Investment in Community Development and Emerging Domestic Markets

by Michael Swack
Boston Federal Reserve Bank
May 16, 2008
Community Development Investments (Emerging Domestic Markets)

• People, places, projects or enterprises that face capital constraints as a result of imperfect market information (and/or high transaction costs)

• Over the past 25 years, proven track record of performance – demonstrated ability to assess and manage risk while producing returns to investors.
Examples of CD investment

• Companies serving low-to-moderate-income populations
• Affordable housing
• Cooperative and worker-owned businesses
• Companies that create jobs for target areas or populations
• Microfinance
• Ethnic, minority and women-owned firms
Future Population Growth Due to Ethnic Population

Population, Millions

- Non-Ethnic
- Ethnic

Years:
- 2000
- 2010
- 2020
- 2030
- 2040
- 2050

Bar chart showing population growth by ethnic groups from 2000 to 2050.
U.S. Ethnic Market

World’s 7th Largest Economy in 2005

GDP (Trillions of US$)

- USA
- Japan
- Germany
- China
- UK
- France
- US Ethnic
- Italy
- Canada
- Spain

U.S. Ethnic Market = $1.9 trillion
EDM vs. International Market Opportunities

- The U.S. Hispanic consumer market is estimated to be greater than $860 billion in 2007, about the same size as Mexico’s entire economy.

- The African American consumer market is similar, approximated at $845 billion.

Challenges to Accessing Capital

- Lack of loan performance data
- Size & scale (amounts needed are often too small and thus incur high information and transaction costs)
- Non-standard investments (one of a kind)
- Fewer professional and social networks
- Lack of a viable secondary market
What is Active Community Development/EDM Investing?

• Investments which provide benefits to investors and state and regional economies
  – Increased Jobs
  – Business Growth
  – Economic Development

• Risk-adjusted market rate of return commensurate to rates of return on alternate investments with similar risk characteristics

• Fits with overall portfolio goals such as return, diversification, liquidity and investment policy
EDM Investment Opportunities

*Across Asset Classes*

- Public Equities
- Fixed Income
- Alternative Investments
  - Real Estate
  - Private Equity
- Cash
Continuum of Community Investments

<table>
<thead>
<tr>
<th>Grants</th>
<th>Recoverable Grants/ Guarantees</th>
<th>Loans</th>
<th>Community Development Venture Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Cash
  - Deposits

- Fixed Income
  - Bonds
  - Bond Funds
  - Asset-Backed Securities

- Public Equity
  - Direct Public Equity
  - Screened Funds

- Alternative Assets
  - Direct Private Equity
  - Private Equity Funds
  - VC Funds
  - Urban Real Estate
  - Fund of Funds
  - Buyout Funds

Philanthropic Return

Financial Return
Fixed Income

• Lower risk market-rate investments

• Spectrum of investments include simple products, such as government bonds, to more complex products, like collateralized debt obligations

• Targeted mutual funds provide capital to communities and firms that have been underserved by traditional financial markets
Targeted Private Equity

• Risk-adjusted market rate of return

• Direct investments in businesses located in or meeting needs (e.g., jobs, products and services) of geographic areas or underserved communities

• Investing is long-term; matches long-term investment focus of institutional investors

• Public Equity (Heron)
Real Estate

- Investments in real estate located in underdeveloped areas (e.g., urban cores and rural regions)

- Includes housing, commercial and industrial construction investments

- May generate multiplier effects, attracting additional investments
Cash

- Deposits in community development banks or credit unions, or minority-owned banks
Returns on Community Development /EDM Investments

- **Fixed Income**
  - Access Capital Strategies Community Investment Fund, Inc.
    Annualized return since inception = 5.06%

- **Private Equity**
  - Minority-Focused Venture Capital Funds:
    One study found that VC funds specializing in financing minority businesses earned a weighted average IRR of 15.4% through 2003.

- **Real Estate**
  - CalPERS’ California Urban Real Estate (CURE):
    Annualized return since inception = 20.2%
Rest of day

• F.B. Heron Foundation’s experience
• Review of investment opportunities across asset classes.