

Taking Capital for Social Purposes to a New Level

Nancy Andrews

President and CEO, Low Income Investment Fund

What links all of us who are committed to community development is a belief in the power of the idea that capital employed for social purposes can multiply itself many times over. In the past two decades, that belief has birthed a field in community investing unlike anything else in the world.

Consider how far we've come. Twenty years ago, LISC and the Enterprise Foundation were just getting started and were still finding their way in the world. My organization, the Low-Income Investment Fund (LIIF), had just been incorporated and had only \$200,000 in capital under management. The community capital movement was still more an idea than reality.

Twenty years ago, I was also a young program officer at the Ford Foundation. I made one of my first PRIs, a \$500,000 loan, to the Institute for Community Economics (ICE) and clearly remember my investment recommendation to the officers of the Foundation: "ICE is creating a network of community-based loan funds and this PRI will be used to seed their creation." Then, boasting a bit about the scale of this new community loan fund network, I said, "There are twelve of these organizations across the country with \$27 million in capital." At that time, \$27 million nationwide seemed like a large and impressive number.

Today, we know that there are more than five hundred community loan funds, with \$18 billion in capital nationwide. LIIF now manages \$2.5 billion in assets and has helped to create affordable housing for the working poor; special needs housing and services for the homeless; housing for victims of domestic violence and people with disabilities; unique home-ownership developments; and community facilities such as child-care centers and charter schools. At the same time, in twenty years, this half a billion dollars in lending has produced losses of only \$192,000: a capital-loss rate of only 0.12 percent, or one-eighth of one percent.

In many ways, we succeeded beyond our expectations, and our success has ignited new ambitions. Now we are focused on creating scale in our industry and on building a bridge between private-capital markets and poor communities.

The private-sector capital most accessible to us, the banking industry motivated by the Community Reinvestment Act, is regulated. It simply cannot do the types of loans that we do and still pass muster with its auditors and regulators. So, two major trends are combining at once: we need the scale the private sector offers, but we are too weird and funky, or, in polite terms, "nonconforming," to be accepted by the private sector.

To meet the capital demands of our borrowers, we must take the weird, funky, nonconforming community loans and make them palatable to the capital markets, and we are pursuing many strategies to accomplish this. For example, a number of CDFIs and nonprofit developers have banded together through the Housing Partnership Network to create a \$100 million relationship with Freddie Mac where we can sell our projects. We are looking for funds to serve as the first loss cushion. Whether we succeed is largely a function of our ability to raise these risk-absorbing funds. Likewise, LIIF is working with Fannie Mae on a large-scale transaction that does the same thing.

Another example is the \$35 million loan pool that LIIF is now assembling for charter schools. We are using a \$1.7 million Department of Education grant as the cushion against losses, though it could just as easily have been funds from a foundation or the proposed Affordable Housing Fund, which was included in GSE reform legislation last year. That's a leverage ratio of more than 20 to 1. Citigroup is our lead investor in the pool; Prudential, Merrill Lynch, and LISC are involved, as is the Annie E. Casey Foundation. The ultimate result of this collaboration will be thousands of low-income kids attending high-performing schools and receiving a quality education. The financial leverage in this example is huge. The human capital leverage can be measured only in the lives of the kids touched by the chance to have a high-quality education that prepares them to enter the economy of the information age.

Another potentially revolutionary strategy would have the GSEs take the lead in helping to securitize community-development loan pools, which could trigger a flood of new capital for community development. A GSE could make a commitment to buy pools of loans from high-performing CDFIs like LIIF, the Enterprise Foundation, the Reinvestment Fund, Self-Help, and LISC, all of which finance housing for extremely low-income populations. These loans are considered "nonconforming" because they do not meet the highly structured traditional underwriting standards of the banking community or the GSEs. Yet they perform like the highest-quality assets. While these loans are perceived as risky, the truth is that our industry has a loss rate of less than one percent with more than twenty years of history behind us.

Here's how the idea would work. The GSE would agree in advance to buy, say, \$100 million of these loans and would establish a special loss reserve pool or "credit enhancement" from the GSE Affordable Housing Fund. The GSE would then pool these funds into a mortgage-backed security and provide a credit enhancement that would confer its AAA bond rating on the pooled security. This security could then be sold in the capital markets.

It is important to point out that while any individual loan may bear some risk, the exposure of the GSE would be limited and highly diversified. First, the organizations selling the loans would likely provide a top-loss guarantee, probably five percent. We would be on the hook, ensuring disciplined lending. Second, these loans all have substantial collateral, which could be used to absorb capital losses. And finally, the special loan loss reserve established by the GSE would be tapped before there is any impact on the GSE. Given that the historic loss rate on these portfolios is less than 1 percent, it is unlikely that any losses would trickle

down to the GSE. The leveraging potential is enormous. The social return on investment is enormous.

LIIF has already structured this kind of transaction in New York, working with the State of New York Mortgage Agency (SONYMA). LIIF established a guarantee of \$260,000 to leverage SONYMA insurance for a \$2.6 million loan to a homeless shelter in New York City. The investor was the United Methodist Pension Fund. Given the AA credit enhancement from SONYMA, LIIF induced even the most hard-boiled, profit-oriented firm on Wall Street to invest in a homeless shelter on Staten Island. In this example, you see the real power of leveraging and credit enhancement. You see a way to multiply the bang for the buck.

These kinds of transactions would have enormous positive implications for distressed communities across America. GSE securitization would provide our institutions with much-needed capital liquidity to be able to make greater volumes of loans for deeply targeted housing. With the GSE credit rating in place, it would bring the longest terms (30 years) and the best prices of the capital markets to bear in a highly targeted project in a safe and sound fashion. This idea would yield leveraging of perhaps \$100 for every dollar committed, given our record of capital losses. The cost to the public at the end of the day would be negligible, yet the community benefits would be tremendous.

Together, we have proved that the idea of investing capital for social purposes works. We have proved that the idea of investing in communities works. We have taken an idea that started in the 1960s with action in the streets and transformed it into capital invested in neighborhoods throughout this country. Now we need to take the next step: scale and leverage.

Nancy Andrews is currently the President and Chief Executive Officer of the Low Income Investment Fund (LIIF). Ms. Andrews' background spans 30 years in the community development field, with positions at the Ford Foundation, as the Deputy Director of the Ford Foundation's Office of Program Related Investments and Chief Financial Officer of the International Water Management Institute, a World Bank-supported international development agency. Ms. Andrews consulted for the Department of Housing and Urban Development and the Department of Treasury, helping in the establishment of the Community Development Financial Institutions Fund. Ms. Andrews did her graduate work at Columbia University where she received a M.S. in Urban Planning, with a concentration in Real Estate Finance.