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Exploring Community Investment Strategies for Manning and Webster City

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Executive Summary

Who We Are

We—third-year law students Dario Rodriguez, Abraham Sotelo, and Jennifer Wiltse, and undergraduate student Kalena Meyer—are part of the Community Empowerment Law Project (CELP) at the University of Iowa College of Law. The CELP is a practice group in the law school's legal clinic, providing legal representation to nonprofits and municipalities with the goal of strengthening communities, creating economic opportunity, and advancing social justice in the state of Iowa.

In the fall of 2018, we worked with CELP clients Manning and Webster City, who had articulated the goal of creating an investment vehicle. The proposed investment vehicle would serve to capture local wealth and promote entrepreneurship, and would contribute to the larger revitalization goals and continued growth of the towns.

Who the Client Is: Manning

Manning is a town of approximately 1500 people located in west-central Iowa, with a history of economic and community success despite its small size. For example, the town's first hotel was recently built after many willing investors in Manning contributed to a loan fund for the hotel. The town also draws in tourists with its historic landmarks like the German Heritage Hausbarn. Ron Reischl is our Manning contact. He serves as the chair of the Business Improvement Committee of Main Street Manning, a nonprofit organization with a mission of revitalizing and stimulating growth in the town.

Manning applied for an opportunity to partner with the University of Iowa through the Iowa Initiative for Sustainable Communities (IISC). While Webster City was ultimately chosen to be the official partner of IISC and is working with numerous other colleges at the University of Iowa to fulfill other goals of the overall project, IISC recognized that Manning and Webster City shared a similar interest in utilizing an investment fund to help revitalize their communities. IISC believed this part of the project could be consolidated to include both cities and this is how CELP became involved. Travis Kraus, the Director of Economic Development & Sustainability at the Office of Outreach & Engagement at the University of Iowa, oversees the larger project and is our contact at IISC.

Goals of the Project

This project is part of a broader effort to revitalize our client communities. Our project focuses on creating tools that would allow the communities to pool investments from their residents and provide funding for entrepreneurs who live in or want to come to Manning or Webster City to start a business. The clients have stressed that it is important for such an investment vehicle to be

sustainable, keep wealth local, and serve the larger mission of improving the lives of all the residents of Manning and Webster City.

Research, Defining the Project

We set out to identify entities that would serve our client's goals. We identified three categories of entities: for-profit, nonprofit, and cooperatives. We quickly discovered that most for-profit investment entities would be subject to securities and investment laws—complying with these laws would be overly burdensome and cost-prohibitive for our clients. As we went forward, we assessed the entities we identified by asking how well they fulfilled the clients' goals and if the activities the entities were engaged in were exempt from or not subject to securities laws.

Final Recommendations

At the end of this report we ultimately make recommendations on what strategies we believe would work best for both communities. However, we stress that the recommendations for Manning could also apply well to Webster City and vice versa. Our recommendations are based on our understanding of what we believe could be successful in each city in combination with what each city has specifically stated it is looking for in an investment fund. Based on these factors, we recommend that a Local Investing Opportunity Network and a partnership with Cedar Valley Growth Fund are both potential options for Manning. For Webster City we recommend a partnership with other cities or with an already-registered crowdfunding portal or broker-dealer, and community foundations either as an affiliate or simply by utilizing an existing community foundation.

Define the Project

Initial Project Overview

CELP has partnered with the IISC to provide legal services at no cost to communities in Iowa. Currently, CELP is working with two communities in rural Iowa: Webster City and Manning. CELP has partnered with these communities with the broad goals of revitalization and promoting economic growth. More specifically, CELP has focused on developing a plan for harnessing community wealth and creating a Community Investment Fund (CIF). Both communities have expressed a desire to utilize the CIF to lend funds to entrepreneurs and business people within the community. The CIF could be used to support businesses and local economic growth, while ensuring that individuals who contribute to the CIF feel a sense of community connection and can see tangible improvement in their communities.

Background of Clients

Our client contacts are Ron Reischl and Lindsay Henderson on behalf of Manning and Webster City, respectively. Both towns are small, rural communities with a significant amount of wealth tied up in farms.[1] Both towns also have identified particular needs for their communities in the form of daycare providers and skilled labor opportunities, like manufacturing or construction.[2] Both Ron and Lindsay grew up in, left, and returned to their respective hometowns and have a desire to move their communities forward, while capturing and growing local wealth.

Manning

Manning is a town of approximately 1500 people. The community shares a strong sense of pride and identity, stemming in part from their landmarks, hospital, hotel, and other businesses, which signal a thriving and sustainable community and economy, as well as a capability and desire for local investment.[3] The town has stood out as an exception to the declining populations of small towns across this country. In fact, Manning has been able to maintain their population and hopes to continue to do so,[4] and ultimately, they would like to grow in size. The town wants to encourage "slow, smart growth," ideally in the form of a 5–15 person employer within the manufacturing/skilled labor sector.[5]

Another reflection of Manning's success is the fact that the city owns its own utilities and fosters small business growth by distributing USDA-funded grants to local businesses through a revolving loan fund.[6] Loans extended to small businesses draw on three different funds; two of the loan funds are organized and distributed by the city, while the remaining fund is administered

[1] Interview with Ron Reischl (Sep. 18, 2018); Interview with Lindsay Henderson (Sep. 10, 2018).
[2] Interview with Ron Reischl (Sep. 18, 2018); Interview with Lindsay Henderson (Sep. 10, 2018.
[3] Interview with Ron Reischl (Sep. 18, 2018); Interview with Lindsay Henderson (Sep. 10, 2018.
[4] Interview with Ron Reischl (Sep. 18, 2018).
[5] Interview with Ron Reischl (Sep. 18, 2018).
[6] Interview with Ron Reischl (Sep. 18, 2018).

through the utility companies.[7] Currently, small businesses in Manning are able to obtain loans from banks as well as the three funds described above. Despite those opportunities to obtain funding, small businesses' financial needs can exceed the funds available.[8] Manning hopes to create an additional source of funding which will bridge this gap and ensure small businesses can receive the funding they require.

Webster City

Webster City has a population of approximately 8000 people and anticipates that roughly 2000 additional individuals will move to the town over the next couple of years, as a factory farm focused on industrial livestock production is set to open a few miles north of Webster City.[9] The factory farm does not plan to bring workers with them, rather they anticipate drawing from the local workforce.[10] Offering higher wages, this new employer is expected to drive up wages in town, but will also require the town to attract more residents to fill the increased number of jobs, and build more housing for these new residents.

Webster City's recent history has been somewhat turbulent. Webster City hit hard times when their largest employer, Electrolux, relocated its operations in 2011.[11] When Electrolux left, people struggled to obtain employment with similar pay and benefits and the old factory site has been left vacant.[12] But Webster city is a town focused on revitalization and growth— a trend which was exemplified when the town pooled funds together to save their movie theater, also featured in a documentary produced by the company Square.[13] The town realizes that there are still opportunities for growth and improvement, and they see the creation of a community investment fund as a potential step in the right direction. Importantly, residents are determined to never again allow a single employer to employ such a large percentage of the town's workforce, and instead are focused on creating a blueprint for sustainable growth.

Interviews with Residents in Manning and Webster City

We interviewed residents and stakeholders in Manning and Webster City to obtain a more comprehensive understanding of unique factors and perspectives in each town. Our contacts in Manning had identified farmers as a type of potential investor. They provided us with the contact information of a few farmers to interview regarding their experiences and thoughts on investment in the community. We also interviewed Jeff Pingel, the leader of the movement to

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[7] Interview with Ron Reischl (Sep. 18, 2018).
[8] Interview with Ron Reischl (Sep. 18, 2018).
[9] Interview with Lindsay Henderson (Sep. 10, 2018).
[10] Interview with Lindsay Henderson (Sep. 10, 2018).
[11] Interview with Lindsay Henderson (Sep. 10, 2018).
[12] *See* Interview with Lindsay Henderson (Sep. 10, 2018); *see also* James Estrin, *After Factory Closing, Iowans Live Realities of Global Economy*, N.Y.TIMES (Jan. 28, 2016), https://lens.blogs.nytimes.com/2016/01/28/iowa-brendan-hoffman-factory-electrolux.
[13] *Made in Iowa*, SQUARE, https://squareup.com/dreams/webster-city (last visited Nov. 28, 2018).

save the movie theater in Webster City, to gain insight into the experience of raising funds in the Webster City community.

We spoke with three individual farmers who live in or near Manning to learn about their experiences and thoughts on investment in the community and identify themes in their responses. All three men have lived in or near Manning their whole lives, have family in the area, actively own and farm land in the area, and plan on staying in Manning after retirement. All three men also reported that a consideration for them regarding investment is how it will help the community or future of Manning, and that they prioritize their family when it comes to succession planning of their farm and assets.

The farmers we interviewed said that they like living in Manning because it is a small, friendly, clean town. They noted a strong volunteer ethic in the community. When asked what could make Manning better, they each named examples of specific businesses or services, like a farm supply store or new restaurant. There was also a theme of wanting to support initiatives that would attract or keep young people in the town, for example good-paying jobs in agriculture or agricultural manufacturing, which was noted as one of the most viable industries in the area.

We learned from Jeff Pingel of Webster City the details of raising funds to save the theater, which the community rallied around as a turning point in revitalizing the town. After reading about the theater closing in the paper, Mr. Pingel started working with community leaders to form a plan to save the theater. He explored resources like the county attorney, local Chamber of Commerce, and the Iowa Small Business Association to form the HERO board, the volunteer board which governs the nonprofit that now runs the theater. They raised funds through many means like telethons, an adopt-a-seat program, and small walk-in donations. Mr. Pingel said he would not change anything about how they went about the fundraising process. Regarding the future of investment, Mr. Pingel also noted that the Chamber of Commerce would be closing at the end of the year, and this would affect the process of continuing to revitalize Webster City, especially main street.

The key takeaways from this interview were the resourcefulness and determination of Mr. Pingel and others involved, and the willingness of the residents to donate to a community cause. It is also important to consider how the Chamber of Commerce closing will affect the landscape of entrepreneurship in Webster City.

Our key takeaway from these interviews, collectively, is that the residents of Manning and Webster City have a history of and desire to invest locally for the sake of community betterment.

Reframing the Project

Initially, our clients described an "investment vehicle" as the focus of our project, which would gather funds from local investors and channel those funds to potential and existing businesses. Our research started with for-profit entities such as corporations, limited liability companies, and partnerships. At the forefront of the research was the type and structure of the entity, how the entity would choose businesses to invest in, and where the entity's funds would come from. Three key findings changed our perspective and conception of the project and what the ultimate outcome might be: 1) federal and state securities law compliance; 2) Investment Company Act of 1940 compliance; and 3) that there is no "one size fits all" solution to community economic development because of the complexity and novelty of the applicable laws, and the uniqueness of each community.

Federal and State Securities Law Compliance

Compliance with state and federal securities law, which involves disclosures, filings, and likely the help of a securities attorney, is both costly and time-consuming.[14] Securities laws are likely implicated even when they do not involve a readily identifiable security, such as a stock or bond,[15] because federal and state statutes define securities broadly.[16] In addition, federal and state statutes define the phrase "investment contract," as a security type—which serves as a catchall for securities.[17] In *S.E.C. v. W.J. Howey Co*,[18] the Supreme Court defined an investment contract as:

> a contract, transaction or scheme whereby [(1)] a person invests his money in a common enterprise and [(2)] is led to expect profits [(3)] solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the

[14] Refer to the text and citations within this section.

[15] HAROLD S. BLOOMENTHAL AND SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 2:1. OVERVIEW, Westlaw SECLAW-HB (database updated April 2018).

[16] 15 U.S.C.A. § 77b (2012) ("The term 'security' means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."); IOWA CODE § 501.102.28 (2018) ("'Security' means a note; stock; treasury stock; security future; bond; debenture; evidence of indebtedness; certificate of interest or participation in a profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting trust certificate; certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; put, call, straddle, option, or privilege on a security, certificate of deposit, or group or index of securities, including an interest therein or based on the value thereof; put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; or, in general, an interest or instrument commonly known as a 'security'; or a certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.").

[17] *Id.*; BLOOMENTHAL AND WOLFF, *supra* note 15.

[18] *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946).

> enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[19]

This definition encompasses even partnership and limited liability company interests that will be further explained in their respective sections.[20]

Once a security is identified, whoever is offering the security must comply with all applicable federal and state laws.[21] At a federal level, a company issuing securities must first comply with the Securities Act of 1933 that has two main objectives: "require that investors receive financial and other significant information concerning securities being offered for public sale; and prohibit deceit, misrepresentations, and other fraud in the sale of securities."[22] Since this act covers, generally, all securities offered in the United States, one must register that security with the Securities and Exchange Commission ("SEC").[23] This process requires that the offeror of the security community essential facts about the security, such as: "[(1)] a description of the company's properties and business; [(2)] a description of the security to be offered for sale; [(3)] information about the management of the company; and [(4)] financial statements certified by independent accountants."[24] This process can be better described as "a very extensive set of filings that disclose all kinds of facts that would be relevant to an investor's decision about whether to invest in the offering."[25] Registration is meant to protect investors so that they may make informed judgements on their investments.[26]

In Iowa, securities registration is required under its securities laws or Blue Sky Laws.[27] Iowa requires securities registration with the Iowa Insurance Division and registration requires a registration statement filed under the Securities Act of 1933, a prospectus filed under the same act, articles of incorporation and bylaws filing (or substantial equivalent), agreement with

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[19] *Id.*
[20] BLOOMENTHAL AND WOLFF, *supra* note 15 at § 2:3–4 (database updated Apr. 2018) (this will be further explained in the specific sections regarding partnerships and limited liability companies).
[21] Arina Shulga, *Don't Forget to Comply With Securities Laws When Raising Capital, Even if Just for a Film Project*, LEXISNEXIS CORPORATE (Oct. 12, 2012), https://www.lexisnexis.com/legalnewsroom/corporate/b/business/posts/don-t-forget-to-comply-with-securities-laws-when-raising-capital-even-if-just-for-a-film-project; Alexander J. Davie, *Is Securities Law Compliance Really All That Important for a Small Company Raising Money From Friends and Family? (Yes, It Is.)*, STRICTLY BUSINESS (July 31, 2011), https://www.strictlybusinesslawblog.com/2011/07/31/is-securities-law-compliance-really-all-that-important-for-a-small-company-raising-money-from-friends-and-family-yes-it-is.
[22] *Registration Under the Securities Act of 1933*, U.S. SECURITIES EXCHANGE COMMISSION (Sept. 2, 2011), https://www.sec.gov/fast-answers/answersregis33htm.html.
[23] *Id.*
[24] *Id.*
[25] *Registering Securities*, COMMUNITY ENTERPRISE LAW, http://communityenterpriselaw.org/financing-topics/registering-securities (last visited Nov. 15, 2018).
[26] *Registration Under the Securities Act of 1933*, *supra* note 22.
[27] *State Securities Regulators*, U.S. SECURITIES EXCHANGE COMMISSION (Jan. 11, 2005), https://www.sec.gov/fast-answers/answersstatesecreghtm.html ("While the SEC regulates and enforces the federal securities laws, each state has its own securities regulator who enforces what are known as "blue sky" laws.").

underwriters, and many more filings.[28] This type of registration assumes the security-offeror has already registered the securities at a federal level under the Securities Act of 1933, but there are different types of registrations found in Iowa Code sections 502.301 – 502.307.[29] Unless an issuer of a security can find an exemption to registration, the best practice is to hire an attorney who specializes in securities laws to guide the offeror through the registration process.[30] Even some exempt securities still require the offering entity to file a notice with the SEC, such as a Form D.[31] Therefore, even exemptions might not eliminate the need for an entity to follow registration requirements. The hypothetical investment vehicle discussed with our clients could possibly fall into one of the federal or state exemptions depending on its structure. It is difficult to pinpoint an exact exemption that would minimize filings, and which is applicable to federal and state laws without the help of an attorney that specializes in securities.

Appendix B2 explains the most frequently used federal exemptions, a short description of the exemptions, and a link in the footnote for each exemption to the SEC website. Iowa's exemptions to registering securities are described in Appendix B1, including the link to the Code sections. There are no readily available resources for Iowa exemptions and explanations of these exemptions, likely because minimal securities work done is in Iowa, relative to other states like Delaware.[32]

Hiring an attorney to help a business comply with state and federal securities laws or finding an exemption to such laws is cost-prohibitive and burdensome in relation to the type and size of the investment vehicles envisioned for Webster City and Manning. Therefore, we focused our research on entities and/or transactions that were exempt from securities laws.

Investment Company Act of 1940 Compliance

The Investment Company Act of 1940 regulates "investment companies" defined generally as "a company (corporation, business trust, partnership, or limited liability company) that issues securities and is primarily engaged in the business of investing in securities."[33] Under the Act, an investment company must disclose both financial condition and investment policies to the

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[28] *Registration of Securities and Exempt Offerings*, IOWA INSURANCE DIVISION, https://iid.iowa.gov/registration-of-securities-and-exempt-offerings (last visited Nov. 15, 2018); IOWA CODE § 501.303 (2018).

[29] *See* IOWA CODE § 501.303–307. (2018).

[30] *Registration Under the Securities Act of 1933*, *supra* note 22 ("We have provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have any questions concerning the meaning or application of a particular law or rule, *please consult an attorney who specializes in securities law*." (emphasis added)).

[31] *Filing a Form D notice*, U.S. SECURITIES EXCHANGE COMMISSION (Nov. 28, 2017), https://www.sec.gov/smallbusiness/exemptofferings/formd.

[32] Balotti & Finkelsteins' Delaware Law of Corporations and Business Organizations

[33] *Investment Companies*, U.S. SECURITIES EXCHANGE COMMISSION (July 9, 2013), https://www.sec.gov/fast-answers/answersmfinvcohtm.html; Full definition is found in section 3 of the Investment Company Act of 1940, 15 U.S.C. § 80a-3 (2018).

investors when the stock is initially sold and on a regular basis thereafter.[34] The added layers of complexity to securities compliance encouraged us to identify or create an investment vehicle that was exempt from these laws.

The text of the act can be found at the footnote below.[35]

The Uniqueness and Novelty of Economic Development.
From multiple interviews, with individuals and organizations like Brian Beckon of Cutting Edge Capital, Stephen Brustkern of Black Hawk Economic Development, Joseph Engelkes of Cedar Valley Growth Fund I, Danielle Olson of HatchOregon, Torrence Moore of Illinois Facilities Fund, Omar Carrillo Tinajero of Connect Capital, as well as others, we realized that the success stories of community investments funds are ones that are tailored specifically to the community, state, or region they operate in. Each community, state, and region is unique. They each have their own laws, policies, resources, needs, culture, history, and strengths that require careful analysis and study before moving forward with a successful economic development plan. One strategy might not even be enough. Multiple economic organizations and strategies might need to come together for a community to have success. This final finding has reframed our project to consider all the possible options available to Webster City and Manning so that they may make a fully informed choice as to how the economic development process will begin.

[34] *The Laws That Govern the Securities Industry*, US SEC (Oct. 1, 2013), https://www.sec.gov/answers/about-lawsshtml.html#invcoact1940.
[35] INVESTMENT COMPANY ACT OF 1940, P.L. 115–74, Enacted May 24, 2018, available at http://legcounsel.house.gov/Comps/Investment%20Company%20Act%20Of%201940.pdf.

Research on Types of Legal Entities/Corporate Vehicles

We researched corporations, partnerships, limited liability companies, cooperatives, and nonprofits as the possible legal structures for the investment vehicle. Each legal entity is described using five categories that we deemed the most important, when applicable:

- Structure/Overview
- Relevant Interviews (that we conducted for it)
- Criteria (Federal and State)
- Securities Law Implications (Federal and State)
- Taxes (Federal and State)

The purpose of the information below is to allow the reader to obtain a base line understanding of the legal entities described in the five categories above. Although we do not ultimately recommend a specific type of entity—a decision which will need to be made later in the formation process—this research was the foundation of our final recommendations. As each client moves forward with establishing an investment vehicle or strategy, they will need a baseline understanding of the costs, benefits, and legal implications for each entity.

The information on corporations, partnerships, and limited liability companies is located in Appendix A. Nonprofits can be found in Appendix C9.

Research on Investment Funds

We have identified several investment fund types as potential options for our clients' goals. However, there are none that exactly accomplish the goals of Manning and Webster City. Based on our conversations with Ms. Henderson and Mr. Reischl, we have identified eight main criteria that are most important for Manning and Webster City to have in an investment fund:

	CDFIs	Cooperatives	Community Development Corporations	Community Foundations	Local Investing Opportunity Network	Incubators	Intrastate Crowdfunding Portal	Intrastate Crowdfunding Broker-Dealer
Federal Securities Exemption	N/A			N/A	✅	N/A	✅	✅
State Securities Exemption	N/A	✅		N/A	✅	N/A	✅	✅
Federal Tax Benefits	✅		✅	✅		If it's a nonprofit		
State Tax Benefits	✅		✅	✅				
Return on Investment	✅	✅	✅		✅		✅	✅
Community Ownership		✅	✅	✅	✅		✅	
Harness Local. Money/ Investment	✅	✅		✅	✅		✅	✅
Control Over Where Investment or Donation goes	✅	✅	✅	✅	✅		✅	✅

For Profit Entities

Intrastate Crowdfunding

Structure

When a business issues securities it typically has to register them under the federal Securities Act of 1933. However, numerous exemptions exist. One of these exemptions is for intrastate securities (known as the intrastate crowdfunding exemption). These are securities that are issued solely within one state – the state in which the business is organized. Because they are sold only within one state, the federal government has decided it is up to the individual states to regulate these securities. Iowa is one of the states that has enacted laws regulating such securities. The four main types of offerings that occur in the intrastate realm are 1) common and preferred stock, 2) loans and convertible debt, 3) revenue sharing arrangements, and 4) Simple Agreement for Future Equity (SAFEs).

Intrastate crowdfunding securities must be offered through a website, known as a portal, run by an intermediary.[36] The intermediary must be either 1) a broker dealer registered in Iowa under Iowa Code § 502.401 (2017), or 2) an entity, known as an Iowa crowdfunding portal,[37] registered with the Iowa Insurance Division (IID).[38] There is no restriction on what type of organization operates the portal; it can be any type of for-profit or nonprofit entity.

Criteria

a. Federal Securities Exemption

In order to qualify for the federal exemption, the intrastate issuing must meet four requirements. A company must: 1) be organized in the state in which it is offering the securities; 2) have its principal place of business[39] in the state and satisfy at least one of the "doing business" requirements[40] that demonstrates the in-state nature of the company's business; 3) make offers and sales only to residents or persons the company reasonably believes to be residents of that state; 4) obtain a written representation from each purchaser providing the residency of that

[36] Iowa Code § 502.202(24)(e) (2018).

[37] An "Iowa Crowdfunding Portal" must 1) be an entity incorporate or organized under the laws of Iowa, 2) authorized to do business in Iowa, and 3) engage exclusively in intrastate crowdfunding offers and sales of exempt securities through a website. *Id.* § 502.202(24)(a)(3).

[38] *Id.* § 502.202(24)(a)(1).

[39] Principal place of business is defined as the "state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the issuer." General Rules and Regulations, Securities Act of 1933, 17 C.F.R. § 230.147A (2018), https://www.gpo.gov/fdsys/pkg/CFR-2017-title17-vol3/pdf/CFR-2017-title17-vol3-sec230-147A.pdf.

[40] The four methods for showing the company is "doing business" under the law can be found at 17 C.F.R. § 230.147A(c)(2), https://www.gpo.gov/fdsys/pkg/CFR-2017-title17-vol3/pdf/CFR-2017-title17-vol3-sec230-147A.pdf.

purchaser; and 5) place a prominent disclosure[41] on the certificate evidencing the security.[42] The federal rule also provides that resales of the securities may be made to out of state residents six months after the original sale of the security to an in-state resident,[43] and Iowa's regulations do not restrict this in any way.[44] Finally, the exemption is self-executing, meaning that an issuer does not need to apply for the exemption at the federal level before using the exemption.

b. State Securities Exemption

Iowa passed a statute regarding the sale of intrastate securities in 2015, which provides that the intrastate securities are exempt from certain registration requirements under Iowa law.[45] The requirements to fall within Iowa's registration exemption are substantively the same as the requirements that must be met to fall within the federal exemption from registration.[46] Additionally, the law provides that, during the twelve-month period preceding the date of the offer or sale of the securities under this exemption, the aggregate amount of securities sold to all investors by the issuing company cannot exceed one million dollars.[47] However, securities sold to Iowa resident institutional investors[48] or to the issuer's management do not count towards this one million dollar limit.[49] Additionally, the aggregate amount sold to an individual investor[50] during this 12-month period cannot exceed five thousand dollars, unless the investor is an accredited investor who resides in Iowa, in which case it can exceed the five thousand dollar amount.[51]

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[41] The disclosure must state: "Offers and sales of these securities were made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of six months from the date of the sale by the issuer of these securities, any resale of these securities (or the underlying securities in the case of convertible securities) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]." *Id.* § 230.147A(f)(i).
[42] *See generally id.* § 230.147A.
[43] *Id.* § 230.147A(e). The rule is different for convertible securities.
[44] Iowa Administrative Code r. 191-50.90(16) (2018).
[45] *See* Iowa Code § 502.202(24), https://www.legis.iowa.gov/docs/code/2017/502.202.pdf.
[46] *See* Iowa Administrative Code r. 191.50.90(2).
[47] Iowa Code § 502.202(24)(c).
[48] Iowa institutional investors include: banks, savings institutions, trust companies, insurance companies, investment companies under the Investment Company Act of 1940, pension or profit-sharing trusts, other financial or institutional buyers, or broker dealers. *Id.* § 502.102(11).
[49] *Id.*
[50] Investors that are considered "individual" investors under the law include (1) a relative, spouse, or relative of the spouse of an investor, who has the same principal residence as the investor; (2) a trust or estate in which the investor and any related person collectively have more than 50% of the beneficial interest, excluding contingent interests; and (3) a corporation or other organization of any investor in which the investor and any related person collectively are beneficial owners of more than 50% of the equity securities. *Id.* § 502.202(24)(d)(1)-(3).
[51] *Id.* § 502.202(24)(d).

The regulations regarding this exemption can be found in the Iowa Administrative Code.[52] While this section only discusses a few of the noteworthy regulations, the link to all of the applicable regulations is included in footnote 52.[53]

To get started, any person or entity interested in intrastate crowdfunding must file a notice with the Iowa Insurance Division (IID), the state regulatory agency which oversees intrastate crowdfunding in Iowa.[54] IID does not currently have a notice form prepared; rather the interested party contacts IID and IID works with the party to decide what information is needed. If the party decides it wants to have a portal as its intermediary it must then register the portal with the IID.[55] IID also does not currently have a form prepared for portal registration. The interested party must again reach out to IID for guidelines on what information IID needs. Once the intermediary's website is up and running, only intrastate securities may be offered through it; securities of any other type may not be offered on the website.[56] While the offering of the securities is ongoing, any funds resulting from purchases of the securities must be placed in escrow, and the escrow agreement must be between the issuer and the bank, not the intermediary and the bank.[57] If the offering does not reach its minimum offering limit[58] within the required time frame of 12 months, then the funds in escrow must be reimbursed to the investors.[59] Finally, the intermediary may charge any structure of fees for its services.[60] This is an important point because many other states have limited the structures of fees that can be charged by portals (as opposed to broker-dealers), specifically to only allow a portal to charge to an upfront, fixed fee, which has often been cost-prohibitive for keeping the portals profitable and running. Specifically, other states have prohibited portals from charging success fees based on the amount that was successfully raised through the offering.[61] Many individuals we have talked to have noted that being required to charge a flat fee has been very limiting to the success of the portal.[62]

Relevant Interviews

We spoke with Localstake, a broker-dealer that has been the intermediary for intrastate crowdfunding offerings in other states. Localstake can provide the platform (i.e. the website) through which securities can be issued and purchased. It can also act as the broker-dealer,

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[52] *See* Iowa Administrative Code r. 191-50.90 (2018), https://www.legis.iowa.gov/docs/iac/rule/04-11-2018.191.50.90.pdf.

[53] The applicable regulations include guidelines on topics such as duties of both the crowdfunding portal and the issuer, the advertising and communication of the securities offering, and disclosure requirements.

[54] Iowa Code § 502.202(24)(f).

[55] Iowa Administrative Code r. 191-50.90(10).

[56] Iowa Code § 502.202(24)(a)(3); *see also* Iowa Administrative Code r. 191-50.90(11)(e).

[57] Iowa Administrative Code r. 191-50.90(7).

[58] *See id.* at r. 191.50.90(6).

[59] *Id.* at r. 191-50.90(7)(c).

[60] *Id.* at r. 191-50.90(13). We have confirmed with the IID that there are no restrictions on the types of fees that may be collected. Typically, the fees charged are for services such as running the website, helping the organization get prepared to issue its offering, for educational support, etc.

[61] *See, e.g.,* Interview with Janice Shade (Nov. 13, 2018).

[62] *See, e.g.,* Interviews with Amy Pearl and Janice Shade (Nov. 13, 2018).

conducting the screening of the issuers to be placed on the website and the purchasers that wish to register as an investor. These are two separate services, and require two separate agreements. The downside of having an organization like Localstake act as the broker-dealer is that the intrastate crowdfunding becomes less community-run. The upside is that Localstake already does this kind of work and is an expert on advising prospective businesses and investors. A party interested in intrastate crowdfunding could choose to have Localstake only provide a platform, and not work as a broker-dealer, so that there is greater community ownership, but it will then lose the expertise and experience of a broker-dealer. An email Localstake sent us providing an overview of the services offered can be found in Appendix D5.

Companies interested in issuing securities through the Localstake website contact Localstake who advises them on federal security exemptions, and then places the offering on its website. This is a particular benefit of working with a broker-dealer, who are knowledgeable on securities laws and could be helpful in advising Manning and Webster City on their options. However, as mentioned above, Iowa's regulations provide that only intrastate securities can be offered through the intermediary's website are intrastate securities, which limits some of the potential sources of investment when working with a broker-dealer like Localstake.

We have also spoken with numerous representatives of the National Coalition for Community Capital (NC3),[63] including Amy Pearl, Amy Campbell Bogie, Janice Shade, and Brian Beckon. NC3 is a nonprofit whose mission is retention of capital in communities. To do this, it focuses on five key areas: infrastructure, research and best practices, education and training, policy, and leadership and advocacy. NC3 would be a very useful resource for Manning and Webster City: the organization offered to consult with Manning and Webster City, should either city go forward with intrastate crowdfunding or have additional questions regarding community investment in general, and NC3 is currently creating a community practice group, scheduled to launch at the end of 2018, for people that are either interested in setting up or already have set up a portal.

Several of the individuals at NC3 are also part of other organizations of interest to Manning and Webster City. Janice Shade, the treasurer at NC3, is also a co-creator of Milk Money Vermont, the first intrastate portal in the state. She also runs the nonprofit Initiative for Local Capital, which works in tandem with Milk Money Vermont to educate communities about intrastate crowdfunding. Amy Pearl, an advisor at NC3 is the founder of Hatch Oregon, an intrastate portal, and Brian Beckon, Vice-Chair at NC3 also works for Cutting Edge Capital, which advises communities on options for community investments. Contact information for each of these people can be found in Appendix E1.

[63] NC3's website can be found at *Welcome to the National Coalition for Community Capital (NC3)*, NC3, http://nc3.comcap.us (last visited Dec. 3, 2018).

The first intrastate crowdfunding portal in Iowa is Silicon Prairie Portal and Exchange (SPPX). Similar to Localstake, it was approved in May of 2018. SPPX also provides an option for using their platform as a white label. David Duccini, founder and CEO at SPPX, indicated that SPPX is very interested in getting intrastate crowdfunding started in Iowa, and would be interested in working with Manning and Webster City. In his opinion, intrastate crowdfunding is a useful tool for smalls towns that want to buy and renovate abandoned property, which aligns with Webster City's goal of returning property to active use. The contact information for Mr. Duccini is in Appendix E1, and a description of the services provided by SPPX is in Appendix D4.

Advice We Were Given to Keep in Mind

Throughout our interviews on intrastate crowdfunding, these experienced individuals shared advice on how to make intrastate crowdfunding succeed:

1. Start by raising awareness for businesses and investors about the intrastate crowdfunding option. Make sure there is an interest in this model.
2. After raising awareness and before getting the website up and running, educate investors about the procedures for investing and how to understand disclosure documents. Milk Money suggested that having a separate nonprofit for investor and entrepreneur education could be helpful.
3. Keep investors interested. One piece of advice we were given was to hold an educational workshop and then, at the end of the workshop, help everyone get registered. From there, consider sending out update emails to those who are registered, about new offerings, offerings that are reaching their deadline, and other opportunities.
4. Build a relationship with your state regulators as you are going through the process of setting up a portal, particularly if you choose to set up your own.
5. Avoid allowing businesses to set a high minimum amount needed for the offering to be successful. Higher amounts are harder to reach, making it more likely the offering will not succeed during the time period the securities can be offered.
6. Common stock is the most successful type of offering. It is easiest for investors to understand.
7. Sustainability is key. Keeping an intrastate platform up and running can be burdensome for a single town, both financially and for the time and effort required to attract entrepreneurs to the platform (which helps with the costs). Based on the advice we received, we suggest considering partnering with other towns who would also be interested in this type of fund. The platform will be shared, but community members will still be able to go to the website and see which projects are available for their towns and invest directly in those.

Local Investing Opportunity Network (LION)

Structure

A Local Investing Opportunity Network (LION) is open to non-accredited investors and is exempt from securities regulations and investment company regulations.[64] LIONs are typically run by volunteers and can simply be informal networks.[65] While they do not have to be legal entities, they are often nonprofits or have nonprofit fiscal sponsors.[66]

A LION is not a pool of investor money. It is separate deals with members of the network who are interested in investing in a specific opportunity: Each member makes their own decision about whether or not to invest in each investment opportunity and invests their money independently.[67]

Criteria

LIONs are able to invest in *private* securities offerings such as equity and debt securities.[68] However, these private securities offerings have to be made between people with *pre-existing* relationships.[69] Simply meeting with each other in order to learn more about the investment opportunity is not enough. There needs to be a relationship established first, and then once it has been established, financial information about the company can be disclosed to the investor(s).

This does not preclude all business-related contact between a business owner and investors that do not already have a pre-existing relationship. They can discuss non-financial matters about the business, including personal and business history, the business's mission and values, opportunities and challenges the business has, and any other non-financial information.[70] This information can be presented in the form of a presentation in front of LION members or the public, through meetings, or any other method. The limitation on LIONs precludes discussing topics such as terms, amounts, financial projections, and details of previous investments offered.[71]

In order not to qualify as an investment company, the LION cannot provide investment advice on any of the opportunities to any of its members, nor can one member educate or counsel another.[72] This can be a barrier to entry for people who are interested in becoming members and investing, but do not feel they have the knowledge to invest wisely. Members and potential members are welcome to consult their own financial advisors separately from the network, however, and the

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[64] Local Investing Clubs & Networks, LOCAL INVESTING RESOURCE CENTER, https://www.local-investing.com/how-to/local-investing-clubs-and-networks#starting_a_group (last visited Dec. 2, 2018).
[65] *Id.*
[66] *Id.*
[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] *Id.*
[71] *Id.*
[72] *Id.*

LION can direct people to groups that provide investor education.[73] Additionally, when a member joins a LION, there is no requirement that they invest. They can join the network and simply watch and learn how the network works, which can help them make their own informed decisions in the future. Ultimately, each member has to be active in their investment decisions; they cannot merely provide money and expect others to make investment decisions for them.

Contact information for the founders of the original LION in Port Townsend—James Frazier, Michelle Sandoval, and Marty Gay—can be found in Appendix D7, as can a copy of Hatch Oregon's guide to establishing a LION. A link to a comprehensive guide on how to establish a LION can be found in footnote 73.

Nonprofit Entities

Community Foundations

Structure

Community foundations are grantmaking, philanthropic public charities that work to serve the needs of donors who wish to better their local community long-term.[74] Donors include individuals, families, and businesses. They are nonprofits that are governed by a board of directors, chosen in accordance with the organization's applicable bylaws.[75] There are no stakeholders, but rather donors. The board oversees and controls the donations made to the foundation, including investing the donations so that interest can be made off the donations, but donors may specify how they want their donations to be used.[76] For example, as discussed below, certain types of funds allow donors to choose which organization/s or causes they want their donation to go to.

Types of Funds and Donations

Examples of funds that donors can create with community foundations include donor-advised funds, designated funds, discretionary funds, field of interest funds, community pass through funds, and scholarship funds. Donor-advised funds allow the donor the flexibility to choose each year what organizations or causes they want their donations to go to.[77]

Designated funds do not allow the flexibility each year that donor-advised funds do, but they allow the donor to choose which specific organizations they want their donations to go to when

[73] Another resource can be found at the Local Investing Resource Center, which provides a comprehensive overview of how to make local invest decisions. *See Evaluating Local Investments*, LOCAL INVESTING RESOURCE CENTER, https://www.local-investing.com/how-to/evaluating-local-investments (last visited Nov. 27, 2018).
[74] *What is a Community Foundation?*, FORT DODGE COMMUNITY FOUNDATION, http://www.fd-foundation.org/cms-view-page.php?page=what-is-a-community-foundation.
[75] *Id.*
[76] Interview with Randy Kuhlman, memo found in Appendix E.
[77] Donor-Advised Funds, FORT DODGE COMMUNITY FOUNDATION, http://www.fd-foundation.org/cms-view-page.php?page=donoradvised-funds (last visited Nov. 27, 2018).

the fund is first set up.[78] The donors can choose the amount given and the schedule it is given on. Once the fund has been established, the community foundation then manages the fund, and should an organization originally designated by the donor cease to exist, the foundation chooses an organization with a similar purpose.

Discretionary funds are used to respond to "new programs, emerging needs and innovative services for the benefit of [the] community."[79] When donors donate money to these funds, they may not set limitations on the way the donation is used. Rather, once they money is in a discretionary fund, the board of the community foundation has freedom to choose where the money will be best spent.

Field of interest funds are similar to discretionary funds in that the donor doesn't choose a specific organization to receive their donation.[80] However, the donor does get to choose a specific "field of interest," such as economic vitality, for the granting of their money.[81]

Community Pass Through Funds (CPTF) are used when the amount to be raised is small, and are usually short-term funds (about 12 months or so). The donor first will create the fund and establish where they want their donation to go to. The donor can then add more money to the fund throughout the fund's life, and others are also able to make donations to the fund. The donations then flow through and are managed by the community foundation. However, the money in this type of fund is not invested in the same way the other funds are—instead, CPTF are typically put in a money market fund, earning around 1% interest. When the fundraising is over, the community foundation gives the money in the fund to the person or entity designated as the beneficiary. While the project is active, the community foundation also has the ability to pay any of the project's bills from the fund account.[82]

Finally, donors can choose to set up scholarship funds. These can be restricted scholarship funds, in which the donor chooses the institution the scholarship will go to and the criteria for selection of the recipient of the scholarship, or discretionary scholarship funds, in which the donor

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[78] Designated Funds, FORT DODGE COMMUNITY FOUNDATION, http://www.fd-foundation.org/cms-view-page.php?page=designated-funds (last visited Nov. 27, 2018).
[79] Discretionary Funds, FORT DODGE COMMUNITY FOUNDATION, http://www.fd-foundation.org/cms-view-page.php?page=discretionary-funds (last visited Nov. 27, 2018).
[80] Field of Interest Funds, FORT DODGE COMMUNITY FOUNDATION, http://www.fd-foundation.org/cms-view-page.php?page=field-of-interest-funds (last visited Nov. 27, 2018).
[81] For example, Fort Dodge Community Foundation's fields of interests funding includes social services, economic vitality, health and well-being, public safety, youth development, environment and beautification, education and lifelong learning, and emergency needs.
[82] We were unable to find any information about these types of funds on Fort Dodge Community Foundation's website, but Randy Kuhlman discussed them with us during our interview with him. For more information contact Randy Kuhlman, whose contact information can be found in Appendix E1.

specifies criteria for receiving students but the foundation oversees the rest of the process.[83] Community foundations thus provide donors with ample flexibility in how they want their money to be used. They do not, however, allow for a return on the money donors have put into the foundation.

A new potential option for a fund in a community foundation is a pooled income fund (PIFs). Cutting Edge Capital is currently exploring the potential to establish PIFs in community foundations. The PIFs would allow an unlimited number of investors to "pool their resources into a community-scale fund that can make equity investments in local businesses."[84] The income from these investments is then distributed to the donors throughout their lifetime. Upon the death of a donor, their donation is moved to the nonprofit controlling the fund (this is a "charitable remainder"). Such funds would be exempt from the Investment Company Act of 1940 because of the charitable remainder.

It is important to note that no one has established a PIF at a community foundation and the details are still being worked out. However, we think it would be worth exploring and suggest reaching out to Brian Beckon at Cutting Edge Capital to discuss this option further. His contact information, and an article on the potential of establishing PIFs through community foundations, can be found in Appendices E1 and C3 respectively.

Additionally, community foundations, regardless of the type of fund, are extremely flexible in the types of donations they can receive. They are able to receive donations of cash, publicly traded securities, closely held stock, life insurance, real estate, and other items of tangible property. This provides an easier way for residents to invest in their community than would an organization that can only take cash, such as when an organization conducts a securities offering.

Criteria

Because community foundations are 501(c)(3) nonprofits, they must be organized and operated exclusively for religious, charitable, educational, etc. purposes to receive tax benefits.[85] The charitable mission shared by community foundations is to enhance the quality of life in the local area that it serves. This is very broad, and can include grants to nonprofit entities, grants to establish new parks, and scholarship funds, amongst others.

Theoretically, the mission can also include grants to for-profit entities that are needed in the community. The Fort Dodge Community Foundation believes that it could grant funds to a for-profit entity, so long as the for-profit added something for the public benefit. However, there are

[83] Scholarship Funds, FORT DODGE COMMUNITY FOUNDATION, http://www.fd-foundation.org/cms-view-page.php?page=scholarship-funds (last visited Nov. 27, 2018).
[84] Brian Beckon, Reimagining the Pooled Income Fund: A Community-Scale Mutual Fund at 2, found in Appendix C3.
[85] I.R.C. § 501(c)(3) (2018).

no clear examples we can find of Fort Dodge Community Foundation having made such a grant, though they did grant funds to a community theater. It may be possible to use a community foundation to fund limited types of for-profit entities, but it is not the most feasible option on its face.

Federal and State Securities Law Implications

Donations to community foundations are charitable gifts to the community foundation, and as such do not qualify as securities transactions.[86] Thus, donations to community foundations do not implicate any securities laws and do not require any exemptions from the regulations.

Tax Benefits

Federal Tax Benefits

Donations of cash to community foundations are deductible up to 60% of the donor's adjusted gross income (AGI).[87] For donations of appreciated assets, such as publicly traded stock and real estate, donors are eligible to deduct the fair-market value of donated asset deductible up to 30% of the AGI.[88] Additionally, the donor does not have to pay capital gains tax on the appreciation.

State Tax Benefits

Those who make donations to a permanent endowment fund in a community foundation are eligible to use the Endow Iowa Tax Credit, administered by the Iowa Economic Development Authority, which can be used in addition to any federal tax benefits.[89] Donations may receive a tax credit equal to 25% of the gifts, with a maximum yearly tax credit of $300,000.

Relevant Interviews

We spoke with contacts at Sioux Center and Fort Dodge community foundations. The most helpful interview was with Randy from Fort Dodge Community Foundation. Randy Kuhlman, of the Fort Dodge Community Foundation, described the diverse projects they had funded relating to parks, trails, community unification, arts and culture, recreation, senior citizens, and helping the underprivileged. He explained that the projects are typically about improving the quality of life in the community, with the foundation defining "quality of life" very broadly. He explained that Webster City or Manning could set up a fund at a community foundation to advance entrepreneurship. The parties would then sign an agreement, give the foundation any money which would then go into the financial management process, and the fund would be up and

[86] Interview with Randy Kuhlman, memo found in Appendix E.
[87] *Community Foundations vs. Private Foundations*, COMMUNITY FOUNDATION FOR THE CENTRAL SAVANNAH RIVER AREA, https://www.cfcsra.org/CommunityFoundationsvsPrivateFoundations.
[88] *Id.*
[89] Endow Iowa, IOWA ECONOMIC DEVELOPMENT AUTHORITY, https://www.iowaeconomicdevelopment.com/CommunityDevelopment/Philanthropic (last visited Nov. 27, 2018).

running "in less than 30 minutes."[90] Then, any donation to that fund is immediately considered a charitable contribution.

Mr. Kuhlman also mentioned that Fort Dodge Community Foundation would be interested in opening an affiliate foundation in Webster City. Webster City is currently served by the Community Foundation of Greater Des Moines. However, Fort Dodge could work with the Community Foundation of Greater Des Moines to establish an affiliate that would be linked to their community foundation. The affiliate foundation would have its own Webster City board and would raise its own funds that would then flow through, and be managed/invested by, Fort Dodge Community Foundation. The local board would then work with Fort Dodge to decide how to distribute the funds raised by the affiliate foundation. Contact information for Randy Kuhlman to discuss this possibility or learn other information about community foundations can be found in Appendix E1.

Opportunity Zones

Ms. Henderson expressed interest in learning whether any of the investment fund options we identify have potential to be useful for the opportunity zones that were recently recognized in Webster City. While there is very little information about opportunity zones or how they will work, our research suggests that community foundations are potentially positioned to utilize and maximize opportunity zones.[91] Even if Webster City decides against creating their own community foundation or partnering with an existing one, they could still work with the Community Foundation of Greater Des Moines. Links to articles discussing the potential to utilize community foundations for opportunity zones are found in footnote 91.

Community Development Financial Institutions (CDFIs)—Community Development Loan Funds (CDLFs)

Structure

Community Development Financial Institutions (CDFIs) "are private financial institutions that are 100% dedicated to delivering responsible, affordable lending to help low-income, low-wealth, and other disadvantaged people and communities join the economic mainstream."[92] CDFIs can take different forms, though the four most popular forms are: Community Development Banks, Community Development Credit Unions, Community Development Loan Funds, and Community Development Venture Capital Funds.[93]

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[90] Interview with Randy Kuhlman (Oct. 5, 2018).

[91] *Community Foundations Can Help Make the Most of Opportunity Zones*, COUNCIL ON FOUNDATIONS, https://www.cof.org/blogs/amplify/2018-10-29/community-foundations-can-help-make-most-opportunity-zones; *Opportunity Zones – A Value to Your Community?*, COUNCIL ON FOUNDATIONS, https://www.cof.org/content/opportunity-zones-value-your-community.

[92] *What is a CDFI?*, OPPORTUNITY FINANCE NETWORK, https://ofn.org/what-cdfi (last visited Nov. 28, 2018).

[93] *CDFI Certification: Your Gateway to the CDFI Community*, CDFI FUND (Jan., 2016), https://www.cdfifund.gov/Documents/CDFI_CERTIFICATION_updatedJAN2016.pdf.

Once the underlying legal entity is created (oftentimes a nonprofit), a CDFI can seek CDFI certification from the U.S. Department of the Treasury CDFI Fund.[94] CDFI certification involves, at a minimum: formation of a legal entity; a primary mission of promoting community development; existence of a financing entity; primary focus on servicing one of more target markets; providing development services in conjunction with its financing activities; and is a non-governmental entity and not under control of any government entity (tribal governments are excluded from this last requirement).[95] Once CDFI certification is obtained, this will ensure that the CDFI entity is "qualified to apply for technical assistance and financial assistance awards, as well as training provided by the CDFI Fund through the Capacity Building Initiative."[96]

Community Development Loan Funds (CDLFs) are particularly relevant to our clients' goals. CDLFs are "revolving loan funds [which] target a specific state or geographic region, making low interest loans to small business owners and entrepreneurs that might not qualify for a bank loan."[97] CDLFs typically receive funding "through grants and low-interest loans from foundations, the U.S. government and banks looking to fulfill their CRA obligations."[98] In addition, CDLFs may also receive funding from "other institutions . . . philanthropic organizations, and individuals."[99]

CDLFs will typically borrow the lending capital from their lenders/donors at low interest rates "and then relend those funds to borrowers at slightly higher rates."[100] However, the revenue derived from a CDLFs lending activities alone is oftentimes insufficient to cover the CDLFs costs. In addition to its lending activities, a CDLF will "typically require some combination of credit enhancements and ongoing operating subsidies, commonly from public and philanthropic sources" in order to be "financially sustainable."[101]

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[94] *Certification*, CDFI FUND, https://www.cdfifund.gov/programs-training/certification/Pages/default.aspx (last visited Nov. 28, 2018).
[95] *CDFI Certification*, CDFI FUND, https://www.cdfifund.gov/programs-training/certification/cdfi/Pages/default.aspx, (last visited Nov. 28, 2018).
[96] *CDFI Certification: Your Gateway to the CDFI Community*, CDFI FUND (Jan., 2016), https://www.cdfifund.gov/Documents/CDFI_CERTIFICATION_updatedJAN2016.pdf.
[97] *CDFIs & Community Development Loan Funds*, LOCAVESTING, https://www.locavesting.com/how-to-invest-local/community-development-loan-funds (last visited Nov. 28, 2018).
[98] *CDFIs & Community Development Loan Funds*, LOCAVESTING, https://www.locavesting.com/how-to-invest-local/community-development-loan-funds (last visited Nov. 28, 2018).
[99] *Community Development Loan Funds: Partnership Opportunities for Banks*, OFFICE OF THE COMPTROLLER OF THE CURRENCY (Oct., 2014), https://www.occ.treas.gov/topics/community-affairs/publications/insights/insights-community-development-loan-funds.pdf
[100] *Community Development Loan Funds: Partnership Opportunities for Banks*, OFFICE OF THE COMPTROLLER OF THE CURRENCY (Oct., 2014), https://www.occ.treas.gov/topics/community-affairs/publications/insights/insights-community-development-loan-funds.pdf
[101] *Community Development Loan Funds: Partnership Opportunities for Banks*, OFFICE OF THE COMPTROLLER OF THE CURRENCY (Oct., 2014), https://www.occ.treas.gov/topics/community-affairs/publications/insights/insights-community-development-loan-funds.pdf

In addition, CDLFs will often have different target areas for development and for their loaning activities. An April 2018 report released by the Global Investing Network, which studied the impact of over 100 CDLFs, discovered that "40% of the [CDLFs] focus on housing, 33% on local business financing, and the rest provide financing to microenterprises and community facilities."[102] A copy of the Global Investing Network report is included herein as Appendix C2.

While CDLFs are a powerful tool and offer an avenue for communities to assist small businesses, local housing needs, or other worthy goals, the initial start-up and continued operation of a CDLF is costly. Funding is just one of the difficulties start-up CDFIs face: "Funding is needed for business operations and for the loan fund."[103] In addition, "[a] lending track record is needed to attract financing or to become eligible for a technical assistance grant through the CDFI Fund."[104] A guide to establishing a CDFI is included can be found in Appendix C.[105]

Relevant Interviews

We spoke with Nikki Henderson at the Grow Iowa Foundation, a 501(c)(3) private non-profit organization that serves as a regional development group, and was established approximately 20 years ago. The Foundation exists as a Revolving Loan Fund (RLF) and lends money to individuals and businesses within its operating area. The Foundation's fund is replenished when those lenders repay their debts to the fund. The Foundation receives funds from various sources, including from USDA Intermediary Relending Programs (IRP), CDFI funds. Importantly, they have no individual donors, they only receive money from governmental organizations and business entities.

Ms. Henderson stressed that the Foundation has substantial operating costs due to the documentation and audit requirements they are required to meet. As a result, she recommended that we become more familiar with the existing RLF structure within our client communities, so as to avoid creating redundant funds which are unlikely to provide much benefit.

We spoke with Torrence Moore, the Managing Director of Lending at the Illinois Facilities Fund (IFF). The IFF was formed in 1988 and seeks to "creat[e] opportunities for low-income

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[102] Bonny Moellenbrock, *Community Development Loan Funds: An Effective Partner for Local Impact Investing*, LOCUS IMPACT INVESTING, https://locusimpactinvesting.org/news/blog-articles/community-development-loan-funds-an-effective-partner-for-local-impact-investing.html (last visited Nov. 28, 2018).
[103] *Community Development Loan Funds*, COMMUNITY ACTION PARTNERSHIP (June, 2018), https://communityactionpartnership.com/wp-content/uploads/2018/06/loan-fund.pdf
[104] *Community Development Loan Funds*, COMMUNITY ACTION PARTNERSHIP (June, 2018), https://communityactionpartnership.com/wp-content/uploads/2018/06/loan-fund.pdf
[105] *Community Development Loan Funds*, COMMUNITY ACTION PARTNERSHIP (June, 2018), https://communityactionpartnership.com/wp-content/uploads/2018/06/loan-fund.pdf

communities and people with disabilities … [a]cross the Midwest."[106] IFF exists as a CDFI and in fact is the "largest nonprofit CDFI in the Midwest."[107] Mr. Moore explained that the funds his organization receives come from various sources—foundations, mission investors, and socially responsible investors. In addition, since IFF is certified as a CDFI it is eligible for certain federal dollars, in the form or Financial Assistance awards and Technical Assistance grants disbursed by the CDFI program.

Mr. Moore went on to explain IFF's operations. IFF typically offers loans to nonprofits, but it is not restricted to nonprofits, and in fact offers loans to some for-profit organizations. The loans IFF awards are overseen by a committee and typically require some collateral. In addition, IFF is usually not subordinate to any other parties. At the conclusion of this interview Mr. Moore expressed a strong interest in assisting our client communities in any manner possible, and asked us to reach out with any additional questions. His contact information is in Appendix E.

Criteria

Applicable Federal Law: To be recognized as a CDFI, organizations must be certified as CDFIs by the U.S. Department of the Treasury. A link to a review of the requirements and steps required to apply for CDFI certification is in Appendix C.[108]

Applicable State Law: There is no applicable Iowa state law related to the formation of CDFIs.

Securities Law Implications

Applicable Federal Law: CDFIs and CDLFs are subject to the same reporting requirements as any other entity which offers securities. However, these entities are able to be structured so that they do not offer securities, an example of which is IFF. If a CDFI does not offer securities, these requirements are not applicable.

Applicable State Law: CDFIs and CDLFs are subject to the same reporting requirements as any other entity which offers securities. However, these entities are able to be structured so that they do not offer securities, an example of which is IFF. If a CDFI does not offer securities, these requirements are not applicable.

Taxes

Applicable Federal Law: CDFIs and CDLFs that exist within a nonprofit entity structure are entitled to the same tax benefits as other nonprofits.

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[106] *Mission and History*, ILLINOIS FACILITIES FUND https://www.iff.org/about/mission-history (last visited Nov. 28, 2018).

[107] *Mission and History*, ILLINOIS FACILITIES FUND https://www.iff.org/about/mission-history (last visited Nov. 28, 2018).

[108] *CDFI Certification*, CDFI FUND, https://www.cdfifund.gov/programs-training/certification/cdfi/Pages/default.aspx, (last visited Nov. 28, 2018).

Applicable State Law: CDFIs and CDLFs that exist within a nonprofit entity structure are entitled to the same tax benefits as other nonprofits.

Certified Development Corporations (CDCs)

Structure

"Community development corporations (CDCs) are 501(c)(3) non-profit organizations that are created to support and revitalize communities, especially those that are impoverished or struggling."[109] CDCs are frequently involved in developing and growing affordable housing opportunities, but their focus can include a wide variety of social impact programs, including: "education, job training, healthcare, commercial development, and other social programs."[110]

An interesting feature of CDCs, of interest to our clients, is "the inclusion of community representatives in their governing/advisory boards. While it's difficult to enforce because CDCs act independently, the rule of thumb is at least one third of the board is comprised of local residents."[111] As a result, CDCs are a good option for community-driven economic growth.

As discussed, CDCs are not limited to creating affordable housing. CDCs can also be "certified and regulated by the [U.S. Small Business Administration (SBA)], that work with participating lenders to provide financing to small businesses."[112] CDCs were established by the SBA "to finance [SBA 504] loans, since the SBA does not loan money directly."[113] SBA 504 loans "provide[] small businesses with long-term financing used to acquire and improve major fixed assets."[114] SBA 504 loans may be used by small businesses to purchase certain fixed assets,

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[109] Rachid Erekaini, *What is a Community Development Corporation?*, NATIONAL ALLIANCE OF COMMUNITY ECONOMIC DEVELOPMENT ASSOCIATIONS (Sept. 17, 2014), https://www.naceda.org/index.php?option=com_dailyplanetblog&view=entry&category=bright-ideas&id=25%3Awhat-is-a-community-development-corporation-&Itemid=171.

[110] Rachid Erekaini, *What is a Community Development Corporation?*, NATIONAL ALLIANCE OF COMMUNITY ECONOMIC DEVELOPMENT ASSOCIATIONS (Sept. 17, 2014), https://www.naceda.org/index.php?option=com_dailyplanetblog&view=entry&category=bright-ideas&id=25%3Awhat-is-a-community-development-corporation-&Itemid=171.

[111] Rachid Erekaini, *What is a Community Development Corporation?*, NATIONAL ALLIANCE OF COMMUNITY ECONOMIC DEVELOPMENT ASSOCIATIONS (Sept. 17, 2014), https://www.naceda.org/index.php?option=com_dailyplanetblog&view=entry&category=bright-ideas&id=25%3Awhat-is-a-community-development-corporation-&Itemid=171.

[112] *Certified Development Company*, DATA.GOV, https://catalog.data.gov/dataset/certified-development-company (last visited Nov. 28, 2018).

[113] Jentri Smith, *What is a Certified Development Corporation?*, COMMUNITY BUSINESS FINANCE, http://www.communitybusinessfinance.com/blog/what-certified-development-corporation (last visited Nov. 28, 2018).

[114] *SBA Certified Development Company/504 Loan Program*, OFFICE OF THE COMPTROLLER OF THE CURRENCY (May, 2017), https://www.occ.treas.gov/topics/community-affairs/publications/fact-sheets/fact-sheet-sba-certified-dev-co-504-loan.pdf.

including: land, existing buildings, long-term machinery and equipment, improvements, or to build new facilities or modernize, renovate or convert existing facilities.[115]

Despite the benefits which CDCs provide to communities, a CDC may not be an ideal solution for our clients' goals. CDCs are costly to start up and to maintain over time. In addition, they do not offer the kind of lending or investment opportunities that our clients want to nurture in their communities. Although CDCs can act as a lender of SBA 504 loans, the availability of SBA 504 loan funds is limited and would likely not meet the full extent of lending needed in Manning or in Webster City. A list of CDCs in Iowa is included in the final presentation.

Criteria

Applicable Federal Law: CDCs are self-identified. That is, there is no specific tax ID or certification that distinguishes a CDC from other non-profits.[116] In addition, there is no national organization that works with CDCs, however there are some organizations, like the National Alliance of Community Economic Development, that works with CDCs from all regions.

Organizations may seek CDC certification from the SBA. A link to a review of the requirements and steps required to apply for CDC certification is in Appendix C. [117]

Taxes

Federal

"As non-profits, CDCs are tax-exempt and may receive funding from private and public sources."[118] In addition to their tax-exempt status, CDCs and their lenders are eligible for additional tax credits. The scope of these tax credits is complex, but a link to more detailed information is in Appendix C7.[119]

State

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[115] Katie Murray, *The 504 Loan Program Explained*, U.S. SMALL BUSINESS ADMINISTRATION (Sep. 13, 2016) https://www.sba.gov/blogs/504-loan-program-explained.

[116] Rachid Erekaini, *What is a Community Development Corporation?*, NATIONAL ALLIANCE OF COMMUNITY ECONOMIC DEVELOPMENT ASSOCIATIONS (Sept. 17, 2014), https://www.naceda.org/index.php?option=com_dailyplanetblog&view=entry&category=bright-ideas&id=25%3Awhat-is-a-community-development-corporation-&Itemid=171.

[117] *CDC Certification Guide*, U.S. SMALL BUSINESS ADMINISTRATION (Apr. 24, 2015), https://www.sba.gov/document/support--cdc-certification-guide.

[118] Rachid Erekaini, *What is a Community Development Corporation?*, NATIONAL ALLIANCE OF COMMUNITY ECONOMIC DEVELOPMENT ASSOCIATIONS (Sept. 17, 2014), https://www.naceda.org/index.php?option=com_dailyplanetblog&view=entry&category=bright-ideas&id=25%3Awhat-is-a-community-development-corporation-&Itemid=171.

[119] Carol Steinbach, *The CDC Tax Credit: An Effective Tool For Attracting Private Resources To Community Economic Development*, BROOKINGS (Aug. 1, 1998) https://www.brookings.edu/research/the-cdc-tax-credit-an-effective-tool-for-attracting-private-resources-to-community-economic-development.

"As non-profits, CDCs are tax-exempt and may receive funding from private and public sources."[120] The scope of tax benefits specific to CDCs in Iowa is not clear. Our clients should inquire with the Iowa Department of Revenue for a better understanding of CDC state tax benefits.

Incubators

Structure and Criteria

A business incubator (sometimes called a business accelerator) is an organization that aims to provide support and resources to businesses, typically start-ups or small businesses in the early stages of development. These resources can come in the form of office space, funding, education, technical support, networking, or any other services the incubator would like to provide.[121] A business incubator does not necessarily have to be structured as a for-profit or nonprofit entity; this decision is dependent on the organization's specific mission and operations. An example of a nonprofit business incubator in Iowa is the West Des Moines (WDM) Business Incubator.[122] The WDM Business Incubator describes itself as a program that provides specific opportunities, such as networking events or office hours with lawyers and accountants, to member entrepreneurs.

Taxes and Securities Laws Implications

If the incubator is a nonprofit, it would be eligible for the same tax benefits as any other 501(c)(3). Since incubators typically do not attract investment or advertise investment opportunities, securities laws do not apply.

Cooperatives

Structure and Criteria

A cooperative, or co-op, is an organization founded on the idea that its members are its beneficiaries, and that these members have equal access to resources and equal decision-making ability.[123] The term "cooperative" can refer to organizations with a formal legal identity as such, and can also be used to describe other legal structures or informal organizations that operate on the principles of a cooperative. Common examples or types of co-ops include housing, grocery, agricultural, day care, and credit unions. One of the primary reasons to join or form a co-op is that philosophically and financially, the goal is to maximize benefit to the members, not to

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[120] Rachid Erekaini, *What is a Community Development Corporation?*, NATIONAL ALLIANCE OF COMMUNITY ECONOMIC DEVELOPMENT ASSOCIATIONS (Sept. 17, 2014), https://www.naceda.org/index.php?option=com_dailyplanetblog&view=entry&category=bright-ideas&id=25%3Awhat-is-a-community-development-corporation-&Itemid=171.

[121] *Getting Started With Business Incubators*, ENTREPRENEUR, https://www.entrepreneur.com/article/52802 (last visited Nov. 29, 2018).

[122] *West Des Moines Business Incubator*, WEST DES MOINES BUSINESS INCUBATOR, https://www.wdmbusinessincubator.com (last visited Nov. 29, 2018).

[123] Memorandum from Interview with Dave Holm (Nov. 6, 2018).

maximize profit. Additionally, under current Iowa law, it is relatively easy to form and maintain a co-op.[124]

Any co-op in Iowa must be organized under one of three chapters: 499, 501, and 501A.[125] Chapter 499 can be used generally, for electric or grain co-ops. Chapter 501 is for closed farming co-ops. Chapter 501A was passed in 2005 to allow for an organization that takes elements of a co-op and a Limited Liability Company with patron and non-patron members, "a business structure option that enables patron members to access equity capital from non-patron investors to assist them in capitalizing the cooperative."[126]

Relevant Interviews

Dave Holm, the Executive Director of the Iowa Institute for Coops, informed us that, to his knowledge, there are not any co-ops in Iowa that serve a purpose similar to a community investment vehicle as described by our clients.[127] Given his expertise on the subject, this could indicate that using a formal cooperative structure for this purpose is not feasible. However, it could also be that such a purpose would be new, non-traditional territory for a cooperative in Iowa. In either case, further research and counsel would be necessary before pursuing a cooperative structure for an investment vehicle. In addition to the Iowa Institute for Coops, another possible resource is Shared Capital Cooperative, a Minnesota-based CDFI that serves cooperatives in all states through a revolving loan fund.[128] The contact information for both organizations is in Appendix D1.

Securities Law Implications

At the federal level, cooperatives are not exempt from securities. However, at the state level, cooperatives are exempt from securities laws in Iowa under certain conditions, namely:

1. "Such stock or similar security is part of a class issuable only to persons who deal in commodities with, or obtain goods or services from, the issuer.
2. Such stock or similar security is transferable only to the issuer or a successor in interest of the transferor who qualifies for membership in such mutual or cooperative organization.
3. No dividends other than patronage refunds are payable to holders of such stock or similar security except on a complete or partial liquidation."[129]

Taxes

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[124] Memorandum from Interview with Dave Holm (Nov. 6, 2018).
[125] Memorandum from Interview with Dave Holm (Nov. 6, 2018).
[126] *Laws Governing Coops*, IOWA INSTITUTE FOR COOPS, http://iowainstitute.coop/about-us/laws-governing-coops (last visited Nov. 29, 2018).
[127] Memorandum from Interview with Dave Holm (Nov. 6, 2018).
[128] *Shared Capital Cooperative*, SHARED CAPITAL COOPERATIVE, https://sharedcapital.coop (last visited Nov. 29, 2018).
[129] IRC § 1388(a) (2018); Worker Cooperatives and Tax (Subchapter T), Co-op Law.org, http://www.co-oplaw.org/finances-tax/worker-cooperatives-and-tax (last visited Nov. 29, 2018).

Subchapter T allows "any corporation working on a cooperative basis" to avoid paying federal taxes on member refunds.[130] Otherwise, there are no special state or federal tax benefits for cooperatives.

[130] IOWA CODE § 502.201 (2018); *see also* 26 USC Subtitle A, Chapter 1, Subchapter T: Cooperatives and Their Patrons, available at: http://uscode.house.gov/view.xhtml?path=/prelim@title26/subtitleA/chapter1/subchapterT&edition=prelim.

Black Hawk Economic Development and Cedar Valley Growth Fund

This section explains how these organizations became relevant to our research and provides a general overview of who they are and what services they offer that would be beneficial to Manning and Webster City. Most of the information is summarized from their respective websites, annual reports, and our communications with the organizations. Therefore, for more detailed information please refer to the links provided as well as the memos in Appendix E16.

How We Learned of Black Hawk Economic Development and Cedar Valley Growth Fund I
As previously mentioned, nonprofits are able to enjoy securities exemptions, investment law exemptions, and tax benefits for donors. Consequently, nonprofits were a focal point of our research. With the help of Paul Thelen, Director of the Larned A. Waterman Iowa Nonprofit Center, we conducted a comprehensive search of GuideStar[131] for nonprofits that shared the same community revitalization goals as our clients. We identified Cedar Valley Growth Fund I ("CVGF"), an Iowa-based nonprofit with a mission:

> 1. To increase the availability of investment funds to small businesses located in the service area of the corporation, as established from time to time by the Board of Directors.
>
> 2. To increase the level of technical assistance available to small businesses in need.
>
> 3. To encourage and promote an increase of business activity in the service are through new business start-ups and business expansion and retention projects.
>
> 4. To create a revolving loan fund to accomplish the foregoing purposes; the income from which will be used to provide technical assistance to area small businesses, to fund administration costs, and to replenish the revolving loan fund.[132]

The similarity of CVGF's goals and Manning and Webster City's were clear. Based on our research, we learned that CVGF partners with Black Hawk Economic Development ("BHED").[133] These two entities work together to provide small businesses with near-equity capital, loans, and technical assistance.[134] While BHED and CVGF work together, each entity is a separate organization with its own board of directors, committees, and sets of funds.

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[131] GuideStar is an organization that "gathers, organizes, and distributes information about U.S nonprofits. It sounds simple, but in reality it's an enormous undertaking." *Hi! We're GuideStar.*, GUIDESTAR, https://learn.guidestar.org/about-us (last visited Dec. 3, 2018).
[132] *The Organization*, CEDAR VALLEY GROWTH FUND I, http://www.cvgf.net/participants/theorganization (last visited Nov. 27, 2018).
[133] *The Plan*, CEDAR VALLEY GROWTH FUND I, http://www.cvgf.net/participants/plan (last visited Nov. 27, 2018).
[134] *Id.*; *See generally Home*, BLACK HAWK ECONOMIC DEVELOPMENT, https://www.bhed.org (last visited Nov. 27, 2018).

An overview of BHED and CVGF can also be found in the BHED Annual Report, available in the footnote below.[135]

Black Hawk Economic Development

Stephen Brustkern is the Executive Director of BHED and our main contact. BHED is headquartered in Waterloo, Iowa.[136] It is a 501(c)(4) nonprofit that has four different loan programs that help it achieve its objective: "To actively engage in sustainable economic and community development activities for the benefit of all constituents."[137] The General Loan Fund Program ("GEN") is administered statewide in Iowa.[138] "Eligible businesses/organizations include both for-profit and not-for-profit, and eligible use of funds include purchase of land and buildings, building construction/improvements, purchase and installation of equipment and fixtures and working capital."[139] It functions similarly to the loans that CVGF administers, which will be further explained in the Cedar Valley section below.

The three remaining financial assistance loan programs BHED offers are Small Business Administration 504 Program ("SBA 504"), Revolving Loan Fund Program ("RLF"), and Intermediary Relending Program ("IRP").[140] These three loan programs have federal oversight, thus, they have more restrictions associated with them than the GEN.[141] An overview of the SBA 504, RLF, and IRP will follow, along with a link to the respective website.

The RLF was "founded with the assistance of the U.S. Department of Commerce–Economic Development Administration" and is available to Black Hawk, Bremer, Buchanan, Butler, Chickasaw, and Grundy counties.[142] Its purpose is to provide "gap financing" to for-profit businesses.[143] This means that this financing is typically used to "fill" the final portion required in a project after bank financing and equity investment have not covered it fully.[144] An eligible business "must meet the generally accepted definition of a small business: for profit, independently owned and operated, not dominant in its field of operation, and meet certain

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[135] EMPOWERING AMERICA'S BUSINESSES SINCE 1978: 2018 ANNUAL REPORT BLACK HAWK ECONOMIC DEVELOPMENT 2, 5 (2018), https://www.bhed.org/documents/2018AnnualReport.pdf.
[136] *Home*, *supra* note 134.
[137] EMPOWERING AMERICA'S BUSINESSES SINCE 1978: 2018 ANNUAL REPORT BLACK HAWK ECONOMIC DEVELOPMENT 2, 5 (2018), https://www.bhed.org/documents/2018AnnualReport.pdf.
[138] *Id.* at 6.
[139] *Id.* at 9.
[140] *See id.* at 6.
[141] *See generally id.*; Memorandum from Interview with Stephen Brustkern, Joseph Engelkes, and Steven Weidner (Nov. 7, 2018) (Appendix E16).
[142] EMPOWERING AMERICA'S BUSINESSES SINCE 1978: 2018 ANNUAL REPORT BLACK HAWK ECONOMIC DEVELOPMENT, *supra* note 137, at 10.
[143] *See id.*
[144] *See id.*

employment and/or sales size standards."[145] All of the information for the loan program is available on the BHED website.[146]

The SBA 504 "is a U.S. Small Business Administration (SBA) economic development program administered on a local level by a Certified Development Company, such as [BHED]" and is administered statewide in Iowa. [147] Its purpose is "to provide direct financing for long-term fixed assets under new business start-up, expansion and retention projects."[148] An eligible business must meet the definition of a "small business" that includes: for-profit, independently owned and operated, not dominant in its field of operation, tangible net worth of less than $15 million, and after federal income tax net income for the two years immediately preceding the application cannot exceed $5 million per year on average.[149] Generally, eligible businesses are manufacturing, service, professional and retail.[150] All of the information for the loan program is available on the BHED website.[151]

BHED "leveraged with funds from U.S. Department of Agriculture (USDA) to capitalize" the IRP.[152] It is available to Rural Benton, Black Hawk, Bremer, Buchanan, Butler, Chickasaw, Floyd, Grundy, and Tama counties.[153] It operates as "gap financing" similarly to the RLF except that in addition to the for-profit businesses, certain community based organizations and governmental entities may be eligible.[154] It purpose "is to promote new business startup, expansion, and/or retention projects in *rural areas*."[155] An eligible business "must meet the generally accepted definition of a small business: for profit, independently owned and operated, not dominant in its field of operation, and meet certain employment and/or sales size standards."[156] Also, "[t]he business must also certify it will employ at least 10% of workers from members of families with income below the poverty line and that no delinquent debt to the

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[145] *Revolving Loan Program*, BLACK HAWK ECONOMIC DEVELOPMENT, https://www.bhed.org/revolving-loan-program.htm (last visited Nov. 27, 2018).
[146] *Id.*
[147] EMPOWERING AMERICA'S BUSINESSES SINCE 1978: 2018 ANNUAL REPORT BLACK HAWK ECONOMIC DEVELOPMENT, *supra* note 137, at 12.
[148] *Id.*
[149] *SBA 504 Program*, BLACK HAWK ECONOMIC DEVELOPMENT, https://www.bhed.org/sba-504-program.htm (last visited Nov. 27, 2018).
[150] EMPOWERING AMERICA'S BUSINESSES SINCE 1978: 2018 ANNUAL REPORT BLACK HAWK ECONOMIC DEVELOPMENT, *supra* note 137, at 12.
[151] *The Program*, BLACK HAWK ECONOMIC DEVELOPMENT, https://www.bhed.org/sba-504-program.htm (last visited Dec. 3, 2018).
[152] *Id.* at 14.
[153] *Id.*
[154] *Id.*
[155] *IRP Program*, BLACK HAWK ECONOMIC DEVELOPMENT, https://www.bhed.org/irp-program.htm (last visited Nov. 27, 2018) (emphasis added).
[156] *Id.*

federal government exists."[157] All of the information for the loan program is available on the BHED website.[158]

Cedar Valley Growth Fund I

CVGF is based in Waterloo, Iowa and is a 501(c)(3) nonprofit that focuses on economic development on a smaller scale than BHED, but with fewer restrictions on their loans.[159] Our contact from CVGF is Joseph Engelkes, an accountant at the organization. CVGF offers both loans and technical assistance to businesses.[160] CVGF requires that for a business to be eligible, the business must "meet the generally accepted definition of a small business; for-profit; independently owned/operated; not dominant in its field of operation; and/or meet certain employment and/or sales size standards,"[161]—the same definition used by BHED. Two ways CVGF maintains its funds are:

(1) CVGF's nonprofit status allow it to accept donations from contributors, which will in turn grow the fund and give a tax benefit to the contributor. The contributor would be able to deduct that donation in their taxes.[162]

(2) CVGF also accepts loans. This means that someone can make a loan to the fund, the fund will then loan the money to businesses, the businesses will pay back the loan (principal and interest) to CVGF, and then the individual lenders are finally paid back with interest. If the loan is not repaid, CVGF collects on whatever collateral was agreed upon and uses it to pay back the original loan to the fund.[163]

This allows CVGF to diversify and grow their fund and at the same time provide a benefit to individuals who wish to contribute or loan to the fund.

Benefits of Black Hawk Economic Development and Cedar Valley Growth Fund

Manning and Webster City can benefit from BHED and CVGF because individual businesses from each of our client communities can apply for the loans these organizations make available, or our client communities may elect to partner with CVGF. In terms of loans, individual businesses would be able to apply for the statewide loans, GEN and SBA 504, from BHED, and/or apply for a loan and/or technical assistance from CVGF. Each business is able to apply

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[157] *Id.*
[158] *IRP Program*, BLACK HAWK ECONOMIC DEVELOPMENT, https://www.bhed.org/irp-program.htm (last visited Nov. 27, 2018).
[159] *See* EMPOWERING AMERICA'S BUSINESSES SINCE 1978: 2018 ANNUAL REPORT BLACK HAWK ECONOMIC DEVELOPMENT, *supra* note 150, at 16.
[160] *Id.*
[161] *Eligible Businesses*, CEDAR VALLEY GROWTH FUND I, http://www.cvgf.net/the-concept/eligible-businesses (last visited Nov. 27, 2018).
[162] *See* Memorandum from Interview with Stephen Brustkern, Joseph Engelkes, and Steven Weidner, *supra* note 141.
[163] *Id.*

for the loan(s) that are best suited for it. This is available to any business at any point when they decide to apply for the loan, but not all businesses will be approved for a loan. For more information about eligibility, please refer to the information above and the links provided.

CVGF could also choose to establish a new chapter, CVGF II, in Manning and/or Webster City.[164] This will allow any partnering community to enjoy the same benefits as CVGF.[165] As explained above, CVGF adds to its generally available funds through contributions and loans. The benefit to contributors and individuals who choose to make contributions or loans is related to the nonprofit status CVGF enjoys, and the concomitant tax benefits. CVGF must ensure that it maintains a "charitable purpose" so that their nonprofit status remains unchanged, and they continue to benefit from any tax-deductible contributions.[166] CVGF is able to provide technical assistance to businesses because "charitable purpose" includes education.[167] CVGF invested considerable time and resources to have the Internal Revenue Service ("IRS") approve of this structure.[168] A partnership with CVGF would allow Manning and/or Webster City to receive similar benefits as CVGF.[169]

Another potential benefit of a partnership is related to the fact that CVGF obtained costly opinion letters from reputable securities attorneys who researched what legal compliance CVGF must follow, including any applicable securities laws compliance.[170] The opinion letters stated that CVGF was exempt from a variety of filing requirements:

- Security filings and registration → nonprofit exemption
- Banking regulations → CVGF does not take deposits so this does not apply
- Investment Company Act of 1940 → nonprofit exemption
- Investor Advisers Act → CVGF's activities do not fit the definition of "investor advisors"[171]

A partnership with CVGF would circumvent the need to have expert attorneys analyze and research the structure of a new organization and draft opinion letters.[172]

Any partnering community would have its own fund segregated from CVGF's current fund.[173] The funds could be used to target specific businesses in the community so long as the selection is

[164] *Id.*
[165] *Id.*
[166] *See id.*
[167] *See id.*
[168] *See id.*
[169] *See id.*
[170] *See id.*
[171] *See id.*
[172] *See id.*
[173] Email from Stephen Brustkern, Executive Director of Black Hawk Economic Development (Nov. 21, 2018, 06:33 CST) (on file with author).

not discriminatory.[174] Though the community would not have its own board, the selection process of loan-worthy businesses could be facilitated through a community advisory board.[175] Also, there is no foreseeable membership fee which would be charged to any partnering community.[176] To obtain a more in-depth understanding of what a partnership might involve, the partnership needs to be discussed in greater detail with CVGF—representatives from CVGF have expressed their availability and willingness to engage in such discussions.

Note: with limited staff, only a select number of chapters are available, thus, CVGF will be selective in choosing.[177]

[174] *Id.*
[175] *See* Memorandum from Interview with Stephen Brustkern, Joseph Engelkes, and Steven Weidner, *supra* note 141.
[176] *See id.*
[177] Email from Stephen Brustkern, Executive Director of Black Hawk Economic Development, *supra* note 173.

Other Research

Programs

Rural Business Investment Program (RBIP)

A Rural Business Investment Program (RBIP) is a "program [that] promotes economic development and creat[es] wealth and job opportunities among individuals living in rural areas and help to meet the equity capital investment needs primarily of smaller enterprises located in such areas."[178] In order to become RBIP member, interested applicants will first need to establish a Rural Business Investment Company (RBIC), and meet several other criteria. Once an entity has established itself as a RBIC, the entity may "use the equity raised in capitalizing their funds to make venture capital investments mostly in smaller enterprises located primarily in rural areas."[179] Unfortunately, the requirements for RBIC certification are quite high, these include: relevant experience in venture capital or community development financing, raising a minimum of $10 million in private equity capital, and other requirements related to the legal structure of the RBIC.[180] These requirements notwithstanding, the possibility for creating a relationship with an existent RBIC exists, with the goal of driving funds into our client communities, and could potentially be pursued.

Tools to Attract New or Returning Residents

Giving Out Land

Some small towns have attempted to attract new or returning residents with the offer of free land. A few examples throughout the country exist and can be found in Loup City, NB,[181] Marne, IA,[182] Marquette, KS.[183] These are just a few examples and a more extensive list can be found in the footnote links below.[184] The structure of these programs differs but typically the new resident must commit to either starting a new business, building a house in a certain timeframe, or remaining in the community for a certain period.

Repaying Student Loans and Free Money

Other communities have enticed new or returning residents with offers of tuition reimbursement, repayment of student loans, or offering money to individuals who meet certain criteria, such as residing in the community for a certain period or constructing property within a certain

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[178] *Rural Business Investment Program*, UNITED STATES DEPARTMENT OF AGRICULTURE (May, 2016), https://www.rd.usda.gov/files/fact-sheet/RD-Factsheet-RBS-RBusInvestmentProgram.pdf.
[179] *Id*.
[180] *Id*.
[181] *John Subdivision*, LOUP CITY, NEBRASKA, http://www.loupcity.com/business/housing/john-subdivision (last visited Nov. 28, 2018).
[182] *Are You Looking for a Great Place to Live?*, MARNE, IOWA, http://marneiowa.com/marne-free-lots (last visited Nov. 28, 2018).
[183] *Home*, MARQUETTE, KANSAS, http://www.freelandks.com (last visited Nov. 28, 2018).
[184] Swetha, *These 8 Places Are Giving Free Land to People Who Want to Settle & Build a Home! Am I Dreaming?*, SCOOP WHOOP, https://www.scoopwhoop.com/Countries-Giving-Free-Land-Build-A-Home/#.5yht8ekvz.

geographic area. Programs that repay student loans or offer free money exist all over the country and include the examples in St. Clair, MI,[185] and Niagra Falls, NY.[186]

[185] *Small Towns Use Financial Incentives to Lure Young, Educated Workers Back Home*, CBS NEWS (May 31, 2018), https://www.cbsnews.com/news/work-in-progress-small-towns-lure-young-educated-workers-financial-incentives.
[186] *Niagara Falls Will Repay Your Student Loans - for a Price*, SPLINTER (Dec. 8, 2014), https://splinternews.com/niagara-falls-will-repay-your-student-loans-for-a-pri-1793844397.

Recommendations

This section first explains the options we are not recommending and explains our reasoning. The second half of the section explains our final recommendations and how we think these options could benefit Manning and Webster City.

Not Recommended and Why

Corporations, Partnerships, and Limited Liability Companies
These legal entities will likely require compliance with federal and state securities laws and with the Investment Company Act of 1940. As described in the previous section "Reframing the Project" and Appendix B, complying with these laws is cost-prohibitive for small entities. The recommended practice is to hire an attorney that specializes in securities laws to either help with the registration process or find an exemption that fits the investment vehicle. In either scenario, the hiring, and maintaining a relationship with, an attorney is itself likely cost-prohibitive—even without the additional costs and fees associated with registration and compliance. Therefore, we felt these entities were not viable options to serve as an investment vehicle for Manning and Webster City.

Cooperatives
Based on our interview with the Iowa Institute for Cooperatives, there does not seem to be an avenue to create a cooperative that would function as an investment vehicle in the way Manning or Webster City envisioned. Cooperatives are also subject to federal securities laws compliance, which would be expensive and time-consuming. However, any organization can utilize the philosophical principles of a cooperative, and the resources outlined in earlier sections can assist entrepreneurs who would like to form a cooperative.

CDFI-CDLF
CDFIs and specifically CDLFs are powerful tools for any community-focused organization. CDLFs offer communities the ability to create revolving loan funds which can assist a variety of needs and causes within communities, including, but not limited to, housing programs, small businesses, and other needs. However, CDLFs incur significant start-up and ongoing maintenance costs, which may be cost-prohibitive for small communities. In addition, CDLFs rarely operate in revenue-positive territory on the basis of their loan payments alone. Instead, CDLFs often require additional subsidies from private or public sources in order to maintain ongoing operations. Instead of incurring these significant initial and ongoing costs, our client communities may wish to partner with a CDLF which is already in existence to obtain the benefits of a CDLF, without the associated costs.

CDC

CDCs are important community-focused organizations that typically focus on housing in their communities, but may also focus on other aspects of community development. One of the unique characteristics of CDCs that is particularly relevant to our clients' goals is their ability to act as conduits for SBA 504 loans. The SBA does not act as a lender itself, and instead other organizations, like CDCs, serve as lenders in the SBA 504 program. However, the availability of SBA 504 loans and the permitted uses of SBA 504 funding are limited, and likely do not provide either of our communities with a comprehensive solution. In addition, the set-up and ongoing maintenance costs of CDCs are non-negligible and might be difficult to maintain. For these reasons, CDCs are not recommended entities for either of our clients to pursue.

Incubators

Business incubators can provide many important resources for growing businesses such as technical assistance, office space, funding connections, and more. However, the structure and purpose of a typical incubator does not meet the goals of community ownership or individual investment. It may be helpful to work with a business incubator, but an incubator by itself would not fit the goals of the investment vehicle.

Final Recommendations

Manning

LION
Our research suggests that a LION has potential to work well in Manning. Manning is a small, tight-knit community and many of the necessary pre-existing relationships already exist. In addition, the start-up, maintenance, and compliance costs associated with a LION are minimal, making it a cost-effective option.

Partnership with Cedar Valley Growth Fund I
CVGF is an economic development organization that uses a revolving loan fund to achieve their goals of increasing investment funds to small businesses, increasing technical assistance to small businesses, and promoting business activity. The organization's structure allows donors to contribute tax deductible donations to the fund, allows for a return on investment for people who wish to loan money to the fund, and it is exempt from several securities and investment laws.

A partnership with CVGF would create a chapter in Manning which meets its goals of community investment, community ownership, tax benefits, technical assistance, and return on investment. A chapter in the partnering city would enjoy the same benefits that the structure of CVGF offers as described above. In addition, the partnering city would have its own set of funds separate from the main CVGF, and an advisory board to help select eligible businesses for loans and/or technical assistance.

Webster City

Intrastate Crowdfunding
We see potential for intrastate crowdfunding to work successfully in Webster City. However, we suggest working in a partnership, whether that be through a white-label or broker-dealer agreement with Localstake or SPPX and/or through a partnership with other towns. Based on our research, we believe a partnership will be the most cost-effective and sustainable way for intrastate crowdfunding to be successful in Webster City. The crowdfunding option may also allow the city to rehabilitate abandoned properties, a topic of particular concern to Ms. Henderson, and for investors to have one central place to find projects in need of investment in their community. Regardless of whether Webster City decides to go forth with a partnership, we suggest reaching out to SPPX, which has substantial expertise to help Webster City better understand the costs, benefits, and potential uses of intrastate crowdfunding.

Community Foundations

We also see potential for Webster City to utilize community foundations through either an affiliate partnership or using the already-existing foundations to create funds that could assist businesses with their necessary start-up costs. Intrastate crowdfunding provides a centralized investment option, which was important to Webster City, however, community foundations could still be utilized to invest money in the community and in conjunction with opportunity zones, once more is known about how opportunity zones will work.

Appendix A1

Corporations

C-Corporation

Structure/Overview

This is the most common form of corporation.[1] "All domestic corporations other than S-corporations are C-corporations."[2] Corporations are created once the articles of incorporation are filed with the appropriate state authority, usually the secretary of state.[3] They are owned by the shareholders, "managed by directors and officers" and are its own "person" meaning they "can own its own property, enter into contracts, sue or be sued in court, and lend or invest money."[4] Advantages of a C-corporation are:

- Limited liability. This applies to directors, officers, shareholders, and employees.
- Perpetual existence. Even if the owner leaves the company.
- Enhanced credibility. Gain respect among suppliers and lenders.
- Unlimited growth potential. The sky's the limit thanks to the sale of stock.
- No shareholders limit. However, once the company has $10 million in assets and 500 shareholders, it is required to register with the SEC under the Securities Exchange Act of 1934.
- Certain tax advantages. Enjoy tax-deductible business expenses.[5]

Relevant Interviews

Not Applicable.

Criteria

Applicable Federal Law

State law governs corporations generally, but federal law such as tax and securities also regulate corporations.[6]

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[1] *Glossary: C-corporation*, PRACTICAL LAW.

[2] *Id.*

[3] *See What Is a C Corporation?*, CSC, https://www.incorporate.com/starting-a-business/c-corporation (last visited Nov. 16, 2018).

[4] CT Corporation Staff, *What is a C Corporation?*, WOLTERS KLUWER (Mar. 20, 2016), https://ct.wolterskluwer.com/resource-center/articles/what-c-corporation.

[5] *What Is a C Corporation?*, *supra* note 3.

[6] MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 1:2. OVERVIEW, Westlaw 5 IAPRAC (database updated Nov. 2018).

(There is no general federal legislation dealing with the formation of business associations. Thus, aside from federal laws pertaining to income taxation, and the federal securities laws, which primarily regulate securities sales and trading for large or publicly-traded business organizations, under the internal affairs choice of law doctrine, it is Iowa law that applies to business associations organized here.").

Applicable State Law

"An Iowa corporation is formed when one or more persons acting as 'incorporators' execute and file articles of incorporation with the Secretary of State, together with the required filing fee."[7] The necessary items in the article so incorporation are:

- "A corporate name for the corporation that satisfies the requirements of section 490.401.
- The number of shares the corporation is authorized to issue.
- The street address of the corporation's initial registered office and the name of its initial registered agent at that office.
- The name and address of each incorporator"[8]

Securities Law Implications

Federal

If a corporation is issuing securities, then it must comply with the registration requirements of the Securities Act of 1933 to a minimum.[9] An overview of the requirements and exemptions are listed in the section "Reframing the Problem, Federal and State Securities Law Compliance."

State

Refer to the section "Reframing the Problem, Federal and State Securities Law Compliance" for registration requirements and exemptions.

Taxes

Federal

A C-corporation is taxed at two levels: at the entity level and the stockholder level.[10] This is generally the defining tax factor of a C-corporation.[11] "A C Corporation is taxed as a separate entity and must report profits and losses on a corporate tax return. The C Corp pays corporate taxes on its profits while the shareholders are not taxed on the corporation's profits. C Corp shareholders report and pay income taxes only on what they are paid by the corporation. Now when the corporation chooses to pass along any of its after-tax profits to shareholders in the form of dividends, the shareholders must report those dividends as income on their personal tax returns even though the corporation has already paid corporate taxes. This is commonly referred

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[7] MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 17:1. FORMATION OF CORPORATIONS IN GENERAL, Westlaw 5 IAPRAC (database updated Nov. 2018).

[8] Iowa Code Ann. § 490.202 (2018). The corporation name guidelines are set out in section 490.401 of the Iowa Code ("Must contain the word "corporation", "incorporated", "company", or "limited", or the abbreviation "corp.", "inc.", "co.", or "ltd.", or words or abbreviations of like import in another language.").

[9] If the securities are wanting to be offered to the general public then the Securities Exchange Act of 1934 is the governing law. *The Laws That Govern the Securities Industry*, US SEC (Oct. 1, 2013), https://www.sec.gov/answers/about-lawsshtml.html#invcoact1940.

[10] *Glossary: C-corporation*, PRACTICAL LAW.

[11] *See* Practical Law Corporate & Securities, *Taxation of Corporations*, WESTLAW (2018); *What Is a C Corporation?*, *supra* note 3.

to as "double taxation", something that is avoided with an S Corporation (a pass-through tax entity)."[12] More in depth taxation issues should be consulted with a tax attorney.

State
Like individuals in Iowa, corporations that are "doing business in this state, or deriving income from sources within this state" are subject to income tax called Iowa Corporate Income Tax found in Chapter 422 of the Iowa code, more specifically in section 422.33.[13] More in depth taxation issues should be consulted with a tax attorney specializing in Iowa law.

S-Corporation

Structure/Overview
An S-corporation, or small business corporation, is a C-corporation that elected to not have double taxation, but instead is taxed only once at the shareholder level, not at the entity level too.[14] Whether or not the profits or losses are distributed to the shareholders, shareholders will report their respective share of them in their income taxes.[15] Therefore, S-corporations enjoy the much of the same benefits of C-corporations such as limited liability, as long as the corporation meets the applicable criteria to maintain its S-corporation status.[16]

Relevant Interviews
Not Applicable.

Criteria
Applicable Federal Law
Eligibility of S-corporation status requires that a corporation not have:

- (A) have more than 100 shareholders,
- (B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual,
- (C) have a nonresident alien as a shareholder, and
- (D) have more than 1 class of stock.[17]

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[12] *Forming your business in Iowa*, MAXFILINGS, https://iowa.maxfilings.com/KC-differences-between-c-corporations-s-corporations.php (last visited Nov. 17, 2018).
[13] IOWA CODE § 501.102(28) (2018), https://www.legis.iowa.gov/docs/code/2018/422.pdf; David M. Steingold, *Iowa State Business Income Tax: What kind of tax will you owe on Iowa business income?*, NOLO (June. 12, 2018), https://www.nolo.com/legal-encyclopedia/iowa-state-business-income-tax.html; Michael Mertens, *Iowa Individual and Corporate Income Tax and Franchise Tax*, IOWA LEGISLATURE, https://www.legis.iowa.gov/docs/publications/CLE/804721.pdf (last visited Nov. 17, 2018).
[14] *Glossary: S-corporation*, PRACTICAL LAW.
[15] *Id.*
[16] *See* Practical Law Corporate & Securities, *Taxation of S-Corporations*, WESTLAW (2018).
[17] IRC §1361(b) (2018), http://uscode.house.gov/view.xhtml?req=(title:26%20section:1361%20edition:prelim).

"To qualify for an S-corporation election, an eligible US entity generally must make a timely S-corporation election on IRS Form 2553, no more than two months and 15 days after the beginning of the tax year the election is to take effect."[18] More in depth taxation issues should be consulted with a tax attorney.

Applicable State Law

"Iowa recognizes the federal S election, and Iowa S corporations are not required to pay corporate income tax to the state. However, an individual S corporation shareholder will owe tax on his or her share of the company's income."[19] Iowa, unlike other states, does not require another filing past the IRS Form 2553 as noted above.[20]

Securities Law Implications

Federal

If a corporation is issuing securities, then it must comply with the registration requirements of the Securities Act of 1933 to a minimum.[21] An overview of the requirements and exemptions are listed in the section "Reframing the Problem, Federal and State Securities Law Compliance."

State

Refer to the section "Reframing the Problem, Federal and State Securities Law Compliance" for registration requirements and exemptions.

Taxes

Federal

As mentioned above, an S-corporation has pass-through taxation, therefore, not taxed at the entity level when all the requirements are met and the IRS form 2553 is filed.[22] Whether or not the profits or losses are distributed to the shareholders, shareholders will report their respective share of them in their income taxes.[23]

State

As mentioned above, Iowa recognizes corporations that have elected to be taxed s S-corporations without further filings past IRS form 2553.[24]

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[18] *Id.*

[19] Steingold, *supra* note 13.

[20] *Iowa S Corporation Formation Services*, MAXFILINGS, https://iowa.maxfilings.com/form-iowa-S-Corporation.php (last visited Nov. 17, 2018); *Iowa Incorporation*, LAW INC, https://www.lawinc.com/learning-center/iowa-incorporation (last visited Nov. 17, 2018).

[21] If the securities are wanting to be offered to the general public then the Securities Exchange Act of 1934 is the governing law. *The Laws That Govern the Securities Industry*, US SEC (Oct. 1, 2013), https://www.sec.gov/answers/about-lawsshtml.html#invcoact1940.

[22] IRC §1361(b) (2018), http://uscode.house.gov/view.xhtml?req=(title:26%20section:1361%20edition:prelim).

[23] *Glossary: S-corporation*, PRACTICAL LAW.

[24] *Iowa S Corporation Formation Services*, MAXFILINGS, https://iowa.maxfilings.com/form-iowa-S-Corporation.php (last visited Nov. 17, 2018); *Iowa Incorporation*, LAW INC, https://www.lawinc.com/learning-center/iowa-incorporation (last visited Nov. 17, 2018).

Benefit Corporation

Structure/Overview

A benefit corporation is a traditional corporation with modified obligations committing it to higher standards of purpose, accountability and transparency:

- Purpose: Benefit corporations commit to creating public benefit and sustainable value in addition to generating profit. This sustainability is an integral part of their value proposition.
- Accountability: Benefit corporations are committed to considering the company's impact on society and the environment in order to create long-term sustainable value for all stakeholders.
- Transparency: Benefit corporations are required to regularly report to shareholders on how the company is balancing these interests.[25]

Instead of the traditional model where profit maximization drives decisions, benefit corporations take into account a larger set of stakeholders rather than only investors.[26] It is important to note the difference between a B Corp and a benefit corporation as they are often confused. B Corp is a certification given by B Lab that is "available to every business regardless of corporate structure, state, or country of incorporation."[27] A benefit corporation is a legal entity. More in-depth differences are found here http://benefitcorp.net/businesses/benefit-corporations-and-certified-b-corps.

Relevant interviews

Paul Thelen Director of the Larned A. Waterman Iowa Nonprofit Resource Center

Paul Thelen mentioned this type of entity during our interview with him. Unfortunately, this type of entity does not yet exist in Iowa, but the legislature is in the process of attempting to pass this type of legislation. Model legislation and the proposed Iowa legislation on benefit corporations are found in the subsequent section.

Criteria

Applicable Federal Law

Because a benefit corporation only affects the mission of the corporation, it is still governed by state law and federal securities and tax laws apply the same as a traditional C-corporation.

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[25] *What is a Benefit Corporation?*, B LAB, http://benefitcorp.net/what-is-a-benefit-corporation, (last visited Nov. 17, 2018).

[26] *Id.*

[27] *Benefit Corporations & Certified B Corps*, B LAB, http://benefitcorp.net/businesses/benefit-corporations-and-certified-b-corps, (last visited Nov. 17, 2018).

Applicable State Law

Iowa does not have the legislation for a benefit corporation to incorporate in the state but is currently in the process of drafting and approving legislation to allow benefit corporations.[28]

Model legislation.- http://benefitcorp.net/sites/default/files/Model%20benefit%20corp%20legislation%20_4_17_17.pdf

Iowa House Pending Legislation- https://www.legis.iowa.gov/legislation/BillBook?ga=87&ba=HF62

Iowa Senate Pending Legislation - https://www.legis.iowa.gov/legislation/BillBook?ga=87&ba=SF22

Securities law implications

Federal

If a corporation is issuing securities, then it must comply with the registration requirements of the Securities Act of 1933 to a minimum.[29] An overview of the requirements and exemptions are listed in the section "Reframing the Problem, Federal and State Securities Law Compliance."

State

Refer to the section "Reframing the Problem, Federal and State Securities Law Compliance" for registration requirements and exemptions.

Taxes

Federal

"A company still elects to be taxed as a C or S corp[oration]. Benefit corporation status only affects requirements of corporate purpose, accountability, and transparency; everything else regarding corporation laws and tax law remains the same."[30]

State

Assuming that the benefit corporation legislation does not affect this Iowa regarding corporate income tax, a benefit corporation can be weather a C or S corporation.[31] Thus, this should not affect the corporation's tax status.

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[28] *State by State Status of Legislation*, B LAB, http://benefitcorp.net/policymakers/state-by-state-status, (last visited Nov. 17, 2018).

[29] If the securities are wanting to be offered to the general public then the Securities Exchange Act of 1934 is the governing law. *The Laws That Govern the Securities Industry*, US SEC (Oct. 1, 2013), https://www.sec.gov/answers/about-lawsshtml.html#invcoact1940.

[30] *FAQ*, B LAB, http http://benefitcorp.net/faq, (last visited Nov. 17, 2018).

[31] *See id.*

Appendix A2

Partnerships

General Partnership

Structure/Overview

A partnership is "the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership."[1] "No written agreement, public filing, or minimum capital is required in connection with formation," thus, it is possible to have an inadvertent formation of a partnership if two or more persons fit the definition.[2] Their subjective intent is not important but what is important is "whether the individuals intended to jointly carry on a business for profit" because the intent can be inferred form the conduct.[3]

Relevant Interviews

We interviewed Professor Joseph Yockey gain a better understanding of unincorporated entity formation. The interview started out in that direction but evolved to securities compliance.

Criteria

Applicable Federal Law

State law governs partnerships generally, but federal law such as tax and securities also regulate partnerships.

Applicable State Law

Iowa partnership law is governed by Chapter 486A in the Iowa Code, the Uniform Partnership Act.[4] This is the default law that will apply to the partnership if no partnership agreement is created.[5] Therefore, it is best to draft a partnership agreement so the default rules do not apply to the partnership. Also, a partnership is its own legal entity separate from the partners much like a corporation.[6]

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[1] Iowa Code Ann. § 486A.202(1) (2018).

[2] MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 4:1. DEFINITIONS OF PARTNERSHIP—CASE LAW AND STATUTORY CRITERIA, Westlaw 5 IAPRAC (database updated Nov. 2018) (quoting *Hillman v. Cannon*, 810 N.W.2d 25, *5 (Iowa Ct. App. 2011)).

[3] *Id.* (quoting *Hameed v. Brown*, 530 N.W.2d 703, 708 (Iowa 1995)).

[4] Iowa Code § 486A (2018).

[5] Iowa Code § 486A.103(1) (2018) ("Except as otherwise provided in subsection 2, relations among the partners and between the partners and the partnership are governed by the partnership agreement. To the extent the partnership agreement does not otherwise provide, this chapter governs relations among the partners and between the partners and the partnership.").

[6] Iowa Code § 486A.201 (2018) ("A partnership is an entity distinct from its partners."); MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 3:6. THE ENTITY THEORY OF PARTNERSHIP, Westlaw 5 IAPRAC (database updated Nov. 2018).

Securities Law implications

Federal

Although a partnership interest can fit the literal definition of a security from the Securities Acts, courts have concluded that a partnership-investor is active in the business, therefore, his or her interest is not a security.[7] This is because "investment contract," as previously mentioned, requires that partner-investor solely depend on the efforts of others for the interest to be classified as a security.[8] Therefore, unless the partner-investor is not active in the business, the interest will not be a security and will go against the literal definition of a security under the applicable acts.[9]

State

Iowa specifically states that a security can be "an interest in a limited liability company or in a limited liability partnership," but does not mention general partnership interest.[10] Iowa also states that a security is "an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor."[11] Since Iowa does specifically mention a general partnership interest as a security, and investing in a common enterprise is not a security if the investor is the one "putting the effort[]" in the common enterprise then a general partnership interest is not a security.[12]

Taxes

Federal

"An entity taxed as a partnership is not itself subject to US federal income tax. The entity's profits and losses pass through to the entity's partners . . . who report their respective share of those items on their separate income tax returns."[13] It is a pass-through taxation entity.[14]

State

"Partnerships in Iowa are considered pass-through entities. This means the partnerships pay no business tax in Iowa, but the income from the partnership is passed on to the owners' personal income, where it is then taxed as income."[15]

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[7] *See* HAROLD S. BLOOMENTHAL AND SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 2:3. PARTNERSHIPS, Westlaw SECLAW-HB (database updated April 2018).
[8] *See id.*
[9] *See id.*
[10] Iowa Code § 502.102(28)(e) (2018).
[11] Iowa Code § 502.102(28)(d) (2018).
[12] *See* Iowa Code § 502.102(28) (2018).
[13] Practical Law Corporate & Securities, *Taxation of Corporations*, WESTLAW (2018).
[14] *See id.*
[15] Mary Wenzel, *How to Form an Iowa Partnership*, LEGALZOOM (July 2015), https://www.legalzoom.com/articles/how-to-form-an-iowa-partnership.

Limited Partnership

Structure/Overview

> [A] limited partnership involves one or more persons coming together as general and limited partners to conduct a business, developing a partnership agreement, selecting a name for the partnership, establishing a registered office, designating a registered agent, and preparing and filing an initial certificate of limited partnership with the Iowa Secretary of State.[16]

This cannot be inadvertently formed since a limited partnership agreement must be filed with the Secretary of State.[17] This type of partnership must have two types of partners as defined by the Iowa Uniform Limited Partnership Act: general and limited.[18] A general partner is jointly and severally liable "for all obligations of the limited partnership unless otherwise agreed by the claimant or provided by law."[19] "A limited partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the limited partnership solely by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership."[20]

Relevant Interviews

We interviewed Professor Joseph Yockey gain a better understanding of unincorporated entity formation. The interview started out in that direction but evolved to securities compliance.

Criteria

Applicable Federal Law

State law governs limited partnerships generally, but federal law such as tax and securities also regulate limited partnerships.

Applicable State Law

> The normal process of forming a limited partnership involves one or more persons coming together as general and limited partners to conduct a business, developing a partnership agreement, selecting a name for the partnership, establishing a registered office, designating a registered agent, and preparing and filing an initial certificate of limited partnership with the Iowa Secretary of State.[21]

The applicable law is the Iowa Uniform Limited Partnership Act.[22]

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[16] MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 11:5 FORMATION OF A LIMITED PARTNERSHIP, Westlaw 5 IAPRAC (database updated Nov. 2018).
[17] *See id.*
[18] *Id.*; Iowa Code § 488 (2018).
[19] Iowa Code § 488.404 (2018).
[20] Iowa Code § 488.303 (2018).
[21] DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 11:5 FORMATION OF A LIMITED PARTNERSHIP, *supra* note 16.
[22] Iowa Code § 488 (2018).

Securities Law implications

Federal

Generally, "[a]n interest in a limited partnership is a security" if it fits the definition of an "investment contract."[23] As mentioned, an investment contract is found when

> [(1)] a person invests his money in a common enterprise and [(2)] is led to expect profits [(3)] solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[24]

Therefore, since a limited partnership interest usually fits the first two prongs, the final prong is where courts must analyze the partnership to see if the partner participated in the business or had enough "control" to not meet the third prong.[25] Therefore, a limited partnership interest is possibly a security, but it is a case-by-case analysis.

State

Iowa specifically states that a security can be "an interest in a limited liability company or in a limited liability partnership," but does not mention limited partnership interest.[26] Iowa also states that a security is "an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor."[27] Since Iowa does specifically mention a limited partnership interest as a security, and investing in a common enterprise is not a security if the investor is the one "putting the effort[]" in the common enterprise then a general partnership interest is not a security.[28]

Taxes

Federal

"An entity taxed as a partnership is not itself subject to US federal income tax. The entity's profits and losses pass through to the entity's partners . . . who report their respective share of those items on their separate income tax returns."[29] It is a pass-through taxation entity.[30]

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[23] *See* HAROLD S. BLOOMENTHAL AND SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 2:3. PARTNERSHIPS, Westlaw SECLAW-HB (database updated April 2018).

[24] *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946).

[25] *See* HAROLD S. BLOOMENTHAL AND SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 2:3. PARTNERSHIPS, Westlaw SECLAW-HB (database updated April 2018); Michael Smith, *When is the Interest in a Limited Liability Company a "Security"?*, INDIANA BUSINESS LAW BLOG (May, 18, 2015), https://businesslaw.smithrayl.com/blog/when-is-the-interest-in-a-limited-liability-company-a-security ("Courts have had no problem determining that, if the [*Howey*] criteria are satisfied, a member's interest in a limited liability company is a security.").

[26] Iowa Code § 502.102.28(e) (2018).

[27] Iowa Code § 502.102.28(d) (2018).

[28] *See* Iowa Code § 502.102(28) (2018).

[29] Practical Law Corporate & Securities, *Taxation of Corporations*, WESTLAW (2018).

[30] *See id.*

State

"Partnerships in Iowa are considered pass-through entities. This means the partnerships pay no business tax in Iowa, but the income from the partnership is passed on to the owners' personal income, where it is then taxed as income."[31]

Limited Liability Partnership

Structure/Overview

> [A]n Iowa partnership qualifies as a limited liability partnership by filing a one-time registration with the Secretary of State. If such a filing is made, the limited liability partnership's partners have no personal liability for any partnership obligations the partnership incurs thereafter. Thus, after qualification, the partners are in the same position, for liability purposes, as shareholders of a corporation or members of a limited liability company. In all other respects, the normal "partnership" rules of [the Iowa Uniform Partnership Act] . . . apply to limited liability partnerships.[32]

More simply, a limited liability partnership is a partnership with limited liability. This election of limited liability must be approved by the partners of the partnership through a proposal "by the vote necessary to amend the partnership agreement or, where the partnership agreement specifically addresses partner contributions, by the vote necessary to amend those provisions."[33]

Relevant Interviews

We interviewed Professor Joseph Yockey gain a better understanding of unincorporated entity formation. The interview started out in that direction but evolved to securities compliance.

Criteria

Applicable Federal Law

State law governs limited liability partnerships generally, but federal law such as tax and securities also regulate limited liability partnerships.

Applicable State Law

Iowa codes 486A.1001 and 486A.1002 are the applicable limited liability partnership sections.[34] The process of electing to become a limited liability partnership is

> One or more partners who are authorized to do so must then execute a 'statement of qualification' on the partnership's behalf. This statement must contain:

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[31] Mary Wenzel, *How to Form an Iowa Partnership*, LEGALZOOM (July 2015), https://www.legalzoom.com/articles/how-to-form-an-iowa-partnership.

[32] MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 9:1 OVERVIEW, Westlaw 5 IAPRAC (database updated Nov. 2018).

[33] MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 9:2 LIMITED LIABILITY PARTNERSHIP QUALIFICATION, Westlaw 5 IAPRAC (database updated Nov. 2018).

[34] Iowa Code § 486A 1.001–1.002 (2018).

- the name of the partnership (which must end with "Registered Limited Liability Partnership" or an appropriate abbreviation thereof);
- the street address of the chief executive office of the partnership;
- the partnership's registered office and agent; and
- a statement that the partnership elects to become a limited liability partnership. The statement must be filed with the Secretary of State, accompanied by a filing fee of $50.[35]

Securities Law Implications

Federal

Since a limited liability partnership is essentially a general partnership, refer to the general partnership federal securities section.

State

In the Iowa code, the definition of a security

> includes as a security an interest in a limited liability company or in a limited liability partnership or any class or series of such interest, including any fractional or other interest in such interest, provided "security" does not include an interest in a limited liability company or a limited liability partnership if the person claiming that such an interest is not a security proves that all of the members of the limited liability company or limited liability partnership are actively engaged in the management of the limited liability company or limited liability partnership; provided that the evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company or limited liability partnership, or the right to participate in management, shall not establish, without more, that all members are actively engaged in the management of the limited liability company or limited liability partnership.[36]

Therefore, the third prong of the definition of an "investment contract" per *Howey* is what matters most.[37] It is a case-by-case basis.

Taxes

Federal

Since a limited liability partnership is essentially a general partnership, refer to the general partnership federal tax section.

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[35] MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 9:2 LIMITED LIABILITY PARTNERSHIP QUALIFICATION, Westlaw 5 IAPRAC (database updated Nov. 2018); Iowa Code § 486A 1.001 (3)−(4), 1002, 1202.
[36] Iowa Code § 502.102.28(e) (2018).
[37] *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946).

State

Since a limited liability partnership is essentially a general partnership, refer to the general partnership state tax section.

Appendix A3

Limited Liability Company

Structure/Overview
A limited liability company is a legal entity with the limited liability of a corporation but with the flexibility of partnerships and pass-through taxation.[1] It may be member-managed or manger-managed.[2] Member-managed is analogous to partners in a partnership where every owner/member participates in managing the business, whereas manager-managed means there are designated people running the company that do not need to be owners and other members/owners are "passive" or do not participate in running the business.[3]

Relevant Interviews
We interviewed Professor Joseph Yockey gain a better understanding of unincorporated entity formation. The interview started out in that direction but evolved to securities compliance.

Criteria
Applicable Federal Law
State law, specifically contract law, governs limited liability companies generally, but federal law such as tax and securities also regulate limited liability companies.

Applicable State Law
In Iowa, the Revised Uniform Limited Liability Company Act is the applicable law.[4] To form a limited liability company, Iowa requires that one or more persons file a certificate of organization with the Secretary of State.[5] The certificate must contain:

- "The name of the limited liability company, which must comply with section 489.108.
- The street address of the initial registered office and the name of the initial registered agent for service of process on the company."[6]

The name "must contain the words 'limited liability company' or 'limited company' or the abbreviation 'L.L.C.', 'LLC', 'L.C.', or 'LC'. 'Limited' may be abbreviated as 'Ltd.', and 'company' may be abbreviated as 'C'."[7]

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[1] LARRY E. RIBSTEIN ET AL., UNINCORPORATED BUSINESS ENTITIES 57 (5th ed. 2013).
[2] *Id.* at 59.
[3] *Id.*; David M. Steingold, *Member-Managed LLCs Versus Manager-Managed LLCs*, NOLO, https://www.nolo.com/legal-encyclopedia/member-managed-llcs-versus-manager-managed-llcs.html (last visited Nov. 17, 2018).
[4] Iowa Code § 489 (2018).
[5] Iowa Code Ann. § 489.201(1) (2018).
[6] Iowa Code Ann. § 489.201(2) (2018).
[7] Iowa Code Ann. § 489.108(1) (2018).

Since a limited liability company is a "creature of contract,"[8] the "contract" is the operating agreement, which is analogous to a partnership agreement.[9] Therefore, the operating agreement governs, and what the operating agreement is does provide for then the Revised Uniform Limited Liability Company Act governs.[10]

Securities Law Implications

Federal

> Courts have had no problem determining that, if the above criteria are satisfied, a member's interest in a limited liability company is a security. Most LLCs — excluding those that are formed for non-business purposes with no expectation of profits, such as holding a family vacation cottage solely for the members' enjoyment — satisfy the first [two prongs of an "investment contract" per *Howey*] . . . . The question in any particular situation is whether the profits will be derived primarily from the efforts of others. Unfortunately, there are no bright line answers to that question. Instead, each case must be evaluated independently by considering both the LLC itself and the member who holds the interest in the LLC.[11]

State

The Iowa code specifically mentions that an interest in a limited liability company is a security unless

> all of the members of the limited liability company . . . are actively engaged in the management of the limited liability company . . . provided that the evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company or limited liability partnership, or the right to participate in management, shall not establish, without more, that all members are actively engaged in the management of the limited liability company.[12]

Therefore, the third prong of the definition of an "investment contract" per *Howey* is what matters most.[13] It is a case-by-case basis.

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[8] MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 13:5 DEFINITION AND NATURE OF A LIMITED LIABILITY COMPANY UNDER RULLCA, Westlaw 5 IAPRAC (database updated Nov. 2018).

[9] *See* MATTHEW G. DORE, IOWA PRACTICE SERIES: BUSINESS ORGANIZATIONS § 13:16 THE OPERATING AGREEMENT—IN GENERAL, Westlaw 5 IAPRAC (database updated Nov. 2018).

[10] Iowa Code Ann. § 489.110(2) (2018) ("To the extent the operating agreement does not otherwise provide for . . . this chapter governs the matter.").

[11] Michael Smith, *When is the Interest in a Limited Liability Company a "Security"?*, INDIANA BUSINESS LAW BLOG (May, 18, 2015), https://businesslaw.smithrayl.com/blog/when-is-the-interest-in-a-limited-liability-company-a-security; HAROLD S. BLOOMENTHAL AND SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 2:4. LIMITED LIABILITY COMPANY, Westlaw SECLAW-HB (database updated April 2018); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946).

[12] Iowa Code § 502.102(28)(e) (2018).

[13] *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946).

Taxes

Federal

"There are no separate tax rules that apply to LLCs. Therefore, LLCs and their members are generally subject to the tax rules for partnerships."[14]

State

> Like S corporations, standard LLCs are pass-through entities and are not required to pay income tax to either the federal government or the State of Iowa. Instead, income from the business is distributed to the LLC members, and each individual member is subject to federal and state taxes on his or her share of the company's income.[15]

[14] Practical Law Corporate & Securities, *Taxation of Partnerships*, WESTLAW (2018).

[15] David M. Steingold, *Iowa State Business Income Tax: What kind of tax will you owe on Iowa business income?*, NOLO (June. 12, 2018), https://www.nolo.com/legal-encyclopedia/iowa-state-business-income-tax.html.

Appendix B1

Iowa Security Exemptions

For Iowa, registering securities is not required if it is a federally covered security or falls within an exemption.
A federally covered security is defined in the National Securities Markets Improvement Act of 1966 as:

- Listed or approved for listing on certain national securities exchanges.
- Of an issuer that has securities listed or approved for listing on certain national securities exchanges, where those securities are senior to the listed securities (for example, bonds issued by a NASDAQ-listed company) or equal in rank to the listed securities.
- Issued by an investment company registered under the Investment Company Act of 1940.
- Sold only to qualified purchasers, as defined by the SEC. The SEC has not created a general definition of "qualified purchaser" for purposes of NSMIA. However, as part of 2015 amendments to Regulation A, the SEC defined qualified purchaser to include all offerrees and purchasers in Tier 2 Regulation A offerings (Rule 256, Securities Act).
- Exempted from Securities Act registration under most provisions of Section 3(a) of the Securities Act, including Section 3(a)(3) and Section 3(a)(2), except that a municipal security exempt under Section 3(a)(2) is not a covered security with respect to offers or sales in the issuer's home state. Notably, securities exempt under Section 3(a)(4) of the Securities Act are not covered securities.[1]

Iowa's exemption to registering securities are found in sections 502.201 – 502.204.[2]
Link to the code sections: https://www.legis.iowa.gov/docs/ico/chapter/502.pdf.

[1] *Glossary: Covered Securities*, PRACTICAL LAW.
[2] IOWA CODE §§ 502.201–502.204 (2018).

Appendix B2

Federal Securities Exemptions

The most asked about federal exemptions to securities registration, along with a short description, are as follows:[1]

Private placements - Rule 506(b)

"Section 4(a)(2) of the Securities Act exempts from registration transactions by an issuer not involving any public offering."[2]

General solicitation — Rule 506(c)

"[P]ermits issuers to broadly solicit and generally advertise an offering, provided that:

- all purchasers in the offering are accredited investors
- the issuer takes reasonable steps to verify purchasers' accredited investor status and
- certain other conditions in Regulation D are satisfied"[3]

Exemption for limited offerings not exceeding $5 million—Rule 504 of Regulation D

> [E]xempts from registration the offer and sale of up to $5 million of securities in a 12-month period. A company is required to file a notice with the Commission on Form D within 15 days after the first sale of securities in the offering. In addition, a company must comply with state securities laws and regulations in the states in which securities are offered or sold.[4]

Regulation Crowdfunding

> [E]nables eligible companies to offer and sell securities through crowdfunding. The rules:

- require all transactions under Regulation Crowdfunding to take place online through an SEC-registered intermediary, either a broker-dealer or a funding portal
- permit a company to raise a maximum aggregate amount of $1,070,000 through crowdfunding offerings in a 12-month period
- limit the amount individual investors can invest across all crowdfunding offerings in a 12-month period and
- require disclosure of information in filings with the Commission and to investors and the intermediary facilitating the offering

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[1] *Exempt Offerings*, US SEC (Nov. 28, 2017), https://www.sec.gov/smallbusiness/exemptofferings.
[2] *Private placements - Rule 506(b)*, US SEC (Dec. 4, 2017), https://www.sec.gov/smallbusiness/exemptofferings/rule506b.
[3] *General solicitation — Rule 506(c)*, US SEC (Nov. 29, 2017), https://www.sec.gov/smallbusiness/exemptofferings/rule506c.
[4] *Exemption for limited offerings not exceeding $5 million—Rule 504 of Regulation D*, US SEC (Nov. 29, 2017), https://www.sec.gov/smallbusiness/exemptofferings/rule504.

Securities purchased in a crowdfunding transaction generally cannot be resold for one year. Regulation Crowdfunding offerings are subject to "bad actor" disqualification provisions.[5]

Regulation A

[E]xemption from registration for public offerings. Regulation A has two offering tiers: Tier 1, for offerings of up to $20 million in a 12-month period; and Tier 2, for offerings of up to $50 million in a 12-month period. For offerings of up to $20 million, companies can elect to proceed under the requirements for either Tier 1 or Tier 2.[6]

Intrastate offerings

Section 3(a)(11) of the Securities Act is generally known as the "intrastate offering exemption." This exemption seeks to facilitate the financing of local business operations. To qualify for the intrastate offering exemption, a company must:

- be organized in the state where it is offering the securities
- carry out a significant amount of its business in that state and
- make offers and sales only to residents of that state

The intrastate offering exemption does not limit the size of the offering or the number of purchasers. A company must determine the residence of each offeree and purchaser. If any of the securities are offered or sold to even one out-of-state person, the exemption may be lost. Without the exemption, the company would be in violation of the Securities Act if the offering does not qualify for another exemption.[7]

Employee benefit plans – Rule 701

[E]xempts certain sales of securities made to compensate employees, consultants and advisors. This exemption is not available to Exchange Act reporting companies. A company can sell at least $1 million of securities under this exemption, regardless of its size. A company can sell even more if it satisfies certain formulas based on its assets or on the number of its outstanding securities. If a company sells more than $5 million in securities in a 12-month period, it is required to provide certain financial and other disclosure to the persons that received securities in that period. Securities issued under Rule 701 are "restricted securities" and may not be freely traded unless the securities are registered or the holders can rely on an exemption.[8]

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[5] *Regulation Crowdfunding*, US SEC (Sept. 27, 2018), https://www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding.
[6] *Regulation A*, US SEC (Nov. 28, 2017), https://www.sec.gov/smallbusiness/exemptofferings/rega.
[7] *Intrastate Offerings*, US SEC (Nov. 28, 2017), https://www.sec.gov/smallbusiness/exemptofferings/intrastateofferings.
[8] *Employee benefit plans – Rule 701*, US SEC (Nov. 28, 2017), https://www.sec.gov/smallbusiness/exemptofferings/rule701.

Appendix C1

Office of the Comptroller of the Currency

Community Developments

Fact Sheet

Community Affairs

www.occ.gov/capublications

SBA Certified Development Company/ 504 Loan Program

The Small Business Administration (SBA) helps small businesses and entrepreneurs obtain loans, build skills, and gain access to government contracts. Among other lenders, the SBA works with national banks and federal savings associations (collectively, banks) to provide loans to small businesses that might not otherwise obtain financing on reasonable terms.

This fact sheet highlights the SBA's Certified Development Company/504 Loan Program (504 loan program). This program and the 7(a) Loan Program are two of the SBA's flagship efforts to expand access to capital. Together, they encourage banks and other lenders to help small businesses and entrepreneurs start and grow their businesses.

What Is the 504 Loan Program?

The 504 loan program offers banks a financing tool for eligible small businesses that are looking to create jobs or meet certain public policy goals. The program provides small businesses with long-term financing used to acquire and improve major fixed assets.

Under the program, a lender partners with a certified development company (CDC), a specialized SBA-certified nonprofit corporation, to finance an eligible small business loan request. Each partner makes a loan to the qualifying small business.

Typically, the lender's loan is secured by a first lien covering 50 percent of a project's cost. The SBA does not provide a loan guarantee for the bank-funded portion of the financing.

The CDC's loan is secured by a second lien for up to 40 percent of the project's cost and is backed by a 100 percent SBA-guaranteed debenture. The borrower contributes equity of at least 10 percent of the project's cost.

The SBA does not limit a project's size or the total loan amount that a bank and CDC can jointly finance under this program. The SBA does, however, limit a CDC's financing participation to 40 percent of the total project cost—a maximum of $5 million for most businesses and $5.5 million for small manufacturers or specific types of energy-efficient projects.

What Is a CDC?

A CDC is a nonprofit organization certified by the SBA to provide 504 loans to small businesses.

There are about 252 CDCs nationwide. Some offer only 504 loans, while others offer a range of additional programs to help small businesses. The SBA certifies a CDC to operate statewide and could certify the CDC to offer the 504 loan product in contiguous states.

To find a CDC in your area, see the SBA's list of CDCs.

How Do Banks Participate?

Banks are eligible third-party lenders in the 504 loan program. The SBA recommends that lenders interested in participating in the 504 loan program contact their local SBA district offices.

The bank and the CDC each underwrite the loan. The bank portion of the loan is evaluated against the bank's underwriting guidelines. The bank and the CDC may communicate during the underwriting period to discuss any concerns. While the terms and conditions on the bank and CDC loans may differ, they are coordinated by the bank and CDC to meet the needs of the borrower.

As part of the loan closing documents, lenders are required to execute a third-party lender certification confirming that 504 loan program requirements have been met.

Bank first-lien loans are salable on the secondary market, providing lenders greater liquidity.

The CDC portion of 504 financing provides permanent or take-out financing. A bank may provide an additional construction or bridge loan before project completion and the sale of the debenture. After the project is completed, the CDC closes the 504 loan. The proceeds from the debenture sale repay the interim lender for the amount of the 504 project costs that it advanced on an interim basis.

What Businesses and Uses Are Eligible?

This program is for eligible businesses that cannot obtain financing at reasonable terms without SBA participation.

The 504 loan program helps businesses purchase major assets, such as owner-occupied commercial real estate, long-term machinery, or equipment. Real estate financed by a 504 loan must be at least 51 percent owner-occupied for existing buildings and 60 percent owner-occupied for new construction.

To be eligible, a business must operate as a for-profit entity and meet SBA size requirements. A business qualifies if its tangible net worth is $15 million or less and its average net income for the last two years prior to application is $5 million or less after federal income taxes. Alternatively, a business may qualify if it meets the SBA 7(a) program size standards. Loans cannot be made to a business engaged in nonprofit, passive, or speculative activities. Additional restrictions may apply.

Generally, a business must create or retain one job for every $65,000 guaranteed by the SBA debenture; for small manufacturers, the amount is $100,000. In certain circumstances, a business may qualify without the job creation or retention requirement if it meets certain community development or public policy goals.

The loans must be used for fixed assets, such as the purchase and/or improvement of land, buildings, long-term machinery, and equipment. Loans cannot be used for working capital or inventory.

Existing debt may be refinanced, as explained in a later section of this fact sheet.

How Do 504 Loans Help Banks Meet Community Credit Needs?

Through the program, banks can offer long-term financing to small business customers that otherwise might not obtain the

necessary financing to grow. The low down payment and fixed interest rate are particularly attractive to new and growing businesses.

Banks making 504 loans may qualify for Community Reinvestment Act (CRA) consideration, depending on loan amounts. In most cases, loans of $1 million or less qualify as small business loans and may be considered under the CRA lending test for banks of all sizes.[1] Intermediate small banks may choose to have small business loans of $1 million or less, which meet the regulatory definition of community development, evaluated as community development loans.[2] Loans of greater than $1 million made under the 504 loan program are considered community development loans[3] under the lending test[4] or the community development test,[5] depending on the bank's size. For a 504 loan to qualify for CRA consideration as a community development loan, it must meet the geographic requirements in the regulation.[6]

Under What Circumstances Can Existing Loans Be Refinanced?

The 504 loan program offers eligible small business borrowers the ability to refinance existing debt with or without business expansion.

SBA 504 Debt Refinancing Program—Refinance Without Expansion

Eligible small businesses may be able to refinance certain qualifying existing debt[7] under the SBA 504 Debt Refinancing Program. Loans made through this program are structured like traditional 504 loans. Borrowers can refinance up to 90 percent of the current appraised property value. The refinancing may also include a limited amount of eligible business expenses.

The business must have been in operation for at least two years before submitting the application.[8] The debt to be refinanced must be a commercial loan that

- was incurred for the benefit of the small business concern not less than two years before the date of the 504 Debt Refinancing application.
- was used to acquire a 504-eligible fixed asset (i.e., owner-occupied real estate, land, equipment, etc.).
- is secured by 504-eligible fixed assets.
- has been current on all payments for at least the last 12 months before the application.

Existing 504 projects and government-guaranteed loans are not eligible to be refinanced.

[1] See 12 CFR 25.12(v) and 195.12(v).

[2] See "Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Guidance," __.12(h)–3, 81 Fed. Reg. 48506 and 48529 (July 25, 2016).

[3] Ibid.

[4] See 12 CFR 25.22 and 195.22 (large banks), and 12 CFR 25.26(b) and 195.26(b) (small banks).

[5] See 12 CFR 25.25 and 195.25 (wholesale or limited-purpose banks), and 12 CFR 25.26(c) and 195.26(c) (intermediate small banks).

[6] See "Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Guidance," __.12(h) and __.25(e), 81 Fed. Reg. 48506, 48528, and 48544 (July 25, 2016).

[7] SBA Policy Notice 5000-1382 (May 26, 2016).

[8] If the ownership of the borrower has changed during this two-year period, the CDC must follow the new business guidance in the SBA's Standard Operating Procedure 50 105 (H), determine whether the borrower is considered a new business, and document the justification for its determination in its credit memorandum. SBA Policy Notice 5000-1939.

Refinance With Business Expansion

An eligible small business planning an expansion may refinance existing eligible debt. A business expansion includes acquisition, construction, or improvement of land, buildings, or equipment for use by the small business.

The existing debt being refinanced must have been used to purchase assets eligible for financing under the 504 loan program, must be collateralized by 504-eligible fixed assets, and must have been incurred for the benefit of the small business.

The existing debt being refinanced cannot exceed 50 percent of the cost of expansion. The debt being refinanced plus the expansion cost equal the project cost, so the amount being refinanced must be one-third or less of the project's total cost.[9]

The new financing must provide a substantial benefit to the business after taking into account prepayment penalties, financing fees, and other financing costs. The terms or interest rate must be better than those of the existing indebtedness. Finally, as with the standard 504 loan, the business must create or retain a job for every $65,000 guaranteed in the debenture by the SBA ($100,000 per job for small manufacturers).

For More Information

- SBA CDC/504 Loan Program
- SBA Standard Operating Procedures
- SBA 7(a) Loan Program
- OCC *Community Developments Insights* report on the 504 loan program
- OCC *Small Business Resource Directory*
- OCC district community affairs officers' contact information

[9] See 13 CFR 120.882(e).

Appendix C2

THE FINANCIAL PERFORMANCE OF IMPACT INVESTING THROUGH PRIVATE DEBT

APRIL 2018

symbiotics

GIIN
GLOBAL IMPACT INVESTING NETWORK

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ACRONYMS

AUM	Assets Under Management
BMR funds	Below-Market-Rate Seeking Funds
CAGR	Compound Annual Growth Rate
CDFI	Community Development Financial Institution
CDLF	Community Development Loan Fund
CHF	Swiss Francs
EQ2	Equity Equivalent
EURIBOR	Euro Interbank Offered Rate
GAAP	Generally Accepted Accounting Principles
HNWI	High-Net-Worth Individuals
IFRS	International Financial Reporting Standards
IRR	Internal Rate of Return
LC	Local Currency
LIBOR	London Interbank Offered Rate
MR funds	Market-Rate Seeking Funds
NAV	Net Asset Value
OFN	Opportunity Finance Network
PDIF	Private Debt Impact Fund
SDGs	Sustainable Development Goals
SME	Small or Medium-Sized Enterprise
TA	Total Assets
TER	Total Expense Ratio
UN	United Nations
USD	U.S. Dollars
WASH	Water, Sanitation, and Hygiene

FOREWORD

AMIT BOURI, CEO, GIIN

The GIIN is pleased to partner with Symbiotics, a leader in performance analysis, to offer *The Financial Performance of Impact Investing Through Private Debt*. This report provides much-needed evidence and transparency on the performance of private debt funds investing globally and across a range of impact themes, and follows our publication of financial performance benchmarks in private equity and real assets.

The Financial Performance of Impact Investing Through Private Debt confirms the credibility and viability of impact investing opportunities in the private debt asset class, the largest in impact investing. The findings indicate that a wide array of investment options are available for those seeking a stable return, portfolio diversification benefits, and positive impact.

Impact investing is one of the most promising – and perhaps critical – approaches to help solve the world's most pressing social and environmental challenges. Yet much more capital is required if it is to meaningfully address issues such as those related to climate risks, rising inequality, and access to basic services. By bridging knowledge gaps in both financial performance and impact measurement, we at the GIIN are working towards a future where capital is available at scale to meet these challenges.

We hope that this report helps readers recognize their role in shaping the future of impact investing. For those already making impact investments, this report can inform how private debt can enhance a portfolio; we encourage investors to share their financial performance data to help bring further transparency to the industry. For those new to impact investing, we hope this report provides confidence to enter the market and deploy capital that can generate powerful global progress while also meeting financial objectives.

ROLAND DOMINICÉ, CEO, SYMBIOTICS

The Financial Performance of Impact Investing Through Private Debt is an important milestone in impact investment knowledge sharing and capacity building. This investment class has been driving private sector capital flows in the industry over the past decade and will continue to be a very large share of the capital focused on the SDG 2030 horizon.

This report provides important insights into private debt impact fund business models, their investment strategies and key terms, investor characteristics and impact measurement practices, and—foremost—their performance. This study is a success in itself, with over 150 funds participating in the survey in its first year. It will also raise interest among the impact fund management audience, and among policy-makers, academics and researchers, and, above all, investors seeking benchmarks and references when approaching the industry and reviewing their investment universe. Most importantly, we hope to replicate the exercise over the years and build lasting analysis tools to further pursue these goals.

We are both delighted with and grateful to the GIIN for this new partnership, with whom we share a dedication to raising impact investment awareness, transparency and knowledge. We believe this partnership contributes to building our ecosystem and furthering our impact investing objectives.

EXECUTIVE SUMMARY

Impact investments — investments made into companies, organizations, and funds with the intention of generating positive social or environmental impact (or both) alongside financial return — are vital to addressing a range of global challenges, including slowing and mitigating climate change, ending poverty and hunger, and achieving gender equality in both emerging and developed markets. In addition to pursuing their impact goals, impact investments also offer promising market opportunities for investors across the risk-return spectrum.

This report adds vital new data to the expanding base of evidence regarding the financial performance of impact investments. Private debt or fixed income instruments comprise the largest asset class in impact investing, accounting for 34% of impact investors' reported assets under management (AUM).[1] The Global Impact Investing Network (GIIN) and Symbiotics have partnered on this report to analyze in aggregate the performance of impact investing through private debt. All surveyed funds provided audited or unaudited annual reports dating back to 2012 (or the earliest available year since), representing the sole basis on which all the return figures in this study were calculated. In general, this analysis shows that private debt funds seeking positive impact can offer very stable returns across various private debt risk-return strategies, sectors, impact themes, and geographies.

Of two main chapters in this report, one focuses on Private Debt Impact Funds (PDIFs), and the other focuses on Community Development Loans Funds (CDLFs). These two types of debt funds were studied separately because they have different legal environments and financing constraints. Key highlights of the report for both PDIFs and CDLFs are summarized below.

PRIVATE DEBT IMPACT FUNDS

Fifty PDIFs took part in the study.

Key Findings

- **Impact:** The most frequently targeted impact themes are financial inclusion, employment generation, and entrepreneurship. Others include access to energy, health improvement, clean technology, sustainable consumption, and agricultural productivity.
- **Fund Size:** Funds range in size from USD 3 million to more than USD 1 billion, with a median just below USD 100 million as of December 2016. Total AUM in the sample were USD 10.6 billion as of December 2016, registering compound annual growth of 15% between 2012 and 2016.
- **Return Philosophy and Net Returns:** Although a large majority of funds in the sample (representing on average more than 80% of total sample assets throughout the reviewed period) target competitive, risk-adjusted, market-rate returns, other funds in the sample, approximately one-fifth, intentionally target below-market-rate returns. By weighted average, the funds targeting market-rate returns generated a compound annualized net return of 2.6% over the five-year period under review. Funds targeting below-market-rate returns generated a compound annualized net return of −6.8%. For levered funds, interest paid to investors on issued notes averaged 3%.
- **Portfolio Quality:** As of December 2016, across the full sample and by weighted average, funds provisioned 2.6% of their total portfolios for potential losses while the average write-off

1 Abhilash Mudaliar, Hannah Schiff, Rachel Bass, and Hannah Dithrich, 2017 Annual Impact Investor Survey (New York: Global Impact Investing Network, 2017), 25, https://thegiin.org/research/publication/annualsurvey2017.

ratio was only only 0.7%, demonstrating high loan-recovery rates.

- **Portfolio Yield:** Average portfolio yields, the major source of income for PDIFs, remained stable throughout the period, varying between 6.0% and 6.4% for all funds, while income from other activities was a marginal source of revenue.
- **Cost Structure**: The average expense ratio decreased slightly from 3.4% in 2012 to 3.1% in 2016.
- **Comparison to Other Asset Classes:** Compared to other asset classes, risk-adjusted, market-rate-seeking PDIFs register relatively low but stable returns. Compared to emerging-market bonds, for example, PDIFs generated lower returns (2.6% versus 5.4%) but also exhibited far lower volatility (0.9% versus 7.2%) for a significantly better Sharpe Ratio (0.77 versus 0.49). From another perspective, PDIFs outperformed the Libor USD three-month more than five-fold, with almost equivalent volatility.[2]

Sample Characteristics

- **Sector Allocation:** The majority of sample PDIFs focus on the financial services sector (including microfinance), followed by funds that invest in arts and culture, education, energy, and food and agriculture.
- **Geographical Allocation:** The PDIFs in our sample invest in emerging markets all over the world. In terms of portfolio exposure, the two largest are Eastern Europe and Central Asia, followed by Latin America and the Caribbean, which combined represent 64.5% of the funds' overall weighted portfolio allocations.
- **Hedging Strategy:** Almost 40% of sample funds are fully hedged. Fully unhedged funds are characterized by higher volatility but also higher average returns.
- **Leverage:** Approximately one-third of PDIFs use leverage. For those funds, leverage represents on average 20% of their total assets.
- **Types of Investors:** Private investors, including institutional (37.9%) and retail (33.5%) investors, provide the largest share of funding to PDIFs.
- **Impact Measurement:** Funds measure impact through various output metrics, which vary by impact theme and include such metrics as 'number of women/clients reached,' 'number of jobs created,' 'amount of land cultivated,' and 'metric tons of CO_2 emissions reduced.'

COMMUNITY DEVELOPMENT LOAN FUNDS

The report analyzes the performance of 102 CDLFs, which cater to the financing needs of low-income communities in the United States.

Key Findings

- **Impact:** The top three targeted themes are employment generation, affordable housing, and food security.
- **Fund Size:** Typical CDLFs are small in terms of asset size, with approximately USD 25 million under management at the median as of December 2016. AUM in the total sample as of December 2016 were USD 5.6 billion. The average CDLF in the sample registered a CAGR of 5% since 2012.
- **Return Philosophy and Net Returns:** Almost all CDLFs in the sample target below-market-rate returns. CDLFs primarily raise capital through notes issued to investors, with interest paid on these notes averaging 2.9%.[3] These rates are relatively stable across different investment sectors, and larger CDLFs tend to pay slightly higher rates than smaller ones.
- **Portfolio Quality:** In 2016, loan-loss provisions comprised 4.9% of total portfolio across the sample. Microenterprise-focused funds have the highest provision for losses, while funds focused on housing and community facilities have the lowest. However, loans written off during the same year represented only 0.6%

2 The correlation analysis between PDIFs and other asset classes is limited by a small number of observations (i.e., only five periods of available annual data). A comparable asset class with 60 monthly observations for this time period, Microfinance Private Debt Funds, has a correlation with developed-market bonds of only 0.09 and negative correlations with all other asset classes. It also has a high Sharpe ratio of 1.77.

3 Since CDLFs' equity is typically in the form of grants, a net return comparable to the 2.6% return to equity investors in PDIFs cannot be calculated.

of outstanding portfolio, demonstrating a high loan-recovery rate.

- **Portfolio Yield:** Loan portfolio yields remained stable across years, ranging slightly from 5.2% to 5.4%; however, yields represent a relatively small share of CDLFs' total income compared to grants.
- **Cost Structure:** The total expense ratio (TER) in the sample has been relatively stable since 2013 at 9.4%.
- **Capital Structure:** CDLFs comprise both debt capital at market or below-market rates and grants from different types of private organizations and federal or local governments.

Sample Characteristics

- **Sector Allocation:** CDLFs that have a core focus on affordable housing dominate the sample, representing nearly half of total sample AUM. Those with a focus on business lending, community facilities, and microenterprises are also represented in the sample.
- **Geographical Allocation:** All CDLFs invest exclusively in the United States.
- **Legal Structure:** 98 out of 102 CDLFs are nonprofit companies.
- **Leverage:** All CDLFs use leverage, which represents almost half of total assets.
- **Types of Investors:** CDLF funding is mainly sourced from institutional investors (75%), including pension funds; financial institutions such as insurance companies, banks, and foundations; and non-governmental organizations. Public funders, the second-largest source, represent 18% of total assets.
- **Impact Measurement:** CDLFs measure impact through various output metrics encompassed by different impact themes, including affordable housing units created or retained; jobs created or retained; and number and diversity of beneficiaries reached.

This report takes the first steps towards developing benchmarks for investors and fund managers to understand and compare the performance of private debt impact investing funds that use a range of strategies. These data will be updated on an annual basis. As the sample grows, it will be possible to distill the data in more specific and segmented ways, expanding the usefulness for investors and fund managers focused on generating positive impact alongside stable financial returns.

1. MOTIVATION & BACKGROUND

Impact investments—investments made into companies, organizations, and funds with the intention of generating social or environmental impact (or both) alongside financial return — are vital to addressing a range of global challenges, including slowing and mitigating climate change, ending poverty and hunger, and achieving gender equality in both emerging and developed markets. In addition to pursuing their impact goals, impact investments also offer promising market opportunities for investors across the risk–return spectrum.

As of December 2016, a sample of 208 surveyed impact investors, allocating capital to various geographies, sectors, and asset classes and seeking a range of returns from below-market to above-market, managed USD 114 billion in impact investing assets.[4] Assets under management (AUM) among existing impact investors have recently been growing at an estimated 18% compound annual growth rate (CAGR), with new investors also steadily entering the field.[5]

Driving this growing interest, in part, are the Sustainable Development Goals (SDGs), launched by the United Nations (UN) in 2015 to target improvements in a wide range of social and environmental issues by the year 2030. Meeting these goals will require an estimated USD 2.4 trillion or more in investment capital over the coming decade.[6] While the impact investing market has shown robust growth, the need for exponential expansion is critical.

Industry growth will require, among other factors, rigorous data on the financial performance of impact investments. Evidence regarding such financial performance has recently begun to expand,[7] evidence to which this report contributes. Private debt or fixed income is the largest asset class in impact investing, accounting for 34% of impact investors' reported AUM, followed by real assets (22%) and private equity (19%).[8] The Global Impact Investing Network (GIIN) and Symbiotics have partnered for this report to analyze in aggregate the performance of impact investing through private debt.

Impact investing funds that use private debt vary by sector and geography. Seeking to reflect this reality, the report includes two distinct chapters. It first focuses on *Private Debt Impact Funds (PDIFs)* in various sectors and markets. These funds have varying capital structures, but mostly rely on equity and debt capital from investors such as pension funds, foundations, banks, or public sector funders. Next, the report considers *Community Development Loan Funds (CDLFs)*, which invest exclusively in the United States and rely on both private funding and grant.

The key analyses in this report will be updated annually—both with new, yearly data from existing funds and with data from the incorporation of new funds—to continually enhance their quality and maintain their relevance.

4 Abhilash Mudaliar, Hannah Schiff, Rachel Bass, and Hannah Dithrich, 2017 Annual Impact Investor Survey (New York: Global Impact Investing Network, 2017), xi, https://thegiin.org/research/publication/annualsurvey2017

5 Abhilash Mudaliar, Aliana Pineiro, and Rachel Bass, Impact Investing Trends: Evidence of a Growing Industry (New York: Global Impact Investing Network, December 2016), 5, https://thegiin.org/research/publication/impact-investing-trends.

6 Business & Sustainable Development Commission, Better Business, Better World (London: 2017), 16, http://report.businesscommission.org/.

7 Abhilash Mudaliar and Rachel Bass, GIIN Perspectives: Evidence on the Financial Performance of Impact Investments (New York: Global Impact Investing Network, November 2017), https://thegiin.org/research/publication/financial-performance.

8 Mudaliar et al., 2017 Annual Impact Investor Survey, 25.

1.1 METHODOLOGY

1.1.1 Sample

PDIFs considered in this report are mostly for-profit and invest in developed and emerging markets. CDLFs, which are certified by the U.S. Department of the Treasury, are largely nonprofit funds and exclusively invest in the United States.[9]

Given their different business models, the report separates these two peer groups.[10] Also, results on samples of fewer than three funds are not shared here in order to protect anonymity.

1.1.2 Inclusion Criteria

With regard to PDIFs, this report focuses only on independent investment vehicles that allocate on average more than 85% of their portfolios to private debt, target and measure social or environmental impact objectives (or both), target positive returns to investors, and manage capital from multiple investors.

The sample of CDLFs included only funds with more than half on average of their non-cash assets allocated to lending activities in the last five years (excluding funds that allocate most of their non-cash assets to other investment activities or training). Because CDLFs' core mission is to promote community development in their respective target markets, their impact criteria are implicitly verified by the sample selection. Nonetheless, excluded from the final sample were CDLFs primarily serving individual consumers, either through housing or consumer finance products (with such products for individual consumers, that is, representing more than half of the CDLF's lending portfolio). Analysis instead focuses on those funds investing in projects, organizations, or businesses (Table 1).

Table 1
Inclusion Criteria

	Included		**Excluded**	
Criteria	PDIFs	CDLFs	PDIFs	CDLFs
Impact	Intention/mission to generate social and environmental impact alongside a financial return.		No clear intention/mission to generate social and environmental impact alongside a financial return.	
Status	Independent Investment Vehicles			
Investors	Open to multiple investors		Open to single investor	
Fixed Income Investments	⩾85% on average for five years	All CDLFs	>15% equity; fund of funds	Venture Capital Funds, Intermediary CDLFs, CDLFs lending to individuals
Investment Portfolio	⩾50% of non-cash assets		<50% of non-cash assets	
Audited or Unaudited Financial Statements	Available		Not available	

9 More than 1,000 CDFIs (Community Development Finance Institutions) are certified as of October 2017, segmented into the following types: banks, credit unions, depository institution holding companies, loan funds, and venture capital funds. This report focuses only on the financial performance of loan funds. For a list of funds as of this date, see https://www.cdfifund.gov/Documents/Copy%20of%20CDFI%20List%2010-31-2017.xlsx.

10 For more information on business models, please refer to Sections 2.1 and 3.1 for PDIFs and CDLFs, respectively.

1.1.3 Source

PDIFs were identified through various networks and databases, including the GIIN's ImpactBase database, ImpactAssets 50, LuxFlag, Fundpeak, and the Symbiotics databases of microfinance and small and medium enterprise (SME) funds.

CDLFs matching the inclusion criteria (Table 1) were identified through the Opportunity Finance Network (OFN), the leading national network of CDFIs.

1.1.4 Data Accuracy

Participants in both peer groups submitted annual audited or unaudited financial statements for the past one to five fiscal years (that is, 2012–2016; see Appendix 2, Table 1), from which the Research Team standardized financial performance calculations as follows.

- **Extrapolation:** While most funds end their fiscal years on December 31, others operate on a different cycle. To enable comparison, their data were extrapolated accordingly as of December 31.
- **Exchange rates:** Most metrics, including growth calculations, were determined using end-of-year exchange rates.
- **Outliers:** Since this study focuses on patterns of return, the Research Team identified outliers only for sub-sections of the respective 'Financial Performance Breakdowns' of PDIFs and CDLFs. Outliers were defined as values amounting to three standard deviations above or below the mean of a particular metric. All figures in these sections include outliers. However, where helpful, the main text presents the results both including and excluding outliers.
- **Valuation methods:** Given the studied time frame of five years, the report presents no review of different funds' accounting methods, such as historical cost versus fair value, since these do not greatly impact the final performance figures.

Additionally, all PDIFs included in the sample completed a brief survey to provide supplemental background information on the financial and legal structure of their respective funds, target investment areas, impact themes, and geographic reach. The Research Team followed up with funds individually to ensure the accuracy of the supplied information. For CDLFs, OFN shared self-reported metrics with the Research Team from their network for the year 2016, which covered most of the survey questions. CDLFs were requested to input certain metrics on the survey platform when their information was incomplete.

1.1.5 Performance Calculation

For PDIFs, the Research Team computed fund performance based on the growth of Net Asset Value (NAV) per share, that is, net assets (assets net of liabilities) divided by the number of shares outstanding. This methodology gives the most accurate results in terms of fund performance. However, NAV per share information is not always available in funds' financial statements because most regulators do not require reporting on this metric. In such cases where critical NAV per share information was missing for a given fund, the Research Team approximated its NAV per share growth by using primary financial statement data.[11] Results based on this latter methodology will slightly differ from the NAV per share growth methodology, namely because information on the timing of cash flows related to share subscriptions and redemptions is not available in funds' financial statements. Thus, results presented in sections 2.5 A, B, C, D and E differ from the results presented in figures 12 and 13 ('Financial Performance Breakdown'), the latter figures being computed exclusively based on funds' annual reports.

Further, for multi-currency funds that offer share classes in currencies other than the fund's accounting currency, the Research Team approximated the unrealized foreign exchange variation against the USD for these respective currencies (mainly EUR and CHF share classes)

11 For more detail, see Appendix 1.

in order to extrapolate missing information on unrealized foreign exchange gains or losses from the funds' annual financial statements. The figures for return volatility shown in the report were calculated by considering the volatility of each respective sub-sample's (e.g., sector, hedging strategy) weighted performance.

For CDLFs, given their different capital structure, financial performance is mainly shown from the perspective of an investor buying notes issued by the CDLF and expecting, in most cases, a fixed-income return on this type of debt. Volatility for CDLFs is not calculated, because return patterns were very stable across the entire sample.

1.1.6 Regions and Sectors

Breakdowns by region and investment sector used for PDIFs are derived from recognized definitions from the World Bank and the GIIN, respectively (Tables 2 and 3). Analysis by region did not apply to CDLFs, which invest solely in the United States.

Table 2
List of Regions (World Bank Classification, 2017)

Regions
1 East Asia & Pacific
2 Europe & Central Asia
3 Latin America & the Caribbean
4 Middle East & North Africa
5 North America
6 South Asia
7 Sub-Saharan Africa

1.1.7 Selection of Impact Profiles

While the central objective of this report is to assess the financial performance of impact investing funds that provide loans to financial intermediaries or lend directly to projects and companies, several profiles showcase the approaches to impact measurement and management of typical funds in each sample. For PDIFs, profiles include one Financial Services fund, one Agriculture fund, and one Multi-sector fund. The CDLF profile focuses on a fund active in the Community Facilities sector in the United States.

Table 3
List of Sectors

GIIN Classification	OFN Classification
1 Education	1 Community Services Organizations
2 Energy	2 Housing
3 Financial Services (incl. Microfinance)	3 Small Business
4 Food & Agriculture	4 Microenterprise
5 Healthcare	
6 Housing	
7 Information and Communication Technologies	
8 Water, Sanitation and Hygiene	
9 Multi-sector	

2. PRIVATE DEBT IMPACT FUNDS

2.1 BUSINESS MODEL

PDIFs are independent investment structures differentiated by their legal status and distribution (public or private), investment sector, and geographies, all factors that ultimately affect their business models. Most funds (all but four) in this sample are for-profit. Most invest indirectly in end clients through financial intermediaries, mostly non-investment-grade institutions, while a few invest directly in projects and companies.

All but two funds specialize in investments in emerging markets, with an average portfolio maturity of 4.5 years. Impact objectives include economic development for low-income communities, increased access to financing for micro, small, and medium-sized enterprises, and the financial needs of smallholder farmers, among others.

PDIFs are managed by specialized investment management companies that have developed labor-intensive business models by internalizing the full investment value chain, from data collection and monitoring of investees to evaluation of credit risk and pipeline management. Thus, these investment management firms represent a primary gateway for international investors who are interested in entering the impact investing space. The PDIFs included in this study are managed and advised by 27 investment managers based primarily in Europe and North America.

Funding for these PDIFs is sourced from different types of investors (public, private, retail, and high-net-worth individuals), either by issuing shares with varying subscription and redemption periods or by raising debt capital from which investors can generally expect a fixed-income return.

PDIFs invest in Financial Services (including Microfinance), Multi-sector, and Other sectors (including Arts and Culture, Education, Energy, and Food and Agriculture).

2.2 SAMPLE SNAPSHOT

The team identified 166 Private Debt Impact Funds that met our inclusion criteria, out of which 50 funds participated.

50
PRIVATE DEBT IMPACT FUNDS

30%
PARTICIPATION RATE

Table 4 lists the total number of participating PDIFs by year for which data was gathered. Most PDIFs provided four to five fiscal years of relevant financial statements.

Table 4
Number of Participating Funds by Year

Year	Number of Funds
2012	31
2013	37
2014	41
2015	48
2016	46

The PDIF sample mainly comprises funds that invest in Financial Services, including Microfinance, largely in emerging markets. Eight funds focus primarily in other sectors, including Arts and Culture, Education, Energy, and Food and Agriculture (in 'Other' Table 5).

Table 5
Main Investment Sector

Year	50%+ in Financial Services	50%+ in Other	Multi-Sector
2012	22	6	3
2013	27	7	3
2014	29	7	5
2015	34	8	6
2016	37	7	2

On average, one-third of PDIFs use leverage amounting to a maximum of one-fourth of total assets (Table 6).

Table 6
Levered versus Unlevered Funds

	Unlevered	Levered	
Year	Number of Funds	Number of Funds	Leverage Ratio
2012	22	9	24%
2013	25	12	20%
2014	29	12	21%
2015	33	15	18%
2016	30	16	17%

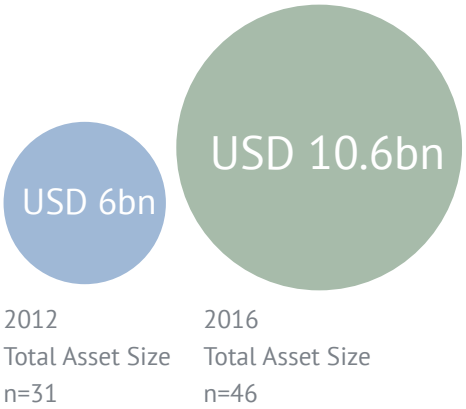
Nearly 40% of the sample is fully hedged, six funds are fully unhedged, and the remainder are partially hedged. Two funds invest only in USD.

Most respondents are private, for-profit funds and thus target risk-adjusted, market-rate returns. However, some nonprofit (five) and a few for-profit funds (eight) seek below-market-rate returns (either closer to capital preservation or closer to market-rate returns).

2.3 ASSET SIZE

2.3.1 Total Asset Growth

The total sample of PDIFs comprised USD 10.6 billion in assets as of December 2016, up from USD 6 billion in December 2012. This implies a CAGR of 15% between the two observations. However, this growth is partly explained by a higher sample size (n=46 in December 2016; n=31 in December 2012). Removing the effect of sample size, analysis of a constant sample of 29 funds between 2012 and 2016 gives a CAGR of 11.2%, a figure that better reflects the growth of the market.

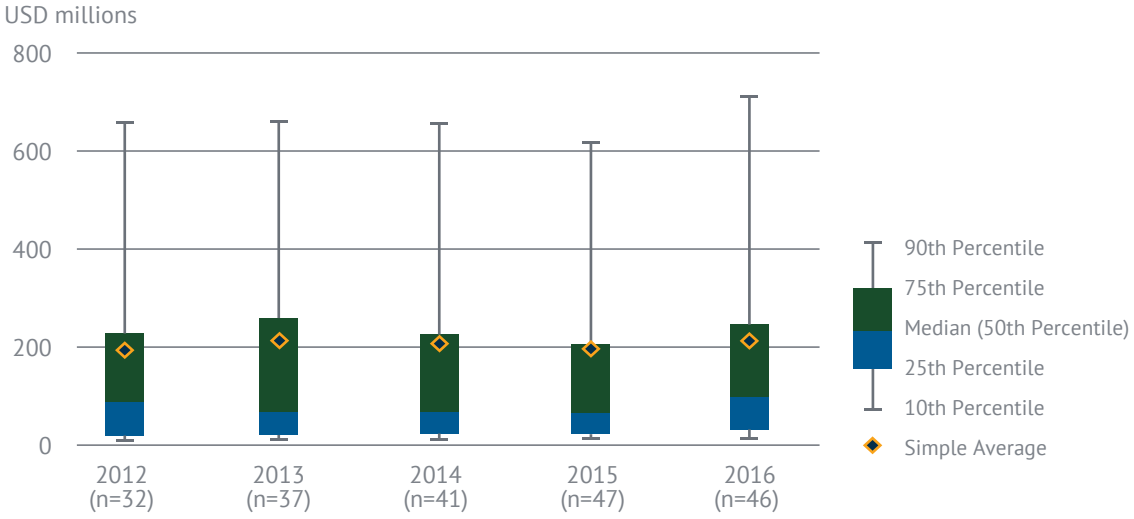


Over the past five years, the average size of PDIFs remained stable at around USD 200 million (Figure 1), growing by 2% per annum (CAGR). The range of funds' size is quite broad, with minimum assets of USD 3.5 million and maximum assets of USD 1.3 billion for 2016. On average, funds seeking risk-adjusted, market-rate returns are four to five times larger than funds seeking below-market returns. Levered funds average USD 232 million in assets, and unlevered funds average USD 147 million.

By sector, Multi-sector funds registered the highest average growth, driven mainly by one fund's growth (102% including outliers; 46% without outliers) and notably starting from a much lower base than the other sectors. Financial Services (16% of funds) registered the second-highest average growth.

Figure 1

Assets Under Management, Distribution of Sample



2.3.2 By Place of Incorporation

PDIFs are incorporated in various countries, most in Luxembourg (62% by size and 46% by number of funds). The Netherlands is the second-most-common place of incorporation in terms of volume (26%), while the United States is second in terms of number of funds (24%) and third in terms of total volume (8%; Appendix 2, Table 2).

2.3.3 By Vintage Year

Most PDIFs in the sample (30 out of 50) have a long track record (six years or more; Figure 3). PDIFs in the Financial Services sector tend to have the longest track records. However, the overall sample is relatively new; nearly two-thirds of funds are younger than 10 years.

Figure 3

Age of Funds

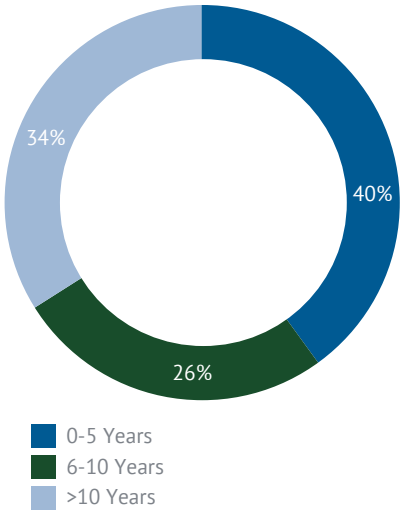


Figure 2

Average Assets Under Management by Sector [12]

USD millions

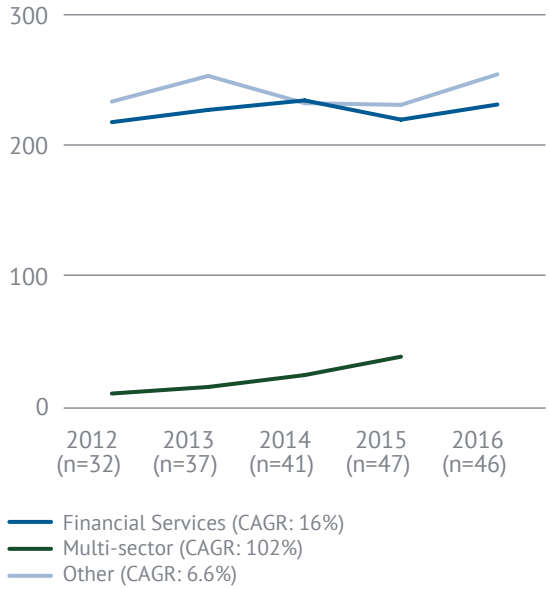
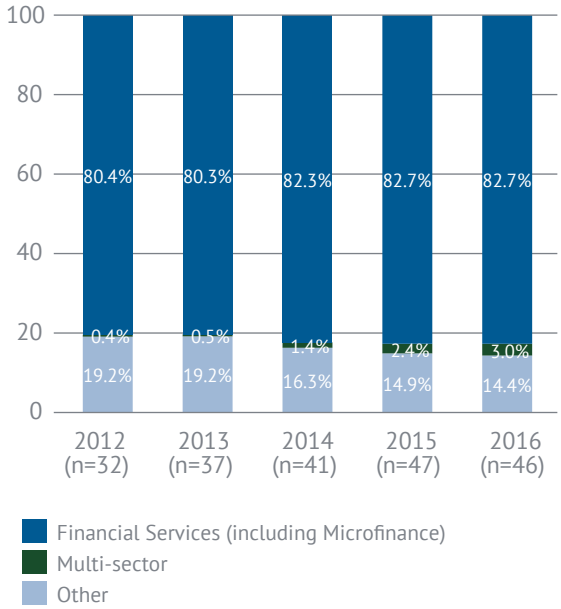


Figure 4

Total Assets by Sector

% of Total Assets



12 Due to a small sample size of funds in this category, metrics for Multi-sector funds are not disclosed for 2016.

Table 7

Total Asset Size (USD million) and CAGR by Sector

	Total Assets 2012		Total Assets 2016		CAGR of Total Assets	
Year	Average	Median	Average	Median	Average	Median
Financial Services (including Microfinance)	217.5	100.1	231.1	94.3	1.5%	–1.5%
Multi-sector	9.1	7.2	37.4	19.0	60.1%	38.1%
Other	233.3	160.5	254.2	104.2	2.2%	–10.2%

2.3.4 By Main Investment Sector

Financial Services (including Microfinance) is the most represented sector in the sample by both volume (80.4% in 2012 and 82.7% in 2016) and number of funds (70% in 2012 and 80% in 2016; Figure 4 and Table 7). Funds specialized in other sectors and those operating in multiple sectors have a small share of the sample in terms of both volume and number of funds.

2.3.5 By Size

Figures 5 and 6 split the PDIFs in the sample into tiers: large funds with more than USD 250 million in AUM, medium-sized funds with USD 50–250 million AUM, and small funds with less than USD 50 million in AUM. Compared to 2012, in 2016 the proportion of large funds in the sample decreased slightly in terms of both total assets and number of funds, while the proportion of medium-sized funds increased. The proportion of small funds remained consistent in terms of total assets and number of funds during the period under review.

Figure 5

Total Assets by Size

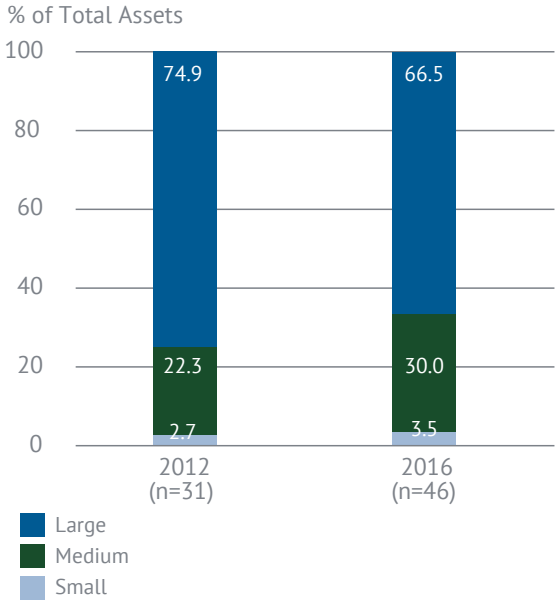
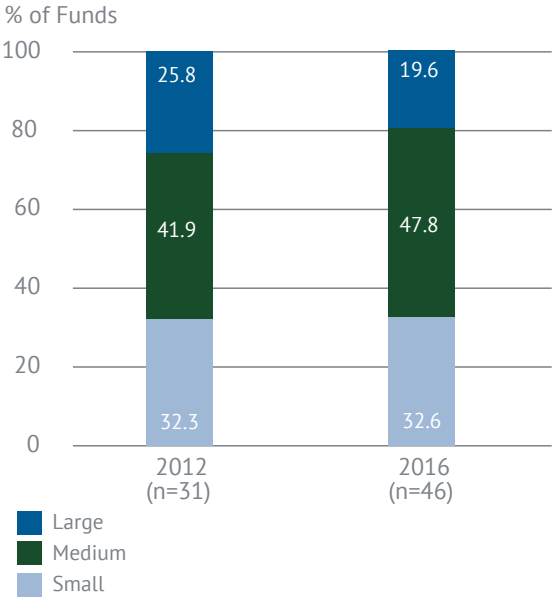


Figure 6

Number of Funds by Size



2.3.6 By Return Philosophy

Funds seeking risk-adjusted, market-rate returns (MR funds) comprise the majority of the sample in terms of number (on average 77%) and asset volume (on average 85%). MR funds have average AUM of USD 244 million, compared to below-market-rate-seeking funds (BMR funds) with average AUM of USD 38 million. In terms of investment sector, MR funds are mostly invested in Financial Services (81.7% on a five-year average), while BMR funds are primarily invested in 'Other' sectors (48%), followed by Financial Services (41%). By geographic allocation, BMR funds' main exposure is to Latin America (55%) and Sub-Saharan Africa (29%), while MR funds are primarily exposed to Eastern Europe and Central Asia (32%) and Latin America (31%).

2.4 PORTFOLIO AND INVESTOR CHARACTERISTICS

This section analyzes the sample funds' loan portfolios, excluding cash and other assets.

2.4.1 Total Loan Portfolio

As of December 2016, the combined loan portfolio of the PDIF sample reached USD 9.1 billion. The average fund in the sample has a loan portfolio of USD 182 million, while the median portfolio in the sample has USD 72.8 million. Roughly 75% of portfolios in the sample fall just below the mean, with a few large funds raising the sample average (Figure 7).

2.4.2 Average Maturity

The maturity of the average outstanding loan portfolio is 4.5 years. Larger funds by asset size appear to have longer maturities (Figure 8). By sector, there are shorter maturities in Financial Services and Multi-sector funds compared to other impact sectors (Figure 9).

Figure 8

Portfolio Maturity by Fund Size (2016, weighted average)

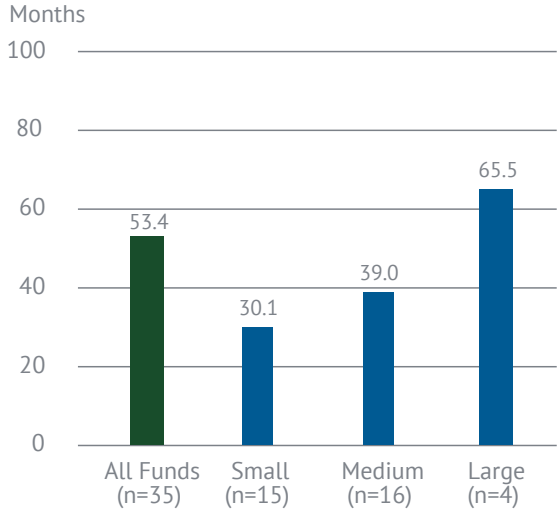


Figure 9

Portfolio Maturity by Sector (2016, weighted average)

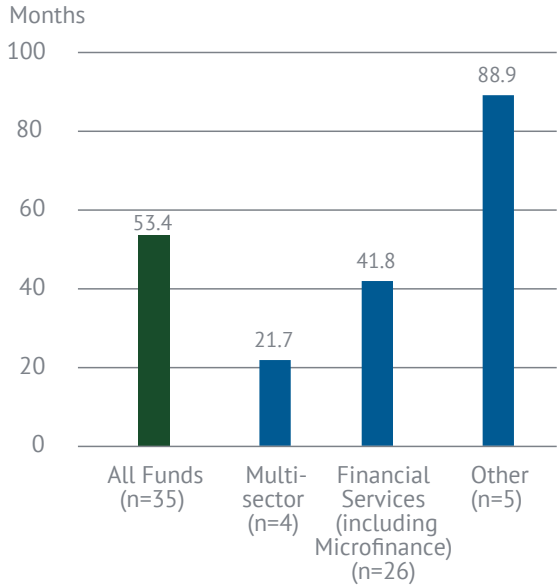


Figure 7

Portfolio Size, Distribution of Sample (2016)

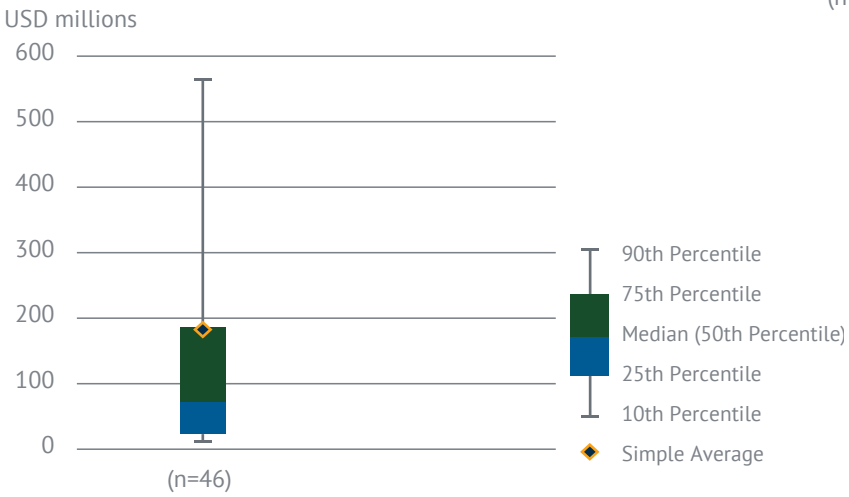


Table 8
Geographical Breakdown of Total Portfolio by Main Investment Sector

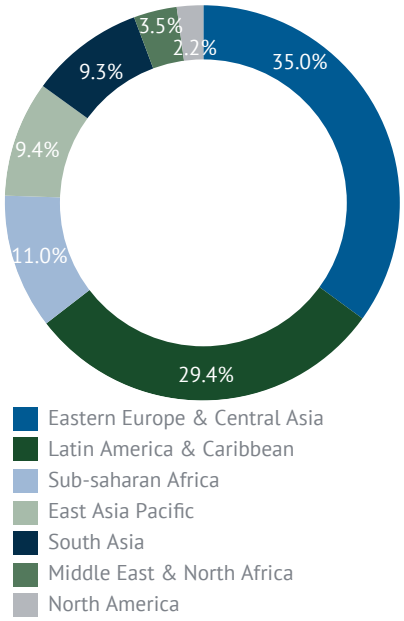
	Financial Services (including Microfinance)	Other	Multi-sector
Latin America & Caribbean	32%	9%	32%
Eastern Europe & Central Asia	30%	84%	2%
South Asia	11%	0%	0%
Sub-Saharan Africa	11%	3%	37%
East Asia Pacific	11%	0%	12%
Middle East & North Africa	3%	4%	4%
North America	2%	0%	13%

2.4.3 Geographic Breakdown

The largest region in terms of portfolio exposure is Eastern Europe and Central Asia, followed by Latin America and the Caribbean, two regions that together represent 64.5% of funds' overall weighted portfolio allocations (Figure 10). The lowest exposures are in the Middle East and North Africa and North America (3.5% and 2.2%, respectively, of the funds' portfolios).

Considering only the Financial Services sector, Latin America and the Caribbean has the largest allocation (32%), followed by Eastern Europe and Central Asia (30%; Table 8). Multi-sector funds invest primarily in Sub-Saharan Africa (37%). Separately, only funds focused in Financial Services invest in South Asia, while only Multi-sector funds have some significant exposure to North America (Table 8).

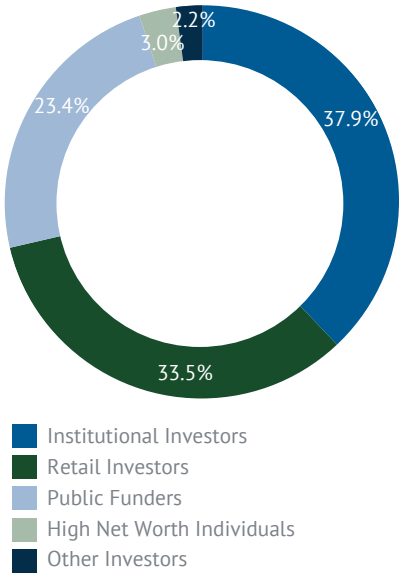
Figure 10
Geographical Breakdown by Total Portfolio Volume (2016, n=49)



2.4.4 Types of Investors

Private investors, including institutional (37.9%) and retail (33.5%) investors, provide the largest share of funding to PDIFs. Public sources (development finance institutions or government agencies) represent less than a quarter of total funding, and high-net-worth individuals represent only 3% (Figure 11).

Figure 11
Investor Type by Volume of Total Equity and Notes (2016, n=47)



2.5 FINANCIAL PERFORMANCE BREAKDOWN

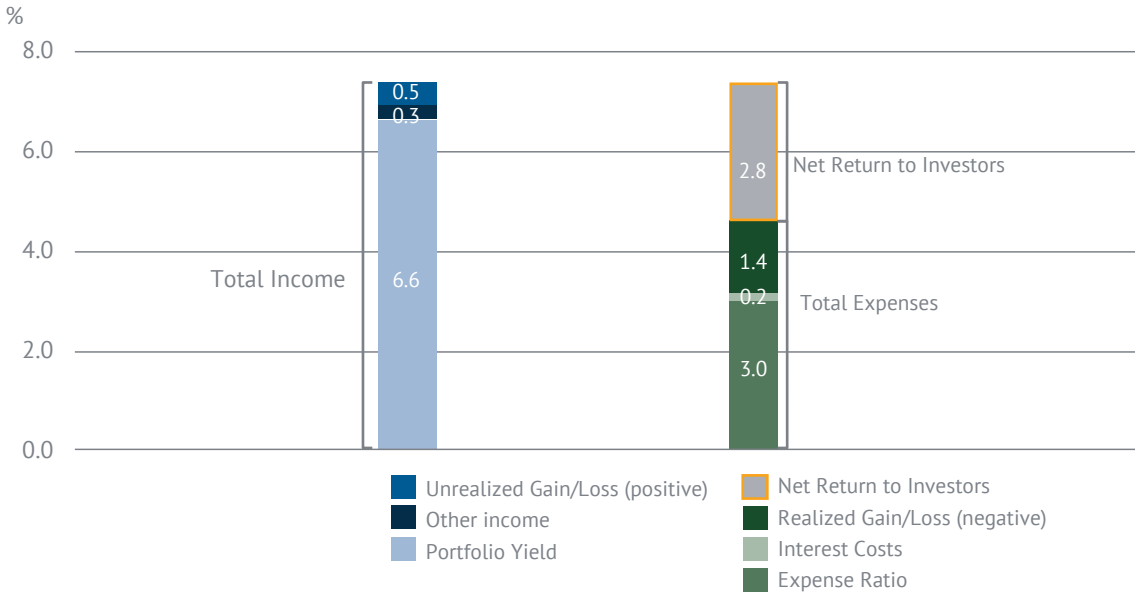
The following section assesses the financial performance of PDIFs.

From the perspective of an equity investor forming part of the shareholding structure of a PDIF, net returns depend on several factors. Broadly speaking, net returns primarily relate to the level of income generated by PDIFs' core lending business (the portfolio yield) and their total expense level. Figures 12 and 13 provide more detail regarding how MR and BMR funds have generated net returns to investors from 2012 to 2016.

For MR funds, income is composed mainly of portfolio yield (proceeds from the loan portfolio). Other sources of income include realized or unrealized gains (changes in the valuation of funds' assets, which in our sample are mainly driven by currency exchange fluctuations), proceeds from equity investments, if any, and recovery from write-offs, among other possible items. Costs include management fees, interest costs (cost of borrowing for levered funds), and realized or unrealized losses. Portfolio yield, other income, expense ratios, and interest costs are all relatively stable across the five years. The main drivers of fluctuations in annual performance are realized and unrealized gains or losses on assets.

MR funds generated a total income of 7.4% (expressed as a percentage of NAV) on a five-year average, comprising mostly the portfolio yield (6.6%; Figure 12). The sum of all expenses, including interest, amounts to 3.2%. After a realized loss of 1.4%, net return on the period was 2.8%.[13]

Figure 12
Financial Performance Breakdown (2012–2016), Risk-Adjusted, Market-Rate Funds

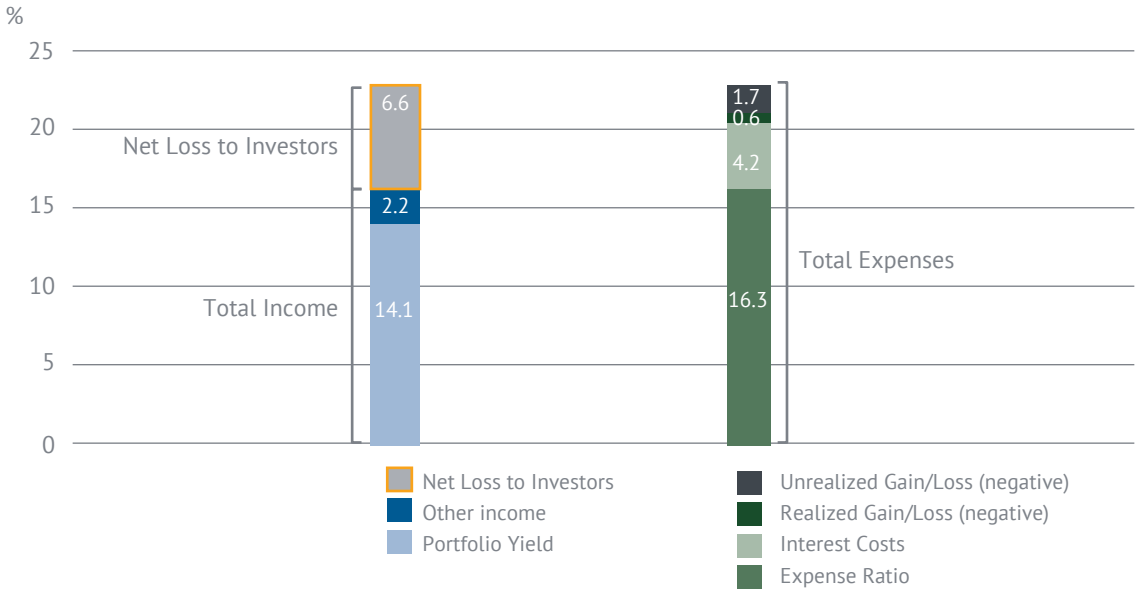


13 Net returns to investors in this section—that is, 2.8% for MR funds and −6.6% for BMR funds—differ from the respective averages of 2.6% and −6.8% for MR and BMR funds presented later in the chapter due to the different methodology required to calculate the complete financial breakdown shown in Figures 12 and 13. For more detail, please see 1.1.5 in the Methodology section.

A similar analysis for BMR funds (Figure 13) shows that these funds' total income is mainly generated by portfolio yield (14.1%) while total expenses are much higher (20.5%), with a much higher expense ratio (16.3%) due in part to greater leverage (and consequently a higher numerator; see section 2.5.3). As a matter of fact, all BMR funds regardless of their leveraging strategy show higher portfolio yields and expense ratios than MR funds, this may also be linked to their respective underlying portfolio investments. Furthermore, BMR funds' greater leverage also leads to higher interest costs (4.2%). Overall, the five-year period has negative net returns of −6.6% on a weighted average basis (including outliers).

The following sub-sections analyze more deeply a specific component of financial performance—first net returns, then portfolio yield, and finally cost structure—each broken down by segment (hedging strategy, use of leverage, return philosophy, and sector).

Figure 13
Financial Performance Breakdown (2012–2016), Below-Market-Rate Funds



2.5.1 Net Returns to Investors

A. Return Philosophy

Most funds in the sample seek risk-adjusted, market-rate returns (Table 9), both by number of funds and total assets (comprising, on average, more than 80% of total sample assets throughout the period under review).[14]

Weighted net returns of risk-adjusted, market-rate-seeking funds averaged 2.6% over the last five years. Over the same period, more than 90% of funds generated positive returns, ranging from 0% to 6.6%. In 2016, the 90th percentile of MR funds by performance registered 10% returns. Annual median and averages are close, evidence of relatively homogenous returns across the sample.

On the other hand, almost half of the below-market-rate-seeking funds had negative net returns (Figure 14). Weighted net returns of below-market-rate-seeking funds averaged −6.8% over the last five years, pulled down by an outlier. Excluding this outlier, the five-year average return of such funds is −0.2%.

Figure 14

Average Net Returns by Return Philosophy (2012–2016)

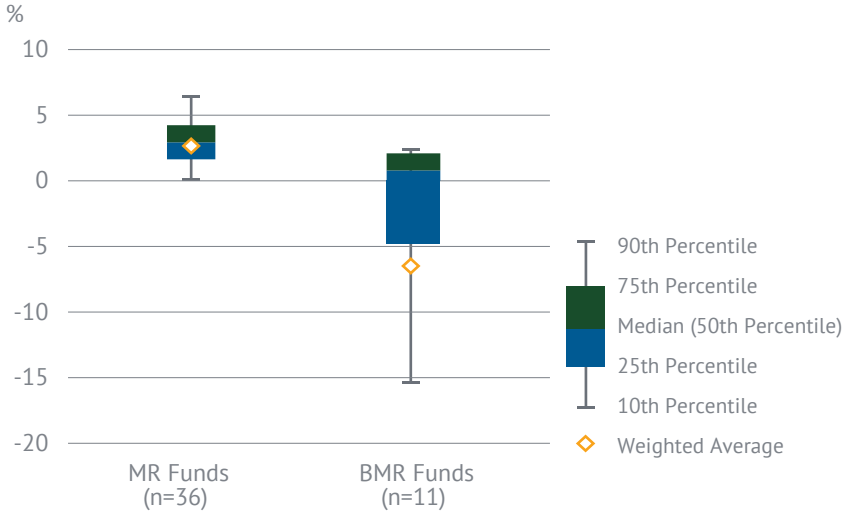


Table 9

Return Philosophy

	BMR Funds		MR Funds	
Year	Number of Funds	Sample Proportion by Total Assets	Number of Funds	Sample Proportion by Total Assets
2012	6	4.0%	23	82.5%
2013	8	3.5%	26	83.3%
2014	10	4.1%	28	85.6%
2015	11	4.2%	33	86.7%
2016	9	3.7%	34	87.7%

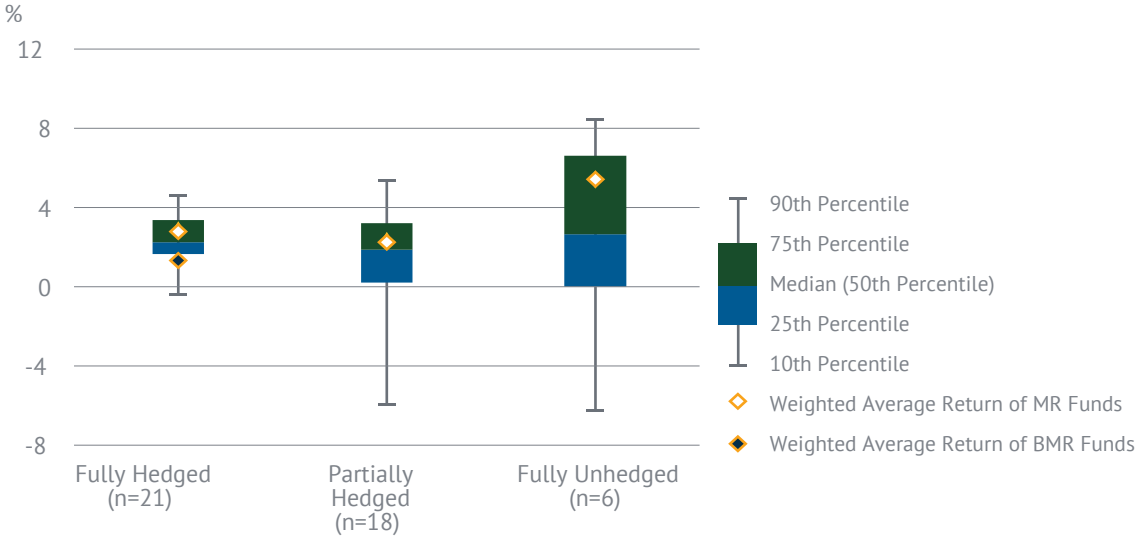
14 The sample proportion by total assets for BMR and MR funds does not sum to 100% because some funds in the sample did not report their return philosophies; these have been classified as neither MR nor BMR funds.

B. Hedged Versus Unhedged Funds

From 2012 to 2013, PDIFs (most investing in emerging markets) registered low returns due to the instability of several emerging market currencies that depreciated against the USD.

Figure 15

Average Net Returns by Hedging Strategy (2012–2016)



This depreciation impacted funds' hedging costs. Returns increased in 2014, before falling again in 2015–2016 after several political and economic challenges in emerging markets. For MR funds, the highest average annual compound returns over the period were registered by fully unhedged funds (5.6%) compared to fully hedged funds (2.8%; Figure 15). However, fully unhedged funds also had higher volatility (5.2%) compared to fully hedged (0.7%) or partially hedged (1.3%) funds (Table 10).

Table 10

Returns and Volatility by Hedging Strategy

	All Funds	Fully Hedged	Partially Hedged	Fully Unhedged
Compound Annual Net Return (5 years)	2.6%	2.8%	2.3%	5.6%
Volatility	0.9%	0.7%	1.3%	5.2%
Sharpe Ratio	0.77	1.27	0.29	0.71

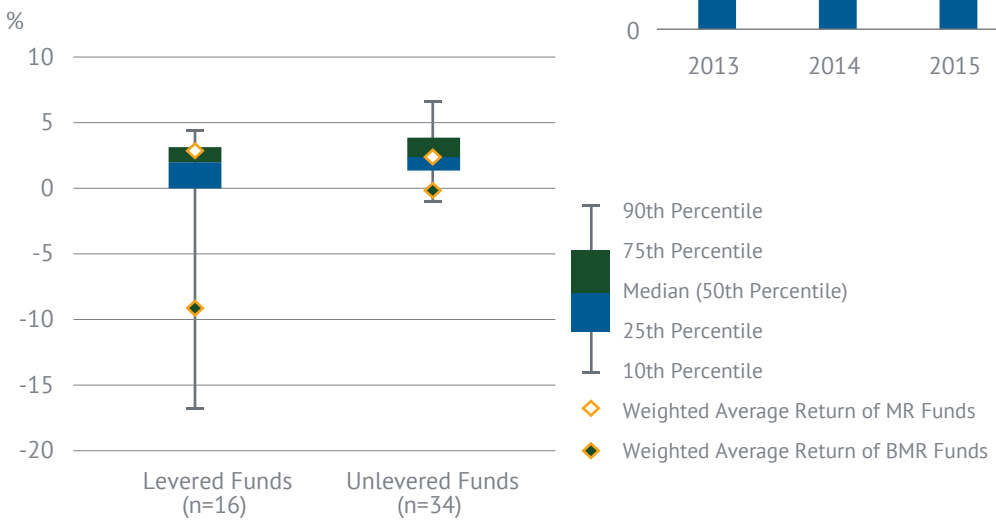
Table 11
Returns and Volatility by Leveraging Strategy

	All Funds	Levered	Unlevered
Compound Annual Net Return (5 years)	2.6%	3.0%	2.3%
Volatility	0.9%	0.6%	1.3%
Sharpe Ratio	0.77	1.96	0.29

C. Levered Versus Unlevered Funds
Overall, levered funds showed higher returns (3%) on average than unlevered funds (2.3%) over the five-year observation period (Table 11 and Figure 16). Using leverage enhances portfolio performance if the underlying portfolio return exceeds the cost of debt.

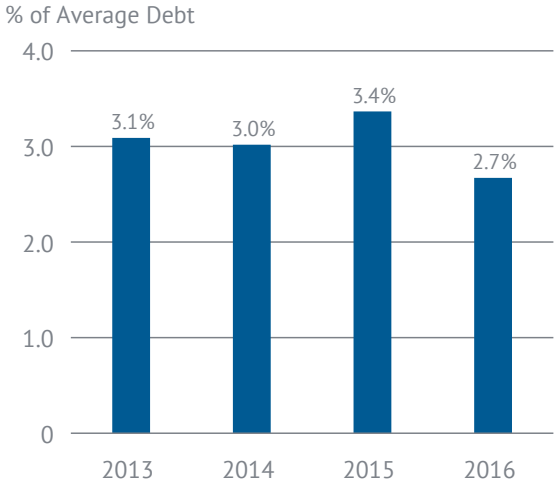
While the above figures on net return relate to the performance of PDIFs from the perspective of an equity investor, debt investors can also benefit from interest on debt capital provided to PDIFs. These types of investors can usually expect a fixed-income return from levered funds over a certain period of time.

Figure 16
Average Net Returns of Levered and Unlevered Funds (2012–2016)



Levered funds comprise one-third of the sample by number of funds and one-fourth by total assets. Interest rates they provide on notes issued to investors have averaged 3% on a weighted basis, with a maximum of 3.4% in 2015 (Figure 17).

Figure 17
Interest on Debt



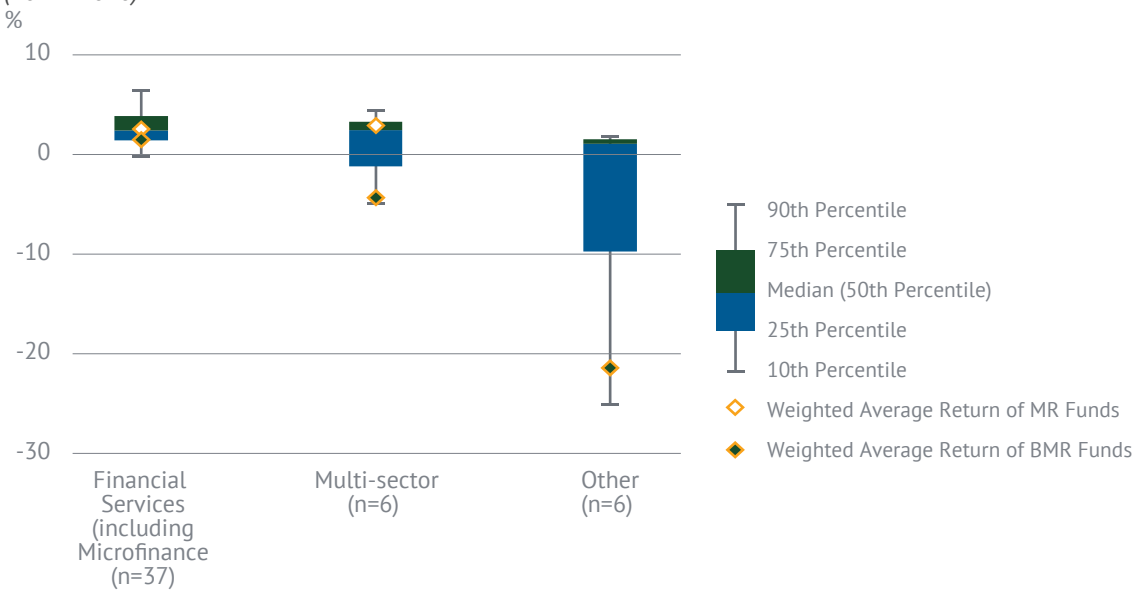
D. By Sector

Again considering net returns to equity investors, MR funds investing in the Financial Services sector (including Microfinance) showed more stable returns across the years, i.e. 2.6% (Figure 18), with the lowest annualized volatility of 1.0% compared to 4.0% for Multi-sector funds and 1.1% for funds investing in other sectors. The highest returns by sector were registered by Multi-sector MR funds (2.9% on a five-year average), while the worst performance was recorded by BMR funds investing in other sectors (−21.3%, or −10.6% when excluding one outlier).[15]

Finally, several outliers characterize the 'Other' sector category, mainly due to the heterogeneous sectors in which the funds invest, which results in wider variations in net return.

Figure 18

Average Net Returns by Main Investment Sector (2012–2016)



15 Funds in 'Other,' sectors targeting risk-adjusted, market-rate returns are not shown on the graph due to a small subsample size.

E. Comparison with Other Asset Classes

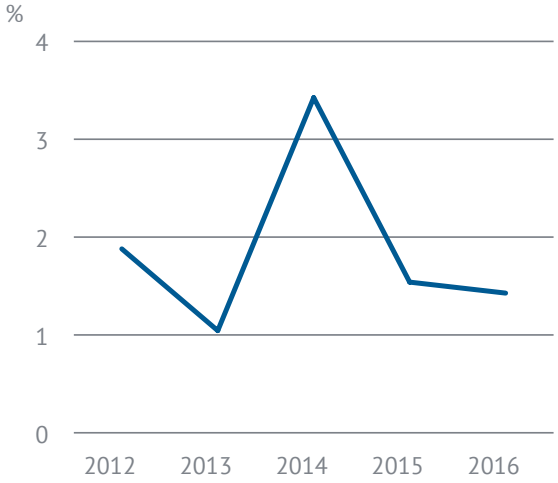
Among the respondents, seven funds benchmark themselves to three- or six-month Libor USD, two funds benchmark to six-month Euribor, and the others target a range of returns over a five-year term from 3% to 5%.[16]

Compared to other asset classes (Table 12),[17] PDIFs register relatively low but stable returns.[18] They outperformed the three-month LIBOR USD ('Cash' in Table 12) more than five-fold, while exhibiting annualized volatility (0.9%) trailing only three-month LIBOR USD (0.1%). PDIFs have a low to negative correlation with a range of other asset classes and a higher Sharpe ratio.[19] While these findings are based on a limited number of observations (five periods of annual data), they are supported by the SMX-MIV Debt Index of Microfinance Private Debt Funds, which is similar in key characteristics and based on 60 monthly observations for the same time period. The SMX-MIV Debt Index has a correlation with developed-market bonds of only 0.09 and negative correlations with all other asset classes shown. [20]

The spreads of MR funds above money markets (Figure 19) move in a band between LIBOR +100 and +300 basis points net return.

Figure 19

Net Return Spread over Three-Month Libor USD



16 LIBOR is the London Interbank Offered Rate, or the rate of interest at which banks offer to lend money to one another on the wholesale money markets in London. Euribor, short for the Euro Interbank Offered Rate, is based on the average interest rates at which a large panel of European banks borrow funds from one another.

17 Returns and volatility for other asset classes were calculated using the following market indices:
- For Developed Market Bonds, 'JPM Hedged USD GBI Global.'
- For Emerging Markets Bonds, 'JPM EMBI Global.'
- For Microfinance Private Debt, 'SMX-MIV Debt USD'.
- For World Stocks, 'MSCI World Index.'
- For U.S. Stocks, 'S&P 500.'
- For Alternatives, 'HFRX Global Hedge Fund Index.'
- For Cash, 'Three-Month Libor USD.'

18 Compound Annual Net Return of PDIFs and their annualized volatilities are calculated only for MR funds.

19 The Sharpe Ratio is the average return earned in excess of the risk-free rate per unit of volatility or total risk. The risk-free rate used to compute the Sharpe Ratio is the 5y, Daily U.S. Treasury Yield Curve Rate as of December 31, 2016, published by the U.S. Department of the Treasury.

20 0 implies no existing correlation, while 1 implies perfect correlation.

Table 12

Returns, Volatility, and Correlation by Asset Class (2012–2016)

	Private Debt Impact Funds (MR Funds only)	Microfinance Private Debt	Developed Markets Bonds	Emerging Markets Bonds	Cash	World Stocks	US Stocks	Alternatives
Compound Annual Net Return (5 years)	2.6%	2.7%	3.4%	5.4%	0.4%	8.2%	12.2%	1.6%
Annualized Volatility (5 years)	0.9%	0.5%	3.1%	7.2%	0.1%	11.2%	10.4%	3.6%
Correlation Table								
Private Debt Impact Funds (MR Funds only)	1.00	0.91	0.81	0.45	-0.43	-0.01	0.07	0.10
Microfinance Private Debt		1.00	0.09	-0.00	-0.30	-0.08	-0.11	-0.19
Developed Markets Bonds			1.00	0.37	-0.12	-0.17	-0.18	-0.13
Emerging Markets Bonds				1.00	0.05	0.57	0.44	0.42
Cash					1.00	-0.03	-0.03	0.04
World Stocks						1.00	0.95	0.85
US Stocks							1.00	0.83
Alternatives								1.00
Sharpe ratio	0.77	1.77	0.48	0.49	-25.45	0.56	1.00	-0.08

All results from the table (Returns, Volatility, Correlation and Sharpe Ratio) for Private Debt Impact Funds are calculated using five annual observation points (2012–2016) whereas results for all other asset classes are calculated using 60 monthly observation points (Jan. 2012 – Dec. 2016)

2.5.2 Portfolio Yields

Average portfolio yields, the major source of income for PDIFs, varied slightly between 6.0% and 6.4% over the five-year period, while income from other activities remained a marginal source of revenue (Figure 20).[21]

Overall, levered funds naturally had higher portfolio yields than unlevered funds (Figure 21), particularly from 2014 to 2016, because portfolio yield is calculated on net assets plus average net subscriptions. For a given net asset size, a levered fund would have a larger portfolio than an unlevered fund. This higher numerator raises the portfolio yield of levered funds. Portfolio yields are higher for BMR funds (14% on average for the five-year period) compared to MR funds (6.6%, both levered and unlevered combined).

Figure 20

Total Income (Weighted Average)

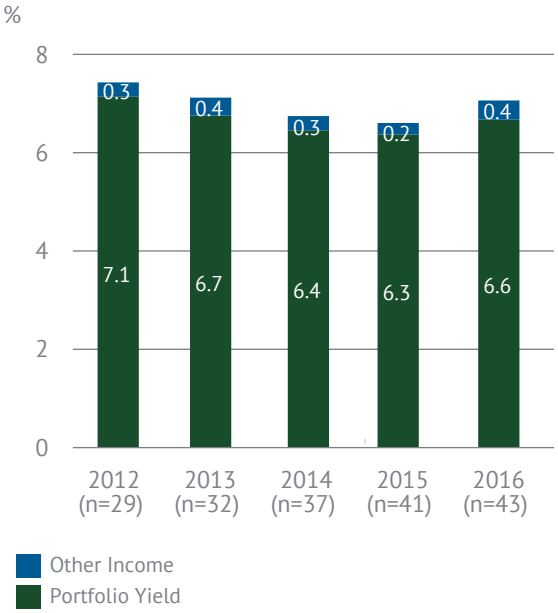
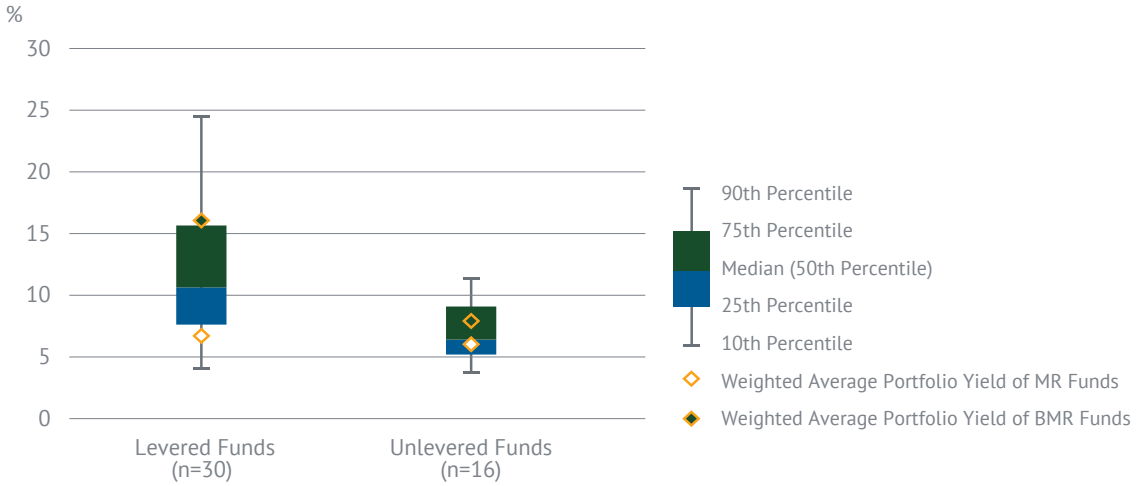


Figure 21

Average Portfolio Yield of Funds, (2012–2016)

Unlevered Versus Levered



21 All figures in this section are calculated based on net assets and average net contributions.

2.5.3 Cost Structure

For PDIFs, the expense ratio, which includes management fees and other expenses,[22] constitutes the largest cost (Figure 22). The average expense ratio (3.1% over all five years) decreased slightly from 3.4% in 2012 to 3.1% in 2016 for all PDIFs, mainly because Financial Services funds have achieved economies of scale due to their long track record and size (see section 2.3.3).

Average interest costs for all funds remain low, between 0.2% and 0.3%, reflecting in part the zero interest costs of unlevered funds.

As with portfolio yields, total expenses are higher for levered funds (4.9%) than for unlevered funds (2.4%). One explanation is that the denominator (net assets plus net average subscriptions) is lower for the former, naturally resulting in higher total expenses for such funds relative to assets. BMR funds have a much higher average expense ratio (16.3%) than MR funds (3.0%) over the five-year period.

Regarding the expected total expense ratio (TER) as self-reported by PDIFs (Figure 23), most funds target a TER between 1% and 3%, but, depending on the fund's structure, TERs can exceed 5%.[23]

Figure 22
Average Fund Cost Structure (2012–2016)

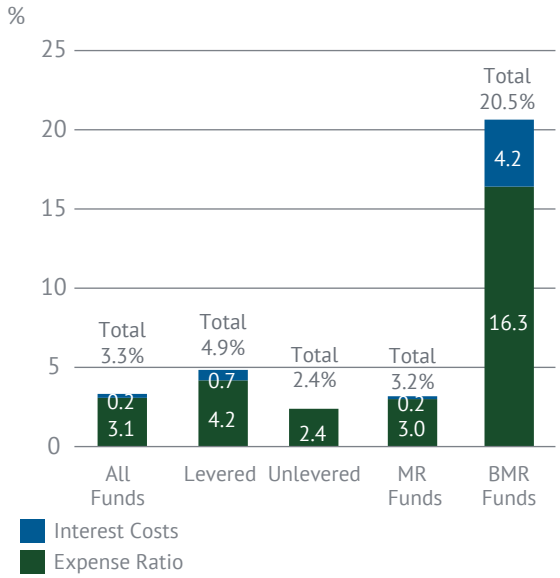
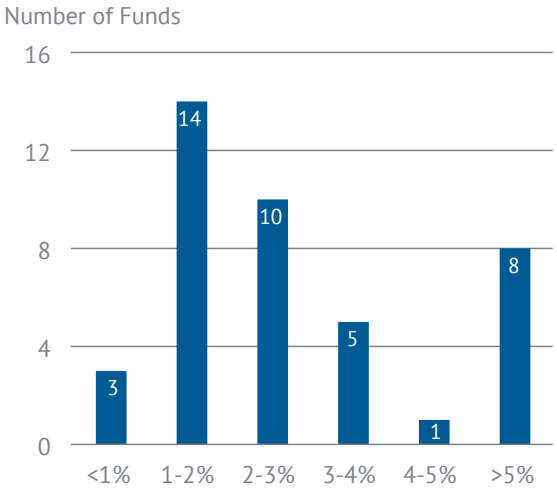
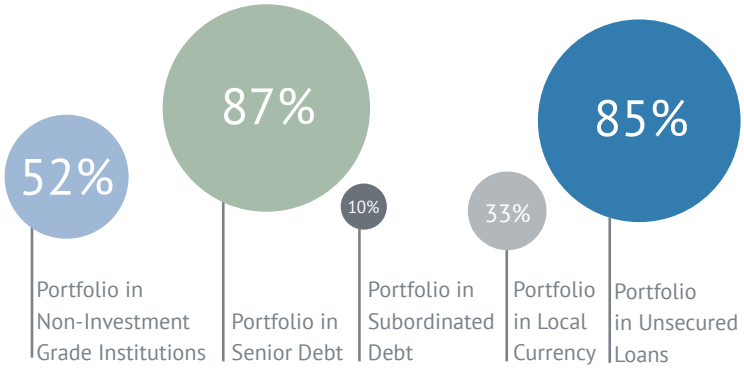


Figure 23
Distribution of Expected Total Expense Ratio



22 Other expenses include accounting fees, custodian fees, legal fees, marketing and distribution costs, and general administration fees.

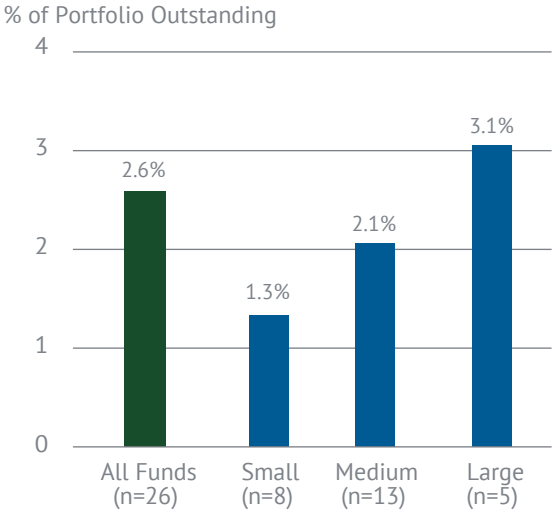
23 Expected TER was self-reported by participants on the survey platform and differs from the expense ratio computed using annual financial statements. Expected TER is also calculated using a different denominator, namely total assets, while the expense ratio computed from financial statements used as a denominator net assets plus average net contributions.



2.6 PORTFOLIO RISK

Most of the sample invests in emerging markets (see section 2.4.3 Geographical Breakdown), which informs their risk-management strategies in terms of investees, seniority, and portfolio quality. As of December 2016, half of the PDIFs' total portfolio is invested in non-investment grade institutions (< BBB–), 33% denominated in local currency, and 85% in unsecured loans.

Figure 24
Loss Provisions Outstanding by Fund Size
(2016, Weighted Average)



The level of loss provisioning for PDIFs in the sample was 2.6% on a weighted average basis (Figure 24). Larger funds tend to have higher provisioning ratios than smaller ones. Funds with total assets below USD 50 million had only 1.3% provision on average, whereas funds with total assets greater than USD 250 million had 3.1% of their portfolio provisioned, on average. BMR funds provisioned on average 7.3% compared to 2.6% for MR funds.

Furthermore, regarding hedging strategy, partially hedged funds have the highest provision rate (4.6%), and fully unhedged funds have the lowest rate (0.5%; Figure 25). However, fully unhedged funds are less mature than the others, on average, with most having fewer than three years' track record.

Large funds have the highest proportion of written-off loans (Figure 26), even though the proportion remains relatively low compared to their provisioning ratio.

Figure 25
Loss Provisions Outstanding by Hedging Strategy
(2016, Weighted Average)

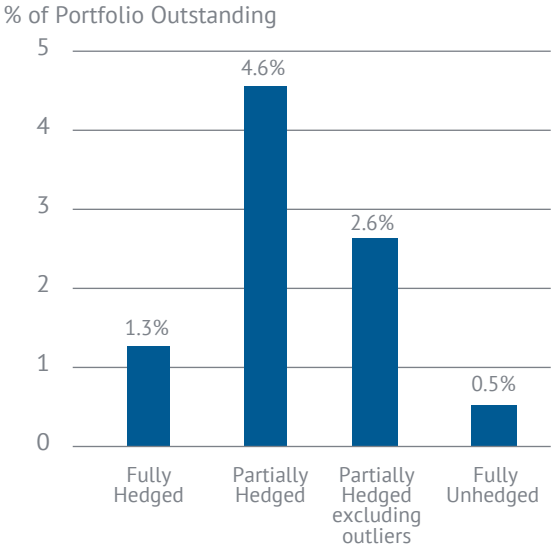
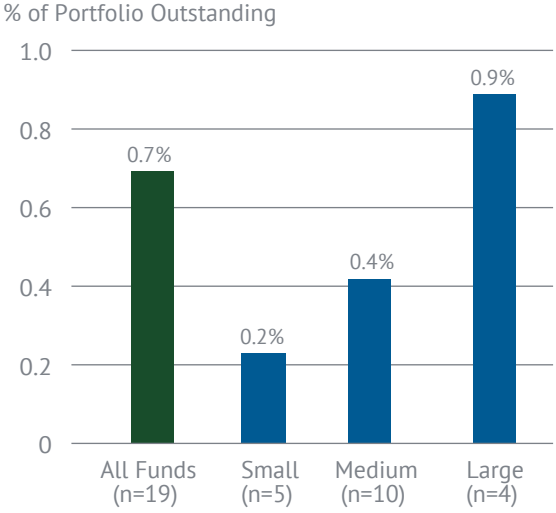


Figure 26
Write-offs by Fund Size
(2016, Weighted Average)

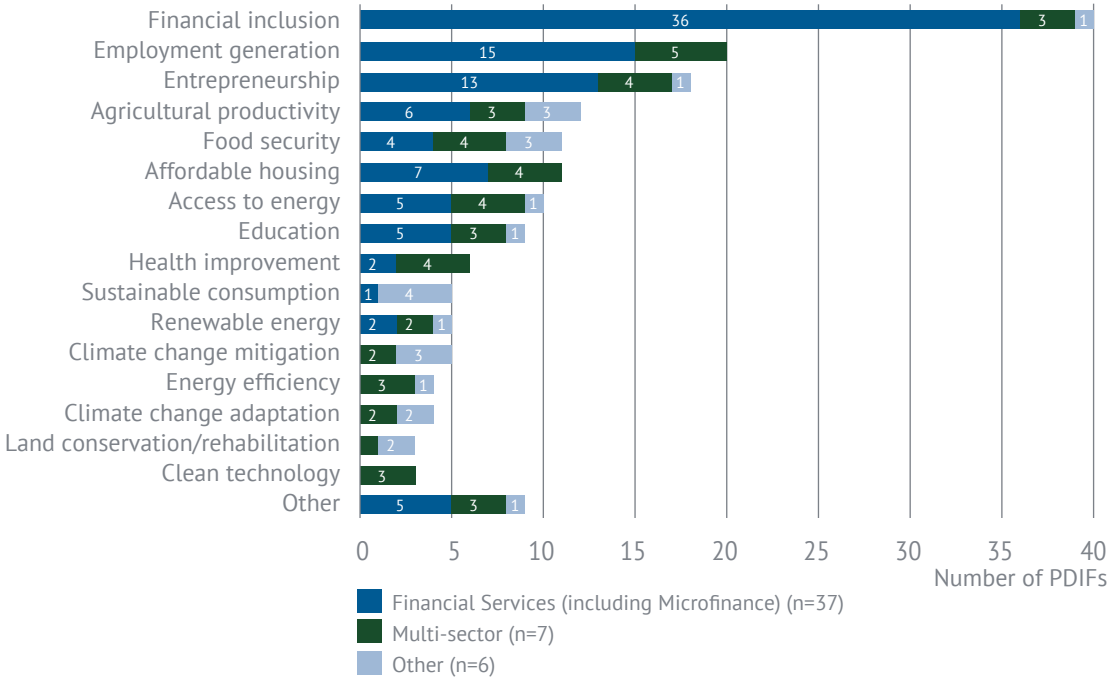


2.7 IMPACT MEASUREMENT

The most frequently targeted impact themes (particularly by funds mainly investing in Financial Services, including Microfinance) are financial inclusion, followed by employment generation and entrepreneurship (Figure 27). In addition to employment generation, funds that invest in multiple sectors mainly target access to energy, health improvement, and clean technology. Sustainable consumption, agricultural productivity, climate-change mitigation, and food security recur the most across funds investing in other sectors.

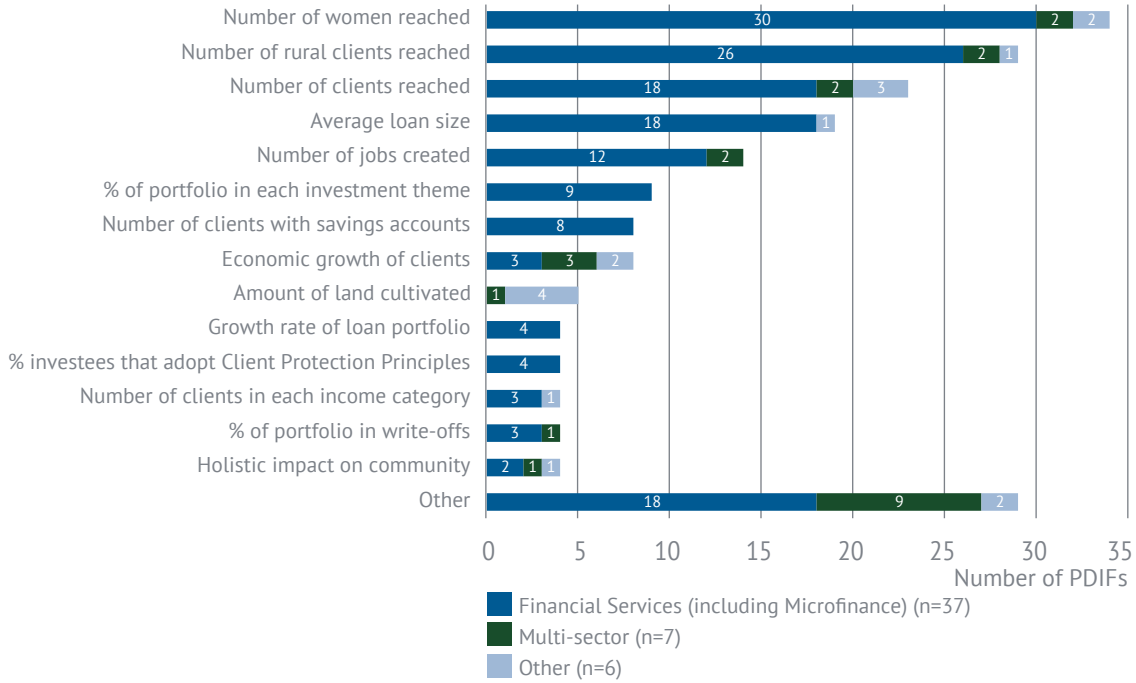
Forty-six of the 50 funds surveyed responded to an optional question about impact criteria applied prior to investment to inform investment selection or due diligence. Of those responding, 41 funds apply impact criteria to all their investments, two apply criteria only to some investments, and three did not apply any criteria. Furthermore, of the 28 respondents that described the type of impact criteria applied to investments, 11 use an Environmental, Social, and Governance (ESG) exclusion list.

Figure 27
Impact Themes by Main Investment Sector



In terms of impact metrics, funds listed up to five primary impact metrics they used to measure their social or environmental impact (Figure 28). After grouping impact metrics by category and sector, recurring the most for Financial Services funds are number of women reached (30 out of 37 funds), as well as number of rural clients (26 out of 37). Other impact metrics mentioned in this sector include average loan size (20) and number of jobs created (12). For PDIFs investing in other sectors, the most common impact metric is amount of land cultivated (four out of six funds), followed by number of clients reached (three). Finally, for Multi-sector funds, economic growth of clients (three of seven funds) and number of clients (by gender and location) are the most common.

Figure 28
Impact Metrics by Main Investment Sector



2.8 IMPACT PROFILES

The following section describes impact measurement and management processes and practices of three sample PDIFs: one investing primarily in Food and Agriculture, one focused on Financial Services (including Microfinance), and a third, Multi-sector fund.

2.8.1 Food and Agriculture

Background

By investing in agricultural businesses in developing countries, this open-ended fund aims to contribute to the sustainable development of actors in the value chain of local agriculture who can directly or indirectly contribute to the socioeconomic and ecological development of rural regions.

Specific impact objectives relate to agricultural productivity, resource security, job creation, working standards in agriculture, and livelihoods for farmers. Agriculture-related businesses to which the fund lends must:

- employ a sustainable business model;
- empower people at the base of the pyramid by sourcing from smallholder farmers or employing people from low-income groups.
- demonstrate a commitment to socially and environmentally friendly production;
- ensure owner and manager integrity; and
- have a real financing need (to avoid over-indebtedness).

Impact Measurement and Management Process

Monthly and quarterly reports are produced for investors with the following impact indicators:

- number of investments;
- number of institutions;
- number of farmers reached;
- number of countries; and
- number of commodities.

Impact Results

In November 2017 (the most recent month for which data were available), the fund was invested in 53 commodities spanning 44 developing countries. The fund reached over 814,000 farmers through the agricultural organizations it financed, helping drive economic growth in rural areas. For example, one company the fund financed helped rebuild the northern Ugandan cotton crop after the protracted period of armed conflict that ended in 2008. A capital injection enabled the company to establish cotton buying and processing operations, including purchasing a ginnery and accessing international buyers. Through its network of community-based agents, the company has provided agricultural extension and training services to 60,000 farmers on topics including agronomy, organic farming, post-harvest handling, numeracy, and financial literacy.

2.8.2 Financial Services

Background

This open-ended private placement fund seeks to increase financial inclusion by providing short-term loans to microfinance and SME financing institutions in emerging markets. The fund targets risk-adjusted, market-rate returns. Prior to investment, it assigns each prospective investee a social impact score, which it reviews, along with data on financial performance and anti-money laundering (AML) compliance, to determine whether to invest.

Impact Measurement and Management Process

The assessment prior to investment of social and environmental impact typically entails site visits to meet with various staff at the target investee, as well as interviews with end borrowers. The fund also considers whether the investee adheres to standard frameworks for client protection and social performance management, such as the SMART Campaign. After investing, the fund shares observations of social, environmental, or financial performance with senior leadership of the investee.

The fund continually measures progress towards improving financial inclusion by reviewing several key metrics on a quarterly basis. Examples include:

- percent of borrowers that are women;
- percent of investee staff that are women;
- average loan size issued by the investee;
- whether the investee is a deposit-taking institution and thus has an appropriate range of product offerings; and
- growth rate of gross loan portfolios.

The fund monitors investee performance over time. If significant changes occur—such as a modification of investee product offerings or borrower demographics—the fund will conduct additional analysis to understand any underlying factors. The fund may then choose not to renew a loan. Additionally, the fund annually produces a publicly available impact report that aggregates data at the fund level, assessing the fund's contributions toward three SDGs: 1. No Poverty, 5. Gender Equality, and 8. Decent Work and Economic Growth.

Impact Results

As of 2016 year's end, the fund had financed a total of 36 institutions across nearly 20 countries. Among these financial institutions, nearly half were deposit-taking. On average, its portfolio companies reached nearly 300,000 active borrowers during 2016, among whom approximately 60% were women. Over three-quarters of loans were productive. In 2016, the fund also received a Gold GIIRS rating of its social and environmental impact.

2.8.3 Multi-sector

Background

This open-ended private placement fund seeks market-rate returns from its portfolio, which is invested exclusively in emerging markets. The fund invests in multiple sectors, including Education, Energy, Food and Agriculture, and Housing to achieve a range of impact objectives aligned to six of the SDGs: 1. No Poverty, 7. Affordable and Clean Energy, 8. Decent Work and Economic Growth, 10. Reduced Inequalities, 12. Responsible Consumption and Production, and 17. Partnerships for the Goals.

Impact Measurement and Management Process

Prior to offering financing to a prospective loan client, the fund gathers data to ascertain their impact potential. To determine whether to invest, the fund reviews both business-related criteria—such as operational track record, profitability, and growth—and impact-related criteria, including the quality of the investee's products and services, the extent to which their impact can be measured, their governance structures, their reporting capabilities, and alignment of the company's and fund's visions.

During the life of a loan, the fund collects and reports impact data quarterly, using metrics identified by sector through the IRIS catalog. Additionally, investees participate in a GIIRS audit each year. The fund's reports include the following metrics, among others:

- metric tons of CO2 emissions reduced;
- number of smallholder farmers;
- number of clients receiving access to credit for the first time;
- percent of clients that are women; and
- percent of clients that live in rural areas.

Though the fund does not set quantitative impact targets, it does monitor changes in investee performance on each metric over time. If the data show decreasing or stagnating impact performance, the fund will investigate the underlying causes of the issue. The fund may choose not to renew loans if they do not achieve the desired impact.

Impact Results

During 2016, the fund reached nearly 400,000 clients, 90% of whom live in rural areas and 34% of whom are women. Portfolio companies employed over 4,500 staff. In one example, a solar energy portfolio company installed a solar system in a primary school in rural Uganda, which generated sufficient light and energy to power the school. As a result, students could access information through TV programming and study at the school during the evening hours.

3. COMMUNITY DEVELOPMENT LOAN FUNDS

3.1 BUSINESS MODEL

Community Development Financial Institutions (CDFIs) are mission-driven financial institutions, certified by the U.S. Department of the Treasury, that cater to low-income people in the United States.[24] CDFIs are split into four main groups by business model and legal structure: community development banks, community development credit unions, community development loan funds, and community development venture capital funds, the most common of which are Community Development Loan Funds (CDLFs).[25]

This chapter focuses only on CDLFs, which are mostly nonprofit organizations that provide financing and technical assistance to the following sectors, as the Opportunity Finance Network (OFN), the industry association for CDFIs, defined in their 2017 *Side by Side* Report:[26]

- **Microenterprises:** Financing for-profit and nonprofit businesses with five or fewer employees (including the proprietor) and with a maximum loan or investment amount of USD 50,000 for the purpose of start-up, expansion, working capital, or equipment purchase or rental.
- **Businesses:** Financing for-profit and nonprofit businesses with more than five employees or with an amount greater than USD 50,000 for the purpose of expansion, working capital, or equipment purchase or rental.
- **Commercial Real Estate:** Financing construction, rehabilitation, acquisition, or expansion of nonresidential property used for office, retail, or industrial purposes.
- **Housing Developers:** Financing housing organizations for purposes such as predevelopment, acquisition, construction, renovation, lines of credit, working capital, and mortgage loans to support the development of rental or for-sale housing, including service-enriched and transitional housing.
- **Community Facilities:** Financing human and social service agencies, advocacy organizations, cultural or religious organizations, health care providers, child care providers, and education providers.

CDLFs operate as investment funds that directly finance individual clients, projects, and companies in specific states, thus benefiting from close engagement with their end clients in addition to building local knowledge and expertise. The funds collect and analyze data on their clients, evaluate the risks of specific clients and projects, and manage portfolios while negotiating funding needs with investors.

CDLFs comprise both debt capital at market or below-market rates and grants from different types of private organizations and federal or local governments. Investors have several ways to invest in CDLFs, most commonly by providing debt financing through notes and credit lines.

24 U.S. Department of the Treasury, "Community Development Financial Institutions Fund," https://www.cdfifund.gov.
25 Opportunity Finance Network, "What are CDFIs?," https://ofn.org/CDFIs.
26 Side by Side is an annual reference guide for industry practitioners, investors, and others interested in assessing the activity and performance of the opportunity finance industry. It presents data from OFN Member financial institutions and includes peer group analyses for the primary financing sectors. Opportunity Finance Network, Side by Side Fiscal Year 2016 (Philadelphia: Opportunity Finance Network, 2017).

Banks are one of the primary classes of investors to make use of this investment channel, as investment in CDLFs enables them to fulfill the 1977 Community Reinvestment Act, which encourages depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods.

Investing in CDLFs by buying shares is also possible, though atypical. A special financial instrument designed for CDLFs, the equity equivalent (EQ2) investment, is similar to preferred stock. EQ2 notes are designed to leverage additional debt capital in order to increase lending and investing activities in disadvantaged communities.[27]

According to the latest data,[28] as of fiscal year 2016, 524 CDLFs were certified by the CDFI Fund, of which 197 report data to OFN. These 197 CDLFs had total financing outstanding of USD 7.4 billion. By sector, two-thirds of CDLF assets went into Businesses (27%), Housing to Organizations (23%), and Microenterprises (14%). The remaining third was invested in Housing to Individuals (12%), Community Facilities (10%), Commercial Real Estate (7%), Consumer Finance Products (3%), Intermediaries (2%),[29] and Other segments (2%).

3.2 SAMPLE SNAPSHOT

All CDLFs are incorporated in the United States, use U.S. GAAP for their accounting, and lend locally and exclusively in USD. The Research Team identified 163 CDLFs among OFN's members that met our inclusion criteria, of which 102 participated. As noted earlier (in Section 1.1.2), CDLFs primarily serving individual consumers (that is, CDLFs with more than half their lending portfolio allocated to housing or finance products for individual consumers) were excluded from the sample to focus the analysis on funds investing in projects, organizations, or businesses.

102
COMMUNITY DEVELOPMENT LOAN FUNDS

63%
PARTICIPATION RATE

Table 13
Number of Participating Funds by Calendar Year

Year	Number of Funds
2012	89
2013	93
2014	99
2015	102
2016	57

The number of participating funds for each year varies according to the availability of annual financial statements (Table 13). The number of participating funds dropped remarkably in 2016 because nearly half of the CDLFs in the sample operate on a non-calendar business cycle.

27 Equity equivalent (EQ2) notes are subordinated, low-interest debt with rolling maturities and limited rights to repayment acceleration. However, due to a lack of consistent, standardized reporting on EQ2 among CDLFs, this report does not track this metric.
28 These figures differ from those presented in this report due to differences in the sample size and dataset used. Opportunity Finance Network, *Side by Side* Fiscal Year 2016 (Philadelphia: Opportunity Finance Network, 2017).
29 "Intermediaries" correspond to financing provided to other CDFIs. Opportunity Finance Network, *Side by Side* Fiscal Year 2016 (Philadelphia: Opportunity Finance Network, 2017).

However, some CDLFs self-reported data for December 2016 to OFN regarding their total assets and loan portfolios, so all trend figures related to assets and portfolios are also shown for 2016. Data for most other metrics are shown until 2015, since the 2016 sample is much smaller than for the previous years. Most CDLFs provided four to five relevant financial statements (Appendix 2, Table 6).

By main investment sector, Housing-focused CDLFs comprise nearly 40% of the total sample (Table 14). CDLFs that finance local businesses form one-third of the sample, while CDLFs providing loans to microenterprises and investing in community facilities represent 16% and 10% of the total sample, respectively.

Table 14
Investment Sectors

Year	Business	Community Facilities	Housing	Microenterprise	Other
2012	29	9	36	13	2
2013	31	9	37	14	2
2014	34	10	38	15	2
2015	35	10	38	17	2
2016	22	7	19	7	2

As mentioned above (Section 3.1), these loan funds rely heavily on leverage to finance their own lending activities. On average, leverage represented nearly half of total assets in the sample from 2012 to 2015 (Table 15).

Table 15
Leverage as a Percentage of Total Assets

Year	Average Leverage as % of Total Assets
2012	47%
2013	49%
2014	49%
2015	50%
2016	Small sample

3.3 ASSET SIZE

3.3.1 Total Asset Growth

At the fund level, CDLF total assets range widely (Figure 29), from less than USD 1 million up to USD 1 billion. At the end of 2016, the average and median CDLF funds had USD 55.2 million and USD 24.9 million in AUM, respectively. In terms of growth from 2012 to 2016, the mean size of CDLFs grew 5%, while the median grew 12.4%.

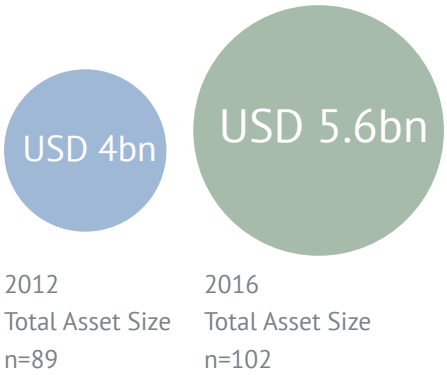
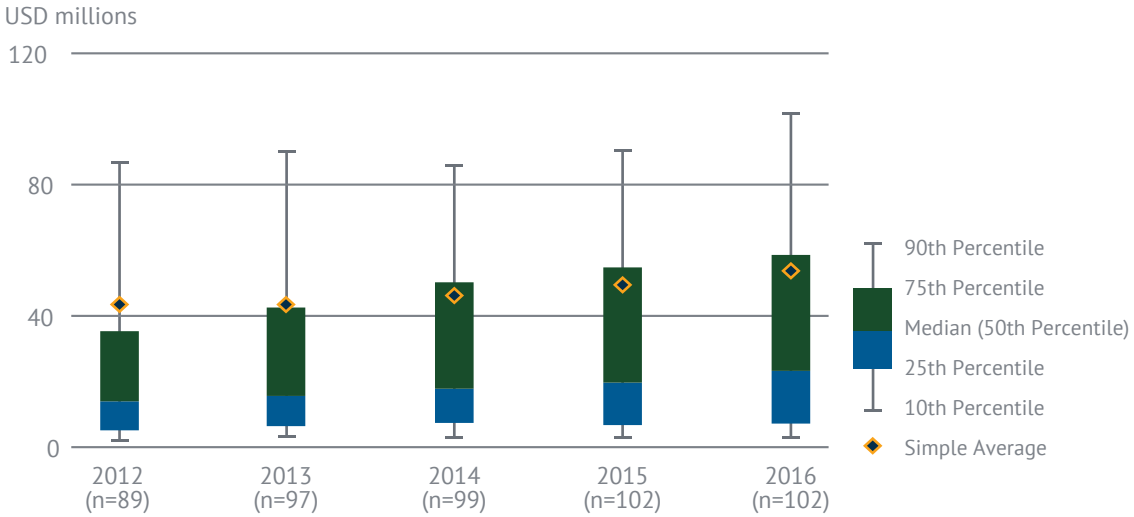


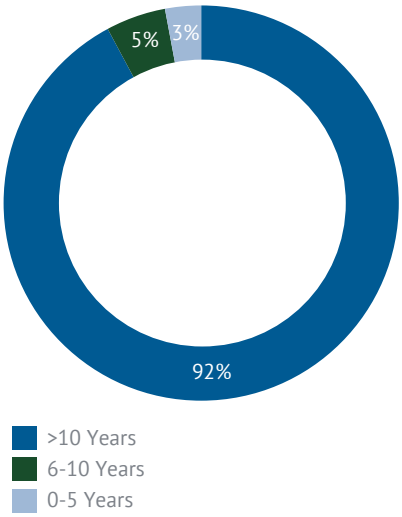
Figure 29
Assets Under Management, Distribution of Sample



3.3.2 By Vintage Year

Most CDLFs in the studied sample were incorporated around the mid-1980s. Hence, most (94 of 102) have a significant track record of a decade or more (Figure 30).

Figure 30
Age of Funds



3.3.3 By Main Investment Sector

Housing is the main sector of activity for CDLFs, and has slightly decreased by 6 percentage points between December 2012 and 2016 (Figure 31). By contrast, assets of CDLFs investing in community facilities have increased as a proportion of the sample from 20% in December 2012 to 23% at the end of 2016. CDLFs of this type are larger, on average, as illustrated by the fact that they only represent 10% of the total sample by number of funds (Table 14). Meanwhile, CDLFs investing in microbusinesses are comparatively smaller on average, representing 4% of total sample assets as of 2016.

Over the period under review, CDLFs investing in microenterprises have grown the fastest on both average and median bases, although from a much lower base (Table 16). At the median, all types of CDLFs except those investing in community facilities have shown double-digit growth.

Figure 31
Total Assets by Sector

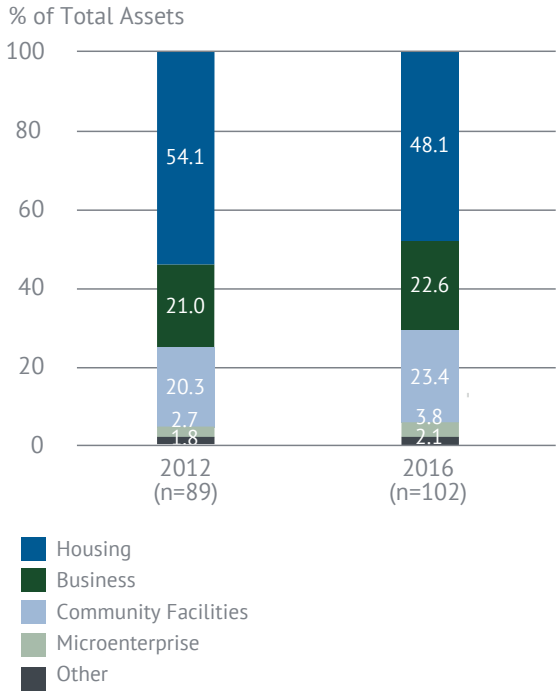


Table 16
Total Asset Size (USD millions) and CAGR by Sector

	Total Assets 2012		Total Assets 2016		CAGR of Total Assets	
	Average	Median	Average	Median	Average	Median
Business	29.3	13.3	36.4	22.7	5.6%	14.3%
Community Facilities	91.2	45.5	132.0	44.9	9.7%	-0.3%
Housing	60.6	21.2	71.2	32.4	4.1%	11.2%
Microenterprise	8.5	3.7	12.5	7.5	10.3%	19.6%

3.3.4 By Size

At the end of 2016, 72% of the CDLF sample is characterized by small funds, those with total assets below USD 50 million. Medium-sized CDLFs (USD 50–250 million in assets) form nearly a quarter of the total sample, up from 13% at the end of 2012. Finally, large CDLFs with assets in excess of USD 250 million are few, averaging less than 5% of the sample over the five-year observation period.

Large CDLFs, while scarce in number, represent the largest proportion of total sample assets in 2016 at 41% up from 33% at the end of 2012. Medium-sized and small CDLFs account for more than 35% and more than 20% of the total sample, respectively.

3.4 PORTFOLIO AND INVESTOR CHARACTERISTICS

3.4.1 Total Loan Portfolio

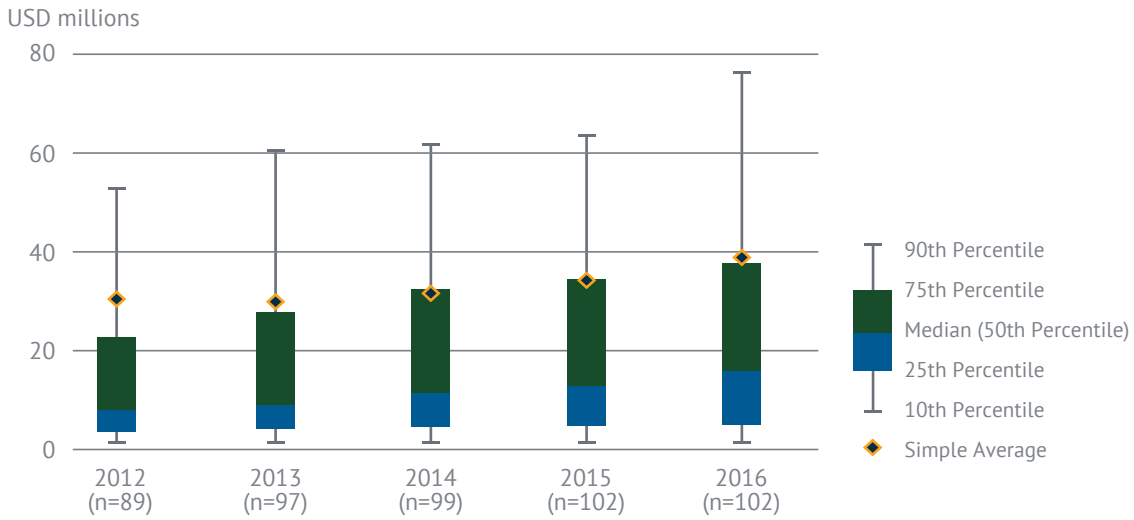
This section analyzes the loan portfolios of CDLFs in the sample, excluding cash and other assets, to specifically analyze their core lending activity.

3.4.1.1 Average Loan Portfolio Size

Combined, the outstanding loan portfolio of our sample of 102 CDLFs amounted to nearly USD 4 billion as of December 2016, implying an average loan portfolio of USD 39.1 million (Figure 32). Since 2012, CDLFs in the sample have grown their loan portfolios by 6.4% annually.

The median portfolio value almost doubled in size from 2012 to 2016, from a base value of USD 8.2 million in December 2012 to USD 16.3 million at the end of 2016. This represents a CAGR of 18.7% over the same period.

Figure 32
Loan Portfolio, Distribution of Sample



3.4.1.2 Average Maturity

At the end of 2016, the maturity of CDLFs' outstanding loan portfolios averages 102.2 months when weighted by portfolio size.

By CDLF sector, average maturity varies widely (Figure 33). CDLFs financing community facilities have the longest maturity (145.4 months), while Housing CDLFs have the shortest (83.3 months).

By size (Figure 34), the largest funds have the longest maturity (115.4 months). The average maturity for the total sample is thus driven upwards by a small number of large funds.

Figure 33
Portfolio Maturity by Sector

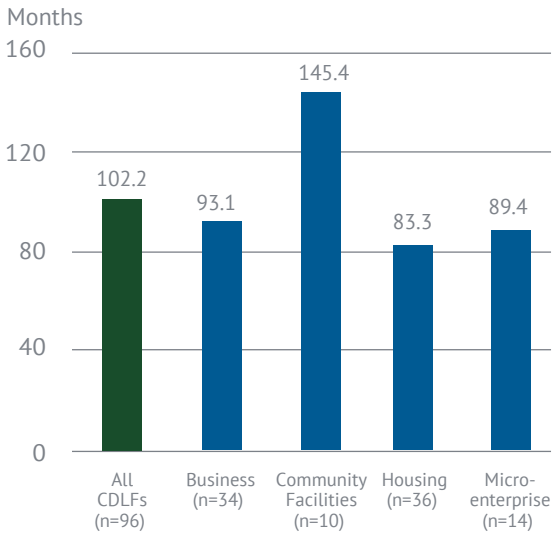
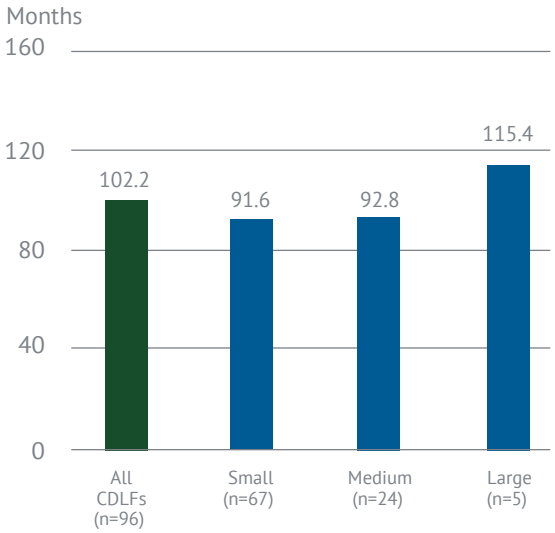


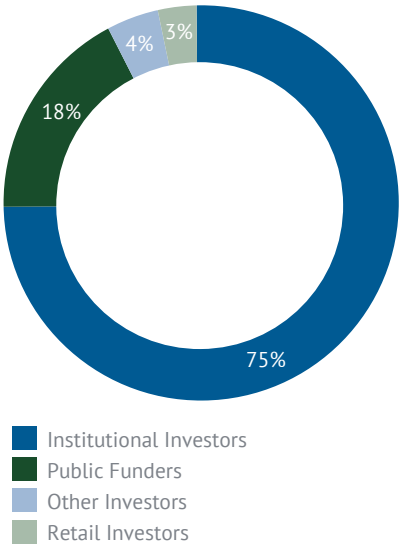
Figure 34
Portfolio Maturity by Size
(2016, Weighted Average)



3.4.2 Types of Investors

As of December 2016, institutional investors have provided 75% of funds that CLDFs have borrowed,[30] broadly including pension funds; financial institutions, such as insurance companies, banks, asset management companies, and corporate treasuries; non-governmental organizations; and foundations. Public funders account for 18% of CLDF funds, while the remaining portion of borrowed funds came from retail (3%) and other (4%) investors (Figure 35).[31]

Figure 35
Investor Type as a Percentage of Notes and Lines of Credit (2016)



30 Borrowed funds that form the basis of this investor breakdown include both notes payable and lines of credit. They do not, however, systematically include EQ2, which primarily originate from banks (institutional investors). Hence, the share of institutional investors could be understated.

31 Given the relatively small number of observations for the investor breakdown (n=55) compared to the total number of CDLFs (n=102) in the sample, these data might not entirely capture the current investor breakdown.

3.5 FINANCIAL PERFORMANCE BREAKDOWN

This chapter analyzes return patterns of CDLFs from the perspective of a debt investor who finances a fund's capital structure and expects a fixed-income return on this investment. This analysis begins with the interest rate that investors earned on this debt financing, followed by general consideration of the portfolio yields CLDFs generated, examination of how these differ by size and sector, and, finally, discussion of cost structure.

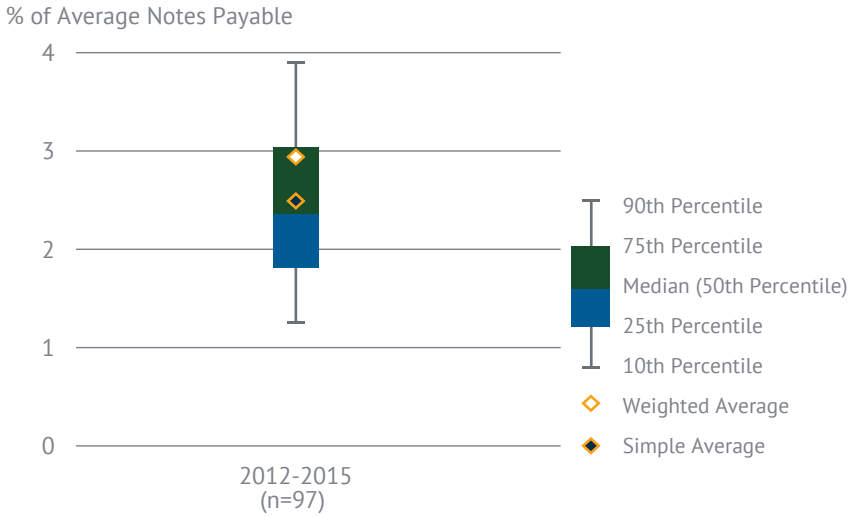
3.5.1 Net Returns to Investors

Most CDLFs are nonprofit entities, as is well-reflected in their return philosophies: only one CDLF in the sample reported targeting risk-adjusted, market-rate returns.

Interest rates paid on notes have been very stable for CDLFs, averaging 2.9% over the four-year period, with little dispersion of values between the 10th and 90th percentiles (Figure 36). Removing outliers does not change this weighted average of 2.9%.

Figure 36

Average Interest Rates on Notes (2012–2015)



CDLFs also pay interest on lines of credit, usually raised from banks, but most CDLFs in the studied sample did not report doing so. Only four to six funds, depending on the year, used this type of debt financing, paying relatively stable rates, given the small sample size, around a five-year average of 3% (except for a peak observed in 2013).

Interest rates paid on notes were relatively consistent by year across all sectors (Figure 37). Housing CDLFs paid the highest interest rates, while funds lending to microenterprises generated the lowest returns to investors, with rates between 2.1% and 2.6% depending on the year.

Large funds exhibited higher returns to investors compared to mid-sized or small funds (Figure 38). Rates are very stable since 2013 across all sizes of fund, averaging 3.2% for large CDLFs,[32] 2.9% for medium-size CDLFs, and 2.6% for small CDLFs.

Figure 37

Interest Rates on Notes by Sector

% of Average Notes Payable

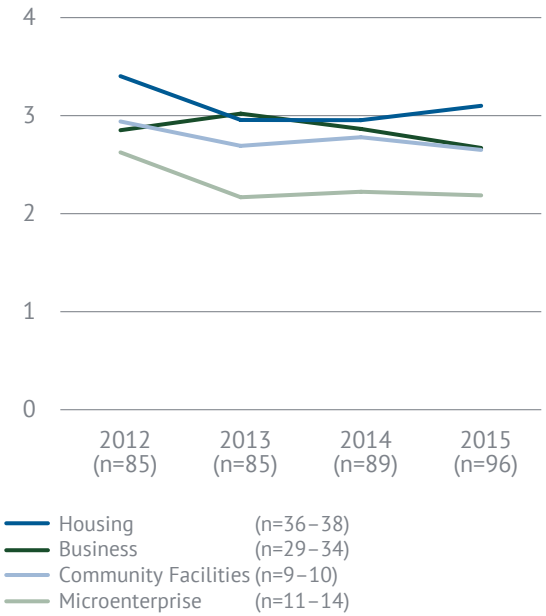
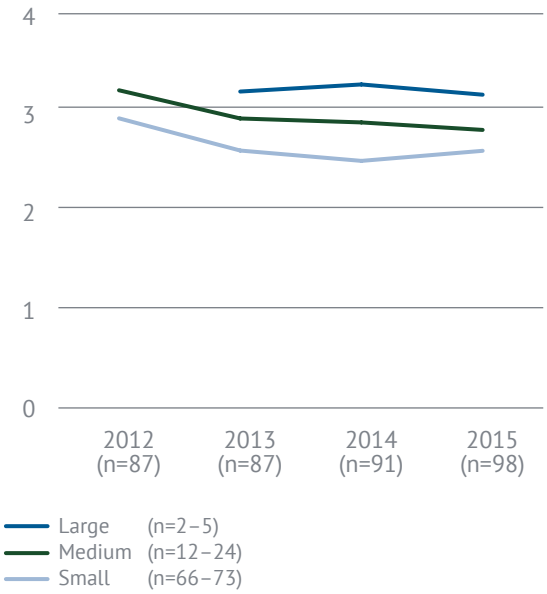


Figure 38

Interest Rates on Notes by Size

% of Average Notes Payable



32 2012 value for Large CDLFs is not shown due to a sample size fewer than three.

3.5.2 Portfolio Yields

The portfolio yield of CDLFs provides a good proxy for the interest rates these funds charge in their lending activities.[33] On a weighted average basis, portfolio yields were relatively stable over the observation period, staying within a band from 5.2% to 5.4%. Ninety percent of CDLF observations fall between 4% and 9% (Figure 39), averaging 5.3% over the sampled period (or 5.2% after removing outliers).

Yields by investment sector, which were likewise stable across the observed years, were highest on average for CDLFs investing in microenterprises (12.5%) and lowest for Housing-focused CDLFs (4.2%; Figure 40). Interest rates on loans to businesses or community facilities fell between these extremes. After removing outliers, the portfolio yield for Microenterprise-focused CDLFs drops to an average of 9.2%.

Figure 40
Portfolio Yield by Sector

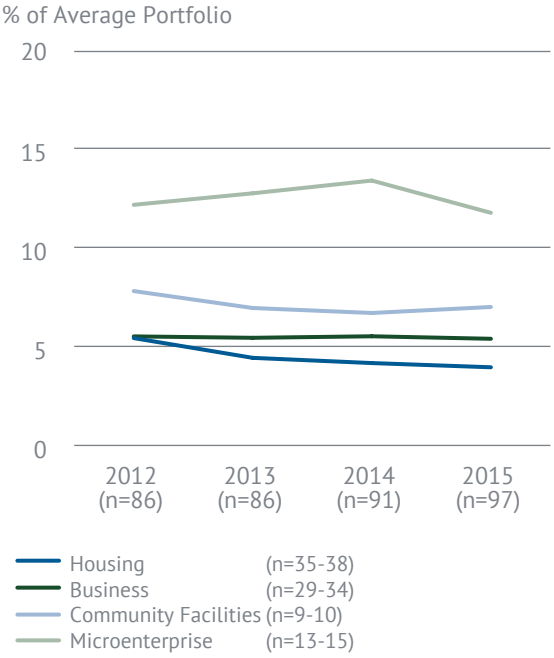
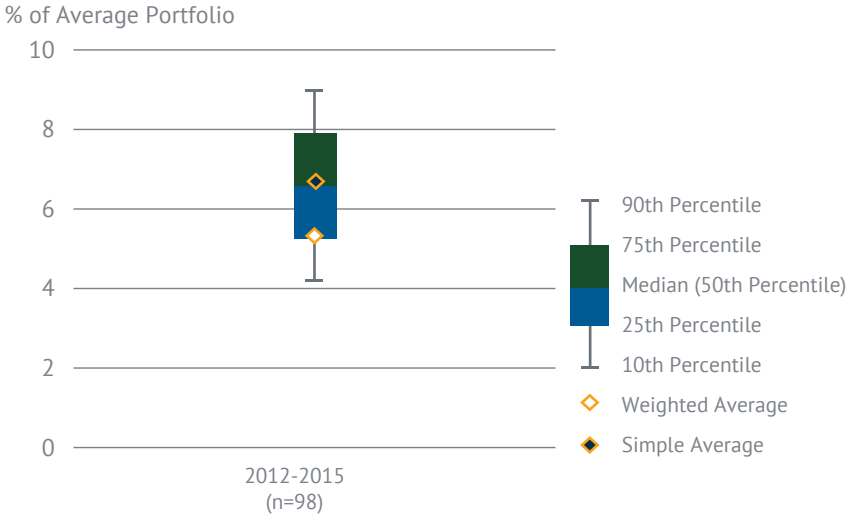


Figure 39
Average Portfolio Yield (2012–2015)



33 The portfolio yield of CDLFs is calculated on the average loan portfolio over two years.

Small CDLFs have higher yields compared to medium-sized or large CDLFs (Figure 41),[34] perhaps because they make generally smaller loans that tend to command higher rates of interest.

As nonprofit funds, CDLFs often rely on grants and donations from mission-driven organizations in addition to income from their lending activities to cover their operational costs.

Breaking down the ratio of total income to average assets (Figure 42), interest income from the lending portfolio remained stable at 3.6% of average assets, but this did not represent funds' main source of income. The more volatile grants and contributions (Figure 43) comprise the major proportion of sample CDLFs' total income, averaging 5.7% from 2013 to 2015. On average, during the same period, other income represented 3.7% of sample CDLFs' total income.[35]

Figure 41
Portfolio Yield by Size

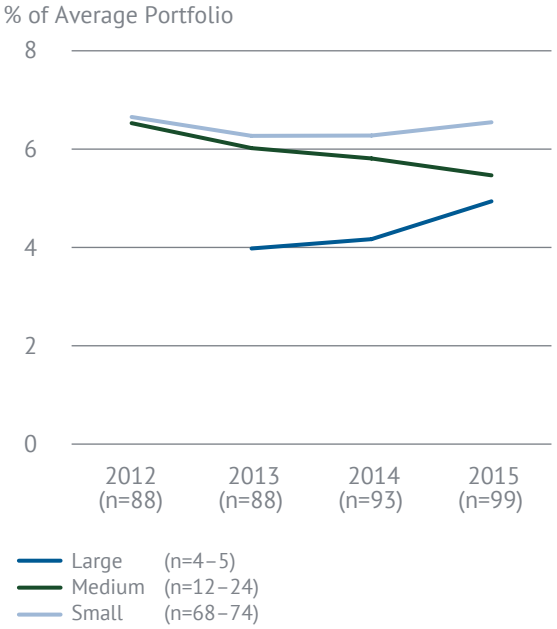


Figure 42
Sources of Fund Income

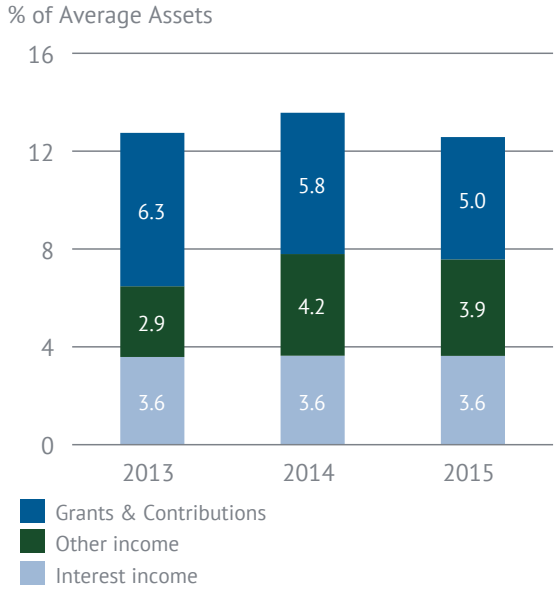
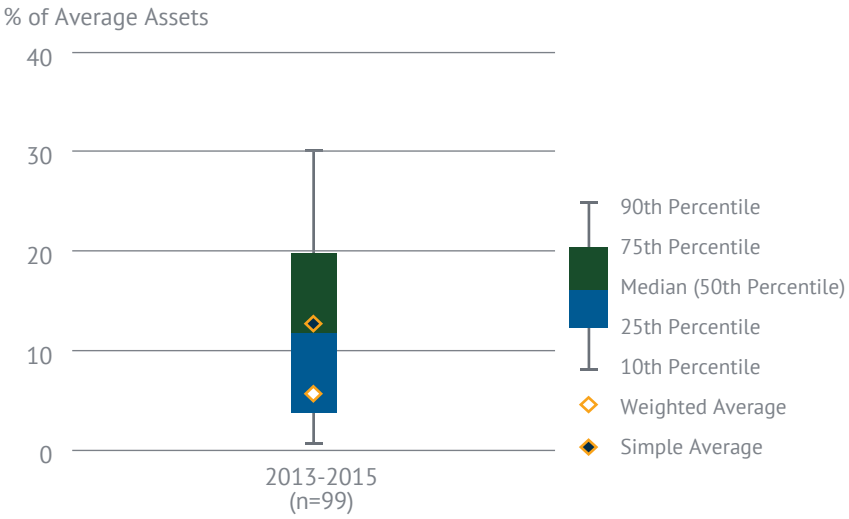


Figure 43
Average Grants and Contributions (2013–2015)



34 2012 value for Large CDLFs is not shown due to a sample size fewer than three observations.
35 Components of "Other income" vary by the sector of focus of each CDLF. Usually, other income comprises non-interest income, such as management or advisory fees, investment income, unrealized gains, and rental income.

3.5.3 Cost Structure

The TER of CDLFs, calculated on average assets over two years,[36] has been relatively stable at 9.4% (9.3% when excluding outliers) since 2013 (Figure 44). Interest expenses have also been very stable at 1.4% of average assets. Expenses unrelated to interest payments to note holders and credit lines drive the relatively high expense ratio. Larger CDLFs tend to have smaller TERs (Figure 45). On a weighted average basis, from 2013 to 2015, the TERs were 13.4%, 9.7%, and 6.5% for small, medium, and large CDLFs, respectively. Small CDLFs excluding outliers have a slightly lower weighted averaged TER of 13.1%.

These other expenses, which vary by sector of focus, are usually split into program expenses, fundraising expenses, and general and administrative expenses, all of which can include payroll, pension benefits, loan loss provisions, professional or consultancy fees, marketing costs, maintenance, depreciation and amortization, business development, and rental expenses.

Figure 44
Components of Total Expense Ratio

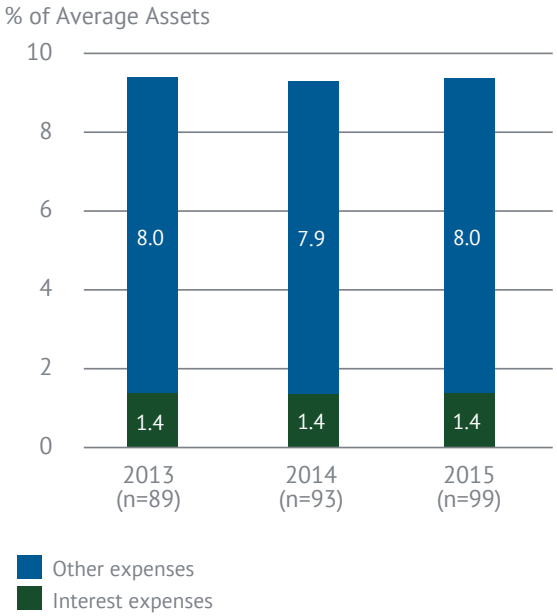
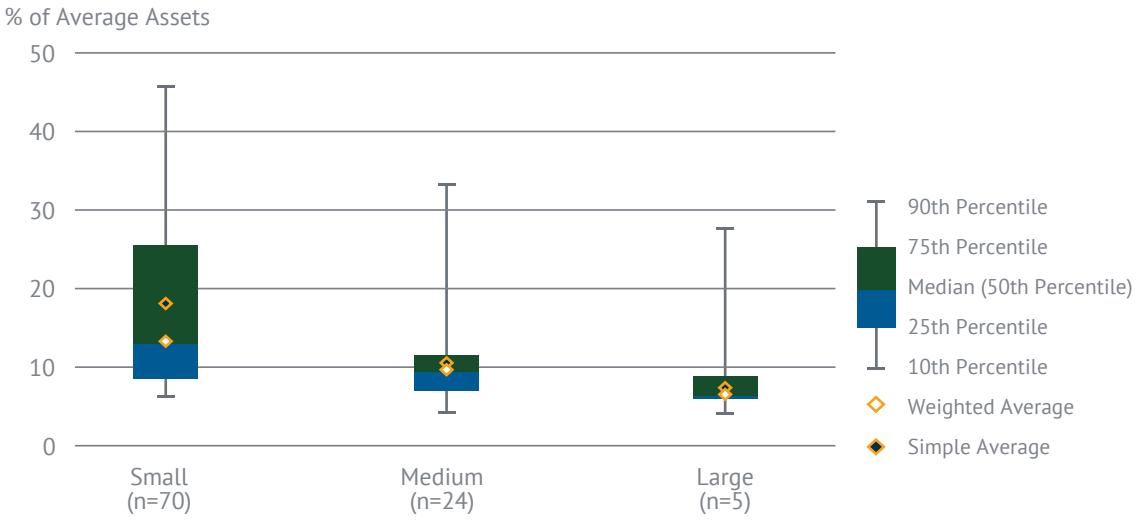


Figure 45
Average Total Expense Ratio by Size (2013–2015)

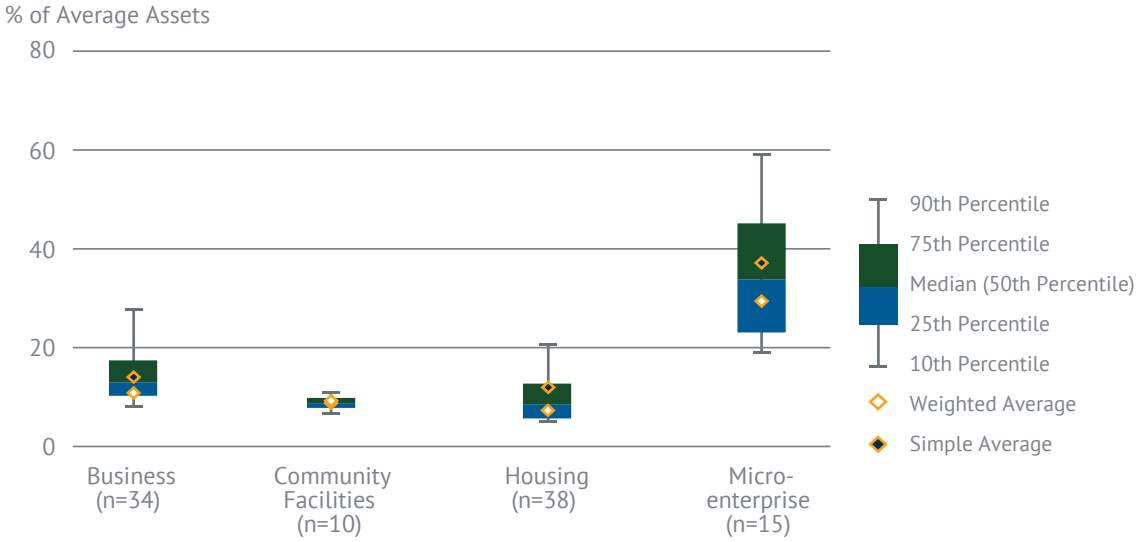


36 Given their different business models, the TER is calculated differently for CDLFs (on average assets over years) compared to PDIFs (on net assets plus average net subscriptions). In addition, since CDLFs finance themselves primarily through debt, interest expenses are included as part of the TER for CDLFs but not for PDIFs.

The TER of CDLFs that mainly finance microenterprises is the highest relative to the other investment sectors in the sample, at 29.5% on average from 2013 to 2015 and somewhat decreasing from 31% at the end of 2013 to 27.8% at the end of 2015 (Figure 46). Housing CDLFs have the lowest TER, averaging 7.4% and, given their weight in the sample, driving the overall trend in TERs for all studied CDLFs.

Figure 46

Average Total Expense Ratio by Sector (2013–2015)



3.6 PORTFOLIO RISK

Considering the full sample of CDLFs,[37] at the end of 2016, loan loss provisions outstanding as a percentage of total portfolio amounted to 4.9%, with differences within the sample by sector or size.

Microenterprise-focused funds have the highest loss-provisioning ratio at 6.9%, while CDLFs lending to businesses have a ratio of 6.6%. The remaining two sectors, Housing and Community Facilities, have the lowest ratio of loss provision to total portfolio, with 4.4% each.

Large funds in the sample had the lowest loss-provisioning ratio (2.6%) compared to small (5.7%) or medium-sized funds (7.2%; Figure 47).

Loans written off during 2016 represent 0.6% of portfolio outstanding, with relatively more write-offs by smaller funds in the sample (Figure 48). They were also more common at Microenterprise-focused CDLFs in the sample, at 4.4%, compared to funds focused on other sectors, which have write-off ratios below 1%.

Figure 47
Loss Provisions Outstanding by Size (2016)
% of Portfolio Outstanding

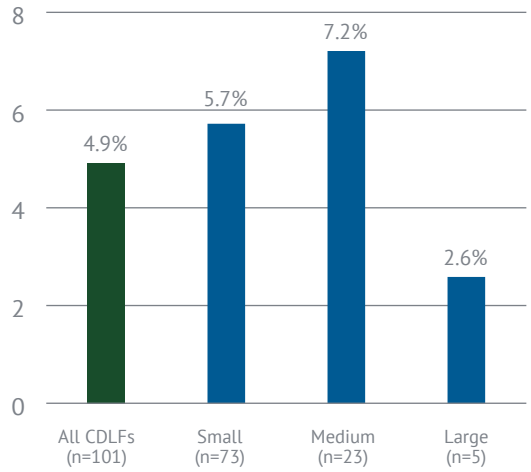
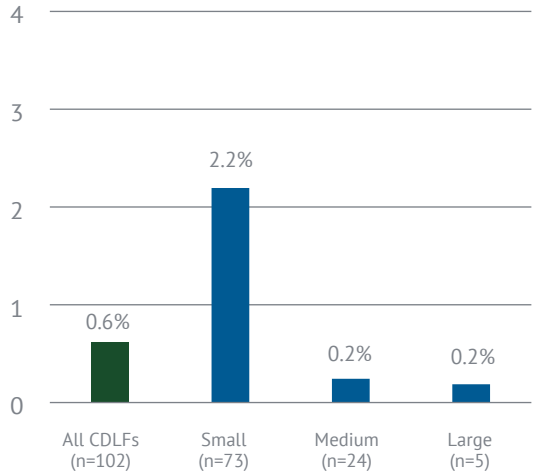


Figure 48
Write-Offs by Size (2016)
% of Portfolio Outstanding



37 101 CDLFs out of the full sample of 102 CDLFs reported this metric.

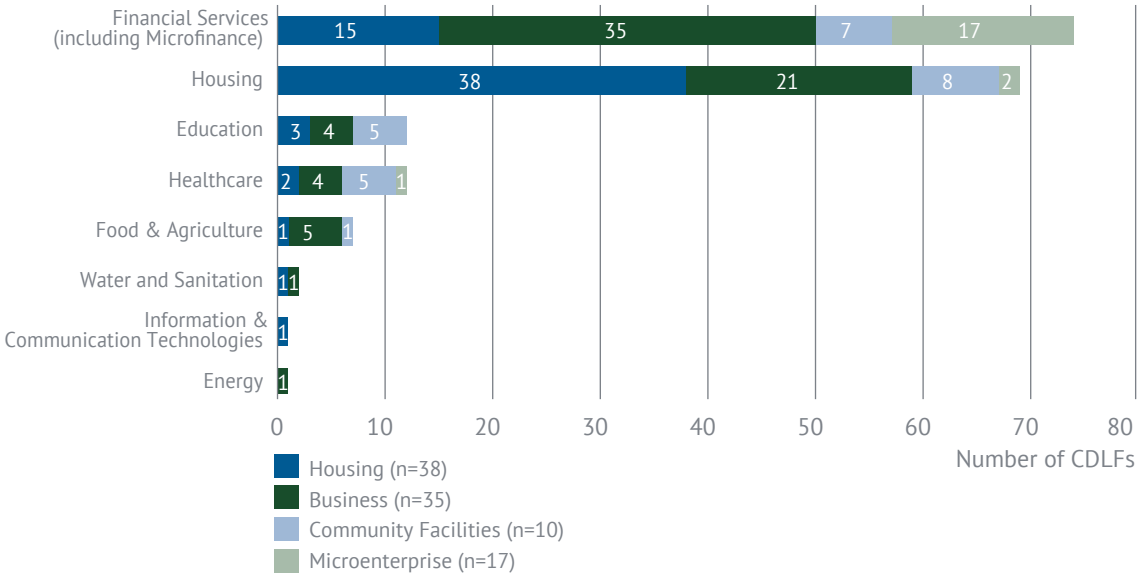
3.7 IMPACT MEASUREMENT

While each CDLF tends to focus on one main investment sector—such as Business, Housing, Community Facilities, or Microenterprises—CDLFs provide lending products in various different sub-sectors.[38] The most prevalent sub-sectors in the sample (Figure 49) are Financial Services (including Microfinance) and Housing, with nearly three-fourths of funds in the sample exposed to one of these two sectors. Twelve CDLFs in the sample focus on each of Education and Healthcare.

All of the Business- and Microenterprise-focused CDLFs invest in Financial Services (including Microfinance), while all of the Housing-focused CDLFs invest in the housing sub-sector. However, these CDLFs also invest in Healthcare, Education, Food and Agriculture, Energy, and WASH to varying degrees.

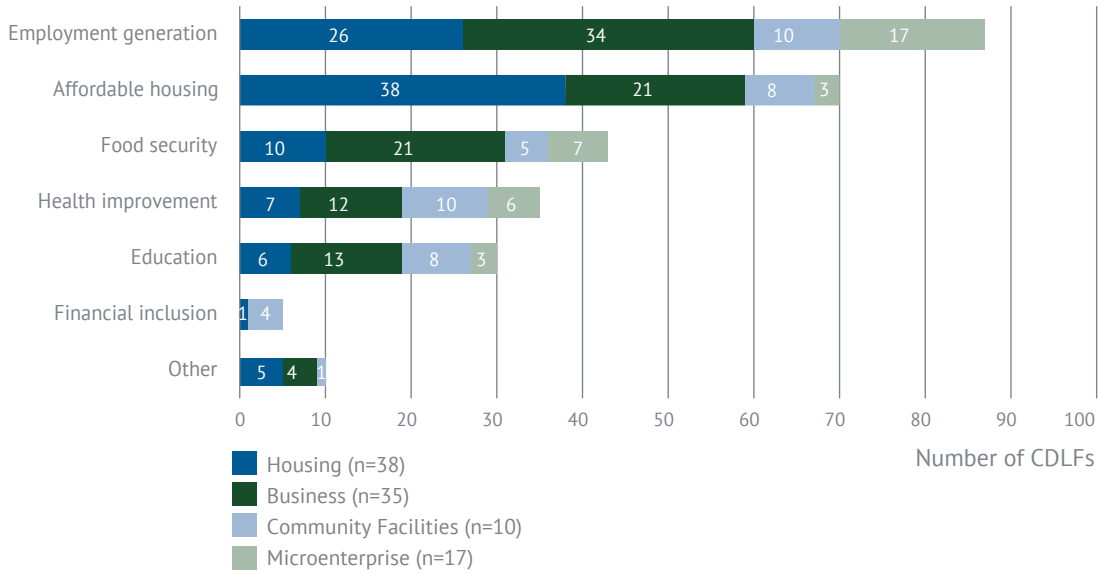
CDLFs focused on community facilities also have multi-sector characteristics, investing not only in Housing (eight of 10 such CDLFs) but also Financial Services including Microfinance (seven), Healthcare (five), Education (five), or Food and Agriculture (one).

Figure 49
Sectoral Activity by Main Investment Sector



38 Most self-reported information by CDLFs to OFN with regards to their investment sectors or impact themes did not cover the full range of this study's internally defined list of sectors and impact themes. In particular, Community Facilities-focused CDLFs cover a broad range of sectors and impact themes. Therefore, the Research Team re-allocated some answers by the Community Facilities-focused CDLFs to match our internal definitions.

Figure 50
Impact Themes by Main Investment Sector

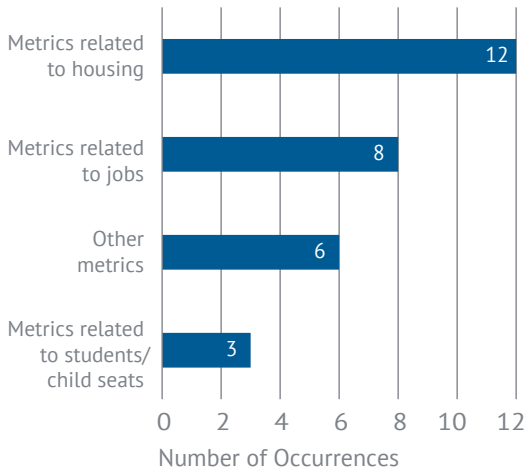


In terms of targeted impact themes (Figure 50), CDLFs in the sample most commonly target employment generation, affordable housing, and food security (respectively targeted by 87%, 71%, and 43% of the sample funds). In another common practice among CDLFs, one-third of the sample targets health improvement, education, or both.

Categorizing the list of self-reported impact metrics that CDLFs use to measure their social and environmental impact, metrics related to housing recur the most, notwithstanding the relatively small sample (seven) of overall respondents self-reporting any impact metrics (Figure 51). Specific targeted metrics among the CDLFs reporting most commonly relate to the number of housing units created or preserved or the number of people housed. The second most common impact metric is the number of jobs created or preserved, followed by the catch-all category, 'Other metrics'.[39]

Metrics relating to education and childcare are least common in the sample.

Figure 51
Impact Metrics (n=7 CDLFs)



39 'Other metrics' include outreach indicators related to low-income populations, women, and small businesses.

3.8 IMPACT PROFILE

The following section showcases the impact measurement and management processes and practices of a typical CDLF investing in community facilities.

Background

This revolving loan fund makes loans to nonprofit organizations, cooperatives, and mission-driven enterprises in the western United States. The fund targets below-market rates of return and strong, local social impact. Its borrowers provide healthcare, affordable housing, food, and other critical goods and services to low-income communities. Its loans—for working capital and real estate, among other needs—often offer more flexible terms than are available from commercial lenders, helping borrowers become more financially resilient.

Impact Measurement and Management Process

Every three years, the fund completes a strategic planning process, during which it identifies needs in its service area and establishes a capitalization strategy to address those needs. Impact-related targets are set during this process based on the amount of funds the CDLF can raise and invest, as well as goals related to impact and influence, financial sustainability and economic growth, and organizational performance. Indicators used include:

- affordable housing units created or retained;
- square feet of community space created or retained;
- jobs created or retained; and
- number and diversity of beneficiaries reached.

The fund obtains baseline information on these metrics from borrowers during the underwriting and due diligence process. The projected impact and area of operation inform an internally developed social-impact rating. For borrowers with high ratings, the fund may be willing to offer more favorable terms or absorb greater risk. A low score might prompt the team to talk to the borrower to determine ways to achieve greater impact.

The fund's entire staff reviews the impact data received every quarter to inform decisions about geographies and lending programs to maximize impact. The fund produces an annual impact report for investors and staff, along with a bimonthly team newsletter featuring specific impact stories; all of these materials are posted to its public blog. The fund also checks in with borrowers several years after project completion to estimate long-term impact achieved.

Impact Results

In fiscal year 2017, the fund made 26 loans totaling USD 21.6 million in nine counties. Projects financed by the fund during the year created or preserved 545 jobs, 494 affordable housing units, and more than 109,000 square feet of community-facility space. One loan to a food justice organization enabled that organization to acquire land to develop a permanent plant nursery, small aquaponics farm, and retail fresh food stand to grow and sell a diverse array of trees and plants. The organization employs formerly incarcerated individuals while promoting organic food production and environmental sustainability in its region.

4. CONCLUSION

Investors can choose from a wide range of products to build diversified portfolios. This study demonstrates that investors have attractive options if seeking stable returns alongside positive impact.

Performance analysis over the period 2012 to 2016 presented here offers insights into the behavior of impact investments in private debt. They are also consistent with other research showing that returns on such investments typically maintain low volatility in the face of risk while performing in line with expectations.[40]

Whether focused on emerging markets (like the PDIFs in this sample) or developed markets (like the CDLFs), private debt impact investing funds are a gateway for different types of investors who seek to generate social and environmental impact, or both, alongside a financial return.

This study has shown that private debt impact investing funds have the following characteristics:

- **Offer stable returns**
  Returns for PDIFs seeking market-rate returns have averaged 2.6% per annum since 2012, with low volatility of 0.9%. Such PDIFs had a higher Sharpe ratio than a range of traditional investment products, including bonds and cash. Some PDIFs also raise debt financing, providing a fixed-income return to investors that has averaged 3% since 2012. CDLFs paid an average of 2.9% to holders of their notes, with very little year-on-year variation. Write-off ratios of 0.7% for PDIFs and 0.6% for CDLFs also demonstrate these funds' high portfolio quality.

- **Offer investors different risk-return strategies**
  Investors accustomed to the traditional bond market may hesitate to invest in different, potentially less stable currencies. Such investors may prefer fully hedged funds—and such funds in the study's sample registered a solid average return of 2.8% with 0.7% volatility. However, the data also show that returns on average are higher (5.6%) in the more adventurous segment of fully unhedged funds, albeit with higher volatility (5.2%).

- **Seek impact through a range of sectors**
  While a range of sectors are represented in this sample, PDIF assets, at least in this sample, are concentrated in Financial Services. The most frequently cited impact objective for this group is financial inclusion, though funds also seek many other types of impact, from increased access to basic services like health and education to promotion of entrepreneurship and employment. For CDLFs, which work exclusively in low-income areas in the United States, top impact themes are employment generation and affordable housing, and some funds also aim to advance food security, health, education, and financial inclusion in their communities.

This study, which adds to a growing body of evidence regarding the financial performance of impact investments, takes the first steps toward building a robust database of private debt impact investing funds that will be maintained and regularly updated. This effort will establish much-needed, reliable benchmarks to help impact investors and fund managers make allocation decisions and compare their performance to peers. As the samples grow, so will their representativeness and value for current and prospective impact investors alike.

40 Abhilash Mudaliar and Rachel Bass, GIIN Perspectives: Evidence on the Financial Performance of Impact Investments (New York: Global Impact Investing Network, November 2017), https://thegiin.org/research/publication/financial-performance.

5. APPENDICES

5.1 METHODOLOGY

PRIVATE DEBT IMPACT FUNDS

Metric	Simple Average	Weighted Average
2.2 Sample Snapshot		
Participation Rate	N/A	Number of Funds Meeting Criteria / Number of Funds Assuming They Met the Criteria
Leverage as a % of Total Assets	Sum of Total Debt to Assets Ratio / n	Sum of Total Debt / Sum of Total Assets
2.3 Asset Size		
Total Assets	Sum of Total Assets / n	N/A
Total Assets by Sector	Sum of Total Assets of Sector i / Number of Funds of Sector i	Sum of Total Assets of Sector i / Sum of Total Assets of All Sectors
Total Assets by Size	Sum of Total Assets of Size i / Number of Funds of Size i	Sum of Total Assets of Size i / Sum of Total Assets of All Sizes
Number of Funds by Size	N/A	Sum of Number of Funds of Size i / n
Number of Funds by Age	Number of Funds of Age i / n	N/A
Average Net Assets	Sum of Net Assets / n	N/A
Average Net Subscriptions	Sum of Average Net Subscriptions / n	N/A
2.4 Portfolio and Investor Characteristics		
Average Portfolio Size	Sum of Total Portfolio / n	N/A
Outstanding Average Maturity	Sum of Average Maturity of Outstanding Loan Portfolio / n	Weight of Fund 1 * Average Maturity of Fund 1 + Weight of Fund 2 * Average Maturity of Fund 2 + ... + Weight of Fund n * Average Maturity of Fund n
Oustanding Average Maturity by Sector	Sum of Average Maturity of Outstanding Loan Portfolio of Sector i / Number of Funds of Size i	Weight of Fund 1 in Sector i * Average Maturity of Fund 1 in Sector i + Weight of Fund 2 in Sector i * Average Maturity of Fund 2 in Sector i + ... + Weight of Fund n in Sector i * Average Maturity of Fund n in Sector i
Outstanding Average Maturity by Size	Sum of Average Maturity of Outstanding Loan Portfolio of Size i / Number of Funds of Size i	Weight of Fund 1 of Size i * Average Maturity of Fund 1 of Size i + Weight of Fund 2 of Size i * Average Maturity of Fund 2 of Size i + ... + Weight of Fund n of Size i * Average Maturity of Fund n of Size i
Geographical Breakdown by Region	N/A	Sum of Portfolio in Region i / Sum of Total Portfolio
Geographical Breakdown by Sector	N/A	Sum of Portfolio in Region i for Funds in Sector i / Sum of Total Portfolio for Funds in Sector i
Investor Breakdown by Type	N/A	Sum of Investments by Investor Type i / Sum of Total Equity and Notes Volumes
2.5 Financial Performance Breakdown		
Net Asset Growth	N/A	Sum of Net Income / Sum of Net Assets (t-1) + Average Net Capital Movement t OR NAV per share t / NAV per share (t-1) -1
Net Returns by Return Philosophy	N/A	Sum of Net Income for Funds in Return Philosophy i / Sum of Net Assets (t-1) + Average Net Capital Movement t for Funds in Return Philosophy i OR NAV per share t for Funds in Return Philosophy i/ NAV per share (t-1) for Funds in Return Philosophy i -1

PRIVATE DEBT IMPACT FUNDS

Metric	Simple Average	Weighted Average
2.5 Financial Performance Breakdown		
Net Returns by Hedging Strategy	N/A	Sum of Net Income for Funds in Hedging Strategy i / Sum of Net Assets (t-1) + Average Net Capital Movement t for Funds in Hedging Strategy i OR NAV per share t for Funds in Hedging Strategy i/ NAV per share (t-1) for Funds in Hedging Strategy i -1
Net Returns by Leverage Strategy	N/A	Sum of Net Income for Funds in Leverage Strategy i / Sum of Net Assets (t-1) + Average Net Capital Movement t for Funds in Leverage Strategy i OR NAV per share t for Funds in Leverage Strategy i/ NAV per share (t-1) for Funds in Leverage Strategy i -1
Net Returns by Sector	N/A	Sum of Net Income for Funds in Sector i / Sum of Net Assets (t-1) + Average Net Capital Movement t for Funds in Sector i OR NAV per share t for Funds in Sector i/ NAV per share (t-1) for Funds in Sector i -1
Net Returns by Size	N/A	Sum of Net Income for Funds of Size i / Sum of Net Assets (t-1) + Average Net Capital Movement t for Funds of Size i OR NAV per share t for Funds of Size i/ NAV per share (t-1) for Funds of Size i -1
Net Target Return	Sum of Net Target Returns / n	Weight of Fund 1 * Net Target Return of Fund 1 + Weight of Fund 2 * Net Target Return of Fund 2 + ... + Weight of Fund n * Net Target Return of Fund n
Cost of Debt on Notes Payables	Sum of Interest Expense Ratio / n	Sum of Interest Expense i / Sum of (Debt/Coupon i + Sum of Debt/Coupon (t–1) /2)
Portfolio Yield	Sum of Portfolio Yield Ratios / n	Sum of Interest on Investments i / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t)
Other Income	Sum of Other Income Ratios/ n	Sum of Other Income i / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t)
Total Income	(Sum of Portfolio Yield Ratios / n) + (Sum of Other Income Ratios / n)	Sum of Interest on Investments + Other Income
Portfolio Yield by Leverage Strategy	Sum of Portfolio Yield Ratios for Funds in Leverage Strategy i / Number of Funds in Leverage Strategy i	Sum of Interest on Investments i for Funds in Leverage Strategy i / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t) for Funds in Leverage Strategy i
Portfolio Yield by Sector	Sum of Portfolio Yield Ratios of Sector i / n	Sum of Interest on Investments i for Sector i / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t) for Sector i
Portfolio Yield by Size	Sum of Portfolio Yield Ratios of Size i / n	Sum of Interest on Investments i of Size i / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t) of Size i
Total Expense Ratio	Sum of TER / n	Sum of Total Expense i – Sum of Interest Expense i / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t)
Interest Costs	Sum of Interest Costs Ratio / n	Sum of Interest Expense i /(Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t)
Realized/Unrealized Gains/ Losses	(Sum of Realized/Unrealized Gain Losses Ratio + Sum of Unrealized LC Classes Ratio)/ n	Sum of Realized/Unrealized Gain Losses i + Sum of Unrealized LC Classes i / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t)

PRIVATE DEBT IMPACT FUNDS

Metric	Simple Average	Weighted Average
2.5 Financial Performance Breakdown		
Unrealized on Local Currency Classes	Sum of Unrealized LC Classes Ratio / n	Sum of Unrealized LC Classes i / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t)
TER – Levered	Sum of TER of Leveraged Funds / n	Sum of Total Expense i of Levered Funds – Sum of Interest Expense i of Levered Funds / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t) of Levered Funds
TER – Unlevered	Sum of TER of Unlevered Funds / n	Sum of Total Expense i of Unlevered Funds – Sum of Interest Expense i of Unlevered Funds / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t) of Unlevered Funds
Expected TER	Sum of Expected TER Ratios / n	Weight of Fund 1 * Expected TER of Fund 1 + Weight of Fund 2 * Expected TER of Fund 2 + ... + Weight of Fund n * Expected TER of Fund n
Expected TER by Sector	Sum of Expected TER Ratios of Sector i / n	Weight of Fund 1 of Sector i * Expected TER of Fund 1 of Sector i + Weight of Fund 2 of Sector i * Expected TER of Fund 2 of Sector i + ... + Weight of Fund n of Sector i * Expected TER of Fund n of Sector i
TER by Sector	Sum of TER of Sector i / n	(Sum of Total Expense of Sector i – Sum of Interest Costs i of Sector i) / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t) of Sector i
TER by Size	Sum of TER of Size i / n	(Sum of Total Expense of Size i – Sum of Interest Costs i of Size i) / (Sum of Net Assets (t–1) + Sum of Average Net Subscriptions t) of Size i
2.6 Portfolio Risk		
Investment Grade Investees	N/A	Sum of Total Portfolio in Investment Grade Institutions / Sum of Total Portfolio
Local Currency Portfolio	N/A	Sum of Total Portfolio in Local Currency / Sum of Total Portfolio
Seniority	N/A	Sum of Total Portfolio in Senior Debt / Sum of Total Portfolio
Secured vs. Unsecured Lending	N/A	Sum of Total Portfolio in Secured Loans / Sum of Total Portfolio
Provisions Outstanding	Sum of Provision Ratios / n	Sum of Provision Volumes / Sum of Total Portfolio
Provisions Outstanding by Sector	Sum of Provision Ratios of Sector i / Number of Funds of Sector i	Sum of Provision Volumes of Sector i / Sum of Total Portfolio of Sector i
Provisions Outstanding by Size	Sum of Provision Ratios of Size i / Number of Funds of Size i	Sum of Provision Volumes of Sector i / Sum of Total Portfolio of Size i
Provisions Outstanding by Hedging Strategy	Sum of Provision Ratios of Hedging Strategy i / Number of Funds of Hedging Strategy i	Sum of Provision Volumes of Hedging Strategy i / Sum of Total Portfolio of Hedging Strategy i
Write-offs	Sum of Write-off Ratios / n	Sum of Write-off Volumes / Sum of Total Portfolio
Write-offs by Sector	Sum of Write-off Ratios of Sector i / Number of Funds of Sector i	Sum of Write-off Volumes of Sector i / Sum of Total Portfolio of Sector i
Write-offs by Size	Sum of Write-off Ratios of Size i / Number of Funds of Size i	Sum of Write-off Volumes of Size i / Sum of Total Portfolio of Size i

PRIVATE DEBT IMPACT FUNDS

Metric	Simple Average	Weighted Average
2.7 Impact Measurement		
Impact Themes	Number of Funds of Impact Theme i / n	N/A
Impact Themes by Sector	Number of Funds of Impact Theme i and Sector i / Number of Funds of Sector i	N/A
Impact Metrics	Number of Funds of Impact Metric i / n	N/A
Impact Metrics by Sector	Number of Funds of Impact Metric i and Sector i / Number of Funds of Sector i	N/A

COMMUNITY DEVELOPMENT LOAN FUNDS

Metric	Simple Average	Weighted Average
3.2 Sample Snapshot		
Participation Rate	N/A	Number of Funds Meeting Criteria / Number of Funds Identified from U.S. Government Website
Leverage as a % of Total Assets	Sum of Total Debt to Assets Ratio / n	Sum of Total Debt / Sum of Total Assets
3.3 Asset Size		
Total Assets	Sum of Total Assets / n	N/A
Total Assets by Sector	Sum of Total Assets of Sector i / Number of Funds of Sector i	Sum of Total Assets of Sector i / Sum of Total Assets of All Sectors
Total Assets by Size	Sum of Total Assets of Size i / Number of Funds of Size i	Sum of Total Assets of Size i / Sum of Total Assets of All Sizes
Number of Funds by Size	N/A	Sum of Number of Funds of Size i / n
Number of Funds by Age	Number of Funds of Age i / n	N/A
Average Net Assets	Sum of Net Assets / n	N/A
3.4 Portfolio and Investor Characteristics		
Average Portfolio Size	Sum of Total Portfolio / n	N/A
Outstanding Average Maturity	Sum of Average Maturity of Outstanding Loan Portfolio / n	Weight of Fund 1 * Average Maturity of Fund 1 + Weight of Fund 2 * Average Maturity of Fund 2 + ... + Weight of Fund n * Average Maturity of Fund n
Oustanding Average Maturity by Sector	Sum of Average Maturity of Outstanding Loan Portfolio of Sector i / Number of Funds of Size i	Weight of Fund 1 in Sector i * Average Maturity of Fund 1 in Sector i + Weight of Fund 2 in Sector i * Average Maturity of Fund 2 in Sector i + ... + Weight of Fund n in Sector i * Average Maturity of Fund n in Sector i
Outstanding Average Maturity by Size	Sum of Average Maturity of Outstanding Loan Portfolio of Size i / Number of Funds of Size i	Weight of Fund 1 of Size i * Average Maturity of Fund 1 of Size i + Weight of Fund 2 of Size i * Average Maturity of Fund 2 of Size i + ... + Weight of Fund n of Size i * Average Maturity of Fund n of Size i
Geographical Breakdown by Region	N/A	Sum of Portfolio in Region i / Sum of Total Portfolio
Geographical Breakdown by Sector	N/A	Sum of Portfolio in Region i for Funds in Sector i / Sum of Total Portfolio for Funds in Sector i
Investor Breakdown by Type	N/A	Sum of Investments by Investor Type i / Sum of (Notes + Lines of Credit)

COMMUNITY DEVELOPMENT LOAN FUNDS

Metric	Simple Average	Weighted Average
3.5 Financial Performance Breakdown		
Notes Interest Rates	Sum of Notes Interest Rates Ratios / n	Sum of (Interest Expense t + Accrued Interest Expense t – Accrued Interest Expense t–1) / (Sum of (Notes Payables t + Sum of Notes Payables t–1) /2)
Lines of Credit Interest Rates	Sum of Lines of Credit Ratios / n	Sum of (Interest Expense on LOC t + Accrued Interest Expense on LOC t – Accrued Interest Expense on LOC t–1) / (Sum of (LOC t + Sum of LOC t–1) /2)
Notes Interest Rates by Sector	Sum of Notes Interest Rates Ratios by Sector i / n	Sum of (Interest Expense t + Accrued Interest Expense t – Accrued Interest Expense t–1) of Sector i / (Sum of (Notes Payables t + Sum of Notes Payables t–1) /2) of Sector i
Notes Interest Rates by Size	Sum of Notes Interest Rates Ratios by Size i / n	Sum of (Interest Expense t + Accrued Interest Expense t – Accrued Interest Expense t–1) of Size i / (Sum of (Notes Payables t + Sum of Notes Payables t–1) /2) of Size i
Net Target Return	Sum of Net Target Returns / n	Weight of Fund 1 * Net Target Return of Fund 1 + Weight of Fund 2 * Net Target Return of Fund 2 + … + Weight of Fund n * Net Target Return of Fund n
Portfolio Yield	Sum of Portfolio Yield Ratios / n	Sum of (Interest Income t + Accrued Interest t – Accrued Interest t –1) / (Sum of (Portfolio t + Sum of Portfolio t –1) /2)
Other Income	Sum of Other Income on Average TA Ratios / n	Sum of (Total Income – Interest Income) / (Sum of (Total Assets t + Sum of Total Assets t –1)/2)
Total Income	Sum of t otal Income on Average TA Ratios / n	Sum of Total Income / (Sum of (Total Assets t + Sum of Total Assets t –1)/2)
Portfolio Yield by Leverage Strategy	N/A	N/A
Portfolio Yield by Sector	Sum of Portfolio Yield Ratios of Sector i / n	Sum of (Interest Income t + Accrued Interest t – Accrued Interest t –1) of Sector i / Sum of (Portfolio t + Sum of Portfolio t –1) /2) of Sector i
Portfolio Yield by Size	Sum of Portfolio Yield Ratios of Size i / n	Sum of (Interest Income t + Accrued Interest t – Accrued Interest t –1) of Size i / Sum of (Portfolio t + Sum of Portfolio t –1) /2) of Size i
Total Expense Ratio	Sum of TER / n	Sum of Total Expenses / (Sum of (Total Assets t + Sum of Total Assets t –1)/2)
Interest Costs	Sum of Interest Expenses on Average TA Ratios / n	Sum of (Interest Expenses on Notes + Interest Expenses on Lines of Credit) / (Sum of (Total Assets t + Sum of Total Assets t –1)/2)
Other Expenses	Sum of Other Expenses on Average TA Ratios / n	Sum of (Total Expenses – Interest Expenses on Notes – Interest Expenses on Lines of Credit) / (Sum of (Total Assets t + Sum of Total Assets t –1)/2)
TER by Sector	Sum of TER of Sector i / n	Sum of Total Expenses of Sector i/ (Sum of (Total Assets t + Sum of Total Assets t –1)/2) of Sector i
TER by Size	Sum of TER of Size i / n	Sum of Total Expenses of Size i / (Sum of (Total Assets t + Sum of Total Assets t –1)/2) of Size i

COMMUNITY DEVELOPMENT LOAN FUNDS

Metric	Simple Average	Weighted Average
3.6 Portfolio Risk		
Provisions Outstanding	Sum of Provision Ratios / n	Sum of Provision Volumes / Sum of Total Portfolio
Provisions Outstanding by Sector	Sum of Provision Ratios of Sector i / Number of Funds of Sector i	Sum of Provision Volumes of Sector i / Sum of Average Total Assets of Sector i
Provisions Outstanding by Size	Sum of Provision Ratios of Size i / Number of Funds of Size i	Sum of Provision Volumes of Sector i / Sum of Average Total Assets of Size i
Write-offs	Sum of Write-off Ratios / n	Sum of Write-off Volumes / Sum of Total Portfolio
Write-offs by Sector	Sum of Write-off Ratios of Sector i / Number of Funds of Sector i	Sum of Write-off Volumes of Sector i / Sum of Total Portfolio of Sector i
Write-offs by Size	Sum of Write-off Ratios of Size i / Number of Funds of Size i	Sum of Write-off Volumes of Size i / Sum of Total Portfolio of Size i
3.7 Impact Measurement		
Impact Themes	Number of Funds of Impact Theme i / n	N/A
Impact Themes by Sector	Number of Funds of Impact Theme i and Sector i / Number of Funds of Sector i	N/A
Impact Metrics	Number of Funds of Impact Metric i / n	N/A
Impact Metrics by Sector	Number of Funds of Impact Metric i and Sector i / Number of Funds of Sector i	N/A

5.2 SAMPLE SNAPSHOT, OTHER METRICS

5.2.1 Private Debt Impact Funds

Appendix 2, Table 1
Count of Financial Statements Submitted and Used

Statement Count	Number Submitted
5 Financial Statements	27
4 Financial Statements	5
3 Financial Statements	5
2 Financial Statements	3
1 Financial Statement	10

Most PDIFs are incorporated in Europe (36), followed by North America (12) and Africa (2).

Appendix 2, Table 2
Countries of Incorporation

Country	Number of Funds
Luxembourg	23
United States	12
Netherlands	8
Other	7
Total	**50**

Accounting principles follow the same trend, with 15 funds applying Luxembourg Generally Accepted Accounting Principles (GAAP), followed by the International Financial Reporting Standards (IFRS) and U.S. GAAP.

Appendix 2, Table 3
Fund Accounting Principles

Country	Number of Funds
Lux GAAP	15
IFRS	14
US GAAP	11
Other	5
Other	5
Total	**50**

Most funds use either USD or EUR as their main accounting currency.

Appendix 2, Table 4
Fund Accounting Currencies

Accounting Currency	Number of Funds
USD	34
EUR	15
Other	1
Total	**50**

Appendix 2, Table 5: Fund Asset Size by Place of Incorporation

Country of Incorporation	Total Assets 2016, Millions USD	Number of funds
Luxembourg	6,586	23
Netherlands	2,744	8
United States	871	12
Other*	502	7
Total	**10,702**	**50**

* Belgium, Italy, Mauritius, Norway, South Africa and Switzerland

5.2.2 Community Development Loan Funds

Appendix 2, Table 6: Count of Financial Statements Submitted and Used

Statement Count	Number Submitted
5 Financial Statements	51
4 Financial Statements	39
3 Financial Statements	2
2 Financial Statements	6
1 Financial Statement	4

5.3 LIST OF RESPONDENTS

Private Debt Impact Funds

Actiam Institutional Microfinance Fund II
Actiam Institutional Microfinance Fund III
Actiam-FMO SME Finance Fund I
agRIF Fund
Alterfin CVBA
ASN-Novib Microcredit Fund
BlueOrchard Microfinance Fund
Capital for Communities Fund
Community Investment Management Enterprise Loan Fund
Cresud SpA
Dual Return Fund SICAV
Dual Return Fund – Vision Microfinance Local Currency
Envest Microfinance Fund
European Fund for Southeast Europe
Finethic Microfinance
Finethic Microfinance II
Fond pour l'Inclusion financière en RDC
Green for Growth Fund
GroFin SGB Fund
Higher Education Finance Fund
Incofin CVSO
Incofin Fairtrade Access Fund
Income & Impact Fund
Kolibri Kapital ASA
Living Cities Blended Catalyst Fund
Living Cities Catalyst Fund
Luxembourg Microfinance and Development Fund
Microfinance Enhancement Facility
MicroVest + Plus
MicroVest Local Credit Fund
MicroVest Short Duration Fund
Oikocredit
Regional MSME Investment Fund for Sub-Saharan Africa
responsAbility Fair Agriculture Fund
responsAbility Micro and SME Finance Fund
responsAbility SICAV (Lux.) Financial Inclusion Fund
responsAbility SICAV (Lux.) Micro and SME Finance Leaders
responsAbility SICAV (Lux.) Mikro- und KMU-Finanz-Fonds
Root Capital
SocialAlpha Bastion: Impact Debt Fund
Emerging Impact Bond Fund
SEB Microfinance Fund
SEB Microfinance Fund II
SEB Microfinance Fund III
SEB Microfinance Fund IV
High Yield Frontier Impact Fund
The Small Enterprise Impact Investing Fund
TriLinc Global Impact Fund
Triodos Cultuurfonds
Triodos Groenfonds

Community Development Loan Funds
Access to Capital for Entrepreneurs
ACCION Chicago
Arcata Economic Development Corporation
Arkansas Capital Corporation
Baltimore Community Lending
Black Business Investment Fund
Boston Community Capital
Bridgeway Capital
Business Center for New Americans
Business Impact NW
Capital Impact Partners
Carolina Small Business Development Fund
CASA of Oregon
Cincinnati Development Fund
Clearinghouse CDFI
Colorado Enterprise Fund
Common Capital
Community Capital of Vermont
Community First Fund
Community Health Center Capital Fund
Community Loan Fund of the Capital Region
Community Reinvestment Fund
CommunityWorks
Cooperative Business Assistance Corporation
Cooperative Fund of New England
Craft3
Economic and Community Development Institute
Economic Opportunities Fund
Enterprise Development Fund
Entrepreneur Works Fund
Finance Fund Capital Corporation
Florida Community Loan Fund
Forward Community Investments
Four Bands Community Fund
Fresno Community Development Financial Institution
Fund for Good Jobs
Genesis Fund
Genesis LA Economic Growth Corporation
Greater Minnesota Housing Fund
Harlem Entrepreneurial Fund
Hope Enterprise Corporation
Housing Partnership Network
Housing Trust Silicon Valley
Idaho Nevada Community Development Financial Institution, Inc.
IFF
Impact Capital
Invest Detroit Foundation
Justine Petersen Housing and Reinvestment Corporation
Kentucky Habitat for Humanity
Land Bank Twin Cities
Latino Economic Development Corporation
Legacy Redevelopment Corporation

Leviticus Alternative Fund
Liftfund
Local Enterprise Assistance Fund, Inc.
Los Angeles LDC
Mountain Association for Community Economic Development
Main Street Launch
Maryland Capital Enterprises
Mercy Loan Fund
Mile High Community Loan Fund
Milwaukee Economic Development Corporation
Montana and Idaho Community Development Corporation
Mountain BizCapital
National Housing Trust Community Development Fund
Natural Capital Investment Fund
National Council on Agricultural Life and Labor Research Fund
Nebraska Enterprise Fund
Neighborhood Lending Partners of Florida
NeighborWorks Capital
New Hampshire Community Loan Fund
Nonprofit Finance Fund
Nonprofits Assistance Fund
North Alabama Revolving Loan Fund
North Carolina Community Development Initiative
Northcountry Cooperative Development Fund
Northeast Entrepreneur Fund
Northern California Community Loan Fund
Northern Initiatives
Northside Community Development Fund
Ohio Capital Finance Corporation
Opportunity Fund Northern California
Opportunity Resource Fund
Partners for the Common Good
People Incorporated Financial Services
ROC USA Capital
Rural Community Assistance Corporation
Rural Electric Economic Development
San Luis Obispo County Housing Trust Fund
Siouxland Economic Development Corporation
Southeast Community Capital Corporation
The Chicago Community Loan Fund
The Disability Fund
Valley Economic Development Center, Inc. (VEDC)
Vermont Community Loan Fund
Virginia Community Capital
Vital Healthcare Capital (V-Cap)
Wisconsin Women's Business Initiative Corporation
WomenVenture
Working Solutions
Anonymous CDLF

Symbiotics SA
Rue de la Synagogue 31
1204 Geneva
Switzerland

Global Impact Investing Network
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Appendix C3

Reimagining the Pooled Income Fund: A Community-Scale Mutual Fund

By Brian Beckon

At Cutting Edge Capital, we think a lot about the possible legal strategies that can advance community capital. There are the often-used (if not well-known) strategies like crowdfunding, direct public offerings, and charitable loan funds. But then there are strategies that have been on the books for decades but have seldom, if ever, been used as a vehicle for community capital. Sometimes innovation doesn't mean doing something new, but rather doing something old in an innovative way.

Years ago, I helped a community foundation set up a pooled income fund (a "PIF"). The idea of a PIF is that a contributor puts money or assets into a trust, where it is pooled with the contributions of other contributors and jointly invested. Income from the investments is distributed to the contributors (and often their spouses or other beneficiaries) for their lifetimes. Upon the death of each life beneficiary, the pro rata value of the fund at that time is removed from the trust and given over to the charity that sponsors the trust. A portion of the amount contributed is tax deductible to the contributor in the year of the original contribution, based on a formula that measures the actuarial value of the remainder interest that will eventually go to the charity.

Many foundations, universities, and other (usually large) charities have established PIFs as a planned giving device. From the point of view of these sponsoring charities, the purpose is to eventually receive the remainder interest upon the death of each contributor, though the charity may have to wait years, and sometimes decades. But with enough contributors in a PIF, it is inevitable that one by one they will pass on over the years, and those assets will come into the charity, as planned.

Meanwhile, the assets of the PIF are typically invested as most charitable assets are – in Treasuries, bond funds, perhaps some socially screened equity funds, but nothing that looks too risky. Big charities are a pretty conservative bunch. From the sponsoring charity's point of view, the goal is to preserve and grow principal, while generating just enough income to fulfil the promises made to contributors.

And so we went to work at the community foundation, thoroughly researching the topic, developing a plan for how we wanted the PIF to work, and carefully crafting all the necessary legal documents, including a declaration of trust, a contribution agreement, and a disclosure document that explained everything. There was no discussion of using the PIF to make place-based investments – by which I mean investments in small ventures rooted in a local community that could contribute to a healthier and more resilient local economy. But I'll come back to that in a moment.

When it was all finalized, we put it out there. And nobody came. The feedback was that anticipated annual returns just weren't enough. I think the PIF had a grand total of maybe three contributors before the community foundation pulled the plug and went through another hassle to unwind the PIF. It seemed like a lot of wasted effort.

Fast-forward to the present. Recently we at Cutting Edge Capital have focused on community investment funds as a critical tool for moving the needle forward significantly toward a more inclusive and equitable society. (We wrote about that here.)

But there are gaps in the legal landscape for community investment funds – a landscape dominated by the Investment Company Act of 1940. That law would impose a heavy regulatory burden on any investment fund that doesn't qualify for an exemption, a burden so heavy that it is not financially feasible for a community-scale fund.

But, the 1940 Act includes a number of exemptions. Hence, it's fairly simple to set up a charitable loan fund or a community-owned real estate fund, because each of those is exempt from the 1940 Act. However, there is no simple exemption strategy for a fund that makes equity investments in small businesses and is open for investment by the non-wealthy. There are a handful of exemption strategies that could work, but each of those strategies requires a fund to squeeze into a business model that may not align with what is needed.

In that context, we think the humble PIF deserves another look. The PIF fits within the charitable exemption from the 1940 Act because of the charitable remainder component. But even so, it can do what no other type of investment fund can do: It allows any number of investors of any level of wealth to pool their resources into a community-scale fund that can make equity investments in local businesses (along with any other kind of investments), with profits from those investments shared among the investors. No regulatory review is required, because of the securities law exemptions, which makes it efficient to set up. It's like a local mutual fund without the regulatory burden.

There is, of course, the downside that the investors can't get their money back because of the charitable remainder element. But that charitable remainder also brings a tax deduction, along with the knowledge that contributions will eventually go to a charitable cause. And depending on how the fund is invested, the years or even decades of income from a PIF may be far more valuable than the remainder interest. If the need arises, that life income stream can be transferred to another beneficiary.

Some may also argue that the assets of a PIF, being in a sense charitable assets, must be invested in a conservative way that does not accommodate the kind of small business equity investments that we are contemplating here. However, this argument is rooted in a false myth that fiduciary standards require charitable assets to be invested for capital preservation or for maximum financial return. While state laws vary, the general rule, as spelled out in the Uniform Prudent Management of Institutional Funds Act, is that charitable funds should be invested in a manner appropriate to the organization's purpose – which could mean investing in local businesses, even if there is a higher risk of loss. The IRS recently underscored this point in a 2015 release on mission-related investing.

A PIF can be much more than just a planned giving device that will eventually benefit the charitable sponsors. It can truly be an engine for local economic development that offers the benefits of investment to anyone in the community in an equitable and inclusive way. To date we are not aware of any PIF that is being used as a vehicle for community capital – that is, as a way

for anyone to invest in the success of local businesses. However, in recent conversations that we've had, this idea has sparked significant interest, and we expect to see such a reimagined pooled income fund in action soon. So stay tuned.

Of course, nothing written here should be taken as legal, investment, or tax advice. If you would like to schedule a consultation with one of our principals at Cutting Edge Capital, click here.

Appendix C4

BYLAWS
OF
[Name of Organization]

ARTICLE I
NAME AND PURPOSES

Section 1.01. Name. The name of the organization is _____ (hereinafter referred to as "Corporation").

Section 1.02. Purpose. The Corporation is organized for the purpose[s] of ____ _____.

Notwithstanding the foregoing, however, the Corporation is organized exclusively for charitable, religious, educational and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (or the corresponding provision of any future United States Internal Revenue Law).

ARTICLE II
OFFICES

Section 2.01. Principal Office. The principal office of the Corporation in the state of Iowa shall be located in the city of _____, in the county of _____. The Corporation may have other offices, either within or outside the state of Iowa, as the Board of Directors may determine or as the affairs of the Corporation may require.

Section 2.02. Registered Office. The Corporation shall have and continuously maintain in the state of Iowa a registered office, and a registered agent whose office is identical with the registered office, as required by the Revised Iowa Nonprofit Corporation Act, Iowa Code section 504.501. The registered office may be, but need not be, the same as the principal office in the state of Iowa, and the address of the registered office or the registered agent at the registered office, or both, may be changed from time to time by the Board of Directors.

ARTICLE III
BOARD OF DIRECTORS

Section 3.01. General Powers. The affairs of the Corporation shall be managed by its Board of Directors. Directors need not be residents of the state of Iowa.

Section 3.02. Number, Tenure and Qualifications. The number of directors shall be ___. Each director shall hold office until the next annual meeting of directors and until his or her successor is elected and has qualified. However, the term of the director may not exceed five years.

Section 3.03. Election. The directors are to be elected by an affirmative vote of two-thirds of the board of directors.

Section 3.04. Removal. A director may be removed at any time for cause by a vote of a majority of the entire Board at any special meeting of the Board called for that purpose, provided that at least one week's notice of the proposed action has been given to the entire Board of Directors then in office. Such notice shall state that a purpose of the meeting is to vote upon the removal of one or more directors named in the notice. Only the named director or directors may be removed at the meeting.

Section 3.05. Resignation. Any director, member of a committee or officer may resign at any time by filing a written resignation with the President or the Secretary. Resignation is effective at the time specified in the resignation, or if no time is specified, when it is received by the President or Secretary. Acceptance of a resignation is not necessary to make it effective. A resignation is effective when the notice is effective unless the notice specifies a later date. If a resignation is made effective at a later date, the board may fill the pending vacancy before the effective date if the board provides that the successor does not take office until the effective date.

Section 3.06. Increase in Number. The number of directors may be increased by amendment to these Bylaws by the affirmative vote of a majority of the entire Board.

Section 3.07. Regular Meetings. A regular annual meeting of the Board of Directors shall be held without other notice than this bylaw. The Board of Directors may provide by resolution the time and place, either within or without the state of Iowa, for the holding of additional regular meetings of the Board without other notice than the resolution.

Section 3.08. Special Meetings. Special meetings of the Board of Directors may be called by or at the request of the President or any director. The person or persons authorized to call special meetings of the Board may fix any place, either within or without the state of Iowa, as the place for holding any special meeting of the Board called by them.

Section 3.09. Notice. Notice of any special meeting of the Board of Directors shall be given at least two days previously by written notice delivered personally or sent by mail or telegram to each director at his or her address as shown by the records of the Corporation, unless the meeting must be held within two days. If mailed,

the notice shall be deemed to be delivered when deposited in the United States mail in a sealed envelope so addressed, with postage prepaid. Any director may waive notice of any meeting. The attendance of a director at any meeting shall constitute a waiver of notice of the meeting, except where a director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the Board of Directors need be specified in the notice or waiver of notice of the meeting, unless specifically required by these Bylaws.

Section 3.10. Quorum. A majority of the Board of Directors shall constitute a quorum for the transaction of business; but if less than a majority of directors are present at the meeting, a majority of the directors present may adjourn the meeting without any further notice.

Section 3.11. Manner of Acting. The act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors, unless the act of a greater number is required by law or by these Bylaws.

Section 3.12. Vacancies. Any vacancy occurring in the Board of Directors and any directorship to be filled by reason of an increase in the number of directors may be filled by the affirmative vote of a majority of the remaining directors, though less than a quorum. A director so elected shall be elected for the unexpired term of his or her predecessor in office, or for the full term of the new directorship, as the case may be, and until his or her successor is elected and has qualified. If a director ceases to be a director, the vacancy may be filled by the board in absence of a contrary provision in the articles or the Bylaws. Where a vacancy occurs in any office held by an appointed director, only the person who appointed the director may fill the vacancy in the absence of an article or bylaw provision to the contrary.

Section 3.13. Compensation. Directors as such shall not receive any stated salaries for their services, but the Board of Directors may by resolution allow a fixed sum and expenses of attendance, if any, for attendance at each regular or special meeting of the board. Nothing in these Bylaws shall be construed to preclude any director from serving the Corporation in any other capacity and receiving compensation for that service.

Section 3.14. Informal Action by Directors. Any action required to be taken at a meeting of directors, or any action which may be taken by directors, may be taken without a meeting and without voting if all of the directors sign a consent in writing, setting forth the action taken.

Section 3.15. Meeting by Conference Telephone. Members of the Board of Directors may participate in a meeting of the Board by conference telephone or similar communications equipment. All persons participating in

the meeting shall be able to hear each other, and participation in a meeting pursuant to this provision shall constitute presence in person at the meeting.

Section 3.16. Presumption of Assent. A director of the Corporation who is present at a meeting of the Board of Directors at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless his or her dissent is entered in the minutes of the meeting or unless he or she files a written dissent to the action with the person acting as the Secretary of the meeting before the adjournment of the meeting or forwards a dissent by registered mail to the Secretary of the Corporation promptly after the adjournment of the meeting. A director who voted in favor of an action may not dissent from the action.

ARTICLE IV
OFFICERS

Section 4.01. Officers. The officers of the corporation shall be a President, a Vice-President, a Secretary, a Treasurer and such other officers as may be elected in accordance with the provisions of this article. The Board of Directors may elect or appoint the other officers, including one or more Assistant Secretaries and one or more Assistant Treasurers, as it may deem desirable, to have the authority and perform the duties prescribed by the Board of Directors. Any two or more offices may be held by the same person. The officers may be, but need not be, members of the Board of Directors.

Section 4.02. Election and Term of Office. The officers of the Corporation shall be elected annually by the Board of Directors at the regular annual meeting of the Board of Directors. If the election of officers is not held at such meeting, it shall be held as soon thereafter as is convenient. New offices may be created and filled at any meeting of the Board of Directors. Each officer shall hold office until his or her successor is elected and has qualified, or until his or her death, resignation or removal.

Section 4.03. Resignation and Removal. Any officer, agent or employee elected or appointed by the Board of Directors may be removed by the Board of Directors whenever in its judgment the best interests of the Corporation would be served by his or her removal, but removal does not prejudice the contract rights, if any, of the person removed. Election or appointment of an officer or agent does not of itself create contract rights. Further, an officer may resign at any time by delivering notice to the corporation.

Section 4.04. Delegation of Authority. To the full extent allowed by law, the Board of Directors may delegate to any officer any powers possessed by the Board of Directors.

Section 4.05. Vacancies. A vacancy in any office because of death, resignation, removal, disqualification or otherwise, may be filled by the Board of Directors for the non-expired portion of the term.

Section 4.06. President. The President shall be the principal executive officer of the Corporation and shall in general supervise and control all of the business and affairs of the Corporation. He or she shall preside at all meetings of the Board of Directors if present at the meeting. He or she may sign and execute alone in the name of the Corporation any deeds, mortgages, bonds, contracts, or other instruments which the Board of Directors has authorized to be executed, either generally or specifically, except in cases where the signing and execution has been expressly delegated by the Board of Directors or by these Bylaws or by statute to some other officer or agent of the Corporation; and in general he or she shall perform all duties incident to the office of President and any other duties that the Board of Directors prescribes.

Section 4.07. Vice-President. In the absence of the President or in event of his or her inability or refusal to act, the Vice-President shall perform the duties of the President, and when so acting, shall have all the powers of and be subject to any restrictions upon the President. Any Vice-President shall perform any other duties that the President or the Board of Directors assigns to him or her.

Section 4.08. Treasurer. If required by the Board of Directors, the Treasurer shall give a bond for the faithful discharge of his or her duties in the sum and with the surety that the Board of Directors determines. He or she shall render to the President and the Board of Directors at the regular meetings of the Board of Directors, or whenever they request, an account of all his or her transactions as Treasurer and of the financial condition of the Corporation. He or she shall have charge and custody of and be responsible for all funds and securities of the Corporation; keep full and accurate account of receipts and disbursements in books belonging to the Corporation; disburse the funds of the Corporation as may be ordered by the Board of Directors or the President, taking proper vouchers for the disbursements; receive and give receipts for moneys due and payable to the Corporation from any source whatsoever, and deposit or cause to be deposited all such moneys in the name of the Corporation in the banks, trust companies or other depositaries as are selected in accordance with the provisions of Article VI of these Bylaws; and in general perform all the duties incident to the office of Treasurer and any other duties that the President or the Board of Directors assign to him or her.

Section 4.9. Secretary. The Secretary shall keep the minutes of the meetings of the Board of Directors in one or more books provided for that purpose; see that all notices are given in accordance with the provisions of these Bylaws or as required by law but if the Secretary is absent, or refuses or neglects to give such notice, any notice may be given by any person who is directed to give notice by the President, or by the directors upon whose requisition the meeting is called as provided in these Bylaws; be custodian of the corporate records and of the seal of the Corporation and see that the seal of the Corporation is affixed to all documents, the execution of which on behalf of the Corporation under its seal is authorized in accordance with the provisions of these Bylaws and in general perform all duties incident to the office of Secretary and any other duties that the President or the Board of Directors assign to him or her.

ARTICLE V
COMMITTEES

Section 5.01. Committees of Directors. The Board of Directors, by resolution adopted by a majority of the full Board of Directors, may designate from among its officers an Executive Committee and one or more other committees, each of which, to the extent provided in such resolution, shall have and may exercise all the authority of the Board of Directors; provided, however, that no such committee shall have the authority of the Board of Directors in reference to:

1. amending the articles of incorporation;
2. adopting a plan of merger or consolidation;
3. recommending the sale, lease, exchange or other disposition of all or substantially all the property and assets of the Corporation;
4. recommending a voluntary dissolution of the Corporation or a revocation thereof;
5. amending, altering or repealing the Bylaws of the Corporation;
6. electing, appointing or removing any director or officer of the Corporation; or
7. amending, altering or repealing any resolution of the directors, unless by its terms the resolution may be amended, altered or repealed by the committee.

The designation of any such committee and the delegation of authority to the committee shall not operate to relieve the Board of Directors, or any director, of any responsibility imposed by law.

Section 5.02. Other Committees. Other committees not having and exercising the authority of the Board of Directors may be designated by a resolution adopted by a majority of the directors present at a meeting at which a quorum is present. Except as otherwise provided in the resolution and the President of the Corporation shall appoint the members of the committees. Any member may be removed by the persons authorized to appoint the member whenever in their judgment the best interests of the Corporation would be served by removing the member. The Board of Directors may terminate any committee so designated as the Board of Directors deems appropriate.

Section 5.03. Term of Office. Unless otherwise provided in the resolution of the Board of Directors designating a committee or by the President in appointing a committee member, each member of a committee shall continue as a member until the next annual meeting of the members of the Corporation and until his or her successor is appointed, unless the committee is terminated sooner, or unless the member is removed from the committee, or unless the member ceases to qualify as a member of the committee.

Section 5.04. Chair. One member of each committee may be appointed chair by the person or persons authorized to appoint the members of the committee.

Section 5.05. Vacancies. Vacancies in the membership of any committee may be filled by appointments made in the same manner as in the case of the original appointments.

Section 5.06. Quorum. Unless otherwise provided in the resolution of the Board of Directors designating a committee or by the President in appointing a committee, a majority of the whole committee shall constitute a quorum and the act of a majority of the members present at a meeting at which a quorum is present shall be the act of the committee. A committee may act by unanimous consent in writing without a meeting and, subject to action by the Board of Directors, the committee by majority vote of its members may determine the time and place of meetings and the notice for meetings.

Section 5.07. Rules. Each committee may adopt rules for its own government not inconsistent with these Bylaws or with rules adopted by the Board of Directors.

Section 5.08. Meetings by Conference Telephone. Members of a committee may participate in a meeting of the committee by conference telephone or similar communications equipment. All persons participating in the meeting shall be able to hear each other, and participation in a meeting pursuant to this provision shall constitute presence in person at the meeting.

ARTICLE VI
CONTRACTS, LOANS, CHECKS, DEPOSITS AND INVESTMENTS

Section 6.01. Contracts. The Board of Directors may authorize any officer or officers, agent or agents of the Corporation, in addition to the officers authorized by these Bylaws, to enter into any contract or execute and deliver any instrument in the name of and on behalf of the Corporation, and such authority may be general or confined to specific instances.

Section 6.02. Loans. No loans shall be contracted on behalf of the Corporation and no evidences of indebtedness shall be issued in its name unless authorized by a resolution of the Board of Directors. Such authority may be general or confined to specific instances.

Section 6.03. Checks, Drafts, etc. All checks, drafts or orders for the payment of money, notes or other evidences of indebtedness issued in the name of the Corporation, shall be signed by such officer or officers, agent or agents of the Corporation and in such manner as may be determined by resolution of the Board of Directors. In the absence of a determination by the Board of Directors, the instruments shall be signed by the Treasurer of the Corporation.

Section 6.04. Deposits. All funds of the Corporation shall be deposited to the credit of the Corporation in the banks, trust companies or other depositaries as the Board of Directors may select.

Section 6.05. Investments. The funds of the Corporation may be retained in whole or in part in cash or be invested and reinvested from time to time in such property, real, personal or otherwise, including stocks, bonds or other securities, as the Board of Directors may deem desirable.

Section 6.06. Gifts. The Board of Directors or the President may accept on behalf of the Corporation any contribution, gift, bequest or devise for the general purposes or for any special purpose of the Corporation.

Section 6.07. Loans to Directors and Officers Prohibited. No loans shall be made by the Corporation to the directors or officers. Any director or officer who assents to or participates in the making of any such loan shall be liable to the Corporation for the amount of the loan until it is repaid.

ARTICLE VII
BOOKS AND RECORDS

Section 7.01. Books and Records Maintained. The Corporation shall keep correct and complete books and records of account and shall keep minutes of the proceedings of its Board of Directors and committees having any of the authority of the Board of Directors. The following records are to be kept at the principal office: articles, Bylaws, resolutions, minutes, list of names and addresses of current directors and officers, the most recent biennial report delivered to secretary of state, and appropriate accounting records.

Section 7.02. Inspection of Records by Directors. A director of a corporation is entitled to inspect and copy the books, records, and documents of the corporation to the extent reasonably related to the performance of the duties of a director as a director.

ARTICLE VIII
FISCAL YEAR

The fiscal year of the Corporation shall begin on the first day of _____ and end on the last day of _____ in each year.

ARTICLE IX
WAIVER OF NOTICE

Whenever any notice is required to be given to any director of the Corporation or to any member of a committee of the Corporation under the provisions of the Iowa Nonprofit Corporation Act or under the provisions of the Articles of Incorporation or Bylaws of the Corporation, a waiver of notice in writing signed by the person or persons entitled to notice, whether before or after the time stated in the notice, shall be equivalent to the giving of notice.

ARTICLE X
AMENDMENTS TO BYLAWS

These Bylaws may be altered, amended or repealed and new Bylaws may be adopted by a majority of the directors present at any regular meeting or at any special meeting, if at least two days' written notice is given of intention to alter, amend or repeal or to adopt new Bylaws at the meeting.

These Bylaws adopted at a meeting of the full Board on the _____ of _____, 2016 by a majority vote of the Directors in office.

DATED this _____ day of _____ , 2016.

[Name of Organization]

By_____
President

By_____
Secretary

Appendix C5

Region 12 Revolving Loan Fund

An economic development organization that makes loans to start-up and/or young expanding businesses that will create or retain new, full-time jobs in eagle, garfield, grand, jackson, moffatt, pitkin, rio blanco, routt, and summit counties.

Pacific Community Ventures

Pacific community ventures envisions a world of thriving communities where everyone has a fair shake. Our mission is to invest in small businesses, create good jobs for working people, and make markets work for social good. We achieve our mission through a combination of fair lending, free mentorship, skilled volunteerism, impact investing consulting services, and field-building research.

Washington Area Community Investment Fund

The washington area community investment fund, inc. (wacif) is a regional nonprofit community development loan that supports economic development in underserved communities in the washington, dc, metropolitan area by providing access to capital and technical assistance

Nevada Business Opportunity Fund

To enhance the economic self-sufficiency and quality of life of low - and moderate-income individuals through entrepreneurial training, technical assistance and access to loans for new and expanding businesses throughout nevada.

Ventures

Ventures empowers individuals with limited resources and unlimited potential to improve their lives through small business ownership. We serve those in the puget sound region of washington state for whom traditional business development services are out of reach, with a focus on women, people of color, immigrants, and individuals with low income.

The Southern Development Council

the organization's mission is to promote small business growth and development by assisting them with obtaining the financing they need in order to achieve thatjgrowth and development including job creation.

Northeast South Dakota Economic Corporation

To stimulate economic opportunities through loans, technical support and partnerships

Mo-Kan Development Inc

To assist small businesses obtain loans.

South Arkansas Venture Enterprises

Revolving loan funds established to strengthen the economic base of a 22 county area by making loans to qualified entities for the establishment and expansion of small businesses.

Greensboro Community Development Fund

To generate economic growth, encourage small business development, create jobs, and revitalize neighborhoods by providing loans and financial services to underserved businesses in our community.

Cedar Valley Growth Fund I

Economic development loans for new business start-ups and business expansion and retention. To provide technical assistance to small businesses.

Georgia Small Business Lender

The purpose of the georgia small business lender is to encourage growth and development in the middle georgia area by providing loans to small businesses.

Mainestream Finance

To promote community development and perform all functions permitted as community development financial institution, primarily through financing activities servicing the low income targeted population of the state of maine.

Chippewa Valley Incubation Center

Chippewa valley innovation center, inc. Promotes industrial development and reduces small business failures by providing instruction in accounting, marketing, staffing, and other business needs of the inexperienced entrepreneur. Chippewa valley innovation center, inc. Also provides flexible, low-cost building accommodations for businesses to operate and access to a loan program with the purpose of providing direct loans or guaranteeing loans up to $50,000.

South Central Ozark Council of Governments

Assist local governments and administer revolving loan funds.

Black Business Investments Fund

The mission is to develop and promote black and other business enterprises through education,

Ameritrust CDC

To promote and facilitate a loan program entitled "504" which encourages economic development.

Des Plaines River Valley Enterprise Zone

Incubator program for the promotion of small businesses in the desplaines river valley enterprise zone. Funds are loaned at low rates of interest.

Greater Cincinnati Microenterprise Initiative

To promote the development of business and enterprise in low-income neighborhoods by sponsoring and participating in business training, education, small business loans and ongoing support programs in the greater Cincinnati area.

Adams County Economic Development

To provide low interest loans to new or exapnding businesses in the community.

Womens Venture Fund
The organization helps women of diverse backgrounds establish thriving businesses in urban communities. WVF offers training, small business loans, technical assistance and a network of business advisors to help women reach their goals.

Ccd Business Development Corporation
Assist with industrial prospecting and recruiting of new business in local areas and providing low interest rate loans.

Lakota Fund
The lakota fund exists to provide business management, education, technical assistance, start-up capital, and working capital loans to small businesses based on the pine ridge indian reservation.

Prince Georges Financial Services Corporation
The Organization is a private noprofit corporation designated as a certified development corporation by the US Small Business Administration. The Organization's principal business objective is to provide non-traditional funding sources to underserved markets.

East-Central Idaho Development Company
East-central idaho development company procures, funds, and services sba 504 loans.

Wyoming County Business Assistance Corporation
The corporation's mission is to manage the business loan funds on behalf of the wyoming county industrial development agency and engage in other allowable activities promoting economic development.

Regional Development Company
To help small businesses become aware of sba 504 loan financing.

Assets Lancaster
Assets lancaster changes lives and promotes economic development by providing business support services to aspiring entrepreneurs.

Pacific Coast Regional Urban Small Business Development Corporation
Pacific Coast Regional (PCR) is a private, non-profit corporation founded in 1977 to assist small business owners in becoming successful members of the Southern California business community. Through contracts with the Federal Government, the State of California, and partnerships with private institutions, PCR provides financial, educational and consulting services. In addition, PCR has been certified by the U.S. Treasury as a Community Development Financial Institution (CDFI).

Brightbridge Inc

Promotion and assistance of growth and development of small business concerns in the communities in and around hamilton county, tennessee through direct financing or assistance with sba loans.

Carolina Business Capital

Cbc is a nonprofit, non-stock corporation whose purpose is to promote economic growth and development of small businesses in north carolina through the origination and servicing of sba loans.

Montana Business Assistance Connection Inc

Montana business assistance connection, inc. Supports the retention of existing jobs and promotes create of new jobs in lewis & clark, broadwater, and meagher counties. This is accomplished through the creation, promotion and management of public and private revloving loan funds, providing training, counseling, technical assistance and access to capital for start up or expansion of qualified businesses, and the promotion and evaluation of county and city community development block grant requests and management of these loans.

Omaha Small Business Network

Osbn has been one of the leading sources for small and micro-business development in omaha since its inception in 1982. We've helped countless small businesses move from ideation to execution by providing below market-rate office space in the heart of north omaha, start-up counseling programs as well as low interest rate micro-loans to those unable to access traditional financing.

Houston Business Development Inc

To stimulate economic growth, support the expansion of small businesses, combat community deterioration and foster employment opportunities for low-moderate income citizens by providing flexible small business loans & office space at reasonable rents to businesses.

Valley Small Business Development Corporation

Providing capital, management assistance and other financial resources, including loan services, personnel and business education to small business entrepreneurs in economically disadvantaged areas, and thereby stimulating economic development.

Washington Heights And Inwood Development Corp.

WHIDC's Business Operating Success System (BOSS) provides small business loans to local entrepreneurs who may have limited educational backgrounds or who struggle with language barriers. The BOSS program has provided over 430 loans since 1995 to small storefront businesses, street vendors and in-home businesses.

Two Rivers Cdc

The corporation will primarily focus on economic development to include affordable housing development, job creation, entrepreneurial support, training, development of economic infrastructure, such as low-interest loans, credit union services, and partnerships in non-profit.

Vermont Center For Emerging Technologies Inc

Vcet's purpose is to accelerate innovation and entrepreneurship across vermont. This is accomplished by providing expert mentoring and technical assistance, the operation of three coworking/incubation facilities and the operation of a revolving early stage seed capital fund.

Appendix C6

CDC CERTIFICATION GUIDE

I. INTRODUCTION

The Certified Development Company 504 Loan Program is economic development financing specifically designed to stimulate private sector investment in long-term fixed asset financing and to foster economic development, create or preserve jobs, and stimulate the growth, expansion, and modernization of small businesses.

Certified Development Companies (CDCs) are non-profit corporations certified and regulated by the Small Business Administration to package, process, close, and service "504" loans.

The 504 Loan Program was authorized by Congress under the Small Business Investment Act. The regulations governing the 504 program can be found in 13 Code of Federal Regulations Part 103 and Part 120, (Sections 120.800 – 120.991 refer exclusively to the Development Company Loan Program). We strongly encourage you to read thoroughly the requirements for program participation before submitting an application.

Additional Loan Program Requirements are detailed in the SBA Standard Operating Procedures and Notices.

II. HOW TO BECOME A CERTIFIED DEVELOPMENT COMPANY (CDC)

A. Non-Profit Status - 13 CFR§120.820

A CDC must be a non-profit corporation and must be:

1. In good standing in the State in which the CDC is incorporated and must provide a Certificate of Good Standing, or its equivalent;
2. In compliance with all laws, including taxation requirements, in the State in which the CDC is incorporated and any other State in which the CDC conducts business; and
3. CDC applicants must provide a copy of their IRS tax exempt status letter.

B. Area of Operations - 13 CFR §120.821

A CDC must operate only within its designated Area of Operations approved by SBA except as provided in 13 CFR §120.839. The Area of Operations is the state of the CDC's incorporation.

C. CDC Membership – 13 CFR§120.822

The Membership as a requirement, 13 CFR§120.822, became optional in regulations published on March 21, 2014. CDCs may, at their discretion, continue to have a Membership. If the Membership option is chosen representation is no longer limited to financial, business, government, and community groups, but these groups may continue to be represented.

D. CDC Board of Directors - 13 CFR§120.823

The CDC must have a Board of Directors. The initial board may be created by any method permitted by applicable state law. In addition board members or renewal of board terms must be approved by the board.

1. There must be at least nine (9) voting members of the Board of Directors; however, we recommend no more than twenty-five (25) voting members. A CDC may request an exception for good cause from the D/FA or designee to have a Board with fewer than nine (9) directors.
2. The Board shall be comprised of persons, currently employed or retired, with a background/expertise in internal controls, financial risk management, commercial lending, legal issues relating to commercial lending, and corporate governance. A person may meet more than one of the background/expertise requirements.
3. At least one voting director must represent the economic, community or workforce development field.
4. At least two voting directors, other than the CDC manager, must represent the commercial lending field.
5. No person who is a member of a CDC's staff may be a voting member of the Board except for the CDC manager.
6. The Board must meet at least quarterly and shall be responsible for CDC staff decisions and actions.
7. The quorum shall be set by the CDC, but shall be no less than 50% of the voting members of the Board of Directors. The Board meetings require a quorum to transact business. A quorum must be present for the duration of the meeting.
8. Attendance at meetings may be through any format permitted by state law (i.e. in-person, teleconference, e-mail, fax, web conference and video conference).
9. Directors from the commercial lending fields must comprise less than 50% of the representation on the Board.
10. If the CDC is an approved affiliate with another entity under 120.820, there is no limitation on board overlap.
11. With the exception of approved affiliates, a CDC may not permit more than one of its directors to be employed by or serve on the Board of Directors of any single entity (including that entity's affiliates), unless that entity is a civic, charitable, or comparable organization that is not involved in financial services. No CDC Board member may serve on the Board of another CDC.
12. The Board shall have and exercise all corporate powers and authority and be responsible for all corporate actions. There must be no actual or appearance of a conflict of interest. The Board responsibilities include, but are not limited, to the following:
    a.) Approving the mission and policies for the CDC;
    b.) Hiring, firing, supervising and annually evaluating the CDC manager;

c.) Setting the salary for the CDC manager and reviewing all salaries; and

d.) Establishing committees, at its discretion, including an Executive Committee and a Loan Committee. See Sections E and F.

13. The CDC business plan should include that all Board Directors must annually certify in writing that they have read and understand this section, and copies of the certification must be included in the Annual Report to SBA.
14. The Board of Directors shall maintain Directors' and Officers' Liability and Errors and Omissions insurance in amounts established by SBA.
15. It is the policy of the SBA to allow interim vacancies on the Board of Directors to be filled by a majority of the remaining Board members. However, any person filling an interim vacancy must stand for election at the next Annual or Special meeting of the Board of Directors whichever comes first.
16. When the Board votes on SBA loan approval or servicing actions, at least two voting Board members, with commercial loan experience satisfactory to SBA, other than the CDC manager, must be present and vote.

E. Executive Committee - 13 CFR§120.823(a)

To the extent authorized in the Bylaws, the Board of Directors may establish an Executive Committee. The Executive Committee may exercise the authority of the Board; however, the delegation of its authority does not relieve the Board of its responsibility imposed by law or Loan Program Requirements. No further delegation or redelegation of this authority is permitted. If the Board establishes an Executive Committee and delegates any of its authority to the Executive Committee as set forth in the Bylaws of the CDC, the Executive Committee must:

(A) Be chosen by and from the Board of Directors; and

(B) Meet the same organizational and representational requirements as the Board of Directors, except that the Executive Committee must have a minimum of five voting members who must be present to conduct business.

F. Loan Committees - 13 CFR§120.823(a)

The Board may establish a Loan Committee with the authority of the Board. The Loan Committee's action must be ratified by the Board or Executive Committee prior to Debenture closing. The delegation of authority does not relieve the Board of its responsibilities imposed by law or Loan Program Requirements.

The Loan committee:

1. must be chosen by the Board from the Membership (if any), shareholders, or the Board,
2. have a quorum of at least five (5) committee members authorized to vote; have at least two members with commercial lending experience satisfactory to SBA;
3. have no actual or appearance of a conflict of interest;
4. consist of members who live or work in the Area of Operations of the state where the504 project they are voting on is located unless the project falls under one of the exceptions listed in 13 CFR§120.839.

5. may be delegated the authority to provide credit approval for loans up to $2,000,000 but, for loans of $1,000,000 to $2,000,000, the Loan Committee's actions must be ratified by the Board or Executive Committee prior to Debenture closing.

Only the Board or Executive Committee, if authorized, may provide credit approval for loans greater than $2,000,000.

G. CDC Staff - 13 CFR§120.824

A CDC must have:

1. A full-time professional management, including an Executive Director (or the equivalent) managing daily operations.
2. A full-time professional staff qualified by training and experience to market the 504 program, package and process loan applications, close and service the loans.
3. All officers and paid employees of the CDC (including all contracted staff and contractors performing loan packaging, processing, closing and servicing for the must submit a completed SBA Form 1081, signed and dated within 90 days of submission to SBA, for each officer and paid employee and fingerprint cards for paid employees and contractors.
4. Professional services contracts must comply with the requirements in the most current version of SOP 50 10.
5. Board Members must also submit SBA Form 1081 and if they answer yes to question numbers 10 a, 10b, 10c, or 11 on SBA Form 1081 they must submit using either fingerprint cards or Electronic Fingerprint Submission.
6. CDCs may obtain, under written contract, professional services. However, the CDC must have:
   - (a) At least one salaried professional employee that is employed directly (not a contractor or an associate of a contractor) full-time to manage the CDC. A CDC may petition SBA to waive the requirement of the manager being employed directly if:
     - (1) Another non-profit entity that has the economic development of the CDC's Area of Operations as one of its principal activities will contribute the management of the CDC.
     - (2) The CDC petitioning SBA for such waiver is rural and has insufficient loan volume to justify having management employed directly by the CDC.
   - (b) SBA must pre-approve professional service contracts with the exception of accounting, legal, and IT services.
   - (c) Contracts must clearly identify terms and conditions satisfactory to SBA
   - (d) The CDC must provide copies of these contracts to SBA for review annually.
   - (e) If a CDC's Board believes that it is in the best interest of the CDC to contract for professional services, the CDC's Board must explain its reasoning to SBA. The CDC's Board must demonstrate to SBA that:
     - (1) The compensation under the contract is only from the CDC and is reasonable and customary for similar services in the Area of Operations.

(2) The compensation must be stated as an hourly rate for each person performing on the contract.
(3) The compensation is only for actual services performed.
(4) The full term of the contract (including options) is reasonable.
(5) The contract does not evidence any actual or apparent conflict of interest or self-dealing on the part of any of the CDC's officers, management, and staff including members of the Board and any Loan Committee.

(f) No contractor (under this section) or Associate of a contractor may be a voting or non-voting member of the CDC's Board.

H. Financial Ability to Operate - 13 CFR§120.825

A CDC must be able to sustain its operations continuously, with reliable sources of funds (such as income from services rendered and contributions from government or other sponsors). Any funds generated from 504 loan activity by a CDC remaining after payment of staff and overhead expenses must be retained by the CDC as a reserve for future operations or for investment in other local economic development activity in its Area of Operations.

I. SBA Form 1246 APPLICATION TO BECOME A CDC

SBA Form 1246 can be obtained from SBA's website at http://www.sba.gov or from any SBA Office. Review the application document carefully. Below are some of the documents which must accompany the application.

1. Membership – Membership no longer required.
2. Board of Directors - A listing of the Board of Directors which identifies each Director organized by their area of expertise as required in 13 CFR§120.824. All Board of Directors must submit a SBA Form 1081 Statement of Personal History (any Board member responding "yes" to questions numbers 10 a.,10 b., or 10 c. on the Statement of Personal History must also submit using either fingerprint cards or Electronic Fingerprint Submission.
3. Plan of Operation - a narrative describing the applicant's ability to package, process, and service the loans. In addition, the plan should identify the applicant's financial and legal capacity and identify how it plans to market the 504 program and the geographic area it plans to serve.
4. Organizational Chart - Listing of all officers and paid staff of the CDC (including all contracted staff and contractors performing loan packaging, processing, and servicing for the CDC) accompanied by SBA Form 1081 Statement of Personal History and fingerprint cards.
5. Certificate of Good Standing or its equivalent.
6. Articles of Incorporation - When working with counsel, we encourage the use of regulatory language be kept to a minimum. This will reduce the number of changes that will need to be made when regulations are revised.
7. By-Laws –certified copy of the By-laws signed by an officer of the Board of Directors. When working with counsel, we strongly encourage the incorporation of regulatory language to be included from Board of Directors sections.

8. Board Resolution authorizing the CDC's application.
9. Financial Statements and Projections demonstrating the CDCs financial ability to operate. Start-up CDCs must provide documentation of the sources of their start-up capital (i.e. Notes, grants, Contributions, etc.)

The completed application must be submitted to the local SBA District Office for review and eligibility. SBA prefers the application be submitted by e-mail. Upon completion, the District Office will forward its recommendation to the Associate Administrator for Financial Assistance at the SBA Headquarters for a final decision.

III. SUMMARY

As a regulated agent acting under the auspices of the U. S. Small Business Administration, it is important to understand that Certified Development Companies are autonomous and must not be controlled by any other entity or group as SBA can only regulate the CDC. 13 CFR §120.820, effective March 21, 2014, permits CDCs to be affiliated under specific circumstances detailed below:

(a) A CDC must be independent and must not be affiliated (as determined in accordance with 13 CFR §121.103) with any Person (as defined in 13 CFR §120.10) except as permitted below.

(b) A CDC may be affiliated with an entity (other than a 7(a) Lender or another CDC) whose function is economic development in the same Area of Operations and that is either a non-profit entity or a State or local government or political subdivision (e.g., council of governments).

(c) CDCs may apply to participate in the **SBA Community Advantage pilot loan program.**

(d) A CDC must not be affiliated (as determined in accordance with 13 CFR §121.103) with or invest, directly or indirectly, in a 7(a) Lender. A CDC that was affiliated with a 7(a) Lender as of November 6, 2003 may continue such affiliation.

(e) A CDC must not be affiliated (as determined in accordance with §121.103 of this chapter) with another CDC. In addition, a CDC must not directly or indirectly invest in or finance another CDC, except with the prior written approval of D/FA or designee and D/OCRM or designee if they determine in their discretion that such approval is in the best interests of the 504 Loan Program.

(f) A CDC may remain affiliated with a for-profit entity (other than a 7(a) Lender) if such affiliation existed prior to March 21, 2014. A CDC may also be affiliated with a for-profit entity (other than a 7(a) Lender) whose function is economic development in the same Area of Operations with the prior written approval of the D/FA or designee if he or she determines in his or her discretion that such approval is in the best interests of the 504 Loan Program.

(g) A CDC must not directly or indirectly invest in a Licensee (as defined in §107.50 of this chapter) licensed by SBA under the SBIC program authorized in Part A of Title III of the Small Business Investment Act, 15 U.S.C. 681 et seq. A CDC that has an SBA-approved investment in a Licensee as of November 6, 2003 may retain such investment.

SBA defines affiliation in 13 CFR§121.103 which states, in part:

(a) General Principles of Affiliation.

(1) Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists.

(2) SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships, in determining whether affiliation exists.

(3) Control may be affirmative or negative. Negative control includes, but is not limited to, instances where a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

(4) Affiliation may be found where an individual, concern, or entity exercises control indirectly through a third party.

(5) In determining whether affiliation exists, SBA will consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation.

This document is to serve only as a guide to the CDC certification process. Some of the source documents have been provided in the "Tools and Links" section below. If there is a conflict between this guide and SBA's regulations and policies, then SBA's regulations and policies shall prevail.

IV. TOOLS & LINKS

1. The web page for the 504 Application for certification:
   http://www.sba.gov/sbaforms/sba1246.pdf

2. The web for the Small Business Investment Act:
   http://www.sba.gov/regulations/sbaact/small-business-investment-act-text-only.htmlThe pertinent material starts at:
   TITLE V LOANS TO STATE AND LOCAL DEVELOPMENT COMPANIES.....Sec. 501. STATE DEVELOPMENT COMPANIES.

3. The Web page for the current Code of Federal Regulations:
http://www.access.gpo.gov/nara/cfr/waisidx_07/13cfr120_07.html
13 CFR Part 103 and Part 120, (Sections 120.800 – 120.991 refer exclusively to the Development Company Loan Program).

Appendix C7

THE CDC TAX CREDIT: AN EFFECTIVE TOOL FOR ATTRACTING PRIVATE RESOURCES TO COMMUNITY ECONOMIC DEVELOPMENT

Carol Steinbach

A Discussion Paper Prepared for
The Brookings Institution
Center on Urban and Metropolitan Policy

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The Brookings Institution Center on Urban and Metropolitan Policy would like to thank the Ford Foundation for its support of the Center's research and policy work on the future of community empowerment. The Center is examining ways in which public policies and private sector actions can better support community development efforts to build and preserve strong neighborhoods. This becomes increasingly important as a number of new challenges (e.g., growing concentrated poverty, welfare reform, continued exodus of jobs and families from central cities) are making it harder for community development corporations, faith-based organizations, and other community-based institutions to effectively serve their neighborhoods -- and the families who reside there. This discussion paper evaluates the effectiveness of a federal demonstration program to help promote community economic development, a tax credit that was enacted in 1993.

ABOUT THE AUTHOR

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THE CDC TAX CREDIT:
AN EFFECTIVE TOOL FOR ATTRACTING
PRIVATE RESOURCES TO COMMUNITY ECONOMIC DEVELOPMENT

I. EXECUTIVE SUMMARY

In 1993, Congress established a pilot program that provided a tax credit for community development corporations (CDCs) to help these nonprofit organizations promote economic development in low-income areas. Under the program, individuals and corporations may claim a credit on their federal income taxes for cash grants and loans made to 20 CDCs selected competitively by the U.S. Department of Housing and Urban Development (HUD). Congress directed that at least eight of the winning groups had to be rural organizations. Each CDC in the demonstration received $2 million in tax credits.

Each year for 10 years, funders who give grants, provide loans or make investments in these CDCs can claim a tax credit equal to 5 percent of the overall amount they provided. If the contribution is a grant, the contributor may claim *both* the CDC tax credit and the standard income tax deduction for charitable contributions. CDCs must use the money generated from tax credits to create employment and business opportunities for residents of their target areas.

In authorizing this one-time demonstration, Congress followed two well-established precedents. First, the lawmakers encouraged investment in an important national priority – community economic development – through the tax code. And second, Congress sought to gain experience with a pilot before extending the program to more CDCs.

The demonstration shows that the 1993 CDC tax credit can be a very good vehicle for promoting community development and that it should be reauthorized and expanded. The pilot was also useful in showing the modifications that could be made in the tax credit's present structure to make it more effective.

Tax credits work well in today's community development environment.

Until a few years ago, the promotion of community economic development in low-income areas had to be financed largely by public sector grants. Tax credits were not a preferred method of stimulating revitalization because most poor communities did not have a strong enough infrastructure of organizations, or sufficient development opportunities, to attract meaningful private sector investment or participation.

The emergence over the past two decades of thousands of nonprofit community development corporations and allied organizations in low-income areas has changed the equation dramatically and ushered in a new era in community development. With the help of a strong corps of national and in some cases local

intermediary organizations, CDCs have developed a solid capacity to undertake community development in partnership with the private sector, even while remaining community-based and controlled. Now, tax credits can be an effective tool for promoting economic activity that engages significant private financial support *and* that is sensitive to community needs.

Tax credits' most important advantage is that they engage the private sector directly in community building. The projects or activities undertaken in exchange for tax credits have private-sector discipline, and sponsoring organizations are held accountable for results. Well-structured tax credit transactions typically leverage private investment many times the amount of public funds foregone. Working with private sector partners on tax credit activities can be an excellent way for nonprofits to forge lasting relationships with banks, corporations and other investors whose participation is vital to effective community revitalization.

A prime example of the positive potential of tax credits is the Low Income Housing Tax Credit, enacted as part of the Tax Reform Act of 1986 and made permanent in 1993. The housing credit has increased the nation's supply of affordable housing by nearly one million units. Housing credit projects have anchored revitalization activities in many communities and primed the pump for further redevelopment. CDCs that sponsor housing credit projects have grown stronger organizationally. The mutual respect and personal relationships created between CDCs and their private sector partners in housing credit transactions have often carried over into other joint community development activities.

The Low Income Housing Tax Credit has become the nation's primary engine for affordable rental housing. Both Congressional leaders and the Administration support its expansion. The housing credit has generated 80,000 -100,000 units each year – plus an estimated 70,000 jobs, $1.8 billion in wages, and $700 million in tax revenues annually.

To be sure, tax credit programs have limitations. The approach is not appropriate for every group or all types of activities. In their initial years of operation, new tax credit programs are not always efficient, since the marketplace needs time to master their complexities. Nor does the use of tax policy to promote community development obviate the need for other grant programs that help community groups build capacity so that they can undertake this complex work.

But, just as the Low Income Housing Tax Credit has spurred substantial private investment in housing, a federal tax credit targeted toward CDC economic development activities can be an important tool for drawing private investment into low-income communities. The timing is right. The ground level network of strong organizations that can make effective use of a tax credit exists. The private sector has demonstrated a willingness to participate. And the neighborhoods themselves are ready, with many now able to sustain economic development over the long term.

Experience with the 1993 CDC tax credit offers valuable lessons.

The 20 CDCs selected to participate in the CDC tax credit demonstration had, as of mid-1998, used the credit to raise about $20 million in private-sector grants, loans and investments for their activities. The majority of those dollars came from banks, and grants accounted for a higher percentage than loans. The funds had been used for a variety of purposes, including economic development loan funds, small business promotion, CDC operations, commercial projects and other development-oriented activities.

CDCs' experience with the 1993 credit also offers valuable lessons about how the credit could be improved. While a handful of CDCs have had no difficulty finding donors and investors, many have had to invest substantial staff time and resources trying to place their tax credits or design market worthy transactions. Of course, this is to be anticipated with any new program. By mid-1998 – with one year remaining before the CDC pilot tax credit program expires – about half of the eligible CDCs had met their $2 million CDC tax credit limit. As the expiration deadline approaches, CDCs are intensifying their efforts.

Of the CDCs that have raised significant amounts using the CDC tax credit, three received major technical and financial help from the Local Initiatives Support Corporation (LISC), a national community development intermediary. LISC pioneered an innovative limited partnership that made it economically worthwhile for major banks to make contributions and loans in exchange for the credits. Importantly, LISC's complex limited partnership structure could not have been designed without the active participation of the banks, which were drawn to help because of the mutual trust and respect between them, the CDCs, and LISC.

As structured, the pilot CDC tax credit is primarily designed to attract grants to CDCs. The double benefit allowed for grants – the CDC tax credit plus the standard charitable deduction – is relatively generous. To make it financially feasible to serve low-income residents, CDCs almost always need some grant funds in their projects, combined with market rate loans, investments and other financing. Grants can

also be extremely valuable in helping CDCs build their operational capacity. Consequently, a tax credit designed to generate a larger flow of grants can benefit CDCs by enabling these groups to expand both their community economic development activities and their organizational capabilities.

However, the institutions that CDCs have historically tapped for grants are almost exclusively tax exempt – primarily foundations, government agencies, and religious institutions. For these traditional funders of community development, the CDC tax credit is not a drawing card.

Armed with the CDC tax credit, CDCs could expand their grant raising activities among individuals and institutions with tax liability. But that would require marketing of a kind that has not yet accompanied the pilot credit. Apart from the very limited efforts of some individual CDCs and LISC, marketing of the 1993 CDC tax credit has been virtually non-existent. Without clear direction from the Internal Revenue Service about the tax treatment of grants made in exchange for the CDC tax credit, some potential contributors have shied away, fearing later consequences if their assumptions turn out to be wrong.

The CDC tax credit hasn't been an easy vehicle for attracting bank loans or other investments, either. Without complex financial structuring of the kind provided by LISC, the rate of return on loans made to get the CDC tax credits is too low to entice a bank or other corporation to lend to CDCs, which are relatively risky, carrying higher than average transaction costs. Now that LISC has created a limited partnership structure, these problems should be easier to address. But more than one CDC leader described a process of finding a bank potentially interested in the credits – and then being shuttled back and forth between a bank's loan division and its charitable department. Said one CDC executive director: "Some bankers we approached said the tax credits didn't fit their investment profile and sent us to their charitable contributions division – which then told us it wasn't a contribution either. And we went around and around."

The 1993 CDC tax credit can be made more effective.

CDC practitioners offer the following suggestions for improving the effectiveness of the CDC tax credit in promoting economic development in low-income communities.

1. Undertake a centralized marketing campaign to attract more grant dollars .

Most CDC practitioners agree that a concerted marketing effort, with participation by the federal government, could draw in new grant dollars to CDCs from individuals and other tax-liable entities, particularly in a strong economy. To be successful, the effort would have to inform and excite a national audience about the positive track record of CDCs and ensure that the relevant federal regulators publicize clear formal guidance about the treatment of the CDC tax credits.

2. Adjust the tax credit to better reflect today's emerging market-based approach to community

revitalization and to better attract more loans and investments.

As structured, the pilot CDC tax credit still mirrors the old-style grant approach to community development rather than the decentralized investment orientation reflected in the Low Income Housing Tax Credit. HUD selects the winning groups, not the marketplace. The amount of tax credits that CDCs receive is fixed, not flexible. Continued high performance by the CDC is not required or even rewarded by the pilot CDC tax credit structure. In truth, not all of the 20 CDCs chosen by HUD for the pilot tax credit have exhibited the capabilities to handle complex financing. Nor is $2 million in tax credits necessarily the right amount for every organization. Such factors make the CDC tax credit less attractive to private sector lenders and investors than it could be with relatively slight modifications.

An alternative approach would be to modify the CDC tax credit so that it is better aligned with today's market-oriented style of community revitalization. Such a tax credit would have the following features:

- **Is Market-Based**. While the selection of the CDCs eligible for the 1993 tax credit was made through a competitive process, the competition was marked by a set of rigid rules. In short, the selection was based on a pre-determined number of winners and a pre-determined size of the tax credit. A market-oriented competition would reward CDCs that have demonstrated capacity and have specific projects or activities in mind. Winners of a more flexible selection process would not be limited to only 20 CDCs but may involve hundreds of CDCs with smaller tax credits, depending again on the identified project or activity. The amount of the tax credit should be determined by the specific financial needs of the project or the activity to be covered, not by a one-size-fits-all statute. Overall, this process would help ensure that the organizations that receive the tax credits have the capacity to effectively carry out the transactions and that their projects and activities satisfy a market threshold. A market-based competitive program for credits of varying amount is a natural outgrowth of the 1993 CDC tax credit demonstration.

- **Promotes Public-Private Partnerships.** One condition of winning tax credits could be that CDCs must secure a contingent financial commitment from one or more private sector partners either to invest jointly with the CDC in any development project for which tax credits are being sought or to participate as a partner or mentor to the CDC for non-project activities to be covered by the tax credits. Such non-project activities might include programs to promote small business growth, home ownership or welfare-to-work transitions, or to enhance CDC operational capacity. The private sector partner or mentor requirement acts as a screen to help ensure recipient groups are capable. Even more important, it fosters the long-term relationships between nonprofits and private companies that have become so vital to community revitalization.

About a dozen states have enacted state tax incentive programs to promote investments, grants and

donations of cash and goods and services to CDCs and related organizations. The state programs have encouraged strong partnerships between the corporate and nonprofit sectors. The best state programs are flexible, well targeted and easily monitored to avoid potential pitfalls in program administration.

Conclusion

The CDC tax credit has significant potential as a tool for community economic development. To realize every bit of this potential, Congress should modify the tax credit's structure, and reauthorize and expand the 1993 program. Just as the Low Income Housing Tax Credit has spurred billions of dollars of private investment in affordable housing, a federal tax credit targeted toward CDC economic development activities could become a tool for drawing private investment into low-income communities. The private sector has demonstrated a willingness to participate in such transactions. CDCs have developed a solid capacity to undertake community development in partnership with the private sector without losing community control or endangering their local base. Tax credits can promote economic activity that is attractive to private investors and responsive to community needs.

The following paper provides an expanded explanation of the 1993 tax credit for CDCs and Congress' original intent for the program. Based on interviews with the 20 CDCs qualified to use the tax credit, various community development intermediaries, and other practitioners in the CDC field, this paper reviews the experience of the tax credit program to date and makes recommendations on ways in which the program can be restructured and improved.

II. CDC TAX CREDIT BACKGROUND AND USE

How the CDC tax credit works

Congress established the CDC tax credit in the Omnibus Budget Reconciliation Act of 1993 as part of its Empowerment Zones/Enterprise Communities initiative. The idea originated with Dennis West, then-president of Eastside Community Investments, a large Indianapolis CDC. West prevailed on then-Representative Andy Jacobs of Indianapolis to introduce the credit to his fellow lawmakers. Under the pilot program, individuals and corporations may claim a credit on their federal income taxes for qualified cash contributions made to any of 20 CDCs selected competitively by HUD.

Congress authorized the tax credit as a one-time demonstration only – meaning that the lawmakers would have to pass additional legislation to extend the program beyond 1999 or to include groups other than the current 20 designees. The program is governed by Section 13311 of Title XIII, Chapter I, Subchapter C, Part II of the Omnibus Budget Reconciliation Act of 1993.

Each participating CDC may offer up to $2 million in credits to any combination of donors and investors. To qualify for the program, a CDC must be a 501(c)(3) tax-exempt charity, and its primary purposes must include promoting employment and business opportunities for individuals who reside in its target area. That target area must meet the geographic designations for an Empowerment Zone or Enterprise Community, have an unemployment rate at or above the national average and have a median family income at or below 80 percent of the locality's median family income. Congress directed HUD to give priority to CDCs with a demonstrated record of performance in administering community development programs that target at least 75 percent of the jobs emanating from their investment funds to low-income or unemployed people.

A funder may provide a loan or other long-term investment, a gift or a Section 170 charitable contribution, and must make the transfer of cash before June 30, 1999. The contribution must be available to the CDC for at least 10 years, and the CDC must designate the contribution as eligible for the credit. Funders can claim a tax credit of 5 percent of their total contribution each year for 10 years. The credit period begins with the taxable year during which the contribution is made. The credit is subject to the general business credit limitations of Section 38 of the IRS Code and, therefore, may not be used to reduce alternative minimum tax. If a CDC grants a credit for a project that is subsequently found not to be in compliance with the authorizing Act, corrective action will be solely against the CDC, not the investor.

CDCs interested in participating applied to HUD, which made its selections based on a point system. The CDCs agreed to submit annual progress reports to HUD for 10 years, detailing all of the programs and activities undertaken with designated contributions, the census tracts within which they took place, the dollar amounts of contributions spent, the number of jobs and/or businesses generated during that time period, and other public and private participating parties including their roles and contributions. This report must be filed

on or before December 31 of each year. There are no other reporting requirements. In the event of any non-compliance, HUD reserved the right to revoke a CDC's designation at any time.

HUD moved quickly in selecting the CDCs, motivated by a July 1, 1994 deadline. Selection criteria appeared in the request for proposals to participate in the pilot. HUD did not write regulations. Although the CDC tax credit and Empowerment Zones/Enterprise Communities were joined legislatively, neither Congress nor HUD ever linked the two initiatives in practice.

Intermediaries step in to help implement the CDC tax credit.

Three of the designated CDCs placed all of their tax credits quickly. Among the first was Southern Dallas Development Corporation, headed by a former Dallas assistant city manager. The CDC struck an agreement with Texas Instruments, which had committed to create new jobs for local residents to compensate for a plant closure. Texas Instruments' $2 million grant to Southern Dallas Development Corporation in exchange for tax credits fulfilled the company's job pledge. Two other CDCs – Bethel New Life in Chicago and Urban Edge in Boston – also had no difficulty securing commitments for their $2 million in tax credits. Both groups are experienced organizations, located in cities with aggressive financial institutions and a long tradition of community development activism.

For other CDCs, however, placing the tax credits became a tougher challenge. By 1995, 17 groups still had not raised any meaningful tax credit money, and Congress nearly rescinded the CDC tax credits that had not already been placed. By mid-1997, HUD program administrators concluded that some changes in the tax credit structure would likely be necessary before extending it more broadly. "A review of the most recent annual reports submitted by the CDCs authorized to offer tax credits in exchange for cash contributions reveals at the very least a wide disparity between organizations' marketing ability -- and probably more acutely an initiative that was born from the wrong premise," a May 12, 1997 HUD memo stated.

But there were some hopeful signs. The Local Initiatives Support Corporation (LISC), a national community development intermediary, began achieving results with a new limited partnership structure that it designed to place the tax credits. The novel structure overcame the weaknesses of the CDC tax credit as an investment vehicle for banks and major corporations.

Under LISC's structure, a limited partnership is formed. The National Equity Fund (NEF) – a LISC subsidiary – serves as the one percent managing general partner and the investor is the 99 percent limited partner. The partners make an initial investment. LISC supplies a bridge loan to the partnership for the balance of what will become over time the investor's full contribution. Structured payments from the investor then finance the repayment of LISC's loan. In creating the structure, LISC synthesized a credit that resembled the Low Income Housing Tax Credit. One goal was to make the CDC tax credit economically worthwhile for investors by expanding the basis on which the credit can be claimed. LISC's bridge financing

boosts the yield.

On January 16, 1997, LISC closed its first $2 million CDC tax credit transaction, with Coastal Enterprises, Inc. in rural Maine. KeyBank Corp., a bank with a long relationship with both the CDC and with LISC, worked aggressively to help make the transaction feasible. Transaction time and costs were high, but a structure was eventually crafted that could be replicated. In March 1998, Kentucky Highlands Investment Corporation placed all of its tax credits with Bankers Trust using the LISC structure. A third deal was set to close in mid-1998 for Marshall Heights Community Development Organization in Washington, DC. That CDC appeared likely to place most of its tax credits with NationsBank and Citibank using the LISC structure.

LISC also began working to create a master partnership arrangement with a large national bank to help other CDCs with smaller tax credit transactions. The idea was to create a $6 million - $10 million contributions pool from the bank that would assist about five CDCs that did not have the full $2 million left to place or that lacked sufficient financial strength to provide the collateral needed for a $2 million influx.

LISC deliberately targeted banks in arranging its transactions, mainly because of the Community Reinvestment Act, which requires banks to serve all communities where they have branches and which has drawn in hundreds of millions of dollars of investment to CDC activities. LISC also reasoned that banks would be more comfortable than other corporations with its limited partnership structure involving both a grant and a loan component.

Furthermore, by approaching banks LISC increased the possibility that it could generate some measure of standardization and economies of scale for its structure – thus reducing the very heavy transaction costs and time requirements of these deals. Banks were attracted to the non-recourse feature of the CDC tax credits. Unlike Low Income Housing Tax Credits, which can be taken away for nonperformance, the individual or institution that claims CDC tax credits in exchange for grants or loans can keep the credits even if the CDC fails to perform.

In addition to banks, Prudential Insurance, a company with an aggressive and experienced social investing arm, became interested in the CDC tax credit. Prudential purchased $2 million in tax credits from New Communities Corporation, located in its hometown of Newark, and from New Economics for Women, in Los Angeles. Both transactions were based on the LISC model.

Elsewhere, two CDCs leveraged state tax incentive programs to successfully sweeten the economic appeal of the federal CDC tax credit for investors. Virginia Mountain Housing, located near Roanoke, combined the federal CDC tax credit, which is only applicable to cash contributions, with a state tax credit that also allows write-offs for contributions of real estate, goods and services. First Union bank agreed to contribute. Because Virginia's tax credit program limits how much corporations can claim in any one year, First Union's contributions will be made over three years.

And Chautauqua Opportunities Inc., serving a rural county about 50 miles from Buffalo, New York, raised about $100,000 in tax credit contributions by combining the federal CDC tax credit with a state economic development zone program that offers incentives for contributions to groups serving designated lower income areas.

LISC Limited Partnership Draws in Banks

The chart below shows how the LISC structure works for a $2 million investment, created from an initial contribution of $100,000 and a $1.9 million bridge loan.

The CDC receives $2 million from the limited partnership at closing – some as a grant, the rest as a loan, with the precise blend tailored to the specific needs of the CDC and the economic return required by the investor. In this model, the CDC receives $1.2 million as a charitable donation and $800,000 as a 10-year loan, carrying an interest rate that is set to meet the economic needs of the investor and provide attractive capital for the CDC.

The investor receives a tax deduction in the full amount of the charitable donation made by the partnership to the CDC. The investor also receives a 5% tax credit annually for 10 years equal to the total amount invested in the partnership, as well as any interest on a loan from the partnership to the CDC and repayments of the loan principal after the 10th year.

Designing the structure – and implementing three transactions – was highly time intensive. Among the challenges was to figure out how loans to the CDCs from the limited partnership could be collateralized when no specific project secures the transaction. LISC solved this by having the CDCs buy a Certificate of Deposit – using revenues separate from the transaction – to pledge to the partnership as collateral. For CDCs without sufficient cash available to buy a large CD, LISC is also looking at doing smaller loans.

CDC Usage of the Tax Credit
(As of May 1998)

Bedford Stuyvesant Restoration Corp. 1368 Fulton Street Brooklyn, NY 11216	Contributions, mostly relatively small, have been dedicated to a revolving loan fund that totals over $100,000. This flagship CDC is seeking only grant funds.
Bethel New Life 367 North Karlov Chicago, IL 60624	The full amount has been raised, as follows: A zero interest loan for $1,425,000 A zero interest loan for $200,000 Donations of $100,000 and $275,000 All of this was committed in 1995.
Chautauqua Opportunities Inc. 188 South Erie Street P.O. Box B Mayville, NY 14757	Over $500,000 has been raised, with a major portion coming from Key Bank in Buffalo in a phased series of grants. $100,000 of that amount came from combining the federal tax credit with a state economic development zone program. The CDC is negotiating for about $400,000 in additional tax credit contributions, including a potential $200,000 micro loan package from Chase Manhattan Bank.
Coastal Enterprises, Inc. P.O. Box 268 Wiscasset, ME 04578	After a two year effort, this CDC raised the full $2 million from KeyBank Corp., using the structure designed by LISC, providing $1.2 million as a grant and $800,000 as a loan. Coastal Enterprises is using the money to establish a $1.8 million revolving loan fund for job creating small businesses. Some $200,000 has been set aside over a two-year period to pay for project management costs associated with the lending and job development activities.
Delta Foundation 819 Main Street Greenville, MS 38701	This old-line CDC has had a hard time raising tax credit contributions. Southern Development BancCorp had been interested in providing funding, but the deal fell through. Delta has also sought assistance from LISC.
El Pajaro 318 Main Street, Suite 208 Watsonville, CA 95076	This small CDC has raised about $200,000 in pieces from banks and other groups, including $25,000 from local agricultural growers. El Pajaro had been negotiating with Prudential, but that transaction apparently fell through. LISC was working to help the CDC raise additional tax credit funds.

Free the Children 1192 Peabody Memphis, TN 38104	Since raising $100,000 at the end of 1995, this group has not attracted many new contributors. A collaborative effort based in Pittsburgh fell through.
Grasp Enterprises, Inc. 55 Marietta Street, NW Suite 2000 Atlanta, GA 30303	The CDC has not raised significant tax credit contributions to date. Prudential is considering a transaction, and LISC is working with the CDC to raise additional funds.
Hough Area Partners in Progress 8610 Hough Avenue Cleveland, OH 44106	This small organization has raised no significant tax credit contributions. One issue has been CDC staff turnover. The group that applied for and won the HUD designation has departed. LISC is working with Hough Area Partners to approach Cleveland banks, which have tended to look favorably on these kinds of investments. CDC capacity may remain an issue.
Kentucky Highlands Investment Corp. P.O. Box 1738 London, KY 40743	In March 1998, Kentucky Highlands finally closed a transaction with Bankers Trust in New York City for the full $2 million, using the LISC partnership structure. Considering the strength of the Kentucky Highlands' balance sheet and its noteworthy track record, this CDC's difficulties in attracting regional banks was a strong indicator of the hardships rural groups have had in using the CDC tax credit.
Marshall Heights Community Development Organization, Inc. 3917 Minnesota Ave., N.E., 2nd Floor Washington, DC 20019	This well-respected CDC was poised to close the third partnership transaction structured by LISC. NationsBank is providing $1.2 million; Citibank is supplying a $750,000 loan. This tax credit transaction is fairly unusual in that it is structured around a specific project.
New Community Corp. 233 West Market Street Newark, NJ 07103	This large CDC placed all of its tax credits with Prudential, using the structure pioneered by LISC.
New Economics for Women 379 South Loma Drive, Suite One Los Angeles, CA 90017	This CDC placed all of its tax credits with Prudential using the structure pioneered by LISC. Prudential provided $1.2 million as a grant and $800,000 as a 10-year loan.

North Cambia Community Development Corp. P.O. Box 174 Barnesboro, PA 15714	This CDC has raised contributions from two banks in its area: $30,000 from US National Bank and $6,000 from Portage National Bank. It's also received $145,325 from PNC Bank of Pittsburgh, which also gave NORCAM a small building. A portion of the contributed capital went into renovations, thus the unusual sum of cash. NORCAM is currently working with LISC to raise additional tax credit funds.
Rural Development & Finance Corp. 711 Navarro Street Suite 350 San Antonio, TX 78205	This CDC has not raised any tax credit funds but is now working with a major bank. It has also sought help from LISC.
Southeast Development, Inc. 10 South Wolfe Street Baltimore, Maryland 21231	First Union provided a $250,000 grant in exchange for tax credits. Other banks – including Mercantile, Provident and First National -- are reportedly very interested.
Southern Dallas Development Corp. 201 Griffin Street West Dallas, Texas 75215	This group was among the first CDCs to raise the full $2 million in tax credit contributions. It did so from one corporation – Texas Instruments – which provided the money as a grant to the CDC to create jobs that the company had committed to generate.
Tacolcy Economic Development Corp. 645 N.W. 62nd Street, Suite 300 Miami, Florida 33150	This group raised $50,000 in tax credit contributions. It's pitching the remaining tax credits to banks for two real estate transactions – a Walgreen's store and a Winn-Dixie. The CDC has reportedly generated interest from Chase Manhattan Bank and NationsBank.
Urban Edge Housing Corp. 2010 Columbus Avenue Boston, Massachusetts 02119	This experienced CDC raised the full $2 million with $1,075,000 as grants and the balance of $975,000 as bank loans.
Virginia Mountain Housing, Inc. 930 Cambria Street, N.E. Christiansburg, VA 24073	This rural CDC raised the full amount by combining the federal tax credit with Virginia's state tax credit program in innovative bundling. First Union bank provided the contributions in three parts. A small community bank also supplied $25,000 using the federal credit.

III. LESSONS LEARNED FROM THE PILOT CDC TAX CREDIT

A lack of aggressive marketing of the tax credit has made it difficult for CDCs to attract a new wave of grant dollars.

Congress intended that the tax credit would generate new grants for community economic development. But from the outset, the designated CDCs found little appetite among traditional community development donors for such grants because the vast majority are already tax-exempt. In addition, the number of corporations with little or no useable tax liability is higher than most CDC leaders initially recognized – until they started asking companies for contributions in exchange for tax write-offs. "We could interest only a modest few whose companies had had a great year," said a rural director. "And they were only interested in providing us $25,000 or less."

While individual donors might indeed benefit from the CDC tax credit, most CDCs have never gone to individuals to raise significant amounts and have little experience marketing to this audience. Because the credit was new and because it was unclear how the IRS would treat it for tax purposes, some potential donors were advised by their attorneys to shy away. "The first question out of people's mouth is 'will this cause me to be audited,'" said one CDC director. "There are also alternative minimum tax concerns," he added.

There was no marketing of the CDC tax credit by the federal government and very little, initially, by the national community development intermediaries. As a result, individual CDCs had to try to sell the investment and donor community on the new instrument by themselves. "Once the tax credit passed, nobody became its champion," said the director of one community development intermediary. "No one publicized it." The National Congress for Community Economic Development (NCCED) came up with a plan for CDCs to pool their tax credits, with NCCED mounting a national marketing campaign to find athletes and sophisticated investors to purchase them. The initiative never got organized.

Some CDC leaders may have expected to place their credits relatively easily because of their experience with the Low Income Housing Tax Credit. After more than a decade, the housing tax break has spawned a robust industry ready to package, sell, invest in and market the housing tax credits. "I didn't have to market anything to generate interest in a million-dollar housing tax credit project," said one CDC director. "But I have to do three or four song and dances to get even a nibble of interest on the CDC tax credit." Courting potential donors and investors requires even more time, the director said. "First they come to visit and we show them our operations. Then we propose a package. Then there's a revision to that package. All of this takes months and very intense transaction time from our staff."

One reason marketing has been so challenging is because the tax credit is a demonstration, and it is unique. "We're the only group in our state that has this," said a CDC director. "So when I go to a bank or corporation, they don't know from federal community development tax credits. They think housing credits or

historic preservation tax credits. There's a high learning curve. And the responsibility is almost totally on the CDC."

Experience with the CDC tax credit pilot shows that the rural CDCs have had a particularly difficult time placing their tax credits and may need extra marketing assistance in the future. Congress' requirement that eight winners had to be rural is understandable given the need for economic development in these communities. But most rural CDCs, even the strongest ones, operate in an environment without a high concentration of banks or other financial institutions. Kentucky Highlands Investment Corporation is a prime example. This 30-year-old flagship CDC has an enviable track record and a multi-million dollar fund balance, but it could not find any local banks interested in its tax credits. Finally, Bankers Trust – headquartered 700 miles away in New York City – agreed to do a deal using LISC's limited partnership structure. Because Bankers' Trust is meeting the lending needs of the neighborhoods in its own assessment area, CRA regulations allow the bank to get CRA credit for the Kentucky Highlands investment.

The current structure of the CDC tax credit requires CDCs to package complex financial deals in order to make the tax credit economically attractive to major lenders or investors.

One community development finance professional likened each CDC tax credit transaction to "a finely crafted Faberge Egg." They are great to look at but require much time and expense to put together. That's because, by itself, return from the CDC tax credit has not been large enough to generate a wave of investments and loans to CDCs. "We haven't found any financial analysis that says the 5 percent tax credit, coupled with charitable deduction, will motivate many corporate investors. It simply isn't that big," noted a representative from a community development finance intermediary. "You can't sell this on the basis of a return," added the director of another intermediary.

A major problem is the way the accounting is done. The company making a charitable donation has to take a huge expense deduction in year one on its books, but it must take 10 years to claim the full value of the tax credit. "Having the credit spread over 10 years – even on $2 million – is not substantial enough to attract contributors unless they already are seriously considering such gifts," HUD's memo of May 12, 1997 concluded.

Take a simple case where an investor – say it is a bank – is considering making a loan for the full $2 million in tax credits to a qualifying CDC. That bank would receive $100,000 in tax credits annually for 10 years – or the equivalent of 5 percent annual interest. If the bank charges no interest to the CDC for that loan, the bank gets the equivalent of about an 8 percent return, figuring in the after-tax value of the credit. An 8 percent return isn't bad – but it's not high enough to motivate banks to lend to nonprofit community groups. The bank could get an acceptable return by charging the CDC interest on the loan of somewhere around 4 percent. But that's not such a good deal for the CDC.

Another issue became how to collateralize a loan made in exchange for the CDC tax credits. Congress did not require that the tax credits be applied to a designated project. While this gave CDCs more flexibility in the use of funds, some lenders felt uncomfortable considering loans without tangible collateral.

As bankers looked at the CDC tax credit, most immediately recognized that it was designed to generate donations, not investments. But donation decisions are typically made in a different department of a financial institution. Very few CDCs have the connections to most senior-level executives that would permit that kind of conversation. Even if they did, most banks do not make very large donations – and nowhere near the $2 million level. "Financial institutions as a rule don't have large grant budgets," said a community development finance expert. "If they make a $25,000 grant, that's a big deal."

LISC's structure overcame the CDC tax credit's major financial barriers by enabling banks to make a market-worthy investment in a limited partnership created and funded by LISC. In so doing, the intermediary synthesized a structure that looks a lot like the Low Income Housing Tax Credit – which gives the investor the ability to base tax write-offs on the entire cost of the project, not the size of the investment made. As explained in the sidebar above, LISC also solved the collateral problem by requiring its CDCs to buy a Certificate of Deposit – using resources acquired outside of the transaction -- and pledge it to the partnership as collateral.

The LISC model works and can be reused often, but it has been somewhat hard to market. "It takes a unique program and then makes it more complicated," said one CDC director. "Even though it's of more benefit to the bank – it's hard for the bank staff to digest it." LISC's efforts also couldn't address a related problem: potential bank investors keep merging or consolidating. LISC and the CDCs would start conversations with one group of bankers, trying to explain this difficult credit and how it could be contorted

to work on a financial basis, and then the decision-making power would shift somewhere else.

While having HUD select the winning CDCs may have been appropriate in a demonstration, an expanded CDC tax credit program should use a more flexible and competitive process.

In providing a level playing field in the competition to be chosen as a tax credit eligible CDC, HUD may have unwittingly given too much of an advantage to smaller and younger CDCs without a significant track record. As a result, some CDCs that won didn't have the background, experience or capability to use $2 million in tax credits. "Any time you award something on proposal writing skills and there's no chance of taking it away – that's a danger," said one CDC practitioner. "We looked more at what the CDCs proposed to do with the money than understanding the structure of how they would get the credit out," a former HUD official said. "Looking back, that was the wrong way to do it."

Providing $2 million per group would also not be the optimal approach for the future, most CDC finance experts agree. Some groups can easily handle that amount or more, while others would do better with a much smaller or more flexible designation.

IV. LESSONS FROM RELATED TAX CREDITS

Low Income Housing Tax Credit

The Low Income Housing Tax Credit has become the nation's primary generator of affordable rental housing. The housing credit has facilitated the construction of 80,000 -100,000 units each year. In addition, it has created about 70,000 jobs, $1.8 billion in wages and $700 million in tax revenues annually. Since 1986, the housing credit has leveraged over $12 billion in corporate investment – much of it from corporations that had not previously invested in affordable housing. Many of the state agencies that administer the Low Income Housing Tax Credit have become highly creative and active in the multifamily housing arena. An April 1997 report from the General Accounting Office found that while some areas needed improvement, especially in program oversight, the housing credit has been very effective in generating new affordable housing for low-income people.

It took a decade for the Low Income Housing Tax Credit to become an efficient instrument for promoting low-income housing. Eventually, its presence spawned the development of a healthy professional infrastructure of private and nonprofit developers, attorney, accountants, appraisers and marketers. Because it is small and a pilot, the CDC tax credit has not created a similar supporting cast. But it presumably could do so if expanded. It might even capitalize on the infrastructure already created to support the housing tax credit.

In 1998, Senators Alfonse D'Amato (R-NY) and Bob Graham (D-FL) introduced legislation that would increase the annual state authority to allocate housing tax credits from the current $1.25 per capita to an inflation-adjusted $1.75 per capita -- a 40 percent increase. The increase would spur the production of an additional 30,000 – 36,000 housing units annually. The bill would index the housing credit for inflation beginning in 1999. Similar legislation is also pending in the House of Representatives. Citing the Low Income Housing Tax Credit as a key to revitalizing America's distressed communities, Vice President Al Gore, on a January 1998 visit to a Chicago neighborhood that had been rebuilt by the housing tax credits, announced the Administration’s support for the 40 percent increase in its FY 1999 budget.

State Tax Credit Programs for Neighborhood Development

About a dozen states have enacted state tax incentive programs to promote investments, grants and donations of cash and goods and services to CDCs and related organizations. These so-called "neighborhood assistance programs" are informative in the context of the federal tax credit program.

Most state tax incentives programs for neighborhood development offer tax credits to businesses and individuals who make cash and non-cash contributions to CDCs. In some cases, buildings, land, computers, office equipment and management and financial services are considered tax-credit eligible donations, as are related contributions that support the CDC's ongoing work – for example, donations of new appliances for affordable housing units or emergency energy funds to help families pay high fuel bills. In such cases, an independent appraiser typically establishes the value of the non-cash contributions for tax purposes. Most state programs allow tax credits to go to businesses or individuals not only for supporting CDC projects and activities, but also in exchange for providing general operating support to CDCs.

Writing in the January/February 1997 issue of *Shelterforce* magazine, Carol Wayman, associate director of programs for NCCED, reported that neighborhood assistance programs were operating in 11 states – Connecticut, Delaware, Florida, Indiana, Kansas, Maryland, Missouri, Nebraska, Pennsylvania, Virginia, and West Virginia – with legislation pending in at least two others.

Some states prescribe a minimum contribution in return for the tax credits. Some have a maximum allowable donation, ranging from $25,000 to $500,000. Businesses may usually carry over unused tax credits for up to five years. The community development organization is typically required to submit a report, if not a formal audit, documenting how it used the tax credit eligible contributions. Each state has its own procedures for designating nonprofits that are eligible for tax credit contributions, and for proposal review, project certification, tax credit approval and follow up. The best programs tend to be simple and flexible.

Wayman reports that state tax credits for neighborhood assistance have "created solid and unprecedented partnerships between the corporate and nonprofit sectors." The best tax credit programs, she advises, are well targeted and easily monitored to avoid potential pitfalls in program administration that can lead to unused or abused programs. The range of services permitted should be relatively wide. To encourage the participation of small businesses, legislation should set low minimum contributions.

In the early 1990s, Congress and community advocates discussed legislation that would provide federal support for state neighborhood assistance programs. Among other features, the legislation would have provided federal matching funds for the administration of state-run programs and adjusted the federal tax code to exempt the state tax credits from federal taxation. While some CDC leaders still support the idea of federal backing for state programs, most would like to see the federal government adopt its own CDC tax

credit program for community economic development.

Philadelphia Plan enlists major businesses as CDC partners

Pennsylvania adopted the nation's first state tax credit program for neighborhood development in 1967. Philadelphia corporations have used that program to create an innovative model of how tax credits can be used to attract major private sector backing for community revitalization.

Under the Philadelphia Plan, begun in 1994, a private business that agrees to become a long term partner with an individual CDC can receive significant tax credits. The business is expected to be a full participant with its CDC partner in community development for at least 10 years – including helping the CDC develop a revitalization plan for its neighborhood. The business is expected to provide financial, accounting, legal, audit and other in-kind support to help the CDC with its management. The private sector partner donates up to $250,000 a year in cash and in-kind contributions to the CDC and, in return, receives a 70 percent state tax credit for eligible donations – or up to $175,000 in state tax write offs.

A dozen CDCs in Philadelphia now have corporate partners under the program. Philadelphia Plan Executive Director Philip Price believes the city could probably support double that number of partnerships but is limited by a $3.25 million state cap on the number of tax credits that can be issued annually. "There are plenty of able CDCs in Philadelphia," Price says, "and a growing number of corporations that are interested."

Among the businesses participating in the Philadelphia Plan are the city's major banks, a box manufacturer, a local utility, Lucent Technologies, Tasty Baking Company and two insurance giants -- Allstate and State Farm. Price and his staff are presently working with Rep. James C. Greenwood (R-PA) to encourage Congress to consider a pilot effort to support state tax credit programs like the one Philadelphia firms have used to help CDCs.

In addition to forging strong relationships between CDCs and their business partners, the Philadelphia Plan is considered a national model because it creatively addresses a thorny problem that many CDCs face: how to enlist longer term support for their core operations and management.

Community Revitalization Tax Credit

Legislation is also pending in Congress that would create a Community Revitalization Tax Credit for non-residential real estate projects. That tax credit would provide incentives for private firms that make equity investments in commercial development in lower-income areas. Unlike the Community Revitalization Tax Credit, the CDC tax credit can be used for a much wider range of economic development and operational

activities.

Community Development Financial Institutions Tax Credit.

As part of the Administration's welfare to work initiative, the FY 1998 budget proposed a $100 million credit, to exist between 1997-2006, for investors in a particular type of community development organization known as a Community Development Financial Institution (CDFIs). Although the proposal had similarities to the CDC tax credit, the number of CDFI organizations that could qualify for the tax credit was far smaller than the thousands of CDCs and closely related nonprofit organizations that would be eligible for the CDC tax credit. As initially proposed, an investor could invest up to $1 million in a CDFI and claim the CDFI tax credit, including up to 25 percent of the investment in the year it was made. The Administration did not propose the CDFI tax credit in the FY 1999 budget.

V. OPTIONS FOR GOING FORWARD

Reauthorize and expand the CDC tax credit.

Nearly all of the CDC representatives interviewed for this paper favored a renewal and expansion of the CDC tax credit, with a few important modifications to improve its use. Tax credits encourage a performance-based style of community revitalization that most CDCs welcome. CDCs want a tool that engages the private sector directly in community building – to provide resources, bottom-line discipline, leverage and flexibility. They have come to understand that without significant private sector participation, effective neighborhood revitalization cannot go forward.

A revitalization approach rooted in public-private partnerships might not have been so feasible a decade or so ago. But today, the presence of a strong and capable network of thousands of community development corporations in low and moderate income areas -- and allied intermediary organizations that support them – helps ensure the tax credits will be used well and attract maximum leverage. From a national policy standpoint, too, CDCs are worth investing in. They are community controlled and geographically based in distressed neighborhoods and rural counties. Perhaps their greatest value is that they are an effective point of operational intervention in communities that have typically lost many of their strong and responsible institutions.

Make the CDC tax credit more effective.

CDC practitioners offer the following suggestions for improving the effectiveness of the CDC tax credit in promoting economic development in low-income communities:

1. To attract more grant dollars using the CDC tax credit, undertake a centralized marketing campaign.

The majority of CDC practitioners interviewed for this paper believe that a marketing campaign that includes federal government involvement could draw in new grant dollars to CDCs from individuals and other tax-liable entities, especially now that the economy is booming. The campaign must raise awareness of CDCs' strong history of success, and it must include clear guidance from relevant federal regulators about the treatment of the CDC tax credits. One recommended approach is to have the marketing campaign sponsored by CDC intermediaries, with the IRS, HUD, and banking regulators providing formal guidance on the tax treatment.

One CDC director recommended the establishment of a national board, with significant private sector representation, to advise on the marketing of the CDC tax credit. "There needs to be serious private sector involvement in the operation of the marketing campaign so we get corporate buy in from the get go," he said.

2. To attract more loans and investments, adjust the CDC tax credit to better reflect today's emerging market-based approach to community revitalization.

The pilot CDC tax credit reflects an old-style grant approach to community development, not the decentralized investment orientation reflected in the Low Income Housing Tax Credit. Instead of the marketplace selecting the best groups, HUD does. Instead of a flexible amount of tax credits, determined by their need, CDCs receive a fixed sum. The pilot program did not require a CDC to show continued high performance, nor did it reward high performance. As a result, some of the 20 CDCs chosen by HUD for the pilot tax credit have not been able to handle complex financing. Moreover, not every organization needs or can place $2 million in tax credits. As structured, the CDC tax credit is less attractive to private sector lenders and investors than it could be with slight modifications.

LISC's limited partnership has effectively bridged the gulf between the CDC tax credit as presently structured and the market requirements of corporate lenders. But this has exacted a high cost in terms of transaction time, staff resources and complexity. As good as the LISC structure is, it would be advantageous also to modify the CDC tax credit so that it addresses some of the market needs of investors before the fact, not after, and is better aligned with today's market-oriented style of community revitalization. Such a tax credit would have the following features:

Is Market-Based. While the selection of the CDCs eligible for the 1993 tax credit was made through a competitive process, the competition was marked by a set of rigid rules. In short, the selection was based on a pre-determined number of winners and a pre-determined size of the tax credit. A market-oriented competition would reward CDCs that have demonstrated capacity and have specific projects or activities in mind. Winners of a more flexible selection process would not be limited to only 20 CDCs but may involve hundreds of CDCs with smaller tax credits, depending again on the identified project or activity. The amount of the tax credit should be determined by the specific financial needs of the project or the activity to be covered, not by a one-size-fits-all statute.

CDC leaders are nearly unanimous in recommending that the eligibility criteria be sharpened to ensure that qualifying CDCs have had considerable experience in economic development and project finance. Such experience will translate into stronger connections with lending institutions and less problems placing the tax credits. If Congress wants less experienced CDCs to be able to use tax credits, the lawmakers may want also to support technical assistance for groups that need help placing their tax credits or structuring complex transactions.

Overall, this modified selection process would help ensure that the organizations that receive the tax credits have the capacity to effectively carry out the transactions and that their projects and activities satisfy a market threshold. A market-based competitive program for credits of varying amount is a natural outgrowth of the 1993 CDC tax credit demonstration.

Finally, Congress could improve the attractiveness of the CDC tax credit to lenders and investors by boosting the rate of return – but this would come at an additional cost in foregone revenues. Investors could find it more economically effective to claim the full value of the CDC tax credit over five years instead of ten. Congress could, of course, also boost the rate of return by increasing the amount of credit that can be claimed.

Promotes Public-Private Partnerships. The tax credits could be awarded only to those CDCs that have secured a contingent financial commitment from one or more private sector partners. These partners could either invest jointly with the CDC in any development project for which tax credits are being sought or they could be a partner or mentor to the CDC for non-project activities to be covered by the tax credits, such as programs to promote small business growth, home ownership or welfare-to-work transitions, or to enhance CDC operational capacity. This requirement screens out the groups that are less able to take advantage of the program. More importantly, it fosters the long-term relationships between nonprofits and private companies that have become so vital to community revitalization. The state tax credit programs in general, and the Philadelphia Plan in particular, have been especially successful in encouraging strong partnerships.

Once designated for a tax credit award, the CDC should have a set period of time to formalize the partnership. If it cannot do so, the tax credits could go back into the pool where other groups could compete for them.

Is Flexible. The amount of tax credit should be determined by the specific financial needs of the project or the activity to be covered, not by arbitrary legislative language.

Fills Market Gaps. To the greatest extent possible, the CDC tax credit should not duplicate existing federal tax incentives but should instead be designed to fill market gaps. Because of the Low Income Housing Tax Credit, Congress should continue to exclude rental housing production from eligibility under the CDC tax credits. A CDFI tax credit, if enacted, would not take the place of the CDC tax credit. Although similar in structure, the CDC tax credit would be available to a far wider number and range of community-based development organizations. The vast majority of community development groups are not CDFIs.

Importantly, the CDC tax credit would not be an economic development analogue to the housing tax credit in the strictest sense. If the CDC tax credit is modified to better respond to private market signals, the two tax credit programs would necessarily share similarities. But community economic development is not as absolute or easily quantified as real estate development. Where the housing tax credit must satisfy very specific outcome requirements – in terms of number of units produced, the income level of people served and the like – the CDC tax credit would need to continue to be much more flexible and ecumenical in its performance criteria.

Conclusion

Congress should reauthorize the 1993 CDC tax credit program with modifications in the tax credit's present structure to make it more effective, because this tax credit can be an excellent way to promote community economic development. A federal tax credit targeted toward CDC economic development activities could become a tool for drawing private investment into low-income communities, along the lines of the way the Low Income Housing Tax Credit has generated billions of dollars of private investment in affordable housing. The private sector has already shown that it is willing to participate in such transactions, and CDCs are now able to enter into partnerships with the private sector and simultaneously maintain their vital community connections. Tax credits can promote economic activity that attracts substantial private investment and, thanks to CDCs, is sensitive to community needs.

APPENDIX 1:
OMNIBUS BUDGET RECONCILIATION ACT OF 1993: SEC. 13311

Subchapter C – Empowerment Zones, Enterprise Communities, Rural Development Investment Areas, Etc.

Part II – CREDIT FOR CONTRIBUTIONS TO CERTAIN COMMUNITY DEVELOPMENT CORPORATIONS

SEC. 13311. CREDIT FOR CONTRIBUTIONS TO CERTAIN COMMUNITY DEVELOPMENT CORPORATIONS

IN GENERAL.—For purposes of section 38 of the Internal Revenue Code of 1986, the current year business credit shall include the credit determined under this section.

DETERMINATION OF THE CREDIT.—The credit determined under this section for each taxable year in the credit period with respect to any qualified CDC contribution made by the taxpayer is an amount equal to 5 percent of such contribution.

CREDIT PERIOD.—For purposes of this section, the credit period with respect to any qualified CDC contribution is the period of 10 taxable years beginning with the taxable year during which such contribution was made.

QUALIFIED CDC CONTRIBUTION.—For purposes of this section—

IN GENERAL—The term "qualified CDC contribution" means any transfer of cash—

which is made to a selected community development corporation during the 5-year period beginning on the date such corporation was selected for purposes of this section,

the amount of which is available for use by such corporation for at least 10 years,

which is to be used by such corporation for qualified low-income assistance within its operational area, and

which is designated by such corporation for purposes of this section.

LIMITATIONS ON AMOUNT DESIGNATED.—The aggregate amount of contributions to a selected community development corporation which may be designated by such corporation shall not exceed $2,000,000

SELECTED COMMUNITY DEVELOPMENT CORPORATIONS.—

IN GENERAL—For purposes of this section, the term "selected community development corporation" means any corporation—

which is described in section 501(c)(3) of such Code and exempt from tax under section 501(a) of such Code,

the principal purposes of which include promoting employment of, and business opportunities for, low-income individuals who are residents of the operational area,

which is selected by the Secretary of Housing and Urban Development for purposes of this

section.

ONLY 20 CORPORATIONS MAY BE SELECTED.—The Secretary of Housing and Urban Development may select 20 corporations for purposes of this section, subject to the availability of eligible corporations. Such selections may be made only before July 1, 1994. At least 8 of the operational areas of the corporations selected must be rural areas (as defined by section 1393(a)(3) of such Code).

OPERATIONAL AREAS MUST HAVE CERTAIN CHARACTERISTICS.—A corporation may be selected for purposes of this section only if its operational area meets the following criteria:

The area meets the size requirements under section 1392(a)(3).

The unemployment rate (as determined by the appropriate available data) is not less than the national unemployment rate.

The median family income of residents of such area does not exceed 80 percent of the median gross income of residents of the jurisdiction of the local government which includes such area.

QUALIFIED LOW-INCOME ASSISTANCE.—For purposes of this section, the term "qualified low-income assistance means assistance—

which is designed to provide employment of, and business opportunities for, low-income individuals who are residents of the operational area of the community development corporation, and which is approved by the Secretary of Housing and Urban Development.

APPENDIX 2:
LETTER TO CDC AWARDEES

CEO of Urban Designee
Name of Urban Designee
Address
City, State & Zip Code

Dear

I am pleased to inform you that (name of urban designee) has been selected in accordance with Section 13311 of Title XIII, Chapter I, Subchapter C, Part II of the Omnibus Budget Reconciliation Act of 1993 (Public Law l03-66) as one of twenty designated Community Development Corporations (CDCs). As a designated CDC your organization may accept cash contributions from tax-paying entities that in turn may receive a five percent tax credit for their qualified contributions. The total amount of contributions received and designated by a CDC is $2,000,000 and must be received within the five years immediately following the date of this notification.

The aforementioned Law and the Notice published by the U.S. Department of Housing and Urban Development (HUD) in the Federal Register on March 22, 1994 set forth the requirements prescribing the use of qualified contributions and the operational area in which eligible activities and programs may be undertaken.

It is suggested that if you have any questions regarding the qualifications of cash contributions you confer with the Office of the Chief Counsel, Branch 5, of the U.S. Internal Revenue Service or legal counsel qualified to give tax advice.

The operational area you designated in your application will be the prescribed area in which (name of urban designee) ('s) programs and activities must be undertaken. If any of the census tracts or block numbering areas within that prescribed area do not meet the income limits of eighty percent (80%) of the median family income of the local jurisdiction in which your operational area is located those census tracts or blocks will be considered ineligible and no contributions can be used nor any programs and activities you proposed in your Application to HUD be undertaken in those tracts or numbering blocks. The median family income for census tracts, block numbering areas and local jurisdictions is based on the 1990 decennial census.

If any part of your prescribed operational area includes a census tract that is located in a central business district as described in the 1982 Census of Retail Trade, RC82-C-5, Major Retail Centers in Standard Metropolitan Statistical Areas, that census tract must have a level of poverty of not less that 35 percent of the population or it must be excluded from the operational area. State Data Centers should have information on current designation of most recent Central Business Districts.

In your Application you agreed to submit a progress report no later than December 31 of each calendar year for the ten (10) years following the date of your designation, and you agreed to any review that HUD may deem necessary. The first progress report will be due no later than December 31, 1994.

Those progress reports should include, in detail, all of the programs and activities undertaken with designated contributions, the census tracts within which they took place, the dollar amounts of contributions spent, the number of jobs and/or businesses generated during that time period, and other public and private participating parties including their roles and contributions.

In the event of any non-compliance with a HUD inquiry, HUD reserves the right to revoke a CDC's special designation at any time. Those annual reports should be addressed to the following Office:

The Office of Economic Development
U.S. Department of HUD
Room 7136
Washington, D.C. 20410

Again, congratulations on your designation. If you have any questions on this designation or the reporting process, don't hesitate to call Roy Priest, Director, Office of Economic Development at (202) 708-2290 or Donner Buchet, Director, Community and Economic Development Services division at (202)
708-2290.

APPENDIX 3:
LETTER INFORMING THE IRS OF DESIGNATED CDCS

Honorable Margaret Milner Richardson
Commissioner of Internal Revenue
1111 Constitution Avenue N.W.
Washington, D.C. 20224

Dear Ms. Richardson:

The Omnibus Budget Reconciliation Act of 1993 authorized the Secretary of the U.S. Department of Housing and Urban Development (HUD) to select 20 Community Development Corporations (CDCs) to entitle them to accept contributions from taxpayers who in turn may receive special tax credits for such contributions. The statute required HUD to select the CDCs receiving this special designation before July 1, 1994. Eight of the organizations selected were required to be in rural areas and twelve in Urban areas.

On March 22, 1994, HUD published a notice in the Federal Register advertising the opportunity for certain nonprofit organizations to request consideration for CDC designation by HUD. Applications were received from 165 organizations by the deadline date of May 16, 1994.

HUD's Office of Community Planning and Development (CPD) evaluated and scored all applications. A representative from the Department of Agriculture assisted with the assessment of the rural applications.

This letter is to inform you that on June 30, 1994 the following CDCs were designated by HUD in accordance with the statute:

Grasp Enterprises, Inc.
55 Marietta Street, NW
Suite 2000
Atlanta, GA 30303

Southeast Development, Inc.
10 South Wolfe Street
Baltimore, MD 21231

Urban Edge Housing Corporation
2010 Columbus Avenue
Boston, MA 02119

Bethel New Life, Inc.
367 North Karlov
Chicago, IL 60624

Hough Area Partners In Progress
8610 Hough Avenue
Cleveland, OH 44106

The Southern Dallas Development Corporation
201 Griffin Street West
Dallas, TX 75215

Marshall Heights Community Development Organization, Inc.
3917 Minnesota Ave., N.E., Second Floor
Washington, DC 20019

New Economics For Women
379 South Loma Drive, Suite One
Los Angeles, CA 90017

Free The Children, Inc.
1192 Peabody
Memphis, TN 38104

Tacolcy Economic Development Corp., Inc.
645 N.W. 62nd Street, Suite 300
Miami, FL 33150

Bedford Stuyvesant Restoration Corporation
1368 Fulton Street
Brooklyn, NY 11216

New Community Corporation
233 West Market Street
Newark, NJ 07103

El Pajaro Community Development Corporation
318 Main Street, Suite 208
Watsonville, CA 95076

Kentucky Highlands Community Development Corporation

P.O. Box 1738
London, KY 40743

Coastal Enterprises, Inc.
P.O. Box 268
Wiscasset, ME 04578

Delta Foundation
819 Main Street
Greenville, MS 38701

Chautauqua Opportunities Inc.
188 South Erie Street
P.O. Box B
Mayville, NY 14757

North Cambria Community Development Corporation
P.O. Box 174
Barnesboro, PA 15714

National Rural Development & Finance Corporation
711 Navarro Street
Suite 350
San Antonio, TX 78205

Virginia Mountain Housing, Inc.
930 Cambria Street, N.E.
Christiansburg, VA 24073

If you need more information, please call Roy Priest or Donner Buchet in HUD's Office of Economic Development at (202) 708-2290.

Appendix C8


Helping People. Changing Lives.
community Action
PARTNERSHIP
AMERICA'S POVERTY FIGHTING NETWORK
TOOLKIT
COMMUNITY DEVELOPMENT LOAN FUNDS
Community Economic Development Toolkit

Disclaimer

Support for the Community Economic Development project and this toolkit is provided by the Department of Health and Human Services Administration for Children and Families, Office of Community Services (OCS), grant award number: 90ET0426/01.

COMMUNITY DEVELOPMENT LOAN FUNDS

Use of this Guide

The Community Development Loan Fund Guide is intended for use by community development organizations for the following purposes:

1. Organizations wanting to learn about Community Development Loan Funds
2. Organizations creating alternative lending and investment programs
3. Organizations seeking services and capital from loan funds

NOTE: For purposes of this guide, focus will be on business lending (to start, expand or invest in business development) and to a lesser degree on personal loans (home, auto or educational loans). This guide is one of five guides covering an array of lending and investment activities including:

1. *Community Development Loan Funds (CDLFs): This broad category includes all loan funds that are not Credit Unions or Equity Investment funds. The information in this section includes the steps and considerations for starting a loan fund.*
2. *Microloan Funds: This is a sub-category type of loan that fund focuses on smaller loans, primarily for start up financing.*
3. *Credit Unions: This is a federal/state designation for a lending institution that meets certain capital requirements, operating guidelines and management systems.*
4. *Equity Investment Funds: Funds that provide equity investment (versus loans) into community development activities.*
5. *Community Development Financial Institutions (CDFIs): This is a Federal US Treasury designation based on organizational and lending standards that allows loan funds access to US Treasury grants through the CDFI Fund (includes most CDLFs, Microloan funds and Credit Unions).*

Organizations interested in expanding access to capital for underserved communities have focused on various forms of loan and investment funds. This guide will begin with Community Development Loan Funds, the broadest category that encompasses all types of loan and investment funds. Loan funds can specialize and focus lending for various products and markets (home or auto loans, business start ups or expansion) in specific neighborhoods or regions.

All forms of loan and investment funds are eligible to become certified Community Development Financial Institutions. This federal certification allows loan and investment access a wider menu of grants and programs designed to bring capital to low income and underserved communities.

Community Development Financial Institutions (CDFIs) is becoming the standard nomenclature categorizing all community development lending and investment entities (albeit not all such entities have obtained the official US Treasury designation, most have and will apply for the CDFI designation because it represents a recognizable industry standard). The Opportunity Finance Network is the association representing all types of lending institutions and has broadly

categorized all lending institutions as CDFIs and subcategorized lending and investment institutions as follows:[1]

> *"As with mainstream lenders, a variety of institutions has emerged to serve the broad range of needs in emerging domestic markets. Although they share a common vision of expanding economic opportunity and improving the quality of life for low-income people and communities, the four CDFI sectors—banks, credit unions, loan funds, and venture capital (VC) funds—are characterized by different business models and legal structures":*
>
> 1. *Community Development Banks: Community development banks provide capital to rebuild economically distressed communities through targeted lending and investing. They are for-profit corporations with community representation on their boards of directors. Depending on their individual charter, such banks are regulated by some combination of the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and state banking agencies. Their deposits are insured by FDIC.*
> 2. *Community Development Credit Unions: Community development credit unions (CDCUs) promote ownership of assets and savings and provide affordable credit and retail financial services to low-income people, often with special outreach to minority communities. They are nonprofit financial cooperatives owned by their members. Credit unions are regulated by the National Credit Union Administration (NCUA), an independent federal agency, by state agencies, or both. In most institutions, deposits are also insured by NCUA.*
> 3. *Community Development Loan Funds: Community development loan funds (CDLFs) provide financing and development services to businesses, organizations, and individuals in low-income communities. There are four main types of loan funds: microenterprise, small business, housing, and community service organizations. Each is defined by the client served, though many loan funds serve more than one type of client in a single institution. CDLFs tend to be nonprofit and governed by boards of directors with community representation.*
> 4. *Community Development Venture Capital Funds: Community development venture capital (CDVC) funds provide equity and debt-with-equity-features for small and medium-sized businesses in distressed communities. They can be either for-profit or nonprofit and include community representation.*

The companion "Community Development Financial Institutions (CDFI) Guide" also touches on many aspects of loan funds and should also be reviewed. The CDFI Guide however is usually the "next step" for established loan funds. We would also recommend reviewing the "Business Technical Assistance Guide" since the two community development activities work hand in hand.

Due to recent economic and financial turmoil, commercial lenders and investors have tightened lending requirements, resulting in a "credit crunch" where credit needs are greater than resources. This economic landscape has resulted in commercial financial institutions relying more on community loan funds as the mechanism to better serve niche market needs. Financial institutions now invest and lend more aggressively to financially sound and stable loan funds. Loan funds have built a strong reputation by understanding local credit nuances and needs resulting in sound lending and strong loan portfolios

[1] Opportunity Finance Network, website: www.opportunityfinance.net

Loan funds come in many sizes and focus on a myriad of community development credit needs. Community based loan funds are integrated with training and business technical assistance programs. Together these resources enhance and support the small business industry, a very important part of community development and stabilization. Business programs, services and loan funds are usually managed by the same organization that provides comprehensive business assistance. Loan funds, however can stand alone and become a centralized funding mechanism in partnership with other local and regional business support programs and organizations.

For successful loan funds, the CDFI designation is very important and allows lending programs to grow dramatically. Most foundation and corporate grants and investments from financial institutions look for the CDFI designation before grant or investment discussions begin. Over the last three years, financial institutions have been very actively seeking sound CDFIs to invest in. CDFIs have been a very successful mechanism for financial institutions to meet lending and investment measures required by the Community Reinvestment Act (CRA) and enforced by banking regulators. A high CRA rating is needed if the financial institution has plans to expand in the future.

The CDFI designation is determined through a certification process conferred by the CDFI Fund of the Department of Treasury. The designation is for financial institutions (and lending programs including community loan funds) and allows access to Treasury programs and investments. *NOTE: Because the CDFI designation is so important, it will be referred to throughout this guide and will be summarized at the end. The "Community Development Financial Institutions Guide" should be referred to for details on the CDFI Fund and its programs.*

Loan and investment funds play an integral role in a community economic development strategy. Loan funds bring capital to underserved markets that include business finance (start up, micro, non-profit, small and business expansion), real estate development finance (affordable housing, commercial and office, community facilities and industrial) and personal finance (auto, home or personal). Capital enhances economic stability while creating jobs and opportunities for community residents. Creation of personal and community assets is a keystone in building and strengthening communities. Loan funds also bring communities a higher level of technical expertise in business and finance, increasing the potential for sustained community stability and growth.

Financial institutions have become more effective in meeting customer demands in low income and disadvantaged communities through channels created by loan funds. Financially successful funds generate income to cover organizational operating and overhead expenses and can bring additional income to support other community credit needs, such as business technical assistance programs and expansion of lending services (such as auto loans, microloans, home or business loans). A stronger and financially viable lending business enhances the overall success and longevity of your community development organization while supporting community credit needs.

Loan funds play a very important role in community development (revitalization and stabilization). The effects are substantial and include:

For the Organization:

1. Generates additional income for the program
2. Supports and allows for the creation of complementary programs, services and projects
3. Expands staff capacity and capabilities by attracting and retaining experienced professionals in business finance and development

For the community:

1. Increases access to capital
2. Increased access-related resources such as training and technical assistance in the areas of finance and business development
3. Creates personal and community assets
4. Enhances the local economy by supporting important segments of the economic infrastructure including business, residential and industrial sectors

Successful lending efforts (and ancillary financial programs) results in economically stronger communities, stronger workforces, more informed and capable businesses and tenants, and ultimately a stronger and more inclusive economy.

COMMUNITY DEVELOPMENT LOAN FUNDS

The general category of community development loan funds (CDLFs) includes many types of funds created to meet specific market needs and concerns. There is an extensive network of lending entities throughout the country developed by and through various funding sources. These include:

1. Economic Development Loan Funds: Many times managed by local governments, these loan funds are capitalized by various federal funding sources that include Community Development Block Grants (CDBG), repayment from Urban Development Action Grants (UDAG) and the Economic Development Administration (EDA) Grants. The early forms of CDBG, EDA and tax increment funded entities were usually programs within the redevelopment or community development agency, but could be a separate lending enterprise. Other government supported efforts include those by the Small Business Administration (SBA) in the form of Small Business Investment Companies (SBIC)[2] and Minority Enterprise Small Business Investment Companies (MESBICS)[3]. Most of these entities are created and managed by local government (or strongly related entities) and have been used to support major inner city revitalization and improvement efforts.
2. The second major category is the private, non-profit loan funds operated by community development organizations used to finance affordable housing, non-profit facilities, local business and industry and other projects targeted to low income distressed communities. Capital for these funds comes from both the public and private sector. This category of loan funds is the focus of this guide.

According to the Opportunity Finance Network, "Community development loan funds (CDLFs) provide financing and development services to businesses, organizations, and individuals in low-income communities. [Loan and investment funds] are defined by the client served, though many loan funds serve more than one type of client in a single institution. CDLFs tend to be nonprofit and governed by boards of directors with community representation."[4]

CDLFs are not regulated entities and deposits or investments into funds are not guaranteed; however most adhere to a standard created by two major entities. The first is a federal program through the Community Development Financial Institution (CDFI) Fund. The Fund has established guidelines to become a CDFI (and be eligible for program grants). The second has been established by the Opportunity Finance Network (OFN). OFN is a non-profit association whose membership requires that prospective members meet performance standards that are appropriate for their particular operating context.

OFN standards are based on:

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[2] SBIC is a private investment company co-funded by the Small Business Administration. SBICs provide businesses with debt or equity financing options. All of the SBICs are privately owned, but they are licensed and regulated by the Small Business Administration. Using their own capital and loan guarantees from the government these financial institutions make equity and debt investments into businesses. A business with a net worth of less than $18 million and an after tax income of $6 million will qualify as a small business to receive funding.

[3] MESBICs are private institutions that invest (debt and equity) exclusively in companies owned or controlled by members of minority groups. They are regulated by the Small Business Administration and are eligible to sell notes or stock to the SBA to leverage their private capital.

[4] Opportunity Finance Network, Website: www.opportunityfinance.net

1. Mission and Impact: Primary mission to "strive and to have a positive impact on low income. Low-wealth and other disadvantaged people and communities"[5]
2. Finance Led Strategy: Lending activity history of over two years, be a non-governmental entity and provide affordable, responsible financial products and provide financial services.
3. Commitment to Performance: Meet certain loan and risk management policies and procedures, have audited statements and meet certain capital and portfolio ratios and requirements.
4. Support OFN's Mission

OFN also provides extensive technical assistance and access to information and data to assist in the start-up, operation and management loan funds.

Lending and Investment Program Feasibility Concepts: Operating a loan fund is a business. Loan funds can generate income for organizations if they are operated properly and have the right level of activity. Key management terms and concepts include:

1. Cost of Funds: Your loan pool may include various sources of grants and investment funds. Some will come in at different interest rates. The blended rate is the average rate for your loan pool. If you received all grants the rate would be "0" but if you received an investment or loan, the rate might be 2-5%.
2. Interest Rate Spread: The spread is the differential between cost of funds and what the rate of return is for your funds (average interest rate you are charging).
3. Breakeven: This is the minimum rate (above the cost of funds) you need to charge to cover your expenses.
4. Fund Expenses and Overhead: Expenses include business operations (loan and portfolio management), business management and marketing, office and staff costs. These are expenses that should be paid from the income derived from the "interest rate spread". If your income does not cover expenses, you will need to secure ongoing funding for operations.
5. Loan Loss: This is the expected rate of losses in bad loans. All funds have provisions for loan losses and the more aggressive the fund is (willing to take more lending risks), the greater the losses could be. Successful funds estimate loan losses well below 5% (which at one time was a standard commercial lending loss expectation).
6. Loan Loss Reserve: Loan loss reserves are funds set aside that may be needed to repay any loans or investments made to your fund. If your fund consists of a mix of loans investments and grants, and a portion (or majority) of the bad loan needed to be repaid to a lender or investor, you would draw the funds from a loan loss reserve. If one loan went bad and your fund lost $25,000., you would need to tap into the reserve to repay the lender or investor. The riskier your lending is or if you have had historically high loan losses, you would need a higher loan loss reserve. High loan loss reserves do not benefit your fund since they are dollars that are set aside and are not "working" as outstanding loans or generating interest income.

   In financial institutions and in larger funds, loans in portfolio are rated. Those with greater risk or in various stages of distress (late payments) will have a higher percentage set aside for potential loan losses.
7. Feasibility: Income needs to exceed expenses. The larger the lending pool (and level of funding you have out to borrowers) the greater your potential returns are. Similarly,

[5] Ibid

smaller sized funds have a more difficult time generating income to cover expenses. Smaller loans have greater relative operating costs because handling and processing costs for each transaction is about the same whether the loan is for $500 or $5,000,000.

Start-up or Expansion / Becoming a Community Development Loan Fund (CDLF)

The following section will discuss various strategies and steps that should be considered if you are a start up loan fund or if you are expanding to gain CDFI designation. We will look at the following:

1. Start-up loan fund:
    A. As a new fund
    B. Through a partnership
2. Existing, slightly experienced loan fund
3. Existing, experienced loan fund

Start-up CDLF: Starting a loan fund is very difficult due to costs. Funding is needed for business operations and for the loan fund. A lending track record is needed to attract financing or to become eligible for a technical assistance grant through the CDFI Fund.

The following is a suggested guide for organizations that have clearly identified needs and strong support to create a fund. Support from your organization and board is critical. The fund should be targeted to a specific market segment: micro businesses, small businesses, affordable housing or consumer financing. There are two potential ways of becoming a CDLF, one starting from scratch and one through partnerships.

Strategy 1: New Fund (If your plans call for the creation of a new fund or start up). A significant amount of funding and predevelopment work is needed for developing the business plan, marketing and management plans. Consider applying for a CDFI Technical Assistance Grant. You will also need funding for operations and for the loan fund. If this is the case, consider the following steps:

1. Fund Initiation: Secure seed funds to allow for staff or consultant assistance for the following: (funding could be lower if your staff has the time to conduct the preliminary research)
    A. Concept Paper: Creation of a one to two page summary that includes a summary description of your organization, needs, size, management, and potential resources available for the business and fund.
    B. Community Support: Obtain support from entities that represent your target market
    C. Public and Private Sector Support: Identify support from entities that represents your target market
    D. Identify potential sources for predevelopment funds
    E. Seek grants (or plan to self-finance)
2. GO/NO GO: The information researched above will allow you to develop the concept paper. This will allow your organization to decide if the creation of a loan fund makes sense and is feasible. Securing predevelopment funds will be essential especially if you are trying to create a large fund. The concept paper will be the basis of the business and marketing plan.

    Determination of the scope, size, and direction of your loan fund should provide a good indication of feasibility. Sources of initial capital are secured through foundation and

corporate grants and, in some instances, from local government programs, especially if there is a targeted market with tremendous needs.

Financial institutions often provide corporate grants to penetrate markets by effectively partnering with community organizations that represent and serve these communities. You must make the case, present need, and indicate how your organization's role will enhance the effort. (See Development Tips at the end of the Guide)

Your organization must assess how the proposed program costs will benefit the overall economic development strategy of the community and organization while assessing impacts to individual CED projects and programs. The creation of a loan fund offers substantial benefits to the community and its economic well being.

3. Pre-development Activities:
    A. Business Plan/Market Analysis: Conduct a market analysis and develop a business plan for the fund.
    B. Management Plan:
        1.) Fund Management: Included are the documents that define lending parameters, lending guidelines, requirements the application process.
        2.) Loan Management: Included are the loan management functions (loan approval process, closing, documentation, and loan management (billing/collections) process).
        3.) Portfolio Management: Guidelines and standards on risk management (loan loss tolerance, reserves and risk rating of loans).
4. Board: Creation of the Board of Directors is a very important step that builds the foundation for a successful loan fund.
    A. Proper balance between mission (helping improve distressed communities) and risk (lending guidelines and requirements) is maintained by board representation.
    B. Fundraising: Fundraising is a critical need for loan funds and having representatives from entities that either funds/invests in loan funds or are in peer industries that can support loan fund activities is critical.
    C. Management: Expertise in lending, business or law provides the necessary input and oversight of lending activities and overall success.
5. Loan Committee: The loan committee should in many ways mirror the balance of the board of directors but have focus on management issues. The committee must have members versed in understanding of the lending guidelines and policies of the fund. Experienced lenders can typically be recruited from financial institutions that invest or lend into the fund.
6. Start Up Lending Activities
7. Application for a CDFI certification. Once you receive certification you are eligible to apply for a Technical Assistance Grant (to conduct or upgrade your business plan) or for a Financial Assistance Award (grant for your loan pool). *NOTE: You can apply for a Technical Assistance Grant to start a CDFI and loan pool from scratch, but these are in very high demand and are very difficult to obtain. The more experience you have, the greater the possibility of receiving a grant.*

Strategy 2: Partnership: If there are other loan funds or CDFIs operating in your area (or nearby), you may want to consider partnerships that will leverage their expertise with your understanding of local needs. This strategy allows you to build capacity and expertise and maintain a goal of creating your own loan fund (and potentially obtain CDFI certification at a later date). Some of the strategies include:

1. Expansion of Service Area: If it is possible, an existing loan fund or CDFI could expand its coverage area to include your geography. You could become a marketing arm for their products and services and possibly provide space, coordinate meetings or provide language services.
2. Creation of a Dedicated Fund: If there is significant interest and resources for creating a fund, you may want to consider creating one and having the CDFI or neighboring loan fund manage it. There are significant ongoing expenses for operations and all "back-room" operations (loan servicing and management). Your organization could participate in developing the lending guidelines and standards, or possibly be on the loan committee for the fund. This intermediary step allows you to gain experience that you will need if you create your own fund.

The partnership structure is important if you are considering operating a small loan fund or provide smaller loans. Remember, the management and handling costs for a small loan are the same as for larger loans. In addition, the larger the loan pool (and the greater the amount of funded loans) generates more interest income used for operations and management. For these smaller pools, it may financially wise to have another institution service and manage your loan fund. Another strategy to lowering operating costs is to partner with other organizations that could handle marketing, training and technical assistance.

Existing slightly experienced loan fund: If your organization has some experience in lending or wants to build a lending track record, you can immediately apply to become a Certified Development Entity (CDE) through the US Treasury's CDFI Fund. Although the definition focuses on New Markets Tax Credits, a CDE's activities meet CDFI standards and provide an established certified lending track record for organizations. As a CDE you will be able to apply for CDFI certification and a Technical Assistance Award. The process to become a CDE is straightforward and relatively simple.

As defined on the CDFI website, "a CDE is a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments, or financial counseling in Low-Income Communities (LICs). Benefits of being certified as a CDE include being able to apply to the CDFI Fund to receive a New Markets Tax Credit (NMTC) allocation to offer its investors in exchange for equity investments in the CDE and/or its subsidiaries; or to receive loans or investments from other CDEs that have received NMTC allocations."[6]

Existing or experienced loan fund: If you are currently operating a loan fund, you should consider applying to the CDFI Fund for certification. The certification process is straightforward (check at www.CDFIfund.gov). Once you receive certification, you are eligible to apply for a Technical Assistance Award (to allow you to create the business, marketing and management plans) for your CDFI. You can also apply for a Financial Assistance Award that provides capital for your new or expanded loan fund.

Development Tip: Manage Expenses: Managing your income and expenses is essential for your long term survival.

1. Partnerships with other related lending entities allow you to expand your market and cut down on your own expenses in the areas of marketing, loan processing and loan management.

[6] CDFI Fund Website, Op Cit

2. Loan losses decrease the size of your loan pool and lower your potential income
3. Reserves impact your business success. These are funds set aside that do not generate income.
4. Your lending guidelines and approvals also impact your success. The greater risks your fund incurs; the greater the potential losses.
5. The expenses for marketing, processing and managing a small loan are the same as expenses for a larger loan.
6. Partnering and sharing of loan management and portfolio management functions are an excellent means of managing and reducing expenses.
7. If you already have loan processing and management experience, you may want to market this capacity and generate additional income by managing funds for partner organizations.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFIs)

Microlending programs, most CDLFs and credit unions are eligible entities under the CDFI program. *NOTE: (Please refer to the Community Development Financial Institution (CDFIs) Guide for specific details).*

The key programs include CDFI Certification, Technical Assistance (TA) Awards and the Financial Assistance (FA) Awards. These programs are designed to enable CDFIs to leverage private capital to meet the demand for affordable financial products and services in economically distressed communities.

The mission of the Community Development Financial Institutions Fund is to "expand the capacity of financial institutions to provide credit, capital and financial services to underserved populations and communities in the United States"[7] The CDFI Fund has several programs that enhances access to capital. Upon receiving certification, CDFI's are eligible to compete for technical assistance grants, capital grants, New Markets Tax Credits as well as other targeted incentive programs.

The CDFI designation allows lending programs access to compete for CDFI resources, but these resources are in very high demand. Since the start of the program in 1994, the competitive bar has risen dramatically and organizations receiving grants have significant experience in operating a successful loan fund or conducting lending activities. Therefore, we highly recommend that organizations closely study the application guidelines found at www.cdfifund.gov.

CDFI PROGRAM BENEFITS

The CDFI certification is a requirement that will allow you to access CDFI program funds. These programs include: *Note: Source material for this section is from the CDFI website at: www.cdfifund.gov . The website includes annual changes in the program or special programs, for example the 2011 application process included the Healthy Food Financing Initiative that made 12 awards for $25 million. The goal of this program is to use CDFI capacity to make investments in a range of health food projects serving food deserts including grocery stores, mobile food retailers. Farmers markets, cooperatives, corner stores, bodegas or other food related items (including health foods).*

CDFI Financial Assistance and Technical Assistance: To be eligible for an FA award, a CDFI must be certified by the CDFI Fund before it applies for the award. Prospective applicants that are not yet certified must submit a separate certification application to be considered for FA during a funding round.

Both certified and non-certified CDFIs are eligible to apply for TA awards. However, non-certified organizations must be able to become certified within two years after receiving a TA award. The TA awards will cover expenses needed to build the capacity of organizations to become eligible for CDFI designation.

2011 CDFI Award Categories:

[7] Community Development Financial Institutions Fund "CDFI Certification Application", Department of Treasury, June 2007, pg 4

1. Financial Assistance: Certified CDFIs may receive awards in the form of grants, loans, equity investments, deposits and insured credit union shares
2. Technical Assistance: Non-certified CDFI's may apply for TA (not both) to build organizational capacity. If you have not been certified, TA could help you get certified. These funds do not require matching funds.
3. Healthy Foods Financing Initiative: Awards to CDFIs to address the need for healthy foods in their markets (USDA and HHS support)

CDFI Application for Technical Assistance Awards: This award supports your organization towards building systems and capacity to apply for the Financial Assistance Awards.

CDFI Application for Financial Assistance Awards: This award is a grant that can be used to improve organizational systems and as seed capital (or expansion capital) for your loan fund. This is a grant and can be used for your loan fund at 0% interest.

Summary Steps to Becoming a CDFI: To gain CDFI designation the steps are relatively simple. The work is in the planning and application process.

Process:

1. Technical Assistance to developing the organization and program structure
2. Obtain Community Development Entity (CDE) designation
3. Financing participation /partnership (strategy to gain experience)
4. Application for Technical Assistance Awards
5. Developing the CDFI organizational and program structure
6. Apply for CDFI status
7. Request for CDFI funding
8. Other investments and matches
9. Make loans
10. Manage loans

OTHER NOTES:

Service Gaps: One criticism of CDFI lending programs has been the "uneven landscape" that results in gaps in service. Most effective CDFIs operate in small geographies (communities, cities and counties) while larger entities might serve states or multi-state areas. Some of the larger lending institutions may be national but they may not serve all communities with the same lending products.

Areas served by CDFIs with lending products may not meet local needs. Many CDFIs serve only one segment of lending activity such as businesses, real estate or personal, which may not match with needed credit service in a given area.

This issue presents an opportunity for a CDFI to expand or for a new CDFI to emerge, especially if there is need and interest amongst the residents and constituency affected by the lack of capital.

SOURCES OF FUNDS:

1. Federal, State and Local
    a. Small Business Administration
        i. Microloan Program: Funds to nonprofit community-based MDOs with loans capped at $35,000 recently increased to $50,000 pursuant to the Jobs Act. The average loan is $13,000. For FY 2010, $25 million was allocated to the program.
        ii. Program for Investment in Micro-entrepreneurs (PRIME): In 2010 there were 92 grants made from a $8 million dollar pool. Grants up to $250,000 can be awarded to MDOs to fund direct assistance to customers of funds or to build the MDOs own resources or capabilities.
        iii. Community Advantage Program: The Community Advantage Program is a three-year pilot program that will allow MDOs and other lenders that target underserved populations to access the SBA 7(a) program (with loans up to $250,000).
        iv. The 7(a) Loan Program includes financial help for businesses. These special requirements are: loan proceeds may be used to establish a new business or to assist in the acquisition, operation, or expansion of an existing business.

            For example, funds are available for loans to businesses that handle exports to foreign countries, businesses that operate in rural areas, and for other very specific purposes:
            1. Special Purpose Loans: Businesses impacted by North American Free Trade Agreement, support for Employee Stock Ownership Plans and pollution control.
            2. Export Loan Programs
            3. Rural Business Loans
            4. Advantage Loan Initiative: Focus on underserved communities.
            5. Community Advantage Approved Lenders: Pre-approved organizations.
            6. Express & Pilot Programs: Streamlined expedited loan procedures for specific target borrowers.
        v. The 504 Loan Program provides approved small businesses with long-term, fixed-rate financing used to acquire fixed assets for expansion or modernization. 504 loans are made available through Certified Development Companies (CDCs) which are SBA's community based partners for providing 504 Loans. 504 Loans are typically structured with SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs, and the borrower contributing10% of the project costs. In special circumstances, a borrower may be required to contribute up to 20% of the total project costs
    b. Department of Treasury: CDFI Fund
        i. CDFI Certification: Certification Program for loan funds to become eligible to apply for CDFI programs
        ii. Technical Assistance: Grants allow certified CDFIs and established entities seeking to become certified to build their capacity to provide affordable financial products and services to low-income communities and families. Grants may be used for a wide range of purposes including equipment, materials, or supplies; for consulting or contracting services; to pay the salaries and benefits

of certain personnel; and/or to train staff or board members. The CDFI Fund makes awards of up to $100,000

iii. Financial Assistance: Awards of up to $2 million are made to certified CDFIs under the FA component of the CDFI Program. A CDFI may use the award for financing capital, loan loss reserves, capital reserves, or operations. FA awards are made in the form of equity investments, loans, deposits, or grants, and the CDFI is required to match its FA award dollar-for-dollar with non-federal funds of the same type as the award itself.

iv. Other Programs: Other CDFI Fund programs include:

1. Bank Enterprise Award (BEA): This program provides financial incentives to institutions to expand investments in CDFIs and to increase lending, investment, and service activities within economically distressed communities over a specific time period.
2. Capital Magnet Fund (CMF): provide competitively awarded grants to CDFIs and qualified nonprofit housing organizations. CMF awards can be used to finance affordable housing activities as well as related economic development activities and community service facilities. Awardees will be able to utilize financing tools such as loan loss reserves, loan funds, risk-sharing loans, and loan guarantees to produce eligible activities whose aggregate costs are at least ten times the size of the award amount.
3. Financial Education and Counseling (FEC): Through the FEC Pilot Program, the CDFI Fund provides grants to eligible organizations to enable them to provide a range of financial education and counseling services to prospective homebuyers
4. New Markets Tax Credits: The NMTC Program attracts investment capital to low-income communities by permitting individual and corporate investors to receive a tax credit against their Federal income tax return. This is in exchange for making equity investments in businesses and commercial projects that creates jobs in low income communities. *NOTE: The NMTC program has become a very important tool for Community Economic Development. Please review the separate Guide on New Markets Tax Credits for more details.*
5. Native American CDFI Assistance Program (NACA): Focused program supporting activities for Native American communities
6. Certification for Community Development Entities (CDE): Benefits of being certified as a CDE include being able to apply to the CDFI Fund to receive a New Markets Tax Credit (NMTC) allocation.

c. United States Department of Agriculture:

i. Rural Microenterepreneur Assistance Program (RMAP): Maximum loan: $500,000. Low interest, 20 year loans with 2-year deferral of payments, to capitalize a revolving microloan fund. The microlender must establish & maintain a 5% loss reserve from their funds. Loan proceeds are to be used for relending as fixed rate microloans (≤ $50,000) to rural microentrepreneurs.

ii. RMAP Technical Assistance Grants: ($100,000 maximum size) to allow a microlender to provide technical assistance to their microloan borrowers. They can pay administrative expenses of the microlender, but not more than 10% of the grant. Maximum TA grant award is ≤ 25% of microlender's RMAP loan portfolio.

iii. RMAP Enhancement Grants ($25,000 maximum size) to allow a microlender to increase its capacity to serve rural microenterprises. Enhancement grant awards are *not* tied to the operation of an established RMAP loan fund. RMAP grants cannot provide more than 75% of the cost of the project.

d. Health and Human Services, Office of Community Services, Community Economic Development: Community Economic Development Grants: discretionary grant funds to Community Development Corporations (CDC) for well-planned, financially viable, and innovative projects to enhance job creation and business development for low-income individuals. Up to $800,000 is available for projects that include revolving loan funds, real estate development and business start up and expansion.

e. Department of Housing and Urban Development:

i. Community Development Block Grants (CDBG): Microloan funding is an eligible activity under the CDBG progam. Use of funds is determined by citizens input into the CDBG process by the participating jurisdiction (local or state government). Many jurisdictions have allocated funds for MDO support and all types of small business activities.

ii. Community Service Block Grants (CSBG): Loan funds are also supported though CSBG funding through eligible state and local jurisdictions. Most of the local jurisdictions are community action agencies or a local government affiliate that determines use of CSBG funds.

2. Foundations and Private Sector:

a. Grants: Foundations have been a strong supporter of microenterprise lending and development. Most of the support is conducted on a relationship basis.

b. Investments: To a great degree, banks and financial institutions have made equity type investments into loan funds, primarily CDFIs. They have also actively provided deposits in credit unions. Program Related Investments have been made by larger national foundations in the past and focused on specific industry support. The California Endowment has recently made a substantial investment into a fund to support the development of markets in "food deserts" as part of national "healthy food" initiatives. The fund is in partnership with the NCB Bank (previously known as the National Coop Bank).

DEVELOPMENT TIPS:

Consider what community needs are and design the lending or investment activity appropriately. Consider what resources you have or can access to help determine size and scope of your program. Some key development tips to remember include:

1. If you are starting a new fund, do the initial investigative research and concept paper to determine if the project is feasible. The concept paper will also be your base tool to present to potential funding and resource partners and becomes the basis for your business plan. As you gather data, your concept paper should be continually updated. This information will become the basis of your business plan.
2. Instead of starting your own fund, consider partnerships to bring the resource to your community or to create a specialized fund that can be managed by an existing CDFI or loan fund. This may be an intermediary step for you to gain experience if you later want to create and manage your own fund.
3. Become a Community Development Entity (CDE) and get CDFI Certification. This is especially true if your organization has a lending program.
4. The CDFI designation only allows you to apply for CDFI Fund resources. They are very competitive. It is important to build your capacity and track record.
5. Once you get a CDFI designation make sure conventional lending institutions are part of your planning/development process. Enlist them as supporters (on your board, advisory board or project committee). Remember, conventional financial markets have realized the importance and successes of CDFIs and seek CDFIs to place investments.
6. Your board of directors and loan committee are very important to the growth and success of your loan fund.
    a. Board: Creation of the Board of Directors is a very important step that builds the foundation for a successful loan fund.
        i. Proper balance between mission (helping improve distressed communities) and risk (lending guidelines and requirements) is maintained by board representation.
        ii. Fundraising: Fundraising is a critical need for loan funds and having representatives from entities that either funds/invests in loan funds or are in peer industries that can support loan fund activities is critical.
        iii. Management: Expertise in lending, business or law provides the necessary input and oversight of lending activities and overall success.
    b. Loan Committee: The loan committee should in many ways mirror the balance of the board of directors but have focus on management issues. The committee must have members versed in understanding of the lending guidelines and policies of the fund. Experienced lenders can typically be recruited from financial institutions that invest or lend into the fund.
7. Manage Expenses: Managing your income and expenses is essential for your long term survival.
    a. Partnerships with other related lending entities allow you to expand your market and cut down on your own expenses in the areas of marketing, loan processing and loan management.
    b. Loan losses decrease the size of your loan pool and lower your potential income
    c. Reserves impact your business success. These are funds set aside that do not generate income.

d. Your lending guidelines and approvals also impact your success…the greater risks your fund incurs; the greater the potential is for losses.
e. The expenses for marketing, processing and managing a small loan are the same as expenses for a larger loan.
f. Partnering and sharing of loan management and portfolio management functions are an excellent means of managing and reducing expenses.
g. If you already have loan processing and management experience, you may want to market this capacity and generate additional income by managing funds for partner organizations.

8. Additional Capital: The CDFI Financial Assistance Award is a grant that can start your lending program, but you should look at it as an opportunity to locate additional matching funds to expand your loan pool.

   It is important to determine who in the marketplace, has interest in supporting your lending activities.

   Your board, advisory board, or project committee should have members who represent financial institutions, local businesses and corporations, and local government and community leaders. They can become your spokesperson(s) and can convene meetings with their peers to market interest in your fund.

   Engagement and discussions with the banking regulators; Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of Currency (OCC) and Federal Reserve Bank (FRB) regarding your fund are a very important activity. These institutions can be an important resource for knowing who might be interested in supporting lending activities or are interested in your community. They are also great resources for convening meetings with financial leaders to generate interest in your fund.

Final Note:

Community development loan funds can specialize in its market and services. Becoming a loan fund is not easy and requires a strong commitment from the organization and the members of the development team. With experience the natural progression is to gain CDFI certification and access its many resources. With this added capacity, organizations can become equity investors or can expand their services to the entire community by creating a credit union. The goal can be accomplished with the support of the community, local government and interested financial institutions. It is most important to have staff dedicated to the project and if they do not have the expertise, locate resources to support and guide the effort.

This document is intended to be a guide that outlines some of the key issues and identifies possible solutions and steps. It is not intended to be your source since every project has its own issues, concerns and peculiarities and its own unique solutions. The document is not intended to encourage any organization into project development but only to lay out some of the key steps and issues once the decision is made to proceed.

***APPENDIX A - FOR MORE INFORMATION**: Resources Websites:*

Opportunity Finance Network: (www.ofn.org) "Opportunity Finance Network (OFN) is a national network of community development financial institutions (CDFIs) investing in opportunities that benefit low-income, low-wealth, and other disadvantaged communities across America.

OFN Members are performance-oriented, responsible investors that finance community businesses, sparking job growth in the areas that need it most, and delivering both sound financial returns and real changes for people and communities.

Our Network has originated more than $23.2 billion in financing in urban, rural, and Native communities through 2009. With cumulative net charge-off rates of less than 1.4%, we have demonstrated our ability to lend prudently and productively in unconventional markets often overlooked by conventional financial institutions."

Coalition of Community Development Financial Institutions (CDFI Coalition): (www.CDFI.org) "Formed in 1992 as an ad-hoc policy development and advocacy initiative, the Coalition of Community Development Financial Institutions (CDFI Coalition) is the lead national organization in the United States promoting the work of community development financial institutions (CDFIs). Through its member organizations, the Coalition represents CDFIs working in all 50 states and the District of Columbia. This national network of CDFIs includes community development loan funds, community development banks, community development credit unions, microenterprise lenders, community development corporations and community development venture capital funds. The CDFI Coalition coordinates industry wide initiatives to increase the availability of capital, credit and financial services to low-income communities across the nation."

Community Development Financial Institutions Fund: (www.cdfifund.gov) "Through monetary awards and the allocation of tax credits, the CDFI Fund helps promote access to capital and local economic growth in urban and rural low-income communities across the nation.

Through its various programs, the CDFI Fund enables locally based organizations to further goals such as: economic development (job creation, business development, and commercial real estate development); affordable housing (housing development and homeownership); and community development financial services (provision of basic banking services to underserved communities and financial literacy training).

California Association for Micro Enterprise Opportunity (CAMEO): (www.microbiz.org) "CAMEO's mission is to promote economic opportunity and community well-being through Micro Enterprise development.

Our member organizations provide entrepreneurs with small business financing such as loans and credit, technical assistance and business management training.

As California's statewide Micro Enterprise association, CAMEO is the voice for Micro Enterprise in California. We expand resources and building capacity for its member organizations – over 160 lenders, training programs, job creators, agencies and individuals dedicated to furthering Micro Enterprise development in California

National Community Reinvestment Fund (CRF,USA): (www.crfusa.com): "Community Reinvestment Fund, USA (CRF) helps change the lives of people living in economically distressed communities across the country. We supply capital to local community development lenders so they can meet goals like these:

- Grow small businesses
- Increase affordable housing
- Create and preserve jobs
- Build child care centers
- Develop community facilities

At the same time, we enable financial institutions, socially-motivated investors, and accredited individuals to reach their social investment goals.

CRF operates the leading national secondary market for community and economic development loans—a market CRF pioneered. We purchase economic development and affordable housing loans from community development lenders. We then pool them into asset-backed debt securities and New Markets Tax Credit (NMTC) investment funds, which we privately place with institutional investors"

FOR MORE INFORMATION: *Websites, Organizational Examples*

National Specialized Fund:

Low Income Investment Fund (LIIF): (www.liif.org) "LIIF is a community development financial institution (CDFI) that provides innovative capital solutions that support healthy families and communities. As a CDFI, LIIF invests in projects that have high social value but may not be able to access the services offered by traditional financial institutions. In this way, LIIF connects low income communities with the capital markets. LIIF offers a wide range of products, including community capital loans, New Markets Tax Credits, grants and technical assistance. LIIF's mission-driven approach combined with its market and industry knowledge have distinguished it as a CDFI that creates flexible, affordable financing solutions that work for community organizations and investors. In 2011, LIIF invested over $1.1 Billion."

NCB Capital Impact (NCB, formerly the National Coop Bank): (www.ncbcapitalimpact.org) "As a national nonprofit organization and a certified Community Development Finance Institution, NCB Capital Impact improves access to high-quality health and elder care, healthy foods, housing, and education in low-income communities.

Our impact is built on a diverse and extensive network of alliances, our depth of experience, and a cooperative approach. We partner with public and private organizations that are like-minded in mission, and dedicated to long-term success. NCB Capital Impact has deployed $1.6 Billion in loans, investments and assistance."

Regional CDFIs:

Clearinghouse CDFI: (www.clearinghousecdfi.com): "At Clearinghouse CDFI we believe in providing equal access to credit in neighborhoods of all income levels and ethnicities. We spend the

time and energy required to find creditworthy borrowers whose projects create assets in the community. These borrowers, because of their unique circumstances, are rejected or not even considered by traditional lenders.

Community development lending must be profitable in order to be sustained. As with conventional lenders, we carefully evaluate each applicant's ability to repay the loan. Unlike traditional lenders, we do not have predefined loan programs. We analyze each loan application individually. Every loan we make benefits the community in a measurable way.

Clearinghouse CDFI is a Community Development Financial Institution serving low-income communities and families throughout the State of California. Through our two lines of business, Core and NMTC lending, we have funded $760 million in loans and equity investments in low-income communities. Our 1,232 loans have assisted borrowers such as nonprofits and other community development groups to create 3,005 affordable housing units, enable 846 first-time homebuyers, create 4,270 construction and permanent jobs, and serve 215,000 clients of low-income communities annually."

Coastal Enterprises Inc (CEI): (www.ceimaine.org) "CEI in 2012 is a Maine-based organization with strategic expansions outside of Maine, serving more rural communities directly or through alliances and having an ever greater impact on poverty, which is documented with data. The organization has a high financial sustainability ratio, thanks to new and expanded sources of funds through private giving, public funds, and income from funds and venture capital. CEI has a metric for looking at the balance of the 3 Es—economy, equity and environment—through all initiatives, and has a group in place measuring impact, scanning for opportunities, and developing policy."

Community Based Funds:

Fresno Community Development Financial Institution (FCDFI): (www.fresnocdfi.org) "Fresno CDFI is a comprehensive financial services, training, and asset development institution for low- and moderate-income residents and businesspersons. Since our inception in May 2008, our professional, seasoned, and multi-lingual staff – experienced in micro-finance, credit counseling, business plan development, and advocacy for low-income families – has helped hundreds of entrepreneurs realize their dreams. We serve a 9-county region in Central California."

People Incorporated Financial Services: (www.peopleinc.net) "People Incorporated Financial Services was created in 2001 to address business development financing needs throughout Virginia. This People Incorporated affiliate administers the microenterprise development and small business financing activities for People Incorporated

As a Community Development Financial Institution certified by the U.S. Department of Treasury, People Incorporated Financial Services offers loans, development services and financial products to small and emerging businesses. People Incorporated Financial Services works to strengthen local economies in 17-jurisdiction service areas.

People Incorporated Financial Services has extensive experience providing small business and microenterprise development and lending services in low-income communities, and is the only CDFI headquartered in rural Virginia. Since its inception in 1992, the People Incorporated Financial Services loan portfolio has grown to include 308 microenterprise and business loans, which to date have created 475 jobs and retained 180 more."

Community Action Partnership
1140 Connecticut Avenue, NW, Suite 1210
Washington, DC 20036

202.265.7546 | fax 202.265.5048
www.communityactionpartnership.com

Appendix C9

Nonprofits

Structure/Overview
Nonprofits are legal entities which are "organized for purposes other than generating profit and in which no part of the organization's income is distributed to its members, directors, or officers."[1] The IRS recognizes 27 types of nonprofits for tax-exempt status.[2]

Relevant Interviews
We spoke with Paul Thelen of the Larned A. Waterman Iowa Nonprofit Resource Center (INRC). The INRC works with nonprofits in the state of Iowa to assist them with education, training, creation, and continued success. Mr. Thelen described the assistance that his organization provides others with and directed us to the website Guidestar, which is a repository of information for nonprofits at a national level. Mr. Thelen suggested we could use Guidestar to investigate nonprofit organizations around the country, which share similar goals to our clients'. More information on INRC can be found at the link below.[3]

Criteria
Applicable Federal Law: The IRS makes determinations on tax-exempt status for organizations around the country. However, nonprofits are organized under state law.

Applicable State Law: Nonprofits in the state of Iowa must file articles of incorporation with the Iowa Secretary of State's Office.[4] Information on the list of requirements for filing articles of incorporation can be found in the footnote below.[5] Following the filing of the articles of incorporation, the Iowa Secretary of State will issue a certificate of acknowledgement to the nonprofit organization. After the certificate of acknowledgement has been received, a nonprofit organization must hold an organizational meeting and adopt bylaws.

Securities law implications
Applicable Federal Law: Any federal securities laws applicable to a nonprofit entity would be dependent on the types of offerings and fundraising conducted by the nonprofit.

Applicable State Law: Any state securities laws applicable to a nonprofit entity would be dependent on the types of offerings and fundraising conducted by the nonprofit.

Taxes

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[1] https://www.law.cornell.edu/wex/non-profit_organizations
[2] https://www.business.com/articles/5-popular-types-501c/
[3] https://inrc.law.uiowa.edu/about-inrc
[4] https://sos.iowa.gov/nonprofits/forming.html
[5] https://sos.iowa.gov/nonprofits/MinCodeReq.html

Applicable Federal Law: "For federal tax purposes, an organization is exempt from taxation if it is organized and operated exclusively for religious, charitable, scientific, public safety, literary, educational, prevention of cruelty to children or animals, and/or to develop national or international sports. Social security tax is also currently optional although 80 percent of the organizations elect to participate."[6]

Applicable State Law: Nonprofit entities are automatically granted tax exempt status from Iowa income tax if they are designated as exempt by the IRS.[7] However, nonprofit entities may be subject to other taxes. More information on the taxation of nonprofits in Iowa can be found at the link below.[8]

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[6] https://www.law.cornell.edu/wex/non-profit_organizations
[7] https://tax.iowa.gov/iowa-tax-issues-nonprofit-entities
[8] https://tax.iowa.gov/iowa-tax-issues-nonprofit-entities

Appendix D1

Entrepreneur Capital Campaign Readiness and Recommendation

Company:
Founder(s):
Date:

Story	1	2	3	4	5	6	7	8	9	10
Team	1	2	3	4	5	6	7	8	9	10
Product/Service	1	2	3	4	5	6	7	8	9	10
Branding	1	2	3	4	5	6	7	8	9	10
Online Presence	1	2	3	4	5	6	7	8	9	10
Operations Capacity/Scalability	1	2	3	4	5	6	7	8	9	10
Competitive Advantage	1	2	3	4	5	6	7	8	9	10
Bandwidth (for managing campaign)	1	2	3	4	5	6	7	8	9	10
Capital need within investor range	1	2	3	4	5	6	7	8	9	10
Compelling sell to investors	1	2	3	4	5	6	7	8	9	10

Score:

Story:

Team:

Product/Service:

Branding:

Online Presence:

Operations Capacity/Scalability:

Competitive Advantage:

Bandwidth:

Capital Need within Investor Range:

Compelling sell to Investors:

Overall fit with Proposed Campaign Structure:

Recommended Next Steps:

Appendix D2

Silicon Prairie Online

Investment Crowdfunding

Is Investment Crowdfunding right for you?

What is it?

Investment crowdfunding is a new way for businesses to raise money using technology. A company sells shares of their business via a special website to a crowd of investors. It's similar to Kickstarter but the backers get real STOCK instead of items like T-shirts.

What does this mean?

You can skip traditional gatekeepers to pursue investment from the people that have a real interest in your success. The average person doesn't have a large pile of cash laying around, so you need a way to combine many small investments together to reach the same fundraising goals – that's Crowdfunding! Transactions must occur on special websites called a portal, to ensure the investment is handled legally. Now your friends, family & fans can help make the dream a reality AND they are protected by owning REAL shares.

What can it do for you?

Regulation crowdfunding provides a legal way for small to mid-sized businesses to raise $50,000 to $2 Million dollars of capital for operating expenses or expansion (additional tools may allow up to $5 Million). This program bridges the gap between the SBA/ bank loans and formal Angel/ Venture Capital investment. Previously, issuing shares required a banker, lawyer, and accountant – now technology does the heavy lifting to reduce the cost by approximately 80% compared to the old manual process.

What are some of the benefits?

- Unlock a new way to raise money for your business
- Democratic access to a broad range of people, ideas, and businesses
- Online platform streamlines the process to issue shares AND invest
- Cost to issue shares is under $10,000 (compared to $50,000 manually)
- Engaged and excited investors

Am I ready for investment crowdfunding?

This new format is a great way for ANY TYPE of businesses to raise capital. It's useful for Brick-and-mortal business like Breweries and Franchises, AND High Tech companies like mobile applications.

Here are a few guiding thoughts:

- Is your goal to raise between $50,000 and $2 Million dollars?
- Is your business in a location we cover?
  State-based campaigns allowed in Minnesota, Wisconsin, & Iowa
  (see website for updated list).
  Also, National Campaigns are supported anywhere in the USA!
- Do you have a legitimate business need for the capital such as product development, facilities, sales team, etc? (Investors want to see a return on their investment – not to pay for your debts or lifestyle.)
- Do you have the math to support your business plan, for example do you know when you will break even and generate a profit?
- Are you confident you can focus on selling the BUSINESS to a crowd of investors, not just the product to a consumer?

Is this legal – Aren't stocks regulated?

Yes, completely! The JOBS act of 2012 paved the way for State Legislation like MNvest to function as an exemption from the Federal SEC regulations. This means small businesses can issue shares using this format instead of having an IPO like a large corporation. For example, under MNvest the regulatory burden moves from the Securities Exchange Commission (SEC) to the Minnesota State Department of Commerce.

These exemptions work to allow public solicitation of investment from regular people AND wealthy people, but the transactions must occur within a legally regulated marketplace (Portal) and the Regulator must formally review the Issuers paperwork before the Campaign company can begin advertising. In order to protect the consumer there are mandatory risk disclosures, caps on the total amount of the raise, and caps on the amount an individual may invest.

Without this type of exemption, it is NOT LEGAL to ask for INVESTMENT publicly i.e. on Facebook or by holding an event. To clarify, rewards crowdfunding on Kickstarter is legal because those campaigns ask for a DONATION in exchange for a product. However if you sell an INVESTMENT (including Shares, Notes, Loans) those are financial security products and they must go through this exemption process or the Founder is breaking federal securities law. This also applies to Initial Coin Offerings.

Regulations and laws

MNvest is the state exemption that allows Minnesota companies to raise money from the public, by issuing stock or selling debt, to any investor in MN, by promoting it publically via an approved website. Other States have their own exemptions too.

Reg CF is the federal exemption that allows for national campaigns under SEC & FINRA oversight. We have been approved for Reg CF Portal Operations, we also support SCOR and 506(c) campaigns. These regulatory buckets have different rules – we are the experts who help you determine which one is right for your business.

Why haven't I heard of this?

This legislation is very new, previously this format has been illegal since the Stock Market crash in the 1920's. The freeze was intended to protect investors, but created a valley-of-death in small business funding. The JOBS act of 2012 opened the door, but it took several years for additional laws to be written and passed to clarify proper use. The first Software Portals were approved here in late 2016.

Since then we have been working hard to make a practical software tool that allows small businesses to leverage these laws. Now, several Minnesota companies have met their crowdfunding goals: In fact Silicon Prairie used investment crowdfunding in 2017 to raise ~ $256,000 to convert our passionate supporters into investors in our business!
We're Silicon Prairie Online or SPPX.

Does it work?

Yes!

"Silicon Prairie made our dream possible. Their portal, deep knowledge and support made reaching our investors easy. And we are opening up Rustech Brewing Company in April 2018."

Bill Burt
Rustechbrewing.com

Who can offer stock?

Businesses that want to sell shares are called issuers, we can help you decide which type offering is best for your needs. Depending on the format, slightly different rules will apply to your issue. For example, the State-based exemption called MNvest requires that the business is mostly within Minnesota. This means 80% of the business assets, revenue, proceeds, or employees are in that state. They may raise up to $1 million with financial statements written by the founder, or up to $2 million with professionally audited or reviewed documents. Other States, and the National Reg CF format have slightly different guidelines.

Who can invest in an offering?

The allowed investors depends on the format used to issue shares. A state exemption such as MNvest is open to investors from that State and has maximums for regular people that may be separate from wealthy people. For example, MNvest allows regular people to invest up to $10,000 per deal and professional investors are not limited to a dollar amount (up to the maximum of the entire campaign). Other States or the National Reg CF rules have different maximums that may be related to net worth.

Steps toward an investment crowdfunding campaign

1. Sign a contract with us, we help you gather the appropriate documents
2. Complete the state application, on hold during a 10 day review period
3. We upload the campaign and you begin marketing
4. Accept investor pledges and encourage them to complete transactions
5. Investment funds go into your campaign's escrow account
6. Reach your minimum goal to unlock funds from escrow
7. Investor e-signs their documents and disbursement occurs per the offering
8. Close the raise or choose to keep it open for up to 12 months
9. If Minimum goal is not reached, investments unwind back to their owners

Will you find me wealthy investors?

No – unfortunately, no method will pour easy money on your business. Yes, some websites make good revenue by selling the IDEA that they have exclusive access to pool of wealthy people, but the logic doesn't hold up. The wealthy already have money managers or brokers working on their behalf – they don't want to be shoe-horned into a party where desperate entrepreneurs have paid to meet them. Be careful that you don't accidentally poison your cap table with funds from an unlicensed "finder".

What does B.Y.O.C. mean?

It stands for 'Bring Your Own Crowd' we use it as shorthand for the goal of converting your supporters into your share-holders. Once you have an active exemption we encourage you to talk to everyone including; your friends, family, neighbors, faith community, interest group, vendors, suppliers, previous supervisors, coworkers, and direct reports. Ask them, "What return on investment & perks would it take for you to invest in this business immediately?" These people already know you're trustworthy and credible so they are the best ones to ask for funds - now you're on the right track!

If you don't have one person to write a check for $100,000 - then you need 100 people to write a check for $1,000 each, plus a plan for handling the paperwork.

What are the costs?

Silicon Prairie (SPPX) charges fixed fees in jurisdictions where required, i.e. under State based rules like MNvest (Minnesota) we provide portal services for $5,000 - $7,500 - plus you should also budget for a Lawyer with fixed-rate fees around $5,000.

Sometimes we are allowed to use a success fee model, this means we charge ZERO up front, but collect up to 7% of the campaign total. For example a Reg CF (National) Campaign that raised $500,000 would result in SPPX collecting $35,000 in software fees as the funding round closes. Lawyer fees of $5,000 and Accountant fees of $3,000 apply.

As a software company we also license our infrastructure as a service for other companies to use! Under a "White Label" agreement portal operators pay $2,500 for initial customization and onboarding, then pay 20% of the portal fees that they then charge campaign companies to SPPX. We recommend that the portal operator should charge their customers a minimum of $2,500 fees, so that SPPX collects a minimum of $500 per deal we facilitate.

Can we advertise our offering?

Yes. Once you have state approval, you can advertise your offer through public channels such as social media, paid ads and events subject to required regulator caveats and disclosures. We can help keep your campaign compliant!

Who is Silicon Prairie Portal and Exchange?

We are a software company in Minnesota that operates an investment crowdfunding portal.

Next steps and how to get started

If you'd like to find out more about equity crowdfunding, please feel free to contact us.

Visit us at: https://sppx.io
Email -- info@sppx.io
Phone: 651-645-7550

Silicon Prairie Online
Where Good Ideas Grow™

Information provided by www.sppx.io
(Approved in MN, WI and IA & Federally as a REG CF Portal).

This is not legal advice, please consult your lawyer.

Appendix D3

Investment Crowdfunding Comes to Iowa

Now You Can Raise Startup Funding or Expansion Capital Using a Crowd in Iowa!

Iowa Code section 502.202(24) and Iowa Administrative Code rule 191-50.90 are the laws that allows Iowa based companies to raise up to $5M dollars publicly from Iowa investors. For the first-time ever companies can offer real financial security products like equity, debt, or convertible notes in their business to the public instead of selling rewards like tee shirts on sites like Kickstarter. The good news is *everyone* is eligible to invest!

This is a *state based exemption* from federal securities laws and requires all transactions to occur on an approved web site known as a *funding portal.* It works because all investors are verified to be residents of Iowa. Other options exist that permit investors from multiple nearby states (the SCOR option) or seek up to $1M in investment from any investor in any state using Regulation Crowdfunding (REG-CF).

Silicon Prairie Online (https://sppx.io) is the **first and only** Iowa crowdfunding portal operator to be approved by **both** the Iowa Insurance Division as well as federally under REG-CF by the SEC and FINRA!

Who can make an Offering (sell shares)?

Businesses that want to use investment crowdfunding are called *Issuers*. The business must be based in Iowa, meaning that 80% of its revenue comes from or the use of proceeds will be spent in Iowa. If a company has a majority of its employees in Iowa it also qualifies! Companies can raise up to $5 Million dollars every twelve months under these rules and depending on the amount sought it may require an independent CPA review or audit of the financials.

What are the steps to Issue an Offering?

1. Engage a Portal Operator such as Silicon Prairie Online at https://sppx.io
2. Prepare the required documents: Business Plan, Risk Factors, Term Sheet etc.
3. File a notice with the Iowa Insurance Commissioner (may be subject to a waiting period)
4. Publish on the Portal and begin Marketing the Offering to potential Investors
5. Raise the Minimum Amount to begin receiving cash and keep it open for up to a year!

Who can invest in an Offering (buy shares)?

All Iowa Individuals and Businesses -- including companies with owners outside of Iowa provided that the company was not created for the sole purpose of investing in a particular offering. Any non-accredited investor may invest up to $5,000 per deal per year and accredited investors may invest any amount up to the total offering maximums.

Investment Crowdfunding Comes to Iowa

How does money change hands?

1. Investors view the Offer on the Portal and Pledge a dollar amount
2. Funding Portal collects the payment via check, ACH, or wire transfer (No credit/debit cards)
3. Bank or Escrow Agent holds the funds until Minimum Raise is obtained
4. When the Minimum Raise is achieved Investors electronically sign Subscription Agreements
5. Escrow Agent disburses funds to the Issuer via the Funding Portal
6. Note: If Minimum Raise is not met before the offer expires – funds are returned to the Investors

When can the Offer be advertised?

Once the Offer is deemed "effective" by the Iowa Insurance Commissioner it may be published on a state approved Funding Portal such as Silicon Prairie Online. Issuers and Investors may promote the offering through public channels such as Social Media, Paid Ads, and Investor Events! Portals may not recommend any specific Issue unless they are also a licensed Broker Dealer. Offers may be displayed on a marketplace or a private label website that contains a single issue.

Steps for an Investment Crowdfunding Campaign

Sign Contract	Press Play	Get the Gold	Feel the Love
1. Sign SPPX Contract	3. Complete State Application	6. Funds Flow into Escrow	8. Close Raise or Continue Hosting
2. Gather Documents	4. Publish Offer on Our Web Portal	7. Reach Minimum Goal to get $	9. Disbursement per Subscription Agreement
	5. Marketing + BYOC (bring your own crowd)		

Visit Silicon Prairie Portal and Exchange at Sppx.io for more details or contact David.Duccinni@sppx.io or Jade.Barker@sppx.io

Information provided by Silicon Prairie Portal, llc dba Silicon Prairie Online an Iowa & REG-CF Portal https://sppx.io
This is not legal advice, please consult a lawyer familiar with securities laws.
More information at: https://www.legis.iowa.gov/docs/ico/section/2018/502.202.pdf

Appendix D4

(Email from SPPX)

Here is a list of services SPPX offers:

1. Intrastate investment crowdfunding portal hosting in MN, IA, WI, and MI where the company and its investors are in the same state
    a. Hosted in our main "catalog" of offerings https://sppx.io
    b. Hosted privately (aka "walled garden") on a dedicated URL — see https://201.sppx.io for an example

2. Multi-state Small Corporate Offering Registration (SCOR) - up to $5M filed in home state and then petition to be made effective in other states

3. Interstate regulation crowdfunding aka REG-CF open to any company in any state with investors from any state up to $1,070,000

4. Stock Transfer Agent services

5. Private Placement Memorandum (PPM) preparation using our Geppetto Smart Document system which can save up to 90% of the time and legal fees

6. Consulting on Campaign best practices and management as well as blockchain based distributed ledgers for cap table management

7. Portal as a Service — we have licensed our portal system to other portal operators in Minnesota as well as Colorado see https://cfex.sppx.io

We are at present the first and only portal system that is integrated with ALTOIRA.COM, a self-directed IRA custodian that allows investors to setup tax-advantaged accounts and make direct investments in any of the offerings on any of our portals!

In January we will be the first portal operator to offer the assurely.com "crowdprotector" insurance product that is designed to step in to protect both company and investors against fraud.

We have also begun filing as a Broker-Dealer in MN first to bring about a secondary-market to facilitate exchange of these exempt securities with a goal of registering as an SEC Alternative Trading System in 2020.

Let me know how we can help your clients. Happy to jump on a zoom meeting or forwarding on any presentations we have done in the last two years. We host a monthly meetup on the third Tuesday of every month and open office hours every Friday morning from 9:30-11:30 central. More info can be found here:

https://www.meetup.com/Silicon-Prairie-Investing/

We are also planning on doing a presentation in Des Moines in early January.

Appendix D5

Great talking with you yesterday. I think there is a way for Localstake to help you and your clients develop more active community capital markets in Iowa. As we discussed there are number of different forms our involvement could take, depending on the business model your clients are looking to achieve. I've outlined the three main ways we could help below with a few comments on each.

Please let me know if I can provide any additional info. I'd be happy to speak with your clients directly as well if you think that would be appropriate at some point.

1. Simple, informal referral relationship. Localstake can help Iowa business, now, prepare an execute investment offerings aimed at individual investors who live in the community. Both Iowa businesses and investors can sign up on Localstake now to pursue investment opportunities. Your clients could take the role of simply promoting the Localstake platform in the community and performing basic educational and awareness type work. We could provide them with basic marketing info and platform data to support them in this effort. The economic (debt or equity, detailed offering terms) and regulatory (intrastate crowdfunding, federal crowdfunding, traditional Reg D) details of a given transaction would be sorted out as a business worked through our offering onboarding process on the platform.

2. Client engages Localstake to provide a white label platform. I've attached a deck here that provides more detail on this. There's also a fee sharing component to this arrangement that allows us to share fees with the partner so it could be a revenue generating partnership for your client. The client would also have more direct access and involvement in using the platform to help companies prepare and execute the offerings. So if they are currently providing advisory services they could use the platform to assist in that effort. Annual cost for this is $10,000 which includes a portion spent upfront for setup and the remaining paid monthly. Investors would sign up review and make investments on a deal by deal basis. There would be no fund or captive source of capital but its also a simpler, cheaper way to accomplish essentially the same concept.

3. Client engages Localstake to provide white label platform and community investment fund vehicle. Essentially the same as number 2 but we'd also integrate an actual fund vehicle to hold investors funds and deploy on a deal by deal basis. This would include all legal, accounting and related administrative services to set up and maintain the fund vehicle. Obviously this would be a bit more involved and depending on the client's business model (do they have a fund manager selecting investments? Do they want to earn fees and or carried interest from the investments?) some additional details would need to be sorted out. Cost for this would include the annual $10k outlined above plus a one-time $10,000 fund setup fee (and depending on some details, potentially some additional fund maintenance fees).

Hopefully, this helps provides some additional clarity. We'd love to help out on this front so let me know if I can provide any other info.

localstake

Simplifying private securities transactions

Platform Overview
Fall 2018

Full-service funding platform to support your business

Best in-class capital raising software

- Built-in terms analysis and offering document creation to streamline fundraising preparation
- Profile building and investor processing automatically adapted to meet regulatory requirements based upon laws selected
- Investor CRM with tracking from initial outreach through to completed investments; including automated follow up
- Investment execution, funds transfer (with built-in escrow solutions, as needed) and post-investment distribution transfers managed electronically
- Investment and business document storage; automated annual tax document creation for both parties in all debt-based offerings

Enterprise portal features

- Partner-branded marketing pages outside the website with content customization to match your firm's messaging
- Customizable required questions for issuers to answer to meet your diligence requirements
- Administrator level oversight of all business and investment activities from user onboarding to post-investment management
- Custom portal-level payment processing to charge your businesses subscriptions and monthly or recurring invoices
- Manage your investor group through the portal with engagement tracking, deal-by-deal interest levels, accreditation and ID verification

We've spent nearly 7 years building industry-leading software to handle all types of private securities transactions

Build your raise on Localstake's proven platform

- Formed company in **Q4 2011**
- Operating broker dealer and funding portal since **mid-2013**
- Total business customers: **~125**
- Total closed offerings: **35**
- Total funds raised: **$8.6m**
- Number of active investment accounts**: 3,750**; Total users: **12,800**
- 60/40 non-accredited / accredited investment account split
- Average investment size: non-accredited**: $5k**; accredited: **$10k**
- Securities laws utilized to-date: **Reg D 504**, **Reg D 506b**, **Intrastate Crowdfunding**, **Regulation Crowdfunding**
- States with closed or active transactions: **Indiana**, **Michigan**, **Colorado**, **North Carolina**

Broker dealer services simplified

Broker dealer services

- Terms underwriting and financial structuring
- Due diligence services including management team and operating plan reviews, background and credit checks
- Financial projections and sensitivity analysis
- Offering material creation
- Regulatory exemption advisory, facilitate offerings using any available registration exemption at the federal or state level
- Federal and state regulatory filings
- Offering solicitation and advertising advisory
- Offering execution and funds transfer services
- Access to additional broker dealer investor base of 11,000+

Broker dealer history

- 6 years exclusively facilitating private securities transactions, advising on hundreds of offerings
- Created customizable documentation for a wide variety of investment structures
- Provide capital raising advisory and term underwriting for hundreds of small businesses and real estate transactions
- Regulated by FINRA, zero regulatory disclosure events
- All broker dealer activity handled in house by our team; no licensing or registrations needed by our partners

Administration for pooled investment vehicles

For certain transactions, investors may be able to use a SPV investment vehicle to streamline the investment process

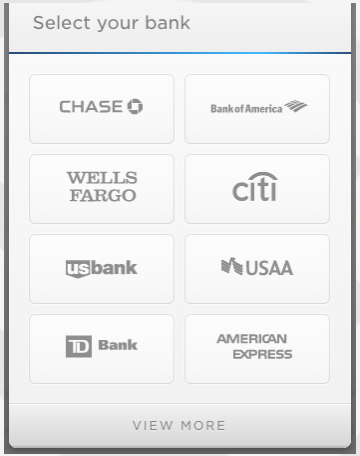
Fund setup and ongoing administration services are available through our partner, Assure Services, and can be seamlessly integrated into the platform experience. Assure provides all of the services below, as needed:

- Fund LLC formation, operating agreement, bank account and tax ID
- Manage receipt of investor documentation and fund transfers into fund
- If appointed, manage fund investing, book entries and fund transfers for each investment into portfolio companies, submit securities filings for the fund
- Pay ongoing fund expenses, collect and distribute payments to and from the fund; represent fund in target company decisions; respond to investor and target company inquiries
- Manage winding down of fund, distribution of proceeds from liquidity event, interface with escrow/transfer agents
- Prepare and file annual partnership tax returns for the fund and generate and distribute Schedule K-1s for each investor

ASSURE SERVICES

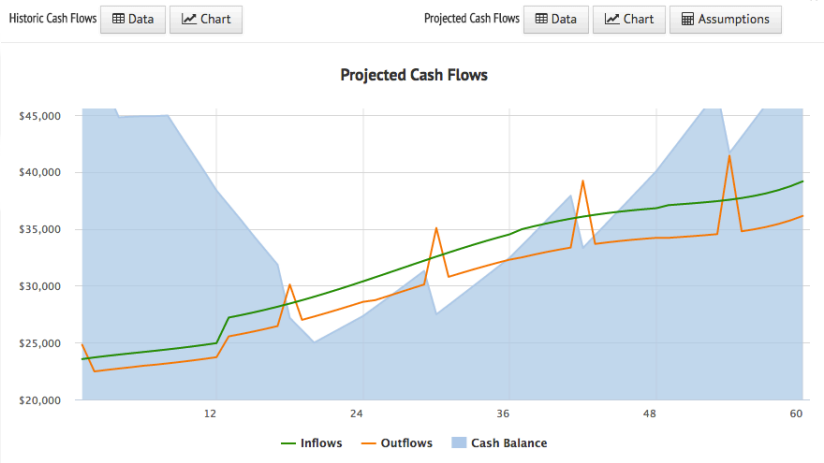
Assure is a complete back office solution, from accounting to investor relations, marketing, deal log and executive assistance. Assure provides fund setup and administration, security filings, general partnership accounting, bookkeeping, taxes, reporting, compliance and analytics for special purpose vehicles and funds. Assure has helped put over $1 billion of capital to work by providing solutions for thousands of private investment transactions.

Financial analysis tools

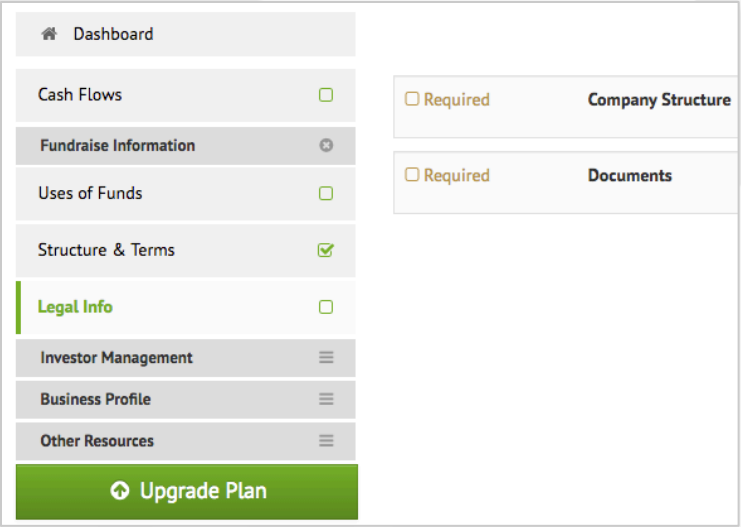


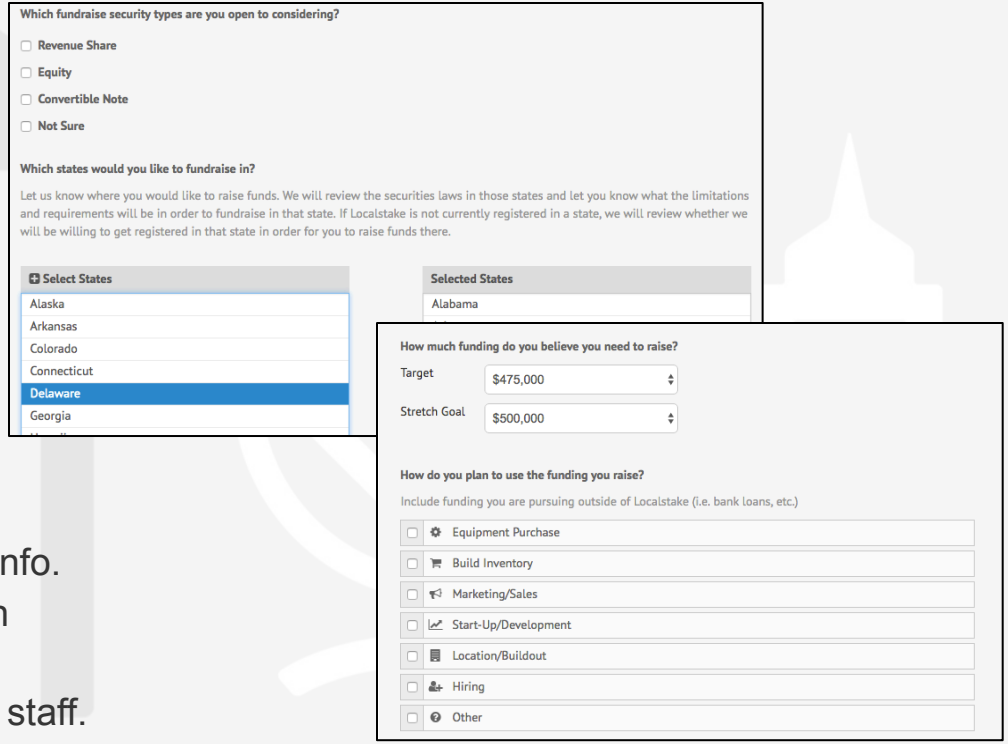
- Connect company bank account to feed historical data into the projection model.
- Continual updates based on actual data – no manual excel updates.
- Blend your company data with Localstake's industry and comparable company data to produce defensible projections.

- Design a capital raise structure based on Localstake projection model and incorporate impact of offering into projections.
- Benchmark your projections against similar companies and industries.
- Identify optimal type of capital to pursue and timing to enter the marketplace to close funds.



Investment offering onboarding





- ✓ Easy integration with existing company info.
- ✓ No version control issues or email driven workflow.
- ✓ Dedicated support from FINRA-licensed staff.

Build and organize target investor audience

Integrate directly with email contacts and Linkedin connections…

Add individual contacts from your LinkedIn, Gmail or Office 365 accounts

LinkedIn Contacts Import | Gmail Contacts Import | Outlook Contacts Import

Add one contact

First Name | Last Name | Email Address | Add

Or, add from file

Select .csv File

(Accepted formats: .csv)

Include the following column headings in this order:
Email, First Name, Last Name
Example CSV file

Send Invite

You can send invitations one at a time or to everyone at once. The more you are able to personalize your invitations, the higher success rate you will have. If a contact hasn't responded to your invitation in a while, send another invitation or follow up with a personal email or phone call.

Message

Customize your message to the selected investors

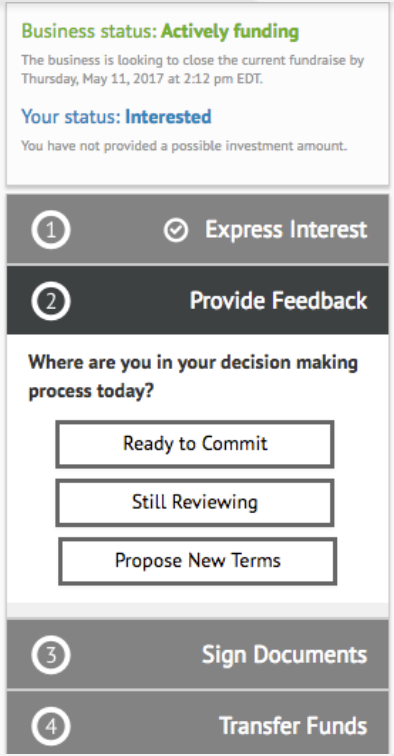
☐ I have a pre-existing relationship with each of these individuals

…efficiently send personalized emails with links to the offering, while staying compliant with applicable securities laws.

Track engagement and follow up accordingly...

	Name	Last Sent Invite	Contact Count	Status	Invited By	Actions
☐		Thu, Apr 7 '16	1	Delivered	Garret Flynn	Invite
☐		Thu, Apr 7 '16	1	Read	Joe Peoni	Invite
☐		Thu, Apr 7 '16	1	Read	Garret Flynn	Invite
☐		Thu, Apr 7 '16	1	Clicked	Joe Peoni	Invite

Run an efficient process



Offering and interest status updates.

Collect indications of interest either prior to offering or as initial step to see who's really interested.

Gather feedback to gain insight on investor reaction and to force action.

Once committed, close docs online via e-signature.

Collect funds directly via ACH, check or wire either through integrated escrow or directly.

Get critical investor details right

Liquidity
Investing in private businesses is not for investors with short-term time horizons. Are you comfortable investing in securities that have limited liquidity?
- (●) Yes
- ( ) No

Risk Profile
Investing in private businesses involves significant risk. When investing on Localstake, are you willing to take on significant risk to potentially earn a return on your investment?
- (●) Yes
- ( ) No

Sophistication
I believe that I have the knowledge and experience in finance and business to evaluate the merits and risks of investing in private businesses on Localstake.
- (●) Yes
- ( ) No

Risk Tolerance
Select the risk level you are comfortable with when investing on Localstake. Your selection will impact the investment opportunities that Localstake can display to you.
- (●) Aggressive: Maximum risk to principal to aggressively seek maximum returns, and understand I could lose most, or all, of the money invested. (Example: Investing in an early stage private company)
- ( ) Moderate: Some risk to principal and tolerate some volatility to seek higher returns, and understand I could lose a portion of the money invested. (Example: Investing in a public company)
- ( ) Conservative: Preserve principal, with minimal risk, even if that means I do not generate significant income or returns and may not keep pace with inflation. (Example: Investing in a certificate of deposit)

Experience
I have managed my own portfolio, including a significant number of private investments, for the last 20 years

Your Financial Information

Please note that the personal financial information you provide here will have a direct impact on how much you are able to invest in businesses on Localstake.

Expected income this year	Over $300,000	( ) Joint	(●) Individual
Income last year	Over $300,000	( ) Joint	(●) Individual
Income two years ago	Over $300,000	( ) Joint	(●) Individual
Net worth	Over $1,000,000		

← Previous Save & Continue →

- ✓ Permission-based access to offering info based on regulatory framework and target investor characteristics.
- ✓ Streamlined investment account opening process.
- ✓ Auto-fill investor info to offering docs to ensure accuracy and completeness.
- ✓ Access existing community of investors to supplement your network.

Disclosures

Securities offered through Localstake Marketplace, LLC. Member FINRA/SIPC. Securities offered are private placements. Investment products are not FDIC insured, may lose value, and there is no bank guarantee. There is no guarantee of a return on your investment. The JOBS Act has not yet been implemented. Localstake Marketplace LLC relies on the safe harbor pursuant to Regulation D and Rule 147 for all securities offerings.

This is neither an offer to sell nor a solicitation of an offer to buy. An offering is made only by the providing of offering materials over the localstake.com marketplace platform. A copy of the current offering materials must be made available to you in the connection of an offering and should be read in order to understand fully the implications and risks of an offering.

The offering materials describe the various risks and conflicts of interest relating to an investment in the specific offering and to its operations. You should read the offering materials carefully to determine whether an investment is suitable for you in light of, among other things, your financial situation, need for liquidity, tax situation, risk tolerance and your other investments.

The past performance of any investment is not necessarily indicative of future results. You should only commit risk capital to an investment which means money that you can lose. Private placement investments are not for everyone and entail risks that are different from more traditional investments. You should obtain investment and tax advice from your advisers before deciding to invest.

Localstake Marketplace, LLC nor any of its affiliates, including its parent, Localstake LLC, provide investment, legal, or tax advisory and do not make investment recommendations. This presentation is not a recommendation nor a solicitation for an order. There is not enough information contained in this presentation in which to make an investment decision and any information contained in this presentation should not be used as a basis for making an investment decision.

All investments on Localstake are private placements. When considering private placement investments you need to be informed of the various risks including:

You are investing in speculative securities and your investment may lose value.
The private placements you are investing in on Localstake are usually small businesses and may be early-stage businesses that are looking to launch a product or service. Many times, they do not have a proven track record. You need to be prepared to bear the economic risk of any investment that you make in private placements.

Your investment may be illiquid.
By investing in private placements you are required to hold on to the security for at least one year before you can sell it. At that time, there might not be an investor that is interested in your security so you might not be able to sell. There is no secondary market for these securities. For equity or other securities with no termination date, there is increased illiquidity risk.

Required payments are not guaranteed.
By investing in private placements relating to loans or revenue sharing securities, companies are required to make payments on a recurring basis. These payments may not be received due to financial or other difficulties experienced by the company. Investors must be prepared to bear the risk of not receiving their expected payments. Equity securities often do not come with required payments.

Private businesses are not required to report on their financial status quarterly like public companies.
The businesses that we place on the website have agreed by contract with Localstake to update their investors with how the company is performing on a quarterly basis, but there is no guarantee that they will. Localstake will NOT be policing these businesses to ensure they are providing updates.

Private businesses are not subject to the same regulatory requirements as a public company.
When a company goes public they are required to disclose specific information in a 10K and they must adhere to the Sarbanes-Oxley Act. Private businesses are not required to meet these restrictions.

Private placements may involve complex tax structures.
Private placements can involve complex tax structures in different types of corporate entities. Since the tax consequences of an investment in private placements may not be the same for all investments or for all investors, prospective investors are encouraged to consult their own tax advisors with specific reference to their own tax situations, including the application and effect of federal, state, local, and foreign tax laws and possible changes in such laws.

Private placements often charge high fees.
It is important to review the transaction fees outlined in the offering materials before investing.

Appendix D6

MITCHELL | HAMLINE School of Law

Mitchell Hamline Law Review

Volume 43 | Issue 5 Article 5

2017

How to Crowdfund and Not Fall Flat on Your Face: Best Practices for Investment Crowdfunding Offerings and the Data to Prove It

Zachary J. Robins

Timothy M. Joyce

HOW TO CROWDFUND AND NOT FALL FLAT ON YOUR FACE: BEST PRACTICES FOR INVESTMENT CROWDFUNDING OFFERINGS AND THE DATA TO PROVE IT

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I. INTRODUCTION

Regulation Crowdfunding ("Reg CF") has already celebrated its first anniversary.[1] After a frustratingly long delay during Securities and Exchange Commission (SEC) rulemaking for the JOBS Act's most modern securities fundraising technique,[2] issuers may now tap the Internet's vast populace to raise money. By many measures, the law is working—existing small businesses and new startups alike are getting the jumpstart they need.[3] As an added benefit, the companies funded by investment crowdfunding also seem to be creating the kinds of jobs (if perhaps not yet in the desired numbers) originally envisioned by lawmakers.[4] It seems that, barring some shift in the legislative agenda of Congress, federal investment crowdfunding is here to stay.[5]

1. *See* Crowdfunding, Securities Act Release No. 33-9974, Exchange Act Release No. 34-76324, 80 Fed. Reg. 71,388, 71,388 (Nov. 16, 2015) (to be codified at 17 C.F.R pts. 200, 227, 232, 239, 240, 249, 269, and 274) [hereinafter Regulation Crowdfunding] ("The final rules and forms are effective May 16, 2016 . . . ."). Portal registration has been open since January 29, 2016. *Id.*

2. *See* Samuel Guzik, *JOBS Act Crowdfunding Begins on May 16, 2016: Don't Get Busted for Solicitation!*, CROWDFUND INSIDER (Mar. 28, 2016, 4:00 AM), https://www.crowdfundinsider.com/2016/03/83470-jobs-act-crowdfunding-begins-on-may-16-2016-dont-get-busted-for-solicitation/ ("Though Congress dictated that this task be completed by the end of 2012, the SEC missed the mark by nearly three years."); *see also* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306, 320 (2012) [hereinafter JOBS Act] (requiring rulemaking by the SEC "not later than 270 days after the date of enactment").

3. *See* Larry Alton, *Does Crowdfunding for Startups Actually Work?*, PURCH, https://www.business.com/articles/does-crowdfunding-for-startups-actually-work/ (last visited Mar. 31, 2017).

4. *See* Sherwood Neiss, *Here's How Regulation Crowdfunding Performed in 2016*, VENTUREBEAT (Jan. 11, 2017, 5:05 PM), http://venturebeat.com/2017/01/11/heres-how-regulation-crowdfunding-performed-in-2016/ (reporting a job creation rate of 2.2 jobs per funded company, often in "underserved communities").

5. *See id.* (advocating for the incoming administration to promote crowdfunding, especially as an economic booster since many investors fund local projects). It seems unlikely that the current Republican-controlled Congress will drastically alter the JOBS Act, a measure that originally passed with overwhelming Republican support. *See* Pete Kasperowicz, *House Approves JOBS Act in 390-23 Vote*, THE HILL (Mar. 8, 2012, 6:02 PM), http://thehill.com/blogs/floor-action/house/214979-house-passes-jobs-act-sends-to-senate. In fact, the Crowdfunding Enhancement Act is already under consideration in an attempt to further enable online capital raising via crowdfunding. *See* Crowdfunding Enhancement Act, S. 1031, 115th Cong. (2017), https://www.congress.gov/bill/115th-congress/senate

At the same time, many states have also waded into the fray with their own crowdfunding solutions.[6] In fact, several states had operational investment crowdfunding systems months and even years before the federal government.[7] Many of the same benefits—job creation, driving community entrepreneurship, survival of small businesses—seem to be trickling down in the intrastate models as well.[8] The probability exists, especially as the federal model builds steam and gains even broader support across state legislatures, that state-level investment crowdfunding will also be around for the long haul.[9]

While there have been comparatively few Reg CF offerings to date (with relatively small offering amount aggregates, at least as

-bill/1031; *see also infra* Part V.

6. *See, e.g.*, MNvest Registration Exemption, MINN. STAT. § 80A.461 (2016). For a list of intrastate crowdfunding statutes current through November 16, 2016, see N. AM. SEC. ADM'RS ASS'N, NASAA INTRASTATE CROWDFUNDING UPDATE (2016) [hereinafter NASAA INTRASTATE OVERVIEW], http://nasaa.cdn.s3.amazonaws .com/wp-content/uploads/2014/12/NASAA-Intrastate-Crowdfunding-Update -111616.pdf.

7. NASAA INTRASTATE OVERVIEW, *supra* note 6, at 3.

8. *See id.* at 5 (listing a variety of businesses and industries that use intrastate crowdfunding).

9. As contrasted with federal Reg CF, legislative changes will be almost necessary in order for intrastate crowdfunding statutes to maintain their efficacy. Most intrastate crowdfunding models are tied to the federal intrastate offering exemption under 15 U.S.C. § 77(c)(a)(11) (2016). *See* N. AM. SEC. ADM'RS ASS'N, INTRASTATE CROWDFUNDING LEGISLATION (2016), http://nasaa.cdn.s3.amazonaws .com/wp-content/uploads/2014/12/NASAA-Crowdfunding-Index-11-16-2016.pdf. The SEC recently made changes to the Rule 147 safe harbor for intrastate offering advertising and solicitation and introduced a completely new exemption dubbed Rule 147A. *See* Exemptions to Facilitate Intrastate and Regional Securities Offerings, Securities Act Release No. 33-10238, Exchange Act Release No. 34-79161, 81 Fed. Reg. 83,494 (Nov. 21, 2016) [hereinafter Final Rules 147/147A]. State laws based on compliance with section 3(a)(11) of the Securities Act of 1933 *and* Rule 147 will need to be amended in order to take full advantage of the revisions. For a deeper analysis of the problem created by mandatory compliance with section 3(a)(11) and old Rule 147, see Timothy M. Joyce, *1000 Days Late and $1 Million Short: The Rise and Rise of Intrastate Equity Crowdfunding*, 18 MINN. J.L. SCI. & TECH. 343 (2017).

compared to other options like Regulation A+[10] and Regulation D[11]), there have been enough offerings to amass sufficient data[12] from which to draw some meaningful conclusions about the likely causes of the success or failure of an offering. And some practitioners have already begun to crunch the numbers.[13] To the extent that it is possible to glean some useful guidance from previous offerings, this article attempts to synthesize the data with the authors' personal and practical experiences[14] to propose some investment crowdfunding

10. *See* J.D. Alois, *NextGen Reports on Reg A+ Market: Reviews Early Data on 131 Filings*, CROWDFUND INSIDER (Oct. 10, 2016, 4:18 PM), http://www.crowdfundinsider.com/2016/10/91066-nextgen-reports-reg-market-reviews-early-data-131-filings/ (summarizing a NextGen report on Regulation A+ offerings under Title II of the JOBS Act). "[F]or a full year between June 19, 2015 and June 22, 2016," Tier I and Tier II companies solicited a combined total of more than $2 billion. *Id.* Based on just the raw numbers of offerings, Regulation A+ seems to have somewhat similar popularity as Reg CF. *Compare id.* (reporting either 131 or 144 Regulation A+ offerings, depending on which analysis is trusted), *with* Samuel Effron, *Regulation Crowdfunding: A Six-Month Update*, JD SUPRA (Dec. 28, 2016), http://www.jdsupra.com/legalnews/regulation-crowdfunding-a-six-month-15854/ (reporting 160 Form C filings in 2016).

11. *See* Effron, *supra* note 10 ("[T]he total amount raised in Reg CF offerings in this six-month period compares very unfavorably to the amount raised in Regulation D offerings during the same period, which is close to $30 billion.").

12. Form C data is publicly available via search of the EDGAR system. *See EDGAR Search Tools*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/edgar/searchedgar/webusers.htm (last visited Mar. 31, 2017). Wefunder, one of the first registered portals under Reg CF, also keeps up-to-date tallies of Reg CF offerings. *See The Current Status of Regulation Crowdfunding*, WEFUNDER, https://wefunder.com/stats (last visited Mar. 31, 2017) (reporting 122 offerings to date, 82 of which have been successfully funded, for a total in excess of $20 million).

13. *E.g.*, *CCA Regulation Crowdfunding Indices*, CROWDFUND CAP. ADVISORS, http://crowdfundcapitaladvisors.com/cca-regulation-crowdfunding-indices/ (last visited Mar. 31, 2017); *The Current Status of Regulation Crowdfunding*, *supra* note 12; Marc A. Leaf et al., *Leading the Crowd: An Analysis of the First 50 Crowdfunding Offerings*, DRINKER BIDDLE: INSIGHTS & EVENTS (July 14, 2016), http://www.drinkerbiddle.com/insights/publications/2016/07/leading-the-crowd-first-50-crowdfunding-offerings. The Crowdfund Capital Advisors numbers inform a substantial part of the analysis in Part III, *infra*.

14. Author Zach Robins participated in the drafting of the MNvest statute in Minnesota. He practices in the area of securities law and represents clients on both the issuer and portal operator sides of an offering. Author Tim Joyce assisted Zach on one of the first crowdfunding offerings under MNvest during a 2016 summer associateship at Winthrop & Weinstine, PA in Minneapolis, Minnesota.

best practices.[15] In addition, this article suggests some best practices for potential crowdfunders in areas of offerings not easily reduced to numerical data points.[16] In the end, the authors hope to provide actionable advice to the potential crowdfund issuer and its counsel for crafting the most appropriate offering structure for a given capital raise.[17]

The article proceeds in four[18] parts: Part II provides a brief description of investment crowdfunding, as a necessary history for an uninitiated reader.[19] Next, Part III examines the publicly available data on federal crowdfunding offerings to date.[20] Then, Part IV uses the data to recommend best practices for investment crowdfunding offerings using Reg CF, including some best practices that do not submit easily to numerical data points.[21] Part V offers some next steps in the evolution of federal- and state-level crowdfunding and a brief conclusion to the article.[22]

II. REGULATION CROWDFUNDING OFFERINGS AT A GLANCE

Any evaluation of the ideal crowdfunding offering will require an understanding of crowdfunding's unique place in the panoply of securities fundraising techniques. Investment crowdfunding first emerged as one part of a comprehensive solution to free up stalled U.S. capital markets, particularly for small businesses.[23] After the catastrophic market crash in the latter part of the first decade of the twenty-first century, traditional sources of capital had dried up.[24] For the most part, the end result and purpose—the "what" and "why" of

15. *See infra* Part IV.
16. *See infra* Part IV.
17. *See infra* Part IV.
18. Note that the Postscript, *infra* Part VI, is intended as an addendum speaking to the topic of the 2017 Mitchell Hamline Law Review Symposium. The scope of the Postscript is both broader and different than the rest of the article.
19. *See infra* Part II.
20. *See infra* Part III.
21. *See infra* Part IV.
22. *See infra* Part V.
23. *See* WILLIAM MICHAEL CUNNINGHAM, THE JOBS ACT: CROWDFUNDING FOR SMALL BUSINESSES AND STARTUPS 21 (2012) ("When banks are told to reduce risk, small businesses, especially startups, are the first to see credit levels reduced.").
24. *See, e.g.*, *id.* at 23 ("Over the last ten years, the number of companies raising capital through the issuance of stock in the public securities markets has declined dramatically.").

a crowdfunding offering—are much the same as any securities offering.[25] An issuer receives money from investors for the purpose of starting, maintaining, or expanding its operations. It is in the details about market players and offering implementation—the "who," "how," and "how much" of these offerings—that investment crowdfunding offers truly unique fundraising solutions. The next sections will highlight and comment upon the most important differences between crowdfunding and other federal[26] securities exemptions.

A. *The "Who": Investors and Issuers*

Where other parts of the JOBS Act focused on increasing the amount of capital available to an issuer each year[27] or freeing up publicity restrictions,[28] the main innovation embodied in Title III of the Act involved reaching a previously underrepresented type of investor on a large scale: the non-accredited investor.[29] Prior to that

25. The academic literature is rife with analysis of how investment crowdfunding fits (or does not fit) into the federal securities regulation schema. For a recent exploration of how Securities Act section 4(a)(6) and Reg CF stack up against other securities fundraising techniques, particularly Minnesota's intrastate alternative, see generally Joyce, *supra* note 9. This article will not attempt to replicate those efforts and thus assumes at least a passing familiarity with federal securities law. However, for the truly uninitiated, roughly: In the United States, the offer and sale of shares of profits based on the efforts of others is governed by securities laws, both at the state and federal levels. Issuers offering such shares must either register the shares or find an exemption. Section 4(a)(6) in Title III of the JOBS Act created an exemption for the sale of securities based on a crowdfunding model, 15 U.S.C. § 77d(a)(6) (2012), and it is with this exemption that this paper is principally concerned.

26. The most accessible crowdfunding offering data comes from federal Form C filings with the SEC. Although many states have operational intrastate crowdfunding statutes, information based on those offerings is either nonpublic or simply not large enough to warrant the drawing of many conclusions. *See* NASAA INTRASTATE OVERVIEW, *supra* note 6. Further, each state's enactment of intrastate crowdfunding differs slightly from the others; thus, a comparison would be of apples and oranges.

27. *See* JOBS Act, Pub. L. No. 112-106, 126 Stat. 306, 401–02 (2012) (Regulation A+ offering exemption for annual limit increases).

28. *Id.* § 105.

29. It is estimated that only a miniscule portion of the U.S. population qualifies as "accredited investors" for securities law purposes. *See* Devin Thorpe, *SEC Mulls Changes to Accredited Investor Standards, 18 Crowdfunders React*, FORBES (July 15, 2014, 12:32 PM), https://www.forbes.com/sites/devinthorpe/2014/07/15/sec-mulls

point, the substantial[30] pool of potential investors who did not meet the income or net worth thresholds for "accreditation" were effectively barred from participation in the most common form of fundraising: the private placement.[31] Non-accredited investors were able to participate in certain types of offerings like Regulation A and fully registered offerings, but these very expensive types of offerings were the first to dry up during the market crash.[32] In short, there was a problem with finding legal and affordable means to match the large supply of non-accredited investors with the large demand for capital by smaller issuers.

Crowdfunding also provided an option that was much needed by smaller issuers for several reasons. First, these issuers traditionally were not able to afford the costs of raising funds. For existing small businesses, even the costs of a private placement or SCOR (Small Corporate Offering Registration) offering can be substantial.[33]

Next, even if these companies could afford the costs, the success of such an offering was necessarily tied to the size of the company's network of "three Fs"—friends, family, and fools—available to the issuer.[34] Without enough people in the potential investor pool, a

-changes-to-accredited-investor-standards-18-crowdfunders-react/#5497b7fe12f2 (reporting estimations of the number of accredited investors in the country).

30. *See id.*

31. *See* John S. Lore, *The Most Common Exemption—Regulation D Rule 506*, CAP. FUND L. GROUP, http://www.capitalfundlaw.com/2015/04/05/the-most-common-exemptionregulation-d-rule-506/ (last visited Mar. 31, 2017) ("Rule 506 is the most commonly relied upon exemption in private offerings (accounting for more than 90% of offerings, according to SEC statistics).").

32. *Cf.* SCOTT BAUGESS ET AL., CAPITAL RAISING IN THE U.S.: AN ANALYSIS OF THE MARKET FOR UNREGISTERED SECURITIES OFFERINGS, 2009–2014 1 (2015), https://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf ("Capital formation through private placement of securities has increased substantially since the onset of the financial crisis. Amounts raised through unregistered securities offerings have outpaced the level of capital formation through registered securities offerings during recent years, and totaled more than $2 trillion during 2014.").

33. *See, e.g.*, Mike Goodrich, *Raising Money: What Is a Private Placement Memorandum (PPM) and When Do You Need One?*, WELD: BIRMINGHAM'S NEWSPAPER (June 19, 2012), http://weldbham.com/blog/2012/06/19/raising-money-what-is-a-private-placement-memorandum-ppm-and-when-do-you-need-one/ (estimating that a quality private placement memorandum can be prepared for around $20,000).

34. *See* David T. Schneider, Can Equity Crowdfunding Crowd-Out Other Alternative Sources of Finance? 15–18 (Sept. 12, 2016) (unpublished M.S. thesis,

cash-strapped issuer will not be able to justify the costs of fundraising compliance. Even if an issuer has a built-in network of enthusiastic supporters,[35] these individuals often do not have enough money to make substantial investments in companies, at least not the kind that can truly jumpstart a business.

Finally, these smaller issuers often do not have the history of operations, if any history, necessary to attract attention from the types of institutions that offer capital in smaller amounts. Angel investors and venture capitalists also often demand an active role in the management of a company in which they invest. Conversely, owners of closely-held issuers, whose livelihoods can depend on the flexibility of company operations, may be hesitant to select any fundraising option that cedes significant control to an unknown outsider.

Although seemingly negative, the same factors listed above also provide small issuers some key benefits that they may not otherwise access. The JOBS Act offers (1) an *affordable* fundraising option that (2) reaches enough potential *investors*, (3) with enough available *capital*, (4) all *without* requiring a significant shift in *management* control.[36]

B. The "How": Use of the Internet and Portals

An important corollary to the innovative expansion of offerings to non-accredited investors was the use of the Internet in general, and social media in particular, as a medium to reach the crowd.[37] In fact, the models on which investment crowdfunding was patterned—

HEC Paris), http://www.vernimmen.net/ftp/160912_Thesis_David_Schneider_vF.pdf (providing a helpful chart breaking down types of investors and the amounts and types of projects they support).

35. *See* Stacy Cowley, *Tired of Waiting for U.S. to Act, States Pass Crowdfunding Laws and Rules*, N.Y. TIMES (June 3, 2015), http://nyti.ms/1GZIym1.

36. *See generally* Mlopes, *Why Is Crowd Funding a Good Idea?*, CROWDFUNDING AM. (Dec. 6, 2011), http://crowdfundingamerica.blogspot.com/2011/12/why-is-crowd-funding-good-idea.html (discussing benefits of crowdfunding in general).

37. *See* Peter J. Loughran et al., *The SEC Hands out a Halloween Treat to Crowdfunding Supporters*, A.B.A. BUS. L. TODAY (Dec. 2015), http://www.americanbar.org/publications/blt/2015/12/06_loughran.html ("Title III and Regulation Crowdfunding seek to model popular websites like Kickstarter and IndieGoGo, for securities offerings . . . .").

exemplified by the practices of Kickstarter[38] and Indiegogo[39]—almost certainly owe their success to the fact that projects can reach a vast network via social media platforms.[40] Campaign founders on these crowdfunding platforms prove the worth of their projects via short videos.[41] The projects are then judged by the "wisdom of the crowd"[42] at large, instead of being limited to backers in the person's[43] direct personal network. Historically, however, communication with such a large number of non-accredited strangers (for example, via a publicly available Facebook post or Tweet) would have run afoul of securities law.[44]

The fact that "[o]nline capital raising is . . . at its core a 'general solicitation'" exists in tension with the general ban on advertising and solicitation of unregistered offerings in the rest of securities

38. *See About Us*, KICKSTARTER, https://www.kickstarter.com/about (last visited Mar. 31, 2017).

39. *See How It Works*, INDIEGOGO, https://www.indiegogo.com/how-it-works (last visited Mar. 31, 2017).

40. *See* Dara Fontein, *The Secret to the Best Kickstarter Campaigns Is Social Media*, HOOTSUITE (Sept. 2, 2015), https://blog.hootsuite.com/the-best-kickstarter-campaigns-secret-weapon-is-social-media/ ("Community is the backbone of any Kickstarter project, so how you use social media can make or break a campaign.").

41. *See, e.g.*, Jessica Taige, *Jessie's Nutty Cups: Help Spread the Nutty-ness!*, INDIEGOGO, https://www.indiegogo.com/projects/jessie-s-nutty-cups-help-spread-the-nutty-ness#/ (last visited Mar. 31, 2017).

42. *See* Jamie Hopkins & Katie Hopkins, *Not All That Glitters Is Gold—Limitations of Equity Crowdfunding Regulations*, 16 DUQ. BUS. L.J. 1, 9–10 (2013) (quoting U.S. SEC. & EXCH. COMM'N, STATEMENT REGARDING THE PROPOSING RELEASE ON CROWDFUNDING (Oct. 23, 2013) (statement of Comm'r Kara M. Stein)).

43. Typically, it is individuals seeking funding that use these models, rather than companies. *See, e.g.*, Zack "Danger" Brown, *Potato Salad*, KICKSTARTER, https://www.kickstarter.com/projects/zackdangerbrown/potato-salad/description (last visited Mar. 31, 2017). *But see, e.g.*, *Oculus Rift: Step into the Game*, KICKSTARTER, https://www.kickstarter.com/projects/1523379957/oculus-rift-step-into-the-game (last visited Mar. 31, 2017) (demonstrating a notable exception to the generalization that individuals rather than companies use these models). Sometimes, it is a mix of the two—individuals trying to start their small businesses. *See, e.g.*, Taige, *supra* note 41.

44. There simply was not an exemption from registration which permitted advertising to non-accredited strangers. This is problematic because "Title III investments [are] the riskiest class—and [are] being peddled to the most unsophisticated and vulnerable class of investors." Samuel Guzik, *SEC Quietly Injects Life into Title III Crowdfunding Solicitation!*, CROWDFUND INSIDER (June 27, 2016, 7:30 AM), https://www.crowdfundinsider.com/2016/06/87260-sec-quietly-injects-life-title-iii-crowdfunding-solicitation/.

law.[45] Under Title III of the JOBS Act, however, Congress solved this problem by conscripting the web-based platforms hosting these offerings to act as "portals" in much the same way as underwriters and broker-dealers.[46] These portals act as the front-line of investor protection, serving multiple functions: gatekeepers to the official offering documents,[47] market signals of regulatory compliance for the offering,[48] and policing agents to verify individual investor qualifications and limits.[49] Once the issuer files its Form C with the SEC, it is still severely—though not entirely—restricted in the

45. Georgia Quinn, *Advertising, Social Media and the New World of Crowdfunding*, CROWDFUND INSIDER (Jan. 30, 2014, 8:00 AM), https://www.crowdfundinsider.com/2014/01/30968-advertising-social-media-new-world-crowdfunding/ (raising a potential securities law pitfall in the fact that crowdfunding online "intuitively lends itself to the use of the multitude of social media outlets"). The ban on general solicitation (absent registration) of a securities offering is longstanding and subject to only a limited number of exceptions. *See id.*

46. In fact, a registered broker-dealer can serve as the portal. *See Regulation Crowdfunding: A Small Entity Compliance Guide for Crowdfunding Intermediaries*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/divisions/marketreg/tmcompliance/cfintermediaryguide.htm (last visited Mar. 31, 2017) (identifying who can act as a crowdfunding intermediary and requirements for both intermediaries and funding portals).

47. When issuers are ready to communicate with the crowd, section 4A(b)(2) of the Securities Act prohibits advertising the terms of a crowdfunding offering, "except for notices which direct investors to the funding portal or broker." *Regulation Crowdfunding Rules*, SEEDINVEST, https://www.seedinvest.com/blog/crowdfunding/regulation-crowdfunding-rules (last visited Mar. 31, 2017). Any information relating to the offering that is posted on the intermediary's website must be filed with the SEC. *Id.*; *see* 17 C.F.R. § 227.204 (2016).

48. Crowdfunding intermediaries are responsible for having a "reasonable basis" to believe that an issuer is not conducting a fraudulent offering. *See* 17 C.F.R. § 227.301. There are some commentators, however, who argue that funding portals should be allowed a much more active role in "curating" (i.e., vetting) crowdfunding offerings. *See* Darian M. Ibrahim, *Crowdfunding Without the Crowd*, 95 N.C. L. REV. 1481, 1496 (2017) (noting that even if portals themselves are not legally able to offer subjective investment advice, expert investors could provide the kind of "merits" review that would be useful to novice investors). Industry players agree with the sentiment. *See Equity Crowdfunding Rules: The Good, the Bad and the Ugly*, SEEDINVEST, https://www.seedinvest.com/blog/jobs-act/equity-crowdfunding-rules-good-bad-ugly-part-ii (last visited Mar. 31, 2017) ("Why not allow a portal such as SeedInvest, which employs former professional investors, to filter out the noise for the benefit of its investor base? Why not allow an additional layer of fraud protection on behalf of investors?").

49. Limitations on individual investors' commitments to an issuer are a new concept to securities law. *See infra* Section II.C.

content of its outside-the-portal advertising.[50] Social media distribution can serve the function of driving potential crowd-investors to the portal via hyperlinks, though admittedly not much else under the current regulations.[51] Even considering the severe restrictions, the use of the Internet in general—and social media in particular—under Reg CF remains groundbreaking for small securities offerings involving non-accredited investors in the United States.

C. *The "How Much": Per-Offering Limits, Per-Investor Limits, and Integration*

Reg CF has a $1 million yearly limit for issuers.[52] This relatively low total, at least as compared to the JOBS Act's increase for Regulation A+,[53] is in line with the goal that this style of offering help smaller businesses and startups.[54] And, as far as securities law in general goes, a smaller limit is not unusual when non-accredited investors are involved.[55]

50. *See Advertising Your Regulation CF Offering: What Issuers Need to Know*, SEEDINVEST, https://www.seedinvest.com/blog/advertising-your-regulation-cf-offering-what-issuers-need-to-know (last visited Mar. 31, 2017) ("After you launch your offering by filing your Form C with the SEC, there are only two types of communication permitted outside the platform: [c]ommunications that don't mention the 'terms of the offering'; and [c]ommunications that just contain 'tombstone' information.").

51. *See id.*; *see also* 17 C.F.R. § 227.204 (noting the limited information in a crowdfunding issuer's "tombstone" ad).

52. 15 U.S.C. § 77d(a)(6)(A) (2012); 17 C.F.R. § 227.100(a)(1).

53. *See* 17 C.F.R. § 230.251(a) (limiting Regulation A+ offerings to $20 million (Tier I) or $50 million (Tier II), depending on factors like the type of financial audits involved).

54. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Final Rules to Facilitate Intrastate and Regional Securities Offerings (Oct. 26, 2016), https://www.sec.gov/news/pressrelease/2016-226.html.

55. *See id.* Until recently, Rule 504 of Regulation D, which allows unlimited numbers of non-accredited investors, had an identical annual limit; the new limit is $5 million. *Id.* The increased dollar limits of revised Rule 504 may increase its desirability relative to current Reg CF. However, the Rule 504 advertising restrictions (when targeting non-accredited investors, at least) will remain a comparative detriment to Reg CF's (restricted) embrace of Internet advertising. *Compare* 17 C.F.R. § 230.504 (incorporating § 230.502's advertising restrictions), *with id.* § 227.204 (restricting issuers from advertising terms of an offer).

What *is* new to the realm of securities fundraising options is the limitation on yearly investments by a given investor.[56] Under Reg CF, not only are issuers limited in yearly fundraising, but individual investors are also capped, depending on certain income and net worth factors.[57] If either the annual income or net worth of an investor is below $100,000, the limit is calculated one way.[58] If both the annual income and net worth of an investor are $100,000 or above, the calculation is different.[59] And in no case is *any* investor, accredited or not, allowed to invest more than $100,000 in Reg CF offerings in one year.[60] The upshot here is that any Reg CF offering of $1 million will require at least ten extremely wealthy, and extremely convinced, backers to hit the yearly cap. More likely of course, and as explored in the actual data in more detail *infra*, is the situation where several hundred backers are required for a successful offering.

A positive feature of Reg CF offerings is that they are not subject to integration with other securities offerings.[61] This should mean that issuers are free to experiment with crowdfunding offerings without fear of losing the protection of other exemptions. In theory,

56. *See* Christopher Mirabile, *2016 Crowdfunding Rules: How the Restrictions Work and Why It Matters*, INC. (Apr. 11, 2016), http://www.inc.com/christopher-mirabile/2016-crowdfunding-rules-how-the-restrictions-work-and-why-it-matters.html.

57. *Id.*; *see* 17 C.F.R. § 227.100; *Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers*, U.S. SEC. & EXCHANGE COMMISSION (May 13, 2016), https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm (providing a handy chart illustrating how to determine one's investment limit). Although somewhat similar to the income and net worth standards which qualify an investor as "accredited" (and thus unlimited in yearly investing), the Reg CF investor limit calculations have numerically different thresholds. *See* 17 C.F.R. § 227.100; *Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers*, supra.

58. *See* § 227.100(a)(2)(i) (limiting the amount to "[t]he greater of $2,000 or 5 percent of the lesser of the investor's annual income or net worth if either the investor's annual income or net worth is less than $100,000").

59. *See id.* § 227.100(a)(2)(ii) (limiting the amount to "10 percent of the lesser of the investor's annual income or net worth . . . if both the investor's annual income and net worth are equal to or more than $100,000").

60. *See id.* (limiting the amount to "10 percent of the lesser of the investor's annual income or net worth, *not to exceed an amount sold of $100,000*, if both the investor's annual income and net worth are equal to or more than $100,000" (emphasis added)).

61. *See* Regulation Crowdfunding, 80 Fed. Reg. 71,388, 71,494 (Nov. 16, 2015) ("[A]n offering made in reliance on Section 4(a)(6) is not required to be integrated with another exempt offering . . . .").

deliberate sequencing of a crowdfunding offering could also serve a vetting function for a later private placement.[62] A similar funding-begetting-funding situation may be possible if the fundraising monies are used to satisfy a lender that sufficient borrower's equity is backing an enterprise.[63] Avoiding the legal fees associated with ensuring integration compliance is yet another reason to prefer investment crowdfunding as a securities fundraising technique.

D. The "How Else": Intrastate Crowdfunding and SCOR Offerings

Of course, crowdfunding at the federal level does not exist in a vacuum. Some of the reasons why "private placement exemptions [are] generally unavailable for crowdfunding transactions, which are intended to involve a large number of investors and not be limited to investors that meet specific qualifications,"[64] have already been discussed. Issuers have several other options at the state level with which to raise funds.

As of the end of 2016, thirty-three states have intrastate crowdfunding laws on the books.[65] These laws may have significantly higher annual maximums than Reg CF.[66] But they also come with restrictions that can compare unfavorably to their federal counterpart. These intrastate crowdfunding laws roughly fall into two models.

62. This would be analogous in effect, if not cost, to the "testing the waters" stage allowed in Regulation A+ offerings. *See* Michael Raneri, *Testing the Waters and Filing a Regulation A+ Offering with the SEC*, FORBES (May 26, 2015, 5:52 PM), http://www.forbes.com/sites/mraneri/2015/05/26/testing-the-waters-and-filing-a-regulation-a-offering-with-the-sec/#435826499dec ("[T]he 'Testing the Waters' stage is relatively informal. Issuers can use public channels like social media or email to let investors know they're considering offering securities . . . .").

63. A similar technique is included in the projections used for the MNvest crowdfunding raise for Torg Brewery. *See generally* TORG BREWERY, LLC, INVESTOR PACKAGE (Dec. 16, 2016) (on file with author).

64. *See* Regulation Crowdfunding, 80 Fed. Reg. at 71,389.

65. *See* NASAA INTRASTATE OVERVIEW, *supra* note 6 (listing effective dates for thirty-two laws, with Wyoming's effective July 1, 2017).

66. *See Informed Investor Advisory: Crowdfunding*, NASAA, http://www.nasaa.org/12842/informed-investor-advisory-crowdfunding/ (last updated May 2016) ("These amounts range from $100,000 to $4 million in a 12-month period, and $100 to $100,000 per investor, unless accredited.").

The first model is based on Rule 504[67] and, depending on state law, traditionally allows an issuer to advertise the sale of registered securities to accredited and non-accredited investors.[68] But the costs associated with creation and filing of registration materials can make this type of Rule 504 usage cost-prohibitive for business startups.[69] Other options under Regulation D might allow even freer sales of securities to accredited investors only. However, accredited investors do not a "crowd" make.

The second model is based on section 3(a)(11) of the Securities Act plus SEC Rule 147[70] and/or 147A.[71] This model is by far the most common nationwide.[72] Importantly, these laws do not currently allow for general advertising or solicitation via the Internet.[73] That will soon change;[74] but even once Internet advertising becomes

67. *See, e.g.*, ME. REV. STAT. ANN. tit. 32, § 16304.6-A.D (West, Westlaw through 2015 2d Reg. Sess.) ("The offering meets the requirements of the federal exemption . . . in 17 Code of Federal Regulations, Section 230.504 (2013). . . .").

68. *See* MINN. STAT. § 80A.50(b)(2) (2016) ("The securities offered must be exempt from registration . . . pursuant to Rule 504 of Regulation D . . . ."); *see also Fast Answers: Rule 504 of Regulation D*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/answers/rule504.htm (last updated Oct. 27, 2014).

69. *See* Goodrich, *supra* note 33; *see also SCOR Forms*, NASAA, http://www.nasaa.org/industry-resources/corporation-finance/scor-overview/scor-forms/ (last visited Mar. 31, 2017) (hosting downloadable forms for the "Small Corporate Offering Registration" or "SCOR" offering, including the 118-question Form U-7).

70. *See, e.g.*, MINN. STAT. § 80A.461 (describing the MNvest statutory codification, which requires compliance with *both* section 3(a)(11) *and* Rule 147).

71. The recent creation of Rule 147A, with its exemption where intrastate crowdfunders can freely advertise and solicit on the Internet, will likely mean that many states will consider amending their statutes. *See* Final Rules 147/147A, *supra* note 9.

72. *See* NASAA INTRASTATE OVERVIEW, *supra* note 6.

73. One of the major reasons the SEC created Rule 147A as a standalone exemption was because the existing Rule 147 acts as a safe harbor to section 3(a)(11), which only works if all "offers" *and* "sales" are in-state. *See* Final Rules 147/147A, *supra* note 9. State crowdfunding laws based on the section 3(a)(11) plus Rule 147 model thus effectively barred issuers from the use of the Internet. *See* Joyce, *supra* note 9, at 357–58.

74. *See, e.g.*, Georgia Quinn, *Advertising, Social Media and the New World of Crowdfunding*, CROWDFUND INSIDER (Jan. 20, 2014, 8:00 AM), https://www.crowdfundinsider.com/2014/01/30968-advertising-social-media-new-world-crowdfunding/ ("Although [retail crowdfunding is] not legal at this time, many people are preparing for crowdfunding permitted under Title III of the JOBS Act and currently proposed Regulation CF or 'retail crowdfunding.'").

permissible, issuers without a devoted single-state following may lack sufficient numbers of investors to access any kind of useful capital.

To briefly summarize this overview, Reg CF offers a new and exciting way to raise capital for smaller issuers. A previously untapped group of investors is connected via modern technology to issuers who previously would have been unable to afford the costs of fundraising. Internet portals have been inserted as gatekeepers for investor protection and facilitation of offerings. There are also new restrictions, though. Investors and issuers are subject to relatively small investment and fundraising limits, and access to the offerings is highly structured. Intrastate alternatives provide even more options for the prospective issuer but are subject to unique statutory restrictions on advertising and solicitation. Thus, despite the numerous options for crowdfunding and crowdfunding-esqe fundraising, even the most deserving crowdfunding projects run the risk of failure if not crafted properly. Next, Part III will dissect some statistics of the first eight months of Reg CF offerings, with an eye toward recommending best practices in Part IV.

III. REGULATION CROWDFUNDING OFFERINGS BY THE NUMBERS

After a four-year-and-one-month delay during rulemaking, May 16, 2016, marked the end of a long wait for Reg CF and the beginning of a new and exciting era in peer-to-peer investing.[75] Demand had certainly pent up, as that launch date presented ten active federal funding portals with approximately thirty-two offerings.[76] Over the remainder of the year, the number of platforms would double, and the number of offerings would balloon to 186.[77]

75. *See* Regulation Crowdfunding, 80 Fed. Reg. 71,388, 71,388 (Nov. 16, 2015) ("The final rules and forms are effective May 16, 2016 . . . ."); Neiss, *supra* note 4 and accompanying text.

76. *See* JD Alois, *Week One: How Are Title III Crowdfunding Platforms Doing?*, CROWDFUND INSIDER (May 24, 2016, 10:01 AM), http://www.crowdfundinsider.com/2016/05/86040-week-one-how-are-title-iii-crowdfunding-platforms-doing.

77. The authors are grateful to Sherwood Neiss and the folks at Crowdfund Capital Advisors (CCA) for the use of their data reporting on 2016 Reg CF offerings. CCA analyzed all 186 Form C filings with the SEC in 2016 and tracked the performance of issuers throughout. A recorded webinar summary of their findings, reported in substantial portion herein, is publicly available at Sherwood Neiss & Jason Best, CCA Grp., *2016 Regulation Crowdfunding Year End Analysis*, YOUTUBE (Jan. 11, 2017), https://youtu.be/j4sQpN1cJpE [hereinafter *CCA Data*]. Discussion of the 186 offerings begins about eight minutes into the video. Citations to other

In this Part, the article dives into the data behind all 186 offerings to uncover themes and ultimately offer takeaways in Part IV.

It is worth noting at the outset that 186 offerings in an eight-month period is still a relatively small sample size upon which to make judgments. Nonetheless, it is a large enough sample size to see storyline progress. For instance, the first storyline is that of 338 offerings, 145 hit their minimum funding target.[78] This equates to a 43% success rate, a remarkably similar success rate to Kickstarter,[79] the predecessor in many ways to investment crowdfunding.

Just as in a democracy where the public elects worthy candidates by voting, in crowdfunding the crowd "elects" worthy offerings by voting with their wallets.[80] Based upon this early data, 58% of offerings are failing to meet their goal, and that is perfectly acceptable. The crowd, in its infinite wisdom, is deciding who is worthy of capital.[81]

Some commentators may seek to exploit this failures data in order to prove Reg CF's unworthiness. These commenters would be armed with the additional news that the Financial Industry

commentators' crowdfunding reports can be found at *supra* note 13.

78. *CCA Data*, *supra* note 77.

79. *See Stats*, KICKSTARTER, https://www.kickstarter.com/help/stats (last visited May 12, 2017) (reporting successful funding of 124,612 projects out of a total of 352,636 project launches, a 35.34% success rate); *CCA Regulation Crowdfunding Indices*, *supra* note 13.

80. *Cf.* John S. Wroldsen, *The Crowdfund Act's Strange Bedfellows: Democracy and Start-Up Company Investing*, 62 U. KAN. L. REV. 357, 361 (2013).

> Like successful candidates in democratic elections, crowdfunding prowess derives from large numbers of equal followers, not from small groups of influential or wealthy contributors. It is democratic insofar as any idea that captures the attention of the crowd can attract substantial amounts of money, typically in low-dollar contributions from numerous people, similar to how politicians achieve electoral success in a democracy by winning the support of many voters who each casts a single vote.

Id.

81. It should be noted that the Reg CF statistics, while premature, are in line with data from other countries, such as Australia. That is, a significant portion of all offerings are not ultimately successfully funded. *Cf.* Andy Kollmorgen, *Crowdfunding Risks, Rewards and Regulation*, CHOICE (Feb. 15, 2016), https://www.choice.com.au/money/financial-planning-and-investing/stock-market-investing/articles/crowdfunding-risks-and-rewards (comparing Australian platform Pozible's claim of 55% success to Kickstarter's 43% success in mid-2014).

Regulatory Authority (FINRA)- and SEC-registered portal, uFundingPortal, was shut down by administrative order—an Acceptance, Waiver and Consent (AWC) filed by FINRA—in November 2016 for not adhering to basic regulatory requirements.[82] Critics could characterize the fact that both of these important regulatory bodies missed uFundingPortal's malfeasance as evidence that crowdfunding is somehow inherently risky and could never adequately protect investors. Yet, wiser observers counter that this is simply a healthy system ridding itself of unfit portals and issuers.[83]

Nearly $18,000,000 in capital was invested into Reg CF issuers in the abbreviated time span of May 16, 2016, to December 31, 2016.[84] "This money was raised in a fraction of the time that it would have taken if these entrepreneurs had gone to venture capitalists. It was also raised by many companies that don't qualify for VC capital because they don't hit the sweet spot for VC investment."[85] This quote is especially powerful considering that many of the 2016 Reg CF issuers were (1) pure startup companies and/or (2) stemming from alternative industries.[86] Either of these facts can be

82. JD Alois, *FINRA Action on uFundingPortal: Potential for Fraud Found on Crowdfunding Platform*, CROWDFUND INSIDER (Dec. 13, 2016, 10:37 AM), http://www.crowdfundinsider.com/2016/12/93663-finra-action-ufundingportal-potential-fraud-found-crowdfunding-platform. Notably, uFundingPortal had listed potentially fraudulent issuers that

> had an impractible [sic] business model, oversimplified and overly-optimistic financial forecasts, and other warning signs. For example, 13 of the issuers—despite having different business models—all coincidentally listed identical amounts for their target funding requests, maximum funding requests, price per share of stock, number of shares to be sold, total number of shares, and equity valuations. None of these 13 issuers reported any assets or history of operations before May 2016, and each claimed an unrealistic, unwarrented [sic], and identical $5 million equity valuation.

Id.

83. *See* Nathaniel Popper, *Doubts Arise as Investors Flock to Crowdfunded Start-Ups*, N.Y. TIMES (Jan. 24, 2017), https://www.nytimes.com/2017/01/24/business/dealbook/crowdfunding-fraud-investing-startups.html (highlighting prominent crowdfunding consultant Sherwood Neiss, who said "that he was confident that the crowd had enough wisdom to screen out the bad companies and those that were not providing enough information").

84. *CCA Data*, *supra* note 77, at 8:13.

85. Neiss, *supra* note 4.

86. *CCA Data*, *supra* note 77.

disqualifying from a venture capital perspective, where mature companies from the technology industry fare best.[87]

Among the top six industries in 2016 Reg CF offerings, farming and fishing, wine and spirits, transportation, and food and beverage were all represented.[88] One would be hard pressed to find any data supporting strong venture capital interest in any of the aforementioned industries. Healthcare and entertainment/media were also represented; however, those industries have never shied from venture capital.[89]

What may be most astounding from the 2016 Reg CF results is the average number of investors per closed offering, which was 331.[90] Whereas a traditional "friends and family" private round conservatively may yield ten to twenty investors, we are seeing an increase on the order of more than ten times that so far in Reg CF offerings.[91] The question is whether such a large influx of investors into a young and presumably small company is feasible and sustainable in the long run. What's more, will future investors balk at such a large capitalization table? For this reason and others, some issuers, often with the help of a funding portal, create a special

87. *See* Niall McCarthy, *Which Industries Attract the Most Venture Capital?*, FORBES (June 27, 2016, 9:12 AM), http://www.forbes.com/sites/niallmccarthy/2016/06/27/which-industries-attract-the-most-venture-capital-infographic ("[S]oftware receives the largest slice of the VC pie by a considerable distance, accounting for 36.2 percent (nearly $12 billion) of all investment over the past year. Biotechnology was in second place with 17.3 percent ($5.7 billion) while media and entertainment rounded off the top three with 9.5 percent ($3.2 billion)."); Dileep Rao, *Why 99.95% of Entrepreneurs Should Stop Wasting Time Seeking Venture Capital*, FORBES (July 22, 2013, 10:00 AM), https://www.forbes.com/sites/dileeprao/2013/07/22/why-99-95-of-entrepreneurs-should-stop-wasting-time-seeking-venture-capital ("Most VCs like to invest in ventures after the potential has been proven and the risk reduced.").

88. *CCA Data*, *supra* note 77.

89. *See* PWC/CB INSIGHTS, MONEYTREE REPORT Q4 AND FULL-YEAR 2016 13 (2016), http://pwc.to/2jbyJMd.

90. *CCA Data*, *supra* note 77.

91. *Cf.* Miguel Vega, *What Is the Difference Between "Friends and Family", Seed and Series A Financings?*, COOLEY GO, https://www.cooleygo.com/difference-friends-family-seed-series-financings/ (last visited Mar. 31, 2017) (describing the differences between various start-up options).

purpose entity (SPE) in order to house investors.[92] Part IV takes a deeper look into the unique solutions and issues created by SPEs.[93]

The explanation for large numbers of average investors per closed offering is largely related to the average commitment per investor at only $833.[94] At this rate, a company would need well over a thousand investors to reach the maximum raise of $1,000,000. This dollar amount is achieved by low minimum investment amounts set by issuers.[95] Certain psychological theory contends that whichever amount is set as the minimum is what the majority of investors choose as their investment amount.[96] This phenomenon is called "anchoring," where a cognitive bias influences a person to rely too heavily on the first piece of information received.[97]

Applied to investment crowdfunding, anchoring impacts issuers in that a certain portion of investors can be expected to invest the minimum, to take a flyer on an interesting opportunity.[98] It is tough to estimate how many investors will choose the minimum, but in one recent state crowdfunded offering, 75% of the investors invested the minimum investment amount of $5000.[99] Issuers ought to be cognizant of this effect and not set the minimum too low.

92. Amy Wam & Jillian Sidoti, *Why "Special Purpose Entities" Are So Special*, CROWDFUND INSIDER (Sept. 12, 2016, 2:49 PM), https://www.crowdfundinsider.com/2016/09/90049-special-purpose-entities-special/.

93. *See infra* Part IV.

94. *CCA Data*, *supra* note 77.

95. *See* David M. Freeman, *$100 Minimum Investment Levels Will Drive Socially Motivated Investing*, FIN. POISE (July 6, 2016), https://www.financialpoise.com/columns/crowdfunding-for-investors/100-minimum-investment-levels-will-drive-socially-motivated-investing/.

96. *See* Albert Phung, *Behavioral Finance: Key Concepts—Anchoring*, INVESTOPEDIA, http://www.investopedia.com/university/behavioral_finance/behavioral4.asp (last visited Mar. 31, 2017).

97. *See* Linda Sapadin, *The Anchoring Effect: How It Impacts Your Everyday Life*, PSYCHCENTRAL: WORLD OF PSYCHOL. (July 27, 2013), http://psychcentral.com/blog/archives/2013/07/27/the-anchoring-effect-how-it-impacts-your-everyday-life/.

98. *See The Guide to Equity Crowdfunding*, CROWDFUNDER, https://blog.crowdfunder.com/crowdfunding-startups/the-guide-to-equity-crowdfunding/ (last visited Mar. 31, 2017).

99. UNMAPPED BREWING CO., INVESTOR PACKAGE (Sept. 9, 2015) (on file with author); *see also Investing in Unmapped Brewing*, UNMAPPED BREWING, http://www.unmappedbrewing.com/#investing-unmapped-brewing (last visited Mar. 31, 2017) (indicating minimum investment of $5000). Author Zach Robins was counsel for Unmapped during this offering.

Yet, positive trends indicate that the minimum investment per Reg CF offering is increasing.[100] When Reg CF launched in May 2016, the average commitment per investor was $750.[101] Excepting a small dip shortly thereafter, the minimum commitment only continued to grow through the end of year.[102] It is expected that the average commitment will reach $1000 in 2017, which is an encouraging development from the viewpoint of investor-relations management.[103]

Company valuation is another key factor in seeking investors. This vital component of an offering sets the worth of a company and effectively determines what "piece of the pie" equity investors will be receiving in exchange for cash.[104] The data shows that despite a handful of outliers, valuations for Reg CF offerings have a median of $5,300,000,[105] which is in line with venture capital seed stage valuations at $5,900,000 (using the most recently available data).[106] This Reg CF valuation data point is especially encouraging, because in a Reg CF offering the *issuers* are able to set the valuation, whereas in a venture capital transaction the *investors* set the valuation.[107] Since Reg CF issuers now hold more leverage in setting deal terms, there was the possibility of abuse from early issuers. However, once again the data shows Reg CF valuations were not only in-line with, but actually less than, seed stage venture capital valuations.[108]

100. *CCA Data*, *supra* note 77.

101. *Id.*

102. *Id.*

103. *Id.*

104. Suspiciously high valuations are also cause for concern when an issuer's business operations cannot support them. *Cf.* Alois, *supra* note 82 (illustrating how a pattern of identical and identically-unsupported valuations—due to identical absence of operating histories—ultimately piqued regulators' suspicions at uFundingPortal).

105. This number excludes three outlier campaigns. With these campaigns included, the valuation increases to $8.9M. *See* Neiss, *supra* note 4.

106. GARRET JAMES BLACK, PITCHBOOK, 1H 2016 VC VALUATIONS REPORT 7 (2016), http://files.pitchbook.com/pdf/PitchBook_1H_2016_VC_Valuations_Report.pdf.

107. *See generally* Goncalo de Vasconcelos, *Valuations in Crowdfunding: Are We All Barking Mad?*, FORBES (May 27, 2015, 3:30 AM), https://www.forbes.com/sites/goncalodevasconcelos/2015/05/27/valuations-in-crowdfunding-are-we-all-barking-mad/#52a4dae55424 (describing the disparity in valuation between company-led crowdfunding platforms versus investor-led platforms).

108. It should be noted that "seed stage" venture capital is the category most

It is worth noting that certain industries in particular skewed the Reg CF valuations. For instance, not surprisingly, software was more than double the average valuation at $12,125,000.[109] Renewable energy offerings, perhaps due to the industry's nascence, rounded out the bottom end with $1,195,000 as the average valuation.[110] Transportation and farming and fishing sectors represented the extreme outliers at $29,975,000 and $30,652,600, respectively.[111]

Yet valuations seen in a vacuum do not tell the complete story since other variables weigh heavily on company value—namely, age and maturity. To wit, the companies most successful at raising capital under Reg CF happen to be companies that are more than six years old.[112] Specifically, companies six to seven years old had the highest average capital committed at $420,965, and companies more than ten years old ranked second at $336,175.[113] Clearly, when it comes to average capital committed, older is better. Nonetheless, the plurality of companies (39%) raising capital through Reg CF are less than one year old.[114] These same companies pulled in 43.5% of all Reg CF capital committed.[115] While the average capital committed, at $251,198 per campaign, is far less, comparatively, than the average for older companies, it is evident that Reg CF is well designed for pure startups, which is the stage at which companies are most challenged to raise capital.[116]

Another factor traditionally tied to valuation is company sales.[117] It remains to be seen how many of the Reg CF issuers had sales at the launch of their campaigns. If Regulation A+ (Title IV of the JOBS Act) is any indicator, many of these companies do not have any revenue at all at the time of offering.[118]

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apropos to Reg CF offerings, yet some issuers may be better suited for Pitchbook's Series A category. *Cf.* BLACK, *supra* note 106, at 10–11.

109. *CCA Data*, *supra* note 77.

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *See, e.g.*, *id.*

118. *Cf.* RICHARD SWART, THE EVOLUTION OF INVESTMENT CROWDFUNDING: EARLY DATA AND INSIGHTS, TITLE IV REG A+ 8 (2016), https://www.scribd.com/document/327099379/NextGenCrowdfundingRegA-WhitePaper-October62016 (finding

The average capital committed per successful campaign was $226,578, and the median minimum funding target was $50,000.[119] These successful campaigns took an average of forty-five days to hit the minimum and an average of ninety-seven days to hit the maximum.[120] For all Reg CF campaigns, the median length was 108 days, and the average length was 132 days.[121]

In the aggregate, companies younger than four years in age raised approximately 77% of Reg CF capital.[122] It will be interesting to see whether older companies (in this case companies four years and older) will comprise a larger portion of Reg CF issuers in the future. As Reg CF becomes more well known as a financing option, presumably more established companies will take advantage.

A total of 21,550 investors committed capital through all 186 Reg CF offerings.[123] Nearly 68% of the investors were represented by one single federal funding portal, Wefunder.[124] Some experts believe that more than 43,000 investors will participate in Reg CF in 2017.[125]

Reg CF issuers need to be aware of the costs of raising capital, with one of the largest costs being fees paid to the federal funding portal.[126] These platform costs were on average $11,239 per successful campaign.[127] Some portals also receive compensation in the form of warrants (in order to participate in the upside), miscellaneous fees, and expense reimbursement.[128] Wefunder and

that seventy-nine of the 131 offerings studied were by firms reporting no revenue).

119. *CCA Data*, *supra* note 77.

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*; *cf. The Current Status of Regulation Crowdfunding*, *supra* note 12 (reporting that Wefunder offerings account for 67% of investment volume, 65% of successful offerings, and 68% of total investments, as of February 12, 2017). According to CCA, Wefunder represented 14,622 of Reg CF investors. *CCA Data*, *supra* note 77.

125. *CCA Data*, *supra* note 77.

126. *See* Louis A. Bevilacqua, *How Much Does It Cost to Raise Money Through Equity Crowdfunding?*, BEVILACQUA BLOG (Sept. 26, 2016), http://bevilacquapllc.com/much-cost-raise-money-equity-crowdfunding/ (stating that the fee paid to a portal is typically between three and six percent of the amount raised, proportionally more than other fees).

127. *Id.* For an industry-wide comparison of portal costs, see *The Current Status of Regulation Crowdfunding*, *supra* note 12.

128. *CCA Data*, *supra* note 77. Warrants give the company something similar to

Mr. Crowd have taken the low fee approach, hoping to make up for lost revenue in the future by focusing on market saturation now.[129]

Of the twenty-one federal funding portals approved by the SEC and FINRA, there has been only one failure to date: uFundingPortal (UFP LLC).[130] FINRA banned the portal in December 2016 due to its failure to properly vet issuers, who, as it turns out, were not compliant with SEC regulations.[131]

an option, where they buy shares later but on terms defined now. Letting portals take compensation in warrants means that issuers do not have to immediately shell out some money from the Reg CF offering to pay the portals. *See* Reem Heakal, *Warrants: A High-Return Investment Tool*, INVESTOPEDIA (July 4, 2017, 12:00 PM), http://www.investopedia.com/articles/04/021704.asp.

129. *See, e.g.*, *The Current Status of Regulation Crowdfunding*, *supra* note 12.

130. *See* Alois, *supra* note 82.

131. This noncompliance seems too egregious and widespread to qualify as an innocent mistake.

> [uFundingPortal] reviewed and in some cases assisted in the preparation of required paperwork filed with the SEC by 16 different issuers that offered securities through UFP's platform. UFP knew that none of the 16 issuers had filed the following required disclosures with the SEC:
>
> > (1) a description of the business of the issuer, and the anticipated business plan of the issuer;
> > (2) a description of the purpose and intended use of the offering proceeds;
> > (3) a description of the ownership and capital structure of the issuer;
> > (4) a discussion of the issuer's financial condition;
> > (5) all positions and offices with the issuer held by the directors and officers (and any persons occupying a similar status or performing a similar function). The [sic] period of time in which such persons served in the position or office and their business experience during the past three years;
> > (6) a description of how the exercise of rights held by the principal shareholders of the issuer could affect the purchasers of the securities being offered;
> > (7) the risks to purchasers of the securities relating to minority ownership in the issuer and the risks associated with corporate actions including additional issuances of securities, issuer repurchases of securities, a sale of the issuer or of assets of the issuer or transactions with related parties;
> > (8) a description of the restrictions on transfer of the securities;
> > (9) a discussion of the material factors that make an investment in the issuer speculative or risky; and
> > (10) a description of the process to complete the transaction or

In the aggregate, the funding portals are averaging four new campaigns per week.[132] Wefunder was the most prevalent portal out of the gate, launching the most offerings on day one, and continued the trend through year end, representing 29% of all campaigns.[133]

IV. RECOMMENDATIONS AND BEST PRACTICES FOR CROWDFUNDING OFFERINGS

Although Reg CF is in its infancy and funding models are still being tweaked and tested, there are nonetheless many lessons to be learned.[134] Ideally, prospective issuers and portal operators can benefit from such best practices and continue to refine their methods, meanwhile providing feedback to the investment crowdfunding community. It is going to "take a village" in order to bring Reg CF and other forms of investment crowdfunding to the forefront and consciousness of average citizens. By collaborating and sharing best practices, hopefully the rising tide will lift all boats.

By and large, the most important advice to any company contemplating investment crowdfunding is the most traditional, yet obvious advice: ensure the business plan is well thought out and thorough, as investors will quickly see through gaping holes or inexact assumptions. Certainly the ultimate success of the crowdfunded business may depend largely on the collective experience of the founders.[135] However, thoughtful planning and a

cancel an investment commitment.

Financial Industry Regulatory Authority Letter of Acceptance, Waiver and Consent (No. 2016051563901) from Gary Shao, Managing Dir. of uFundingPortal, to Dept. of Enforcement, FINRA (Nov. 25, 2016), http://www.finra.org/sites/default/files/fda_documents/2016051563901_FDA_JG411996.pdf.

132. *CCA Data*, *supra* note 77.

133. *See id.*; *cf. The Current Status of Regulation Crowdfunding*, *supra* note 12 (reporting that Wefunder has hosted ninety-nine campaigns as of May 15, 2017).

134. The authors were unable to find other examples like this data-driven analysis in academic literature. This is probably unsurprising, given the limited time frame and limited number of offerings to date. The authors hope that this article is the first of many to periodically review and reassess the efficiency of crowdfunding models.

135. *See, e.g.*, Nathan Pierce, *MicroBrewr 066: How to Get an SBA Loan for a Startup Brewery*, MICROBREWR (May 26, 2015), http://microbrewr.com/how-to-get-sba-loan-for-startup-brewery/ ("[T]he ideal candidate should have experience working in a commercial brewery . . . . If you're a homebrewer wanting to get an SBA loan, it could help to have awards for your beer.").

well-rounded team can often make up for inexperience and pay dividends in the end. Fortunately, Reg CF requires disclosures including a "description of the issuer's business [plan]" to protect investors.[136] Rather than seeing such disclosures as a burdensome obligation, issuers ought to embrace the challenge and see this is an opportunity design a strong and viable business plan.

The SEC also mandates that issuers provide "a reasonably detailed description of the purpose of the offering, such that investors . . . understand how the offering proceeds will be used."[137] Here, the early insight shows how critical a low and achievable minimum funding target is to success. As evidenced by Reg CF data to date, if the issuer struggles to raise its minimum amount within forty-five days, the likelihood of ultimately closing on funding is diminished.[138] Once again, this advice is obvious, but some may struggle to apply it to their offering. The clear solution is to provide investors with three scenarios: worst case, average case, and best case. This three-tiered structure grants issuers the flexibility to execute on effectively different roll-outs of the business plan, contingent on how much capital is raised. For instance, an issuer could (1) in the worst case, lease premises and equipment; (2) in the average case, lease premises but purchase equipment; or (3) in the best case, purchase both premises and equipment. Even though company founders may prefer to purchase both premises and equipment, they would be better served by at least considering a worst case scenario, because they will sooner find themselves on the road to a successful offering.

With respect to minimum investments per investor, our advice is somewhat counter to the previous paragraph, in that a minimum too *low* may backfire on the company. This strategy once again relates to the psychological theory of anchoring, wherein an investor who, for example, otherwise may invest $2000 in a company instead settles for the bare minimum $1000.[139] Under this scenario, the issuer has lost half of the potential investment and will require twice

136. 17 C.F.R. § 227.201(d) (2016); Regulation Crowdfunding, 80 Fed. Reg. 71,388, 71,390 (Nov. 16, 2015).

137. Regulation Crowdfunding, 80 Fed. Reg. at 71,401 (Part II.B.1(a)(1)(c)(iii)).

138. *CCA Data*, *supra* note 77. One hundred thirty-two days is the average length of all Reg CF campaigns. *Id.* One hundred eight days is median length of Reg CF campaigns to date. *Id.*

139. *See supra* notes 96–98 and accompanying text.

the number of potential investors.[140] Now, it is also admittedly true that the higher the minimum investment per investor, the smaller the actual pool of willing and able investors. This is a fine line to walk, but as in any securities offering it is the company's role to figure out the "sweet spot": where enough investors are able to participate, yet the investment level is not too low.

Our advice is not to dip below $1000 per investor in an equity offering and to preferably hover between $2500 and $5000, if possible. For most offerings, this strategy will yield a capitalization table of one hundred investors or less,[141] which we believe is manageable. Once a founder, especially an unseasoned one, is left to manage investors in the triple digits, the founder may find his or her time and resources are too often being spent managing investor questions, expectations, and administrative tasks, such as transfers of interest. Additionally, issuers who are able to inform the crowd that only one hundred investors at the very maximum will be permitted to invest may benefit from the competition created to fill those spots. And, in the event one or more investors purchase a large amount of shares, the number of investors permitted could radically drop.[142] Absent a reasonably high minimum and cap on total number of investors, issuers may find themselves with close to one thousand investors,[143] an untenable situation for some.

A strategy often suggested to curb the issues arising from the sheer number of non-accredited investors on the company's cap table is to create a special purpose entity (SPE).[144] The main

140. As mentioned briefly in Section II.A, *supra*, the size of the issuer's network can play a major role in the ultimate success of a crowdfunding offering.

141. This estimate is the result of a comparison of the average committed and successful capital numbers from the text accompanying *supra* notes 116 and 119 (approximately $251,000 and $226,000, respectively) and dividing by $2500.

142. *See* 17 C.F.R. § 227.100(a)(2)(ii) (2016) (allowing an annual investment of up to $100,000 for the wealthiest investors).

143. *E.g.*, *Cleveland Whiskey*, WEFUNDER, https://wefunder.com/cleveland.whiskey (last visited Mar. 31, 2017) (displaying a successful offering that raised $711,787 from 952 investors).

144. Note that SPEs are prohibited under the Final Rules for Reg CF, but proposed legislation, the Crowdfunding Enhancement Act, S. 1031, 115th Cong. (2017), includes a reversal of this ban; this bill was previously proposed as the Fix Crowdfunding Act in 2016 but did not make it out of the Senate, despite being passed by the House. *See* Anthony Zeoli, *The Fix Crowdfunding Act. What It Fixes & What It Does Not*, CROWDFUND INSIDER (July 28, 2016, 5:45 PM), https://www.crowdfundinsider.com/2016/07/88536-fix-crowdfunding-act-fixes-not/.

objectives to this structure are to (1) only show one investor on the issuer's capitalization table; (2) effectively silence the investors from a corporate governance standpoint; and (3) prevent a secondary market from forming where investors are trading company shares.[145] This strategy has mixed consequences in the crowdfunding context.[146] On one hand, SPEs are a strategy worth considering from the issuer's perspective, because management of the company will potentially run more smoothly and future (more sophisticated) investors may appreciate the smaller capitalization table. On the other hand, however, crowdfunded investors may get wise to some of the inherent concerns related to SPEs, such as (1) Who is creating the SPE?; (2) Who is managing the SPE?; (3) Who is covering the costs related to the SPE?; and (4) How should transfers of interests in the SPE be dealt with? On this last question, the most pressing concern is that investing in a private company is an inherently illiquid proposition. So, offering investment in an illiquid entity that itself owns interests in an illiquid entity seems to do a disservice to unsophisticated investors. Having said all of this, there are examples where SPEs are apparently working.[147]

Shifting to another truism of investment crowdfunding, we now discuss the adage that an issuer should raise as much as it can—typically in the form of verbal commitments—before commencement of the offering.[148] Anecdotally, this often shakes out to 30–40% of capital committed prior to the launch of the campaign. As a verbal commitment of course, investors are not obligated to

145. *Id.*

146. *See id.*

147. For example,

> PeerRealty invests as a single limited member into a sponsor's Limited Liability Company ("LLC") or Limited Partnership ("LP"). All PeerRealty investors are pooled into a special purpose [entity], typically an LLC, and then PeerRealty subscribes to the sponsor's entity as a single investor. This means the sponsor is only responsible for one report, one distribution and one K-1. PeerRealty processes all of the underlying reports, distributions and K-1s for our investors.

Education: Sponsor Questions, PEERREALTY, https://peerrealty.com/pages/education (click "How are investments structured?" under "Sponsor Questions") (last visited Mar. 31, 2017).

148. Of course, issuers may not officially solicit for investments until the Form C offering statement has been filed with the SEC. *See* Regulation Crowdfunding, 80 Fed. Reg. 71,388, 71,423 (Nov. 16, 2015).

follow through on their promise.[149] Nonetheless, assuming a large portion of the commitments does indeed invest, the issuer can ride that wave of investors towards a successful closing. This concept is best known as the bandwagon effect, where someone is more likely to perform an action if others have, too.[150] In more modern times, this has also been termed "FOMO," or the "fear of missing out."[151] Applied to crowdfunding, if individuals see across their social networks that friends and acquaintances support a campaign, they are more likely to follow suit.

A similar strategy to pre-funding a campaign with verbal commitments is funding via a convertible note bridge financing.[152] The capital raised here funds company operations and campaign-related expenses[153] during the campaign. In a common scenario, the issuer offers "friends and family" superior investment terms to the crowdfunded offering round.[154] These investors are rewarded for backing the company at a somewhat riskier stage by receiving a conversion discount on the back end.[155]

149. *See The Guide to Equity Crowdfunding*, *supra* note 98 (discussing the art of closing a deal with an investor).

150. *See Bandwagon Effect*, INVESTOPEDIA, http://www.investopedia.com/terms/b/bandwagon-effect.asp (last visited Mar. 31, 2017).

151. *See FOMO*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/FOMO (last visited Mar. 31, 2017).

152. Convertible notes are debt instruments paying interest with a firm maturity but with the unique quality of converting into equity securities of the issuer upon a certain "trigger" such as a sales benchmark or Series A Financing. *Compare* Gordon Daugherty, *Using Verbal Commitments to Secure Your First Investors*, SHOCKWAVEINNOVATIONS (Dec. 27, 2016), https://shockwaveinnovations.com/2016/12/27/using-verbal-commits-to-secure-your-first-investors/ (explaining the use of verbal commitments to secure investments), *with* Antone Johnson, *Convertible Note Financing 101 for Startups*, BOTTOM LINE L. GROUP: MASHTAG BLAWG (Oct. 31, 2011), http://www.bottomlinelawgroup.com/2011/10/31/convertible-note-financing/ (discussing convertible note financing).

153. These campaign-related expenses can include, for example, legal, accounting, marketing, public relations, and portal fees.

154. *See, e.g.*, *How to Set Conversion Discounts in Convertible Notes*, STARTUP LAW. (Dec. 18, 2009), http://www.startuplawyer.com/seed-rounds/how-to-set-conversion-discounts-in-convertible-notes. A common example is a conversion "discount" of somewhere between ten and twenty-five percent. Effectively, upon closing of an equity crowdfunded investment round, the convertible note investors can buy shares or units at $0.80 or $0.90 on the dollar.

155. *See, e.g.*, Johnson, *supra* note 152 (discussing conversion discounts).

One of the paramount considerations for issuers is the legal structure of their company. Issuers typically choose between limited liability companies (LLCs) and C Corporations (C-Corps) as the two most common entity types.[156] However, more and more "public benefit corporations" (B-Corps) or some variant thereof are being used as a means to provide some social good in addition to profits.[157] C-Corps, despite double taxation, are the most used entities for raising capital, with 73% of all Reg CF offerings, according to CCA.[158] Further, of security types, common stock is the most widely used, representing over 47% of all C-Corp offerings.[159] Additionally, common stock offerings represent the most capital closed upon through Reg CF offerings to date, accounting for over $3.6 million.[160] Meanwhile, for LLCs, common membership units as a security type raised the most capital under Reg CF, accounting for 22%.[161] The lesson to be learned here is that simple financing structures—like corporations raising capital via common stock—offer the best opportunities to raise capital in the short term.[162]

156. *CCA Data*, *supra* note 77.

157. *Id.* At a higher level of abstraction, apparently even crowdfunding platforms themselves are reincorporating as B-Corps. *See* JD Alois, *Saving the American Dream: Wefunder Becomes a Public Benefit Corporation*, CROWDFUND INSIDER (Nov. 2, 2016, 8:10 AM), https://www.crowdfundinsider.com/2016/11/91963-saving-american-dream-wefunder-becomes-public-benefit-corporation/; Alison Griswold, *Kickstarter Wants to Be Sure You Know How Much Good It's Doing*, SLATE: MONEY BOX (Sept. 21, 2015, 4:58 PM), http://www.slate.com/blogs/moneybox/2015/09/21/kickstarter_incorporates_as_a_public_benefit_corporation_that_supports_creative.html.

158. *CCA Data*, *supra* note 77.

159. *Id.*

160. *Id.*

161. *Id.* ($1.73M out of $7.7M).

162. Over time, the crowd may become more sophisticated and open to alternative security types such as SAFEs and more complicated debt securities. SAFEs were designed by incubators in Silicon Valley. *See Startup Documents*, Y COMBINATOR (Feb. 2016), https://www.ycombinator.com/documents/. They represent a significant portion of total crowdfunding offerings, both for corporations and LLCs. *See CCA Data*, *supra* note 77. However, commentators have mixed reactions as to whether SAFEs are appropriate for unsophisticated investors. *Compare* Joseph M. Green & John F. Coyle, *Crowdfunding and the Not-So-Safe SAFE*, 102 VA. L. REV. ONLINE 168 (2016), *with* Amy Wan, *When You Use a Bomb to Swat a Fly: A Response to the Proposal of Banning SAFEs in Crowdfunding*, CROWDFUND INSIDER (Sept. 27, 2016, 12:01 PM), https://www.crowdfundinsider.com/2016/09/90501-use-bomb-swat-fly-response-proposal-banning-safes-crowdfunding/, *and* Joe Green

In addition to focusing on traditional security and entity types, issuers would be wise to incorporate investor perks into their campaigns, such as access to special company products and services. Melding Kickstarter-like rewards into investment crowdfunding campaigns can yield increased enthusiasm from investors.[163] Examples include free growlers from breweries[164] and promotional discounts on certain products.[165]

Campaigns will also see more success from strong video presentations accompanying their offering documents, once again according to CCA data.[166] Early evidence shows that campaigns with no video or a video with poor production quality fared worse in terms of raising capital.[167] CCA's analysis of the videos, although purely subjective, determined that campaigns with videos scoring an eight or higher on a scale of ten were most likely to reach the minimum funding target.[168] So, the takeaway for issuers is to invest marketing dollars into videos in order to create an emotional connection with the audience.[169]

Social network reach has been shown to be a critical component to campaign success.[170] Data aggregated from CCA cross-referenced

& John Coyle, *When It Comes to Retail Crowdfunding, SAFEty First*, CROWDFUND INSIDER (Oct. 26, 2016, 8:00 AM), https://www.crowdfundinsider.com/2016/10/91609-when-it-comes-to-retail-crowdfunding-safety-first/.

163. In fact, there are those who argue that rewards in some sense are essential to *any* crowdfunding raise. *See* Kathleen Minogue, *What Rewards Can Teach Equity Crowdfunding*, CROWDFUND BETTER (July 25, 2016), http://crowdfundbetter.com/rewards-can-teach-equity-crowdfunding/ (arguing that rewards are a way to build essential "social proof" of concept).

164. *See, e.g.*, *Invest in Hawaii Cider Company*, WEFUNDER, https://wefunder.com/hawaiicider (last visited Mar. 31, 2017) (giving free growlers to individuals investing $1000 or more in the company).

165. *See, e.g.*, *Invest in My Trail*, WEFUNDER, https://wefunder.com/mytrail (last visited Mar. 31, 2017) (offering lifetime 20% discounts to investors of $1000 or more).

166. *CCA Data*, *supra* note 77.

167. *Id.*

168. *Id.* In fact, campaigns that had any video outperformed campaigns with no video by a factor of almost 11:1. *See id.* (reporting videoless campaigns at $1,497,218 and campaigns with video at $16,447,251).

169. In many ways, this emotional connection is tied in with the concept of "social proof." *See* Minogue, *supra* note 163.

170. This is not unique to equity crowdfunding. Rewards crowdfunding campaigns also depend on extensive social network reach. *See 18 Factors that Impact How Much You'll Raise Through Crowdfunding*, USEED, https://useed.org/18-factors

against Reg CF campaigns indicates that it takes approximately 3225 connections across company founders' social networks in order to raise $50,000.[171] Extrapolated further, it takes 9275 connections to raise $250,000 and over 16,000 connections to raise $750,000.[172] Although there are certainly exceptions to this rule, it is very clear that the wider the reach a company has in social networks—whether it be Facebook, Twitter, LinkedIn, or the next hot platform—the higher the likelihood of raising capital.

Another obvious statement, though worth noting, is that issuers should avoid both launching campaigns and spending advertising dollars on the weekends and right before holidays, as both timeframes equate to low investor engagement, according to CCA.[173] Conversely, data shows that launching and/or marketing in the middle of the week leads to the highest level of investor engagement.[174]

Similar to reward-based crowdfunding campaigns on Kickstarter and IndieGoGo, constant and timely communication with investors is key.[175] According to CCA, "companies that communicated with their investors saw higher valuations than those companies that did not communicate."[176] The lesson learned is that providing progress updates engages investors, builds trust, and leads to more capital invested.

In conclusion, there is no one package, plan, or product that will guarantee issuers success. Rather, there are suggested best practices to follow both before and during offerings to increase the likelihood of reaching minimum funding. Such practices include, but are not limited to (1) simple, easy to digest securities such as common stock; (2) traditional entity structure in the form of a corporation; (3) large social networks for the directors and officers to tap into; (4) strong video production; and perhaps most importantly, (5) gaining pre-commitments from family and friends prior to launch.[177] We acknowledge that these conclusions may be

-impact-much-youll-raise-crowdfunding/ (last visited Mar. 31, 2017).

171. *CCA Data*, *supra* note 77.

172. *See id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.* Preferably the pre-commitments are accomplished by a non-integrated

somewhat premature in this very nascent industry. All the same, we hope that these recommendations might provide issuers and their counsel with useful starting points when considering how to use investment crowdfunding.

V. CONCLUDING REMARKS: THE FUTURE OF CROWDFUNDING

In conclusion, investment crowdfunding offers an exciting opportunity for small issuers to access a previously untapped (and arguably untappable) pool of capital. Based on the first eight months of offerings, it is possible to draw some tentative conclusions; as each Part above includes a brief summary, they need not be repeated here. Investment crowdfunding is also an area ripe for immediate and ongoing research to see how businesses perform after the capital raise, especially as more offerings close (or fail to close) on funds.

In the meantime, it is incumbent upon lawmakers to pass legislation improving upon and easing the capital-raising process. Namely, the Crowdfunding Enhancement Act attempts to fix, among other issues, the SPE prohibition discussed above.[178] Additionally, the Crowdfunding Enhancement Act has contemplated increasing the $1,000,000 Reg CF funding limit.[179] We think these are sensible proposals for immediate action.

At the state level, amendments to many of the thirty-plus intrastate investment crowdfunding offerings are currently

convertible note offering.

178. *See* Crowdfunding Enhancement Act, S. 1031, 115th Cong. (2017), https://www.congress.gov/bill/115th-congress/senate-bill/1031.

179. *See id.* § 2. Throughout Europe, where investment crowdfunding has matured over the past decade, maximums up to $5 million are standard. JEFF LYNN & BEN THORN, CROWDFUNDING LEGISLATION REFORM: WHAT IS NEEDED AND WHY 2 (2016) (on file with author).

> If the burdens placed on issuers make raising capital through investment crowdfunding significantly more expensive, time-consuming or otherwise difficult than raising money through other channels (such as institutional or private angel investors), the consequence is not just higher costs to the issuers. Instead, it will cause businesses only to turn to crowdfunding as a last resort after more efficient capital-raising methods have failed. The result will be that ordinary retail investors will have access only to those businesses that cannot raise capital elsewhere and that, by implication, have the least chance of success.

Id. at 1.

underway[180] in order to (1) accommodate the new Rule 147A and (2) benefit from Rule 504's higher ceiling of $5,000,000.

We are also encouraged by the prospects of a new SEC chair intent on decreasing regulation in this space.[181] With the current President's wealth of business experience,[182] together with the Republican-majority Congress that generally supports his platform of business de-regulations,[183] perhaps we are embarking on a golden era of private capital funding.

However, if we are to raise over $100,000,000 in Reg CF capital as some have suggested,[184] a lack of public awareness would still hold us back. Making the public more cognizant of this new avenue to raise capital will take time, creative marketing campaigns, and perhaps the good luck of a Reg CF issuer taking a meteoric rise. The next chapter in the story of crowdfunding should be titled: Onward!

VI. POSTSCRIPT: BEST PRACTICES FOR INVESTING IN THE NEXT GENERATION OF BUSINESS LAWYERS

Editor's Note: After writing this article and as the authors prepared to participate in the symposium associated with this issue of the Mitchell Hamline Law Review*, "Lawyers as Business Leaders: The Unique Skills, Knowledge, and Perspective of a Legal Education," the authors compiled the following reflections on the symposium topic.*

A symposium on how well law schools prepare the next generation of business lawyers is either extremely timely or long

180. *See, e.g.*, H.F. No. 444, 90th Leg., 1st Sess. (Minn. 2017), https://www.revisor.mn.gov/bills/bill.php?b=House&f=HF0444&ssn=0&y=2017 (proposed 2017 MNvest amendment).

181. *See* Connie Loizos, *Why Silicon Valley Is High-Fiving over Trump's SEC Pick*, TECH CRUNCH (Jan. 26, 2017), https://techcrunch.com/2017/01/26/why-silicon-valley-is-high-fiving-over-trumps-sec-pick/ (predicting that under nominee Walter "Jay" Clayton's leadership, "the pace of deal-making will accelerate . . . including on crowdfunding platforms").

182. *See* Brody Mullins & John D. McKinnon, *In Donald Trump's Washington, Business Lobbyists Champ at the Bit*, WALL ST. J. (Jan. 10, 2017), https://www.wsj.com/articles/trump-win-puts-range-of-business-interests-back-in-play-1484044223 (discussing the current climate of excitement among U.S. businesses in anticipation of Trump's business-friendly policy).

183. Diane Stafford & Mark Davis, *Obamacare, Numerous Regulations Face Trump Reversals*, KAN. CITY STAR (Nov. 9, 2016, 5:50 PM), http://www.kansascity.com/news/business/article113776653.html.

184. *CCA Data*, *supra* note 77.

overdue, depending on who you ask. In some ways, a dialogue of how best to introduce young people into the ranks of our esteemed profession will always be relevant regardless of the particular focus, and it is our pleasure to contribute here. But in recent years, it has become patently clear that the role of lawyers, in business particularly, is changing. In general, it can no longer be assumed that the only pinnacle of law school success is a big firm job in private practice.

More and more lawyers are asked to step into leadership positions in-house, and that has brought with it heavier ethical responsibilities and higher expectations that lawyers speak the language of business. Technological breakthroughs have begun to replace some of the functions traditionally filled by junior attorneys. Today's business-focused law school graduate will be expected to speak fluently not only in legal issue-spotting, but also in balance sheets, corporate strategy, and industry politics.

To their credit, many law schools are already adjusting course to adapt to this new reality. We offer some thoughts below about the best of these trends and some suggestions as to where there might be room for improvement. These thoughts, of course, are influenced by personal experience and should therefore be received with deserved grains of salt. Feel free to disagree or demand more explanation as you wish.

Zach Robins: These days, I interact with law school via the summer associates at the law firm where I practice. For some, it is clear that they have specifically tailored their law school experience to overlap substantially with what might traditionally be considered business school subjects. Others seem entirely baffled by balance sheets and governance concepts, and this confuses me. Even if not working on corporate or transactional projects, most lawyers interact with business clients at least at some point in their career. Even non-business-focused lawyers deal with these concepts personally at some point when in a firm or government setting. Having a working knowledge of these daily concerns seems like a no-brainer. I think law schools could do a better job exposing students to these concepts earlier on.

It is not clear to me who can best "teach" this concept, but I think law students should be empowered to define their own career path. In this regard, I think law firms and other legal employers have a part to play. For example, my participation in getting the

Minnesota intrastate crowdfunding statute drafted was not due to some work assignment bestowed from on high. We had the enthusiasm, we defended the value proposition to my employer, and my firm was entirely supportive. To tie in with my earlier point, my experience with defending a business idea came in handy when advocating for a potentially negative-return time commitment. Crowdfunding issuers continue to contact the firm for assistance with their offerings, rewarding the bravery.

Tim Joyce: I was fortunate (in my opinion) to come to law school after approximately a decade in the "real world." Now, I am about to go back into the real world, one degree richer and several thousand dollars further in debt. This has caused me to think critically and objectively at many points about the value of a law degree in 2017.

From an older student's perspective, I think the most valuable thing law schools have begun to do is focus on practical and clinical experiential learning. In addition to knowledge of the law, this style of instruction (done properly—that is, graded holistically) most closely simulates the real-life experience of attorneys. For instance, my 1L class was given the opportunity to evaluate the merits of a hypothetical employment case and draft memos to both the client and the assigning partner. The assignment gave us the opportunity to practice some non-legal writing skills—formatting, tone, addressing a non-lawyer audience—that can have as much, if not more, impact on the outcome of a negotiation as the merits. In another class, we spent the semester negotiating the terms of a hypothetical LLC operating agreement while simultaneously learning the law of partnerships, LLCs, LLPs, and other business organizations. I can honestly say that concepts related to this assignment have come up literally dozens of times in my clerkship. Law schools need more classes like this one, and such classes should be more often included in graduation requirements.

In a similar vein, and I openly admit the apparent dissonance between my statements and the publication medium, I think law schools spend too much time emphasizing the benefits of participation on law reviews and journals. That is not to say that I think journals are wholly without value—I wouldn't manage the tech journal at my school if I thought that. I only think the historical prestige associated with being an editor or staffer is either no longer relevant or never was. Being an editor or staffer is fine for students

interested in becoming subject-matter experts (say, in investment crowdfunding) or impressing a judge with demonstrated attention to detail. For everyone else, see my earlier comments about the value of experiential learning opportunities.

Appendix D7

Economic Development in Rural Places

- NEOEDD contracted with Hatch Innovation to create new economic development strategies for the rural region. (NE Oregon, 3-county area, pop. 2,000 – 12,000)
- The Northeast Oregon Economic Development District (NEOEDD) ended up creating the Northeast Oregon Community Capital Collaborative as a vehicle to build collaboration, educate, and regional solutions in their very rural area.
- “Community Capital” as an ideal united leadership from each county (for the first time)
- The Local Impact Investing Opportunities Network (LIION) was one strategy.
- Three were developed, one in each town/county, along with the educational programming.
- Hyper-local

Northeast Oregon Economic Development District

New Initiatives for Economic Development

- ✓Local Impact Investing Opportunity Network (LIION)
- ✓3-Hour Workshops and Training
  1. *Introduction to Local Investing*
  2. *How to be a Smart Local Investor*
  3. *What Local Investors Want*
- ✓Local-First Campaigns
- ✓Crowdfunding (Kickstarter)
- ✓Pre-Purchasing (CSAs, Credibles)
- ✓CrowdInvesting (Community Public Offerings)

Northeast Oregon Community Capital Collaborative

A LIION is:

- A loose-knit, hyper-local group that is designed to foster economic development.
- An educational forum where you learn about your local economic climate.
- A place to network with business owners and citizens.
- A place to learn about local investing opportunities.
- A chance to get involved in your local economy.

A LIION is Not:

- An investment club.
- A fund.
- A place where you can get help figuring out where the good deals are.

Contact Lisa Dawson, ED, NEOEDD: lisadawson@neoedd.org

Northeast Oregon Community Capital Collaborative

springboard
INNOVATION

Resources for Growing Community Capital

Part of the Community Capital Resources of ChangeXchange NW

HOW TO LAUNCH A LIION

Local Impact Investment Opportunities Network

change X change
northwest

"If demand for microenterprise-intensive services and products was met locally in communities around the United States, we would create 10-16 million new jobs."
-"The Power of One in Three" report, 2012. Association of Enterprise Opportunity

springboard
INNOVATION

"What if...

we invested 50% of our assets within 50 miles of where we live?"

-Woody Tasch, author, *Slow Money: Investing as if Food, Farms and Fertility Mattered*

"What if...

the citizens of a town could be in charge of the health of their own local economy?"

"In any economic ecosystem, everyone is a stakeholder, accredited or not—wealthy or not. Why don't we invite these potential community investors to become sources of local economic capital as well as recipients of valuable returns?"

-Amy Pearl, Founder, ChangeXchange NW

What if it really was up to us?

LION: A matchmaker for investors, businesses

Allison Arthur | PTLeader.com

This article has been shortened for brevity but content was not changed.

Earll and Rena Murman are banking on Sweet Laurette's Café and Bistro – and HOPE Roofing & Construction, Finnriver Farm & Cidery and Pindell Engineering – to succeed. So it's not unusual for the Murmans to have dinner at the café with friends. And it's not unusual for Earll, a retired aerospace engineering professor, to stop in at HOPE Roofing to see how Jordan and Zach Eades are doing. "Every one of these investments we've made – have connections to the company beyond the financial connection," said Earll. **"The ultimate return is stitching together community."**

The Murmans are two of some 50 members of Local Investing Opportunities Network (LION), a community of local investors who meet up online with local businesses and nonprofits in need of funding. As Wall Street banks make headlines for being bailed but then in turn pull the plug on funding for small businesses on Main Street, organizations such as LION are surfacing all over the country. And the one in Port Townsend not only is growing, it has been written up in how-to books including *Local Dollars, Local Sense* by Michael Shuman, which has the subtitle *How to Shift Your Money from Wall Street to Main Street and Achieve Real Prosperity.*

In another, *Locavesting: The Revolution in Local Investing and How to Profit From It* by Amy Cortese, a former *BusinessWeek* editor, LION got its own chapter. **Before LION, local investing was uncoordinated**.

Growing the network

As of January 2012, 20 investors had made 74 transactions in 43 deals for a total of $2.33 million in loans to local businesses and nonprofits throughout Jefferson County. Another $400,000 or so is in actual equity stakes (ownership). The average size of a loan is $66,000, but the median loan is for $35,000 with seven loans larger than $100,000 and one almost at $300,000.

LION actually doesn't do transactions on its own. "It's up to people to initiate their own connections. We allow businesses to let potential investors know about their investing opportunities. It's more like the way things used to be. Local investing used to be the only kind of investing. Then the global markets took over. Now we're getting back to our roots," said Frazier. Technically, many LION investors are unaccredited, "which means everyone can do it, not just wealthy people."

LION facilitates that "getting to know" process and investors use what is known as a nonpublic exemption.

"We need to have pre-existing relationships between the business owner and the potential investors and in a small community like ours they are usually already in place," Frazier said. Businesses and investors who know each other can invest without dealing with a lot of restrictions – and that trend is growing nationwide.

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Gap funding high on list
Recently, LION has been hearing about a lot of businesses in need of gap funding, funding to help buy inventory for the summer or make it through the winter. "A number of local businesses have had their lines of credit cut and pulled," said Frazier. **"We're not here to bail people out. We want to help the ones that are here to stay. We're not a bank, but we can help get people through seasons and do expansions and realize opportunity," he said.**

Banking in the living room
Jordan Eades remembers the meeting well. LION members who expressed interest were invited Dec. 14, 2011 to come meet her and her husband Zach and talk about HOPE Roofing & Construction.

"Initially, we considered (LION) as a last resort option. But then, we kind of felt like we were running out of options," said Zach of being told by a bank that it might take three to four more months to know about a loan. Instead, they went to a LION open house in November 2011 and within two weeks submitted a request. **The terms we got were very good, better than what we would have received through the Small Business Administration."**

While a local bank had talked about 7.5-percent or possibly even 9-percent interest on the loan, the Eadeses ended up with a five-year loan at a 5.5-percent interest rate. Investors are fine with that rate because they couldn't get that kind of return on their money at a bank these days.

And unlike bankers, who might cut a check and never call unless the Eadeses missed a payment, Earll stopped by after the deal was made to see how things were going. "I don't think anyone has ever had a banker stop by to see how they're doing. From head to toe, it's been a good experience," said Zach.

More than money
The Eadeses say Murman has given them more than money. **"It's more than just monetary support,"** said Jordan, director of the Jefferson County Chamber of Commerce's Young Professional Network, a group committed to making the county "the land of local opportunities for young professionals. It's the potential guidance and involvement of your investors. Many of them are able to offer business advice and strategic planning. "At the end of the day, they want to see you succeed as much as you want to succeed," she said.

The Eades have started paying off the loan the Murmans and three other investors gave them. "I think our model of lending is changing," said Jordan. "As a community and a county, we are working to provide resources to our residents and business community. That type of support is critical and is a model for local sustainability. **"Without a shadow of a doubt, I would go through the process of LION again. It was a moving process and makes me feel so good about choosing to live in this community."**

Investing risks, community
Every investor has objectives, said Earll Murman, who moved to Port Townsend from New England in 2006 and joined LION in 2009. "Every investment is risky and every investment has risk, but in this case, we're investing in people who are in the community who we can work with if they need help," he said of the Eadeses. "It's a risk we know and understand and are willing to take. You contrast that with investing in a mutual fund."

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There are other risks that Murman says exist that people might not realize. "If we don't have a community with a good economy, that's another risk," he said. "We feel good about investing in our community so it can do well. We all benefit."

As for LION growing, Murman said there is plenty of opportunity for investors. In fact, LION is able to fund less than 50 percent of the requests it gets. Day-to-day banking services and LION are complementary and compatible. "I think banks view LION as an asset to the community," Murman said. "There are loans they can't finance because of bank rules. It is not at all competitive."

While investors with LION get more return than if their money were in a bank savings account, investors also take more of a risk since bank deposits are secure and the local loans are not. So far, loans through LION are current, Frazier said.

Paying back the 'angels'

Laurette Feit, now the solo owner of Sweet Laurette's Café and Bistro in Port Townsend, first learned about LION from a story in the *Leader*. That she could be eligible for a LION loan didn't register with her, she said, until she started looking at a loan she had with a local bank. By using her savings, she had reduced one loan substantially, but the interest rate had risen from 5 percent to 10.25 percent, even after being reworked by a second local bank. "I was at their mercy and it was really killing me," said Feit. Ironically, it was her banker who suggested that she check out LION.

Eventually, two couples and two individuals stepped forward and helped her lower the interest rate on the loan. **"What was great was that everyone was willing to come up with terms that would help me, not hurt me," she said of investors.** "I got better terms with real people in my community who personally are invested in my restaurant," she said of the six-year loan at 5.5 percent interest she is paying to LION investors. Those investors, including the Murmans, come in as paying customers. All told, Feit has seven investors helping her keep 15 people employed in the community.

"I feel like my business is a partnership with the community," said Feit. "When I sign those checks every month and send them off, I'm grateful. "Part of that is that my money is staying in the community. It's not going to California or Japan or anywhere else. They feel the same way, too, this group of angels. They're doing the same thing in reverse. "We're investing in the local community that employs local people. It's a win-win for all parties involved."

Watch the video of the Port Townsend LION and Local Investing

http://vimeo.com/54806298

What is the status of our local economies?

PROBLEM: Our money is flowing out of our local communities.

"100% of our long-term money is invested on Wall Street. Not a single one of the 7,500 mutual funds in the United States invests a penny in local business. And only a third of our short-term money is local."

-source: Michael Schuman

Small businesses account for half of GDP and over three quarters of new job growth. Why is virtually none of our long-term savings directed towards small businesses?

DEMAND: Social and locally owned businesses are underserved by current funding sources.

"Last year alone, the major U.S. commercial banks turned down roughly one million applications for small business financing. And this number reflects only Main Street businesses whose situations were sufficiently promising to even be considered for financing by commercial banks. At the other end of the spectrum, an additional one million U.S. households—without access to mainstream banking services—borrowed small-dollar short-term loans for business purposes."

-"The Power of One in Three" report, 2012. Association of Enterprise Opportunity (AEO).

Standing in the way of small business growth are unmet capital needs. With the effects of the recession continuing to limit the availability of credit, entrepreneurs are hard-pressed to find the capital they need, and the opportunities for returns on investment are limited to a select few. However, the *Oregon Capital Scan* suggests that these gaps "represent clear opportunities for both profitable investment and increased economic development".

OPPORTUNITY: Inviting and engaging new community investors.

If our long-term savings (totaling nearly $30 trillion) that leave for Wall Street were to be redirected towards small businesses across the country, that would constitute the largest stimulus effort in history without costing taxpayers a dime.

RESULTS: Resourcing better enterprises improves communities.

"If just one in three microenterprises hired a single employee, the US would be at full employment." -"The Power of One in Three" report, 2012. Association of Enterprise Opportunity.

The benefits of purposeful redirection of unproductive capital are that we have more power over the local and even the national economy. When small, locally-owned businesses grow and thrive, so do communities. Citizens that are engaged in local investing are far more likely to care about their communities.

Welcome to building a healthy community!

Local economic activity is the weft of the social fabric of a place, creating the livelihoods, relationships and structures that define our lives and our community identity. We know economic health powers wealthy communities. So far, economic activity has been in the hands of a limited few, resulting in economic crisis. Average citizens have never pushed for real structural change—*until now.*

Locally focused capital creates many kinds of returns.
More than two dozen studies have shown that every dollar spent in a locally owned business, when compared to a dollar spent in a similar nonlocal business, generates two to four times the jobs, income, wealth, taxes, and other economic-development benefits. Consider the multiplier effects of a wholesale shift in personal savings towards the community, allowing local businesses to expand local purchasing, hiring and the procurement of services. A stronger local economy in turn builds a more robust regional economy, promoting stability and self-reliance.

Bringing our money home, and keeping it there.
Each of us can decide where our money goes and what it supports. We can move our capital into productive portfolios that match our values. There is a great need for new, independent channels for investment that target the needs of our community. Community investing democratizes capital, allowing ordinary citizens to support the local businesses that enrich their lives and to benefit by those investments.

Investing with an Eye to Impact
Imagine the impact on a community when investment is funneled towards locally-owned and mission-driven enterprises. Community investing becomes a powerful tool to improve communities. In other words, choosing to invest in your community is impact investing.

What is Community Capital?
There are seven different kinds of "capital," or resources, which build community wealth: natural, cultural, human, social, political, built and financial. Investing financial capital in a community positively affects the other types of capital.

What capital does your community lack most?

So, what stands in our way?

Despite the critical importance of relocalizing our capital for healthier economies, there are many challenges that face agents of community-led change. Regulatory structures and lack of knowledge and infrastructure make it difficult to launch, grow, or invest in locally-owned businesses. Most importantly, there are huge misperceptions about local investing that must be overcome before we can generate the needed groundswell towards true homegrown finance.

Outdated Regulations

Securities regulations, written during the Great Depression, were written for a different time in a different context, and no longer meet the needs of our time. If you are an "unaccredited investor" (around 99% of the US population), investing in local businesses is challenging.

Lack of Infrastructure

Many entrepreneurs lack the access to capital that, were it for the right infrastructure, could be available to their business from interested local and regional investors—your neighbors. These gaps in the capital market are structural problems. The 2012 *Oregon Capital Scan* suggests that these gaps "represent clear opportunities for both profitable investment and increased economic development". Local investing broadens this opportunity for return on investment out to ordinary citizens and creates targeted impact at the local level.

Misperceptions

What we think is "common knowledge" is often a myth in need of busting. Consider the following:

- Investing in small businesses is especially risky
- Equity investment is only for venture capitalists
- Angel investors are rich and experienced
- Investing is for professionals
- Local investing is illegal
- The stock market is a safer place to invest

The statements above are misleading or just plain wrong. If citizens learn and engage in compliant practices, anyone can invest their capital in local business—and become a local angel! And, i*nvestments of any kind are risky!* (That is certainly true of the stock market.) But, if we revisit the concept of "investment" and understand that every dollar saved can be a dollar invested into job-creating, livelihood-building local businesses, we fundamentally remodel our role as citizens. Becoming a local investor means actively participating in community-building, but first we must challenge these misperceptions and learn some new terms.

A Local Solution

Introducing the Local Impact Investment Opportunities Network

A Local Impact Investment Opportunities Network (LIION) helps citizens learn about local investing. Its legal, three-part process allows people (accredited and unaccredited) to engage in local enterprises and the local economy. Local businesses often need small amounts to grow, from as low as a few thousand dollars, and learning how to engage to fill that gap is what LIION forums are all about. A LIION helps improve communities.

What's in a Name? LIION says it all.

Local. A LIION is launched by and for a local community or county region.

Impact. By investing in locally-owned and mission-driven businesses, a LIION creates new avenues for improving communities—*on purpose*—rather than focusing only on financial gain. LIION activities can be a town's strategy for economic *and community* development, helping address many kinds of local challenges.

Investment. Citizens invest *directly* into local enterprises facilitated by the LIION events.

Opportunities. Finding opportunities to invest in local businesses is extremely challenging. A LIION exists to introduce these opportunities to interested and qualified local investors, bringing entrepreneurs and community members together to understand the benefits and risks, building important relationships.

Network. A LIION is a network of community members dedicated to establishing a vibrant local economy. It is an opportunity for the community to introduce, understand and meet needs.

Your LIION Logo here!

A Three-Step Model

Central to LIION's success is a three-step process. (Note! Only the *first two* are part of the actual LIION event!

LIION FORUM EVENING

1. The public educational Forum
2. The members-only Spotlights
3. **The PRIVATE MEETINGS** that may or may not happen between an interested investor and entrepreneur **after** LIION events.

The first two parts are facilitated by a team of 3 - 5 lead organizers, and they constitute the actual LIION Evening Event. Both events are educational in nature, helping citizens learn about the economic and social conditions of their city. The two occur one after the other, in the same evening, with food and drinks.

However, these first two LIION events are not when a local investment takes place—the last piece of the model is the time for investment conversations.

> *A LIION is not a lending club, a broker/dealer, an advisory group, or a pitch night. LIION events help facilitate local community economic understanding and activities, but they do not advise on or benefit by any final investment deal. LIION coordinators do not vet business plans or share financial projections. Investing is risky.*

Practice explaining what a LIION is and isn't!

Who is behind this effort? What is ChangeXchange NW?

Since 2004, Springboard Innovation, an Oregon-based 501(C)(3) has been working to build an innovation ecosystem, enabling citizens to drive the future of their own communities. They are an educational nonprofit that helps translate complex and arcane information into usable knowledge. They have worked with experts and visionaries, like James Frazier, Michael Shuman, and Michelle Sandoval, to gather and refine resources that can be replicated in communities everywhere. They developed educational workshops for the ChangeXchange NW Network communities.

Springboard launched ChangeXchange NW to build a regional backbone of experts, tools, and workshops to strengthen local economies across the states of Washington and Oregon.

ChangeXchange NW wishes to grow local economies by connecting the dots between socially-minded investors and locally-owned businesses, enabling communities to invest in themselves.

change X change
northwest

www.changexchangenw.org

Intent of this toolkit

A few communities are launching LIIONs with passion and excitement. But, because of a lack of understanding of the legal landscape, some have incurred regulatory scrutiny. Although there are specific details to keep in mind and some simple rules to follow, it is important to remember that investing practices demand clear guidelines and transparent practices. This toolkit is the result of wanting to help communities create LIIONs legally to facilitate local investment deal flow.

This document is intended to help current or potential LIION organizers understand the legal landscape around community investing and provide clarity about the law, the SEC and other unfamiliar concepts. It is a collection of best practices informed by securities regulations and relevant case law. The resources in this toolkit are here to help the organizers and participants of a LIION successfully facilitate community investment.

Also included in this toolkit are also tools and resources for businesses and entrepreneurs in search of capital.

Let's get a LIION started for community-led community change!

springboard INNOVATION

Roadmap

1. GETTING UP TO SPEED
    a. KEY TERMS YOU SHOULD UNDERSTAND
    b. INVESTING AND THE LAW: WHAT YOU NEED TO KNOW
    c. FREQUENTLY ASKED QUESTIONS
2. LAUNCHING A LIION
    a. SET UP THE ORGANIZING TEAM
    b. PREPARING FOR SUCCESS
    c. MARKETING AND MEMBERSHIP: GROWING THE LIION AUDIENCE
3. THE COMMUNITY CAPITAL EVENT: WHAT TO KEEP IN MIND?
    a. EVENT BASICS
    b. SCENARIO PLANNING
4. PLANNING THE PUBLIC EVENT
5. PLANNING THE MEMBERS-ONLY FORUM
6. CHANGE ON THE GROUND
    a. HOLDING THE LIION EVENTS
    b. POST EVENT FOLLOW UP
7. CONCLUSION
8. RESOURCES AND TEMPLATES

1a. GETTING UP TO SPEED: KEY TERMS YOU SHOULD UNDERSTAND

- **Entrepreneur**

French: "One who assumes the risk."

- **Securities**

Federal definition: "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." - Howey test

State definition (about 15 states): "Any situation where funds are being raised for a business venture, the investment opportunity is offered to the public, and the funder's money is 'at risk'"

- **Securities offering**

According to the SEC: "The term ''sale'' or ''sell'' shall include every contract of sale or disposition of a security or interest in a security, for some identified **value**. The term ''offer to sell'', ''offer for sale'', or ''offer'' shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, **for value**."

- **Debt**

An amount of money borrowed from one party to another with the expectation that it will be repaid in full plus interest.

- **Equity**

A stock or other security that represents an ownership stake. Returns are based on how well the business does, with the terms outlined in the offering agreement. There is no guarantee of any financial returns.

- **Accredited investor**

According to the SEC, an individual is an accredited investor if they meet any one of the following criteria:

1. "a bank, insurance company, registered investment company, business development company, or small business investment company;
2. an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;
3. a charitable organization, corporation, or partnership with assets exceeding $5 million;
4. a director, executive officer, or general partner of the company selling the securities;
5. a business in which all the equity owners are accredited investors;
6. a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds $1 million at the time of the purchase, excluding the value of the primary residence of such person;

7. a natural person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; or
8. a trust with assets in excess of $5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes."

Anyone who does not meet these criteria is considered an **unaccredited investor**. "Unaccredited investors" account for approximately 99% of the American population.

- **Due diligence**

Due Diligence is the process of evaluating a prospective decision by acquiring information about the financial, legal, and other material data. The process of gathering relevant information about a person, company or organization in preparation for some kind of transaction.

The term *due diligence* describes a general duty to exercise care in any transaction which may have a material impact on one's livelihood.

- **Substantial, pre-existing relationship**

Having a "substantial pre-existing relationship" pretty much means what it implies, though its definition varies from state to state. The bounds of this term are currently established by case law and SEC rulings, but, generally speaking, a substantial and pre-existing relationship is important when discussing a private investment opportunity. It also implies that any financial discussions remain **private, between two parties who know each other.**

Because there is no formal definition provided by the SEC, the LIION process we recommend is built on two practices as safeguards: 1) develop substantial pre-existing relationships between potential investors and entrepreneurs through multiple events, and 2) all financial and deal-specific information is shared between two parties, in private.

- **General solicitation**

Offering securities to the public. "The Public" is interpreted to mean people you do not know. You engage in public selling when you place an ad in the paper, put up a poster or a flyer, or address a large crowd of people.

- **Forward-looking statements**

When a company projects future expenses and revenue for next year based on certain assumptions, that is a forward-looking statement. These statements make inherent "promises" on potential income, and thus possible returns on an investment. For example, the statement "we project an 80% growth rate in sales" is a forward-looking statement. Forward looking statements are often based on best guesses and cannot be predicted accurately.

- **Microbusiness**

According to the Association for Enterprise Opportunity, a microbusiness is a small business having fewer than 10 employees. Microbusinesses comprise 80% of businesses in the country.

- **Small business**

According to the SBA, a small business is generally defined as having fewer than 500 employees and annual receipts under a certain amount, depending on the industry.

- **Locally-owned and independent**

A business is considered locally-owned if the controlling owners live within the region.

- **Mission-driven/social enterprise**

An enterprise designed *intentionally* to address a social, environmental, financial, or educational issue by leveraging a market-based strategy. Nonprofits can be social enterprises.

1b. GETTING UP TO SPEED: INVESTING AND THE LAW: WHAT YOU NEED TO KNOW

- ✓ Registration and exemptions
- ✓ Accredited vs. unaccredited investors
- ✓ General solicitation
- ✓ Developing substantial pre-existing relationships through a LIION

Registration and exemptions
All securities must be registered with the SEC or must qualify and file for an exemption (or both). Generally, registering a major securities offering is an expensive process that is prohibitive for most small businesses. Recognizing that many of these small businesses have different needs and abilities, the Securities Act of 1933 included sections such as Regulation A, Regulation D, and will now encompass a new Crowdfunding Section with additional exemptions. Within these Regulations are guidelines that provide for special exemptions to the registration of securities.

Entrepreneurs should consult with their legal and tax advisors before deciding which of these exemptions they can and will use, but there are certain stipulations that run through all of them that both entrepreneurs and LIION organizers should be aware of.

Accredited vs. unaccredited investors
Investors in any deal are categorized as either accredited or unaccredited. **Accredited investors** must either work on behalf of an organization or fund that is dedicated to investment, or have extremely high net worth (see "Key terms you should understand" above for the full definition). **Investing by unaccredited investors** (estimated to be around 99% of the population) is regulated far more stringently.

For certain exemptions, you are limited to a specific number of unaccredited investors, generally no more than 35. Beyond that number you will have to register your securities offering. Even in LIION, unaccredited members can ONLY invest in businesses that have gone through the right process to accept investment from unaccredited investors. All deals facilitated through a LIION should aim to qualify for an exemption.

Public pitching

An entrepreneur cannot offer securities to unaccredited investors whom they do not know. This is called "**general solicitation**"). Angel investor forums, pitch fests, and venture capital events are often pitching to all *accredited* investors, who we now know have more opportunities to freely engage in investing. Although there are some platforms – like ChangeXchange NW – that allow entrepreneurs to tap a pool of socially-minded accredited investors, LIION events are designed to help everyone in the entire community, including unaccredited investors, learn more about local investing.

Because the law protects unaccredited investors from unsolicited offerings, an offering of securities cannot be made "publically". An entrepreneur, therefore, cannot stand up during a LIION event and offer a sale of securities or talk about an investment opportunity. They cannot specify any of the details of a potential deal and cannot make '**forward-looking statements'** such as what financial benefits an investor might receive in the future by investing. An entrepreneur can talk about the history of their business, their own expertise, the market outlook and any other general information that does not touch on the future financials or their specific capital needs. See the template in our additional resources for specifics on this presentation. For these **"Spotlights"** we provide a template for entrepreneurs to use.

Before two people talk about securities sales or business financials, they should have a "**substantial, pre-existing relationship**". Typically, investments of these kinds come from **friends and family**. You can understand why. People who know one another will have some knowledge of each other and their business acumen or experiences, will have a feel for their integrity, and should have some level of trust. They will likely have a long history by living in the same town. These kinds of relationships are thought to lower the risk of investing. While this is not always true, data show that the closer the relationship the more likely it is that the investor understands what they are getting involved in.

The structure of the LIION event is designed to develop and cultivate relationships between community members, increasing understanding of local economic realities that go both ways.

Key Takeaways

Since an offering of securities must be registered or file for an exemption, entrepreneurs seeking local investment should be aware of how securities regulations define what they can say to whom. Most importantly, an entrepreneur cannot offer securities to unaccredited investors whom they do not know. However, if an entrepreneur has been invited to describe the terms of a possible investment opportunity by someone with whom they have a "substantial pre-existing relationship" then that conversation is **private**. Participating in the three-part LIION model helps grow these relationships, allowing for community members to learn more about investing in locally owned businesses.

1c. GETTING UP TO SPEED: FREQUENTLY ASKED QUESTIONS

1. Is what LIION does legal?

Yes! LIION is an educational experience. The Network tries to increase knowledge about the law, local investing, and locally owned businesses in order to build important relationships for the local economy to grow. It is not acting as a channel for deals, but an opportunity to learn more. It helps people stay within and understand the SEC regulations, thus enabling people to work within the system. Specifically, remember that:

- An entrepreneur cannot offer securities to unaccredited investors whom they do not know (known as "general solicitation").
- An unaccredited investor may invest in an entrepreneur with whom they have a "substantial pre-existing relationship".
- The three-step LIION model develops these substantial pre-existing relationships between entrepreneurs and local investors.

2. Is this LIION part of a national network of LIIONs?

Yes and no. Many local networks are popping up across the country, but this model is unique and copyrighted by Springboard Innovation, and therefore available for you to use if you are in this training. There is no official national network of LIIONs and LIION is not a trademarked term. It denotes a concept and a methodology for growing the local economy. However, the ChangeXchange NW Network is a regional network of NODEs (Northwest Opportunity Development Ecosystem), which allows for shared best practices and helpful resources. You're not alone!

3. If we are only talking about private investing, why do we still need to care about securities regulation?

All offerings of securities are regulated by the SEC. Private deals often qualify for an exemption from the registration of securities, but they must meet specific requirements to do so. This toolkit will guide you through some of those requirements, but you will need to speak with your legal and tax advisors about the specifics. Springboard has additional workshops for those wishing to become a local investor as well as for entrepreneurs wishing to receive local investment.

4. What kinds of conflicts of interest should I be aware of as an organizer?

Each of the organizing team members should be clear about their motivations for starting the LIION and their understanding of its mission. Communicate with each other to ensure that there is transparency between all the members about the intention and mission of the LIION.

For example, Jim may think LIION is about making businesses more bankable, Melissa thinks the LIION is about mission-driven organizations and Scott thinks the LIION should try and fund each business that comes through. This organizing team will have to identify the key points of agreement and find the places where they need to compromise on the overall mission and intent of the LIION.

5. *What range of capital needs can a LIION help meet?*

Typically, LIION deals range from $5,000 to $150,000, though there is no legal limit. Entrepreneurs may be challenged to find capital from LIION participants above that limit. Another resource for mission-driven organizations is ChangeXchange NW, an online secondary market for mission-driven and locally-owned organizations serving the Pacific Northwest.

6. *Why does starting a LIION need special training?*

Securities regulations limit what can be said publicly about a potential securities offering. We have worked with expert SEC lawyers to provide safe guidance of the process to ensure success. This is why the LIION model has three parts: the public event, the members-only forum, and the private meetings. By creating opportunities for people to meet each other and learn about local businesses, relationships between entrepreneurs and community members can develop naturally. This recommended LIION process can help citizens safely understand the regulations surrounding community investment.

7. *I've never been to any kind of investing forum or workshop. What do I need to know?*

First, this is not an investing forum. In fact, think of these events as public forums for learning. Don't expect to hear about the potential return on your investment, financials or any specifics of a "deal". That may happen for you if you choose to build a relationship with a business owner. Be prepared to think about questions you would like to ask about the business. You can ask any question that does not touch on the offering of securities.

8. *Will I need a lawyer? When should a lawyer or my financial advisor be involved?*

All local investment deals should be reviewed by your lawyer and tax advisor before any paperwork is signed. Financial advisors can help educate you on risk, but generally do not work with local investments. This is up to the investor!

9. *Can we advertise the LIION events?*

Yes, if done correctly. Be aware of the following limitations:

- Don't advertise the sale of securities, that participants will have the opportunity to invest in a particular business, or any kind of return on investment is guaranteed. This would be a problem, and is simply not a true representation of what will transpire.
- Do advertise that it will be a great learning experience and an opportunity to meet your community members over food and drink.
- Do advertise that participants of the public event will be able to become members of LIION, an organization dedicated to improving the community.

<u>Note any questions below</u>

2a. BUILDING A LIION: SET UP THE ORGANIZING TEAM

- ✓ **Team Expertise**
- ✓ **Coordination**

Team Expertise

A strong leadership team has a range of skills. Recruit others who can fill gaps in knowledge and experience. Consider people with expertise in these areas:

- The law
- Finance
- Marketing
- Organizing
- Networking (someone who knows everyone)

Coordination

To maximize efficiency, delegate responsibilities to team members. If your leadership team is more than five people or so, you may even consider creating committees to handle certain areas of organization. Some suggestions for these roles and committees are:

- Member vetting
- Venue planning
- Food procurement
- Agenda planning
- Budgeting

Key Takeaways

Forming and preparing the leadership team is a crucial first step towards the establishment of a healthy LIION. This leadership team is not a formal group – it does not need titles or public meeting notes. However, certain basic rules must be communicated to members, and it is the job of the organizers to ensure that these rules are followed.

Consider the likely roles of each of your LIION team members. Write out a few ideas below:

1. **Team Role and Ideal Experience:**

2. **Team Role and Ideal Experience:**

3. **Team Role and Ideal Experience:**

2b. BUILDING A LIION: PREPARING FOR SUCCESS

To help you be prepared, we've created a list of important considerations to work through with your leadership team.

- ☐ **Define your region.** What geographical region will you serve? Are there any other LIIONs in the region? If so, who operates where? These boundaries don't need to be set in stone, but it will help you decide what it means to be a part of your community. Organizers can then establish relationships with nearby LIIONs to build regional capacity.

- ☐ **Name your LIION.** A name confers important identity and association. A LIION in Northeast Oregon might be called LIION:NEO.

- ☐ **A clear, stated mission.** The mission of a LIION is to strengthen the local economy by retaining capital in the region.

- ☐ **Commitment.** We suggest that the organizers commit to leading the LIION for at least six months.

- ☐ **Advisory Panel for your LIION.** It is important to have a broad professional asset pool that can offer advice and insight. Look to your community to fill in gaps in expertise and approach the individuals who can best fill them. These will be the people you turn to for answers. Springboard and the organizers of this training are here for you, too!

- ☐ **Establish your lines of communication.** We suggest that the organizers use a range of communication channels including an email list, Web sites, newsletters of affiliated organizations, and social media.

- ☐ **Growing and improving.** With models and systems in place to receive and track feedback from participants, LIION organizers can recognize areas of improvement. Also, try to document successes, and community impact. Suggested forms are included in the additional resources.

- ☐ **Be ready for wild success!** Are you ready for fifty people to show up to your event? How will you handle the sudden increase in volume? We recommend having a contingency plan for unexpected attendees so that you do not have to turn anyone away.

2c. BUILDING A LIION: GROWING THE LIION AUDIENCE

- ✓ **New members**
- ✓ **Public event participants**
- ✓ **Publicizing the events**
- ✓ **Outreach strategies**

New members

Establishing membership is the distinction between participants of the public forum and the members-only meeting. Springboard suggests that to become a member, an individual must:

1. Come to the public event at least once, better if twice,
2. Be invited by an existing member,
3. Complete and sign the membership form.

The primary source of new members will be the public event. With that in mind, how will you bring more people to the public LIION event? What is the opportunity for doing so?

Public event participants

The public event is a great way to introduce the community to the concept of local investing. If the agenda is rich with learning opportunities, it will draw in a range of community members. To provide the greatest return with limited resources, organizers should use a range of low-cost publicity methods and carefully target their audience.

Broadening the appeal of the LIION event out to the community will spread a wider net for membership. While much of the community may not be ready to jump in, the LIION holds the potential to prepare them as they continue to attend and learn. Through workshops, activities and the creation of new social ties, an educational LIION event can be the staging ground for the recruitment of new members.

Publicizing the events

When developing your marketing strategy, remember to be careful about how you describe your event. You are publicizing the public learning event, with speakers and food, **not** the members-only forum. You must be careful to make clear that there will not be any sales of securities at the event. Implying that there may be constitutes "general solicitation" and is grounds for the denial of a registration exemption. This puts your entrepreneurs at risk as well as the organization.

That being said, a tailored marketing strategy designed to attract community members interested in learning more about local investment and community development will be extremely helpful in widening your audience.

Consider establishing a target market profile. For example, you may consider using "civically engaged", "financially aware" and/or "community-inclined" as your initial criteria for the identification of potential members. Where would you find similar people? What kinds of institutions would attract them?

Using these criteria, who might be interested in attending a LIION event? Examples include:

- Credit union, community bank members, or coop members
- Chamber members
- Philanthropists and foundations
- Charity event attendees
- Community event organizers

Outreach strategies – Technology can help.

Reach out to your target audience using some of these low cost outreach strategies:

- **Create a flyer and a one-page handout.** Create a flyer with the event details, description and goals that can be easily distributed. It should be clear and aesthetically pleasing.
- **Direct people to a Web site.** A simple web site or Facebook page that shares the schedule will be helpful. If you're particularly tech-savvy, you can create a QR code that will link to your website. QR codes are two-dimensional barcodes that can be read by any smartphone with a QR reader (available for free). There are free QR builders online.
- **Gather emails with permission.** This should be set up through your Web site. Anyone interested in learning more will sign up for your newsletter and/or events notifications, and you can use this pool of contact information as your first wave of publicity.
- **Use social media.** Don't underestimate the importance of a Facebook page, Twitter account and LinkedIn group. These can easily reach a wide range of people without any cost to you. Use these networks as a distribution channel.
- **Engage community partners.** Work with your partners to spread the word.
    - Community calendars
    - Promotion through their media channels
    - Hang flyers at their locations
    - Seek personal recommendations for both members and distribution channels

Key Takeaways

New members of the LIION should come from the public event attendees. Broadening the public event audience is a goal of all LIIONs. Since each citizen is a potential local investor, organizers should implement a range of low-cost outreach strategies that reach a wide, inclusive audience.

3a. THE COMMUNITY CAPITAL EVENT: EVENT BASICS

- ✓ **Remember the three-step model**
- ✓ **Plan for the future**
- ✓ **What are the costs?**
- ✓ **Food and drink**

Remember the three-step model.
A LIION facilitates local investment deals through the three-step model: the public event, the members-only forum and the private meetings. Although investment only takes place in the third, private meetings, the two initial LIION events are necessary to build the relationships between community members that create community-based deal flow. Organizers will have to prepare for two related events, each with different goals and activities.

- The **public event** is a social and educational event that strengthens the local economic ecosystem through educational opportunities and community-building exercises.
- The **members-only forum** is an opportunity for the members of a LIION to hear entrepreneurs present on their locally owned businesses.

Plan for the future.
Springboard suggests that the organizers plan to hold **no fewer than four and up to ten events** during the year. This allows for more members to join, more educational opportunities, and more business needs to be met. *Organizers can then plan well in advance*, allowing them to schedule speakers for future events, prepare long-term marketing strategies and create complementary events.

Food and drink.
Since LIION events are primarily a social opportunity, we highly recommend offering food and drink. Food and drink are important for both the public event and the members-only forum. Some ideas are: host the events at a local restaurant or pub, order pizza or other takeout, or organize a potluck.

What are the costs?
Since the organizers should not be asked to take on the financial burden of organizing the LIION events, you should plan out a budget for the year. Consider all of your expenses (food/drink, venues, workshops, speakers, marketing materials, other various costs) and then decide how you will match them (charge for entry, membership dues, tickets to speakers, sponsorships, donations) or reduce them (sponsorships, community partners, in-kind donations).

Key takeaways
Organizers need to plan both the Public Event and the Members-Only Forum. We suggest planning for 10 events during the year. Remember that food and drink will enhance the appeal of the events. Plan out how you will pay for the event and set a reasonable cost for attendees.

3b. THE PUBLIC EVENT: SCENARIO PLANNING

There are many potential scenarios that could arise that you, as organizers, must be prepared to address.

Someone shows up to the LIION event and starts telling everyone that this is illegal. How do you respond?

Calmly explain to the individual and the group that a LIION is *not* illegal. Certain actions that could be construed as not compliant with SEC security regulations are expressly prohibited by the organizers. The structure and guidelines of a LIION as set out in this toolkit are perfectly compliant with securities regulations. Since no securities are being offered and no money is being transacted, a LIION event does not violate securities regulation.

An entrepreneur makes a presentation and is a complete flop. You and the rest of the leadership team believe that they should not have presented. You notice, however, that a member of the audience seems interested. Each member is expected to pursue interest in any way they choose, but you are concerned. What do you do?

As organizers, you never make recommendations about any investment or business. LIION is a neutral meeting ground. Additionally, poor communication skills do not equal a bad investment, and your judgment of the quality of the presentation may not be accurate. Your role is to emphasize before, during and after an event that all investments are inherently risky and that a savvy local investor knows to conduct their own due diligence and have a balanced portfolio. You may ask questions in the follow up period that reveal some of your concerns, as long as they are appropriate and connected to the presentation.

An entrepreneur and a local investor start talking together in the middle of the room and begin to discuss the terms of a deal in plain earshot. What do you do?

Discussing the terms of a deal in a public manner may constitute a public securities offering. Thank the entrepreneur for their presentation and remind them that the place for private deal-making is outside of the context of a LIION.

Someone wants more education, but the organizing team doesn't have the time to teach them. Where do you send them?

Springboard has many resources to educate individuals and communities on the new landscape of community investment. We have a broad array of materials, courses and professional advisors that can help to answer all questions that arise.

Questions?

4. PLANNING THE PUBLIC EVENT

- ✓ **Speakers**
- ✓ **Workshops and activities**
- ✓ **Potential agenda topics**

Speakers

Speakers offer an educational experience for the community and can contribute to the growth of the local economic ecosystem. We suggest looking to the community. What kind of experience do your community members have? What would interest their neighbors?

Planning for up to ten events also allows for scheduling speakers from out of town well in advance. These include experts on community investing, prominent authors, and academics. Springboard can help facilitate connections to these speakers. Their insights on local investing may bring in a fresh perspective to your LIION, and can offer some "star power" to the event.

Workshops and Activities

Interactive workshops are a great way for participants to have hands-on learning. Springboard and others will be offering workshops around local investing. The public event is also a great opportunity for small group activities that are educational. Using materials from a workshop or a speaker, have these small groups work together on coming up with a mission statement, a preliminary marketing plan, or another focused activity where peer input would be helpful. Don't forget to plan for time to be spent mingling and socializing!

Potential Agenda Topics

Now that you have the outlines of an agenda, what might you want to have people speak about? Be sure to plumb your community for expertise first. Some potential topics include:

1. Impact investing
2. What's wrong with this market?
3. How do we invite young families to our community?
4. Community investing potential
5. Measure your impact
6. How to gauge your business needs
7. Making a private investment deal – what you need to know
8. Building the network
9. Sharing entrepreneurial challenges and problem solving
10. Increasing opportunities for growing entrepreneurialism in your community

Key takeaways

The public event is a fun and engaging event for community members. A well-planned, varied agenda can facilitate community bonding and education, and as organizers your role is to find out what the community wants to learn and then build an agenda around that need. Springboard can help you plan this agenda.

5. PLANNING THE MEMBERS-ONLY SPOTLIGHT FORUM

- ✓ **Preparing the entrepreneurs**
- ✓ **What does the presentation look like?**
- ✓ **Choosing presenters**
- ✓ **Connecting entrepreneurs to other LIIONs**

Preparing the entrepreneurs
One of your roles as organizers will be to prepare the local entrepreneurs to present to the LIION participants. By setting up the "rules of the game" and ensuring that all participants adhere to them, the organizing team keeps the event legally compliant. By preparing the entrepreneurs to present, they will be more successful.

What does the presentation look like?
We include a presentation template that lays out what ought to be included in a community presentation. Also included is a one-page handout that lays out the "rules of the game" you provide to presenters. What can entrepreneurs say and what can they not say? What can occur at the LIION event? What should a local entrepreneur be prepared to do next?

Choosing presenters
The organizing team does not vet the quality of an offering. However, we recommend creating a standardized set of criteria that each entrepreneur must meet (e.g. minimum two years of operation or the owner has lived in the community for a year or more). The criteria should be published and available to all LIION participants. In the end, it is the responsibility of the investing party to conduct their own due diligence before making an investment. **This is not the role of the LIION coordinators.**

Connecting entrepreneurs to other LIIONs
There may be times when an entrepreneur cannot find the funding they need from local investors. The organizers can always send them to other LIIONs. Strong relationships with other LIIONs will strengthen the entire region.

Key Takeaways
Using this toolkit, organizers will be the best-informed participants at a LIION event. It is important to share this knowledge with the other participants and set them up for success. By establishing guidelines for the members-only meeting and preparing entrepreneurs before they present on their businesses, the organizers are keeping the event on track and in line with the mission.

IDEAS? Who might be a good presenter?

6a. CHANGE ON THE GROUND: HOLDING THE LIION EVENTS

- ✓ **Pre-meeting paperwork**
- ✓ **Standard introduction**
- ✓ **Answering questions**

Pre-meeting paperwork
When your participants arrive, especially in the early stages, direct them to the guidelines of the evening. This maybe a flyer or a poster. Someone in the team will publicly present a standard introduction (included).

Standard introduction
Each meeting should begin with the standard introduction, provided in the additional resources. You can adapt it to your specific situation, but it is extremely important to give the introduction before every meeting. Doing so makes clear the "rules of the game" and aligns all participants to the mission of the events. As long as you abide by the rules and do your best to ensure that participants do as well, the LIION will be legally compliant and ready to build the local economy!

Answering questions
As the organizers of the event, most questions will naturally be directed towards you. There are some questions that you can answer and some that you should not. To help you answer them, we've prepared a set of example questions and the appropriate answers.

Hey Bob, I know that you've spent a lot of time with Business X. Do you think I should invest?
I'm sorry, but I can't give any recommendations about any specific investments. You really should sit down with him and look through his business materials. Why don't you have lunch with him and get to know him and his team better?

Can I sign the paperwork for a deal today?
You're welcome to set up a time outside of the event to discuss the business. We suggest that you sit down with the other person, ask questions about their readiness for investment and learn the details of a potential deal. Then, talk with your legal and tax advisors before signing any paperwork.

My friend wants to come present at the next LIION event. What does she have to do?
Invite her to the next public event, where she can meet the members and learn about local investment. Then, she can let the organizers know of her interest in presenting and we can start the process of preparing her.

Key Takeaways
Standardized paperwork and introduction help to keep the participants aligned to the mission of the events. As organizers, you can help by making clear the rules and knowing what questions you can and cannot answer.

6b. CHANGE ON THE GROUND: POST-EVENT FOLLOW UP

- ✓ **Organizer debrief**
- ✓ **Participant feedback**
- ✓ **Measurement and reporting**

Organizer Debrief

Immediately after the event is over, have all of the organizers get together to do post-event debrief. Record data and your impressions of the event. Think of these questions:

- What went well, what didn't, what has to change, what can we do better next time, any legal or specific member questions, guess how many deals, how many participants, how many new participants, did the enterprises present well?

Participant Feedback

A day or two after the event, send the participants a follow-up email with either a survey document or a link to an online survey. Thank them for coming and remind them that an essential element to the success of their LIION is the reporting and aggregation of data. You are following up with them to find out ways in which you can improve the event and to measure your impact on the community. See the additional resources for a sample feedback questionnaire. Keep all of this paperwork on file, either digitally or in this toolkit binder.

Measurement and Reporting

Using this ongoing feedback from participants, collect your data over time and aggregate it into a quarterly (or annual) report detailing the details of the deal flow. You will also want to collect the qualitative data, or the stories, from the event. These quarterly (or annual) reports will be your best marketing tool. We suggest posting these reports on your website, emailing them to participants, and sending them to Springboard, the local newspaper and other LIIONs.

Finally, tell the story of business impact. What are these businesses doing with their investments? Are they hiring, expanding, moving? Using dollars, jobs and business growth, explain how this LIION is growing the local economy. Springboard will help with this process

Key Takeaways

Gathering and responding to organizer and participant feedback will improve future LIION events. A major part of a LIION's future success will be a demonstrated improvement in the local economy. The more data collected by the organizers, the more strongly a LIION will be able to make their case that it is transforming the local economy. Sharing this data with regional support networks, like Springboard and the ChangeXchangeNW Network, as well as with other local leaders, will help bring political and community support to this innovative form of financing.

7. CONCLUSION

How do we build healthy communities?

> *"More than 75% of small businesses that applied for a loan during the first half of [2010] did not receive the credit they needed."*
>
> *-Locavesting: The Revolution in Local Investing.* Amy Cortese, 2011. p. 11.

It begins at the local level. Bringing citizens into the economy as genuine actors strengthens the regional economies, democratizes capital and builds community. Few "traditional" investment strategies direct our money into productive channels that will build our local economies. As the engineers of community change, we must create new systems and tools that can align our money with our values.

A Local Impact Investment Opportunities Network allows community members the opportunity to actively engage in the process of community-building. Through the three-step model of the public event, the members-only forum and the private meetings, a LIION develops the relationships between entrepreneurs in need of capital and the potential local investors who are tired of watching their savings bounce around the Wall Street trading markets.

These social and educational events are revolutionizing the way we relate to our money and to our community. There is something for everyone here: speakers, workshops, activities, good food and drink, old and new friends. Most of all, there is potential: that by listening, learning and socializing, everyone is coming together to re-envision and redefine what it means to be a part of a community. Together, we are changing the nature of investing.

Thanks to all of the hard work of the organizing team, the LIION event should be a fun, friendly and engaging evening for your neighbors, friends, and community. With your careful planning, publicity and preparation, you have sown the seeds of a stronger local economy. Remember that every interaction, every new connection is a success. Enough of these successes can create the kind of place you want to live in: a healthy, thriving community with a strong sense of place that you are proud to call home.

8. RESOURCES AND TEMPLATES

The materials below, along with other sample documents, can be downloaded from the ChangeXchange NW Web site, as well as on your local ChangeXchange NW Node page. These materials may be updated as the laws change or materials are improved and more samples are created. The link to these materials will be provided to you.

- ✓ Standard introduction
- ✓ Sign-in sheet
- ✓ Template for business presentations
- ✓ Sample membership form for both investors and entrepreneurs
- ✓ Sample feedback form
- ✓ Organizer debrief form
- ✓ Sample marketing and outreach (postcard/flyer)
- ✓ Sample language for a press release
- ✓ One-page handout that lays out the "rules of the game" for entrepreneurs

Record questions below.

Guidelines for Spotlight Presenters

1. Do not share any financial information. No budgets, projections, or deal details. You are not to ask for capital in any form.
2. (If you are asked point blank in the presentation about your financial information, use general terms, refer them to the guidelines they signed, and then offer to meet privately.)
3. Explain any technical terms up front that would be important for a potential supporter to understand before they listen.
4. Be sure to have a handout that people can take with them. Include your contact data. Again, do not include financial projections, but it can include details not in your presentation, for example, market analysis or historical data.
5. Be creative. Schedule an Open House, a lunch, or in-house presentation where people can visit you and your business.
6. TIP. Use imagery, and bring tangible things to share, handout. DO NOT READ SLIDES TO THE AUDIENCE.
7. NOTE: Use the PPT template. Feel free to change styles. Rule of thumb: one slide = one minute.

Guidelines for LIION Spotlights

1. Do not share any financial information related to the future. No projections or investment details. Nothing that implies positive returns.
2. If you are asked point blank in your presentation about your financial information, use general terms, and offer to meet privately.
3. Explain any technical terms up front that would be important for a potential supporter to understand before they listen.
4. Be sure to have a handout that people can take with them. Include your contact data. Again, do not include financial projections, but it can include details not in your presentation, for example, market analysis or historical data.
5. Be creative. Schedule an Open House, a lunch, or in-house presentation where people can visit you and your business.
6. TIP. Use imagery, and bring tangible things to share, handout. You do NOT have to use this design.
7. NOTE: This is a PPT template. Feel free to change styles. Rule of thumb: one slide = one minute.

Your Enterprise Name

(and the tag line here)

Presented by (your name and role)

springboard innovation

← Your logo here

launching community-led community change

Table of Contents (delete this slide for the presentation)

(page numbers important. On this template they change when you remove slides)

3

INTRODUCTION

- An "Executive Summary" that sets the stage. (no detail – that's in the next slide)
- Use images (i.e. "Here we are in the field with the grass-fed beef we raise"… or "This is my staff at the shop demonstrating how it works…")
- Do state the stage of your business (startup, growth…) Why are you at an inflection point? What has changed? What is the opportunity?
- Also, define any technical terms people may stumble over.
- (You may need two slides to accomplish this.)

4

THE BUSINESS

- Describe the business/enterprise/project in more detail
- *How does it work? Be simple, clear.*
- *(reminder: USE PICTURES and then SPEAK the description.)*
- *DO NOT READ SLIDES*

5

TEAM

- Who are *you?*
- Who is on your team? Board?
- Why do they matter?
- What expertise guides your planning?

6

HISTORY

Be clear and honest about your past performance. Address issues you overcame, weaknesses and strengths.

- Use charts if needed.
- Images of successes? (even disasters can be funny)
- Historical timelines
- Share what you've learned… Why are you smarter now?

7

YOUR MARKET

- What is the market gap you identified? How did you identify it? Prove it.
- In what way do you see it as an opportunity for growth and community value?
- How do you know you're on to something? (Data here)

8

YOUR VALUE ADD TO THE COMMUNITY

- Convince your audience that you have value to add. Why you/your enterprise?
- What is your special advantage?
- Why would your success contribute to the community? (What is your *extra* value? Remain locally owned? Social enterprise?)
- What metric might you use in addition to positive cash flow that would demonstrate your returns to the community?
  (NOTE: YOU CAN USE DATA HERE SO LONG AS IT IS NOT FINANCIAL DATA. In other words, if you plan to offer more jobs, or localize a food product, or reduce your carbon footprint, describe that value add clearly.)

9

MEDIATING RISKS

- What opportunity could you miss?
- What are your near and long-term challenges?
- What are you doing to mediate against known risks?
- *Again, be very honest…*

10

IN CLOSING

- Questions?
- Image here. Inspire us.
- Publicize any upcoming event to meet the team, visit the place, get a more personal feel for it.
- Contact data here. (hand out biz cards now)
- Close with something memorable.

11

Appendix E

Name	City	Affiliation	Phone	Email
Dave Holm	Ames	Executive Director, Iowa Institute for Cooperatives	(515) 292-2667	
Janice Shade	Charlotte, VT	NC3, Initiative for Community Capital, and Co-Founder of Milk Money Vermont	(802) 373-0340	janice@localcap.org
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Ron Reischl	Manning	Business Improvement Committee Chair of Main Street Manning	(512) 635-5941	cabinron@hotmail.com
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Harvey Dales	Manning	Mayor		khdales@mmctsu.com
Jeff Blum	Manning	President of Main Street Manning	MSM office: (712) 655-6246	mainstmanning@mmctsu.com
Greg Sextro	Manning	Local attorney	(712) 655-3365 (office phone)	gregory.sextro@denisonialaw.com
Jaime England	Manning	Owner of The Market Place		
Teresa Wickland	Manning	Owner of Brickhaus Brews	Brickhaus #: (712) 655-2739	
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Dennis Dokter	Sioux Center	Sioux Center Land Development	(712) 722-0761	ddokter@siouxcenter.org
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Darcy Swon	Webster City	Enhanced Hamilton County Foundation- Development Director	(515) 835-0437 (foundation's number, not Darcy's)	dswon@enhancehamiltoncounty.org
Jeff Pingel	Webster City	Community Organizer	(515) 297-3776	

TO: Manning/Webster City Google Drive
FROM: Abraham Sotelo
DATE: 9/29/18
RE: Interview with Professor Yockey

Length of Interview: 30 min

Introduction and Securities Laws
After initially explaining the project to Professor Yockey, he asked us what kind of research we had done. We explained that we did:

Everyone: different organizations with similar goals (i.e. cutting edge capital)

- Abe: for-profit entities (incorporated and unincorporated)
- Dario: non-profits
- Kalena: Co-ops
- Jen: Hatch Oregon, Sioux Center/community foundations

Then, Professor Yockey immediately turned the issue from one about entity formation and to one about securities. He felt that was our biggest issue. While entity formation is important, the security regulation issues were at the forefront. It did not matter what type of entity or structure we set up, but what mattered instead was what creating the entity entails such as tax considerations and security regulation issues.

The Broad Definition of a Security
Professor Yockey gave us three options to likely choose from regarding the entity formation: nonprofit, LLC, or Co-op. From these, he explained that we would need to be very detailed in the operating agreement of the LLC. To make the LLC adhere to the specifications Ron Reischl requested, such as flexibility in adding and removing investors, we likely would need a manager-managed LLC. What this means is that the managers are the people that manage day-to-day tasks for the LLC while the members would be passive investors, which makes it look more like an investment contract rather than say bonds. An investment contract is created when someone gives money to someone else to invest on their behalf. This clearly brought up securities laws issues because the members would elect the managers to do the work, thus, the "Howey Test" could be met meaning that securities are in play. Professor Yockey briefly explained the two cases that he uses to teach this part in unincorporated business associations. The test has three parts that must be met: 1- invest money; 2- in a common enterprise; 3- and expect profits through the efforts for others (seen through the objective, reasonable investor). We would need an affidavit that the investors are not seeking a profit, which is very unlikely. The investors would also need to be accredited investors to get around some more securities regulation issues (if not accredited investors then more they deserve more information than an accredited investor since they are not as "business savvy").

Nonprofit Exemptions
Professor Yockey knew little about co-ops so he mostly leaned more towards nonprofit because of this type of entity usually is exempt from securities laws and taxes. One of the only restrictions Professor Yockey could think of in the moment for a nonprofit is the restriction on politics and how involved they can be politically. This is not an issue for us as there has been no discussion of a political-based entity. He also mentioned that nonprofits tend to be less competitive with each other, and thus might be more helpful and willing to speak with us.

Professor Yockey also gave us some insight into who we should speak to such as Paul Thelen (Director) at the Waterman Nonprofit Center and any other organizations (likely nonprofits) that appear to do the kind of community revitalization that our clients want. This is where Professor Yockey said we could get our questions of securities and shareholders answered with more specificity.

Suggestions from Professor Yockey
Professor Yockey mentioned the Encounter Cafe located downtown in Iowa City near the Vue (rooftop bar). It is a restaurant that is run by a church in Kalona. He also specifically mentioned a “window-based delivery system” in Cedar Rapids that is geared towards community development - in this case an ice cream store was able to get “seed money” through a community fund in Cedar Rapids. Another organization he mentioned was one in Detroit that helped artists obtain funding to better neighborhoods through their art. Another one he mentioned was “Artnet” (not sure if this was spelled correctly). This is a clearing house/marketing intermediary where proposals for loans are sent and the viable ones that get chosen a very small interest rate.

Professor Yockey also mentioned that some CLE materials and Practical Law (in Westlaw) could guide us on some issues for nonprofits and securities. Some manuals in the library or ABA materials could get us started. Finally we asked what he would want to know if he could ask the clients anything and he said maybe the long-term goals and whether there is any space that’s just sitting there and not being used, but said it seems all the information we need we mostly have.

Jen is unsure if this is the Detroit organization he was talking about, but in her research based on that she found this which looks at least something like what Lindsay was wanting:

- Michigan Economic Development Corporation, which started the program Public Spaces Community Places
    - https://www.miplace.org/programs/public-spaces-community-places/
    - https://www.miplace.org/about-us/
    - https://www.patronicity.com/puremichigan#!/

TO: Manning/Webster City Google Drive
FROM: Abraham Sotelo
DATE: 10/3/18
RE: Interview with Brian Beckon

Length of Interview: 1 hour

Introduction and Overview
The interview began a little later than planned as Brian was coming off another meeting. The interview started as usual: introduction (from Abe, Jen, and Dario) then an overview of the legal clinic and who our clients are as laid out in the interview outline. Brian immediately said that from the description we might want to do a nonprofit loan fund but was eager to answer questions to get a better perspective on the issue.

Abe began by asking him about the history of Cutting Edge Capital. Brian said that Cutting Edge Capital grew out of a law firm by John Katovich. John noticed that the advice given to the clients of the firm could be tailored better for the clients, as it seemed that people tended to get nudged into a particular type of fund because that's what the lawyer knew how to do, not because it was the best option for the client. John decided to take matters into his own hands and started to want to help communities that needed more than just legal work, such as financial work that doesn't necessarily have to be done by a lawyer. Cutting Edge Capital then was born from there. Brian Beckon joined 5 years ago. Brian has the same mindset as John in that they are looking to better the world and communities and that there's more ways than just one to attracting community investors/investments. Not "trying to get rich."

How Cutting Edge Capital Chooses Clients and the Challenges They Present
The next question was how Cutting Edge Capital chose clients. After the explanation of John and Brian's way of thinking, Brian mentioned that any community that aligns itself philosophically with them are ideal clients. As long as the clients want to help better the world and themselves, and not just trying to make money, then that is a good project for them to take. For example, he said it would be hard for them to take a project on with someone involved in the petroleum industry. Still, it is hard for them to turn anyone away because the type of clients they tend to attract are the type of clients they want to work with anyway.

The following question asked what are the challenges in working with these communities. Since the communities they try to democratize are usually low income or with a majority of people of color as residents, then the challenge comes from convincing the people that it can be done. "It" being to help the community prosper. Cutting Edge Capital pushes the envelope in any way it can but not legally. They always are in compliance with the applicable laws such as securities but try to find creative ways to help the community while abiding by those laws. Since there is a

lot of misinformation out there, Brian explained, people do not trust that they can be helped, so they must be educated at the same time. Jen then asked a follow-up question, “how do these communities raise enough capital when our two clients are very small?” Jen gave a more in-depth explanation of our clients to give Brian better context. Brian replied by saying it depends on the community. Small communities are a challenge just by sheer numbers they lack. How much funds are enough then? It all depends on strategy and infrastructure. Brian works with a small rural client, about 100,000 people, in Western Massachusetts that has raised $1 mil, but they also already had existing infrastructure for a fund (Franklin County Community Development Corporation) which helped. They have become self-sustaining with this. This is different from someone who needs $15 mil because they are a larger community. So we should not be discouraged by the small numbers of our clients.

Exemptions to Securities

Abe then asked about Direct Public Offerings (DPO) and why/how Cutting Edge Capital uses them. Brian explained that DPOs are just an IPO essentially but with no intermediary, i.e. broker or investment bank, that will take a cut. With that in mind, Brian said that securities laws requires one to register securities or find an exemption. Private offerings does not work because there are limits in advertising and in what type of investors can invest (only accredited). Instead, Brian mentioned four common exceptions:

- Charity Exemption
    - It is like a charitable loan fund.
    - About 40 states allow for this exemption. Federally it is an exemption.
    - This kind of exemption uses “investment notes “or “promissory notes”
        - This is a debt instrument. This is used since nonprofits cannot issue equity securities since no one can own them.
    - Still have to have detailed disclosure documents about material information, etc. but don’t have to register under federal law (and in most states).
- Intrastate Strategy
    - All investors in same state
    - Usually still must register securities at state level, but this is not burdensome at all.
    - This is a for-profit entity.
- Direct Public Offering - R504 under Regulation D
    - allows for public offerings.
    - Must register in whatever state(s) you are operating in.
- Regulation A
    - A sort of “mini registration” more than an exemption.
    - Two Tiers

- Tier 2- covered securities - preempts state securities laws (usually still have to file a notice in the state, though) - $20 million cap - audited financials required.
- Tier 1 - does not preempt state law - no audit financials but most states still require it for their security laws so makes no sense to do tier 1.

Factors to Consider Before Choosing a Strategy

Dario then asked what Brian would recommend in our situations, what type of entity is best for what our project? Brian said he was not worried about the small number of investors that our clients likely have. Usually a community will have less than 100 investors. Before Brian gave us a recommendation, he explained the factors to consider. One such factor is the Investment Company Act of 1940 (an additional layer to the Securities Act of 1933). If the act applies, then the entity is regulated like a full mutual fund (S1 regulation). So, we must find an exemption from both acts. But what exemptions are available? Charities is one exemption for both acts mentioned. A private fund is an exemption under the 1940 act. But then the question became, "what if you want equity investors?" The problem is that a charity will not work since the charity can only issue debt. A possible solution could be a Real Estate fund that is exempt from the 1940 act. Brian then focused more on our issue (as Ron has explained it to us) when he asked, "but what if you want to do a community venture capital fund?" Brian explained that the problem there is that there is no simple exemption for such an entity, so you have to squeeze it into some other exemption or strategy like a **small business holding company**. This is a business that invests in other companies and takes a majority in these companies, which is then deemed as being in the business of its subsidiary, not securities. An example of this is Berkshire Hathaway.

Another strategy is a **pooled income fund** which is easier than the holding company. Anyone can "invest" or donate and the entities funds pay the investors until they die. After they die, then the initial money put into the fund by the investor becomes a donation to the fund. A final one is the intrastate strategy under the 1940 act, but it's not as good as the intrastate exemption under the 1933 act. The limitations are that it allows you to set up a closed-end fund. This means that the fund raises capital just once. It is not revolving and there is a cap up to $10 mil in assets. Similar to hedge funds. Finally, it is also not self-executing like the other exemptions. You have to actually get approval to claim the exemption, whereas the other exemptions are self-executing in that if you meet the requirements of the exemption, that's it.

The interview ended with Brian saying that he would love to talk to us again if we had more questions. This was apparent as it was obvious he loved to educate on this subject. He spoke a lot though the whole interview which we all appreciated.

Memorandum

TO: Google Drive
FROM: Jen Wiltse
DATE: 10/5
RE: Interview with Randy Kuhlman from Fort Dodge Community Foundation

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Introduction
We began the interview by introducing ourselves and providing a background of what we are currently working on. Before we got started, we asked Randy if he had any questions for us - which he did. He asked us about how much money we expected to put into the fund and how we expected to get investment, more about the cities themselves, what the cities expected from the fund, and who the possible investors might be and how we might reach out to them.

Structure of the Community Foundation
After answering these questions, we began by asking Randy to hear more about the organization and how it got started. He explained that the organization is both a community foundation and a United Way, which raises money from the community and grants it back out to organizations that are designed to help disadvantaged people of all ages. He explained that the community foundation part is much larger in scope - it can help any type of charity or public cause and typically investments focus around ones that will improve the quality of life in a community. He said that “quality of life” is defined very broadly.

For example, he detailed some of the projects the Fort Dodge Community Foundation helps fund. He said it funds everything from community projects relating to parks, trailing, community unification, recreation projects, projects for senior citizens, projects for helping underprivileged communities, to arts and cultural projects, etc. He explained the foundation’s mission as being to support and fund ongoing and long-term operations and missions of the community that advance community betterment and quality of life. He also noted that they are a perpetual fund, where 95% of the funds stay in and 5% of the funds go out. We’re thinking this could be significant, because he was saying the fund was large enough to just pay out the interest the fund accrues without having to eat into the principal amount.

Description of Types of Donor Funds
Overall, he said the foundation manages about 110 funds. He then detailed some of these funds:

- <u>Community Pass-Through Funds</u>
    - These are small, where someone/an entity is going to go out and raise money, and the funds they raise flow through the organization and the organization manages those funds, and when the person or entity needs the funds back to cover the project, the foundation then writes a check. He explained that the

purpose of the foundation being a pass-through is that people can then take advantage of the tax benefits.
    - When we asked for a little more information on these, he explained that they're usually short-term. The money flows in with the expectation that it'll probably be granted back out in less than 12 months. Typically, when that happens the foundation doesn't invest that money; instead, it puts the money in a money market fund which at best make 1% interest.
    - He also noted that the foundation can even pay bills out of the fund when the projects the funds are designated for send the foundation a bill relating to their project.
- Designated Funds
    - These are funds that are dedicated for specific projects and programs, and people can then decide to invest in them or not.
- Unrestricted Funds
    - Here, the board determines what grants they want to give to various projects organizations, etc. In other words, with these types of funds the donors do not have a say in where their money will go.

Setting Up the Funds

He also explained a little bit more about how the funds get set up. He explained a situation where someone says "hey, we want to set up a fund to advance entrepreneurship" and what the foundation would then do. He said the parties would sign a simple agreement and give the foundation the money, which would go into the financial management process by the foundation, and then the fund would likely be up and running in less than 30 minutes. Then once the fund is set up, any donations to that fund is immediately considered a charitable contribution for tax purposes.

How to Become an Affiliate

We then asked about affiliates of the foundation and how that process would work. Randy explained that they have one affiliate from Calhoun County. How it works is that all the funds the Calhoun County affiliate raises, and any grants it gets, flows through the Fort Dodge foundation. Then the foundation works with the affiliate's board to figure out how to distribute those funds. He also explained that Calhoun County originally was affiliated with the Des Moines Community Foundation, but felt that it was too big and too far away, so it decided to switch to Fort Dodge. When asked further about how this works, he said that Fort Dodge works with the foundation the affiliate is already organized with, here the Des Moines foundation, to get the details worked out. He mentioned that this could also be a possibility for Webster City, who technically would fall under the Des Moines foundation but could affiliate with the Fort Dodge foundation, particularly because Webster City is just down the road from Fort Dodge. He also explained that pretty much every county in Iowa has a community foundation and that to be a community foundation you have to be a nationally qualified community foundation, qualified with the national community foundation. We asked whether it was possible for a single town, rather than a county or an area, could establish its own community foundation. He said it was a possibility but that they don't have to.

Types of Donations Accepted

We then asked about what kinds of donations they accept. He said they can accept all kinds of donations - real estate, stock, cash donations, etc. They haven't had farm land yet but he said it would be possible to accept farm land and either sell it off or hire someone to manage it, and if a foundation wanted those kinds of donations they could certainly advertise that and talk to farmers who maybe would want to donate their land. When asked if donors/investors can choose what they want their funds to be used for, he said the foundation allows them to choose with charitable organization specifically they want the money to go to.

As a final note, he mentioned that he thought it would be hard for a town of Manning or Webster City's size to raise a couple hundred thousand.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 10/5
RE: Interview with Dean Gabhart from Sioux Center Community Foundation

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Introduction
The interview began by everyone introducing themselves, and Jen telling Dean a little bit about the Clinic and the project we are working on. After asking whether Dean had any questions before they got started (he didn't), Jen asked to hear a little about the organization and how it got started. Dean replied that Sioux Center had been involved in building a recreation center in their town, and that as part of the funding there was a $900,000 endowment. After this, the town was trying to figure out a way to manage those funds in an ongoing way because the funds were intended to provide for the upkeep and maintenance for the recreation center, aka to keep going.

Organization Structure
Jen followed up by asking whether the town had explored other types of entities and, if so, what made them decide to go with a community foundation. Dean replied that the town had wanted to keep the money local and manage it local in terms of investments. He also said the foundation had expanded beyond its original purpose. They realized that there were other organizations in town that could run money through the foundation for projects and to help people fund projects with that money, and to still keep it clean taxwise. He mentioned that the other organizations were typically community projects and nonprofits. He gave an example of the town's library, which had burned down. There was a fundraiser and those funds went into the community foundation, which charged a fee for managing, but most of the money went back through to the project. He also noted that they now participate with other regional organization, so that if in the future someone decided to leave money to the city, they would have a place to put it and manage it.

Tax Benefits of Community Foundations
Dario then asked to hear a little more about the tax benefits Dean had mentioned. Dean said that because they had registered as a 501(c)(3), any donations to the foundation are tax deductible as long as the disbursements of the donations are in line with the 501(c)(3) purpose. He said the board controls the donations and where/how the donations are disbursed. He also said that it seemed like the residents were more comfortable writing a check to the foundation than to the library itself because they knew that the taxes will be "clean" from the donation there.

Obstacles

Jen then asked whether there had been any challenges in setting up or running the foundation. Dean said that all the investments have to be in keeping with the 501(c)(3) purpose, and that you have to file all the right forms and have a registered agent who files the right tax form every 2 years in Iowa.

Affiliate Community Foundations

Jen asked about whether the foundation had considered being an affiliate before deciding to register as its own organization. He said they had, but that the main reason they're not an affiliate is because the foundation is connected with the city of Sioux Center. However, he mentioned that the foundation is starting to get away from that after advice from a lawyer. It used to be that the board was all city council members and all appointed by the city, but now the public has a hand in it through an application to join the board and then the board ultimately decides whether to recommend the person to the city council and the council ratifies it. Still, he said the foundation is much more affiliated with the city than most community foundations are.

Donations

Jen asked how donations and investments to the foundation work, particularly when it's something like farm land. Dean said that the foundation had to create an investment/acceptance of gifts policy when it organized, where they had to try to consider some of the circumstances that could come up with donations and how the foundation would handle those types of donations. As for land, he said that the foundation had received land and noted that a lot of foundations have a policy where they'll get a valuation on the land and sell it, but that their foundation had decided to hold onto the land that they received to use it later. He noted that they'd also received donations of stock, which they then sell immediately.

Donors' Directions of Donations

Jen then asked whether people who donate or invest have a say with how their donations/investments are used by the foundation, and how the foundation decides what to fund. Dean said that they could recommend how they want their money to be used but that ultimately, once it's in the foundation, the board controls the funds and decides what's done with them. He did say that sometimes there's a fund agreement, for example for a scholarship, that designate a group of people to make recommendations to the board, but that again ultimately the board decides. He also noted that when there's a specific project and people are wanting to donate specifically to that project, the foundation must apply those funds to the project directly.

Board & Bylaws

Dario then asked to hear more about the board. Dean said that the bylaws provide for between 5-12 board members, who each serve 3 years and can serve for two consecutive terms but then have to come off for awhile.

Community Foundations and Loans

Jen then asked whether the foundation was involved in giving out loans. Dean said no, but that they now can do grants (although they initially could not). In order to do grants, they had to get the money/interest rate up to the point where the money was deep and reliable enough to do an

endowment. He talked about the Generations Community Endowment Fund, which is a separate fund controlled by the foundation and the interest from that fund is used in a competitive grant process. He said nonprofits have the opportunity to apply for the grants, and that if it's an organization that is not a non-profit, they have to get a fiscal sponsor in order to apply.

Community Foundations and Funds for For-Profits

Jen asked whether the foundation would be able to provide funds to a business that wanted to start up in the community, and he said he believed that it would have to be a nonprofit that started the fundraiser to do so and then run it. He said if Manning and Webster City were looking to have an organization that helps with something like this, that we should look at the Sioux Center Land Development. This organization helps Sioux City with commercial and retail and community development, land transactions, buying buildings, fixing up and selling them, etc. He says that the organization is like an arm of the government because they work with the government to accomplish these things, but that they aren't really part of the government because they have an independent board and their own way of running things. He said it operates as a permanent endowment, where it established an amount of money so that it operates on the interest it earns from developing/attracting commercial retail.

Jen then concluded the interview and thanked Dean for taking the time to speak with us.

TO: City of Manning/Webster City File
FROM: Dario Rodriguez
DATE: 10/8/18
RE: Phone Call with Central Appalachia

Organization's Structure
On October 8, 2018 we interviewed Stephanie Randolph and Sara Morgan. Ms. Randolph is a member of the Cassiopeia Foundation team, an innovative philanthropic investment. Ms. Morgan works with Fahe, which is a regional organization dedicated to eliminating persistent poverty in Appalachia.

On the call we were told that Central Impact Appalachia, the organization that Ms. Morgan and Ms. Randolph work with, was set up approximately 2 years ago. The setup process was relatively quick, as strong regional networks already existed. Their focus has been on building diversified local economies and communities to create thriving businesses. They conducted a survey to identify what capital was needed for and determined that approximately $350 million was needed for new businesses. Some businesses required grants, some needed debt, and some needed equity. As a result, the focus of their organization was to align what were the needs in each sector and absorb the capital. In other words, Central Impact Appalachia was focused on aggregating deals into a pipeline of systems so they can alter the way the market works.

Fund Creation
We were also informed that Central Impact Appalachia has yet to establish a fund, but that they are in the process of doing so. They plan to create a 501(c)(3) that will then launch an LLC investment fund, the 501(c)(3) entity will be able to accept and deploy grant capital while a traditional investment fund is maintained in parallel. The traditional investment fund will maintain an investment committee that will approve loans in tandem with a community advisory group. The community advisory group will play the critical role of identifying needs in the community and advising the investment committee on those needs. In addition, we were informed that the organization is not exempt from securities laws reporting requirements, the organization has worked with an attorney to meet these requirements—CALVERT Impact Capital is an organization with similar goals based out of Bethesda, MD, which operates as a nonprofit and may not implicate securities laws.

When asked if there was a critical mass which was necessary to set up a fund, they responded that that wasn't the case. Instead, the important aspect was setting up a management structure. As an alternative, our interviewees suggested that we look into potentially partnering with an already existent CDFI to partner with. Finally, we were told that it is critical to identify who is making loans in the region, what if any angel networks exist, and who is part of the capital supply to prevent any redundant efforts. At the end of the conversation our interviewees asked to be kept up-to-date on any developments.

Memorandum

TO: City of Manning/Webster City File
FROM: Dario Rodriguez
DATE: Oct. 8, 2018
RE: Meeting with Paul Thelen

Center's Mission
On October 10, 2018 we met with Paul Thelen, Assistant Director of the Larned A. Waterman Iowa Nonprofit Resource Center (Center). The mission of the Center is "to strengthen the operational capacity of Iowa nonprofit organizations."

Our conversation with Mr. Thelen was very helpful, he asked us several questions about our client communities, their goals, and what research we had done. After gaining an in-depth understanding of our work so far, Mr. Thelen had several suggestions for what we might look into.

Incubators
First, Mr. Thelen proposed looking at incubators in Iowa as a possible partner entity, or as a possible model to meet our clients' goals. He did state however that incubators can likely provide businesses with space and with assistance, but it is unlikely they will be able to provide businesses with loans. Instead, incubators can help businesses and entrepreneurs develop skills and provide the support necessary to ensure the business can function. One example he mentioned was an incubator in Cedar Rapids.

Chamber Organizations
Another suggested entity that Mr. Thelen proposed was a community development organization. He mentioned that these are sometimes referred to as 'chambers' in some communities. Some of these chambers serve as a type of liason between for profits and nonprofits, which might be of interest to our clients. Mr. Thelen also mentioned B-Corps but noted that these were not an option in Iowa as legislation permitting the formation of B-Corps has not been passed, however, he suggested that such legislation may be on the horizon.

Guidestar
Following this discussion, Mr. Thelen introduced us to Guidestar, a website containing a comprehensive set of data on nonprofits at a national level. He suggested we could search for nonprofits which share similar goals to our clients'. This was possible since each nonprofit is coded based on their organization type and goals. We chose to search using the S43 NTEE code which is used for community organizations that assist with lending and small businesses. Mr. Thelen suggestd we look closely at these nonprofits and then review each organization's 990 form to determine who the directors at each organization are and then reach out to contact those individuals.

After completing the search for similar nonprofits Mr. Thelen suggested that we also consider completing a community assessment to understand who the stakeholders in the community are and to ensure we make as many allies, or at least avoid making enemies, within the community. Finally, Mr. Thelen also mentioned the Targeted Small Business (TSB) Assitance Program which “is designed to help women, individuals with minority status, service-connected disabled veterans and individuals with disabilities overcome some of the hurdles to start or grow a small business in Iowa,” as a potential organization to reach out to.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 10/11
RE: Interview with Dennis Dokter from Sioux Center Land Development

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Length of interview: 30 minutes

Introduction
We began the interview by introducing ourselves and providing Dennis with a little bit of background information about ourselves and the Clinic. We mentioned to him that we had been referred to the SCLD through the Sioux Center Community Foundation, because our contact there believed that the SCLD might be able to help more with economic development concerns.

Background Information on SCLD
We then asked Dennis if he could provide a bit of background information about the organization and his role in it. He said that he is the community development director for the city, and as part of that he got involved with the SCLD. The organization is a tool that started about 40-50 years ago, and it's a "401 something" type of corporation. He said it works side by side with the city to grow economic development, but that they are separate entities and that sometimes it works well to have this private entity on the side to work in a different manner and at a different speed than the city to do development projects. From its inception the organization was set up to be an organization that develops land. It got seed money and then bought up land to develop where people could build new industries and businesses. It is involved with land that needs to be negotiated, bought or developed, and it has also help fill the gap of not having affordable homes in the community. In the last few years it has helped build 95 new homes.

City Government Involvement
He said the city also plays a role with recruiting and incentivizing organizations to come into town and work through the SCLD. Because of the relationship with the city, the city has been able to make projects work. The SCLD developed a golf course and the city council thought the best vehicle to do this was the SCLD. So the city directed the golf course to the SCLD and then provided incentives throughout the project to keep the project going - such as by providing offsets in the infrastructure costs. He said it really takes the two sides working side by side to make it work.

Attracting Shareholders
When asked about the shareholders and how they got involved, he discussed that 40-50 years ago a guy went out and asked people to put some money in to buy a share and have an ownership stake in the organization. He said that it's a simple process to leave, so long as the organization is still running and has money. The shareholders just cash out their original

investment. He noted that the SCLD does not ever give out dividends. He said it's designed this way because the SCLD is designed to benefit the community, not to benefit individuals. So, if the organization makes money off a project then it keeps that money within the organization for the next project. The investors' return on the project is that it benefits the community.

When asked about ongoing efforts to recruit shareholders, he said that they continue to actively try to get shareholders. Particularly, they try to get the younger generation involved - teaching them about what the organization does and why it's doing it. One thing the SCLD does is hold a leadership session that's 9 months long, meeting once a month, where they teach community members about the organization, the different governments, nonprofits, educational systems, etc. and usually at the end they get a few people that want to buyin. Because their projects are so big now, it also attracts people that way. Additionally, the organization holds annual meeting where the board updates shareholders and community members on what they're doing and why they're doing it.

Loan Options

When asked about loans, he said the closest thing to a loan that the organization had done was for a few developers interested in developing townhouses and apartments on land, but that didn't have enough money to buy the land. So the SCLD bought the land to develop the substreet and infrastructure there and is selling it back to the developers over 4 years, and if they haven't paid it all by then the organization will put it on the market. He said the city couldn't do this very well because it would have to make the buy back open to the public from the start, and so this is an example of where having a private entity is beneficial.

We asked about the Country Kitchen that the SCLD had been involved in attracting to the community. He said that had actually gone poorly - the restaurant had left after 6 months and the SCLD lost about $400,000 in the process. However, he said there was a new restaurant that so far had been a success. There were a group of developers who wanted to buy the land and lease it to the restaurant over 10 years, and then the restaurant would buy the land, and the developers wanted the SCLD to be one of the owners. So the SCLD got involved, and now the risk is just if the restaurant doesn't work out that the developers have to find someone else to lease the land.

At this point we had asked all of our questions, so we thanked Dennis for his time.

Memorandum

TO: City of Manning/Webster City File
FROM: Dario Rodriguez
RE: Phone Call with Nikki Henderson
DATE: 10/18/2018

Structure of Grow Iowa Foundation
On October 18, 2018 we interviewed Nikki Henderson. Ms. Henderson works for the Grow Iowa Foundation. Ms. Henderson may be contacted at nhenderson@growiowa.org or at (641) 202-1558.

Grow Iowa Foundation is a 501(c)(3) private non-profit organization. We were told that despite being a nonprofit, Grow Iowa is a for profit organization, which was a designation they indicated in their initial application forms. They are located in Lennox, IA. The Foundation "provides capital for small business, industrial, manufacturing or affordable housing projects within southwest Iowa." Grow Iowa was established close to 20 years ago through an area development group called the SouthWest Iowa coalition, which still exists but in a much smaller capacity.

Funding Source
Grow Iowa has existed as a Revolving Loan Fund (RLF) which was able to obtain USDA funds through USDA's Intermediary Relending Program (IRP). The Foundation was able to obtain matching funds from different counties in their region. The benefit of existing as an RLF is that the funds which have been loaned out come back as payments and they can then loan them out again. Ms. Henderson explained that a large number of RLFs exist around the state of Iowa and she suggested we investigate as to whether an RLF already exists which services our client communities and which could then apply to be a CDFI and receive additional funds. She mentioned multiple times that there can be too many CLFs in an area, and if that is the case, no one benefits.

Bank Relationships
Ms. Henderson then explained that her organization does not compete with banks, rather they works alongside banks to meet their area's lending needs. In addition, the Foundation partners with the chamber of commerce, area development groups in counties and towns, and area banks—all these organizations put in money in the loan pool match program. We were told that pairing the RLF funds with bank loans can be a very rewarding strategy for both the borrower and the lender. Ms. Henderson also explained that her organization was typically subordinate to banks on claims they might have on the borrower's land and/or equipment. Thus, often the borrower will offer something else as collateral.

CDFI Status
We also inquired as to Grow Iowa's status as a CDFI, but Ms. Henderson was uncertain as to how this designation was initially obtained, or what other requirements were involved. She did mention that approximately one-third of their organization's funding comes from CDFI funding. When asked about any security reporting requirements, we were explained that the organization has no individual donors so they are exempt from such requirements.

Finally, Ms. Henderson emphasized the significant operating costs they experience. She mentioned that they are audited frequently, they have an experienced board of directors, and they have documentation costs.

TO: Manning/Webster City Google Drive
FROM: Abraham Sotelo
DATE: 10/22/18
RE: Interview with Stephen A. Brustkern

Length of Interview: 30 min
Attendants: Abe and Dario

Introduction and History
We called at 11:30 A.M. Wednesday, October 22. We introduced ourselves, the clinic and the clients. The conversation began with Stephen (Steve) speaking generally about Cedar Valley Growth Fund and its purpose. He explained that Cedar Valley is a 501(c)(3) that started out several years ago. The problem that it attacked was owners of businesses looking to retire, but no one stepping in to take that business over. Eventually the owner would start to auction off the equipment of the business and the community became upset that no one acted to try to keep the business. So, along with that, the larger aspect of the Cedar Valley Growth Fund is that they are trying to help those smaller deals in the communities find capital. Cedar Valley Growth Fund became the fund people invest in to better their community and the generations that come. The concept was to use people as an alternate investment, so they could create jobs for the community.

Security Law, Investment Act Compliance, and Tax
We then asked about securities compliance and Investment Act of 1940 compliance, and if these were issues that came up with his work in the organization. Steve said that these were the same questions they were asking when starting the organization. He explained that after several costly legal opinions, the model they wanted to use was deemed feasible. People could, in theory, loan money to the organization then the organization loans the money out to the business. Because this is a loan this means that the there are no securities implications, per the legal opinions. Dario then asked if Steve was able to share the legal opinions that allowed him to move forward with his security exempt organization. Steve said he would speak to his lawyers about this.

In terms of the IRS for tax issues, 501(c)(3) organizations must use their funds for a charitable purpose. The IRS first disagreed with Steve that loaning out money to community businesses was a “charitable purpose,” but after an appeal from Steve he was able to convince the IRS to allow “economic development” as a “charitable purpose.” The organization received a certificate to be able to receive donations and the donor of the donation could get a tax write off.

Possible Partnership
Steve seemed interested to help us and even offered attempting to partner with the Manning and Webster. Dario made sure he meant that he was willing to help us with our project and Steve said as long as he can help the communities then he is open to the idea. Steve agreed

that the goal of the community investors should be and is to revitalize the community and not expect a return. This goal lines up with what Manning and Webster have expressed.

A tentative meeting was set for November 7th at 1:00 P.M. at the Ground Transportation Center Skywalk in Cedar Rapids. This is where they have another branch of Black Hawk.

TO: Manning/Webster City Google Drive
FROM: Abraham Sotelo
DATE: 10/23/18
RE: Interview with Torrence Moore

Length of Interview: 30 min

History and Overview of IFF

The call began as usual. Abe explained who we are, the clinic, the clients, and the goals for the project. Abe first asked why the IFF is set up as a CDFI and the benefits of doing so. Torrence explained that CDFIs are mission-based lenders that focus on providing access to credit to underserved areas. IFF was formed in 1988/30 years ago and even celebrated the 30-year anniversary recently. During 1988, banks were very tight with credit and the founder of IFF was a program officer at the local community trust. There they were funding nonprofits with grants, so she formed IFF to provide loans and access to credit to local nonprofits. Abe then asked if it is difficult to become a CDFI. Torrence specified that CDFIs are a certification that is done by the Department of Treasury where they have a division called the CDFI Fund, and they have grants that they give to CDFIs. They also have a capital magnet fund, and the most recent program is called the CDFI Buyer Guarantee Program, which is the newest source of funding. Torrence further explained that once you get the certification as a CDFI you get the Financial Assistance awards and Technical Assistance grants. This is all from the federal side. From the CRA – which is the Community Reinvestment Act, banks will typically provide loan capital because it qualifies for CRA credit. Abe followed up by asking why IFF is structured as a nonprofit. Torrence replied that CDFIs don't necessarily have to be non-profits but it is a good certification to have because it brings on other sources of funds through grants available only to CDFIs.

Funds

The question then became where do the funds come from, if not just grants? Torrence said that funds come from multiple sources such as banks, foundations, mission investors, and socially responsible investors. Hearing about investors, Abe and Dario asked about securities compliance and Investment Company Act of 1940. Torrence said that they are not offering securities, thus, no issues have come up. Typically, the capital from banks is from a line of credit. But it is not a venture investment so the Investment Company Act nor securities are a worry to them.

IFF's Structure of Lending and Iowa involvement

Abe said that he noticed on their website that they loan to nonprofits almost exclusively and then asked if Torrence could explain why. IFF's focus area is loans and nonprofits, but others may be small businesses or consumer mortgages, microloans, etc. So IFF does do some for-profit entities (i.e. grocery stores that are in food deserts), and when developers are setting up low income housing. In the application to the Treasury for the certification you inform the Treasury of what your focus area will be. Torrence then explained that the loans are given out

through a loan committee and typically require collateral. IFF is usually not subordinate to anyone either.

Abe then asked if the small market of work the IFF does in Iowa is stifled for any specific reason since other states get more help from the IFF. Torrence explained that Iowa, like Minnesota, does not have am IFF office and so it is harder to reach out to them so they depend on people like us to reach out to IFF.

The interview ended with Torrence asking about our clients more specifically and who else they partner up with besides the College of Law. We explained that we are part of a larger effort to revitalize the communities so different types of students from different majors and Colleges are involved. Finally, Torrence was happy to help us out in the future with anything he could.

Memorandum

To: City of Manning/Webster City file
From: Kalena Meyer
Date: 24 October 2018
Re: Interview with Jeff Pingel

Dario, Jen, and Kalena were all present on the phone call with Jeff Pingel and Kalena conducted the interview. We wanted to speak with Jeff because he was the leader of the movement to save the Webster City Theater and we wanted his input on the process of fundraising and possibilities of investment in Webster City.

How did you become the lead on the initiative to save the Webster City Theater?

- By accident. He and his wife thought about buying the theater. But it wasn't feasible and then the town got a new director of the chamber of commerce. They had town hall meetings around the theatre. He went to the county attorney's office and said he wanted to start a nonprofit and he was told it was very difficult and that he should find one that already exists – so they went to the chamber of commerce.

How much funding came from smaller donations or how many people donated in smaller amounts? What worked when it came to getting donations?

- Dodgeball tournament, telethon on the radio, a couple kids gave their allowance. A lot of little walkin, give-what-they-could donations. They raised $96,000 through their adopt-a-seat program, where a person buys a seat and has their name and a small statement on a plaque on a seat in the theater.

What were the obstacles and who were the allies?

- Seneca Street Saloon owner was the main ally.
- Jeff called Bob Van Diest for ideas and feedback, he ended up giving $10,000.

How do you envision soliciting donations working for Webster City in the future?

- He wouldn't change anything. They currently mail out letters to people that have donated in the past and let them know you can do a tax-deductible donation. It's more difficult to solicit donations now that they have a functioning business.

Can you tell us more about the HERO Board?

- This is the board that runs the theater. They got started with help from IA SBA.
- High school students in an entrepreneurship class created most of the business plan.
- Board members had to have a skill for the theater project - electrician, plumber, manager (local people and local skills on the board), very hands-on.

What do you think Webster City needs right now?

- Chamber of Commerce is closing at the end of the year. The bowling alley closed this year. Jeff can't think of any specific needs except that he wants main street to be more vibrant.

If you were going to participate in an investment vehicle, what would your needs be?

- He probably wouldn't be able to participate in an investment vehicle because he has so much going on right now. If he could, he would want to see the historic downtown have more vibrancy and visual appeal, similar to the one in Ames.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 11/1
RE: Interview with Danielle Olson from Hatch Oregon

Introduction
Because we hadn't been able to get ahold of anyone at Hatch Oregon through email, we went ahead and called their office number. We were directed to the Program Director of Hatch Innovation, Danielle Olson. We started out by explaining who our clients were and that they were interested in intrastate crowdfunding.

Organization of the Crowdfunding Portal
We then asked Danielle if there was some sort of blueprint that Hatch Oregon used to set up their intrastate crowdfunding portal. Danielle explained that there wasn't really – they had just wanted a separate organization from Hatch Innovation, which is the 501(c)(3) that owns Hatch Oregon, because it would insulate Hatch Innovation from lawsuits. She said from there, the actual platform was built upon a "souped-up work press plugin," which was Ignition Deck. She briefly mentioned that it was different for Ignition Deck because they typically do donation-based crowdfunding and Hatch was doing equity-based crowdfunding.

She then mentioned Local Stake, which is another software company that runs platforms. She suggested that we look into them, and that she would be willing to make the introduction if we wanted. She said that for Hatch to run their own platform would require a full-time staff to take care of the platform, and they weren't necessarily concerned with setting up their own platform. They were perfectly fine having someone else run it, they just want there to be a platform. For Local Stake, she said they have launched platforms in Michigan, Indiana, North Carolina, Colorado, and possibly soon in Oregon. She said that they have set up platforms for both regulation D offerings under the Securities Act as well as platforms for intrastate crowdfunding. For Hatch, they are discussing doing a white label partnership, where the website is run by Local Stake but says something like "Hatch Oregon Powered by Local Stake" so that it's still clear that it is Hatch Oregon's website.

We then asked how Hatch had decided what type of structure to organize under, and whether organizing as a nonprofit was an option. She said she wasn't sure about the nonprofit part, but that she imagined it would be possible. For them specifically, having an LLC was simpler to set up than another 501(c)(3), particularly because they wanted Hatch Innovation to own Hatch Oregon, but a 501(c)(3) cannot be owned by another organization, so Hatch Innovation and Hatch Oregon would have had to make a partnership. Additionally, they wanted it to be wholly owned so that Hatch Innovation was shielded from liability for Hatch Oregon's activities. She

also mentioned that they could still access grant money through their 501(c)(3) for locavesting activities.

Securities-Related Questions

We asked whether it was possible for nonprofits to offer securities through their portal, and she said that some people have looked into doing so but that no one has actually done that through their portal at this time. She said that no one can have an ownership stake in a nonprofit, so the nonprofit couldn't sell equity but rather just a debt instrument. And at that point, there's less incentive for a nonprofit to do it because if you're putting in the effort to raise funds like that, why not just put in that effort to raise donor dollars?

We mentioned that we know some states don't allow portals to collect fees if they're not registered brokers, and asked whether this was something Hatch Oregon has run into. She said that they charge a fee for the accelerator (it's required in order to get onto the platform), and that they charge a flat monthly fee for offerings on the platform and for educational materials. However, she said that it is illegal in Oregon to collect fees based on the amount actually invested in a company on their platform.

Reach of the Portal

When asked about the area they service, she said that Hatch Oregon services the whole state. She also said that she hopes that other similar portals will open up in Oregon. Right now, their platform is currently paused because they are looking at the partnership with Local Stake and because in Oregon companies are allowed to create portals on their own websites and not use an intermediary, so they've had some issues with financial support. (Earlier in the interview she asked if Iowa required an intermediary portal for the offering of the securities, and we answered that Iowa does require this.) She really thinks that this intrastate crowdfunding portal will be useful, particularly in rural areas.

Advice

Finally, we asked whether she has any suggestions on next steps for us. She said that we should reach out to Amy Pearl (who we had tried reaching out to but kept getting bounced emails back, apparently, she had switched to a new organization) at Seedpay. She gave us Amy's new email as well as her own email. Lastly, she suggested that we reach out to NC3 and Local Stake. We thanked her for her time and said we would reach out if we had any more questions, which she said she would be happy to answer.

Memorandum

TO: City of Manning/Webster City File
FROM: Dario Rodriguez
RE: Phone Call with Omar Carrillo Tinajero
DATE: 11/2/18

Structure of Organization
On October 2, 2018 we interviewed Omar Carillo Tinajero. Mr. Carillo Tinajero is the Assistant Director of Programs at Connect Capital within their Center for Community Investment (CCI).

We discovered that CCI works with six different communities to expand investment. CCI thinks about the supply and demand of capital and what it takes to organize demand of capital. In other words, they emphasized the importance of creating a pipeline of projects to take on capital. CCI's Capital Absorption Framework is how they ensure that communities buy into priorities that they can work with.

Central Appalachia Work
Mr. Carillo Tinajero proceeded to describe one of the regions CCI works with, Central Appalachia, which shares similarities with our client communities. CCI's work in Central Appalachia has involved switching the theme of the region from that of poverty, to one of success. The CCI team in Central Appalachia has identified multiple economic development opportunities near the highways in the region but has worked hard to not leave the rural areas behind. Mr. Carillo Tinajero proceeded to offer to put is in contact with the Central Appalachia work team.

Mr. Carillo Tinajero described the Central Appalachia work team. He spoke about how they present themselves not necessarily as experts, but rather as partners. They work to analyze deals that have and have not happened in the region, and have identified barriers that others how face, and how they might unstick those barriers.

Specific Advice
Later in the conversation, Mr. Carillo Tinajero gave us some advice specific to our own project. He suggested that as we develop funds within our client communities. He advised us to ensure that we focus not only on developing the funds, but also for developing demand for the funds, and to ensure that this is a concurrent process. In addition, he told us to also focus on the type of funds that were needed (i.e., startup funds, small business loans, etc…). Finally, he also suggested we ask if a fund is the best answer for our client's needs—perhaps there might be an alternative mechanism which would produce similar results.

Memorandum

To: Manning/Webster City File
From: Kalena Meyer
Date: 6 Nov 2018
Re: Phone call with Iowa Institute for Coops

The phone call took place at 3 pm on Nov 6th, 2018 and lasted about 15 minutes. Jen, Abe, and Kalena were present. Kalena called Stacey Webster, the Director for Cooperative Development, and she invited Dave Holm, the Executive Director, on the call. Dave provided the answers during the call.

Kalena began by introducing ourselves and the clinic, and how our clients of Manning and Webster City seek to harness local community wealth and reinvest those resources into local businesses and entrepreneurs through some sort of entity.

Kalena asked about the advantages of a cooperative over other models. Dave responded that there are three:

1. Philosophically: People who use the services are the beneficiaries. The goal is to benefit the beneficiaries, not to maximize profit.
2. Legally: There is a securities exemption in Iowa.
3. Financially: All members share profits and benefits.

Kalena then asked about the powers of a cooperative specifically relating to making loans or buying equity. Dave responded that there are 3 organizing statutes in Iowa, one of which is Credit Unions. The other two cannot take deposits.

Kalena asked if there were any specific obstacles to setting up a coop in Iowa and Dave responded that there are none in particular, Iowa is very coop-friendly.

Kalena asked Dave to expand on the securities exemption, for example if there is a federal exemption. Dave explained that coops must register securities under S521 of the IRS code and must maintain 85% funds from agriculture producers. Most ag coops are also securities exempt because their investors are accredited.

Kalena asked if Dave knew of any coops that existed with the goals that we had described and he replied that he does not know of any; it sounds more like a foundation.

Finally, Kalena asked Dave to explain the purpose of a 501 or 501A coop. Dave explained that 501A is completely unrelated to 501. There are three active chapters under the Code: 499, 501, and 501A. 499 is the traditional cooperative that most people envision – electric, grain, etc. 501 is functionally nothing but an exemption to the corporate farming law. 501A was passed in the mid-2000's to take all the best attributes of a cooperative and of a LLC and put them into one

statute. This allows outside equity capital to flow into the company, which is prohibited under the traditional cooperative model.

Memorandum

To: City of Manning/Webster City File
From: Kalena Meyer, Dario Rodriguez, Abraham Sotelo, Jennifer Wiltsie
Date: 11/7/18
Re: Interview with Stephen Brustkern (Black Hawk Economic Development, Inc., Executive Director), Joseph Engelkes (Cedar Valley Growth Fund I, Inc.), and Steven Weidner (Attorney who has advised both organizations)

Length of Interview: 1:45

Background of Organizations
The interview was held at the Ground Transportation Center, which is where the Black Hawk Economic Development, Inc. (BHED) offices are located, in Cedar Rapids, IA. Abe, Jen, and Dario led the meeting. Stephen Brustkern gave a general overview of BHED and its history. BHED is a 501(c)(4) nonprofit established in 1978 that offers financial assistance programs to businesses. BHED operates under the federal oversight of certain agencies, including USDA, Department of Commerce, SBA, Department of Treasury, and others. BHED focuses its efforts on three different loan programs: SBA 504 Program (https://www.bhed.org/sba-504-program.htm), Revolving Loan Program (https://www.bhed.org/revolving-loan-program.htm), and the IRP Program (https://www.bhed.org/irp-program.htm).

Cedar Valley Growth Fund I, Inc. (CVGF) is a 501(c)(3) nonprofit established in 2009 and the largest "client" (so to speak) of BHED. BHED partners with CVGF so that CVGF has sufficient funds to lend out. Another operation that partners with BHED is Advance Cap Access, which is an organization that is in the process of establishing itself as a Community Development Investment Fund, and is trying to take advantage of new market tax credits. BHED initially gifted Advance Cap Access $500,000 to create a microloan fund. CVGF and Advance Cap Access are smaller and nimbler organizations which are not subject to the same level of oversight and burdensome regulations as BHED. All three entities have different Boards of Directors, which are volunteers. The boards oversee the organizations and decide which business are awarded loans. In addition to offering loans, CVGF offers technical assistance in case a business needs help in developing a business plan—community bank loan officers are also helpful for education on this front, as are SBDCs.

Abe asked what the difference was between a 501(c)(4) and a 501(c)(3). Stephen responded by explaining that a 501(c)(4) can operate as a nonprofit where you do not pay income tax, but a 501(c)(3) can receive donations/contributions which are tax-deductible to the donor. He did not provide more detail, but the relevant differences are summarized here: http://www.nonprofitlawblog.com/comparing-501c3-vs-501c4-nonprofit-startups.

Abe then asked if both organizations have staff and if so, what funds are used to pay them. Stephen replied that both organizations have staff who are paid from the fund. Abe then asked

how CVGF maintains its nonprofit status while lending to for-profit entities. Stephen replied that CVGF's "charitable purpose," per the IRS, extends to for-profit lending since CVGF also offers "education" or technical assistance to businesses. "Education" falls under the "charitable purpose" definition, and by offering ed2uction as well as loans, any contributions made to CVGF are tax deductible.

Funding for Organizations

The next set of questions were regarding funding sources for both organizations. BHED was funded when it was established in 1978 and since then it has grown its fund as a result of its three lending programs. BHED receives loan origination and loan servicing fees from the three programs it administers, but that comes with federal oversight. CVGF has minimal expenses and no federal oversight for its lending. CVGF's funds come from grants from corporations (including some that wish to remain anonymous) and individuals who make loans or contributions to the fund, the fund will then loan the money to businesses, the businesses will pay back the loan (principal and interest), and then the individuals are finally paid back with interest. If the loan is not repaid, CVGF collects on whatever collateral was agreed upon. CVGF always asks its borrowers for "skin in the game", but the primary objective is community benefit from a quality of life standpoint, not about making money.

Securities Compliance and Regulation

The questions that followed were about compliance and regulation, so Stephen called the organizations' primary attorney, Steven Weidner. Steven explained that the organizations had obtained opinion letters from securities lawyers at Shuttleworth & Ingersoll. CVGF did not ask Shuttleworth to research specific regulations, but instead asked Shuttleworth to evaluate their organization and research what possible regulations might impact their operations. This broadened the scope of the research and enabled CVGF to understand what compliance was needed. Shuttleworth came to the conclusion that CVGF was exempt from a variety of filing requirements: security filings and registration (nonprofit exemption), banking regulations (they do not take in deposits), the Investment Company Act of 1940 (nonprofit exemption), and the Investor Advisors Act (CVGF's activities do not fit the definition of investor advisors).

Examples of Success Stories

Abe then asked for examples of small businesses the organizaions have supported. These included:

- A manufacturer in Monticello that needed funds to buy additional equipment. Initially, the manufacturer pursued a SBA504 loan through BHED, but because of the size of the loan and the closing conditions, this was not feasible. CVGF stepped in to provide the loan funding;
- Another manufacturing operation in New Alban;
- A dog kennel operation in Jones County;
- Loans provided to Ross Holdings, which owns the call center where our meeting took place.

Lending Operations

CVGF and BHED can pursue a wide variety of potential borrowers since the organization is not subject to the same conditions which the SBA is subject to. Also, the ability of a borrower to repay is not the primary factor in making a loan, which is typically the most important criterion for the SBA. Where a business gets its loan from, either BHED or CVGF, depends on the size of the business and the loan. CVGF handles smaller loans while BHED focuses on larger loans. Therefore, CVGF is typically loaning to many main street businesses.

Typically the loans are paid at an interest rate of somewhere around 5%, the highest rate they recalled charging was 6%. They also explained that funds could be set up as a dedicated or unrestricted account which would enable individuals to contribute their money towards a specific cause, or to the general fund. An additional source of flexibility could be in allowing individuals to split their contribution as part-grant and part-loan.

The organizations also work closely with local economic development groups when they decide to issue loans. It is beneficial if the organizations can pair with the local groups so that the groups can vouch for the potential borrower and monitor the borrower's activities throughout the course of the loan.

Potential Partnership

The remainder of the conversation focused on discussing a potential partnership with Manning and/or Webster City. It was suggested that a partnership could come in the form of a "Manning and/or Webster City Chapter" of CVGF. Neither BHED nor CVGF foresee charging any type of membership fee to Manning or Webster City—in our discussion it was stressed that the organizations are not here to make money but rather to help communities. The chapters would not have their own boards but could potentially have local advisory councils which would inform the board. The chapters would be a part of CVGF and would be overseen by the CVGF board. Having individual boards within each chapter community would be overly burdensome for CVGF, but they expressed a strong interest in partnering with each community and working with local advisory councils.

Jen also asked what benefit BHED and CVGF might receive from a partnership. Both Steven and Joseph explained that they gain very little other than helping the communities. They are both interested in partnering because of the concept we discussed. Steven explained that their focus now is on assisting low-income census tracts and that he was a firm believer in ensuring that all children have equal opportunities. He stated that the best way to achieve this was to enable each family from an economic standpoint. Finally, he said that one potential benefit to the organizations could be that beneficiaries of CVGF loans might eventually seek out BHED for larger loans, but he stressed this was not a requirement and would only be a potential benefit.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 11/8
RE: Interview with Zach Robbins from MNVest

Introduction
We spoke with Zach Robbins, Board Co-Chair of MNVest and Minnesota attorney at Winthrop & Weinstine. We explained who we were and that we were helping two rural clients in Iowa who were potentially interested in intrastate crowdfunding. Zach said that he wasn't all that familiar with the intrastate crowdfunding laws in Iowa, but that one of his clients has a registered portal in Iowa (SPPX). Later in the interview he connected us through email with David, who works at SPPX.

Obstacles Faced by Portals
We began by asking what types of obstacles businesses in Minnesota run into when getting involved in intrastate crowdfunding. He said there are 3 main obstacles. The first, and biggest, obstacle is cost - legal, portal, and marketing fees. He recommends having at least $5,000 set aside for both legal and portal fees before getting started at the least-complex level of an offering (aka, would need more money for more complex offerings), and that marketing fees just depend on what the issuer wants to do (could be from $0-$10,000). He explained that legal fees have gone down recently due to a smart document system that David from SPPX uses, and that we should look into that because it could work in Iowa too. The second obstacle is education - he said a lot of people don't really understand what intrastate crowdfunding is and that it can be quite complex. The third obstacle is building a crowd to actually raise money from. He's seen numerous businesses fall on their face because of this.

What Makes an Offering Successful
We asked him for some examples of successful offerings from businesses in the state, and he said that 17 businesses have taken advantage of the law so far. 10 of those were breweries, 3 were tech companies, 2 were real estate companies, one was an entertainment/theater type company, and one was a restaurant. Of these 17, 8 had successful offerings that are now closed on accepting capital, and of the 9 left about half didn't succeed and are dead, and the other half are ongoing. When asked what made the successful ones successful, he said that having a lower offering minimum is key. If it's a higher amount, it's harder to reach that amount, and it's obviously easier to reach a lower amount. He suggested that getting it below $100,000 is key, and the ideal amount would really be $50,000 for an offering minimum. He also said that businesses that come in with a marketing strategy and actually execute/stick to that strategy tend to do the best.

We then asked more about the escrow accounts the money is deposited into while the offering is ongoing, whether it is set up by the portal or by the issuer. Zach said that currently there's really only one main portal in Iowa (Silicon Prairie, which is the sister organization to SPPX in Iowa) and that it has a preferred relationship with Sunrise Bank. So, Silicon Prairie sets up the escrow account with the bank and Zach helps draft up the portal agreement with the Bank, Silicon sends the info to the bank and the bank sends for the info it needs from the issuer (I believe), and then it can get the info set up. He suggested looking into Sunrise Bank for Iowa as well - he believes they have banks all over and they already have experience with this so it could be useful for us to look into.

Structure of Portals

We then asked him about the type of organization portals can be. He said he wasn't familiar with Iowa law and if there were any restrictions, but that he couldn't see any issue with the organization being a nonprofit. He said there was one nonprofit/public benefit portal registered in Minnesota but that it hadn't done any intrastate offerings as of yet, only kickstarters. Otherwise he said the main ones are for-profit entities.

Return on Investment

We also asked about the type of return on investment that investors see. He said for breweries it typically is in the high single digits annually, for real estate it is typically 8-12% annually, and for high-tech it's typically 0 if there ever is any return.

Securities Law Related Questions

Next we asked about the types of securities sold, that we understood Minnesota law allowed equity, debt, convertible debt, and SAFEs, and if he had any experience regarding what type worked best. We mentioned that we had seen some reports that SAFEs were less likely to get investments. He said that this was correct, and that based on data he had seen from Crowdfunding Capital Advisors (CCA) in Florida, that common stock tends to do the best. The reason for this is that common stock is understood by the masses so there doesn't need to be any education there on what the securities types are, whereas you do have to do that with securities such as SAFEs and convertible notes. After the interview, he sent us a link to a powerpoint from CCA that includes more statistics, as well as a law review article that he wrote regarding intrastate crowdfunding:

- https://app.box.com/s/fbv5uahmtzj0kp7vssr9949p5bejwu9n (powerpoint)
- https://open.mitchellhamline.edu/cgi/viewcontent.cgi?article=1105&context=mhlr (law review article)

We also asked about the Minnesota laws, because MNVest was the organization that drafted the laws that ultimately were adopted. Zach said the main concern for them when writing the laws was to make it as easy as possible for the issuer and to be laws that are actually used. He mentioned that there is another similar type of law, SCORE (which he said is also in Iowa), that doesn't really get used. He wanted to avoid that happening again with this law, so he wanted to make it useable.

Advice

Finally, we asked whether there was anything else he thought someone interested in setting up a portal or issuing intrastate securities should know. He said that from his perspective he thought the most important thing is to get create a crowd of issuers - get in front of issuers before you get started setting up the portal. He said what happens is these organizations tend to worry more about the technology for getting the portal running, but that this is easy to just white label out (such as through Localstake). The main thing they don't consider is having issuers set up who are actually going to use the portal and offer intrastate securities. Part of this is doing some "old school business counseling" to get these issuers knowledgeable and prepared to make offerings once the portal is running. He also said that it would be really helpful if the state and non-state related actors (like the SPA, chambers of commerce, etc.) got more involved advocating and educating on the usage of this law. He said equity crowdfunding could be a really useful tool, particularly for encouraging more bank investment. If you can raise initial money from a crowd, a bank is much more likely to be willing to give you a loan. Lastly he just mentioned that this type of model seems to work really well for breweries, at least in Minnesota, and that this is something to consider.

We thanked Zach for his time, and for introducing us to David with SPPX (he sent an email to him with Jen cc'd during the phone call). He said he'd be happy to help if we have any more questions come up.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 11/13/18
RE: Interview with Janice Shade from Milk Money Vermont, NC3, and the Initiative for Local Capital

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Structure of Milk Money Vermont
We began by asking what type of entity Milk Money was and why they decided to go with this type. Janice answered that they decided to go with a for-profit company because the company would be dealing with business people in the for-profit world and they felt it was important for the company to mirror that. They also felt that it would help hold the entrepreneur accountable for their own crowdfunding campaign if they had to pay for these services. She did mention that looking back they might have done things differently. When asked about this she said that because so much of Milk Money ended up being about educating investors and entrepreneurs, they basically spent a ton of their time driving all over Vermont to educate, that they would have had a separate nonprofit for the education part of the business from the start if they had known this was how it would be. This is what they are doing now and why Janice is no longer at Milk Money – she left to start the nonprofit side of the company, which is the Initiative for Local Capital and works in tandem with Milk Money. Having this separate nonprofit helps save Milk Money costs related to paying Janice for her time educating all over and provides for grant options. The nonprofit educates investors about what intrastate crowdfunding is and what it takes to evaluate a business proposal and do due diligence. She's also doing research on other ways for unaccredited and accredited to create community investor funds.

Obstacles
We then asked what key obstacles Milk Money Vermont ran into when getting started. She said that for Milk Money the key obstacle was and remains how it is able to charge fees for its services to the entrepreneurs. Because they chose not to go with a broker-dealer, their portal was unable to charge success-based fees, which are fees paid based on the successfulness of a company's campaign. Instead, it has to charge the fee upfront, which is tough because the reason the issuing business is doing this campaign is because they have no money. She said they addressed this at first by having an initial investor which provided capital for their portal. However, eventually the investor wanted to see Milk Money generating some cash flow, and this was a problem for Milk Money based on the fees it was able to charge.

Another problem was deal flow. She said Milk Money saw huge interest from the entrepreneur side when it first started, but that then the interest started to dry up. The problem was that they thought they had an "unlimited pipeline" of businesses but then this dried up. She believed part of this was the upfront expense of using their model because the portal kept having to raise their prices in order to be sustainable, but then this made it harder for businesses to use Milk

Money's services. She also added that the average length for a campaign on Milk Money's platform was 9-12 months.

Startup Costs

We followed up by asking about the typical costs needed to start up the portal, as this was the first anyone had mentioned to us an investor to get their portal running. She said that for Milk Money the biggest reason it needed capital was because Janice and her co-founder had decided to build their own platform for the portal, and that is a huge cost. We asked whether they had considered using an organization like Localstake that already has existing platforms, and she said no because these types of organizations didn't exist when Milk Money first started. However, she said that's something Milk Money has started looking into now. She also suggested Venture.co as another organization similar to Localstake.

Advice

Based on what we had told her were our clients' interests, Janice suggested speaking with Brian Beckon. She said Brian had presented six different ways to organize a community investment fund, and the one that seems the most viable in Vermont is a Pooled Income Fund (PIF). These funds get a tax deduction for their initial "donation" and that capital is pooled together and invested in the community and investment funds, and the income the fund generates is then paid back to those initial investors over the course of their entire lifetime. She said this is exempt from securities legislation because of a loophole Brian found in the Investment Company Act of 1940. She also said that this type of option speaks to the type of investment funds that tend to be the most sustainable for communities in the long run because it allows for different investment structures, such as revenue sharing or other convertible debt models.

Traits of Successful Companies

When we asked what she had noticed in the companies that tended to have successful offerings, she said that they have been the types of businesses that are "built to last" and not built to sell off to the highest bidder eventually. They also are consumer facing, and easy for the average investor to understand.

Choosing Businesses for the Platform

We then asked about the process Milk Money goes through to decide which businesses to add to the portal. Janice explained that they use a ready assessment tool when they interview each business, which rates the business on 10 different aspects. She said she would send it to us if we followed up with her after our phone call (which we did, and she passed it along). She said if a business achieved a score of 80 or above then they were deemed ready to move forward and talk about a Milk Money campaign. If a business did not achieve that score, they would tell the business what they needed to fix. For example, Working Fields was a solo entrepreneur and he had so much ready for a campaign, but they were worried about the management team because they thought the business would expand quickly and he wouldn't be able to handle it on his own. They explained this to him and he went out and hired someone, and his campaign was one of the most quickly funded campaign funds that Milk Money did and he continues to be

a success story. Thus, she explained that the ready assessment tool was not just useful for Milk Money but for the entrepreneurs as well.

Educational Tools

Finally, we asked about any suggestions for educational tools for both investors and issuers that our clients could use. Janice responded that she is currently working on creating models that can be used and replicated throughout the country, and that she would be happy to share this with our clients. One of the first projects is a Women Investor Network because they have had many people saying they want to invest in women-owned businesses, but they don't know where to start. So, Janice is putting together a "safe space" that meets on a regular basis (about every two months), where someone will come in and present, and Janice will lead the attendees through the process of what they learned from the presentation and what they need to know before they can make an informed investment decision. Additionally, she said that NC3 is developing some of these things in tandem with the Initiative for Community Capital, and that they will have a robust educational tool curriculum soon, tool kids, etc. that our clients could use. NC3 also recently held a regional roundtable, and said that they could absolutely do another one of those but in Iowa this time.

This concluded our questions for Janice so we thanked her for her time and let her know we would be in touch and that we would be sure to pass along her information to our clients.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Dario Rodriguez
DATE: 11/14/18
RE: Interview with Ryan Flynn from Localstake

Structure of Localstake
To begin our conversation, we asked Ryan about the structure of his organization and what his organization's goals were. Ryan shared that Localstake is a registered broker-dealer which allows Localstake to provide different levels of supports to organizations that wish to make securities offerings than non-broker dealer organizations can. Localstake obtained their broker-dealer status in 2012. The benefit of Localstake being their own broker-dealer is that they are less restricted as to what sorts of fees they can change clients—this allows them to create a more sustainable model.

Localstake's business model focuses on providing and operating a marketplace where Localstake provides advise to businesses what want to raise capital and Localstake helps to them to understand the structure and the regulatory path these organizations need to undertake. Localstake also provides these busiensses with a platofrm to allow them to raise funds. On the investor side of the marketplace Localstake has an account opening and accreditation process, and they are able to access investment opportunities based on their parameters.

Partnership Structure
In addition to explaining the structure of Localstake, Ryan also discussed how his organization partners with potential crowdfunding entities across the United States. This partnership can take different forms, some partnerships are less formal and some are more formal. In North Carolina they have established a formal relationship with a group and they group utilizes their platform to facilitate their business.

A potential partnership with Manning and/or Webster City would depend on the goals of our client communities and what legal form the investors wish to take on. Traditionally, Localstake would provide a white-label platform for communities to use and investors can invest in the platform directly—Localstake usually manages the platform. The cost of this type of partnership is included in an Appendix to the final deliverable. Another option would be to create a fund mechanism that would need to be managed by an advisor—this would be a different regulatory structure and would require a more involved conversation.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 11/14/18
RE: Interview with Amy Campbell Bogie with NC3

Introduction
We began the interview by explaining who we were, that we were representing two rural Iowa cities, and what our representation of the clients entails.

Obstacles Faced in Intrastate Crowdfunding
Our first question was about what types of obstacles or barriers she has seen for businesses wanting to use intrastate crowdfunding. She replied that it depends on the state. The biggest challenge has been everyone trying to figure out how this actually works because it's so new. Her best advice is to get friendly with state regulators, especially when just getting started, which is similar to what Janice Shade said. She also suggested North American Securities Administrators Association (NASAA), who helps with education on intrastate crowdfunding.

Info About Slow Money
We mentioned we saw NC3 had mentioned Slow Money on their website and asked if Amy could provide a little more information on it. She said that it's a national network of organizations that are dedicated to specifically financing food businesses and farms. She noted different regions are trying out different models, which has been a great way for others to learn what's possible for working outside of typical financial institutions. However, she said it's very limited in size as well as the type of business they're financing. For NC3's purpose, they're really just looking at Slow Money to provide case studies as to what can be done, but not necessarily to perpetuate what is currently the Slow Money model.

Advice
We asked if there was anything else she thought someone interested in intrastate crowdfunding should know. She said that the business model for starting an intrastate model is really terrible right now. In many states, if you aren't a broker-dealer you can't take success fees; you're stuck in a flat fee situation. She said there's opportunities for add-on services, such as consulting services, marketing the offering, preparing the offering documents, and ongoing support after the offering is done with regards to investment management. Because of this, it's been proven time and time again that the volume of deals needed to keep an intrastate model up and running can be prohibitively high. However, she said there are other ways to financing projects without using an intrastate model (like, is it a single startup they're trying to fund, or do they want this to be an ongoing thing?). She said Localstake is an option to bring down costs, and the parent company is a broker-dealer which could help with costs, and we told her we were actually speaking with Localstake later that afternoon.

Amy also mentioned that if our clients are interested in a nonprofit model, they should go directly to the economic development for their state or region to solicit funding. She said if they could figure out a way to track job creation and local economic impact, that might help our clients get farther. She said “what would it look like if states were actually brought in in some way for these portals?” and that she thought this might be a possibility for nonprofit portals.

Suggestions for Options Other Than Intrastate Crowdfunding

Because NC3 is focused on community investment in general, we asked whether Amy had any other suggestions for entities that would hit what our clients are interested in (local ownership, harnessing local investment, ability to see the options available and donate specifically to those, possible return on investment). She said that another way is cooperatives, depending on the interest area of the client and how democratic they want the business to be. She also mentioned real estate investment trusts.

Intrastate Portal Support Group

Finally, Amy mentioned that NC3 is currently talking about creating a community practice group for people that are interested in portals or have a portal already set up, that will likely launch after the end of this year. We said we would inform our clients to keep an eye out for this should they decide to go forward with intrastate crowdfunding.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 11/14/18
RE: Interview with Amy Pearl, founder of Hatch Oregon

Introduction
We began the interview by explaining who we were, that we were representing two rural Iowa cities, and what our representation of our clients entails. We explained that we had conducted a lot of research on intrastate crowdfunding and how it works both federally and in Iowa, but that we had a few specific questions for Amy based on her experience starting and running an intrastate crowdfunding portal.

To start out our conversation, Amy began by giving us a lot of advice. First she suggested that we or our clients consider talking to the Sustainable Economies Law Center in Oakland, California. It's an educational nonprofit law center founded by Janelle Orsi and Amy said "they're amazing." She also suggested we look at the development of a fund as just one strategy, and that Brian Beckon at Cutting Edge Capital would be our guy for that. She also cautioned us to not put too much weight into any feedback we get (even from herself) because people's experiences in intrastate crowdfunding and community investment in general have been very different. She also stressed not too worry too much about the platform, because teaching small business owners how to offer a local investment security to their neighbors was the most powerful thing she did in her time with Hatch Oregon. She said it was the greatest effect on entrepreneurs, and that this educational piece is also something you can charge for. Finally, she mentioned she would be happy to help us or our clients once she knows more what the Iowa intrastate crowdfunding laws looks like.

Establishing Hatch Oregon
We first asked Amy to walk us through the process of establishing Hatch Oregon. She said it's a separate LLC to protect the nonprofit (Hatch Innovation) which owns it. She said it's an initiative of the nonprofit and that it's still a work in progress. She really sees it as a state-wide effort, and thinks we need to get together with a bunch of other towns rather than just one town on its own.

Broker-Dealers & Community Investing Networks
When we mentioned that we heard Hatch Oregon is looking into working Localstake she said she is skeptical of companies such as Localstake because so much of the intrastate crowdfunding effort is local, which you can't get from a white-label technology. Even if you get it up and running with the white-label, then what? It really boils down to a partner/network strategy for raising awareness, and then someone has to teach the entrepreneurs and investors about what all of this intrastate stuff means. She said awareness first, then education. She suggested

looking into a Local Investing Opportunity Network (LION), which works well for small towns where everyone knows each other. It's not a loan or a fund, but rather a membership of local people coming together to support local businesses and invest their money locally, and "friends and family are always exempt when offering investments to each other." These LION organizations have investor meet-ups to keep the interest going.

Obstacles Faced at Hatch Oregon

We then asked what the biggest obstacles were that she ran into at Hatch Oregon and that she's seen for business wanting to use intrastate crowdfunding. She said the biggest obstacle is awareness. Another big obstacle is that they will get connected with people and get them really excited about it, but that people don't end up investing because they don't normally invest and don't have that type of experience, typically they just give their money to financial advisors. She said you have to help get them in the swing of things, to get them into investing as a habit, and to keep them interested in investing and not forget about the option. Local investor meetups could be a solution for this; could do something like LION here. She also mentioned lack of diversity as an obstacle, because there were not as many minorities involved.

What Makes Companies' Offerings Successful

When asked what, in her experience, made companies successful at intrastate crowdfunding, she said the answer isn't easy. Some of the companies she thought were going to do great ended up doing poorly, and vice versa. There were a couple main points she made, however, about what some companies definitely did wrong. The first was that the issuers forgot they were selling a security, not their product. People would end up wanting to buy the product rather than invest in the company, which is the whole point. So, they need to focus on selling their business *model*. Second, the issuers were bad communicators once people invested. Investors wanted to know what their money was being used for behind the scenes and how it was helping the business. For example, let them see the new equipment you bought, etc. The investors need information or they get mad.

Other Reading Suggestions

Amy then had to go to another meeting, but as a last thought she suggested a couple books that could be useful. The first is The Small-Mart Revolution: How Local Businesses are Beating the Global Competition Book, by Michael Schuman. She said he's "THE local economist." The second is Amy Cortese's book Locavesting. Finally, Game Plan for Community Capital which Amy developed.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 11/15/18
RE: Interview with Dennis Britson from Iowa Insurance Division (IID)

Introduction
We had a short interview with Dennis Britson from IID, who was involved in the updates to the Iowa intrastate crowdfunding regulations that came out in Iowa of 2018. We began the interview by explaining who we were, that we were representing two rural Iowa cities, and what our representation of the clients entails. We explained that we had conducted a lot of research on intrastate crowdfunding and how it works both federally and in Iowa, but that we had a few specific questions for them as the first registered crowdfunding portal in Iowa.

Iowa Intrastate Crowdfunding Regulation Questions
First, we confirmed with him that the regulations under the Iowa Administrative Code for intrastate crowdfunding were recently updated in April of 2018. We then asked about what intermediaries need to do to confirm that an investor is indeed a resident of Iowa, because it looked like the regulations didn't provide for anything more than the federal regulations whereas some states required pictures of drivers licenses or something similar. Dennis said that they had decided not to add anything else to the federal requirement.

We also confirmed that intermediaries may only offer intrastate securities on their website, and not any other type of security at all. Dennis said this was correct. Next we confirmed that only the issuer can enter into the required escrow agreement for the raised funds, and that the portal can't take any part in this. Dennis said this was also correct. We next asked Dennis about the fees that intermediaries are allowed to charge for their services. We said that other states had restricted portals' ability to collect success-based fees and that only broker-dealers could charge success-based fees, but that it didn't look like Iowa restricted the types of fees that can be charged at all. David said that this is correct, that there is no limit on the types of fees that can be charged or the amount.

Required IID Forms for Registration
We then moved on to the forms that need to be filed with IID. We mentioned that we couldn't find the notice filing form or the portal registration form on the IID website currently, although the website did mention these forms. Dennis said that they have not yet finalized the forms, and that what SPPX (the only Iowa registered crowdfunding portal) did, and what our clients should do if they want to do intrastate crowdfunding, is to just reach out to IID. They'll work together to see what information IID needs. We also asked whether there was a specific registration process for broker-dealers involved in intrastate crowdfunding in Iowa and he said no, that Iowa already has

registrations for broker-dealers and that once that is done they don't need to do anything extra to offer or sell intrastate securities.

Disclosure Requirements

We then discussed disclosure requirements with Dennis. He said there's always a disclosure requirement, and that it depends on the offering and who is involved as to how much is required, but that it often rises to the level of an actual disclosure document, but that some might do a private placement memorandum. He suggested using the North American Securities Administrators Association's (NASAA) website, which has a SCOR offering document, which is specifically designed for people who can't afford to use high-price securities counsel. He said they're currently in the process of making it more technologically up to date, and that revisions either have or soon will be out for comment. (It appears that the SCOR document is used for others types of exempt securities offerings, but could potentially still have useful information.)

Update to the Iowa Regulations

We then asked what the reasoning was for updating the intrastate regulations. He said it was a variety of things – there were issues with the language in the first regulations that made it unlikely Iowa would get a lot of filings, so they wanted to open it up and make it more usable. They also wanted to address the issue of the requirement for a registered Iowa portal. They considered opening it up to FINRA registered portals as well, so that small businesses would have a greater ability to find someone who could help them with the offering. He sent an email after our conversation that said it looked like the FINRA provision didn't make it in to the final updated regulations. Finally, we asked whether they have seen any more interest in intrastate crowdfunding in Iowa since the updates were approved, and he said that Silicon Prairie has been in touch but hasn't come back yet to make any offerings, but are in the process.

We thanked Dennis for his time and said we would let him know if we had any more questions, and he said he'd be happy to answer them if we did.

Memorandum

TO: Manning/Webster City Google Drive
FROM: Jen Wiltse
DATE: 11/19/2018
RE: Interview with David Duccini with Silicon Prairie Portal & Exchange (SPPX)

Introduction
We began the interview by explaining who we were, that we were representing two rural Iowa cities, and what our representation of the clients entails. We explained that we had conducted a lot of research on intrastate crowdfunding and how it works both federally and in Iowa, but that we had a few specific questions for them as the first registered crowdfunding portal in Iowa.

SPPX's Registration Process in Iowa
To begin, we asked David to explain a bit more about SPPX's experience getting approved in Iowa, and what drew Silicon Prairie to start offering its services in Iowa. David replied that they became interested in Iowa because it was a natural expansion of SPPX, as Iowa is a "silicon prairie" state. He also felt SPPX was well-positioned to bring it to Iowa as the first to do it, since it hadn't been done in Iowa yet and his organization had done this already in numerous states (Minnesota and Wisconsin). He then explained that they first talked to the Iowa Insurance Division's (IID) office last summer. During this time IID was in the process of updating their intrastate crowdfunding regulations, and SPPX was able to provide feedback based on their experience in other states. He said it was a very interactive process, and their approval came in during May of this year.

Services Offered by SPPX
We then asked whether SPPX is a broker-dealer. David replied that they were not yet registered as one in Iowa but are currently in the process of registering as one. Next, we asked about the platform SPPX already has developed and whether it was something our clients might be able to utilize. David responded that they can create a private-label (i.e. white label) version of their site. Then when the portal SPPX is partnering with sends their investors there, the investors only see the offerings being made through that portal. He described this as the "Wall Garden Experience" and said that currently there are 3 different portal operators who use just their platform, and that SPPX has a revenue share model with those portals. David explained that there are two other options for working with SPPX, which Jen later followed up on in an email to learn more information about (and is still awaiting a response as of 11.26.18).

Smart Doc System for Lowering Attorney Costs
We also asked to hear more about SPPX's smart doc system that Zach from MNVest had mentioned during our interview with him. David explained that it essentially converts Word or PDF documents into source code through latex. For example, you can put variables into a contract and it recreates the entire document with the new inputted information. It's basically a

smart contract. Using this system has dramatically lowered the time and thus costs associated with using lawyers. For example, private offering memorandums used to take from 40-50 hours and now only take 4-5 hours to review instead.

Regulation Crowdfunding versus Intrastate Crowdfunding

We then asked about the Regulation CF versus intrastate crowdfunding exemption, and David said he thought there were competitive advantages for intrastate crowdfunding because the rules are more relaxed and because of the state of the financials of the issuer themselves. In other words, that the issuers using this (small businesses) typically can't afford to comply with SEC securities regulations, so having this intrastate exemption that allows them to skip these regulations is very useful.

Advice

Next we asked whether David had any advice in general that he thought we should know when informing our clients about the intrastate crowdfunding option. He said that the $5,000 for households for non-accredited investors is low from what he's seen for other states (usually households aren't treated as one investor for investment limit purposes) but that at least accredited investors are free to invest as much as they want.

We also asked whether there was any interest currently in Iowa for SPPX's portal there. David said that there is currently a solar energy installer that is interested in intrastate crowdfunding, and that there has been some interest from breweries. He said breweries are fantastic for crowdfunding because "who doesn't want free beer in return for their investments?"

Zach, who was listening in on the call, jumped in at this time and said he suggested that the best use of time is for someone interested in doing this to find the first offering that everyone can sort of work together on and understand how it works, and then make future decisions from that. He said it takes a lot of effort to create this entirely new ecosystem, and that if he, or SPPX, or any other groups interested in intrastate crowdfunding in Iowa could partner with on finding that first, second, or third offering, everyone is going to learn a ton about how this can work in Iowa and who the partners are that can make this work.

David then mentioned that he had also suggested to IID that they create an IID-run website with approved offerings. He said it would help with education that this option exists, that it's legal, and that it's being used successfully. He also mentioned that intrastate crowdfunding is a really useful tool for small towns to use for buying and renovating abandoned property. We didn't have time to follow up on this with him, but we plan on including this in our final deliverable to the clients so that they can follow up with him to see how this might work if they are interested.