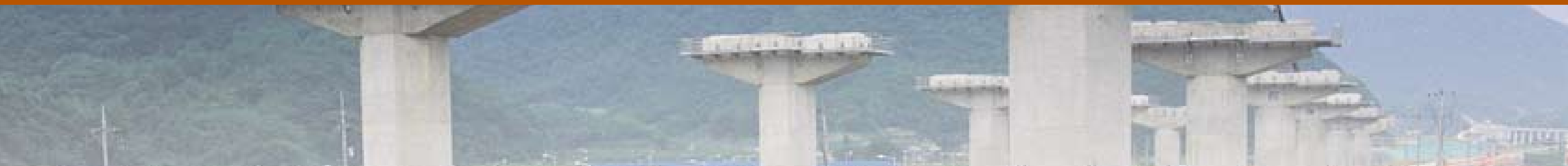

Lending for Rural Development Projects

Infrastructure, Community Facilities, and Affordable Housing

By Robert Longman, Credit Officer, Rural Community Assistance Corporation (RCAC), a nonprofit CDFI Loan Fund.

Lending for community development projects in rural areas presents unique challenges and opportunities. A number of complexities arise because rural communities often lack the organizational infrastructure and capacity to plan, undertake and manage community development projects.[1] Community development projects in rural areas may consist of infrastructure projects such as water, sewer and solid waste, community facilities to house essential services such as health care, public safety and education, as well as affordable housing projects. In cities, these types of projects are typically planned ahead of need and financed by bonds supported by a fiscal base, and services are often provided by a single governmental body. In rural areas, however, services and infrastructure may be provided by a number of different entities, including nonprofit corporations. These issues affect the ability of rural entities to finance and develop housing and other projects essential for a community's economic development and overall viability.

Rural Community Assistance Corporation (RCAC), a nonprofit CDFI Loan Fund that operates in 13 Western states including all the states in the Federal Reserve's 12th District, seeks to overcome these barriers to financing community development projects in rural communities. Supported through partnerships with public and private entities, RCAC operates a Loan Fund that helps meet the capital needs of nonprofits and municipalities engaged in a range of projects in rural areas. With over 25 years of experience of service in rural areas, RCAC has learned important lessons about creating opportunities for banks to meet the credit needs of rural communities, either on their own or in partnership with groups like RCAC.

Infrastructure Projects

Long-term financing for infrastructure in rural communities is typically provided by federal or state programs that provide below-market interest rates and grants. However, these funds are typically not accessible until a project is ready to start construction. Therefore, small municipalities and other service provider entities often need to borrow funds for feasibility studies, environmental reports, legal costs, design engineering services and other predevelopment expenses in order to access federal or state construction and permanent financing funds. Nonprofit loan funds like RCAC and local community banks are good sources.

The community of Mineral in Northern California's Sierra Nevada foothills wrestled with the issue of finding predevelopment funds when it sought to upgrade its water system. Redwood water storage tanks, sited on a hillside above the picturesque community of 300 residents, were the community's sole water storage for a privately-owned water system constructed in the 1920s. The system had fallen into a state of disrepair over the years, resulting in a Health Department boil water notice, a building moratorium, high insurance rates and unreliable water service. In 2002, the local Water District decided to purchase the system from the private owner, but because it had no experience in running a water system or in obtaining financing for improvements, the District Board faced a formidable task.

Mineral, California was able to upgrade its water storage system through funding from bank, nonprofit, and government sources.

The financing solution came from RCAC and a local community bank, which provided the foundation for grant funding to upgrade the water system. First, a local community bank in Red Bluff, California, was able to make a short term loan for the system acquisition. RCAC was then able to make a predevelopment loan for a preliminary engineering and environmental report, which were necessary for the District to apply for permanent financing from federal or state agencies. The short term bank loan was also repaid as part of the RCAC loan. The District was then able to secure United States Department of Agriculture (USDA) Rural Development program funding as well as emergency grant funding, resulting in an approximate 70 percent grant for the overall funding needed to replace the deteriorated system. Only two years after funding approval–extremely fast for this type of project–the community had a modernized system in place. Today, Mineral has a bright future with a safe and dependable water supply, adequate fire flow protection, lower insurance rates, and renewed capacity for new construction.

In many rural towns, lack of critical infrastructure limits other forms of community and economic development. Mineral was fortunate in having a local community bank that was willing to provide the initial funds to start the ball rolling, a nonprofit loan fund that could provide funding for predevelopment costs, and extra grant funds from USDA that made the water rates feasible for end users. The effort provides an excellent example of marrying several types of funding from bank, nonprofit, and government sources to provide for a basic infrastructure need.

Community Facilities

Providing essential services like health care, education, and public safety in rural areas is difficult principally due to lack of economic feasibility. Primary facilities or services may be available in larger communities within a reasonable distance, but localities may only be able to support smaller scope facilities. For example, most small communities lack a hospital but may be able to support a satellite clinic, and students may need to go some distance to attend high school, although elementary grades are available locally. To finance even these smaller scale projects, rural entities often need to find innovative ways to leverage financial resources.

Although financing for these types of community facilities is far from mainstay lending, government guarantees provide an excellent mechanism for private lenders to be involved in these worthwhile projects. For example, lenders can utilize the USDA Rural Development Community Facilities guaranteed loan program, which provides a 90 percent guarantee. Not only is risk greatly reduced, but the guarantees are readily marketable on the secondary market. USDA also provides other guaranteed loan programs for water/waste projects, business, industry and multifamily housing. USDA guaranteed loan programs may also be utilized with direct agency funding, resulting in a lower interest rate when necessary for project feasibility.

New medical facilities in Colusa, California, financed through USDA guarantees.

The northern California farming community of Colusa was able to leverage USDA guarantees when it launched an effort to retain its hospital. Many rural community hospitals have closed over the last decade due to lack of economic viability and an inability to attract and retain health care professionals. When the absentee owner of Colusa's hospital announced plans to close the facility, the citizens of Colusa decided to make every effort possible to save their hospital. Despite lack of experience in hospital operations or finance, the citizens formed a nonprofit corporation for the purpose of purchasing the facility. The nonprofit succeeded in negotiating a framework for purchase and resolved myriad regulatory issues, but lacked the financing necessary to complete the transaction. RCAC was able to utilize the USDA Rural Development Community Facilities guaranteed loan program, in conjunction with USDA direct funding, to structure a long term loan. On the day the hospital was scheduled to close its doors, the loan closed and the hospital remained in operation. Today, some five years later, the hospital has not only remained viable but just completed two new medical arts buildings on the hospital campus to provide much needed space for health care providers. RCAC was involved in this project also, this time as the construction lender for the project with USDA providing the permanent financing.

In financing a project, it is important to note that facilities such as medical clinics, charter schools, and assisted living facilities produce revenue streams and can carry long term debt. But this is not always true of all the community facilities needed to support rural development. For example, community centers, police facilities, and libraries are largely non-revenue producing and generally cannot carry debt, and therefore are typically provided by public bodies through revenues generated by a tax base. In rural areas with limited availability of public financing, innovative mechanisms are needed to finance these types of facilities.

Affordable Housing

Most rural communities are in dire need of both single family and multifamily affordable housing. In urban areas, affordable units can often be cross-subsidized by higher-cost housing within a development; in rural areas this is generally not an option, and more subsidies are needed. Cost write-downs, such as those provided through self-help housing programs and Low Income Housing Tax Credits (LIHTC), represent excellent mechanisms for providing affordable housing in rural areas.

As with community facilities, nonprofit loan funds can play an integral role in both single family and multifamily affordable housing development. Nonprofit loan funds are particularly important in providing financing for raw land acquisition and predevelopment expenses. But they can't do it alone. Bank funding is often needed to provide the larger loans necessary for site development of a single family subdivision or construction of a multifamily project. And, in most instances, funding is also needed from federal or state programs that can provide forgivable loan or grant funds needed to write-down single family mortgages or rents in multifamily housing projects.

Nonprofit loan funds can play an integral role in both single family and multifamily affordable housing development.

A good example of an affordable single family housing development bringing all of these resources together is near Marysville in Yuba County, California. A nonprofit affordable housing developer had the opportunity to acquire a subdivision tentatively mapped for 101 lots. RCAC was able to complete the acquisition loan and also provide needed predevelopment funds; however, the site development loan amount needed was in excess of the nonprofit loan fund capacity. A major bank stepped up to provide a loan for the site development work. The housing is currently being developed via the USDA self-help housing program with lot sales repaying the RCAC and bank loans. The self-help participants provide sweat equity, and with the use of other federal and state resources, the entire subdivision will serve low- and very-low-income families.

In high cost rural areas like Sonoma County, California, it is particularly difficult to develop affordable housing, and even more layers of financing are necessary. In Santa Rosa, RCAC worked with a local nonprofit affordable housing developer to develop a 56 unit multifamily project. A local bank provided a loan for 80 percent of the acquisition cost, and RCAC was able to offer a loan for the remainder as well as for some predevelopment expenses. The State of California, through its Department of Housing and Community Development (HCD), provided additional predevelopment funds. The development subsequently received an allocation of LIHTCs, which is the mechanism that enables the housing to be affordable. A major bank working with the CalHFA state bond program was able to provide favorable construction financing as well as a portion of the long term financing. Other funding resources included the HCD Joe Serna farmworker grant program, HOME funds, AHP funds, CDBG funds and state MHP funds. The project was successfully completed and provides affordable housing for families whose incomes range from 30 to 60 percent of county median income, with 14 units set aside for agricultural worker households and seven units set aside for households with a developmentally disabled or mentally ill family member. While the multiple sources of funding and partners made this project extremely complex, the end result was housing for a population that would otherwise not be able to afford to live and work in the area.

As these few examples show, there are many opportunities for banks, nonprofit loan funds and federal and state programs to work together to finance the various elements needed to not only sustain the viability of our rural communities but to provide opportunities for economic growth. Creation of high-wage jobs and retention of youth in rural areas are critical, and are all the more likely if essential services and housing are available. Innovative partnerships between various lending sources can ensure that rural areas will have the facilities and infrastructure to support a vibrant future. CI