Social Impact Investing and Community Development Corporations

An Analysis of the Opportunities and Threats

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An analysis for the benefit of MACDC on the threats and opportunities within the social impact investing market. The research discusses the current state of the infantile market, the expected direction of the market as it relates to Community Development Corporations and recommendations for the MACDC based on the research.
Opportunities for CDCs to participate in the growing area of impact investing

Impact investing consists of financing opportunities that create social or environmental benefits with at least a return of capital (Global Impact Investing Network, 2013). Many terms are used to describe impact investing and include mission related investing, socially responsible investing, social finance and sustainable investing amongst others. Limiting the scope of the market for social impact investing to community development corporations (CDCs) only mildly contracts our range. A key point to remember when discussing the market is that it is in a period of rapid change and evolution, and new products are constantly being introduced.

The types of investments being investigated within this space need not be limited to loans and equity, but may span a wide range of investments (Fig 1). Generally, these investments are provided in addition to grants in order to leverage results of the latter (Cheney, 2012). Because of the historical lower rate of financial return, social impact investing will mostly come as restructured philanthropy money at the beginning. However, a shift is believed to be occurring, in which investors who generally were concerned with more social outcomes are moving into considering financial outcomes as well, creating a more efficient and transparent market for social impact investments (Thornley & Dailey, 2010, p. 6).

Fig 1

Mission-Related Investment Continuum

Source: The F.B. Heron Foundation
With only $8 billion, the impact investing market is still small compared to philanthropy and very small compared to capital markets (Thorpe, 2013). However, there is believed to be significant growth potential given that unlike philanthropy, there is at least the potential for a return of capital. Positive social outcomes would also be believed to attract new capital, thus possibly expanding this new market to up to $1 trillion by end of the decade (Thorpe, 2013). Hence, this represents a potentially significant source of funding for CDCs.

**Performance indicators may symbolize both an opportunity and a threat**

According to the Massachusetts Housing Investment Corporation CEO, Joe Flately, the majority of debt financing provided to CDCs for projects is by banks through the requirement of the Community Reinvestment Act (CRA) of 1977 and this capital is often supplemented by grants or loans from private investors. This suggests that currently investors’ motivation to provide capital is not directly related to social impacts, but is instead imposed through legislation. While this may currently be the case, recent publications by the San Francisco Federal Reserve Bank have discussed criticism of the CRA, which is that it “overemphasizes activity tracking and does not adequately recognize or encourage activities that have a significant community impact” (Moon, 2010).

Based on various conversations we have had with market participants, the focus on “outcomes” or “performance measures” emerged as a common theme within the social impact investing community. Developing such measures is challenging because it goes beyond figures related to tangible outputs (e.g. number of units, percent of occupation, etc.), and relates more to the ultimate mission of the underlying CDC. The idea itself is controversial given the uncertain reliability and accessibility of the data. However, we believe it is a clear opportunity for CDCs
to take a stand within the conversation and have a say in the movement of the market rather than the possibility of eventually having this shift forced upon them by investors or lenders. In order to illustrate where this shift is already taking place, we can look to the Change Capital Fund in New York City, which recently awarded grants to ten New York City CDCs in order to restructure their business plan to fight poverty. While this may already be an indirect goal of the CDCs, the true monumental shift is happening through the CDCs “identify(ing) methods to demonstrate improved outcomes and quantify associated reductions in public spending for crisis services” (Nonprofit Finance Fund, 2013).

While we may have determined that the social impact market represents a unique source of funding opportunity for CDCs, there are also threats, or risks, that need to be considered. Bill Pinakiewicz, of the Nonprofit Finance Fund, believes that as more of the market moves towards outcomes measurement in their investment assessment, the capital available to those who are not able to measure and communicate these outcomes are at a disadvantage, and would face difficulty tapping new capital. According to the Federal Reserve Bank of San Francisco, this may even include the capital being provided by banks through the CRA (Thornley & Dailey, 2010, p. 34). This suggests that CDCs will not only need to start measuring and communicating outcomes, but that it may eventually be a requirement for existing capital.

In the event that CDCs delay their adoption of these efforts, it is possible that the expected outcomes differ for each funding source, which would be further complicated by the number of funding sources CDCs generally utilize in a transaction. A timeline for this shift in the market is difficult to generate; according to the Federal Reserve Bank of San Francisco, it will only be expedited by the entry of new investors in the field of social impact investing (Thornley &
Dailey, 2010, p. 16). That being said, these performance indicators are, what we believe to be, the more stringent requirements seen in the market, and the indication is that any change towards this model is still in the future.

**Current status of market expectations and CDC movement**

To better understand what sort of outcomes investors are *currently* looking for, we spoke with April Schrenker of the Dunkin Donuts Foundation, a $2.6mm community based foundation that awards grants to local 501(c)(3) organizations. Schrenker was clear that in order to maintain eligibility for the grants, the 501(c)(3) must annually submit an “Impact Report”, which is drafted by the 501(c)(3) and has no required content, rather is usually formatted by the 501(c)(3) itself. We believe that these sorts of requirements are more reflective of the current status of the social impact investing market.

Based on our conversations with two CDCs, we have identified some of their strengths and weakness pertaining to their competitiveness for social impact capital. As previously discussed, it is possible that CDCs will need to start re-defining social impact into a more objective measure in order to meet the investor’s second bottom line. Recognizing the unique characteristics of each CDC, creating “one size fits all” performance measure will be unrealistic.

However, at the forefront of this trend in Boston communities is URBAN EDGE, who has begun to implement the *Logic Model*. URBAN EDGE’s *Logic Model* tests different variables they collect throughout the community to better understand correlations between quantifiable information received and subjective outcomes seen or felt. What they are finding is the impact for each project may be quite different each and every time and depends on a multitude of variables and outcomes, both intended and unintended or consequential. We believe that this is a
clear model of the ability for CDCs to be able to develop their own hypotheses and test them with feedback received from their constituents.

Unfortunately, it is possible that the resources required to assess project impact may only be available to larger CDCs thereby creating an entry barrier for smaller CDCs to take advantage of social impact investing in the longer term. Smaller CDCs must have the human resources and organizational structure to obtain and evaluate information on a consistent basis. Since the metrics to assess project specific impact are unknown, data will need to be accumulated over a long period of time before, during and after the completion of the subject project. Although there is a present weakness for smaller CDCs, a possible opportunity exists for multiple CDCs, both large and small, to work closely together to achieve joint outcomes.

As this niche industry gains more traction, we believe that there will be additional emphasis placed on objectively measured social impacts. One concern would be that a conflict of interest emerges as CDCs begin measuring their impact for the benefit of investors, creating the potential for an atmosphere of uncertainty regarding the legitimacy of the outcomes. To counter this conflict of interest and to create measurements devoid of all bias, it may be that an independent 3rd party will need to be brought into the picture. Therefore, an independent assessment of impact may be the next step in the evolution of social impact investing.

Based on our conversations with several regional CDCs, we believe they have the potential to develop desirable characteristics to attract investments due to the relatively low-risk nature of their operations. For instance, the Dorchester Bay Economic Development Corporation has the strong potential to generate profits from its innovative Bornstein & Pearl Food Production Business Center in addition to rental revenue after the project is completed. This ‘profit’ could
be a factor attracting future funding within the competitive scene. In addition, the creation of Dudley Village has also resulted in community improvement via job creation and a decrease in crime rates. Hence, we believe that CDCs have the desired characteristics to be competitive in the future market for impact investment.

Conclusion

We believe the impact investing market has significant potential to grow and become a significant source of capital for organizations having a positive societal impact, including CDCs. Based on our conversations with several CDCs, we believe they have the desired characteristics to be strong candidates in the market, as they positively impact society and are able to generate stable cash flows. In order to utilize this capital, CDCs may need to begin redefining their performance along indicators that would satiate investor’s requirements. There is a risk as well for CDCs who choose to ignore this shift in the markets, as it is possible their current source of funding may transition to measured performance indicators in the near future.
Recommendations to the MACDC

1. **Support the development of performance indicators**

   The social impact bottom line is distinct from the financial bottom line but nevertheless important. Performance indicators could be innovative combining social, financial and risk factors. We believe that the MACDC can play an important role in helping define what level of outcomes, or indicators are adopted by CDCs, and how they will be measured and reported.

2. **Educate current CDC members about the potential of impact investing**

   Because of the uniqueness of each CDC, it is important to engage each of them at some level since they may be better able to understand how this type of financing can be tailored to their organization. By involving the CDCs early on in the process, there is a greater chance for success.

3. **Market new tax credits to the social impact market**

   One new opportunity for capital that has just arisen within the past year is the Massachusetts Community Investment Tax Credit Program (CITC) (Commonwealth of Massachusetts, 2013), which allows CDCs to raise capital through the sale of tax credits. Given the potential benefit these tax credits have for high net worth individuals, and the new opportunity we believe to be available in the social impact space, we believe this would be a timely opportunity for CDCs to begin marketing themselves to the impact investing space. This could happen through local family offices and direct retail marketing. This would be a natural first step into the space and a timely opportunity to begin marketing as a “social impact investment”.


4. Leverage MACDC role

The MACDC might need to act as an intermediary role for its CDC members by:

(i) acting as a change agent for the transfer of knowledge regarding performance measurements among various CDCs; (ii) helping smaller CDCs with risk mitigation; (iii) collaborate with larger CDCs to help acquire funds for smaller CDCs

Limitations of our research

Our recommendations were made based on our belief that the impact investing market will significantly grow over the next several years due to a shift towards more social awareness by investors. Currently, CDC members are able to access funding partly due to legal obligations and incentives. The MACDC should follow the impact investing trend with respect to changes in current legislation that might affect CDCs’ access to funding.

Our interview with only two CDCs represents major limitations to our recommendations pertaining to the leverage of internal factors to better position the CDC members as competitive candidates for social capital.
Bibliography


