Equity Capital for CED

By Stewart E. Perry

To engage in CED as a comprehensive strategy includes making long-term investments in productive pieces of the local economy – for example, in new or expanded businesses, in commercial property development, or in affordable housing. All of these require the investment of some form of equity right from the beginning of the project. Rarely can they be financed totally through some sort of borrowing.

Just as prospective homeowners need a down payment to qualify for a mortgage, so a CED organization (CEDO) needs funds of its own that it can risk in the early stages of an investment project and, most of the time, leave in the project, even after mortgages and other funding are in place. Access to such equity is a challenge that confronts any CED group ambitious enough to want to make a permanent difference in its community. How can that first powerful bit of money to jumpstart a project be accumulated?

There are many answers to that question, but the best ones recognize that capital is only part of the issue. Making any sound investment involves capital, competence, and capacity, and matching the demands or conditions of each to the other two. Those investment funds that CED practitioners themselves have created in the social economy (Québec's Chantier Trust, Edmonton's Social Enterprise Fund, and others) succeed because they recognize the relationship between capital and the competence and the capacity of those who would use the capital.

But these investment tools are all too rare, and their resources are strictly limited. Even if they have received some government monies to supplement the other funds they have raised, they must mainly deal in loans, not equity investments. In the end, only governmental institutions, with their command of the deeper resources of society as a whole, can mobilize the equity necessary for a fundamental investment in CED.

Unfortunately, to the extent that they act on this need, governments everywhere seem to confine themselves to the provision of capital. They do not meld their investment dollars with initiatives to boost the recipients' competence and capacity.

There is a model, however, that shows it can be done. That is the thinking behind one of the oldest and most effective builders of CED capital, New Hampshire's Community Development Finance Authority (CDFA). The generous tax incentive offered by CDFA for corporate donations to CED projects is relatively common knowledge. Less well known are CDFA's programs for building the capacity and competence of local organizations, and without which the impact of the tax incentive would be vastly reduced. CDFA covers not one, but all three of the factors key to sound community investment.

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Capital, Competence, & Capacity

Let's make sure we are on the same page when we use these three terms, capital, competence, and capacity.

Capital we should recognize as the dollars or other assets (patents or real estate, for example) that are available for investment in a community economic development project. Capital may take the form of equity – that is, an ownership investment – or some form of credit, that is, loans, bonds, mortgages, etc. Equity is not just invested after a project is designed. It includes the preliminary thinking crucial to any project, even the initial selection of ideas to study and consider. All this preliminary effort is truly an equity investment and its dollar value must be recognized in the ultimate capitalization of the project, even though ordinary dollars as such are critical.

Competence refers to the technical skills ready to handle the capital and the project. In addition to financial and deal-structuring skills, this involves the skills to run the project after it is operational. The immediate availability of able workers for the projected business or for the construction and management of the projected housing are examples.

Capacity concerns the experience, talent, and values that a CEDO brings to its central function, "organizing" – in other words, the organization's readiness to take on a project and make it go. In the main, capacity is a measure of an organization's ability to divide responsibilities up among board, staff, committees, or departments; their ability to work smoothly with each other and outsiders; and their ability to make good decisions rapidly, carry them out efficiently, and monitor them afterwards.

The most successful CEDOs combine all three – capital, competence, capacity. They will mobilize sources of capital; they will strengthen their staff, clients, and fellow citizens in terms of a range of skills essential to projects; and they will carefully design and carry out the projects they initiate or with equal care assess the projects of others in which they intend to take part. Where they are short of something, these CEDOs make sure to find partners that can make up the difference.

Rarely is the problem merely a lack of capital, however. Hard as it may be to believe for money-starved community groups, capital generally can be found so long as competence and capacity are at hand. If a CEDO's staff and board have taken a project well past the drawing board and are able to handle the necessary capital, they will ordinarily find that capital.

Too often we CED folk complain about the lack of capital for CED. Often, people both inside and outside government believe that capital is the main thing that is needed and is the single most valuable thing that government can supply. In fact we should be complaining more about how hard it is to recruit or train good people (or recruit and orient good business partners), and about how hard it is to shape a project so that it is really attractive to capital.

That's the wisdom behind New Hampshire's CDFA. It explicitly combines programs to address the competence and capacity of CEDOs, not just their capital needs.

CDFA's Tax Credit Program

There are over a million people scattered around the state of New Hampshire, mostly in small towns and rural areas. What few cities there are have had a history of industrial desertion. The landscape is dotted with many old unused mills, some dating back to the days of water wheels.

So, much of New Hampshire has been capital starved for a long time despite its proximity to the financial centre of Boston. These days, positive spill-over from the new high tech industries in neighbouring Massachusetts can be seen in New Hampshire's southern parts. Farther north there are all the usual problems of low incomes, unemployment, and welfare dependency, together with the negative social effects of those conditions.

The CDFA was put together to counter the economic distress of these people and communities (and parts of communities) that were not benefiting from the high tech surge. Although a government agency, CDFA was designed not by a government department but by CED activists. One was a businessperson and elected state official who had been a board member of a north country community development corporation for many years. A second key person had, among other accomplishments, started a very successful nonprofit affordable housing loan fund in the state as well as a graduate degree program in CED at what is now known as Southern New Hampshire University.

Through CDFA, New Hampshire offers a tax incentive to any business, bank, or corporation (not individuals) that will donate money or real estate for an approved CED project and its community. Community development corporations, worker co-ops, and other nonprofit community groups are eligible recipients of donations. No for-profits are eligible, although a nonprofit can promote its own for-profit project. Municipal departments or agencies concerned mainly with community development can also qualify.

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The donation is actually made to CDFA, which then passes it along to the CED group after deducting 15% if the donation is made in the form of real estate – 20% if made in cash or stock. This deduction is used for administrative expenses. CDFA receives no state money at all for operations. Everything the Authority spends comes from the donations made by businesses for CED purposes.

Of course, the tax incentives are government expenditures (called "tax expenditures"), in the sense of foregone tax revenues. The benefit from this type of government funding is that the program does not have to go back each year for a new legislative appropriation of money to keep it going. The program keeps on going on its own.

As is so often the case the tax picture is complex, but it is generous. The immediate tax incentive is 75% of the donation, which can be applied to any of the three kinds of state taxes for which New Hampshire businesses are liable. Thus, for every $1,000 contributed, the business can take a credit of $750 against the taxes it would otherwise pay to the state. But there is an extra kicker: the state will also allow the business to deduct from its *income* the amount of the contribution, so the business will save about $85 more. And if that were not enough, the federal government happens to allow an income deduction for contributions made to any government agency – local, state, or federal. Since technically, the donation is made to CDFA, the business can claim a $250 deduction from its taxable income, so that it will likely save something like $56 on its federal income tax return by reporting the $250 contribution that was not offset by the state tax deduction. In short, then, each $1,000 contributed might cost the donor only about $109!

In the history of CDFA, most of the larger contributions have actually been made by banks operating in New Hampshire. They like it because it earns them brownie points in their Community Reinvestment Act record.[1] In short, the banks do things in settings that they have previously ignored, and that's good because, as a certain bank robber once testified to a Congressional committee, when asked why he robbed banks, "That's where the money is."

At what scale has CDFA's tax credit program operated? Well, after its launch in 1991 the first three or so years were so active that more than US$22 million in incentives were committed, or almost $30 million in total donations. (Admittedly, some of the incentives and donations were to be spread out over a number of years.) In fact, the response of the private sector banks and businesses was so enthusiastic that the legislature had to call a temporary halt to the awarding of credits. In 1998, new legislation allowed donations to start again, but with a cap of $5 million per year, and that has continued since then and presumably will go on indefinitely into the future.

What sort of project is this money capitalizing? Up until the new authorization of tax expenditures in 1998, more than 125 projects had been assisted.[2] At that juncture, the affordable housing projects actually accounted for 26% of all the affordable housing units created in the state in that period. CDFA had financed 191 units for mostly low-income working families. Since that short, initial period, a steady stream of housing units have been created under the program. Museums, art centres, science centres, and commercial developments, including a 40-room hotel, have also received capital infusions. And something like a couple hundred jobs were created.

Later CDFA records are spotty, but they document for the last five years 54 more projects, including (for the last three years) 398 housing units and 2,755 new or retained jobs.

Beyond Capital

All this speaks to CDFA capital assistance. But the Authority is also in the business of strengthening competence and capacity in the community groups it serves or would like to serve. To this end, it began by using dollars from its 15-20% deduction from the total donations to underwrite a wide variety of programs to support the best use of capital resources – for example, for grants to cover CEDO operational expenses to improve their capacity to design and develop good projects. Later CDFA instead began to budget a yearly contribution of about $40,000 to every organizational member of two informal state networks, one involving ten nonprofit organizations that specialize in affordable housing and the other composed of nine regional CED groups. Annually, these groups and CDFA solicit (tax creditable) contributions for this purpose.

These grants can be used for any purpose the network members deem most important – for overhead expenses, for

Résumé : Mise de fonds pour le DÉC

Pour avoir un vrai impact, les organisations de développement économique communautaire (ODÉC) doivent être propriétaires de parties productives de l'économie locale. Mais de trouver le capital pour faire de tels investissements n'est qu'une partie de la question. Une ODÉC a aussi besoin des aptitudes techniques (compétences) et des habiletés de gestion (capacité) égales à la tâche.

Malheureusement, les bailleurs de fonds les plus aptes a fournir du capital sont aussi les moins enclins à marier cet argent avec des programmes pour accroître la compétence et la capacité d'un requérant. Heureusement, ce mélange est au cœur de la Community Development Finance Authority (CDFA) Autorité financière du développement communautaire du New Hampshire. Les donateurs de fonds ou de biens immobiliers à la CDFA ont reçu un crédit de 75 % de la valeur de leur don sur leur impôt d'état. Les dons vont à des projets de DÉC identifiés par le donneur, avec de 15 à 20 % de retenu pour les frais d'opération et pour appuyer le financement de fonctionnement des ODÉC.

La réponse des banques et des entreprises a été enthousiaste. Pendant les années 1994 - 1998, les projets financés par la CDFA composaient 26 % de toutes les unités de logements abordables bâtis dans l'état.

C'est un modèle que les juridictions canadiennes pourraient vouloir imiter. Ils devront toutefois résoudre plusieurs questions avant : le pouvoir relatif de stimulation de crédits et de déductions d'impôts; l'importance d'intéresser tant les donneurs individuels que corporatifs; comment faire le lien entre des donneurs et des projets communautaires dans des régions éloignées qui ont peu de présence corporative; et de combien de revenus d'impôts est-ce que le gouvernement est prêt à se priver. ■

staff, for technical consultants to help CEDOs with their project planning, strategic planning, accounting or legal issues, with packaging loan and grant applications – just about anything.

Before this arrangement was established, CDFA would make specific technical assistance grants. For example, over time some $300,000 went to a business improvement program that increased the income and success of the lower-income self-employed, like taxi drivers, home daycare providers, carpenters, and craftspeople. Now, CDFA delegates such decisions to the network members themselves.

There have also been training and education grants and loans for workshops, conferences, even scholarships for CED coursework. An early grant to the Women's Rural Enterprise Network financed an 8-month training program for rural women entrepreneurs. Today CDFA will seek out businesses specifically to co-sponsor general workshops – for instance, on how to adapt empty but re-usable buildings.

So CDFA energizes an array of programs to address CEDOs' needs not just for capital, or competence, or capacity, but all three.

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The Systemic Results

CDFA reports a leverage return of $6.80 for every $1 of state tax credits. Municipal tax revenues have increased substantially due to the improved property values and economic activity generated by CDFA-funded projects.

Community centers, after-school programs, revitalized historic theatres, and other such projects have served more than 150,000 people over the last five years. In short, the scope of impact is not to be considered simply in dollar terms.

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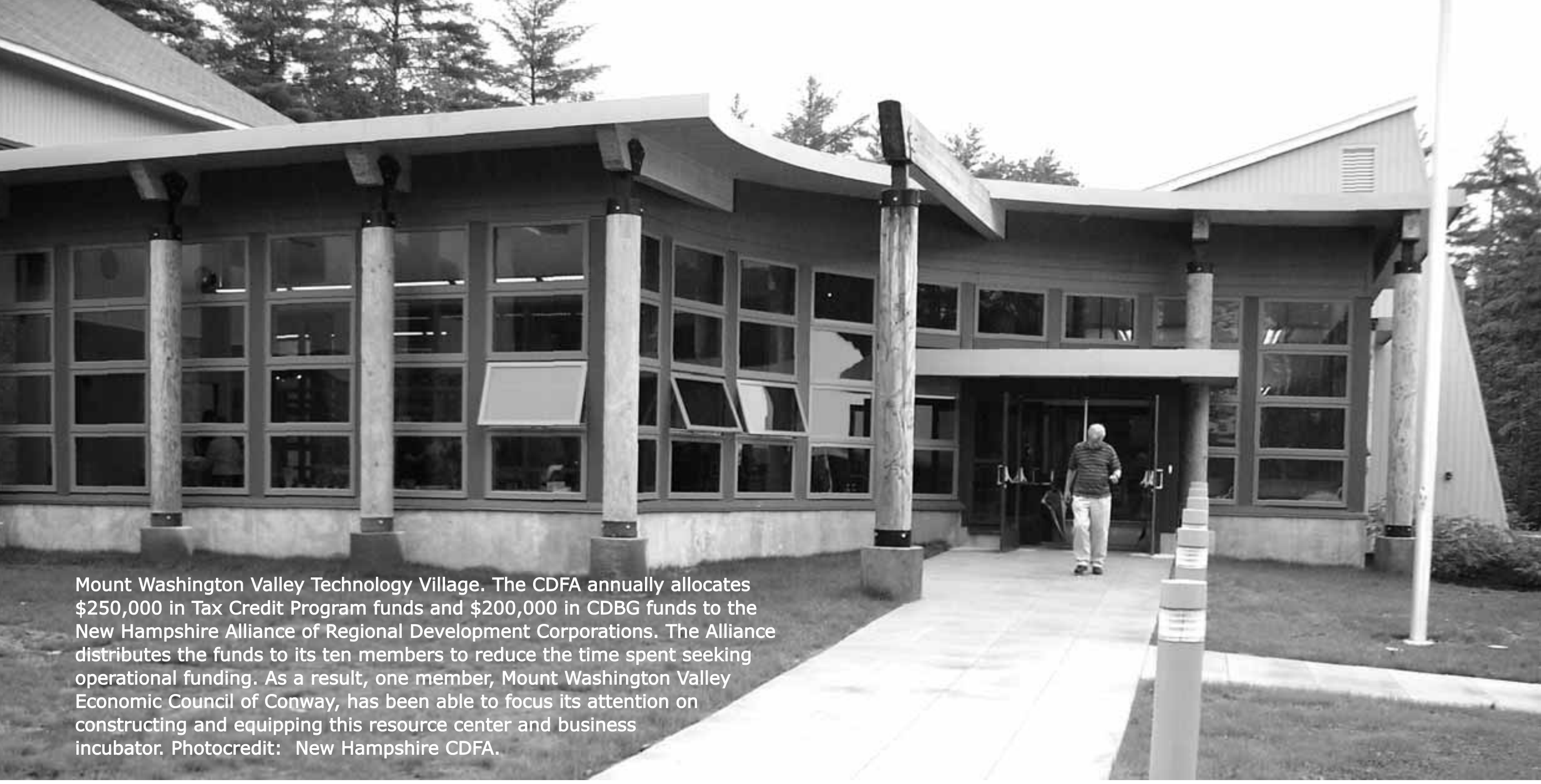

Mount Washington Valley Technology Village. The CDFA annually allocates $250,000 in Tax Credit Program funds and $200,000 in CDBG funds to the New Hampshire Alliance of Regional Development Corporations. The Alliance distributes the funds to its ten members to reduce the time spent seeking operational funding. As a result, one member, Mount Washington Valley Economic Council of Conway, has been able to focus its attention on constructing and equipping this resource center and business incubator. Photocredit: New Hampshire CDFA.

to supply a donation because the concept is sound and the CEDO can manage it effectively. The CEDO then applies for and receives an eligibility ruling from the CDFA, enabling its partner to claim the tax credit as soon as it deposits the money with the CDFA.

In many instances, however, CEDOs first seek project eligibility from the CDFA and thereafter look for a business to contribute the equity in return for the tax credit. For the groups with potential projects but no partner prospects, CDFA has its other programs, as described; but it can also steer partners to each other.

Another positive feature of the program is the way it is run. First of all, CDFA's board has wide representation. It is made up of four representatives from community development organizations, two from small business, one from organized labour, one from training and education, two from the private financial community, and one state government representative. The governor appoints the board, but clearly it is not a government-run agency. Secondly, the board has limited, staggered terms. There is little chance for deadwood to accumulate. Finally, for years CDFA could administer the funds with only four or five staff people.

However, CDFA has expanded its purview. Over the years the state has given it two other responsibilities. One is the Neighborhood Stabilization Program that deals with the threat of foreclosures to communities. The other is just as demanding but broader: managing the state's Community Development Block Grant. Both are actually federal programs targeted to the needs of low- and moderate-income people and localities and to public facilities that are critical to health and welfare of a strapped community.

As a consequence of these additional responsibilities, CDFA now has a much larger staff than it required earlier. Although the agency also receives some administrative allocations to cover the costs, increased overhead consumes some of the tax credit funds too.

The new programs have unquestionably increased CDFA's scope. The CDBG is a $9 million federal allocation that each state can allocate as it deems appropriate for CED and for other development purposes, like waste water treatment. For example, CDFA recently granted $500,000 in CDBG funds to a community group that provides meals for seniors. This money has enabled them to continue to provide services while bringing their equipment and building up to code. Also, the CDFA can now combine initiatives, using both state tax credits and the federal funds, for example, to help a CEDO renovate a building for community purposes or provide technical assistance on community projects. (See photo, this page.)

Applicability to Canada

What are some of the implications of this U.S. story for CED throughout Canada?

Any province could establish a comparable program. At various times there has been provincial interest here and there. And certainly there have been other provincial models that provide tax credits for CED projects, most notably, Nova Scotia's Equity Tax Credit and CED Investment Funds (see "What's So Special About Nova Scotia," *Making Waves*, Winter 2008, pp. 23-25). This program is not as far-reaching as the CDFA. There are no competence and capacity programs and tax credits are provided only to individuals, not corporations or banks. So the scale of investment (and the power of a project) is limited to what a community can raise from individuals.

Manitoba too has a similar tax credit program. But again the greater capital resources of the corporate and banking world have not been engaged, and the program addresses the capital question, without attention to capacity and competence.

Would a program more akin to the CDFA work in a Canadian context? Many CED groups in Canada are active in marginal areas without substantial corporate or bank installations. The local and regional partnerships so characteristic of the CDFA might be harder to come by. Could a national CDFA-like agency fill that gap? If so, how would the eligibility of projects as targets for tax-creditable contributions be assessed? Could an existing government agency (such as Revenue Canada) administer the program? Or should a new crown corporation be established for this purpose?

Would a program more akin to the CDFA work in a Canadian context? The local & regional partnerships so characteristic of the CDFA might be harder to come by. Then there are the different types of tax advantage to choose between. Which will work better & at what cost to the government?

Could such a federal initiative provide that the tax credits be available to individuals as well as businesses and banks? As evidenced by the Nova Scotia experience, there are individuals and families who want to make socially responsible investments. Figuring out how they could do so through a national CED capital institution is a task well worth pursuing. Also, depending on financing, design, and the particular project in question, there may be a way for these investments to qualify for other credits (for renewable energy, for example), or be RRSP-eligible, as is the case in Nova Scotia.

Then there are the different types of tax advantage to choose between. The "tax credit" format is by far the most powerful. It allows taxpayers to deduct from their tax bill a portion of their CED donation. In contrast, a "tax deduction" format allows taxpayers to reduce their taxable income (and therefore the percent of taxes due) by the amount of the CED donation. Which will work better and at what cost to the government?

Such questions require careful examination. But again, the focus cannot be capital alone. Any such program must also be intended to build capacity and to enhance competence.

Surely a way can be found to use Canada's tax structure to foster more CED projects at a more effective level. Eligible projects would have to be defined broadly enough to include not only individual social enterprises and CEDO businesses, housing, and commercial property development, but also all other CED activities, such as human resource training and development, entrepreneurial support activities, community loan funds, cultural resources, technical assistance. Clearly, any equity provided by the program would also lever a wide variety of other funds (including matching grants from foundations, mortgages from credit unions or banks, investments from co-venturers, etc.).

Most importantly, the immediate beneficiaries will have to be carefully defined. Marginal localities and populations must be the primary recipients. As the beneficiaries reach a more productive status within the society, the program's benefits will naturally ripple out to advantaged populations.

These ideas and working models have been around for many years now. There is enough experience to assess how communities across Canada could grow with a tax initiative that integrates capital, capacity, and competence. It will be up to us practitioners in the social economy to make that happen.[3]

References

[1] The U.S. Community Reinvestment Act (CRA) is legislation that encourages banks to offer their lending and any other services in the communities from which any of their deposits come. Banks who need government approval for such things as mergers or expansions can point to their CRA record as a reason for the desired approvals.

[2] Richard England et al., *The Economic Impacts of Community Development Finance Authority Programs* (Durham, NH: Center for Business and Economic Research, University of New Hampshire, January 1998).

[3] For some suggestions (meant for U.S. application), see Woollard Lett and Michael Swack, "New Hampshire Community Development Finance Authority (CDFA) Replication Recommendations," *World Institute on Disability*, May 2005. 28 April 2009 <http://www.wid.org/programs/access-to-assets/equity/equity-e-newsletter-may-2005>.

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