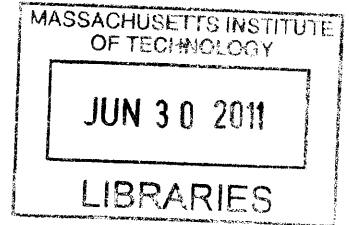


Capital for Communities:  
Connecting Community Development Loan Funds to Individual Investors

By

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Bachelor of Arts in Sociology  
Amherst College  
Amherst, MA (2004)



Submitted to the Department of Urban Studies and Planning  
in partial fulfillment of the requirements for the degree of

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**Abstract**

Community development loan funds (CDLFs) play a critical role in financing affordable housing, small businesses, and non-profit organizations in low-income communities throughout the US. Since the 2008 financial crisis disrupted CDLFs' primary sources of capital—banks and foundations—many CDLFs have been pursuing new sources. During these years of economic recession, individuals' confidence in the financial system declined while the Socially Responsible Investing and Impact Investing sectors experienced significant growth. With these concurrent trends as a starting point, this thesis explores the potential for socially-minded individuals to become a more substantial source of capital for CDLFs.

Using case studies of two organizations with successful individual investor programs—Boston Community Capital (BCC) and Calvert Foundation—my research examines the costs and benefits of individuals as a source of capital. Specifically, I study BCC's local capital raising for its Boston Community Loan Fund and newer Stabilizing Urban Neighborhoods Initiative and Calvert Foundation's Community Investment Note, a retail product available to individuals nationwide. My research analyzes the advantages and shortcomings of these differing approaches, assesses the viability of replicating each model, and makes recommendations for scaling up individual investing in CDLFs.

**Thesis Supervisor: Karl Seidman, Senior Lecturer in Economic Development  
Department of Urban Studies and Planning**

**Thesis Reader: Ellen Golden, Managing Director  
CEI Investment Notes, Inc., an affiliate of Coastal Enterprises, Inc.**





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# Chapter 1: History of Community Development Loan Funds and Current Conditions

## Introduction

The 2008 financial crisis triggered a series of devastating effects on American people and communities: 2% of housing units nationwide received foreclosure notices in 2009, families living in doubled-up housing units spiked to a 50-year high of 13.2%, the unemployment rate has hovered around 10% for two years now, and the poverty rate has reached a 15-year high with one in seven people living below the poverty line.<sup>1</sup> At this time of extreme need, the community development loan funds (CDLFs) that offer essential financing to small businesses and providers of affordable housing, have faced serious financial challenges with 61% of community development financial institutions (CDFIs) reporting capital constraints in 2009.<sup>2</sup> During this period of financial upheaval, Americans' personal savings rates peaked while confidence in investment companies declined.<sup>3</sup> Also, between 2007 and 2010, while the US economy shrank, investments in socially responsible funds increased 13%.<sup>4</sup> My thesis explores these concurrent trends and evaluates the prospects for community development loan funds to capitalize on the upswing in socially responsible investing and expand individual households as a source of capital for community development. I study two financial institutions that have had great success raising capital from individuals for CDLFs and continued to thrive in this tumultuous economic environment.

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<sup>1</sup> "The 20 cities with the highest foreclosure rates."; "Bureau of Labor Statistics: Employment Situation Summary."; Luo, "Recession Creates Spike in Multifamily Households."; US Census Bureau.

<sup>2</sup> *CDFI Market Conditions Third Quarter 2010*.

<sup>3</sup> "Bureau of Economic Analysis: Personal Saving Rate."; "Investors Flee Stock Funds - washingtonpost.com."; Bogdan, Sabelhaus, and Schrass, *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2010*.

<sup>4</sup> *2010 Report on Socially Responsible Investing Trends in the United States*.

## Community Development Loan Funds' History and Present

Community development loan funds emerged in the 1960s in response to the wholesale economic abandonment of US cities that characterized that era. In a story now familiar to students of American history, a series of policies including Federal Housing Administration mortgage insurance and the Federal-Aid Highway Act—working in concert with racially discriminatory development and lending practices—led to the flight not only of whites, but also of investment from American cities to surrounding suburbs. As a result, people in low-income neighborhoods did not have access to capital to buy homes, build housing, or establish businesses. Lack of credit access has been a major cause of physical decline of urban centers and persistent wealth inequality between whites and minorities.<sup>5</sup> Activists within poor urban and rural communities responded to these inequalities by forming what would come to be known as community development loan funds with a goal of providing low-income people and places with the affordable financial services and investment necessary to build vibrant communities.

Community development loan funds (CDFs) are non-profit funds that provide credit to people, businesses, and non-profits in underserved communities as well as financing for the construction of affordable housing and community facilities.<sup>6</sup> Unlike a bank or credit union, community development loan funds are not depository institutions. Instead, they raise capital primarily from banks, non-bank financial institutions, foundations, and government, pool that capital into loan funds, and then lend it out to borrowers in the community. Community development loan funds typically lend to a

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<sup>5</sup> Oliver and Shapiro, *Black Wealth/White Wealth*; Rubin, Zielenbach, and Benjamin, "Community Development Financial Institutions," 177-183.

<sup>6</sup> *Providing Capital, Building Communities, Creating Impact: CDFI Fiscal Year 2008 Report*, 4.

particular sector of the community development network—affordable housing developers, small businesses, non-profit social service providers, microentrepreneurs, or community facility developers. However, some CDLFs work with more than one type of borrower.<sup>7</sup>

Community development loan funds are one type of organization within the larger sphere of community development finance institutions (CDFIs) that employ financial tools to fulfill diverse community development needs. The other entity types include community development banks, which are for-profit entities with community representation on their boards that provide credit and basic financial services to local people and businesses; community development credit unions (CDCUs), which are collectively owned non-profit institutions that provide basic financial services and credit to low-income communities and often offer financial education to their members; and community development venture capital funds, for-profit entities that make equity investments in small and medium businesses that serve or provide job opportunities to low-income communities.

My research focuses on community development loan funds because of their unique role in supporting the bricks-and-mortar community development industry. Amongst the different types of CDFIs, community development loan funds invest the largest portion (66%) of their assets in housing with a total of \$520 million in housing financing outstanding in FY2008 that enabled the construction of 58,566 units of affordable housing.<sup>8</sup> CDLFs are also implementers of the New Markets Tax Credit program, through which they have leveraged \$26 billion in private capital for the development of community facilities

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<sup>7</sup> Ibid.

<sup>8</sup> Ibid., 3.

and job-creating commercial developments in low-income neighborhoods.<sup>9</sup> In addition, many CDLFs finance the operations of community-based social service providers.

Starting in the 1960s and accelerating in the 1980s, the general trend of US housing policy has been a shift from centralized federal funding programs to a system of distributed subsidies and financial incentives for private development and investment.<sup>10</sup> Currently, the Low Income Housing Tax Credit is the federal government's primary rental housing production program. The New Markets Tax Credit Program has been called "arguably the largest community and economic development program in existence today."<sup>11</sup> However, no single federal subsidy or tax incentive covers the total development cost of a housing or community facility development. In fact, equity proceeds from the Low-Income Housing Tax Credit on average account for only 46% of total development costs.<sup>12</sup> Instead, community developers assemble a patchwork of subsidy and financing before breaking ground on each project.<sup>13</sup> Community development loan funds provide the financing that completes that patchwork and enables projects to be built. As such, CDLFs play an essential role in the localized community development network that has supplanted federal provision of housing and community facilities.<sup>14</sup>

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<sup>9</sup> *Ibid.*, 10.

<sup>10</sup> Frisch and Servon, "CDCs and the Changing Context for Urban Community Development," 92; Walker, Gustafson, and Snow, *National Support for Local System Change*; Pinsky et al., *The Economic Crisis and Community Development Finance: an Industry Assessment*, 2; *Financing Low-Income Communities*, 198.

<sup>11</sup> *Reengineering Community Development for the 21st Century*, 9; Cummings and DiPasquale, "The Low-Income Housing Tax Credit: An Analysis of the First Ten Years."

<sup>12</sup> Cummings and DiPasquale, "The Low-Income Housing Tax Credit: An Analysis of the First Ten Years," 258.

<sup>13</sup> Hebert and Wallace, "Nonprofit Housing: A Study of Costs and Funding," 214.

<sup>14</sup> Rubin, Zielenbach, and Benjamin, "Community Development Financial Institutions," 183-4; Okagaki and Moy, *Changing Capital Markets and Their Implications for Community Development Finance*.

## Community Development Loan Fund Capital Sources

Similar to community developers, CDLFs have a diverse array of capital sources. Historically, community development loan funds have relied on three key sources of capital to support their community development lending: banks, foundations, and the federal government. In recent years, economic and political changes have altered CDLFs' financial support system, impairing their ability to support community development work.<sup>15</sup>

The Community Reinvestment Act (CRA) has been a key tool for incentivizing investment in CDLFs. Originally passed in 1977 under the Carter administration, CRA requires that banks receiving federal deposit insurance meet the credit needs of the communities in which they do business, including the low-income. However, it was not until 1995 that CRA became an important resource for CDLFs. Under the Clinton administration, the CRA regulations were modified to include CDLFs as investments that qualified as serving the low-income.<sup>16</sup>

CRA-motivated banks continue to be a major source of capital for community development loan funds, but the cost of capital from private lenders has been increasing over the past decade while the size of loans has been decreasing.<sup>17</sup> This is in part due to regulatory changes to CRA under the Bush administration in 2005, which loosened the community lending requirements for banks with assets under \$1 billion, significantly

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<sup>15</sup> Cates and Larson, *Connecting CDFIs to the SRI Community*, 3; Rubin, "Adaptation or Extinction? Community Development Loan Funds at a Crossroads," 201.

<sup>16</sup> Pinsky, *Taking Stock: CDFIs Look Ahead After 25 Years of Community Development Finance*, 29.

<sup>17</sup> Rubin, *Shifting Ground: Can Community Development Loan Funds Continue to Serve the Neediest Borrowers?*, 6; Cates and Larson, *Connecting CDFIs to the SRI Community*, 4.

decreasing the capital available to CDFIs.<sup>18</sup> CRA has also lost effectiveness as a result of changes in the financial market. In the past 50 years, Americans' personal savings have moved increasingly out of banks and into money market, mutual fund, and other financial institutions that are not regulated by CRA.<sup>19</sup> Moreover, the continuing consolidation of the banking industry throughout the past three decades and the widespread bank closures and the overall tightening of bank credit since the 2008 crisis, have even made capital from banks even more costly and scarce.<sup>20</sup>

Private foundations, another long-standing source of capital for community development have also receded, decreasing from 14% of CDLFs' aggregate capital sources in 2006 to 10% in 2008.<sup>21</sup> Most foundation endowments suffered huge losses during the recent financial crisis and many have decreased their grant-making activity and program related investment in all sectors, and CDFIs have been no exception.<sup>22</sup>

The largest source of federal funding for CDLFs has been the CDFI Fund, which has provided \$1 billion in grant, debt, and technical assistance since its establishment by the Clinton administration in 1994.<sup>23</sup> However, the Fund's appropriation levels have varied a great deal in the past 16 years. Under the Bush administration, the CDFI Fund was reduced by more than 50% to \$55 million in 2007.<sup>24</sup> Obama has strongly supported the Fund,

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<sup>18</sup> Rubin, "Adaptation or Extinction? Community Development Loan Funds at a Crossroads," 204.

<sup>19</sup> Okagaki and Moy, *Changing Capital Markets and Their Implications for Community Development Finance*.

<sup>20</sup> Cates and Larson, *Connecting CDFIs to the SRI Community*, 4; Pinsky et al., *The Economic Crisis and Community Development Finance: an Industry Assessment*, 33; Rubin, "Adaptation or Extinction? Community Development Loan Funds at a Crossroads," 205.

<sup>21</sup> *Providing Capital, Building Communities, Creating Impact: CDFI Fiscal Year 2006 Report*, 35; *Providing Capital, Building Communities, Creating Impact: CDFI Fiscal Year 2008 Report*, 33.

<sup>22</sup> Rubin, "Adaptation or Extinction? Community Development Loan Funds at a Crossroads," 206; Cates and Larson, *Connecting CDFIs to the SRI Community*, 4; Pinsky et al., *The Economic Crisis and Community Development Finance: an Industry Assessment*, 3; *GivingUSA 2010*, 1.

<sup>23</sup> Pinsky et al., *The Economic Crisis and Community Development Finance: an Industry Assessment*, 28; Pinsky, *Taking Stock: CDFIs Look Ahead After 25 Years of Community Development Finance*, 30.

<sup>24</sup> Rubin, "Adaptation or Extinction? Community Development Loan Funds at a Crossroads," 202.



quadrupling its budget in 2008, and proposing a \$227 million allocation for 2012.<sup>25</sup>

However the Fund's spotty budget history and the ongoing federal budget crisis suggest that continued funding at this high level is by no means assured.<sup>26</sup>

In light of reduced financial support from banks and foundations and uncertain funding from the federal government, it has become increasingly urgent for community development loan funds to explore new sources of capital. My research will examine one potential new source: individual investors.

### **Individual Investors and Socially Responsible Investing**

In recent history, individual investors have not been a significant source of capital for community development, representing only 1-7% of CDLFs' assets and about 2% of CDLFs' aggregate capital.<sup>27</sup> However, individual investors were instrumental in the original creation of many community development loan funds. Before the support of the Community Reinvestment Act or the CDFI Fund, faith-based and socially motivated individuals were the first investors in CDLFs.<sup>28</sup> Chuck Matthei and the Institute for Community Economics helped establish 25 community development loan funds in the 1970s and 80s.<sup>29</sup> This early generation of CDLFs was based on a model of using "local capital to meet local social needs."<sup>30</sup>

The advent of CRA and later the CDFI Fund provided CDLFs access to new and large sources of capital from the federal government and regulated banks. This new inflow of

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<sup>25</sup> "CDFI Fund Call to Action."

<sup>26</sup> Cates and Larson, *Connecting CDFIs to the SRI Community*, 4.

<sup>27</sup> Ibid.; *Providing Capital, Building Communities, Creating Impact: CDFI Fiscal Year 2008 Report*, 33.

<sup>28</sup> Pinsky et al., *The Economic Crisis and Community Development Finance: an Industry Assessment*, 13; Pinsky, "Commentary."

<sup>29</sup> Rubin, *Shifting Ground: Can Community Development Loan Funds Continue to Serve the Neediest Borrowers?*, 2.

<sup>30</sup> Okagaki and Moy, *Changing Capital Markets and Their Implications for Community Development Finance*, 2.

capital spurred a jump in the number of CDLFs in the '90s and a general shift within CDLFs from time-intensive local capital campaigns, to more institution-focused capital raising.<sup>31</sup> The 2008 economic crisis has highlighted weaknesses in this formerly stable capital base for CDLFs, prompting many to reconsider individual investors as a viable source of capital.

There is a growing contingent within the CDLF and the socially responsible investment (SRI) industries that argue the potential for individual household investment in CDLFs is great.<sup>32</sup> Community investing has been a part of the SRI industry for some time; in fact, community investing is one of the three pillars on which the industry is based along with screening investment using social, environmental, and corporate governance criteria and shareholder advocacy. However, most SRI community investment at this time is cash or CD investments with community development banks and credit unions.<sup>33</sup> CDLFs have not been as successful in accessing the SRI industry.

A surge of reports published in the past two years have focused on improving CDLFs' access to the SRI investor pool. The Federal Reserve Bank of San Francisco's has dedicated two of the last five volumes of Community Development Investment Review to SRI-related topics. The Triple Bottom Line Collaborative, a group of 12 CDFIs with the support of the Ford Foundation, focused a 2010 research paper on this very issue—"Connecting CDFIs to the SRI Community." In addition, another collaborative of community development loan funds, the CDFI Community Investment Initiative, has been working over the past year to explore potential financial mechanisms to enable greater access to SRI capital markets.

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<sup>31</sup> Rubin, Zielenbach, and Benjamin, "Community Development Financial Institutions," 190.

<sup>32</sup> Cates and Larson, *Connecting CDFIs to the SRI Community*, 7; *Money for Good: Impact Investing Overview*, 9; Pinsky et al., *The Economic Crisis and Community Development Finance: an Industry Assessment*, 4.

<sup>33</sup> Cates and Larson, *Connecting CDFIs to the SRI Community*.

Community development investing is also attracting attention under the umbrella of the emerging impact investing movement. The impact investing movement, born out of the more established SRI field, encompasses a wide range of investments ranging from renewable energy businesses to social entrepreneurs to CDLFs. JP Morgan recently released a report making the case for considering impact investments as a new and separate asset class. They define impact investing as:

...investments intended to create positive impact beyond financial return. As such, they require the management of social and environmental performance (for which early industry standards are gaining traction among pioneering impact investors) in addition to financial risk and return. We distinguish impact investments from the more mature field of socially responsible investments (“SRI”), which generally seek to minimize negative impact rather than proactively create positive social or environmental benefit.<sup>34</sup>

A cohort of influential corporations and foundations are engaged in supporting the growth of this emerging field including the Monitor Institute, Rockefeller Foundation, and the Aspen Institute. There is a general sense amongst these players that the future potential of socially motivated investment is great and that the current economic and political environment is ripe to realize that potential. As the Monitor Institute’s report on impact investing declared, “this emerging industry has reached a transitional moment in its evolution, poised to move from a phase of uncoordinated innovation and to build the marketplace required for broad impact.”<sup>35</sup>

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<sup>34</sup> O’Donohoe, Leijonhufvud, and Saltuk, *Impact Investments: An Emerging Asset Class*, 5.

<sup>35</sup> Freiereich and Fulton, *Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry*, 13.

One indicator of potential is the current and rapidly expanding level of investment in socially responsible investment vehicles. At the outset of 2010, a total of \$3.07 trillion was invested in socially responsible financial products, \$38 billion or 1.2% of which is currently invested in community development.<sup>36</sup> Of the \$3.07 trillion total, \$77 billion or 2.6% was invested by individual households. A particularly exciting trend in the SRI field has been the growth in investment despite the recession. Since 2007, the total assets under SRI management have increased by 13%.<sup>37</sup>

Estimating the future potential size of impact investing, let alone the community development portion of that potential, is problematic. One recent study estimated that there is an additional \$48 billion market of socially motivated individual investors.<sup>38</sup> The Monitor Group estimated that there is \$500 billion in potential from all types of impact investors.<sup>39</sup> JP Morgan focused their estimate on the market demand for social investment in the developing world, and found that the market potential could range from \$400 billion to \$1 trillion.<sup>40</sup> While it is impossible to specify the market size for community investment from individual households, by all indications, it is substantial. In FY2008, the total assets of all community development loan funds was \$5.5 billion. If CDLFs were successful in accessing even 5% of the more conservative \$48 billion dollar market estimate, that would represent a 50% increase in capital for the industry.

Of course, individuals are not the only new potential source of capital for CDLFs. In a recent working paper for the Federal Reserve Bank of San Francisco, Julia Sass Rubin cited

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<sup>36</sup> *2010 Report on Socially Responsible Investing Trends in the United States*, 10.

<sup>37</sup> *2010 Report on Socially Responsible Investing Trends in the United States*.

<sup>38</sup> *Money for Good: Impact Investing Overview*.

<sup>39</sup> Freiereich and Fulton, *Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry*.

<sup>40</sup> O'Donohoe, Leijonhufvud, and Saltuk, *Impact Investments: An Emerging Asset Class*.

three others: state and local governments, broader capital markets, and pension funds.<sup>41</sup>

There are a number of innovative state and local programs such as California's Community Organized Investment Network in which insurance companies collectively invest in community development. But, with 44 states facing budget shortfalls in FY2012, the prospects of new community development financing programs are dim.<sup>42</sup>

Community development loan funds have also explored ways to move beyond investments from local banks and tap into broader capital markets. One approach to accessing the capital markets has been securitizing CDFI-originated loans and selling them into the secondary market. Several CDFIs have participated in secondary market sales, but lack of standardization in community development lending remains a major barrier to the expansion of this model.<sup>43</sup> In addition, apart from the small number of securitized loan pools, community development investment products are non-traditional, unrated investments. As such, they fall outside the bounds of what most institutional investors are willing or capable of purchasing.

Pension funds have been a long sought after source of capital for community development. With an estimated \$7 trillion under management, approximately 28% of all privately manages assets in the US, pension funds represent a huge portion of Americans' wealth.<sup>44</sup> Current pension fund investment in community development is limited, with the notable exceptions of the California Public Employee Retirement System (CalPERS) and the New York City Public Pension Funds. One of the principal barriers to larger scale

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<sup>41</sup> Rubin, *Shifting Ground: Can Community Development Loan Funds Continue to Serve the Neediest Borrowers?*.

<sup>42</sup> "States Continue to Feel Recession's Impact."

<sup>43</sup> Swack, "Creating the First Rated Pool of Securities Backed by Community Development Assets," 17; Rubin, *Shifting Ground: Can Community Development Loan Funds Continue to Serve the Neediest Borrowers?*, 11.

<sup>44</sup> *2010 Report on Socially Responsible Investing Trends in the United States*, 8; Rubin, *Shifting Ground: Can Community Development Loan Funds Continue to Serve the Neediest Borrowers?*.

investment by pension funds in community investing is Employee Retirement Income Security Act of 1974 (ERISA), the federal legislation that regulates how private pension funds are managed and has deeply influenced the management of public pensions as well. ERISA dictates that all pension investments must meet the expected risk-adjusted rate of return. Other benefits such as jobs created or community stabilization cannot be considered, unless an investment attains that initial expected return threshold.<sup>45</sup> While several pensions like CalPERS have made significant investments in economically disadvantaged areas in spite of these regulations, ERISA excludes many community investments that do not provide market returns. Also, the regulation can be a major disincentive for pensions to even consider socially motivated investments for fear of extraordinary reporting burdens or compliance issues.

The regulatory impediments to attracting institutional investors and particularly pension funds are critical challenges to the expansion of capital resources for community development loan funds. Tackling these barriers will be an important part of the continued growth of the CDLF industry. However, the fact that individual investors are free from such regulations presents a potentially more immediate capital raising opportunity. While there are a number of regulatory issues that impact CDLF's ability to attract individual investors (discussed further in Chapter 2), there is no legislation limiting an individual's right to consider social impact when making investment decisions or capping the amount an individual can invest in below-market investment products. Furthermore, individuals are not required to invest in traditional, credit-agency-rated investments. Of course, lack of legislative barriers does not translate into unlimited demand from individuals for

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<sup>45</sup> Logue and Clem, "Putting Labor's Capital to Work:".

community investments, nor does it suggest that individuals should invest wholly in community development. But, the relatively low level of regulation does present an important opportunity for community development loan funds.

My thesis studies two organizations that have raised significant capital from individuals for CDLF investment: Boston Community Capital and Calvert Foundation. The questions my research aims to answer are: What are the costs and benefits of individual investors as a source of capital? What can the CDLF industry do to increase the scale of individual investment in community development loan funds?

### **Boston Community Capital and Calvert Foundation**

Boston Community Capital (BCC) and Calvert Foundation represent extraordinary models of raising individual investor dollars in support of community development loan funds. BCC is an example of success in direct individual investment in a CDLF whereas Calvert Foundation is a financial intermediary that raises capital from investors nationwide, pools the funds, and makes loans to CDLFs and international community development lenders.

Boston Community Capital has two opportunities for individual investment in pooled community development funds. The first, the Boston Community Loan Fund (BCLF) has accepted investments from community members since its inception in the 1985. Individuals can purchase BCLF notes at as low as \$1,000 increments and earn 1-3% returns. Currently, \$4.1M of the BCLF's \$55M in debt capital comes from individuals. The second individual investment opportunity is in BCC's Stabilizing Urban Neighborhoods (SUN) Initiative, which has no minimum investment, but is restricted to accredited

investors. All SUN investments have a May 30, 2015 maturity date and a 4.25% APR. Of the \$50M total capitalization goal for SUN, \$26.4M has been raised from individuals since early 2009.

Calvert Foundation was established in 1995 by Calvert Investments with the express goal of offering a community investment financial product that was widely available to retail investors. The Community Investment Note can be purchased by mail, electronically through brokerage firms, or online at MicroPlace.com. The Note is the only community investment product currently sold electronically or online. Calvert Foundation currently manages \$228.6M raised through the Note and invests that capital into approximately 250 CDLFs, CDFIs, and microfinance institutions worldwide.

## **Methodology**

My research is based primarily on semi-structured interviews with key staff at each organization, as well as a small number of associated financial advisors and investors. I draw from financial statements, annual reports, as well as data each organization provided on their capital sources and investments over time in order to better understand the role individuals have played.

In order to contextualize these case studies, I review the literature on the capital resource challenges for CDLFs, synthesize industry survey data from the CDFI Data Project, and conducted a brief survey of 8 CDLFs with individual investors on the range of CDLF investment products currently offered.



## **Thesis Outline**

In Chapter 2, I provide an overview of community development loan funds' capital needs, individuals' investment preferences, and the current field of individual household investment in CDLFs.

Chapter 3 is my case study of Boston Community Capital and individual household investment in the Boston Community Loan Fund and the SUN Initiative. I detail the historical role of individual investors in BCC's establishment and the organization's recent experience with raising capital from high net worth individuals for the SUN Initiative. I also put forward an initial assessment of applicability to the broader CDLF field.

Chapter 4 is my case study of Calvert Foundation. I review the history and evolution of Calvert Foundation's model, including its sales platforms, marketing strategies, and approach to lending. I outline the process whereby the Community Investment Note became an electronically traded investment product and the advantages and challenges of this sales method.

Finally, in Chapter 5, I review lessons learned from both cases, discuss the benefits and challenges of individual investors as a source of capital for CDLFs, and suggest paths forward for the CDLF field to enhance its individual investor capital base.

## **Chapter 2: Current Status of Individual Investment in Community Development Loan Funds**

### **Community Development Loan Fund Capital Needs**

Community Development Loan Funds' are capitalized by a blend of equity, equity equivalents, and borrowed funds. On average, loan fund capital is 35% equity or near equity and 65% debt.<sup>46</sup> Equity is an essential part of CDLFs' capital structure; it funds loan loss reserves, which CDLFs can leverage to attract debt investment and lower the cost of debt capital. As non-profit entities, CDLFs cannot receive traditional equity investments and therefore must raise equity through earned revenue or grants designated for that purpose from foundations.<sup>47</sup>

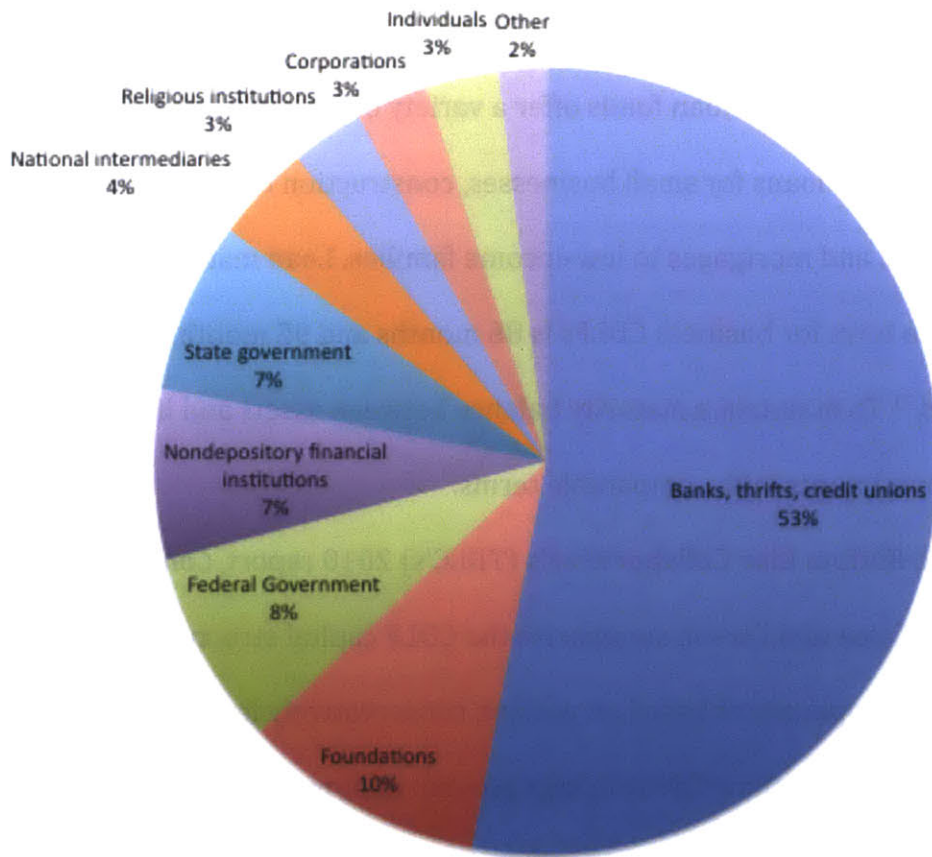
The majority of loan fund capital is low-interest debt. For most CDLFs, the majority of that debt capital comes from banks, with smaller percentages from foundations, government, non-depository financial institutions, religious institutions, and individuals.

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<sup>46</sup> *Providing Capital, Building Communities, Creating Impact: CDFI Fiscal Year 2008 Report.*

<sup>47</sup> *Ibid.*

**Figure 1. Community Development Loan Funds FY2008 Aggregate Capital Sources<sup>48</sup>**



CDLFs require low-cost debt in order to lend to community borrowers at reasonable rates, while maintaining their financial sustainability. According to the Opportunity Finance Network’s FY2008 CDFI survey data, the weighted average cost of capital for business loan funds was 2.5% while the average interest rate on loans issued was 7.3%. For loan funds that primarily lend to affordable housing developers, the average cost of capital was 2.9% and average interest rates on loans issued was 5.6%.<sup>49</sup> This spread,

<sup>48</sup> Ibid.

<sup>49</sup> *Opportunity Finance Institutions Side by Side: Fiscal Year 2008 Data and Peer Analysis.*

ranging from 2.7%-4.8% in this sample, is revenue that covers a substantial portion of CDLFs' operating costs.<sup>50</sup>

Community development loan funds offer a variety of loan types to their borrowers including working capital loans for small businesses, construction loans for affordable housing development, and mortgages to low-income families. Loan maturities vary greatly, but the average loan term for business CDLFs is 86 months and 95 months for affordable housing loan funds.<sup>51</sup> To maintain a maturity balance between assets and liabilities, loan funds need debt investments with comparable terms.

In the Triple Bottom Line Collaborative's (TBLC's) 2010 report, *Connecting CDFIs to the SRI Community*, Cates and Larson summarize the CDLF capital structure succinctly: "CDFIs have built their operations based on patient, conservatively leveraged capital structures. These structures allow CDFIs to take greater-than-market financing risk and deliver social and environmental returns to communities."<sup>52</sup> Current threats to the supply of low-cost capital for CDLFs threaten loan funds' ability to provide those social returns. To the extent that individuals are or can become a reliable source of low-cost capital, they can support CDLFs' long-term viability.

### **The Challenges of Accessing the Individual Investor Market**

In the TBLC report, Cates and Larson highlight seven difficulties community development loan funds face in attracting individual investors: lack of awareness, uncompetitive returns, lack of liquidity, higher perceived risk, unstructured terms, inability

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<sup>50</sup> Rubin, "Adaptation or Extinction? Community Development Loan Funds at a Crossroads," 192; Cates and Larson, *Connecting CDFIs to the SRI Community*.

<sup>51</sup> *Opportunity Finance Institutions Side by Side: Fiscal Year 2008 Data and Peer Analysis*.

<sup>52</sup> Cates and Larson, *Connecting CDFIs to the SRI Community*, 3.

to sell investments electronically, and lack of financial incentives for financial managers.<sup>53</sup> While these challenges are particularly focused on the financial services sector, the TBLC report hits on the key barriers between CDLFs and individual investors. In order to speak to individual investing in community development more generally, I have reframed the list of challenges as follows: aligning CDLF capital needs and individual investor preferences; educating investors about community investing; marketing and sales costs; compliance with applicable securities laws; and financial advising regulations.

While the capital needs of CDLFs and the investment characteristics individuals seek are not completely matched, there is overlap. Typical individual investors seek market returns and liquidity, two features CDLFs are hard pressed to provide. In the current market, community investment returns are competitive with many cash and short to medium term, fixed-income investments. However, when the US economy recovers, community development investment returns will once again be below-market. CDLFs therefore must attract investors on the basis of not only financial returns, but also the social benefits community investments generate.

The illiquidity of CDLF notes can also be a hindrance to attracting individual investors. Community development banks and credit unions do not face the same challenges in attracting individuals to similarly illiquid investments—certificates of deposit (CDs)—as the liquidity risk of CDs is offset by the investment guarantee provided by deposit insurance. CDs are also familiar financial products, offered by traditional banks and thrifts everywhere, whereas CDLF notes are less familiar to individual investors.

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<sup>53</sup> Cates and Larson, *Connecting CDFIs to the SRI Community*.

In order to attract investment despite the illiquid nature of CDLF notes, loan funds offer individuals short- and medium-term (typically 1-5 year) investment terms. These debt maturities are not an ideal match for CDLFs that lend for an average of seven years, but compromise is necessary given individuals' wariness of uninsured illiquid products. However, the loyalty of individual investors, manifested in high renewal rates, alleviates the maturity mismatch challenge created by short-term notes.<sup>54</sup> The current market of individual investment in CDLFs indicate that the below-market interest rate offerings and liquidity challenges can be overcome, when CDLFs are able to balance their capital needs and individuals' preferences.

Once a loan fund has structured an investment product with terms that appeal to individual investors while meeting their capital needs, they need to ensure compliance with applicable securities regulations. Non-profit entities are exempted from federal Securities and Exchange Commission (SEC) registration requirements, but state securities regulators' policies on non-profits vary. In many states, like Vermont and New Hampshire, CDLFs are unregulated entities and CDLF notes are not considered securities or required to register. In other states, CDLFs can file for registration exemption as non-profit corporations.<sup>55</sup> However, in states with more strict securities regulators, such as Pennsylvania, CDLFs are required to register notes as securities. In order to register, a CDLF has to contract a legal team to draft a full prospectus and submit necessary registration forms to the state security regulator. This may be further complicated by the fact that CDLF investment notes are non-traditional, unrated products, and therefore do not fit into the standard registration framework.

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<sup>54</sup> Evidence of individual investor loyalty discussed further in Chapters 3 and 4.

<sup>55</sup> Hollands, interview.

In states where registration is required, or in other cases where a CDLF deems it appropriate, a loan fund may choose to restrict their investment offering to accredited individuals, defined by the SEC as an individual with over \$200,000 annual income or net worth of over \$1M.<sup>56</sup> Investment products available exclusively to accredited investors are exempted from federal and state registration requirements.<sup>57</sup> Each CDLF handles security registration differently based on its state's regulatory environment and its capital raising goals.

After a CDLF has developed an investment product and complied with applicable securities regulation, there is a net of intertwined challenges to selling that product to individual investors. The initial challenge for any community investment is the lack of public awareness or understanding of the community development industry. Unlike banks with CRA obligations or community development foundations, most individuals are unfamiliar with the idea of community investing and the community development loan fund model. As a result, the upfront time required to attract an individual investor may be significant. Additionally, in most cases, to raise the same \$1M that a CDLF could receive from a single foundation, a CDLF would likely need to attract tens or potentially hundreds of individual investors. This type of communications is very different than the focused relationship building with a small number of institutional investors that CDLFs are accustomed to. That scale of outreach is also costly and can be organizationally daunting for a loan fund to develop.

Finally, to access the roughly 40% of consumers who manage their investments through financial advisors or brokers, CDLFs must confront another set of marketing and

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<sup>56</sup> "Legal Information Institute: United States Code: Title 15,77b."

<sup>57</sup> "Accredited Investors."

regulatory challenges.<sup>58</sup> Most financial advisors and brokers, like the rest of the general public, are unaware of community investing and therefore need to be informed about CDLF options in order to potentially suggest them to a client. Beyond unfamiliarity, two structural issues complicate CDLFs ability to reach and sell to financial service professionals. First, most financial products pay commissions to brokers at sale. CDLFs' tight margins constrain their ability to pay such commissions. Calvert Foundation is the only non-profit community development product that currently provides any such compensation to financial professionals.

Second, registered financial advisors have a fiduciary duty to their client, which obligates them to prioritize clients' interest above their own.<sup>59</sup> The SEC has elaborated that advisors should "make reasonable investment recommendations independent of outside influences" and "make recommendations based on a reasonable inquiry into a client's investment objectives."<sup>60</sup> These parameters for the definition of fiduciary duty are broad and open to interpretation. Many financial advisors believe that fiduciary duty precludes them from recommending CDLF or other community investments to their clients given their below-market returns.<sup>61</sup> However, financial advisors in SRI circles, such as the First Affirmative Financial Network, do not see the recommendation of CDLF investments as contradictory to their fiduciary obligations. This is one of the central reasons, SRI networks are viewed as part of the critical path to scale up individual investing in CDLFs. While much of the financial advising field sees community investing as contradictory to their

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<sup>58</sup> In the 2007 Federal Reserve Board's Survey of Consumer Finances, 29.3% of respondents counseled lawyers, accountants, or financial advisors before making investment decisions. 38% of respondents counseled bankers, brokers or sellers of financial service providers.

<sup>59</sup> "Investment Adviser Guide."; Cates and Larson, *Connecting CDFIs to the SRI Community*.

<sup>60</sup> "Investment Adviser Guide."

<sup>61</sup> Bressan and Erikson, "Catalyzing American Retail Investment in Community Development Finance: What Can We Learn From other SRI Success Stories?," 34.



professional duties, SRI firms see community investing as an important part of what they do.

### **Individual Investing in Community Development Loan Funds Today**

Despite the battery of challenges to accessing and attracting individual investors, community development loan funds across the country have active individual investor programs. Individual investors represent 2% of CDLFs' aggregate assets, but for many loan funds, individuals are a substantial and long-standing source of capital. Additionally, many CDLFs have recently developed or are developing new individual investor products in an effort to diversify their sources and tap into the emerging impact investing movement.

The following table provides basic information on eight CDLFs, in addition to Boston Community Capital and Calvert Foundation, with distinctive investment products for individuals. This is not a comprehensive list of community development loan funds with individual investors, but rather a sample of funds with well-known individual investor efforts and/or a significant individual investor base.

**Table 1. Community Development Loan Fund Products<sup>62</sup>**

CDFI	Investment Product	Marketing Channel	Term	APR	Minimum Investment	Type of investors	State Registered Security?
Boston Community Capital (BCLF)	Promissory Note	Faith Networks, word of mouth, Community Organizing	1-5 years	1-3%	\$1,000	Unrestricted	No
Boston Community Capital (SUN)	Promissory Note	Philanthropic community, SRI and high-net-worth financial advising firms	5 years	4.25%	N/A	Accredited	No
Calvert Foundation	Definitive, Book-entry, and Online Notes	SRI Financial Advisor Network	1-5 years	.5-2%	\$20	Unrestricted	Yes, 49 states
CEI Investment Notes, Inc.** (affiliate of Coastal Enterprises, Inc.)	Promissory Note	Individuals, institutions, philanthropy, SRI advisors	3, 5, 7, or 10 years	2-3.5%	\$5,000	Accredited	As required by state law
Cooperative Fund of New England	Promissory Note	Word of mouth	Variable	0-3%	\$1,000	Unrestricted	No
Enterprise Community Loan Fund	Definitive Note	Enterprise staff, foundations	2-10 years	2-3.5%	\$5,000	Accredited, residents of 23 states	Yes
Montana Community Development Corporation	Promissory Note	Website, national member organizations, other lenders	1-5 years	2-4%	\$1,000	N/A	No
New Hampshire Community Loan Fund	Promissory Note	Financial advisors, local marketing	1-25 years	2-5%	\$1,000	Unrestricted	No
Northern California Community Loan Fund	Promissory Note	Mostly word-of-mouth, personal touch	1-20 years	0-3%	\$1,000	Accredited	Yes

<sup>62</sup> Data in tables 1 and 2 has been compiled from responses to a brief survey circulated to these CDFIs as well as information provided on each organization's website.

CDFI	Investment Product	Marketing Channel	Term	APR	Minimum Investment	Type of investors	State Registered Security?
RSF Social Finance (Social Investment Fund)	Definitive Note	Online, print advertizing, conferences	90 days	1% annualized (adjusted quarterly)	\$1,000	Unrestricted	39 states, DC, 3 Canadian provinces
Vermont Community Loan Fund	Promissory Note	Advertising: print, radio, web, social media, event sponsorships	1-unlimited Years	0-3%	\$1,000	Unrestricted	No

**Table 2. Individual Investor Capital in Community Development Loan Funds**

CDFI	Community Development Investment Activity	Geography of Investment	Year Individual Investment Product Launched	Date of Financial Data	Loan Fund Assets	Amount of Debt Capital Outstanding to Individual Investors	Individual Debt Capital as % of Fund Assets
Boston Community Capital (BCLF)	Affordable Housing, Childcare, Education, Community Facilities, Commercial Real Estate	Boston, MA and surrounding region	1984	12/31/10	\$87,00,0000*	\$4,103,057	5%
Boston Community Capital (SUN)	Foreclosure response	Boston and Revere, MA	2009	3/10/11	\$36,350,000	\$22,850,000	63%
Calvert Foundation	Affordable Housing, Small Business, Microfinance, Social Enterprise	Global	1995	12/31/10	\$228,576,000	\$86,401,728*	38%
CEI Investment Notes, Inc.** (affiliate of Coastal Enterprises, Inc.)	Affordable Housing, Small Business, Commercial Real Estate, Community Facilities	Maine	2009	4/5/11	\$1,450,000	\$670,000	47%
Cooperative Fund of New England	Co-operative business, Co-operative housing, Community-based non-profit organizations	New England and New York	1975	12/31/10	\$9,000,000	\$2,200,000	24%
Enterprise Community Loan Fund	Affordable Housing	National	2010	12/31/09	\$176,352,000	Unknown	Unknown
Montana Community Development Corporation	Small Business	Western Montana	2002	12/31/10	\$15,435,202	\$165,000	1%
New Hampshire Community Loan Fund	Affordable Housing, Community Facilities, Resident-Owned Manufactured Home Communities	New Hampshire	1983	3/31/11	\$72,216,418	\$11,197,180	16%

CDFI	Community Development Investment Activity	Geography of Investment	Year Individual Investment Product Launched	Date of Financial Data	Total Assets	Amount of Debt Capital Outstanding to Individual Investors	Individual Debt Capital as % of Total Assets
Northern California Community Loan Fund	Community Facilities, Affordable Housing, Businesses, Non-profit organizations	Northern California	1987	2/28/11	\$32,512,565	\$4,141,500	13%
RSF Social Finance (Social Investment Fund)	Food, Agriculture, Education, Arts, Ecological Stewardship	North America	In current entity since 2006, since inception of loan fund 1984	12/31/10	\$76,943,406	\$67,907,543	88%
Vermont Community Loan Fund	Affordable Housing, Community Facilities, Small Business, Child Care	Vermont	1988	2/28/11	\$27,952,608	\$7,705,825	28%

\*Approximate

\*\*CINI is an affiliate 501c3 that supports its parent organization Coastal Enterprises, Inc. Individuals represent less than 1% of CEI's total assets.

While there is some diversity amongst the CDLF investment products listed above, there are some common characteristics: all investments are notes and all but Calvert Foundation's online note have at least \$1,000 minimum investments. Loan funds offer a range of maturities usually starting at one year going all the way up to 30 years. There is also a range of interest rates offered, though all relatively low, ranging from 0% to a maximum of 5%. The rates and terms reflect the balance struck between CDLFs' capital needs and individual investor demand.

This sample of CDLFs provides a snapshot of the variation in the relative weight of individual investor dollars in loan fund capitalizations. For seven of these 11 funds, individuals provide over 10% of the loan fund's total capital.<sup>63</sup> Not surprisingly, the longer standing (over 10 years) individual investor products, have raised larger (multimillion-dollar) investment amounts and are more significant proportions of their respective loan funds. This suggests that these organizations have found cost effective ways to make individual investors a sustainable source of capital. In this context, it is also clear that BCC's SUN Initiative and Calvert Foundation stand out for the amount of capital raised from individuals as well as the high percentage of their respective loan funds. My case studies in Chapters 3 and 4 delineate how BCC and Calvert Foundation have gone about raising this level of investment, how each organization has handled the complexities of attracting individual investors, and begin to discuss how other loan funds might replicate their success.

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<sup>63</sup> I have excluded CEI Investment Notes from this count because while individuals are a large portion of note sales, CEI Investment Notes represent a small portion of CEI Inc.'s overall capital sources.

## Chapter 3: Boston Community Capital

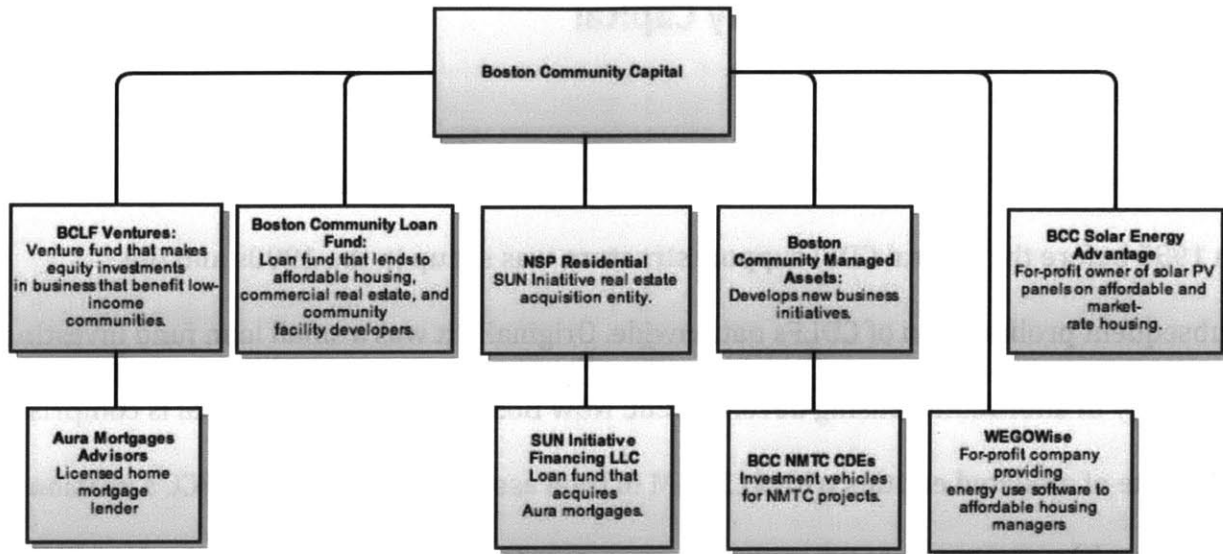
### Overview

Amongst the first generation of loan funds, Boston Community Capital was founded in 1985 before the federal CDFI support structure was set up in the 1990s and the subsequent proliferation of CDLFs nationwide. Originally it was a small loan fund investing primarily in affordable housing development. Now Boston Community Capital is comprised of a suite of affiliated entities with \$120.4M in total assets working toward BCC's mission to "build healthy communities where low-income people live and work."<sup>64</sup> Boston Community Capital's current organizational structure includes nine entities (exclusive of BCC's NMTC community development entities) shown in figure 2. While individual investors play a role in several BCC entities, my research focuses on the two entities in which individuals played a pivotal role: the Boston Community Loan Fund (BCLF) and the Stabilizing Urban Neighborhoods Initiative (SUN).

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<sup>64</sup> *Boston Community Capital and Affiliates Consolidated Financial Statements; Boston Community Capital Annual Report.*

**Figure 2: Boston Community Capital Organization Chart**



### **Boston Community Loan Fund Background**

The Boston Community Loan Fund is the original incarnation of what is today known as Boston Community Capital. Created with the assistance of the Institute for Community Economics, the Loan Fund’s purpose was to provide capital to affordable housing developers in low-income Boston communities where, at that time, banks were not lending. Before a national community development system or community investing market was in place, BCC’s first investors, the only people willing and able to invest, were “a group of approximately 12 individuals and one order of nuns.”<sup>65</sup> Using community organizing techniques, hosting dinners, connecting to local religious networks, and providing countless neighborhood tours, BCC built up the BCLF from \$62,000 in 1985 to \$5.2M in 1989 from over 300 investors, primarily religious orders and community-minded individuals.<sup>66</sup>

<sup>65</sup> Jones, interview.

<sup>66</sup> *Boston Community Capital Annual Report*, 29.



During the 1990s, a combination of factors led BCC to shift its capital raising focus from individuals toward institutions. At this time, a new federal source of capital—the CDFI Fund—and modifications to the Community Reinvestment Act encouraged bank investment in CDFIs. And BCC was evolving as an organization; its new development staff was more connected to institutional investor networks than previous staff whose roots were in community organizing.<sup>67</sup> Perhaps most importantly, BCC moved toward institutional investors to curtail the marginal costs of raising capital.

Since its founding, BCC leadership has focused on its organizational sustainability and growth.<sup>68</sup> In its early years, BCC spent substantial time building relationships with hundreds of individual investors at evening meetings and on neighborhood tours. Relationship building was particularly important given that the CDFI model was new and BCC initially had no loss reserves or track record to assuage investor concerns. With time, BCC recognized that while relationship building created an important community connection, it was costly. With only five staff in 1989, time spent giving tours or visiting houses of faith, was time that could not be spent on lending or strategic planning. If BCC was to grow beyond \$5.2M, it needed to attract larger investments at lower incremental costs. This led BCC to pursue bigger fish—banks, the CDFI Fund, foundations, and financial intermediaries. The organization was extremely successful in obtaining institutional investments; after 10 years of incremental growth, the Loan Fund almost tripled in size between 1993 and 1999, growing from roughly \$7M to nearly \$20M.<sup>69</sup> Since then, the BCLF has continued to grow at a rapid pace with total assets of \$87M in 2010.

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<sup>67</sup> Jones, interview.

<sup>68</sup> Ibid.; Cherry, interview.

<sup>69</sup> *Boston Community Capital Annual Report*.

As the Loan Fund has grown, it has also diversified its lending activity beyond affordable housing to include commercial real estate, healthcare, childcare and education facilities, as well as organizational lending.<sup>70</sup>

**Table 3. Boston Community Loan Fund Net Loan Portfolio as of December 2010<sup>71</sup>**

Loan Type	Amount
Affordable Homeownership	\$15,845,969
Affordable Rental	\$17,578,303
Supportive Housing and Shelters	\$5,104,869
Commercial Real Estate	\$24,326,861
Healthcare, Childcare, and Education Facilities	\$17,282,825
Business	\$56,212
Other	\$2,474,316
<b>Total</b>	<b>\$82,669,355</b>

**Recent History of Individual Investors in the Boston Community Loan Fund**

As BCC’s capital raising focus moved away from individuals, the percent of debt capital from debt investors has declined. Investment in the BCLF remains open to all individuals, from Massachusetts or out of state, at a minimum of \$1,000.<sup>72</sup> BCC has deliberately kept this minimum investment low “because it is really important for us that individuals from the communities where we work are able to invest in the organization.”<sup>73</sup> Yet, \$1000 is the minimum amount BCLF can accept while still being cost effective. BCC issues promissory notes, paper transactions, that pay interest from 1-3% with 1-5 year maturities (shown in table 4), though some investors elect to invest for longer terms. Based on the advice of legal counsel, BCC determined its promissory notes are not securities and the Loan Fund has therefore not pursued Massachusetts securities registration.

<sup>70</sup> “Data provided by Boston Community Capital.”

<sup>71</sup> Ibid.

<sup>72</sup> Jones, interview.

<sup>73</sup> Brooks, interview.

**Table 4. Boston Community Loan Fund Note Rates**

Note Term	APR
1-3 years	1%
>3-5 years	2%
> 5 years	3%

BCC has maintained many of its original investors and continues to welcome new individuals, despite the costs of file keeping, note renewals, and communication with these smaller investors. BCC leadership chose to keep the BCLF open to individual investors, often citing the idea that “when you have individuals in with you who provide investment dollars for a particular mission, it helps you to stay true to that mission.”<sup>74</sup> Individuals invest because of their personal belief in BCC’s mission and they often know the communities and projects the Loan Fund is supporting. If BCC were to go off mission, individual investors would likely be the first to take BCC to task. In addition, individual investors are also a local constituency, who can be supportive in local political challenges and in negotiations with larger investors.

Individual investor dollars are also low cost, bringing down the Loan Fund’s average cost of capital.<sup>75</sup> Whereas the BCLF’s average cost of capital was 3.64% in 2010, most individual investor capital is at or below 3%.<sup>76</sup> Additionally, BCC’s individual investors have been quite loyal. The majority of initial individual investors have remained with the Loan Fund, which has an investor retention rate of 90%. And while most individuals aren’t multimillion-dollar investors, the median investment size of \$10,000 is well above the minimum.

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<sup>74</sup> Cherry, interview.

<sup>75</sup> Ibid.

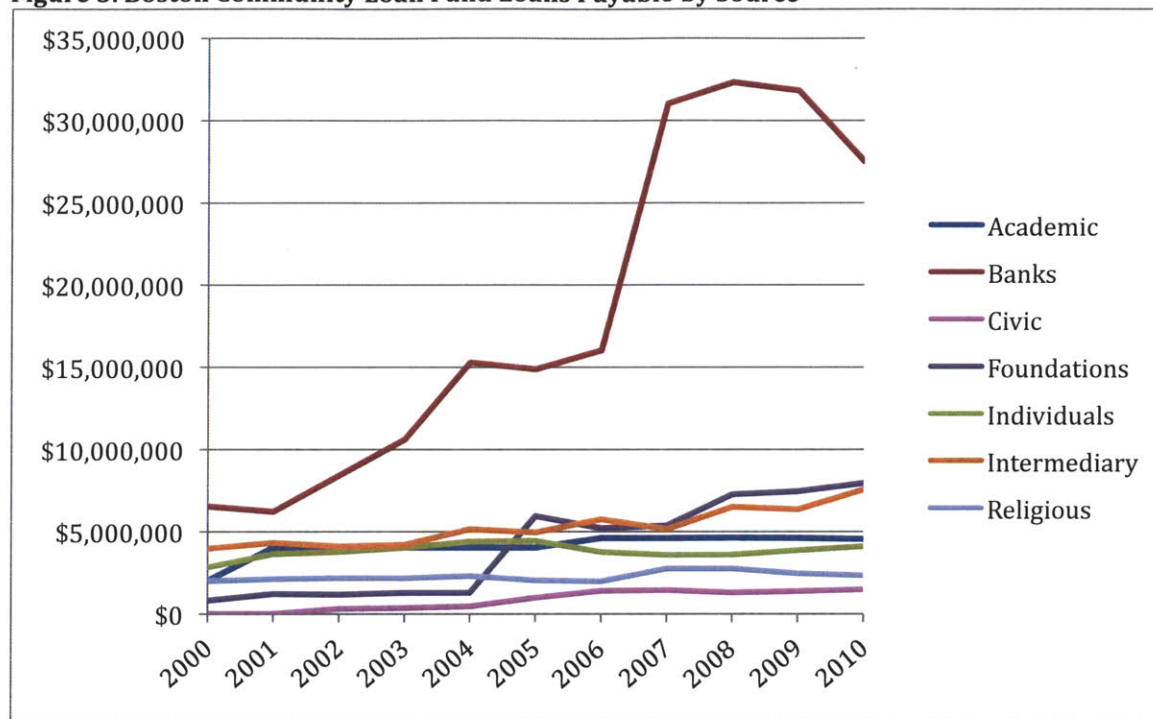
<sup>76</sup> For the limited number of individuals who have invested over \$200,000 and/or for over five years, Boston Community Capital offers slightly higher rates, negotiated on a case by case basis.

**Table 5. Individual Investments in the Boston Community Loan Fund 2006-2010**

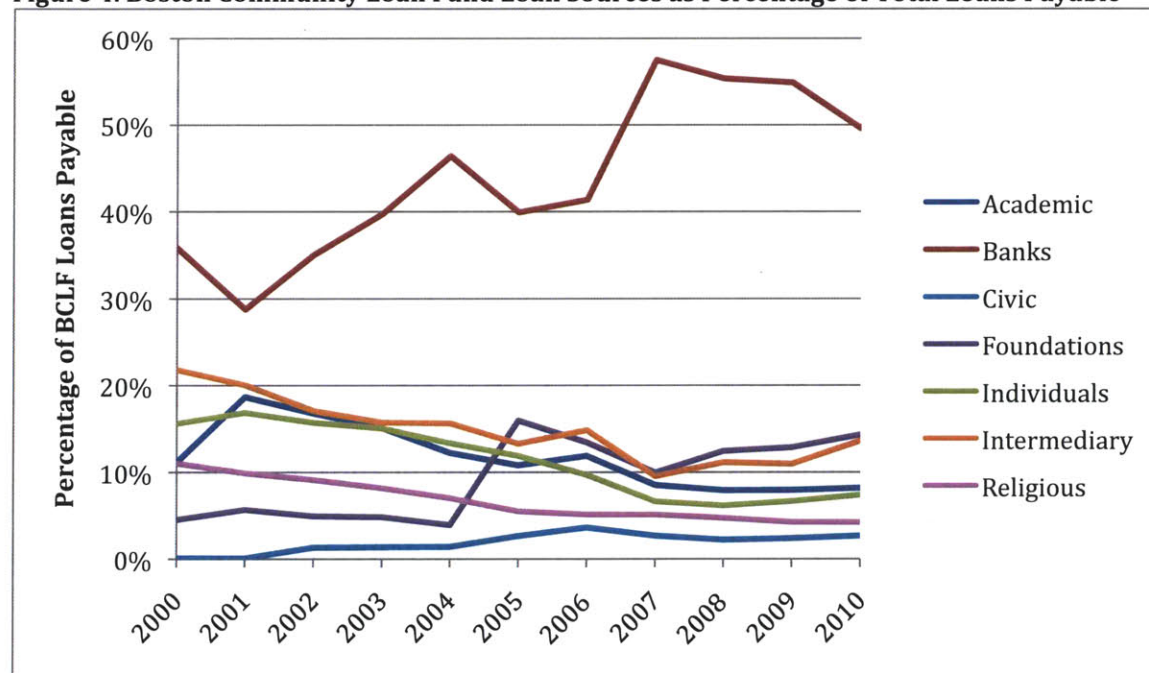
	2006	2007	2008	2009	2010
Number of Individual Investors	205	195	187	183	184
Average Investment Size for Individual Investors	\$18,348	\$18,399	\$19,270	\$21,124	\$22,299
Median Investment Size for Individual Investors	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000

Despite the fact that BCC has not actively recruited individual investors in recent years, the amount of individual investor capital in the BCLF has remained fairly steady, around \$3.8M, for past 10 years. Of course, during this time, BCC's foundation and bank investments swelled, making individuals a smaller portion of the Fund's capitalization (see figures 4 and 5) . Individuals currently account for just 7% of loans payable and 4.7% of the Fund's \$87M in total assets, putting BCC on the high end for percentage of capital invested by individuals relative to community development loan funds nationwide. That said, 7% is a 50% decline from just 10 years ago and a dramatic drop from BCC's early years when individuals were the Fund's primary source of capital.

**Figure 3. Boston Community Loan Fund Loans Payable by Source**



**Figure 4. Boston Community Loan Fund Loan Sources as Percentage of Total Loans Payable**



The BCLF story follows the trend of the broader CDLF field. Established through grassroots organizing and capital raising, as the community development system came of

age and as BCC sought to expand its impact, the organization moved toward institutional investors who could commit larger amounts for lower capital acquisition costs. BCC has, however, continued to ensure that individuals can invest and, as a result, its original community of individual investors remains a stable and low-cost component of the BCLF's assets.

In 2009, BCC marked a new era in connecting to individual investors with the development of its new foreclosure response program: the Stabilizing Urban Neighborhoods (SUN) Initiative. In the two years since SUN was conceived, BCC has raised \$26.35M of its \$50M goal from high-net-worth individuals in Massachusetts and beyond.

### **Stabilizing Urban Neighborhoods Initiative Background**

During the peak of the housing bubble, Boston Community Capital became concerned with the simultaneous upsurge of property values and mortgage defaults in the low-income communities of Dorchester, Mattapan, Roxbury, Hyde Park, East Boston, and Roslindale, where BCC had been investing for many years. Between 2003 and 2006, rents and income in these neighborhoods remained fairly level, yet the average home sales price leapt from \$159,000 to \$359,000.<sup>77</sup> BCC's research also found that over a third of new mortgages issued in these communities were high-cost loans. In 2007, BCC published a white paper on its findings about foreclosure trends and their impacts. Interpretation of this data painted a clear picture—the skyrocketing sales prices in Boston's low-income communities were enabled by unsustainable loans to low- and moderate-income people, and the emerging foreclosure crisis held the potential to wreak havoc in neighborhoods BCC had worked in for decades.

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<sup>77</sup> "REO & Vacant Properties: Strategies for Neighborhood Stabilization - Boston Fed," 116.

Recognizing the impending crisis, in 2008, BCC marshaled its own resources and a grant from the Boston Foundation to continue its analysis and formulate a response. BCC examined the titles of over 700 properties undergoing foreclosure and conducted focus groups with homeowners to better understand what types of mortgage products were resulting in foreclosure and the most common triggers for default. Based on their research, BCC derived six factors that were key to homeowners staying current on their mortgages: an appropriately priced mortgage (relative to income); a fixed-rate mortgage with level monthly payments; automatic paycheck deposits and mortgage payment withdrawals; budget assistance; capitalizing reserves up front; and homeowner education on finance and housing costs.<sup>78</sup>

BCC tested various approaches with the financial institutions initiating foreclosures in BCC's target neighborhoods. Initially, BCC examined strategies to intervene pre-foreclosure, including purchasing portfolios of non-performing loans, but found lenders unwilling to sell at prices that would enable BCC to successfully reposition.<sup>79</sup> BCC ran into similar reluctance from lenders when it proposed purchasing homes with defaulted mortgages at discounted prices through short sales. BCC finally started to gain traction with banks looking to unload properties post-foreclosure. At that point, banks were often willing to sell their REO properties at market prices, which, in the target neighborhoods, are as much as 50% below homeowners' pre-foreclosure mortgage amounts.<sup>80</sup> With this level of discount, BCC was able to design a scalable program to keep people in their homes and formally launched the SUN Initiative in early 2010.

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<sup>78</sup> Ibid., 119.

<sup>79</sup> Brooks, interview.

<sup>80</sup> "REO & Vacant Properties: Strategies for Neighborhood Stabilization - Boston Fed," 121.

## The SUN Initiative Structure

The primary goal of BCC's SUN Initiative is to stabilize communities by keeping people in their homes, avoiding the displacement of longtime residents and widespread vacancy. The SUN Initiative accomplishes this goal by purchasing foreclosed homes from banks and selling them back to homeowners. In some cases, SUN sells homes to existing tenants of foreclosed properties who are financially prepared for homeownership. BCC provides soundly underwritten, 30-year, fixed-rate mortgages to SUN participants, unless the homeowner obtains a similarly prudent mortgage product from an outside lender.

The SUN program targets the city of Revere and the Boston neighborhoods of Dorchester, Mattapan, Roxbury, Hyde Park, East Boston, and Roslindale. These six communities accounted for 83% of all Boston foreclosures between 2007 through 2009.<sup>81</sup> The SUN Initiative model works for residents who earn sufficient income to support a new fixed-rate mortgage and REO owners willing to sell at a reasonable price.; criteria that encompass hundreds of homes in BCC's target neighborhoods. As of February 2011, the SUN Initiative had deployed \$12.1M in loans to acquire 97 homes, with an additional 8 homes in contract.<sup>82</sup>

BCC uses three subsidiary entities to carry out the SUN Initiative. Aura Mortgage Advisors (Aura) is a Massachusetts-licensed mortgage lender. Using BCC's market research as a guide, Aura's standardized mortgage products and ongoing homeownership counseling are designed to support homeowner success. Aura loans are 30-year, fixed rate products with 6.5 - 7.5% interest rates. Aura mortgages have a maximum housing expense

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<sup>81</sup> Cherry and Hanratty, "Purchasing Properties from REO and Reselling to Existing Occupants: Lessons from the Field on Keeping People in Place," 116.

<sup>82</sup> Brooks, interview.



limit of 38% and a maximum debt-to-income ratio of 48%.<sup>83</sup> Aura Mortgage Advisors requires an upfront reserve of three to six months of housing expenses such as real estate taxes and property insurance. Additionally, to ensure mortgage payments are on track, Aura mortgages include automatic paycheck deposits to owners' checking accounts with same-day automatic mortgage payment withdrawals.

NSP Residential LLC is a non-profit real estate acquisition company that purchases foreclosed properties from REO owners. BCC's research found that average property values in its target neighborhoods are 59% below peak and NSP Residential's offers are typically discounted an additional 20-30% below market price due to property's distressed status.<sup>84</sup> The original homeowners or tenants then use the financing provided by Aura to repurchase their homes from NSP Residential. The NSP Residential sales price includes a 25% markup from the acquisition price; the markup proceeds are directed to the SUN Initiative's loan loss reserves as an additional level of risk management. For homeowners, NSP Residential also issues a second shared-appreciation mortgage. The second mortgage is zero-interest and zero-amortizing; its purpose is to preclude the moral hazard of homeowners intentionally going into foreclosure and entering the SUN program to "cash in" later when property values recover. Under the terms of the second mortgage, homeowners' share of the appreciation is equal to the principal balance of their Aura mortgage divided by the outstanding balance of their previous mortgage at foreclosure.<sup>85</sup>

The third entity, SUN Initiative Financing LLC, is a financing entity that acquires mortgages issued by Aura Mortgage Advisors. This LLC is the capital-raising entity for the

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<sup>83</sup> "REO & Vacant Properties: Strategies for Neighborhood Stabilization - Boston Fed," 120.

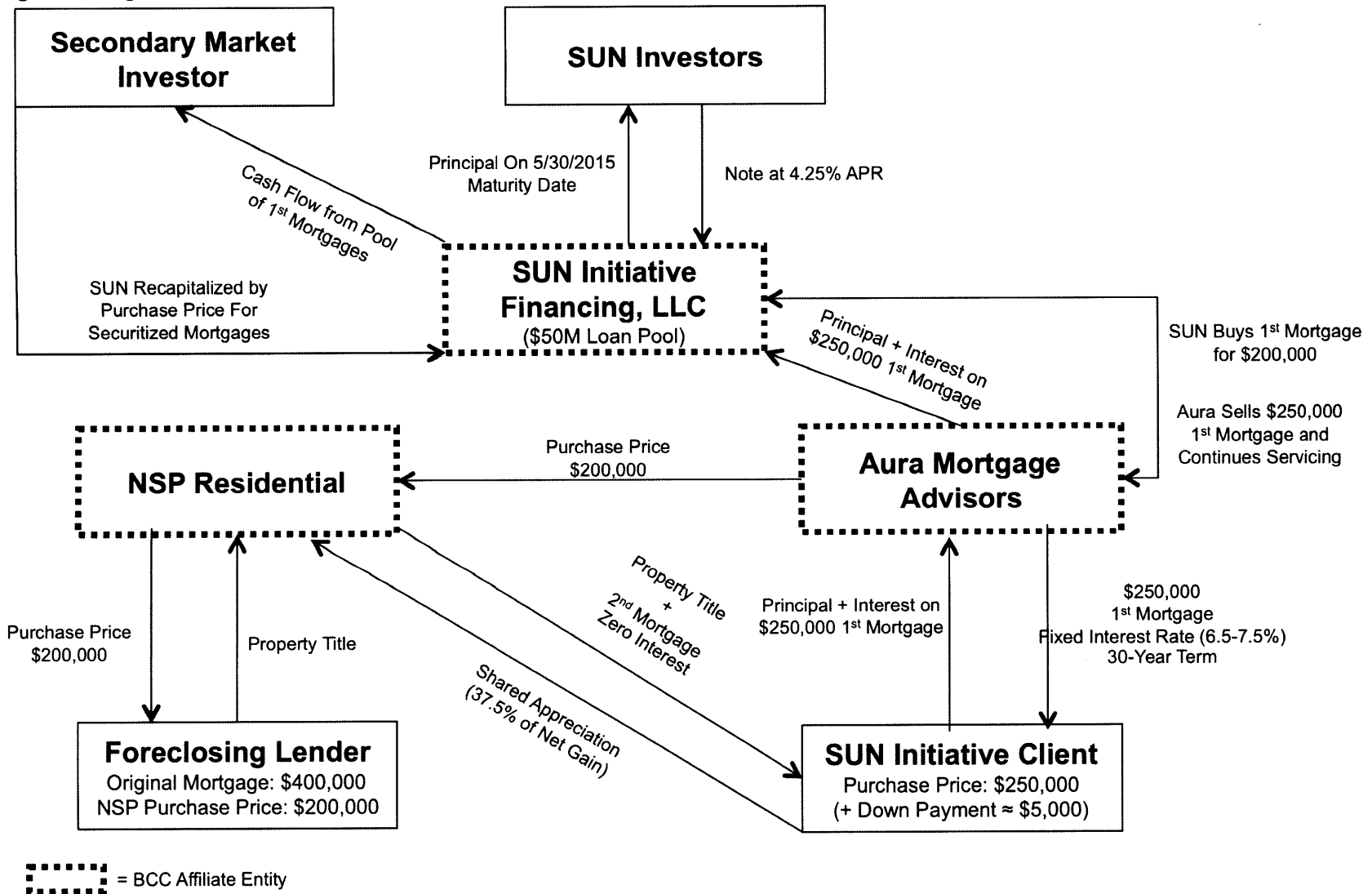
<sup>84</sup> Ibid., 118.

<sup>85</sup> Ibid., 120.

SUN Initiative. SUN Initiative Financing LLC issues non-registered notes to accredited investors at 4.25% interest with coterminous maturity date of May 30<sup>th</sup>, 2015; for most SUN investors this was a five-year investment. BCC plans to sell the SUN mortgages into the secondary market to recapitalize the SUN Initiative funds. The secondary market sale addresses two issues: the liability mismatch between SUN notes 5-year term and Aura mortgages 30-year term, and increasing the SUN Initiative's capacity, enabling the program to reach its goal of acquiring and reselling 2,000 housing units by 2015.

The following diagram illustrates how the SUN model works using a sample \$200,000 home purchase:

Figure 5. Diagram of SUN Initiative<sup>86</sup>



<sup>86</sup> Diagram adapted from Valle, "Here Comes The SUN: A Case Study of the Stabilizing Urban Neighborhoods Initiative in Boston, Massachusetts."

BCC is currently in the process of structuring its secondary market sale. Given how critical the secondary market sale is to SUN's model, BCC is keenly focused on delineating a plan for securitizing the mortgages and identifying a purchaser. BCC's leadership is currently pursuing several potential strategies—a pilot securitization with Fannie Mae or Freddie Mac and a private investment firm, as well as private placement approach with religious institutional investors or union pension funds.<sup>87</sup> BCC aims to finalize its secondary market strategy and complete its first secondary market transaction by the end of 2011.

### **SUN Initiative Capital Raise**

At the outset, BCC leadership set a goal of raising \$50M for the initiative, and aimed to do it quickly. The number of Boston home foreclosures jumped from 261 to 703 from 2006 to 2007.<sup>88</sup> If the SUN Initiative was in fact going to stabilize neighborhoods, it needed to move swiftly before evictions and property abandonment overwhelmed these communities. Armed with a compelling analysis of how the foreclosure crisis was unfolding in Boston and a carefully designed response to the challenge, BCC pursued a multi-pronged campaign to attract investments from foundations, banks, and other community development investors.

Not surprisingly, financial institutions were skittish about mortgage investments, particularly to high-risk borrowers, when housing markets and the economy at large were in disarray.<sup>89</sup> The foundations BCC approached required an extensive review process to vet the untested SUN model before making the case for a program related investment (PRI) to their investment committees or boards. PRIs are investments of a foundation's

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<sup>87</sup> Cherry, interview.

<sup>88</sup> *Foreclosure Trends 2010*, 8.

<sup>89</sup> Cherry, interview.

endowment; they are expected to support the foundation's mission and be low-risk while providing returns. As a result, foundation boards required significant due diligence periods before committing to invest in SUN.<sup>90</sup>

In the midst of BCC's capital raising campaign, the founders of a local foundation stepped forward. Though SUN did not fit the foundation's grant making activities, these individuals recognized the urgency of the problem and believed in BCC's proposed program; they decided to make a \$3.5M equity investment of their personal savings in the initiative. The family, who has chosen to remain anonymous, offered their capital to serve as first loss reserves for the fund, providing a loss cushion of at least 7% for subsequent SUN investors.<sup>91</sup>

BCC also decided as an organization to invest its own assets in SUN. In 2009, BCC leadership worked with Boston Community Loan Fund to obtain approval from its loan committee to commit \$10M in debt from the Boston Community Loan Fund. In interviews, BCC leadership framed the SUN initiative in the context of the Savings and Loan Crisis of the late '80s and early '90s and the devastating impact it had on Boston's real estate markets. Housing lending virtually froze at that time and several of BCC's lenders collapsed, forcing BCC to restructure its portfolio in the midst of a recession. BCC prides itself on making it through that crisis while preserving investor capital and maintaining the affordability of its housing investments. This was a tremendous accomplishment, but BCC management wanted to be able to do even more the next time a financial crisis arose.

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<sup>90</sup> Brooks, interview.

<sup>91</sup> \$3.5M provides a first loss reserve of 7% for the ultimate \$50M fund goal. However, given that committed funds are at a total of \$36.35, the equity currently provides a nearly 10% loss cushion.

Jessica Brooks, BCC's Director of Development and Communications described this experience and the ambition it spurred:

...We said at that time, the next time a crisis like this comes around...we want to be bigger, we want to be big enough to have an impact that's at the scale of the problem. And so, they [BCC Leadership] made a really conscious effort to build the balance sheet of the organization, to make us a sustainable organization, to make us an organization that could sort of put our money where the need was. Because that's the other thing with something like SUN, it's possible that you could have raised grant capital to get it off the ground—it would have taken a heck of a lot of time, and that was time we felt like we didn't have.<sup>92</sup>

Boston Community Capital's SUN Initiative aims to respond at scale. With the loss reserve in place and the BCLF \$10M commitment to kick things off, BCC approached individuals with an operational program to invest in. BCC leadership pitched SUN Initiative investment to local philanthropic networks and financial advisory firms and was met with enthusiasm. Many individuals were excited to be part of a solution to an endemic crisis, and financial advisors saw SUN as an opportunity for their clients to make a social impact while earning a decent return. Between early 2009 and March 2011, utilizing approximately 5% of BCC's CEO's time and 30% of BCC's Director of Communication, BCC raised \$26.35M in investment from 43 individuals.

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<sup>92</sup> Brooks, interview.

## **BCC's Success with Individual Investors**

BCC cites a few key factors that contributed to its capital raising success. Foremost is BCC's track record. BCC has worked in low-income communities for 25 years and, during that time, invested in 10,000 units of housing and created 1,400 jobs. These accomplishments built BCC's reputation as a CDFI that is effective and responsible. In addition, over the past 25 years, BCC has created several successful new entities, including the Boston Community Venture Fund and BCC Solar Energy Advantage. As such, though SUN is a new program, investors trust in BCC's organizational capability to execute.

The salience of the foreclosure crisis was also an important factor. The crisis is central to the US recession and its economic impact is ubiquitous. Many individuals were compelled by the predatory lending practices used in neighborhoods like Dorchester and wanted to use their resources to make an impact in these communities.<sup>93</sup> The media attention the SUN Initiative attracted as a model that could potentially scale nationally was also a draw for investors who wanted to be part of a wide-reaching solution to the foreclosure problem.

In addition to the moral argument, SUN investment notes are an attractive financial investment to many individuals at 4.25% APR for a medium-term note. SUN Initiative's financially conservative design was also important for high-net worth individuals and their financial advisors. On top of the \$3.5M first loss reserve, each home is sold to homeowners with a 25% mark-up on the acquisition price that funds additional loan loss reserves, further bolstering the collateral cushion for investors.

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<sup>93</sup> Johnson, interview.

BCC has gone to great lengths to make SUN a safe investment for its lenders and a sustainable product for its borrowers. In spite of the financial safety nets in place, BCC is aware of SUN's experimental nature and elected to restrict SUN investment to accredited investors. It has also been very upfront with investors regarding the uncertainty around the secondary market sale. Ultimately, though, the SUN Initiative mission and potential for scale, attracted investors despite the risks.

### **Lessons for Scaling Up**

In many ways, the story of individual investing in SUN is a return to BCC's early days and the "local capital to meet local needs" model. Similar to the 1980s, individuals stepped in where banks would not. This time around, however, individual investors were able to invest at institution-level amounts. Yet, as individuals, investors can make decisions faster than an institution's board and require less reporting. In this way, BCC is able to offer a relatively high rate of return for a community investment, 4.25%, but is able to sustain the SUN program with its 2.25-3.25% spread as a result of relatively low costs of marketing and communication with 43 individual investors. SUN has not yet reached a self-sufficiency point, but BCC estimates that later this year, when the program is lending \$3M a month, the SUN Initiative will cover its costs.<sup>94</sup>

While this model is innovative and a seemingly sustainable method for CDLFs to raise capital, the question remains: is it replicable? One consideration in replication is current market conditions. Clearly SUN's investors did not invest solely for financial returns, yet, 4.25% is a fairly competitive rate for a medium-term fixed-interest product. In better times, individuals and financial advisors might consider the low returns of

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<sup>94</sup> Brooks, interview.



community development investments too much of a sacrifice or might choose to invest at smaller amounts.

The secondary market exit for investors is also a critical but unresolved element of the SUN model. Secondary market sale will not be an option for many CDLF lending programs. The secondary market for affordable housing and other community development loans is not well developed, and it has been a challenge for the industry to standardize its loan making, a necessary prerequisite for the development of the secondary market. However, if community development loan funds were able to successfully attract large, shorter-term investors as BCC has done, the capital could be used for short-term lending activities, such as pre-development or business loans, which would preclude the need for a secondary market strategy.

In order to appeal to those high-net-worth individuals though, CDFIs will need to provide attractive investment products with conservatively underwritten portfolios. In order to access those individuals, CDFIs will have to challenge themselves to connect to local philanthropists and SRI networks and make a compelling argument for local community development investment. Realizing these steps will not be easy, but for CDLFs in locations with high-net-worth residents, BCC's success offers promise.

## Chapter 4: Calvert Foundation

### Overview

Calvert Foundation was established by Calvert Investments, a for-profit investment firm specializing in SRI. The Foundation is the manifestation of an ambition of Calvert Investments and its investors to include community investing in its SRI approach. Founded in 1976, Calvert Investments manages a range of traditional mutual funds and SRI funds wherein environmental and social impact criteria are incorporated into investment decisions alongside financial performance. Calvert SRI mutual funds eschew investments in companies that do not meet its environmental and social index thresholds. Additionally, Calvert, like other SRI investment firms, leverages its shareholder power to advocate for continual improvement of business practices in the corporations in which it invests.

In 1990, Calvert Investments sought to expand the reach of its SRI strategy by including community investing in its portfolio. Through a resolution to its shareholders, Calvert proposed committing 1% of its funds under management to community investment. The response was overwhelmingly positive, launching what would become Calvert Foundation.

Calvert Investments was limited by legal and practical constraints from carrying out its community investments in-house. Logistically, Calvert Investment fund managers did not have the expertise necessary to identify and evaluate community investment opportunities, which are typically nontraditional and unrated.<sup>95</sup> Legally, SEC daily pricing and liquidity requirements made direct investment in CDLFs difficult given that CDLF notes

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<sup>95</sup> Glenshaw, interview.

are illiquid investments that do no trade in public markets. As a result of these impediments, Calvert Investments concluded that the best way to fulfill its community investment goals was to establish a third-party community investment vehicle—Calvert Foundation.

With initial grant support from Calvert Investments and the Ford, MacArthur, and Mott Foundations, Calvert Foundation began operations in 1995. Calvert Foundation is a 501(c)3 community development financial institution. Its mission echoes that of the broader CDFI industry: “to maximize the flow of capital to disadvantaged communities in order to create a more equitable and sustainable society.”<sup>96</sup> What distinguishes Calvert Foundation is its focus on making community investment a retail investment product, available through traditional investment channels to regular people with savings. While the Foundation’s establishment was triggered by Calvert Investments’ desire to invest in communities, Calvert Foundation sought to make community investment accessible not only to Calvert mutual fund investors, but also to the broader world of retail investors.

### **Calvert Foundation Capital Structure and The Community Investment Note**

As of the end of 2010, Calvert Foundation’s total capitalization was nearly \$266M. The Foundation’s primary source of capital is the Community Investment Note (the “Note”), an investment product sold to retail investors and institutions. The Note is senior debt obligation that is currently offered with a fixed interest rate of between 0.5% and 2%, depending on the note’s maturity (shown in table 7). Investors can also choose to receive 0% interest, an option that 9% of investors select; an additional 1.2% of investors decide to donate their interest at maturity.

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<sup>96</sup> “Mission & History - Calvert Foundation.”

The note represents 83% of the Foundation’s capitalization, with an additional 4% consisting of subordinated debt and 13% in net assets from grant support, program revenues, and investment income (see table 7). Calvert Foundation’s subordinated debt, provided primarily by foundations and banks (shown in table 8), provides a capital cushion to protect investors should losses ever exceed the Foundation’s loss reserves.

**Table 6. Community Investment Note Interest Rates**<sup>97</sup>

Note Term	APR
Any maturity	0.00%
1 year	0.50%
2 year	0.75%
3 year	1.00%
4 year	1.50%
5 year	2.00%

**Table 7. Calvert Foundation Capitalization**<sup>98</sup>

Capitalization	Amount	Percent of Total
Community Investment Notes	\$219,601,875	83%
Subordinated Loans Payable	\$11,923,000	4%
Net Assets	\$34,421,035	13%
<b>Total Capitalization</b>	<b>\$265,945,910</b>	<b>100%</b>

<sup>97</sup> Calvert Foundation Community Investment Note Application.

<sup>98</sup> Calvert Foundation Community Investment Note Prospectus.

**Table 8 Calvert Foundation's Subordinated Debt Investors<sup>99</sup>**

Senior Subordinated Debt Investors	Amount
The Ford Foundation	\$750,000
Calvert Administrative Services Co.	\$1,000,000
The FB Heron Foundation	\$500,000
<b>Total Senior Subordinated Debt</b>	<b>\$2,250,000</b>
Junior Subordinated Debt Investors	
MacArthur Foundation	\$3,500,000
JP Morgan Chase	\$3,000,000
San Francisco Foundation	\$500,000
Lemelson Foundation	\$100,000
North West Area Foundation	\$500,000
The Rockefeller Foundation	\$450,000
Private Individual	\$150,000
Bank of America	\$10,000
Community Foundation Land Trust	\$500,000
Child Relief International	\$238,000
Wells Fargo	\$500,000
Oswald Family Foundation	\$125,000
Page Hill Foundation	\$100,000
<b>Total Junior Subordinated Debt</b>	<b>\$9,673,000</b>
<b>Total Senior and Junior Subordinated Debt</b>	<b>\$11,923,000</b>

**Table 9. Community Investment Note Sales Platforms<sup>100</sup>**

Sales Platform	Purchase Method	Year Launched	Minimum Investment
Definitive	Paper transaction with Foundation	1995	\$1,000
Book-entry	Electronic through brokerage account	2005	\$1,000
MicroPlace	Online at MicroPlace.com	2007	\$20

The Community Investment Note is currently available through three sales platforms: definitive, book-entry, and online at MicroPlace.com (shown in table 10). For its first nine years, Calvert Foundation sold the Community Investment Note exclusively as definitive notes, whereby investors purchased the Notes directly from the Foundation. The definitive Note is an entirely paper transaction—an investor mails in his/her application

<sup>99</sup> Ibid.

<sup>100</sup> Hollands, interview; *Calvert Foundation Community Investment Note Prospectus*.

and a check and receives confirmation of purchase in the mail. Though a cumbersome process, using this sales channel, Calvert Foundation grew from its initial \$483,860 capitalization to approximately \$95M in 2005, when electronic book-entry note sales kicked off.<sup>101</sup>

It took almost four years for Calvert Foundation to obtain required approvals and establish necessary partnerships to offer the Community Investment Note electronically. Calvert Foundation had to register the Note as a book-entry security product, or obtain registration exemption, in every state in which it would be sold. The Foundation then worked with several banks before finding an indenture trustee willing to transact the Note. As a new and nontraditional product, it was an extended process to make an indenture trustee comfortable. Calvert Foundation then had to gain entry to the electronic securities trading system from the Depository Trust Company (DTC), which regulates the electronic exchange of securities. Four years later, Calvert Foundation obtained its CUSIP (Committee on Uniform Security Identification Procedures) number, contracted with the indenture trustee, Bank of New York, found a distributor, InCapital, and became the first and only CDFI able to sell its notes electronically in 2005.<sup>102</sup>

Establishing the technical capability to sell was only half the battle. With a CUSIP number in hand, Calvert Foundation then had to convince the compliance division of brokerage firms that the Community Investment Note truly was a suitable retail product that should be available on the firm's internal platform for brokers to sell the Note to their clients. Calvert Foundation also had to convince brokerage firms that the Note is a

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<sup>101</sup> Conway, interview.

<sup>102</sup> Glenshaw, interview; Bressan and Erikson, "Catalyzing American Retail Investment in Community Development Finance: What Can We Learn From other SRI Success Stories?".

worthwhile product, despite the fact that the volume of sales of Community Investment Notes is generally lower than traditional investment products.

In the intervening years, Calvert Foundation has successfully gained entry to many investment firms, including major national financial service providers such as Charles Schwab, Fidelity, and Wells Fargo. To incentivize Note sales, Calvert Foundation offers fixed fee compensation to broker-dealers and transacting financial advisors, paid to investment firms at the time of sale. Fees range from 7.5 basis points for 1-year notes to 87.5 basis points for 5-year notes and are paid by the Foundation as part of its cost of capital. Because sales commissions are a significant portion of broker-dealers' earnings, Calvert Foundation's incentive fees, though lower than most traditional products, are key to promoting sales and to the book-entry note model.

Gross electronic sales of the Note have reached nearly \$118M in the six years since the book-entry platform was established (from 2004-2010). The Foundation's growth can be attributed to its successful outreach and marketing to the financial advising industry, particularly to advisors in socially responsible investment networks. After years of SRI conferences, articles in financial services periodicals, and one-on-one relationship building, the Community Investment Note is now available through over 400 brokerage firms, and Calvert Foundation's name is familiar in SRI circles.<sup>103</sup>

In 2007, Calvert Foundation further broadened the accessibility of its Note through its partnership with MicroPlace, a web platform for socially responsible lending. Working in collaboration with the founders of eBay and PayPal, of which MicroPlace is a subsidiary, Calvert Foundation began offering the Community Investment Note at a new low \$20

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<sup>103</sup> Conway, interview.

investment minimum online. Investors are able to select Community Investment Note programs and organizations they want to support at MicroPlace.com, enter the necessary personal information, and purchase immediately using PayPal or their checking account. In the four years since its launch, Calvert Foundation has reached gross sales of \$7M through MicroPlace. Thus far, Community Investment Note sales through MicroPlace have primarily supported international microfinance institutions with only one participating domestic CDFI, ACCION Texas.<sup>104</sup>

### **Community Investment Approach**

Calvert Foundation lends the proceeds from the Community Investment Note to a portfolio of 250 community development organizations and social enterprises globally. Geographically, approximately 60% of the Foundation's portfolio is invested domestically and 40% internationally. Note proceeds are invested most heavily in domestic CDLFs, which represent 38.5% of the portfolio, followed by international microfinance at 29.5%, community development depository institutions at 13.5%, affordable housing developers at 7.5%, with the remaining 11% invested in social businesses, the secondary community development market, and diverse higher-risk community development deals under the Foundation's "Mission Plus" program.

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<sup>104</sup> "Data provided by Calvert Foundation."



**Table 10. Calvert Foundation Investments by Borrower Type<sup>105</sup>**

Sector	Borrower Type	Percentage of Total Investments*	Percentage of Total Investments*
Affordable Housing	Community Development Corporations	2.0%	7.5%
	Developers	5.5%	
Community Development Loan Funds	Small Business Lenders	32.0%	38.5%
	Affordable Housing Lenders	6.5%	
Community Development Depository Institutions	Community Development Banks and Credit Unions	13.5%	13.5%
Fair Trade	Fair Trade	1.0%	1.0%
International Microfinance	Direct	13.0%	29.5%
	Indirect	12.5%	
	Network	4.0%	
Non-traditional investment	Community Development Securities	4.5%	4.5%
High-Impact Community Development Deals	Mission Plus	1.5%	1.5%
Social Enterprise	Social Enterprise	4.0%	4.0%
<b>Total</b>		<b>100.0%</b>	<b>100%</b>

\*Percentages dollar weighted. Accurate as of 12/31/10.

Calvert Foundation’s portfolio is the manifestation of their mission to provide capital to disadvantaged communities and the types of community development organizations that have a demand for debt capital—CDFIs and MFIs have a continuous need for debt capital to sustain and expand their lending. But, a few exogenous factors shape how the specific distribution of investments has evolved. First, Calvert Foundation must keep at least 60% of its investments in domestic community development in order to maintain its status as a CDFI with the US Treasury Department and thereby its eligibility for federal CDFI Fund dollars.<sup>106</sup> Second, the Community Investment Note is meant to be a

<sup>105</sup> Ibid.

<sup>106</sup> Kuchar, interview.

security for everyday investors to hold; for that reason, Calvert Foundation takes a variety of measures to ensure that its portfolio is low-risk.

Loans to CDLFs and Microfinance Institutions are backed by borrowers' entire balance sheets, rather than a single project or borrower organization. As a result, investments in financial institutions are inherently diversified and lower-risk, which is why these borrowers make-up the majority of Calvert Foundation's portfolio. Community development banks and credit unions, also a large portion of the Foundation's portfolio, are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration and are therefore extremely low-risk investments. The low-risk profiles of these borrowers enable Calvert Foundation to simultaneously meet its mission and ensure that the Community Investment Note remains an investment appropriate for retail investors.

Calvert Foundation's loan terms also reflect its desire to meet the needs of its community borrowers while managing risk. The Foundation typically makes general recourse loans at 2-5% interest rates, with an average interest rate for domestic borrowers of 3.92%.<sup>107</sup> Calvert Foundation loans have 3-5 year bullet maturities with semi-annual interest-only payments. Loans are senior debt, but unrestricted; borrowers have flexibility to use the capital to lend to organizations and individuals in need, irrespective of geographic or program restrictions. This flexibility can be a great benefit to CDLFs whose other sources of capital, CRA-motivated banks or foundations, often place programmatic and/or geographic limitations on the use of their capital. However, Calvert Foundation

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<sup>107</sup> Ibid.; "Data provided by Calvert Foundation."

requires senior position and general recourse to an organization's balance sheet in an effort to minimize its own risk.

As another risk management mechanism, Calvert Foundation maintains a diversified investment portfolio, similar to a mutual fund. Loans must be less than 10% of the borrower's total assets and no more than 5% of Calvert Foundation's assets, with a maximum loan amount of \$4M.<sup>108</sup> The average loan size is \$850,000 and usually well below 10% of a borrower's total assets.<sup>109</sup> As such, Calvert Foundation's investments are widely distributed, and its exposure to any single organization is limited.

Calvert Foundation also maintains loan loss reserves for every loan issued. Loss reserve levels are based on industry standards and differing historic default rates among types of lending: the Foundation maintains 3% reserves for CDLFs, 5% on loans to affordable housing developers and MFIs, and 20% on loans to non-traditional or "mission plus" borrowers. Over its 15-year history, Calvert Foundation's actual losses have been approximately 1%.<sup>110</sup>

The final, critical element of Calvert Foundation's risk management is its due diligence process. Before issuing a loan, the Foundation evaluates every borrower using its proprietary risk rating model. Initial evaluation includes a 40-60 page due diligence report, which is updated on an annual basis. The Foundation only lends to organizations that have been in business for at least three years and have net assets in excess of the potential loan amount.<sup>111</sup> After loans are issued, borrowers are required to provide quarterly financials so

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<sup>108</sup> Conway, interview.

<sup>109</sup> Kuchar, interview; Conway, interview.

<sup>110</sup> "Community Investment Note - Calvert Foundation."; Conway, interview.

<sup>111</sup> "Lending Criteria - Calvert Foundation."

the Foundation can keep tabs on every borrower’s financial health.<sup>112</sup> Calvert Foundation’s due diligence and monitoring practices are a central and highly time intensive part of its business.

### Community Investment Note Sales and Investors

Currently, definitive notes make up the majority of Calvert Foundation’s \$228M in outstanding Community Investment Notes (shown in table 12). MicroPlace draws far more unique individual investors, but remains the smallest source in terms of dollars invested.

**Table 11. Community Investment Notes Outstanding by Sales Platform<sup>113</sup>**

Sales Platform	Notes Outstanding as of 12/31/10	Percentage of Outstanding Notes	Number of Unique Investors	Notes Outstanding/Number of Investors
Definitive	\$144,252,000	63%	2,082	\$69,285
Book-entry	\$80,318,000	35%	>1,000	Unknown
MicroPlace	\$4,006,000	2%	5.606	\$715
<b>Total</b>	<b>\$228,576,000</b>	<b>100%</b>	<b>8,688</b>	

While individuals make up the overwhelming majority in terms of numbers, approximately 80% of definitive note capital comes from institutional investors. Calvert Foundation does not receive data about what entities purchase book-entry notes, so the type and number of investors are unknown for book-entry sales; but, Calvert Foundation is aware that there are over 1,000 book-entry note holders. However, to get an understanding of what portion of Calvert Foundation investments come from individuals, I’ve assumed that two-thirds of book-entry notes and all MicroPlace notes are all held by individuals in

<sup>112</sup> Conway, interview; Kuchar, interview.

<sup>113</sup>The \$228,576,000 total notes outstanding figure includes approximately \$9M of Community Investment Notes held by Calvert Foundation’s affiliated donor advisors. In Table 9, Notes held for donor advisors are counted as net assets rather than Community Investment Notes. As a result, the total Notes outstanding figure is around \$9M higher in Table 12 than in Table 9.

table 13 below.<sup>114</sup> This may overestimate individual investors' share of notes, as the proportions of book-entry notes held by institutions may be higher, but this estimate can be considered the upper bound of what individuals have invested.

**Table 12. Percentage of Community Investment Notes Investment Held By Individuals**

Sales Platform	Currently Outstanding	Percent Attributed to Individuals	Amount of Outstanding Notes Attributed to Individuals
Definitive	\$144,252,000	20%	\$28,850,400
Book-entry	\$80,318,000	67%	\$53,545,328
MicroPlace	\$4,006,000	100%	\$4,006,000
<b>Total</b>	<b>\$228,576,000</b>	<b>38%</b>	<b>\$86,401,728</b>

While the Community Investment Note is designed for the retail investor, individuals less than half of Calvert Foundation's investments. Still, having 38% of capital from individuals distinguishes Calvert Foundation from typical CDLFs, which have only 1-7% of capital from individuals. Yet, it is remarkable that institutional investors play such a large role in the only community development investment product designed for the retail market.

The volume of institutional investors is less surprising, however, upon consideration of Calvert Foundation's history. The Foundation was created, in part, as a means for Calvert mutual funds to invest in community development. As a retail security with a daily price that is available for sale nationally, the Community Investment Note can be easily incorporated into other mutual fund or financial institution's portfolios. The Note provides an "easy in" for institutions that are interested in community investing, but do not have capacity to underwrite community investment deals in-house. Community Investment Notes are also relatively simple ways for Foundations interested in impact investing to do

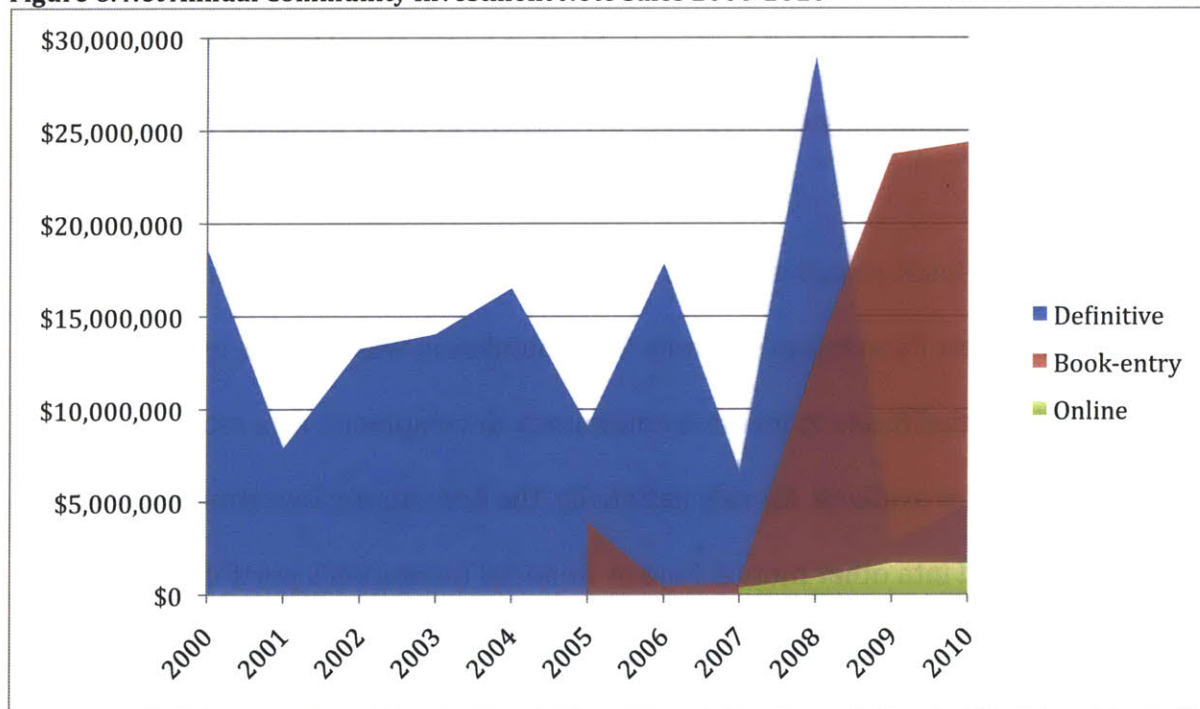
<sup>114</sup> The 67% assumption accounts for large institutional book-entry note holders that Calvert Foundation is aware of, but does not take into account other institutional book-entry purchasers that have not directly provided Calvert Foundation information on their investments.



so. In fact, Calvert Foundation describes Community Investment Notes as “PRI in a box” on their website.<sup>115</sup>

Still, the fact that the only CDFI with a retail investment product available for electronic and online sale, even with some 8,000 investors has received only \$86M in investments from individuals nationwide, less than half of its loans payable, underscores the challenges of accessing and working in the retail investor market. It also calls into question the multi-billion dollar estimations of the individual investor market for impact investing. However, looking at net note sales over the past 10 years, we see that book-entry sales, presumably to retail investors, have doubled since 2008 while definitive sales have dropped off.

**Figure 6. Net Annual Community Investment Note Sales 2000-2010**



Similar to the experience of BCC and the SRI market more broadly, individuals’ interest in Community Investment Notes seems to have jumped during the recession. This

<sup>115</sup> “Program-Related Investing - Calvert Foundation.”

spike supports the idea presented by the Monitor Institute’s “Investing for Social Impact” report, the wake of the financial crisis may indeed be a “transitional moment” for impact investing and, consequently, the community investing industry.

## **Lessons for Scaling Up**

Calvert Foundation overcame numerous upfront barriers to establish itself as the retail community investment product it is today. After Calvert Foundation dedicated years to developing the Note and the Foundation’s investment model, it then had to obtain approval of state securities regulators, which in many cases was a drawn out process given the Community Investment Note’s nontraditional nature.<sup>116</sup> Securities regulation was not only an upfront challenge, but is also an ongoing expense for the Foundation. Annual filing and registration with state regulators is a lengthy, costly process for the Foundation every year.

Perhaps the most complex hurdle Calvert Foundation overcame, the only CDFI to do so as of yet, is the ability to offer the Community Investment Note electronically as a book-entry note. While one would hope that the process of DTC approval and securing a distributor and indenture trustee would be shorter for the next CDFI given Calvert Foundation’s groundbreaking work, only a small number of very large CDLFs might be able to take on that kind of infrastructure-building work. In fact, leveraging its niche expertise, Calvert Foundation created a subsidiary, Community Investment Partners, which provides fee-for-service regulatory navigation and investor management services for other CDLFs looking to offer retail investment products. However, Calvert Foundation’s Community Investment Note remains the only product offered electronically.

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<sup>116</sup> Glenshaw, interview.

The economies of scale that are achieved on the “money in” side (as more investors buy Community Investment Notes through the financial advisor network the Foundation has built) are not reflected on the lending side. Virtually every staff member interviewed cited due diligence and transaction costs of small loans as an inhibitor of the Foundation increasing its self-sufficiency, though these ongoing expenses are critical to Calvert Foundation’s model. Every new loan necessitates an extensive initial due diligence process, followed by quarterly financial reports and annual report updates. While ratings such as CDFI Assessment and Rating System (CARS) were developed to aid in evaluating a CDFI’s financial health, Calvert Foundation, like most in the community investing field, believes it necessary to conduct its own due diligence and rating process. This, however, requires a staff of 18 investment officers and risk managers. These staff members spend a portion of their time working on lending for Calvert Foundation’s affiliates, but most of their time is dedicated to Calvert Foundation business. Calvert Foundation leadership note that working with fewer borrowers and/or making larger loans would cut costs, but that would decrease Calvert Foundation’s diversification and narrow its impact, which would be contrary its mission.

Calvert Foundation also boasts a six-person sales and marketing team, which has successfully promoted community investment broadly and established the Foundation amongst financial advisors and investment managers in the SRI field. To date, Calvert Foundation has not carried out large scale direct marketing to retail investors, but has instead worked extensively with financial advisors, who act as intermediary connections to their retail client base. Penetration of the retail investment market has proven difficult, but



the recent years of growth in book-entry sales suggest that Calvert Foundation's years of industry building are paying off.

On top of the substantial logistical and marketing challenges, the marginal costs of being in the retail securities market are substantial and a central consideration in scaling up this model. Calvert Foundations pays investors 2.05% interest and charges 4.4% on average, leaving a 2.35% spread to cover costs.<sup>117</sup> This is a very tight spread considering that CDLFs are operating roughly on a 3-5% spread. Calvert Foundation's average interest paid to investors has been declining over the past two years, when the Foundation shifted from 0-3% to 0-2% interest rates on its Notes. However, the Foundation has maintained roughly the same spread as it is simultaneously decreasing average interest rates on loans from 4.5% to closer to 4%.<sup>118</sup> Calvert Foundation has made these interest rate shifts in order to provide more attractive capital to its community borrowers.

For electronic sales, Calvert Foundation's spread has to cover brokerage fees and transactional costs, which range from 20-100 basis points.<sup>119</sup> In other words, the cost of being in the book-entry market leaves Calvert Foundation with only a 1.35-2.05% spread to cover all of aforementioned operational costs like marketing, underwriting, and loan loss reserves. In this light, the value of definitive note investors becomes clear. Such tight margins also highlight another barrier for other CDLFs to follow Calvert Foundation's path into the retail market.

Calvert Foundation is an important resource to its CDFI and MFI borrowers; the Foundation provides a stable stream of unrestricted capital to CDFIs and MFIs, particularly

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<sup>117</sup> "Data provided by Calvert Foundation."

<sup>118</sup> Conway, interview.

<sup>119</sup> "Data provided by Calvert Foundation."

valuable in recent years. In creating the first and only retail community investment product, Calvert Foundation has attracted individuals and institutional investors who might not otherwise have been able or inclined to invest in community development. However, the regulatory barriers and marginal costs of making the Community Investment Note available to retail investors are a caution for other loan funds contemplating this model.

## **Chapter 5: Paths Forward**

### **Boston Community Capital and Calvert Foundation as Models**

In this thesis, I set out to explore the possibility for individual households to become a more substantial source of debt capital for community development loan funds. I examined two case study organizations that have had great success raising capital from individuals for community development, using distinctive approaches. Boston Community Capital has attracted individual investor capital through non-security promissory notes; in their early years, as small investments from community members and most recently as large investments from high-net-worth individuals for the SUN Initiative. Calvert Foundation has attracted capital from individuals nationwide, through Community Investment Notes, securities designed for the retail investor and registered with state regulators. Calvert Foundation is something like a community investment mutual fund, raising capital from many individuals, pooling it, and investing it in a large portfolio of CDLFs, MFIs and other community development organizations. Community Investment Notes are functionally similar to traditional investments and can be purchased electronically by brokers.

Calvert Foundation and Boston Community Capital's distinctive approaches can be viewed as different paths forward for CDLFs to access individual investors and broader capital markets. Each approach reaches different markets, through different means, with different costs. BCC and Calvert Foundation's models are not the only methods to tap into the individual investor market, but provide illustrations of options for CDLFs looking to connect to individual investors.

## Different Products, Different Investors

**Table 13. Boston Community Capital and Calvert Foundation Individual Investment Products**

Loan Fund	Calvert Foundation	Boston Community Loan Fund	SUN Initiative LLC
Size of Fund	\$228.6M	\$87M	\$42.4M
Amount from Individuals	\$86.4M*	\$4.1M	\$26.4M
Product	Community Investment Note	Promissory Note	Promissory Note
Return	0-2%	0-3%	4.25%
Term	1-5 years	1-5 years	5 years
Registered Security	Yes	No	No
Electronic Sale	Yes	No	No
Risk	Low	Medium	High
Geography of Investors	National	Primarily local	Primarily local
Marketing Channel	Financial Advisors	Word of mouth	Local philanthropists, local financial advisors
New Investors Reached	Retail investors, high-net-worth individuals, mutual funds, corporations	Retail investors	High-net-worth individuals

\* Approximate

As illustrated above, the terms of the products offered by BCC and Calvert Foundation are largely similar. They are all short-term, illiquid investments with relatively low, fixed returns. The key factors that distinguish these products and thereby marketing strategies and pool of investors are: risk, security registration, and electronic sale.

One could argue that Calvert Foundation and the Boston Community Loan Fund are both low-risk given that both funds have historic loss rates of less than 1%. However, Calvert Foundation's layered risk management strategies make it the lowest risk product of the three. The Foundation's loss reserves, thorough underwriting, and diversification practices significantly mitigate credit, sector, and geographic risks. While no SUN Initiative

borrowers have defaulted as of yet, the program is clearly a higher-risk investment. BCC has put several risk mitigation measures in place, including substantial loss reserves and conservative underwriting standards. But, the initiative has a short history, about 18 months, and is working with homeowners who have known credit problems. Also, the program is geographically concentrated by design. The differing risk profiles of each product have implications on the types for investors willing to invest. As lower-risk products, Calvert Foundation and the Boston Community Loan Fund are able to attract retail investors. The SUN Initiative is not intended for the everyday investor, but rather for high-net-worth individuals interested in social impact.

The fact that Calvert Foundation registers the Community Investment Note as a security in every state where it is required and notifies securities regulators in the remaining states, gives the Foundation the ability to market and sell Notes nationwide. The capacity to make sales electronically further expands Calvert Foundation's reach, but is predicated on the Note being a registered security. Together, these two features facilitate sale of the Community Investment Note by brokerage firms throughout the US. BCC's products, on the other hand, are non-security investments and its marketing is primarily focused on local individuals and investment firms.

The Community Investment Note's low risk profile and likeness to traditional investment products has also enabled Calvert Foundation to access a broader set of investors in the capital markets than individual households. As a note with a CUSIP number and a daily price, mutual funds, financial institutions, and foundation endowment managers can more easily add Community Investment Notes to their portfolios than they can underwrite an investment into a CDLF or design their own community development

investment strategy. While institutional investors are not the focus of my research, this is a fundamental distinction between the Community Investment Note model and a “local capital for local needs” approach like BCC’s. As I noted in Chapter 1, individual investors are just one new potential source of capital for community development loan funds. CDLFs are also looking at ways to access pension funds and broader capital markets, and Calvert Foundation’s Community Investment Note model brings CDLFs closer to that goal.

BCC attracts significant investment from financial institutions, but primarily from long-time community development investors: banks motivated by CRA and religious institutions by their values. Institutions like mutual funds and corporations, however, have no legal or values-based obligation to make community investments and generally lack the underwriting capacity to make such investments. Consequently, these sources are largely untapped by the CDLF field. The ease and low-risk of purchasing a Community Investment Note lowers the bar of entry to CDLF investing to these institutional investors without a history of community investment, who may be newly interested in the social or impact investing movement. Of course, as detailed in my review of Calvert Foundation’s product development and ongoing costs, there is a price for access to wider capital markets. This trade-off between size of markets accessed and the cost of reaching those markets, is a key consideration for the CDLF field as it considers diversifying its sources.

### **Evaluating the Costs**

The Boston Community Capital model, “local capital for local needs,” is the fastest and lowest cost route to individual investors. Within this model, BCC provides two approaches: focusing on high-net-worth individuals or opening up investment to the

broader community. Limiting investment to high-net-worth individuals is the most straightforward path for CDLFs: it does not require securities registration or the associated legal costs, and soliciting high-net-worth individuals is similar to the capital raising CDLFs currently do with banks, foundations, and other institutional investors. BCC did not undertake a major marketing campaign, so its expenses were the portion of time invested by two staff members leading the capital raise. As a result, BCC's acquisition cost for the \$26.4M of individual investment in SUN is likely well under 1%.

Working with retail investors is a costlier and less familiar endeavor for many CDLFs. My research did not include detailed information on BCC's capital raising costs from individuals in its early days. But, a comparable CDLF and leader in individual investor capital raising, the New Hampshire Community Loan Fund, has the equivalent of two full time staff managing their marketing and communications for \$11M in investments from over 300 individuals.<sup>120</sup> This level of staffing is probable for a CDLF planning to launch a new individual investor capital raising strategy. While two full-time staff is not insignificant, NHCLF's estimates that their capital acquisition cost ranges from 1.5%-5%, which seems reasonable considering an individual investor renewal rate of 95%.<sup>121</sup>

Calvert Foundation's model of creating a retail investment product registered and available nationwide is a far more complex endeavor. It is difficult to price the upfront time and expense used to develop the Community Investment Note, register it nationwide, or the near four year process to sell the Note electronically. But, it is safe to say that creation of any similar product would require senior staff time, likely for well over a year, and substantial legal costs. Beyond the upfront cost, though, is the associated marketing

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<sup>120</sup> "Raising Capital with an Individual Investor Strategy: the Ins and Outs."

<sup>121</sup> Ibid.

required to reach out to the general public and the logistics of having tens, hundreds, or thousands of individual investors. Calvert Foundation has a team of six full-time staff to manage their national marketing and sales for its 8,000+ investors. Another loan fund pursuing a retail investor market might not need that level of staffing, if it did not take on the industry building and national scope that Calvert Foundation has. However, a conservative estimate of \$300,000 in ongoing annual registration, sales, marketing, and administration costs suggests that only the handful of large loan funds operating at a national scale could take on the development of a retail investment product. In fact, only two loan funds currently offer individual investment products on a scale close to that of Calvert Foundation—RSF Social Investment Fund (\$76.9M total assets) and Enterprise Community Loan Fund (\$176.3M total assets)—but neither is available electronically or in as many states as the Community Investment Note.

Beyond the upfront establishment and ongoing operational costs, the three note products—definitive, book-entry, and online—present three sales mechanism options with differing ongoing transactional costs. The book-entry note can reach the broadest spectrum of individual investors, but is also the costliest means of sale. The great advantage of electronic sales and marketing through financial advisory firms is that it enables Calvert Foundation to tap into the existing household investment infrastructure. However, the cost of capital from book-entry notes is higher than most CDLFs are seeking. Calvert Foundation currently spends between 20-100 basis points to be in the book-entry market on top of an average of 2.32% interest to individual investors, for a total cost of capital 2.55-3.32% exclusive of the marketing and operations costs discussed above.



In addition, it is unclear if a single CDLF, even a large organization with good credit history and significant loss reserves, would be permitted by the DTC or major investment firms to sell electronically. Calvert Foundation spent significant time explaining how the Community Investment Note is an appropriate retail investment product, first to the DTC and then to national investment firms. A single CDLF, without the diversification and secondary layer of underwriting and loss reserves that Calvert Foundation brings, would likely face serious difficulty convincing DTC and financial service companies that its notes were suitable retail investment products.<sup>122</sup>

Online note sales are similarly costly. MicroPlace charges a 1% listing fee for CDFIs or MFIs to raise capital through their online platform. Calvert Foundation passes this cost along to borrowers listed on MicroPlace so it does not detract from the Foundation's spread. Nevertheless, the listing fee is a substantial ongoing cost for access to the online market. However, the lower marketing and communications for online sales could make it more financially feasible for a CDLF interested in entering the retail investor market.

The definitive note does not face the 20-100 basis point cost of being in the market, but the trade off is the cost of handling paper transactions internally. Despite this trade-off, definitive notes are likely a more feasible approach for CDLFs without the capacity to go through the electronic sale process. However, as a paper transaction in a world of electronically traded products, the definitive note does not facilitate access to capital individuals have placed with large financial services firms. An individual can purchase definitive notes from Calvert Foundation or direct his or her independent broker to buy a definitive note, but it is a cumbersome process that does not provide incentive to advisors

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<sup>122</sup> Glenshaw, interview.

to sell community investment to their clients. Despite these shortcomings, as a low-cost source of capital with low ongoing renewal and reporting costs, it could be a better match for CDLF capital needs.

### **Implications for Scaling Up Individual Household Investment in CDLFs**

In the near term, local individual investor programs are the most promising options for CDLFs to access individual capital in a way that is relatively fast and affordable to implement. Reaching out to high-net-worth individuals is the easiest and least costly path. But for states that do not require CDLFs to register their notes as securities, reaching out to a broader group of investors could also be worthwhile. Surely, much of BCC's success in raising capital for the SUN Initiative is due to the salience of the US foreclosure crisis and the national attention that SUN has received. However, organizations like New Hampshire Community Loan Fund and the Vermont Community Loan Fund have attracted significant investment from individuals without such high-profile programs and with similarly small scale staffing.

Within our current policy framework, the replication of Calvert Foundation's model does not seem to be a sustainable way to connect CDLFs to individuals. Calvert Foundation is like an intermediary of intermediaries, meaning that multiple organizations are subsisting on the 4-8% spread between community development investors and the ultimate community borrowers. For Calvert Foundation, this means very slim margins, an average of around 2.5% or closer to 1.5% for book-entry note sales. And for CDLFs this means loans that are expensive relative to their other sources. While all of the Calvert Foundation borrowers that I spoke with felt that the Foundation was a loyal investor that

shared their mission, all noted that Calvert Foundation loans are amongst the most expensive capital they have. Calvert Foundation capital is best suited for the portion of CDLF lending that is higher interest, but would be a problematic source to expand when CDLF business models are based on 3% weighted average cost of capital.

Policy interventions that would lower the costs of being in the retail market (such as nationwide exemption from securities registration or subsidized transaction costs) or that lower the cost of capital (like tax incentives for CDLF investment or the CDFI Bond Program) would make replication of Calvert Foundation's model more financially sustainable and even necessary to absorb new investor capital. Analysis of these policies falls outside of the scope of my thesis research, but it is safe to say that any such policy would not only fuel Calvert Foundation's growth, but also greatly expand the base of investors for the entire CDLF field.

In my view, the most promising element of Calvert Foundation's model is how it has brought the CDLF industry closer to broader capital markets: financial investment firms, corporations, mutual funds, and potentially pension funds. The intermediary of intermediary approach of Calvert Foundation and its affiliate, Community Investment Partners (CIP), is a very promising model for directing institutional investments from the capital markets to CDLFs. Institutions interested in community investing can easily make large definitive note purchases at a very low transactional cost to Calvert Foundation, or, if they are interested in more specialized investing, place capital under the management of CIP, which utilizes the infrastructure developed by Calvert Foundation to lend to CDFIs and MFIs worldwide. The most prominent example of this is the Communities At Work Fund, wherein Citibank put up \$200M in fall 2010 to fund an economic development fund,

managed by CIP. In both cases, intermediation enables a large investment from the capital markets, but unlike retail channels, does not incur high transaction or marketing costs.

## **Recommendations**

The volume of capital raised by Boston Community Capital and Calvert Foundation, in addition to the eight CDLFs profiled in Chapter 2, is strong evidence that individual households are and can be a stable source of low-cost capital for community development loan funds. More importantly, for BCC, Calvert Foundation, and three of the other CDLFs surveyed, the level of investment increased since 2008 when CDLFs most needed it. For loan funds looking to diversify their sources of capital, individuals could play an important stabilizing role during economic downturns. Another notable advantage cited by BCC, Calvert Foundation, and virtually every other CDLF staff person interviewed, is the low reporting costs for individual investors. While the initial costs of attracting individual capital may be higher than foundations or banks, individuals have no specific reporting requirements, so ongoing communication is very low-cost. Given these benefits, individual households are a market that individual community development loan funds and the field at large should pursue.

CDLFs in states with favorable securities regulation policies should consider opening investment in their loan funds to retail investors. Each CDLF will need to evaluate the product and approach most appropriate for its organization. But Boston Community Capital as well as the survey of individual investor products provide guidance. Promissory notes with \$1,000 investment minimum and 1-3% interest rates are attractive investments for many social investors that can also fill CDLFs' demand for low-cost debt capital.

Marketing and communications likely require one to two full-time staff. Consequently, if a CDLF aims to keep its capital acquisition cost down around 1-2%, an individual capital raising effort is only worthwhile if a CDLF believes it can attract at least \$5M.

For CDLFs in states with more restrictive securities regulation or wary of opening investment to the general public, capital raising from high-net-worth individuals is low-cost and a potentially substantial new source. CDLFs can capitalize on the growing popularity of social investment, the idea of investing for good, to attract individuals who may not associate themselves with traditional SRI investment. Additionally, Boston Community Capital has illustrated the role that philanthropists can play in scaling up community development investment. As individuals with an explicit interest in community improvement, philanthropists are a logical market of potential CDLF investors. CDLF investment can be presented as a new way of leveraging wealth for social benefit.

High-net-worth individuals could not only support CDLFs' ongoing lending activity, but could also support new initiatives. Clearly, not every CDLF is going to launch a program on the scale of SUN. But, if a CDLF has identified a community development finance demand that is unaddressed by its current financing sources, individual investors could provide a way to capitalize a fund dedicated to a more specialized need. This is beneficial to community borrowers who might otherwise go unserved and to CDLFs, as new funds or lending strategies could draw new high net worth individuals to invest.

The community development loan fund industry should support CDLFs connecting to individual investors by raising public awareness of CDLF investing and providing technical assistance. The major upfront challenge that all CDLFs face in raising capital from individuals is the lack of awareness and understanding of community investing in the

general public. Calvert Foundation has made significant headway addressing this challenge through its industry building and education work, particularly with the financial advisers. However the CDLF industry would be well served by developing unified messaging about what community development loan funds are and how investing in them works. If a central organization, like Opportunity Finance Network, (OFN) created well-designed language and materials to inform the general public about CDLF investing, the industry as a whole would benefit.

A website to promote community investing as well as a directory of CDLF investment opportunities is also desperately needed. Currently, OFN's materials are directed to stakeholders within the CDFI field. Until recently, there had been a "Community Investing Center" site supported by the Social Investment Forum and Green American that provided basic information on CDFI investment, but it was poorly organized and appears to have been shut down. This lack of unified language and online presence is a missed opportunity for the sector.

To facilitate entry into the individual investor market, OFN or another community investing advocacy organization could also develop a guide for interested CDLFs, which would include the considerations I have mentioned, such as information on securities regulation, and provide template promissory notes and note terms. Currently, Calvert Foundation's affiliate, Community Investment Partners, appears to be the only organization equipped to provide that type of support.

And finally, the industry should support the creation of intermediaries like Calvert Foundation as a bridge to the capital markets. Despite CDLF efforts to connect to the capital markets, there are still a variety of systemic changes needed for the industry to align with

traditional investing practices. The Carsey Institute's Financial Innovations Roundtable's study on this issue finds that "standardization of technology, reporting, and analysis" across the industry is a precondition of access to capital markets.<sup>123</sup> Community development loan funds need to continue working toward that goal, but are not there yet. Intermediaries like Calvert Foundation, that create more traditional investment products and reduce risk through due diligence and diversification, could attract investment from new institutional investors interested in social impact like investment firms or foundations without prior community investment experience. Focusing on institutional investors would reduce the sales and marketing costs and potentially underwriting costs as the investment product would no longer need to meet the standards of a retail investment. As discussed in Chapter 2, the estimates of the impact investor market size range widely from \$48B to \$500B. However, looking at a segment of that market, the largest 100 foundations in the US have a total of \$226.8B in assets.<sup>124</sup> If Calvert Foundation-like intermediaries facilitated the investment of 1% of those foundations' assets, it would represent a 50% growth in size for the CDLF industry.

### **Further Research**

The conclusion of my research leaves many avenues open for continued exploration of the potential of individual investors for community development. I spoke with a small number of investors in the Community Investment Note and the SUN Initiative, but I was left wanting to understand more about who current individual investors are; what are their demographic characteristics, motivations, and investment preferences? Hope Consulting's

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<sup>123</sup> Tansey et al., *Capital Markets, CDFIs and Organizational Credit Risk*.

<sup>124</sup> "Top 100 U.S. Foundations by Asset Size."

“Money for Good” report began to explore philanthropic and social investment preferences amongst high net worth individuals, but there is much more work that can be done on this issue.

There is also additional research to be done on models for online community investing. MicroPlace has not attracted a large scale of investment for Calvert Foundation, but it is unclear if this is a result of disinterest in the model or the lack of awareness that plagues all community investment opportunities. Another route for online community investment could be the Kiva model. Kiva, a microlending website for retail investors, has raised \$100M online since its founding in 2005. This is no doubt partly a result of Kiva’s high-profile endorsements from people like Oprah and Bill Clinton. However, Kiva also benefits from the regulatory freedom of not being a security. Kiva lenders do not earn interest, and Kiva’s “loans” are therefore not marketed or conceived as investment products. As such, it is a very simple process for interested individuals to lend. Also, the fact that Kiva pays lenders no interest, resolves some of the cost of capital issues Calvert Foundation faces. One could imagine a Kiva-like site, but with community development projects to support rather than microentrepreneurs. The potential downside of this model is that if investors earn no return, there is surely a lower limit to the amount of capital they are willing to lend. Regardless, I believe the online investment model holds potential for community development loan fund and merits further exploration.



## **Appendix I: Interview Participants**

The following individuals served as primary sources of information for my thesis research. I also conducted semi-structured interviews with three Calvert Foundation investors and one SUN Initiative investor whose identities remain confidential. In addition to these interviews, I spoke informally with several individuals in the CDLF and SRI industries who provided contextual information that was helpful in shaping my thesis.

### **Boston Community Capital**

Jessica Brooks, Vice President of Development and Communications

Elyse Cherry, Chief Executive Officer and Venture Fund President

DeWitt Jones, Executive Vice President, Managed Assets President, and Solar Energy  
Advantage President

### **Calvert Foundation**

Justin Conway, Senior Relationship Officer

Patrick Davis, Senior Associate

Lisa Hall, President and Chief Executive Officer

Chip Hollands, Senior Vice President and Chief Financial Officer

Amber Kuchar, Investment Officer

Carrie Hutchison McGarry, Manager of Marketing and Communications

### **Clean Yield Asset Management**

Elizabeth Glenshaw, Managing Director (formerly Senior Vice President at Calvert  
Foundation)

**Fresh Pond Capital**

Julie Johnson, Co-founder and Managing Director

**Just Money Advisors**

Andy Loving, Certified Financial Planner and Accredited Investment Fiduciary

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