Equity Factor

Connecting Real Estate Developers to Meaningful Social Change

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(Illustration by Sarah Jacoby)

In Providence, Rhode Island, the Mercantile Block houses 22 affordable, live/work artist studios, a business incubator and office space for two nonprofits in a restored historic building. In Upper Manhattan, Sugar Hill is a stunning, modern development that includes 124 units of affordable housing, a preschool and a children's museum of art and storytelling. In North Texas, Meals on Wheels of Tarrant County delivers over a million meals a year to 5,000 vulnerable individuals, while connecting people with an array of essential services, all out of their new 63,000-square-foot facility.

Across the country there is a small sub-sector of nonprofits, community developers and socially conscious private developers working to build important assets like these that focus on social impact — improving people's lives and making our communities stronger and more prosperous. I call it "impact development" — and it deserves more attention.

With today's expanding focus on impact investing, millennial developers' desire to do well and do good, and subsidies like New Markets Tax Credits becoming ever more competitive, impact development may represent one of the most significant new shifts shaping the landscape of America's cities.

There is certainly some fuzziness around what qualifies as impact development. Is it helping vulnerable people? Job creation? Space for nonprofits? Filling gaps in community goods and services? Sustainable design? Smart growth? Ultimately the answer is yes to all of these, and the most impactful projects are the ones that can holistically hit on most or all of these points. At the concept's root is a developer who is aware of how a project can effect social change and who makes meaningful efforts to realize that potential based on a community's identified needs.

Impact development represents a great opportunity, but these projects also face serious challenges in the current marketplace. In my hometown of Philadelphia, a children's museum and a theater conducted large capital campaigns, but ended up struggling to service their debt. A local charter school, burdened by the high cost of the tax-exempt bonds that financed it, needed to lay off teachers and cut services for students. One could argue that market-rate developers and operators face similar challenges all the time. But with impact development, the stakes are much higher. If the project suffers, public assets can disappear and scarce subsidies can go to waste.

Social impact projects are, by nature, **hard to finance.** They are higher-risk and offer lower (financial if not social) return. In low-income communities, projects often need more subsidies than is typically available. Building values may not be sufficient to obtain mortgages. Due to nonprofit tenants and uses, cash flow from operations may not support enough debt. And often sponsors lack balance sheets capable of guaranteeing deals in weak-market neighborhoods.

Currently, impact development is, in part, enabled by a number of subsidies including the federal Low-Income Housing Tax Credit, New Markets Tax Credit, HUD 108 loans, and various other federal, state and local grants, loans, tax credits, and loan guarantees. **Community development financial institutions** remain an extremely important source of accessible capital for impact development projects and the groups that operate them. But CDFIs are only one piece of a multifaceted puzzle.

There are some emerging financing sources as well. Several firms are testing the boundaries of **crowdsourcing equity** while philanthropies are developing program-related investment (PRI) funds. There are myriad "impact investors" looking at real estate as the next frontier. These innovations are exciting but few have figured out how to harness them through new marketplaces, or successfully incorporate them into a predictable toolkit for financing social impact deals.

By many accounts one of the most successful subsidy programs is the federal Low Income Housing Tax Credit (LIHTC). It is a deep subsidy and most states have predictable sources for filling the gap with other grants or tax-exempt bond revenue. However demand far outpaces supply. Still LIHTC represents a model of a program that enables social impact projects, attracts significant private market interest and has relatively low risk.

Outside of affordable housing, however, the subsidies become scarcer and more catch-as-catch-can. A big problem is that the subsidies we have are not deep enough, and they are too scattered and uncoordinated. They often do not work well with each other, or require matching funds that are just as difficult to secure as the initial subsidy.

Take for example the New Markets Tax Credits program. It is an important and valuable subsidy, but it does not work well for many social impact projects. The subsidy is too shallow, and the projects often cannot support the leverage they need. Good sources of capital grants and sufficient low-interest loans are often not readily available. In fact the national philanthropic community has been moving farther away from capital grants, favoring program investments and policy work instead.

Many financing sources have incompatible requirements that are hard to juggle. I worked on one deal that had 11 different financing sources: federal, state and local grants, PRI, and some low-interest debt. It worked out in the end, but few developers have the experience, capacity and patience to manage so many different sources.

Finally, the most successful impact developments require time on the ground in communities. Great deals happen when developers and investors commit to community engagement and partnership. Through community needs assessment, they can determine demand for the social impact components. They find ways to support the community to enhance the deal's long-term impact. And they assess the project's impacts based on both quantitative and qualitative on-the-ground research.

Many developers are new to the social impact space and, while well intentioned, simply do not understand it. One developer recently told me that his approach to providing healthy food access to a very low-income community in Philadelphia was to include three white-tablecloth restaurants in his project ($40 chops are not exactly the answer to food insecurity). Still, I see it as an encouraging sign that developers who do not fully understand it are looking to enter the social impact space. With some education and resources, those who are interested and committed can build great impact developments.

Then there is the issue of how smart we are being with our existing subsidies. Should we be pumping hundreds of millions of dollars into stadiums, for example, when there are developers looking to invest in low-income areas that could potentially put those dollars to better use? It is up to all of us to make sure that, in a world of scarce public dollars, we are being smart and responsible, and making the greatest impact with the programs we have.

The aforementioned projects in Providence, Manhattan and North Texas are notable examples, but they are still too few and far between. Government and private-sector actors alike need to focus on integrating social impact into our urban developments and creating stronger and more coordinated financing mechanisms that still realize a decent return. Enabling impact development could truly change the way we rebuild our cities and communities in 21st century.

The Equity Factor is made possible with the support of the Surdna Foundation.

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