The Community Investment Trust: Revolutionizing Ownership in Real Estate, One Investor at a Time

BY JOHN W. HAINES

The views expressed in this article are those of the individual author/authors and do not represent the views of or an endorsement by the Federal Reserve Bank of St. Louis, the Federal Reserve Board of Governors, the Federal Reserve System or the U.S. Department of Agriculture.

Access to real estate ownership in neighborhoods is a missing link in the flurry of innovative efforts taking place to democratize development strategies and foster inclusive wealth building. Marginally actionable buzzwords swarm around processes: inclusive, regenerative, intentional, purpose built, steward ownership, equitable development, place-making, ladder to opportunity. The systemic change from top-down efficiency to bottom-up effectiveness is the community development opportunity we face. The challenge is that new funding needs to be delivered to neighborhoods but also built with, guided by and managed by neighborhood residents themselves.

The challenge is that new funding needs to be delivered to neighborhoods but also built with, guided by and managed by neighborhood residents themselves.

Increasing minimum wage, providing savings plans and including residents in neighborhood planning are all necessary and important steps toward financial inclusiveness and health. But inspiring innovations and intentions nationwide notwithstanding, people in neighborhoods living with low or no financial assets deserve and need an early and sustained financial stake in the changes happening in their neighborhood. They have always needed this.

Ownership matters: Including families in planning and place-making efforts without providing a path for real estate ownership means that many are just one rent increase or medical bill away from having to move out of the gentrifying neighborhood they have helped to build. Families will fall further behind.

The Community Investment Trust (CIT) solves these challenges by creating a financial product that meets first-time investor's needs *and* desires, a product in the asset class of real estate, specifically in commercial retail real estate.

Why real estate? For one, people seek tangible, proximate connections to ownership. Second, homeownership may be out of reach for many, particularly in high-priced areas and for others without a sufficient down payment. An immediately accessible entry into real estate, therefore, is a step toward homeownership for some and an opening into the big tent of ownership for others.

The CIT offers a new approach: a localized real estate investment product using patient investment capital as an equity shift to enable residents to invest and build equity via shared ownership in real estate as the property pays down debt and increases in value. A pilot in Portland, Oregon's most diverse and highest-poverty neighborhood, the East Portland CIT Corporation, an Oregon-registered C corporation, offers a model for financial inclusion that has taken fire. Currently more than 220 families, impacting over 700 people, invest $10-$100/month into a long-term, risk-protected path to building family wealth through the ownership of a strip mall with 30 business and nonprofit tenants. Most of Portland's investors are first-time investors and low-income renters. The majority are Black, Indigenous and people of color, women and first-time investors. Feasibility studies for replication of the Portland model are now taking place in 15 similar neighborhoods in cities nationwide, from Atlanta to Albany, Kansas City to Memphis and Omaha to Fresno.

People in neighborhoods living with low or no financial assets deserve and need an early and sustained financial stake in the changes happening in their neighborhood. They have always needed this.

In most respects the CIT is simple because it was built up from the people in a neighborhood. Their voices designed the CIT through human-centered design and using behavioral economics to highlight neighborhood challenges, changes and opportunities and to blend those with family motivations.

The CIT's unique attributes include the following: 1. affordable investments at $10 to $100 per month for localized zip-code-prescribed investors in commercial real estate; 2. short- and long-term returns through an annual dividend and share price change; 3. guaranteed protection from loss through a direct pay letter of credit from a bank; 4. a financial action course, “Moving from Owing to Owning,” translated into five languages; and 5. user-friendly stock offering and an investment management portal and website: investcit.com.

When we began to investigate creating a localized C corporation stock offering for unaccredited investors in prescribed zip codes, attorneys with Orrick, an international public finance law firm, told us simply, “You cannot do that legally.” But instead of stopping the CIT vision in its tracks, it researched options and found a provision in the Federal Security Act of 1933 known as 3(a)2. This provision allows for the creation of a security exempt from registration by requiring downside loss protection for the investors through either a government guarantee or a direct pay letter of credit from a bank.

“What bank will do that?” we asked. “No bank has been asked. Give it a shot,” they suggested.

“A direct what from who?” we asked.

“Like a guarantee but put in place continually and immediately for the benefit of the unaccredited investors,” they coached.

“What bank will do that?” we asked.

“No bank has been asked. Give it a shot,” they suggested.

According to the attorneys, municipal bond offerings often use a credit-backed bond structure to enhance their ratings and therefore their marketability. We would register a state C corporation, East Portland CIT Corporation (EPCIT), and target low-income investors in four high-poverty zip codes with a loss-protected investment.

Why not turn conventional corporate finance structures on their head for the benefit of the poor and excluded?

Why not turn conventional corporate finance structures on their head for the benefit of the poor and excluded?

Thus, we began our search for a bank. We found one, a solid regional real estate-focused bank, Northwest Bank, who considered the underlying mortgage on the property in a distressed census tract to fit their need for credit under the CRA, the once visionary now somewhat stale (though now poised for reform) Community Reinvestment Act of 1977, one of President Carter’s early successful initiatives. The bank underwrote the loan with the direct pay letter of credit, which covers the entire value of shareholders' share value (which increases annually as we gain investors and revalues the share price annually (from $10/share to $17.05/share in the 38 months since launching the CIT) based on an annual appraisal of the property and the paydown of the amortized debt (just like owning a home). This "exposure" to the bank resides within the underlying mortgage and the letter of credit as it inevitably increases under a conventional 75% loan-to-value (LTV) for both the primary mortgage and the full value of the investor's share value. We benefited from a surge in value of a foreclosed property that is now 100% leased to 30 business and nonprofit tenants.

But what about a stagnant market and that tricky LTV, not to mention a 1.25 cash flow coverage covenant from our bank?

To scale through sharing the model nationally, we will need banks to partner with patient impact investors and philanthropic equity to make our vision of 100 projects throughout the U.S. fit an acceptable risk profile, like we have done in Portland. This may mean a risk/liquidity backstop such as a linked deposit of foundation funds with the banks to reduce the credit exposure of the direct pay letter of credit. At the same time, there should be an effort to update provisions of the CRA laws to credit banks for providing the direct pay letter of credit, which could induce large bank participation. As a contingent liability for the banks, it is not pushing money out the door in a conventional way but instead leveraging a bank's balance sheet to support old-fashioned self-determination through bootstrap investing by families for their long-term success and for the good of all.

John W. Haines is the executive director of the Community Investment Trust, a project of Mercy Corps in Portland, Oregon.