

**METROPOLITAN ECONOMIC STRATEGY**

**LEVERAGING PRIVATE FINANCING AND INVESTMENT FOR ECONOMIC AND COMMUNITY DEVELOPMENT**

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**Introduction**

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 US 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 urban 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 US government in 1977 precisely to address this problem, both requiring and encouraging private lenders to provide more substantial financing for neighborhood improvement.

In this article I will address the specific issue of leveraging private financing and investment for economic and community development, primarily in disadvantaged urban neighborhoods that are not generally thriving through the normal operations 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 for everyone. Due to the particular nature of the intergovernmental system in the US, 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 neighborhoods are intended to address the causes and consequences of insufficient capital devoted to community economic 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), community-based organizations (CBOs), and other non-governmental organizations (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 nationwide 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-authorized 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 revitalize entire neighborhoods, 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 subsidize private capital to invest in distressed communities, with very little to show in terms of resulting neighborhood revitalization and spin-off economic activity. Thus, leveraging private capital must be recognized 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 recognize 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 subsidizing any and all types of businesses and property developers.

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 neighborhoods 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 industrial loft-style structures, "broadband" fiber optic cable lines under the railroad tracks, the role of the nation's capital as an international media center, 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 in 1998 was the necessity to build a 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 continued to operate, rather than as an extension to the end of the rail line. As coordinator 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 a very effective economic plan that definitely would make their property more valuable for development, as long as it became transit-accessible, which, for example, is a legal prerequisite for private building owners to lease office space to federal government agencies in Washington, DC. After more than a year of joint negotiations during 1997 and 1998, a group of major private property owners agreed collectively to pay US\$25 million through a 30-year special

property tax assessment to build the Metro 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 US\$31 million in federal funds to supplement both the US\$25 million private sector contribution and the city's own US\$34 million share of the costs. This US\$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 neighborhood, which in addition to the New York Avenue Metro Station, also included US\$100 million in federal funds for the new national headquarters of the US Bureau of Alcohol, Tobacco, and Firearms (ATF) 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 US Securities and Exchange Commission (SEC). The NoMa economic strategy was designed to generate more than US\$1billion of total public-private investment and over 5,000 permanent jobs in NoMa by the time the New York Avenue Metro Station opened on November 20, 2004, and these highly ambitious goals now clearly will be surpassed. The NoMa area, home to Cable News Network (CNN), Black Entertainment Television (BET), National Public Radio (NPR), 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 neighborhood 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 developing the McKinley Technology High School and Campus in the heart of the neighborhood to create career opportunities in technology fields for African-American youth and adults; creating the NoMa Community Outreach and Marketing Center to provide business assistance, job placement, and other important services to neighborhood residents, and to strengthen the emphasis on grassroots participation and citizen opportunity; designating the neighborhood commercial district along North Capitol Street as a Main Street Corridor for physical improvements, business promotion, and community marketing; and building a major shopping center featuring the first Home Depot store 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 United Nations designated the NoMa initiative as one of the world's 40 most exemplary models of sustainable community economic development and public-private partnerships, according to the UN-Habitat Global Awards Program for Best Practices to Improve the Living Environment (also known as the Dubai Awards). Similarly, during November 2002, the Ford Foundation and Harvard University selected the NoMa initiative as a nationwide semifinalist for the prestigious Innovations in American Government Award. The eight-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 or even billions of dollars in private investment and development activity.

## **Why Incentives are Needed and How 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 organizations with public policy goals 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 subsidized insurance. The US 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 US 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 neighborhoods since the 1960s.

Similarly, if the barrier is the perceived lack of a market, then guaranteed demand is an appropriate solution. The US 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 in order to make it predictably profitable for property developers to build or renovate affordable housing in distressed communities, and particularly to enable developers to obtain private financing from lenders and investors. However, a problem arose after 20 years, when the time limits expired on the legal requirements keeping the housing affordable for low- and moderate-income tenants, and many building owners decided to substantially raise their rents or convert their buildings to luxury for-sale condominiums, which then forced the US 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 authorized Section 8 commitments as an incentive to draw pension fund capital into investing in the construction of affordable housing. US\$100 million of Section 8 guaranteed rent commitments were reserved for pension funds, and these investment funds then competed for 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 substantially enhancing their opportunities to attract private capital for establishing and expanding 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 neighborhoods 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 utilize targeted procurement strategies – purchasing goods and services from small and medium-sized businesses operating within neighborhoods in need of economic assistance – to strengthen market conditions 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 favorable 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 involve multiple forms of these and other subsidies. 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 amount of subsidy and complexity of financing can become so great that it may require long and difficult negotiations to determine the appropriate level of public support and reach an acceptable agreement between all of the public, private, and community stakeholders. Government agencies at all levels – federal, state, and local – need experienced professionals who specialize 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 organizations like the International Economic Development Council, the Urban Land Institute, the Association for Enterprise Opportunity, and the National Development Council.

If the primary financial barrier is that transaction costs are too high, financing deals are too small for major institutions, or community development loans and investments are too unfamiliar for the comfort level of mainstream firms, then the solution is to create intermediary organizations specializing 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 US, groups such as the Local Initiatives Support Corporation (LISC), Enterprise Community Investment, the Neighborhood Reinvestment Corporation, Living Cities (formerly the National Community Development Initiative), and Community Builders, 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 the federal government's Low Income Housing Tax Credit program, which is managed 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, private financiers who specialize in community economic development, as well as non-profit community developers, increasingly need highly professionalized training to empower them in their challenging work, as do government economic and community development officials. 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 improve neighborhoods. Non-profit community-based economic development in the US is generally much more difficult and challenging than standard market-rate financial deals for business or real estate activity. Instead of the one or two sources of financing that characterize a normal deal, investing in distressed communities may require up to a dozen different sources of funding for a development project to be successfully financed. Handling such financial obstacles with professionalism and technical expertise is a constant problem for neighborhood groups, which is why capacity-building activities are an essential element of the overall process, and a necessary prerequisite for leveraging private capital.

During the first three months of 1998, I coordinated a citywide competition in Washington, DC for the city government's Department of Housing and Community Development (DHCD). At that time DHCD was responsible for disbursing a substantial backlog of funds – US\$70 million to be exact – for economic and community development and affordable housing and homeownership targeted to the city's low- and moderate-income neighborhoods. 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 politicized by local elected officials, was to provide loans rather than grants to community development organizations, on the theory that loans

were more “business-like” and that loan 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 subsequently 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 to collect the outstanding debt. As a result, in our first few months on the job we were forced to write off as uncollectible more than US\$50 million in bad loans. But the worst part of this situation was 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 US\$.70 (70 cents) in other private funds, which was an abysmal record.

Under DHCD’s new citywide funding competition initiated in January 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, investors, and donors, 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 US\$70 million in funding we awarded to the winners of the competition in March 1998 leveraged an additional US\$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 private lenders would utilize stricter and more market-oriented underwriting criteria, and that the community borrowers would be much more likely to repay a loan from a private financial institution.

Expanding private leverage became the key to generating a total of US\$300 million in public-private investments for Washington, DC’s low- and moderate-income neighborhoods, 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 revitalized neighborhood shopping areas and business districts, and over 50 community services centers, including health care and child care, arts and culture, education and counseling, 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 neglecting to spend 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 highly publicized national 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 in producing real results.

To cite just one example of strategic leveraging from the 1998 citywide local government funding competition in Washington, DC, a solidly established community development group, the United Planning Organization (UPO), came to DHCD with a request for a US\$1.675 million loan. This group already had saved US\$100,000 in equity to spend on building a US\$1.775 million community services center in an area of southeast Washington called Anacostia. The purpose of this new community services center on Good Hope Road was to support and empower predominantly African-American low-and moderate-income families and neighborhoods 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 US\$1.5 million, which left them with a US\$175,000 funding gap. Under the previous management, DHCD would have simply provided UPO with a government loan for US\$1.675 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 US\$1.5 million loan, and having obtained this bank loan commitment, they could come back to us and request a US\$175,000 grant. Fortunately, this well-managed community development organization did take our advice, and their proposal succeeded in obtaining the requested US\$175,000 in grant funding through the citywide competition. The project got built and is doing very well today. The city government saved US\$1.5 million, which then became available to fund other projects, and we effectively leveraged US\$1.6 million in private capital for strategic community economic 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 governments promoting private leverage is to generate new financial instruments inducing private investors to put their capital into economic and community development and affordable housing and homeownership 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 targeted vehicles. In the US, 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 by providing them with a steady, safe, 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 these tax credits, 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 two decades, 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 US.

The sale of tax-exempt government bonds by state and local governments 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 subsidizing 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 providing 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 economic development or affordable housing finance that would not otherwise attract such capital investment, because the securitization of the loan packages and bonds have been significantly pooled, thereby lowering the risk as well as substantially reducing the transaction costs. Fannie Mae and Freddie Mac, two nationwide secondary mortgage market entities that securitize home mortgage loans by purchasing them from mortgage lenders and selling these securities in institutionalized capital markets, have attracted literally trillions of dollars over the past three decades to increase capital availability and reduce the financing costs of homeownership in the US.

Government agencies, financial institutions, and philanthropic foundations have worked together on a smaller scale in the US to create secondary markets for economic and community development loans and investments in distressed neighborhoods, such as the nationwide Community Reinvestment Fund, a non-profit organization supported mainly by foundations and corporations, which purchases community development loans from state and local government and non-profit community development financial institutions (CDFIs), and then packages these loans together as securities and sells them to investors through “private placements” (not through securities brokers or institutionalized 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 US for home mortgages, because the latter represent an enormous volume of a highly standardized 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, syndications, and securitization 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 financial 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. This relative anonymity makes them far less politicized and thus more likely to survive as legislation, especially 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 of bidders for contracts, leases, deposits, charters, or other valuable public benefits, that in exchange for such publicly authorized value, the private firm must invest in certain communities or engage in investment or development partnerships with economically disadvantaged organizations to accomplish major public policy objectives. A good example in the US is the federal government’s Community Reinvestment Act (CRA), which scrutinizes 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, credit and debit cards, and automated teller machines (ATMs).

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 organizations who fight for full enforcement of the CRA – groups such as the National Community Reinvestment Coalition, the Association of Community Organizations for Reform Now (ACORN), 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 economic and community development such that many banks now engage in voluntary efforts to expand their lending in distressed neighborhoods, 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, J.P. MorganChase Bank, Citibank, the Consumer Bankers Association, and the National Association of Affordable Housing Lenders.

In addition to requiring certain community-oriented private investment behavior, public officials and government programs can also give a preference to certain applicants based on their fulfilling additional public policy purposes, and governments also can provide extra incentives to encourage private entrepreneurs to engage in such priority activities. For example, many local governments in the US 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 percent and 20 percent 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 also can change laws and regulations to permit certain activities, such as 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 safe and sound 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 secure.

Finally, governments can create favorable laws and regulations allowing financial intermediaries to function for specific purposes, such as savings and loans, cooperative banks and insurance entities, community credit unions, community development banks, community loan funds, and community investment funds. During the 1990s in the US, President Clinton established the Community Development Financial Institutions Fund in the federal Department of the Treasury, to provide millions of federal grant dollars annually for private financial institutions, generally but not exclusively non-profit organizations, to enable them to substantially increase their equity investments and lending activities in distressed communities.

In most efforts to revitalize distressed communities in the US, 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 state governments and the federal government. Most approaches will involve combining direct funding, tax incentives, a variety of targeted programs, legal authorization, and regulatory approval. 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 ranging from economic development corporations to urban redevelopment authorities. This “thick stew” also generally includes numerous private sector institutions, foundations and other non-profit groups, labor unions and civic associations, faith-based and community-based organizations, and the communications media, all of them needing to be actively involved in order for urban community regeneration to truly succeed. In a report published during 2002 by the National Governors Association (NGA) in the US – *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 policies, programs, and funding generally are far more centralized in most countries, which may allow for an easier process of investment, though it might also be less accommodating for grassroots leaders who are attempting to organize community initiatives.

### **Leveraging Private Financing for People or Places?**

Since this article is about leveraging private financing and investment for economic and community development in distressed areas, a crucial issue to be addressed is what kind of investment is being encouraged in those neighborhoods. There are many examples from the 1960s “urban renewal” era in the US and around the world, where the public sector successfully leveraged private investment for

commercial or residential development in partly deteriorated central districts and inner-city neighborhoods, 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 it is supported and even actively encouraged through public policies 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 policymaking process that guides all of the subsequent public and private redevelopment actions. At 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 neighborhood improvement efforts included a major focus on attracting and retaining more of a mixed-income population. People that do not have living wage jobs need 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 stabilize the neighborhood as a livable environment along the lines of sustainable, human-scale, pedestrian and transit-oriented 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, the current federal government political leadership has decided not to renew or expand Bridges to Work and Homeownership Zones. However, many state and local governments and private non-profit organizations at the metropolitan or community level are actively promoting similar initiatives, from various community rebuilding activities based on large-scale homeownership, to a wide range of regional city-suburban job 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. Effective economic and community development strategies, well-conceived and carefully implemented, 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 neighborhood upgrading. Achieving such a result is certainly a major public policy challenge, and leveraging private financing and investment 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 behavior and a broad view of urban and regional assets. In other words, targeting distressed communities should be tied to a Metropolitan Economic Strategy as described in my United Nations report of 2001 on *Productive Cities and Metropolitan Economic Strategy*, and in my article from the May 2005 issue of *Global Urban Development Magazine* entitled “Teamwork: Why Metropolitan Economic Strategy is the Key to Generating Sustainable Prosperity and Quality of Life for the World.” Private investment should be shaped by public policies that are genuinely inclusive of low-income families as contributors to, not victims of, neighborhood improvement actions.

## **Conclusion: Linking Private Leverage to Public Policy and Economic Strategy**

Much of this article is devoted to the section on “Why Incentives are Needed and How to Use Them.” I will not recapitulate here the pages of detailed analysis and information as to the best ways and means of

planning and implementing effective public policies to promote substantial private investment and development specifically designed to generate 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 behavior, such that financial incentives will effectively induce them to make loans and 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 genuinely profitable market opportunities.

Two points stated earlier, however, are so essential that they warrant re-emphasis. The first point is that in order to get the private sector to invest, the public sector itself must first 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 UK government and London Transport finally built the Docklands Light Railway and the extension of the Jubilee Line in the underground railway system. When the necessary public investments were eventually made, substantial private investments quickly followed.

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 intelligently conceived and effectively executed. Here it is worth repeating four key arguments that I made at the beginning of this article: "Indeed, far too often government officials, on the theory that any private business activity or property development project is better than nothing, eagerly subsidize private capital to invest in distressed communities, with very little to show in terms of resulting neighborhood revitalization and spin-off economic activity. Thus, leveraging private capital must be recognized 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 recognize 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 subsidizing any and all types of businesses and property developers."

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