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STABILIZING NEIGHBORHOODS, SUPPORTING PORTFOLIOS WITH COMMUNITY INVESTING

As the United States financial markets enter a period of gradual stabilization, the full impact of the credit crisis has yet to be seen. For companies worldwide, balance sheets are still in need of significant repair not only to support consumption going forward, but also to repay the debt that fueled consumer purchases. Individuals in all corners feel the impact, and those in low income communities struggle to meet unreasonable mortgage terms created by the very system that collapsed in such dramatic fashion. Corporate unrest, increased unemployment, foreclosures, and credit issues continue to impede a full recovery.

Such pains are well noted, but the effort to rebuild also brings with it a tremendous amount of opportunity. Investors are returning to fundamentals and in many cases are favoring a mainstream version of socially responsible investing (SRI) that draws stronger correlations between company performance, integrity, and transparency. As noted in a 2009 Reynders, McVeigh Insight Paper, *Best Practice In Portfolio Management: Socially Responsible Investing Comes Of Age* [pdf download available at <http://reyndersmcveigh.com/insights.html>], issues such as energy and shortages of food and potable water capture the growing appeal of tailored SRI portfolios. Although these challenges affect the global population as a whole, they were historically left unaddressed by investors and funded instead through government intervention. That attitude is changing; well-constructed portfolios today include mission-based investments that balance positive returns with social advances.

Community investing is gaining momentum in a similar fashion, as more investors realize that putting money into underserved neighborhoods can provide reliable financial returns while building healthier communities. Community Development Financial Institutions (CDFIs) have a track record of leading this charge by providing community based businesses and low income individuals with access to credit, equity, and capital.

In their basic forms, the resulting investment opportunities support community banks, credit unions, community loan funds, and community development venture capital funds.

Proven Track Record

CDFIs are providing solutions that not only stabilize families and neighborhoods, but will play a meaningful part in stabilizing our economy as a whole. The national impact of well-crafted initiatives is beginning to be felt as the right community investing model is tested, proven over the long term, and becomes replicable on a larger scale. This model will provide investors with a window to recycle capital for a cause, reinvesting returns into lending initiatives that can build strength from the ground up, in community after community.

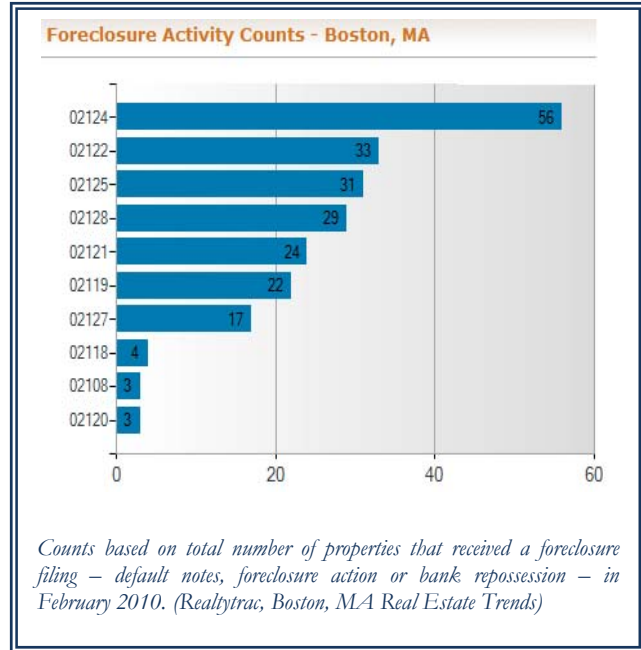
Community investing initiatives have been a core part of the economy for decades, having in many cases proven themselves to be financially attractive and socially beneficial vehicles. For example, Calvert Investments of Maryland uses investment capital to enable organizations to address critical social problems by creating a sustainable, scalable model in its Community Investment Notes. The product has emerged as a sound investment that provides stable returns due to protection afforded by two layers of loan loss reserve – the first is provided by the community lenders, the second by Calvert itself.

The Notes are comprised of carefully selected community investments pooled into a professionally managed portfolio of affordable loans that are issued to nonprofit organizations and social enterprises. The structure of the product provides benefits similar to those of a mutual fund, with the ability to spread risk across a diversified array of loan funds. Calvert's socially-minded model, however, also channels investments to specific regions or areas of interest such as affordable housing, microcredit, and environmental issues. The full power of an investor's principal is put to work in areas of that investor's choosing, and when the principal amount is repaid at the borrowers' level, that capital is recycled for new community loans. The process continues until investment maturity is reached and the principal is returned with interest.ⁱ

Boston Community Capital, a Massachusetts-based CDFI with a national reach, is creating local lending models that address specific neighborhood needs while supporting investor goals. The institution has underwritten more than \$300 million in loans to support affordable housing, child care facilities, schools, shelters, and community services, and has helped to create and preserve more than 10,000 units of affordable housing. Despite a weak economy and substantial cuts to subsidies for affordable housing and community services, the foresight of the CDFI's money managers, its deep understanding of risks in the portfolio, and its adequate and appropriate reserves have provided protection from the losses experienced by countless others during the economic downturn. Boston Community Capital successfully maintained the quality of its loan portfolio, working with community organizations and low-income borrowers to help them weather the crisis while protecting the security of investors' capital and generating positive financial and social returns.

The CDFI's most recent innovations are aimed at addressing the foreclosure crisis in selected low-income neighborhoods in and around Boston, a region that can benefit significantly from community investing. Boston communities were severely impacted by the credit crisis, with petitions for foreclosures increasing more than 28 percent in 2009.ⁱⁱ Low-income neighborhoods were particularly hard hit -- between January 2007 and December 2009, six low-income Boston neighborhoods accounted for less than one third of all housing in Boston but 83 percent of total foreclosure activityⁱⁱⁱ; while property values in these neighborhoods have dropped by more than 50 percent.^{iv} Without intervention -- and new lending models -- these

communities may spend decades recovering as foreclosures set off a ripple effect of instability and blight. Foreclosure-related evictions lead to vacancies, resulting in a lack of cohesion and security that presents a seemingly insurmountable barrier for families and neighborhoods that hope to rebuild. On a wider scale, evictions and unemployment will keep homelessness on the rise while homes sit idle and reduce abutting real estate values. Going a step further, the reduction in tax revenues caused by the increase in foreclosures opens a gap between services that are needed to protect communities, leading to an increase in regional crime.”



To address these issues, Boston Community Capital has created the Stabilizing Urban Neighborhoods (SUN) initiative, a vehicle designed to fight neighborhood destabilization by keeping homeowners and tenants in their homes, while providing consistent returns to investors. SUN is an unprecedented model that purchases foreclosed properties at a steep discount, resells these properties to the existing homeowner or tenant, and provides a new, affordable, and fixed rate mortgage based on traditional underwriting criteria (i.e. mortgage payments totaling less than 38 percent of household income). SUN minimizes the potential for “moral hazard” with a "shared appreciation" zero-interest, non-amortizing second mortgage, reducing a foreclosed homeowner’s share of eventual property appreciation to account for the reduced principal amount of the new mortgage. Most importantly, by preventing evictions, the initiative keeps families in their homes and puts a stop to the foreclosure trends that threaten the security of these communities.

In tandem with other state and local initiatives, SUN will help slow the rapid increase of foreclosures and evictions in Boston area neighborhoods, further stabilizing low-income communities and serving as a case study in successful community investing. While not a complete solution to the overarching financial crisis, the SUN model is a critical strategic step towards rebuilding communities and sustaining local value.

Maximize Returns While Achieving a Social Benefit

Investment efforts from institutions like Calvert Investments and Boston Community Capital are rightly focused on areas that were hit hardest by the recession. Low-income neighborhoods are often the first to be affected and the last to recover from such pronounced economic downturns; property values collapse and remain suppressed by a cycle of foreclosures, evictions, and home abandonment. Disconnected financial services seeking high margin products have perpetuated the pattern by encouraging low-income borrowers to finance their homes through the use of opaque mortgage securities, resulting in an increase in their own exposure to high risk and steadily rising default rates.

But local lenders with deep roots in these communities and intimate relationships with borrowers are equipped to identify regional risks and opportunities. Lending models like the SUN initiative can create positive outcomes for all sides of the equation with a laser focus on appropriate underwriting, generating a

close bond with borrowers and a clear view of their financial history and earning potential – qualities that went missing from the underwriting models of the early 2000s. Indeed, community investing is gaining traction for its ability to deliver on three critical areas of mission-driven portfolios:

1. Consistent returns

The presence of risk in the community lending process – though well-understood and carefully monitored – means that investors have an opportunity for similar or greater returns than the market might offer. Currently, community loan funds are providing an advantage in yield over depressed treasuries, which makes them a reasonable complement to a traditional fixed income strategy (for example, Boston Community Capital's SUN initiative offers investors 4.25% for a 5-year loan). At the same time, community investing provides a social and ethical return demanded by the emerging generation of savvy investors.

2. Lower default risks

Community investing has proven to be a financially sound investment due to the rigorous underwriting and intense analysis inherent in the lending process.

For example, borrowers who qualify for Boston Community Capital's SUN initiative are offered a 30-year fixed rate mortgage based on specific criteria derived from a thorough credit and lifestyle investigation. By contrast, the lending philosophy of subprime mortgage providers was by some accounts dependent on the increased credit risk of its borrowers;^{vi} at the very least, loan originators and brokers in that product arena gained from the imposition of fees and therefore had little incentive to accurately gauge a borrower's ultimate ability to pay.

3. Community benefit

Foreclosures are traumatic to those who have lost their homes, but they also leave an enduring mark on the surrounding community. Initiatives like SUN have the power to reverse that trend by creating an air of consistency, character, and energy that promotes economic resurgence. When neighborhoods demonstrate strength and permanence, businesses grow, properties maintain their values, and a sense of continuous improvement and promise permeates the area. This increases returns on local investments and impacts adjacent areas, creating a Doppler effect that can stabilize a slowly widening network of communities.

By preserving the stability of low-income neighborhoods, community investing also helps to preserve their vitality. In time, neighborhoods supported by such programs will recover and a nationally replicable model will be validated that can salvage homes, lives, and potentially entire cities. Properly applied in the current environment, community investing can serve as a foundation for long term recycling of ethically managed capital and a successful component of a portfolio that benefits from the economic rebuilding process.

About the Authors

Patrick McVeigh, President and Chief Investment Officer of Reynders, McVeigh Capital Management, is widely recognized as a pioneer in bringing traditional investment management together with socially responsible investing. He was one of three original employees at Trillium Asset Management; his research was key to asset growth from startup to \$700 million.

A voice of reason and leadership within the socially responsible investing realm, Patrick has served as Managing Editor of *Investing for a Better World*, authored numerous articles on ethics and ecology, and contributed chapters to *The Social Investment Almanac* (New York: Henry Holt, 1992) and *Working Capital: The Power of Labor's Pensions* (Cornell University Press, 2001).

Since 1995, Patrick has been project manager for a series of groundbreaking studies conducted by the Social Investment Forum, tracking the growth of socially responsible investing and its implications in the investment markets. He also served on the boards of SEED: The Haitian Community Loan Fund, directing approximately \$1 million to peasant cooperatives in Haiti to create businesses; the Social Investment Forum; and the San Jose Food Co-operative.

Elyse D. Cherry is CEO of Boston Community Capital (BCC), a community development financial institution with a 25-year track record of providing financing to communities where low-income people live and work. Under her leadership, BCC has invested more than \$450 million in underserved communities – financing more than 10,000 affordable homes and 750,000 square feet of inner city commercial real estate, investing in more than twenty companies, and creating or preserving more than 1,400 jobs.

Ms. Cherry is a leader in the community development finance industry, and has served as Vice Chair of the Board of the Opportunity Finance Network. She also chairs the Board of the Massachusetts Cultural Council and is a recent past Chair of the Board of Directors of MassEquality, an organization dedicated to the establishment and protection of civil marriage for the GLBT community.

Cherry is a former partner at Hale and Dorr, where her legal practice focused on commercial real estate, affordable housing and preservation of open space. She started her career as a VISTA Volunteer at the East Tennessee Community Design Center. Among other appointments, she is a member of the Boards of Wall Street Without Walls and The Philanthropic Initiative, the Dean's Council of Northeastern University Law School, the Mission Driven Investment Committee of the Kellogg Foundation, and the external Board of the Institute for Global Leadership at Tufts University. Elyse is a graduate of Wellesley College and the Northeastern University School of Law.

Endnotes

ⁱ Community Investment Notes, http://www.calvertfoundation.org/invest/community_investment_notes/index.html

ⁱⁱ *Foreclosures worm way into tony towns; Wealthier areas are feeling the strain that has already scarred other communities*, Jennifer B. McKim. Boston Globe. December 31, 2009.

ⁱⁱⁱ Warren Group CHAPA Town Foreclosure Statistics.

^{iv} Warren Group CHAPA Database.

^v *Foreclosure Crises has Ripple Effect*, Haya El Nasser, USA Today, March 11, 2008

^{vi} *Subprime Mortgage Lending: Benefits, Costs, and Challenges*. Remarks by Governor Edward M. Gramlich: At the Financial Services Roundtable Annual Housing Policy Meeting, Chicago, Illinois. Federal Reserve Board. May 21, 2004.