

Inner City Returns

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By Richard Gentilucci



Success among double-bottom-line funds is encouraging investment in underserved communities, where the spending power may exceed that in suburban markets.

Through the creation of regional "double bottom line" funds, a significant amount of real estate investment capital is finally finding its way into impoverished communities throughout the United States. Over the years, there has been a disinvestment, or lack of capital flow, into low-income areas due to the widely held belief that community investment and generation of appropriate risk-adjusted returns are mutually exclusive.

However, the pioneering effort of an initiative born out of recession and civil unrest in Los Angeles more than a decade ago clearly illustrates that achieving financial goals and social returns from investments in underserved communities are both possible.

In 1998, under the stewardship of then-Los Angeles Mayor Richard Riordan and Deputy Mayor Rockard (Rocky) Delgadillo (currently Los Angeles city attorney), Genesis LA Economic Growth Corp. was formed to spur a public-private partnership to generate quality jobs and stimulate private investment in low- and moderate-income neighborhoods throughout the city of Los Angeles.

Genesis was inspired by the 1992 redevelopment of a shuttered General Motors plant on a 100-acre site in a gang-infested neighborhood of Los Angeles. Today, The Plant—a 68-acre retail center with 35 tenants, including Office Max, Home Depot, Babies R Us and a 16-screen theater—has transformed the area. The balance of the development is composed of 355,000 square feet of manufacturing facilities. In addition to creating more than 2,500 jobs, the project's financial success has spurred further private-sector investment and thoroughly transformed the community.

In 1998, Genesis LA Economic Growth Corp. selected Shamrock Capital Advisors, an affiliate of Burbank-based Shamrock Holdings of California Inc., the investment arm of the Roy E. Disney family, to be the manager of the Genesis LA Real Estate Fund. The mission of the Genesis Real Estate Fund is to offer market-driven solutions for businesses, developers and communities while at the same time championing economic development, job creation and community growth through urban revitalization. Two years into its creation, relying solely on capital from institutional investors that have at the same time been able to receive positive Community Reinvestment Act consideration, the fund grew to \$85 million.

To date, the Genesis Real Estate Fund has invested more than \$70 million in the form of equity and mezzanine debt. That investment has facilitated the development of 11 new and renovated retail, office, industrial and mixed-use urban-area projects with an aggregate value in excess of \$400 million. And it has successfully exited eight of those investments, generating an internal rate of return of more than 30 percent while at the same time creating and/or retaining more than 4,000 jobs in targeted areas of Southern California.

The success of the pioneering Genesis Fund has led to the creation of similar funds throughout the United States, managed by proven fund managers with outstanding track records. (The Sept. 16, 2004, issue of CPN featured an Executive Q&A with Michael Fried, CEO of Phoenix Realty Group, which has worked with Genesis and other funds.) According to the Social Investment Forum, a national nonprofit membership organization promoting the concept, between 2001 and 2003 assets in community investment funds and institutions increased by 84 percent, to more than \$14 billion. Additionally, the several funds operating for three or more years are showing handsome risk-adjusted returns.

Among the subsequently formed funds is the \$75 million Smart Growth Fund sponsored by the Bay Area Council, a coalition of large San Francisco-based employers. Created in 2002, and arguably still in its infancy, that fund has invested in several retail, housing, commercial and industrial projects and is already reinvigorating what it calls "the urban core of the Bay Area." San Diego also has a fund, and work is now underway on initiatives in other cities, including Miami, Sacramento and Portland.

An important feature of the double-bottom-line investment vehicles such as the Genesis Fund is that small-to-midsize development firms are provided with necessary capital to develop larger projects in these underserved communities.

Additionally, developers typically have access to the fund's investors that allows them to obtain construction financing at a lower interest rate and a higher cost ratio than can normally be obtained via their own resources. Also important, as is the case with the Genesis Fund in Southern California, developers also receive financial structuring support from the funds' seasoned management teams to ensure that the project is financially sound and successfully underwritten.

In the past, many lenders viewed urban investment as merely a social obligation and a means to meet the required federal guidelines set forth by the Community Reinvestment Act. Consequently, these investments were typically among the lower performers in their portfolios. That is changing as investors pursue opportunities based on a concept retailers learned only a few years ago: Because of the density of the urban core, lower-income communities can have a spending power that equals or exceeds the suburban markets. Some have said that this spending power may be as much as six times greater. Lenders are now turning to vehicles like the Shamrock-managed Genesis Fund to generate a market-rate risk-adjusted return in their CRA portfolio.

Many feel that today there is too much capital chasing too little product. For certain product and in certain places, that may be the case. But perhaps the capital providers have not always been looking in the right places.

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