

Sustainable Community Development,
Capital Formation and Financial Regulation:
A Policy Advisory Proposal to the Obama Administration



David Paul Rosen & Associates

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Executive Summary

Leveraging upon the massive efforts that are now being undertaken by the Obama Administration to spur economic recovery, David Paul Rosen & Associates proposes to advise the Administration on the execution of a sustainable community development agenda that advances the community development efforts of the past thirty years, and integrates into these efforts the principles of sustainable development. In Section 1 of this proposal we discuss how the principles of sustainable community development provide a strategic framework for addressing many of the important issues that have emerged out of the current economic crisis. Banking and capital market troubles have brought investment in community development activities to a virtual halt, while foreclosures, failed businesses, and state and local government budgetary difficulties threaten to reverse the historic gains made in community development. At the same time, the global warming crisis mandates an approach to community development that embraces principles of environmental sustainability such as energy efficiency, mass transit, land-use planning, jobs/housing balance and energy efficient community facilities development.

As is discussed in Section 2 of this proposal, the Administration's economic recovery initiatives have or will soon put into place the capital and regulatory resources for sustainable community development. These resources fall into five areas of federal intervention: (1) appropriations, (2) asset purchases and investment, (3) federal financial guarantees and government sponsored enterprises, (4) federal tax policy as it relates to community development, and (5) financial markets regulation.

We propose that, through application of the intervention tools highlighted above, the sustainable community development agenda be made an integral component of the Obama Administration's response to the nation's economic crisis. Advancing this agenda will not require the introduction of new resources beyond those that will become available under the Administration's economic recovery initiatives. Instead, it can be advanced by providing policy guidance and regulations that provide a framework for utilizing these resources. Section 3 of this proposal provides examples of action items that the administration could adopt in furtherance of this goal.



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David Paul Rosen & Associates (DRA) is a 30-year old policy and financial advisory firm with a nationwide practice and expertise in affordable housing, economic development and sustainable development. DRA has worked in more than 200 cities in 39 states on more than \$7 billion of community development transactions and portfolios. DRA's clients include federal, state and local government agencies, institutional investors and lenders, for-profit and non-profit developers, foundations and other institutions.

Introduction

The Obama Administration's response to the current economic crisis should assure the formation of an enduring public/private capital investment partnership and regulatory framework that continues the substantial progress made over the past thirty years in the area of community development. At the same time, the global warming crisis mandates that the community investment agenda fully embrace the principles of sustainable development.

Thirty years of community development practice in hundreds of cities throughout the United States has produced a network of state and local government agencies, for profit and non-profit private enterprises, and their public and private sector lending and investment partners. This community development practice has crafted a well-defined agenda, with tangible results and goals. These include first-time homeownership, affordable rental housing, small business lending, and community facilities development. The combined effects of rising foreclosures, the banking and capital markets crisis, and tightening credit have all but halted, and threaten to reverse three decades of advances in community investment.



Global warming, and the worldwide imperative to reduce greenhouse gas emissions, requires we re-think land use planning, jobs/housing balance, mass transit, and community facilities development in the United States. It further requires we develop renewable energy on a nationwide scale. It requires that our communities become energy efficient and environmentally sustainable.

Taken together, the community development and sustainable development agendas reinforce one another. They comprise a comprehensive agenda for sustainable community development. This agenda materially contributes to our economic recovery and long-term vitality.

The Obama Administration has embraced these policy goals, and begun to address them in assertive fashion. We propose to sharpen the Administration's efforts to address -- comprehensively -- the capital requirements and regulatory framework needed to achieve the sustainable community development agenda.

1. Framing the Sustainable Community Development Agenda

A comprehensive strategic response by the Obama Administration can put in place a public and private sector investment partnership and regulatory framework that will accomplish the following:

- Stabilize, repair and revitalize the mortgage industry, while simultaneously articulating a durable federal homeownership policy that builds upon lessons learned from current mortgage crisis, 30 years of community development best practices, is formulated on sound underwriting principles, and will stabilize families and neighborhoods;
- Provide debt and equity investment capital for the production and preservation of hundreds of thousands of safe, decent, sustainable apartments affordable to hard-working Americans who can neither afford homeownership nor market-rate rental housing;
- Provide lending and investment capital to small businesses, including minority and women-owned businesses, capable of creating and preserving productive jobs;
- Provide public and private investment capital to assure sustainable development throughout America's communities;
- Involve land use planning with job/housing/transit/community facilities development in environmentally sustainable communities (the "horizontal" sustainable development agenda);



- Establish and finance energy efficient standards (the “vertical” sustainable development agenda) for new construction and rehabilitation, sustainable community development; and,
- Develop a renewable energy infrastructure for the United States.

2. Capital and Regulatory Resources for Sustainable Community Development

The Obama Administration is marshalling capital, asset purchase, guarantee, regulatory and tax policy resources at an unprecedented scale to address the current economic crisis and spur recovery. The massive efforts undertaken by the Administration for economic recovery fall into five areas of federal intervention:

1. Appropriations;
2. Asset purchases and investment;
3. Federal financial guarantees and government-sponsored enterprises (GSEs);
4. Tax policy; and,
5. Financial markets regulation.

Additionally, federal monetary policy administered through the Federal Reserve Bank has lowered short-term interest rates to near zero.

These five areas of federal capital intervention are summarized below.

2.1 Appropriations

The American Recovery and Reinvestment Act (ARRA) allocates \$787 billion to a range of public investments and tax incentives aimed at economic recovery. Many of these measures directly support community development objectives, e.g., support for the Federal Low Income Housing Tax Credit Program, the HOME program, public housing modernization and energy efficiency, support for wide-scale infrastructure investments at the community level.

The Omnibus Budget Act provides continued, and expanded, federal spending for community development and sustainable development oriented activities.

2.2 Asset Purchases

The Troubled Asset Relief Program (TARP) and the Term Asset-Backed Securities Loan Facility (TALF) provide \$700 billion and more than \$1 trillion in asset purchases and



investment obligations respectively, in an effort to stabilize ailing financial institutions and spur consumer lending.

2.3 Federal Guarantee Programs and GSEs

A wide-range of federal guarantee and GSE institutions provide financial guarantees and institutional support for homeownership, affordable rental housing, small business finance and rural development activities. Agencies include Fannie Mae, Freddie Mac, Ginnie Mae, FHA, SBA, Rural Development, the VA, the Federal Home Loan Bank and others. Collectively, these guarantee programs and GSE institutions provide very large-scale capital support for sustainable community development initiatives. Clearly, the future integrity and role of Fannie Mae and Freddie Mac are under intense review to assure they remain economically viable in their own right, while simultaneously providing valuable support to a revitalized financial industry for single family and multifamily lending and investment.

2.4 Community Development Tax Policy

A variety of federal tax-based programs provide direct investment opportunity for community development objectives. These include the federal Low Income Housing Tax Credit, the New Markets Tax Credit, the Historic Rehabilitation Tax Credit, Business Energy Tax Credits, accelerated depreciation for renewable energy investments, tax-exempt private activity revenue bonds and others. Many of these tax-based incentives for community development do not work well in the current economic climate, and require reform.

2.5 Financial Markets Regulation

The Obama Administration has signaled its strong intention to comprehensively review and reform the regulation of financial markets in the United States, in the wake of disastrous losses in the banking, mortgage and securities industries. Existing federal banking and securities regulatory agencies include the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission. Other sectors of the financial, securities and mortgage industry currently are unregulated or under-regulated by federal authorities. The Obama Administration has signaled the imperative need to review and reconceive the regulation of the financial industry overall, including those sectors currently unregulated, e.g., mortgage banking and brokerage, insurance, hedge funds, derivatives, credit default swaps, other off balance sheet leveraged investments, and credit rating agencies, among others.



This new, and reformed, financial regulatory framework must assure access to capital for creditworthy projects of the sustainable community development agenda.

3. Sustainable Community Development Action Plan

The Obama Administration's highest priority is appropriately centered on economic recovery. Strategically, the Administration seeks at the same time to invest in key components for durable and prosperous economic future:

- Renewable energy;
- Health care reform;
- An educated workforce;
- Revitalization of the nation's infrastructure.

We propose that the sustainable community development agenda be made a central, integral, top to bottom component of the Obama Administration's response to the nation's economic crisis, and its recovery. The following are **examples** of action items DRA recommends be undertaken. These sustainable community development action items are organized within the five broad areas of the Obama Administration's response to the economic crisis:

1. Appropriations;
2. Asset purchases;
3. Financial guarantee and GSEs;
4. Tax policy; and,
5. Regulatory policy.

3.1 Appropriations

Action item: Assure that federal spending authorized by ARRA and the Omnibus Budget Act provide direct support for creditworthy, durable community development investments in the fields of homeownership, affordable rental housing development, small business lending and investment, mass transit, renewable energy development, and broad based sustainable development practices at the urban level. This requires quantifying **maximum feasible leverage of private sector capital**. It further requires assuring efficient linkages to federal guarantee and GSE initiatives described below. Federal spending should be



focused on maximizing leverage of private sector capital, assuring creditworthy lending and investment support of federal spending on sustainable community development initiatives. Examples include:

- Private sector mortgage market support of the HUD Secretary's initiative to refinance and rewrite mortgages for **current creditworthy homeowners** who are either over-extended on their mortgage payments and/or over-leveraged;
- Extension of construction and permanent debt financing, and **federal tax credit supported equity investment**, on affordable rental housing development, renewable energy development, and development of community facilities;
- Extension of creditworthy loan and equity investment capital to small, minority-owned, women-owned businesses;
- Investment in tax-exempt **private activity** revenue bonds, and **public purpose bonds** supporting transit, infrastructure, renewable energy development and other sustainable community development initiatives.

Action item: In the specific area of **affordable rental housing development:**

- Identify and fund all "shovel ready," and creditworthy, affordable rental housing developments identified through existing state and local housing agency underwriting and allocating agencies (e.g., state low income housing tax credit and private activity bond allocating agencies, local HOME entitlement jurisdictions, and financially stable public housing authorities);
- Quantify, and provide, required federal gap financing; and,
- Quantify and assure creditworthy private loan and equity investment capital.

Action item: Link appropriations to efforts aimed at encouraging **local government** to adopt community-wide **sustainable development practices**. Frame a comprehensive federal policy for horizontal and vertical sustainable community development standards and practices. Elements include:

- Mass transit linking jobs, housing and community facilities, reducing emissions through better land use planning and transit;
- Creation of a new national infrastructure of renewable power generation and distribution;



- Creation of nationwide standards for energy conservation and generation in new construction and rehabilitation throughout the built environment (“Sustainable Building Code”).

3.2 Asset Purchases

The TARP, and potentially the TALF, capital investments and commitments have not produced measurable community development investment benefits to date. Given the sheer schedule of the federal investment in financial institutions through TARP, prospectively through TALF, and through other asset purchase proposals, an analysis of the potential for such asset purchases and investments to spur community development lending and investment is warranted. Many of the institutions receiving TARP investments have been active lending and investment partners with community development initiatives through the Community Reinvestment Act. However, in the current downturn, many of these same institutions have sharply curtailed their lending and investment activities in community development. Often, community development lending represents some of the most secure and creditworthy real estate investments available to private sector financial partners.

Action Item: Review and quantify creditworthy lending and investment demands for rental housing, community facilities, renewable energy installations, public infrastructure improvements and other community development investments for presentation to recipients of TARP and TALF funds as priority potential investments for new lending and equity.

Action Item: To the extent financial institutions receiving federal investments have taken real estate-owned (REO) onto their balance sheets, review REO portfolios for potential transfer to healthy community development institutions for operation as affordable housing, community facilities or other real estate developments of benefit to sustainable and viable communities.

3.3 Federal Guarantee and GSE Programs

Action item: Quantify the capital capacity, community development benefits and extent of taxpayer risk of loss, among the comprehensive set of federal guarantee and government-sponsored enterprise programs and agencies currently established to provide credit support and capital for the sustainable community development activities of affordable homeownership, affordable rental housing development, small business lending and investment.



Action item: Develop underwriting policy recommendations for federal guarantee and GSE institutions for homeownership, affordable rental housing development, and the financing of other community development projects. Base this review on the statistical analysis of mortgage losses during the current foreclosure crisis, contraction of the private activity bond and low income housing tax credit capital markets, and constraints on tax-exempt financing for public purpose community development improvements.

Action item: Advise on the reconception, restructuring and capital roles for Fannie Mae and Freddie Mac, particularly in the context of emerging financial and mortgage market regulation and the continuing roles of FHA, Ginnie Mae, VA and Rural Development for both homeownership and affordable rental housing development.

A key policy goal of **restructuring Fannie Mae and Freddie Mac** must be the re-establishment of a healthy and liquid capital market supporting first-time affordable (and durable) homeownership for creditworthy buyers and the development and preservation of affordable rental housing. New housing development, especially that associated with replacing out-of-date stock and responding to population growth should be developed with densities, linkages to transit and jobs consistent with the best principles of sustainable development and smart growth.

Action item: Small business lending and investment:

- Assure well underwritten and creditworthy capital flows for loan and investment capital to small, minority and women-owned business enterprises, addressing lending and investment needs of businesses of various sizes, focusing on small business enterprise lending and investment with strong job generation.
- Prepare underwriting and credit scoring guidelines for small business lending. Analyze and recommend the appropriate mix of public and private resources for small business lending initiatives.

3.4 Community Development Tax Policy

Action item: Conduct a **comprehensive review** of federal tax policy as it affects, and aims to encourage, sustainable community development lending and investment. Examples include the federal Low Income Housing Tax Credit, the New Markets Tax Credit, the Business Energy Tax Credit, the Historic Rehabilitation Tax Credit, accelerated depreciation, tax-exempt private activity revenue bonds, tax-exempt general obligation bonds and other public-issued debt in support of sustainable community development initiatives. In the current financial crisis, many of the investors and lenders who have been reliable financial partners using these tax tools no longer find them viable.



Alternatively, many of the financial partners themselves are no longer viable or financially active. Additionally, federal tax policy raises contradictory rules to efficient community development, or erects other capital barriers to long-term viable community development assets. Two examples include the substantial user issue regarding housing credits and tax-exempt private activity bonds, and capital account tax obligations on nonprofit community development organizations using tax credit structures.

Action item: Prepare detailed recommendations aimed at **revitalizing the non-functioning low income housing tax credit** equity market as well as recommend appropriate levels of federal gap financing assistance. Prepare recommendations aimed at streamlining and maximizing the effectiveness of an integrated federal tax policy in support of sustainable community development initiatives, lending and investment.

Action item: Quantify the costs and benefits of various federal tax-based policy initiatives, comparing cost to the Treasury against measurable community development and sustainable development outcomes.

3.5 Financial Regulation

Assure that a new federal comprehensive financial regulatory structure comprehensively meets creditworthy loan and investment demands for sustainable community development initiatives.

Action item: Analyze lessons learned from **financial regulation and community development**. These include the Lending and Qualified Investment tests of the Community Reinvestment Act (CRA), the Affordable Housing Goals of Fannie Mae and Freddie Mac, the Target Lending Initiative of Ginnie Mae, use of federal tax incentives (e.g., tax credits, expense provisions, accelerated depreciation) for sustainable community development initiatives such as affordable housing and renewable energy development. Also included are state financial regulation programs aimed at boosting community investment (e.g., the California Organized Investment Network (COIN) representing a partnership among the California Department of Insurance, property, casualty and life insurers, and community development practitioners).

Action item: Assure that each sector of the newly regulated financial industry provides appropriately underwritten and adequately scaled lending, investment and credit enhancement capital for sustainable community development initiatives.

Conclusion

A comprehensive sustainable community development agenda represents a material contribution to both national economic recovery and investment in a sustainable

economic future. We at DRA propose discussing with the Obama Administration how a complete review of federal economic recovery efforts can assure that the unprecedented scale of federal resources applied to economic recovery result in long-term benefits for sustainable, and vibrant, communities.

Attachment: DRA Firm Qualifications