Staro Insights
Mobilizing Capital for Your Cause

Case Study: The Dream of a Community

By Kate Krebs Lyda, Staro Insights

It was a dream come true: a community-driven development that would create economic opportunity through the combination of fresh foods and cultural arts. The nonprofit organization had been working on this vision for some time, and they believed it could happen, but could they make the numbers work?

The organization had added an affordable housing component to the project at the city's request. With a Low-Income Housing Tax Credit award, this financing could pencil out – revenue from apartment rents could cover expenses and loans taken out to build the project. But could they raise enough money for the other piece—their vision of a grocery store, retail space for local small business owners, a cultural arts center, and nonprofit office and community space? Even if they could secure additional tax credits through the New Markets program, the budget might be just out of reach.

Through a development partner, the executive director was introduced to Kate Krebs Lyda and Staro Insights. Kate could see the vision and the path for getting the organization there. Kate believed that securing philanthropic capital in the form of *impact investment*s might be just the type of capital the organization needed to make its project work.

Laying the Groundwork

Kate started with an assessment. First, she reviewed organizational information and talked with key staff and board members to understand the organization's readiness to take on a fundraising project of this scope and complexity—specifically one that included program-related investments.[1]

Second, Kate began reviewing the plans and the financials related to the project itself. It was a complex capital stack: tax credits, construction loans, government grants, bond financing, a capital campaign and more. These sources would bring a significant amount of capital to the project, but the organization would still need to come to the financial closing with millions of dollars. Because the young organization had not yet established a large base of major donors, this goal would be a challenge. Capital grants from dedicated foundations could contribute a

[1] Program-related investment (PRI) is an IRS term for impact-first loans or investments made by private foundations that count toward the foundation's required minimum distribution. In order to be considered a PRI, the investment a) must further the foundation's tax-exempt purpose b) financial return must not be the primary purpose c) must not be used for political campaigns or lobbying. The terms program-related investments and impact investments are sometimes used interchangeably although PRIs are specific only to private foundations.

substantial amount to the capital campaign, but a gap remained. This is where impact investments would make the difference.

Testing the Case

From the materials review and financials review, and staff and board interviews, Kate created a Staro Insights Social Impact Prospectus™. In addition to the organization's case for support, the Social Impact Prospectus outlined the impact investment opportunity and the social impact metrics for potential investors.

Together with the executive director and prospect committee, Kate compiled a list of potential donors and funders to interview about the investment opportunity. The team shared the prospectus with potential investors, asked targeted questions, and solicited constructive feedback on the opportunity.

Findings from current funders and potential investors helped shape the organization's capital campaign plan. Some funders were ready to provide capital support in the form of grants while others were interested in a PRI or both grants and PRIs. The investors confirmed that there was enough interest in impact investments for the organization to pursue this strategy.

The Deal

With the help of the organization's attorney and one of the funder's attorneys, Kate worked on a term sheet for investors. She also created a virtual data room[2] and began compiling FAQs, and uploading information pertinent to investor underwriting.

Philanthropic investors would make loans of at least $100,000 each and all agreed to the same rates and terms to simplify the deal. Kate coordinated regular updates with the investors and answered questions and provided information for any underwriting. The organization would provide quarterly interest payments along with impact reports to the investors. The community benefits agreement the organization had worked on with the community codified the project's social impact for project and with all of the project tenants.

Kate had determined that with $5M-$6M in low-cost debt from philanthropic sources, the financial model would pencil out. These loans would have low interest rates (2%) or less and very favorable terms. The organization could make interest-only payments for the term of the loan which was seven years and aligned with the NMTC period. Rent from tenants would produce income for the debt service for the PRI loans and other loans, and the favorable rates and terms made the payments affordable. At the end of the term, the organization would have

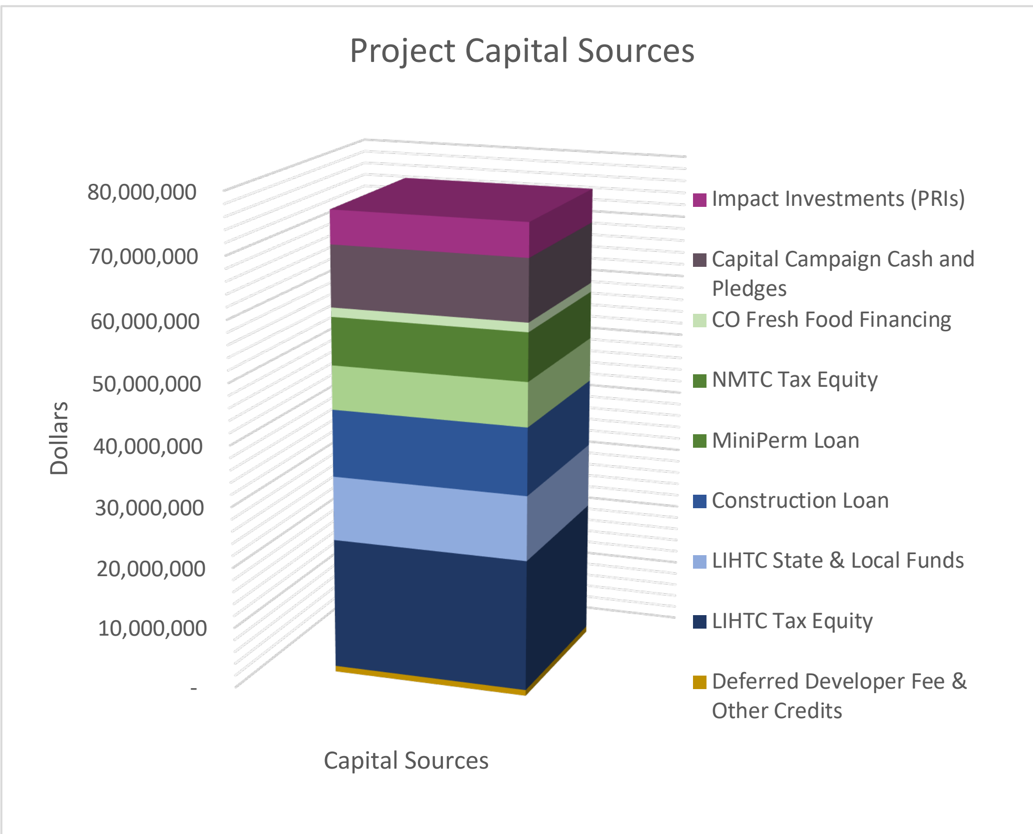
[2] A data room is a secure location often on a server that houses financial and legal information related to a specific investment.

a significant amount of equity in the project and would be able to refinance all of the debt with a conventional loan. Kate worked closely with the organization's tax credit consultants and internal team on *pro forma* financials[3] that illustrated how the capital flowed through the project and that the project would produce enough income for investors to be repaid.

Bringing it All Together

In the end the organization rounded out its $75M capital stack with with $5.5M in impact investments from a combination of about a dozen investors (See Chart 1). In addition to allowing the organization to raise enough capital for its vision, the impact investments helped the organization secure other types of financing for the project; banks were happy to underwrite a project that included subordinated and flexible financing. Also, the impact investments attracted new funders and donors to the project who did not have a history with the organization, and allowed the organization to work with existing funders in a new and innovative way.

Chart 1.



[3] *Pro forma* is a Latin term that means for the sake of form. *Pro forma* financials are based on projections looking into the future rather than financials the report on past performance.