

Leveraging Local Investment for CDFI's

2016 CDFI Fund Prize Competition

Economic Development and Financing Corporation

EXECUTIVE SUMMARY

Rural economic development is challenged primarily due to low population density. "Patient", affordable, risk-tolerant capital is needed for the long path to profitability for entrepreneurs in rural communities. This type of capital is difficult to find even in more robust urban economies. By leveraging the desire of investors to invest locally, CDFIs help serve local investors and entrepreneurs by providing due diligence, risk mitigation, and loan servicing. EDFC is requesting \$350,000 to match the \$350,000 raised by the community to help cover the legal and operating costs of the Local Social Impact Loan Fund, capitalize significant loan-loss reserves, buy down the interest rate for projects with social benefit, and expand offer the product to more eligible entrepreneurs.

ABOUT EDFC

Economic Development and Financing Corporation, Inc. (EDFC) is a non-profit 501(c)3 organization founded in 1995 whose mission is "Connecting money and ideas with entrepreneurs to create sustainable prosperity in Lake and Mendocino Counties." EDFC received certification as a CDFI in 2013. EDFC fulfills its mission by providing gap financing and acting as a lender-of-last resort.

EDFC has a 21-member board of directors, which includes 2 county supervisors, a member city council member from each of Mendocino County's four incorporated cities. and various community, tribal, business, banking, and non-profit organization representatives. The Executive Director reports to the Board of Directors.

Since its founding, EDFC has disbursed 83 loans totaling over \$5.1 million creating over 200 jobs.

A description of the problem(s) creating barriers to accessing capital in the targeted rural areas (and, if applicable, that are characterized by persistent poverty;

Mendocino and Lake Counties are located in rural Northern California. The poverty rate in Mendocino County is 18.8% and 24% in Lake County, contrasted to the US rate of 14.8%. In addition, Lake County recently suffered from one of the most devastating fires in California history.

The economy in the two counties has been historically resource extractive and is now in decline. The region has little ability to attract and retain large employers which makes entrepreneurship the primary path of building wealth in our community. The 2012 "Business

and Microenterprise Needs Assessment” prepared for the County of Mendocino highlighted that 80% of businesses in Mendocino have fewer than 10 employees, with most of these companies generating less than \$1 million in annual sales. This statistic is similar in Lake County. Low population density and challenging topography create a difficult environment for small businesses. Entrepreneurs in our community need “patient” and affordable risk-tolerant capital. There is also a need for grant funding to jump-start new markets or rebuild or revitalize older dormant industries.

EDFC ‘incubates’ industries such as woody biomass conversion and small scale meat processing by accessing grant funding for feasibility studies and business plans with the end goal of attracting entrepreneurship. EDFC’s access to grant funding is constrained by the ability to come up with matching funds. A grant awarded to EDFC to develop a meat processing plant was decreased due to lack of matching funds.

[A description of the innovative idea or strategy for solving the problem\(s\) described above, including any proposed evaluation and the likelihood that it has yielded or will yield meaningful insights into the effectiveness of the solution;](#)

In addition to the need for “patient”, risk-tolerant capital, many individuals in the local community desire to diversify their investment away from traditional Wall St. investments and seek the direct social benefits of investing in the local community.

This desire has been kept at bay due to the lack of credible projects, an aversion to risk, due diligence rigors, and servicing of the investment. Investors want low risk projects and do not want to have to find deals, vet deals, or service deals.

Investing locally has been limited to accredited investors, which hinders middle class investment into local communities.

EDFC realized that its credibility in the community, experience in lending, and CDFI status could mitigate these concerns and create a capital base for local projects.

Given the innovative approach of accessing non-accredited investment for local economic development, EDFC proposed a Local Social Impact Loan, targeting investors who value social return as much, if not more than financial return. This would allow low financial hurdles rates for this unproven model. Future programs will be able to offer a more market risk-adjusted return with the success of this program

Local investment is a form of Impact Investment. The Global Impact Investing Network (GIIN) conducted a survey showing over \$60 billion involved in this sector. EDFC’s proposal leverages this desire for impact returns to help fund the local community.

Studies have shown that 45 cents of every dollar spent at a local business gets reinvested locally. This compares to 15 cents reinvested for every dollar spent at a non-locally owned business. Investing in traditional securities provides a dividend, but local investment also facilitates the “Local Multiplier Effect.”

Since the offering will have to be open to all California residents, this program allows for urban investors to help build an equitable rural community which is the urban communities’ source of food, energy, and water.

EDFC will use the DPO funds as match for grants to help buy down the interest rate of EDFC borrowers that offer social benefit to the community. The grant funds will also be used to fund loan-loss reserves appropriate to the risk of the portfolio. In California, CDFI status allows EDFC to access portfolio insurance and collateral assistance programs (CalCAP) to further mitigate the risk of loans that have social benefit.

The depth of need for investment capital and the lack of access to such capital within the targeted rural areas;

Mendocino and Lake Counties, like most rural communities, have been resource extractive economies with little value added. With over-extraction, many of the industries are gone or in severe decline.

In both counties grant funding has helped re-vision resource extraction into a more sustainable model. The next step is to give entrepreneurs access to “patient”, affordable, risk-tolerant capital to develop the newly feasible opportunities. Examples of this in our region include:

- Funding woody biomass conversion businesses that convert waste from proper forest management into biochar, electricity or liquid fuel.
- Create a small-scale meat processing facility to add value to the high-quality meat produced in the region.
- A wool processing plant to bring back a dormant industry to address the burgeoning demand for high quality local fiber.

These types of projects are too risky for traditional lending and do not have high enough returns for traditional venture capital.

Unlike CDFI’s in more populated areas, EDFC has not been able to leverage banking partnerships to access funds for these projects and similar projects for our region.

The rural areas to be served or that have been served through the proposal;

1. If the idea or strategy has not yet been implemented, expected short-term outcomes (within one year of implementation) and expected long-term outcomes (within five years of implementation);

Project has been implemented.

2. If the idea or strategy has been implemented, outcomes achieved ;

EDFC worked with Cutting Edge Capital out of the San Francisco Bay Area to use the Rule 504 exemption of Regulation D of the Securities Act of 1933 to offer a security to both accredited and non-accredited investors in order to fund a Local Social Impact Loan Fund for economic development projects and businesses in Lake and Mendocino Counties.

EDFC was approved in February of 2015, by the California Department of Business Oversight, to offer up to \$1M in unsecured notes with a 6-year term at 2% interest. Any investor in California was able to invest \$2,500 in the Local Investment Social Impact Note. Larger investments were allowed if the investor met suitability requirements.

EDFC had until February 2016 to raise a minimum of \$250,000 in order to use the funds raised or return the money to investors. By February 9th, EDFC had raised \$354,000 from 88 investors with an average investment of \$3,954. 77% of the investment came from Mendocino and Lake Counties. The remainder of the investment came from the San Francisco Bay Area.

EDFC approved a \$350,000 loan to Mendocino Wool & Fiber to build out a wool processing plant that will employ up to 7 people when fully operational. The Mill is expected to open in the fall of 2016.

In addition to the successful capital campaign, EDFC raised its brand awareness in the local community and region and has been asked to share the experience with other communities.

Given the innovative program, short-time frame, and limited staffing capacity, EDFC was only able to raise enough investment to fund the one project.

EDFC is hoping the CDFI Fund Challenge prize could be used to match the funds raised in order to fund more projects, capitalize loan-loss reserves, cover administrative and start-up costs, and develop the next fund.

An explanation of any partnerships that have or will be created to increase capacity and leverage private, public, and philanthropic capital to expand investments in the rural designated areas, including the roles of each partner (submission must include a Memorandum of Understanding or other formal partnership agreement documenting the terms of the partnership); and The scalability and/or replicability of the idea or strategy.

The key to this type of project is having skilled legal counsel. Cutting Edge Capital is a leader on crowdfunding and Direct Public Offerings. EDFC retained Cutting Edge Capital to handle the application and registration of the offering.

EDFC relied on grants from organizations such as local banks, non-profits, and companies to help pay for the legal costs for the offering. Organizations that provided funding for some of the administrative costs of the project include:

- Redwood Coast Rural Action
- The Community Foundation of Mendocino County
- Pacific Gas & Electric
- Savings Bank of Mendocino County
- Mendo Lake Credit Union (another local CDFI)

The local community foundation was a key partner for grant funding of the project, but it was imperative that they also invested in the fund. Community foundations seek impact in their community and to have them invest a small portion of their endowment in local business should be one of their mandates (the Subscription Agreement for the Community Foundation is included in the supporting documentation)

EDFC works with the local Small Business Development Center, West Company, to provide technical assistance to the borrowers to further mitigate risk (the MOU is include in the supporting documentation).

Access to the State of California CalCAP program was also key in mitigating the risk of this type of investing. The loan to the wool mill was enrolled in the CalCAP Collateral Assistance Program (application included in supporting documentation).

This type of capital goes beyond money. The 64 local investors are now directly involved in the success of the project (A complete list of Subscription Agreements can be provided). Several successful investors have come together to provide coaching for the owner of the wool mill. There is also the benefit to the CDFI of raising awareness of the organization and how it serves its community.

The project is easily replicable. There are CDFI's (Northern California Community Loan Fund) who offer securities to accredited investors, but rural communities that have been overlooked by traditional capital sources, or projects that don't fit existing investment profiles, can use this approach to not only fund projects, but build strong community support.

CONCLUSION

Local investment is a burgeoning and fast growing investment sector. The impact of local investing is higher in rural communities. CDFI's sit in a unique positon to offer expertise and credibility to foster this investment class to help build stronger, equitable, and resilient communities.

