COMMUNITY ECONOMIC DEVELOPMENT HUB

RESEARCH REPORT

Making Community Development Capital Work in Small and Midsize Cities

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Executive Summary

Community development investment differs from other forms of investment because community investors use financial tools explicitly to engender social good. These investors often take on more risk than market investors or provide preferential terms or rates to clients. Community development investments are still, however, fundamentally market-based. As such, along with other forms of capital, community development investment can be more challenging to deploy in small and midsize cities.

At the Health Capital Roundtables—a series of convenings hosted by Reinvestment Fund as part of the Invest Health initiative, with support from the Robert Wood Johnson Foundation—community development investment practitioners shared their experiences financing projects that aim to improve social determinants of health in small and midsize cities through community development capital. Informed by their insights and a literature review, this report describes the challenges many small and midsize cities face in attracting and sustaining the capital needed to develop a pipeline of community development projects, as well as the opportunities that their size provides.

We identified eight factors that challenge community development investors in small and midsize cities. These cities often have emerging community development ecosystems with fewer supporting actors than larger cities offer. They are also more likely to have limited government capacity to coordinate community development projects. And investors may have limited relationships with communities to gain local knowledge. Furthermore, investors often specialize in transaction types that smaller cities may not provide in sufficient volume. These factors can result in higher per-transaction costs because of fixed costs. Investors also have more limited data on local economies in small and midsize cities, and there is a fear of negative impacts on local actors, such as the crowding out of competing local institutions. Finally, there is a dearth of federal incentives to divert community development capital to these cities.

Despite these challenges, community development investors can take advantage of the opportunities that small and midsize cities provide to break a cycle of disinvestment. These opportunities include having a manageable scale that makes bureaucracies easier to navigate, as well as strong community ties. They also include lower coordination costs and outsize impact for smaller price tags. Often, projects in small and midsize cities have enhanced visibility. Many small and midsize cities have a strong entrepreneurial spirit, growth potential, and interconnectedness with other small cities in a region. Finally, community investors can face less competition in these communities.

In this report, we lift up five models for sustainably and successfully expanding investment in small and midsize cities. They include a web of towns that can be treated as a single market able to sustain a sufficient project volume. They also include mergers of financial institutions, which can lower costs and make smaller markets economically viable. In addition, smaller groups can work together as a network in a defined region to share loan services and facilitate capital access, and local anchor institutions can be partners with sufficiently strong balance sheets and the local expertise to advance projects. Finally, cities can become friendly to community development financial institutions by creating a dedicated intermediary between them and the city to promote community development transactions locally.

Drawing from the challenges, opportunities, and model examples, we make recommendations to improve the flow of community development capital to small and midsize cities. Cities can build a capital fund to decrease the costs of community development investment through subsidies, guarantees, or other methods. They can also help construct the investment pipeline and review and improve the local regulatory environment. And they can improve collection of data on the local economy, city operations, and community development. For their part, community development investors can strategically leverage existing philanthropic and public-sector capital; generate effective cross-sector partnerships, especially with an anchor institution or local capital entity, that go beyond anecdotal collaboration; and exploit regional networks to grow. In turn, funders can support learning opportunities and knowledge building, provide grants and other financial supports to community development investors and/or cities, and support planning and technical assistance.

Making Community Development Capital Work in Small and Midsize Cities

Community development investment differs from other forms of investment because community investors use financial tools explicitly to engender social good. These investors often take on more risk than market investors or provide preferential terms or rates to clients. Community development investments seek to ameliorate conditions for vulnerable populations that markets and local governments do not (or cannot) address. Even so, community development investments are still fundamentally market-based interventions that are subject to local economic forces (Hacke, Wood, and Urquilla 2015).

At the Health Capital Roundtables—a series of convenings hosted by Reinvestment Fund, with support from the Robert Wood Johnson Foundation—community development investment practitioners shared their experiences encountering and addressing systems challenges while financing projects that aim to improve social determinants of health in small and midsize cities (box 1). Informed by roundtable participants' insights and a literature review, this report describes the challenges many small and midsize cities face in attracting and sustaining a pipeline of community development projects, as well as the opportunities that their size provides. We describe several cross-cutting lessons and introduce five examples of models that cities and community development investors have and could be used to drive more capital into these communities.

This report examines community development through the lens of the social determinants of health (Ahnquist, Wamala, and Lindstrom 2012; Baum 2007; Marmot 2005; Ompad et al. 2007; Thornton et al. 2016; Williams et al. 2008). Lower incomes, higher poverty rates, and limited job creation lead to poorer health outcomes for residents. Conversely, community development can positively affect the near- and long-term health of residents by improving access to reliable housing, healthy food, safe neighborhoods, and higher-quality education, among other examples.[1] Through these determinants, community development investors can drive positive health outcomes for residents.

Investing in smaller cities can involve challenges that are less present in larger cities and metropolitan areas. (We define small and midsize cities, the focus of this report, in box 2.) Diminished access to capital for investments that bolster positive, local social determinants of health in small and midsize cities coincides with the economic and social trends that affect these localities. Relative to bigger areas, smaller cities, counties, and metropolitan areas have experienced disproportionate growth in the number of their residents with low incomes and low wealth (Kneebone 2017). For example, since 1980, cities smaller than the 250 largest ones have seen their share of the national income shrink from 18.3 percent to 14.6 percent.[2]

BOX 1

Introduction to Invest Health and the Health Capital Roundtables

The Health Capital Roundtables were part of Invest Health, an initiative of Reinvestment Fund in partnership with and with support from the Robert Wood Johnson Foundation that began as a forum for 50 small and midsize cities to define community needs and investment challenges, devise solutions, and align investment capital, other resources, and policies to address the social determinants of health. The roundtables grew out of an early lesson learned that smaller cities faced challenges when trying to channel investments into their communities. The roundtables' focus was to generate ideas for increasing investments that address the social determinants of health in these places by leaders in the capital deployment sector (e.g., community development financial institutions, traditional banks, credit unions, loan funds, health care anchor institutions, and philanthropy). Invest Health is in the third phase of its journey and is focused on sustaining the 50-city learning community network and sharing lessons with other smaller cities.

Within this context, bolstering community development finance and services is even more crucial. But organizations such as community development financial institutions (CDFIs) that invest this type of capital operate in a challenging field. For example, the rates, terms, and duration of bank loans that CDFIs rely on are not always favorable (Seidman, Fazili, and Theodos 2017),[3] and although new public sources of long-term debt—including the CDFI Bond Guarantee Program and Federal Home Loan Banks—exist, these tools can take the form of secured lending, with general recourse to the CDFI's entire balance sheet, thus making seemingly riskier CDFI investments, such as those in small and midsize cities, more difficult.

These trends illustrate the increasing need for affordable and market-rate capital that can activate economic development and improve social determinants of health within smaller cities. However, as we discuss later, these trends are also among the factors that prevent community development investors from starting significant ventures in these cities in the first place.

BOX 2

What Do We Mean by "Small and Midsize" Cities?

No standard definition of small and midsize cities exists. In the Invest Health initiative, for example, the Robert Wood Johnson Foundation and Reinvestment Fund define such cities as those with populations of 50,000 to 400,000. For this report, we use this definition while emphasizing smaller places that do not neighbor large cities. In doing so, we can present strategies that cities and investors can use to increase the flow of community development capital into these areas.

When describing small and midsize cities, understanding their diversity is as important as understanding general trends because no single archetype of a small or midsize city exists. Some small and midsize cities are growing rapidly: witness Boise, Idaho, whose population has increased by two-thirds since 1990. Conversely, some cities fail to keep up with overall US population growth and may even be shrinking: since 1990, Youngstown, Ohio, for example, has lost a third of its population. Small and midsize cities are in every state and have a diversity of economic drivers, anchor institutions, population trends, racial/ethnic compositions, governmental structures and approaches, and philanthropic activity. All these elements matter in both explaining community development capital trends and thinking through strategies for expanding this sector.

Challenges of Investing in Social Determinants of Health in Small and Midsize Cities

Small and midsize cities in the aggregate are falling behind their larger peers in attracting and receiving community development investments (Theodos and Hangen 2019). In thinking through why, considering the challenges that community development investors face to enter, operate, and remain in these markets can be helpful. The expansion of the innovation sector, which consists of jobs that are difficult or impossible to automate, and the decline of US manufacturing have led to disparities in the relative amounts of investment that large and small-to-midsize cities receive (Moretti 2012). Workers in innovation sectors earn higher wages on average and tend to live around one another, concentrating themselves and their incomes in large cities (Abel and Deitz 2019).

The COVID-19 pandemic presents opportunities for small and midsize cities to attract higher-paying jobs in the innovation sector. Adoption of remote work practices allows employees to move to smaller cities in search of lower housing costs and/or general lifestyle shifts.[4] Whether the changes wrought by the pandemic will be at a sufficiently large scale to result in new residents and employment in small and midsize cities is yet to be seen.

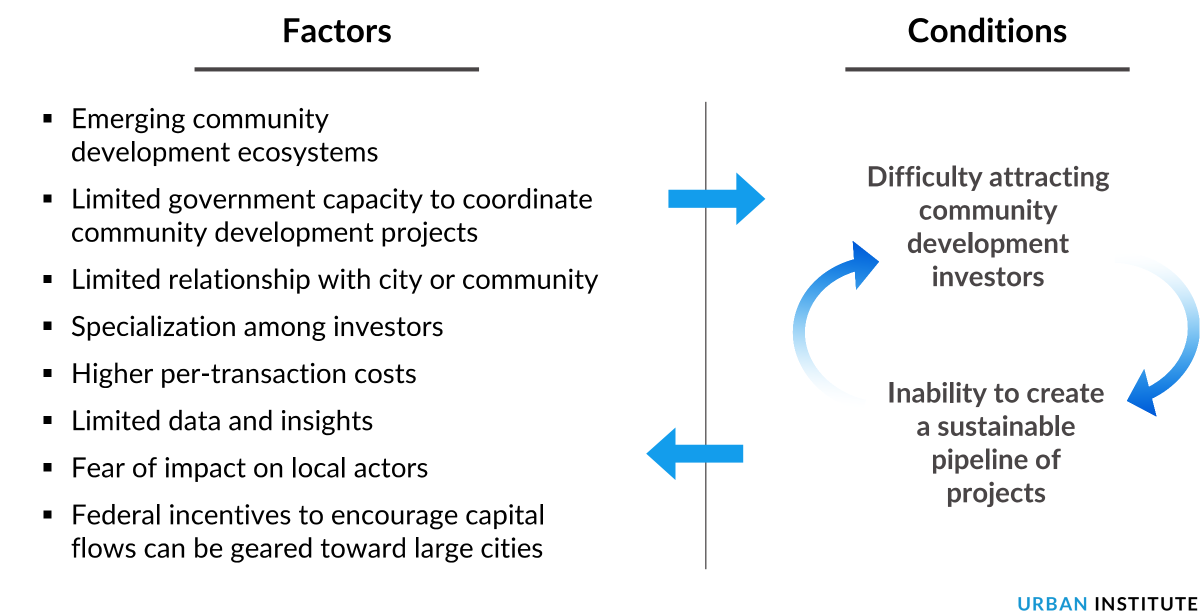
In places with lower incomes, less wealth creation, and greater vulnerability to economic shocks, external capital is often necessary to expand the economy and facilitate positive social, economic, educational, and health outcomes. However, investors may perceive this heightened need as increased risk. They may believe that local governments, nonprofit organizations, small-business owners, and developers in small and midsize cities have less capacity to pay off loans, given their lower levels of cash flow. This belief could prevent the development of an entrepreneurial ecosystem that creates demand for and sustains a pipeline of community development projects. Investors' concern about reduced capacity in small and midsize cities can also manifest itself as, for example, the perception that city officials cannot manage their funds effectively enough to alleviate strain on public and private services.

Community development investment is using financial tools for a social end. We usually struggle with calibration because we're using market tools to do something the market is not doing. We're subject to market forces, and we're being pushed to the margin. When going into fringe places, our work gets harder.
—Roundtable participant

These perceptions among investors are especially detrimental for community development projects that seek to achieve health equity through improved access to affordable housing, access to healthy food, access to education, and other mechanisms. This is the case because, as we describe in this report, investors' willingness (or lack thereof) to invest in a city creates a feedback loop that either encourages or attenuates further community development investment within that city. Additionally, when the health of a city's residents improves, the residents access a host of other benefits that affect their lives and are linked to health outcomes, such as higher education levels, higher rates of employment and labor participation, and reduced racial disparities and greater inclusion.

At the Health Capital Roundtables, community development investors spoke about the factors that make advancing investments in social determinants of health more challenging in small and midsize cities and grounded them in the realities of these cities' capacities to absorb community development investment. To synthesize the discussion, we have grouped these into eight factors that are affected by two broader conditions (figure 1). Together, these two conditions and eight factors can create feedback loops in which the lack of prosperity in some small and midsize cities drives investors' hesitancy to enter a market. Although these trends are most acute for market-rate investors, they also create challenges for mission-minded financiers interested in improving social determinants of health. The upshot is that small and midsize cities receive substantially less community development investment than their larger counterparts do, even on a per-capita basis. Considering that some of these economic outcomes directly facilitate health outcomes, the challenge at hand is how to break the cycle and enable community development finance to flow into smaller cities in ways that work toward health equity.

FIGURE 1
Community Development Investment Challenges in Small and Midsize Cities



Source: Authors' analysis.

The eight factors behind the underinvestment in small and midsize cities are both distinct and overlapping, and they reinforce one another. This dynamic can create a cycle in which less investment leads to less investment. Furthermore, these eight factors that drive away community development investment can stunt residents' access not only to equitable social and economic outcomes but also health outcomes in small and midsize cities. We explore each of the eight factors below.

Emerging Community Development Ecosystems

Roundtable participants reported that the investment ecosystems of small and midsize cities not near a large city have yet to fully mature and develop. This means that a city may lack an adequate supply of the supporting actors—like accountants, developers, and lawyers—needed to facilitate investment. Or if the city has a sufficient supply, the supporting actors may not be oriented to the arcane rules of many federal community development programs. Also, philanthropy, often a key player in filling capital gaps in community development projects, is less present in small and midsize cities, as some roundtable participants pointed out. This can mean that, as a representative from the health care sector explained, "a lot of nonprofits have to compete for the same grants." Similarly, a shortage of community development corporations or other sophisticated development partners in small and midsize cities can mean that community development investors have relatively few potential partners (Walker 2002; Wood, Grace, and Hacke 2012b). And even though neighborhood associations exist within cities regardless of size, those in smaller cities are less likely to have as much expertise in coordinating projects as community development corporations. Finally, if a business that receives an investment fails, a small or midsize city is less likely to have a replacement tenant in the wings to pay off the loan.

The large cities have more sophistication and more networks, but in smaller [cities], they don't have access to federal funds or the vernacular around housing or community development. They're completely lost on who to turn to for economic development guidance and help.
—Roundtable participant

Limited Government Capacity to Coordinate Community Development Projects

Roundtable participants reported limited capacity as a challenge of working in small and midsize cities. This may reflect that city staff members do not know enough about the community development industry and its needs, including the need for subsidy or loss mitigation support, and do not understand blended finance vehicles, which are regularly used for risk-adjusted, impact investments. Even if government officials are not the architects of these deals, community development practitioners feel that having city governments coordinate local players and projects is often important. Limited local capacity may also be evidenced in a regulatory environment that does not facilitate the quick review and completion of community development projects. These conditions create barriers to overcome and are especially challenging for projects that already have higher transaction costs or are perceived as being risky (Wood, Grace, and Hacke 2012a).

Limited Relationship with City or Community

Effective community development investment requires a strong understanding of a local market's social and economic conditions to support deal sourcing and loan underwriting. Community leaders and local government officials can help investors navigate the local policy and business context. However, roundtable participants shared that those relationships are more difficult to cultivate in small and midsize cities. Furthermore, such relationships are strengthened through an ongoing pipeline of investment, which, as shown in our feedback loop model, is challenging to build. One roundtable participant's experience illustrates how relationships with local leaders are key for community development investments: "We are trying to start operations in [midsize city], but we don't have that knowledge on financing agricultural projects to meet the local demand…We have to put the cart before the horse, trying to make this financing happen without having the knowledge first or having a strong partner with [that knowledge]."

You can't service a market in an abstract sense. We're…focused on what we need to run a business, which is more deals.
—Roundtable participant

Specialization among Investors

Community development investors often focus on one or more types of investments or asset classes. This allows them to build expertise in those products and lower their costs. However, because of their size, smaller cities are likely to have fewer specific community development investment needs and therefore the chance that an investor's expertise and the need of a community will align is lower. For example, a community development investor may specialize in affordable housing, while a particular midsize city may need small-business working capital loans. This investor would have a better chance of encountering extended need for this and other types of financing in a larger city. Specialized product offerings often require lenders and investors to source projects over a range of geographic areas, but small and midsize cities may offer few investment opportunities and be overlooked in the process.

There is deep demand, but just not for the type of stuff that we do. Do we change our entire capital structure to meet the community where they are?
—Roundtable participant

Higher Per-Transaction Costs

For a lender to understand each place in which it invests takes time, meaning that operating in a market has a certain level of fixed costs regardless of the number of transactions. With fewer deals to spread fixed costs across, the per-deal transaction costs of operating can be higher in small and midsize cities than in larger markets. Investment in social determinants of health, such as housing or educational systems, might include even higher fixed costs because investors must learn about not only the local economy but also the local infrastructure of the sector in which they wish to invest.

Limited Data and Insights

Convening participants noted that data such as a city's economic standing, its investment opportunities, and the nature of local government incentives are generally less available for small and midsize cities than for large cities. When community development investors conduct due diligence on a potential project, a lack of high-quality information about the local economy may prevent them from pursuing the opportunity. Larger cities are more likely to have organizations that collect high-quality economic data, or they may simply have an accessible performance and pricing track record for investments similar to those investors are interested in placing. With less firsthand knowledge and without reliable heuristics, some investors simply avoid small and midsize cities. Furthermore, valuing a property and determining the value of collateral for a project are much more difficult for appraisers if a city does not have similar developments. And without strong collateral values, investors may find lending in a city uncomfortable. Therefore, limited or less reliable data restrict a community development investor's ability to learn about the intersection between a city's economy and health outcomes.

Investors who want to enter small and midsize cities are missing access to data and an understanding of the market forces they work against. What is the problem a particular city is trying to solve?...We need data to identify [a city's] needs, not just build up a pipeline.
—Roundtable participant

Fear of Impact on Local Actors

Even though small and midsize cities need outside investment, roundtable participants noted that cities sometimes resist it. For these cities, outside community development investment may represent real or perceived competition with a local bank or investor. Cities and local actors have also questioned whether organizations would add capacity or invest in communities with sufficient regard for their structures and local relationships. And questions have been raised about whether outside investors heed local partners' goals or leverage partnerships to further their own goals. City and organizational leaders may believe these investments will crowd out local actors, and they claim outside investors are less likely than local investors to reinvest profits in a small and midsize city after an investment is repaid. As a result, the net impact of a dollar of outside investment may be less than that of a dollar of local investment, because the former is less likely to recirculate in the local economy. This can lead to tensions that make partnerships between outside investors and local institutions more challenging.

Federal Incentives to Encourage Capital Flows Can Be Geared toward Large Cities

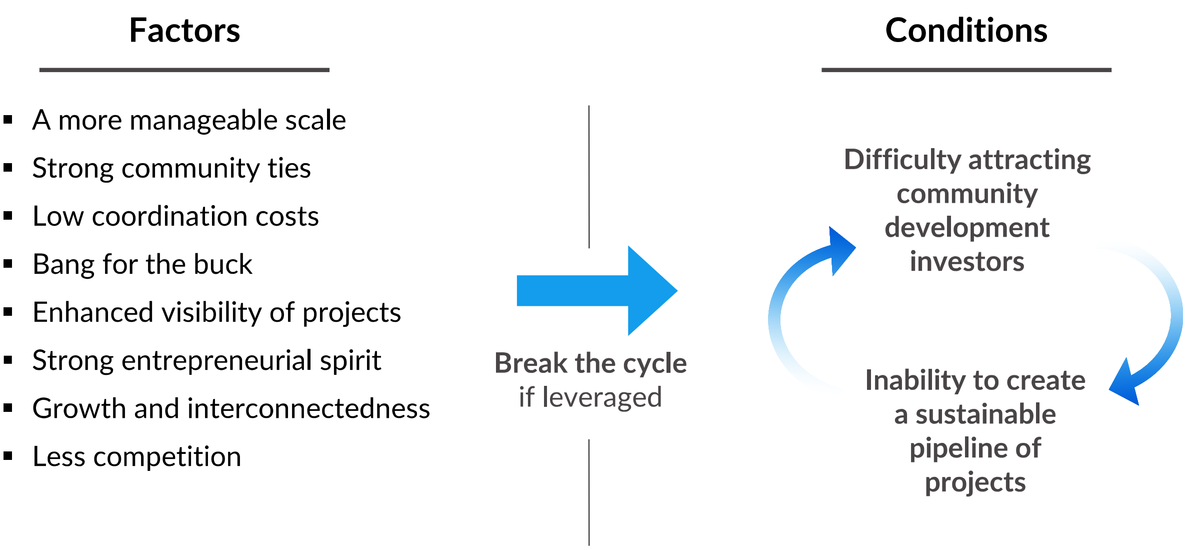
Although many factors that make community development investment in small and midsize cities challenging are internal to cities, external forces are also at play. Most notably, federal programs targeted toward community development may not be as effective or efficient in smaller cities as they are in larger ones. For example, in rural communities, getting large or even medium-size banks to make Community Reinvestment Act–qualified loans is difficult because they cannot get full credit for projects outside their assessment areas and banks of this size tend to select assessment areas with largely urban or suburban populations (Wiley, Brumfield, and Oberdorfer 2016). These difficulties may be exacerbated by the size and capacity of investors themselves. At the Health Capital Roundtables, CDFI staff said they often struggled to leverage some federal subsidy programs, such as the New Markets Tax Credit and the Low-Income Housing Tax Credit. These programs require that funding recipients have the significant capacity required to court and manage the investment. Additionally, given legal, accounting, and compliance costs, programs like the New Markets Tax Credit and the Low-Income Housing Tax Credit often work better for larger projects, which are less likely to occur in smaller cities.

Opportunities for Investing in Social Determinants of Health in Small and Midsize Cities

So far, we have explored the characteristics that make developing a consistent pipeline of economic activity that invites community development investment more challenging in small and midsize cities than in larger cities. However, some of these factors have upsides that investors can unlock and leverage, providing opportunities for investors to engender as much social good as possible in small and midsize markets. We provide specific examples of such conditions below and in figure 2.

FIGURE 2

Community Development Investment Opportunities in Small and Midsize Cities



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Source: Authors' analysis.

A More Manageable Scale

Small and midsize cities are, by definition, smaller than large cities. This characteristic alone can make community development investment in these cities easier to navigate. The National League of Cities lists the following as distinctive traits of small and midsize cities: (1) personal relationships and a more manageable scale that can make it easier to convene stakeholders and work together; (2) a culture of helping neighbors and other local residents; (3) frequent contact between local officials and the people they serve; (4) and a smaller scale of government that creates possibilities for responding more quickly to emerging needs, with fewer bureaucratic hurdles to overcome (National League of Cities 2013).

Roundtable participants who had closed deals in smaller cities agreed with the National League of Cities' list of traits, explaining that they had encountered more manageable coordination costs in smaller cities. Practitioners also found that small and midsize cities were more likely to have a single, effective point person or agency and that when such a champion for community development projects existed, the point person could "effectively drive change." Easier access to government officials may offset some capacity challenges discussed earlier. In many cases, local champions are anchor institutions such as hospitals, institutions of higher education, faith-based organizations, or municipal or other local government enterprises. Some of these institutions may also have philanthropic arms that could be key in reducing the risk of transactions through grant capital or loss reserves, as some roundtable participants explained.

In smaller cities, it is more [common] to have one dominant health care provider. It is easier to have them at the table because you don't have as many people.
—Roundtable participant

Strong Community Ties

Roundtable participants mentioned that community members in smaller cities had different (and at times stronger) connections compared with those in large cities. They noted that residents of smaller cities may be more likely to volunteer and engage in community development projects because they feel more invested in their cities' well-being. A CDFI representative described the tight-knit communities that the organization had worked with in small and midsize cities. "We're always wishing for a local partner that may be our eyes and ears but also kind of the gatekeeper of the place—someone who is credible to the people on the ground and who can be a radar for what's on the ground," the representative said. Data support this assessment. For example, the congressional Joint Economic Committee recently developed a social capital index that uses variables related to family structure and stability, family interaction and investment, civil society, trust and confidence in institutions, community cohesion, institutions, volunteerism, and social organization (US Congress Joint Economic Committee 2018). Although the data are not available at the city level, counties with populations of 50,000 to 150,000 perform better than those with populations of less than 50,000 and larger counties.[5]

Roundtable participants expressed that civic engagement and involvement are crucial for the success of community development investment projects, not only because they are vehicles through which investors can align projects with a community's needs and priorities—including those related to social determinants of health—but also because community support can facilitate the economic success of a project and the sustainability of a community development investment.

In addition to community members, other stakeholders may have stronger ties in small and midsize cities than they do in larger cities. A representative of a community development corporation said: "Small and midsize cities facilitate the development of relationships between community stakeholders and leaders. We find…each other at a lot of the same events, and we just get to know each other better. Ultimately, that is what builds the trust that allows an organization like ours to work collaboratively with a large anchor institution."

Lower Coordination Costs

Community development investors may encounter lower coordination costs when designing and executing transactions in small and midsize cities because of the cities' relatively small scale. Being able to expedite government support can improve a given project's financial viability, adding to the sustainability of an investor's involvement in a small market. In contrast, investment plans in larger cities may require coordination among multiple municipal government agencies, authorities, and bureaucracies, forcing an investor to expend more time and resources (e.g., on hiring third-party brokers). Roundtable participants noted that lower coordination costs in small and midsize cities can also be a result of these cities' having a single point person in government who can guide investors through local rules and regulations. Lower coordination costs are also an advantage when creating partnerships in small and midsize cities. A CDFI representative said: "The nature of creating cross-sector partnerships is inherently complicated and time-consuming, and they are based in human relationships and organizations. That's why they're easier in a small city."

Bang for the Buck

Many practitioners mentioned that investing in small and midsize cities allows them to potentially have outsize impacts on communities for smaller price tags than in large cities. Community development investors can be powerful allies for smaller cities with lagging growth by filling the capital gaps of projects that help promote equity and improve social determinants of health. These institutions can also find in small and midsize cities a ready audience for their nonfinancial services, such as technical assistance, financial education, and business development.

Enhanced Visibility of Projects

Because the median amounts of community development funding are lower in small and midsize cities than in large cities, a given investment may have relatively more visibility at the local level in a smaller city than in a larger city. “You’re able to see the projects, and that return on investment, more easily,” said a CDFI representative. A higher share of community members, entrepreneurs, and government officials can learn about loans, credits, and investments within these smaller markets. This may make building support for community development projects and coalitions to back them more feasible for investors. Roundtable participants also highlighted that measuring outcomes of social determinants of health projects may be easier in small and midsize cities if few other interventions take place around the same time or if the project is large relative to the size of the community.

Strong Entrepreneurial Spirit

When it comes to investments in the business ecosystem of a small or midsize city, the lagging economic growth mentioned earlier is only a part of the full story. Business activity constitutes an important counterexample. Community development investors at the roundtables pointed out that tax incentives, lower tax burdens, lower costs of operating a business, and a relatively high quality of life make smaller cities good environments for entrepreneurship and likely to cultivate successful business ventures that can benefit from community development capital. Consequently, entrepreneurship per 1,000 residents in cities with populations of less than 250,000 is almost equal to that in metropolitan areas with 1 million people or more.[6] Additionally, the five-year business survival rate is higher in the former.

Growth and Interconnectedness

Cities that are small or midsize today may not remain so, and some of the challenges raised earlier can be addressed through growth. For example, 87 percent of metropolitan statistical areas with 50,000 to 500,000 residents experienced population growth between 2005 and 2013.[7] Those in the top quartile of economic dynamism—an index that incorporates productivity, market growth, and labor force retention rates—grew an average of 12.1 percent, compared with 8.6 percent for the US overall.[8] The growth in small and midsize cities can also be a result of anchor institutions’ acting as an economic hub for surrounding rural and urban communities. Additionally, businesses in small towns and cities that are clustered together perform better than those in towns and cities that are more spread out (Erickcek and McKinney 2006).

Less Competition

A lack of competition can make the products and services offered by community development investors such as CDFIs more attractive and likely to succeed from a financial standpoint. As noted earlier, community development investments are fundamentally market-based interventions. Traditional banks and financial institutions often underserve small and midsize cities, a situation that has been exacerbated by large banks' closures of branches across the country and their increased reliance on ATMs and online banking. These changes disproportionately affect low-income communities and smaller cities by decreasing the number of workers that banks and financial institutions hire locally and by making it more difficult for residents of small and midsize cities to access some services such as loans. The evidence suggests that closing bank branches has a prolonged negative effect on credit supply, particularly for local small businesses (Nguyen 2014), and a decrease in credit supply impedes a community's access to a wide array of social determinants of health, including education, food, housing, jobs, and utilities. The more limited competition in small and midsize cities may actually provide more opportunities for community development investors. A CDFI representative said: "We were punching above our weight. A $100 million CDFI telling multiple billion-dollar banks, 'This is where you are going to invest and how you have to do it.' You can't do that in Chicago because banks are very smart about that market. In a smaller city, we are at the front of the line."

Models of Sustainably Expanding Investment in Small and Midsize Cities

Considering the mix of challenges and opportunities, how do CDFIs and other investors and partners better support small and midsize cities? The answer lies in some combination of importing capacity, better leveraging existing local capacity, and building new local capacity. What are the real-world examples that can be learned from, replicated, and built on? Representatives at the roundtables raised compelling models for sustainably expanding investment in small and midsize cities, and we have augmented these with additional interviews. While diverse, these examples by no means represent the full universe of potential approaches.

The Web of Towns Model

Community First Fund is a nonprofit CDFI headquartered in the Pennsylvania city of Lancaster (population 59,708). It serves the central Pennsylvania region, with offices in four small or midsize cities: Allentown, Harrisburg, Reading, and York. Together, these five cities have roughly 360,000 residents. Community First Fund focuses on investments in social determinants of health, such as food security, entrepreneurship, education, affordable housing, and early childhood. Before Community First Fund's incorporation in 1992, the region had no active CDFI. Initially, Community First Fund focused on small-business lending and affordable housing. However, because there were no other community development capital providers, it soon recognized the need to expand into other types of investments and developed an expertise in New Markets Tax Credit financing. The expanded array of services allowed Community First Fund to serve cities close to Lancaster and to develop a web of towns model that can sustain a sufficiently large stream of transactions.

The Merger Model

DuPont employees founded Cape Fear Credit Union in Cape Fear, North Carolina, in 1979. In its heyday, the credit union managed approximately $15 million in assets and employed 15 people. However, around 2005, as technology started to transform the way credit unions operated, Cape Fear realized it could not offer technologically integrated services to its members. The board of directors decided to merge its sole remaining branch with another organization. After evaluating several prospective partners, Cape Fear was impressed with the mission of Self-Help Credit Union to serve families who are historically underserved and have low incomes and low wealth. Although the credit union was not failing, Cape Fear merged with Self-Help because Self-Help could offer an economy of scale that would allow Cape Fear to modernize its operations and continue long term. After the merger in 2006, the newly minted branch of Self-Help retained local staff, and that helped the credit union's members continue to feel connected to the institution. Through the merger, the credit union used Self-Help's capacity to expand its services for both its members and its employees. Self-Help's approach maintained a CDFI presence in the city, ensuring that a local institution could continue to offer services and strengthen its presence in the community.

The Network Model

Fahe is a regional CDFI headquartered in Berea, Kentucky, working to improve access to capital for the creation of housing and other community development projects, with the mission of eliminating persistent poverty in Appalachia. Fahe is a membership organization with a network of more than 50 nonprofit organizations, through which it has invested $1.1 billion and generated $1.6 billion in finance since 1980.[9] Recently, Fahe partnered with Fannie Mae to increase access to affordable mortgage products in hard-to-serve communities in Appalachia by leveraging its network of local nonprofits and leaders. The nonprofits originate mortgage loans in their communities, and the mortgages are underwritten and securitized by Fahe (after paying a fee to the nonprofit). The securities are then sold to Fannie Mae and other bank aggregators. This way, Fahe brings to its members capital that they could not otherwise access.

The Anchor Institution Model

The Ohio city of Toledo, having historically relied on the automobile industry for employment, is an example of a midsize city that is struggling to grow. With a population of roughly 275,000, the city has been losing residents since 1970 and is 30 percent smaller than it was at its population peak. In this context, the Local Initiatives Support Corporation, a CDFI, approached ProMedica, a nonprofit health care system and Toledo's largest employer, to create a $25 million loan pool to support development in Northwest Ohio and Southeast Michigan. In 2017, this fund approved a loan for the "Wonder Bread" apartments project; 20 percent of the 33 units are restricted to residents whose incomes are at or below 80 percent of area median income. ProMedica was a crucial partner in the project: in addition to providing capital to the loan pool, the Toledo anchor institution, which had a strong balance sheet, helped navigate the permitting process for building on a historical structure and helped meet the requirements for accessing historical tax credits. For ProMedica, the partnership allowed the system to tap into Local Initiatives Support Corporation's expertise in structuring financing for real estate deals and advance toward its goal of improving local social determinants of health.

Another example of this model is the MetroLab Network in North Carolina. Here, the University of North Carolina-Greensboro acted as an anchor institution that increased the city's capacity for housing data collection and analysis. This capacity in turn was key in attracting national investors such as Reinvestment Fund.

The "CDFI Friendly" Model

When he became mayor of Bloomington, Indiana, John Hamilton drew from his experience helping found two CDFIs. With Mark Pinsky, he developed CDFI Friendly Bloomington, a nonprofit that acts as an intermediary between CDFIs and city organizations to promote community development opportunities in the region. The organization has a full-time staff person who meets with developers and technical assistance providers to find prospective deals and match them with CDFIs. The nonprofit has created a credit enhancement fund made up of debt and equity raised from local government, banks, and foundations to enhance CDFI Friendly deals. The fund will only be used *pari passu* in response to demonstrated interest for a CDFI at the CDFI's request. It will not be the sole funder in an investment; rather, the fund will be used to support deals or otherwise reduce the amount of risk a CDFI might incur by investing. Additionally, Bank of America will match CDFI investment in Bloomington dollar-for-dollar at 0 percent interest for 10 years. The CDFI Friendly Bloomington model mitigates CDFIs' potential risk of investing in a city and increases the amount of local capital available. The future pipeline of investment through this initiative is unclear, however. The initiative had its first project with Cinnaire, a CDFI, in fall 2019.

Toward an Improved Flow of Community Development Capital

Drawing from the challenges, opportunities, and model examples, we synthesize several steps that roundtable participants shared about how actors can improve the flow of community development capital to small and midsize cities. We present first the steps that community development investors can take, second the steps that cities can take, and third those that funders can take.

For Community Development Investors

Community development investors can take the following steps to overcome the challenges to investment in small and midsize cities.

1. **Strategically leverage existing philanthropic and public-sector capital to reduce the risk of investments**. Community development investment—whether in small or large cities—often relies on low-cost capital (or free capital such as grants). Investors said that finding willing philanthropic and public-sector support is a useful first step in driving capital to small and midsize cities where investors are not active. Investors can also help introduce new approaches to reducing the risk of investment to local leaders. Investors can elevate their track record of responsible investment, local engagement, and good stewardship to reassure government officials and community leaders who might be skeptical or wary of community development investment that originates outside their communities.

2. **Create partnerships, not only collaborations.** To overcome resistance to outside investors, community development investors need to build local connections in the cities they want to enter. Finding the right partner is especially important for single asset investors that are unlikely to build or access a pipeline of projects large enough to support a lending officer or other staff person locally. Roundtable participants agreed that effective cross-sector partnerships require going beyond thinking of collaborations and transactions. They require dedication to processes, inclusion, and consideration of systems change for the long term. To achieve this, roundtable participants laid out the following recommendations:

    a. Get high-ranking officials at each organization involved.
    b. Dedicate time to understanding the "yield drivers" of potential partners.
    c. Act with humility, and value partners (especially important for larger partners in relation to smaller partners).
    d. Consider using written agreements that, as one CDFI representative put it, "are drafted cooperatively and in a good spirit and offer support for the work of the partner if they are less resourced."
    e. Ensure that community representatives are part of the partnership, and establish more than one way to engage members and integrate their input. "We need to be comfortable with a 'friendly tension' with the community," a local government representative explained. "That's what a broad and deep partnership with the community means."
    f. Invest in resident leadership training.

What makes successful cross-sector partnerships is the fact that the work we are trying to do is voiced and centered around an ongoing and strong presence and agency of the community.
—Roundtable participant

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3. **Partner with an anchor institution or other local entity.** Many small and midsize cities have anchor institutions that can be effective partners and champions for community development projects, helping coordinate government agencies and community members and even providing capital and other contributions. A hospital representative said: "We have access to intellectual

capital that other smaller organizations don't have, like specialized attorneys and accountants. We can bring that expertise to the table."

Large employers in small and midsize cities, particularly hospitals and health systems, have a vested interest in working to improve conditions in the communities in which their employees live by addressing issues such as affordable housing, education, wealth building, and community well-being that are related to social determinants of health. In a recent survey of hospitals across the country, 80 percent reported that their leadership was committed to "establishing and developing processes to systematically address social needs as part of clinical care" (Lee and Korba 2017, 1). Other partners can be capital entities, such as smaller banks or CDFIs that are already on the ground, and engaging with them could mean providing referrals, partnering on loans, sharing technology, or even merging organizations.

4. **Think regionally; start locally.** Small and midsize cities are not isolated. In many US regions, people frequently traverse different towns—living, working, studying, and shopping in multiple jurisdictions. In the aggregate, these interconnected cities may offer opportunities for community development investors to build and sustain a pipeline of projects that allow investors to maintain strong balance sheets and diversify the risks in their portfolios. Allocating resources to understand where these potential networks are and which have sufficient economic dynamism to attract and sustain investment is important. Once investors identify those networks, they can enter a single city before developing a web of activities across jurisdictions. Building relationships and capacity takes time, resources, and dedication, and if community development investors spread themselves too thinly, they may not devote enough energy to meaningfully build individual relationships with prospective partners.

For Cities

Small and midsize cities can use the following tools to break the feedback loop that prevents them from increasing the flow of capital toward their communities—whether it be decreasing risk, increasing return, or facilitating the permitting and investment processes.

1. **Build a capital fund to decrease the costs of community development investment through subsidies, guarantees, or other methods.** Community development investors can benefit from flexible subsidy sources, especially for smaller projects. They often need patient equity capital. Depending on the project type, they may benefit from additional capital for subordinate debt. Cities can create dedicated credit enhancement funds to support CDFI or similar community

investments locally. Such a fund could house capital from the city, local banks, philanthropists, anchor institutions, businesses, or credit unions, ensuring that community development investors entering a city or a community can leverage existing capital, rather than position themselves in opposition to it. Cities also may have access to or control federal or state community development dollars that they can use to attract further investment.

2. **Construct part of the investment pipeline that community development investors might build themselves in larger cities.** Roundtable participants frequently cited the lack of an investment pipeline as a reason they refrain from investing in small and midsize cities. Such cities can help spur development by providing clear signals about local priorities. They can adopt city plans with sufficiently long horizons. They can do leading work around land assembly, demolition, brownfield remediation, and other pre-development activities. They can help assemble and package possible projects for investors. For example, several cities (and states) are creating prospectuses to present to Opportunity Zone investors or building out exchanges where those with project ideas and those with capital can connect. Local or regional technical assistance providers can help cities vet early projects and prepare them to receive investment. Above all, a city can begin to develop a reputation as welcoming to community development investment.

3. **Review and improve the local regulatory environment.** The local regulatory environments of cities vary. Some cities can provide a more consistent, explainable, and predictable approach to developers and investors. This includes zoning, code enforcement, and permitting, along with any environmental or other reviews or approvals. Some projects with sufficient community benefit may warrant fast-tracked reviews or reduced fees.

4. **Improve collection of data on the local economy, city operations, and community development.** By partnering with research institutions, local universities, or other organizations to improve data collection tools, methods, and approaches, cities can expand their capacity to understand and develop community investment opportunities. They can also hire or reallocate dedicated staff to collect and disseminate data and to act as a connection point for investors. If city governments already collect data on neighborhood economies, operations, and development, they can make that information accessible by keeping it available and up to date on their websites. This will have the added benefit of inviting resident review and engagement.

For Funders

The philanthropic sector has an important role to play in furthering community development investment. Specifically, it can take the following steps.

1. **Support learning opportunities and knowledge building.** As community development investors expand their work into small and midsize cities, sharing the knowledge they gain with other practitioners is important so peers can learn from the investors' challenges and opportunities and accelerate their own expansion into smaller markets.
2. **Provide grants, low-cost loans, investments, guarantees, loss reserves, and other financial supports to community development investors and/or cities.** Flexible and low-cost capital can help reduce the risks of potential investment opportunities in small and midsize cities.
3. **Support planning and technical assistance.** Philanthropies can underwrite or provide local planning and technical assistance geared toward either cities or the community development finance industry.

Conclusion

Even though some small and midsize cities may seem disadvantaged in their ability to absorb community development capital, they can house many assets. Community development investors have the potential to significantly affect the health outcomes of residents of small and midsize cities by promoting health equity. Indeed, community development investors can help imbue economic equity into regions that private, public, and philanthropic investors have overlooked and underserved for the past several decades. Investing in these communities helps fulfill the mission of community development investors, but they will need to take less traditional approaches, such as those highlighted in this report, and to consider ways of redefining a successful transaction and adjusting expectations for what an optimal market to enter looks like.

The burden does not rest solely on investors, however. Cities must have a clear plan for community development projects that they wish to undertake, use subsidies and risk mitigators to create a track record of successful community development, build the pipeline that community development investors search for when evaluating prospective projects, and match external investment and their own funding with project ideas. The synergistic partnership between community investors and the governments of small and midsize cities may also create a feedback loop that increases the cities' capacity to promote health equity.

Of course, cities do not operate in a vacuum—their community development goals are supported or undermined by state and federal policies, subsidies, supports, and regulations. State and federal resources can far exceed what small and midsize cities otherwise have available. Some federal resources, like those from the US Economic Development Administration or programs like the Community Development Block Grant, may bolster the development tools and resources of small and midsize cities. However, others, like Opportunity Zone financing, rely on developer and investor expertise and exposure that may be geographically limited in the ways described in this report. Apart from disaster recovery funds and Opportunity Zones, the core of federal financing for community and economic development has been flat or declining in recent years, and that means fewer federal resources are available for small and midsize cities and investors than ever before. For example, after adjusting for inflation, the Community Development Block Grant program has just a fifth of its peak allocation, and the US Department of Housing and Urban Development's HOME Investment Partnerships Program stands at less than 40 percent of its peak allocation (Theodos, Stacy, and Ho 2017). Additionally, beyond shrinking grant and tax programs, reforms to Community Reinvestment Act rules pose new challenges for many communities, though they may create opportunities for others.[10]

Because social determinants of health are at the intersection of biological health, the economy, and society, promoting health equity improves not only health outcomes but also a host of tangential outcomes, such as educational attainment, income, wealth, employment, and racial equity and inclusion. Therefore, community development investors that promote health equity in small and midsize cities simultaneously expand residents' access to prosperity, safety, and inclusion. Attracting community development capital is, then, in the best interests of cities, and entering underserved, underdeveloped markets is in the best interests of mission-driven community development investors.

The COVID-19 pandemic has illustrated how social determinants of health can affect who survives a dangerous virus and who does not. Occupational segregation into essential jobs; precarious housing conditions, including overcrowded or multigenerational housing; unstable financial circumstances that stem from job losses or income reductions; and a lack of access to open spaces for recreational activity have all been found to be connected to higher chances of virus transmission (Clark et al. 2020).[11] The reality left by the virus makes evident new challenges and opportunities for community development finance practitioners interested in social determinants of health. Although the virus made communities more vulnerable—for example, through job losses and evictions—the pandemic has raised the visibility of why these community conditions matter. The task ahead is to leverage the opportunities, and that will require strong cross-sector partnerships, especially in small and midsize cities. The good news is that many of these partnerships already exist. A health care representative who participated in the roundtables asked, “How can we leverage some of these forged-in-fire relationships that we developed quickly over the last three or four months?” That is the question of the moment for the field.

In this endeavor, practitioners must remember that the residents of small cities are not a small share of the US population. Although some small cities are doing well, others are experiencing stagnation or decline. Community investment by mission-oriented organizations with financial discipline can help change this trajectory. But to drive community development and opportunities in a way that supports health equity in America’s small and midsize cities, investors, cities, and their partners in state and federal government will need to coalesce around a new agenda of inclusive investment.

Notes

[1] "Social Determinants of Health: Know What Affects Health," Centers for Disease Control and Prevention, accessed March 9, 2020, https://www.cdc.gov/socialdeterminants/index.htm.

[2] Jed Kolko, "Yes, Rich Cities Are Getting Richer. But That's Not the Whole Story," *New York Times*, updated November 1, 2020, https://www.nytimes.com/2020/02/19/upshot/rich-city-poor-city-population-growth.html.

[3] This is in part because most unsecured loans from which CDFIs obtain their capital come from banks seeking to meet their regulatory obligations under the Community Reinvestment Act and that law has become less effective as a driver of debt capital into CDFIs, according to participants in the Scaling CDFI Impact convening (Seidman, Fazili, and Theodos 2017).

[4] "Are We Witnessing a Great Tech Migration?" Center on Rural Innovation, September 1, 2020, https://ruralinnovation.us/are-we-witnessing-a-great-tech-migration/.

[5] Calculations made by the Urban Institute using data from US Congress Joint Economic Committee (2018).

[6] Brian Thiede, Lillie Greiman, Stephan Weiler, Steven C. Beda, and Tessa Conroy, "The Divide between Rural and Urban America, in 6 Charts," *US News & World Report*, March 20, 2017, https://www.usnews.com/news/national-news/articles/2017-03-20/6-charts-that-illustrate-the-divide-between-rural-and-urban-america.

[7] Will Lambe, "Economic Dynamism in Small Cities," Federal Reserve Bank of Atlanta, March/April 2015, https://www.frbatlanta.org/community-development/publications/partners-update/2015/02/community-development-finance/150414-economic-dynamism-in-small-cities-part-01-of-02.aspx.

[8] Will Lambe, "A New Look at Economic Dynamism of Small Cities," Federal Reserve Bank of Atlanta, July/August 2017, https://www.frbatlanta.org/community-development/publications/partners-update/2017/04/170711-a-new-look-at-economic-dynamism-of-small-cities.

[9] "About Fahe," Fahe, accessed May 22, 2020, https://fahe.org/about-fahe/.

[10] Laurie Goodman, Brett Theodos, and Ellen Seidman, "The Community Reinvestment Act Faces Major Changes, but Regulators Are Not Aligned," *Urban Wire* (blog), Urban Institute, January 17, 2020, https://www.urban.org/urban-wire/community-reinvestment-act-faces-major-changes-regulators-are-not-aligned.

[11] Sophia Tareen, "Coronavirus Complicates Safety for Families Living Together," Associated Press, May 12, 2020, https://apnews.com/article/8512463a90d314ca730bb246eddd8e8d; Trevor Hughes, "Segregated Parks Linked to Higher COVID-19 Deaths for Black and Latino Americans," *USA Today*, updated August 24, 2020, https://www.usatoday.com/story/news/nation/2020/08/22/covid-outbreak-park-access-barrier-black-latino-communities/3291907001/.

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