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The Green Advisor: Urban Sustainable Investing

Community investing as an alternative to traditional fixed income

Robert F. Keane

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"They're creating a new environment where the people who are living in the homes are living sustainably," Chat Reynders told me during a recent conversation I had with him and his partner Patrick McVeigh. These two SRI investors weren't talking about some New Age alternative energy-based community in Arizona's Sonoran Desert, however, but rather neighborhoods in and around Boston, where their firm, Reynders McVeigh Capital Management, is headquartered.

The investment management firm has partnered with Boston Community Capital (BCC) to help their clients invest in BCC's Stabilizing Urban Neighborhoods (SUN) initiative, a lending program designed to fight neighborhood destabilization by acquiring foreclosed properties and reselling them to existing occupants before evictions occur.

The program is built upon a unique lending model that purchases foreclosed properties from the mortgage holder at a steep discount, resells these properties to the existing homeowner or tenant—at a price somewhat above BCC's purchase price—and provides a new, affordable, fixed-rate mortgage based on traditional underwriting criteria. The increased price helps mitigate BCC's risk. To qualify the potential owner must have a job where the payment on the mortgage would represent only a specific percentage of their income and the money comes directly from the individual's paycheck. There are also provisions that would prevent the homeowner from receiving an inordinate windfall should the property's value increase dramatically.

"The owner doesn't participate in all of the upside because there's a moral hazard in that," explains Reynders. "The neighbor who does pay his mortgage or who has had a responsible mortgage doesn't want to see his next-door neighbor being bailed out and then suddenly getting a windfall if the price of the house should go up. Boston Community Capital shares that upside with this owner."

Investing Returns, Stable Neighborhoods
SUN minimizes the potential for such a "moral hazard" with a "shared appreciation" zero-interest, non-amortizing second mortgage, reducing a foreclosed homeowner's share of eventual property appreciation to account for the reduced principal amount of the new mortgage. Most important, by preventing evictions, the initiative keeps families in their homes and puts a stop to the foreclosure trends that threaten the security of these communities.

"What we care about here are replicable models where you can utilize capital to make a real difference," explained Reynders of the firm's involvement. "This foreclosure crisis is happening all over the country and all over the world. We think this is a model that is replicable and should be used in other communities around the country."

The SUN program kicked off this past October and quickly raised more than $30 million in funding. They've just finished the first round of refinancing, which involved between 50 and 60 homes, and they currently have a long list of potentially foreclosed-upon homeowners who would like to participate.

"We're beginning to see some banks appreciate the benefit of models like this," explains McVeigh. "I don't think it's lost on banks that they need to support the communities that they're lending in. I think that when you see a successful model like this working, it's going to lead to more banks following through on it. At least that's our hope."

"Part of the reason our clients are interested in this is that they've seen how banks have destroyed these neighborhoods over the past decade by writing these terrible loans to individuals that had no chance of success," adds Reynders. "Our interest is in creating the model of how you can do this right so that banks can re-enter the market. They can see that even though groups like Boston Community Capital are lending to supposedly the highest risk audience, their success rate is much greater than banks that are lending to supposedly more secure markets."

More Than One Way to Float a Loan
The SUN program is not the only way that Reynders McVeigh is helping its clients reap returns from community lending. McVeigh has been active in the community lending arena for a number of years and has been involved with starting several community loan funds, including ones in South Africa and Haiti.

"We always felt that it's an important part of the portfolios of people who are interested in this," Reynders says. "Their goals could be met by investing in traditional markets—stocks and bonds—but also there's an important need in local communities to funnel capital to areas that banks traditionally don't do an effective job of lending money to."

The partners indicate that one of the reasons they've found their clients are attracted to this investment model is that there's much more transparency. "This community loan fund world has matured," Reynders observes. "It used to be that you would buy one disparate loan fund in one area or you would create one in another area; now there are some alternatives."

Targeted Loans With Extra Reserves
One of the alternatives that Reynders McVeigh is suggesting to its clients is Calvert's Community Investment Notes. "The Calvert Foundation takes a number of different community loan funds and puts them in a package," Reynders continues. "Each of those loan funds has its own loan loss reserves, its own protection, and its own management. Then on top of all of those, Calvert creates a loan loss reserve. That keeps these individual loan funds accountable. It also has money that they get from foundations that is first-loss money. About 10% of the money in the Calvert Foundation would have to be lost before any investors would lose their money."

Another unique aspect of the Calvert offering is that investors can direct that their money be used to make loans in a specific geographic area, or for a specific purpose, such as job creation. According to Reynders, this is one of the only community loan funds that an investor can buy much like they would any security.

"They have a CUSIP number and every month or so they come out with what their yield is going to be, and you can buy that yield on that certain month and it becomes a part of the whole pool."

"An investor could go directly to their broker or their money manager and have them buy it just as they would by any stock or bond, whereas with most loan funds you have to fill out a subscription form and it feels more like a private equity arrangement," adds McVeigh.

"I think the goal of everyone participating in this type of community lending is to get the mainstream market to buy into this, to learn how to do it the right way," says Reynders in conclusion.

For those advisors looking to explore this subject further, Chat Reynders and Elyse Cherry, CEO of Boston Community Capital, recently authored a white paper entitled, "Stabilizing Neighborhoods, Supporting Portfolios With Community Investing," which is available for downloading at here.

SIDEBAR
A Win-Win

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