Summary of the 16th Annual Financial Innovations Roundtable

March 23-24, 2016
Federal Reserve Bank of New York

Executive Summary

Over the past fifteen years, the Financial Innovations Roundtable (FIR), located at the Carsey School of Public Policy at the University of New Hampshire and hosted by the Division of Consumer and Community Affairs at the Federal Reserve Board of Governors, has worked with a range of community development and other types of financial institutions, government agencies, foundations and trade associations to address and solve problems related to access to capital for low-and moderate-income consumers and communities. The FIR does this by tapping the expertise of thought leaders from the institutional investment, banking, philanthropic, and community development industries.

The 2016 Financial Innovations Roundtable focused on "Addressing the Disconnect: Linking Impact Investing Dollars with On-the-Ground Community Development." While social impact investing is capturing the imagination of investors, community development organizations such as CDFIs have largely depended on government grants, bank debt driven by the Community Reinvestment Act, and (to a lesser extent) grants and program-related investments from foundations for their capital.

This year's Roundtable brought together impact investors and community development practitioners to explore the barriers and opportunities to scaling impact investment in community development. Conversations focused around:

- Understanding the diversity of impact investors with interests in community development impacts – including private wealth managers, investment advisors, family offices, Donor-Advised Funds, community foundations, and institutional investors such as banks – and the unique investment parameters and challenges that each investor segment brings to the table when considering an investment in community development finance;

- Refining the messages and the marketing strategies that the community development sector must employ to reach these investors;

- Building more standardized products and/or aggregated platforms to more efficiently raise capital for the field;

- Exploring recent innovations where community development practitioners have raised or are planning to raise capital for new sources;

- Communicating the impacts that community development finance is achieving for people and communities, including the role of community development finance institutions themselves as agents for transformative change; and

- Providing feedback to the Kresge and MacArthur Foundations on a proposed syndication platform, as an applied exploration of the key event themes outlined above.

Table of Contents

Executive Summary 1

Table of Contents 3

Welcoming Remarks: Framing the Challenge 4

Opening Plenary: “US Community Development: Opportunities and Challenges for Diverse Impact Investors” 9

Opening Plenary Discussion with Impact Investors 11

The Medium Becomes the Message: New Narratives, New Platforms, and What they Mean for Impact Investment and Community Finance 17

Plenary Discussion ..... **Error! Bookmark not defined.**

Innovation Lightning Round 22

Scaled Syndication Platform Presentation and Discussion 26

Welcoming Remarks: Framing the Challenge

Anna Alvarez of the **Federal Reserve Board of Governors** opened the conference by providing the example of Mama Turney's pies and Pathway Lending, a CDFI that funded Mama Turney's expansion after the minority-owned business had been turned down by mainstream banks for a loan. The Federal Reserve is interested in the potential of impact investing to bring dollars to disinvested communities – as well as the related questions of:

- how to develop financial products that are capable of attracting impact investing dollars, and
- how do we build local capacity to accept and deploy these dollars.

Furthermore, as a Community Reinvestment Act (CRA) regulator, the Federal Reserve is "intrigued by how CRA might incent the flow of impact investment dollars."

Jack Gutt of the **New York Federal Reserve Bank** noted that "how to get more impact dollars committed to community development" is a fundamental question for the future. Solving this challenge could unleash significant investment in affordable housing, small business, financial services, and many other community development goals. Gutt also noted that the Fed is involved in two local impact investing conferences that are upcoming, one in Rochester, NY and one in San Juan, Puerto Rico.

Michael Swack of the **University of New Hampshire Carsey Center for Impact Finance** told a story that provides an analogy for understanding the current state of the field of community development finance. Many years ago, Swack was working in Maine with the State Department of Agriculture. Due to recent free trade agreements, the market for Maine-grown potatoes was declining in the face of competition from cheap, high-quality exports from Canada. The Department of Agriculture sponsored a study that recommended that Maine farmers should stop growing potatoes, and start growing broccoli instead, to take advantage of emerging markets for healthy eating in places like Boston. Swack was sitting at the conference with a farmer who had listened to the whole presentation, and asked the farmer what he thought. The farmer replied, "Well, do you know what I would do if I won a million dollars in the lottery? I'd keep growing potatoes until I ran out of money."

The analogy to connect back to community development finance is that potatoes – in this case meaning the capital mix of government grants, bank debt investment, and foundation PRIs that CDFIs have relied on - have been good for the field for a long time. The field has grown, performed strongly, and shown an ability to manage risk. But some recent studies, including the Carsey School's Industry Analysis of the CDFI field published in 2012, and a new study by Jeremy Nowak that has just been released, suggest that in some ways the field may be hitting a plateau. To achieve a new phase of growth and higher impact, capital from new sources will be needed.

As Swack put it, "We need to grow broccoli, because we need to move BEYOND what we are doing now to attract new investment to expand our work."

In research conducted for the Global Impact Investing Network, the Carsey School found two main challenges for the community development field to raising capital from impact investors:

1. First, investors perceive that placing money in US community investments is too hard – there are few tradeable securities, no CUSIP numbers, no liquidity, little spread to compensate investment advisors for placing money, and "everything is a one-off." While many impact investors are interested in the field – and many appear satisfied with the fairly rudimentary measures of impact that are in place – the field needs to make it easier for investors to make US community investments.

2. Second, the community development field is not marketed effectively – many people haven't heard about it, and most people seem to equate "impact investment" with investments in environmental sustainability.

Swack quoted Joe Keefe, CEO of PaxWorld mutual funds, who described the challenges for the field from the perspective of a major, socially responsible mutual fund.

As we have discussed, community/impact investing is difficult for Pax World to do – even though we are committed to the space and would like to do more – because as a mutual fund manager we mostly manage assets on behalf of individual (vs. institutional) investors, and some 96% or more of our shareholder assets come in through advisors (wire houses, independents, etc.). We don't do private placements, have to invest in investable securities and for the most part have to invest in liquid assets because we have to strike an NAV at the close of each business day. As you know, liquidity and securitization are major challenges in doing community impact investing. We have certainly welcomed the trend toward creating notes (Calvert Foundation, CEI, etc.) which has enabled us to do some community investing where previously we couldn't. But that will not be enough to catalyze the advisor and retail markets.

Today, increasing numbers of investors want their investments to have impact, and I think most Pax World investors fall into this category. But we have been stymied in how much community investing we can do. We will continue to do one-off notes where they are available but if community investing is going to really be accessible to individual investors, a larger response to the liquidity/securitization dilemma is in order. The problem is bigger than just creating trading platforms, some of which are beginning to appear. While that's a positive development, if all they have to trade is one-off private placements and notes then I suspect there will continue to be insufficient uptake by advisors and their individual clients.

Finally, Swack mentioned two other areas of potential endeavor for CDFI capital expansion: (i) collaboration between depositories and non-profit loan funds; and (ii) development of other investors with common investment interests: hospitals, utilities, insurance companies.

Debra Schwartz of the **MacArthur Foundation** welcomed the participants by noting that "we have two worlds coming together who are talking about the same thing: using capital to change communities." While there are disconnects and mismatches between these two worlds, Schwartz noted that the Financial Innovations Roundtable afforded the opportunity to talk constructively about how US community investment is happening. She further noted that neither the world of impact investors nor the world of community development finance is monolithic – "there is a spectrum of impact investors out there, just as there is a spectrum of capital need out there."

Schwartz then briefly reviewed the results of a survey of participants conducted by the Carsey School.

Summary of pre-event participant survey

Information about event participants (n=65):

- A broad array of organizations were represented, including CDFI loan funds, depository institutions, and venture capital funds; a variety of investor types; and university and consultant participants.
- Participants were interested in a wide range of impact verticals. Housing, urban revitalization and education / child development were the three most common issue areas.
- The majority of participants had more than 10 years of experience in community development finance or impact investing; only 13 percent of participants had been involved for less than 3 years.
- Sixty percent of participants had experience in the mainstream financial industry, in a variety of roles.

Forty-five survey respondents answered a detailed question asking them to rank the top challenges to increasing impact investment in US community development. By weighted score of the rankings, the top three challenges were the risk / return profile of investments, insufficient marketing of the investments, and concerns over exit or liquidity. However, literally all of the items on the survey questions were marked as a challenge by a majority of respondents (respondents had the option to mark any item as "not a challenge").

In the "other" category, respondents noted challenges around:

- Fragmented, difficult deals
- Regulatory challenges for banks

- Lack of daily pricing for mutual fund investors
- Shallow incentives for investors to make community development investments, especially outside of housing
- Lack of tools for investors to efficiently describe what type of impact they are looking for

Challenge	weighted score	% rating as top challenge	% rating as a challenge
Risk/return profile	339	20%	89%
Insufficient marketing	310	18%	96%
Exit / liquidity	301	16%	82%
High costs to underwrite and /or execute transactions	299	7%	98%
Information on performance and risk	288	11%	86%
Lack of an investment rating	246	0%	89%
Impact is unclear or too hard to measure	232	0%	86%
Investment size is too small	228	11%	80%
Term of investment is too long	227	5%	80%
Investment size is too big	100	0%	55%
Something else	142	14%	52%

Several themes emerged from open-ended survey questions asking respondents to discuss potential solutions to their top perceived challenges, and to raise topics for discussion during the roundtable event:

- *Scale and aggregation*. Comments included:
  - How can we create an effective wholesale system for investment?
  - Aggregation and securitization of assets by asset class and by type of obligor (banks, credit unions, loan funds)
  - Ways to aggregate investments to scale, such as a tranched note with multiple underlying investments.
  - Scale large enough for public market transactions
  - Business development companies and other Evergreen, publicly traded fund structures
  - Regional investment vehicles

- *Product standardization.*
  - Need for a set of standardized financial products that can be originated by a variety of community development lenders and aggregated into sufficient pools to attract investors.

- Standardization of CDFI business lending products leading to opportunities for securitization.

- *CDFI equity.*
  - Strategies for building CDFI balance sheets with equity
  - "Development of conventional form quasi-equity for CDFIs"
  - Structures to enable non-profits to raise market equity - such as forming LLCs/REITS/LPs in which the non-profit is the control investor and other investors receive market rate returns

- *Information gaps.*
  - Marketing campaign to educate investors about the risk/return dynamics
  - Standardized materials to share views on risk and reward that are framed in terms of historical CD investment performance.
  - More transparency about investment performance including impact characteristics and risks.
  - A standard investment rating for nontraditional products
  - Develop definitive data regarding community development venture capital investments
  - Articulation of impact thesis and metrics from CDFIs

- *Marketing.*
  - "Going beyond increasing capital supply to organizing demand for capital"
  - Leadership from CDFI associations to interface with investor associations
  - National initiatives to recruit potential investors
  - Role of community foundations in organizing demand
  - Impact investing "app" (Airbnb for impact investing)
  - "Channel partnerships" between wealth managers and impact investment managers; "Selling concession" for wealth advisors
  - Some comments on issues for particular investor segments, such as ERISA for pension funds

- *Use of incentives for investors.*
  - Use CRA to require / incent long-term community development investments
  - Credit enhancement
  - For Bond Guarantee program, use of risk subsidy to reduce risk ratings for CDFIs
  - Public / private partnerships, capital stacking
  - Role of government to "stimulate progress through additive funds, de-risking and other incentives"

- MacArthur "market-making" syndication model

- *Collaboration.*
  - collaboration of depositories with non-profit loan funds
  - collaboration of for profit and non profits
  - Nontraditional community investment actors (utilities, health systems, transit authorities) and the roles they can play
  - How to adequately engage communities in the process?

- *Skill building.*
  - "Technical guidance to help launch and develop staff expertise."
  - "Investees would benefit from investor relations skills"
  - Sponsors of impact investing need to understand the risk/reward of their asks, price accordingly, and understand that it is very difficult to make investments that are "one off" with no chance of replication.
  - "Can impact investors be more precise on trade off between financial and social returns?"

- Other topics raised by survey respondents included:
  - small business financing, fin tech competition
  - automated online bank referrals of appropriate declined loan to CDFIs
  - use of online lending platforms to reduce underwriting and loan servicing cost
  - Infrastructure financing
  - Community financing solutions for consumers (not commercial enterprises)
  - How to ensure that value created is fairly distributed

Opening Plenary: "US Community Development: Opportunities and Challenges for Diverse Impact Investors"

Jeremy Nowak, consultant and Senior Fellow at the Carsey School, presented some observations from his recent paper, prepared for the Opportunity Finance Network, on the evolution of the CDFI industry.

Nowak described three phases of growth in the field – a "start-up" phase that lasted from the 1970s until 1998, a "steady growth" phase from 1999 to 2010, and a "capital transformation" phase that began in 2011. The "steady growth" phase was marked by the new availability of public capital through the CDFI Fund and the New Markets Tax Credit program, the dominance of bank funding for leverage, and stronger product and process standardization. The "capital transformation phase" is moving towards recognition by capital markets (such as S&P rated CDFIs), convergence with social impact investors, and the growth of the CDFI depository sector.

Nowak also highlighted the fact that now a number of CDFIs are delivering product nationally, no longer depending on a specific locale

He also talked about the focus on using conventional financing tools to bring mastery of capital in the community

Attributes of Each Stage

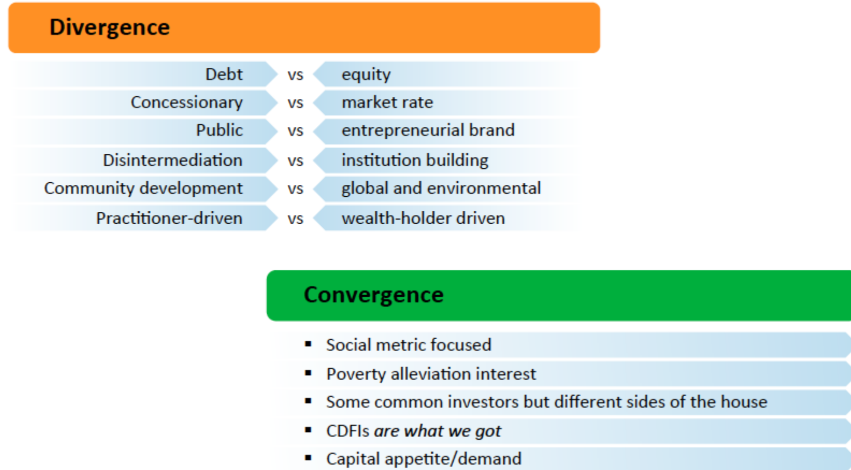
Start-up	Steady Growth	Capital Transformation
▪ Diversity of mission investors: individuals, religious, foundations, civic ▪ Limited balance sheet leverage ▪ Market and product exploration	▪ Public capital through CDFI Fund/NMTC ▪ Banks become dominant source of leverage ▪ Stronger product and process standardization ▪ Prototyping of boutique liquidity strategies and structured finance pools	▪ Capital market recognition (e.g. S&P rated CDFIs) ▪ Balance sheet security to investors in exchange for long term capital ▪ Convergence with social impact investors ▪ Emergence of Tech CDFIs ▪ Growth of CDFI depository sector
Crisis: Legitimacy	**Crisis: Diversification**	**Crisis: Identity**
Challenge: Basic lending systems	**Challenge: New investor structures**	**Challenge: Risk management & technology**

Nowak stated, "To accelerate change in this next phase, we need to have the innovation investment capacity that this field for the most part does not have. We don't have accelerators, incubators – things to accelerate change. We think of change in terms of growth, not in terms of change of platform. There is a need to invest not simply in what the organizations are now but what they can be going forward. This new inflection point is driven by opportunity of capital, and by potential diversification issues for growth."

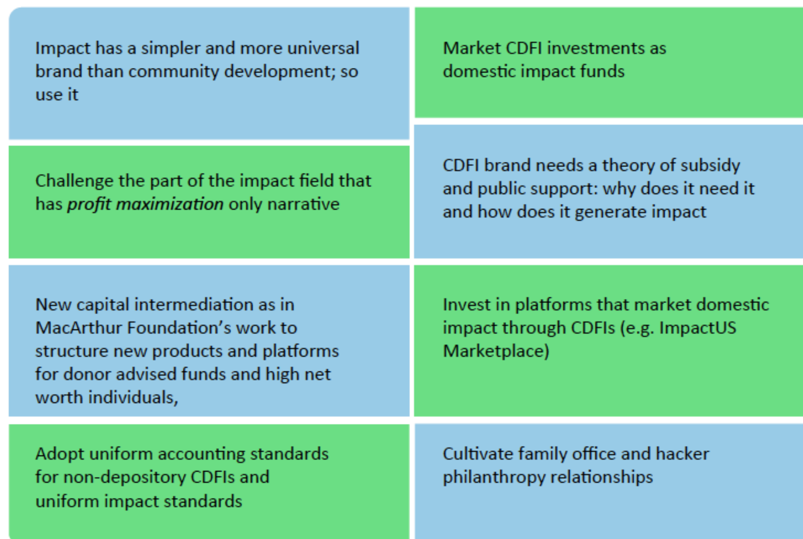
Nowak then focused on areas of convergence and divergence between the CDFI Field and impact investors. "In the community development world, it is a world of debt, boring bonds," he said. "A lot of the impact people want to be in the exciting world of equity. In the community development world there is a lot of concessionary debt. In the impact world, you can eat all the chocolate cake you want and never get fat – there are still people that preach that. In the community development world, we have a more public sector brand than those of us who work in it understand – it feels like the public sector, whereas in the Impact world they are looking for a more entrepreneurial brand than what they perceive in us. For a lot of new wealth, a lot of it has been made because of disintermediation – the largest cab company in the world doesn't on a car; the largest hotelier doesn't own a hotel. The community development world is about institution building... Impact investing is a wealth-holder-driven world. Part of our problem is the cultural disconnect." Reflecting that disconnect, very few CDFIs report that they receive capital from social impact investors, reported Nowak.

As part of this discussion about the sunset of concessionary rates in CDFI Nation Nowak also highlighted the notion that there is a difference between profitability and profit maximization for the investor – a critical distinction that must be understood and pursued.

Disconnections and Connections Between CDFIs and Non-CDFI Impact Investment Field



Brand, Marketing, Platform, and Products



Opening Plenary Discussion with Impact Investors

Building off of Nowak's comments, **Debra Schwartz** moderated a discussion with a panel of impact investors, in which the discussants described their motivations as well as their parameters for involvement with US community investments.

Gary Hattem of **Deutsche Bank** explained the bank's involvement in US community investing. Deutsche is a wholesale institution and a large provider of capital to the community development sector; it has invested $1 billion in the field so far. The Community Reinvestment Act has been a principal driver of this activity. Deutsche Bank also runs an impact platform that invests globally; Hattem noted that "I was able to set that up after demonstrating what we had achieved in the US."

Anna Snider of **US Trust** Wealth Management described how US Trust is looking for opportunities to invest in US community investments. US Trust is placing funds for individual investors in its wealth management division, which gives it a different approach than the way other divisions of Bank of America invest in the space. She noted that "clients are coming to us and saying that they want to invest in their communities, and are trying to understand what products and services are available for them to do so." US Trust's philanthropic group was the first division of the corporation to hear from clients. It is also the case that US Trust talks to its clients about opportunities for impact investing.

Bert Feuss of **Silicon Valley Community Foundation** (SVCF) commented on the emerging involvement of Donor-Advised Funds (DAFs) in US community investing. A DAF is a component fund of a charitable organization. Donors receive a tax deduction upon establishing a Fund, and the gifted assets are subsequently granted out to charitable grant recipients. The term "Advised" means that donors setting up the funds can advise on where the grants are distributed and how the Fund's assets are invested. SVCF is the largest community foundation in the world with $7 billion in assets, largely in DAF structures. It serves as a fiduciary and administrator of the DAFs, and "has some influence" with donors as to distribution of grants and investment of assets..

Feuss described the foundation as "dabbling" in community development investment, with three principal mechanisms through which it has been involved. First, the foundation has a Social Impact Pool that seeks both financial and social return. This pool is one of five investment options for donor funds. SVCF is considering a carve-out of the pool for local community impact. Second, the foundation has responded to donors on a "one-off" basis when they have requested to make a Program-Related Investment (PRI) out of their DAF. As a fee for service offering, SVCF will perform due diligence and monitor such investments. Third, SVCF places cash deposits with CDFI Banks in the Bay Area through the CDARS network, but they are limited by capacity constraints of the individual banks and the CDARS network.

Fran Seegull is Chief Investment Officer of **ImpactAssets**, which runs Donor Advised Funds for impact investors. While a relatively small DAF administrator, Impact Assets is the "largest pure play impact investing donor advised fund" at $275 million in assets under management. ImpactAssets invests almost 15 percent of its assets in Calvert Foundation Community Investment Notes, making that product "a huge impact investment workhorse for us." Impact Assets runs the ImpactAssets 50 database, a curated list of impact investing opportunities based on screened

applications from impact firms. In 2015, about 10 percent of the funds included in that database were CDFIs, such as Calvert Foundation, The Reinvestment Fund, and Craft 3. ImpactAssets will allow donor-advisors to originate investments in individual deals, but "it is important for the donor to have performed their own diligence, and important to know that the donor fully understands the risk inherent in the deal."

One of the questions that came out of her discussion was: "is there a CDFI equity product that makes sense?"

Other comments: "We don't diligence individual deals for our platform. The onus of diligence is on the client "power user."

"Impact measurement and reporting are key, regardless of whether we invest in an impact fund or an enterprise."

Seegull noted that one of the challenges in impact investing is the lack of impact cash alternatives and that "it is impact-dilutive to hold cash in a non-impact vehicle." Responding to this challenge, ImpactAssets is development "Impact Cash," comprised of laddered CDARS and small allocations to other private debt offerings "as a way of aligning our cash" for impact.

Bruce Hoyt described the impact investing activities of **Gary Community Investments / Piton Foundation**, a $400 million, Denver-based family foundation with a mission focus on children in Colorado. The foundation has moved heavily into US community investing – in part because "we have a two-generational approach, recognizing that you have to help parents to help children," and in part because "it has been easier to find impact investments in community development than in early education." Some recent investments have included investing in bringing Acción to Colorado; investing in the Urban Land Conservancy to acquire properties ahead of the development of light rail in Colorado; and teaming with Enterprise Fund to turn those parcels into affordable housing. Hoyt indicated that they were willing to sacrifice rate for impact to some degree.

Currently, 80 percent of the Foundation's portfolio is invested outside the state of Colorado with CapRock Investments; Hoyt says that "we want to bring those dollars back into Colorado with an impact lens, and we are very willing to sacrifice return for the social impact." Informing that viewpoint is the fact that "we are not a perpetual foundation and plan to be out of business in 17 years."

Michael Lent is Chief Investment Officer of **Veris Wealth Partners**, a wealth management firm dedicated to impact investing. Veris is "dedicated to including CDFIs into our impact platform," including introducing the idea of investing in CDFIs to clients. Veris works in all asset classes and works to structure an asset allocation for clients, with CDFIs allocated as fixed income investments. For Veris, the process of selecting CDFI investments begins by understanding the thematic and geographic impact objectives of the client; "then we try to match up the financial goals with the impact desires." Lent cautions that Veris "is not discretionary; we are fiduciary;" for

any investment "we have to do the full due diligence, so any support we can get in doing that due diligence is very helpful."

Schwartz asked Lent about whether clients are okay with investing in intermediaries as opposed to directly in community development deals. Lent responded that Veris only invests in intermediaries. "Some people are excited about individual deals, but we caution about that and talk about the importance of diversification and structuring the portfolio."

Schwartz asked Lent, "is it hard to make the investment?" Lent discussed the transaction costs – "You have to send the money in and then monitor it. We have special software to monitor these investments alongside the public equity," but still need to make manual entries to prepare statements for clients. There are also state registration issues to deal with. In sum, "you have to really want to do it and be committed to doing it… there is a huge transaction cost in terms of actually carrying it out."

Sam Bonsey is a member of **The ImPact**, a network of family offices and foundations that are committed to impact investing. Bonsey stated that "I would be lying if I said that CDFIs were a hot topic within our network – but I think that they COULD be." Bonsey described a "triangular problem" in which older generations of wealthy families are trying to get the younger generation to care about the family assets, younger family members are trying to get the older generation to care about impact, and investment advisors "are desperately trying to retain their clients." The tension has created a kind of stalemate in which "everyone is interested in impact investment, but no one is doing it." To move forward with impact investing, "you need a simple, tangible, immediate investment opportunity with measurable impact from an entity that has an extensive track record of returning capital to investors and generating measurable social impact – and there are more people in this room doing that than there are equity fund managers, although that is where the attention is." Bonsey is a Veris client, and has invested in both the Enterprise Community Loan Fund and in Boston Community Capital's SUN mortgage fund. "Those investment opportunities met a real need that I had. I couldn't have cared less about investing; these opportunities gave me a chance to feel meaningfully engaged with the work."

Andrea Armeni of **Transform Finance** described his organization's goal as "trying to bridge the worlds of finance and social justice." Transform Finance supports a network of investors – a "community of practice" of people who are eager to use finance as a tool for transformative social change. Most of Transform Finance's work is around field building and standard building – for example, around "what does it mean to invest for quality jobs? What kinds of jobs are being created, what are the pathways for advancement and ownership? We are looking not just to move more money, but move it better." Armeni uses webinars to connect people to talk about specific investment opportunities, for example a recent discussion on the work of the New Hampshire Community Loan Fund, as a springboard to talk about the broader issues the group is trying to tackle. "We look at the opportunity

through the lens of non-extractiveness and deep community engagement." Transform Finance is set up as a non-profit and does not take placement fees from investors.

Schwartz asked Snider to describe an impact investing platform that would work for US Trust. Snider responded that US Trust is looking at Donor-Advised Funds as the best way to address impact investing in a Trust, and described barriers that arise due to the fact that wealth managers are acting in a fiduciary capacity. A CDFI "may have a good track record, but relative to what? Federal Debt? Junk Bonds? Structure and return are issues. How do you underwrite notes and do due diligence on it?" Schwartz asked if the investment opportunity needs to look more like a standard conforming investment vehicle, e.g., a corporate or muni bond. Snider responded "Yes, or we need a new standard that we can use to do that over and over again. Are we ready for quarterly audits? Is there another standard that we follow? If there is, that opens up legal risk and compliance issues for us. But that is a challenge we are committed to taking on." Schwartz followed up to ask whether obtaining a rating, such as the AA Standard and Poors rating obtained by Clearinghouse CDFI, would make a difference. Snider responded "yes, for one little piece of the due diligence process – but we still don't have the benchmarks. Is there a translation mechanism that a traditional investor can make between a CDFI rating and a corporate rating?" On the same point, Hattem noted that the momentum towards standardization will improve transparency – "it becomes a communications strategy as much as anything else."

Schwartz followed up to ask how important it was to the investors on the panel that more CDFIs might eventually have S&P ratings, or Aeris ratings. Bruce Hoyt (Gary Community Investments") replied that "for us, it is not very important because we are so mission focused." Michael Lent indicated that Veris uses Aeris in its decisions about whether and how much to invest, although ultimately "we have to do our own due diligence and sign off on everything." Jeremy Nowak is currently advising a family office on impact investing, and added that with that family, "Aeris or S&P did not mean much because they had a certain risk tolerance, but some of the trustees were non-family members and when I explained Aeris to them they did the translation, and talked about how hospitals and universities can be S&P rated." Nowak concluded that "we don't know what rated paper will mean – will it open up pension funds, we don't know – but it can't be a bad thing." Schwartz wondered about the possible trade-offs that could result from a push towards standardization, in terms of the "high-touch customer lending that has been [the field's] bread and butter."

A general question was raised about how much the investors were willing to commit. The ranges included the following:

500k-2mm

25k-25mm

25k-1mm

1mm-20mm

50k up

100mm

Eileen Fitzgerald of **Stewards of Affordable Housing for the Future** noted that there are nonprofits who do not require the intermediation of a CDFI to be investable, such as affordable housing nonprofits, and asked how the investors on the panel would feel about this kind of investee. **Michael Lent** replied that for Veris, the issue is the cost of due diligence, as well as whether there were other clients they could aggregate around the same investment in order to spread out the due diligence costs. **Fran Seegull** noted that ImpactAssets "power users" are in investing in individual impact deals, and wondered about the possibilities of creating a proprietary crowdfunding platform to make these individual deals more broadly available.

Clara Miller, president of the FB Heron Foundation. commented on whether a process of "mass customization" could ease due diligence.

Frank Altman of **Community Reinvestment Fund** noted that CRF has issued S&P rated bonds, and reminded the group about the possibilities of standardization of securities in which multiple CDFIs might have loans.

Elyse Cherry of **Boston Community Capital** described her experience of raising money for her CDFI in the impact investing world as "wildly difficult," so much so that she went back to her traditional bank investors to meet the organization's capital needs. For Cherry, a key problem we need to solve is cost of capital. CDFIs are now paying a cost of funds between 3 and 4 percent, which Cherry described as "above market by any assessment, when you compare the risk." At the same time, "impact investors' desired returns are all over the map."

Gary Hattem responded that "the CDFI Industry works remarkably well, but if we want to be part of a transformation of how the world's economy is working, there is a generational shift that needs to occur. If it is just about "is there another flow of cheap money to keep this going" I don't think Impact Investing is worth the bother, but if we want to change the way disadvantaged communities enter the economic mainstream we need to challenge ourselves. A lot of us are about fixing problems of the past and that is less exciting in some way."

Andrea Armeni felt that "in the case of the people we work with, it is a matter of saying 'where is this capital needed' – can we put it at the service of something? And maybe it will come at market, and other times at a negative return – but asset owners want to know what can they contribute. Most of the asset owners we work with are trying to flip the script on the role of the investor, asking instead, where is the capital most needed, and how, and can I provide it? Essentially viewing the

investor's role as being subordinated to that of the project, more as an enabler, rather than the one who drives."

Fran Seegull commented on the inefficiency of the current market - "trying to find a one-to-one match between impact investor and investee is really difficult. Structuring can ease that burden and I hope is something we can talk more about."

Paraphrasing Sam Bonsey, Schwartz ended the session by noting that "there are folks who are going to have a lot of wealth and they care about how that wealth is used."

The Medium Becomes the Message: New Narratives, New Platforms, and What they Mean for Impact Investment and Community Finance

Chris Gebhardt of **Participant Media** led off the session by asking, "How do you use story-telling to drive impact? There is a narrative that is missing or fragmented, and has prevented the formation of investment structures from happening. We are trying to get people engaged and involved in an issue – have them get their money to do something good."

Andrei Cherny of **Aspiration** agreed, "we are talking about hundreds of millions of people who haven't had access to sustainable investing products – and who feel like the financial firms they have access to do not share their values." Aspiration was founded to tackle the challenge that less than 2 percent of impact investing flows come from ordinary investors; 98 percent comes from institutions, wealthy individuals, family offices, and the like. Aspiration "set out to create a financial firm that is about democratizing great investment products." Products currently include a high-yield checking account and a sustainable investment mutual fund, with a "pay what is fair" fee structure. Seventy-three percent of Aspiration investors hold no other investments. Aspiration applies 10 percent of revenues to charitable giving, and is currently working with Acción around micro-loan programs. Aspiration recently launched in IRA product, and noted that "a lot of the investments that these folks should make are long-term, less volatile investments," suggesting some potential for US community investments to compete for these dollars.

Gebhardt noted that expanding access to impact investing would require plumbing for investment structure. **Vincent Molinare** of **Ouisa Capital** agreed, describing it as "a heavy lift – how do you aggregate these investors, and make it seamless." Molinare described the role of Ouisa Capital as the "New York Stock Exchange meets Air-bnb of impact investing" – a platform seeking to convert impact investing into more of an investable security, presenting due diligenced product that has been seasoned and helps create investment liquidity.

Jennifer Tescher of the **Center for Financial Services Innovation** worked with Gebhardt on a financial inclusion film project called "Spent." Tescher described the field's challenge as "reaching beyond the choir," challenging participants to think about the language we use. Tescher pointed out that CDFIs "are one of the only fields that calls itself its acronym from its US Treasury department designation –

there could not be a less sexy way to describe the work that we do." Gebhardt agreed, claiming that "community development could be the epicenter of impact investing."

Gebhardt asked Cherny for his sense of the market. Cherny responded, "What we hear is a desire to want to do more in the community space, to want to invest their values. People give an emotional reaction about the chance to have this kind of investing. It is a large part about how do you tell the story to people who easily get skittish / scared off by the system." Cherny continued, "Finance is one of the few industries where people tell you that before you invest you have to be an expert," and described ways in which Aspiration tries to ground customers in financial concepts in an approachable way.

Molinari added, "We thought that when we built the technology everyone would come. But there is a communication disconnect with the financial managers. And issues around communicating with the base of the pyramid rather than the financial managers. It is a lot more about story telling."

Tescher inquired about the role of "robo-advisors" going forward. Cherny responded that by some definitions, Aspiration could be considered one, in that it is an exclusively online company. Molinari was "not sure if it is a blessing or a curse for impact investing to be robo-advised. If impact investing is robo-advised we lose a lot of money for really good things."

Eric Hangen at the **Carsey Center for Impact Finance** asked about whether there were opportunities to attract more US community investment dollars from low-income populations, noting the success of community development banks and credit unions in providing a place for low-income households to deposit funds. Cherny responded that Apiration wants to serve "people with just a few hundred dollars as well. We want to target the underbanked but also the under-invested."

Swack hypothesized that people may be attracted to invest in environmental causes because of opportunities to personalize their engagement in the issue (for example, by recycling or installing solar panels). "You see people willing to change their behaviors and are compelled by the stories. I don't know if affordable housing and childcare have reached that level yet." Swack asked the panelists, "How can we be more compelling that your little bit of money that you have to invest can make a difference?"

Tescher responded, "I think the environmental people have been at it as long or longer than we have. There has been a massive campaign in the environmental movement." She suggested that a good next step for the field would be to engage a marketing expert to help identify more compelling messages, noting that culturally, community investment practitioners have been "bound up by their desire to find ways to create plumbing – I'm not saying we shouldn't be doing it, but talking about it is not sexy."

Molinari felt that "visibility and availability of the product is the issue. When we create platforms it is a numbers game" – the more you can display the product, the more you can sell. Ouisa has been investing in technology to efficiently clear and settle investments for the nonprofit world, opening the potential for collaboration between the private sector and nonprofits to resolve these marketing and sales issues.

Cherny disagreed with Swack and Tescher: "I don't think there is any reason to believe that people have a stronger connection to the environment than to community development. My two kids decided to give their lemonade stand money to a local food bank. People are concerned with their local community. The difference is in how that story has been told." Cherny suggested that our message should not be about "affordable housing or other specific issues, but the larger cause and how there are ways to address it."

Gebhardt suggested that "the story is not enough," highlighting the importance of fomenting a diffusion model, or as he put it, "a tribe of people acting" in which "1 percent of people act, 9 percent see them act, and that's how you get to the 90 percent."

Nowak noted that "the environment is a universal principal, a public and collective asset. The messaging challenge is how to make social justice into a universal or collective asset. I am not sure we have figured out how to do that."

Dinner Remarks

To wrap up day one of the Financial Innovation Roundtable, the group went to the dining room for dinner. Prior to dinner, **Eric Belsky** of the **Federal Reserve Board of Governors** delivered brief remarks summarizing the main themes and challenges he heard that afternoon.

Roundtable Discussion

Joseph Firschein of the **Federal Reserve Board of Governors** opened the Financial Innovation Roundtable's second day by highlighting some of the most poignant points from the day before. Firschein also outlined some of the major challenges that had not yet been addressed and noted his excitement to hear the conversation develop further.

Michael Swack then invited observations from participants. He asked participants to assume that the field has had good performance for the past 20 years, has been impactful, and could deploy additional investment – consonant with observations that the Carsey School and other researchers in the field have made. Given those assumptions, he asked, how do we address the issue of getting in more capital?

Charlie Hammerman of the **Disability Opportunity Fund** described the "non-conformist" nature of the CDFI industry, with a wide variety of niche products governed by some basic financial conformity around standards like the 20 percent

minimum net asset ratio. He questioned, "Are we going to try to conform closer to impact investors, or are we going to try to get them to conform to our non-conformity – where do you meet in the middle?" Noting that not all impact investors have struggled to invest in the field, he asked, "Why were the nuns able to figure out how to get capital to us?" Lastly, he noted the need to balance new reporting demands from impact investors with existing reporting demands from players like the CDFI Fund and the Opportunity Finance Network.

Swack commented that CDFIs "oppose standardization but are not always clear what we are talking about – a lot of standardization already exists. The great fear is that the impact investors will tell us who we have to invest in."

Frank Altman of **Community Reinvestment Fund** commented on the diversity of impacts in our field, suggesting that we should "standardize the way we report impact, first…. [investors] care deeply and need to know their money is going where they think it is going." Altman further noted that "many CDFIs are making very similar loans, with slightly different credit boxes and documentation. If we can standardize documentation and standardized features, those loans can be aggregated and can attract investors in a different way." Altman suggested standardizing around 5 or 6 common things CDFIs do, such as loans to charter schools, day care, business loans, and affordable housing.

Vince Molinari of **Ouisa Capital** reminded participants that "when we talk about standardization we need to understand that it is based on regulation," and complying with fiduciary responsibilities.

Swack agreed and suggested that the field "find the people who understand the regulations and know how to do it already," and work with them to develop products.

Elysse Cherry of **Boston Community Capital** commented that "we have made a fetish of customization in ways that are not helpful." As a potential way forward, she provided the example of standard leases for shopping center tenants that are widely used in the real estate industry, yet are customizable by adding an Exhibit at the end of the lease that tweaks the agreement as needed. Cherry felt that the issue around standardization is better recast as, "how do we respond to the market we are in in a way that concentrates the customized pieces in a way that is easy to isolate them, and then sell the parts that ARE standard – we just keep the funky parts."

Bert Feuss of **Silicon Valley Community Foundation** asked the group, "if I want to invest in small businesses in underserved communities – there are a half dozen managers I can call who could make these investments for me. Are there fund managers who can invest in various CDFIs on my behalf so that I don't have to find and review each of them?"

Andy Rockland of **Reinvestment Fund** wondered to what extent the standardization question might be a "red herring," observing that as big as the CDFI

field has grown, it is "a tiny speck in the financial industry" and that "other folks with boutique financial needs have found ways to go and raise lots more capital than the CDFI industry needs each year." Rockland suggested researching how other parts of the financial industry have raised money for boutique, nonstandardized products.

Ray Dafner of the **Appalachian Regional Commission** briefly described how ten high-performing CDFIs set up a fund focusing on business lending for communities in Appalachia.

Charles Tansey of the **Carsey Center for Impact Finance** commented that it would be helpful to talk about how standardization requirements are different for different asset classes. Schwartz agreed, "It is important to distinguish the kind of capital – what is it that CDFIs need? CDFIs do not need lots more bank market rate debt. Isn't the issue how to access the PRI-type capital more efficiently?" Charlie Hammerman responded, "We need zero-cost capital – whatever equity is called in the world where we live – otherwise we can't grow."

Frank Altman felt that "the idea of a Fund of Funds for PRIs could be really good for the industry – but then we need to agree on what does a standardized set of covenants look like." He further talked about the opportunities to find and license "best in class" financial products that people are creating around the country, citing as an example the New Hampshire Community Loan Fund's royalty business loan program – "why not take this idea and get it across the country?" By standardizing these instruments, aggregating them across CDFIs, and selling those assets, CDFIs could take equity burdens off of their balance sheet.

Charles Tansey noted that cost of funds for banks is very low – for example, for Wells Fargo it was 21 basis points – and commercial paper rates a close to that, concluding "market rates are not necessarily high rates." Thus, recent moves by some CDFIs to obtain a Standard and Poors rating should help to obtain cheaper money. Tansey continued that there is a need for a form of equity, praising past innovations such as EQ2, PRIs, and TARP preferred equity for community development banks and credit unions. He suggested, "There is a wide range of opportunity for looking at what are the 3 or 4 optimal structures that are low cost patient capital. Can we look at DAFs, for example?"

Charlie Hammerman asked whether the industry should be looking harder at consolidations and mergers. "I have huge pipeline," Hammerman stated. "Can someone handle the back office for me while I focus on the mission? I'd sign up tomorrow for that." Hammerman also suggested mentoring programs for small CDFIs.

Anna Snider from **US Trust** questioned whether mergers and acquisitions would help from an investor standpoint. "I'm not sure an investor will want to invest in the CDFI space, versus in their local communities across CDFIs and other socially oriented nonprofits." In other words most investors would prefer to "aggregate in a

more local, place-based level rather than investing in CDFIs as a sector. I don't get a lot of requests from individuals to invest across CDFIs – rather they want to invest in their local communities in or across various impact verticals."

Christina Leijonhufvud from **Tideline** wondered, "We have so much focus on supply and how to crack the markets – but is the capacity to deploy large amounts of capital there? Some of the things that have gone wrong in impact investing have to do with capital that sits in funds and is not being deployed." Swack noted that deployment is very high in the industry, particularly for larger CDFIs, and often at the maximum.

Ellis Carr from **Capital Impact Partners** commented on securitization, "impact investors have said we would love to buy some seasoned loans – but they want to just pay par," which is not sustainable. However, he felt that if CDFIs can securitize and add equity to their balance sheets, they can grow in a sustainable way.

Charlie Hammerman noted that cost of capital and deployment are related – if investors can provide lower-cost funds, CDFIs would pass the savings onto the customer and thus increase deployment. As an example, Disability Opportunity Fund received some 0 percent money from New York State to help people affected by Superstorm Sandy, and passed this money along with no markup.

Robin Hacke of the **Kresge Foundation** commented that in many cases, "CDFIs are aggregating capital to transactions, they are not actually the deal generation capacity. We are assuming there is someone out there putting together the deals that we want to finance. That is an assumption worthy of questioning – deals don't generate themselves. There is a need to invest in deal generation capacity that is being assumed in this conversation."

Innovation Lightning Round

David Wood of the **Harvard University Initiative for Responsible Investment** led a panel discussion of two recent innovations in community development finance.

Housing Partnership Equity Trust REIT

Becky Regan of the **Housing Partnership Network** formed the Housing Partnership Equity Trust (HPET), a national (perpetual) equity REIT owned by 12 nonprofits, to raise capital for acquisition of affordable and workforce rental properties. The 12 nonprofits have 22,000 rental units in 31 states. They faced the question: how to raise capital so that they have sufficient cash on the table to purchase multifamily projects. HPET raised $35 million in equity from the partners, Ford and MacArthur and another $50 million from Charles Schwab, that came with a liquidity enhancement – specifically, a standby purchase commitment - from the MacArthur Foundation. The commitment is in the form of a put that requires MacArthur to buy stock. The REIT pays an annual dividend. 20% of each new dollar

invested is set aside to pay down debt covered by the MacArthur standby commitment.

Michael Solomon from **Schwab**, one of the investors in HPET, described the rationale for their investment. Competitive opportunities include LIHTC equity investments carrying a 7 percent return, as well as real estate private equity opportunities. For Solomon, several factors helped him sell his investment committee on this opportunity. First, the liquidity enhancement from the MacArthur Foundation was critical, especially given the strength of the foundation's balance sheet. Solomon also knew the affordable housing developers who were a part of the deal and had worked with them in the past. The deal structure also included first loss positions, both at the project level where HPET members have skin in the game, and again at the REIT level where bank preferred equity investments are sheltered by a layer of common equity funded by members and two foundation PRIs. Solomon noted strong performance of affordable multifamily mortgages, with loss rates of under 1 percent.

Charles Tansey of the **Carsey Center for Impact Finance** asked whether this structure is replicable, assuming other foundations would be interested in providing similar liquidity and credit enhancements. Solomon replied "yes, we'd absolutely do this structure again."

Both Becky Regan and Debra Schwartz agreed with a commenter that the real test of market success is whether in the future, the Foundation investments will not be needed again. HPET projects to have $1 billion in assets under management by 2020. However, Regan stated, "we could not have gotten to the institutional markets at this moment in time without that enhancement." **Eileen Fitzgerald** of **Stewards of Affordable Housing for the Future** noted a challenge for replicability, in that "not all nonprofit developers could put up the common equity the way the HPN members in this REIT have done."

Community Reinvestment Fund, Calvert and Minneapolis Foundation: "Ours to Own" collaboration to capitalize Small Business Loans

Frank Altman of **Community Reinvestment Fund (CRF)**, **Catherine Godschalk** of the **Calvert Foundation**, and **Jean Adams** of the **Minneapolis Foundation** described a collaborative effort to capitalize a pool of small business loans. The innovation involved the creation of a local investing option for Donor-Advised Funds on the back of an investment product, Calvert Notes, with a track record and broad distribution.

Pursuant to a grant received from JP Morgan Chase, CRF and two other CDFIs (Coastal Enterprises, Inc. and the National Development Council Grow America Fund) created a common platform for SBA 7(a) lending. The loans would be made within the JP Morgan Chase CRA footprint. Calvert Foundation agreed to invest $10 million across the three organizations. As the development of the fund unfolded, a

need emerged for Calvert Foundation to invest an additional $2.5 million in CRF, but Calvert would have violated its rules on concentration of risk if it had done so.

Calvert Foundation was able to sell a participation mechanism to the Minneapolis Foundation, which enabled them to backfill and provide the needed investment. Jean Adams commented, "we were just getting an Invest Minneapolis pool together for our DAFs. [The participation with Calvert] was a great opportunity to jumpstart this investment pool with known players." For the Calvert Foundation, said Catherine Godschalk, "the opportunity to engage and unlock more of that DAF capital is where we hope there is potential." Godschalk later noted that Calvert Foundation has opened a DAF on its balance sheet.

Adams agreed with a question from David Wood about whether the investment was a way for the Minneapolis Foundation to distinguish itself as a DAF manager, noting that the partnership provided a way for the foundation to directly connect donors with action in their community.

Frank Altman noted that the Calvert Foundation's note program provided him an easy way to invest in this same program as an individual. Altman invested some of his retirement IRA in a Calvert Foundation "Ours to Own" note targeted to Minneapolis.

Altman also noted another innovation coming out of the partnership, which is the development of standardized product across all three CDFI lenders. This standardization will help the CDFIs to securitize the non-guaranteed portion of the loans they have made.

Altman also described how the program is focusing its business lending on women, people of color, and veterans. "We are taking a generic tool (the 7a loan) and trying to point it in a direction that it doesn't go. Second, because there is a lack of equity in minority owned businesses, we have a bigger credit box [than traditional business lenders] – we will take a collateral gap, lend to start ups, and lend to franchises." Lastly, Altman described how – with funding support from the Minneapolis Foundation – CRF is funding a staff member who works "on the ground" in Minneapolis to meet with businesses and find lending opportunities.

Gerardo Espinoza of the **Local Enterprise Assistance Fund** expressed a concern with the cost of intermediation, stating that LEAF had looked at Calvert Notes 2 years ago but found them too expensive to use. "We need to aggregate," he said, "but in an efficient way." Godschalk replied that "there is cost and then other elements of the capital that are important." She noted, for example, that with the Ours to Own notes program, Calvert now has 7 and 10-year offerings for investors. "We really wanted to understand what it was about the capital beyond rate that was needed and not being met locally."

Bert Feuss of **Silicon Valley Community Foundation** asked Adams about how the Invest Minneapolis initiative was governed. Adams replied that the board decided not to create a specialized committee.

Other innovations and group discussion

David Wood asked **Liz Sessler** of **ImpactUS** to describe their innovation. ImpactUS has put together a broker-dealer who is aggregating community development product and assisting people with developing their new product offerings. The platform anticipates going live in May or June 2016. The effort responds to a challenge Sessler saw in which organizations were raising capital on their own, in a piecemeal way, and where some investors were concerned about inefficient mechanics of investing.

Wood asked Sessler where the "pain points" are with this effort. Sessler responded that shared due diligence is a top concern and that Impact US is doing "everything we can to expedite that." Sessler also noted a product development challenge – "there is a lot of balance sheet debt for 0 to 4%; we need a wider variety of products. Investment Advisors are saying that if they can get a blended return of somewhere between 6 and 10 percent they could do a lot more." A final key challenge is "the storytelling - different stories [are needed] for different investor types. That 0% money is out there but you have to tell a different story and it is a narrower segment. Plenty of people want more competitive rates, and are willing to compromise a little on how narrow the impact or geography is."

Jane Adams responded to this discussion of cost, saying that "Our Donor Advisors are really open to a low return - between 1 and 3 percent is okay with them. A key issue is to remind donors that this money has already been given – so just to recycle it is not a bad deal."

Wood asked **Kerwin Tesdell** of the **Community Development Venture Capital Alliance** to describe an idea for an evergreen, publicly-traded community development venture fund that CDVCA is developing. He is considering using a Business Development Company platform. Tesdell explained that the fund would allow individual impact investors to place small amounts, perhaps as small as $100, as well as allow investors to sell their interests. He noted that people often donate money for community development (such as donating to their local school), whereas with the venture fund they have an investment opportunity to make a community impact. The main point: while venture capital is much more risky than straight debt and an investor could lose all, this money is being given away anyway. Moreover, there could be very significant returns if the venture capital investment succeeded. Hence it would be a good diversification product. Wood followed up to comment that the innovation within this idea is about "ease of use" – that investments would be liquid and bite-sized. Debra Schwartz commented that "narrative matters" and questioned whether it would work to say to investors, "you give away a lot so why not invest in something risky?"

Michael Solomon from Schwab, and **Jessica Lowery** from **Veris**, both commented on the costs of underwriting a small investment in a VC fund: does it make economic sense to have to provide reporting on investments as small as $100? Lowery added a concern about the evergreen nature of the proposed fund, commenting that

"sometimes the beauty of venture capital is not having to mark to market." Wood asked Lowery if a publicly-traded fund would have less appeal to Veris clients. Lowery confirmed, saying "yes, our clients want to feel closer to their investments."

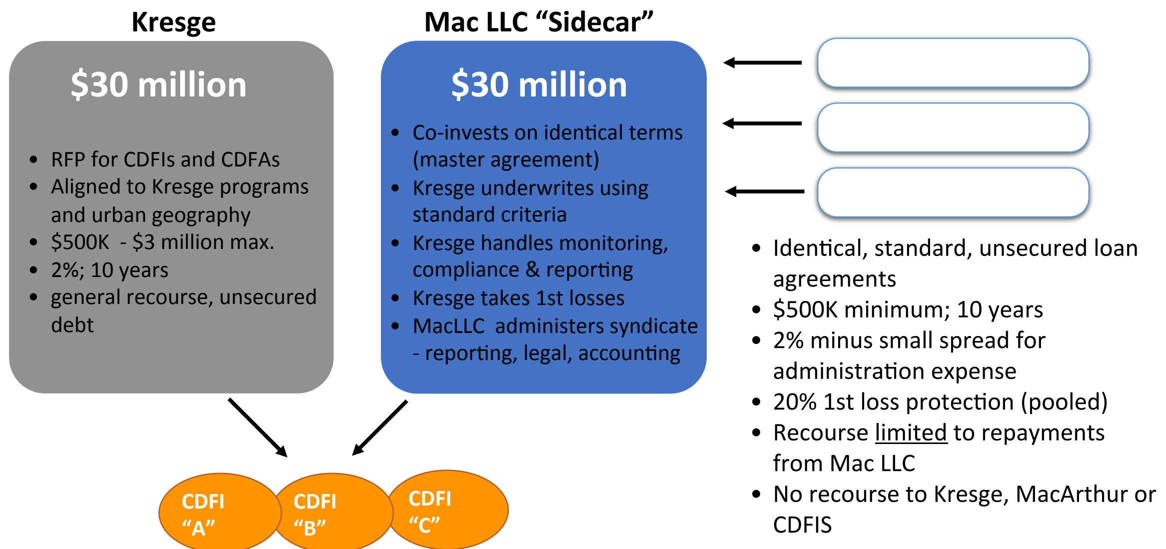
Bert Feuss from the Silicon Valley Community Foundation interpreted that "Kerwin's idea is more impact focused than return focused." The challenge he observed is that "If the investment is coming from my investment portfolio, then I need to evaluate the investment according to my investment policies; if the return profile it is too far out of that realm, then it becomes a charitable activity and I need to evaluate it from that lens. For example, does it meet the 'but for' this capital, the charitable activity wouldn't happen test?"

Andrew Gordon from **Clearinghouse CDFI** outlined the creation of the Clearinghouse CDFI via the dissolution of the Clearinghouse multi-bank non-profit and the consequent donation of $1million to the purchase of the new for-profit stock. The CDFI has been growing rapidly. One of the big challenges is that there is a pull to bigger transactions, not only to build capital, but also to generate cross-subsidy for smaller tougher deals. He think s there is a need for "impact optimization" reporting which addresses both the external impact on the community of the dollar spent by the CDFI and the leveraging of the dollars that create that dollar of investment. This would capture such activities as cross-subsidization.

Scaled Syndication Platform Presentation and Discussion

Kimberlee Cornett of the **Kresge Foundation** and Debra Schwartz of the MacArthur Foundation presented a proposal for a syndication platform that would involve a collaboration of the two foundations to provide a total of $60 million in 10-year, 2-percent, unsecured general obligation debt to CDFIs and Development Finance Agencies. The proposal was in a draft stage; the goal of the session was to receive feedback from Roundtable participants on its design.

As can be seen in the graphic below, the proposed innovation has two main components. First, Kresge is investing $30 million of its own money as PRIs for CDFIs and Development Finance Agencies at a 2 percent interest rate and 10 year term. It will be issuing an RFP to select investees, and will handle underwriting and monitoring of the loans. Second, MacArthur will manage a $30 million "sidecar" vehicle, set up as a sole-member LLC of the foundation, through which impact investors can participate in a senior position in the pool. Investors will be asked to provide their funds for 10 years and 2 percent (minus a small spread for fund administration expense). Investors will be protected first by the Kresge Foundation's $30 million position, and second by a 20 percent pool-level first loss position held in the sidecar. Kresge would manage all aspects of the CDFI investees. Investors would engage directly only with the "sidecar" LLC, and would underwrite their investment in the LLC not Kresge or the CDFIs.



Michael Swack asked Schwartz who the initial investors might be. Schwartz is thinking about this as an impact "first product" that might provide a way for donor-advised funds and small family foundations to get into US community investing. Only accredited investors would be able to invest, they are not looking to serve retail investors. Cornett added that a message for family foundations is that "you don't have to pet the bunny," meaning you don't need to have a hands-on connection with your investments to be making an impact.

Respondent **Martin Eakes** of the **Center for Community Self Help** characterized the proposed initiative as "a first step to a larger syndication platform for PRIs." Eakes particularly supported the idea of the foundations intermediating investments on behalf of CDFIs. "You need to keep me away from the wealth managers," he said. "I despise the idea of 'doing well by doing good' – it is a complete fraud – so how would you like me to be speaking to your investors? How do you have a conversation with people who have inherited great wealth, and ask them, 'I want to negotiate an interest rate with you to provide poor people?' MacArthur can insulate the investors from people like me who would preach at them; it can validate the CDFIs who are in the syndication; you can have standardized due diligence that only gets done once; and you can provide a liquidity facility." Eakes saw potential for expanding the model, noting that "if you had a syndication that is big enough, there is a market there to do unbelievable good things" – citing, for example, the potentially enormous market for home lending to undocumented immigrants. Eakes is seeking 1 percent money for 15 years. He believes that "many players can't handle it, but a number could do the first 5 years at 1% and a liquidity facility could get them in to do the first part."

Respondent **Jim King** of **Fahe** also liked the usefulness of the proposed vehicle to "aggregate demand and aggregate capital," so that "my best talent would get freed up instead of constantly chasing investors." King further suggested that the funds

be made available beyond urban areas, noting the special challenges for rural regions in raising capital. "CRA is not a function that works well for us in Appalachia," King said. "I don't have national banks present and few regional banks. [And] there are no large private foundations in our footprint." For Fahe, the process of raising capital means "leaving where we work, finding it and dragging it back – aggregation would make that easier for us. Then we can concentrate on deal flow."

King also discussed the question of whether smaller CDFIs, and CDFIs in challenged markets, would have the capacity to deploy the funding. He observed that "Capacity follows resources – if there aren't resources you aren't going to have capacity. You need to identify a local leader and back them up with resources and access to expertise. Access to funding that is consistent and regular makes all the difference. The inconsistency of money is what strips away capacity." With the right support in place, King said, "I am willing to bet that most smaller CDFIs could make it work."

CDFI feedback on the proposed syndication

Anthony Bugg-Levine of **Nonprofit Finance Fund** was enthusiastic about the proposed fund, linking it to a broad vision to "take the existing platform of CDFIs and build conduits to the world of impact investment." Bugg-Levine noted that "there is an element of intermediation in building a new industry that is about socialization and trust, more so than the technical elements," which the fund helps to address.

Bugg-Levine asked about how the fund will ensure investors that their impact verticals and geographies will be addressed. Cornett suggested that Kresge can develop a map that shows the geographies of its investments.

Elyse Cherry of **Boston Community Capital** commented that 2 percent, 10-year money is very useful to CDFIs, with the longer term helping to address borrower needs and the lower interest rate helping to bring down the cost of funds. She suggested that for the money to be most useful for their customers, the loans to CDFIs be structured as bullet loans (interest only for 10 years). Kimberlee Cornett clarified that Kresge would like to see some amortization at least in the out years, such as years 8 through 10, of the loan.

Joe Neri of **IFF** suggested that the debt to CDFIs be made available on a pari-passu basis with all of an organization's other subordinate lenders – "almost an equity equivalent," he said, "so that then it is neutral in terms of our capital ratio." Kimberlee Cornett clarified that Kresge intends to make a net assets grant equal to 5 percent of the loan amount, to help deal with the net assets requirement.

Institutional investor feedback on the proposed syndication

Anna Snider of **US Trust** reported that participants asked to consider the proposed investment from the perspective of institutional investors generally felt that it represented "an amazing step forward for aggregation, scale and capacity." She reminded the group, however, that "when you talk about risk, term, and liquidity,

you have to contextualize" to the asset class. Snider felt that the proposed investment product was not a proxy for cash, due to the term. If the product is a proxy for fixed income, "the return is a lot lower if you were to think about non-rated private debt issuance. For 10 years you'd think 5 to 7 percent for unrated private debt." Some other questions and comments from the institutional investor group on the design of the instrument included:

- For institutional investors like Pension Funds that define asset classes, this instrument might be tough to figure out
- If the investment gave off income in the interim (like a quarterly payment of principal and interest) that would be an interesting feature
- Investors would want to know if they were putting money into a blind pool, or if there would be transparency to the underlying assets. They also wanted to know if only nonprofits would borrow the money, or also for profits; and whether the investment would sit in a registered investment advisor.
- The group suggested that a tranched investment structure similar to a CDO might be attractive, to offer different types of risk and return profiles to attract different investors.

Dan Letendre of **Bank of America** reported that "from a CRA perspective, this investment would be challenging." More specifically, he stated that the term would be "challenging in terms of hedging our cost of funds," and that "until CRA is fixed we have a geography issue." Lastly, there is the deployment issue – the investors would want to fund up their investments quickly, leaving the question of "can we find enough good opportunities?" On the other hand, Letendre felt that "overall, this would be great, and applies well to an investor with flexibility around return and geography, and who has limited capacity to underwrite or asset manage. This could bring in new investors to the space."

Snider and other Roundtable participants began a conversation about the question of underwriting when Snider observed that "even though Kresge is an amazing foundation with a good reputation, that can't serve as a proxy for underwriting in the institutional market. Most mainstream investors don't know how to underwrite nonprofits, so you would have to underwrite Kresge. Most risk and compliance people I know may have a hard time getting through the due diligence you have to do on a nonprofit." Snider's division does not underwrite nonprofits, such that they would turn to another division within Bank of America to assist them. Cornett asked whether it would help for Kresge to hire a third party to review them, but Snider replied that they cannot use a third-party review.

When asked whether a rating would help, Snider responded, "maybe, but you would still have to underwrite it in a conforming way. It is tough to work around the fiduciary standard of the institution." Snider also clarified that due diligence would be required regardless of whether the investment was structured as a note or as a pooled fund. Schwartz asked for clarification on whether due diligence would be

required even if the LLC is a fund placed with accredited investors, to which Snider replied, “yes, I have to underwrite it.”

Julie Eades of **New Hampshire Community Loan Fund** noted that this challenge is an important “stuck place” for the industry, commenting that “it is legal and compliance that runs Anna [Snider’s] life, not Anna. Once the money goes into a system with a professional, the individual investors can’t make decisions about what to do with their own money. How do we get money to flow is about this point right here, if you want the big money to flow. Are there other ways around this, or do we have to go to people personally?” Snider rejoined that “I didn’t stay we are stuck, these are hurdles – it is my job to educate our internal people so that we can get over them.”

Vince Molinari of **Ouisa Capital** observed that “a wealth management institution is not the same as an accredited private investor…. MacArthur’s guarantee doesn’t supersede the SEC or due diligence requirements.” Molinari recommended that the product needed to be displayed on a platform, noting it needs to comply with suitability requirements, know-your-customer rules, and adherence to other rules around broker-dealers. As a next-generation idea, Molinari suggested exploring a securities offering focused on one state, so that investors would know that “your capital is going to your community.” Molinari felt that “if you can advertise a security for sale and broadcast its availability widely, that is a game changer – even if a small percentage of the population will accept 2 percent over 10 years.” Molinari stated that Ouisa Capital would be happy to underwrite the investment as a regulated broker-dealer, concluding, “Let’s go out and do the record-keeping and offer secondary liquidity.”

Liz Sessler of **ImpactUS** said, “There is a world of investors in between where Anna [Snider] is and where we are now.” She noted that for US Trust, the dollar volume of investments needed to be very big; for them a $100 million investment is small.

Jessica Lowery of **Veris Wealth Partners** felt that the conversation was getting conflated: “I thought this was a PRI investment at the beginning; now we are talking about selling it to the public and that is a completely different world.” Schwartz replied, “We were in a hybrid space, going for the same economics as a PRI but not necessarily solely presented to foundations, given that there are families, individuals, community foundations that may also be interested.” Another commented that the rate is too low to lock up the money for 10 years even if it is risk free.

Andrea Armeni of **Transform Finance** felt that investors he works with would love the “double guarantee” from Kresge and MacArthur, but “what can you tell us about the impact? If you want the money that is okay with the 10 years and the 2%, you have to give me a little bit more about what happens with my money than ‘it’s going to CDFIs.’” Schwartz asked what a meaningful impact report would look like. Armeni replied that he would like to see a “clearer impact thesis,” and some more information on impacts such as whether the jobs being created are quality jobs, and

whether the affordable housing units created are long-term affordable. (Armeni later clarified in one-on-one conversation that his investors are not looking for academic-quality program evaluations, just a clearer story about impacts. He raised the point that at least for a subset of investors, which is growing, just a generic allocation toward impact is no longer sufficient. The more layers of intermediaries there are, the more doubt arises about the true ultimate impact, which brings a need for stronger data being reported back. Under the MacArthur/Kresge vehicle, my money would go into a pool that then goes to a CDFI that then puts it into a fund that in turn lends to developers... by the time the money has reached the ground, there is very little visibility into the quality of what I have contributed to.)

Community Foundation feedback on the proposed syndication

Bert Feuss of the **Silicon Valley Community Foundation** would "give the fund a 4 on a scale of 1 to 5 – it solves a one problem for us, which is having a trusted intermediary involved for due diligence and underwriting." Feuss felt the product would be "good for family offices, community foundations, accredited investors," but it "scares me a little thinking of this getting retail distribution – my fear is that the impact might get diluted. Maybe that is a next generation development." Feuss' main concern was the 10-year term, combined with concern about repayment. Both Scwhartz and **Graham Macmillan** of the **Ford Foundation** discussed the history of successful repayment of PRIs, Ford Foundation reported under a 2 percent enterprise loss rate on PRIs.

Feuss also described a concern about matching the terms of investment up to the source of funds in the Foundation. If the investment were made out of the endowment, the 10-year term is not a problem, but the 2 percent return is a problem. If the investment were made out of cash reserves, the reverse is true: the 2 percent return is not a problem, but the 10-year term is.

Finally, Feuss discussed a few comments on program and geography. "It would be attractive if this model can be replicated across the country by impact theme or for a specific region." For a national model, Feuss wanted "an assurance that there is at least some investment activity in my region, and a provision to get your capital back if it can't be deployed."

Some conversation ensued on how to ensure that investors would be able to address their desired geographies and impact verticals. **Frank Altman** from **Community Reinvestment Fund** asked whether the idea was to have a blind pool, or to build the pool and then go to market for it. Martin Eakes similarly suggested that the Foundation might consider first warehousing the loans and then placing in a pool. **Mary Vasys** of **Vasys Consulting** suggested a twist in which Kresge could fund 50 percent of each loan amount, and then MacArthur could go to market to fund the remaining 50 percent, "which solves the problem of knowing what the loan

is for." Finally, Martin Eakes suggested the possibility of creating separate funds for each impact vertical.

Bruce Hoyt from **Gary Community Investments / Piton Foundation** said he had "a lot of the same thoughts as Bert (Feuss)." The term and return were fine for him, and the credit enhancement was "extremely attractive." Hoyt also likes to "leverage our capital with others," a further attraction of the syndication, especially since it would require less capacity to monitor than a direct investment. All of the impact areas Kresge is interested line up for Gary Community Investments, Hoyt said, but "we are place based and care about Colorado and Denver Metro Area. So to sell it to us – the closer it gets to a PRI the more it has to be mission driven."

Jane Adams from the **Minneapolis Foundation** was concerned that the terms of investment might narrow the opportunity set – "Donor Advisors don't want to tie up money for 10 years; and an endowment fund may not be happy with 2%." She wondered if there was a way to use those two components back to back, with the DAF investing for the first five years and the endowment taking the DAF out to invest for the second five years.

General discussion around the proposed syndication

Carla Mannings at **Partners for the Common Good** discussed the challenge from the CDFI side of managing the loan fund such that it would have the principal ready to pay back towards the end of the 10-year period, and asked how Kresge would be assessing CDFI plans to do so. Cornett responded that "how you assure that you repay is your management job." Cornett then raised the question of how fast CDFIs would be drawing down. Schwartz suggested that MacArthur could help to bridge the gap by "warehousing a little, and not necessarily drawing investor capital until there is something there."

Becky Regan from **Housing Partnership Network** suggested potentially increasing the size of the pool to get investors to "take us seriously," adding that she thought the syndication model "could be really powerful."

Eileen Fitzgerald from **Stewards of Affordable Housing for the Future** asked about how outcomes would be aggregated. She further inquired about whether the initiative would track human outcomes, and if so, which ones.

Robert Zevin of **Zevin Asset Management** thought that "this fund idea is great – a step up, for both PRI investors and high net worth individuals." Like several commenters before him, Zevin agreed that "The ability to focus more on a particular place or a particular program is still going to be very important. The way to get there is build an inventory first and then sell participation in particular loans that appeal to people with an interest" in a particular geography or issue area.

Schwartz asked **Martin Eakes** to comment on whether CDFIs have a social impact value "in and of themselves, as institutions, for what they represent." Eakes replied, "When I think of impact, I have this disconnect between what I report to funders and

what my staff and I are willing to spend our lives working on." Eakes stated that Self-Help has several broad categories in which it thinks about impact:

- Scaling (having a bigger "surface impact")
- Seeding – helping groups to get started, which Eakes feels is "just as important as scaling"
- Policy Impact – with government, but also with the financial sector. For example, Eakes described efforts to get major banks to drop overdraft fees, to fight predatory lending, and to drive discrimination out of the automobile lending industry

Eakes asserted that "1 percent PRI money can help provide quasi-equity to institutions that themselves will be powerful forces for change – sometimes just incremental change, but if you make a change like get Wells Fargo to change their payday lending product, that impacts millions of people. The institutions themselves are really quite critical, not for the things you think of as their impact but their integrity for the communities they represent."

Paul Bradley of **ROC USA** thanked Kresge and MacArthur for "targeting balance sheet debt - and equity- to build institutions that can have systems level change. It is the right problem to be trying to solve." Bradley asked whether the place-based and sector-specific interests of DAFs could work on a pooled risk basis. Schwartz replied, "I think we could use a participation model [but] the pool model is the simplest. Let's see if people are interested as for us, that is the lowest risk. I wouldn't say there is categorically no way to warehouse the loans and set something up. The size is also a question – until you put something out there, you don't know what kind of appetite there would be. We saw this as a concrete, great way to get started."

Closing comments

Jeff Merkowitz from the **US Department of Treasury CDFI Fund** discussed the CDFI Fund's "framework for the future," which includes raising awareness about the industry, helping create new access to new resources, helping build the capacity of CDFIs to use data as a strategic asset, and driving the field to reach farther and deeper in generating impact. Merkowitz stated, "We believe the role of CDFIs is to trailblaze, and show where there is opportunity. There are many places that CDFIs still have not been able to reach – Ferguson, East Baltimore. We want to figure out ways, whether it is the seeding that Martin [Eakes] talked about or something else, to help there."

Debra Schwartz recommended that participants "figure out a systemic way to keep this conversation going." Michael Swack volunteered that the Financial Innovations Roundtable can coordinate the follow-up, and asked participants to "please provide ideas on what should come out of this."

In closing, **Amanda Roberts** from the **Federal Reserve Board of Governors** thanked the participants for coming and thanked the many people involved with planning the meeting.