Investing in Manufacturing Communities Partnership:

Financing Guide

Introduction

There is no "one-way" to pay for IMCP activities or attract investment. Investing in Manufacturing Communities Partnership (IMCP) communities need to think comprehensively and creatively about opportunities to finance diverse aspects of their "ecosystem approaches" to sustainable economic development. Several emergent or underutilized sources of "impact investing" financing, including industrial development bonds, foundation program-related investments (PRIs), and pay-for-success financing, may prove appropriate for IMCP communities, possibly in combination with other funding sources, including traditional public and private funding. This document presents a stepwise approach to exploring and identifying financing mechanisms and partners for IMCP communities. Planning for financing should occur within the context of assessing your community's needs and developing your IMCP initiative strategy. See the Place-based Playbook for the IMCP for more details (http://manufacturing.gov/imcp).

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STEP 1: CLARIFY NEEDS

Clearly describe your specific funding needs, how the resources will be used, what benefits are anticipated, and who might be willing to pay for or re-pay over time for these services and results.

2

STEP 2: CONDUCT PARTNER LANDSCAPE ANALYSIS

Become familiar with the diversity of potential partners in your community. These might be stakeholders, investors, or other actors whose activities you can leverage. Which relationships exist and which need to be built? What interest in your approach exists among current partners?

3

STEP 3: DETERMINE READINESS

Identify how to improve your readiness to absorb capital investments. How do you describe your needs and investment opportunities to attract interest from investors? How can you enhance the effectiveness of your community investment efforts and your ability to attract investments?

4

STEP 4: ENGAGE PARTNERS

Identify and engage diverse financial partners for short- and long-term needs. Plan for partner engagement by clearly articulating your needs and learning about your partners' interests. How does your mission and your partners' needs align? Engage partners in Step 5 to explore financing options.

5

STEP 5: EXPLORE DIFFERENT TYPES OF FUNDING AND FINANCING

Evaluate different funding and financing mechanisms for fit. What are the eligibility requirements, the size and scale of prior funding activities, the expected return on investment needed, and potential cost savings from different financing options?

Step by Step

STEP 1: CLARIFY NEEDS

IMCP initiatives have diverse capital needs; it is important to clearly characterize these needs to match them with funding or financing options. Four common needs include:

1. Operating resources for intermediary and backbone organizations coordinating the initiative
2. Resources to support scaling and/or sustainability of supporting programs and technical assistance
3. Capital resources to develop or upgrade infrastructure deemed important to implement the IMCP plan
4. Access to capital for manufacturers to make improvements and enable development and growth

Multiple types of funding can be configured to address these needs, ranging from public budget allocations to grants to fee-for-service revenues. In addition, a range of innovative financing mechanisms may also be useful to address specific needs. Exploring the questions below will prepare you to match needs with funding options.

- How much capital is necessary to support the specific need?
- What are the anticipated financial, social, and environmental benefits of this investment? What are the projected financial returns on this investment for investors?
- What are the risks that may affect anticipated outcomes or prospects for re-payment or future financing?
- Do you anticipate that any partners would be willing to pay or re-pay for the IMCP services or results over time?

STEP 2: CONDUCT PARTNER LANDSCAPE ANALYSIS

The work conducted in IMCP communities is anticipated to have multiple benefits. Identifying potential partners who have an interest in IMCP outcomes will allow you to identify opportunities to leverage your community's work, leverage additional investment, and/or build local support. Place-based community foundations are estimated to collectively issue $5 billion in grants yearly.[1] In the initial phase of your landscape analysis, cast a wide net to identify potential partners.

Partners can offer diverse support beyond actual financing so it is important to approach partners as more than potential funders. Partners may offer connections to additional financing networks, facilitate relationships with key stakeholders or decision-makers, or offer strategic advice to assist you in planning an effective initiative. Consider partners who may be critical to your initiative not only now, but also in the long-term.

Identifying Local Partners

Consider reaching out to the following types of organizations in your community:

- Community Foundations: http://communityfoundationatlas.org/
- Community Development Financial Institutions (CDFIs): http://www.cdfi.org/ or http://ofn.org/cdfi-locator
- Development Finance Agencies: http://www.cdfa.net/
- Local Utilities
- State/Regional Economic Development or Philanthropy Networks http://www.cof.org/content/philanthropic-support-network

If you have difficulty finding partners, see the Identifying Partners text box and Step 5 for links to organizations that can help you identify partners. Questions to consider include:

- Which partners have local expertise and convening power?
- Which partners best understand the challenges and opportunities in your community?

[1] Democracy Collaborative, "A New Anchor Mission for a New Century: Community foundations deploying all resources to build community wealth," November 17, 2014, http://democracycollaborative.org/new-anchor-mission.

- Which partners can help you with financing or better help your community absorb capital? See Step 3.
- Are there other sector-specific opportunities you can leverage (i.e., energy, housing, geography/place-based)?
- Which partners are particularly good at interfacing between private financing partners and government agencies?
- Are local partners already funding similar work?

STEP 3: DETERMINE READINESS

There are several key steps to consider to ensure your community is ready to absorb capital investments. According to the Initiative for Responsible Investing at Harvard University and Living Cities, five core functions are required for successful community investment efforts:[2]

1. **Vision and legitimacy** to ensure that investments will meet community needs
2. An **enabling environment** consisting of policies and support tools to facilitate investments
3. A **pipeline** of deals and projects to support the community goals
4. **Management and monitoring** of projects to ensure financial and social performance
5. **Innovation** to strengthen and improve community investments over time

To support these core functions, consider taking these steps:

- Clearly define your goals, needs, and potential improvement projects (see Step 1). In particular, having a good sense of the expected results and the timeframe is important for attracting investment capital.
- Work with potential partners (see Steps 2 and 4) to identify policies and tools needed to support investment transactions, such as subsidies and incentives, outreach and training, data and analysis, and coordination to boost the demand and effectiveness of community investment.
- Ensure your community's backbone organization has a robust system for managing, monitoring, and improving efforts over time, which will help assure funders about the viability of their investments.

STEP 4: ENGAGE PARTNERS

Successful engagement of partners takes time and thoughtful planning. Do research to understand partners' mission and needs. Remember to engage partners for more than financial gain and have in mind your needs from Step 1. Be prepared to describe mutual benefits and be transparent about what you know and do not know – be clear about risk. Continue to foster your partner networks so that the right partners are engaged at every stage of your initiative. Consider these questions when engaging partners:

- How do your needs and program impacts align with your partners' mission and interests?
- What data or metrics do your partners need to measure investment success? How can you plan for future investment by collecting meaningful metrics?
- What are opportunities to broaden the impact of your work by considering expanding your focus to include elements that align with the ongoing work of your partners?

Emerging Trend

Private investors and foundations are increasingly leveraging impact investing to support efforts that help for-profit companies deliver social or environmental outcomes while also making a profit. Engaging and supporting the growth of these "for-benefit" companies in your IMCP initiative may attract more interest from these financial partners.

* For more information, see: Heerad Sabeti, "The For-Benefit Enterprise," Harvard Business Review, Nov. 2011, http://hbr.org/2011/11/the-for-benefit-enterprise/ar/1.

[2] Harvard University Initiative for Responsible Investing and Living Cities, "The Capital Absorption Capacity of Places: A Self-Assessment Tool," Version 3.0, February 2013, http://hausercenter.org/iri/about/capital-absorption.

STEP 5: EXPLORE DIFFERENT TYPES OF FUNDING AND FINANCING

Use the data you collected in Steps 1-4 to look critically with your partners at different funding and financing options. Consider whether more than one mechanism should be pursued. It's never too early to plan for future financing needs. Programs with incomplete evidence about expected benefits may need to engage a diverse mix of investors to mitigate the investment risk and build the evidence base. For example, foundations might invest early without an expected return. This limits the risk for future investors as this early investment can help build evidence, including metrics relevant to private equity investors.

The next section profiles three underutilized financing sources your community could consider. Other potential sources of funding include, but are not limited to, the following: grants from foundations or government agencies, public budget allocations, public guaranteed lending programs and revolving loans, loans from banks or credit unions, angel investors, venture capital firms, crowd funding, tax credit enhanced financing, and fees for services.

A hybrid or stacked approach to financing your IMCP initiative may help meet diverse programmatic needs and garner sufficient support. For example, your initiative may combine grants, subsidized fee-for-service technical assistance, loans, credit enhancements (investments to buy down the interest rates of a loan), and/or tax incentives. The *Blending and Braiding Toolkit* from the Spark Policy Institute (see http://sparkpolicy.com/tools/overview-blending-braiding/) can help you think about how to effectively combine and report on different funding sources.

Federal Financing Clearinghouse

The Council of Development Finance Agencies has a directory of federal financing resources at:

www.cdfa.net/cdfa/cdfaweb.nsf/ffcsearch.html

Funders may be interested in different stages or aspects of your initiative and consider it an advantage that you are engaging more than one type of funder. Think creatively and with long-term goals in mind to combine financing strategies.

Selected Financing Options

Industrial Development Bonds

Manufacturers may receive tax-exempt financing for manufacturing improvements through qualified small issue bonds, a type of private activity bond more commonly known as industrial development bonds. With industrial development bonds, public agencies issue bonds on behalf of a manufacturer so the company can make capital investments; the bond offers a lower interest rate than traditional loans. These bonds may finance up to 100 percent of a project's cost, but are limited to $10 million for tax-exempt status. The private bondholder, not the public agency, holds the risk, as the bonds are backed by project performance.

Considerations for Manufacturing Communities

- Although there are administrative costs with setting up bond financing, the lower financing rates could make these bonds appealing to manufacturers needing to make capital investments in the $1-10 million range.
- The tax-exempt status of the bonds lowers the cost of financing, as interest paid is exempt from federal income taxes. When interest rates are higher, there is greater potential cost savings.

Key Attributes of Industrial Development Bonds

Issuers: Public entities, such as states, counties, cities, towns, and development finance agencies

Eligible Recipients: Manufacturing firms of various types

Activities Funded: Construction or renovation, engineering work, equipment, and land acquisition for manufacturing facilities

Funding Size/Scale: $1-10 million (not cost effective for smaller amounts)

Return Expected: Loans are typically 1-2% less than rates for conventional financing; loan maturity varies from 5-30 years, matching the asset life.*

*Source: NIST MEP, Quick Reference Guide to Growth Financing, Fifth Edition, 2011.

Intermediary Resources: Council of Development Finance Agencies (www.cdfa.net)

Program-Related Investments

A program-related investment (PRI) is an investment a foundation makes to further its charitable mission and goals. Unlike grants, foundations expect that PRIs eventually will be repaid, although the primary purpose of the investment is not income generation. PRIs are most commonly loans, but they may also be equity investments or other financial vehicles in which a below-market rate of return is expected.[3] Foundations use PRIs, as well as market-rate investments, to complement their grant-making portfolios and expand their philanthropic impact.

Key Attributes of Pay-for-Success Financing

Funders: Private equity investors

Eligible Recipients: Multiple; government and non-government

Activities Funded: Proven interventions with benefits that can be monetized

Funding Size/Scale: Variable

Return Expected: Competitive rate of return, traditionally within 4-7 years

Considerations for Manufacturing Communities

PRIs could be a source of investment capital for communities seeking to foster sustainable economic development by investing in manufacturing. PRIs are most likely to be useful in these contexts:

- When traditional financial institutions (banks or credit unions) are unable to provide loans or lines of credit, or when the need is greater than can be met by these sources
- When there are identifiable investments that could be made at manufacturers (e.g., energy efficiency upgrades, worker training, etc.) that will provide some return on the investment and result in measurable improvements related to the foundation's goals

Intermediary Resources: Mission Investors Exchange (www.missioninvestors.org) and *Community Foundation Field Guide to Impact Investing* (https://www.missioninvestors.org/CommunityFoundationFieldGuide)

Pay-for-Success Financing

Sometimes referred to as a social impact bond, pay-for-success financing is a relatively new financing technique that sets up a contractual relationship between a social program and investors such that cost savings of the program can be returned to investors in the program similar to a traditional return on investment.[4] In prior uses of this approach there has been a clear monetary benefit resulting from the program.

Pay-for-success financing traditionally has funded programs that serve a large number of people and require large upfront investment. These programs have a proven track record of achieving intended benefits that result in a cost savings to a government agency.

Key Attributes of Program Related Investments (PRIs)

Funders: Private and community foundations

Eligible Recipients: All types of organizations

Activities Funded: Support causes aligned with foundation's mission

Funding Size/Scale: Few thousand dollars to multiple million dollars, typically as loans

Return Expected: Below market rate of return expected (~0-3%)

Considerations for Manufacturing Communities

- The IMCP context is more complex (i.e., diversity of outcomes, players, and interventions, etc) than contexts where this approach traditionally has been applied. A redesign of the traditional model might monetize the social and environmental benefits in addition to the cost savings.

3 The Foundation Center reported that over 70% of PRIs in 2006-07 were standard loans, bridge loans, or loans to capitalize a loan, and equity investments made up the next largest share of PRIs. Foundation Center, "Doing Good with Foundation Assets: An Updated Look at Program-related Investments," PRI Directory, 3rd Edition, 2010, http://foundationcenter.org/gainknowledge/research/pdf/pri_directory_excerpt.pdf.
4 Nonprofit Finance Fund, Pay for Success Learning Hub website, http://payforsuccess.org/about.

- Review the following aspects of your community's context:
    - Range of outcomes expected
    - Diversity of players and associated interventions
    - Scale of impact
- Evaluate which aspects of your IMCP initiative (e.g., workforce development vs. infrastructure) may be the most transferable to a pay-for-success financing model and the best fit for your community's needs.

Intermediary Resources: Social Finance, Inc. (www.socialfinanceus.org), Third Sector Capital (www.thirdsectorcap.org), and Nonprofit Finance Fund, Pay for Success Learning Hub (http://payforsuccess.org/)

Conclusion

IMCP is committed to continued learning and diffusion of information on emergent and underutilized financing tools and the expanded use of impact investing for community development. This guide profiles three approaches in a rapidly growing field. The stepwise process can be used to assess fit for a diversity of tools. A coherent strategy to identify, pursue, and secure investment requires deliberate planning and engagement of partners and is inherently iterative.

Investing in Manufacturing Communities Partnership

The Investing in Manufacturing Communities Partnership is a collaboration between multiple federal agency programs that support sustainable economic development. Communities participating in the IMCP are strengthening their competitive edge, investing in their workforce, improving their environmental performance, and addressing other community needs. For more information, see: http://www.eda.gov/challenges/imcp/