Fed Forums

For borrowers:

- It's never too early to start talking with potential partners.
- Balance the different priorities of partners.
- Tap the knowledge of consultants, attorneys, accountants.
- Communicate well at all stages of the deal.
- Expect to succeed, even though the road to financing may be long.

For lenders:

- Treat community development loans as good business for the bank, not merely a way to satisfy Community Reinvestment Act requirements.
- Partnerships with the Small Business Administration, the Federal Home Loan Bank, community development financial institutions, and community development entities can provide financing and structure that make loans bankable.
- Collateral may not be equal to loan value, so developers' management experience is vital.
- Encourage business owners to hire experienced accountants (for example, to substantiate the business cash flow), attorneys, and advisers.

relationships with municipal officials early in the process.

Vermont

Vermont Smoke & Cure, a producer of sausage, ham, and bacon that provides smokehouse services to 600 local farmers, worked with local government and multiple public and private partners throughout the development and financing of its expansion. Lenders collaborated over an extended period of time to help the growing smokehouse business to triple its commercial space, revitalize a vacant and otherwise rundown facility, and increase the number of jobs. Highly complex, the deal involved U.S. Department of Agriculture and Small Business Administration loan guarantees, a Community Development Block Grant to the town of Hinesburg, financing from Vermont's Sustainable Jobs Fund, and loans from Community National Bank, the Federal Home Loan Bank of Boston, and the Vermont Economic Development Authority.²

Patience, Collaboration, Risk

At the Boston Fed's community lending forums, multiple organizations have pointed out that in addition to patience and collaboration, a key success factor is acknowledgment of and tolerance for risk. Acknowledgment of risk and creative risk-mitigation strategies help move innovative projects forward.

At one event, a senior officer from Peoples Bank explained, "The more we know about the risks associated with your business, the better we can mitigate them as we structure the loan."

Although "location, location, location" is the mantra in real estate, within the community development lending environment, it's "relationships, relationships, relationships." Relationships are the mortar that binds highly complex deals together. Each Boston Fed Business Opportunities in Community Development Lending case study involves individuals and organizations that developed trusting relationships over an extended period of time as they focused on a common vision while balancing differing organizational objectives and risk.

Chris Sikes of Common Capital puts it simply: "We believe in partnerships." The earlier that organizations begin developing the necessary relationships, the better. (See "Promising Practices in Community Development Lending.")

Evaluating the Fed Forums

In late 2012, the Boston Fed completed an evaluation, asking participants if the forums helped them to understand the elements that could make their projects successful. Overall, the feedback from participants and panelists was positive and cited the Boston Fed's ability to convene stakeholders across sectors to discuss topics they might not otherwise be willing or able to talk about. In the words of one: "The event provided valuable information about the community lending environment, including the challenges that exist and how the environment has changed since the economic crisis."

A respondent who reported pursuing a deal as a result of attending the Springfield forum said his organization was able to establish referral relationships with several organizations, including

Nuvo Bank, Florence Savings Bank, Common Capital, and the Children's Investment Fund. These lenders can now refer riskier-seeming small business loans to the Massachusetts Growth Capital Corporation for funding.

The evaluation allowed the Boston Fed to refine its 2013 strategy, affirm the continued involvement of the partnering organizations, and collect participant feedback on areas where additional training is necessary. Topics suggested for such training include leveraging existing tax-credit programs, differences between public and private subsidies and market underwriting, the importance of predevelopment capital, and CRA training for retail lenders and community-based organizations.

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As New England's economy gradually recovers from the Great Recession, the need for creative community development lending and investment solutions continues. Patience, creativity, broad participation across sectors, and appropriate tolerance for and mitigation of risk continue to be key drivers of successful initiatives.

With innovative investment tools and new sets of partners building interest and momentum within the community development sector, the Boston Fed hopes to collect more examples of successful projects to learn from and to share broadly.

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Endnotes

¹ The Boston Fed also partnered on the 2012 Meet the Lenders event in Augusta, Maine, hosted by Women, Work, and Community, the Small Business Administration, and the other regulators. As of this writing, details for the Boston Fed's June 14, 2013, Business Opportunities in Community Development Lending Forum in Augusta were being finalized. More at www.bostonfed.org/commdev.

² See Claire Greene, "The Story of a Sausage Business," *Communities & Banking* 24, no. 1 (winter 2013), <http://www.bostonfed.org/commdev/c&b/2013/Winter/the-story-of-a-sausage-business.htm>.

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