A Loan and Investment Fund for Non-Profits

Concept Paper

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What is being proposed?

Nora Sobolov of the Intersol Group (an experienced senior executive who has worked in the non-profit, private and credit union sectors) and Arlene Wortsman (a consultant and a Research Fellow at the Carleton Centre for Community Innovation) are exploring the development of an investment/loan fund for non-profits and charitable organizations. The purpose of the fund would be to provide financing that isn't project based (working,bridge funding, lines of credit) for non-profits who do not necessarily have the possibility of a social purpose business as part of their work. One of the models for this exploration is the Nonprofit Finance Fund (NFF) that has been operating in the United States for over 30 years (see backgrounder). It began in New York as a partnership of community foundations, private funders and other institutions. It provides local and regional loans, investments and financial fitness services to non profits through offices across the U.S. The NFF includes a number of Canadian banks among its business partners.

The NFF has offered to explore with us whether there is a possibility that aspects of their model could be adapted for Canadian use. Venturesome, a successful 12 year old multi-purpose investment fund providing loans to charities and non-profits (based in the UK) has agreed to advise during the development phase. We recognize there are also a number of Canadian organizations that also have developed important expertise and tools, in particular at the regional level. It is our view that most if not all of the elements necessary for a successful start up of this funding pool are already available and we can build on existing successful models.

We chose the NFF as one of our primary models because it is able to access capital from a variety of sources, provide real returns on loans, has a successful track record with loan repayment and while a percentage of funds come from government, much of their capital comes from either private sector (bank) or private philanthropic funds. Venturesome also has an impressive track record, achieved entirely with funds from private and philanthropic sources.

The Canadian Fund would seek to partner with existing local funds (should they be willing) to build on their expertise and market knowledge and create economies of scale.

What is the problem we are addressing?
Although there are many groups working to address equity investments and loans for social purpose businesses, many non-profits and charities require working capital rather than project-tied funding and cannot take advantage of potential support for a social purpose business with an income stream.

Traditional lenders often do not have expertise in evaluating the financial viability of non profits. These lenders may be willing to loan funds to larger non-profits, but in general they find the transaction costs of dealing with these organizations to be prohibitive. Non profits are often viewed as risky investments by their banks; loans if available have to be secured against their assets and interest rates are high. Traditional lenders are reluctant to provide financing that would help the non-profit grow, access additional funding or for bridge financing while waiting for a grant or contribution. A non profit loan and investment fund would address these gaps.

A loan and investment fund could help reduce the risk that prevents traditional lenders from taking on non-profits at reasonable rates through its own expertise and understanding of the sector and its finances. Financial capacity building would be a key element of the fund. Access to an intermediary facility fund will provide greater flexibility for non-profit organizations by providing access to a pool of capital that is often difficult or impossible to reach. In addition, since interest would be charged on the loan funds, Foundations could consider participating in these loan funds with their base capital, perhaps at a marginally smaller return than traditional lenders. Through the pooling of funds risk could be distributed and the cost of capital in general could be reduced.

How does this fit into the current context?
We are aware that this is a field with dozens of established individuals and groups in Canada. While many of these groups are working broadly in the field, only a few are providing loans and investment funds that target charitable and non-profit organizations that do not have an additional enterprise or social purpose businesses as part of their revenue strategy. Even fewer have any mechanism to provide loans or investment for organizations that do not have real-estate assets to secure the loans.

Examples of regionally based funds include:

- The Edmonton Social Enterprise Fund provides loans to social enterprise, social purpose businesses, charities who can take loans against assets and non-profit housing. Loans range in size depending on the type of project up to a maximum of $500,000;

- The Ottawa Community Loan fund which provides funds up to $15,000 to small business, social enterprises, coops and individuals. It has recently entered into a partnership with PSAC and others to create an investment for non-profit housing;

- Local financial institutions that provide loans to non-profits, in particular credit unions such as VanCity.

Community Foundations of Canada is developing a pilot project to "link" Foundation efforts in the social investment field and has expressed interest in collaborating on development of this model.

Discussions have taken place with Causeway and through them with several other social finance/enterprise groups and they are ongoing.

International initiatives such as the UK's Venturesome and the Non-Profit Finance Fund have track records and experience that helps prove this type of fund can work. In particular, private sector financial institutions would have the opportunity to consider the experience and success of the U.S. model, as many Canadian banks participate in the Non-Profit Finance Fund. Similarly, the foundations and other potential participants and funders could speak with their counterparts to find out about their experiences with this type of fund.

What would be the next step?

The next step would be preparing a business case and plan for the start up of a financial intermidiary that would provide access to capital for charitable and non-profit groups.

BACKGROUNDER

What is the Nonprofit Finance Fund? (NFF) *

The Nonprofit Finance Fund, a community development financial institution or CDFI, was established in 1980, and provides supportive financing options to non-profits and services to funders (private lenders, community and other foundations, governments). It is headquartered in New York but serves the nonprofit community in the United States through several regional offices.

As of 2008 it has provided $175 million in loans to fund growth, working capital and real-estate for non-profits, which include lines of credit, bridge loans and working capital loans for non-profits and social enterprises. Loans are given to non-profits that have been in operation at least three years, with a budget of at least $500,000 and are typically between $100,000 and 2 million dollars. Through a new grant program, they also offer predevelopment loans to help non-profits with market research, program expansion and real-estate acquisition preparation.

As of 2007, NFF also has a non-profit equity fund that provides Social Return on Investment (SEGUE, see below). The NFF has specialty funds for specific targeted projects (i.e. dealing with shifting audiences in the cultural performance field, decreased funding sources and changing technology in the arts, expansion of childcare, new market tax credits for community centre expansion in low income areas, etc.)

Growth Capital Services

SEGUE (Sustainable Enhancement Grant): Using this fund, non-profits are assisted in designing strategic capital campaigns of $5 million or more to raise growth capital. The Fund and its staff provide services to non-profits and strategic philanthropic investors with "auditable record of the organizations progress towards sustainable operations." They help syndicate funds among several investors and develop a prospectus for potential philanthropic investors.

Consulting and Advice

The NFF offers a series of consulting services that assist non-profits in capacity building and financial strength that include:

***** Material for this backgrounder was taken from the NFF web site www.nff.org, and from its annual report.

•Non-profit business analysis: integrated financial planning for non-profits
•Financial leadership clinics
•System replacement plan (20 year plan to care for buildings)
•Tools for Non-profits to better articulate true financial picture to external audiences
•Advocating change in granting programs to move away from project based funding only, and to fight "mission drift"

Services for Funders:
The NFF offers a series of consulting services that assist funders in the following ways:
•Market Knowledge:
Custom reports that analyze funder grantee portfolios, trends, etc.

•Syndication and Partnerships:
Customized selection of financing, help with managing transactions, including structuring, documentation and reporting

•Underwriting of loan closing, loan monitoring, billing and collecting

•Re-granting:
Providing due diligence on applicants, assistance to grantees to ensure successful completion of proposal and implementation.

Frequently Asked Questions

Is the NFF bank loan fund successful simply due to the Community Reinvestment Act?

While community reinvestment act funds are available to the NFF and some of these are subsidized, a sizable portion of their bank and private lender loans are market rate agreements with the financial institutions.

Why would foundations participate?

Foundations in the U.S. were among the founders of the NFF. They wanted a way to make good use of their capital beyond their granting facility. Since their risk return rate is good foundations have been able to "double their impact" through this type of investing.

Which Canadian banks have been involved?

Affiliates of many of the major Banks have all participated.

What type of incorporation structure would be necessary in Canada?

This will take more investigation, but as there are already community loan fund non-profit structures, a similar structure might be possible.

How is this effort different from other initiatives to form national charitable financial institutions?

- Our plan is to keep focused on the loan and investment fund pool rather than creating a full service financial institution. We recognize the growth potential of this type of organization, but we plan to begin with a clearly defined focused fund and with success will find ways to expand services.
- We will use the experience and knowledge learned in other efforts. There is a great body of knowledge built up from experience in this field. We have no need to reinvent the wheel, and we can learn from evaluations of previous efforts.
- We will use existing successful models to build on and scale. Both the U.S. and UK have models of these types of funds that have operated successfully for several years, and Canada has several models of regionally successful funds.
- Both Foundations and private lenders can look to existing models as proof of concept. We are beginning with models where private lenders, philanthropists and foundations have been significant partners, and so can provide insight to their counterparts about their experience and its value.