FINANCING EQUITABLE DEVELOPMENT

A Survey of Sources and Approaches

A ULI DISCUSSION PAPER

Urban Land Institute

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INTRODUCTION

As a sector, real estate has helped drive much of the racial wealth gap in the United States—a persistent gap that has cost the U.S. economy $16 trillion over the past 20 years.[1] Undertaking deliberate strategies to invest in equitable development can help build a more prosperous future for all, while potentially helping to repair past harm.

Other reasons to focus on equitable finance include the following:

- Real estate finance, a potential mechanism for change, is complicated and requires identifying and securing many different capital sources to make a project work.
- For generations, historically marginalized communities were cut off from many of the best financing tools—as a result, these communities still cannot access many of the most cost-effective tools to drive equitable development.
- Investment in equitable development can be a powerful way to transform communities and build wealth, but it is seen by many as a "riskier" endeavor. As a result, many traditional capital sources are not readily available for this type of development, or they cost more.

Geared toward an audience of ULI members working in real estate finance, this discussion paper identifies current financing vehicles and capital sources that can help to advance equitable development. It discusses the following areas:

- The potential of each model to facilitate equitable development
- Common challenges and barriers
- Questions designed to initiate discussion about charting a path forward

As the paper demonstrates, the landscape for financing equitable development is complex. Many questions must be answered before the potential of those sources to advance equitable development is maximized.

Defining Equitable Development

In this discussion paper, equitable development is defined as real estate development with one or more of the following attributes:

- **Community wealth-building opportunities**. Community members and business owners—especially those historically excluded from ownership opportunities—can own real estate and build wealth.
- **Equitable processes**. Equitable development requires meaningful engagement of communities to ensure that outcomes meet community needs.
- **Equitable benefits**. The resulting development provides benefits—such as affordable housing, commercial space for businesses owned by Black, Indigenous, and people of color (BIPOC)—identified by members of communities that have experienced disinvestment, redlining, and other exclusionary policies and practices.
- **Inclusive development**. Real estate finance channels dollars to developers (including but not limited to BIPOC developers) working on equitable development projects.

Equitable development is not only the presence of the characteristics listed above but also the absence of predatory and extractive practices (such as the use of subprime lending). Predatory practices and exclusionary development created the need for equitable development; those practices continue, making purposeful efforts to build in equitable ways.

We will use this paper to shape follow-on dialogue, and we welcome feedback via email at health@uli.org.

TYPES OF EQUITABLE DEVELOPMENT

In real estate development, many types of projects and investments might qualify as equitable development projects. These projects include but are not limited to the following:

- Affordable housing projects
- Attainable or market rate housing projects, especially those in underinvested neighborhoods
- Missing middle housing that helps densify neighborhoods
- Neighborhood-serving retail or commercial projects, especially those that provide space for BIPOC businesses or offer leases on concessionary terms

For maximum positive impact, individual development projects should be part of a broader equitable revitalization vision, strategy, and process. This strategy could be coordinated by any number of organizations, including anchor institutions, government agencies, or nonprofit groups.

Also, it is important to note this report is focused on equitable real estate development. Many types of infrastructure—including those for parks, active transportation, water, etc.—also offer equity benefits. Those types of projects have their own funding and financing streams that are not covered in this paper. Some approaches—such as PACE bonds—may provide instructive models for equitable real estate development.

WHY EQUITABLE DEVELOPMENT CAN BE HARD TO FINANCE

Many types of developers can engage in equitable development, including not-for-profit developers, small-scale developers, and for-profit developers.

When it comes to equitable development, mission-driven for-profit investors can have advantages over nonprofit investment firms, such as the ability to move capital quickly. Some for-profit investors may have official designations (e.g., B Corp certification) to show their commitment to social impact, and their portfolios may be restricted to investments with both financial and social goals. Some BIPOC developers have explicitly adopted community benefit goals as part of their business mission.

However, social equity–focused developers cannot always access conventional financing vehicles owing to barriers, including the following:

- **Traditional equity requirements.** Equity requirements typically have not been designed for first-time and smaller-scale developers. BIPOC developers focused on social equity and smaller-scale projects may not have access to high-net-worth individuals or wealthy friends and family networks that are essential sources of equity financing.
- **Traditional risk assessments.** The perceived risk of a developer and/or neighborhood can result in lenders denying funding or offering loans with above-market interest rates. That perceived risk may reflect biases—such as the perception that a community, having experienced years of disinvestment, cannot support new development—or criteria that make it difficult for new developers to break in (such as viewing developers without an extensive track record as inherently risky). To begin remedying these issues, lenders can alter underwriting criteria, use credit enhancement, and find other ways to adjust their risk assessments.
- **Biased valuations and appraisals.** Valuations and appraisals have been shown to be consistently biased against Black people and Black neighborhoods. This bias can be due to a lack of comparable properties in the neighborhood, implicit bias among appraisers, or other factors that reflect structural and methodological challenges in appraisal systems. Appraisal bias is an ongoing and acknowledged challenge for wealth building and equitable development.[2]

- **Racism.** BIPOC developers may not receive financing even if they meet investors' criteria, have a track record of success, and otherwise meet investors' standards. Whether implicit or explicit, it is important to recognize that racism is still a factor in investment decisions. For example, several interviewees[3] noted that banks may make concessions to clients who have an existing relationship with them but use a stricter set of standards for equally qualified BIPOC developers with similar projects.
- **Banking regulations.** Regulations like the Equal Credit Opportunity Act, designed to address disparities in lending, can make it more challenging for creditors and lenders to proactively address racial differences in financing and homeownership without running afoul of laws. The Community Reinvestment Act likewise targets low-income neighborhoods, regardless of race.
- **Limited networks.** Many existing networks among developers and investors reflect the current demographics of the field. When white developers and investors have relationships with primarily other white people—especially when meetings, events, mentorships, and other ways of forming networks are exclusive—developers of color are excluded from or have limited access to the networks and individuals who could serve as equity investors. As a result, developers of color face higher barriers to getting investment opportunities than their white counterparts who have those connections.
- **Lack of transparency around terms.** Because information about the terms developers receive, including breakdowns by race, is not made public, BIPOC developers can be intentionally or unintentionally given worse terms—without any channels for accountability or data to advocate for fairer arrangements. It is difficult to measure the success of development projects when BIPOC developers are getting a property with a lower valuation and higher interest rate than white developers; without comparable opportunities, financial success cannot be judged the same way.

These barriers, and the desire to reconfigure financing approaches to benefit communities more inclusively, have spurred the need for the development of alternatives to conventional debt and equity finance, in concert with a push to make changes to traditional commercial lending. However, the alternative approaches come with their own sets of challenges. The following sections describe these approaches and the challenges.

MEASURING BENEFITS AND OUTCOMES FROM EQUITABLE DEVELOPMENT

Despite the barriers discussed, it is worthwhile to pursue equitable development because of its community wealth-building potential and the opportunity to revitalize places without displacement. Though how to measure these benefits remains an area of opportunity.

Nonfinancial equitable development benefits are harder to quantify than development returns, which are typically measured one dimensionally in the form of internal rates of return or return on investment. As a result, it can be difficult to quantify the universe of benefits gained from equitable development, when contrasted with more conventional forms of development that do not take equity into their return calculus.

In the field of impact investment writ large, standardized approaches to quantifying social, health, and equity benefits are emerging (for example, the Global Impact Investing Network's Impact Reporting and Investment Standards project, along with environmental, social, and governance [ESG] metrics). U.S. foundations are pioneering ways to measure outcomes from philanthropic investments in equitable development.

Efforts to standardize metrics for equitable development may sit in tension with the need for real estate development benefits to be customized or defined for each project by communities and stakeholders. Regardless, they hold promise for the eventual convergence of understanding around impact, and metrics that can be compared between projects, impact areas, and communities.

Intersections between Small-Scale Development and Equitable Development

Small-scale development is a rapidly evolving segment of the real estate development profession. As defined in *Building Small: A Toolkit for Real Estate Entrepreneurs, Civic Leaders, and Great Communities*,[4] small-scale development defies a quantitative definition. Instead, it relies on 10 hallmarks—many of which are directly aligned with the precepts of equitable development—including the following:

- It requires a sponsor with a clear sense of purpose, who often takes a triple-bottom-line and long-term-hold view and sees real estate development as a means to an end—the creation of great places that help with the positive evolution of neighborhoods, whether new, maturing, or those being rediscovered.
- It requires a clear vision that generally cuts against customary underwriting and instead focuses on the best value for the neighborhood and community.
- It is not easily classified singularly as residential, office, or retail; it is the antithesis of build-to-suit that strives for long-term agility and flexibility and results in real estate that is adaptable, resilient, and more future-proof.
- It is adaptive use or ground up—with the goal of transforming the building or site into an economic asset and generating positive community outcome and returns to the sponsor.
- It requires a disciplined approach to capital and to execution, and a commitment to wealth creation—for the sponsor and the community—with local economic development as an objective.
- It requires more time and "emotional capital" per square foot because it seeks to be contextually responsible, community responsive, and market differentiated. This means capital, approvals, tenanting, and operations cannot be "off the shelf." The more time a project takes, the greater the exposure of developers and investors to market headwinds and other risks.

Small-scale development is focused on regenerating communities and neighborhoods and is led by locally based developers who care deeply about their communities. It sees real estate development as the means to achieving thriving, healthy communities, rather than an agnostic asset class whose measure of success is one-dimensional returns. There is also an inextricable link between small-scale development and locally owned, independent businesses because developers often co-invest or partner with businesses in their retail spaces to achieve both authenticity and to help grow the local economy.

Because of these intersections, small-scale development experiences many of the financing challenges equitable development faces.

MAXIMIZING THE POTENTIAL

Investors and real estate stakeholders have many reasons to explore these issues, including the following:

- Equitable development projects can generate returns comparable with other development projects, but they require a longer-term horizon. Therefore, the return metrics will need to be adjusted—but they may often outperform short-cycle investments in the long run. Investors should not discount the business case for equitable development. In fact, sometimes the business case is stronger. For example, if there is a government loan guarantee or persistent subsidy, these investments can be less risky than market-rate investments, making them more attractive to debt investors.
- A growing number of ESG-oriented investors are focusing on the "S." Investors want to prepare to meet changing expectations around the social impact of their investments while gaining a competitive edge.
- Successful equitable development projects contribute to stronger real estate markets, and they can help catalyze revitalization by enhancing the value of other investments in the area and demonstrating that there is a market for additional development.
- Capital flows do not automatically support equitable outcomes in communities; even with the growing interest in financing equitable development, the capital directed toward these projects remains limited. More intentionality around these issues is needed.
- A lot of capital is looking for projects that achieve social goals. Government, banks, and investors have made a commitment to leveraging their capital to achieve social goals, and they are looking for more projects that have a strong long-term return on investment (ROI) while embedding social equity in their development strategy.

To unlock these benefits, investors need innovative approaches to financing equitable development projects.

This white paper highlights the potential of new and emerging options, as well as their challenges, and it highlights key questions about how to effectively use those options to finance equitable development.

KEY TAKEAWAYS

Key takeaways from this white paper include the following:

- Established financing vehicles have the potential to finance equitable development projects if harnessed intentionally for social impact. They face barriers, however, that emerging models attempt to work around. These newer approaches are innovative, but often they are too recent and uncommon to fully assess.
- Conventional approaches to and underwriting for real estate development are ill-equipped to pivot to embrace equitable development. Instead, there is a need to work toward a middle ground or a more evolved financing paradigm that considers a broader return calculus and includes an understanding of community benefits.
- One consistent challenge is scaling up place-based financing tools to invest in places, not just projects. Taking a strategic, holistic approach to residential and commercial development can benefit entire neighborhoods. However, that benefit is not easily reflected in underwriting terms.
- Additional key challenges in scaling equitable development as a field include both growing the pipeline of BIPOC developers and building connections between BIPOC developers and high-net-worth investors and others who can finance a developer's early projects and provide backing that helps convince financial institutions to provide capital.

Overview

Designed to foster discussion within the real estate finance community, this discussion paper aims to

1. compile a range of financing vehicles and capital sources that have the potential to more effectively channel investment to equitable development projects,
2. raise questions around what else is needed to transform this potential into actual financing decisions, and
3. elevate understanding of social benefit via equitable development and consideration of how social benefit can more clearly become a part of project financing underwriting.

WHY?

Equitable development is not possible without sufficient financing. This financing can come from both traditional and nontraditional sources, but barriers to these projects—including their smaller scale, a lack of comparable properties in the area, and perceived risk—can make traditional capital sources difficult to secure.

An expanding universe of financing options, from impact investing to crowdfunding and beyond, aim to accomplish both financial and social goals. However, these options come with their own challenges, and questions remain regarding how to move from having these tools available to effectively using them.

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HOW?

Many innovative and potentially promising approaches to financing equitable development exist. This white paper provides a high-level overview of these models and describes the potential for a range of financing vehicles to advance equitable development, the common challenges associated with using those financing vehicles, and key questions for investors as they navigate this evolving financial landscape.

WHO?

Social equity–focused developers are increasingly looking to nontraditional capital sources for investment—not because they eschew "institutional capital" but because institutional capital has shut them out. But capital sources are increasingly exploring ways to demonstrate attention to social impact, including by investing in equitable development projects. This white paper describes these traditional and nontraditional sources.

WHAT?

What is next for equitable development finance and what is needed to continue charting a path forward? This paper covers a variety of issues that are inseparable from real estate finance, including racial bias and undervaluation challenges, the need for policies that create an enabling environment, and the need for meaningful metrics.

EQUITABLE FINANCING SOURCES AND APPROACHES

This section provides an overview of financing sources and approaches that can advance one or more facets of equitable development, and it highlights the potential of each approach and source, the challenges, and key questions investors must address to chart a path forward using these vehicles.

Different financing strategies and mixes may make sense for different deals, understanding that investment decisions have parameters, contexts, and other considerations beyond the basic outlines provided in this paper.

This report is not intended to be comprehensive, but to generally lay out the equitable finance landscape to understand gaps and opportunities.

The financing strategies reviewed in this section are the following:

- commercial banks
- community development financial institutions
- minority depository institutions
- community equity investment
- crowdfunding
- federal government
- high-net-worth individuals/family offices
- impact investing
- pension funds
- philanthropic capital
- state and local governments
- other institutions

Building Community Wealth

"Building Community Wealth: Shifting Power and Capital in Real Estate Finance," a paper by the Inclusive Capital Collective—a consortium of BIPOC and equity-minded developers—shares opportunities for commercial banks to make equitable development projects more possible:

- **"Patient equity":** Provide longer-horizon, below-market-return (0 to 5 percent) preferred and common equity at the project and organizational level, as well as debt-like equity with interest-only options and 12- to 24-month periods before collecting payments.
- **Friendly debt:** Provide higher loan-to-value senior debt (covering up to 90 percent or higher) to reduce the equity burden, and/or subordinate debt with interest rates that facilitate long-term affordability (0 to 8 percent or at cost). Provide optional interest-only periods to allow projects to stabilize.
- **Lines of credit:** Provide access to lines of credit that enable developers to pay for expenses arising between construction draws, due diligence costs, and internal operating expenses, especially at concessionary terms.
- **Loan guarantees:** Facilitate access to guarantors for projects that lenders are unwilling to underwrite without them. Loan guarantees are key to unlocking lending resources from community development financial institutions and banks that are affordable and flexible to each project's needs.

Other options discussed in the paper include construction financing loans, syndicated finance, and mezzanine debt designed to reduce the risk of investing.

COMMERCIAL BANKS

Commercial banks are the largest potential source of capital for equitable development projects. Under the public welfare investment authority and related laws, national banks and federal savings associations can make investments to promote the public welfare. Collectively, banks regulated by the Office of the Comptroller of the Currency annually make more than $10 billion in equity investments in community development activities.

This is a potential source of capital for BIPOC developers. For example, utilizing the public welfare authority, Citi established a financing vehicle with $200 million of capital for BIPOC developers.[5]

The Community Reinvestment Act (CRA), created in 1977, encourages federally insured banks to meet the credit needs of all areas they serve, including low-income neighborhoods that have experienced redlining and disinvestment.

However, the CRA requirements have a broad definition of social impact, which allows banks to count activities that may not advance equitable development, and developers are often considered "too new" or "too small" to actually receive the investments. Banks are also legally prohibited from targeting lending on the basis of race. Recently, federal regulators have sought comment on proposals to strengthen the CRA to better achieve its purpose.

For equitable development, community banks and credit unions can be more flexible and open to local projects.

THE POTENTIAL

- Commercial banks have the capital and infrastructure to fund larger projects, and those financial products can help align their capacity with equitable development project needs.
- Investors would be able to maintain their expectations around financial return while also creating social value.
- Commercial banks can recognize the systematic undervaluation that occurs in communities of color and offer financial products that revitalize existing buildings in communities.
- Financial institutions have an opportunity to broaden their concept of ROI to capture the returns they are getting from equitable development projects. For example, investing in these projects may attract ESG-minded investor capital, which should be considered as institutions weigh the costs and benefits of focusing on social impact.

CHALLENGES AND LIMITATIONS

- The traditional real estate capital stack (80 percent debt/20 percent equity) does not incentivize or equitably compensate community developers.
- Available loan types may not match the project (e.g., owner-occupied duplex with ground-level commercial space). Although private investors may be better able to finance those types of projects, their terms could be more expensive than a local bank's terms.
- Assets are needed to collateralize debt—so people with fewer assets cannot access the best rates.
- Good credit is needed to access this capital, and many first-time developers and community investors do not have the necessary type of credit.

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THE POTENTIAL

- Leveraging traditional debt and equity for financing equitable development projects would more easily fit into a traditional capital stack and not necessarily require new financial products.
- Traditional debt tools are often the lowest cost of capital available—providing more access to this low-cost capital would make more potential projects profitable. With close to $100 trillion of traditional debt capital out there and hundreds of trillions of dollars more in equity capital available, access to these markets gives developers more options to fit their project's revenue model and time horizon.

CHALLENGES AND LIMITATIONS

- Even though there are rules and efforts underway, there is still implicit bias. The power of networks in accessing this capital means that historically marginalized communities often do not have access to these networks, and they still face bias when trying to put deals together.
- Lender expectations may not be feasible in a revitalizing market context.
- Larger banks are often not interested in smaller-scale projects because those projects are inefficient for their overhead cost models.

KEY QUESTIONS

- What can be done to remove barriers so that conventional commercial debt and equity can better finance equitable development? How can banks and investors reduce the barriers that make it difficult for BIPOC developers to access financing?
- How strong is the business case for social equity–promoting real estate investments?
- What would it take for banks to offer the concessionary terms identified in a paper by the Inclusive Capital Collective?[6]
- What shifts in banking are needed to accommodate innovations like crowdfunding in development finance?

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

Community development financial institutions (CDFIs) are specialized lenders that provide a range of financial services in underserved communities. Typically, they are private-sector organizations, and their funds can come from private, public, and philanthropic sources.

THE POTENTIAL

- CDFIs are grounded in the communities they serve, which can help them see development opportunities differently than nonlocal banks.
- CDFIs have the potential to provide patient capital and other types of needed capital that are not otherwise readily available.

CHALLENGES AND LIMITATIONS

- CDFIs are mostly funded by banks. Therefore, they may have capital but not a lot of capacity, with demand for CDFI capital typically exceeding supply.
- CDFIs may present administrative hoops for developers that create burdensome “social overhead costs.” Plus, CDFIs often end up funding a narrow subset of projects that are highly compliant.
- CDFIs’ conventional underwriting does not always work for smaller loan amounts.
- Developers do not always know how to structure deals with or get access to CDFI financing, even when it is a good fit.

KEY QUESTIONS

- How can CDFIs finance larger-scale projects?
- How can CDFIs better educate and work with developers to overcome administrative barriers and other barriers to putting together deals?

MINORITY DEPOSITORY INSTITUTIONS

Minority depository institutions (MDIs) are banks that serve BIPOC, low- and moderate-income, and rural communities at higher rates than mainstream banks. The U.S. Federal Reserve System defines an MDI as an institution for which a majority of the voting stock is owned by BIPOC individuals, or a majority of the board of directors is BIPOC and the community that the institution serves is predominantly BIPOC.

These banks are often referred to as "mission-driven banks" because they disproportionately affect the lives of underserved citizens and communities by making loans and providing other vital banking products and services. Research shows that compared with other financial institutions, MDIs originate a greater share of mortgages to borrowers of color.

THE POTENTIAL

- MDIs offer the opportunity for data collection on BIPOC lending and credit to help dismantle underwriters' perceived versus actual risk of lending to borrowers of color.
- Increasingly, mainstream commercial banks are partnering with MDIs to help expand banking and access to credit in BIPOC communities.
- Grants, equity investments, creation of an investment fund, deposits, and technology support are a few direct ways that private companies or philanthropic organizations can augment the reach of MDIs.

CHALLENGES AND LIMITATIONS

- Since 2001, the number of Black MDIs has declined by more than half, with 21 FDIC-insured Black banks remaining as of 2020.
- Many MDIs are small, and building capacity and scale is critical to growing their operations and expanding services to their communities.
- Smaller institutions lead to smaller loan amounts.

KEY QUESTIONS

- Like CDFIs, how can MDIs finance larger-scaled projects?
- How could data from MDIs about real versus perceived risk in lending to people of color be used in the larger banking/lending ecosystem?
- How can the work of MDIs be uplifted to allow entry of more into the market?

COMMUNITY EQUITY INVESTMENT

Several models, including community shareholding, neighborhood-focused real estate investment trusts (REITs), and community investment trusts, provide community members with ownership stakes in development projects.

The exact structures vary, but all models require the following considerations:

- Are nonlocal shares available? If so, local investors may receive a more favorable redemption plan or other benefits. (Nonlocal shares may be necessary to raise more funds to cover costs.)
- What qualifications do local investors need to participate?
- What are the terms for investors, including local investors, and what are the return expectations? Are funds available for local investors to get their money back if returns are lower than expected?

By offering smaller equity positions in a development, residents can access equity opportunities for as little as $50 or $100. Because these models are still emerging, there is no standard guidance, and these considerations must be made on a deal-by-deal basis.

As a field, community equity investment, community shareholding, and other models are still developing and have yet to scale across the country.

THE POTENTIAL

- Community members have the opportunity to financially benefit from real estate investments in their community.
- A portion of the equity can be allocated for free to long-term residents as a type of sweat equity, benefiting people who invested in their neighborhoods before the market arrived.
- When community members are investors, there may be increased community buy-in and motivation to ensure the project succeeds.

CHALLENGES AND LIMITATIONS

- It is unclear whether this type of model is scalable.
- The capital and time necessary to sustain these models are not always available. It takes a lot of work to manage so many applications and processes for local investors.
- Not everyone has the disposable income to invest; other vehicles that benefit residents who are unable to gain an equity stake need to be available.
- No consistent models exist yet.
- Administrative and establishment costs may make this type of financing difficult to access.
- This type of model is limited by securities law (e.g., shareholders cannot govern the REIT, which limits the ability to promote community governance), but there is still potential within the parameters.
- There is a need to create a common understanding among community members on how real estate investment works.

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KEY QUESTIONS

- How can this type of model be used to attract institutional capital?
- Does this model help prevent displacement as neighborhoods gentrify?
- What are best practices for educating local investors and reducing risk for them?
- What are the opportunities to expand this model, allowing, for example, multifamily renters or commercial tenants to begin earning equity in a property as they lease it?

Project Profile: Nico Echo Park, a Benefit Corporation

- **Size:** Three residential and mixed-use properties (84 units total); $30 million in total asset value
- **Location:** Los Angeles

Nico Echo Park, based in Los Angeles, was structured as a benefit corporation and created by the venture-backed company Nico.

THE PURPOSE

Branded as the first "neighborhood real estate investment trust (REIT)," Nico Echo Park aimed to facilitate community wealth creation, make governance within the neighborhood more democratic, and create a financial product that would be attractive in a larger market. Nico's ultimate vision was to create a company that could be the largest owner of housing and real estate within a neighborhood and to have tens of thousands of local shareholders in that company.

Nico's long-term theory of change looked beyond Nico Echo Park: once the REIT model became more familiar to institutional investors, Nico could more easily attract institutional capital and deploy it in partnership with local stakeholders, who would also have a financial stake in place-based, wealth-building projects.

THE MODEL

Nico Echo Park launched as a public REIT in late March 2020 using a Tier 2 Regulation A+ offering, open to both local and national investors with an investment minimum of $100. For a year before the offering, Nico Echo Park had also raised private capital from mission-aligned high-net-worth investors and acquired three rent-stabilized properties that included 81 apartments and four retail spaces. The REIT chose not to limit the public offering to local stakeholders because it needed to raise enough capital to cover costs.

The offering had the following characteristics:

- Local investors received a more favorable redemption plan.
- Local and nonlocal investors received the same terms.
- Local investors were defined as being within 10 identified zip codes in the neighborhood.
- Investments could be made once or monthly using Nico's digital app.
- Nico Echo Park set the investment minimum as low as possible.
- Any exit would have a redemption plan, with a minimum hold period of two years for nonlocal investors and six months for local investors. Investors could be redeemed at current net asset value per share on a quarterly basis.[7]

Because it launched early in the COVID-19 pandemic, the REIT also created programs to support residents and investors. The rent assistance

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program included a policy that security deposits could be used toward rent, a rent assistance fund composed of cash grants, and a decision to make REIT shares available as a community wealth grant capped at $1,000 per person.

THE OUTCOME

The early pandemic launch meant that Nico Echo Park had to shift its focus from recruiting small-dollar investors to supporting residents. Because of the timing (among other factors[8]), it was unable to demonstrate the potential of scaling this model.

Nico Echo Park has wound down as a public company and is exploring a sale of its assets. However, Nico still exists and is interested in the possibility of launching additional neighborhood REITs in the future.

At its peak, Nico Echo Park reached $30 million of investment. It estimates that future projects would need about $100 million at a minimum to achieve the scale necessary to become a new type of asset and fulfill the vision of neighborhood REITs as a mainstream product for institutional investors that fosters local community wealth building.

"It's an exciting time for shared equity models. They're big ideas that will be shaping neighborhoods over the next 20 years. That being said, we're still at the beginning. This time is about experimentation and trying new things. Winding down Nico had nothing to do with the vision or idea itself—it's just early for institutional investors and there are lessons learned."

—Max Levine, cofounder and CEO, Nico

CROWDFUNDING

Crowdfunding enables both accredited and non-accredited investors to invest in projects, typically through online platforms. These investments vary in size and terms and provide equity capital that can be combined with bank-provided debt finance to form the capital stack.[9]

THE POTENTIAL

- When community members are investors, there may be increased community buy-in and motivation to ensure the project succeeds.
- Crowdfunding significantly lowers the financial barriers to entry, allowing more community members (as well as aligned individuals outside of the community) the ability to participate.

CHALLENGES AND LIMITATIONS

- There are not many available crowdfunding platforms.
- Banks are not used to this vehicle and may be wary of it.
- Crowdfunding is risky, and not all nonaccredited investors may understand the potential downside of investing.
- Bank loans may be difficult to underwrite due to anti–money laundering concerns.[10]

KEY QUESTIONS

- What is necessary to make crowdfunding more mainstream? (For example: How can banks become more familiar with crowdfunding and its role in the capital stack? What do community investors need to know?)

Developer Profile: O'Hara Development Partners

- **Location:** East Baltimore
- **Innovative Financial Vehicles Used:** Crowdfunding

O'Hara Development Partners is a community development company based in Baltimore, Maryland, that rehabilitates decayed properties for residential and commercial use, provides educational and other sustainability services, and transforms green spaces. In 2021, the company purchased six lots of land surrounded by row homes in Midway, a mixed-income, historically disinvested neighborhood in East Baltimore that is now gentrifying.

THE PURPOSE

With crowdfunding, the development is planned to include a community space with water features, outdoor fitness, urban farming, and other amenities.

THE MODEL

O'Hara Development Partners is fundraising through Small Change, an online crowdfunding platform, and aiming to raise equity of $1.6 million, with debt financing provided by banks. The platform is selective and hosts projects that have the potential for walkability, affordability,

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and other goals that attract investors who are looking for projects with value and meaning.

In addition to crowdsourcing, O'Hara Development Partners has sought out other capital sources, including lines of credit, grants, resources from suppliers willing to donate (tile, lumber, structural services, etc.), conventional financing with a bank, and new market tax credits.

THE OUTCOME

Because crowdfunding is a new financing vehicle, many banks were skeptical at first and reluctant to lend—especially considering the high vacancy rates within walking distance of the development. After O'Hara Development Partners spent a significant amount of time building relationships with banks and educating them about the project, the banks eventually provided additional financing for the project.

FEDERAL GOVERNMENT

The federal government supports the financing of equitable development through various tax credits and other incentives, grants, and requirements, including the following:

- **Fannie Mae and Freddie Mac.** For example, Fannie Mae has a program to provide a small interest rate discount to affordable housing developments that become Fitwel certified.
- **Opportunity zones.** Investors can receive federal tax credits against capital gains when investing in opportunity zones, which are specifically designated census tracts that have (generally) seen historic underinvestment.
- **Tax credits.** Examples of available tax credits include the Low-Income Housing Tax Credit and the New Markets Tax Credit.
- **Historic preservation.** Historic preservation regulations can be leveraged for equitable development.
- **Community Development Block Grants.**[11] The U.S. Department of Housing and Urban Development (HUD) administers these grants, which support community and economic development activities within broad requirements.

THE POTENTIAL

- The federal government can incentivize the financing of equitable development projects.

CHALLENGES AND LIMITATIONS

- The federal government does not always have financial products that match the desired development type, such as owner-occupied duplexes with commercial space.

KEY QUESTIONS

- Many of these incentives are race neutral. Can race-neutral investments still be targeted by need? Should race-neutral investments focus on race and on income and geography?

HIGH-NET-WORTH INDIVIDUALS/FAMILY OFFICES

High-net-worth individuals (HNWIs) and family offices typically aim to grow their corpus and may desire to invest in mission-driven, one-time projects with less potential to be serial investments. For both family offices and HNWIs, principals' interests have a large role in decision-making. For many equitable and small-scale developers, friends and family are important early investors in projects.

THE POTENTIAL

- HNWIs and family offices have a significant amount of capital.
- Financing requireaments and expectations can be tailored to individual projects.
- Having this capital can attract other sources.

CHALLENGES AND LIMITATIONS

- Financing decisions depend on HNWIs individual preferences and interests rather than predictable criteria.
- BIPOC and smaller developers may lack access to high-net-worth individuals and wealthy friends and family networks.

KEY QUESTIONS

- How can developers be supported in learning about and accessing these funds?

Special Purpose Acquisition Companies

Special purpose acquisition companies (SPACs), also known as "blank check companies," raise public capital (similar to an initial public offering) to eventually merge with an unidentified target operating company, which could be a real estate business. When combined with a SPAC, a target operating company becomes publicly traded and gains some liquidity.[12] For example, Finance of America Equity LLC (a Blackstone-controlled lender) merged with the SPAC Replay Acquisition Corporation in 2020. Blackstone Tactical Opportunities, a subsidiary of Blackstone Group, now owns 70 percent of the merged company.

SPACs also can merge with private REITs and other owners of real estate portfolios. As these company types become more common, developers can look to them for financing opportunities. Although they do not necessarily use an equity lens, they are emerging as an additional source of capital in the real estate industry.

IMPACT INVESTING

Impact investing is similar to mission-driven for-profit investing, but the expected social returns are typically on par with the expected financial returns. Impact investing can play a variety of roles within real estate finance, including providing operational or predevelopment dollars, serving as part of the capital stack to attract market-rate capital sources, or helping to bridge transitions. Impact investments may be part of a revolving loan fund. However, so far, impact investing as a field has made limited investments in real estate projects.

THE POTENTIAL

- Developers may receive better terms and be able to use this financing as equity, loss reserve funds, or backstop loans.
- Investors expect to get a return, even if it is lower than usual.
- The community benefits from development that might not have been financed had these capital sources not been available.
- Typically takes the patient long-term view that is needed to move markets.

CHALLENGES AND LIMITATIONS

- Not all investors will accept a lower rate of return.
- Most impact investment capital does not currently go to brick-and-mortar real estate projects.
- It remains challenging to quantify the social and equity benefits from real estate development projects.
- Impact investing can actually do harm by moving capital into sectors, such as affordable housing, and driving up costs.

KEY QUESTIONS

- Does impact investing reduce traditionally calculated returns, or can the internal rate of return remain high?
- How can impact investments in real estate be increased and scaled? What is the potential for impact investing in both small- and large-scale projects?
- How can health and social equity benefits from these projects be understood, measured, and valued along with more traditional return-on-investment metrics?

PENSION FUNDS

Significant amounts of capital are held by public pension funds, which typically invest in real estate via real estate investment trusts or private equity pools. Some pension funds already have impact overlays, such as electing to not invest in oil companies, and can create screens for equitable development if they choose to invest in real estate.

THE POTENTIAL

- Pension funds can provide patient capital and other financial products with low volatility, which is particularly appealing to this financing source and necessary for many equitable development projects.

CHALLENGES AND LIMITATIONS

- Social equity is currently seen as a bonus, not as the core of most pension fund investments. Reliable and robust returns remain the priority.
- Although pension funds have a lot of capital, compliance with reporting requirements can be challenging for small developers and the use of an intermediary investor may be necessary.

KEY QUESTIONS

- What criteria can help to determine whether equitable development projects fit the profile that public pension funds look for in their investments?
- How much of the resistance to investing in real estate is because of real and/or perceived risk?

ULI Europe Social Impact Report

The ULI Europe report *Social Impact: Investing with Purpose to Protect and Enhance Returns* explores opportunities and challenges for expanding social impact investing and focuses on strategic approaches, alignment with risk management, and trends among capital sources. Although many of the financial vehicles discussed in this white paper are relatively new, impact investing is an important exception.

The ULI Europe report makes this key point:

At its most fundamental, the integration of social impact strategies into investment plans is not new. Best practice risk management strategies focus on enhancing the experience of their occupiers and/or end users in order to protect and enhance income. However, as the scope of institutional investment opportunities has expanded into new sectors including social infrastructure, it is perhaps the underlying occupier and customer base that is the greatest change for the industry.

Impact investing for equitable development requires the same best practices as incorporating social impact into any development project. However, because the audience—often underserved communities—may be new to investors, a special focus on how to best meet the needs and wants of residents remains necessary.

PHILANTHROPIC CAPITAL

Philanthropies have up to three main sources of capital that can be used for financing equitable development: their corpus, development grants and guarantees, and impact investing programs (usually called program-related investments).

Traditionally, foundations have aimed to grow their corpus to maximize their returns and allow continued investment in programs. In general, they are bound by law to spend at least 5 percent of their endowment per year on grants and program-related investments.

Although the main corpus may have negative screens (the exclusion of companies or industries that do not align with specific values or goals), it has been less common for foundations to use an ESG or social impact investment lens. New approaches focused on Total Foundation Asset Management seek to help foundations use all their programmatic and investment assets to achieve philanthropic objectives.

Outside of their corpus, rather than seeking income, foundations may invest in projects expecting to take a submarket return. Philanthropic capital can serve as a guarantee, as enterprise capital (predevelopment loans or grants to support the early work and operating support required to begin a development project), and as flexible funds to be used as needed.

As some philanthropies use their funds for impact investing, they will recognize a need to have better terms than current interest rates and to peg their expectations to market returns over time. This way, they continue to attract developers who are having difficulty securing bank loans, not receiving reasonable terms, or have worthwhile projects that do not quite meet ROI expectations.

THE POTENTIAL

- Capital guarantees can help to debunk perceived risk by enabling development projects that initiate a track record of success.
- Place-focused foundations have local knowledge that enables them to balance risk based on trusted relationships and other ways of understanding performance (e.g., a first-time developer has had other successful community projects that a bank might not value). Plus, these foundations can strategically invest in projects that they know will remain important community resources or critical sources of affordable real estate, especially as property values increase.

CHALLENGES AND LIMITATIONS

- Foundations are still evolving asset management approaches that would allow for an integrated investment strategy bridging grants, program-related investments, and impact investments using the corpus.
- Philanthropies' impact funds are often separate from their real estate funds—or other siloes—which makes impact investing in equitable real estate development projects difficult.
- Some philanthropies do national work that is less place-based.
- Philanthropies may need help learning how to be part of real estate developments' capital stacks.
- It is difficult to scale capital guarantees, which are typically used for individual development projects.

Continued on following page

KEY QUESTIONS

- How can philanthropies invest their main corpus to achieve impact, and what are the current barriers to doing so?
- How can philanthropic capital be harnessed to attract other capital sources?

STATE AND LOCAL GOVERNMENTS

State and local governments can facilitate the financing of equitable development projects in the following ways:

- **State and local tax credits.** Tax credits can incentivize investment in underinvested neighborhoods, in the creation of affordable housing, and in other development projects that may have an equity lens.
- **Property tax abatements.** Property tax abatements can incentivize certain building uses.
- **Loan guarantees or collateral flexibility.** State and local governments can provide loan guarantees or offer flexibility in collateral requirements, which could enable smaller or less capitalized developers to be more competitive.
- **Grants using state and local dollars.** Grants can facilitate financing by providing matching capital and decreasing risk.
- **Provide land.** State and local governments may own land that they can sell for a low cost to make equity-focused development projects more feasible.
- **Issuing bonds.** State and local governments can issue bonds to finance equitable development projects like affordable housing.[13]
- **Zoning relief.** State and local governments can grant exceptions to zoning laws for development types that meet community-identified wants and needs.
- **Requirements for development (e.g., percentage affordable housing or investor mix) in requests for proposals (RFPs).** Municipal requirements in RFPs can incentivize projects that meet specific equity criteria. If these criteria become expected, investors may also seek out aligned capital sources and compliant projects.
- **Prioritize awarding contracts to small businesses and minority, women, disadvantaged, and veteran business enterprises (MWDVBE).** State and local governments can help to build a track record of development success among small businesses and MWDVBEs by prioritizing them in public development projects.
- **Tax increment financing.** Tax increment financing, which sequesters tax revenue from a designated area for repayment of bonds that are issued to fund capital costs, can drive investment to targeted areas.
- **Leasing.** Localities can agree to long-term leases that help developers obtain financing.

THE POTENTIAL	CHALLENGES AND LIMITATIONS
• Whereas private companies typically have fiduciary duties related to their shareholders, state and local governments have a broader fiduciary duty to be faithful to the public trust. This enables governments to incentivize and work toward equitable development within a more flexible—and not entirely financial—mandate.	• Many of these tactics can be politicized and may be difficult to implement. • State and local policies sometimes undermine equitable development outcomes. For example, zoning policies can, intentionally or unintentionally, perpetuate segregated land use patterns. • Administrative barriers can be prohibitive without sufficient technical assistance. Similarly, requirements (such as minimum liquidity reserve requirements) can disqualify small businesses and reduce the number of possible bidders. To remedy this, states and localities could allow applicants to partner with foundations or create pools of resources that can be pledged for a specific bid.

KEY QUESTIONS

- Some of these tactics, such as zoning relief, are difficult to make targeted, and many are race neutral. To what extent does this matter?
- What training or support do BIPOC developers need to access state and local capital?
- What tools could be created to overcome administrative barriers like liquidity reserve requirements?
- What enforcement or accountability mechanisms are necessary to make these tools effective once they are in place?

OTHER INSTITUTIONS

Other institutions are considering how they might have a role in financing equitable real estate development. These investors are not always seeking a return—they are looking to preserve their capital and achieve institutional goals by building equitably in communities. Others, like hospitals, recognize the potential of affordable housing to reduce health care costs. Other potential roles for institutions looking to invest in equitable development include:

- **Endowments.** Insurance, university, and other endowments can invest in equitable development projects.
- **Hospitals.** Some hospitals have started to help finance affordable housing near them, and these hospitals have the potential to finance other equitable development projects that promote health (including the social determinants of health).
- **University impact funds.** Universities may have impact funds (such as investment funds for experiential classes) that could be targeted to equitable development projects.

THE POTENTIAL

- As nontraditional sources of real estate finance express interest in the sector, they can focus on equitable development.

CHALLENGES AND LIMITATIONS

- Although examples of these investments exist, there is no standard roadmap for other interested institutions.

KEY QUESTIONS

- Beyond the examples above, how can new sources that are seeking to preserve their capital be activated to invest in equitable development?

Exploring Other Equitable Development Tools

Although the following equitable development tools are not financing vehicles covered in this white paper, they are related models that real estate professionals will likely encounter as they explore options for financing equitable development.

Community land trusts and the following related tools can be considered a part of equitable development insofar as community members are interested in using these tools to promote housing affordability. When these tools are part of a development plan, they may affect the financing options available, so developers and investors should be aware of their purpose, benefits, and challenges.

- **Community land trusts (CLTs):** Some municipalities and CDFIs have helped to finance CLTs, but the small scale of CLTs can make investing in them difficult. Plus, the purpose of community land trusts is often to maintain long-term affordability and give residents more control, but it does not always serve as a wealth-building tool.
- **Rent-to-own homes:** These use all or part of monthly payments to build equity while sharing the common goal of supporting stable, affordable housing.
- **Shared rent:** These arrangements involve rental agreements that are tied to gross sales or revenues. For example, they might involve a base rent plus a percentage of gross sales. These practices allow developers and owners to demonstrate their commitment to tenant success, help cultivate up-and-coming business owners, and align tenant and owner business interests.
- **Shared benefit structures:** These help foster collaboration among tenants in a building by ensuring that all tenants in a building are working together to promote project success. Opportunities for this collaboration could include shared marketing or buying each other's goods and services (for example, a restaurant might cater an event hosted by a bookstore or office in the building).
- **Co-investment:** These arrangements involve contributions of cash equity from project tenants, helping to ensure that tenants and owners are equally committed to the success of the building and project.

CONCLUSION

This white paper takes the first step in charting a path to advance equitable development by identifying financing options and discussing how to leverage them: compiling opportunities, challenges, and questions. To continue on this path, that information should be used to explore next steps within real estate finance and the larger policy context, with the ultimate goal of making this financing more feasible, common, and scalable.

Real estate finance is intertwined with the policy environment, U.S. history and culture, and other factors that affect the feasibility of financing equitable development.

The following table identifies gaps in equitable finance as a field and opportunities to address them. After all, capital problems are rarely only capital problems, but also symptoms of other issues. Working on these challenges simultaneously can help ensure there is an enabling environment for equitable development and that capital is being deployed to promote equitable outcomes and wealth building in this country.

NEED/GAP	OPPORTUNITY
There continues to be a lack of financial vehicles dedicated to equitable development that can be scaled up.	• Scale the most promising approaches discussed in this report.
It is difficult for first-time and BIPOC developers to break into existing real estate networks.	• Create and support programming to connect BIPOC developers, investors, and high-net-worth individuals. • While growing the pipeline of BIPOC and social equity–oriented developers, help build these connections through mentorships and partnerships.
Biased appraisals and risk perceptions continue to create a gap in what properties are worth and how they are valued.	• Address structural and methodological sources of bias in property appraisals. • Diversify the appraisal industry.
Developers do not always know about capital sources even when they are available, and investors may not be aware of development projects that they would be interested in.	• Foster more robust networks and information sharing around financing equitable development projects.

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NEED/GAP	OPPORTUNITY
There is a lack of standard metrics to evaluate and communicate social impact. This is especially true for metrics that focus on outcomes (rather than outputs alone), that can attribute results to a specific investment, that have a holistic understanding of ROI, and that measure unintended consequences like displacement.	• Develop industry standards for social impact metrics.
There is a lack of consensus around a definition for equitable development.	• Create criteria and screens that consider multicultural demographics, inclusion, and opportunities for wealth building and job creation.
There is a need for financial vehicles that benefit people with no equity interest (and therefore they cannot retain the gains of investments in their community) or money to invest.	• Scale up models for community shareholding and community equity endowments.
The regulatory environment—whether city and state governments are supportive—and other policy factors can pose additional barriers.	• Maximize the use of government tools to mobilize capital for equitable investment.
There is a need for more transparency in lending decision-making and term sheets.	• Bring open and transparent terms and information about lending decisions to the marketplace.

The Building Healthy Places team encourages readers to reach out to health@uli.org to join us for follow-up convenings and discussions on the ideas presented in this paper.

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RESOURCES

Additional resources and readings can be found on the Equitable Finance Resource List.

The ULI Social Equity Resource Hub—with an array of resources on racial equity and real estate—can be found at uli.org/socialequityresourcehub.

ACRONYMS

BIPOC
Black, Indigenous, and people of color

CDFI
community development financial institution

CLT
community land trust

CRA
Community Reinvestment Act

ESG
environmental, social, and governance

HNWI
high-net-worth individual

MDI
minority depository institution

MWDVBE
minority, women, disadvantaged, and veteran business enterprises

REIT
real estate investment trust

ROI
return on investment

SPAC
special purpose acquisition company

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