IMPACT IN PLACE

Emerging Sources of Community Investment Capital and Strategies to Direct it at Scale

THE U.S. IMPACT INVESTING ALLIANCE

Commissioned by:

FEDERAL RESERVE BANK *of* NEW YORK

TABLE OF CONTENTS

FOREWORDS

IMPACT IN PLACE

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THE STORY OF the pandemic will be illustrated, in part, with images of lines: Unemployment lines, food lines, testing lines, then, finally—vaccine lines. Those early lines for food and benefits showed the pervasiveness of suffering in our poorest neighborhoods, especially among Black and Latino families. The lines were a stark demonstration of the shortfalls of help available.

We must never forget those images of people patiently standing or sitting in snaked rows of cars waiting for food. They must serve as a call to action.

To me, those lines made it heartbreakingly clear that we need more investments in the hardest hit neighborhoods, more innovative and inclusive approaches to those investments, and more tools to make such investments as effective and efficient as they possibly can be. I wasn't alone in this. The past year brought lightning-fast changes to the community investment landscape, with existing and new players announcing investments, seemingly weekly. Among those investors were corporations, including Google, Netflix, PayPal, Twitter; healthcare companies, such as UnitedHealth Group; and family offices, such as Ceniarth.

It was this combination of urgent need coupled with brand-new participants that prompted my team, the Community Development unit at the New York Fed, to commission this report from the U.S. Impact Investing Alliance. Our goal was to create a snapshot of the current community investing landscape and illustrate the potential for new types of investors to fill gaps. We also wanted to detail how both investors and community groups are elevating community voices, ensuring the people in neighborhoods have a say in where investments are directed. This report seeks to spark discussion—and ultimately—direct capital to powerful projects and approaches that help advance economic resilience and mobility. The Alliance is a vital voice in this space and we're proud to partner with their team to launch this report.

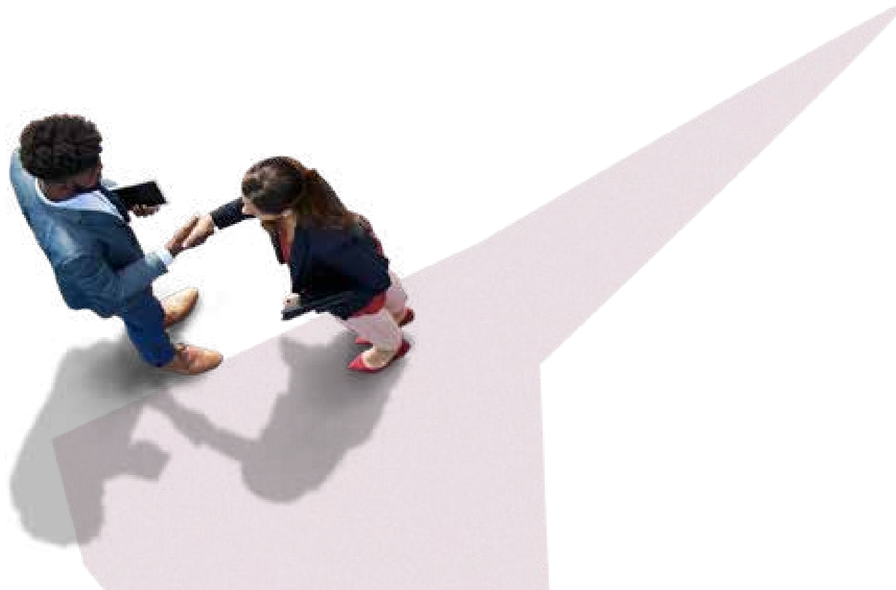
The report also comes as our own team is approaching its work in a completely new way.

During the calamitous events of 2020—with scenes of food lines, hospitals over capacity, family gatherings over Zoom, and street protests—my colleagues at the New York Fed's Community Development team and I hosted a series of events, producing reports and white papers related to the pandemic's fallout. We spent much of the rest of our time struggling to figure out how we can take an even more substantive role in supporting the communities we seek to serve. The result: Our team has committed itself to working more effectively by narrowing our focus on key areas that underpin economic mobility—climate-related risks to low- and moderate-income populations, the economic drivers of health, and household financial well-being—and guiding transformative investment capital to bring innovative strategies within these themes to scale.

To that end, we created a new position on our team, unique in the Federal Reserve system, whose role will focus on connecting innovative ideas with capital. We hope this report will be a resource our new capital connector can share.

I am immensely grateful to Fran Seegull, John Cochrane, Claire Mattingly and Miljana Vujosevic at the U.S. Impact Investing Alliance for their insightful and meticulous work in producing this report. I am also grateful to Darren Walker and the Ford Foundation for their support for this project. Lastly, I would like to thank the thought leaders and impact investors who generously provided their time to be interviewed for this report.

The inequities plaguing communities across the United States were not created overnight, and to even come close to starting to reverse these past wrongs will require long term, repeated, and authentic commitments from investors, both old and new. The time to redouble our efforts to address these inequities, to ensure that we never again see the lines we saw during this pandemic, is right now. I hope this report can serve as one starting point.



Darren Walker

President, Ford Foundation
Chair, U.S Impact Investing Alliance

THE COVID-19 PANDEMIC has unleashed a cascade of economic challenges. There is no single economic catastrophe, but several interrelated crises that each compound the other with every passing day. Lockdowns and stay-at-home orders cripple small businesses across the country. School closures force working parents to sacrifice jobs and careers in order to supervise their children's virtual classrooms, if they have access to necessary technology in the first place. Millions of families live under the looming threats of eviction or foreclosure. If our out-of-balance capitalism was on the precipice before the pandemic, it is now in a state of calamity.

Everyone has been affected by the economic fallout. And yet, as is so often the case, historically disadvantaged communities have been disproportionately impacted first and worst. These underserved communities, many communities of color, need economic relief and resources they have been denied for decades. As we transition to a new year and the next phase of the pandemic, leaders at all levels, and from every sector, must act swiftly to deliver investment capital to these overlooked populations in financial distress and build a more inclusive capitalism. We can no longer afford to bifurcate how we invest capital and how we deploy it for good. We must, instead, integrate our approach to ensure real, equitable impact.

For our part, during the past three years, the Ford Foundation has worked to make impact investing an even more substantial feature of its investment portfolio. Through mission-related investments (MRIs), the foundation has leveraged the power of its endowment to direct capital into several community-focused initiatives, including the fight for affordable housing in the United States. And by issuing $1 billion in social bonds, we were able to double our grantmaking over the next two years in order to support a nonprofit sector devastated by the pandemic, while also creating a new kind of investment vehicle for capital looking to realize a social return.

In addition, the Ford Foundation has helped incubate the U.S Impact Investing Alliance. The Alliance was born out of the need to accelerate justice by growing the impact investing movement. This consortium of the field's top minds constantly seeks out new ways to increase the flow of investment capital to the communities that need it most. With the COVID-19 crisis continuing to wreak economic havoc throughout the United States, and around the world, the inequalities of our economic system are more exacerbated than ever. Low-income communities, Native communities and communities of color are in dire straits. This paper, and the movement it represents, could not arrive sooner.

As President of the Ford Foundation, and Chair of the U.S Impact Investing Alliance, I'm proud to present this insightful report on the current and future state of community investment capital. On the pages that follow, the U.S. Impact Investing Alliance presents a wide array of community investing strategies and capital sources, ranging from the well-established to the newly discovered. While some of these investment interventions are more easily scalable than others, they all deserve careful consideration as viable paths to our ultimate goal: injecting impactful investment capital into communities the system has long neglected.

For all of us who care about delivering justice to these populations, this report is a resounding call to action. As leaders of privileged and powerful institutions, we must take the necessary risks to support the entrepreneurs, small businesses, and local economies that will spur a more equitable post-COVID recovery. With our support and investment, these communities can generate economic recovery and deliver the kinds of reforms that will sustain a more inclusive economy rooted in justice.

EXECUTIVE SUMMARY

COMMUNITY INVESTING IS a powerful tool with the potential to transform underserved communities, including Black, Brown, tribal, rural and others that for too long have been denied adequate access to economic development opportunities. The COVID-19 pandemic and ensuing crises have brought into sharper focus the importance of flowing capital into these communities at scale, efficiently and with deep impact.

Recognizing the urgency of the pandemic and related crises, the Federal Reserve Bank of New York (New York Fed) approached the U.S. Impact Investing Alliance (Alliance) to write a report about the current landscape of capital sources for community investment and how emerging capital sources and strategies could help shape the future of the field. The report also reflects on the existing community investment landscape to understand the relative importance of various capital sources, as well as how to preserve them going forward. Finally, the report concludes with a set of recommendations to investors and others who seek to increase the flow and efficiency of investment capital to underserved communities.

The Alliance identified a number of structural barriers preventing more capital from flowing to underserved communities. Fortunately, there are several ways in which private and public actors alike can work together, alongside community leaders, to overcome these challenges and better leverage capital for generating positive and measurable outcomes for the members of these communities. The authors put forth the following recommendations to the field:

- **There is an immense need for risk-taking capital:** There is significant demand for investors to take bold and early bets to send a positive signal to the rest of the market, and for investors to take increasingly riskier positions in the capital structure. These may include subordinate debt, equity stakes, longer-term and more flexible capital, with fewer programmatic and other restrictions. Investors can also employ a hybrid approach to strengthen the institutions in which they invest. An example is providing a grant to shore up a financial intermediary's net assets or equity position in addition to supplying investment capital. This will improve the organization's financial outlook and help to attract even more third-party capital.

- **Investors can help streamline the capital raising process for community intermediaries:** There is significant demand from financial intermediaries for a more predictable investment approval process from investors. Those receiving investment capital repeatedly cited the laborious process for raising capital and other resources. This was a consistent pain point across almost all capital sources and types of investment. For these financial intermediaries, there is an opportunity cost between allocating staff time to secure capital commitments and deploying that capital into communities. Investors can and should develop more streamlined and predictable investment approval processes that are fully transparent to the intermediary borrower and aim to supply capital in a more rapid fashion. To the extent that investors rely on registered investment advisors (RIAs) or investment consultants, they should coordinate upfront on what are considered suitable investment opportunities to mitigate conflicting feedback shared with the borrower by the client versus the advisor.

- **Client-facing channels, including RIAs and private wealth platforms, should increase their awareness of community investing strategies:** Both impact-oriented and traditional platforms should have a baseline level of knowledge on community investing and its potential to deliver on client objectives. As demand for values-aligned investing grows, establishing this foundational knowledge can help these platforms differentiate themselves and support future business development goals.

With respect to emerging capital sources for community investing, 2020 saw a diverse and growing number of institutions and partnerships emerge, particularly among corporate actors. The Alliance explored many of these developments in specific case studies that show the range of approaches that businesses and investors can take to support underserved communities:

- Collaboration by state and local governments, networks of community lenders, philanthropies and fintech providers to quickly mobilize small business relief in response to the COVID-19 pandemic (Chicago Small Business Resiliency Fund).
- New commitments among corporates providing deposits and other support to Black-owned banks in response to calls for racial justice (PayPal and the Black Economic Development Fund by LISC).
- An innovative, multi-tiered community investing engagement by a major tech company (Grow with Google Small Business Fund with the Opportunity Finance Network).

In addition to corporates, there is large, relatively untapped potential from individual investors across the wealth spectrum and through channels including donor advised funds (DAFs), private wealth platforms, family offices and, more recently, uniquely structured participatory models that seek to embed the community perspective in the investment decision-making process. In the report, the Alliance also explores examples of these innovative models, including:

- Unique leveraging and structuring of DAF capital to support communities and racial justice efforts (ImpactAssets and CapShift)

- Participatory models for local restorative wealth building and small dollar investor engagement (The Ujima Fund).

As new sources of capital for communities grow, it is important to acknowledge, address, and resolve barriers and future challenges that prevent capital from achieving the intended outcomes, especially in communities that have experienced historic underinvestment. Some of these barriers include:

- **Perceptions or concerns about fiduciary duty can limit available opportunities:** Investors should weigh the various factors in deciding which community investing strategy is most suitable for their goals, but fiduciary duty considerations may limit the universe of investable opportunities for investors that work with a Chief Investment Officer (CIO), Outsourced CIO (OCIO), RIA or wealth and donor advised fund (DAF) platforms.

- **Poorly defined market segmentation:** Investors must be knowledgeable about the nuances of the field across impact themes and geographies, types of capital and risk and return profiles.

- **Integrating community investments into traditional portfolios can be challenging:** The unique position that community investments often hold requires investors to make a case for why existing investment orientations should shift to accommodate a new community investing strategy as part of their overall asset allocation.

- **Need for qualified investment professionals that understand the sector:** A successful and efficient community investing strategy requires qualified investment professionals who bring rigor to the investment process and understand the nuances of community economic development, as well as the importance of a formalized investment process.

- **Shifts in internal investor priorities and external factors introduce uncertainty over the long term:** Investments that have a more tenuous link to either an investment strategy (like generating a risk-adjusted return) or a business development goal, are more susceptible to internal or external shifts that might prompt an investor or wealth platform to sunset an existing community investment strategy.

- **Public policy shifts can have both positive and negative impacts:** Community investing capital sources linked to a tax or regulatory action are often drastically impacted by public policy changes.

The community investing landscape is continually evolving, and the findings detailed in this report are responsive to the current moment. In particular, the urgency of flowing more investment capital to underserved communities is made more apparent by the current public health and economic crises due to the COVID-19 pandemic. In addition, the nation's ongoing reckoning with systemic racism reinforces the urgency for promoting innovative investment strategies that prioritize racial equity and seek to combat wealth inequalities. The Alliance hopes that this report will help foster conversations among investors and others regarding the future of community investing to maximize efficiency and impact.

The observations, views and recommendations presented in this report are solely those of the Alliance and do not represent the opinions of the New York Fed or the broader Federal Reserve System. Similarly, any examples of companies or firms highlighted in this report are for educational purposes only and should not be interpreted as an endorsement by the Alliance or the New York Fed.

The authors of this report are also very grateful to the experts and practitioners listed to the left who contributed their expertise by participating in interviews that informed this report's drafting.

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SUMMARY OF TERMS

Alliance: U.S. Impact Investing Alliance
AMI: Area median income
CDFI: Community development financial institution
CEO: Chief executive officer
CFO: Chief financial officer
CIO: Chief investment officer
CRA: Community Reinvestment Act
DAF: Donor advised fund
ECIP: Emergency Capital Investment Program
FDIC: Federal Deposit Insurance Corporation
HNWI: High-net-worth individual
LIHTC: Low-Income Housing Tax Credit
LISC: Local Initiatives Support Coalition
LMI: Low- and moderate-income
MDI: Minority depository institution
MRI: Mission related investment
NCUA: National Credit Union Administration
New York Fed: Federal Reserve Bank of New York
NMTC: New Markets Tax Credit Program
OCC: Office of the Comptroller of the Currency
OCIO: Outsourced chief investment officer
OZ: Opportunity Zones
PPP: Paycheck Protection Program
PRI: Program related investment
RIA: Registered investment advisor

OVERVIEW

THE COMMUNITY DEVELOPMENT Unit of the Federal Reserve Bank of New York (New York Fed) approached the U.S. Impact Investing Alliance (the Alliance) to evaluate the current landscape of capital sources for community investment and propose a set of recommendations for encouraging a broader and more diverse set of capital providers to implement a community investing strategy. Through this report, the Alliance seeks to promote a better understanding of the emerging capital sources that are increasingly becoming more active in community investing. In addition to the potential sources of capital, the report aims to assess the channels or mechanisms used to deploy capital – such as donor advised funds (DAFs) or private wealth platforms. The report also reflects on the existing community investment landscape to understand the relative importance of these capital sources, as well as how to preserve them going forward. Finally, the report concludes with a set of recommendations to investors and others who seek to increase the flow and efficiency of investment capital to underserved communities.

For the purposes of this report, community investing is broadly defined as investment capital that flows to underserved communities for economic development, affordable housing, and growing small business ecosystems. It is not intended to capture non-investment sources of capital (namely government or philanthropic grants) or subsidy programs that are not themselves linked to investment. The definition also excludes the municipal bond market which, while playing an important role in financing infrastructure and other economic development projects, was not commonly cited by subject matter experts as an area with the potential to attract new sources of investment capital. Similarly, the concept of underserved communities is loosely defined as areas in the United States that are not efficiently served by traditional capital markets and thus rely on a unique network of government programs, capital providers and financial intermediaries to meet some of the aforementioned purposes. These parameters are not intended to influence broader definitions of community investing, but rather to set a realistic scope for exploring current trends and making recommendations. While the report is intended to be a thorough assessment of the current landscape, the authors acknowledge that the community investing field is continually evolving.

The insights shared in this report are informed by publicly available data and information, interviews with subject matter experts and the experiences of the authors of this report. The Alliance hopes that the report's findings will be insightful to its readers – particularly to investors and their advisors – and catalyze further investment, policy recommendations and research projects, all with the goal of increasing the amount and efficiency of capital flowing to the most underserved communities throughout the United States.

This report was commissioned by the New York Fed and written by the U.S. Impact Investing Alliance. The observations, views and recommendations presented in this report are solely those of the Alliance and do not represent the opinions of the New York Fed or the broader Federal Reserve System. In addition, specific initiatives described throughout the report, such as those in the case studies, are put forth only for educational purposes, and do not represent endorsement from the Alliance, the New York Fed or the broader Federal Reserve System.

HISTORICAL CONTEXT

In 2018, CRA-motivated capital was responsible for $103 billion in community development loans and $254 billion in small business loans

Public policies related to community investing in the United States often center around the need to correct for racial and other inequities in past financial practices. As of 2016, the net worth of an average White household was nearly ten times greater than that of an average Black household.[1] While the root causes of this significant disparity trace back centuries, studies have also directly linked today's inequities to the public policy choices and financial practices of the first half of the 20th century. From the federal highway program and the GI Bill to the practice of redlining, these factors have been shown to fuel greater economic inequality between cities, communities and households, particularly along the lines of race. For instance, the average homeowner in a formerly redlined neighborhood for mortgage lending has gained "52% less—or $212,023 less—in personal wealth generated by property value increases than one in a greenlined neighborhood over the last 40 years."[2]

Given this backdrop, capital barriers have historically prevented underserved communities, and particularly Black and Brown communities, from easily financing economic development projects or building household wealth. In response, several investment programs emerged during the latter half of the 20th century to either encourage greater investment in these communities by certain industries or to augment the return profile of a given investment. Examples of these investment programs include the following:

Community Reinvestment Act (CRA): The CRA was enacted in 1977, largely in an effort to counteract decades of redlining in Black, Brown and low- and moderate-income (LMI) communities across the United States. At its core, the CRA is a federal law with roots in civil rights policymaking that encourages commercial banks and select other financial institutions to provide financial services to the communities where they have an active presence. Though it initially emerged out of efforts to promote fair housing, the CRA has grown to also become an important driver of small business lending. In 2018, CRA-motivated capital was responsible for $103 billion in community development loans and $254 billion in small business loans.[3]

While vitally important to the community investing ecosystem, the CRA has its lim-

[1] Kriston McIntosh, Emily Moss, Ryan Nunn, and Jay Shambaugh, Brookings, "Examining the Black-white wealth gap," February 2020.

[2] Dana Anderson, Redfin, "Redlining's Legacy of Inequality: $212,000 Less Home Equity, Low Homeownership Rates For Black Families," June 2020.

[3] According to data from the Federal Financial Institutions Examination Council, 615 reporting institutions in 2018 made $103 billion in community development loans. In the same year, 700 institutions reported $254 billion in small business loans. There is likely little overlap in the two figures, as community development and small business loans are typically not totaled together, though that may be the case for a wholesale or limited purpose bank.

itations, and much attention has been paid to efforts to reform the regulatory framework. In recent years, there have been ongoing CRA modernization efforts across the three regulating agencies – the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve and the Office of the Comptroller of the Currency (OCC). As of the publishing of this report, the Federal Reserve is in the beginning stages of its own rulemaking process that may result in changes to the CRA's regulatory structure.[4] Given the importance of the CRA to the community investing ecosystem, investors are eager to see and understand the outcomes of that process.

Various Community Investment Tax Incentives: In addition to or in lieu of producing financial returns, tax credit programs like the Low-Income Housing Tax Credit (LIHTC), the New Markets Tax Credit (NMTC) and, most recently, Opportunity Zones (OZ) were designed to attract critically needed equity capital, mostly at the project level, and bolster returns. Tax credit programs are typically designed as yearly allocations of credits by the federal government that are purchased by investors at a price per credit. The federal government allocated $224.2 million in LIHTC in 2015 and $5 billion in NMTC at the end of 2019.[5] The OZ incentive was designed around a combination of capital gains deferral and forgiveness if certain investment conditions are met. Estimates vary for the amount of capital invested to date through OZ, but it is at least $15.16 billion based on public reporting.[6]

There are several factors limiting the catalytic potential of these tax incentives. Community investors have long advocated for the NMTC program to be made permanent, for example. While the omnibus legislation passed at the end of 2020 included a five-year extension of the program at the $5 billion allocation, lawmakers will need to consider program permanence or further extensions down the road. Additionally, the OZ policy lacks mandated fund- and transaction-level reporting requirements that are necessary to understand the impact of the program.[7] Finally, investors, local developers and others often struggle to pair these various incentives in a cohesive manner. The programs – despite their aligned policy goals – were not designed as a comprehensive set of tools, thereby limiting their potential for impact and increasing the cost and complexity of deals.

Program-Related Investments by Foundations: In addition to the above examples, which incentivize investment by the private sector through varying means, another important source of community investment to date has been foundations, namely private and corporate foundations. Foundation donors receive a tax benefit upon formation or at the time of a contribution but must comply with various requirements including a man-

[4] The Federal Reserve released an Advance Notice of Proposed Rulemaking in September 2020. The public comment deadline for the first step in the rulemaking process closed on February 16, 2021.

[5] New Markets Tax Credit Coalition, "New Markets Tax Credit Receives One-Year, $5 Billion Extension," December 2019.

[6] Novogradac, Opportunity Funds List, updated as of December 31, 2020.

[7] Recognizing the need for better impact and financial data around Opportunity Zones, the Alliance, the New York Fed and the Beeck Center for Social Impact + Innovation at Georgetown University partnered in 2019 to publish the Opportunity Zone Reporting Framework (OZRF), a private sector standard designed to define best practices for funds and investors seeking to achieve positive social, economic or environmental impact for communities in the designated zones.

datory 5% annual payout. Beyond traditional grantmaking, community investments by foundations have most often been structured in the form of program-related investments (PRI). To qualify as a PRI, an investment must be consistent with the charitable mission of the foundation and, though a PRI can generate interest or other financial returns, accrual of income cannot be a "significant purpose." In return, these investments can be counted towards the mandated annual payout. When a PRI generates a financial return, that capital is free to be used for grants or additional PRIs.[8]

Despite the advantage of being able to "recycle" philanthropic capital, PRIs represent a relatively small portion of annual philanthropic activity.[9] The availability and potential uses of PRIs are not widely appreciated, particularly among smaller foundations. Those that do take advantage of the tool often do so conservatively. Guidance from the Internal Revenue Service makes clear that PRIs can be structured in a variety of ways, including equity investments and guarantees, but most are structured as low-interest loans. There is also a widespread perception that PRIs must be concessionary, when in fact a potentially high financial return does not automatically disqualify an investment.

SPOTLIGHT A

THE ROLE OF FINANCIAL INTERMEDIARIES IN SUPPORTING THE DEMAND SIDE:

In addition to growing the supply of investment capital, the past few decades saw the growth of a wide range of financial intermediaries that were well positioned to receive this capital and act as a responsible steward on behalf of the community. The most commonly cited example is community development financial institutions (CDFIs), which are private financial institutions that aim to deliver affordable products and services to underserved communities and individuals, such as housing solutions, small business loans and consumer loans. Among other things, the benefit of becoming a certified CDFI is access to various funding sources and programs administered by the CDFI Fund, an agency of the U.S. Department of the Treasury.

According to the Opportunity Finance Network, there are four sectors of the CDFI industry:[10]

Community development banks: Structured as for-profit institutions, community development banks provide capital to economically distressed communities. These banks are regulated by some combination of the FDIC, the Federal Reserve, the

[8] Internal Revenue Service, Factsheet on Program Related Investments.

[9] Pulling data from the Foundation Directory Online, there were $187.2 million program related investments (PRI) made in 2017 by foundations. 2017 is the most recent year in which there is the most complete information from Forms 990.

[10] Opportunity Finance Network (OFN), "What Is a CDFI?"

OCC, the Office of Thrift Supervision and state banking agencies. Their deposits are insured by FDIC.

Community development credit unions: These organizations are designed to promote savings and asset building among LMI households. Community development credit unions are structured as nonprofit organizations and owned by their members. They are regulated by the National Credit Union Administration (NCUA), state agencies or both. In most cases, deposits are also insured by the NCUA.

Community development loan funds: Typically structured as nonprofit organizations, community development loan funds provide financing and development services to businesses, organizations, projects and individuals in LMI communities.

Community development venture capital funds: These funds provide equity and equity-like debt to small and medium businesses in LMI communities. They can be structured as either for-profit or nonprofit.

There are also many service providers operating in communities that have an affiliate CDFI for lending and financing activities. The most common example is nonprofit developers that serve as sponsors for economic development, rental and homeownership projects in many communities. Mercy Housing and Habitat for Humanity International are two examples of nonprofit developers with CDFI arms that provide financing in support of their own missions or for other third-party activities.

As of July 31, 2017, 1,134 CDFIs were certified by the CDFI Fund. Of these, 575 (51%) were loan funds, 316 were credit unions (28%), 139 were banks or thrifts (12%), 87 were depository institution holding companies (8%), and 17 (1%) were venture capital funds.[11]

A recent development among the most established CDFIs is their ability to access the capital markets. CDFIs such as Local Initiatives Support Corporation (LISC), Enterprise Community Partners (Enterprise), Capital Impact Partners, Low Income Investment Fund (LIIF) and Reinvestment Fund have received investment grade credit ratings from Standard & Poor's to issue bonds in the public markets. Having such ratings enables these CDFIs to further diversify their capital sources and to raise significant capital at a fixed rate over the longer term.

Despite the promise of the capital markets, this option is only available to the largest and most established organizations, with the majority of CDFIs not meeting these thresholds. In addition, maintaining an investment grade rating creates a tension as taking greater risks that may drive greater impact on the ground could lead to a ratings downgrade and a higher cost of capital in the future.

STRUCTURAL CHALLENGES FOR FINANCIAL INTERMEDIARIES RAISING CAPITAL

A through line between the historical sources of capital for community investing is the presence of an outside incentive or policy action that in large part drives and dictates this behavior. While these outside forces help to encourage new investment activity, it can be argued that they are also important for bridging the return expectations of investors and the economics and cost of capital demands of organizations and projects on the ground.

[11] U.S. Treasury Department, CDFI Fund, List of Certified CDFIs.

With respect to the latter, financial intermediaries have unique design constraints that are largely intentional and can inform which capital sources are most suitable for community investing, either now or in the future. Some examples include:

- **Aligning operating principles and underlying economics with a mission orientation can limit financial upside and the universe of appropriate capital sources:** Financial intermediaries operating in a community development context often make business decisions to deepen their impact, even if this results in foregoing potential financial upside. These decisions may include, but are not limited to:
    - Offering lower interest rates to their borrowers;
    - Charging affordable rents to tenants with lower area median incomes (AMI);
    - Foregoing recapitalization or liquidity events on real estate that could generate material capital gains but threaten the long-term affordability of those units if there were a resulting change in ownership;
    - Employing "high touch" lending models that are coupled with significant technical assistance to borrowers and/or involve small dollar loans to individual borrowers, both of which require more resources to deliver and service; and
    - Prioritizing business lines that may be less profitable but are critically needed on the ground, such as by choosing to offer small dollar loans, which can have relatively high transaction costs.
- **Nonprofit structures can limit capital raising options:** Many of these financial intermediaries are structured as nonprofits. Among other things, nonprofits cannot issue shares, which is a barrier to raising critically needed equity capital to sustain a healthy organization and fuel further growth. As a result, most of these institutions rely on grant capital to bolster their net asset (a nonprofit's equivalent to equity) positions, a source which can be unpredictable and often restricted for specific programmatic uses.
- **Performance data on community investments, particularly equity investments, is lacking:** The bespoke nature of community investments, and particularly the lack of transparency around the performance of these investments, can also contribute to a more complicated capital raising process. Without more robust data, qualitative judgment calls, particularly about the riskiness of the sector, can greatly influence if investors choose to participate in a capital raise.

The above points also underscore an inherent tension between driving deeper impact on the one hand and achieving scale and delivering higher rates of return to investors of the other. The majority of community development models are designed to be high touch, sub-scale and driven by a desire to reach the most underserved communities and populations. This can make organizations reliant on low-cost debt capital in order to pass through reasonable rates to end borrowers. Therefore, while some CDFIs, such as LISC and Enterprise, have and will continue to access the capital markets for their capital needs, a robust set of capital sources needs to be developed alongside the public markets for smaller scale organizations and projects.[12] These trade-offs set an important baseline for investors considering deployment to community investing.

CASE STUDY A:

Chicago Small Business Resiliency Loan Fund

SIMILAR INITIATIVES:

New York Forward Loan Fund

California Rebuilding Fund

Ceniarth Campaign to Support the Rural Community Assistance Corporation (RCAC)

In response to significant uncertainty in the small business lending environment due to the COVID-19 pandemic, there were several iterations of local governments, philanthropies, corporates and community lenders quickly banding together to drive capital to these small businesses. Each example builds on a similar model of relying on the expertise and relationships of local community lenders, often with the added efficiencies provided by technological solutions.

In March, the city of Chicago partnered with the Goldman Sachs Urban Investment Group, Fifth Third Bank and other private sector funders to launch the $100 million Chicago Small Business Resiliency Loan Fund. The fund – with banks providing senior debt, local foundations providing subordinate debt and the city providing equity – provided emergency low-interest loans of up to $50,000 to struggling small and micro-businesses through a centralized network of CDFIs – Accion Chicago and the Community Reinvestment Fund (CRF USA) being the primary lenders.

In this respect, the structure streamlined the capital raising and loan application process while still enabling the CDFIs to maintain the appropriate community-lender borrower relationship. The Chicago fund allocated the $100 million after receiving over 11,000 applications for more than $301 million in loans in a matter of days. According to data supplied by the project, of the applicants, 48% were non-white owned and 44% were women-owned small business.[13]

The fund also leveraged existing infrastructure by tapping into the strengths of the community-based lenders. Accion's high-touch customer service and technical assistance paired with the standardization offered through CRF USA's Connect2Capital loan matching platform created an effective and fast-moving process. The loan application process was also targeted to reach the most underserved applicants. The city of Chicago implemented

[12] Local Initiatives Support Coalition (LISC), LISC News Release: "A Game-Changer for Community Development: LISC Offers $100M in Bonds," April 2017.
[13] Community Reinvestment Fund (CRF USA), "Community-Centered COVID-19 Recovery Program Webinar," 2020.

an algorithm for the loan application queuing to ensure that 75% of the funds went to small business owners operating in LMI communities.

Similar efforts are under development across a 15-state region across the South, Southeast and in Washington State. Each of these local response funds model a formula for balancing high-touch, hyper local impact with efficiency and scale. While promising in that regard, it remains to be seen whether this format could be adapted for longer-term community development efforts outside of the current environment and crisis set.

EMERGING SOURCES OF CAPITAL

Against this backdrop, the past few years have seen the emergence of a broader group of investors placing community investing strategies at the forefront. These emerging capital sources bring their own unique motivations, have made varying levels of commitments and use different tools and investment strategies. The report examines each of these sources in further detail below.

1.CORPORATES

A Growing Capital Source

The ongoing crises of the COVID-19 pandemic, economic downturn, racial injustice, climate change and threats to democracy have created a sense of urgency around corporate engagement in community development. With respect to systemic racism, the killings of George Floyd, Breonna Taylor, Ahmaud Arbery and others have resulted in a growing consciousness by many organizations, particularly corporates, to formulate a response. In 2020 alone, companies such as Google, Netflix, PayPal and Twitter announced tangible commitments to racial equity and community development.

CASE STUDY B:

Corporate Commitment to CDFIs and MDIs

Many corporates entered the community investing space in 2020, citing the need for action on racial equity. For example, several major corporations have invested in the $175 million Black Economic Development Fund run by Local Initiatives Support Corporation (LISC), a national CDFI. The fund is designed to provide deposits and other financing to Black-led CDFIs, MDIs, anchor institutions and businesses. PayPal – a major fintech player – is the largest investor, having channeled $50 million into the fund as part of its larger $535 million commitment to support Black-owned businesses and promote economic and social justice.[14] PayPal's broader commitment also includes $50 million in deposits to Optus Bank – a Black-owned MDI in South Carolina – and $50 million invested in early-stage Black and Latinx-led venture capital funds.[15] Other investors in LISC's Black Economic Development

[14] LISC Press Release: "LISC's Black Economic Development Fund Reaches $175M with $50M Investment from PayPal, $12.5M from HubSpot," December 2020.
[15] PayPal Press Release: "PayPal Announces Additional $5 Million Grant Program for Black-Owned Businesses as COVID-19 Crisis Continues," December 2020.

Fund include Aflac, Costco, DICK's Sporting Goods, HubSpot, Netflix and Square.[16]

The structure of these corporate commitments follows a similar pattern. There is a common thread of providing deposits to CDFIs and MDIs, and there is often a partnership with a national, well-established CDFI player, such as LISC or OFN. While these commitments are substantial, their size can be small in relation to an organization's total size. This might indicate that while the appetite for engagement exists, the level of risk these organizations are willing to take on is low. However, the moderately sized commitments could allow for opportunities to grow commitments over time, and it also indicates that barriers to entry could be low for other corporates looking to pursue similar strategies.

While the growth of corporate support for Black-led financial institutions is encouraging, the diverse motivations of these actors make it difficult to predict if that level of commitment will be sustained. Corporate investors can be motivated by public relations concerns, while others are motivated by talent development and employee engagement priorities. In such cases, changing circumstances could lead corporate investors to pull back. Engaged leadership seems to be another key motivating factor. For instance, PayPal's $535 million commitment was a decision driven by the company's CEO directly, and Netflix called on its peers to follow their lead in dedicating 2% of their cash holdings to funds like the Black Economic Development Fund.[17] *Public signaling between corporate actors may be one mechanism for sustaining engagement going forward.*

The structures of these commitments have varied greatly, from deposits to bond issuances, and they point to the potential for investors to select among a range of options for community investing. One growing trend is the decision by larger organizations to redirect a portion of their cash holdings to community banks, particularly minority depository institutions (MDIs) or other minority-serving financial institutions. The decision to redirect deposits to Black-owned institutions is not limited to corporates – this strategy can be easily replicated by other organizations, including foundations and family offices. While encouraging, the MDI industry and community advocates more broadly have urged corporates to go beyond deposits and offer equity investments and grants in tandem to better fortify the capital structures of the MDIs themselves.

For example, Google (and its parent company, Alphabet Inc.) recently announced a multi-pronged strategy – pairing equity and grant capital – aimed at delivering funding and investment capital to both underserved communities and issues such as clean energy and affordable housing. In issuing a $5.75 billion sustainability bond, Google leveraged its scale and credit rating to raise capital on favorable terms, which can then be passed

[16] Local Initiatives Support Corporation (LISC), About the Black Economic Development Fund.

[17] According to a 2020 press statement from Netflix: "We plan to redirect even more of our cash to Black-led and focused institutions as we grow, and we hope others will do the same. For example, if every company in the S&P 500 allocated a modest amount of their cash holdings into efforts like the Black Economic Development Initiative, each one percent of their cash would represent $20-$30 billion of new capital."

through to a range of projects and organizations that would otherwise not be able to attract that type of capital on a standalone basis.

CASE STUDY C:

Google's Partnership with OFN and the Google Sustainability Bond

In early 2020, Google partnered with Opportunity Finance Network (OFN), a national network of CDFIs, to structure the Grow with Google Small Business Fund with several critical elements: patient, 10-year capital with below-market loan rates combined with equity grants to provide flexibility and balance sheet fortification to the CDFIs receiving capital. While funded by Google, the vehicle is administered through OFN to flow responsible, affordable and flexible capital to OFN's CDFI members lending to small businesses in the recovery. The fund is comprised of $170 million in loan capital from Google's corporate treasury, paired with $10 million in Google.org grants, all directed to support communities often overlooked by traditional lenders and with a racial equity lens.[18]

To extend the scale of its pandemic response and stakeholder support efforts, Google also issued $5.75 billion in Sustainability Bonds in August of 2020 to raise investment capital for eight major impact themes, such as clean energy, affordable housing and support for small businesses through CDFI lending. Google estimates that it is the largest sustainability bond issuance of its kind by any corporation to date, and it was significantly oversubscribed, suggesting strong demand by investors.

This is particularly intriguing when considering the fact that CDFIs traditionally struggle to access the capital markets, with only a few of the largest S&P-rated CDFIs successfully issuing bonds. In part, issuing the Sustainability Bond allowed Google to access the capital markets on behalf of CDFIs and their communities.

These initiatives illuminate a pathway for other corporate actors, particularly large tech companies, to engage in community investing efforts. It is no longer the case that social or environmental goals must be siloed within philanthropic structures and strategies. Corporations are beginning to see opportunities in community investing, and they are also likely responding to public perception pressures. As noted in a previous case study on corporate engagement, the sustainability of these activities following the crises is unclear.

Outside of the tech sector, many other corporates have established their own impact investing strategies, often with a focus on community investing. In the financial services industry, Prudential Financial, Inc. (Prudential) and Goldman Sachs Urban Investment Group (UIG) have had dedicated strategies for decades. In early 2020, Prudential announced that it had successfully reached a $1 billion impact investing portfolio, much of which has been deployed to revitalize its headquarters city of Newark, New Jersey.

[18] Opportunity Finance Network (OFN), "OFN Announces Grow with Google Small Business Fund," March 2020.

Goldman Sachs' UIG deploys over $1 billion annually in community and economic development investments and loans across asset classes, including real estate, social enterprise and small business lending.[19] In the healthcare space, UnitedHealth Group has also expanded its community investing activities from just LIHTC transactions to new investment programs, including reaching $500 million in new affordable housing investments.[20]

Each of these commitments originated within the corporate itself and was therefore subject to distinct decision-making processes. Despite these nuances, there are a few key takeaways that undergird these announcements that both inform this growing trend and provide guidance to other corporates exploring strategies of their own:

- **Organization size matters:** It can be argued that these commitments were greatly helped by the fact that their size relative to that of the entire organization is nominal. For example, Twitter's $100 million commitment is just 1% of its cash holdings,[21] and Netflix's similar $100 million commitment is just 2%.[22] This makes it easier to implement or adjust policies or offer concessionary returns, as these individual decisions are not likely to sway the outlook of the entire organization. In fact, launching these strategies likely provides a valuable and intangible benefit in the form of branding and corporate public relations, which helps to offset any concessions on return or complexity of process.

- **Significant time and effort required:** There is considerable upfront effort required to stand up a new investing strategy, particularly one focused on community investing. The process can involve building awareness of the underlying issues, researching relevant organizations, engaging internal stakeholders, creating or adjusting existing policies and procedures, developing internal capabilities and identifying an internal source for investment capital. Corporates seeking to get involved should expect a process that can take anywhere from months to years before they are successfully deploying capital.

- **Return expectations differ greatly, yet investment strategies tend to be conservative:** Corporate investors have different philosophies around return expectations, but the majority favored safer, more secure investments with a focus on capital preservation. Investors are more likely to be flexible around return, with many willing to offer a concessionary rate, though select investors such as Prudential and Goldman Sachs UIG use a hybrid approach of concessionary investments alongside more commercially oriented strategies. Irrespective of return, the majority of investors favored more secure investments, including senior and/or overcollateralized positions, suggesting that the appe-

[19] Goldman Sachs, "What We Do: Asset Management: Sustainability and Impact Investing."

[20] UnitedHealth GroupNews Release, "UnitedHealth Group Invests Additional $100 Million in Affordable Housing to Further Its Commitment to Building Communities That Achieve Better Health Outcomes," June 2020.

[21] Lauren Hirsch, New York Times, "Twitter will invest $100 million in lenders promoting racial equality," November 2020.

[22] Aaron Mitchell and Shannon Alwyn, Netflix News Release, "Building economic opportunity for Black communities," June 2020.

tite for risk was low. The need for risk-taking capital and the relative lack of that capital on the supply side is a continued gap that CDFIs and other financial intermediaries are eager to see solved, whether by corporates or other organizations.

- **Deposits alone are insufficient and need to be complemented with other capital strategies:** While many community investing practitioners and advocates have applauded corporate deposits into Black-owned banks and other MDIs, there is also a growing consensus that more needs to be done to truly fortify these institutions. For instance, in order to strengthen the balance sheets of financial intermediaries, corporate investors should flow equity investments to depositories and grant capital to support net assets for loan funds. These organizations also cannot accept limitless deposits as these liabilities may breach leverage tests or other financial covenants imposed by one or more lenders, potentially triggering an event of default or putting the organization in financial jeopardy. Overall, there is a need for corporates to take a more holistic approach and appropriately align their strengths as investors with the needs of these organizations on the ground.

- **Visionary leadership is crucial:** Many of the above factors – including the time and effort required, and the opportunity cost of foregoing a return – suggest that leadership and a strong commitment by CEOs, CIOs, CFOs, senior management and the board are crucial to offset these logistical hurdles. This component was cited by several interviewees who confirmed the importance of a strong and influential advocate, oftentimes the CEO.

2. CLIENT SOLUTIONS

The Potential for Donor Advised Funds and Other Channels

Outside of the institutional context, there is tremendous opportunity to explore more retail channels for both impact and community investing, particularly as some individual investors may have a more personal level of commitment to a range of impact issues. The larger and more immediate opportunity has centered on high-net-worth individuals (HNWI), which major wealth platforms typically consider to be households with a net worth in excess of $2 million, and the U.S. Securities and Exchange Commission defines as an individual with a net worth of at least $1.5 million.

HNWI and families deploy assets and manage their investment portfolios in multiple ways. The most common channels are private wealth platforms and family offices (both single and multi-family offices), and, in the charitable milieu, family foundations and donor advised funds (DAFs). Most of these channels act as gatekeepers or aggregators, representing one to many retail clients and families. While there is keen interest in the potential of these channels, and notably DAFs, to support community investing, there has been limited traction to date.

First, fiduciary duty concerns are commonly cited as a constraint, as many of these gatekeepers hold a perception that community investments and other types of impact investments breach the fiduciary standard and are therefore not suitable for their platforms and their clients. Indeed, some – though not all – community investing strategies are concessionary in nature and should be appropriately categorized as such by fiduciaries. A related barrier is general market confusion about the range of options that exist for retail investors from pure philanthropy to more traditional investments, including return expectations and investable opportunities.

A critically important element is the very personal level of commitment that individuals may have across a range of social issues, and a growing awareness around the urgency to act now.

In addition to fiduciary duty issues, there are other reasons that have limited the inclusion of community investment offerings particularly on DAF and private wealth platforms. One example is the multi-layered diligence process which requires buy-in from both the platform and the wealth advisor, as well as the individual client. There is also an inherent tension between prioritizing and offering investment opportunities that are likely to meet the needs of a threshold level of clients while also being responsive to the customized needs of individual clients. This is especially true of community investing as these strategies are often place-based and may resonate with a client on a personal level but are not well suited for a national platform that seeks a broader client coverage.

Unlike institutional investors that can achieve investment minimum commitments on their own, HNWI and other retail clients represent fragmented and high-volume market segments. As such, platforms may aggregate smaller individual commitments to meet investment minimum thresholds. Though some HNWI have invested $1 million or more in select impact opportunities, the reality is that individual clients are more likely to invest at much lower dollar amounts, ranging from $50,000-$500,000. These observations – the presence of a gatekeeper and the size of individual investment commitments – suggest that these channels will require significantly more education, engagement, effort and time to reach the level of commitments made by larger institutional investors.

A final consideration – which can present both challenges and an opportunities – is related to donor priorities and impact themes. A sometimes overlooked but critically important element is the very personal level of commitment that individuals may have across a range of social issues, and a growing awareness around the urgency to act now. While robust information on 2020 giving levels is not yet widely available, early data indicates that charitable giving surged in the second quarter of 2020 compared to the first, representing a 7.5% increase in year-to-date donations compared to 2019.[23] Though community investing is often distinct from philanthropic efforts, it is reasonable to assume that this motivation to contribute to the public good could be transferred to community investments as well.

[23] Fundraising Effectiveness Project, FEP Reports, Q3, 2020, December 2020.

Another unique feature is the fact that community investing is inextricably linked to place, such that a level of nostalgia or personal attachment to one's hometown can fuel more investment activity. Shaquille O'Neal is one example of an athlete who has been an active investor in and vocal advocate of his hometown of Newark, NJ, most recently putting his support behind an $80 million luxury apartment building in the city's downtown core. Similarly, Erie Downtown Development Corporation – a nonprofit founded in 2017 to help revitalize the city – has begun hosting a series of "Erie Homecomings" that highlight investment opportunities to former residents who may have an interest investing in the economic future of their hometown. Indeed, individual investor asset allocations are sometimes described as "sticky," meaning there is minimal motivation to alter initial allocation decisions once they are set. Accordingly, an emotional connection can be essential for an individual to adjust existing investment strategies to include a new focus on community.

As the market for impact investment offerings has grown, so have the impact themes that investors can pursue. In addition to targeted community investing options, investors can also prioritize other areas such as education, health, financial inclusion and climate – some of which can overlap with community investing themes but which can also be pursued across broad geographies. This diversity of investment and impact offerings means that clients can tailor their investment portfolios to meet their impact priorities. Ultimately, this level of choice is a welcome shift in the private wealth ecosystem as it has the potential to crowd in a wider swath of new investors. However, it can also fragment the supply of capital. Where there is a desired goal to attract more capital for community investing specifically, DAF providers and other platforms will have to both educate their clients on the merits of community investing strategies and target donors that already have a predilection for this type of impact.

CASE STUDY D:

CapShift and ImpactAssets

Community investing through DAFs is on the rise but still faces barriers that prevent broader uptake. The models and strategies employed by ImpactAssets and CapShift – two leaders in the impact investing DAF market segment – provide insight into the potential for leveraging DAF capital creatively to support communities.

ImpactAssets offers an impact investing DAF with over $1.4 billion under management across 1,500 donor accounts. The firm offers a range of impact investing opportunities to its donors, from model impact asset allocations to ESG mutual funds and impact private debt and equity funds to custom, donor-led impact investments for high-net-worth clients.

One of the appeals of working with DAF platforms is the potential and flexibility to structure more creative investment vehicles that supply critically needed capital to organizations such as community development financial institutions (CDFIs). For example, *ImpactAssets directed $15 million in equity-like capital to Calvert Impact Capital that it used to bolster its net asset position and leverage approximately $105 million in additional lending capacity to support its portfolio CDFIs. While the structure of this investment is complex, the donor experience is designed to be seamless, as they can easily select into this structure as part of ImpactAssets' Community Investment Strategy, one of the many pools and allocations on their investment platform.*

For DAF platforms to be successful, they need to develop a range of tools to match the priorities and comfort levels of donors. CapShift, an impact investing platform, serves as an intermediary for philanthropic institutions, including DAFs, to help source, evaluate and monitor impact investments. In 2020, CapShift partnered with TheCaseMade, organization that works with social movement leaders to apply social science to help bring about systemic change. Together, and leveraging CapShift's technology platform, they published the Racial Justice Framework, which evaluates investment opportunities across asset classes based on how they serve Black, Indigenous, and People of Color (BIPOC) communities across a progressive continuum from diversity and inclusion to racial equity and finally racial justice.[24]

Importantly, the framework is paired with actionable next steps – that is, a continually updated sourcing report of investment and recoverable grant opportunities across the continuum.[25] *Vanguard Charitable, a national DAF, partnered with CapShift to offer recoverable grant opportunities for eligible donors, specifically selected from a COVID-19 Response and Recovery sourcing report.*[26]

The organizations highlighted in this case study are at the forefront of innovation in the DAF space, but the broader market still lags in terms of community investing offerings. There are, however, early anecdotal indications that donors are increasingly interested in investing locally to support their hometowns in the face of the pandemic. As is a consistent theme throughout the report, the potential for leveraging DAF capital at scale to support communities is encouraging but currently uncertain.

3. COMMUNITY-DRIVEN INVESTORS

A More Inclusive Approach

Another emerging opportunity is the creation of investment funds that specifically seek to raise capital from smaller dollar, non-accredited investors, most of whom lacked investment options that matched their investment size and risk tolerance. In addition to creating a new mechanism for investment, these platforms are also unique in that they embed a democratic process to engage their community investor base to set fund priorities and make key decisions. Models such as these are sometimes referred to as restorative investing, which is considered the pairing of community investment with power

[24] CapShift and TheCaseMade, "Getting Started: Investing in an Equitable Future," Racial Justice Framework.
[25] CapShift and TheCaseMade, Racial Justice Sourcing Report.
[26] Vanguard Charitable, CapShift, Recoverable Grants 101.

rebalancing to correct for systemic and often racial inequities.[27] One example of this in practice is the Ujima Fund in Boston, which raised $2.5 million to offer microloans to local area businesses in communities of color across the city. Similar models are emerging across the United States, including the Community Investment Trust and the Real People's Fund in California, all of which share the goals of deploying critically needed capital to underserved businesses and projects in their communities through a participatory process that incorporates authentic community engagement.

While encouraging because of the potential for deep impact in groups often overlooked for investment opportunities, there is an inherent barrier to scale for some of these models, given that they are meant to remain hyperlocal and small in size to appropriately serve the needs of their target borrowers and investees. Still, there is a great deal of interest in and energy around these emerging models, as evidenced by their growing proliferation around the country.[28]

CASE STUDY E:

The Ujima Project in Boston

SIMILAR INITIATIVES:

Runway Project's Real People's Fund

Nico Echo Park, Benefit Corp

Heron Announcement on Community Investment Committees

Community Investment Trust

The Boston Ujima Fund traces its roots back to coordination among grassroots activists and impact investors seeking to bridge the divide between their respective work. Launched in 2018 with a $5 million capital raise targeted for 2021, the Ujima Fund empowers local residents, businesses, and other stakeholders to invest in small businesses, as well as real estate and infrastructure projects in Boston's working-class communities of color.

The fund is especially innovative in two ways. First, the fund itself is democratically managed. Community stakeholders outline their priorities for economic development, engage in the due diligence process with potential entrepreneur investees directly, and make informed voting decisions on whether to allocate funds to projects with the assistance of data collected by the staff at the Ujima Project. Additionally, a democratically elected standards committee reviews the social and environmental impacts of the portfolio companies using 36 impact metrics chosen by the community itself.

The Ujima Fund is also particularly innovative in its employment of a unique capital stack. There are three tiers of noteholders within the fund's structure, the first being non-accredited investors in Massachusetts who can purchase notes as low as $50 and up to $10,000. Second tier investors, who can be accredited investors from Massachusetts and some neighboring states, can invest between $1,000 and $250,000; while the third tier is reserved for philanthropic investors committing at least $5,000.[29] Rather than relying on traditional financing structures in which those who take on the lowest risk receive the lowest return, the Ujima Fund prioritizes securing the highest financial returns first for those who

[27] Rodney Foxworth, Common Future, Medium post: "Do Good by Giving up More: A Vision of Restorative Investing," November 2018.
[28] Brett Theodos and Leiha Edmonds, Urban Institute, "New Models for Community Shareholding: Equity Investing in Neighborhood Real Estate Investment Trusts and Cooperatives," December 2020.
[29] Ibid.

have invested smaller dollar amounts and purchased notes with a shorter duration. The philosophy behind this decision is that the timeline for and relative size of returns should be based on proportionate risk taken relative to the investor's total assets to better enable communities to meaningfully combat wealth inequalities, rather than perpetuating them.

While unlikely to scale by design, initiatives like the Ujima Fund represent a growing trend that could create impactful outcomes for those historically excluded from financial decision-making and investment opportunities in their own communities.

4. RECENT FEDERAL APPROPRIATIONS

Implications for Community Lenders

The Coronavirus Response and Relief Supplemental Appropriations Act, signed into law at the end of 2020, included an unprecedented $12 billion in funding to support CDFIs and MDIs. Specifically, $3 billion was designated for grants and technical assistance through the CDFI Fund. The remaining $9 billion will go toward the newly established Emergency Capital Investment Program (ECIP) to make equity and equity-like investments in CDFIs and MDIs to support expanded lending and investments in LMI communities. Both the grant and investment programs include targets to specifically support smaller lending institutions and those serving minority borrowers. See **Figure A** for more details on the appropriations.

FIGURE A

Coronavirus Response and Relief Supplemental Appropriations Act — $12 Billion in Support for CDFIs and MDIs

CDFI FUND - $3 BILLION

Operated out of the Treasury Department and provides grants and other financial and technical assistance to support CDFIs, including CDFI loan funds

- **CDFI Rapid Response Program - $1.25 billion**
    - Available through FY21
- **Emergency Support and Minority Lending Program - $1.75 billion**
    - Available until expended
    - $1.2 billion targeted to Minority Lending Institutions

ECIP - $9 BILLION

Equity and equity-like capital (e.g., preferred stock) for depository CDFIs and MDIs to expand lending and investments in LMI communities

- **Small Lender Set-aside - $4 billion**
    - $2 billion for those with less than $2 billion in assets
    - $2 billion for those with less than $500 million in assets

SPOTLIGHT B

TECHNOLOGY INNOVATION TO DEMOCRATIZE AND SCALE COMMUNITY INVESTMENT

A common theme among the capital sources highlighted in this report is the high-touch, manual process that dictates how investors are connected to community investment opportunities. Not surprisingly, a range of technology solutions have emerged in recent years to make the capital raising process more efficient. These technology-enabled platforms vary and can help to facilitate transactions, improve the investor experience and ultimately increase the flow of capital. These solutions can ease barriers on both the supply side – providing investors a platform or convenient investment options – and the demand side – offering streamlined application and capital matching processes.

For example, C-Note is a platform founded in 2016 that facilitates investment into a range of CDFI partners. Investors can open accounts with no minimum account size, thereby increasing access for retail investors or those new to community investing. For larger investments, including from institutional investors, C-Note can provide liquidity and deposit insurance by distributing a single investment across vetted and insured depository institutions. Similarly, individual banks can manage large deposits while providing insurance through programs like CDARS. Deposits larger than $250,000 – the FDIC account maximum – are automatically split into smaller CD products at other partner institutions.

The COVID resilience funds discussed in Case Study A provide another set of examples of technology solutions applied to facilitate access to capital. In those efforts, CRF USA's Connect2Capital platform matched local lenders working in target communities with capital available through various state and local funds established to respond to the ongoing economic crisis. Investors were able to quickly deploy capital at scale through the larger fund, while borrowers were able to work with trusted local partners to originate and service their loans.

Finally, equity crowdfunding continues to garner widespread attention. This type of offering was originally created as part of the 2012 JOBS Act, and issuances have grown steadily as regulations are issued and platforms are developed. At least $186 million was raised in 2020 through online platforms, a 78% increase from 2019.[30] Though still small compared to other sources of small business finance, this growth has attracted interest in equity crowdfunding as an emerging tool.

These models are not without their drawbacks. To accommodate investor needs for liquidity, recipient institutions may face new challenges managing cash flows as they may receive requests for redemptions with little advance notice. These challenges must be weighed against the convenience to investors and the expanded access to those investors that recipients gain by participating. For retail investors looking to deploy capital and entrepreneurs looking to raise capital, there is a need to ensure that the risks and benefits of these tech-enabled platforms and those of underlying investments are properly communicated and understood.

Despite these challenges, there are reasons to be optimistic about the potential of technology to both expand the investor base for community investments and extend this capital to a wider and more diverse range of organizations. In the case of COVID resilience funds, these models focus on improving the borrower experience, making the loan application process more efficient and potentially reaching communities that are underserved by the larger banking sector. There is early evidence that these models succeeded in increasing access for minority borrowers as well as those in low- and moderate-income communities. All of the models noted here provide streamlined investment options for a range of investors and could, if they continue to develop and scale, draw more capital into the community investing market.

[30] Olivia Strobl, Kingscrowd, "Year in Review: Crowdfunding in 2020," December 2020.

The new CDFI Fund grant programs and the ECIP seek to improve upon previous pandemic response programs by targeting smaller, more diverse institutions explicitly and providing some added flexibility in use of proceeds. Both the Alliance and subject matter experts interviewed for this report noted the difficulty that many CDFIs and MDIs faced in effectively utilizing programs like the Paycheck Protection Program (PPP) and the Federal Reserve's Main Street Lending Facility when they were initially rolled out.

While the ultimate success of the ECIP's implementation remains to be seen, it undoubtedly represents a historic public sector investment in community banking. Importantly, the program will reward CDFIs and MDIs that meaningfully expand their lending and investments over time in the form of favorable repayment terms. There are, however, some potential challenges to implementation that could be addressed through subsequent technical corrections or regulatory changes. For example, only CDFI depositories are considered eligible to apply for funds through the ECIP. CDFI loan funds are not currently eligible, which many in the industry believe to be a missed opportunity given that they are often specialized in serving otherwise difficult to reach communities and are responsible for an outsize portion of small businesses and affordable housing finance. Further, the exclusion of CDFI loan funds may hamper the success of the program given that eligible institutions might opt not to apply or struggle to draw down the funds quickly.

Overall, the $12 billion represents a large influx of capital that will likely have significant ramifications for the community investing field. While the precise implications are presently opaque, the authors of this report did consider it necessary to acknowledge it as a relevant factor.

CONTINUED BARRIERS TO COMMUNITY INVESTING

Regardless of their longevity, both the historical and emerging sources of capital for community investing face barriers that have limited adoption to date or present potential challenges to this source or channel going forward. These barriers can impact the ease with which investors can allocate capital for community investing, their potential to scale, and their resiliency in the face of a host of internal or external factors. These barriers are often further exacerbated for communities that have experienced historic underinvestment. While each investor or channel may face their own unique barriers, there are several that are shared and worth noting:

- **Investor education and awareness are key:** Community investing requires that investors have a firm grasp of the unique socioeconomic issues on the ground; the range of investment opportunities; the federal, state and local programs that support these investments and the credible actors who can be effective conduits for investment capital. It is not enough to simply direct capital to underserved communities, particularly as that capital may have unintended consequences or mixed outcomes. Furthermore, for achieving durable positive outcomes, it is critical that investors partner with communities and incorporate their input at every stage of the investment process, including pre-investment planning, capital deployment, investment management and responsible exits.

- **Poorly defined market segmentation:** The term “community investing” can encompass a wide range of strategies and objectives, but these approaches are frequently conflated under the single term. Strategies can vary across sectors (e.g., housing, small business, etc.), return profile (from market rate to concessionary) and geography (from rural to urban). From an investor perspective, it is also important to understand the type of capital needed (e.g., debt vs. equity), the risk profile of these investments and potential constraints as they relate to duration, liquidity and headline risk. Investors must be aware of these nuances and trade-offs to effectively implement and execute against a community investing strategy.

- **Perceptions or concerns about fiduciary duty can limit available opportunities:** Investors should weigh relevant factors in deciding which community investing strategy is most suitable for their goals. However, fiduciary duty considerations may limit the universe of investable opportunities for investors that work with a Chief Investment Officer (CIO), Outsourced CIO (OCIO), registered investment advisor (RIA) or wealth and DAF platforms. Specifically, these advisors and platforms are more likely to consider only market rate investments (or those perceived as such), effectively eliminating the option to pursue a more concessionary strategy, even if there is great demand for exposure from clients and for that type of capital on the ground.

- **Integrating community investments into traditional portfolios can be challenging:** For most individual and institutional investors, a community investing orientation is not automatically part of their overall asset allocation strategy. Investors also vary as to whether they consider community investing as part of or outside of their overall investment goals. Non-investment objectives for corporate investors, for instance, can include a desire to be a good corporate citizen, adhering to a regulatory or policy directive, or corporate public relations (or a combination). Regardless of the motive, the unique position that community investments often hold requires investors to make a case for why existing investment orientations should shift to accommodate a new community investing strategy as part of their overall asset allocation.

- **Need for qualified investment professionals that understand the sector:** A successful community investing strategy requires qualified investment professionals who bring rigor to the investment process and understand the nuances of community development, as well as a formalized investment process. Several of the sources and channels cited in this report have varying levels of dedicated teams and defined processes, both of which can hamper the efficiency of capital flowing to communities.

- **Shifts in internal investor priorities and external factors introduce uncertainty over the long term:** Investments that have a more tenuous link to either an investment strategy (like generating a risk-adjusted return) or a business development goal are more susceptible to internal or external shifts that might prompt an investor or wealth platform to sunset an existing community investment strategy. This could include internal strategies, such as those of foundations, which are often on multi-year cycles that can shift considerably over time, potentially siphoning off funding from existing strategies in favor of new opportunities. Another potential constraint is the financial performance of the endowments themselves, which may decline in value during a recession (as many did during the Great Recession in 2008), causing budgets to shrink as well at a time when those resources are arguably most in need. Similarly, other urgent external factors can also require a reallocating of resources to the detriment of existing strategies, such as devoting resources to COVID-19 pandemic relief.

- **Public policy shifts can have both positive and negative impacts:** Community investing capital sources linked to a tax or regulatory action, such as tax incentives or the CRA, are often drastically impacted by public policy changes. The tax reform package of 2017 introduced considerable uncertainty to the Low-Income Housing Tax Credit (LIHTC) market as sponsors were worried that the new 21% corporate tax rate would lead to a reduction in the value of the LIHTC, leaving capital gaps that would need to be filled or eliminating prospective projects that were no longer economically feasible. Investors are similarly monitoring efforts to reform the CRA, as changes could have a material impact on a capital source that has provided over $1 trillion in community development loans since 1996.[31]

[31] Josh Silver, National Community Reinvestment Coalition, "An evaluation of assessment areas and community development financing: Implications for CRA reform," July 2019.

A LOOK TO THE FUTURE

COMMUNITY INVESTING IS a dynamic field, and this report offers a perspective on a snapshot in time. There are several evolving factors, many of which could hold promise for the sector, that the field should continue to monitor:

- **Longevity of corporate commitments:** Corporates have undoubtedly been the most active new participants in community investing in recent years. The announcements are commendable, but it is unclear if these commitments will transition from being one-off to longer-term programs that continue to grow. Though not explicitly mentioned in this report, several other corporates made large commitments to racial equity and communities in 2020, but in the form of grants. It is unclear if those corporates will decide to convert their strategies from purely philanthropic to investment strategies. In the face of potentially growing federal support for community development, several interviewees also questioned if this would cause the private sector to scale back commitments.

- **Future of the ECIP:** As mentioned previously, the Coronavirus Response and Relief Supplemental Appropriations Act, which includes $9 billion for the ECIP, was recently signed into law at the end of 2020. It remains to be seen how these new programs evolve as well as their rate of uptake by a diverse range of community development financial intermediaries, considering the current ineligibility of CDFI loan funds.

- **Potential for an inclusive infrastructure and recovery package:** Though not explored in this report, the authors note that municipal and private activity bonds also provide significant sources of capital for the construction of infrastructure and community facilities. These tools are expected to feature prominently in any proposed infrastructure and recovery package considered by the current Congress. It is possible that these tools could be more explicitly targeted towards supporting investment in LMI communities and could be paired with efforts to support CDFIs, MDIs or other community investing intermediaries.

- **Need for a more coordinated approach by the public and private sectors:** The Alliance continues to stress the importance of advocacy efforts that support the continued refinement and coordination of community investing tools and resources. The Alliance's recent report entitled *"Public Capital, Private Good"* includes a comprehensive set of policy recommendations, many of which address the community development sector.

RECOMMENDATIONS

BASED ON THIS report's findings, the Alliance strongly urges investors and their advisors to consider the following recommendations to catalyze further community investing:

- **There is an immense need for investment of risk-taking capital:** There is significant demand for investors to take bold and early bets to send a positive signal to the rest of the market, and for investors to take increasingly riskier positions in the capital structure. These may include subordinate debt, equity stakes, longer-term and more flexible capital, with fewer programmatic and other restrictions. Investors can also employ a hybrid approach to strengthen the institutions in which they invest. An example is providing a grant to shore up a financial intermediary's net asset or equity position in addition to supplying investment capital. This will improve the organization's financial outlook and help to attract even more third-party capital.

- **Investors can help streamline the capital raising process for community intermediaries:** There is significant demand from financial intermediaries for a more predictable investment approval process from investors. Those receiving investment capital repeatedly cited the laborious process for raising capital and other resources. This was a consistent pain point across almost all capital sources and types of investment. For these financial intermediaries, there is an opportunity cost between allocating staff time to secure capital commitments and deploying that capital into communities. Investors can and should develop more streamlined and predictable investment approval processes that are fully transparent to the intermediary borrower and aim to supply capital in a more rapid fashion. To the extent that investors rely on registered investment advisors (RIA) or investment consultants, they should coordinate up front on what are considered suitable investment opportunities to mitigate conflicting feedback shared with the borrower by the client versus the advisor.

- **Client-facing channels, including RIAs and private wealth platforms, should increase their awareness of community investing strategies:** Both impact-oriented and traditional platforms should have a baseline level of knowledge on community investing and its potential to deliver on client objectives. As demand for values-aligned investing grows,[32] establishing this foundational knowledge can help these platforms differentiate themselves and support future business development goals.

[32] Morgan Stanley Institute for Sustainable Investing, "Sustainable Signals: Individual Investor Interest Driven by Impact, Conviction and Choice," 2019.

CONCLUSION

As of this report's publication, communities are facing a myriad of challenges related to the COVID-19 pandemic and economic crisis, which have in turn widened existing disparities among Black, Brown, tribal, rural and LMI populations. For decades, investors of all types have employed a variety of strategies to flow capital to these communities, motivated by a diverse set of factors. As public and private sector leaders seek to achieve a robust and equitable recovery from the current crises, it is imperative to examine the state of the community investing ecosystem and to consider the saliency of emerging, innovative capital sources. It is in this context that the Alliance came to researching and writing this report and offering recommendations to investors and advisors, both those currently active in community investing and those that may choose to participate in the future.

Community development and community investing are dynamic and multi-dimensional activities, such that they require a unique and diverse set of investment solutions to drive the intended outcomes. One theme that resonated while crafting this report, and in speaking to subject matter experts, was a need for a "both/and" approach to community investing. There is a place for mature and scalable financial intermediaries that have the ability to access the capital markets, and sub-scale, high-touch models that aim to serve the hardest to reach households and communities. Just as the investment opportunities range in size and scale, so does the universe of capital sources. Both institutional investors, such as corporates and financial services firms, and retail clients across the wealth spectrum play an important role in financing the unique needs of communities across the United States.

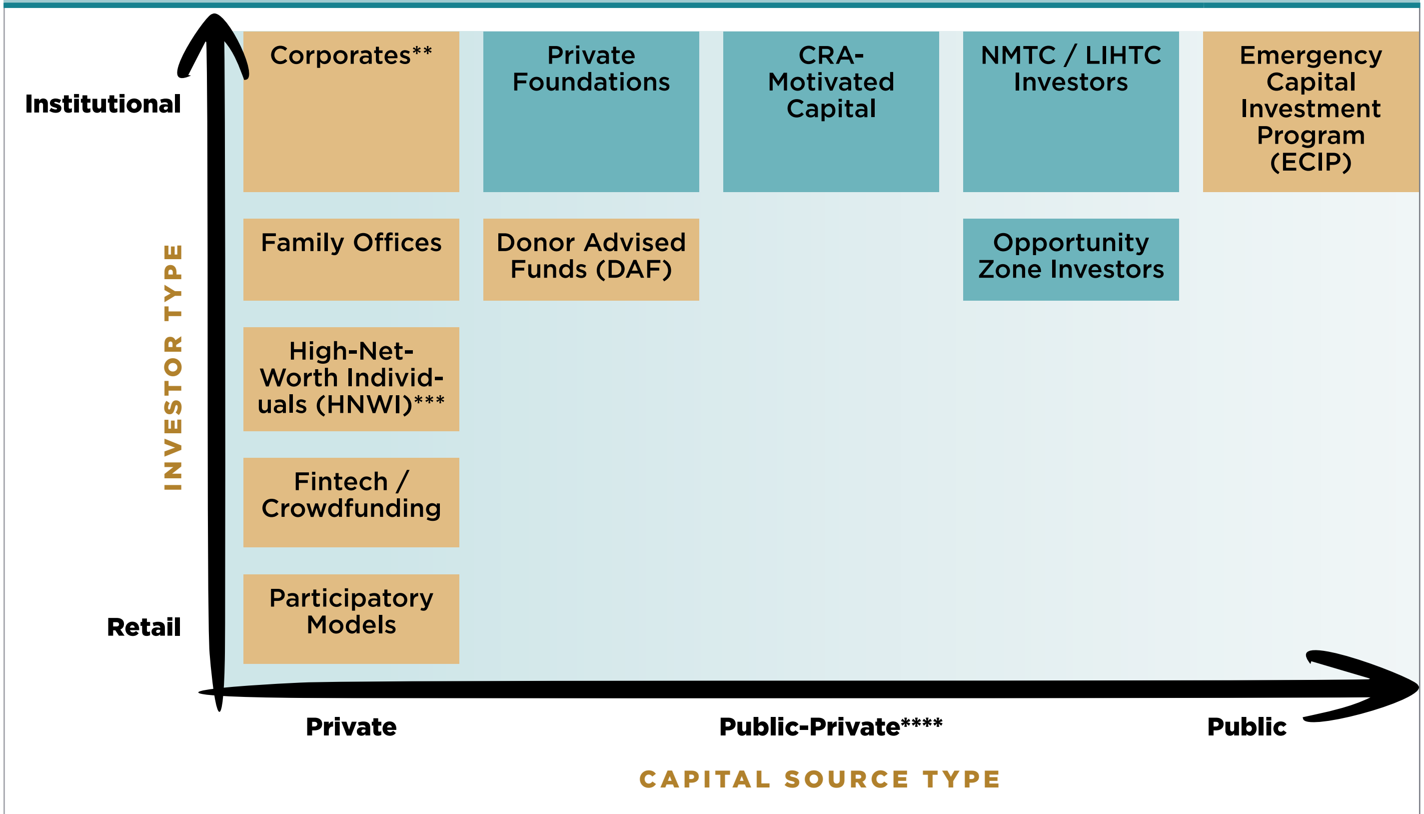
Finally, the unique tensions inherent to community investing suggest a strong need for leadership from both the private and public sectors. Innovation and scale are laudable goals by private actors within the community investing space, but there will always be a need for deep impact and sub-scale strategies that can be buttressed by government subsidies, programs and regulatory action. In that regard, the Alliance hopes that this report lays the groundwork for deepened community investing commitments by both sectors, in terms of the amount of capital flowing, the stakeholders engaged and the strategies being employed. Systemic inequality is deeply rooted in society, but community investment has proven to be an important component of a multi-pronged approach to confronting collective challenges and creating new pathways to meaningful economic opportunity.

The Alliance is grateful for the opportunity to work on this report and for the reader's time and consideration.

APPENDIX

FIGURE B

Landscape of Historical and Emerging Sources of Community Investment Capital*



*Excludes non-investment sources of funding (i.e., government grants, philanthropy, CDFI Fund awards, etc.)
**Defined as corporates without a CRA obligation or investing outside of a corporate foundation
***HNWI investing through a private wealth platform or other RIA
****Public-private defined as investors motivated by some degree of regulatory action or receiving a tax benefit in exchange for this activity

Historical Sources
Emerging Sources

FIGURE C

Select Barriers to Community Investing by Investor Type

PRIVATE	**CORPORATES**	• Motivations for engagement vary and can be unclear, time-limited or context specific • Significant time and effort required to educate senior management and board, identify capital source and formalize process
PRIVATE	**FAMILY OFFICES**	• Impact priorities and investment decision making processes can be opaque • Priorities can be divergent among family members and between families • Decision makers are difficult to access
PRIVATE	**HNWI**	• Fiduciary duty limitations • Requires two-step diligence process with wealth platform and individual investors • Competition with other impact investing themes (e.g., environment, education)
PRIVATE	**FINTECH/ CROWDFUNDING**	• Requires education of general public on investment opportunities • Questionable appropriateness of individual investors understanding and taking on varying levels of risk • Investee might not be structured or prepared to interface with individual investors
PRIVATE	**PARTICIPATORY MODELS**	• Intentionally designed to remain small at the fund level, limiting the ability to scale • Time and resource intensive • Downside risk protection required to protect individual investors
PUBLIC-PRIVATE	**PRIVATE FOUNDATIONS**	• Foundations have adopted PRI/MRI practices at varying rates which may dictate investment appetite • Foundations select their own impact and programmatic strategies, which may differ from one another and shift over time
PUBLIC-PRIVATE	**DONOR ADVISED FUNDS (DAF)**	• Fiduciary duty limitations • Requires increased awareness at DAF, RIA and individual donor levels • Confusing definitions and accounting guidelines for recoverable grants
PUBLIC-PRIVATE	**CRA-MOTIVATED CAPITAL**	• There are ongoing regulatory reform efforts that could impact the overall framework and the flow of capital
PUBLIC-PRIVATE	**NMTC/LIHTC/OZ**	• OZ guidance favors larger and more profitable investments, which may exclude the most underserved • Reapproval requirements create uncertainty • Lack of cohesiveness between community investment tax credit programs
PUBLIC	**EMERGENCY CAPITAL INVESTMENT PROGRAM**	• Uncertainty around inclusion of CDFI loan funds • Uptake and effectiveness of program remains to be seen