



THE FINANCIAL PERFORMANCE OF IMPACT INVESTING THROUGH PRIVATE DEBT

APRIL 2018

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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.¹ 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.²

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.³ 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,⁴ 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%).⁵ 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. This chapter considers *Community Development Loan Funds* (CDLFs), which invest exclusively in the United States and rely on both private funding and grant. Another chapter 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.

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.

1 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>

2 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>.

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

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

1.1 METHODOLOGY

1.1.1 Sample

CDLFs, which are certified by the U.S. Department of the Treasury, are largely nonprofit funds and exclusively invest in the United States.⁶

Results on samples of fewer than three funds are not shared here in order to protect anonymity.

1.1.2 Inclusion Criteria

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

Criteria	Included	Excluded
<i>Impact</i>	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.
<i>Investors</i>	Open to multiple investors	Open to single investor
<i>Fixed Income Investments</i>	All CDLFs	Venture Capital Funds, Intermediary CDLFs, CDLFs lending to individuals
<i>Investment Portfolio</i>	≥50% of non-cash assets	<50% of non-cash assets
<i>Audited or Unaudited Financial Statements</i>	Available	Not available

⁶ 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>.

1.1.3 Source

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 submitted annual audited or unaudited financial statements for the past one to five fiscal years (that is, 2012–2016), from which the Research Team standardized financial performance calculations as follows.

- › **Extrapolation:** Nearly half of CDLFs operate on a non-calendar business cycle. To enable comparison across the entire sample, those CDLFs' data were extrapolated as of December 31.
- › **Outliers:** Since this study focuses on patterns of return, the Research Team identified outliers only for sub-sections of the 'Financial Performance Breakdown' of chapter. 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, OFN shared self-reported metrics with the Research Team from their network of CDLFs for the year 2016. This data provided supplemental background information on the financial and legal structure of the respective funds, target investment areas, and impact themes. CDLFs were also requested to input other metrics on an online survey platform.

1.1.5 Performance Calculation

The financial performance of CDLFs 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 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, section 2.8 showcases the approaches to impact measurement and management of a typical CDLF active in the Community Facilities sector in the United States.

Table 2
List of Sectors

OFN Classification
1 Microenterprise
2 Small Business
3 Housing
4 Community Services Organizations

2. COMMUNITY DEVELOPMENT LOAN FUNDS

2.1 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.⁷ 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).⁸

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:⁹

- › **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.

⁷ U.S. Department of the Treasury, "Community Development Financial Institutions Fund," <https://www.cdfifund.gov>.

⁸ Opportunity Finance Network, "What are CDFIs?," <https://ofn.org/CDFIs>.

⁹ 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.¹⁰

According to the latest data,¹¹ 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%),¹² and Other segments (2%).

2.2 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.

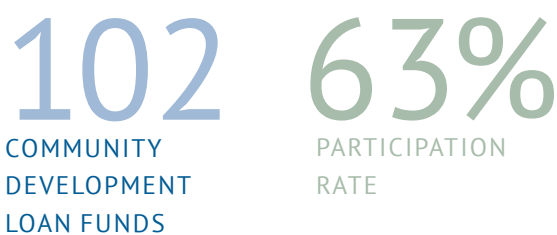


Table 3
Number of Participating Funds by Calendar Year

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 3). 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.

¹⁰ 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.

¹¹ 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).

¹² "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.

By main investment sector, Housing-focused CDLFs comprise nearly 40% of the total sample (Table 4). 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 4
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 2.1), 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 5).

*Table 5
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

2.3 ASSET SIZE

2.3.1 Total Asset Growth

At the fund level, CDLF total assets range widely (Figure 1), 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%.

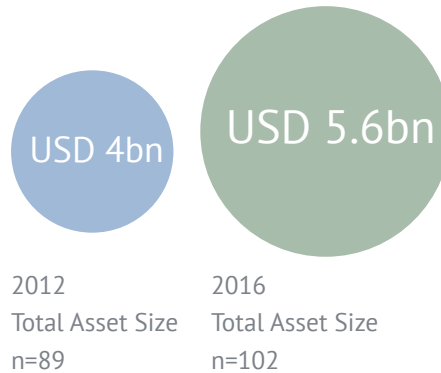
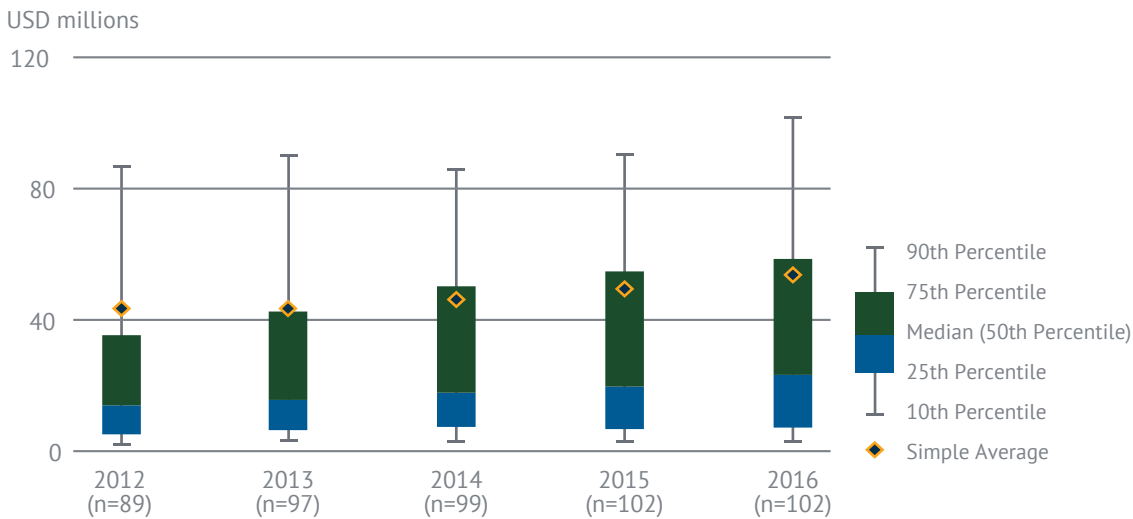


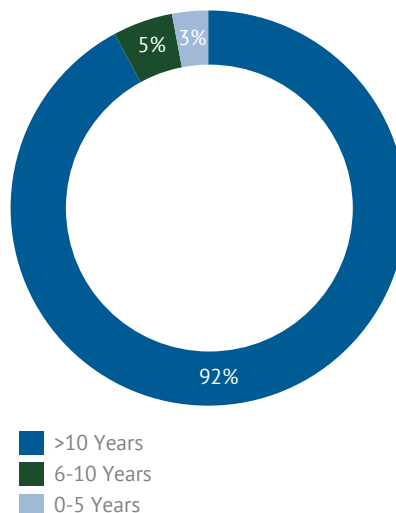
Figure 1
Assets Under Management, Distribution of Sample



2.3.2 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 2).

Figure 2
Age of Funds



2.3.3 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 3). 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 4). 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 6). At the median, all types of CDLFs except those investing in community facilities have shown double-digit growth.

Figure 3
Total Assets by Sector

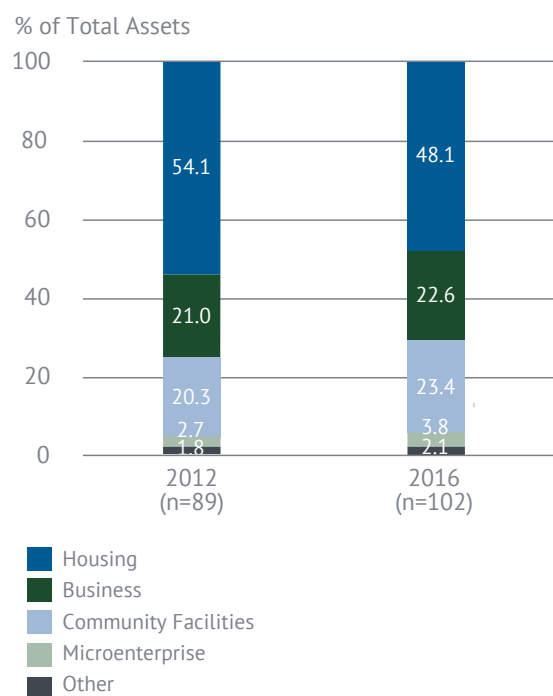


Table 6
Total Asset Size (USD millions) and CAGR by Sector

	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%

2.3.4 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.

2.4 PORTFOLIO AND INVESTOR CHARACTERISTICS

2.4.1 Total Loan Portfolio

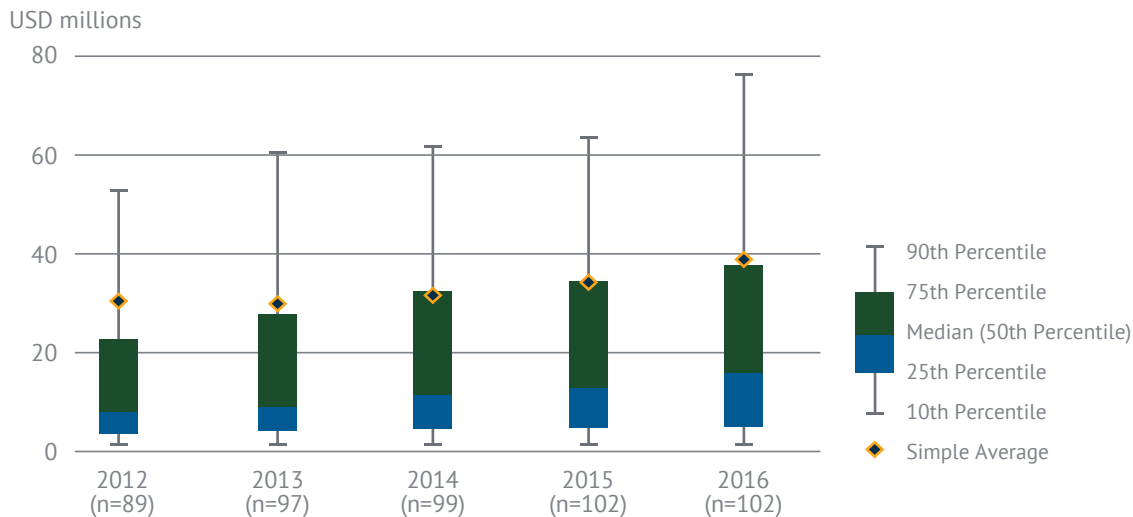
This section analyzes the loan portfolios of CDLFs in the sample, excluding cash and other assets, to specifically analyze their core lending activity.

2.4.1.1 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 4
Loan Portfolio, Distribution of Sample



2.4.1.2 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 5). CDLFs financing community facilities have the longest maturity (145.4 months), while Housing CDLFs have the shortest (83.3 months).

By size (Figure 6), 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 5
Portfolio Maturity by Sector

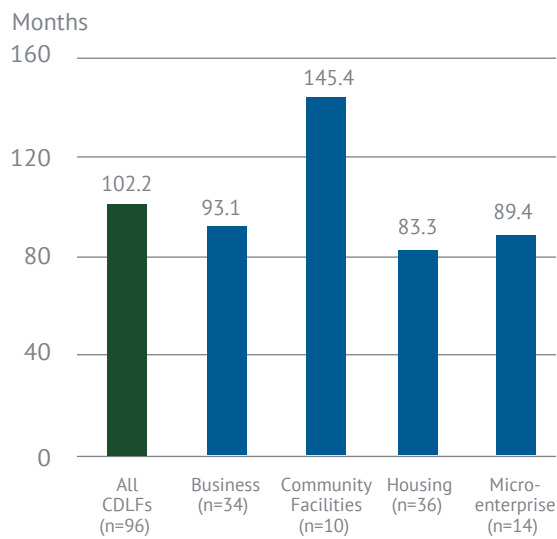
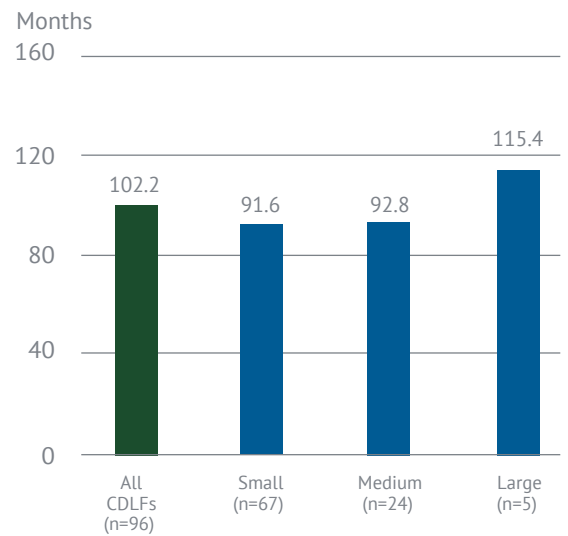


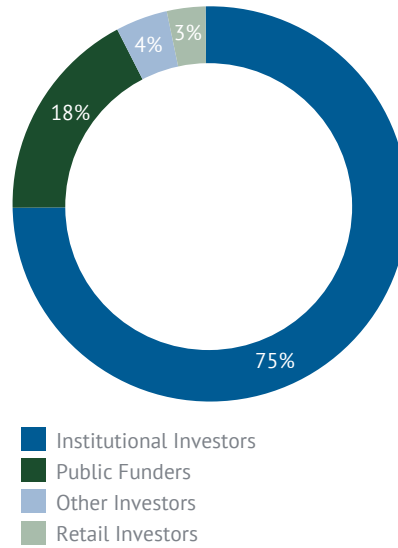
Figure 6
Portfolio Maturity by Size
(2016, Weighted Average)



2.4.2 Types of Investors

As of December 2016, institutional investors have provided 75% of funds that CLDFs have borrowed,¹³ 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 7).¹⁴

Figure 7
Investor Type as a Percentage of
Notes and Lines of Credit (2016)



¹³ 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.

¹⁴ 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.

2.5 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.

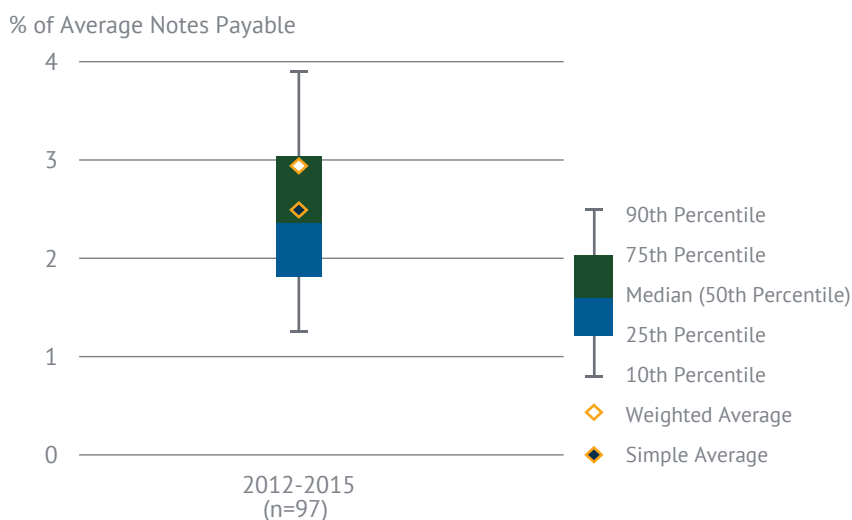
2.5.1 Net Returns to Investors

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 8). Removing outliers does not change this weighted average of 2.9%.

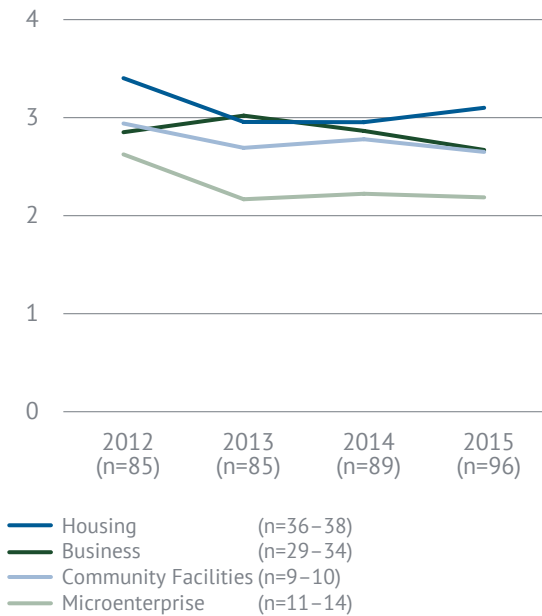
CDLFs also pay interest on lines of credit, usually raised from banks, but most CDLFs in the studied sample did not report doing so. Only four to six funds, depending on the year, used this type of debt financing, paying relatively stable rates, given the small sample size, around a five-year average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

Figure 8
Average Interest Rates on Notes (2012–2015)



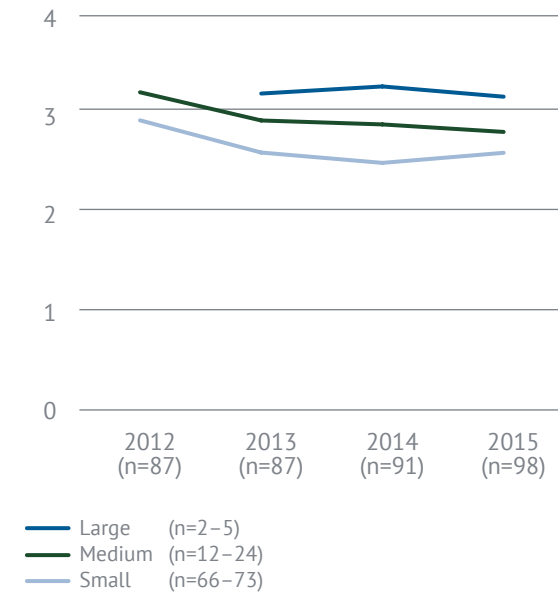
Interest rates paid on notes were relatively consistent by year across all sectors (Figure 9). Housing CDLFs paid the highest interest rates, while funds lending to microenterprises generated the lowest returns to investors, with rates between 2.1% and 2.6% depending on the year.

Figure 9
Interest Rates on Notes by Sector
% of Average Notes Payable



Large funds exhibited higher returns to investors compared to mid-sized or small funds (Figure 10). Rates are very stable since 2013 across all sizes of fund, averaging 3.2% for large CDLFs,¹⁵ 2.9% for medium-size CDLFs, and 2.6% for small CDLFs.

Figure 10
Interest Rates on Notes by Size
% of Average Notes Payable



¹⁵ 2012 value for Large CDLFs is not shown due to a sample size fewer than three.

2.5.2 Portfolio Yields

The portfolio yield of CDLFs provides a good proxy for the interest rates these funds charge in their lending activities.¹⁶ 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 11), 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 12). 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 12
Portfolio Yield by Sector

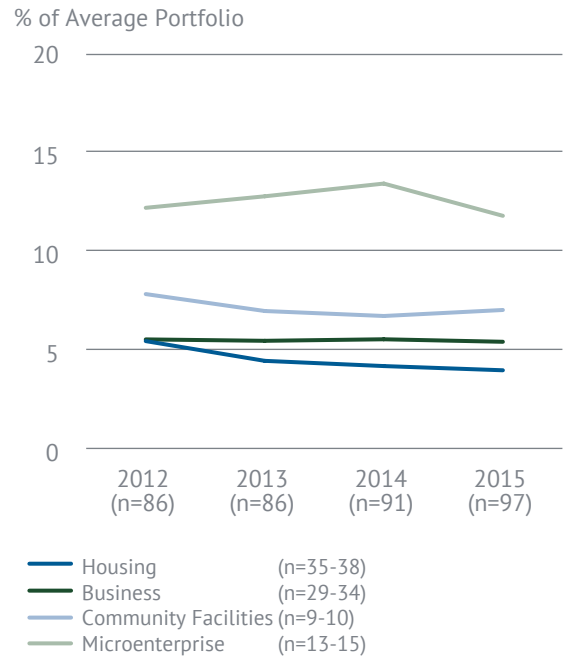
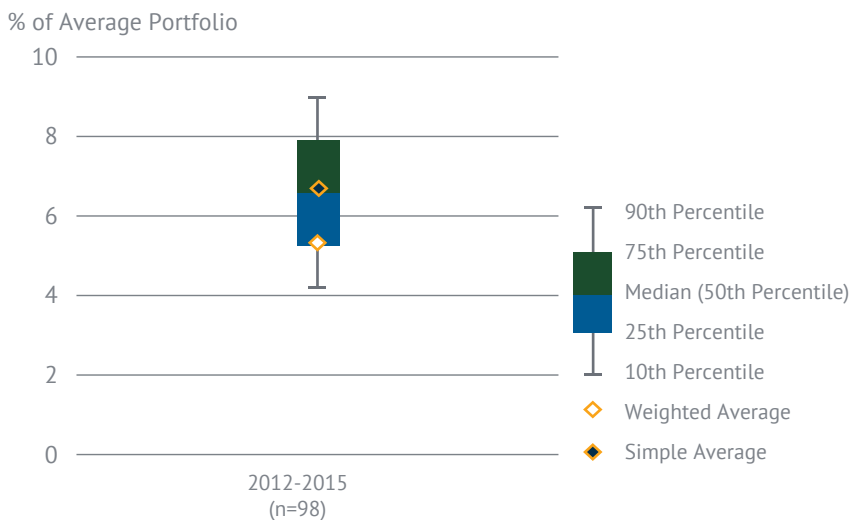


Figure 11
Average Portfolio Yield (2012–2015)



¹⁶ 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 13),¹⁷ 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 14), 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 15) 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.¹⁸

Figure 13
Portfolio Yield by Size

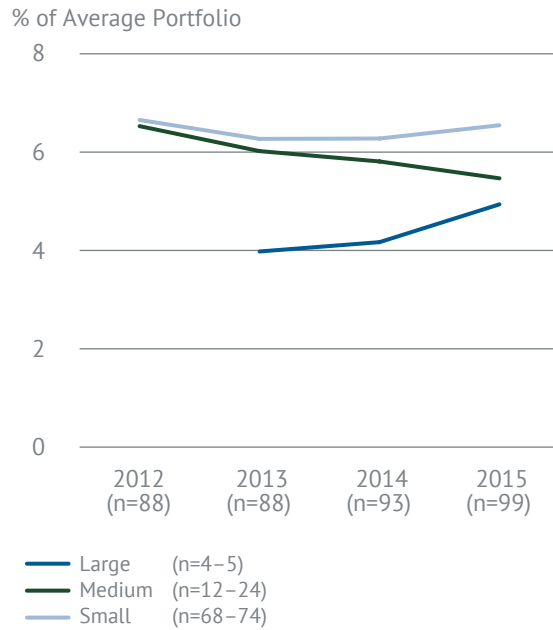


Figure 14
Sources of Fund Income

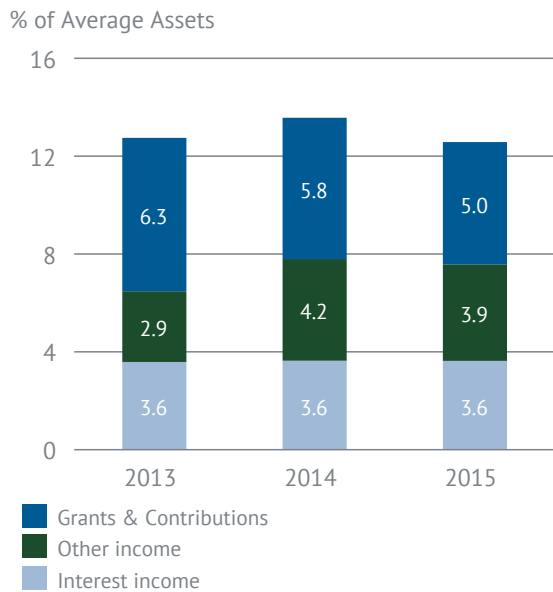
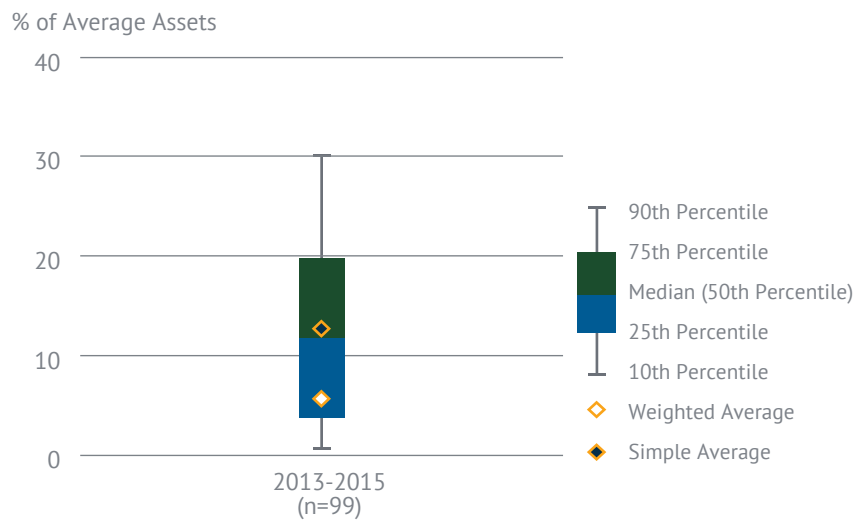


Figure 15
Average Grants and Contributions (2013-2015)



17 2012 value for Large CDLFs is not shown due to a sample size fewer than three observations.
18 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.

2.5.3 Cost Structure

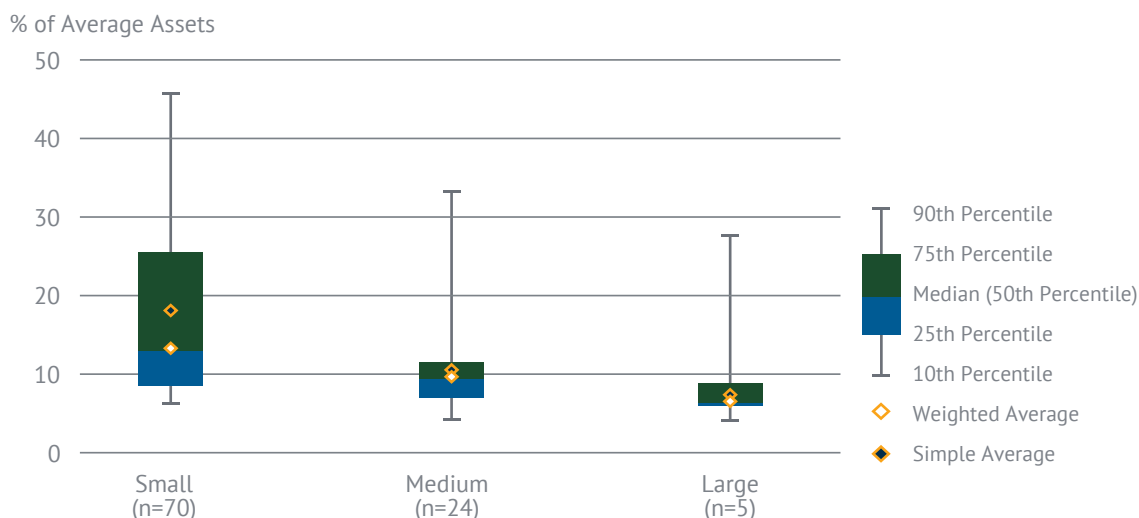
The TER of CDLFs, calculated on average assets over two years,¹⁹ has been relatively stable at 9.4% (9.3% when excluding outliers) since 2013 (Figure 16). Interest expenses have also been very stable at 1.4% of average assets. Expenses unrelated to interest payments to note holders and credit lines drive the relatively high expense ratio. Larger CDLFs tend to have smaller TERs (Figure 17). 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 16
Components of Total Expense Ratio



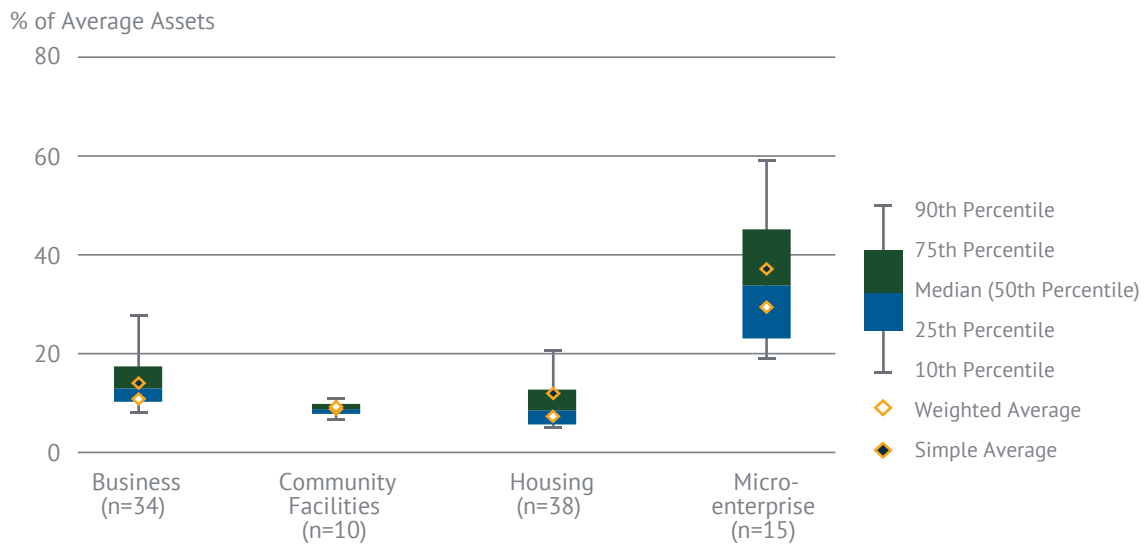
Figure 17
Average Total Expense Ratio by Size (2013–2015)



¹⁹ For CDLFs, the TER is calculated on average assets over two years. In addition, since CDLFs finance themselves primarily through debt, interest expenses are included as part of the TER.

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 18). 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 18
Average Total Expense Ratio by Sector (2013–2015)



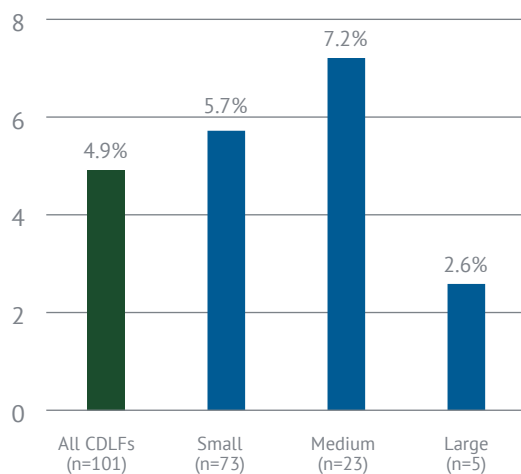
2.6 PORTFOLIO RISK

Considering the full sample of CDLFs,²⁰ 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.

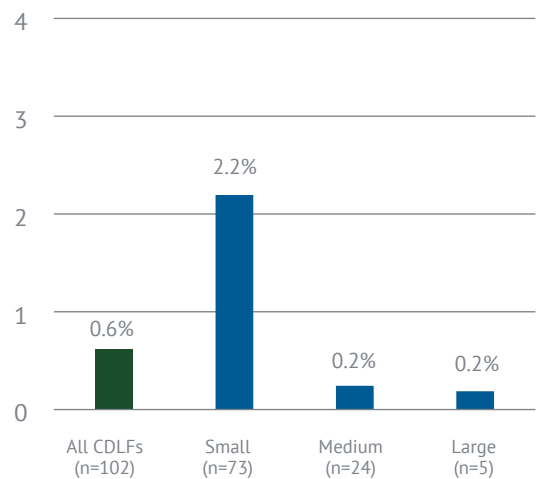
Large funds in the sample had the lowest loss-provisioning ratio (2.6%) compared to small (5.7%) or medium-sized funds (7.2%; Figure 47).

Figure 19
Loss Provisions Outstanding by Size (2016)
% of Portfolio Outstanding



Loans written off during 2016 represent 0.6% of portfolio outstanding, with relatively more write-offs by smaller funds in the sample (Figure 20). 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 20
Write-Offs by Size (2016)
% of Portfolio Outstanding



20 101 CDLFs out of the full sample of 102 CDLFs reported this metric.

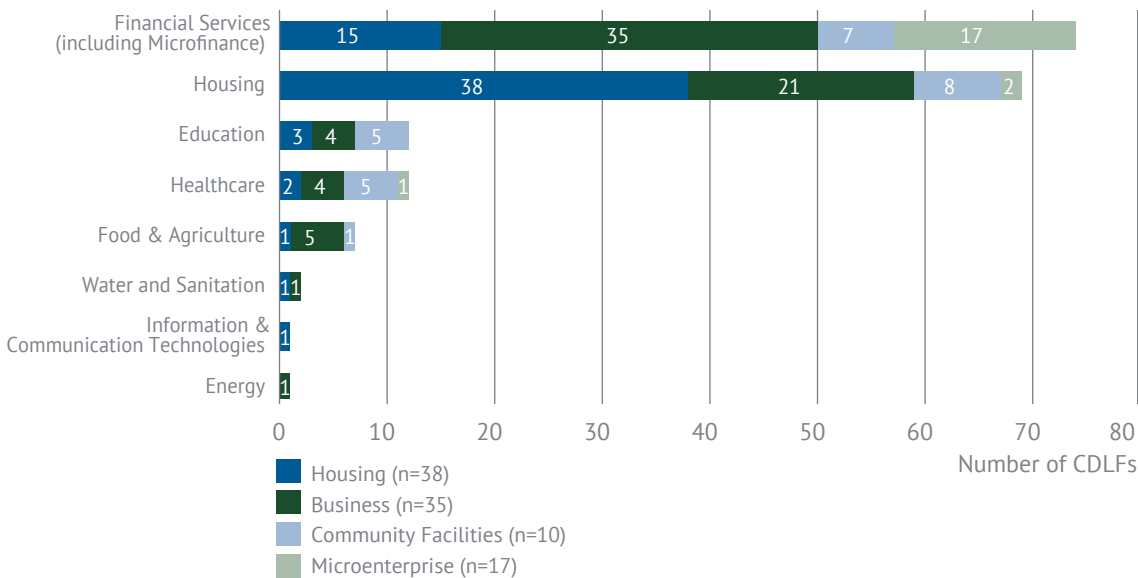
2.7 IMPACT MEASUREMENT

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.²¹ The most prevalent sub-sectors in the sample (Figure 21) 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.

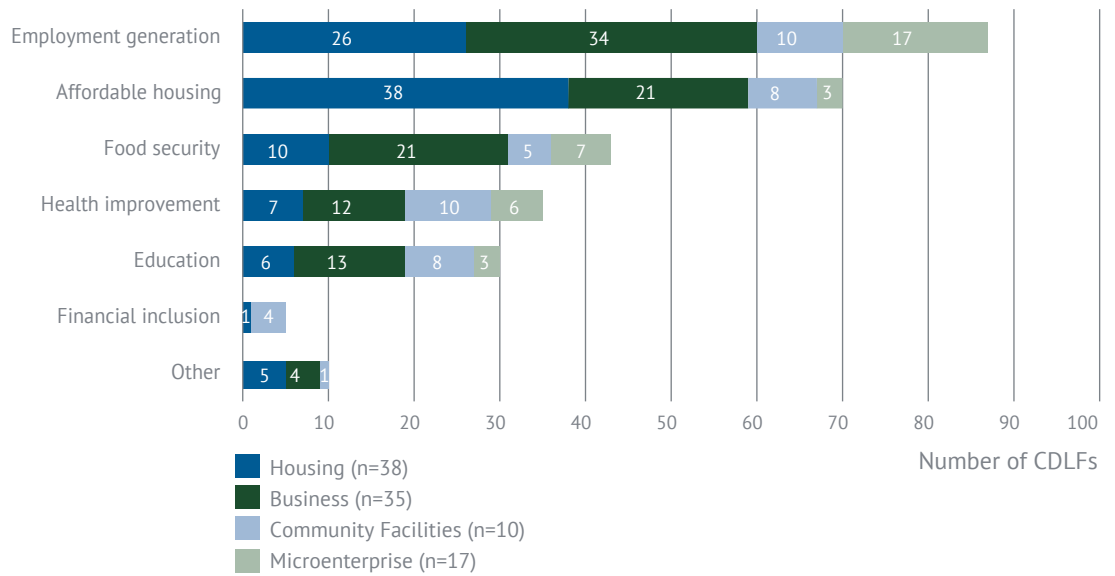
CDLFs focused on community facilities also have multi-sector characteristics, investing not only in Housing (eight of 10 such CDLFs) but also Financial Services including Microfinance (seven), Healthcare (five), Education (five), or Food and Agriculture (one).

Figure 21
Sectoral Activity by Main Investment Sector



21 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 22
Impact Themes by Main Investment Sector

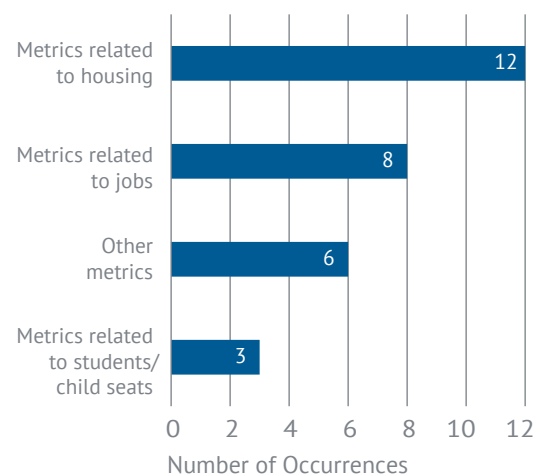


In terms of targeted impact themes (Figure 22), CDLFs in the sample most commonly target employment generation, affordable housing, and food security (respectively targeted by 87%, 71%, and 43% of the sample funds). In another common practice among CDLFs, one-third of the sample targets health improvement, 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 23). 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'.²²

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

Figure 23
Impact Metrics (n=7 CDLFs)



²² 'Other metrics' include outreach indicators related to low-income populations, women, and small businesses.

2.8 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.

3. 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.²³ Private debt impact investing funds structured as CDLFs are a gateway for different types of investors who seek to generate social and environmental impact, or both, alongside a financial return in the United States.

This study has shown that CDLFs have the following characteristics:

- › **Offer stable returns**
CDLFs paid an average of 2.9% to holders of their notes, with very little year-on-year variation. Write-off ratios 0.6% also demonstrate these funds' high portfolio quality.
- › **Seek impact through a range of sectors**
CDLFs work exclusively in low-income areas in the United States. Their 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.

²³ 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>.

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