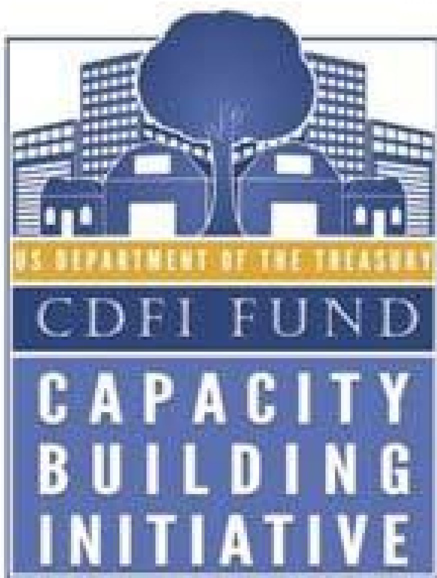
DEBT AND EQUITY MANUAL



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Seven Sisters Community Development Group, LLC is a woman- and majority Native American-owned national consulting firm, which offers culturally relevant and innovative strategies, services, and products that create systemic change. Its team of community development experts works with low-wealth and diverse communities across the country, with a particular focus on Native Communities. The team brings a broad range of experience with tribal governments and communities as well as national and local nonprofits, foundations, corporate organizations, and governmental entities.

Presented by NeighborWorks America with Seven Sisters Community Development Group LLC

Getting Ready to Raise Capital

All Native CDFIs need funding but the key question is: what kind funding do you need? What kind of funding are you likely to get? What kind of funding should you go after? Do you need funding for operations? To expand a capital base for lending? To subsidize the cost of services you're providing? For program development? Or for all of these?

Typically, CDFIs seek grant sources for operations and subsidies, and debt/investments for loan capital. In looking for investments, we are looking for low-cost, long-term or "patient" capital, which will give CDFIs the time and ability to use the funds, to lend them out over a shorter term, and to successfully pay them back.

In this course, we will identify different sources and types of capital and what your organization needs to do to get your "house in order" to access them. We will also start narrowing in on your own needs – what capitalization strategy is right for your organization?

Reasons to Raise Capital There are many reasons why a Native CDFI may need to raise capital. Possible reasons include:

- ***TO MEET INCREASED DEMAND FOR EXISTING PRODUCTS AND SERVICES***
- Geographic expansion
- New product development
- Capital constrained
- To increase scale in order to improve sustainability by generating more revenue

Ways to Use Capital How a Native CDFI will use the capital is important because it will help to determine the most appropriate type of capital to pursue. Examples of ways to use capital include:

- As loan capital to make more loans.
- Research and development to design a new loan product to meet the market demand of the target market.
- Operating capital to cover existing expenses like staff, marketing, rent, professional services, etc.
- Operating capital to cover new expenses related to geographic expansion or new product launch.
- To bolster reserves to cover loan losses.
- Strengthen capital base to leverage more debt resources.

History of Raising Capital Another consideration that will help to determine the most appropriate type and source of capital is the organization's history of raising capital.

- Is there a history or track record of raising money?
- If yes, what types of funds have been raised? All grants? A mix of grants and debt?
- From what sources? Tribe, federal government, foundations, banks?
- What was the success rate?
- Is the CDFI's house in order

Introduction to Debt and Equity

Generally speaking, there are two types of capital:

- **Equity** is the value of an asset after all the liabilities and debts have been paid.

- **Debt** is an obligation owned by one party (the debtor) to a second party (the creditor).

Equity

In a for-profit entity, an owner can sell an ownership share or "equity" in their company. This ownership share has value. The value comes from two places: the appreciating price of the stock and the stream of dividends. The stock or equity share can be sold by the owner for a profit when the value of the company increases. In some cases, a company may go "public" and sell shares in the company to the public through stocks.

Because no one owns a nonprofit, the provider of equity does not become an owner in a company. Equity, in this case, may come from a grant from a public, private, or philanthropic source. Equity is also the retained earnings of the for-profit. If a company makes a profit and does not distribute all of the profit in dividends, the retained profit or earnings is considered equity.

Generally speaking, equity-like investments in nonprofits are free – that is the nonprofit does not give up control of the company. However, CDFI managers should consider the cost of obtaining this type of investment including the following:

- Staff or consulting costs to write grant proposals
- Marketing costs to attract individual donors
- Accounting costs to monitor restricted funds
- Staff or consulting costs to monitor production of grant deliverables
- Overall all grants management costs to track results and file required reports
- Restrictive covenants of the equity provider

When a Native CDFI considers the appropriateness of a potential grant, it should consider whether the amount of the grant is worth the cost and effort to obtain, implement, and report on the grant. It should also consider whether the grant is too restrictive. Is it for general operating support? Or is it restricted to a specific project or program? Does that specific project or program fit into the organization's mission, business plan, or identified need for capital?

Debt

Debt capital is the capital that a CDFI raises by taking out a loan or obligation. The debt is normally repaid at some future date. Debt capital differs from equity because subscribers to debt capital do not become part owners of the business, but are merely creditors. The suppliers of debt capital usually receive a contractually fixed annual percentage return on their loan. A CDFI that is highly leveraged has a high debt-to-equity capital ratio.

Table 1: Advantages and Disadvantages of Debt and Equity

Advantages of Equity	**Advantages of Debt**
• No or low cost (perhaps) Can • be flexible • Does not have to be repaid Can be blended with debt to lower the • cost of funds (for lending) Can be used for operating expenses	• Lender is only entitled to repayment and not a direct claim on future profits • Principal and interest obligations are known amounts which can be forecasted and planned for (except in the case of a variable rate loan) • Few reporting requirements
Disadvantages of Equity	**Disadvantages of Debt**
• May cause mission creep • May have restricted use of covenants • May not cover all operational costs Reporting requirements may be • onerous May incur cost to apply for a grant even if the grant is not awarded • Generally easier for Native CDFIs to get – however until optimum debt/equity • is achieved it is counterproductive.	• Has to be repaid at some point • Cost of funds may be too high • Must have sufficient revenue to service the debt • An organization that is too highly leveraged may find it difficult to grow because of the high cost of servicing the debt • If the CDFI cannot repay, bankruptcy follows shortly

Getting your Financial House in Order

Before approaching a bank, foundation or social investor, your CDFI should know the answers to the following questions:

- How much money do you want?
- How much will you accept?
- Why do you want the money? What will you do with it?
- Who else have you asked?
- What will you do if you don't get the money?

Rather than saying to the funder, "People in my community are poor, and they need our money," be specific about how the investment or loan will be used. For example, you could say that it would:

- Meet increased demand for products and services
- Provide capital for market expansion
- Relieve capital constraints
- Bring us up to scale, thus increasing sustainability

Sources of Data The information you provide to the investor or lender will vary depending on your need for the capital. Looking at the examples of need that are listed above, here are some possible sources of data to justify your request.

Table 2: Sources of Data to Justify Need for Capital

Increased Demand for Products and Services	**Market Expansion**
• Demonstration of pipeline • Market study • Survey • Focus groups • Secondary data • Anything that shows you KNOW YOUR MARKET!	• Maps, if applicable • Interviews with affected institutions • Borrower testimonies • Demonstration of demand • Secondary data
Relieving Capital Constraints	**Increasing Sustainability**
• Cash flow • Benchmark yours organization against similar asset-sized CDFIs • • o *"We are trying to be like other successful CDFIs"*	• Explain how you are driving down operations cost to achieve profitability/sustainability • Ratios: o Cost per constituent served o Cost per loan closed o Cost per mortgage financed o Benchmarks

Financial Fitness Checklist In addition to providing data to justify your request, your CDFI should be able to document that you are financially fit. There are a number of financial indicators that a CDFI should be prepared to discuss:

- Ideally, the organization should be able to show a **positive trend in net income** for the past two to three years. There should also be a positive net income projected going forward for three years both with and without the new capital. If the net income is not positive, the organization should be prepared to explain why not.
- The organization's **net assets** should be increasing.
- **THE ORGANIZATION SHOULD HAVE A STRONG LOAN PORTFOLIO WITH A LOW DELINQUENCY RATE – PREFERABLY LESS THAN 8 % DELINQUENCY.**
- The organization's **reserves should be adequate** based on its level of risk. There should be a cash or accrual loan loss reserve as well as operating reserves.
- The organization's **liquidity should be sufficient**. Its Current Ratio (current assets/current liabilities) should be 2:1.
- **THE ORGANIZATION SHOULD NOT BE TOO LEVERAGED. IT SHOULD BE ABLE TO TAKE ON NEW DEBT. ITS LEVERAGE RATIO (TOTAL DEBT/TOTAL EQUITY) SHOULD BE LESS THAN 5:1.**

Key Organizational Documents In addition to these financial indicators, a Native CDFI should have the following documents available to share with lenders:

- Three years of independent audits.
- Your current operating budget, by line of business
- A list of your current board members and their affiliations
- Your organization documents including documentation of your tax status, articles of incorporation, and bylaws
- A board-approved strategic plan
- A breakdown of your portfolio by
  - Type of loans
  - Security
  - Track record of portfolio
  - Asset/liability mismatch
  - Weighted interest rate
- A summary of your existing corporate debt including:
  - Type, terms, from whom
  - Payment history/workouts
- Information about any existing relationships with foundations, Program Related Investments (PRIs), and other investor money as evidence of your previous success at fundraising and the sustainability of your organization.
- For foundations, data about social metrics such as:
  - Jobs created, homes constructed, community members education, etc.

Minimum Prudent Standards Minimum Prudent Standards are indicators, based on organization type, used by the CDFI Fund to evaluate the loan portfolio quality, financial track record, and financial projections of CDFIs applying for Financial Assistance or Technical Assistance from the CDFI Fund.

The MPS standards include:

- Net Asset Ratio
- Current Ratio
- Deployment Ratio
- Self-Sufficiency Ratio
- Operating Liquidity Ratio
- Net Income
- Earnings Ratio
- Portfolio at Risk
- Loan Loss Ratio
- Loan Loss Reserves

In future courses, we will discuss Minimum Prudent Standards (MPS) ratios – what they are and what they mean. We will look at the reason for the standards, why they are set at a certain level (and not another), and how an organization can effectively change the components of their MPS ratios.

Because some investors may consider an organization's MPS ratio, CDFIs should be familiar with them and be able to explain any deficiencies.

PULLING THE PIECES TOGETHER: ARE YOU READY?

USE THE FOLLOWING CHART AS A SELF-ASSESSMENT TO DETERMINE YOUR READINESS TO APPROACH A POTENTIAL INVESTOR.

What you need to take to investor/to know:	Yes, we have this in place	No, we don't have this in place yet	We definitely need to work on this
Information about Your Request/Product			
How much are you asking for? (max/min)			
What will you use the funds for?			
Do you have a Plan B? (if you are unsuccessful)			
Demand analysis for the product: can you show demand for the proposed product?			
Financial Information			
Financial ratios			
Benchmarks			
Three years of audits			
Three years of financial projections			
Operating budgets			

What you need to take to investor/to know:	Yes, we have this in place	No, we don't have this in place yet	We definitely need to work on this
Portfolio Information			
Portfolio performance			
Calculation of weighted interest rate			
Delinquency report			
Corporate debt performance			
Aging of receivables			
Loan Fund Health			
Adequate reserves			
Statement of loan loss reserve			
Debt capacity			
General Information			
Board experience			
Staff capacity			
Certification of tax-exempt status			
Strategic plan			
Capitalization plan			
Asset/liability match			
Social metrics			

Sources of Capital

To explore the different sources of capital, we will look at a listing of investments that one large, experienced CDFI has accessed. Look at the next two pages. What types of investments do you see?

The pages that follow then provide an overview of different types of investment to consider:

- Bank loans
- Program Related Investments (PRIs)
- Equity Equivalent Investments (EQ2s)
- Social investments
- Religious investments
- Nonprofit intermediaries
- Government programs

OVERVIEW OF DIFFERENT TYPES OF DEBT

Bank Loans

Source of funding	Banks (conventional lenders)
Brief description	Banks are encouraged by the Community Reinvestment Act (CRA) to invest in CDFIs.
What is good about this source?	Underwriting criteria is standard and straightforward.
What is tricky about this source?	Bank focuses solely on underwriting criteria – social mission is not taken into consideration unless it is a completely-CRA motivated loan. Know the difference, as this will help in negotiating. More recently, banks appear to be pulling back from investing in CDFIs and all businesses, and we are seeing shorter terms and higher interest rates.
Interest rate	3%-8% currently
Term	Generally, banks are not going to go longer than 5 years.

Cohort example: notes

PRIs (Program Related Investment)[1]

Source of funding	Foundations (national, regional, community and family)
Brief description	A program-related investment (PRI) is a type of mission or social investment that foundations make in order to achieve their philanthropic goals. Like grants, PRIs are vehicles for making inexpensive capital available to organizations that are addressing social or environmental concerns. Foundations are able to claim the PRI as part of their 5 percent disbursement requirements, yet at the same time have a claim on the funds.
What is good about this source?	PRIs are usually structured with interest-only payments with principal balloons. Renewals in the legal document are usually an option. Ask for it!
What is tricky about this source?	Foundations have decreased PRI activities since many foundations' assets shrunk after the financial crisis of 2008. Foundations are very relationship-based, and will tend to make PRIs to organizations that they (or others) have supported through grants.
Interest rate	0 – 2%: While PRIs are often made with the expectation of a rate of return between 0 and 2 percent, rates will vary depending on risk and foundation mission alignment.
Term	Ten years is not atypical: the duration of the PRI may be from three to even ten years.

Cohort example: notes

1 "Frequently Asked Questions about Program-Related Investments," by PRI Makers Network, Adapted from Answers to the 10 Most Asked Questions about PRIs, Office of Program-Related Investments, Ford Foundation.

EQ2s (Equity Equivalent Investments)[2]

Source of funding	Primarily banks
Brief description	EQ2s represent over 70% of bank investments (a loan is not an investment) in CDFIs. Even though they are called "equity," EQ2s must be repaid, although the bank's claim will be subordinate to other lenders.
What is good about this source?	CDFI makes interest-only payments over the term of the investment. Like permanent capital, EQ2 enhances a CDFI's lending flexibility and increases its debt capacity by protecting senior lenders from losses. However, an EQ2 is not equity – it is debt, and if an auditor does not classify it as debt, they are incorrect.
What is tricky about this source?	Banks have pulled back significantly from EQ2s.
Interest rate	2 – 4%
Term	Longer term (loan often renewable, based on certain benchmark conditions).

Cohort example: notes

2 "Equity Equivalent Investments," Community Investments, March 2002.

Nonprofit Intermediary Loans

Source of funding	Nonprofit intermediary organizations
Brief description	Often, intermediaries access funding and then lend it out to CDFIs or other nonprofits that meet their mission. Some examples include: OFN, Oweesta, Craft3, and the Housing Assistance Council. (Please note that brief descriptions of these organizations may be found in the "Additional Resources" section under the final tab of this binder). Many of these groups are CDFIs.
What is good about this source?	Standardization of documentation; familiarity with the CDFI industry; economies of scale; their funders' "pressure to get the money deployed."
What is tricky about this source?	Often the applicant has to "bend" their request to the funding sources the intermediaries use.
Interest rate	Oweesta: 3 – 5% Craft3: 5%-10%:
Term	Oweesta: 3-5 years Craft3: varies - <7 years OFN: varies - <7 years

Cohort example: notes

Socially Responsible Investments[3]

Source of funding	Sustainable and responsible investors include individuals and also institutions, such as corporations, universities, hospitals, foundations, insurance companies, public and private pension funds, nonprofit organizations, and religious institutions.
Brief description	Social investors look to meet social goals as well as financial return.
What is good about this source?	- CDFIs fit well into the community investment mission of SRIs. - SRIs value community impact in addition to financial performance.
What is tricky about this source?	SRIs may not be aware of CDFIs' successful track records and unique competencies. Many times the request is unusual and if so, you will need to get past the professional fund managers.
Interest rate	Depends on investor – usually market rate plus.
Term	3-5 years

Cohort example: notes

[3] Sustainable and Responsible Investing Facts, US SIF: The Forum for Sustainable and Responsible Investment, webpage, http://ussif.org/resources/sriguide/srifacts.cfm

Religious Investments

Source of funding	Religious orders and religious healthcare systems.
Brief description	Religious investors are a subset of socially responsible investors. Religious funders are motivated by social mission.
What is good about this source?	Religious funds generally already have a socially screened investment portfolio, so to a certain extent you are "preaching to the choir." Focus on impact. Many of these groups have specific social goals.
What is tricky about this source?	Need to develop a relationship with religious lenders; may be hard to establish. These sources are highly competitive.
Interest rate	1 – 3%.
Term	Generally longer term – Ten years with an option to renew is not unusual (NH Community Loan Fund).

Cohort example: notes

Government Loan Programs

Source of funding	Government loan programs
Brief description	There are a number of federal loan programs that have provided significant loan funds to CDFIs, such as USDA's IRP (Intermediary Relending Program), the CDFI fund, and SBA programs.
What is good about this source?	Program guidelines for these programs are straightforward.
What is tricky about this source?	Federal budget issues make the future of these programs uncertain.
Interest rate	USDA IRP – 1%
Term	Depends on program
Special features	Reporting requirements often trump impact – "hidden costs" are often not factored in when making a decision to apply.

Cohort example: notes

Types of Equity

Source of funding	**External:** Individual investors, foundations, corporations, government (federal, state, tribal) **Internal:** Retained earnings, net income, subsidiary revenues
Brief description	The net assets – what is left after everything and everyone has been accounted for. The ownership stake. What are you worth and how are you deploying your wealth? How are you leveraging your equity?
What is good about this source?	The corporation does not owe this capital. It has been earned and is subject to the actions of management and the board in a nonprofit and stockholder/owners in a for-profit venture. It is the basis for what your leverage can be.
What is tricky about this source?	Grant equity may appear to have no cost, but you should consider the cost to prepare and manage grants.
Interest rate	For nonprofits, the cost of equity is 0%. With for-profits, the cost is the dividend payout that the stockholders will receive, which (they hope) is greater than the cost of investment.
Term	Until dissolution or asset transfer with a nonprofit. Until redemption or buy back of stock by the corporation with a for-
Special features	

Cohort example: notes

What Capitalization Strategy is Right for your CDFI?

Since any capitalization strategy should be specific to particular CDFI, there is standard no "fill in the blanks" type of document that, once completed, will give your organization a funder-ready document. There are, however, certain elements that comprise a good plan, and CDFIs should address each one when putting together the plan.

Additionally, a capitalization plan for a start-up CDFI is going to look quite different than that of a mature CDFI with several million in net assets. One difference is this: a start- up is looking for capital to begin operations whereas a mature CDFI may be looking for capital for several different reasons: to balance their debt/equity structure, to begin an expansion or to offer a new product.

What is a capitalization plan? A capitalization plan is a document that lists the sources and uses of capital that the CDFI plans to accumulate. It provides a rationale for capital requests and places the capital within the context of the CDFI's operations and growth strategies.

- **A capitalization plan is an integral part of the business plan** It makes no sense to list sources and uses of capital unless it fits into a larger vision of the organization. If your capitalization plan states that you need $1 million of debt and $500,000 of equity, the obvious question for a lender or investor is going to be "what for?" The acquisition of capital must be part of a story that includes who you are, why you are in business, how you will market yourself, who is running the show, what do you offer your stakeholders and what are your growth strategies? The story leads the plan, not the other way around. Bankers and investors want to be convinced that you will succeed based on a comprehensive market definition, demand analysis, well thought out financial projections and a feel for day-to-day operations. This list comprises the primary components of a business plan.

  It does not matter whether you are a start-up or a mature CDFI – asking for capital is the end stage of a well thought out business strategy. A simplified way of depicting this is shown below.

- **Capital can come from inside the company or from outside sources.** There are three types of capital that are relevant for a capitalization plan: debt, equity and retained earnings or surplus. Let's look at each one.

  - *Debt* – A lender provides capital and the CDFI pays it back. It is listed on the balance sheet as a liability.

  - *Equity* – CDFIs generally call equity *net assets*. These can be either restricted or unrestricted. An example of a *restricted net asset* would be a CDFI Fund Financial Assistance (FA) grant award of $1 million. This capital must be used for lending. It is restricted to lending. When the loans that the CDFI makes with this capital are repaid, more often than not the repayments go into unrestricted net assets.

    An example of an *unrestricted net asset* would be an operating grant from a local corporation or foundation. The capital can be used in any way the CDFI sees fit. Both restricted and unrestricted net assets show up on the balance sheet as such. We use the term equity as an equivalent.

  - *Retained earnings* – CDFIs generally call this type of capital *surplus*. It may be considered the profit of the CDFI, that is, revenue less expenses. It gets stated on the balance sheet as unrestricted net assets, retained earnings, or surplus. They all mean the same thing.

    When developing a capitalization plan, it is important to include the surplus in your capital projections. It will give the lender/investor an idea of the impact their capital will have on CDFI sustainability. If you omit it, the lender/investor may believe that that your organization does not know what it is doing at the most basic level.

- **For how long a period should a capitalization plan address?** As with everything, it depends on why you are writing the plan. If you are writing the plan to coincide and complement your business plan, the capitalization plan should match that of the business plan. This is usually three to five years. If the capitalization plan is part of a ten-year fundraising drive, then the plan should be for ten years. A good rule of thumb is that the plan should be for as many years as the investor/lender dollars are put into the CDFI. A ten-year loan should show CDFI capital sustainability for ten years, so that the lender will have confidence that the loan will be repaid. Match the period to the capital.

- **Where do we get the capital?** You can get debt from any individual or organization that will loan your CDFI money. For equity, foundations, the CDFI Fund, and corporations are the best avenues. Obviously, a significant amount of research needs to be conducted in order to target investors and lenders. You don't want to ask for a $1 million grant from a foundation that has never given out more than $50,000.

- **How optimistic should projections be?** Optimism can be a two-edged sword. Your optimism may be the investor's pessimism. Realism is a better term. Your projections should be the most accurate forecast of your needs – no more and no less. This is for several reasons. Realism keeps the CDFI on track, and it is much easier to defend realistic assumptions and projections than pie-in-the-sky projections. Lenders and investors see many more capitalization plans than we ever will, and they have a sixth sense for sensing when numbers and projections are unrealistic. A good idea is to focus on what you need, not what you can raise.

Example: The Need for Realism in Capitalization Planning

A Native CDFI has $2 million in cash on its balance sheet out of total assets of $2.5 million. The executive director decided to apply for a CDFI FA award for $750,000 because the Notice of Funds Availability (NOFA) was just released and his grant writer called to say she was available to prepare a proposal. He didn't have a plan to deploy his existing capital, but he wanted to get as much no cost equity as possible. His grant writer was expensive, but she had a good track record. He decided to go for it.

- Is this a good strategy? Why or why not?

- Do you think this FA application will be successful?

- What might have been a more realistic strategy?

- **What is the relationship between a capitalization plan and the growth of the CDFI?** A CDFI typically is ranked according to asset size. One grouping for loan funds is as follows:
  - ***<$500,000***
  - $500,000-$1 million
  - $1 million-$5 million
  - $5 million-$10 million
  - $10 million-$$50 million
  - $50 million-$100 million
  - > $100 million

A capitalization plan should that a CDFI through to the next stage of growth. So, if you are a start-up CDFI, focus on a capitalization plan that gets you up to $500,000 first before you write a plan that puts you in the $50 million asset size. Each stage of growth will have specific capital requirements.

For instance, smaller CDFI loan funds typically have a debt/equity ratio of < 1:1, whereas larger CDFI loan funds typically have debt/equity ratios of 2:1 and as high as 8:1. An 8:1 ratio means that the CDFI has $8 dollars of debt for every $1 of equity.

- **Is there a correct debt to equity ratio for a capitalization plan?** The answer is no, but with a caveat that there are certainly incorrect ratios. Recall the example above. With $2.5 million in assets and no debt, a prudent capitalization plan would be to seek debt for growth. Debt generally is easier to obtain and the requirements do not vary from lender to lender as much as foundation or investor requirements. The CDFI above could easily borrow $1.5 million and achieve a debt to equity ratio of 4.5:1.5, or 3:1. However, it should not borrow money for the sake of borrowing money. The loan or debt needs to be tied to a specific need of the organization.

- **How will the *cost of funds* drive your mix of debt and equity?** It is important to model your lending projections to determine how much you will charge in interest for your loans compared to your cost of funds. The spread or margin between the interest rate you charge and the cost you pay for the capital to lend is your earned income.

  Review the "Cost of Funds Sensitivity Worksheet" below to see examples of the cost of capital may impact your mix of debt and equity.

- **What is a good outline for a CDFI Capitalization Plan?** The general outline below may or may not work for every organization. However, if you address all

OF THESE ISSUES, YOUR PLAN SHOULD "HANG TOGETHER" AS YOU PRESENT IT TO YOUR BOARD, LENDER OR INVESTOR.

Introduction: Who you are, what have you done, how long have you been around?

Need: Why do you need capital, what type of capital do you need, under what terms, from whom?

Capital structure: State the proposed capital structure and the rationale for the selected debt/equity target. How you got to this ratio, and why this is the optimum structure for this stage of the CDFI's growth.

Growth of the organization: How the capital will be used and its relationship to the growth of the CDFI.

Financial projections: Minimum three years. This will show how the capital is deployed, for what products, for which stakeholders and the financial and social return. Financial projections include a balance sheet, income statement and statement of cash flows. In addition, if you are a loan fund, a general idea of the portfolio performance, i.e., total number of loans, average and median amounts, charge offs and delinquencies.

Sources of debt and equity: Where will the CDFI get the capital? From whom? Which lenders, foundations and investors?

Responsibilities within the organization: Who is raising the capital? Is this their only responsibility? How realistic is the capitalization targets?

Monitoring and evaluation: How will the plan be implemented and reviewed? Who monitors the plan and what reporting to the board is required? What is Plan B (in the event the capital is not raised in sufficient or targeted amounts)?

Conclusion

A capitalization plan for a CDFI is an essential planning document that, properly done, will lead the organization through an exercise that addresses issues of product development, sustainability and financial analysis. It is not a document that one develops to get a grant or a loan. It is the foundation for planning for the various stages of CDFI growth.

Case Study # 1 Longhouse Loan Fund

The Longhouse Loan Fund (LLF) is a Native CDFI operating on the "Blue Island" Indian reservation. They offer mortgage loans and homebuyer education to tribal members living on and near the reservation.

LLF has a balance sheet that looks something like what is below.

ASSETS = LIABILITIES + EQUITY

Assets	
Cash	$ 100,000
Loans	100,000
Liabilities	50,000
Equity	150,000

The LLF completed a market study and determined that there was a growing demand for affordable homeownership from young families living on the reservation. As a result, the LLF Board has determined they want to start a small mortgage lending program and want to capitalize it with an additional $500,000 of funds. It is your job to make this happen.

Discuss the following questions with your table. Select a spokesperson and be prepared to share your answers.

Questions

1. What are the steps we need to take before we determine whether this money should be raised as debt or equity? (Think cost of capital and cost to borrower)

2. What should we go after – Debt? Equity? Both? How much of each?

3. What are the drawbacks of using each kind of capital?

4. What will the balance sheet look like if your strategy is successful?

5. What are possible sources of capital you might pursue?

Case Study # 2 Arizona Native Business CDFI

The Arizona Native Business (ANB) CDFI is a nonprofit loan fund based in Phoenix, AZ. It provides microenterprise financing, financial education, and business planning courses to Native-owned start-up businesses located in the State of Arizona. It has a 30-year track record, solid board, and highly skilled loan committee.

The ANB CDFI has a balance sheet that looks something like what is below.

ASSETS = LIABILITIES + EQUITY

Assets	
Cash	$ 1,000,000
Loans	5,000,000
Liabilities	3,000,000
Equity	3,000,000

The Board is pleased with the organization's impact on Native businesses in Arizona and is ready to expand their services to meet the growing demand from home-based businesses on reservations around the State. They have determined they want to start a specialized lending program for Native artists and want to begin the program with an additional $1 million of funds.

Discuss the following questions with your table. Select a spokesperson and be prepared to share your answers.

Questions

1. What are the steps we need to take before we determine whether this money should be raised as debt or equity?

2. What should we go after – Debt? Equity? Both? How much of each?

3. What are the drawbacks of using each kind of capital?

4. What will the balance sheet look like if your strategy is successful?

5. What are possible sources of capital you might pursue?

Additional Resource

Native CDFIs: Access to Debt Capital Investments, Oweesta Corporation, 2012.