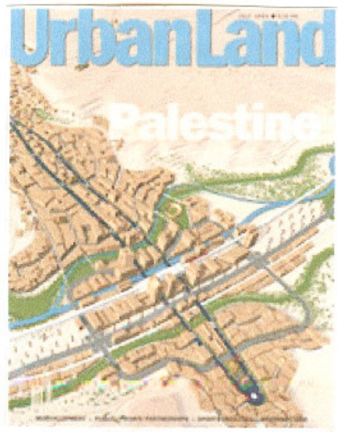


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# Double Bottom Line Investment

by Mark Schaffer and Richard Gentilucci

*Finance Trends: Real estate investment capital is finding its way into impoverished communities through the creation of regional funds.*

A 200-acre parcel of industrial land in Riverside, California, known as Agua Mansa was the kind of project that would make most investors turn and flee. Unable to maintain the debt service on high-interest-rate bonds, the original developer had gone bankrupt. Worse, perhaps, was a site straddling the San Bernardino and Riverside county line, leaving the developer to satisfy entitlement requirements of two different jurisdictions, and despite an existing settlement with environmental regulators, prospective buyers were skeptical about their ability to build on land declared as habitat for an endangered species.

One investor that was not cowed by the red flags was the Genesis L.A. Real Estate Fund, a real estate investment fund dedicated to economic development in neglected urban areas in southern California. Its fund managers had a hunch that the strong appetite for new industrial buildings in the state's Inland Empire region of Riverside and San Bernardino counties would make the project worth the effort. Working closely with the project's new developer, Lowe Enterprises of Los Angeles, Genesis managers waited months while Lowe resolved the problems one by one. The developer refinanced the costly bonds to a lower, more affordable interest rate. Lowe convinced Riverside and San Bernardino counties to actually move the county line a few hundred feet, thus making several parcels easier to build upon and, therefore, more marketable.

In less than two years, the project sold off to 23 separate developers and owner-occupants. The internal rate of return (IRR) to the Genesis Fund from its investment in this problem piece of real estate was 172 percent.

Agua Mansa is an example of what is commonly referred to as a "double bottom line investment": namely, one that creates jobs for the local community while delivering returns to its investors ranging from respectable to robust. Through the creation of regional funds like Genesis, real estate investment capital is finding its way into impoverished communities throughout the United States. Genesis's capital comes from institutional investors, many of which are banks seeking not only attractive investment returns, but also positive consideration under the Community Reinvestment Act (CRA), which requires all U.S. banks to devote a certain amount of their assets to community development.

Prior to the advent of such funds, banks tended to think of their CRA investments as money primarily focused on meeting the social goal of community development rather than on providing good returns. Community reinvestment was not viewed as a viable, money-making activity. But funds such as Genesis have been able to accomplish goals that had seemed mutually exclusive to some people: achieving community investment goals on one hand, notably job creation and retention, and profitable real estate investment on the other. To date, Genesis has invested more than $70 million divided among 11 commercial projects, covering nearly every category of commercial real estate. Projects include a vacated and abandoned facility converted to an industrial business park, a regional mall partly demolished and rebuilt to create a vibrant lifestyle center, a century-old building converted to residential mixed use, and a new air-freight facility on a former aerospace manufacturing site. Considered "untouchable," many of these projects lay neglected for years. Today, these same projects are worth more than $400 million, generating project-level IRRs in excess of 30 percent. At the same time, those projects either created or retained an estimated 4,000 jobs in targeted areas of southern California.

It turns out that the commonly accepted notion of "too much capital chasing too little product" may be untrue. At any rate, it may turn out that capital providers have not been looking in all the right places. Investors, including many retailers, are now realizing that low- and moderate-income communities have a spending power that equals or exceeds suburban markets, in some cases by a factor of six. The reason is population density. What communities may lack in affluence, they more than compensate for in numbers. Investors are now considering funds such as Genesis to generate a market-rate, risk-adjusted return on their CRA investments.

Formed in July 2000, Genesis was the first fund in the country exclusively dedicated to the benefit of low- and moderate-income neighborhoods. The fund seeks to promote economic development and employment opportunities there. Genesis provides gap financing to developers in the form of equity, preferred equity, or mezzanine debt. Each project is evaluated on an individual basis for its risk profile. A typical mezzanine loan is expected to produce returns in the 16 to 19 percent range, while equity is priced in the low to mid 20s.

The purpose of Genesis L.A. was to use private capital as a means to create new jobs while stimulating investment in low- and moderate-income neighborhoods in Los Angeles. The Genesis Fund started up with a mission to champion job creation and community growth through urban revitalization. The inspiration for Genesis was the 1992 redevelopment of a shuttered General Motors plant on a 100-acre site in a gang-infested neighborhood of Los Angeles. Today, the project, known as the Plant, is a 68-acre retail center that has 35 tenants and 355,000 square feet of manufacturing space. In addition to creating more than 2,500 jobs, the project's financial success has spurred further investment and changed the look of the entire community for the better.

With the success of the old GM plant, a small group of people—including Deborah La Franchi, then assistant deputy mayor for economic development who managed the General Motors project for the L.A. mayor's office, and Marci Wiseman, then chief operating officer of the mayor's office of economic development—discussed extending the same business model to other developers who wanted to work in the inner city. "We started to take that thought process a step further, saying, 'How can we actually attract more private capital, because a lot of these developers' assets are all tied up and they can't put together the extra 20 to 30 percent equity they need?' " says La Franchi, "and that is really when we started embarking on developing a fund."

If municipal officials knew something about real estate, running a fund was a different matter, acknowledged La Franchi, who is now executive in charge of Genesis L.A. Family of Funds. "We didn't know what type of fund we needed," she says. "We didn't know how to create a fund. We didn't know anything. But we also knew that we had to get it out of the public sector, because government would strangle the thing with red tape. The fund needed to be nimble. It needed to be fast-reacting."

"There wasn't a lot of appetite for this kind of fund in 2000," La Franchi continues. "The idea was unproven. We didn't even know if investors would come in, even though the idea had come through the mayor's office. It was not a slam dunk for anybody," she says. "It was high risk for the investors. I have to say our initial investors—Bank of America, Wells Fargo, Washington Mutual—really lent their support to the notion of the fund when it was still in its conceptual stages." At that point, she adds, "We knew then there could be an end game. We would have these big investors, and the small investors would follow them."

For Bank of America, Genesis provided an investment platform that was thitherto unavailable to the money-center institution, according to Jennifer LeSar, a senior vice president in charge of real estate investment in the bank's San Diego office. "There had been an absence of mezzanine funding for redevelopment projects, especially in the inner city," she says. Relying entirely on capital from institutional investors, the fund managers were able to put together the initial $85 million fund.

Developers can do business directly with the banks that invest in Genesis. A developer who has earned the respect of a major bank can do business directly with that lender, sometimes obtaining construction financing at a more favorable interest rate and loan-to-value ratio than the developer could have obtained through his or her own resources.

A lot of new money sources have recently begun to look at the same types of projects. The success of Genesis Fund has led to the creation of similar funds throughout the United States. According to the Social Investment Forum, a Washington, D.C.–based nonprofit organization that tracks socially responsible investment, assets in community investment funds and other lenders increased by 84 percent to more than $14 billion, from 2001 to 2003.

One example is the $75 million Smart Growth Fund, sponsored by the Bay Area Council, a coalition of large San Francisco– based employers that has already made a positive contribution to the urban core of the Bay Area. Created in 2002, the Smart Growth Fund has invested in several retail, housing, commercial, and industrial projects. Plans are underway to form several other regional initiatives in cities like Miami, Portland, San Diego, and Sacramento.

The success of these funds now means there will be a lot more competition out there for projects that most lenders would not have touched just a few years ago.

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