Community Investment in an Institutional Portfolio

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Table of Contents

I. Introduction

Community investment is increasingly being recognized as a stable and attractive option for institutional portfolios. Although individuals and religious organizations have traditionally comprised the majority of investors in Community Development Financial Institutions (CDFIs), prominent management firms such as Calvert as well as major foundations such as the Ford and the MacArthur Foundations are leading the way in large capital investment. Recently, institutions of higher education around the country have included or are considering incorporating socially responsible and community investment into their investment portfolios.[1]

According to the National Community Capital Association (NCCA), the leading national network of CDFIs, the CDFI industry continues to experience exponential growth in financing capital. The 2001 and 2002 NCCA data for member institutions show an average of 22% increase in capital per CDFI.[2] Furthermore, the deployment rate by NCCA member institutions in FY 2002 was 81% of total capital in loans and investment.[3] The need for targeted capital remains high and therefore also the need for investment.

This report will present three Community Development Loan Funds (a type of CDFI) located in the Western Massachusetts region which are well suited for institutional investments.[4] While using specific examples to address loan terms, rates of return, and risk, we hope to communicate the viability of community investment as an asset class and demonstrate its suitability for the fixed income bracket of the Mount Holyoke College portfolio.

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[1] "About: The Coalition," *Responsible Endowments Coalition*, < http://www.SRIendowments.org>
[2] "Community Investing 2002: Safety & Soundness Data Findings," *National Community Capital Association* , <http://www.communityinvest.org/press/sif_safety_and_soundness_brochure_2003.pdf>
[3] Ibid.
[4] A complete description of CDFI categories can be found in Appendix A.

II. Community Development Loan Fund Profiles: Acción, CFNE, and ICE

The CDFIs we have chosen to present are all Community Development Loan Funds (CDLFs), which pool capital from both individual and institutional investors in order to provide low-interest loans to non-traditional borrowers. What follows are profiles of Acción Springfield, the Cooperative Fund of New England (CFNE), and the Institute for Community Economics (ICE).

Acción

In 1994, Acción USA was established as a domestic non-profit micro-lender that provides low- and moderate-income entrepreneurs with access to loan capital and business training services. Acción Springfield is part of the Acción U.S. Network, which is the largest domestic microlending network and serves over 30 cities and towns in nine states. Its affiliate organization, Acción International, also lends to micro-entrepreneurs in Latin America and Africa. In 1997, President Clinton honored the Acción U.S. Network with one of the first Presidential Awards for Excellence in Micro-enterprise Development for success in demonstrating the viability of microlending in the United States.

CFNE

The Cooperative Fund of New England (CFNE) is a community development loan fund that serves as a bridge between socially responsible investors and cooperatives, community oriented non-profits, and worker-owned businesses in New England (and parts of New York). The mission of CFNE is to advance community based, cooperative and democratically owned or managed enterprises with preference to those that serve low-income communities. This mission is achieved through the provision of prompt financial assistance at reasonable rates, by being an investment opportunity that promotes socially conscious enterprise, and developing a regional reservoir of business skills with which to assist and advise these groups. CFNE was founded in 1975 by the Haymarket Peoples fund and representatives of producer and consumer cooperatives throughout New England, with the goal of providing badly needed loan capital for food cooperatives.

Since these humble beginnings, types of loan recipients have grown from food enterprises to include worker-owned businesses and cooperative schools, housing co-ops, land trusts, community-based non-profits, and a community health center.

ICE

The Institute for Community Economics (ICE), founded in 1967, is one of the oldest community development loan funds in the country. Its Revolving Loan Fund (RLF) was founded in 1979. ICE was the first to develop the Community Land Trust (CLT) model, in which land is purchased by a private non-profit corporation (either for housing, business, or conservation purposes) and held permanently under the control of that non-profit. An important component of the CLT model is that land buyers agree to keep housing rates at affordable levels regardless of market rates. CLTs are designed to eliminate absentee ownership and place control of quality, affordable land and housing back into local hands. A distinguishing feature of ICE is their commitment to create permanently affordable housing. In more traditional structures with fee simple ownership, after the first owner, the house goes to market price, the subsidies are lost, and the affordability is gone as well, but through the CLT model, initial subsidies are retained and subsequent buyers are able to purchase at an affordable price.

ICE loans primarily to CLTs, limited equity cooperatives, and community-based non-profits creating affordable housing across the country. The organization itself is based in Springfield, Massachusetts, and lending is prioritized in the New England area.[5]

Borrowers

Acción

More than 85% of Acción USA's clients are minorities, 42% are females, and 55% are low-income individuals as defined by the U.S. Department of Housing and Urban Development. Most borrowers from Acción borrow non-start-up capital, meaning that they have been running a business for at least a year that they want to expand or improve upon. When deciding to grant a non-start-up loan to a client, Acción reviews the history

[5] "Revolving Loan Fund Profile 2004," *Institute for Community Economics,* 1, and "About the Institute for Community Economics," *Institute for Community Economics*, <www.iceclt.org>

and integrity of the client's current business, including its profits and future projections. When deciding to grant a start-up loan to a client, Acción does a close investigation of the client's plans, projections, experience, credit history, and requires both a co-signer and collateral. The security measures taken by Acción have to be rigorous enough to weed out financially unstable clients, while flexible enough to lend to "higher risk" clients who are not able to obtain loans from traditional banks. Acción has struck a balance between these two goals, proven by their historically low loss rate of only 5.9% since inception.[6]

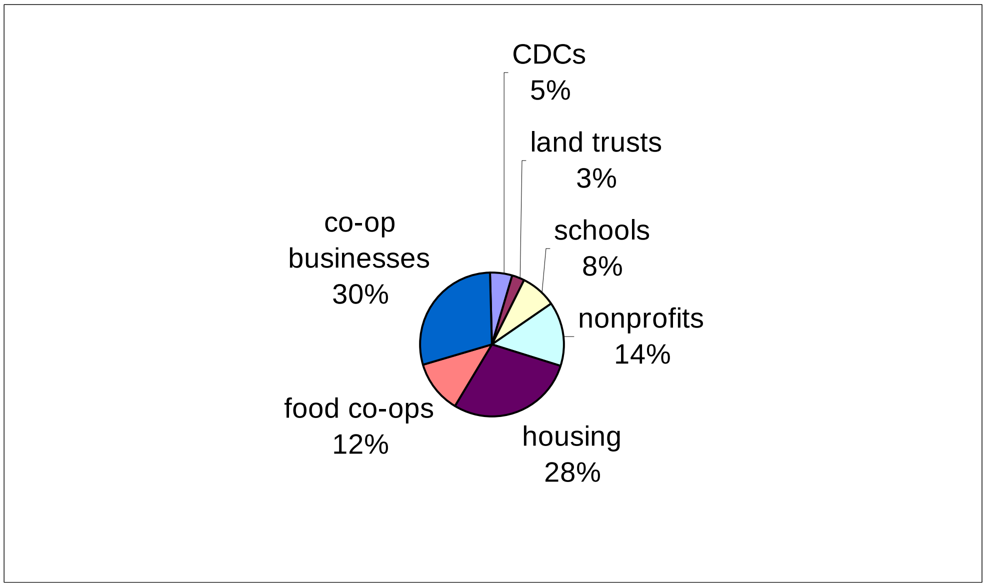
CFNE

As seen in Figure 1, cooperative businesses make up the largest sector of CFNE borrowers, followed by housing, non-profit organizations, and food co-ops. The definition of a cooperative business venture is one that is owned and operated on a democratic basis by members and returns surplus revenues to its members, much as an equity investment would pay out dividends to its stockholders. The purpose of a cooperative is to provide a service or good at an affordable price, empowering people through self-help and self-direction. CFNE has a loan repayment rate of 98.48%.

Many businesses and cooperatives previously funded by CFNE have provided educational and community service opportunities for Mount Holyoke students, as well as existing as successful local businesses students patronize. Collective Copies, a photocopying center in Amherst, MA, Nuestras Raíces, a community center in Holyoke, MA, and Café Habitat in Northampton, MA are just a few examples.

[6] "Annual Report 2002," *Acción USA*

Figure 1. CFNE Loan Recipients as of 12-31-03



ICE

As previously stated, ICE primarily lends to Community Land Trusts (CLTs), limited equity cooperatives, and private non-profit corporations seeking to permanently establish affordable land and housing initiatives. Funds typically go to the acquisition and improvement of land or the acquisition, rehabilitation and construction of affordable housing. Other commonly financed projects include the acquisition of business property for non-profit organizations working in the affordable land and housing field. Examples of borrowers in the Western Massachusetts area include:

- Northern Educational Services, Inc., Springfield, MA. NES, a 35-year-old social services program in downtown Springfield, used the $100,000 loan to acquire and renovate 15 units of housing for low-income women and children receiving services from NES.
- Holyoke Community Land Trust, Holyoke, MA. This CLT was founded 10 years ago with the help of an ICE loan. Since that initial loan, 20 Victorian-style homes have been acquired, renovated and sold at prices affordable to low-income families. In 1999, the Holyoke CLT received loans of $200,000 and $300,000 to help finance new construction and renovation efforts.

All of ICE's borrowers must have a 501(c)(3) or 501 (c)(4) IRS designation. Each project must complete a pre-application for loans in order for ICE to determine project and borrower eligibility. Priority is given to projects creating or acquiring housing which will remain permanently affordable to low-income families, and to projects providing long-term benefits and community control to low-income people.[7] ICE has a loan repayment rate of 99% since inception in 1979.[8]

Technical Assistance to Borrowers

One unique quality of Community Development Loan Funds is that financial advisors work closely with their borrowers to ensure the success of their business or organization and the timely repayment of their loan. For example, Acción offers "financial literacy training" for its microentrepreneurs. Acción has also formed partnerships with law firms and other community organizations to create a network of information and support for its borrowers, making all lenders' investments more secure. The technical assistance at CFNE is provided by three regional Outreach Coordinators who visit and assist current borrowers and future borrowers with business management and financial concerns. Although ICE specializes in advising CLTs or individuals wanting to establish CLTs, technical assistance is provided to all borrowers through site visits, telephone and email communication, and regional and national conferences and trainings.

Investors

Acción

Acción's loan pool totaled $4,482,000 at year-end 2002. As can be seen in Figure 2, both the McArthur and Ford Foundation have invested $1 million since 1995 and 1997 respectively. Both Equitable Insurance and Citizens Bank have invested $500,000 since 2002 and 2003 respectively. One quarter of Acción's loan pool is comprised of investments from 17 different religious groups, banks, and foundations. As of December 2002, there were 10 individual investors in Acción, comprising 4% of the total loan pool, for a combined amount of $162,000.

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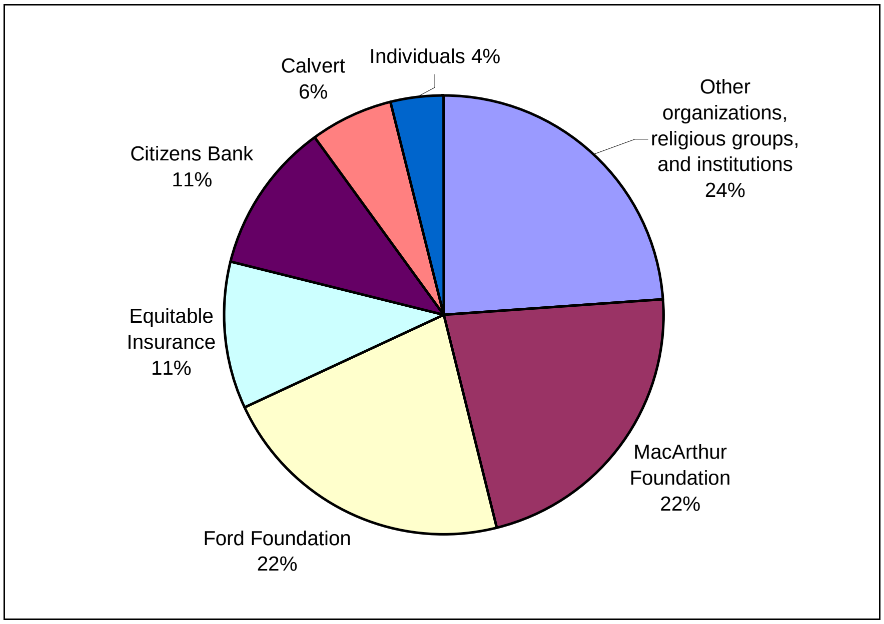
[7]"Revolving Loan Fund Profile 2004," *Institute for Community Economics*, 7.
[8] Clark-Gomes, Raylene and Susan Stern. Personal Communication, 20 April 2004.

Figure 2. Acción Investor Mix



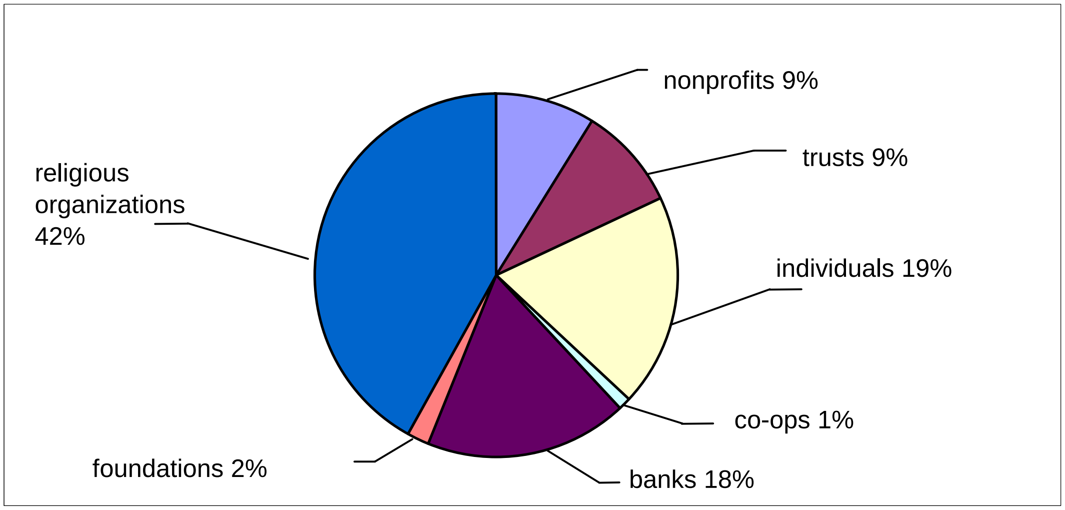
CFNE

CFNE currently receives investments primarily from religious organizations (42% of total investor mix) and individuals (19% of total investor mix). As of December 31, 2003 CFNE had 117 total investors with average investments of $81,378 (see Figure 3). There are currently seven institutional investments ranging from $200,000 to $450,000. The largest investors are:

Episcopal Diocese of Connecticut	$450,000
Calvert Group	$325,000
Chittenden Bank	$300,000
Ascension Health	$250,000
Catholic Health Initiative	$250,000
National Community Capital Association (NCCA)	$250,000
Episcopal Church of USA (received January 2004)	$200,000

Additionally, CFNE has received investments from another educational institution, the Oberlin College Student Coop.[9]

Figure 3. CFNE Investor Mix



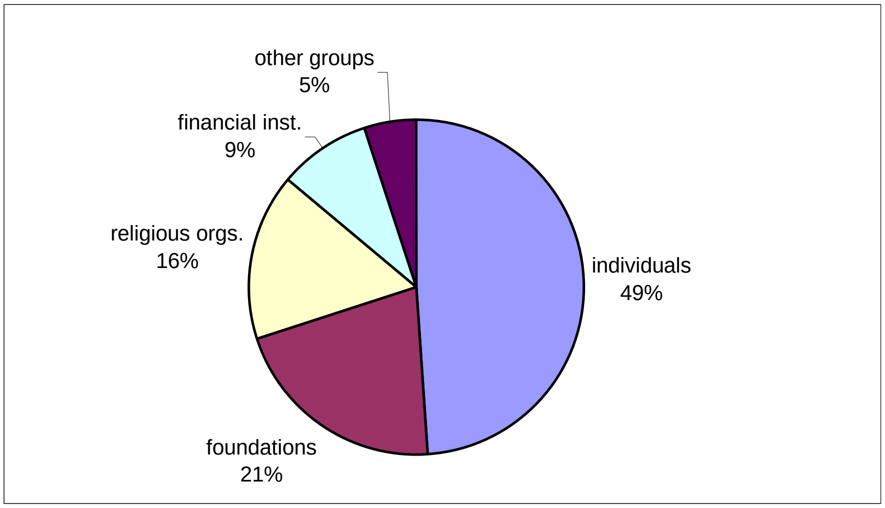
ICE

Forty-nine percent of ICE's Revolving Loan Fund is funded by individuals, and the other half is composed of investments from foundations, religious organizations, financial institutions and other groups (see Figure 4).[10] Currently, 390 investors have $10,759,248 invested in the RLF.[11] The majority of investors invest between $10,000 and $30,000. The investors with the largest investments are:

MacArthur Foundation	$750,000
NCCA	$500,000
Calvert Foundation	$475,000
Private Individual	$385,017
Domini Social Investment	$250,000
Private Trust	$200,000

[9] Dunn, Rebecca. Personal Communication, 29 March 2004.
[10] "Revolving Loan Fund Profile 2004," *Institute for Community Economics*, 4.
[11] Ibid., 1.

Figure 4. ICE Investor Mix



Absorption Capability

Acción

Acción Springfield has a loan pool of $4.4 million which is primarily comprised of a few large investments. Having managed multiple investments of $1 million, as well as many large investments of $500,000 and over, Acción is capable of absorbing investments of up to $1 million.

CFNE

CFNE's total investments have consistently grown by $500,000 yearly since 2001. In 2003, CFNE received $799,000 in new investment money. Total loans repaid in 2003 exceeded $1 million, allowing the loans disbursed in 2003 to exceed 2002 by 16%. This consistent rate of repayment and steady inflow of new loan applicants insures that CFNE continues to maintain the capacity to absorb new investments and grow as an institution.[12] Within their loan pool of $3.4 million, CFNE is able to absorb investments of up to $500,000.

ICE

In the past 25 years, ICE's loan pool has grown to over $13 million. In 2003, ICE committed $1,430,000 in new loans, leaving the current committed year-end total at $2,297,081.[13] ICE regularly absorbs loans of over $500,000, and in 1991 accepted an investment of $2.5 million from the Ford Foundation.[14] Each year, ICE sets a goal of achieving $200,000 in long-term capital—funds that will remain in the RLF for at least ten years. This goal has been consistently met or exceeded every year. At present, ICE has already attained almost half a million dollars in long-term capital for calendar year 2004 alone.[15] ICE is interested in large investments of up to $2 million.

III. Investing in Community Development Loan Funds

Loan Terms and Repayment Streams

Acción

A loan to Acción USA is evidenced with a Promissory Note and a Loan Agreement. Interest Payment dates for the Notes are semi-annual. The term of the loan is at minimum 18 months. The investor must provide Acción USA with written notice, at least 30 days prior to the expiration of the initial or any successive term that the loan must be paid at the end of such term. Acción reserves the right to prepay the whole or any part of the principal of the loan at any time without penalty.

[12] "CFNE Annual Report 2003," *Cooperative Fund of New England*, 3.
[13] "Revolving Loan Fund Profile 2004," *Institute for Community Economics*, 6.
[14] Clark-Gomes, Raylene and Susan Stern. Personal Communication, 20 April 2004.
[15] Ibid.

CFNE

Social investment loans to the Cooperative Fund are provided on terms chosen by the investor within a range of options. The social investor may also designate whether the interest will accumulate with principal or be paid out on a quarterly basis. Repayment may be set at either a fixed or indefinite term.

The Fund encourages long-term investment. Social investment loans, however, may be called for repayment within a short period of time. For those that are particularly large, the Fund asks that repayment be limited to five thousand-dollar increments within each 30-day period after it receives notice of withdrawal.[16]

ICE

Investors propose the size, term, and interest rate of their investments, with the minimum being $1,000 for at least one year. Interest payments are made on an annual or other periodic scale. While investors negotiate their rate of return, ICE is able to offer higher rates of return depending on the length of the loan period, to encourage long-term investments. The repayment of loan principal is usually by lump sum payment on the due date of the loan.

Components of Return

CDLF returns have several unique qualities that differentiate them from conventional investment options. At the outset of investing, from within the parameters set by the loan fund, the investor selects both a rate of return (which remains fixed over the length of investment) and a period of investment. Interest, which is adjusted quarterly, is then paid annually or on another periodic schedule. Alternatively, if the investor chooses, the interest can be reinvested into the loan amount. Upon loan maturation, the initial capital invested is repaid.

Most investors in Acción can choose a rate of return up to 5%, depending on the period of the loan. Large investors, however, negotiate their own rate, which usually falls between 4 and 6%. Currently, CFNE offers rates of return of up to 3%, which, as

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[16] "Terms of Social Investment Loans," *Cooperative Fund of New England*, <http://www.cooperativefund.org/invinfo.html>

previously stated, remain constant over the length of the investment. The majority of ICE's investors are paid between 3-4%, with rates up to 5%.[17]

Risk and Risk Mitigation

These community loan funds are non-profit corporations whose investments are not insured by the federal government. Thus, evaluating the institution's risk and risk mitigation is a function of analyzing the size of loan fund loss reserves, and the pro rata loan loss plan.[18]

Loan Fund Loss Reserves

Acción, ICE, and CFNE have loan fund loss reserves, a pool of funds designed to shield the investor capital from potential losses due to loan default or late payment on the part of the borrowers. Each of the institutions keeps their loan fund loss reserve above a certain percentage of the fund's outstanding loans and standby letters of credit issued by the Fund (see Figure 5).

Figure 5. Target and Actual Size of Loan Fund Loss Reserves

Target and Actual Size of Loan Fund Loss Reserves			
	Designated minimum percentage[19]	Percentage currently in loan fund loss reserve[20]	Current Cash value of loan fund loss reserve
Acción	10%	16.7% (as of 5/31/03)	$317,840 (as of 5/31/03)

[17] After a review of the prevailing market borrowing rates in the spring of 2003, ICE's Community Investment Committee lowered the cap interest income rate for investors from 5% to 4% for loans five years or longer. This change will take affect only upon investment renewal, after current investments at a 5% return rate have matured as set in the original investment terms.

[18] Other factors to be considered include technical assistance to borrowers, as discussed in Part II, and managerial structure and history, as described in Appendix C.

[19] The minimum percentage refers to the goal percentage of the institution's outstanding loans and standby letters of credit.

[20] This column refers to the actual percentage of the loan loss reserve in relation to outstanding loans and standby letters of credit.

CFNE	3%	In excess of 5% (as of 12/31/03)	$148,123 (as of 12/31/03)
ICE	Aggregate reserve of 5% of each loan received[21]	6% (as of 2/29/04)	$417,938 (as of 2/29/04)

Pro Rata Loss Plan

In the event of a default by a borrower under a Fund loan or letter of credit, the loan loss reserve would be used first to help offset any losses incurred. In the event of a loss that is not fully covered by the institution's loan loss reserve, the amount of the loss would be shared on a pro rata basis among all of its investors.[22] An exception to this policy is that Acción offers a senior lenders' standing. A "senior lender" agrees to a slightly lower rate of return in exchange for a higher security investment. In the event of losses, senior lenders hold priority in repayment schedules. Additionally, each CDFI has several investors that have designated their investments to receive a lower priority in a repayment schedule from the loan loss reserves in the event of a loan loss situation.

Community Investment in a Diversified Portfolio

The rate of return selected by the investor upon initiation of the loan will remain constant. Due to this fixed interest rate, a CDFI investment has zero volatility, which ensures a constant income and provides a source of protection for the investor in instances of a down-turned market, where the returns on other investments could be negatively affected.

Investment in Community Development Loan Funds falls in the Fixed Income bracket of the Mount Holyoke College portfolio. Within the portfolio, this investment yields returns comparable to those of the PIMCO Total Return Fund. As of 19 April 2004, PIMCO's annualized one-year returns were 3.87% and the five-year returns were

[21] Each loan is assigned a reserve allowance based on risk classification from 3-25%.
[22] This means that losses that extend beyond the loan loss reserve fund will be drawn from the investors' loan principal in the same proportion that his or her loans bear to the total principal amount of all outstanding fund loans.

6.94%.[23] The three recommended CDLFs would yield 3-5%, integrating well with the college's current low-end fixed bond investments.

[23] "Bond Profile: PIMCO Total Return Fund A (PTTAX)," *PIMCO Advisors*, <http://www.pimcofunds.com/mutualFunds/profile/PMTR/performance_A.jsp>

IV. Educational and Experiential Returns of Community Investment

The additional, non-financial returns of community investment can be categorized in two ways: returns to already existing programs, such as the Community Based Learning Program and C.A.U.S.E.; and returns in the form of new opportunities for increased interaction of students with the surrounding communities, which includes less direct returns such as work experience and job opportunities. In order to quantify the potential returns on this investment, it is necessary to evaluate the existing relationship between Mount Holyoke College and the surrounding communities. Although existing programs most closely work with Holyoke, the benefits of community investment would extend to many other communities in the Western Massachusetts area.

CBL, C.A.U.S.E., and Community Service Work Study

Through the Community Based Learning (CBL) Program, there are on average 15-18 classes that incorporate service learning each semester. This means that every year, approximately 500 students travel off campus to complement their academic studies through engagement with community organizations.[24]

Outside of class, the C.A.U.S.E. program gets students off campus by facilitating 17 community service projects in the surrounding communities. With a mailing list of over 500 students, C.A.U.S.E. connects hundreds to weekly opportunities such as at the North End Community Center in Springfield and Womanshelter/Companeras, a battered women's shelter in Holyoke.[25]

Through the Community Service Work Study program, run by the Career Development Center, over 60 students work at 13 different sites located in Holyoke, Springfield, and Amherst.[26] Students who must spend their free time working for income do not usually have additional time to perform volunteer work. This partnership between the Federal government, Mount Holyoke College, and organizations allows such students a chance to get involved in the local communities.

[24] Smith, Preston. Personal Communication, 14 April 2004.
[25] "Opportunities to Volunteer," *C.A.U.S.E.* <http://www.mtholyoke.edu/org/comserv/index.htm>
[26] Kane, Janice. Personal Communication, 17 April 2004.

Nuestras Raíces:
Educational Returns in Action

An example of the educational returns of community investment can be found in the case of El Jardín Bakery in Holyoke. Using start-up capital from the Cooperative Fund of New England, Nuestras Raíces, a community center in Holyoke, was able to set up an organic bakery and community kitchen in their offices on Main Street. Since 2002 El Jardín Bakery has sold its five varieties of organic artisan bread at restaurants and stores throughout the Valley, while creating much-needed jobs in Holyoke.

After studying community development in their CBL Politics course, eight Mount Holyoke students decided to approach Nuestras Raíces as a community partner for their service learning requirement. The bakery is now collaborating with these students to create a marketing video for the organization. While students learn valuable skills – including interviewing and video editing, as well as enhancing their understanding of community development by seeing it in action, the bakery will gain a new marketing tool. It was the initial investment and the technical assistance provided by CFNE that made this all possible.
http://www.nuestras-raices.org/el_jardin_bakery.htm

Many employers look specifically for applicants with more than just academic experience. Students who have had work experience in the "real world" during college gain a competitive advantage when entering the workforce after graduation.

These data provide a general, though incomplete, picture of the existing relationships between the College and surrounding communities that lead to educational and experiential gains. Preston Smith, Director of the CBL Program, will be completing a more extensive audit next year, which will be instrumental in identifying the possibilities for strengthening this relationship as well as measuring the returns to both the College and surrounding communities.

Returns to Existing Programs

Investment in local communities through financial intermediaries (CDFIs) presents an opportunity to strengthen the capacity of organizations that the College draws on regularly to supplement and enhance the academic curricula.

One of the main problems that students and professors in the CBL program face is the lack of organizational resources, which often makes it difficult for organizations to spend time working with students and engaging them effectively. Chronically understaffed and operating on a shoestring budget, many of these organizations simply cannot afford to engage with students to the extent they would like. Through providing capital to these organizations, CDFIs play an instrumental role in increasing their ability to flourish and grow as organizations, and thereby their ability to provide productive CBL experiences for students. According to Preston Smith, as quoted in a December 2003 article in the College Street Journal, “The more a community organization gains from a CBL experience, the more invested it is in the relationship with the class and the more a student gets from it.”[27]

The returns are similar in the case of community service. Although non-academic, extracurricular community service contributes to a well-rounded educational experience, and is an opportunity for civic engagement, which Mount Holyoke College aims to inspire in its students. While community investment can be seen as fostering an environment in which community service can flourish, it also must be recognized as a commitment to the same values. The receptivity to student community service efforts can be enhanced by the knowledge that the College itself is committed, and literally invested, in the well being of its surrounding communities.[28]

Creation of New Opportunities

Community investment will not only strengthen existing relationships, but will foster new ones, leading to increased access to community resources, work experience and job opportunities, and opportunities to explore questions of investment and ethical business. As stated on the Career Development Center’s website, Mount Holyoke College prides itself on a tradition of service, and the alumnae that carry it on after they graduate:

> Honoring [Mount Holyoke’s] tradition of service, many of our alumnae are employed in fields such as education, social work and the not-for-profit sector….Rather than being a narrow training for a particular career, our curriculum provides the breadth, and our career programs provide the experiential opportunities, to allow our alumnae to succeed in whatever fields their interests and talents draw them toward.[29]

The ability to provide experiential opportunities in the fields of community organizing, non-profit management and development, and social work is fostered, if not dependent on, strong working relationships with the surrounding communities. By investing in these types of organizations locally, the College directly stands to benefit by

[27] “Preston Smith Opens Doors to Students and Faculty for Weissman Center’s Community-Based Learning Program,” *College Street Journal*, 12 December 2003.
<http://www.mtholyoke.edu/offices/comm/csj/121203/ smith. html>

[28] This mission can be found expressed in the Mount Holyoke College Plan for 2010. Community investment would be one more way to realize the goals for purposeful engagement outlined in the Plan.

[29] “Introduction to the CDC,” *Career Development Center*, http://www.mtholyoke.edu/offices/careers/cdcintro/about.htm

being able to provide more experiential opportunities for students, whether through volunteer work or the work study program. While its educational merit has been discussed, this experience is also important for career preparation.

Not only will students gain work experience in the community, but also the College will have more local professionals to use as resources. One example of this is the Community Investment professionals themselves. In November of 2003, the forum entitled "Close to Home: Community and Capital in Western Massachusetts" brought together community investment professionals, community organization leaders, and faculty to discuss issues of local investment and community needs with an audience of students and faculty. This is one example of how simply the conversation on community investment has been able to bring resources to the College, and provide students with valuable information regarding the socially responsible investment field.

At the same time, another return realized by a College commitment to community investment is student education around investment issues. There are a whole range of possibilities resulting from this investment decision, including the creation of an investment club, discussions on institutional and individual investment, "real-world" workshops designed to increase student literacy of economic and investment issues (such as those put on by Smith College).

Furthermore, a greater awareness of the College's investment practices, and the knowledge that these include investing in the local region, also has the potential to generate more interest in donating to the College upon graduation. Furthermore, by appealing to a niche market concerned with socially targeted investment, the College has the opportunity to reach donors who were previously uninterested in donating to the College or felt that donations to other causes were a higher priority. This larger donation pool (made up of donations from recent graduates, new donors, and increased size of donations) can be seen as another indirect yield of including community investment in the Mount Holyoke College.

V. Conclusion

Community investment, as this report has demonstrated, is an asset class that boasts comparable returns to the existing Fixed Income accounts in the Mount Holyoke College portfolio, while providing additional yields in the form of educational, experiential, and fundraising returns. For the Community Development Loan Funds discussed, the investment is insured through strong managerial histories, decades of successful lending experience in the region, and a range of risk mitigation policies.[30] Investing in Community Development Loan Funds is not only a sound financial decision, but is also an opportunity for the College to enhance its portfolio through participating in the growing trend towards socially responsible investment.

In urging Mount Holyoke College to take advantage of this opportunity, we recommend that the College consider investing a fixed percentage of the endowment into Community Development Loan Funds that serve the Western Massachusetts area. Because of their strong track record and important role in the community-led development of the region to date, we recommend the CDLFs presented in this report: Acción USA, the Cooperative Fund of New England, and the Institute for Community Economics. In addition, in order to ensure the successful implementation of this investment, we recommend that a socially responsible advisory board be instated comprised of administrators, faculty, students, and alumnae, such as the one at Williams College.[31] This board would make recommendations regarding the community investments, distribute information and track the success of the investments, and serve as a clearinghouse for College and community investment concerns.

[30] See Appendix C for managerial histories of specific CDLFs.
[31] Orlowski, Mark. Personal Communication, 16 March 2004. The Advisory Committee on Shareholder Responsibility at Williams College is made up of the Treasurer, the Provost, two faculty, two students, two alumni, and the Director of Investment (who holds a non-voting position).

Appendix A. Community Investment as an Asset Class

The current CDFI industry began taking shape in the late 1960s and early 1970s. Some of the first organizations dedicated to community development were created out of governmental efforts to address poverty alleviation and racial discrimination. The Johnson Administration, under its "War on Poverty" campaign and through the Office of Economic Opportunity, launched community development corporations (CDCs) to work in both urban and rural poor communities. The successes of many of these early CDCs lay the foundation for today's CDFI industry.

In the 1990s the CDFI industry expanded dramatically. Factors contributing to this growth included:

- The creation of the CDFI Fund in 1994, a government agency that provides funding to individual CDFIs and their partners through a competitive application process.
- Revised Community Reinvestment Act (CRA) regulations in 1995 that explicitly recognize loans and investments in CDFIs as a qualified CRA activity.
- A growing record of success that has inspired confidence in the CDFI industry and attracted new sources of support and funding.
- In 1986, ICE and CFNE were founding members of the National Association of Community Development Loan Funds (NACDLF), which became the National Community Capital Association (NCCA) in late 1997, "to develop an industry of community-centered financial institutions that combine social and economic justice with solid business performance. It has instilled a sense and system of mutual accountability across the industry and has built a strong national voice for community development loan fund."[32] NCCA represents thousands of investors and millions of loan dollars.
- The Riegle Community Development and Regulatory Improvement Act of 1994 created a government CDFI Fund as well as requiring "the Federal bank and thrift regulatory agencies to conduct a systematic review of their regulations and written policies in order to improve efficiency, reduce unnecessary costs, and eliminate inconsistencies and outmoded and duplicative requirements."[33]

[32] "Information for Social Investors," 2003 Prospectus *Cooperative Fund of New England*, 6.
[33] "Reports - On Section 303(a)(3) of the Riegle Community Development and Regulatory Improvement Act of 1994," *Federal Financial Institutions Examination Council*, <http://www.thecre.com/fedlaw/ egal7q/riegle.htm>

Today the number of CDFIs continues to increase.[34] There are over 600 CDFIs certified by the government CDFI Fund. However, not all CDFIs are governmentally certified, and government approval is not necessarily the only indicator of fund quality. CDFIs operate in every state and the District of Columbia, serving both rural and urban communities.

Helping Low-Income People

CDFIs are private-sector, financial intermediaries with community development as their primary mission. While CDFIs share a common mission, they have a variety of structures and lending goals. There are six basic types of CDFI: community development banks, community development loan funds, community development credit unions, microenterprise funds, community development corporation-based lenders and investors, and community development venture funds. All are market-driven, locally controlled, private-sector organizations.

CDFIs measure success by focusing on the "double bottom line": economic gains and the contributions they make to the local community. CDFIs fund business growth, housing, voluntary organizations, and services central to revitalizing our nation's poor and working class neighborhoods. CDFIs rebuild local economies by increasing the ability of ambitious entrepreneurial people to act in their own economic self-interest.

Not only do local organizations make the decisions about how to best meet community needs, the ripple effects of CDFI activity support responsible homeowners, locally-owned businesses, neighborhood facilities, and other positive benefits to communities that reach far beyond the financial

CDFI Products and Services

CDFIs conduct a wide range of financial activities, including technical assistance to borrowers. Community development credit unions and community development banks supply underserved communities with traditional retail banking services like savings

[34] The Social Investment Forum reported in *2003 Trends Report* that community investment as an asset class has grown a remarkable 84% in the last two years, expanding from \$7.6 billion in 2001 to \$14 billion in 2003. "Revolving Loan Fund Profile 2004," *Institute for Community Economics*, 1.

accounts and personal loans. Microenterprise development loan funds provide capital to small scale entrepreneurs.

Community development venture capital funds provide equity and management expertise to small, often minority owned businesses that promise rapid growth. Community development loan funds (CDLFs) lend to build businesses, affordable housing and community facilities.

Community Development Loan Funds (CDLFs)

Loan funds are typically private, non-profit institutions that provide flexible and low-interest financing. This type of CDFI is arguably the most flexible instrument for investing in projects that have the greatest impact on impoverished communities – usually in the form of affordable housing, small businesses, social services, and agricultural and land conservation projects. As financial intermediaries, the loan funds have the resources and expertise to channel social investment capital into communities by pooling investments from both individual and institutional investors. CDLFs are closely involved with borrowers, providing technical assistance and other services to help ensure the successful repayment of loans, and thus offer a safe investment option to investors, even without being FDIC insured.

CDFIs and Mainstream Financial Institutions

CDFIs differ from mainstream financial institutions in some key aspects. CDFIs cultivate specialized knowledge about the communities in which they do business. They forge deep relationships with their customers and community leaders. This translates into a willingness and commitment to spending time on individualized service, and specialized programs that are often too time-consuming or costly for mainstream financial institutions to implement. For example, many CDFIs offer non-conforming mortgages or loans. Others make accounts available to customers with limited or poor credit history. Mainstream institutions on the other hand, tend to offer a few generic programs designed to capture the broader market.

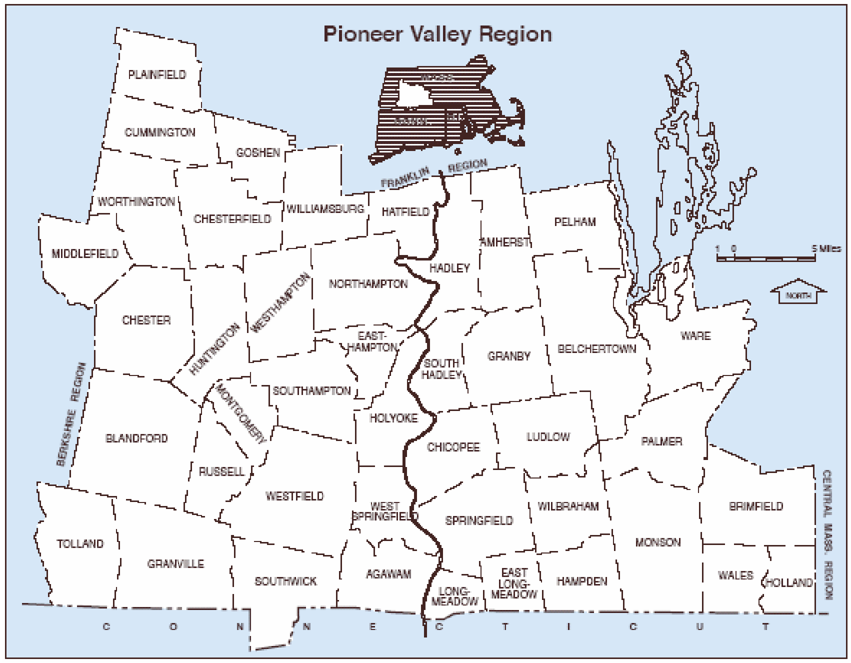
Despite these differences, CDFIs do not supplant conventional financial institutions. In fact, they complement each other. Because CDFIs and banks share a market-based approach, CDFIs often work in partnership with banks to develop innovative ways to deliver loans, investments, and financial services to distressed communities.

Sources of Funding for CDFIs

CDFIs are private-sector organizations that attract capital from private and public sources. Private sector funds come from many sources: corporations, individuals, religious institutions, and private foundations. Depository CDFIs, like community development banks and community development credit unions, get capital from customers and non-member depositors. CDFIs work in partnership with conventional financial institutions to channel private investment into distressed communities, either through direct investment in the CDFI or through coordination of services.

Appendix B. A Macro-Economic Picture of the Pioneer Valley

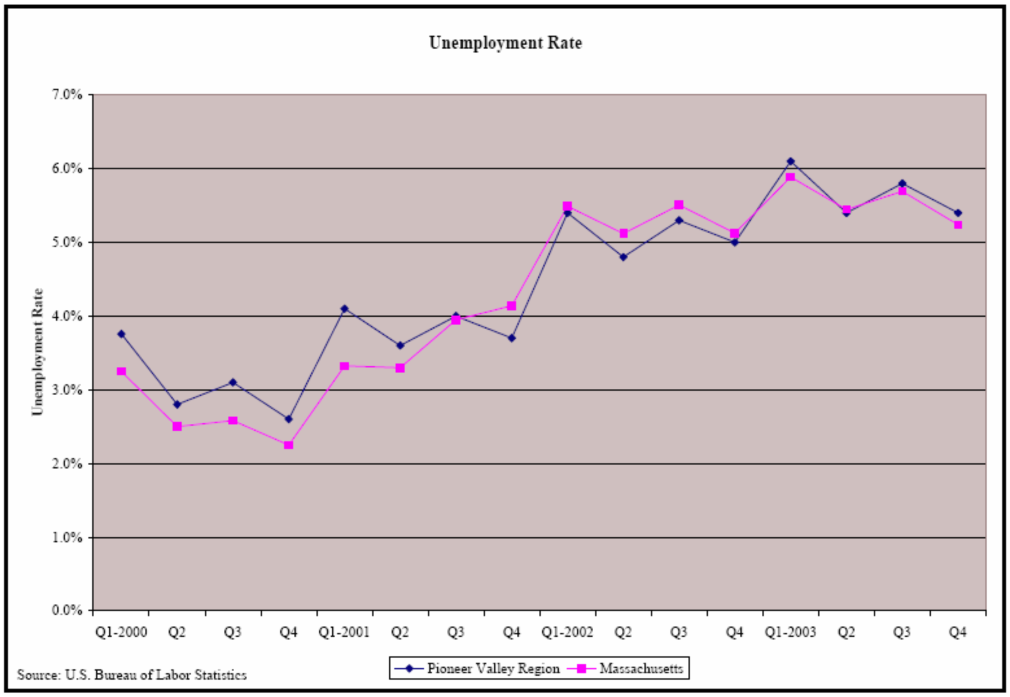
The following is a short synthesis of economic reports recently published in the Pioneer Valley. Its purpose is to give some insight into the economic situation of Western Massachusetts, and provide information about employment, the housing market, and lending in the area.



The Pioneer Valley is located in the Midwest of the state and encompasses 1,179 square miles. It is the fourth largest metropolitan area in New England. It also includes the city of Springfield, which serves as the region's cultural and economic center. Many large employers of the region are based in Springfield, including Massachusetts Mutual Life Insurance Company, Baystate Medical Center, Mercy Hospital Incorporated, and Solutia.[35]

Projected growth in the next thirty years is reason to take notice of this area. The population of the Pioneer Valley in 2000 was 608,479, and is projected to grow to over 650,000 by 2030. There will also be a dramatic but necessary increase in the number of households in the region, from about 230,000 in 2000 to more than 275,000 in 2030.[36] With this increase in population, it is reasonable to expect major changes in employment growth. Steps will have to be taken to ensure that population growth will be able to translate to employment growth. Special attention should also be paid to outer ring suburbs and rural communities, as these areas tend to experience the greatest amount of growth, as opposed to cities and inner ring suburbs.[37]

[35] "Discerning the Future: Population, Household, and Employment Projections, for the Pioneer Valley Region, 2000 – 2030." *Pioneer Valley Planning Commission*, June 2003.
[36] Ibid.
[37] Ibid.



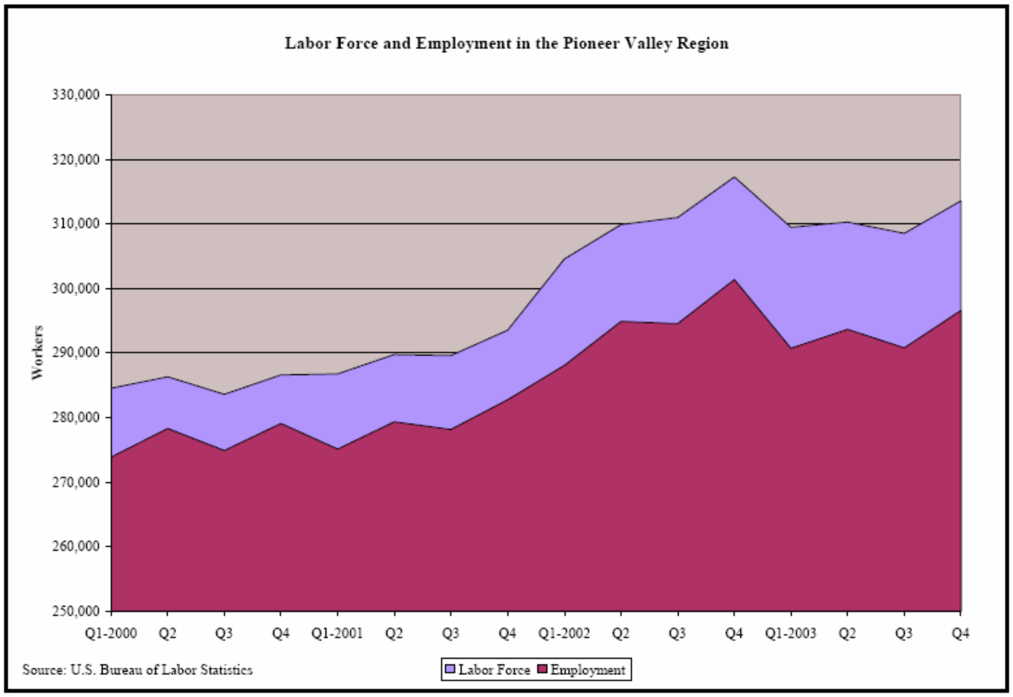
According to a report published by the Pioneer Valley Planning Commission (PVPC) in March 2004, unemployment rates in the Pioneer Valley have been rapidly increasing, as have the rates in all of Massachusetts. By the end of 2003, unemployment rates were higher than they had been in the last four years, at 6.1%, but only 0.2% higher than the rate in Massachusetts as a whole.[38] These high rates are due to changes in the size of the labor force, which is growing at a rate disproportionate to employment growth. From the fourth quarter of 2000 to the fourth quarter of 2003, the Pioneer Valley labor force has increased by 26,985 people, or 9.4%.[39] In the same time period between 2000 and 2003, employment increased by 17,536 people, or 6.3%.[40] Between 2000 and 2015, the PVPC expects a slight increase in employment rates of 6.7%, but these gains may be negated by a 6.6% decline between 2015 and 2030.[41]

It is important to note that the labor force of the Pioneer Valley is increasing at a much faster rate than for the state of Massachusetts as a whole. Over the same time period between 2000 and 2003, the Pioneer Valley region's labor force index rose by 10.0% compared to only 3.4% for the state as a whole. Another difference between the

[38] "In Brief: The Economy Of the Pioneer Valley Region 2000-2003." *Pioneer Valley Planning Commission March* 2004.
[39] ibid.
[40] ibid.
[41] "Discerning the Future." PVPC.

Pioneer Valley and Massachusetts can be found in examining the Pioneer Valley employment index, which increased by 5.9% between 2000 and 2003, while the state employment index rose by only 0.4%.[42] In the last four years, the Pioneer Valley's labor force and employment base have been steadily increasing, trends that both bode well for the economic future of the region.

In the housing market of the Pioneer Valley, there have been several notable



fluctuations. Because the second and third quarters of the year are typically the strongest for home sales, looking at sales during the third quarters of 2000-2003 demonstrates a 10.6% decline in sales between 2001 and 2002, followed by a 25.1% rebound between 2002 and 2003.[43] Over this time period, the peak single-family home price has been higher each year, indicating a general trend of rising prices. Sales in the Pioneer Valley compared to Massachusetts in general show no significant difference. The residential building permits issued during this period rose by 21.2%, and most of these issues were for single-family homes.[44] The index of building permits is considerably higher than the statewide index, which raises some concerns about the diminishing availability of open land.

[42] "In Brief." PVPC.
[43] Ibid.
[44] Ibid.

In the regional lending market, both volume and value have developed considerably in recent years. In the Springfield Metropolitan Statistical Area (MSA), the question of whether similar applicants receive similar treatment is a key factor in understanding the regional lending market. Subprime lending, the practice of making loans available to "risky" applicants at a higher rate of interest, is one policy that affects the regional lending market considerably.[45] Although subprime lending has supposedly been an effort to reduce predatory lending practices, the targeting of more "risky" borrowers – poor people, young people, and disproportionately people of color – at high interest rates maintains unequal lending practices and exploits people traditionally underserved by lending institutions.[46] Between 1996 and 2001, the number of subprime lenders in the MSA grew by 38%.[47] Although subprime lending makes it appear that traditional banking institutions are serving non-traditional borrowers, in actuality there is still a great need for accessible capital and financial services in the area.

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[45] Letter from Governor Gramlich to Senator Gramm (April 28, 2000).
<http://banking.senate.gov/docs/reports/predlend/>
[46] Ibid.
[47] "Owning a Place to Call Home: An Analysis of Fair and Subprime Lending in the Springfield Metropolitan Area." *Pioneer Valley Planning Commission,* December 2003.

Appendix C. Managerial History of Select Community Development Loan Funds

Acción

The success of Acción USA's operations, loan fund, and mission statement are monitored by the Acción USA Board of Directors and the administrative officers. Members of the Board of Directors include the Vice President of the Community Development Banking sector of Bank of America, Vice President of the Low Income Investment Fund, and the President of the Merrill Lynch Community Development Corporation. All current members have served on the Board of Directors since Acción USA's inception in 1994. Acción is proud to have such continuity of leadership and is in the process of growing the Board of Directors to further benefit from their expertise.

Acción USA relies on six administrative officers to make the more functional decisions regarding investment and organizational changes. These administrative officers include the President of Acción USA, two vice presidents, and three senior directors, many of which have also been with Acción since 1994.

CFNE

The Cooperative Fund is a 501(c)3 non-profit and in 1996 was granted U.S. Treasury Department certification as a CDFI. The Fund is run by an Executive Director and three Outreach Coordinators serving Amherst, MA and Hartford, CT; Western and Northern New England; and the Boston area. The Outreach Coordinators are responsible for visiting current and potential borrowers, providing technical assistance, administering the loan portfolio, and marketing the Fund in their regions.

Rebecca Dunn is the Fund's third Executive Director, a position she has held since 1986. Before taking the lead at CFNE, she was a business consultant and commercial loan officer for Barclays American, as well as a bank examiner for the State of Connecticut. The Outreach Coordinators have many years of experience in the investment world, including as former director of lending at the Institute of Community Economics and a loan officer at the Massachusetts Housing Partnership Fund, Director of Lending at the Institute of Community Economics, and a founding Board member of the Boston Community Loan Fund.

Additionally, a Board of Trustees, comprised of nine investment and neighborhood development professionals as well as management consultants, oversees CFNE. There is also a Board of Advisors, which consists of seven educators and co-operative professionals who assist the Board of Directors managing the fund.[48]

ICE

The Board of ICE "establishes policies and procedures for the RLF and oversees the committees of the corporation."[49] The Board is made up of 22 individuals, 16 of whom hold Trustee positions. Many members of the Board hold directorial or other positions of authority in CLTs across the country. Others are professors, real estate professionals, heads of community development councils, or leaders in non-profit and research organizations.

One subcommittee of the Board is the Community Investment Committee, which is composed of between seven and eleven individuals including the Executive Director and the Director of Lending (as non-voting members), four to six ICE Trustees, and one to three non-staff, non-Trustee committee members. This committee is responsible for monitoring the operation of the loan fund, including developing policy for loan disbursement and determining the terms of loans to borrowers and investors.

The Loan Committee, another subcommittee of the Board, is responsible for approving or rejecting loan applications according to Board policy. Each loan application must be considered by at least three Loan Committee members, two of whom must be external Trustees. Final approval and rejection of loan applications are decided by majority vote within this committee.[50]

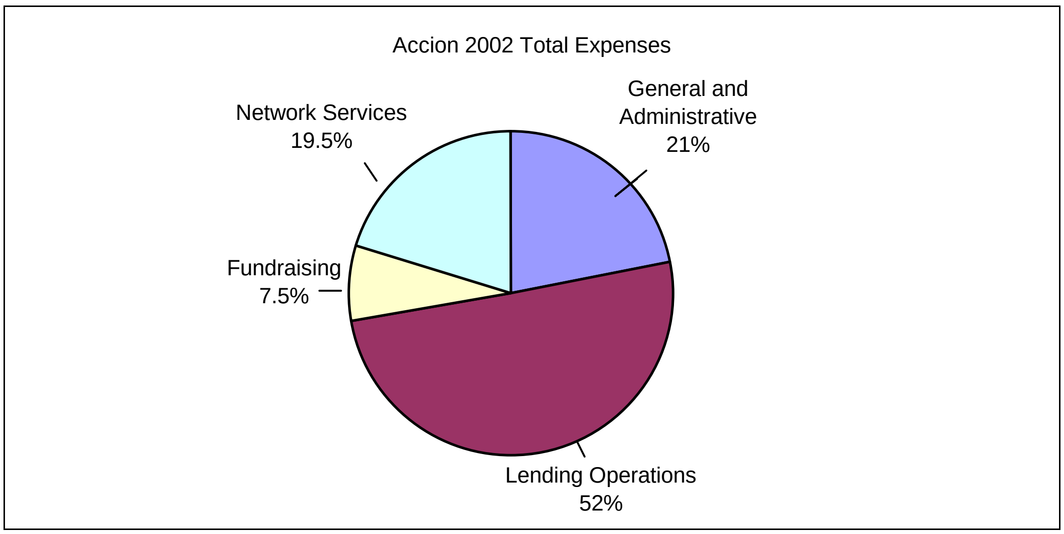
[48] "Executive Board and Staff," *Cooperative Fund of New England*, <http://www.cooperativefund.org/ history>
[49] "Revolving Loan Fund Profile 2004," *Institute for Community Economics*, 11.
[50] Ibid., 11-15.

Size, Profit, and Growth

Acción

Average loan size $6,079[51]

Growth and Expansion:	2002	2001
Total net assets:	$2,530,119	$1,980,403
% growth in net assets from 2001 to 2002: 28% ($549,716)		
Cash and cash equivalents (end of year):	1,154,276	894, 314
Increase in cash and cash equivalents from 2001 to 2002: 29% ($259,962)		
Expenses:	$3,163,487	$3,402,778



CFNE

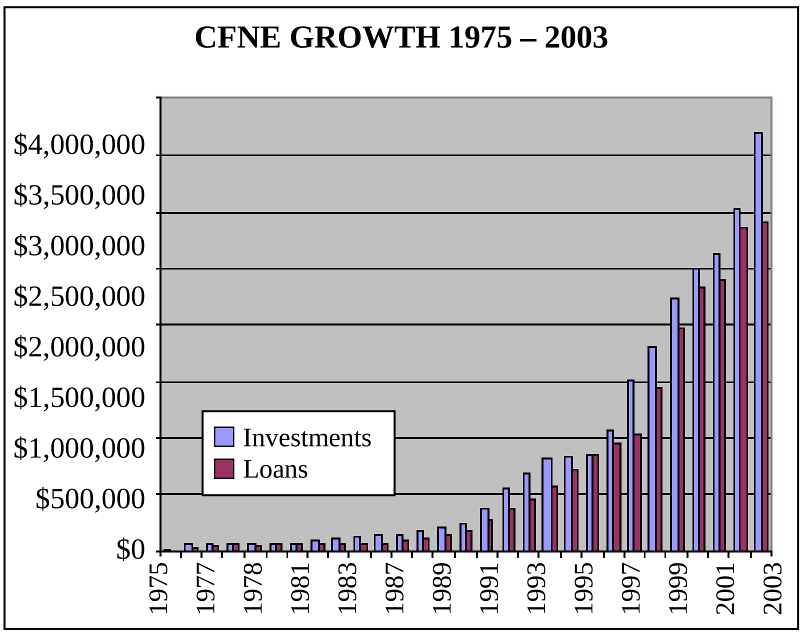
In 2003 CFNE lent out nearly $1.1 million to twenty-three borrowers, with loans outstanding exceeding $2.9 million. Since the founding of CFNE in 1975, over $8.5 million in loans has been lent to almost 260 groups, all in the New England area. The amount of loans funded in 2003 exceeded 2002 by 16%.

Over the course of its 29-year history, CFNE's loan pool has grown by 335%, from initial investments of $11,000 to investments in 2003 of $3,694,548. Additionally, the rate of return offered borrowers has lowered from 11.5% in 1985 to 8-9% in 2000, in order to better serve the most needy populations. Remarkably, no investor has ever lost

[51] "Annual Report 2002", *Acción USA*

money with CFNE and borrowers repay their loans at a cumulative rate of 97.8%, a rate significantly higher than at traditional lending institutions.[52]

		2002	2001
Growth and Expansion:			
Total Net Assets[53]		$526,503	$497,259
% growth in net assets from 2001 to 2002: 6% ($29,244)			
Cash and equivalents, year end:[54]		407,146	441,402
Change in cash and cash equivalents from 2001 to 2002: -8% (-$34,256)			
Expenses:	Program Services	$164,321	$161,368
	Administrative Support	59,632	59,937
	Total	$223,953	$221,575



ICE

Since its inception in 1979, ICE's RLF has received almost 1,000 investments and given over 425 loans to CLTs and non-profits, totaling over $41 million. The income generated by ICE's RLF is derived from three sources: interest earned on cash and certificates of deposits, which nets at 1.16%, interest on uncommitted funds held in traditional banks, which nets at 4.96%, and interest paid on ICE's borrowers, which nets at 7.05%. These income figures for year ended 12/31/03 far exceeded the associated expense to investors, netting a positive difference of over $400,000. However, in

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[52] "25th Anniversary Annual Report 2000," *Cooperative Fund of New England*, 5.
[53] Excluding social investment loans.
[54] Cash and cash equivalents consist of cash held in checking, savings, and money market accounts held in Peoples Bank, South Shore Bank, Schwab Brokerage, and an MBNA money market account.

response to extremely low interest rates in the overall market, the maximum interest rate for investors will be lowered from 5% to 4%.[55] Until now, the interest rate structure for both borrowers and investors had remained constant over the past decade.

Growth and Expansion:	2003	2002
Total net assets:	$2,611,940	$2,737,214
% change in net assets from 2001 to 2002: -5% (-$125,274)		
Cash and cash equivalents (end of year):	5,146,733	6,063,772
Change in cash and cash equivalents from 2001 to 2002: -18% (-$917,039)		
Expenses:	$2,060,816	$1,633,304

[55] Clark-Gomes, Raylene and Susan Stern. Personal Communication, 20 April 2004.

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Acknowledgements

We would like to thank the following individuals for their help in the completion of this report: Raylene Clark-Gomes, Rebecca Dunn, Mary Hoyer, Mary Jo Maydew, Fred Moseley, Michael Robinson, Preston Smith, and Susan Stern.