

SOCIAL ENTERPRISE FUND

BUSINESS CASE
REVISED FEBUARY 2007

Acknowledgements

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PROPOSED COMMUNITY ECONOMIC DEVELOPMENT TAX CREDIT

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EXECUTIVE SUMMARY

Vision

The Social Enterprise Fund (SEF) fuels the social economy by providing alternative financing, leveraging mainstream funding, and providing technical assistance to social entrepreneurs.

Market Analysis: Short supply and great demand

Current market research demonstrates that the demand for financial products and technical assistance among organizations operating within the social economy is substantial. Affordable housing providers are seeking \$63M to build 30 projects while social enterprise operators need \$10M for 24 ventures over the next three years. In addition, technical assistance and pre-start up grants are needed to ensure that ventures are well planned, can pass a thorough due-diligence process and leverage mainstream funds.

The Capitalization of the Social Enterprise Fund

The SEF will be capitalized in the amount of \$10.5M over five years. Key financial partners are likely to include the City of Edmonton, the Edmonton Community Foundation, other levels of government and private donations. A unified investment strategy will see the funds invested in a range of market and non-market vehicles. The blend of returns will be sufficient to sustain operations and provide an ongoing pool of capital for future projects. Over five years, the SEF will be able to provide the following levels of investment and service to social enterprises in Edmonton. The 38% identified as "Market Investments" will be endowed with the Edmonton Community Foundation to generate income towards the ongoing operating costs of the SEF, in perpetuity.

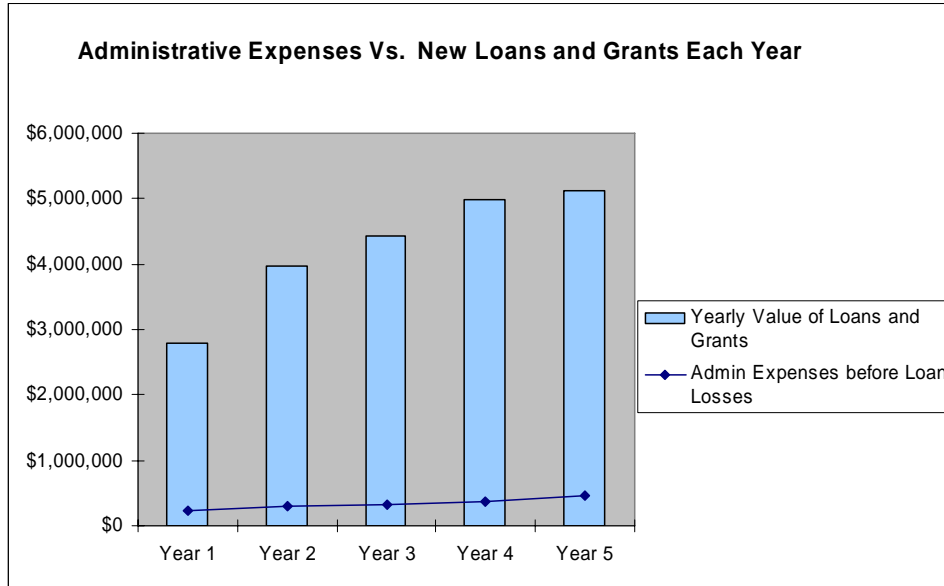
Allocation of Investments and Service Delivery Targets - Five Years

<u>Investment Portfolio</u>	<u>Split</u>	<u>Int. Rate</u>	<u>Av. Size</u>	<u>Total Services</u>
Market Investments	38%	9%		
Affordable Housing Mortgages	10%	7%	\$ 250,000	11
Interim Financing	40%	6%	\$ 200,000	78
Patient Capital Loans	10%	3%	\$ 100,000	28
Grants for Technical Assistance	2%	0%	\$ 20,000	24
Total	100%			140

Over five years, the fund will be able to put over \$21M out to work in the community.

<u>5 Year Total Value of Loans and Grants</u>	<u>Total</u>
Affordable Housing Mortgages	\$ 2,629,500
Short-Term Housing Loans (1 year term)	\$ 15,518,000
Patient Capital Loans (5 year amortization)	\$ 2,792,450
Grants for Technical Assistance	\$ 362,950
TOTAL	\$ 21,302,900

The operating budget reflects \$900,000 in grants to cover operating costs during the first three years. The fund will carry a small reserve and will be self-sustaining by year four. Administrative costs represent approximately 8% of the disbursement pool.



Governance

The primary legal form of the Social Enterprise Fund (SEF) will be a Part IX Company under the Company's Act of Alberta. The initial Members of the Company will be the City of Edmonton and the Edmonton Community Foundation. This is the same vehicle that was used for the Edmonton and Area Land Trust (EALT), recently approved by City Council. The Members of the Company may invite other large funders to join the Company if they wish to participate in that way. The Members of the Company will select the Board of Directors of the Company to operate the Social Enterprise Fund. The Directors will report to the Members as set out in the Articles of Incorporation.

Costs and Benefits

The benefits of this approach far outweigh the costs. Measurable financial benefits include:

- New job creation, along with significant new employment income;
- New business revenue;
- Cost savings to income transfer programs, and
- Business tax revenues and personal tax revenues to other levels of government.

Call for Funds

The Social Enterprise Fund will allow low-income Edmontonians to move towards self-sufficiency and will provide social entrepreneurs with the capital necessary to finance viable, innovative ventures and housing initiatives. A sufficiently large initial capitalization will allow the Fund to operate sustainably over the long term, continuing to create jobs and improve lives in perpetuity. The City of Edmonton's proposed contribution includes \$3M over two years of 'seed' capital for the Fund, and \$600,000 to cover the first two years of operating costs.

SOCIAL ENTERPRISE FUND

1.1. Description of the Fund

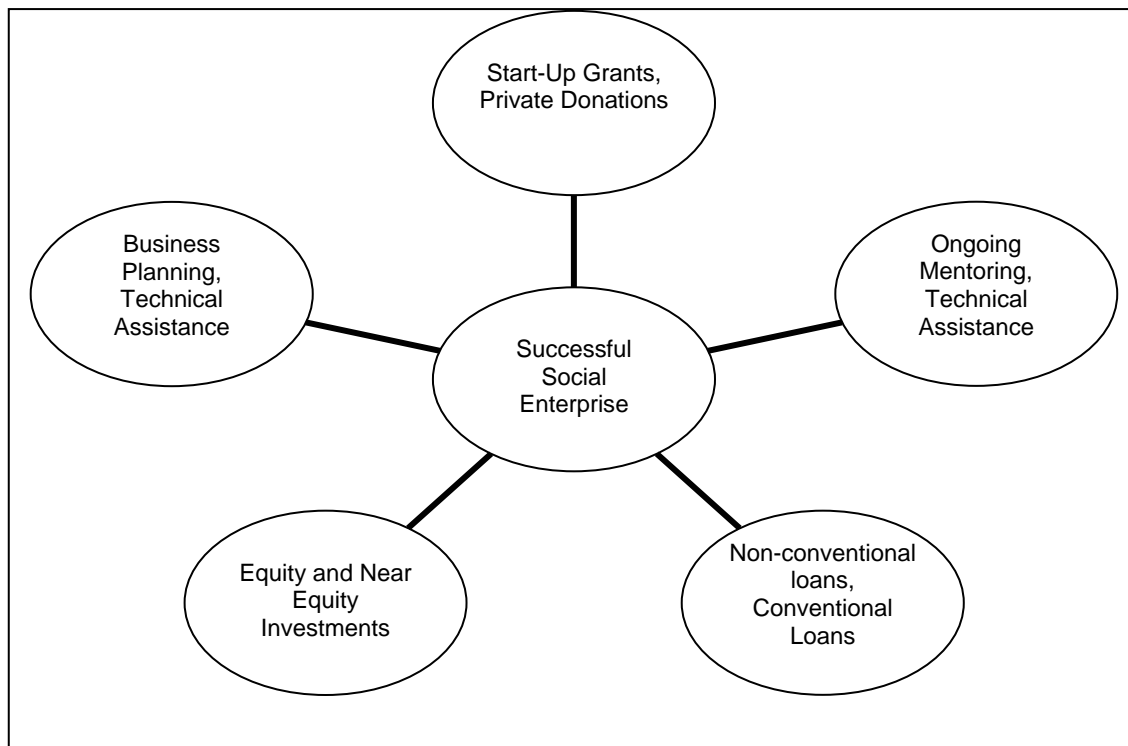
The Social Enterprise Fund (SEF) will provide needed financing and technical assistance to social enterprises. A social enterprise is a type of business venture that has at its core, a 'social good'. Like any business, a social enterprise is designed to be profitable or at least breakeven, over a given period of time. Social enterprises are unique, hybrid organizations that combine a social mission with a business model. The purpose of the Social Enterprise Fund is to put money into the hands of social entrepreneurs who can create jobs and provide needed services. More specifically, this new source of socially-minded financing will enable the community to employ otherwise unemployed or underemployed individuals, develop small businesses that provide valuable community benefit, and create affordable housing developments.

1.2. Products and Services

The social economy requires a range of services and products. The type of service needed depends on the sophistication, experience and mainstream “bankability” of a social enterprise operator. Given the relative newness of the sector, up-front support is essential in order to create sufficient and growing demand for financial services. See below for an illustration of the range of products and services to be delivered by the SEF and its partners.

Exhibit A

Range of Supports and Services to Be Provided



Financial products will be provided through a combination of existing and new services. Specifically, the SEF will bring together various sources of grant funds, conventional loans, patient capital, investments and other forms of financial support. These products will be supplemented with capacity building and ongoing technical assistance services. (This service delivery package is reflective of the market research results summarized in Section 1.3. Also, see Section 1.4.3 for a further breakdown of services and products.)

1.2.1 *The Brokerage Function*

At the heart of the SEF is a brokerage function – a service that can link social enterprises to needed resources. The brokerage acts as a catalyst and puts together deals that link social enterprise ideas with investors, lenders and mentors. The SEF will participate in (and perhaps structure) financing packages, ensure that the business concepts are sound and assist with building capacity in the social enterprise during the implementation phase. For example, the SEF will have a hand in educating funders and training people on how to run businesses on a double bottom-line basis. The Fund will recruit expertise from both the business and non-profit sectors and help adapt standard business thinking to the social enterprise field.

1.2.2 *Partners in Service Delivery*

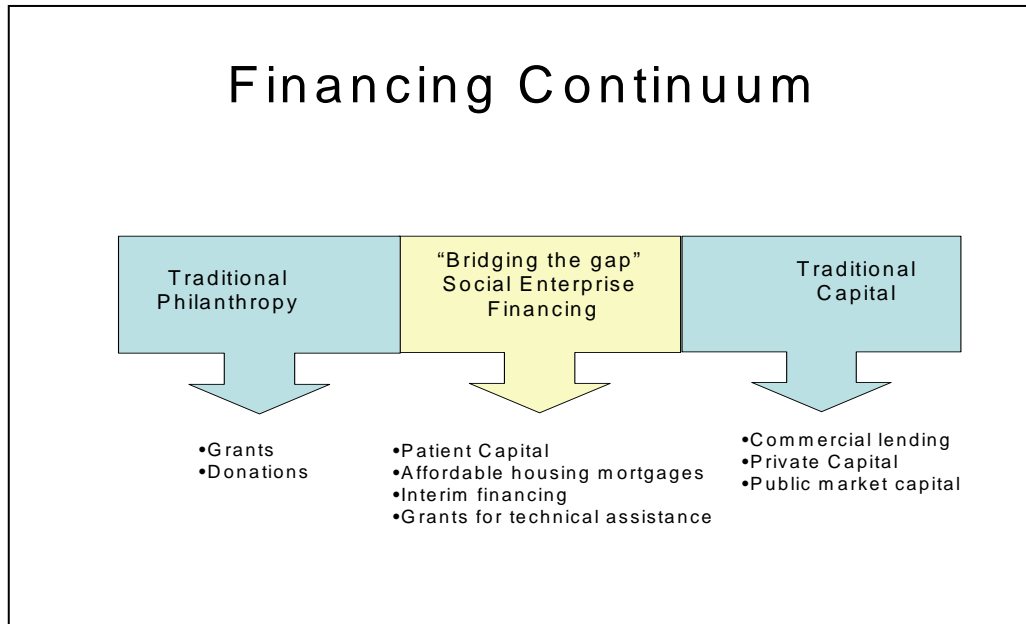
In addition to mainstream financial institutions, the following organizations are expected to support social entrepreneurs. Partners may supply clients, funding, or expertise. The active involvement of such stakeholders will ensure the cost-effectiveness of operations and expand the range of service/support available to the social entrepreneur. Possible partners in service delivery include:

- City of Edmonton – Community Services through its Community Economic Development staff;
- United Way of Alberta Capital Region – Identification of agencies prepared and willing to entertain social enterprise;
- Province of Alberta – Resources and expertise through the FCSS network;
- Western Economic Diversification – Source of loan funds and expertise, particularly through the Business Link, AWEIA, etc.;
- Edmonton Financial Literacy Society – Training opportunities around financial literacy;
- Center for Social Entrepreneurship (U of A) – Faculty, volunteer business mentors and student placements;
- Alberta Community Economic Development Network – Experience and contacts of existing social enterprise operators; and
- CEDTAP – Source of technical assistance funds and roster of approved assistance providers.

1.3. **Market Analysis**

Experience suggests that social entrepreneurs are hampered by inadequate access to capital – investment capital, patient capital and debt. The parent organizations are often not-for-profit social service agencies whose balance sheets show few assets, and therefore, limited means by which to leverage debt or entice investment. Social enterprise operators indicate that they require more flexible underwriting criteria, higher loan ceilings, decentralized decision-making, and access to more substantial working capital and equity.

The following diagram illustrates the gap between conventional financing and grant funding, i.e. the niche market of the Social Enterprise Fund.



Diverse stakeholders at two recent focus groups (held in Edmonton and Calgary) confirmed the need for new financing and recommended additional market research to demonstrate demand. To quantify the demand for financial and related technical support services, the City of Edmonton conducted a survey in December, 2005. The survey focused on existing and potential operators of social enterprises and affordable housing projects in Edmonton. (No attempt was made to target individual, private social entrepreneurs. Anecdotal evidence suggests that there are individual entrepreneurs interested in launching social enterprises, but their numbers are not yet known.)

1.3.1 Social Enterprise Demand

Sixty-eight organizations replied to the social enterprise survey. Of these, 23 currently operate a social enterprise, while 78% plan on launching a social enterprise within the next three years. (Note that those currently operating a social enterprise are most likely to plan on launching another social enterprise in the near future.) The average length of operation for existing enterprises is 23 years, demonstrating a long-term track record in the field.

The types of products needed by new social enterprises include:

- Pre-start-up grant to cover the business planning phase - 41%
- Start-up grant to launch the social enterprise - 41%
- Financing for the social enterprise - 38%
- Training to guide our organization through the social enterprise development process - 34%

The range of financing required by the social enterprises is illustrated below.

- Patient Capital - 28%
- Line of Credit - 24%
- Loans - 22%
- Loan Guarantee - 19%
- Equity Investment - 18%
- Mortgage - 15%

The total demand for funds (over three years) is \$9,710,000. This amount is broken down as follows:

- Loans: \$1,650,000
- Equity Investments: \$1,650,000
- Loan Guarantees: \$1,320,000
- Lines of Credit: \$1,590,000
- Mortgages: \$3,500,000

The average loan size is \$110,000, while the average equity investment is \$150,000. (The average mortgage of \$390,000 is relatively small – less than one-third of the amount required for a housing project.) Social enterprise operators are prepared to pay close to commercial rates for loans, with 80% being prepared to pay between 6% and 12% for loan products.

1.3.2 Affordable Housing Demand

The 2005 market research survey had a 28% response rate with 42 affordable housing developers providing survey data. Of these, 30 plan on developing more affordable housing projects within the next three years. The types of financial products required include:

- Mortgage financing (60%)
- Interim financing (38%)
- Means to option land or a building while awaiting grant funds (27%)
- Loan guarantees (24%).

Interim financing will be used to purchase land/building (26%), cover costs during construction (26%) or provide cash flow while awaiting grant funds (24%). Housing providers also indicate a need for grant funds. These funds would be used for:

- Technical assistance with community consultation and approval of building plans (31%)
- Feasibility studies (26%)
- Legal services (24%)

The total estimated demand for funds among respondents planning to build in the next three years is \$63M. The average mortgage needed is \$1.15M. Respondents are, on average, prepared to pay approximately 5% for mortgage funds.

There is significant demand for financial services in the affordable housing field in Edmonton. Demand greatly outstrips the supply likely available to the Fund. Market research suggests that the Fund will have to leverage its resources and help developers access mainstream lenders rather than attempt to provide 100% of the necessary financing.

1.4. Financials

1.4.1 Capitalizing the Fund

The Social Enterprise Fund will be capitalized with \$10.5M. This amount will be raised over five years. The Fund will be managed in such a manner as to cover operating expenses and supply cash for financing social purpose ventures.

Target Contributors

A small number of large grants, donations and investments will capitalize the Fund. These initial supporters will represent a combination of private and public money, and, ideally, involve contributions from all three levels of government. Once the Fund is established, ongoing donations will be sought from individuals and

corporations (largely through the vehicle of the Edmonton Community Foundation). Charitable receipts will be issued where private funds are secured. See below for the initial contributors of capital.

Exhibit B

Initial Suppliers of Funds

<u>Sources of Lending Capital</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4/5</u>	<u>Total</u>
City of Edmonton	\$1,500,000	\$1,500,000			\$3,000,000
Edmonton Community Foundation	\$500,000	\$1,000,000	\$1,000,000	\$500,000	\$3,000,000
Federal Government	\$1,000,000				\$1,000,000
Province of Alberta	\$1,000,000	\$1,000,000	\$1,000,000		\$3,000,000
Local Funding Agency	\$500,000				\$500,000
Total	\$4,500,000	\$3,500,000	\$2,000,000	\$500,000	\$10,500,000

1.4.2 Distributing Funds

In order to remain sustainable, the Fund will assume an integrated investment strategy that combines three streams of investing. These elements include:

- Capital that generates a market-rate, risk-adjusted financial return (e.g. mainstream investments);
- Capital that generates a blend of social and financial returns, but accepts a reduced financial benefit in exchange for meeting an even greater social returns (e.g. favourable loans, near-equity investments, etc.); and
- Capital that accepts a social return but does not seek a financial return (e.g. technical assistance grants).¹

Market Investments

The Edmonton Community Foundation will assume responsibility for investing this segment of the portfolio. Investments will be made in line with the Foundation's current approach to risk management and rate of return.

Blended Investments

While the Fund can support a multitude of end users, three types of key users are identified for initial service delivery: micro enterprises, small businesses and housing providers.

- **Patient Capital** funding will target initiatives that engage underemployed and unemployed individuals in break-even operations. These initiatives require below market loans that have long repayment periods;
- **Small business loans** will be provided in larger increments with more emphasis placed on the profit-earning potential of the proposed enterprise; and
- **Mortgage** funds will be provided specifically for the development of affordable housing.

Technical Assistance

Business support services are widely available across the province, although business plan development and legal opinions are not available free-of-charge. Small businesses and less experienced non-profit groups will likely need assistance to complete their plans. In order to build organizational capacity, and help bolster program success rates, technical support grants will be made available to organizations requiring assistance with business plan development. In keeping with an integrated investment strategy, see below for the proposed, overall allocation of funds.

¹ Emerson, Jed, Timothy Freundlich and Shari Berebach, *The Investor's Toolkit: Generating Multiple Returns Through a Unified Investment Strategy*, available for download at <http://www.blendedvalue.org>

Exhibit C**Allocation of Investments**

<u>Investment Portfolio</u>	<u>Split</u>	<u>Int. Rate</u>	<u>Av. Size</u>
Market Investments	38%	9%	
Affordable Housing Mortgages	10%	7%	\$ 250,000
Interim Financing	40%	6%	\$ 200,000
Patient Capital Loans	10%	3%	\$ 100,000
Grants for Technical Assistance	2%	0%	\$ 20,000
Total	100%		

Over five years, the fund will be able to place \$21.3M worth of loans and grants. This new money will be put to work in the community, generating housing and employment as well as revitalizing lower income communities.

<u>5 Year Total Value of Loans and Grants</u>	<u>Total</u>
Affordable Housing Mortgages	\$ 2,629,500
Short-Term Housing Loans (1 year term)	\$ 15,518,000
Patient Capital Loans (5 year amortization)	\$ 2,792,450
Grants for Technical Assistance	\$ 362,950
TOTAL	\$ 21,302,900

1.4.3 Distribution of Services

Given the level of investment and allocation of the portfolio, the Fund will be able to provide financing to 116 affordable housing projects and social enterprises over five years. In addition, the SEF will provide 24 matching grants to offset the cost of technical assistance during the start-up phase. These targets are consistent with both the market research conducted to date and the local capacity to assist with start-ups. See below for a year-by-year projection of service delivery levels.

Exhibit D**Service Delivery Over Five Years**

<u>Investment Portfolio</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Total</u>
Affordable Housing Mortgages	2	1	1	3	3	11
Interim Financing	9	16	20	16	16	78
Patient Capital Loans	5	4	2	9	9	28
Grants for Technical Assistance	5	7	4	4	4	24
Total Services by Type	20	28	27	32	33	140

1.4.4 Operating Budget

The proposed operating budget assumes a six month window of operations during which costs will be incurred (staff will be hired, and an office will be established) but no formal lending business will take place. Further, the budget reflects \$900,000 in grants to cover operating costs during the first three years. This approach is recommended to ensure that the fund can develop a small operating reserve and be well-placed to assume responsibility for sustaining itself by year four.

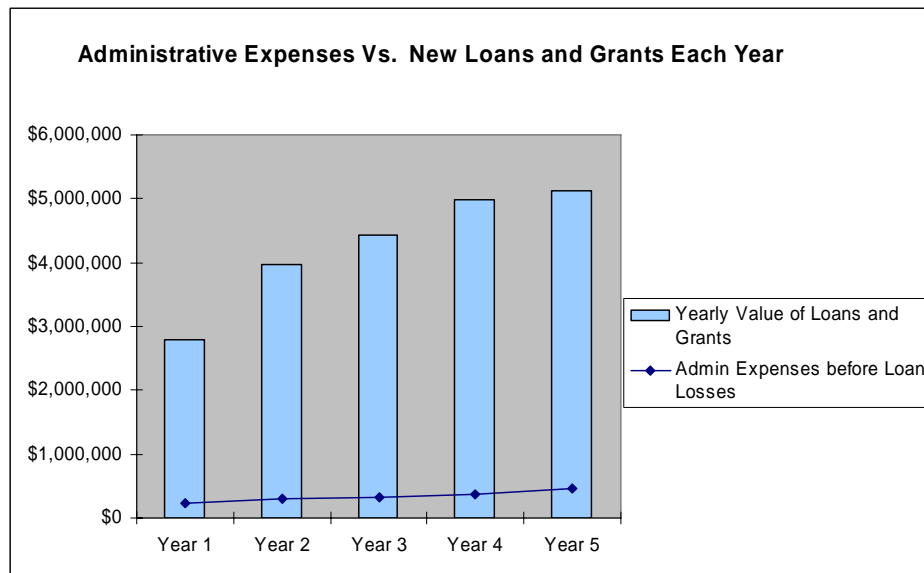
The following operating budget illustrates a modest growth in staff over time, in-kind contributions of office space, and a commitment to holding administrative costs to 8% of the disbursement pool.

Exhibit E

Operating Income and Expenses

Operating Income and Expenses					
Income from All Sources	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Income from Operations	\$ 397,097	\$ 705,950	\$ 886,175	\$ 1,059,832	\$1,304,969
Grant Income	\$ 300,000	\$ 300,000	\$ 300,000	\$ -	\$ -
TOTAL Income	\$ 697,097	\$1,005,950	\$1,186,175	\$ 1,059,832	\$1,304,969
Administrative Expenses	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Staff	\$ 200,100	\$ 277,605	\$ 291,485	\$ 346,532	\$ 415,838
Administration	\$ 18,530	\$ 19,697	\$ 26,880	\$ 29,568	\$ 40,650
Programming	\$ 3,600	\$ 3,780	\$ 3,969	\$ 4,366	\$ 5,239
Total Administrative Expenses	\$ 222,230	\$ 301,082	\$ 322,334	\$ 380,466	\$ 461,727
Loan Loss (4%)	\$ 176,400	\$ 313,600	\$ 392,000	\$ 401,800	\$ 411,600
TOTAL Operating Costs	\$ 398,630	\$ 614,682	\$ 714,334	\$ 782,266	\$ 873,327

The following graph illustrates the relationship between the value of new loans and grants each year and the cost of administering the fund (before loan losses).



1.5. Governance

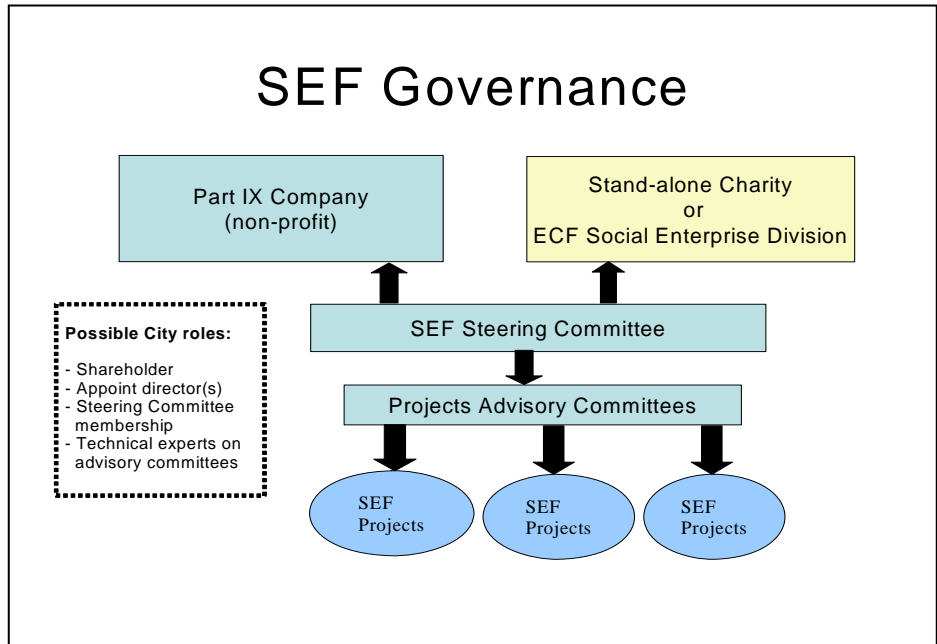
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The primary difference between the Social Enterprise Fund and the EALT is that the SEF Part IX Company will not seek Charitable Registration because some of the activities the SEF plans to undertake are not Charitable as defined by Canada Revenue Agency, i.e., social enterprises not operated by Registered Charities, non-eligible community economic development, and mixed-use buildings, even if they contain affordable housing. Lack of Charitable Registration will not be a barrier to funders who don't require charitable receipts, e.g., City of Edmonton, other orders of government, and organizations or individuals who are investing in the fund rather than making a charitable donation to it.

Parties who do require charitable receipts will be able to donate directly to Edmonton Community Foundation which will carry on the Charitable social enterprise activities of the SEF, e.g., loans to other Registered Charities for start-up or expansion of social enterprises, or for affordable housing, as part of the Foundation's own charitable activity. As the Social Enterprise Fund grows, a separate Registered Charity may be formed. The City of Edmonton would be invited to be a Member of that entity on the same terms as above.

Because the SEF will not have to wait the several months it takes to receive Charitable Registration, the Social Enterprise Fund can begin operations within several weeks of receiving funding. The following diagram illustrates the proposed governance structure.

Exhibit F
Proposed Governance Structure



1.6. Benefits and Costs of the Proposed Program

1.6.1 Cost-Benefit Analysis

The Fund's primary cost is its initial capitalization. Once \$10.5M is raised, and three years of operating funds are secured (\$900,000), the fund will be able to be self-sustaining. All associated Fund expenses are expected to represent no more than 8% of total capital, a relatively minimal cost.

Social economy projects supported by this fund will generate direct benefits to local communities, including employment income and generation, business revenue, unemployment programming cost savings and personal and business tax revenues. For example, the direct benefits of the projects include:

- **Number of affordable housing units built**
Providing affordable housing can help reduce family destabilization, out-migration of workers and their dependents, homelessness, and related demands for social assistance.
- **Number of jobs created and training sponsorships offered**
Benefits include stable long-term labour markets, increased local employment income, unemployment programming cost savings, personal and business tax revenues, and in-migration of business.

Further, there are other direct and indirect impacts of the expenditures associated with the Fund, including:

- **Local and regional impacts**
The Fund will support ventures that trigger substantial expenditures. These expenditures will, in turn, have exponential impact on the local and regional economy. Similar projects indicate substantial increases in Gross Domestic Product (GDP), labour income and employment.²
- **Generated Tax Revenue**
Successful businesses will generate tax revenue in perpetuity. The same can be said for new homeowners.

1.6.2 Leverage

A \$10.5M Fund will leverage significant, mainstream financing. Where ever possible, the Fund will only contribute sufficient loan capital to secure conventional financing. For example, a second mortgages (20% of total loan) coupled with owner equity (20%) will leverage 60% in conventional financing. With this approach in mind, the Fund will be able to leverage approximately 3 times its contribution in private sector financing, particularly in the case of mortgages for affordable housing projects.³

The City of Edmonton's contribution of \$3.6 M will help leverage over \$21.3M worth of loans and grants in the community. Specifically, the City's contribution will help produce a direct yield of \$6 for every \$1 invested. The inclusion of indirect benefits (secondary and tertiary or "spin-off" effects) will result in even higher multipliers and, therefore, greater community impact.

1.7. Conclusion

As an engine to propel the growth of the social economy, the SEF model has many advantages. It:

- Is simple to understand and easy to administer;
- Is financially self-sustaining;
- Requires a minimal ongoing role for government;
- Allows for local capacity building through the provision of technical assistance; and

² For example, the experience of the affordable housing development projects supported by the New Hampshire Community Development Authority shows that, for every US \$1 million of construction costs incurred in building/renovating affordable housing, more than US \$3 million of direct and indirect gross state product (GSP), US \$750,000 of incremental labour income, and 25 additional person years of employment were generated (between 1993 and 1998) in New Hampshire due to community economic development initiatives.

³ The leverage of the New Hampshire tax credit program averaged a ratio of 3.2:1 during the investigation period (or US \$3.2 million of capital raised for every US \$1 million of tax credit). In other words, a US \$1 million tax credit would lead to more than US \$9 million of direct and indirect GSP, US \$2.25 million of incremental labour income, and 75 additional person years of employment. Similarly, in Manitoba an economic impact assessment of the Gold Bond Program shows that, for every \$1 million investment induced by the program, more than CA \$2 million of direct and indirect GDP, CA \$650,000 of incremental labour income, and 18 additional person years of employment were generated between 1992 and 1998.

- Represents a creative, made-in-Alberta initiative that partners community needs with competent organizations and private financing.

1.7.1 Government Support and Action

In view of the significant economic and social benefits of a Social Enterprise Fund, it is recommended that the City of Edmonton pledge an initial \$3M to seed the Fund, along with a \$600,000 grant to cover the cost of operations for the first two years. The Edmonton Community Foundation has pledged to match this investment and work with the City to secure funds from the Provincial and Federal governments and other foundations.