

Beta Handbook: Community Impact Investment

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I. INTRODUCTION

During this last year, I was presented with an exciting opportunity to immerse myself in the world of impact investment through the LISC Rubinger Community Fellowship program. I have been working in the community development sector for most of my career, currently in the role of Deputy Director at Somerville Community Corporation in Massachusetts. As a Rubinger fellow this year, I dedicated a portion of each week to explore the theories, operations, and models of impact investment, with a particular desire to understand underlying connections between community development and impact investment. Throughout this year, I have worked closely with the Boston Impact Initiative, as well as meeting with numerous others from the community impact investment space in my quest to learn how it all works, and to uncover models that could apply to our work locally.

As the end of the fellowship approached, I sat down to put into writing a summary of what I have learned, in the form of a report I would deliver to LISC, the sponsor of the fellowship. Before I knew it, this “summary” grew, and I began to think of it as something that might be useful to a broader audience who, like me, might be active practitioners of community development and other community work, but may be less experienced in investment and finance. As I was finishing my first draft, I attended a NC3 (National Coalition for Community Capital) roundtable in Vermont—which gave me the impetus to share this as a “work in progress”, either to be contributed to other compendia and resources, or to serve as a moving platform that can be edited, expanded, reshaped, reformatted, etc., as a working, community document.

I invite people who are interested in working with this tool to share their thoughts, add new chapters, and be a part of the emerging document.

II. DEFINITIONS, CONCEPTS AND EXAMPLES – COMMUNITY IMPACT INVESTMENT

A Starting Point: Social Impact Investing:

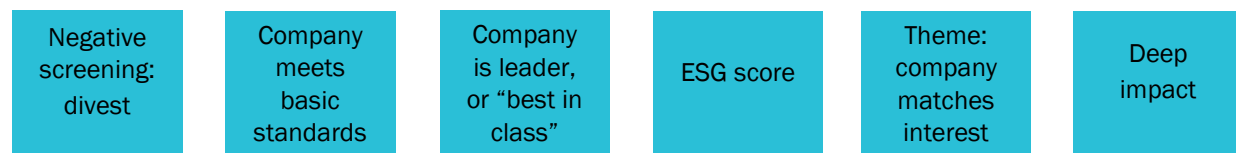
Social impact investing, broadly, is a term given to the investment of capital into companies or organizations that use it to produce something of environmental or social value, as well as generating a capital return. The Global Impact Investment Network (GIIN), defines Social Impact Investment as follows:

Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market, to market rate, depending on investors' strategic goals.

While the concept of directing capital away from harmful practice and towards good practice has been around for decades, the term itself came from the Rockefeller Foundation in 2009 at a gathering in Italy. It was introduced as a new “asset class” to attract a body of investors interested in both a financial return and a mechanism to address challenges across a variety of sectors; examples from GIIIN include: sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education. Social impact investment is a mechanism that investors can use to evaluate and influence the decisions made by companies and organizations, thereby giving investors the ability to impact practice across the world that ideally will lead to better social and environmental outcomes, and a “better” world.

Metrics

Approaches for how to do this span a continuum from divesting from structures that are perpetuating bad practices, to investing in very targeted business models that address an expressed social goal. So, for example, an investor who decides to consider other metrics besides monetary return may assess their investment based on:



- **Negative screening:** This is a mechanism to evaluate performance of a company to see if they fall below specified standards—and if so, to discontinue investment. For example, if you (or your institution) are investing in a country whose leadership supports practices you don’t agree with, such as genocide or torture, you can divest from this company.
- **Basic standards:** You may have a very “low bar” screen, which sets a general threshold you require to make the company eligible for your investment.
- **Best in Class:** You may opt to invest in high performing companies who are leaders in particular areas of interest.
- **ESG Score:** ESG, or Environmental, Social, Governance, is a commonly used system of standards to evaluate companies based on: 1) environmental factors (are they using non-extractive processes, renewable, non-toxic, and regenerative materials?); 2) social factors (what are their hiring practices, compensation ratios, benefits?); and 3) governance (who owns the company? Who are the decision makers? How transparent is the company in its reporting?).
- **Theme:** Investors may choose to evaluate a company based on its sector and performance in that sector, following their own priorities and interests. For example, an investor may decide to invest in clean water companies.

- **Deep Impact:** This metric emphasizes the outcomes realized by the company. Investors may be more motivated to invest in companies that move beyond meeting basic standards, but have notable impact in the areas of priority.

In early years of using investment practices tactically, strategies focused more on the left of this continuum, i.e. divestment and sanction strategies to influence practice. The social investment world has evolved to emphasize positive screens—i.e., selecting businesses based on their positive practices, such as those measured through ESG screens. There is an optimistic sense that value and impact will increasingly drive return. As the movement has grown, more and more investment leaders are exploring and implementing strategies that are more targeted, and designed explicitly to achieve a defined desired outcome.

In all of these examples, use of metrics and standards provide the information investors use to evaluate the companies and businesses they consider for investment. This entails setting up clear standards that can be universalized across investment communities. Metrics based on ESG standards paved the way for social impact investment, and have been implemented globally. Hundreds of data screens have popped up to help investment advisors and investors to evaluate and measure business practices based on multiple variables. With large data engines and user-friendly technology, it is becoming easier to extract data to measure performance across hundreds of categories. Impact investment organizations, like [Just Capital](#), [the GIIN](#), [Aspen Institute](#), B Corps and [Boston Ujima Project](#) have or are rolling out state of the art tools, standards and certifications to help users evaluate companies based on best practices.

Yet reliance on standards and metrics to determine the flow of capital comes with its own set of challenges. Universal metrics, such as those shaped around ESG, have been designed to capture data that is publicly available. Smaller companies and businesses that are not public are harder to measure. Standardizing metrics based on available data can become limiting, as there are numerous data points worth evaluating that might be harder to get. Without having the resources or time to further investigate, investors and advisors may choose to make less informed decisions calculated on a lower-bar threshold. Also, companies may not provide full and accurate data. To fully understand performance and change requires a time frame long enough to capture changes, which also requires consistent tracking over time. Much of what happens within the walls of a business is qualitative and measured in small steps, which may get missed using standardized measurement tools. Finally, there are many areas of social impact that do not fit within the universally established boxes within the ESG framework. For example, economic justice and addressing the racial wealth gap is only recently gaining attention as an important target of impact investment, and may slip below the radar of large-scale investors. For this reason, a number of organizations are building their own means of influencing and measuring impact to address specific and prioritized issues.

Local examples

- [Boston Impact Initiative](#): has created an impact assessment tool that they use with the businesses they fund, which provides a tailored set of questions to measure impact within the scope of economic justice. BII explicitly uses this tool with the individual businesses, so that the businesses participate in the ongoing evaluation, reflection, and positive bend toward the desired impact. A handbook accompanies the survey to make it more accessible

and understandable. This handbook helps explain each of the questions in the survey tool, as well as to give context and examples in each of the categories covered, including: enterprise composition; inclusive ownership and cooperatives; good, fair jobs; suppliers; and customers.

- [The Boston Ujima Project](#): worked with its community network to establish the “Good Business Standards” to both encourage responsible business practices, and to give its community of investors a tool to evaluate businesses when making investment decisions. In Somerville, SCC (where I work) has been developing a set of “Good Jobs” standards we plan to use with our network of employers as we cultivate hiring relationships with SCC’s First Source Jobs participants. A next step will be to explore ways to connect these standards with community investment opportunities.

Community Impact Investing!

While it’s helpful to understand the broader and global context of social impact investment, this report and handbook focuses primarily on “community” impact investing and community capital. Impact investment structures have the primary goal of supporting mission based social, environmental and economic outcomes of positive value. Many often rely on investors of high net worth, therefore concentrating the aggregation of wealth. There is another important variable in the impact investment structure: who gets to invest and benefit from potential growth in assets? Community capital opens up investment opportunities to lower-income individuals who also wish to direct impact in a localized way, while also benefiting financially. There are numerous approaches to involving all members of the community in investing in their local economy and social wellbeing of the community. By connecting all parts of the community in the chain of investment, there is great opportunity for economic justice and growth that benefits everyone.

The National Coalition for Community Capital is in the process of refining their definition of community capital, but here is a starting framework:

“Capital that is sourced from the same community that it is investing in, with equal opportunity for all. By recirculating capital within the same local economy, it maximizes the community wealth-building effects of community capital.”

This is an important distinction in the world of impact investing, as its aim is to divert any points of extraction from the community by making sure investments directly benefit and accrue to the community itself.

Let’s Step Back and Talk about Investment Principles

Let’s start with the basics: Investment flow, equity, and debt. Any business or organization that is generating capital will at some point face a need for more capital—whether it’s to buy their tools, hire new employees, or stay afloat until new revenue comes in. Meanwhile, those who have money to invest are looking for opportunities to leverage their money, either to get a return on

their initial investment, and/or to help the business or organization achieve its growth or impact goals. Three common types of investment are debt, equity, and revenue share.

Debt Investment: the enterprise gets money upfront from the investor, and they need to pay it back over time, as well as paying an interest rate, or charge, to the investor. Subordinated debt investors are those that get paid back after the primary debt investor. Here are some examples of types of loans (from: <http://investibule.co/how-to-community-invest/>):

- **Standard term loan or note:** Most loans have a fixed interest rate and repayment schedule—for example, 5% interest paid to investors quarterly over a three-year term
- **Zero-interest Loan:** On some funding sites, such as Kiva, you can loan money to a small business and they pay you back the principal—i.e. your original investment amount—over time, without interest. (Your reward is knowing that you're helping out a deserving entrepreneur.)

Equity Investment: The investor becomes a part owner of the enterprise. They get paid through: a. dividends when the company has a positive cash flow; b. someone buys their shares; or c. when the company gets sold, they get a portion of the sale based on the number of shares they own. There can be different types of shareholders with different terms. Here are some examples of types of equity (from: <http://investibule.co/how-to-community-invest/>):

- **Common shares** are the most basic form of equity. The shares come with voting rights, but common shareholders are last in line (after preferred shareholders and lenders) to get paid if the company goes belly up.
- **Preferred stock:** Preferred shares are a class of stock designed to attract outside investors. They typically pay dividends and give investors priority over common shareholders, but have limited or no voting rights.
- **Convertible Note:** A Convertible Note is technically a loan that converts to equity at a later date. It's popular for early-stage startups because it puts off the challenge of establishing a value for a company (which may have no product or sales yet) until a later date, usually the next major funding round. At that time, you'll receive equity shares (see Common or Preferred Stock), typically at a better deal than the newer investors coming in. Until the conversion, the notes usually accrue interest like a regular loan.
- **SAFE:** The Simple Agreement for Future Equity (SAFE) is a recent variation on the Convertible Note. It's not a loan. You simply get dibs on equity shares at an attractive price in a future funding round (be sure to read the fine print!)

Revenue Share: This is a kind of investment that falls in between debt and equity. Also known as "royalty", or sometimes mezzanine debt. In this arrangement, the investor's returns are based on how well the company is doing. For example, the investor and the company may agree to setting a specific annual goal of revenue, and the investor gets paid an agreed upon percentage of any revenue that surpasses this goal. These loans have variable repayments that rise and fall with the business' sales. Instead of a fixed interest rate, the business sets aside a certain percentage of sales. Often, the total repayments are capped at an amount expressed as a multiple of your initial

investment, e.g. 1.5x (or \$15,000 on a \$10,000 loan). Your rate of return as an investor depends on how long it takes the business to repay the loan.

There are a number of other variations of these types of investment. Those with money to give or invest can do this in a number of ways:

1. They can donate the money as a gift or subsidy, with no expectation of return.
2. They can donate the money in exchange for a tax return if the organization or business has a connection to federal tax programs that allow for this mechanism
3. They can contribute it as equity in exchange for a share of the company or other rights. This could give them voting rights, or dividends if the business generates a profit after paying back loans, or a share of the sale when the business changes ownership.
4. They can provide a soft loan, either with or without interest, with a long-term expectation that they will eventually be paid back, contingent on the success of the business.
5. They can provide a loan, with an agreed upon interest rate and time frame to pay back principal.

The Investment Stack

Generally speaking, there is an order of priority for who gets paid back—and when—based on type of investment and level of risk. Equity investors are taking the highest risk because their payback depends on the success of the business, or amount captured at time of sale after all debts are paid. They do not get paid interest in regular intervals, but may get dividends if there is a positive cash flow. Because they are the last to get paid back and are taking on the highest risk, they have the highest rate of return.

For those that are providing a loan, there is an order for whom gets paid first, generally starting with government entities, then followed by other investors according to their terms. Some investors are willing to be subordinate, or lower down in the order of who gets paid back, in exchange for a higher interest rate. Other investors will accept a lower interest rate, but will want to be paid back earlier. Soft or patient loans are often provided by quasi-government agencies or foundations aligned with the mission of the organization or business. They are prepared to make loans with longer periods of return, and at lower rates.

The order in which investors are paid back is often referred to as the “capital stack”. Here are two examples of “capital stack” and the sequence of investment:



Table 1: Impact Investing Asset Class/Return Rate Spectrum. Source: Global Impact Investment Network. The left end (in pink) gives an example of investments that rely on subsidy, or grant support, in combination with traditional equity and debt investment. The sequence illustrates the order of what gets paid back first, starting with the segment closest to the center. For the right side (in blue), this shows a typical investment structure and order, assuming a positive cash flow and/or opportunity to exit. This also portrays the order of obligation of return, starting with the segment closest to the center.

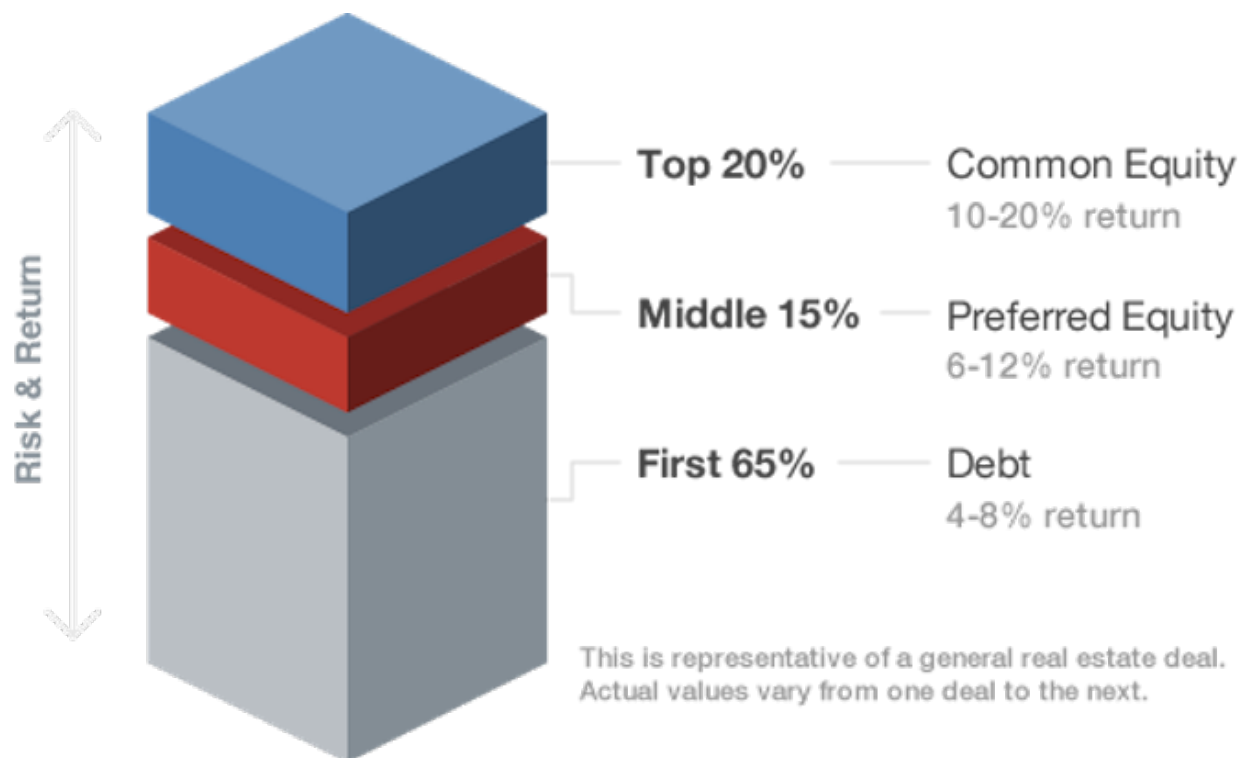


Table 2: Basic capital stack for real estate investment. Source: Fundrise. In this example, Debt is at the bottom of the stack, meaning it must be paid back first. Debt can be further segmented by senior debt (for example, government loans would be the first to be paid back), subordinated debt, which can include soft debt (i.e. debt that has more patient terms of payback), and other agreements with lenders who negotiate different rates of return, interest, and time frame depending on their order in this stack. For example, subordinated debt holders may agree to a position behind other lenders, which is a higher risk position, in exchange for more favorable terms, such as higher interest rate.

There are numerous ways to inject flexibility into investing in different types of enterprises, depending on their stage of growth, size, and type of business. Impact investment strategists have been exploring different approaches and terms to attract investors in their effort to explore resourceful models of investment, business sustainability and impact. Here are a few examples:

Exit Strategies: Equity investors are often looking for a way to “exit” in order to get paid back. This can go against the interest of community investment in a small business the community would like to see in the community into the future without having to sell. There are other ways to build in “exit” strategies for equity holders other than selling the business. For example, at the time of selling equity shares, the partners can build into the term an agreed upon multiple for their investment, so

that when their purchased equity share reaches that value (e.g. 2x the original value, or 5x the original value of the share), the enterprise will pay them back.

Convertibles: An investor can be offered the opportunity to convert debt into equity. This is a way to help a business that might not be in the position to pay back the loan at the time that it's due, and can use that investment for further growth and revenue, which will make the equity share more valuable over time. It's also a good strategy to use with patient investors who are committed to the company without needing to get their money back quickly.

Finance Definitions

There are a number of helpful glossaries that explain various financial terms and concepts. I have also included in Appendix 4 a personal glossary of terms I encountered, though this is a work in progress, with many more terms to add. Here are some links to glossaries I found helpful:

1. Investopedia: <https://www.investopedia.com/>
2. Fundrise: <https://fundrise.com/education/glossary>
3. Realty Mogul: <https://www.realtymogul.com/resource-center/glossary>
4. Cutting Edge Capital: <https://www.cuttingedgecapital.com/>

The New Hampshire Community Loan Foundation has created a helpful tool to help businesses better understand debt, equity and capital needs: [Capital Compass](#)

Who are the players in impact investing?

Who are the players in the world of community impact investment and where does their investment go? Note that these are many of the same players in broader social impact investment, but we'll now focus more precisely on community level investment.

Fund Managers: This includes a broad category of individuals, such as financial planners, and private firms who specialize in managing investment. They often target their services to high wealth donors and institutions. Fund managers have the obligation to steward the assets of their clients responsibly, and in this way are often conservative in their advisory approach, with a keen focus on capital return. They traditionally invest capital in the stock market, in bonds, and in real estate. As the Social Impact Investment field has burgeoned, fund managers have been taking more initiative, or have been directed by their clients, to identify investment opportunities with a social return. This requires extensive research of business performance aligned with their clients' social and environmental interests. Attentive fund managers are often keenly aware of metrics and standards to help guide this part of their work. Because they have an implicit role of gatekeeper for their clients, fund managers play a critical role in directing investing. Conservative fund managers may be unresponsive to innovative investment strategies that fall outside of traditional scope. Proactive fund managers may play a vital role in working with their clients to educate them on new ways of doing business and exploring different forms of return.

There are fund managers, like [ReValue Investing](#), that are paving the way for attracting both accredited and non-accredited investors to community impact investment opportunities. The [National Coalition for Community Capital](#) (NC3) has established a "Community of Practice" for investment advisors committed to community-focused investment.

Family Offices: From Investopedia: “Family offices are private wealth management advisory firms that serve ultra-high net worth investors. They are different from traditional wealth management shops in that they offer a total outsourced solution to managing the financial and investment side of an affluent individual or family. For example, many family offices offer budgeting, insurance, charitable giving, family-owned businesses, wealth transfer and tax services”.

Donor Advised Funds (DAF): This is a category of aggregated funds under management of fund advisors and managers. Donors endow the fund managers with the responsibility to invest the aggregated funds from a pool of donors to reflect their broadly agreed upon goals for the investment. The returns from these investments are often recycled into the aggregated fund to achieve growing, long-term yield. Because Donor Advised Funds have looser restrictions for how money gets invested, there is interest to explore this structure for targeted investment strategies.

Private Foundations: Private foundations can include anything from small family foundations, to community foundations, to larger foundations, such as the Ford Foundation. These are entities that have a large endowment of assets accrued from private donations and investment growth. Part of the foundation’s asset portfolio may include Donor Advised Funds, as described above, through which a group of donors segment a portion of the assets for specific goals or purpose. Foundations typically manage dozens or hundreds of individual funds within their total portfolio. Foundations strive to grow their assets continually, through capturing new donors, attracting larger donations from existing donors, and making returns from their investments. Foundations target a portion of their assets to making grants to mission driven organizations aligned with their own values and goals. Foundations dedicate a portion of their annual return grant distributions (typically 4-7% of their asset base), with the remaining amount folded back into investment. Foundations also can opt to dedicate a portion of their assets to investments that align with their mission and values. These investments are categorized as:

PRI –Program Related Investments: These are investments with low, concessionary rates of return, often below 3%, and patient terms of payback. They are often used as companion investments to other higher interest loans as a way to support below market investments. Impact is primary driver, with “at cost” capital return.

MRI—Mission Related Investments: These investments align with social impact goals, but with an expectation of a sustainable return as part of the endowment investment portfolio.

While most foundations use the bulk of their investments to generate maximum return, with the implicit understanding that this will generate more resources that can be distributed to the community through grants, some foundations are revisiting this ratio, and choosing to invest a higher percentage of their portfolio into socially responsible investment pools. For example, the Heron Foundation targets the typical 5% of its assets for grant distribution, but aims to invest the remaining 95% into socially responsible investments. Many contend that socially responsible investments are increasingly achieving similar returns as more traditional investments.

A number of **community foundations** are creating separate investment funds targeted explicitly to social impact investment. While some of the capital can be taken from the primary endowment investment pool, they also approach their donors, often through DAF’s, to raise additional dollars into social impact funds, noting in some cases for higher risk, potentially lower return, and local impact.

Examples of Community Foundations with targeted impact funds:

- [Maine Community Foundation](#)
- [Rhode Island Foundation](#)

Community Development Finance Institutions, CDFIs: These are institutions that provide financial support and investment to underserved urban and rural neighborhoods, in order to provide economic opportunity to low-income individuals and families, people with disabilities, people of color, immigrants, and others who have less access to community amenities, wealth, and traditional banking services. They work closely with Community Development Corporations. Many were first formed in the 1960's to "ameliorate conditions of poverty by attracting investment in specific neighborhoods and rural regions identified as Special Impact Areas" (see: "Impact Investing and Community Development", Ron Phillips, Maine Policy Review, 2016). CDFI's have been in the business of broadly defined impact investment since their inception 50 years ago, as all of their lending is tied specifically to social purpose outcomes. Through a variety of investment tools, CDFI's provide loans to small businesses and to non-profit organizations for affordable housing and commercial real estate development that directly benefits low-income community members. CDFI's offer typical bank lending products, such as working capital and bridge loans, acquisition and preconstruction capital, and line of credit, often at below market rates with flexible terms. They receive their capital from financial institutions and government agencies, such as the CDFI Fund from US Department of Treasury; PRI's from foundations; and debt capital from financial institutions, which they in turn use to provide financing to their community borrowers. They also have been leaders in servicing and providing investment through tax credit programs, such as the New Market Tax Credit program. CDFI's have also paid close attention to new community impact investment strategies, raising money from impact investors, and establishing targeted funds. CDFI's have played an important role in aligning investment partners to ensure success of the projects it supports.

Examples of CDFIs:

- [Massachusetts Housing Investment Corporation](#)
- [Boston Community Capital \(now BlueHub Capital\)](#)
- [Coastal Enterprise, Inc](#)
- [LISC](#)
- [Enterprise Community](#)
- [New Hampshire Community Loan Fund](#)

Pension Funds, Insurance Companies, University Endowments, Religious Institutions: Numerous institutions set aside endowment pools or employee retirement pools which they invest to grow the

asset. The funding pools—depending on the nature of the institution— are managed by a board of investors who have placed their own assets into this pool. In some cases, these funds need to generate cash to pay out dividends on a regular basis to those who are vested. Because of this, there is motivation to aim for high return on investment. Collectively, these endowments and funds hold hundreds of billions of dollars that are then invested to capture a return. These types of institutions have a broad base of vested participants, as well as a highly public sphere of influence given their community presence. Because of this, they may be more responsive to community influence, which can directly impact the nature and target of their investments.

Example

- [The Initiative for Responsible Development](#), The Hauser Institute for Civil Society

Banks and Depository Institutions: These include credit unions, community banks and national banks. They take the deposits from their customers, and lend this money at a cost (interest). Because they seek strong Community Reinvestment Act ratings, they are motivated to initiate strategies that directly benefit the community they serve. In recent years, more banks have explored new impact investing initiatives to target specific investment funds for social impact enterprise.

Example

- [Eastern Bank Business Equity Initiative](#)

Individual Donors (Accredited, Non-accredited): Most of the above examples represent institutions or management structures that aggregate and invest larger pools of money. Individual donors are people who invest their assets/capital into funds or directly into enterprise. A variety of tools described in the next section have been springing up to offer ways for individuals to make direct investments targeted to match their custom interest. Tools such as crowdfunding, DPO's and community notes give individual donors more flexibility and control in directing their money toward the impact they desire, and to enable lower income individuals to be part of this investment world as an opportunity to build assets. Donors can be classified as accredited or non-accredited.

- **Accredited investors:** are individuals or businesses allowed to make investments and deal with non-registered securities given their knowledge of risk and ability to absorb it, as determined by the Securities and Exchange Commission. Individuals with incomes of at least \$200,000 and net worth of at least \$1 million are among the requirements to be accredited.
- **Non-accredited investors, also known as retail investors:** those individuals who do not meet the threshold requirements for accredited investors. This threshold was put in place as a mechanism to protect individuals from risk when investing in non-registered securities that are considered to be of higher risk. Since the Jobs Act of 2012, Regulation D and definition of crowd funding offer ways for non-accredited individuals to make investments in real estate and investment funds under certain conditions and caps on total amount of investment.

Social and Community Impact Investment Structures and Examples

There are numerous forms and structures that enable social impact investing. I describe several of these structures below, highlighting specific examples.

Social REITS: A REIT is a Real Estate Investment Trust, which is an investment structure that sells shares in the public market through IPO's (initial public offering). The capital raised is pooled into the trust, and then used to purchase real estate. Shareholders then own a portion of a portfolio of real estate, and are paid under terms of the agreement based on the cash flow of the properties, or at point of sale. The REIT is required to pay 90% of its net profit to shareholders. A Social REIT invests specifically in real estate with social purpose, such as affordable housing. Social REITs are managed by a board of directors, with the non-profit investors holding voting rights. This board establishes investment criteria matching the desired social outcome to determine which properties to buy. Unlike the traditional IPO structure, social REITS are not publicly traded. Investment in Social REITS comes from a variety of investors, including family office, high net worth individuals, and non-profits, such as foundations that invest PRI's into the trust with lower rates of return.

Example:

- [Housing Partnership Equity Trust](#): HPET “provides a ready source of long-term, low-cost capital, enabling the 14 mission-driven nonprofits it partners with, to quickly and efficiently acquire apartment buildings that provide quality homes for families, seniors and others with modest incomes.” HPET uses a set of criteria and parameters to assess viable properties to purchase in underserved neighborhoods that have the potential for growth. They look for an annual 2-3% rent growth. Their goal is to hold onto these properties as long as they can to maintain affordability to residents with median income between 60% and 80%, and cap their sales to 10% of their total portfolio each year. While they don't insert use restrictions into the deed of the properties, they are bound by their mission to meet their objectives for affordability.

Terms: The aim is to have 8-10% return, half from dividends, and half from company growth. They distribute returns from aggregated properties, which helps lower risk. Preferred investors are paid 4.5% dividend quarterly, and have option to sell back some of their stock at year 7 and year 10 (either to a new investor, or through a sale). Foundations are preferred investors, with 1% return. Dividends are taxable to investors, with exemptions for non-profit partners.

Municipal Bonds: Municipal Bonds can be considered the oldest “impact investment” structure, in that they are used to generate direct community benefit by investing in neighborhood infrastructure, education, access to health, development of affordable housing, universal access to broadband internet, environmental resilience and amenities, and more. Municipal bonds are issued by state, county or municipal government, as a security debt. The issuer then uses this to finance its expenditures. There are different types of municipal bonds, many of which are tax exempt. They offer a fixed interest rate over a specified period, at which point principal is repaid. The issuer can back these bonds through its tax base. For all of these reasons, municipal bonds are considered to be relatively low risk and reliable, though have lower interest rates.

While municipal bonds have broad community reach, they can also be used to support activities community members might find less appealing, such as funding toxic waste facilities, or supporting untoward police activities, with less desirable outcomes, such as police brutality. These activities can be buried into broad municipal funds, preventing full transparency to the community. There are efforts now to bring more attention to municipal bonds as an opportunity to target investments to desirable activities that lead to favorable community outcomes. This requires community and investor support for transparency and the establishment of designated municipal bonds for prioritized community activities and infrastructure.

Example:

- [Neighborly Investments](#): This is an “impact asset manager” that focuses on municipal bonds. They have developed the technology and investor interface to help those interested in buying municipal bonds examine the data and decide how to allocate their investments that match with their specific objectives for impact.

Charitable Loan Funds: From Cutting Edge Capital: A charitable loan fund raises debt capital from community investors through a direct public offering, or DPO. Investors receive investment notes that pay interest. Then, the fund invests in ventures that advance the fund's charitable mission. Outgoing investments are usually also loans, to provide the cash flow necessary to pay interest to investors and cover the fund's operating costs. The fund may profit from investments; but profits may not be shared with the fund's investors. A charitable loan fund is exempt from the requirements of the Investment Company Act of 1940, a law that regulates some types of investment funds. It is also exempt from securities offering registration at the federal level and in most states, though some states require registration or a notice filing.

Targeted Impact Funds are designated funds to be deployed for a specified investment purpose related to the specified social, environmental, or equitable outcome desired. These funds are made up of securities sold to investors with agreed upon terms. Similar to other capital impact investment structures, they can be diversified in terms and in categories of investment. Funds are created and managed by non-profit and charitable organizations, banks, community development finance institutions, foundations, or other financial institutions. The funds are used to acquire property or support projects using either a debt or equity investment structure.

Examples:

- [Healthy Neighborhoods Equity Fund](#): Mass Housing Investment Corporation (MHIC), in partnership with the Conservation Law Foundation, created the Healthy Neighborhoods Equity Fund to target social investment capital to development in specified areas that meet core development criteria that consider community, environmental, and health impacts in addition to financial returns. The fund HNEF invests in neighborhoods that are in the early to mid-stages of transformation, where investment can help catalyze and accelerate that change, and generate a return to its investors over a 10-year period of 6-8%. The funding blends investment dollars from private, accredited investors, PRI's from foundations, and public funds that take a subordinated position.

- [CEI Investment Notes](#): Coastal Enterprises, Inc (CEI) has developed a pooled fund that provides a capital and social return to its network of accredited investors, called the CEI Investment Note. It's offered to accredited investors who receive a fixed financial return between 2% and 3.5%, depending on the term of the loan. The fund combines the investments with other low interest loans from partners, and turns this into direct loans to business owners or project developers contributing to good jobs and environmentally sustainability as measured by sector specific indicators.
- [Housing Opportunity Fund](#): CommonBond Communities, a non-profit organization based in Minnesota, recently launched the Housing Opportunity Fund as a vehicle to purchase "naturally occurring affordable housing" that is at risk of purchase by speculators aiming to increase the rent to market or above. Accredited investors purchase notes from the fund in the form of a loan, which is then reinvested by CommonBond in the form of equity to acquire properties for the purpose of preserving long-term affordability. While use restrictions are not added to the property deeds, Common Bond, a mission based organization committed to affordable housing, oversees the acquisition and management of the properties. The Common Bond equity covers 3-15% of the total cost of project, with 60-70% debt from HUD loans, and the remaining debt from subordinate and mezzanine loans. The Investors receive a quarterly return, with terms that range from 3-15 years, with returns ranging from .5% to 4%. The loans are secured by CommonBond's aggregate portfolio.
- [NOAH Impact Fund](#): As depicted above, a number of communities across the country are facing the threat of rapid market increase of "naturally occurring affordable housing" given high demand for housing, and an uptick in speculative real estate investment resulting in higher cost housing. In response to this, the Greater Minnesota Housing Fund has created the NOAH Impact Fund. Similar to CommonBond's Housing Opportunity Fund, this fund is used to cover the equity portion of the redevelopment costs of the newly acquired NOAH properties. In this case, GMHF partners with a designated developer to acquire specific properties. These properties are then redeveloped and managed by the partnering operator or developer; unlike other examples, there is no aggregated portfolio. Investors aggregate their money into a designated pool for the specific acquisition. The Fund accepts investments from accredited investors: private, philanthropic, or public entities. They require a \$3 million threshold for investment. By working with larger loan making institutions, GMHF is able to minimize its costs and risks for each of the acquisitions. These properties have an affordability term of 15 years, and 75% of the units must be affordable at 80% AMI, with a deeper target of 60% AMI. Investors are insured a 6.5% return, which if can't be generated from annual cash returns (which are paid out monthly as cash flow distributions), will be compounded and delivered at exit. Terms are generally 5-7 years, though banks can exit earlier. PRI's take a lower rate of return, which helps to insure the 6.5% baseline return to all investors.

Community Investment Fund: This is an aggregated pool of funds raised from community members, often mixed with other investors- that are used to invest in community enterprise, projects, and real estate. Community Investment Funds are often raised from the sale of notes, which are paid back on a predetermined schedule. The fund can aggregate investments from different types of investors through different tranches, including accredited and non-accredited, with lending terms and rates

suitable to the different investors, as determined by fund manager and its board. The funds are managed by a community advisory board to establish investment criteria, which they then use to evaluate potential investments. As charitable investment funds that are exempt from particular SEC regulations, they can accept investment from a broader pool of people, though this comes with risk that must be acknowledged at the point of offering.

Examples

- [Boston Impact Initiative Fund](#): This fund, managed by Boston Impact Initiative, makes investments targeted to economic justice. BII aims to close the racial wealth divide in Eastern Massachusetts, by investing in businesses owned and operated by women and people of color who have been structurally left out of traditional financing structures and viable opportunities to build wealth. BII evaluates its investments based on principles of economic justice, community resilience, and enterprise health. The BII Fund blends different types of capital and investment, including: community notes to non-accredited investors at a 3% return; solidarity notes to accredited investors at different tiers (3% return for 4 years or 4% return for 7 years); and philanthropic notes for those who invest for 5 years with a 1% return. BII also accepts grants into the BII Fund reserve pool as a risk management tool for investments. This blended structure gives BII the flexibility to customize its lending approach depending on the specific needs of the participating enterprises.
- [Community Investment Trust](#): Mercy Corps, Northwest recently launched a new investment tool that enables low-income residents to build their assets by investing in commercial real estate properties held by the Community Investment Trust. These residents invest from \$10-\$100 dollars per month to purchase common shares of the Community Investment Trust (CIT), which are secured by a direct pay “Letter of Credit” from a bank in case of decline in principal over time. How it works: a property is financed through traditional loan at 60-70% of total project cost, with subordinated debt/equity covering the remaining 30-40%. The parent organization, Mercy Corps, along with impact investors, provide the subordinated debt/equity at acquisition. Each property establishes an ownership structure through an LLC under the CIT. The equity is purchased over time by community investors through shares. Shareholders get an annual dividend based on performance, and can sell their shares at any time. An important part of the model is to provide the community investors with training in financial literacy and asset building.
- [PV Grows Investment Fund](#): This fund invests in farm and food businesses in the Pioneer Valley, as well as providing technical assistance. Like other community investment funds, investors include non-accredited community investors who are interested in supporting their local food economy.
- [Boston Ujima Project](#) is a membership organization committed to “organizing neighbors, workers, business owners and investors to create a new community controlled economy in Greater Boston.” They recently launched a community investment fund that will direct community capital to local enterprises their members and investors vote to support. They are national leaders in creating a democratic structure to ensure equitable, community led decision-making and voting.

Other examples

- [Calvert Impact Capital Community Investment Note](#)
- [Democratizing Capital East Bay \(DCEB\)](#)

Crowd Funding: This is a mechanism to raise money in smaller increments from a broader group of people. It can be used to collect tax-exempt donations, or in exchange for rewards or discounts, or as an investment tool, such as through Direct Public Offerings. The 2012 Jobs Act Title III exempted crowd funding for investment from SEC regulations, which opened up investment opportunities for non-accredited (retail) investors, with certain parameters, such as: they must be managed by a third party; there is a \$1 million cap per 12 month period for individual investment; there is a \$2000 cap for individuals with incomes less than \$100,000; there are restrictions on how investments can be marketed. Numerous online platforms and investment portals have emerged to take advantage of this opportunity for investment. These platforms offer specific opportunities for individual investors to provide debt or equity to help finance a project, such as a real estate investment, in exchange for interest or performance based revenue. Terms, rates, exit conditions, and risk qualifiers are explicitly provided on the platform. Some platforms, such as Small Change, tie their investment opportunities to social impact criteria, using an index to evaluate the project.

Examples

- [Fundrise](#)
- [Small Change](#)
- [Kiva](#)
- [Investibule.co](#): This platform has a particular focus on community focused investing

Lending Circles/Peer to Peer Lending and Micro-Credit: These structures are developed by a group of people in the community who agree to terms developed by the particular circle. Each member agrees to contribute a fixed amount on a specified timeline to a pool of money. This can serve as a savings mechanism, through which everyone in the circle gets their contributions back at a designated time, which serves the purpose of helping them to save for high cost events, like home purchase, or education. Or the lending circle can be made up of individuals who then make loans to others in the community aligned with the group's values.

Micro-credit financing is another lending vehicle to help finance small businesses that may not have access to traditional loans. Community members can agree to contribute to a micro-credit fund, with the understanding their principal will be returned, as well as a modest interest. These funds are typically managed by community members, and can be serviced through local banks.

Examples

- [SHARE](#): In this example, a group of community members approached a local bank to ask them to establish a designated loan fund that would offer small loans to local businesses. While the bank originally resisted the idea due to cost of transactions and risk, community members agreed to back the loans with their own savings, as well as to vet and recommend potential loan applicants to the bank. Eager to receive strong CRA

(Community Reinvestment Act) ratings, as well as the appeal of the mission and impact, the bank realized this kind of partnership would strengthen their connection and credibility with the community.

- [Circle of Uncles and Aunts](#): This is a group of people who contribute a monthly allocation to a lending pool that is used to make low interest loans and provide social capital and support to local businesses in the Philadelphia area.

Strategies

All of the structures and funds described above share the goal of achieving deeper impact—whether it’s environmental, economic justice, community equity and power or other. This is a dynamic period in the world of impact investing, and the groups creating these funds and tools are reconfiguring, modeling, creating, recombining, and chiseling every day.

There are a variety of investment approaches and tactics these funds can utilize to incisively deploy their resources and reach the desired community. Some of these have been described in the above examples.

Examples of strategies

- Establishing a reserve fund through grant support to collateralize the loans
- Offering different types of securities to appeal to different types of investors.
- Offering convertible loans, or loans that over time can be converted into equity
- Integrating revenue share into loan terms, where the returns are based on how well the company is doing, but like debt, are paid regularly
- Avoiding forced exit, and allowing for long term sustainability of business
- Creating a diversity of tranches, where different types of investors have different roles in decision-making, for example preferred vs. common stock.
- Giving workers opportunity to own shares (through purchase or sweat equity)
- Opening up investment opportunities, such as through Direct Public Offerings, at different stages of the enterprise’s evolution
- Encouraging patient debt and long term investment through other favorable terms, such as slightly higher rates, role in governance, or other benefits
- Offering non-cash equity to investors
- Using blended capital structures to modulate risk—for example, using PRI’s to provide low interest loans along with other investors at different rates to achieve a higher rate of return
- Using tax credit enhancements, such as New Market Tax Credit or Low Income Housing Tax Credit, in combination with impact investment to leverage larger loans
- Incorporating covenants into investment terms that spell out changes an enterprise must make in order to align with the expressed goals of the impact fund

Operations and Mechanics

To establish a fund and incorporate a variety of flexible strategies requires legally sound, transparent documents and agreements, such as Offering Memoranda, as well as qualified staff to implement and service these investments and loans. This requires capacity and resources. Community funds don’t always structure in a fee to cover the operations to administer the funds. Alternatively, an intermediary can cover its “spread” (difference between the interest they pay and the interest they

charge) by charging a higher interest rate to its borrowers, which is something community impact investors are trying to avoid given their mission to provide more accessible financing. Another way to reduce this spread is to market the social return to investors, and lower the expected capital return.

Because most organizations that have entered the community impact investment space share an ethos of access and transparency, abundantly available materials and resources are making it easier to replicate and build on effective models without duplicating efforts. For example, understanding the law and creating legal structures for various iterations of community funds can be onerous, but as groups discover new legal avenues and approaches, they are paving the way for other groups to follow suit with less difficulty. Also, partnerships within a community ecosystem provide another way to share roles and services.

Resources

- [Crowdfunding for Non-Profits: Legal Considerations for 501\(c\)\(3\) Tax-Exempt Organizations](#)

Policies

There are a number of policies and federal programs that exemplify or directly intersect and enhance impact investment strategies. Two of these are explained in greater depth in the appendix: New Market Tax Credit and Opportunity Zone. A quick overview:

- **Community Reinvestment Act:** This policy was introduced in 1977 to prevent lending institutions and banks from making lending decisions that discriminated against certain people or neighborhoods. This was in response to the practice of red lining, in which banks systematically excluded designated neighborhoods (outlined in red) from receiving loans from their institutions. Bank regulating institutions, such as the Federal Reserve Bank and the FDIC, use the CRA to issue a rating or score for the bank based on its community lending performance. Banks that score low may face barriers, such as ability to merge with other banks during periods of growth. Because banks are motivated to achieve a high CRA score, they may be inclined to develop community lending products, or partner with impact investors to directly serve the community in which they do business, and can be an opportunity to reach individuals and businesses who have been historically left out, such as people of color and low-income owners.
- **Low Income Housing Tax Credit:** From HUD: “Created by the Tax Reform Act of 1986, the LIHTC program gives State and local LIHTC-allocating agencies the equivalent of nearly \$8 billion in annual budget authority to issue tax credits for the acquisition, rehabilitation, or new construction of rental housing targeted to lower-income households.” Investors provide their investment to syndicators who then issue the tax credit, and in turn provide the equity portion of permanent financing for large affordable housing developments over a 15 year period.
- **New Market Tax Credit:** The NMTC Program enables private investors (individual and corporate accredited investors) to receive a tax credit against their federal income tax in exchange for making equity investments for enterprise and development that takes place in federally designated areas. These areas are considered to be underserved districts that have suffered from disinvestment, vacant commercial and industrial space, and poverty. Participants place their investments into specialized financial intermediaries called Community Development Entities. The credit totals 39 percent of the original investment amount and is claimed over a period of seven years. (See Appendix)

- **Opportunity Zone:** This federal policy, enacted this year (2018) provides a tax deferral and abatement strategy for potential investors with capital gains. The program enables investors to recycle their capital gains from previous investments into Opportunity Zone Funds, which are then used to make equity investments in federal designated, low-income areas. During the period of investment (up to 10 years), the capital gains from previous investments receive a tax deferral. Additional gains from the Opportunity Zone Investment Fund, receive a tax discount, depending on length of investment. This policy has been controversial given the lack of regulations or restrictions to direct the investment, other than its geographic location. This could attract speculative investors who are most interested in the capital return without considering social, community impact. (See Appendix)
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