Economic Development

INNOVATIONS FOR SUCCESSFUL SOCIETIES

REVIVING PHILADELPHIA: USING THE HUD SECTION 108 PROGRAM TO CREATE A LOAN POOL FOR ECONOMIC DEVELOPMENT, 1993 – 2000

Hilary Duff drafted this case study based on interviews and research conducted in Philadelphia during November and December 2022. This case is part of a series about using the U.S. Department of Housing and Urban Development's Community Development Block Grant program effectively. The views expressed in the case study do not necessarily represent those of the Department of Housing and Urban Development. Case published in April 2023.

SYNOPSIS

In 1995, Philadelphia, a city on the East Coast of the United States, pioneered a unique use of a long-running federal loan program to bolster economic development and create jobs for low-income communities. Conceived by elected officials and economic development staff and championed by an ambitious mayor, the novel approach employed a lesser-known component of the US Department of Housing and Urban Development's Community Development Block Grant program known as a Section 108 loan guarantee. Philadelphia established the nation's first citywide loan pool funded by the Section 108 program and became a model for other communities wishing to undertake similar projects. This case is the first in a series on financing local housing and economic development initiatives.

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INTRODUCTION

On a Thursday at noon, the Loews Philadelphia Hotel lobby was nearly empty—the period of quiet calm between morning checkout and the afternoon arrival of new guests. Occasional visitors pushed through the revolving door and shook off the December rain. They were greeted by the security guard on duty, Jerome Harvey, who welcomed them to their home away from home in Philadelphia's Center City.

Figure 1

Jerome Harvey had worked at the Loews Philadelphia Hotel in Center City since 2002. Credit: Hilary Duff

Harvey had worked at the hotel since 2002 and said he had no plans to leave the job. "Unless they fire me or I win the lottery, I'm not going nowhere," he chuckled. Before the hotel opened in 2000, Harvey had had little reason to visit the city's downtown. He lived in northwest Philadelphia and had worked at a bakery there. But the new hotel offered better pay and benefits—"a decent job," in his words. (figure 1)

Harvey's position may not have existed if not for a collaboration between the city, the federal government, and private developers. In 1992, the skyscraper that became the Loews hotel was 85% vacant,[1] and Philadelphia was in an economic nosedive. Like other postindustrial cities across the United States, Philadelphia during that period carried the telltale signs of a place that was past its prime.

It had been a different story a century earlier. During the nineteenth century and the first half of the twentieth, Philadelphia had been an industrial superpower. The city was home to factories producing everything from textiles to clothing, to motor vehicles—each manufacturing facility surrounded by a network of row houses for workers. The city had a busy port and downtown business district and became one of the country's largest production sites during World War II. Jobs attracted people to the city, and as its population grew, Philadelphia wielded influence in state and federal halls of power.

But Philadelphia's period of prosperity faltered after the war. From 1950 to 1990, the city's population dropped 23% to 1.6 million people, from 2.1 million.[2] As in many other US industrial cities, middle-class families, most of them white, moved to the suburbs.[3] Historic buildings sat empty and once-thriving factories closed. As the local tax base eroded, tax rates rose to among the highest in the nation, and the city neared bankruptcy as it sold its assets to plug budgetary gaps.[4] Decades of racial segregation and urban-planning policies had created de facto segregation that enforced deep inequalities and sowed distrust among communities of color.[5]

John Kromer, director of housing and community development in Philadelphia in the '90s, wrote in his 2009 book *Fixing Broken Cities: The Implementation of Urban Development Strategies,* "You could find torched cars and weed-choked buildings within a five-minute drive of City Hall in three directions. . . . City Hall was encircled by many thousands of square feet of vacant space."[6]

There were signs the tide might be changing, however. In Washington, Democratic President Bill Clinton had come into office in 1993 with an economic strategy that focused on policies to promote job creation, innovation, and infrastructure through tax incentives and other federal investment. The aim was to counter the lingering aftereffects of an eight-month recession during 1990–91, from which the national labor market had yet to fully recover.[7] When Clinton's term began, national unemployment sat at 6.9%[8] and was significantly higher among residents of African American and Hispanic communities.[9] There was ample opportunity to better reach low- and moderate-income households.

Another cause for optimism was Philadelphia's new mayor, Edward Rendell. A former Philadelphia district attorney, Rendell ran on the Democratic ticket in 1991, pledging sweeping change in the forms of economic revitalization and investment in the business community. "Philadelphia was in the pits," Rendell said in 2022. "No one had any real interest in developing any new projects in the city, so we knew it was going to be impossible to do economic development unless we could find some new ways to incentivize it."

The conversion of vacant downtown buildings into hotels was one example of how Rendell intended to use a burgeoning hospitality sector to kick-start economic development in Center City and, by extension, all of Philadelphia. The sector would also create jobs for people like Jerome Harvey.

The big question was how to finance such an ambitious agenda. Given the resources required, public–private cooperation was a must, and all financing options had to be explored. To succeed, such an initiative would need to enlist a variety of communities and organizations as well as strengthen cooperation across city departments.

THE CHALLENGE

Rendell inherited no shortage of challenges when he became mayor in January 1992. He had a favorite metaphor to describe the city at the time. He said Philadelphia was like a patient who had taken a bullet to the chest and had been diagnosed with cancer. "If you fix the bullet wound, it will give you time to do the rest. That was my theory about why we had to get rid of all the waste in government and then start generating revenue."

The mayor said he saw reviving Philadelphia as a two-step process: reduce spending immediately and incentivize economic growth over the long term. During his first 18 months in office, Rendell and his chief of staff, David Cohen, launched several initiatives to close the city's $200-million annual operating shortfall and its $250-million deficit (the latter figure represented more than one-10th the city's annual budget).[10] These initiatives included privatizing a number of city functions, securing concessions from city employee unions whose contracts were up for renegotiation, and assigning heads of city agencies, departments, and commissions to carry out cost-saving measures.

Although he had many critics, Rendell said he was doing what needed to be done at a turning point in Philadelphia's history. "Nobody had ever cared about saving money or making things more efficient," he said, adding that the measures he took did no damage to the effectiveness of government.

Halfway through his initial four-year term, Rendell was ready to mobilize his economic strategy for drawing private investment back to the city. An anchor of his strategy was the Pennsylvania Convention Center, a huge multiuse facility that opened in Center City in 1993. The convention center had the potential to attract out-of-town visitors and their money. Convention-goers would shop, visit attractions, and buy food at restaurants, generating a variety of jobs—and revenue.

The mayor's office had to find a way to overcome a major constraint, however. At the time, Philadelphia had just 6,702 hotel rooms—too few to accommodate the anticipated numbers of convention delegates[11] and far fewer than competing northeastern convention destination cities, such as Boston, with 20,000 rooms, and Baltimore, with 19,489. During his second term, Rendell would launch a plan called 2,000 Rooms by 2000, in an effort to make Philadelphia competitive in the national market for high-profile meetings.[12] (figures 2 and 3)

Transforming Rendell's hospitality sector vision into reality required that the city overcome several additional challenges: identifying appropriate financial tools to incentivize economic development, creating management capacity, and winning the support of the city's low-income communities, which were among the intended beneficiaries.[13]

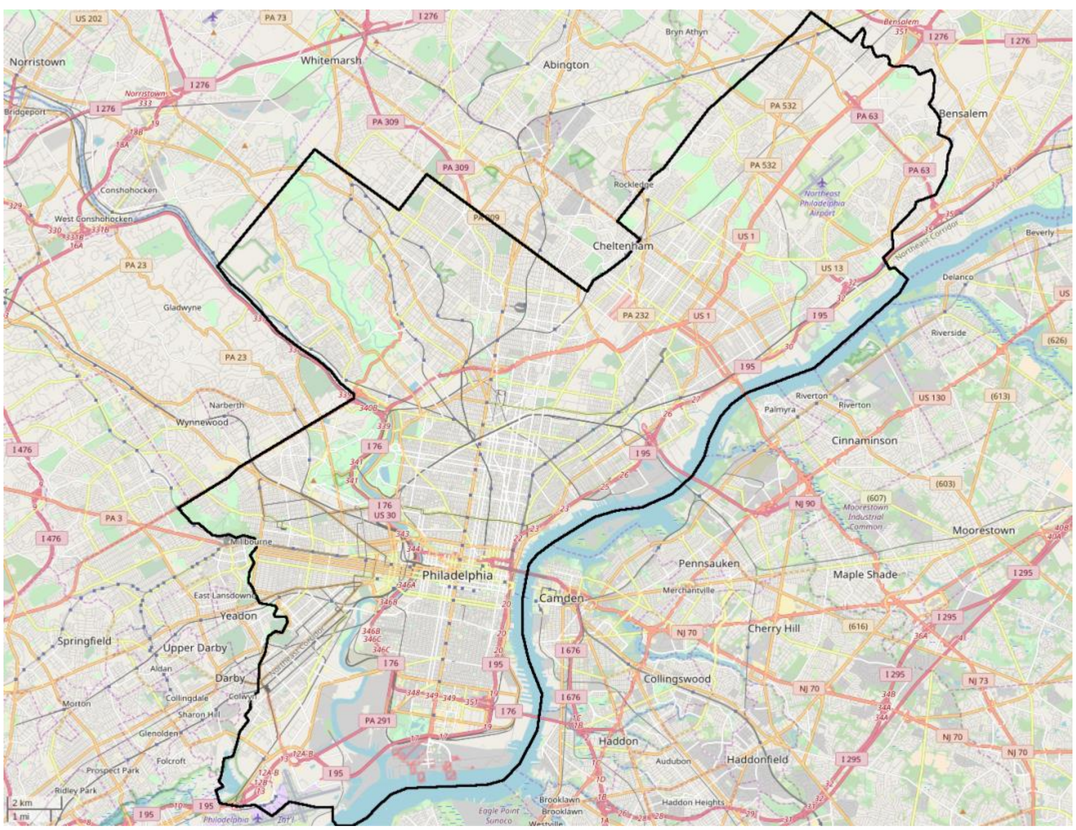
By the mid-1990s, Philadelphia was already using a number of financial tools to foster economic development. The tools included a 10-year property tax abatement scheme, historic-preservation tax credits, and tax increment financing—an approach that enabled local taxing authorities to pay off project bonds with future increased revenue from the redeveloped area. Philadelphia also made use of federal Department of Housing and Urban Development (HUD) housing-choice vouchers to construct affordable housing for low-income families, older people, and people with disabilities.

Another option at the city's disposal was a loan guarantee under Section 108 of HUD's Community Development Block Grant (CDBG) program. Since 1974, the block grant program had channeled federal funds to communities and states for use in various activities that benefited low- and moderate-income people. Most of the funds were transfers that communities did not have to pay back. By contrast, the Section 108 Loan Guarantee Program enabled communities to pledge up to five times their annual block grant allocations toward federally guaranteed, long-term (20-year), low-interest loans for large-scale economic development projects as long as the use benefited low- and

Figure 2: Philadelphia's Center City, including City Hall (front) and the former PSFS (Philadelphia Savings Fund Society) building, now the Loews Philadelphia Hotel.

Credit: Hillary Duff

Figure 3: Map of Philadelphia (Wikimedia)



Text Box 1:
National objectives of the Community Development Block Grant program

Unlike previous federal programs, HUD's block grant program let grantees use funds at their discretion—as long as they supported eligible activities, satisfied national objectives, and had measurable public benefit. The primary categories of eligible activities were economic development, housing, public facilities, and public facility improvements.

The general block grant program rules and requirements also applied to Section 108 projects, all of which had to meet one of the program's three national objectives:

- Principally benefit people of low and moderate incomes, often in the forms of job creation or retention of permanent full-time equivalent jobs at least 51% of which were available to eligible individuals
- Aid in the prevention or elimination of slums or blight
- Meet an urgent need by correcting conditions that posed serious and immediate threats to the health and safety of residents

Information drawn from several sources including HUD Office of Planning and Community Development. "Submissions for Community Development Block Grant Programs, Consolidated Plans, and Indian Community Development Block Grant Program Changes (FR-6148)." Office of Information and Regulatory Affairs. Fall 2021 and Charles J. Orlebeke and John C. Weicher, "How CDBG Came to Pass." *Housing Policy Debate*, 2014 https://doi.org/10.1080/10511482.2013.852989

moderate-income people, aided in the elimination or prevention of slums and blight, or met urgent community needs (text box 1).

Notably, Section 108 loans were designed to help plug the financial gap in a worthy development project. For example, if a proposal to renovate a retail center in a historically underserved neighborhood was expected to cost $40 million, the developer had to come up with a portfolio of financing known as a *capital stack*. In this hypothetical scenario, a bank might lend $25 million, and the developer might invest $10 million, leaving a $5-million shortfall and no additional commercial investors willing to partner because the retail center was in a less-prosperous area. A Section 108 loan enabled the project to move forward.

Section 108 loans were underused because many communities worried that the program would jeopardize future block grant funding. Because these were loans, not grants, a borrowing city had to repay the Section 108 loan principal plus interest at the end of the term. To do that, a city might have to sacrifice several years of block grants—funds otherwise destined for other projects benefiting low- and moderate-income households.

The mayor's plan to revitalize the downtown hospitality sector could put Section 108 loans to good use for three reasons. First, the hotel projects would provide jobs for low- and moderate-income individuals. Second, the hotels would generate revenue that the developer could direct to loan repayment. In the case of a financial shortfall, hotel projects had real estate assets that could be used as collateral. Third, the city could show that without this public money, the projects would not happen. In other words, the hotels were deemed too risky to attract sufficient resources from commercial lenders and needed public finance at a concessional interest rate to help bring private lenders to the table.

However, there was a second hurdle to clear. Political pushback from community leaders was likely unless proponents could prove that the projects financed by Section 108 loans would benefit residents and could generate enough revenue for repayment. Under Section 108's rules, the city or designated public agency was also required to consult with low-income communities in order to develop a strategy for inclusion of those communities in the project benefits.

Third, the complexity and size of the Section 108 program generated administrative burdens for city governments that lacked strong internal capacity. When lending to a third-party borrower, such as a private company, Section 108 recipients were responsible for underwriting those loans—that is, evaluating the creditworthiness or risk of providing financing for a specific borrower for a specific project. In the case of Section 108 loans, underwriting included ensuring that project development costs were projected accurately, that participants had pledged adequate collateral in case of nonpayment, and that the revenue generated would be adequate to cover the debt service on the loan as well as a reasonable cushion.[14] Section 108 loan recipients had to either have a qualified underwriter within their organizational structure or contract an underwriting service.

Text Box 2: Community Development Block Grants and housing in Philadelphia

During the 1990s, the city housing office sought to expand the stock of affordable housing in order to help slow the exodus of population from Philadelphia. It wanted to build new public housing for purchase in parts of the city that were formerly dominated by warehouses and factories and where land was mostly vacant. But home buyers did not have much purchasing power, and the market was depressed. As a result, the prices of homes were lower than the costs of developing them.

On three occasions, including in 1997, Section 108 loans were enlisted alongside other federal and state programs to close the gap between what houses could fetch on the market and what they cost to build. The aim was to subsidize home construction so that the neighborhoods could gradually become more-desirable places to live and could attract private developers that would build market-rate (i.e., full-price) properties. The city repaid the loans by using its future block grant allocations.

Kromer, the director of the office of housing in the 1990s, said that accessing a larger pot of funds up front by using Section 108 was necessary to accelerate the construction of large-scale housing projects, convince people to stay in Philadelphia, and stimulate housing development by the private market. Rendell agreed and encouraged this sort of solutions-centered thinking.

"Having the political support and being able to tell a well-connected elected official that we *can* do this or *won't be able* to do that was huge," said Kromer. "It was very different from having a mayor who said, 'Here's what I want you to do.' [With Rendell,] it was much more of a 'How can we address this problem?'"

Use of Section 108 loans in Philadelphia remained uncommon outside the ambit of PIDC, however. It was usually politically difficult to win support for the sacrifice of future block grants in order to meet a current need.

Under HUD's rules, the Section 108 recipient (city, county, or state) had to administer the loan or it could designate a subrecipient partner to do so. In Philadelphia, HUD block grant funds were typically administered through the city's Office of Housing and Community Development, which occasionally used Section 108 loans for affordable housing. But that department did not possess the specialized knowledge or skills to issue and manage loans for economic development purposes. (text box 2)

FRAMING A RESPONSE

The mayor's team quickly focused on identifying an appropriate management authority that could enable the city to utilize the Section 108 loan guarantee program.

The Philadelphia Industrial Development Corporation (PIDC), established in 1958 by the city and the Chamber of Commerce for Greater Philadelphia, offered an avenue to move forward. Supervised by a board the mayor and the president of the chamber of commerce jointly appointed, PIDC had its own staff financed largely by fees for the business activities the organization supported.[15] The agency was relatively apolitical and operated at arm-length from city departments. Engaging PIDC could help ensure leadership continuity in a city that had a two-term-consecutive limit for mayors. Importantly, PIDC and its leadership team had a solid track record and had won the trust of community leaders. Its director William Hankowsky had served as Philadelphia's commerce director and director of community development in Camden, New Jersey, just across the Delaware River.

As an economic development organization, PIDC was in the business of making loans. It had experience in using various state loan programs and administering federal grants. It had a loan evaluation committee, produced loan portfolio performance metrics to demonstrate success, and employed staff who were certified underwriters for HUD. Being a certified underwriter meant PIDC could evaluate development project risks and ensure that those borrowing from the loan pool complied with HUD national objectives.

Finally, PIDC had specific experience in distributing HUD's block grant funds. Each year, the organization received a few million dollars from Philadelphia's annual block grant allocations to distribute as neighborhood-focused economic development loans. The agency was familiar with the program's national objectives and the types of projects that would be eligible for Section 108 funds.

Hankowsky saw Section 108 as a valuable financial tool, but he wanted to propose a new way to tap Section 108 resources in order to improve their impact and ease of use. He enjoyed what he described as a "terrific relationship" with Rendell and had a standing weekly meeting with the mayor and Chief of Staff Cohen. It was in one of those meetings in 1994 that he floated his ideas and the trio decided to invite a HUD official to visit Philadelphia to discuss a novel approach for using the Section 108 program.

Text Box 3: Impediments to using Section 108 resources during the 1990s

PIDC director Hankowsky said that the Section 108 resources, in their original form, were difficult for cities to use not only because of the skills required to manage them but also because of a cumbersome approval process that clashed with developer needs for quick decisions and access to capital. To receive a Section 108 loan, a city first had to assemble its development project and send it to HUD for sign-off. Then the city and HUD had to negotiate a plan for disbursement of funds. By HUD's own calculations, the process could take more than six months.

Many communities deemed the program untenable because of such a lengthy process, combined with the fact that HUD issued loans only twice a year versus commercial bank loans, which businesses could secure at any time.

Hankowsky's loan pool proposal eliminated those obstacles and made project participation more attractive to private partners.

See: Overview of the HUD Section 108 Loan Guarantee Process and Typical Associated Timelines." February 2020. https://files.hudexchange.info/resources/documents/Overview-HUD-Section-108-Loan-Guarantee-Process-and-Typical-Associated-Timelines.pdf

That HUD official was Paul Webster, director of HUD's Financial Management Division and a veteran of the department, which he joined in 1972. The Clinton Administration had enlisted regional HUD administrators to promote the use of the Section 108 program. Soon, Webster, the civil servant most knowledgeable about the program, started fielding practical questions from cities about how best to proceed. That included questions from Philadelphia.

Webster traveled from Washington, D.C., to Philadelphia to meet with officials, explain HUD's agenda, and discuss how Section 108 lending could help fund the kinds of economic development activities the city wanted to pursue.

At the initial meeting, Hankowsky told Webster that HUD's approval process for Section 108 loans was cumbersome compared with the streamlined approval that commercial banks provided (text box 3).

Hankowsky thought it was possible to accelerate the process by securing preapproval from HUD to use Section 108 funds as part of a loan pool that PIDC would manage. PIDC would seek HUD authorization to borrow $15 million to $20 million in Section 108 guaranteed loans and would work with HUD to establish investment criteria for the kinds of projects HUD could preapprove. "That way, when a developer or a nonprofit approached us, we would have the local discretion to say, 'You need [this amount of finance]. OK, you can do it,'' said Hankowsky.

Unlike the traditional Section 108 model that issued loans for individual development projects, under this loan pool PIDC would oversee the evaluation, selection, administration, monitoring, and documentation of a portfolio of third-party projects to which the organization would relend Section 108 funds. HUD would work with PIDC to determine specific monitoring and reporting requirements against HUD's national objectives.

If HUD accepted the arrangement, the main remaining need involved reaching out to the communities the city hoped would benefit. Though the PIDC loan pool would not siphon block grant allocations away from housing and community development up front, there was a risk that a loan-pool-financed economic development project could fail and as a result, need to be repaid using a community's future block grant allocations. "Legally, you are putting at risk CDBG dollars if it goes south," Hankowsky said. "The housing side of the CDBG world was like, 'What money are you putting at risk? How do we know [these loan pool projects] are sound?'"

Hankowsky said that in 1994, the loan pool idea was not highly controversial, though the organization did need to allay housing advocates' worries and get the idea approved by city council. For this reason, PIDC's policy was only to support activities that generated enough revenue to cover loan repayment and had some source of collateral, such as real estate, which could be pledged to loan repayment.

According to Donna Cooper, deputy mayor of policy and planning during Rendell's tenure, community development groups and neighborhood committees were already working closely with the city. In partnership with the housing office, community development corporations, which launched during the 1970s and 1980s, accessed land for development through the Philadelphia Redevelopment Authority and built new homes that used tax increment financing and took advantage of the city's 10-year tax abatement scheme.[16] "The city rebounded under Rendell, so there wasn't as much angst at the community level," said Cooper. "We were beginning to improve services, and community development corporations had a partner in the government. People were not as hypercritical."

Cooper added that other innovative sources of financing—such as historic tax credits and HUD's section 202 program to create affordable housing for older people—meant that neighborhood groups were still making progress on their agendas. Explained Cooper: "It wasn't so much that people consciously said, 'That's OK' [to use the Section 108 program for economic development], but other things were creating opportunity for them, so they did not have to think the pie was so limited."

To persuade city officials who opposed the use of Section 108 and other financial incentives, Rendell said, he relied on a simple rationale: "I said, 'This is part of a plan I have to revive the city. Tell me your plan.' Nobody had a plan. That's why the city was in such lousy shape—because nobody had a plan or an idea. Given that overwhelming piece of logic, I got approval."

By 1995, the loan pool concept had won local acceptance. Hankowsky and representatives from Rendell's office had agreed on the details and had secured approval from city staff and the city council. The city included the loan pool idea as part of its 1995 annual block grant action plan to HUD. PIDC officially became the public agency designated by the City of Philadelphia to administer and expend funds from the pool.

GETTING DOWN TO WORK

The idea of using Section 108 to create the nation's first citywide loan pool for economic development had to move from the drawing board to reality. The

Figure 4: Sam Rhoads was one of the architects of PIDC's Section 108

Credit: Hilary Duff

task of designing the actual loan pool and putting it into operation was handed off to Sam Rhoads and Caleb Benjamin as implementers. Rhoads, who served as interim president of PIDC many years later, joined the organization in 1995 from the New Jersey Economic Development Authority. Benjamin was a commercial real estate financing staffer who eventually became PIDC's Section 108 loan pool manager.

Under the direction of then PIDC president Hankowsky, as well as senior PIDC staff Jim Fluck and Alex Eldridge, Rhoads and Benjamin were close collaborators on the loan pool project. The two men had a few things in common. Both were quite new to PIDC: Rhoads joined in 1995, Benjamin in 1994. They shared a professional and personal interest and expertise in urban planning, economic development, and financial stewardship: Rhoads had a master's degree in public affairs and urban and regional planning from Princeton University, and Benjamin had a master's degree in public administration and economic development finance from the University of Pennsylvania. Together the pair was keen to bring fresh ways of thinking to a well-established institution like PIDC—and to a beleaguered city. (figure 4)

Three steps lay ahead: working with HUD to specify the terms and conditions of the loan pool, defining the investment structure of the loan pool, and identifying eligible projects to fund.

Establishing the loan pool terms

HUD's approval of the PIDC Section 108 loan pool concept as part of Philadelphia's annual block grant action plan was just the beginning. The next task was to figure out the parameters of the loan pool. For a four- to six-week period in 1995, Webster, based in HUD's Financial Management Division, continued to serve as the intermediary between PIDC officials and HUD headquarters.

From HUD's perspective, these telephone calls were part of an iterative proposal development process. PIDC would ask whether it could use the funds for a particular purpose, and then somebody from HUD would say, "Well, no, you can't do that exactly, but you could do this." That iterative process continued until the result was something that worked for Philadelphia and complied with HUD requirements.

PIDC had to ensure that all projects financed by the loan pool satisfied a national objective of the block grant program: to bring measurable public benefit to low- and moderate-income communities. Community input on projects was obtained via the city council process for approving the block grant annual action plan and was not managed by PIDC.

In addition to the many statutory and regulatory requirements of Section 108 and the block grant program, applicants had to comply with a variety of other federal rules. That included, for example, the Davis–Bacon Act, administered by the U.S. Department of Labor. Davis–Bacon required that laborers and mechanics employed by contractors and subcontractors in the performance of construction work under HUD projects larger than $2,000 be paid the "prevailing wages" for the locality as determined by the Labor Department.

Faced with a litany of requirements and an ocean of small print for PIDC and prospective loan pool borrowers, Rhoads said he raised an additional issue with Webster, namely that "Section 108 has relatively narrow benefit, and that it just so happens that because of a variety of circumstances, it could work really well in Philadelphia." Rhoads added that Webster was receptive to hearing PIDC's concerns and making the program workable.

This first step also involved adapting the standard loan agreements that HUD had with municipalities so as to facilitate a loan pool structure, as well as creating other necessary legal documents.

Determining the investment structure

PIDC had to design an innovative investment structure that would avoid any chance that the organization could fall short of its financial commitments. Finding a workable solution involved significant financial modeling, which Benjamin led, and subsequent validation by a pair of external municipal finance firms.

Though it was later updated, in 1995 PIDC's Section 108 investment structure entailed borrowing from HUD and immediately buying US Treasury bonds that would mature at the same pace as the project and at roughly the same interest rate as the Section 108 loan, thereby enabling PIDC to repay its debt to HUD. That matched-asset-liability portfolio reduced the risk that PIDC might borrow Section 108 money at a certain interest rate—only to have market interest rates go down, making it difficult for PIDC to issue loans to third-party borrowers, who could now get lower cost financing elsewhere.

The US Treasury investment scheme served two functions: First, it enabled PIDC to issue loans at interest rates benchmarked to rates prevailing at the time a given loan was to be issued—rather than at the rate of the initial Section bond issuance, which may have been months or even years prior in a very different interest rate environment. Second, it enabled undisbursed pool funds to earn interim interest that could be applied toward Section 108 bond repayments. Combined, those features enabled PIDC to offer loans from the Section 108 pool at generally competitive interest rates in *any* rate environment. It also minimized any interest rate loss to PIDC during the many months it took to originate and issue loans from the pool.

When it came time for PIDC to issue individual loans from the pool, PIDC sold off a portion of its Treasury bonds so that it had the capital to lend to a borrower. For a given borrower, PIDC charged loan interest at a fixed spread over prevailing US Treasurys rates plus a modest, borrower-specific credit risk premium. The spread was approximately equal to the small difference between US Treasury rates and the Section 108 bond that had been locked in at the date of bond issuance. Adding this spread to loan pool loans enabled PIDC to cover the principal and interest owed to HUD and accommodated the risk of loan loss. The credit spread varied from borrower to borrower and enabled PIDC to bolster the pool against potential future credit losses.

Back at HUD headquarters in Washington, D.C., Webster had to secure agreement from department leadership and office of general counsel to allow Philadelphia to use Section 108 loans to initially purchase US Treasury bonds—something that had never previously been done.

In the course of time, HUD changed its block grant and Section 108 guidelines to increase the program's utility and make the fund more competitive. The change included creating an Economic Development Initiative grant that could be awarded in conjunction with Section 108 to help communities deal with the interest rate risk Philadelphia had identified. In creating its economic development loan pool, Philadelphia became one of the first major initiatives to receive such a grant, which was a critically important element in making the loan pool model feasible in the mid-1990s.

PIDC's investment structure changed as the Section 108 program became more flexible in its overall requirements. In subsequent years, PIDC could seek authorization for up to $20 million in Section 108 loans but draw the funds in smaller amounts as needed.

Selecting eligible projects

When Philadelphia's citywide loan pool received its first round of funding in 1995, a final task involved the identification of appropriate economic development projects for PIDC lending. *Appropriate* meant creating measurable public benefit to people of low and moderate incomes, as required by the block grant program.

As the administrator of the Section 108 loan pool, PIDC had to ensure through underwriting that all loan pool projects would meet HUD requirements throughout projects' life spans. Negotiations between HUD, the City of Philadelphia, and PIDC were able to bring some level of flexibility to those requirements. For example, from the outset in 1995, HUD decided that PIDC did not have to identify any of the borrowers up front as long as borrowers pledged to use funds in a way that met eligibility requirements and produced a minimum level of public benefit.[17] Regulatory compliance was verified by the City of Philadelphia, and PIDC depended on the city to approve loan pool projects.

When PIDC did wish to lend from its loan pool, the agency was required to provide the HUD Philadelphia office with a description of how the proposed investment would satisfy the programmatic requirements. Field office sign-off was viewed as less burdensome than going through the whole application process with HUD's headquarters. PIDC also submitted regular reports on the loan pool projects' public benefit to the City of Philadelphia to include as part of its annual block grant performance report.

PIDC had community-benefit criteria of its own. One of these was evidence that without a public subsidy the project would not materialize. This was to prevent the use of Section 108 funds for projects that would have happened without public funding. This was called the but-for test. In other words, a project had to be deemed too risky a financial investment by other lenders and as a result would not be able to move forward if not for an infusion of public, lower-interest capital. At the heart of the but-for requirement was a contradiction, meaning that the PIDC loan pool could finance only projects that came with inherent levels of risk, yet such projects also had to generate enough revenue or other collateral so their loans could be paid off without dependence on current or future block grant allocations, or with only minimal dependence on these.

HUD itself, through Webster's office, placed greater importance on credit quality. Contracts between the city and HUD's financial management division imposed strict loan-to-value standards. For example, say the lender (in this instance, HUD) imposed a loan-to-value ("LTV") limit of 80%. The collateral to secure a $1 million loan, such as a mortgage on real property, would have to be at least $1,250,000 so that the LTV would not exceed 80%.

According to PIDC, the outcome of the many requirements and the but-for test was that economic development projects financed by the Section 108 loan pool fell predominantly into three categories: retail, hotels, and established commercial and industrial borrowers. Medium- to large-scale not-for-profit projects also emerged as a Section 108 loan pool niche. All projects had significant real estate components that anchored loan collateral. They were also projects that were almost certain to generate revenue sufficient to repay the loan and created entry-level jobs for low- and moderate-income workers.

Because it was an agency in the business of lending money, private, nonprofit, and community developers would approach PIDC in search of capital. PIDC staff members then assessed each proposed project to see which of the agency's financial products would be the best fit. "What we tell the

Figure 5: The Philadelphia Marriott Downtown was the first hotel to be financed in part by Section 108 loans. Its location next to the Pennsylvania Convention Center made it a highly strategic investment in the 1990s.

Credit: Hilary Duff

business community is that we've got flexible financing. We don't tell them we have CDBG money or HUD 108 money," explained PIDC's Rhoads. "People get hopelessly confused with all the abbreviations.. . . It's our job to understand what works and doesn't work in various circumstances."

In the first years of PIDC's Section 108 loan pool program, many of the Section 108 loans went to private developers for conversion of vacant historic buildings into hotels—a cornerstone of Rendell's economic development strategy, which sought to expand Philadelphia's hospitality and tourism sector. Section 108 loans were used in part to renovate the Loews Philadelphia Hotel, convert a City Hall annex building into a Courtyard by Marriott, transform part of the Reading Terminal railway buildings into space for the Philadelphia Marriott Downtown, and to turn the Girard Trust Building into a Ritz-Carlton hotel. (figure 5)

OVERCOMING OBSTACLES

Once PIDC had its Section 108 loan pool up and running, the organization had to ensure the effective and careful administration and monitoring of the program. Doing so was not easy, and two aspects were especially demanding. One difficulty, recognized early on, involved the data collection and reporting requirements of the block grant program as it applied to jobs for low- and moderate-income people. Business borrowers had to document that their projects brought measurable public benefit. For example, to monitor performance related to job creation and retention, developers and employers receiving Section 108 loans were required to question prospective employees about their family sizes, incomes, races, and genders. PIDC staff had to verify the resulting reports and eventually submit the information to HUD to ensure that loan-pool-financed projects were meeting the department's national objectives.

"We had projects that would die on this," Rhoads said of the employment-reporting forms. "A lot of employers don't want to ask people these questions, which can be invasive." There were other ways to prove a project was delivering the necessary public benefit, but Rhoads described the reporting paperwork as "a real practical administrative challenge."

The difficulties extended to PIDC as administrator of the Section 108 loan pool. According to Rhoads: "Our organization must have people who can monitor [that employment reporting]. That is someone's full-time job. We're Philadelphia, so we can afford to support that capacity across our whole organization. But if I'm in a smaller city, I'm probably unable to hire someone to enforce compliance." The upside of that reporting was quality data that could show the social impact of Section 108–supported projects, "but collecting that data is very painful, so the price of that data is relatively high," said Rhoads.

A second persistent challenge for PIDC was the need for coordination with Philadelphia's housing office to ensure the city was not overextending its borrowing limits under Section 108. The program allowed block grant recipient communities like Philadelphia to borrow up to five times their annual block grant allocations. With both PIDC and the housing office using the Section 108 program in the late 1990s, city officials had to be judicious in monitoring their requested amounts. "I asked [the Office of Housing and Community Development] to tell me which loans they borrowed—and the current principal balances—and I would track all of it informally in a spreadsheet," said Rhoads.

ASSESSING RESULTS

The immediate impact of the PIDC citywide loan pool was most obvious in Center City, the part of Philadelphia where the original Section 108 loans had gone toward supporting the conversion of historic buildings into hotels. From 1992, when Rendell was elected mayor, to 2000, when he finished his second and final term in office, Philadelphia added 4,000 new hotel rooms in Center City—a nearly 60% increase.[18] In 2000, the city hosted the Republican National Convention—one of the initial goals Rendell had had for Philadelphia. Other projects carried out at about the same time enhanced access to grocery stores and other essential businesses in low-income neighborhoods.

Rhoads described the change in the city's downtown area as palpable: "Center City, over the course of the time that I've been here, went from a city that had a lot of gaps in its central business district to one that today feels very vibrant and busy." He recalled a visit from his brother in the early 1990s, when the pair tried to get dinner on a Sunday night, only to find nothing was open.

"And a couple of years later, there's many places open and you can't get in because they're all full. I think Philadelphia has gone through a very significant transition," said Rhoads.

Even those who originally questioned the use of Section 108 loans for economic development could not deny the role of the hotels in revitalizing Philadelphia. "The hotels were big contributors to the job creation puzzle in Philly in the 1990s, and they became the vehicles by which all of these other jobs happened at restaurants, at SEPTA [the Southeastern Pennsylvania Transportation Authority], and more," said Cooper, Philadelphia's deputy mayor of planning and policy.

Although those investments did not halt the hemorrhage of population from Philadelphia as a whole, the city's core showed improved health. During the decade ending in 2000, the population of Philadelphia's central business district increased by 8.8%, even though the citywide population still contracted by 4% during the same period, underscoring the continued need for revitalization work in neighborhoods outside the city core.[19] (text box 4)

Over time, the impact of the Section 108 loan pool extended to neighborhoods outside the downtown core. PIDC worked increasingly with community development corporations to acquire and renovate vacant land and old shopping centers with support from loan pool financing. The community corporations were neighborhood-owned developers, many of them established by local activists from high-poverty areas that had been affected by the deindustrialization of Philadelphia and discriminatory urban-planning policies. In the 1980s and 1990s, those groups had worked on affordable housing projects, including projects funded in part by HUD block grants. Because of their experience, the corporations had the legitimacy, capacity, and competency needed to partner with PIDC, and the collaboration became a way to better

Text Box 4: Loan defaults and the metrics of mission-based lending

In the more-than-25 years of the Section 108 loan pool, PIDC experienced one large business borrower that partially defaulted on its loan. The Arden Group, a private development company that purchased the historic former Girard Trust Building south of City Hall, borrowed $16 million from the PIDC Section 108 loan pool. The loan was part of the $88-million renovation costs of opening a 331-room Ritz-Carlton hotel in June 2000. The city was required to use a portion of its block grant allocation to cover the shortfall.

Rhoads of PIDC said lenders always have a default rate: "You do everything you can to underwrite something carefully, but sometimes you get it wrong." At the same time, Rhoads considered the other benefits that had come from the Ritz-Carlton project, including the Philadelphia wage tax (from employees working on and in the hotel), real estate taxes, jobs, hotel beds, and the revitalization of a vacant historic building. "I don't want to minimize the money, but we still achieved many of our objectives," concluded Rhoads, pointing to PIDC's role as a mission-based lender.

See: Peter Binzen. "Hotel Venture May Pay Off." *Philadelphia Inquirer*, January 17, 2000, p. C6. Accessed via Newspapers.com and Tom Belden. "Center City Lodgings Slump Hits New Hotel." *Philadelphia Inquirer*, August 23, 2003, p. C2. Accessed via Newspapers.com

Text Box 5: Using Section 108 to eliminate a food desert

Mayor Rendell's Center City economic development strategy generated jobs for low- and moderate-income residents, but PIDC also used its Section 108 loan pool for purposes that directly benefited low-income communities in other ways. For example, the Bakers Centre, a retail development in northwest Philadelphia, received $3 million in Section 108 financing in 2012 and opened the following year in an area of the city with a historically high poverty rate. ShopRite, a large supermarket chain, signed on as the center's anchor tenant.

The Bakers Centre satisfied HUD national objectives by creating 279 full-time-equivalent jobs for people of low and moderate income. With nearly 400,000 people living within a three-mile radius of Bakers Centre, the project also delivered a presumptive benefit—HUD's term for describing the impact expected to materialize when a business is located in a high-poverty area.

Outside the ShopRite, an employee shared her thoughts about the benefits of the shopping complex—to both her and her community. Tyisha Whaley said she had started working behind the deli counter in 2022 after shopping at that supermarket for nearly a decade. Her prior work had required an early-morning, two-hour commute to South Philadelphia.

Whaley said Bakers Centre was a welcome addition to the neighborhood, which had formerly been a food and retail desert. The supermarket was clean and well stocked, and she said it provided shoppers with a sense of dignity and pride. Plus, it was a social hub. "It's like a community center here," laughed Whaley. "I see my neighbors, people from my kids' school, and church folks from Germantown to Uptown. This is the heart of all North Philly!"

See: HUD. "Commercial Redevelopment Case Study: Bakers Centre Retail." May 2020. https://files.hudexchange.info/resources/documents/Section-108-Case-Study-Bakers-Centre-Retail.pdf and Michaelle Bond and John Duchneskie. "Fishtown, Point Breeze Have Become Far Wealthier in the Last 10 Years and Other New Census Findings." *Philadelphia Inquirer*, December 8, 2022. https://www.inquirer.com/news/census-income-poverty-philadelphia-race-immigrant-20221208.html

direct public resources—including funds from the Section 108 loan pool—to meet neighborhood needs.

HUD reported that as of June 2019, PIDC had closed 76 loans totaling more than $262 million in Section 108 guaranteed assistance.[20] That $262 million was estimated to have leveraged more than $1 billion from private lenders. The average loan issued as part of the PIDC Section 108 loan pool was $3.4 million, with a 6.5% average interest rate to the business or developer (text box 5).

In its 2021–22 action plan, the City of Philadelphia, through the Department of Planning and Development, requested $20 million in Section 108 loans. The amount was administered by PIDC as its next round of Section 108 loan pool financing for economic development.[21] The funding was projected to create 300 jobs and benefit 200,000 people living in very low, low-, and moderate-income areas.

REFLECTIONS

Philadelphia was exceptional in its ability to effectively use the Section 108 Loan Guarantee Program. The citywide loan pool was made possible in large part by active collaboration between the Philadelphia Industrial Development Corporation and the US Department of Housing and Urban Development, working together to create an iterative solution to a serious community problem. But a constellation of factors—national, municipal, economic, and institutional—supported its success.

First, at the national level there was a sense of urgency and innovation with respect to assisting cities. President Bill Clinton came into office in 1993 with an agenda of job creation. Clinton viewed the Section 108 program as one way to fund local economic development projects, and he mobilized HUD field staff to promote the program in their communities. The Clinton Administration also oversaw the creation of HUD's Economic Development Initiative grant, which eliminated what was at the time one financial limitation faced by communities like Philadelphia that wanted to initiate loan pool models to make Section 108 loans to third-party borrowers.

"What helped the HUD 108 program was that Bill Clinton and Henry Cisneros (secretary of Housing and Urban Development from 1993 to 1997) were looking at every way they could help cities develop," said Edward Rendell, Philadelphia's mayor from 1992 to 2000. "Clinton's was the first administration that really cared about city development."

At the municipal level there was also a strong partner: a mayor who was willing to experiment. With a declining population, little economic interest from the private market, and vacant properties across the city, Philadelphia in the 1990s was primed for change. It got that change when Rendell took office. He charted a bold path for the city with never-before-utilized public subsidies and tax incentives, and he personally brokered deals with private developers and the business community.

Many said Rendell's bold leadership was what Philadelphia needed at the time. "[Rendell] was what you see very little of in elected officials today: he was a risk taker," recalled William Hankowsky, who was president of Philadelphia Industrial Development Corporation (PIDC) until 2000. "He was willing to try things even if he was not 100% sure they would work."

Philadelphia also had a number of public officials who were willing to challenge the way things had always been done. "Part of this Section 108 process involved trying to take a national financing resource the government had created and figure out how to make it useful and effective at a local level," said Hankowsky. In the case of Philadelphia, that involved reimagining the loan guarantee program as one that would not finance individual projects but could be used as a loan pool to get money out the door in a more productive manner.

The circumstances at the national and local levels were auspicious, but they did not guarantee action. Dire economic circumstances provided an essential nudge. On the brink of bankruptcy, the city was racing to find ways of promoting economic activity that would increase employment and raise revenue. Through PIDC's citywide loan pool, Section 108 became a significant tool in the city's toolbox of options, which also included property tax abatements, tax increment financing, tax credits, and a range of state and federal subsidies.

Rendell acknowledged the confluence of factors that made using all of those financial tools possible during his time in office. "I ran for mayor in 1987 and lost. If I had been elected in 1987, I probably would never have gotten any of this stuff done, because in '87, it wasn't as apparent how desperate the city's condition was. By 1991, the city was in such terrible shape that I had no trouble persuading people we had to try some new and innovative things to have any chance of turning our economic situation around."

From their experience, PIDC officials speculated that meeting the requirements of the block grant program and finding eligible projects to finance would be easier in economically depressed markets. Where there was a growing market for the service or product an economic development activity generated, projects could likely access financing from private banks and would not pass the but-for test required to receive public subsidy. Finance on concessional terms was needed only if returns might be slower to materialize or if risks were higher.

The Section 108 program would be most viable for communities when interest rates were high or headed upward. When interest rates were low, the private sector was likely to offer loans on terms competitive with HUD's concessional finance.

During the early 2000s, PIDC began using its Section 108 loan pool less as Philadelphia's needs shifted. With a dozen new hotels having opened in Philadelphia from 1997 to 2000,[22]—many of them in restored historic buildings—Sam Rhoads, interim president of PIDC, said the city had exhausted its list of hotel restorations eligible for Section 108 loans. Also, the large retail projects that rounded out PIDC's Section 108 loan pool portfolio had been completed and could likely secure private financing if they needed updates.

"It really is money that's hard to use, and it's very situational based on all of its criteria," said Rhoads. "We had a lot of projects during that time period—whether it was a hotel or a large community-based project—where [Section 108] really made sense."

Rhoads added that PIDC shifted so as to focus its economic development lending on small, minority, and woman-owned developers. "They're doing smaller projects. And smaller developers are less willing and less able to absorb the costs of the rules and regulations of Section 108."

HUD acknowledged the program's challenges. Paul Webster, director of HUD's Financial Management Division and a veteran of the department, which he joined in 1972, referenced a 2021 proposed regulation change—the first significant update since 1995—that was still pending in early 2023. The recommended changes focused on making it easier for recipients to "promote economic development and recovery in low- and moderate-income communities and support investments in underserved areas."[23] The goal was to remove barriers to use of HUD's Community Development Block Grant and Section 108 funding without sacrificing any of the department's programmatic goals.

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