FINANCING THE ENTERPRISE VS. THE PROJECT

The primary funding model for CDFIs and other mission aligned financial intermediaries has been the successful combination of philanthropic and government grants or passive loans (“equity”) with short to medium term loans from depository institutions. This model has served intermediaries well, so long as the money retails their policy and regulatory objectives and the funding is measurable in terms of service impact. While this capital structure has largely been successful in generating necessary funding, there has been a noticeable lack of focus on building operational capacity or creating capital to generate long-term balance sheet independence. Mission aligned intermediaries now have the unique opportunity to begin to realign existing capital relationships to generate organic growth within an organization and create long-term balance sheet stability. One approach is systemic small dollar fundraising using tools such as Pledge Up™

BACKGROUND

A CDFIs greatest value to a lender or investor is their ability to meet the institutions financial, policy and regulatory obligations while exercising prudence on underwriting. The most successful CDFIs have learned to blend capital from government, depository institutions and philanthropies in order to find activity that scales the impact of their investment. Additionally, they have also introduced financial practices for community development such as senior/subordinate loans, repurchase agreement structures and investment trusts. Over the past five years, we have witnessed the introduction of long-term debt financing vehicles that have helped relieve many organizations of the constant struggle to match assets and liabilities based on short-term debt. Since 2013 over $1BN of funding has been issued under the CDFI Bond Guarantee Program and over forty-five CDFIs have become members of the Federal Home Loan Bank system. In an exciting new trend, CDFIs have begun to seek obligor ratings from S&P allowing them to issue rated bonds in the capital markets. While these innovations come at an obvious cost of holding collateral and other forms of capital in reserve to ensure some degree of liquidity, the expansion into capital markets has increased the ability for CDFIs to innovate as intermediaries of capital.

CHALLENGE

While the top tier of CDFIs have been able to demonstrate balance sheet strength necessary for access to capital markets, the majority of CDFIs remain focused on growing the balance sheet to fund allow them to grow leverage that generates spread income. Overall, CDFIs maintain relatively strong balance sheets with net assets averaging approximately 30% using a structure reliant on the combination of retained earnings from spread income, fees derived from New Markets Tax Credits and grant capital. However, reliance on spread income leaves an organization vulnerable to the yield compression between their cost of funds in a rate rising environment and the desire to maintain a low cost product for their customers.

With respect to grants, the most recent year’s federal appropriation of CDFI awards shows that the federal government will, in the near future, be a less robust source of investment capital. Philanthropic equity, and increasingly impact investments, will drive funding needs. However, there are significant costs associated with the process of institutional fundraising and a low hit rate of success. These constraints reinforce the importance of CDFI management, keeping one eye focused on the financial health of the enterprise and another on risk management of its financing activity.

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AMALGAMATED SOLUTION

The CDFI industry has benefited from several recent efforts to use technology to drive investment and these platforms have generally sought to place capital for project finance or to seed funds. Given our focus on treasury management, Amalgamated Bank recognizes that controllers, treasurers and CFOs often stay up at night worrying about whether there exists the appropriate capital to support the infrastructure of an organization as much as there is the appropriate asset-liability management of its debt portfolio. Finance teams often begin thinking of the implications of rate changes on operational capacity as spread income tightens and less retained earnings are realized. When there is also cyclicality to grant awards, the finance team is also regularly planning to manage liquidity.

One way Amalgamated has helped mission aligned organizations to increase operating capital is through small dollar fundraising built on a donors affiliation with values and policy. As an example, Amalgamated has entered into a partnership with the company PledgeUp™, an online platform that allows organizations to process payments, manage payment data and organize by cultivating connections. For Amalgamated Bank's historical union customers, PledgeUp has been an effective way to counter efforts by companies and municipalities to make dues payment collections and canvassing campaigns difficult for the union. This secure platform allows for recurring payment schedules using credit and debit card processing. In this process, Amalgamated Bank provides the treasury management infrastructure behind the PledgeUp technology.

The benefits of small dollar capital campaigns could benefit CDFIs similarly to have they have benefited unions. Just as the recent Janus v. AFSCME ruling firmly reinforces the need for unions to actively recruit and manage financial strategies away from the company or municipality, the FY 2018 cuts to the CDFI Fund's FA and BEA awards should signal that CDFIs must consider diversified capital raise strategies. Just as CDFIs have provided multiple examples of impact to foundations and banks, that same narrative can be used to harness individual fundraising.

Ultimately, CDFIs can use small dollar strategies such as PledgeUp to create balance sheet diversity. As a result, investors will gain greater comfort that CDFIs can withstand cash flow cycles, more effectively reserve against risk and fund operational improvements.

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