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In an inflationary environment, are bond buyers still interested in CDFIs?

Over the last few years, impact investors have sought out community development financial institutions (CDFIs) as vehicles to connect their capital to pandemic relief, racial equity investments and expanded economic opportunity in disadvantaged U.S. communities. The influx of new capital has helped seed and scale innovative efforts that might otherwise have taken years to get off the ground, if at all.

More recently, though, the economics of those relationships have changed. Rising interest rates have created a mismatch for CDFIs, especially those tapping the capital markets to finance activity. To issue debt at market rates means pushing our cost of capital beyond what mission-driven partners and projects can afford. And CDFIs, many of which are themselves nonprofits, can only absorb so much of that gap before it becomes untenable.

The circumstances are raising some difficult questions. Is this environment forcing investors to step back from community development finance? Or, are they willing to respond with “catalytic capital” that specifically meets this moment?

Our recent experience points to the latter. My organization, the Local Initiatives Support Corporation (LISC), is a large CDFI with an Impact Notes program accessible to institutional and retail investors. We had raised $110 million since its launch in 2020—that is, until last spring, as yields grew beyond what we could lend to our community partners. We paused our monthly offerings, drawing on our other sources of capital while waiting to see if rates would settle.

At the time, we were cautious about issuing debt at concessionary rates because of the market-rate we had been able to use for our issuances to date. We were concerned that if we changed this narrative the market might read it as CDFIs being a better fit for philanthropy than the investment market. We have spent years working to educate investors about our market relevance, elevating decades of proof about the structure, stability and impacts of CDFI social investments. If we issued at below-market rates, we could upend that progress and affect future opportunities to raise capital from the markets.

Thankfully, we found those worries to be unfounded. After some promising conversations with ESG investors, we came back to the market in early 2023 with a three-year, ‘AA-‘ notes at 4 percent. While it was below the 4.4 – 5 percent offered at the time by comparable fixed-income products priced to the market, it nonetheless attracted investors drawn by its investment grade S&P rating and our underlying CDFI mission, alongside the note’s clear connection to many of the UN Sustainable Development Goals and our Project 10X initiative focused on racial equity.

At $6.2 million, it was neither our largest-ever one-week raise nor our smallest: it landed in the exact median, just above the average volume raised across our 19 total issuances. We saw participation from both new and old investors, including institutional investors and advisors looking for attractive impact options for their retail client base. They were willing to accept a reasonable, albeit lower, return than might be available in other products because they could see the potential for impact, as well as for financial performance.

Natural Investments, LLC was among our lead investors, seeing this as an opportunity for their pioneering, socially responsible investment advisory. “Our firm seeks partners with a commitment to reasonable returns and deep community impact, through investments that decentralize and democratize the economic system to create greater community resiliency. We were pleased to participate in LISC’s offering at the beginning of the year, blending in patient capital with client portfolios” reflected Michael Kramer, managing director at Natural Investments, LLC.

We were heartened by the investor response, not just because it generates *more* capital for community development, but because it also generates *unrestricted* capital—a scarce but vital resource for CDFIs. Rather than being tied to any one program or funder priority, unrestricted capital is flexible enough to support interest rate write-downs that help local nonprofits affordably borrow just as it fuels economic development investments that can help transform whole communities. Our Impact Notes program is by no means our primary source of financing, and only a handful of large CDFIs issue debt. But for those that do, it is capital that we can tailor to the needs we see in the communities we serve.

That flexibility is also important to our local partners, who can't afford to step back and wait for interest rates to moderate. They need to build affordable housing right now, because every state in the country is facing a shortfall. They need to fuel programs focused on better health in underserved communities, because chronic disease and life expectancy gaps are so clearly tied to race and income. And they need to advance small business growth and safe streets and affordable child care, because they are critical to jobs, local incomes and quality of life.

In other words, we need every financial tool at our disposal to navigate this environment. CDFI issuers need to be strategic about when we come to market so that our offerings are aligned with our pipelines. And we need to continue our outreach and education efforts with ESG-focused financial advisors, investors, and organizations genuinely interested in fueling social impact. But, with all of that, we are cautiously optimistic that investors will continue to seek out opportunities to fuel racial, social and economic progress. By balancing their financial and impact objectives, they can create opportunities for people and communities to thrive.

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