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Community Dividend

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Social impact bonds offer promise of savings, profits, and positive outcomes

By Jacob Wascalus

ILLUSTRATIONS BY KELSEY KING

For state and local governments, the costs associated with social issues can be staggering. Take long-term homelessness, for example. Addressing the health needs of the chronically homeless population involves elevated numbers of trips to the emergency room, increased usage of Medicaid, and frequent mental health consultations. There are also the expenses associated with temporary shelters, police calls and jails, and the personnel running those institutions. All of these services come with price tags, and much of the cost is paid for with public money. These expenses are primarily associated with reactive, supportive services—balms that salve the symptoms but do not address the root causes of homelessness. In the end, these emergency services draw money away from other interventions that social service providers could pursue on behalf of their homeless clientele.

But what if there were a way for a state or local government to allocate more money to the organizations working with homeless populations, knowing with confidence that the public's money was being spent effectively? If the organizations succeeded in transitioning chronically homeless individuals to stable, productive lives, wouldn't the government, on balance, be saving money by

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Federal tax credit program helps spur Butte business revival

By Jacob Wascalus

As local observers recall, the pulse of economic life in the Uptown section of Butte, Mont., in 2006 registered a steady but slow pace. Dozens of century-old buildings lining the streets of this nationally recognized historic district did little more than conjure images of a bustling past. Still, the predominantly brick buildings—some vacant and boarded, others occupied on the ground floor but otherwise mothballed—were endowed with good bones, and it seemed possible, with some type of bold investment, to reanimate the commercial district of this old mining settlement.

Nick Kujawa understood this potential well. He had grown up in Butte and knew the streets and history of the area intimately. And as a New York City-based real estate lawyer engaged in development projects, he knew firsthand how a bold redevelopment in a high-potential, low-investment area can be the potent force needed to spur revitalization.

So when his father contacted him to tell him about Silver Bow County's redevelopment requests for the old Sears building—a five-story, 100-year-old monolith in Uptown Butte that had been shuttered for decades—the younger Butte native knew he had to act. Kujawa flew back to his home city and examined the building. After further research, he understood what the area needed: an anchor, something to give other prospective businesses, and private capital, the confidence that the economic pendulum was on the upswing.

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Eastside Financial Center launches prepaid card with unique perks

By Ela Rausch

PHOTO COURTESY OF EASTSIDE FINANCIAL CENTER

The Eastside Financial Center's new prepaid card, which offers perks designed to encourage budgeting and saving, is available to individuals in St. Paul's Payne-Phalen neighborhood (pictured above) and beyond.

Many individuals and families on the East Side of St. Paul, Minn., know all too well the reality of living day-to-day without a checking or credit account. Monthly check-cashing fees, transportation costs associated with in-store bill pay, the inability to participate in services that require a valid debit or credit card, and the personal safety concerns that come with carrying large amounts of cash are just some of the issues these unbanked households face.

Calculations based on data from the *2011 FDIC National Survey of Unbanked and Underbanked Households* and the U.S. Census Bureau suggest that about 1 in 5 households in the East Side's Payne-Phalen neighborhood lacks access to full banking services.* The reasons for the lack of access are many. For the individuals in some unbanked households, blemishes in their banking and credit histories may preclude them from obtaining an account, while for others, low wages or fixed incomes may prevent them from maintaining the minimum deposit requirement. And for immigrants, language barriers and lack of trust may contribute to low utilization of financial services.

Financial well-being is the goal

In recent years, several prepaid card products have been developed to meet the needs of individuals who lack access to a debit or credit card. Among the most well-known are Bluebird (www.bluebird.com) and Green Dot (www.greendot.com). While these types of cards do address some of the issues associated with not having a checking or credit account, they do not offer features or services designed to improve individuals' overall financial health, nor do they help individuals build relationships with local financial institutions. In addition, the average monthly fees associated with some prepaid cards can exceed those of a traditional checking account.

However, a new prepaid card available to households in the Twin Cities area is designed to help manage cardholders' personal finances while keeping fees in check. The Eastside Financial Center (www.lssmn.org/efc), a program established by the nonprofit organization Lutheran Social Service of Minnesota in 2008 to improve the financial well-being of low- to moderate-income households on St. Paul's East Side, teamed up with Sunrise Banks N.A. (www.sunrisebanks.com) to launch the new prepaid card, which debuted on June 25. The Eastside Financial Center Prepaid MasterCard offers a pair of perks that is not available through any other prepaid card on the market: financial counseling and access to a traditional savings account.

Cardholders will have the opportunity to:

- Meet with a Lutheran Social Service financial counselor to develop a financial plan and review their credit report;
- Open a Special Thrift Savings Account, a savings product co-developed by Sunrise Banks and the Eastside Financial Center that has no enrollment fee or monthly minimum balance requirements; and
- Monitor monthly spending online.

These activities are not mandatory for cardholders. However, Eastside Financial Center staff members are optimistic that the card will be an effective tool for encouraging budgeting and saving behaviors that can ultimately lead to improved financial well-being.

"The prepaid card is in line with our goal and vision to be a one-stop financial shop where customers can receive financial education and access to other wraparound services that will support them in their journey toward financial stability," says Eva Song Margolis, the center's director.

In addition to linking cardholders to financial education, minimizing fees was an important factor in the development of the card. Unlike some prepaid cards on the market, which charge a service fee each time money is loaded onto the card, there is no charge for loading money onto an Eastside Financial Center prepaid card. Instead, the card carries a flat fee of $4.95 a month. Cardholders can deposit funds onto their cards at any of Sunrise Banks' eight Twin Cities branches. Cardholders who receive wage or benefit checks also have the option to enroll in direct deposit using a simple form that can be downloaded online. Cardholders can withdraw funds from any Sunrise Bank ATM free of charge, including the ATM located in the Eastside Financial Center. For each withdrawal at an ATM outside of the Sunrise network, cardholders pay a $1.50 fee, in addition to any fees that the ATM operator may charge. Eastside

Commitment to the Compass Principles

By design, the Eastside Financial Center's prepaid card embodies the four Compass Principles that the Center for Financial Services Innovation (CFSI) has established for excellence in the financial services industry. Sunrise Banks is currently one of seven financial companies nationwide that have committed to incorporating the Compass Principles into their products and services.

For more information about the Compass Principles and CFSI, visit www.cfsinnovation.com/content/compass-principles.

CFSI's Compass Principles

Embrace inclusion

Build trust

Promote success

Create opportunity

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Financial Center staff members can provide guidance on administrative steps, such as completing the direct deposit form, and can offer cardholders tips on ways to access cash without incurring charges.

To help customers manage their spending, the Eastside Financial Center Prepaid MasterCard incorporates the Good Funds model, which requires that sufficient funds be available in order for a transaction to be approved. With this structure, there are no overdraft fees; if the customer does not have enough money available in his or her account, transactions are simply declined. Other consumer protection measures include FDIC insurance and limited cardholder responsibility in the event of loss or theft.

Although households in the Payne-Phalen neighborhood are the target service population for this card program, underserved customers in the Twin Cities who live outside of St. Paul's East Side will also be eligible for enrollment. In fact, the only program eligibility requirements for cardholders are that they must have photo identification and a physical address. Individuals who do not have a Social Security Number will be able to enroll using an Individual Taxpayer Identification Number.

Transforming the nonprofit-bank relationship

Eastside Financial Center hopes to enroll a minimum of 400 prepaid card customers in the program's first year and to exceed that number in 2014. The success of the card will, in part, be measured by the number of cardholders who elect to take advantage of the card's unique perks. Program partners anticipate that the challenges of marketing to and educating the public on how the card works will be the biggest hurdles. They plan to rely heavily on word of mouth and community service providers in order to recruit program participants.

Says Margolis, "We are trying to transform the relationship that nonprofits have with financial institutions, from 'How many new customers can the bank acquire?' or 'How will this support their CRA [Community Reinvestment Act] requirement?' to 'How can institutions deliver services that are sustainable, scalable, and grounded in consumer need?' I think our prepaid card with Sunrise Banks is a good example of that paradigm shift." cd

*The calculations involved applying the FDIC's estimates of the Twin Cities area's unbanked and underbanked population to 2007–2011 U.S. Census Bureau American Community Survey numbers for households living in ZIP Code 55310 (i.e., the Payne-Phalen area). The final calculation was adjusted to reflect additional demographic factors associated with being unbanked or underbanked that are prevalent on St. Paul's East Side. The FDIC report defines individuals as *unbanked* if they lack any kind of deposit account at an insured financial institution. *Underbanked* individuals are defined as having a bank account but also relying on alternative financial service providers, such as check-cashing outlets.

Rise in smartphones puts more financial tools in the hands of the unbanked

By Richard M. Todd

Arthur, a 20-year-old high school dropout, wanted out of the high fees he was paying to conduct routine financial transactions at the check-cashing outlet in his neighborhood. Getting a bank account would address the problem, but it wouldn't be easy, because Arthur's financial record showed that he once had a previous bank account closed for account-management issues.

Fortunately, Arthur found a path to affordable financial services. A volunteer personal finance mentor persuaded him to try opening a bank account and helped him navigate the process. At first, Arthur struggled to manage his account, just as he had before. But this time, he got additional help that his mentor recommended: an app that enables him to check his account balance on his smartphone. Now Arthur is maintaining his bank account and beginning to move into the lower-cost world of mainstream financial transactions.

"Arthur" is actually a composite and not a real individual, but according to a report based on the latest release of an annual financial survey by the Board of Governors of the Federal Reserve System (Board), his story fits a couple of real-world profiles. The Board's 2012 *Consumers and Mobile Financial Services* survey found that the 9.5 percent of American adults, or almost 23 million individuals, who are unbanked tend to have some traits in common.[1] Like Arthur, they are typically young; have low incomes, low wealth, and low education levels (high school or less); and are minorities. According to *Digital Differences,* a recent Pew Research Center report on Americans' Internet access, these same characteristics—apart from youth—are also associated with adults who, like Arthur, are on the have-not side of the so-called digital divide, which separates those with easy access to computers and the Internet from those without.[2]

However, smartphones have become a means of bridging the divide. *The Digital Differences* report indicates that compared to the overall population, smartphone ownership is lower among individuals with low income and low education, but it is already significant and growing quickly. For example, 34 percent of low-income households (those earning less than $30,000 a year) and 25 percent of low-education households owned a smartphone in February 2012, up from 22 percent and 18 percent, respectively, in May 2011. Furthermore, smartphone ownership is roughly equal across racial and ethnic groups, at nearly 50 percent.

When age is factored in, the trend toward smartphones is even more striking. Smartphone ownership is now more common among low-income or low-education young adults (those under age 50) than among older adults with more income or education. Among teens, smartphone ownership is now almost as common in low-income households as in high-income households.[3] Young, low-income, less educated, and minority smartphone owners are also relatively likely to report that their phone is their primary or only means of accessing the Internet.[4] In short, smartphones have become a promising vehicle for providing many low-income, low-education, and minority youths and adults—and thus, many unbanked and underbanked individuals—with tools that will enable them to access mainstream financial services.

Results of the Board's 2012 mobile banking survey suggest some of that potential is already being realized. Among unbanked adults in 2012, 6 out of 10 had a cell phone of some kind, and 3 of those 6 phones were smartphones. For the underbanked, the figures are about 9 out of 10 individuals and over 5 out of 9 phones, respectively. Of the underbanked adults, almost half were already using some form of mobile banking—that is, using a mobile phone to access a bank account, credit card account, or other financial account—and almost one-third were making purchases or payments via their mobile devices. Those proportions will likely swell as today's smartphone-owning teens enter adulthood. The most commonly used mobile banking service is the same one that helped Arthur become successfully banked: checking the balance in an account.

Mobile banking faces many challenges, such as the ever-increasing need for online security, and is not a panacea for the issues unbanked and underbanked adults face. However, as indicated by the reports cited here, there is notable demographic overlap between individuals who are unbanked or underbanked and individuals who are increasingly turning to smartphones for Internet access. Accordingly, the potential for mobile banking and payments to serve Arthur and the millions of other American adults who fit the unbanked or underbanked profile is significant and likely to grow. cd

[1] To read the survey report, which was published in March 2013, visit www.federalreserve.gov/econresdata/mobile-devices/2012-preface.htm. The survey defines adults as *unbanked* if neither they nor their spouses/partners had a checking account, savings account, or money market account. *Underbanked* individuals, who make up an additional 9.9 percent of American adults, are defined as having a banking account but using an alternative financial service such as a payroll card, payday lender, check casher, or auto title loan in the past 12 months. For more on the demographics of the unbanked, see Matthew B. Gross, Jeanne M. Hogarth, and Maximillian D. Schmeiser's summary of the Board's 2011 *Consumers and Mobile Financial Services* survey, titled "Use of Financial Services by the Unbanked and Underbanked and the Potential for Mobile Financial Services Adoption," in *Federal Reserve Bulletin,* v. 98, #4, September 2012, available at www.federalreserve.gov/pubs/bulletin.

[2] Kathryn Zickuhr and Aaron Smith, Pew Internet and American Life Project, April 13, 2012. Available at http://pewinternet.org/Reports/2012/Digital-differences.aspx.

[3] *High income* is defined here as more than $75,000 a year. See Mary Madden, Amanda Lenhart, Maeve Duggan, Sandra Cortesi, and Urs Gasser, *Teens and Technology 2013,* Pew Internet and American Life Project, March 13, 2013. Available at http://pewinternet.org/Reports/2013/Teens-and-Tech.aspx.

[4] See footnote 2.

Social impact bonds

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not having to pay for expensive supports and emergency services?

Over the past couple of years, a handful of cities around the globe have been testing this argument, as governments, nonprofits, and individuals or organizations that invest in social service efforts explore a new social investment tool called a *social impact bond* (SIB). SIBs hold the promise of not just producing a positive social outcome, such as helping a homeless individual find stable and permanent housing, but also saving the government money. And, in theory, SIBs can produce profits for investors. If this win-win-win scenario proves to work, it has the potential to up-end the funding model for an array of social services.[1]

The most common SIB model involves four primary actors: an **intermediary, the government, a service provider,** and **private investors.** The government contracts with an intermediary to obtain social services, such as transitioning high-need homeless individuals into stable living situations. For payment, the intermediary receives money from the government only if certain performance targets are met.

The ABCs of SIBs

The most common SIB model involves four primary actors: an intermediary, the government, a service provider, and private investors. The government contracts with an intermediary to obtain social services, such as transitioning high-need homeless individuals into stable living situations. For payment, the intermediary receives money from the government only if certain performance targets are met. This is called *pay-for-success contracting* (or *outcome-based contracting* or *performance-based contracting*); the performance is subjected to careful evaluation, which the government itself is responsible for arranging. Moreover—and this is a fundamental characteristic of SIB models—the government pays the intermediary *after* the services are provided, with the idea that the money will come, at least in part, out of the savings the government reaps from reduced usage of social services (such as emergency room visits, Medicaid, etc.).

Because payment from the government comes after the provision of services, the intermediary must, in the interim, raise its own operating and program funds. One way to do that is to sell bonds—i.e., social impact bonds—to private investors. The intermediary then subcontracts with a service provider to actually deliver the social services. Upon the successful delivery of services, the government pays the intermediary its agreed-upon fee, and the intermediary then pays back the bondholders according to the bond terms, which could include a profit.[2] (See the chart on the opposite page.)

Pursuing what works

The triple-win scenario of achieving positive social outcomes, generating government savings, and returning investor profit is the most visible benefit of the SIB model. For the government, another prominent benefit is that the service contract is risk-free; in other words, the government pays only if the intermediary delivers its agreed-upon outcomes. But the less-recognized benefit of SIB-backed social service contracts is a continual drive for innovation.

Because investors are paid only when performance targets are achieved, it behooves the intermediary to ensure that its service providers are meeting expectations in order to fulfill the outcomes established in the contract. This means the intermediary will encourage the service provider to pursue social service strategies that really work. If the service provider does not employ effective interventions, the intermediary has the option to subcontract with a different service provider that uses different methods. In effect, the pressure to succeed will weed out social service practices that don't deliver adequate results.

Barriers and considerations

In theory, the SIB model appears to be a simple machine. But in practice, it has many moving, often complicated parts, and there are many facets and repercussions that must be considered.

One challenge inherent in the implementation of SIB-backed pilot projects is the need for rigorous, objective assessment of whether the targeted outcomes were achieved. The "gold standard" of assessing project outcomes is to have program evaluators (typically, third parties) measure the differences in outcomes between a treatment group and a randomly selected control group. In the case of our homelessness example, adequately sized populations of homeless individuals, randomly assigned to receive assistance or not, would have to be tracked, or similar research-like protocols would have to be implemented. That would be a challenging task given the relatively itinerant nature of some homeless individuals. Tracking a similar universe of assisted and unassisted populations, or implementing other rigorous protocols, would be needed for other SIB-funded projects. However, alternatives such as comparing outcomes to historical norms may also work.

Another consideration is ensuring that the government has adequate resources to establish and monitor SIB-funded contracts. This means there must be committed and knowledgeable staff who shepherd the project from inception to completion, which can take multiple years. And it means there must be an appropriate level of technical expertise on hand, as SIB-funded projects require the drafting of outcome-based contracts, cost-benefit analyses, and complex evaluations, among other things. Furthermore, steps must be taken to ensure that the assisted populations are not abandoned in the event of a failed SIB-funded project. Again in the case of homeless interventions, this would mean that base-level social services, such as temporary shelters, would still be available regardless of the interventions being provided through an SIB-funded project.

Pilot projects test the model

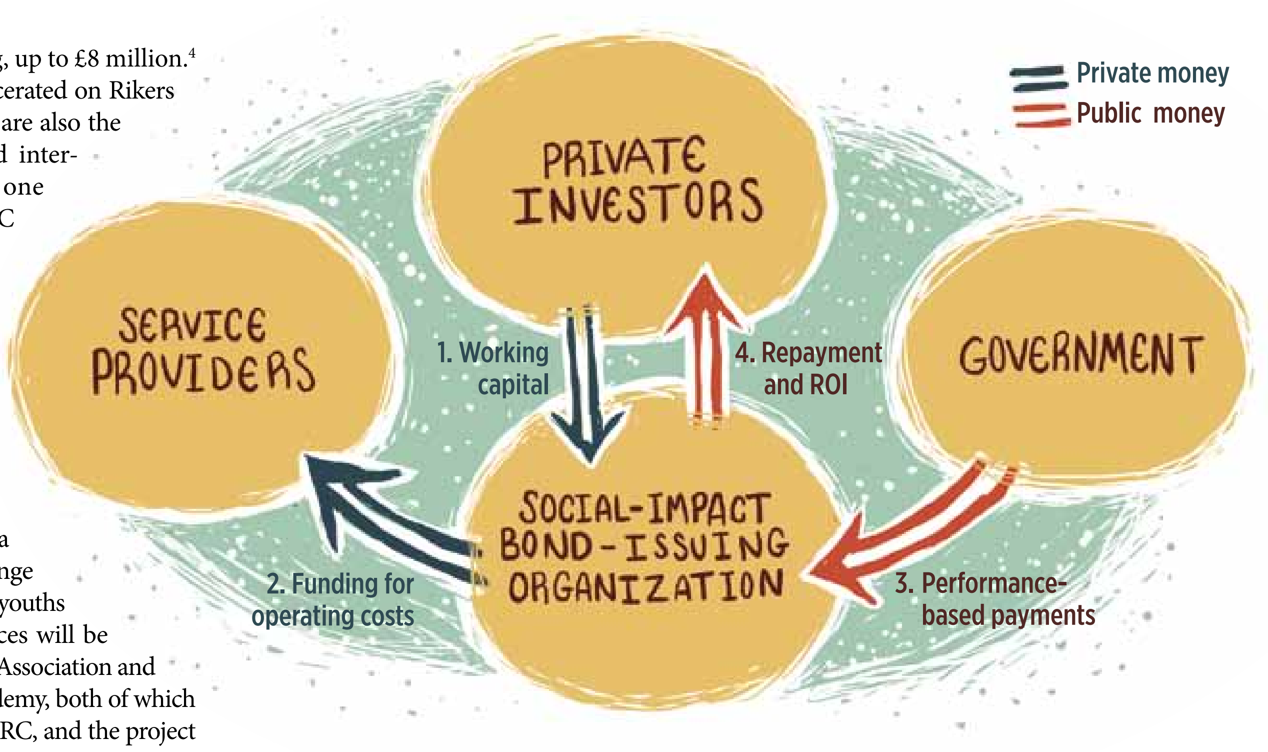
Determining exactly which social services are appropriate for SIB-financed projects remains unclear, but some potential areas are emerging. They include:

- Lowering recidivism rates among adult ex-offenders;
- Counseling at-risk youth who will soon age out of the foster care or juvenile justice systems;
- Delivering workforce development training for difficult-to-employ individuals;
- Providing preventive care for individuals at risk of developing specific ailments, such as asthma and diabetes;
- Delivering in-home health services to elderly people so they can avoid nursing homes; and
- Providing prenatal, early childhood, and preschool services to improve the chances of success for at-risk or low-income households.[3]

Pilots testing these interventions are currently under way or being planned. The oldest—and first—pilot of an SIB-backed project was launched in 2010 in Peterborough, England, with the goal of reducing the rate of recidivism among adult men imprisoned for sentences shorter than 12 months. Social Finance Ltd. (the intermediary) raised £5 million to fund the delivery of interventions—job training, substance abuse counseling, etc.—to approximately 3,000 inmates. If the rate of recidivism is reduced by more than 7.5 percent over six years, Social Finance will be paid a portion of the cost of reoffending, up to £8 million.[4]

Youths who are incarcerated on Rikers Island in New York City are also the target of an SIB-funded intervention project, this one announced in 2012. MDRC (formerly Manpower Demonstration Research Corporation), an intermediary with a history of testing emerging policy concepts, received a $9.6 million loan from Goldman Sachs[5] to design and coordinate a program to provide a range of therapeutic services to youths ages 16 to 18. The services will be provided by the Osborne Association and the Friends of Island Academy, both of which are subcontractors of MDRC, and the project will last four years and reach an estimated 3,400 youths annually. The Vera Institute of Justice will evaluate the effectiveness of the interventions by measuring recidivism rates of the youths 12 and 24 months after their release dates and comparing the rates to historical norms. The City of New York Department of Correction will pay MDRC anywhere from $4.8 million, if readmission to prison is reduced by at least 8.5 percent, up to $11.7 million, if readmission is reduced by at least 20 percent. For MDRC and Goldman Sachs to break even, readmission must drop 10 percent.[6] Anything above that would result in a profit.

In Fresno, Calif., an initiative is being planned to reduce the incidence of asthma emergencies among 200 high-risk children. Nearly 20 percent of the children living in Fresno are diagnosed with this respiratory condition, compared to 10 percent nationally, and approximately 20 people a day are rushed to the emergency room for asthma-related ailments, costing the city nearly $35 million annually. Two intermediaries, Collective Health and Social Finance Inc. (the sister organization of Social Finance Ltd. of the Peterborough pilot), together received a $1.1 million investment from the California Endowment to work with local service providers to deliver in-home interventions for a year, such as identifying asthma triggers and explaining how to remediate them. The goal of the project is twofold: to reduce the number of trips to the emergency room and thereby decrease the City of Fresno's annual hospital costs for the target population from an average of $16,371 per person per year to $7,773, and to establish a viable market for a "health impact bond" (HIB). The pilot project is projected to save $1.6 million. When the initiative is scaled up and expanded to 3,500 participants, the savings could be upwards of $27 million.[7]



Based on a chart in the report "Social Impact Bonds: A promising new financing model to accelerate social innovation and improve government performance," by Jeffrey Liebman, published by the Center for American Progress in February 2011.

The innovation continues

For SIBs (or HIBs, in the case of Fresno) to have any sort of substantial impact on the way services are funded and delivered, they must be employed on a large scale. The pilot SIB projects unfolding in communities around the globe are starting out small—probably too small at this stage to be considered a major shift. But the pilot projects are continuing the process of identifying effective strategies while weeding out ineffective ones. This is both important and necessary, as the results of these efforts, over the next several years, will go a long way toward evaluating the viability of SIBs as an alternative approach to providing valuable social services. cd

[1]SIB advocates have noted barriers that impede government-only solutions to capturing the same benefits and savings made possible through SIBs. They include difficulties in recognizing how spending by one department can create savings for another department (for example, if an intervention by a human services department results in decreased incarceration rates among the individuals served, thus lowering costs for the corrections department), annual budgets that limit how savings in future years can be used to justify spending today, and political pressures that can make it difficult to defund a less-effective existing program in favor of a more-effective alternative.

[2]This description of the SIB model is drawn from the article "Social Impact Bonds: Lessons Learned So Far" by Hanna Azemati, Michael Belinsky, Ryan Gillette, Jeffrey Liebman, Alina Sellman, and Angela Wyse. It appeared in *Community Development Investment Review,* Volume 9, Issue 1, 2013, published by the Community Development Department of the Federal Reserve Bank of San Francisco, available at www.frbsf.org.

[3]See footnote 2.

[4]For more on this, visit www.socialfinance.org.uk.

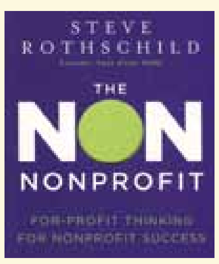
[5]The Goldman Sachs loan will be partially guaranteed through a $7.2 million grant made by Bloomberg Philanthropies.

[6]From an August 2012 press release by the City of New York and the article "Rikers Island: The First Social Impact Bond in the United States" by John Olson and Andrea Phillips, which appeared in the *Community Development Investment Review* issue referenced in footnote 2.

[7] From the article "Can Pay for Success Reduce Asthma Emergencies and Reset a Broken Health Care System?" by Rick Brush, in the *Community Development Investment Review* issue referenced in footnote 2.

ONLINE EXTRA

A conversation with Steve Rothschild of Invest in Outcomes



Steve Rothschild is the founder of Twin Cities RISE!, a workforce development organization headquartered in Minneapolis. He is also the current CEO of Invest in Outcomes, which helped devise the human capital bond, a variation of a social impact bond that relies on the government to sell bonds rather than an intermediary. In an online-only interview with *Community Dividend,* Rothschild shares his perspectives about performance-based funding for nonprofits. He also discusses his recent book about nonprofit leadership, titled *The Non Nonprofit: For-Profit Thinking for Nonprofit Success.* To read the interview, visit the *Community Dividend* section of the Publications & Papers tab at www.minneapolisfed.org.

PHOTO COURTESY OF WORLD MUSEUM OF MINING, BUTTE, MONT.

PHOTO COURTESY OF KUJAWA ARCHITECTURE, CHICAGO

The first floor of the Sears building in the Uptown area of Butte, Mont., circa 1910 (above left) and after its recent revitalization and conversion to a full-service grocery store (above right).

Federal tax credit

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Four years later, Kujawa, having been awarded the redevelopment rights by the county and having partnered with a local construction firm, was the proud co-owner and operator of a full-service grocery store and four floors of market-rate apartments—a mixed-use redevelopment of the historic Sears building that drew on an innovative mixture of public and private financing and helped catalyze a resurgence of economic activity in Uptown Butte.

"I was looking for a transformative project," explains Kujawa, "and this was it."

"Twinning" tax credit programs to leverage private financing

From the outset, redevelopment of the 80,000-square-foot former department store generated more questions than answers. Who would be willing to invest in such an endeavor? The structure's steel frame and brick exterior, both mostly intact, exuded the raw potential that splashy redevelopment projects were built on, but overall the building was in terrible shape.

As one of Kujawa's then-prospective partners recalls, "You could stand on the roof and look down into the basement."

Moreover, how would Kujawa find the millions of dollars needed for the project? He had access to $1.4 million in personal equity, but would prospective bank investors be willing to make the loans necessary to acquire and refurbish the building? After all, no comparable development projects, or "comps," had been completed recently or were currently under way in the Uptown section of Butte, and they would have been helpful risk indicators for financial institutions seeking to gauge their potential investment. This was a significant challenge that Kujawa encountered as he sought out conventional financing for a year and a half. Then the 2008–2009 contraction in private finance prompted him to look elsewhere.

That's when Dave Glaser, the prospective partner who had stood on the building's roof and gazed down to the cellar, announced his support. As the president of Missoula-based Montana Community Development Corporation (Montana CDC), Glaser envisioned the same watershed investment as the lawyer/developer, and he recognized how the redevelopment of the historic Sears building could be a stimulative boon to Butte. What's more, his organization had the ideal tool to help: New Markets Tax Credits (NMTCs).

The NMTC Program, established by Congress in 2000 and administered by the U.S. Department of the Treasury (Treasury), is intended to "spur new or increased investments into operating businesses and real estate projects located in low-income communities," according to Treasury's web site.[1] Treasury awards tax credit allocations to Community Development Entities (CDEs), which then re-distribute the tax credit allocations to corporations and individuals who invest private capital in a qualifying project. Since the program's inception, Treasury has awarded more than $36 billion in tax credit authority to CDEs across the country. To some, the NMTC Program has the reputation of being an investment tool that is used primarily in large urban areas. But it can be applied in settings with considerably smaller populations, too. Glaser knows this firsthand: Since 2008, Montana CDC, which is a CDE, has received and re-allocated more than $123 million in NMTCs to projects in Montana and Idaho. Many of those projects were in smaller urban or even rural areas.

To be eligible for this funding, Montana CDC requires prospective projects to meet several criteria, including being located in a low-income census tract.[2] The Sears building—located in a tract with a median annual household income of $20,469, or roughly half the $40,030 median for the entire county[3]—matched Montana CDC's NMTC requirements on all points and, according to Glaser, was ideally suited to leverage an NMTC allocation. And so in 2009, several weeks after Glaser's Butte visit, Montana CDC awarded Kujawa an NMTC allocation that added $1.9 million in capital to the project.

Concurrent with his discussions with Montana CDC, Kujawa had been exploring other financing options, including applying for federal historic tax credits through a program administered by the U.S. National Park Service. The Sears building lies within the Butte-Anaconda National Historic Landmark District, a designation the area received in 1961 because of its location at the center of national mining-related labor movements in the late nineteenth and early twentieth centuries. If Kujawa could parlay these attributes into a successful application for federal historic tax credits, the Sears building would be the first project of its kind in the state of Montana to "twin" federal historic tax credits and federal New Markets Tax Credits.

Several weeks after receiving notice of the NMTCs from Montana CDC, the Sears building project was awarded historic tax credits worth nearly $1.5 million in additional capital. With a total of nearly $4.8 million now raised from personal and federal sources, Kujawa was able to secure a $1.3 million low-interest loan from the Butte-Silver Bow Urban Revitalization Agency and a nearly $3 million commercial loan from Glacier Bank. The grand total of $9.1 million was enough funding to buy and rehab the historic building on Granite Street.

"When the right person has the right tools at the right time," says Montana CDC's Glaser, "they can get amazing things done for the community."

Building to satisfy local demand

With the project fully funded, Kujawa and his construction partners set about transforming the old department store into a community asset—a retail food source, a high-quality residential option, a family destination, and a job creator with the potential to inject additional money into the local economy.

The previous grocery store serving the residents of Uptown had closed several years prior, leaving the closest retail food outlet about a mile and a half away.

"We heard from a lot of people that we needed a market in Uptown," says Karen Byrnes, the director of the Community Development Department and Urban Revitalization Agency for Butte-Silver Bow. "The majority of the low- to moderate-income residents in Butte live near the Sears site, and it's extremely important that they have access—even walkable access—to this new market."

Recognizing the area's limited retail food options, Kujawa and his partners built a full-service grocery store called the Hennessy Market. It offers a wide array of foods, from generic-label canned and frozen foods to organic brands and fresh produce. The market also offers a catering service, deli, bakery, and butcher. For the 12,000 residents of the Uptown area, as well as the thousands of daytime workers whose offices and job sites are located nearby, this neighborhood store is now a convenient, go-to source for food.

"We're very happy that the grocery store is an 'integrated' market and serves everyone in the area," says Kujawa, who, along with his wife Jen, manages the store. "Our goal is to provide the whole mix of things, including the basics."

On the four floors above the grocery store sit 34 one-, two-, and three-bedroom market-rate apartments with high ceilings, sleek bathroom fixtures, large kitchens, and hardwood floors—design features that weren't found in the existing Uptown housing stock. Kujawa had heard over and over of the need for "high-quality market-rate living options" in Uptown Butte, and he was happy to build them.

But Kujawa and his partners didn't stop with just the retail food store and the new housing units. Below the grocery store, in the basement that Montana CDC's Glaser viewed from the roof, they constructed a fully finished commercial space that is now leased by a family-oriented, hands-on science museum that opened its doors to the public in late 2011.

Says Kujawa: "We wanted this building to be a fully mixed-use development."

For the building's rehabilitation, Kujawa and his partners tapped into the wealth of labor talent residing in the surrounding area. The construction itself generated nearly 50 new jobs and paid out more than $1 million in wages over 15 months. Post-construction, the Hennessy Market now employs 30 Butte residents—three-quarters of whom were previously unemployed and half of whom live in Uptown—and provides 24 families with a primary job and benefits. Over the next ten years, the economic impact of the Sears building is estimated to be $12 million.[4] Moreover, the features and components of the building's redevelopment are equivalent to those required by the LEED (Leadership in Energy and Environmental Design) Silver certification, which means they adhere to strict environmental standards for material re-use, energy and water efficiency, and indoor air quality.

A catalyst for business growth

The pace of economic activity—specifically, business creation—in Uptown Butte is steadily gaining speed. According to Karen Byrnes, 42 businesses have opened in the area since 2005, during the years that the energy around the Sears project started to coalesce.

"We're seeing a lot of interest in housing, retail, and restaurants," she says. "There's a definite excitement about the area."

One of those new businesses is Headframe Spirits, a distiller of hard liquor products that is owned and operated by John and Courtney McKee. In 2009, after surveying the area and recognizing its potential, they purchased a building that was constructed in 1919 and had served as a Buick dealership. The building boasts massive 12′ by 12′ windows. From the outside, passersby can view the newly installed copper and stainless steel stills situated in the former showroom, which has its original marble flooring. Above the showroom, on the second floor, an expansive, 5,000-square-foot former dance hall hosts the distillery's tasting room.

Above and at right: Exterior shots of the refurbished Sears building's architecture.

PHOTOS COURTESY OF KUJAWA ARCHITECTURE, CHICAGO

"There are so many great old buildings that just scream to have something done in them," he says. "We sensed a lot of possibility in Uptown and wanted to be here to operate our business out of one of them."

Around the corner from Headframe Spirits and the Hennessy Market is an eight-story structure built in 1906 that is now, thanks to an entrepreneur named Ron Ueland, a mixed-use development of condominiums, office space, retail space, and a restaurant. Called the Metal Bank Building—named for the entity that once operated from it—the building was purchased and rehabbed in 2007 to meet the emerging demand in Uptown. Ueland owns several other properties, including units in a condo development in Seattle, and believes he bested that Pacific Coast property primarily because of the historic character inherent in the Butte architecture.

"It has all of its original flair and beauty," he says, noting that the architect, Cass Gilbert, also designed the Minnesota State Capitol and the U.S. Supreme Court building. "I don't have any available condos left, but people are still calling me."

Ueland redeveloped his property at the same time that Kujawa was redeveloping the Sears building. And while Ueland did not pursue federal tax credits for his Metal Bank Building rehabilitation, he noted the power that NMTCs can have in spurring development, how they can have a "multiplier effect that can be tremendous once momentum gets going."

Kujawa reels off a list of the newly opened businesses that feed off and contribute to all of this energy: an engineering firm, small restaurants and cafés, coffee shops, personal services like hair salons and spas, a microbrewery (in addition to the distillery). And, of course, more housing.

His latest development endeavor—after the conclusion of the Sears redevelopment—is an eight-story condominium tower. The building, kitty-corner from the Hennessy Market, is 110 years old and is considered the first skyscraper in Butte. The ground-floor tenant, a women's clothing store, has operated out of the building for nearly three decades and will continue to do so, but the upper seven floors, all of which had been vacant for the better part of the past two decades, are being converted into condos. Kujawa is paying for the multi-million dollar project with conventional financing.

"All of them have sold," he adds. "Taking an empty building and creating spaces where people can be owners who are now committed to lifting and supporting the neighborhood is a tremendous benefit for the area."

In all, Uptown has notched about $12 million in residential investment since 2007, according to Byrnes of Butte-Silver Bow. In addition to Kujawa's and Ueland's rehabs, the area has seen some newly constructed duplexes and fourplexes pop up.

"It's huge for our community," she says.

A commitment to the future

Kujawa sees interest in the area skyrocketing but cautions that the Uptown rebirth is still in the making. To build on the momentum, the property and business owners in Uptown are forming the Uptown Butte Business Improvement District. One of their first orders of business will be to voluntarily support a property tax levy, all with the intention of promoting and maintaining the area's growing economic vitality.

Recently, Kujawa and his fellow entrepreneurs remaking Uptown Butte received some good news: NorthWestern Energy, a multi-billion dollar electricity and natural gas provider, announced its intention to build a $23 million office building at the intersection of Main Street and Park Street, just one block west and two blocks south of Kujawa's Sears building. NorthWestern already has a corporate presence in the area, occupying several buildings in Uptown, but from Ueland's point of view, the power company's decision to invest millions in a capital project underscores its commitment to the future of Butte, and particularly of Uptown, as a viable economic center.

Kujawa concurs, adding, "We just heard they've gotten approval to receive New Markets Tax Credits." cd

[1] For more information about the NMTC Program and what constitutes a CDE, visit www.cdfifund.gov/what_we_do/programs.asp.

[2] Other Montana CDC criteria are: the project must have high community impact, the total cost must exceed $4 million, at least 20 percent of the income from the completed project must come from commercial (i.e., nonresidential) use, and the completed project must not be sold for at least seven years.

[3] Figures are drawn from the U.S. Census Bureau's 2011 American Community Survey 5-Year Estimates.

[4] Employment, wage, and economic impact figures are from Montana CDC.

News and Notes

Study confirms that pre-purchase counseling reduces mortgage delinquencies

Home buyers who receive pre-purchase counseling are about one-third less likely to be delinquent on their mortgages, according to a recent study conducted by Experian and Neil Mayer & Associates on behalf of NeighborWorks® America (NWA). As detailed in the report *Pre-Purchase Counseling Impacts on Mortgage Performance: Empirical Analysis of NeighborWorks® America's Experience,* the study examined approximately 75,000 loans originated between October 2007 and September 2009. The loans represented 18,258 home buyers who received pre-purchase counseling from an NWA network organization and a comparison group of 56,298 borrowers who did not receive counseling.

To ensure sound results, the researchers needed to mitigate the risk of *selection bias,* or the possibility that the members of the treated group in a study have unobserved characteristics that make them behave differently from the members of the comparison group. In other words, the researchers had to make sure that the NWA counseling was truly the only factor differentiating the treated group (i.e., the borrowers who received counseling) from the comparison group and that the treated borrowers weren't just inherently less likely to be delinquent on their mortgages in the first place. To address the selection bias problem, Experian used *propensity scoring,* a technique for developing a comparison group whose characteristics match those of the treated group as closely as possible. In order to arrive at the closest match, the propensity scoring process used multiple data points about the borrowers and their credit histories, including their credit practices prior to the originations of the studied mortgages.

After controlling for selection bias in this way, the researchers found that two years after origination, borrowers who received a minimum of eight hours of group education and individual counseling sessions from an NWA network organization were 31.7 to 33.1 percent less likely to be 90+ days delinquent on their mortgages than the comparison borrowers. The findings show slight variations in delinquency rates depending on the year of origination and whether the borrower is a first-time or repeat home buyer, but the difference in rates stays the same across years and buyer groups. According to the report, these findings are consistent with the results of previous studies of other pre-purchase counseling programs, even though the earlier studies did not rigorously control for selection bias.

To access the full report, visit www.nw.org and enter "pre-purchase" in the search field.

USDA report explores what *rural* means

In a recently released report, the U.S. Department of Agriculture (USDA) Rural Development division discusses the multiple ways the word *rural* is defined across its 40-plus program areas. The *rural* designation is crucial for determining whether the location of a proposed activity is eligible for USDA Rural Development grants and loans, but there is no common definition of *rural* in use by the agency. For example, a default definition listed in the 2008 Farm Bill defines an area as rural if it is not a city or town with a population greater than 50,000, and if it is not urbanized land adjacent to such a city or town; however, for practical reasons, some USDA Rural Development programs need to apply exceptions that reduce the population cap in the definition to 20,000, or even 10,000. According to the report, inconsistencies in the definition create arbitrary barriers between geographic areas that can reduce communities' ability to pursue regional development strategies. The report includes a matrix of the assorted *rural* definitions used by the agency and lists recommendations for addressing the inconsistencies. To read more, visit the Reports section of the USDA Rural Development web site at www.rurdev.usda.gov.

Minneapolis Fed co-authors report on collaborations to improve community health

A recent report co-authored by the Federal Reserve Bank of Minneapolis and Wilder Research provides new information about collaboration between community development and health organizations to improve the health of communities. *Collaboration to Build Healthier Communities: A Report for the Robert Wood Johnson Foundation Commission to Build a Healthier America* discusses current levels of collaboration, factors that most strongly influence the success of cross-sector projects, and recommendations for furthering collaborative efforts to improve community health. The research also shows that the Healthy Communities Initiative championed by Federal Reserve Banks and their partners has provided a valuable platform for laying the groundwork necessary for collaborative success. The findings are based on a survey of more than 650 practitioners across the United States. To read the report, visit www.minneapolisfed.org/community_education/mnhealthycommunities/#news. For more on the Healthy Communities Initiative, see www.frbsf.org/community-development/initiatives/healthy-communities.

Calendar

Native American Credit Counseling Certification Program

Starting in August, specific dates to be determined

An 11-week webinar series offered by Rural Dynamics, Inc., of Montana, to help individuals and organizations in Native communities obtain their credit counseling certification so they can then implement new counseling programs and services in their communities. This training opportunity is the first step in a 36-month accreditation process. **ruraldynamics.org/nacc-certification**

Policy Summit on Housing, Human Capital, and Inequality

September 19–20, Cleveland

Join academics, bankers, elected officials, practitioners, and policymakers in exploring the changing role of regulations in economic and community development. Presented by the Federal Reserve Banks of Cleveland and Philadelphia.
clevelandfed.org/community_development/events/ps2013/index.cfm

Capacity-building training for CDFIs

The U.S. Department of the Treasury's Community Development Financial Institutions (CDFI) Fund is offering an array of training opportunities in 2013 and beyond as part of its ongoing Capacity Building Initiative (CBI) to boost CDFIs' ability to deliver financial products and services to underserved communities. Highlights are listed below; for more information on these and other CBI training series, visit **cdfifund.gov/cbi.**

Scaling Up Microfinance

Various dates, July through October, 2013

In this series of technical-assistance webinars, CDFIs that specialize in microfinance will learn about best practices and tools they can use to scale their operations. Provided by Opportunity Finance Network.

Financing Community Health Centers

Dates and locations to be determined

A series of in-person and online training and technical assistance sessions on financing and providing services to community health centers in underserved communities. Provided by Opportunity Finance Network.

Preserving and Expanding CDFI Minority Depository Institutions

Dates and locations to be determined

This training and technical assistance series will support CDFI Minority Depository Institutions through a specialized program focused on leadership development, capitalization, organizational transformation, and other relevant subjects. Provided by Deloitte Financial Advisory Services LLP.