

**InSight at Pacific Community Ventures**

**Social Impact Investing and Job Creation: Assessing the Potential of an Expanded Tax Credit for Capitalizing CDFIs, in California and Beyond**

**A Big Idea for Job Creation Working Paper**

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## Executive Summary

The California Organized Insurance Network (COIN) CDFI Tax Credit program (the Program), administered by the California Department of Insurance, has a track record of creating jobs in some of California's most underserved communities. Drawing on a well-designed policy framework, an efficient and dedicated team of public officials responsible for COIN, and an effective statewide infrastructure of capital providers and community finance intermediaries, the Program has financed projects with large-scale employment potential in low- and moderate-income (LMI) communities.

Expanding the Program in California, and to other parts of the United States, presents a promising opportunity to direct private capital to public purpose, contingent on carefully considering the conditions that have supported its successful implementation to date. In truth, these conditions are reflective of the very particular size and institutional characteristics of the private capital market in California that they impact and may be difficult to replicate. However the 'Big Idea' should not be considered an isolated policy or intervention for job creation. Rather, it is the paradigm of using a policy lever (tax credits in this case) to direct massive volumes of private capital toward public purpose that would otherwise not be invested with the goal of generating significant and explicit social benefits, including employment growth. Community finance already benefits from similar incentives at the national level, like the Low Income Housing Tax Credit (LIHTC) and New Markets Tax Credit (NMTC). These policies provide a complement to the Community Reinvestment Act and ensure that banks are motivated to invest in low-income communities along with the other key providers of capital, namely philanthropic foundations and private individuals. This Program brings other types of private, institutional capital to the table, in this case from the insurance industry. In the counterfactual scenario, business as usual would lead to the capital affected by the Program being invested in markets without an imperative for, or explicit impact on, social good.

The Program demonstrates that tax credits can be used to catalyze private capital investment for social benefit – a practice known as impact investing. The social benefit of concern in this paper – job creation in places where unemployment is endemic – has resulted particularly from investments using the Program in housing and the provision of finance/loans to both individuals and small businesses.

A unique feature of this model is its focus on social investment intermediaries that further deploy the capital into a diverse portfolio of projects aligned with their mission of serving LMI communities. The flexibility to dynamically recalibrate this portfolio of investments makes it a highly versatile Program that is not locked into one intervention. Instead intermediaries are able to constantly refine their investment strategies in order to maximize impact, including through financial sustainability. This is salient within the context of impact investing and speaks to a novel way of leveraging tax credits. It must be noted that the job creation benefits are indirect and subject to the context of the capital deployments, which are dependent on the prevailing market opportunities in a particular market/place. As such, comparing the job creation benefits of the Program to other policies is like comparing apples to oranges.

The paper begins by exploring the relationship between investments in housing and loans, and job creation. It then explains the COIN CDFI Tax Credit program in California, including its origins, features, related infrastructure for implementation, and performance.

The paper explores recent developments in the Program and plans for its expansion and further refinement to optimize impact. It also provides conservative estimates of job creation as a result of this expansion and provides recommendations for replicating a similar model in other states. Finally, the paper discusses key drivers necessary to make a similar program feasible and closes with thoughts on what the success of the Program means for the larger field of impact investing.

## 1 From Tax Credits to Job Creation

Impact investing is the practice of deploying capital to projects and enterprises that deliver measureable social benefits while also generating financial returns. With deep roots in established fields including microfinance, international development finance, community finance, and housing finance, impact investing represents a “third way” of putting assets to use, looking beyond the binary choice of realizing social impact primarily through grants and donations, or of generating financial returns through capital markets, agnostic to the social or environmental outcomes resulting from economic activity.

Companies and projects that create new jobs in low- and moderate-income communities, where unemployment is prevalent and persistent, represent a significant opportunity for impact investing.

What microfinance, international development finance, community finance, and housing finance all have in common – and now impact investing -- is a very active role for government. Moving forward,

government is expected to continue to be ubiquitous in impact investing and policy interventions will play a crucial role in realizing the promise of the field.<sup>1</sup> Most notably, for the purposes of this paper, tax incentives that bolster the returns of investments increase investor confidence and have been very effective in mobilizing large-scale private capital for high-impact projects.<sup>2</sup>

Certain types of investments have a particularly significant impact on employment, by directly creating new jobs or avoiding job losses. Labor-intensive projects like housing construction, and loans to small businesses that typically struggle to access capital, directly create new jobs, including in low- and moderate- income communities. They also have indirect job creation benefits by building infrastructure, facilities and services that improve conditions in these communities. **Tax credit incentives that reward large scale investments in such projects can thus be a powerful policy lever for job creation.**

### 1.1 Investments with Impact in Low Income Communities

The recent recession and continuing moderate recovery has had the highest impact on low- and moderate-income (LMI) communities. These communities have lost substantially more income over this period than high-income groups, and faced greater difficulty in securing employment, attaining affordable housing and access to credit.<sup>3</sup>

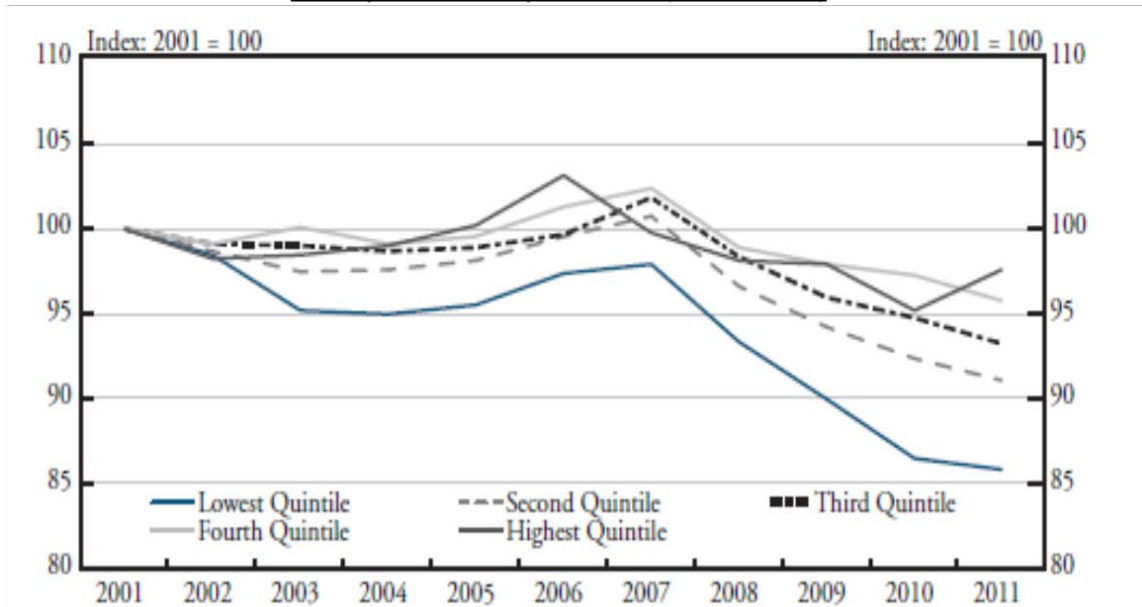
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<sup>1</sup> See the Impact Investing Policy Collaborative *London Principles*: <http://iipcollaborative.org/london-principles/>

<sup>2</sup> “Impact at Scale”, Insight at Pacific Community Ventures, Initiative for Responsible Investment at Harvard University <http://www.rockefellerfoundation.org/blog/impact-scale-policy-innovation>

<sup>3</sup> <http://www.kc.frb.org/publicat/community/connections/spring-2013.pdf>;

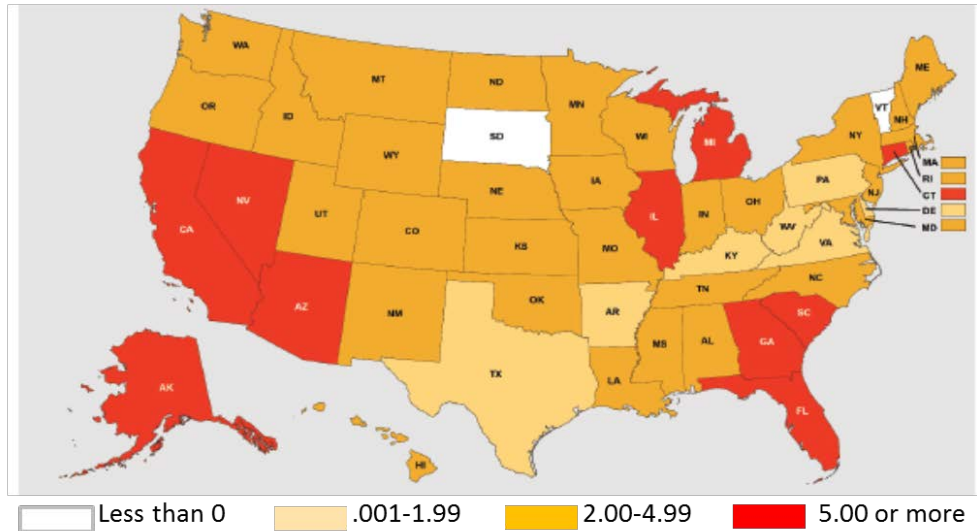
**Family Income, by Quintile (2001-2011)**



Note: Each observation shows inflation-adjusted family income relative to its 2001 level, in percentage terms. Income for the lowest income quintile in 2011, for example, is 85.8% of what it was for that quintile in 2001. Source: U.S Census Bureau; <http://www.kc.frb.org/publicat/community/connections/spring-2013.pdf>;

The share of low-income working families increased by 5 percentage points between 2007-2011 in 10 states across the United States. As of 2011, LMI families comprised 47.5 million people, nearly 32 percent of the population. The wealthiest 20 percent of working families took home 48 percent of the income while the bottom 20 percent received just 5 percent of it. States with the highest proportion of low-income working families are located in the southern or western United States.<sup>4</sup>

<sup>4</sup> [http://www.workingpoorfamilies.org/wp-content/uploads/2013/01/Winter-2012\\_2013-WFPF-Data-Brief.pdf](http://www.workingpoorfamilies.org/wp-content/uploads/2013/01/Winter-2012_2013-WFPF-Data-Brief.pdf)

**Change in Families Below 200% of Poverty (2007-2011)**

Source:

U.S Census Bureau;

[http://www.workingpoorfamilies.org/wp-content/uploads/2013/01/Winter-2012\\_2013-WFPF-Data-Brief.pdf](http://www.workingpoorfamilies.org/wp-content/uploads/2013/01/Winter-2012_2013-WFPF-Data-Brief.pdf)

Projects that serve LMI communities directly create new jobs as employees are hired to support expansion (e.g., construction jobs, jobs for loan officers, jobs in healthcare and education).<sup>5</sup> Small business loans also create new jobs and help revitalize the economy.<sup>6</sup>

More detailed evidence for the impact of projects in affordable housing and access to finance for small businesses is provided in the following sub-sections.

**1.1.1 Affordable Housing**

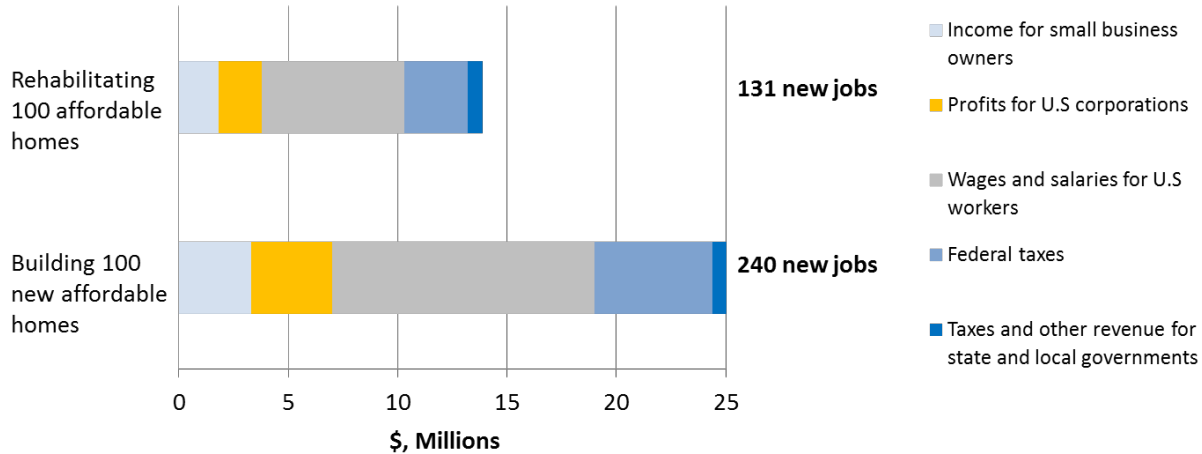
Residential construction (i.e., building new homes as well as rehabilitation of old assets), is a significant engine of job creation. People are hired directly to build the housing. Indirect jobs are created in industries on the supply side like lumber, concrete, lighting, and heating. Jobs are also created in the services sector, for example for engineers, architects, and real estate professionals. Income generated by workers and profits made by business owners lead to substantial tax revenue as well as revenue from permits and licenses. A comprehensive study by the National Association of Home Builders in 2012

<sup>5</sup> COIN

<sup>6</sup> <http://www.economics.uci.edu/~dneumark/REStat%20small%20businesses.pdf>

reveals the impact of building and rehabilitating affordable homes. A summary of the normalized impact of building 100 new affordable homes and of rehabilitating 100 affordable homes is provided below.<sup>7</sup>

**Impact of Building and Rehabilitating 100 Affordable Homes**



Source: “The National Impact of Affordable Housing - Income, Jobs, and Taxes Generated”, NAHB, Housing Policy Department, 2012

Another study estimates the first-year economic impact of building 100 apartments in a typical low-income housing project through the Low Income Housing Tax Credit (LIHTC) program as follows:<sup>8</sup>

- 116 jobs, about half of which are in the construction sector
- \$8.7 million in income (for local workers, proprietors, small businesses, and corporations)
- \$3.3 million in taxes for federal, state and local governments

Finally, a study on the economic impact of building 13,825 single-family homes in Washington State in 2011 reported the following:<sup>9</sup>

- New jobs - 41,000 in the first year and 7,231 recurring annually
- Income for Washington residents - \$3.1 billion (first year) and \$448.6 million (recurring annually)
- Tax revenue to local governments - \$728.8 million (first year) and \$198.5 million (recurring annually)

To be sure, analyzing the full impact of housing projects is relatively complex. Opportunity costs for affordable housing include a lower tax impact (from tax revenues) than in the case of commercial developments. And there are invisible costs underlying this impact such as the cost of infrastructure in order to support the housing, which can be substantial.

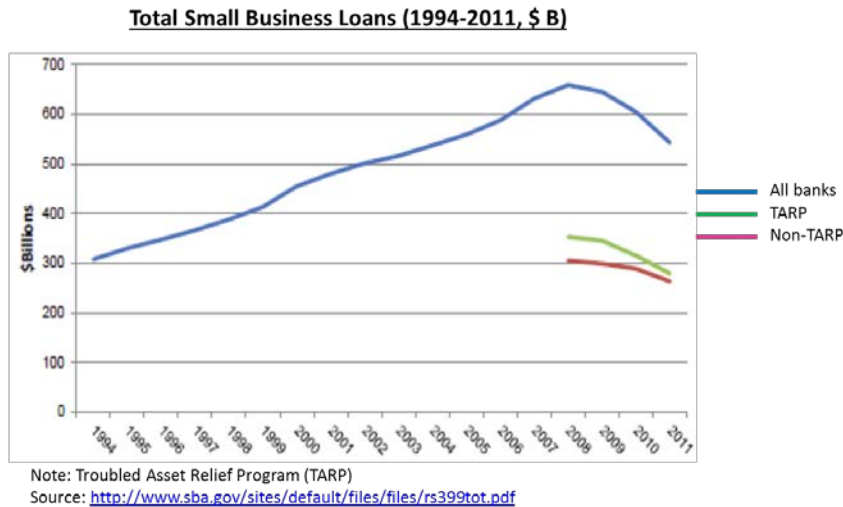
<sup>7</sup> “The National Impact of Affordable Housing - Income, Jobs, and Taxes Generated”, NAHB, Housing Policy Department, 2012

<sup>8</sup> [http://www.nahb.org/fileUpload\\_details.aspx?contentID=151606](http://www.nahb.org/fileUpload_details.aspx?contentID=151606)

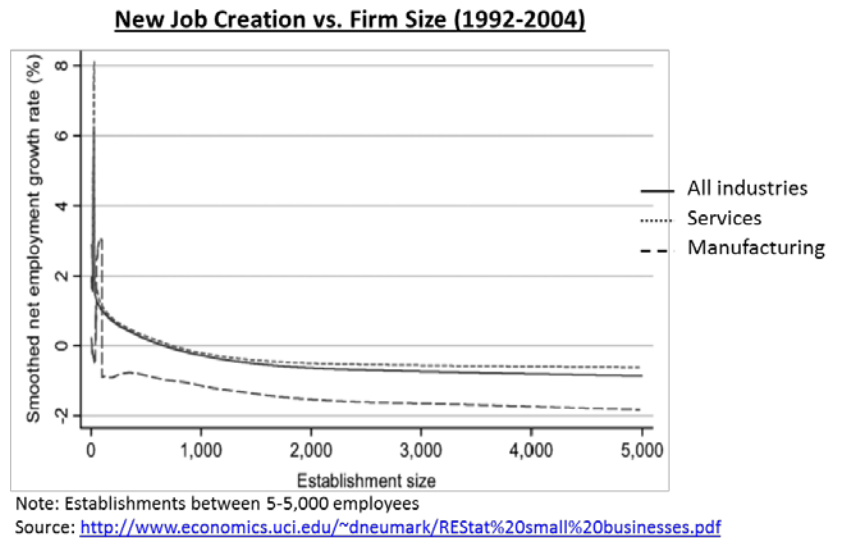
<sup>9</sup> <http://www.rcac.org/pages/1024>

### 1.1.2 Small Business Loans

Small businesses depend largely on banks for credit and have been hit hard by the financial crisis. Bank lending to all firms declined by 8 percent between 2008-2011 and to small businesses by 18 percent.<sup>10</sup>



Small businesses play an important role in creating jobs in the US economy. A study of job creation in the US economy, for both manufacturing and services sectors between 1992-2004, found that smaller firms create a disproportionate number of jobs. Specifically, firms with fewer than 20 workers accounted for 26.7 percent of jobs but 51.1 percent of new jobs.<sup>11</sup>



<sup>10</sup> <http://www.sba.gov/sites/default/files/files/rs399tot.pdf>

<sup>11</sup> <http://www.economics.uci.edu/~dneumark/REStat%20small%20businesses.pdf>



## 2 COIN CDFI Tax Credit Program – A Model for Scaling Job Creation

### 2.1 Origins and Infrastructure

The California Organized Investment Network (COIN) is a partnership to channel private sector capital into projects that deliver economic and social benefits to California’s underserved communities while providing financial returns to investors. It was established in 1996 at the behest of the insurance industry, as an alternative to state legislation that would have required insurers to invest in low-income communities in the same manner mandated by the federal Community Reinvestment Act (CRA) for the banking industry. The COIN CDFI Tax Credit Program was launched in 1997 to support these efforts by providing an incentive for private sector investments into projects that deliver social, economic and environmental benefits for California’s underserved communities.

The key stakeholders in this partnership are Community Development Financial Institutions (CDFIs), the insurance industry, the California Department of Insurance (CDI), and state government leaders.

CDFIs are private-sector, market-driven, and locally-controlled financial intermediaries with community development as their primary mission. They are licensed by the US Department of Treasury and have a variety of for-profit and non-profit structures and development goals. They belong to six broad categories: community development banks, community development loan funds, community development credit unions, microenterprise funds, community development corporation-based lenders and investors, and community development venture funds. CDFIs participating in the tax credit Program must be certified by the CDI. At a minimum this requires that the CDFI be a private financial institution located in California, with community development as its primary mission, and which lends or invests in urban, rural, or reservation-based communities within California.<sup>12</sup>

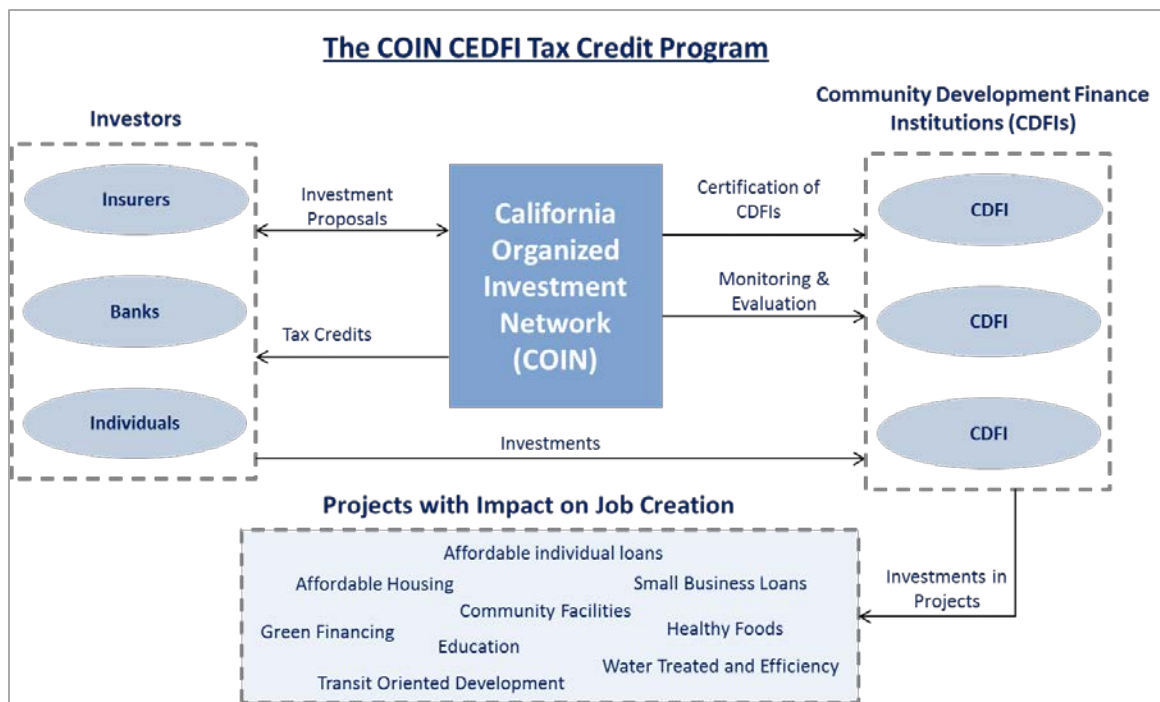
COIN is housed as an office within CDI and provides a centralized platform to operate the Program. The COIN office consolidates diligence and certification of CDFIs, certification of some qualifying investment projects, and the allocation of tax credits to investors. COIN thus minimizes transaction costs, by saving

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<sup>12</sup> <http://www.cdfi.org/about-cdfis/what-are-cdfis/>; <http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/CDFICOINCertificationwBoardRecommendations.pdf>

investors the time and effort of identifying financial intermediaries and opportunities that have been determined by the state to have significant social impacts.

Under current legislation, a tax credit of 20 percent (of the value of the investment) is provided for investments up to a total of \$10 million annually, by insurance companies, banks or individuals, including through interest-free loans, equity, or equity-like debt (i.e., convertible debt). The credit is deductible from Insurance Gross Premium Tax, Personal Income Tax or Corporations Tax obligations, depending on the structure of the investor. Eligible tax credits thus add up to \$2 million annually (20 percent of \$10 million).



## 2.2 Current Features for Targeted Impact

The Program maximizes impact in a number of ways: 1) by mandating that all investments be made in certified CDFIs; 2) by directing investors to a set of certified individual investment proposals, providing an easier route to capital deployment, although institutions would still be expected to undertake financial due diligence independently; 3) by providing the best financial terms for CDFIs, described below; and 4) by prioritizing investments with the likelihood of having higher impacts (when the Program is oversubscribed).

### 2.2.1 Certified Investments through CDFIs with benefits for LMI Communities

COIN's target beneficiaries comprise low- to moderate-income individuals, families, or communities in California.<sup>13</sup> As such the Program awards tax credits only for investments in CDFIs. State legislation requires that these CDFIs be dedicated to providing financial services and products to communities underserved by traditional financial markets, as well as the non-profit institutions that serve these communities.<sup>14</sup> Additionally, participating CDFIs have self-reported that their programs benefit low-to-moderate income areas and/or households. In sum, the Program creates incentives to invest in CDFIs, which in turn invest in high-impact projects that would not otherwise have been funded.<sup>15</sup> Since 1997 the Program has generated \$135 million of direct, interest-free investments in some of California's most underserved communities.<sup>16</sup>

Until 2011 CDFIs were certified into perpetuity. However since 2011, CDFIs have been certified annually, thus raising the bar for impact higher still.<sup>17</sup>

### 2.2.2 Lending Terms

The program ensures the best lending terms for CDFIs. Qualifying investments must be in the form of non-interest bearing term debt, equity or equity-like debt instruments of \$50,000 or more, for a period of 60 months or longer. In the event a CDFI uses an investment to finance a project and is repaid prior to 60 months, the CDFI is expected to use the monies to fund a subsequent loan or project that qualifies for the Program. This must be continued for a period of 60 months for the investor to be eligible for tax credits.<sup>18</sup>

### 2.2.3 Policy to Prioritize High Impact Projects When Tax Credits are Oversubscribed

Until 2011 tax credits were awarded to investments on a first-come, first-served basis. However in 2011 this was modified (California Assembly Bill 624) to prioritize investments considered to be better aligned

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<sup>13</sup> Low income – Individual income or median family income is less than 50% of the Average Median Income (AMI)

Moderate income - Individual income or median family income is between 50% and 80% of AMI

<sup>14</sup> <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=ins&group=12001-13000&file=12939-12939.2>

<sup>15</sup> <http://www.cdfi.org/about-cdfis/what-are-cdfis/>; <http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/CDFICOINCertificationwBoardRecommendations.pdf>

<sup>16</sup> [http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab\\_0001-0050/ab\\_32\\_cfa\\_20130510\\_145538\\_asm\\_comm.html](http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab_0001-0050/ab_32_cfa_20130510_145538_asm_comm.html)

<sup>17</sup> COIN

<sup>18</sup> <http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/TaxCreditCertificationwBoardRecommendations2013.pdf>

with target beneficiaries. When demand for tax credits outstrips supply, investments that serve low-income communities in a “tangible, direct and immediate manner” receive priority.<sup>19</sup>

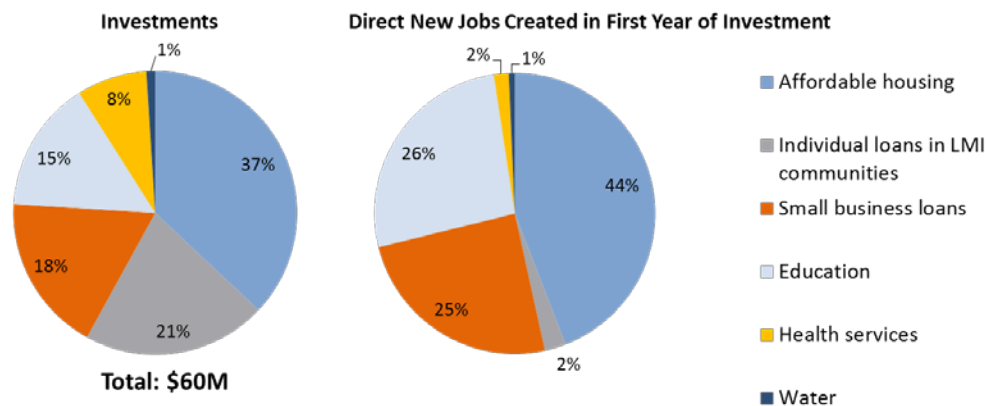
### 2.2.4 Policy to Prioritize High Impact Projects in Housing Projects

Also beginning in 2011, COIN revised its policy to prioritize rental housing, mortgages for community-based residential programs, and self-help housing over single family housing, arguing these projects serve the neediest constituencies.<sup>20</sup> Self-help housing helps very low- and low-income households build their own homes. Participants typically perform 65 percent of the construction labor on each other’s homes under qualified supervision. The reduction in labor costs allows otherwise ineligible families to own their own homes.<sup>21</sup>

## 2.3 High Impact Investments through the COIN CDFI Tax Credit Program

In 2011, soon after the election of Commissioner Dave Jones to lead the CDI, COIN started tracking investment and impact data for the CDFI Tax Credit program on a formal basis. For the purposes of this research, in order to be conservative in estimating historical impacts, we simply share the distribution of investments across different categories, and COIN’s attribution of historical job creation benefits to these categories, rather than precise employment numbers.<sup>22</sup>

**COIN CDFI Tax Credit Program, Investments and Impact – 2006-2011**



<sup>19</sup> <http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/TaxCreditCertificationwBoardRecommendations2013.pdf>

<sup>20</sup> <http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/TaxCreditCertificationwBoardRecommendations2013.pdf>

<sup>21</sup> [http://www.rurdev.usda.gov/rhs/sfh/brief\\_selfhelpsite.htm](http://www.rurdev.usda.gov/rhs/sfh/brief_selfhelpsite.htm)

<sup>22</sup> Historical data (2006- 2011) was self-reported by CDFIs, as directly observed. Where directly observed data was unavailable, COIN used RIMS II multipliers (described in Section 3.2) to develop estimates.

Of the total \$60 million invested through the Program between 2006 and 2011 (yielding \$12 million of tax credits), the largest proportion of investments were in affordable housing projects (37 percent), followed by loans to individuals (21 percent) and small businesses (18 percent), all in underserved communities. As discussed in Section 1.1, the categories of affordable housing and small business finance have significant, proven positive job creation and economic impacts. According to COIN estimates (using RIMS II multipliers and self-reported data from CDFIs), affordable housing investments and small business loans led to 43 and 32 percent of jobs, respectively.

## 2.4 Examples – CDFIs, Projects and Impact

Some CDFIs financed through the program are profiled below. Here “Funding through COIN” means investments through the COIN CDFI Tax Credit Program. “Target Beneficiaries”, “Projects Supported”, “Outcomes” and “Economic Impact” are self-reported by CDFIs, through their websites and reports. These indicators extend to all projects supported by these CDFIs (i.e., beyond those financed by the Program). The examples are included in this report for the sole purpose of providing additional insight into the types of intermediaries that the Program supports, not to affirm their own claims about impact.

### CDFI: Rural Community Assistance Corporation (RCAC)



<p><b>Target beneficiaries:</b> Low-income residents of rural and Native American communities and community-based organizations</p>	<p><b>Outcomes:</b></p> <ul style="list-style-type: none"> <li>46,739 individual water and wastewater connections</li> <li>11,627 housing units</li> <li>1,149,471 feet of community facility space</li> <li>Impact since 1978</li> </ul>
<p><b>Projects supported:</b> Affordable housing, environmental infrastructure and community facilities</p>	<p><b>Economic impact:</b> 13,297 jobs created/retained (since 1978)</p>
<p><b>Funding through COIN:</b> \$5.6M from 1999-2012</p>	

Source:  
<http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/CDFIInvestments19972012byCDFI.pdf>,  
[http://www.opportunityfinance.net/industry/industry\\_locator\\_proc.asp](http://www.opportunityfinance.net/industry/industry_locator_proc.asp)  
<http://www.rcac.org/home>

### CDFI: Clearinghouse CDFI



**Target beneficiaries:**  
Low-income families and communities

**Projects supported:**  
Affordable housing, home financing, community development, small businesses

**Funding through COIN:**  
\$8.05M (1997-2012)

**Outcomes:**

- 3,900 affordable housing units
- 885 first-time homebuyers assisted
- 288,000 low-income community clients served
- Annual figures

**Economic impact:**  
5,900 construction and permanent jobs (annual)

Source:  
<http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/CDFIInvestments19972012byCDFI.pdf>,  
[http://www.opportunityfinance.net/industry/industry\\_locator\\_proc.asp](http://www.opportunityfinance.net/industry/industry_locator_proc.asp)  
<http://www.clearinghousecdfi.com/communityImpact.asp>

### CDFI: Bridge Housing Corporation



**Target beneficiaries:**  
Low-, moderate- and mixed-income communities, senior citizens

**Projects supported:**  
Affordable community housing and assisted living, transit oriented development (TOD)

**Funding through COIN:**  
\$11M (2000-2005)

**Outcomes:**

- 21,248 homes and apartments
- 14,783 affordable homes and apartments
- Figures 1983-2012

**Economic impact:**  
Not reported

Source:  
<http://www.bridgehousing.com>  
<http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/CDFIInvestments19972012byCDFI.pdf>

## CDFI: Low Income Investment Fund (LIIF)



<p><b>Target beneficiaries:</b> Low-income and special needs communities and individuals</p>	<p><b>Outcomes:</b></p> <ul style="list-style-type: none"> <li>• 60,700 units of low income and special needs housing</li> <li>• 191,000 child care spaces</li> <li>• 62,000 school spaces for children</li> <li>• 6.7 million sft of community space</li> <li>• Figures since 1984</li> </ul>
<p><b>Projects supported:</b> housing, childcare, and education</p>	
<p><b>Funding through COIN:</b> \$34.3M (1997-2012)</p>	<p><b>Economic impact:</b> \$24.9 B of monetary benefits to families and communities (since 1984)</p>

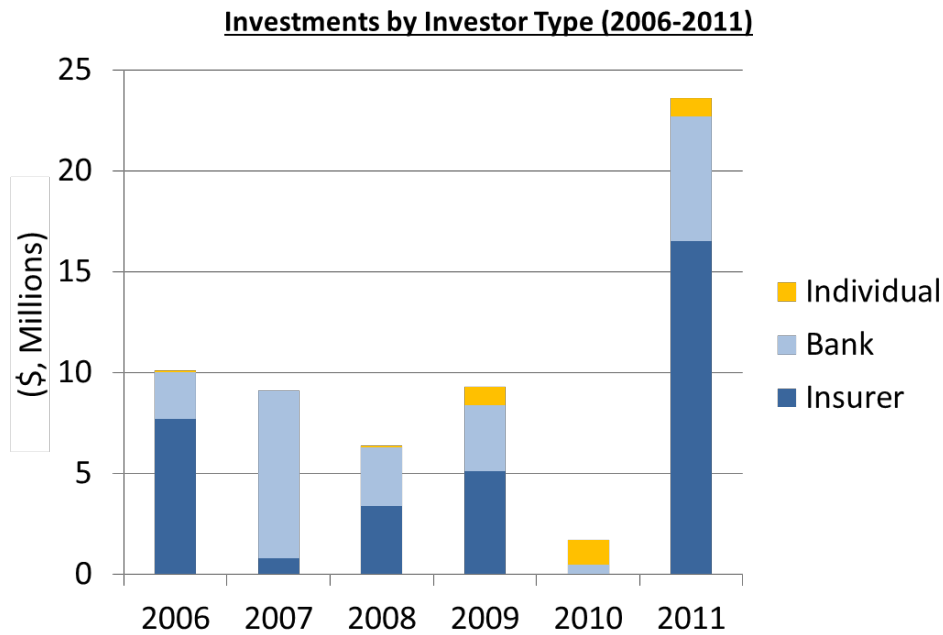
Source:  
<http://www.liifund.org/about-liif/our-impact-2/>  
<http://www.insurance.ca.gov/0250-insurers/0700-coin/upload/CDFIInvestments19972012byCDFI.pdf>

### 3 Recent Developments and Proposed Expansion

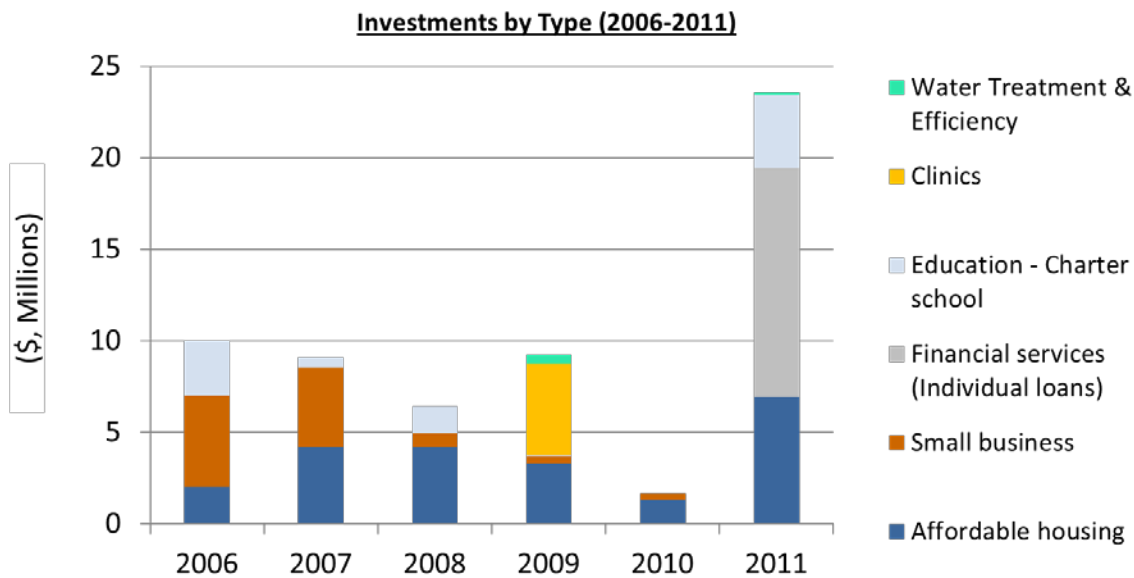
COIN, and the CDFI Tax Credit Program, became a priority for CDI Commissioner Jones following his election in 2011. COIN expanded to five staff members from three and started collecting investment and impact data on a formal basis. Executives from the insurance industry were added to the COIN advisory board, and marketing efforts were accelerated to increase awareness about investment opportunities among the Program’s target audience – primarily comprising the top 200 insurance companies that operate in California and hold over \$5 trillion in assets.<sup>23</sup> As a result of these efforts a record number of

<sup>23</sup> COIN estimates

investment applications were received in 2011 and 2012 that fully depleted both the tax credit quotas for these years as well as unused tax credits from prior years – a noteworthy accomplishment.<sup>24</sup>



As discussed earlier, changes were also made to target underserved beneficiaries and high impact investments (Sections 2.2.3 and 2.2.4).



<sup>24</sup> [http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab\\_0001-0050/ab\\_32\\_cfa\\_20130328\\_154906\\_asm\\_comm.html](http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab_0001-0050/ab_32_cfa_20130328_154906_asm_comm.html)



### 3.1 California Assembly Bill 32: Expansion and Changes

In December 2012, Speaker of the California Assembly, John A. Perez, introduced Assembly Bill 32 (AB 32) for expanding the scale of the COIN CDFI Tax Credit Program and increasing its impact through better-targeted investments. AB32 was signed into law by California Governor Jerry Brown on October 7, 2013.

The defining features of AB32 are twofold. First, the scale of investments would increase to five-times the current amount, bolstering the annual aggregate investments eligible for tax credits to \$50 million from \$10 million. Second, COIN will be permitted to prioritize high-impact investments. Current policy does not allow COIN to score investments based on their potential for impact. AB 32 will allow COIN to use a scoring mechanism to prioritize investments that directly benefit low-income persons and investments for rental housing, mortgages for community-based residential programs, and self-help housing ahead of single-family-owned housing. COIN believes that rental housing, community-based residential programs and self-help housing have higher impact as they serve needier constituencies unable to afford single-family housing. AB 32 also mandates that the investment in any CDFI in a given year is limited to 30 percent or less of the aggregate amount of tax credits awarded, ensuring that investments are not concentrated in a few CDFIs. It also requires that 10 percent of annual aggregate investments be in the range of \$200,000 – a relatively small sum.<sup>25</sup>

Economic recovery, renewed political support, and active efforts by COIN to promote the Program have resulted in an upsurge in demand for tax credits that far outstrips the current quota. The stated demand for 2013, within days of opening the tax credit cycle, as reported by investors and CDFIs, was almost \$80 million, translating to \$16 million of tax credits.<sup>26</sup>

### 3.2 Job Creation and the Economic Impact of AB 32

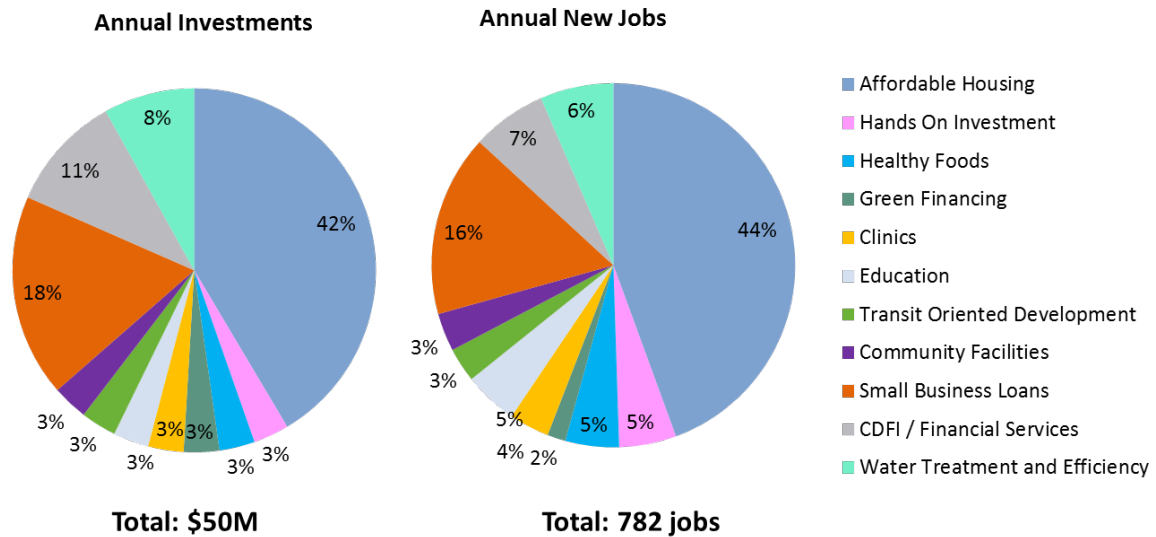
COIN has estimated the job creation benefits of the CDFI Tax Credit program expansion as prescribed by AB 32.

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<sup>25</sup> [http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab\\_0001-0050/ab\\_32\\_cfa\\_20130328\\_154906\\_asm\\_comm.html](http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab_0001-0050/ab_32_cfa_20130328_154906_asm_comm.html)

<sup>26</sup> [http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab\\_0001-0050/ab\\_32\\_cfa\\_20130328\\_154906\\_asm\\_comm.html](http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab_0001-0050/ab_32_cfa_20130328_154906_asm_comm.html)

### **Annual Investment and Impact - Estimates Post AB 32 Expansion**



**Notes on Some Investment Categories:**

- a. Hands On Investment – Senior care, assisted living facilities
- b. Education – Schools e.g., Charter schools
- c. Transit Oriented Development - Mixed-use residential and commercial areas designed to maximize access to public transport
- d. Community Facilities – Child care, community centers etc.,
- e. CDFI / Financial Services – Affordable loans and financial services for communities underserved by mainstream financial services

**According to COIN, the expansion of the COIN CDFI Tax Credit program will lead to the creation of 782 new jobs annually in California. The total economic impact of the expansion will amount to roughly \$115 million annually.<sup>27</sup> CDFIs have reported to the CDI that jobs have historically been created in low-moderate income communities, as mandated by their mission.**

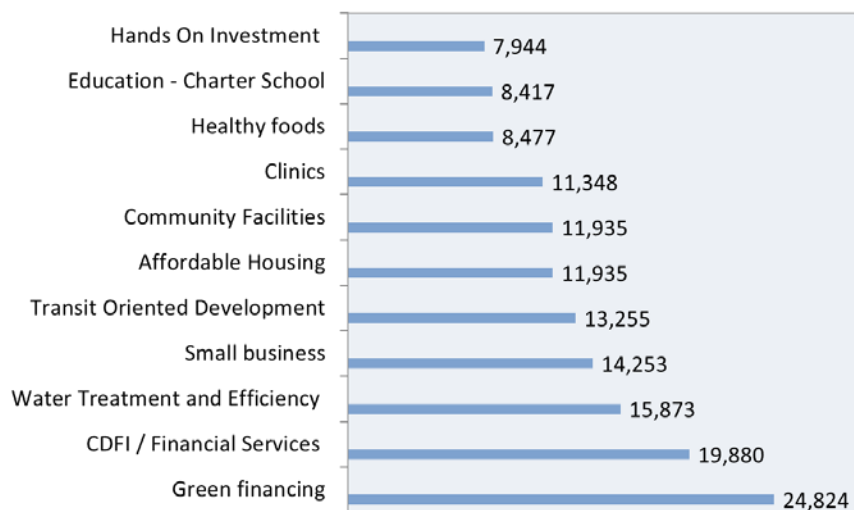
The key cost of the Program is revenue lost through tax credits. The total cost of tax dollars lost annually is \$10 million, assuming total investments of \$50 million. If we add the budget for COIN requested as

<sup>27</sup> COIN's economic analysis has been independently audited and verified by Pacific Community Ventures, under contract and as part of a project that is separate from this study.

per AB 32 (\$1.2 million), **the net economic impact in California is approximately \$104 million (\$115 million less costs of \$11 million).**<sup>28</sup>

The cost of creating new jobs, in terms of tax credits (loss of tax revenues) is shown below, calculated using COIN’s estimate of the employment affects of AB32. Note that this does not include the total investment (of which tax credits account for 20%), as this is capital would be expected to be repaid to the investor by the investment intermediary. The estimates are based on the expected investment in each category, the estimated number of new jobs generated, and the corresponding cost of the tax credits as a loss of revenue.

**Tax Dollars Needed for Each Job Created (\$, Tax Credit on COIN Investment)**



*\*New job created directly, in first year of investment*

**Methodology and Assumptions for Estimates**

**Methodology:**

- a. **Multipliers for estimating job creation and economic impact.** COIN has used **Regional Multipliers from the Regional Input-Output Modeling System (RIMS II)** for estimating the economic and job creation impact of the expansion of this program. These multipliers have

<sup>28</sup> COIN

been developed and maintained by the Bureau of Economic Analysis (BEA) since the 1980's (latest revisions from November 2012 are used for this analysis).

**b. RIMS II multipliers are appropriate for these estimates for several reasons:**

- i. Empirical tests show that estimates based on relatively expensive surveys and RIMS II-based estimates are similar in magnitude.<sup>29</sup>
- ii. RIMS II multipliers are used to estimate the regional economic impact of projects and programs, using an accounting framework that maps the input-output structure of nearly 500 U.S industries based on BEA's national I-O economic accounts. These reflect the current industrial structure and trading patterns in a region, and are granular to the level of specific counties. As such they are rigorous (net of all economic inflows and outflows), versatile (encompassing diverse industries) and can be applied with specificity to California.

**c. Limitations of Input Output Multipliers**

- i. I-O multipliers are transitory in that they estimate short-term changes and do not account for long-term adjustments in a region's economy. They are also 'fixed' in the sense that they do not account for relative changes in purchasing patterns of an industry relative to changes in its output levels. Finally, they account for interactions between sectors in a region, but not for inter-regional feedback effects.<sup>30</sup>

**d. Specific RIMS II multipliers used.** COIN used the following RIMS II multipliers for California for its estimates:

- i. **For new jobs** - Total number of jobs created across all sectors in California, for each dollar invested in a project, in each category of the COIN CDFI Tax Credit Program.
- ii. **For economic impact** - Total economic impact in terms of dollars generated in the economy across all sectors, for each dollar invested in a project in each category of the COIN CDFI Tax Credit Program.
- e. **Jobs displaced** - Estimates account for all initial dollars flowing into the economy, consistent with the RIMS II Multipliers. As such these jobs are net of jobs displaced if any.
- f. **Timeline and immediacy of jobs created** - Estimates are only for new jobs created annually, and only for jobs created directly by projects funded by COIN investments, in the first year of investment. As such these estimates are conservative.
- g. **Types of jobs created.** As per an assessment of historical data (2006-2001) from CDFIs, CDFIs self-reported that most jobs were created in LMI communities. Further the nature of investments (construction, small business loans, green energy, water treatment and efficiency etc.), and the fact these investments are made specifically in LMI communities, are strongly indicative that jobs are mostly created for individuals that are themselves of low- or moderate-income. PCV InSight's proprietary research tracking the social and economic impacts of investments in small- to medium-sized enterprises on behalf of clients including the California

<sup>29</sup> See U.S. Department of Commerce, Regional Input-Output Modeling System (RIMS II), chapter 5. Also see Sharon M. Brucker, Steven E. Hastings, and William R. Latham III, "The Variation of Estimated Impacts from Five Regional Input-Output Models," *International Regional Science Review* 13 (1990): 119-39.

<sup>30</sup> [http://research.stlouisfed.org/publications/review/91/01/Consumer\\_Jan\\_Feb1991.pdf](http://research.stlouisfed.org/publications/review/91/01/Consumer_Jan_Feb1991.pdf)

Public Employees Retirement System and Annie E. Casey Foundation shows that around 70 percent of employees at companies located in LMI communities are themselves from LMI communities. Please note that jobs estimates from the multiplier model are FTE equivalents, and do not delineate full-time or part-time work.

**Assumptions:**

- a. **Volume of private capital deployed.** A total of \$50 million will be invested annually through the Program when expanded as per AB 32. This is a reasonable assumption considering demand for investments was \$80 million in 2013.
- b. **Distribution of investments across investment categories.** 80 percent of investments will follow the broad historic pattern (2006-2011) for key sectors like affordable housing, small business loans, CDFI financial services, education, health services and water treatment and efficiency. The remaining 20 percent are assumed to be distributed evenly between smaller and emerging categories such as hands-on investment, healthy foods, green financing, transit-oriented development and community facilities. The distribution of investments may change, but the job creation impacts are still likely to be higher than the estimates provided since AB 32 intends to create a scoring mechanism to prioritize investments with higher and immediate impacts on low-income communities.
- c. **Exclusion of jobs created through reinvestment.** Jobs created through the reinvestment of recycled funds are not included (when the investment amount is repaid before the minimum term of 60 months), providing for a more conservative, and in our opinion realistic, estimate.
- d. **Emerging relevance of affordable loans to LMI communities for job creation.** CDFI Financial Services are anticipated to comprise a significant proportion of investments due to their high potential for impact. These include affordable loans to communities underserved by mainstream financial services that are particularly vulnerable to predatory financial services. The job creation (and preservation) impacts of these investments are likely to be underestimated and not fully accounted for by RIMS II multipliers, as evidence of their direct affects on job creation and economic impact is unclear. These estimates are thus likely to be conservative.

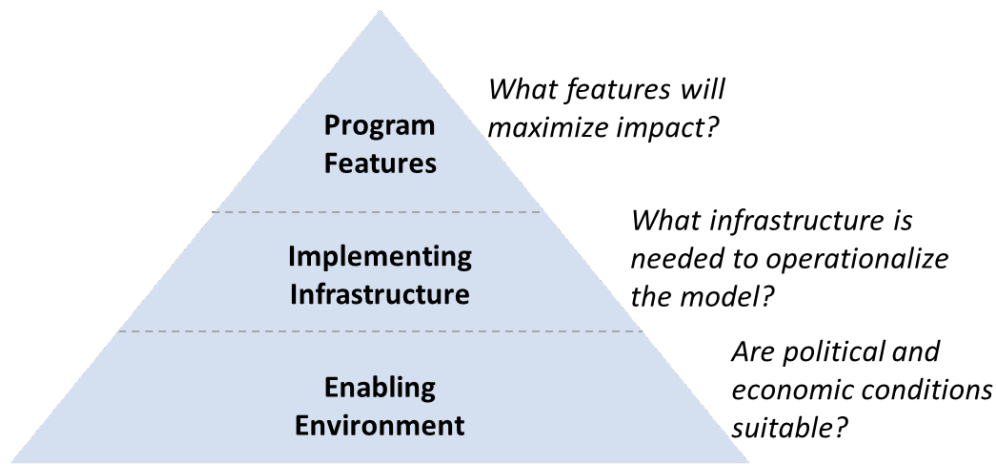
## 4 Recommendations for Replication and Scaling

### 4.1 Key Success Drivers

The COIN CDFI Tax Credit Program has been developed and successfully demonstrated in California. With further expansion under AB 32, the Program will create an estimated 782 new jobs and a net economic impact of \$104 million dollars annually for the Californian economy, with benefits targeted to

underserved low- and moderate-income communities. The Program holds great promise for immediate, large-scale job creation if replicated and scaled in other parts of the United States, particularly where CDFI infrastructure is well developed. When considering the Program for adoption and replication in other places, it is important to consider the various factors with the greatest influence on implementation and impact, within the specific region and public sector administrator of interest. These success drivers have been listed below and grouped into three categories.

### **Key Success Drivers of the Model**



#### **4.1.1 Enabling Environment**

The economic and political environment of a region will have a significant influence on the feasibility and success of a policy modeled along the lines of the COIN CDFI Tax Credit Program. The key elements of an enabling environment for this model are listed below:

1. Legislation must be in place to channel private sector investments into appropriate projects, with appropriate investment terms and conditions, and to award tax credits in exchange for these investments. Political support is also essential for setting up a centralized agency like COIN to administer the program, and for empowering it to realize its full potential. The election of Commissioner Dave Jones to lead the CDI in 2011 has had a particularly telling effect on the Program. Renewed support for the Program led to the expansion of the COIN team. Executives from the insurance industry were added to the board. The COIN team ramped up its marketing efforts to create awareness among the target investors in the program and, for the first time since 2006, demand for tax credits not only exceeded the annual quota, but also absorbed unused tax credits from previous years in 2011 and 2012. The 2013 cycle saw a record demand

for investments through this program. Policymakers must therefore gauge the political appetite for legislation and infrastructure to make a program like this feasible.

2. The tax credit will have impact only if there is a sizeable demand for projects that generate employment in low- and moderate-income communities. These include affordable housing, affordable loans for underserved communities, and small business loans. There should be a sizeable market for these or other projects with the potential to generate a large number of jobs.
3. The presence of large and experienced CDFIs in California has played a crucial role in the success of the Program. Established financial intermediaries dedicated to projects that benefit low-income communities, and with the capacity to manage large-scale investments, will contribute significantly to the success of this model. These intermediaries are in a position to broker the needs of investment projects in different categories (e.g., small businesses, affordable loans and financial services, affordable housing etc.,) with the needs of low and moderate income workers. They are also accustomed to demonstrating capacity and commitment by incorporating relevant metrics into their investment strategy, monitoring impact by carefully tracking performance, and sharing key learnings with the Program to demonstrate success. These elements are necessary to ensure that investments achieve and maximize their targeted impacts in terms of employment for target constituencies of the Program.
4. The presence of a sizeable investment community with the appetite to participate in such a program is also essential. Policymakers should assess the prevailing economic conditions of the region and determine if a similar program with tax credits is likely to generate interest and participation from a critical mass of private-sector investors.
5. The Program represents a cross-sector partnership between industry, government agencies and financial intermediaries. The success of the model requires not only the presence of suitable stakeholders in each sector, but also the willingness and ability to collaborate effectively.

#### 4.1.2 Implementation Infrastructure

Implementing a model along the lines of the COIN CDFI Tax Credit Program necessitates an infrastructure with the following elements.

1. Legislation that provides for tax credits in return for private sector investments.
2. A policy framework to certify investment intermediaries in order to aggregate and deploy large amounts of private capital into high-impact projects with job creation and other social benefits.

3. A centralized government unit, such as COIN, with the capacity to act as a mediator between investors and investment intermediaries (CDFIs), to channel private sector capital into investments determined to be of significant public interest, and for monitoring the manner in which capital has been deployed, and its likely and actual impacts. By way of example, COIN currently discharges these responsibilities, for an annual portfolio of \$10 million in investments, with a team of five people comprising one Managing Director and four Loan Officers.

#### 4.1.3 Program Features

The following features will contribute to making a policy modeled on the COIN CDFI Tax Credit Program more effective in realizing impact:

1. A viable tax credit rate attractive to investors given current economic conditions. At the same time, the benefits of job creation should be able to justify the cost of the program in terms of losses in tax revenues to the state.
2. Features to strengthen ties with private investors in the program. The inclusion of members from the insurance industry on a COIN advisory board has helped to market investment opportunities and solicit feedback.
3. It is essential to identify the right investors. The top 200 insurers operating in California hold combined assets of over \$5 trillion dollars. Tax credits from the Program afford them tax relief from the Insurance Gross Premiums Tax, an excise tax for the privilege of doing business in California. The Program originated at the behest of the insurance industry, as an alternative to being mandated to invest in low-income communities. The Program is also attractive to banks as investments qualify for Community Reinvestment Act credits. Making it possible for businesses to fulfill other investment obligations through a program like this can make it more attractive.
4. A formal mechanism to prioritize investments based on their potential for job creation in low-income communities will maximize the impact of the program. Reforms to the California Program in 2011 undoubtedly strengthened its impacts. With the passage of AB32, a mechanism for explicitly scoring investment proposals based on their potential for social impact will be introduced. COIN will implement and track impact from all investments, specifically weighing jobs and financial benefit. COIN will also review, score and rank applications to become COIN-



certified investments based on their direct benefit to low-income persons and underserved communities.<sup>31</sup>

5. Quality control of intermediaries is also important to ensure that investments are translated into projects with the desired impact on job creation. Investment intermediaries should be certified on an ongoing basis as a result. This is consistent with changes to the Program in 2011, requiring that CDFIs seek certification on an annual basis. Capacity and expertise of investment intermediaries in creating jobs for underserved constituencies, demonstrated by a deliberate investment strategy and clear evidence of past performance, should be a key consideration for certifying and prioritizing such intermediaries for investments through the Program.

#### 4.1.4 Iterative Refinement Based on Evidence and Experience

One of the most powerful features of this model is the ability to refine the portfolio of investments over time. We recommend that COIN or any other centralized implementing agency take a deliberate approach to leverage this flexibility for maximum impact. For instance, interventions could be rigorously evaluated for evidence of impact, and the scoring mechanism for evaluating investment proposals could be continually refined to select proposals which invest in the most effective interventions. There is also an opportunity for the agency to act as an action-oriented convener, bringing together investment intermediaries to share experiences and best practices, better enabling them to make more impactful investments in the future.

## 4.2 Key Barriers

Barriers to replication and scale are the converse of key success drivers for the model.

The absence of an enabling environment, clearly, presents the biggest barrier to replication.

Legislation to channel private investments into appropriate projects and to award tax credits in return, is the biggest barrier. If it is absent, strong political will and time are needed to address it.

This model cannot be replicated in the absence of market opportunities for projects that generate employment in LMI communities. While these opportunities might vary by state, it is unlikely that suitable opportunities are completely absent anywhere. The absence of experienced social investment intermediaries, key actors in this model, could pose a significant challenge; addressing this would involve a significant amount of political will, financial investment and capacity building

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<sup>31</sup> COIN

effort. The absence of a sizeable investment community that can participate in this model also presents a formidable barrier to replication. Finally, the absence of a culture that is conducive to cross-sector partnership between industry, government agencies and financial intermediaries can impede the replication of this model.

Several factors can pose barriers to scale. An insufficient tax credit, as well as lack of awareness amongst private investors, would fail to attract large amounts of capital investments. Fewer, smaller and inexperienced social investment intermediaries would make it challenging to scale this model as they are instrumental in efficiently deploying large amounts of capital into projects with the desired impact. Scarcity of market opportunities for suitable projects with the desired impact on job creation (demand side) and scarcity of private sector capital (supply side) would also limit the scale of this model. Finally, the absence of a central agency such as COIN, whose mission and capacity must match the critical role it needs to play in mediating and facilitating transactions between private investors and investment intermediaries, would be a singular barrier in scaling this model.

### 4.3 Implications for Nationwide Scaling and Replication

The ability to replicate and scale this model in any given state will depend on the presence (or absence) of the key success drivers outlined in Section 4.1.

We deliberately desist from extrapolating the impact of the Program in California to nationwide estimates because these indicators (i.e. the drivers of replication and scale) will vary by state, as will the opportunities for investments by category, and therefore the program's job creation potential. Policies already exist at a national level that incentivize impact investing, for example the Community Reinvestment Act (CRA), the Small Business Administration's Small Business Investment Company (SBIC) program, and tax credits like the Low Income Housing Tax Credit (LIHTC) and New Market Credits.<sup>32</sup> Rather, the intent of this report is to highlight the characteristics of a successful model for using incentives to channel large amounts of private capital into projects with high impact on job creation, strategically and efficiently. Lessons from this model can inform policymakers nationwide to explore how existing and new policies that create incentives for impact investing can be leveraged and enhanced.

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<sup>32</sup> [http://www.federalreserve.gov/communitydev/cra\\_about.htm](http://www.federalreserve.gov/communitydev/cra_about.htm), <http://www.sba.gov/category/lender-navigation/sba-loan-programs/sbic-program-0>, [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/comm\\_planning/affordablehousing/training/web/lihtc/basics](http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/affordablehousing/training/web/lihtc/basics), [http://www.cdfifund.gov/what\\_we\\_do/programs\\_id.asp?programID=5](http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5)

**Level of implementation:**

The most effective jurisdiction for a more targeted program like the CDFI Tax Credit is at the state level. The implementing agency needs to be close to private investors, investment intermediaries (e.g., CDFIs) and the market (projects in the state with job creation impact). There is likely a more generalizable form of the Program, with a less targeted impact, that could be developed at the national level.

**Capacity of implementing agency:**

The capacity of the implementation agency would vary depending on a variety of indicators. These indicators and their corresponding numbers (on average) for COIN are as follows: <sup>33</sup>

- **Number of investment intermediaries the agency engages with.** Currently 30 CDFIs apply for certification/renewal annually.
- **Number of investment proposals processed.** Currently 80 on average for COIN.
- **Number of projects (investments in projects through intermediaries) in the “COIN-approved” portfolio (a small subset of the total number of projects supported by the intermediaries that receive tax credits).** Currently 20 projects, although many are currently turned away due to limited program capacity.
- **Annual volume of investments on average.** Currently \$10 million.

At the current scale detailed above, the FY13-14 budget for COIN’s implementation is \$625,000. However at size envisioned under AB32, with an annual investment volume of \$50 million, COIN’s budget will increase to \$1.2 million, with 10 staff members.

**The key drivers of cost and effort in order of importance are as follows: <sup>34</sup>**

1. Due diligence. Processing and certifying proposals for investments.
2. Due diligence. Certifying intermediaries (CDFIs) based on demonstrated experience in brokering the job creation needs of low and moderate income communities with investment projects, and in monitoring and measuring the impact of investments in these communities
3. Legislation and data calls (research on reported investments to verify their social and/or environmental impact).
4. Monitoring and evaluation of investments.
5. Marketing. Creating awareness amongst investors and intermediaries.

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<sup>33</sup> COIN

<sup>34</sup> According to communications with COIN

**Timeline:**

The timeline for implementation of this model in a state depends on the readiness of the state with respect to the key drivers of success (outlined in Section 4.1). An enabling environment which is a prerequisite for this model needs to be present, and depends on political will. It is therefore hard to predict the timeline for realization of the program in other places. The implementation infrastructure and program features will take at least a year to incorporate from scratch, assuming that the right policies (e.g., tax credit policies), which depend on the enabling environment (though legislation), are in place.

## 6. Conclusion: Implications for the Impact Investing Field

Impact investing is expanding rapidly, drawing the attention of governments, philanthropy, and retail and institutional investors. The UK government's inclusion of social impact investment as a subject for consideration by the G8 in 2013 was a particularly important nod to a maturing market. According to Monitor, the size of the impact investing industry could grow to \$500 billion in assets this decade.<sup>35</sup>

However one of the biggest challenges for impact investors remains deploying large volumes of capital, cost effectively, in investments with clear and demonstrated impact -- including job creation in underserved communities. Job creation remains an imperative both for the global North, hit hard by the economic downturn, as well as the global South, where lack of livelihoods is the cause of grinding poverty.

In this context the COIN CDFI Tax Credit Program offers a promising model for impact investing that can be replicated at large scale with a transformative impact on employment, in the United States and beyond. The Program provides invaluable lessons for impact investing in the following ways:

- It confirms that policy can be used to channel large amounts of private capital into social investments with demonstrated impacts. In the absence of the Program, the same capital would have been invested in traditional market opportunities.

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<sup>35</sup> [http://www.monitorinstitute.com/downloads/what-we-think/impact-investing/Impact\\_Investing.pdf](http://www.monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing.pdf)

- It reinforces evidence that social investments in affordable housing and financial services can have a significant impact on job creation. To be sure, in advocating for AB32, COIN primarily pointed to the bill’s job creation affects as the social benefit of most interest.
- It demonstrates that tax credits, in particular, can be a powerful incentive to leverage large sums of private sector capital for social impact. This is consistent with policies like the Low Income Housing Tax Credit in the United States and the Nova Scotia Equity Tax Credit program in Canada, both of which leverage community finance providers.<sup>36</sup>
- It demonstrates the importance of a well-crafted policy framework in creating the right environment and incentives for channeling private sector capital into projects with high impact on job creation. This includes tax credit policies, standards for intermediaries, and the terms and conditions of qualifying investments. It also highlights the potential of cross-sector partnerships between government, private investors, and socially-oriented investment intermediaries in unlocking capital for large-scale social impacts.
- It highlights the crucial role that a centralized infrastructure (in this case COIN) plays in coordinating impact investing efforts by matching investors with high-impact investment opportunities in an efficient and accountable manner.
- Last but not least, it underscores the role of financial infrastructure (in this case CDFIs) to intermediate between investors and large-scale investment projects, while brokering the needs of low- and moderate-income communities, and balancing fiduciary obligations with a deliberate strategy for social impact. Large and experienced CDFIs in California enable investors to efficiently deploy sizeable capital investments into large-scale projects that generate significant social impacts. Developing such institutions where they are absent, and strengthening their capacity where they already exist, is essential for the success of impact investing models such as this Program.

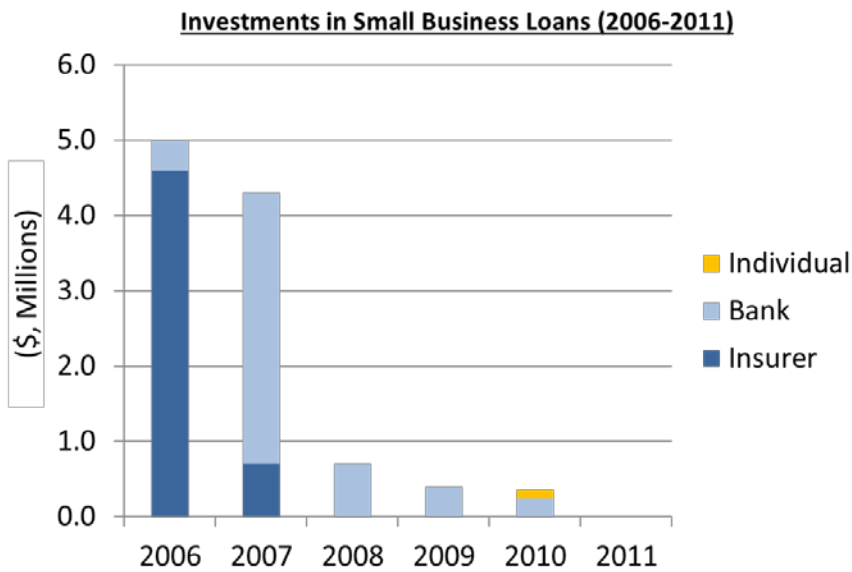
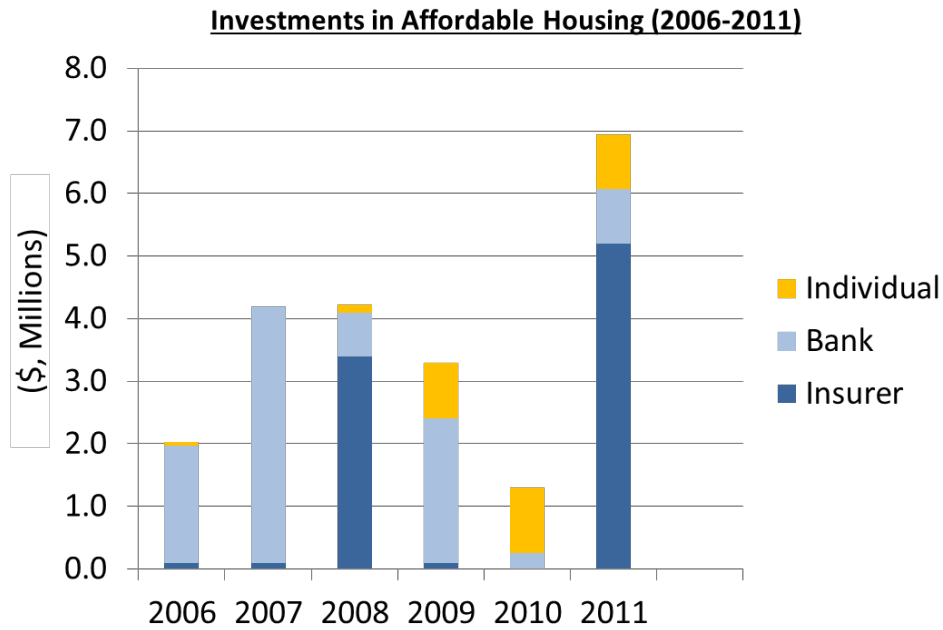
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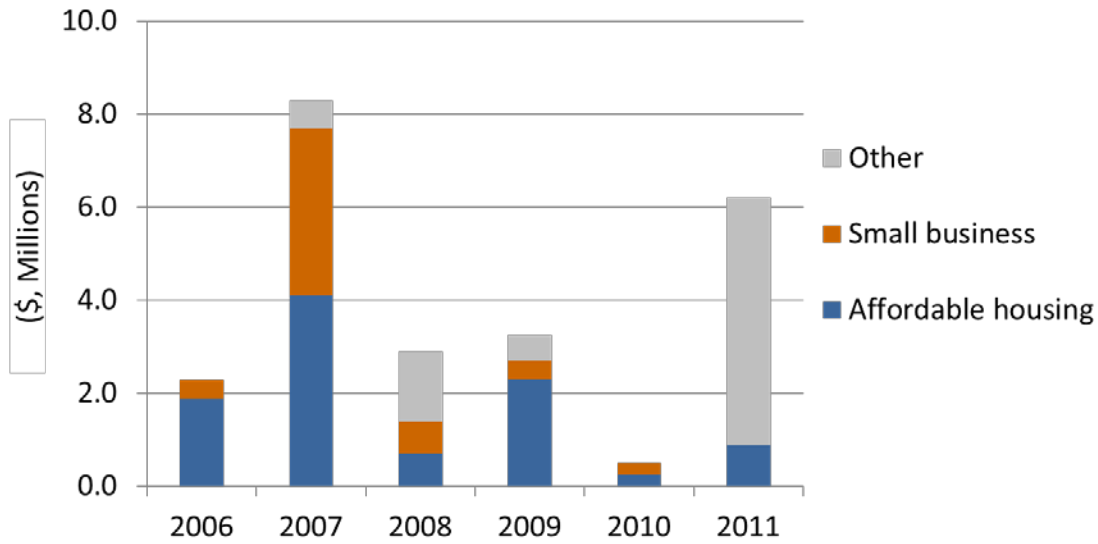
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## 5 Appendix

### 5.1 Some Historic Trends in Investments through the Program

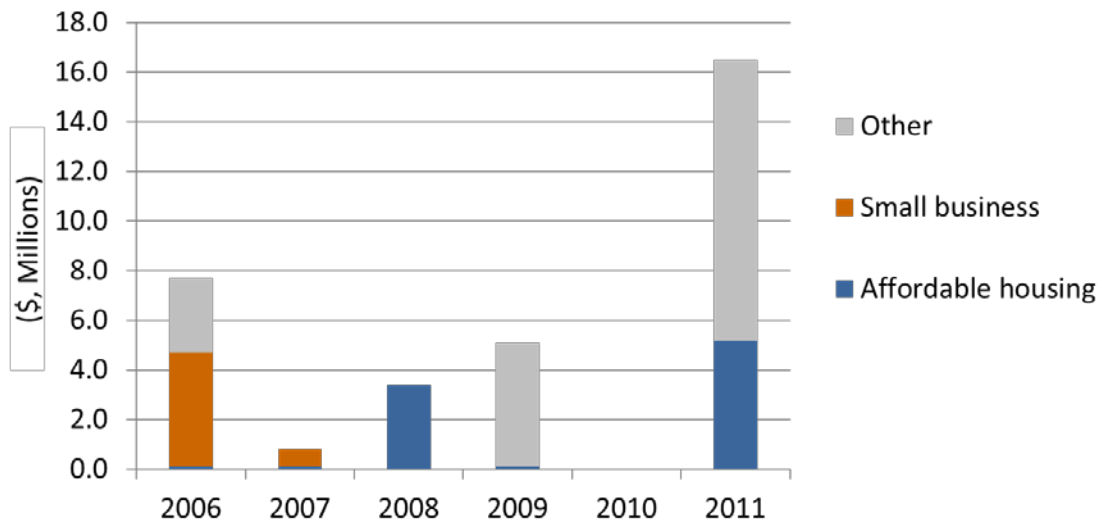


**Investments by Banks (2006-2011)**



In 2011 banks invested heavily in CDFI Financial Services (\$12.5M) and schools (\$4 M)

**Investments by Insurers (2006-2011)**



In 2011 Insurers invested heavily in CDFI Financial Services (\$11.3M)

