Matchmaking FOR Community Investors

Recognizing that community development financial institutions are always looking for more ways to fund good works and that the socially responsible investment (SRI) community is always looking for worthy causes that provide a reliable return, contemporary matchmakers are working to bring the two industries together.

by Anna Afshar • Federal Reserve Bank of Boston

Illustrations: Kirk Lyttle

When CDFIs finance, say, affordable housing or start-up businesses in low- and moderate-income neighborhoods, their loan recipients pay them back, often with returns the lenders can earmark for other goals. But CDFIs could support a lot more community improvement if they could raise more investment money at favorable rates, and socially responsible investors may be the right people to provide it.

One study found that a typical socially responsible investor was a charitably disposed male with an annual income of $50,000 to $100,000.

Different socially responsible investors have different strategies. First are those that do screening. They may avoid companies that test cosmetics on animals, work in the defense industry, or have a bad record of oil spills. Second are those that aim to be part of the solution. Some file shareholder resolutions to address issues such as labor abuses or human rights; others may advocate change directly with managers.

But there are ongoing challenges for the third group, socially responsible investors interested in building strong communities through strategic investment. Potential community investments differ from other investments, making it difficult for socially responsible investors and SRI funds to justify putting money in them. Commonly cited differences include the lack of standardization of community-investment procedures (investors and financial advisers end up with the administrative costs of comparing apples and oranges), the smaller size of community investments (institutional investors require large pools), and the more variable and sometimes lower rates of return (depending on the product, community-investment returns range from zero percent to market rate). These differences stem primarily from CDFIs' dual mission of customizing products for low- and moderate-income clients while producing a good financial return. Other differences are the result of inefficiencies in the overall industry.

With such concerns in mind, the Federal Reserve Bank of Boston and the Aspen Institute of Washington, D.C., held a conference in November 2005 to elicit suggestions for expanding SRI activity in community investment. Joan Bavaria, president of Trillium Asset Management, and Amy Domini, founder and CEO of Domini Social Investments, provided an overview of SRI industry perspectives. Participants from SRI and CDFI organizations exchanged views on how to reach out to new investors and how to improve the viability and performance of the overall community investment sector.

The New Community Investors

Community investments comprise less than 1 percent of total professionally managed SRI portfolios. (See the exhibit "U.S. Socially Responsible Investment, 2003.")[1] Still, there are indications that some socially responsible investors are increasing their community investments and that others are interested.

Linnie McLean, director of finance at Trillium, says that she is seeing growth in the number individuals seeking community investments. However, since Security and Exchange Commission regulations prohibit firms like Trillium from proactively marketing such products, the company offers them as one of numerous investment options. If a client shows interest, Trillium explains the option in detail.

Juliana Eades of the New Hampshire Community Loan Fund sees family foundations as a largely untapped source of community investment. She points out that universities and other institutions with large endowments have learned to solicit the support of these funding sources and recommends that CDFIs do the same.

Elizabeth Glenshaw of Maryland-based Calvert Foundation suggests that another target should be retirement money. Self-directed IRAs, for example, allow investors to assign a portion of their savings to community investments. Some pension funds, such as the one run by the Church of the Brethren, lets investors direct 5 percent of their portfolio to community investment. Glenshaw urges CDFIs and SRIs to advocate for legislation that would promote more widespread use of such options.

Calvert has counterintuitive data from research done to understand its typical socially responsible investor. The profile of that investor, Glenshaw says, is not a high-net-worth individual, as the common wisdom would have it, but rather a charitably disposed male between the ages of 50 and 65, with an annual income of $50,000 to $100,000. As many as 75 percent of that group have no children. Such insights have implications for the marketing initiatives of both SRIs and CDFIs.

New Pathways to Scale

Current efforts to increase community investments go beyond tapping into new investors. According to the Aspen Institute, it is necessary to address the viability of the overall CDFI system. In a paper published by the Federal Reserve Bank of Chicago, "New Pathways to Scale for Community Development Finance," Aspen's Greg Ratliff and Kirsten Moy investigate how the CDFI industry can grow to scale and ultimately

U.S. Socially Responsible Investment, 2003

Investment Type	Total Assets
Screening Out Objectionable Investments Only	$1,702 billion
Screening plus Shareholder Advocacy	$441 billion
Community Investing	$14 billion
Shareholder Advocacy Only	$7 billion

Community Development Financial Institutions Rated by CDFI Rating and Assessment System, CARS

Austin Community Capital Corp.
Coastal Enterprises, Inc.
Community First Fund
Florida Community Loan Fund
Low-Income Investment Fund
Montana CDC
New Hampshire Community Loan Fund
Northern Economic Initiatives
Northland Foundation
The Reinvestment Fund
Rural Community Assistance Corporation
Unitarian-Universalist Affordable Housing Corp.

achieve a greater social impact.[2]

They argue that for years the industry has been focused on getting bigger, in the belief that expanding service delivery will lead to sustainability. But Ratliff and Moy point out that if CDFIs do not also focus on cost control and increased efficiency, then doing the same thing on a larger scale will not help the industry grow in a meaningful way.

Thus, achieving scale for the CDFI industry means expanding volume, reach, and efficiency to reach sustainability. Once they are sustainable, the authors say, CDFIs will be able to attract additional investment and deepen their impact. Ratliff and Moy use 10 case studies of mostly for-profit organizations to develop models, or "pathways," showing how CDFIs can achieve scale at the product, organization, and industry levels.

Tom Bledsoe, president of the Housing Partnership Network, a national network of top-performing affordable housing CDFIs, agrees with Ratliff and Moy that the current CDFI funding system discourages important organizational improvements because it focuses on the volume of loans. He points to his own organization's experience visiting European nonprofits for ideas. The Housing Partnership Network found the European groups more interested in organizational capabilities than U.S. nonprofits. The whole industry supported flexibility, including using subsidies to build up organizational capacity.

Elyse Cherry, president of Boston Community Capital, a financial intermediary, notes that Ratliff and Moy's recommendations for more horizontal integration and industry networking are already occurring but need to expand. BCC, for example, employs its financial position and organizational reputation to attract money both from outright donors and from investors looking for a return. That allows BCC to provide funding to community development organizations and private developers that might not have been able to access to such funds—or to get them at the same cost. Still, Cherry believes that BCC and other CDFIs can benefit greatly if they develop more industrywide partnerships, particularly partnerships that lead to standardization of products or processes.

A New Asset Class?

Although there are clear benefits in the CDFI industry's move toward private-sector models, many SRI and community-investment professionals say that what is unique about the industry can be leveraged to greater advantage, too. For example, the recent volatility of financial markets provides a golden opportunity to promote the fact that community investments are not correlated with mainstream debt and equity markets. Community-investment professionals want to see community investment become its own asset class, with appeal to people focused on financial returns as well as on doing good. But what would it take to create an asset class?

Many argue the need for a reliable and widely used rating system to capture the unique value of CDFIs. The CDFI Assessment and Rating System (CARS), which the National Community Capital Association launched in 2004, may prove to be that tool. (See the exhibit "Community Development Financial Institutions Rated by 'CARS.' ")[3] Like any credit-rating system, CARS analyzes and rates the financial strength and performance of a CDFI. But it also analyzes a CDFI's impact, including the leadership role the institution plays in the industry and the CDFI's efforts to shape public policy. Such measures are attractive to investors who want to know that their investments are having a significant effect.

Still, the challenge remains of how to marry the needs of socially responsible investors for standardized investment products, regular returns on principal—and other such mainstream investment factors—with the idiosyncrasies and financial performance of the community-investment sector. The community-investment world will have to work a little harder on making the overall industry more attractive while simultaneously courting socially responsible investors, one investor at a time.

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Endnotes

1 The data do not capture all money involved in community investing. For example, they do not include Community Reinvestment Act investments that were not made through a CDFI or low-income housing tax credit programs. See *2003 Report on Socially Responsible Investing Trends in the United States* (Washington, D.C.: Social Investment Forum, 2003).

2 Gregory A. Ratliff and Kirsten S. Moy, "New Pathways to Scale for Community Development Finance," *Profitwise News and Views* (Chicago: Federal Reserve Bank of Chicago, December 2004).

3 Twenty-one CDFIs are in the pipeline for CARS ratings. All information is as of November 2005. See http://www.communitycapital.org/financing/cars.html.