SCALING THE USE OF GUARANTEES IN U.S. COMMUNITY INVESTING

GIIN ISSUE BRIEF
List of Acronyms

AECF  Annie E. Casey Foundation
CDFI  Community Development Financial Institution
CWSRF  Clean Water State Revolving Funds
DUS Lenders  Delegated Underwriting and Servicing Lenders
EPA  Environmental Protection Agency
FNMA  Federal National Mortgage Association (Fannie Mae)
FQHC  Federally Qualified Health Center
HNWI  High-Net-Worth Individual
HPET  Housing Partnership Equity Trust
HPN  Housing Partnership Network
HRSA  Health Resources and Services Administration
HUD  Department of Housing and Urban Development
LIIF  Low Income Investment Fund
M-PIRE  Multifamily Property Improvements to Reduce Energy
MRI  Mission-related Investment
NMTC  New Markets Tax Credits
NYCEEC  New York City Energy Efficiency Corporation
REIT  Real Estate Investment Trust
PRI  Program-related Investment
SBA  Small Business Administration
TRF  The Reinvestment Fund
USCI  United States Community Investing
USDA  United States Department of Agriculture

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ABOUT THE GLOBAL IMPACT INVESTING NETWORK

The Global Impact Investing Network (GIIN) is a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing around the world. The GIIN builds critical infrastructure and supports activities, education, and research that help accelerate the development of a coherent impact investing industry. For more information, see www.thegiin.org.

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Dear Reader,

Impact investing is experiencing explosive growth as investors of all types are inspired to make their capital count more by unleashing investment as a global force for good. While this current growth is encouraging, it is still not enough, given the enormous size of the social and environmental challenges facing our world.

To address the pressing issues of today and to build a sustainable future of tomorrow, we not only need more investors to make impact investments, but we need different types of capital to work better together, more effectively and efficiently. Guarantees, a type of credit-enhancement tool, demonstrate one way that different types of capital can work together to develop attractive deals and create larger impact. The tool offers exciting ways for foundations with impact investing experience to amplify their impact; foundations can leverage relatively small amounts of capital to address the real (and perceived) risks that can keep some new investors from participating in high-impact deals.

I am proud to launch our report *Scaling the Use of Guarantees in U.S. Community Investing*, which highlights how guarantees can be used to efficiently stimulate greater investment in areas such as affordable housing, healthcare, community revitalization, and many others. While the report specifically profiles examples of guarantees being used in U.S. community investing, we hope that readers will explore ways of deploying the valuable tool in markets around the world, putting more capital to work, for more people, in more places.

It is inspiring to see such clear examples of how one tool can be used to amplify the power of capital to help even more people and further protect the planet. I’d like to thank our partner Kresge Foundation and those GIIN members who contributed to this critical market research, as well as those who participated in the related GIIN Guarantees Working Group.

Every historic movement needs many active and diverse players — and this is certainly true with impact investing. I’d like to thank those who have already helped advance the market to this point, and, looking forward, I call on many others to join. The future of impact investing and our world will be dependent on all of us demanding more from those investors who are currently still sitting on the sidelines failing to tap into the full power of their capital, and that is a ‘guarantee.’ So, what role will you play?

Amit Bouri
Co-Founder and CEO, Global Impact Investing Network
@AmitKBouri
“The Kresge Foundation is pleased to partner with the GIIN to explore how foundations can expand the use of guarantees to unlock new capital for community development in the U.S. At a time when need is growing and financial sources are threatened, guarantees provide a way for foundations to leverage capital, prove the “investability” of a model or organization and expand their charitable impact. Foundations have provided guarantees for many years, but the tool is underutilized. At Kresge, we use guarantees to invest in communities today, without requiring current resources from our corpus. Our partnership with the GIIN and its working group has provided insights into best practices and identified rich opportunities where guarantees could be especially useful.

We are grateful to the GIIN for its thorough exploration of this topic and to members of the working group for their insights, expertise and participation.”

KIMBERLEE CORNETT
Managing Director of Social Investment Practice
The Kresge Foundation
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Executive Summary

Credit-enhancement tools can be a powerful way to stimulate increased private-sector investment in solutions to social and environmental problems. Guarantees, one type of credit-enhancement tool, offer exciting ways to leverage relatively small amounts of capital to address the real and perceived risks that keep many investors from participating in impactful deals. Guarantees are especially well-suited for foundations that already have experience making impact investments (through mission-related investments and program-related investments) as a way to generate more impact without necessarily requiring current liquidity.

This report explores the use of guarantees in the United States community investing market—a focus that enabled greater depth of inquiry within a specific context, though the findings may also be applicable in other geographies. While a wide range of deals in U.S. community investing have involved some form of guarantee, they have been most commonly applied in affordable housing, community revitalization, and community real estate.

A set of case studies in the report show how guarantees have been used in the housing sector, as well as in healthcare and energy efficiency. The case studies demonstrate the use of guarantees to address a variety of risks including those related to liquidity, sector unfamiliarity, new product development, and uncertain geographic markets. These examples show how this type of tool can have transformative effects when used with creativity and clarity.

Nevertheless, some barriers remain to the widespread use of guarantees in community investing. Guarantee transactions, often quite bespoke, vary widely with specific deal requirements in terms of impact sought, coverage levels, and other structural features. Such customization creates complexity that discourages greater utilization of the tool. In addition, transactions involving guarantees often suffer from the difficulty of aligning priorities across multiple parties, which can undermine the tool’s effectiveness.

This report presents three main recommendations for taking advantage of the opportunities and addressing the challenges preventing the broader use of guarantees at scale.

- First, to streamline structuring, practitioners negotiating guarantees should focus on five key considerations as factors that tend to most influence a transaction’s success: (1) objectives of the guarantee; (2) type of risk addressed; (3) coverage level; (4) financial return expectations; and (5) triggers of and access to the guarantee. The report provides guidance about how choices related to these factors affect different stakeholders.

- Second, practitioners should consider ways to standardize guarantee terms across larger numbers of investments, whether through funds, programs, or other means of pooling guarantee capacity.

- Third, several promising sectors could benefit from the use of guarantees but have seen limited use of the instrument to date, including energy efficiency, renewable energy, and healthcare. Guarantees could also be promising in the food industry and to improve access to finance for small businesses.

The lessons from the case studies and other examples analyzed in this report are intended to inform and encourage the use of guarantees by impact investing stakeholders who are well-placed to employ the tool—including foundations, banks, project developers, community development finance institutions, and other intermediaries—so that they may explore the possibilities to achieve greater impact throughout disadvantaged communities in the United States and beyond.
GUARANTEE

In different segments of the financial industry, practitioners use varying definitions of the term “guarantee,” ranging from narrower, technical definitions to broader definitions that encompass various types of credit enhancement. For the purposes of this report, a guarantee is defined as one of the following two instruments:

1) Unfunded guarantee: A legal agreement in which a third party to a financial transaction promises to pay the investor (or lender) in the event that the investee (or borrower) is unable to do so. The contract specifies the conditions that trigger a payment and the amount to be paid. No funding is provided up front. A fee may be charged, though in the context studied here most guarantors charged a nominal fee or no fee for unfunded guarantees.

2) Funded guarantee: Capital set aside by a third party for the benefit of a financial transaction, to be used in the event that the investee (or borrower) is unable to repay the investor (or lender), depending on specified conditions or triggers. These funds can be provided in several ways, including grants, loans, and deposit accounts. The capital may be reserved on the balance sheet of the guarantor, the investor, the investee, or an intermediary, such as a fund manager.

STAKEHOLDERS

Any transaction involving a guarantee has several important players, which are labeled throughout this report as defined below:

Provider or guarantor: The organization that provides the funded or unfunded guarantee. For funded guarantees, this is typically the organization that originally provides the money to fund the guarantee (even if another party then holds it in their account).

Recipient: The investor or lender receiving coverage from the guarantee.

Borrower/investee: The organization that ultimately obtains capital as a result of the guarantee.

Intermediary: Advisors that help structure deals, as well as, in some cases, fund managers or other organizations through which the invested capital flows. While intermediaries may also invest their own capital, they are usually neither the primary recipients of a guarantee nor the ultimate beneficiaries of the invested capital.
Introduction

Motivation for the Study

In traditional financial markets, credit enhancement is often used to improve the risk-return profile of particular investment opportunities. In the growing impact investing market, many projects and enterprises may have powerful prospects for positive social and/or environmental impact while lacking a risk-return profile that meets the needs of conventional investors seeking risk-adjusted, market-rate returns. For such opportunities, credit enhancement can unlock private capital to help solve a wide range of pressing challenges.

While public subsidies and program-related investments in subordinate positions have been widely used toward these ends, significant opportunities remain to fully leverage the potential of credit enhancement in impact investing. Though the mechanisms of credit enhancement are often highly customized and complex—and therefore often inefficient and costly to execute—in certain contexts these tools could be used more efficiently and at greater scale. The lack of information and resources to help impact investors efficiently utilize credit enhancements was the primary motivation for this research.

This study focuses on one specific form of credit enhancement—guarantees—and its application in the United States community development investing market. The United States has several unique features, including its regulatory and policy context, an environment in recent years of low interest rates (which affects credit availability), and a community investing field with a long history. There is a great need to channel more capital to underserved communities across the United States to preserve and increase affordable housing, promote access to quality services such as education and healthcare, and alleviate environmental pressures, among other concerns. The geographic focus of this study enabled a greater level of depth and specificity of findings within the particular U.S. context, though general principles and considerations may also apply globally.\(^1\)

Prior research has investigated the use of other credit enhancement tools, such as first-loss capital,\(^3\) but the application, usefulness, and scalability of guarantees in impact investing had not yet been examined in depth. Guarantors can leverage additional capital without requiring direct participation in investments or even, in some cases, additional current liquidity, an advantage which sets guarantees apart from other forms of credit enhancement. Foundations accustomed to making impact investments (for example through program-related or mission-related investments) are especially well-placed to take advantage of guarantees as a tool to further their impact, though controls should of course be established to manage future calls on outstanding guarantees.

This study aims to highlight guarantees as a valuable tool to enable borrowers and investees who are creating positive impact to access capital more easily and at better terms, furthering their impactful work. The primary audiences are potential guarantors and recipients of guarantees (investors or lenders). The study outlines how guarantees have been used to date in U.S. community investing, what challenges have been associated with their use, and what opportunities exist to use guarantees at greater scale to ultimately support communities and the environment. The insights, guidance, and case studies presented here are intended to enable more efficient structuring through greater transparency into the guarantee process.

Methodology

The following methods were used to develop the findings and resources in this report and are described in greater detail below. The research team:

- Reviewed relevant historical research regarding credit enhancement (see Appendix 2 for a full list of references and Appendix 3 for summaries of the most relevant research).

\(^{1}\) "Community investing" or "community development investing" is a subset of impact investing that is distinguished by a focus on marginalized areas or communities that conventional market activity does not reach. See a complete definition in Scaling U.S. Community Investing: The Investor-Product Interface (The Global Impact Investing Network, 2014), https://thegiin.org/knowledge/publication/usci, page 15.

\(^{2}\) The research team also interviewed a handful of international guarantors. The report includes these findings where appropriate.

Conducted 40 interviews with a range of practitioners and experts (see Appendix 1 for a List of Interviewees).

Compiled and analyzed a database of 58 community investments in the United States that involved a guarantee.

Tested findings with the GIIN’s Guarantees Working Group, composed of practitioners that have experience with or interest in utilizing guarantees for impact investments.

INTERVIEWS

The graphs below illustrate the composition of the group of 40 interviewees, a full list of which can be found in Appendix 1. In terms of organizational type (Figure 1), most interviewees represented foundations, fund managers, banks, or community development financial institutions (CDFIs). The CDFIs include loan funds, credit unions, and community development banks. The “other” category includes government and quasi-governmental entities in addition to one subject expert from a university. Primary interview topics included the experience of each interviewee with guarantees, as well as perceived challenges to, promising sectors for, and opportunities to standardize and scale their use.

FIGURE 1. INTERVIEWS BY ORGANIZATIONAL TYPE

n = 40 interviews

Most interviews were with those directly involved in negotiating and structuring guarantees and the investments those guarantees protected, including both providers and recipients (see explanation of key terms on page 3). In addition, five interviewees were from intermediary organizations such as advisors, placement agents, or fund managers, and three were borrowers or investees receiving capital as a result of a guarantee. In three cases, recipients were also borrowers or investees—for example, a CDFI that has made a guaranteed loan while also raising capital guaranteed by the CDFI Bond Guarantee Program or a foundation that has both provided and received guarantees in different deals. These cases of “double-identity” are categorized as recipients in Figure 2 below. The “Not applicable” category includes experts who do not participate directly in deals, while the “Not yet used” category includes organizations that could participate in some form but have not done so to date.

FIGURE 2. INTERVIEWS BY ROLE

n = 40 interviews

ANALYSIS OF GUARANTEES DATABASE

Drawing from these 40 interviews, as well as from data submitted by interviewees and gathered from online research, the research team created a database comprising 58 deals involving guarantees. All deals are investments in the United States that have at their core some community development objective. The deals include specific projects and loans as well as funds with fund-level guarantees. To the greatest extent possible, the research team validated key information directly with stakeholders involved in each transaction. Some data points were not available for all guarantees, because both sources of information and structure varied somewhat (for example, some guarantees express coverage based on a certain number of months of operating expenses instead of in percentage form). This resulted in slightly differing sample sizes for the analyses presented in the “Landscape” section. The research team endeavored to gather a representative sample of guarantees used in U.S. community investing. Though by no means comprehensive and not necessarily representative of the entire landscape, the sample of 58 guarantees analyzed here is...
robust enough to generate valuable insights regarding the use of this tool in the U.S. community investment (USCI) market.

GUARANTEES WORKING GROUP

The GIIN convenes time-bound, issue-specific working groups on various topics to foster knowledge-sharing and collaborative action among its members. In April 2016, the GIIN began holding quarterly meetings of the Guarantees Working Group, which explored the opportunities and challenges of structuring guarantees at scale in the context of urban-based U.S. community investing. The group comprised 34 individuals from 23 organizations (see Appendix 4 for a list of participating organizations). In addition to serving as a testing ground for research scope and findings, the meetings led to the development of resources for structuring guarantees, including a list of the main components of a guarantee-backed investment and a matrix of key considerations for various stakeholders involved. The resources are attached to this report.

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4 See more information about GIIN Membership at: https://thegiin.org/membership/.
Landscape of Guarantees in U.S. Community Investing

Though guarantees have generally been underutilized in impact investing, robust examples of their use do exist. To better assess the extent and nature of their current use and to learn from past experience, the characteristics of the 58 deals included in the database are analyzed in this section.

**Impact Themes**

U.S. community development encompasses a range of impact objectives, from preserving affordable housing to ensuring access to healthy food, healthcare, or education. Guarantees have been used in deals targeting a wide variety of these impact objectives (Figure 3). The strong concentration in deals intended to increase the availability of affordable housing is unsurprising given that affordable housing is a major focus in general of U.S. community investing deals. Investments in real assets offer built-in collateral that makes them relatively easy to finance. Also, many lenders active in community investing are already familiar with the structure and cash flows of projects in affordable housing, which further facilitates transactions in this space. However, this sector has a long-standing and continual need for credit-enhanced capital for several reasons, including the difficulty of accessing capital for pre-development costs such as appraisals and environmental surveys, the challenges nonprofits face in accessing traditional bank financing, and market risk in the cities in which affordable housing is often needed.

Many guarantees have backed investments that target broader community development objectives, such as economic revitalization or development, including job creation and other activities designed to drive place-based development. Finally, several guarantees have been used to finance community real estate projects such as fire stations, homeless shelters, and parks. Figure 3 below shows the number of guarantees in the database compiled for this study that target various impact themes.

**FIGURE 3: IMPACT THEMES BY NUMBER OF GUARANTEES**

n = 58 guarantees; some guarantees target multiple themes

Main Players

PROVIDERS

Foundations and government agencies are the two main groups providing third-party guarantees for community development investments (Figure 4). The foundations vary in size from larger foundations that operate nationally to smaller foundations focused on a particular city or area. Private foundations with larger endowments are often able to provide unfunded guarantees (which may be larger in size and scope) based on the strength of their balance sheets. Though less common, in some cases small foundations can also provide unfunded guarantees by leveraging their reputations and strong local relationships. Depending on the context, both types of foundations may also provide funded guarantees.

Government guarantors include federal agencies such as the U.S. Department of the Treasury (through its CDFI Fund) or the Small Business Administration (see more detail regarding government programs on page 14), as well as city- or county-level governments. The types of guarantees provided by federal compared to local government entities vary. Several federal government agencies have guarantee programs with standard terms and requirements for a broad set of investments by qualified parties. By contrast, local-level governments are typically involved more indirectly—for example, by funding an organization set up to enhance credit for impactful deals in a certain city—and on a more case-by-case basis for completing a specific deal. In the cases of the former, the database includes a few specific instances of the use of a program as separate deals, rather than marking the size and other characteristics of the entire program as a single deal. The database includes a mix of deals backed by both federal and local guarantors.

RECIPIENTS

Unsurprisingly, regional and national banks were the most common recipients of guarantees, followed by a variety of CDFIs (Figure 5). Several project developers also received guarantees; these organizations secure financing and manage various aspects of housing or infrastructure development, such as acquisition, construction, and renovation, as well as providing, in some cases, other services, such as resident care or technical assistance. The “project developer” category in the chart below includes some nonprofit developers, while the “nonprofit” category comprises organizations that primarily provide other types of services, such as health services, family

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6 The nonprofit guarantors included: (1) an organization focused on developing, financing, and building charter schools; (2) a multi-service organization focused on housing, disaster response, and financial education; and (3) a nonprofit finance company providing financing and technical expertise to promote energy efficiency.
Motivations and Types of Risk

All of the guarantors studied here are motivated to provide guarantees by a desire to boost their impact, usually in one of two ways. First, some see opportunities to leverage private capital into impactful deals for which the economics do not provide a commercially attractive risk-return profile. For example, low-cost, long-term financing is often needed to enable nonprofit housing developers to acquire properties, but such investments may not meet the requirements of mainstream financial institutions.

Second, others aim to help investors gain comfort and familiarity with a new sector or business model, which may require temporary mitigation of risk. Even where the sector or business model itself is not new, it may be unfamiliar to certain investors or lenders, which have yet to understand the risks sufficiently to develop underwriting guidelines. For example, although federally qualified health centers (FQHCs) are not new, in the past some CDFIs and banks had little experience lending to them; a guarantee helped build lenders’ comfort with the FQHC business model (for further detail, see the case study on The Collaborative for Healthy Communities). This second category also includes unproven types of investment where the risk-return characteristics are not well known, such as urban green infrastructure projects.

Motivations for providing (and receiving) guarantees are connected to the types of risk guarantors and recipients perceive in the deal. Figure 6 shows the types of risk addressed by the guarantees in our database, from the perspectives of both guarantors and recipients. Addressing these types of risk generally achieves the goal of obtaining financing for entities or projects that otherwise could not do so—or, at least, not at the same terms. Many interviewees on all sides of deals cited more attractive terms as a major motivation for using guarantees, including lower cost of capital, longer time horizons for repayment, and higher loan-to-value ratios.7

7 In the Spotlight on the Market (Global Impact Investing Network, 2014), respondents providing credit enhancement selected “to attract capital toward an impact goal/objective” as the most important motivation for doing so (73% said it was “very important”), followed by “to attract investors that otherwise might not have invested” (61%) and “to demonstrate the commercial viability of a market” (44%). Thirty-nine percent said “to reduce the cost of capital to investee” was a “very important” motivation.
In the database compiled for this study, the most common type of risk addressed by guarantees in USCI is some form of borrower credit risk, a category encompassing a range of scenarios, including:

- Small businesses with limited credit history;
- Nonprofits with little or no earned income but steady income from grants; or
- Investees or borrowers that lack appropriate collateral (e.g., a single-purpose building like a school or healthcare facility that is not very valuable as collateral).

In all such cases, regardless of the actual risk or track record, the investee or borrower does not meet the typical lending criteria of a conventional investor. A guarantee helps to fill this gap, bringing needed capital to the investee.

The second-most common type is “operational risk,” which stems from the possibility that an investee’s internal procedures and systems do not function as planned, resulting in shortfalls in revenue. This type of risk can be seen in large-scale property developments that need to find steady residential or commercial tenants to generate project income. If they are unable to do so, they may not be able to service their debts or repay investors. Another example is the risk that a charter school, once constructed, might not enroll enough students to obtain adequate funding from the district and state (which is provided according to the number of students enrolled).

Operational risk is also present when a borrower or investee organization does not have well-established processes and systems for managing operations—as is sometimes the case in smaller nonprofits and start-up companies.

The third-most common type of risk is related to the geographic market of the investment. Many guarantees in the dataset target affordable housing, economic revitalization, or access to basic services in cities or communities that have fallen on hard economic times. For example, Detroit, hit hard by the housing crisis of 2008, still struggles with assessing and documenting appraised values in many parts of the city. While good investment opportunities might exist in economically challenged cities like Detroit, investors may feel less comfortable assessing both potential returns and the time horizon over which they could be realized, since these depend on variables related to the market’s recovery.

Next, many guarantees address risks associated with the physical construction phase of a project development. Two less-familiar types of risk that guarantees can address are also worth noting: (1) an unproven or unfamiliar sector or product

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**FIGURE 6: TYPES OF RISK ADDRESSED BY NUMBER OF GUARANTEES**

\( n = 53 \) guarantees; many guarantees address more than one type of risk

![Figure 6: Types of Risk Addressed by Number of Guarantees](image-url)

Source: GIIN

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8 In our sample, 74% of the guarantees targeted urban areas, 5% targeted rural areas, and the remaining 21% were agnostic between these or could be applied to both urban and rural areas (\( n = 43 \)).
and (2) liquidity need. Regarding the first type, untested business models and their associated risks are fairly common in impact investing, where social entrepreneurs are innovating to find new solutions to pressing problems. Additionally, some sectors or business models are simply not well-known to certain investors; guarantors can step in to cover some exposure while the investor gains experience with the sector or model.

A second interesting use of guarantees is to provide liquidity, either for other investors or for the borrower/investee. For example, the Kresge Foundation provided a guarantee for an intermediary, which had agreements with other investors that required them to keep six months of operating expenses in reserve. The Kresge guarantee was worth three months of operating expenses, which enabled the intermediary to direct an equal amount, which would have been otherwise held in reserve, to hire staff to help coordinate social services for residents of low-income housing developments. Service coordination has been shown to improve resident and property outcomes by enhancing health and wellness, housing stability, and education. This report includes a case study of the Housing Partnership Equity Trust, which includes a liquidity facility that—while not a guarantee—ensures redemption options for investors.

In other cases, the liquidity need relates to timing, with a guarantee helping to provide access to capital faster than it would otherwise be available. For example, The California Endowment provided a guarantee to enable speedy recovery of Northern California’s Crescent City Harbor District after the 2011 tsunami caused significant damage. Long-term capital needed for redevelopment was available from the USDA Rural Development Authority, but waiting out the time horizon for receiving that loan would have meant missing an important season for rebuilding, thus delaying the economic recovery of the area. The California Endowment’s guarantee enabled a CDFI to make a gap loan to the District. Once the USDA loan was approved, it replaced this gap loan, and the guarantee terminated.

**Economics**

**SIZE, COVERAGE, AND LEVERAGE**

The size of guarantees was analyzed in terms of both the value or amount of the guarantee itself and the size of the total project or fund. The research team also analyzed the percentage of coverage provided for the loan or equity tranche to which the guarantee directly applied. Nearly 80% of the guarantees in the studied database are USD 5 million or less in value, and about 80% of the funds or projects they are involved in are USD 50 million or less (Figures 7 and 8). Though both the guarantees and the overall funds or projects in the studied

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**FIGURE 7: GUARANTEES BY SIZE**

- n = 46 guarantees

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<th>Count</th>
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<tr>
<td>USD 11–25M</td>
<td>5</td>
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<tr>
<td>USD 6–10M</td>
<td>3</td>
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<tr>
<td>USD 2–5M</td>
<td>16</td>
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<tr>
<td>up to USD 2M</td>
<td>20</td>
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</tbody>
</table>

Source: GIIN

**FIGURE 8: FUND OR PROJECT SIZE**

- n = 48 funds/projects involving guarantees

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<td>USD 51–100M</td>
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<td>6</td>
</tr>
<tr>
<td>up to USD 5M</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: GIIN

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The database range greatly in size, most are fairly small, with a median guarantee amount of USD 2 million and a median fund or project size of USD 20 million.

The level of coverage or protection provided by the guarantee—calculated as a proportion of the specific tranche of capital to which it applies rather than to the whole fund or project—also ranges widely. The guarantees in the database cluster around the lower and higher ends of the spectrum (Figure 9), with 19 offering 25% or less and 19 offering 75% or greater coverage (n = 44 guarantees).

Some guarantees in the database are not included in this analysis, because they do not base their coverage levels on a percentage of the loan or fund. Coverage provisions can be very deal-specific. For example, a guarantee might cover some number of months of operating expenses or some number of years of debt service. A tax equity investor in a community solar project might be concerned about the risk of obtaining short-term contracts to purchase the power generated by the solar project, in which case a provider might guarantee the sale of a certain amount of energy at a certain price for as long as the equity investor remains in the transaction.

In the sample analyzed here, 65% of the guarantees are unfunded, 29% are funded, and 6% are partially funded (n = 52 guarantees). Figure 9 shows that funded guarantees in the sample tend to offer lower coverage levels, while unfunded guarantees tend to offer higher coverage levels.

A related concept to coverage is the “leverage effect,” the specific amount of capital invested or lent that otherwise would not have been deployed. Calculating leverage is not always straightforward. In some deals, the “leverage effect” might simply be the additional capital contributed by the recipient of the guarantee. In other cases, however, it might be argued that although the guarantee enabled only a small piece of financing, the entire deal would not have happened without that critical piece—so the total project or fund amount could be included in the leverage effect. As another example, if a guarantee applies to a revolving loan fund, the same capital might be lent multiple times over, creating a higher leverage effect than simply the amount committed directly as a result of the guarantee.

**LEVEL**

A key structural element of guarantees is the level at which the guarantee is provided—in other words, at what level are the terms negotiated and to which pool of capital does the guarantee apply? Just over 40% of the guarantees in the database were negotiated for a single loan (Figure 10). Eight percent targeted a certain project, like an affordable housing development or charter school (though some applied to multiple loans or types of financing for the project).

![Figure 9: Number of Guarantees by Coverage Range](https://example.com/figure9.png)

Source: GIIN
Thirty-seven percent were “wrapped” around a fund or portfolio that itself could make multiple investments or loans, all eligible for application of the fund- or portfolio-wide guarantee. The payout in such cases can either be pooled across the whole fund or limited to a per-loan or per-project basis, mitigating the risk of a large, lump-sum payout. For guarantors, one benefit to a pooled guarantee is that any potential payout can be delayed to the end of a fund, enabling management of the timing of potential payouts. For example, if a guarantee covers pooled losses of a whole fund with a term of 10 years, guarantors know that any potential payout will happen in year 10. In the meantime, with an unfunded guarantee, the capital can be invested elsewhere (e.g., in the stock market), earning a risk-adjusted market rate of return. The ability of this capital to earn a strong return over those 10 years may offset the risk of the whole guarantee being called at once.

Finally, a program-level guarantee sets standard terms for any deal that meets its established criteria, without targeting a specific loan, project, or fund. For example, the Small Business Association’s 7(a) program guarantees loans to any small business that meets specific criteria laid out on its website (see text box on this and other government guarantee programs).

**FIGURE 10: GUARANTEES BY LEVEL**

n = 48 guarantees

Source: GIIN
SMALL BUSINESS ADMINISTRATION (SBA) 7(A) LOAN GUARANTEE PROGRAM

The SBA 7(a) program guarantees repayment of up to 85% of eligible loans made by SBA-approved lenders under USD 150,000 (and up to 75% for loans over USD 150,000). The lenders must certify that it would only make the loan if the SBA guarantees it. Given the importance of small businesses to economic strength, the program helps small businesses access loans with greater flexibility and longer repayment terms compared to other available financing options. Lenders and borrowers negotiate specific terms, though certain provisions apply to all loans. To be eligible, the borrower must operate for profit in the United States and be “small” according to SBA definitions, which vary by sector.9 Borrowers must also meet certain financial criteria, such as having a reasonable amount of invested equity, being current on any existing debt obligations to the U.S. government, and using all personal resources before seeking financing. The SBA assesses a guarantee fee ranging from 0-3.75% of the guaranteed portion, depending on the amount guaranteed and the loan’s maturity.10

Interviewees cited the clarity and specificity of the SBA program criteria as advantages; those experienced in using the SBA guarantee program, especially, can easily understand when an application will be accepted. Experienced lenders can then simply underwrite to the established guidelines. The predictability is also an asset when accessing the guarantee. The guarantee’s value is enhanced by the creditworthiness of the guarantor (the U.S. government) and the clearly outlined triggers for payout. One downside to the specificity and relatively stringent credit standards of the program—according to some interviewees—is that potentially impactful and creditworthy small businesses can fall outside of the narrowly defined program eligibility parameters for several possible reasons. For example, the use of proceeds might not be eligible (e.g., to refinance debt) or the business might not score high enough in the SBAs specific credit scoring model.

U.S. DEPARTMENT OF AGRICULTURE (USDA) COMMUNITY FACILITIES GUARANTEE PROGRAM

Through its Community Facilities Guarantee Program, the USDA provides up to a 90% guarantee for eligible borrowers to purchase, build, or improve essential community facilities in rural areas. Eligible borrowers include public bodies, community-based nonprofits, and federally recognized Native American tribes. An essential community facility is defined as “a facility that provides an essential service to the local community for the orderly development of the community in a primarily rural area, and does not include private, commercial, or business undertakings.”11 The program charges a one-time fee of 1% of the principal loan amount multiplied by the percentage of the guarantee. The borrower and lender negotiate interest rates and repayment terms for the loans.

TREASURY CDFI FUND BOND GUARANTEE PROGRAM

Created as part of the 2010 Small Business Jobs Act, this program was intended to address CDFIs’ need for long-term, low-interest capital, helping them to raise this type of financing by guaranteeing 100% of bond issuances in a minimum size of USD 100 million. The qualified issuers (CDFIs or their designees) sell the issued bonds to the Federal Financing Bank and then lend the proceeds to other CDFIs.\(^\text{12}\)

While exposure to the capital markets was also an initial intention of the program, regulation requires that bonds with 100% guarantees from the Federal Government be sold to the government itself,\(^\text{13}\) so the CDFI bonds cannot be sold on the open market. Though this aim of exposing the broader capital markets to CDFIs was not achieved, the program has successfully channeled over USD 1 billion to CDFIs. In addition, interviewees noted that the rigorous credit requirements for accessing this capital have led many CDFIs to improve their financial management processes to meet these criteria.

STATE REVOLVING FUNDS (SRFs)

The State Revolving Funds (SRF) program is a partnership between the Environmental Protection Agency and individual states through which the EPA provides funding for projects that address high-priority water-quality needs. SRFs have the authority to provide credit guarantees for green infrastructure and other environmental projects. In 2013, the New York State Energy Research and Development Authority used the SRF’s guarantee capacity to obtain a higher rating for a bond issuance for residential energy-efficiency retrofits. According to the EPA’s Environmental Financial Advisory Board (EFAB) 2014 white paper, SRF funds are well-placed to guarantee green infrastructure projects given their structure, cash flows, and high credit ratings from the major rating services. According to the EFAB, such guarantees could improve terms for urban green infrastructure projects, as “[t]he critical value of an SRF guarantee would be the improvement in project economics and the resulting increase in the number of projects that are successfully developed in the green infrastructure marketplace.”\(^\text{14}\) As of this writing, various municipalities are still considering this option.

\(^\text{13}\) For more information, see the Federal Financing Bank’s Frequently Asked Questions, \url{https://www.cdfifund.gov/Documents/FEB%20FAQ%202011%202.pdf}
Case Studies

The case studies in the following pages profile deals or projects involving a guarantee or related innovative financing structure. These provide concrete examples of how guarantees have been structured to manage risk and channel additional capital into impactful projects. Each case includes an overview of the key structural elements and results the guarantee enabled. The four cases are summarized below.

### HEALTHY NEIGHBORHOODS
**Loan Pools I & II**
Healthy Neighborhoods promotes community revitalization through property acquisitions and renovations in distressed Baltimore neighborhoods.

### THE COLLABORATIVE FOR HEALTHY COMMUNITIES
The Collaborative for Healthy Communities lends to federally qualified health centers, which provide healthcare to medically underserved communities.

### MULTIFAMILY PROPERTY IMPROVEMENTS TO REDUCE ENERGY (M-PIRE)
M-PIRE was a collaborative pilot between the New York City Energy Efficiency Corporation (NYCEEC) and Fannie Mae that helped Fannie develop green mortgage products.

### HOUSING PARTNERSHIP EQUITY TRUST (HPET)
HPET supports access to affordable and sustainable housing through property acquisitions throughout the United States.

#### INVESTMENT OVERVIEW
- **Healthy Neighborhoods**: Provides community revitalization through property acquisitions and renovations in distressed Baltimore neighborhoods.
- **The Collaborative for Healthy Communities**: Lends to federally qualified health centers, providing healthcare to medically underserved communities.
- **M-PIRE**: A collaborative pilot between NYCEEC and Fannie Mae to develop green mortgage products.
- **HPET**: Supports access to affordable and sustainable housing through property acquisitions.

#### GUARANTEE OVERVIEW
- **Healthy Neighborhoods**: Annie E. Casey Foundation (AECF) provided an unfunded guarantee along with a USD 25,000 grant to be used as first loss capital.
- **The Collaborative for Healthy Communities**: The Kresge Foundation provided an unfunded guarantee to facilitate co-lending among three CDFIs that had limited previous experience lending to health centers.
- **M-PIRE**: NYCEEC provided a funded guarantee to facilitate incorporation of projected energy savings into Fannie Mae's underwriting practices. This enabled larger loan sizes to finance efficiency improvements.
- **HPET**: The MacArthur Foundation provided a stand-by purchase agreement to provide a liquidity source for senior investors.

#### YEAR
- **Healthy Neighborhoods**: Loan Pool I established in 2006; Loan Pool II in 2012.
- **The Collaborative for Healthy Communities**: Initiative launched in 2012.
- **M-PIRE**: Program established in 2014.
- **HPET**: Established in 2013; Guarantee provided in 2015.

#### COVERAGE LEVEL
- **Healthy Neighborhoods**: 10% top loss per loan.
- **The Collaborative for Healthy Communities**: 20% top loss, later reduced to 10%.
- **M-PIRE**: 50% of the incremental loan amount.
- **HPET**: 25% liquidity facility.

#### SIZE OF GUARANTEE
- **Healthy Neighborhoods**: USD 4 million total (USD 1.025 million from AECF).
- **The Collaborative for Healthy Communities**: USD 5 million.
- **M-PIRE**: USD 5 million.
- **HPET**: USD 12.5 million.

#### SIZE OF FUND OR PROJECT
- **Healthy Neighborhoods**: USD 40 million.
- **The Collaborative for Healthy Communities**: USD 132 million.
- **M-PIRE**: USD 200 million (including USD 10 million for energy retrofit financing).
- **HPET**: USD 85 million.

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15 These figures reflect the total estimated potential capacity of the project or fund, rather than the amount ultimately deployed.
CASE STUDY

HEALTHY NEIGHBORHOODS LOAN POOLS I AND II

Background
Healthy Neighborhoods, Inc. is a nonprofit organization founded in 2004 by a bank, a foundation, and community leaders to revitalize undervalued Baltimore neighborhoods by improving properties and strengthening neighborhood identities. The initiative is designed to increase occupancy rates and home values, expand city tax revenues, and build community. Healthy Neighborhoods provides various services, including grants to neighborhood groups to cover marketing, community organizing, and development projects, as well as loans for property acquisition and renovation. The program also supports realtors and housing counselors to help market loans and contracts with architects to assist with design and renovation.

The need for a guarantee
In 2006, Healthy Neighborhoods organized a pool of USD 40 million from 10 lenders (“Loan Pool I”) to lend to homeowners at slightly below-market interest rates for the purchase, refinancing, and renovation of homes in Baltimore City. A guarantee from three local foundations and the Maryland Housing Fund covered the first 10% of losses of each loan, making the loans affordable and enabling a relatively high loan-to-value ratio of 120% of the post-renovation appraised value. The guarantee helped mitigate risks associated with the depressed local housing market, borrowers with limited collateral or credit history, and the start-up of a new program with a limited track record.

In 2012, once all the funds from this first fund had been committed, a second pool of similar size was arranged from six lenders (“Loan Pool II”). M&T Bank acted as the originating lender, with other lenders including PNC Bank, Baltimore County Savings Bank, Hamilton Federal, CFG Community Bank, and St. Casimir’s Savings Bank (many had participated in Loan Pool I). Loan Pool II was also backed by a 10% guarantee of up to a total USD 4 million from two of the original local foundations and the Maryland Housing Fund. Healthy Neighborhoods approached the Annie E. Casey Foundation (AECF) to round out this guarantee pool, since one of the guarantors had decided not to participate in the second pool.

Loan Pool I had proved successful, with a very low loss rate even during a turbulent period for the market, encouraging the banks to participate in the second pool. The guarantee ensured that Loan Pool II could continue providing financing at below-market interest rates and high loan-to-value ratios to draw in buyers and incentivize renovations that would increase neighborhood market values.

This case study, focusing on the second loan pool, draws from the experience of one guarantor in particular, the Annie E. Casey Foundation. AECF saw a chance to reinforce the impact of their work in East Baltimore. The Healthy Neighborhoods target communities were adjacent to East Baltimore, and many residents had relocated to those areas from East Baltimore during a neighborhood revitalization initiative. For both these reasons, AECF was interested in promoting stability and rising home values in those neighborhoods.

**Negotiations**

The guarantee structure for the second fund was largely modeled on that of the first fund, with most of the original stakeholders continuing to participate. Thus, there were no significant negotiations on terms and structure. AECF fully underwrote the transaction and was comfortable with the risk profile, investment terms and guarantors and lenders. Further, a strong existing relationship and trust between AECF and the Abell Foundation facilitated the negotiations.

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17 Significant changes took place in the financial industry between the first and second pools, and some of the original banks had been acquired or ceased to exist.
AECF provided an unfunded guarantee of up to USD 1 million, which was recorded as a contingent liability on their balance sheet and which would be counted as a program-related investment if called. Based on the performance of the first loan pool, AECF estimated that their pro-rata portion of any losses incurred would not exceed USD 25,000, so they decided to provide this amount up-front as a grant to Healthy Neighborhoods in addition to the USD 1 million, in order to simplify payment of any call on the guarantee.

**ESTIMATED POTENTIAL CAPACITY AT THE TIME THE GUARANTEE WAS IMPLEMENTED**

<table>
<thead>
<tr>
<th>USD 40M Debt</th>
<th>USD 40M</th>
<th>USD 4M Guarantee (10%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AECF’s portion:</td>
<td></td>
<td>USD 1.025M (&lt;2.5%)</td>
</tr>
</tbody>
</table>

Note: Capital stack is similar for Loan Pool I, but Annie E. Casey Foundation did not contribute to the guarantee for that pool.

**Results**

AECF’s guarantee had a relatively high leverage effect: Their USD 1.025 million helped leverage USD 40 million by completing the guarantee pool. Most of the guarantee was unfunded, which allowed the foundation to leverage its balance sheet without taking funds out of their endowment, where it could earn a higher return.

According to a case study published by the Federal Reserve Bank of San Francisco in the 2016 issue of *Community Development Investment Review*, the two loan pools together have originated 352 loans totaling USD 53.6 million, with defaults costing the program 2.5% of capital. The program has seen positive measures of progress in metrics such as home sales prices, rehabilitation permits issued, and days homes stay on the market.18

Tracy Kartye, Director of Social Investments at AECF, said, “Healthy Neighborhoods is deploying capital in target neighborhoods and is able to indicate that the loans are remaining stable and property values are increasing, particularly for the relocated residents. They moved into homes with a significant amount of equity, so the ability to grow that equity is meaningful.”

**Conclusion**

This case study exemplifies the use of a low level of coverage and a small amount of upfront capital to significantly expand financing in a troubled market. The program also demonstrates how a guarantee can support an innovative, collaborative structure that provides a variety of interconnected services, in this case grants, loans, and coordination of technical assistance. From the perspective of the guarantor, the way the guarantee was applied could be improved, as a pooled rather than loan-by-loan basis would better distribute the risk, with the fund as a whole required to document a loss before calling on the guarantee (rather than a call being triggered by any loan going unpaid). Still, the structure has good potential for replication, especially in cases where an intermediary with strong linkages to the community, such as Healthy Neighborhoods, can be identified to manage relationships and play a coordinating role with homeowners.

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CASE STUDY

THE COLLABORATIVE FOR HEALTHY COMMUNITIES

Background

Community health centers provide primary and preventative care to some 25 million people in low-income communities around the United States. Growth in the number of insured people in recent years, primarily due to the Affordable Care Act and its accompanying expansion of Medicaid, has increased the demand for healthcare services. Yet many healthcare centers lack access to the affordable capital necessary to expand their facilities and meet the growing demand in their communities.

In 2012, the Low Income Investment Fund (LIIF) and the Reinvestment Fund (TRF), two CDFIs headquartered respectively in San Francisco and Philadelphia, were interested in entering the federally qualified health center (FQHC) financing sector, as they foresaw imminent growth in demand for FQHC services. Though LIIF and TRF had partnered in the past, both were less familiar with the underwriting considerations associated with the health-center market.

The need for a guarantee

For several years, the Kresge Foundation has been interested in improving healthcare in low-income neighborhoods and in supporting collaboration between CDFIs. LIIF and TRF had worked with the Kresge Foundation in the past. Through ongoing dialogue, the three organizations identified FQHC financing as a common interest. The Kresge Foundation agreed to help fund research to identify those states with the greatest need for FQHC financing. This research identified states that were new geographies for LIIF and TRF, posing yet another risk. It would be challenging for LIIF and TRF to obtain board approval for loans in an unfamiliar sector and geography.


20 Federally Qualified Health Centers (FQHC) provide comprehensive primary-care services to medically underserved communities, offering sliding-scale fees and services to all patients regardless of their ability to pay. They are often eligible for reimbursement systems under Medicare and Medicaid.
To mitigate the risks associated with lending to FQHCs in new states, the Kresge Foundation agreed to provide an unfunded 20% guarantee for LIIF and TRF loans to the sector. Kimberly Latimer-Nelligan, the Chief Operating Officer of LIIF, commented that “the guarantee was critical to going into a brand-new sector and geography.” LIIF and TRF launched the Collaborative for Healthy Communities in 2012 to co-lend up to USD 25 million—backed by a guarantee up to USD 5 million—to finance the building expansion of FQHCs in eight states.

By 2014, USD 15 million had been deployed to three deals in Washington, New Jersey, and Pennsylvania, with none of the loans defaulting; the Collaborative had proved successful thus far. The CDFIs felt increasingly comfortable in the sector, having gained a better understanding of the risks involved. To scale the model, the lenders needed significantly more capital, as well as a structure that would provide them with the capacity to lend nationally. LIIF and TRF secured additional investment from Goldman Sachs, and the Rockefeller Foundation invested a relatively small amount in a first-loss position. They also invited the Primary Care Development Corporation (another CDFI) to begin co-lending. The structure of the Collaborative enabled the CDFIs to source, structure, and underwrite deals that fit agreed-upon criteria before obtaining the investors’ approval, who then funded deals directly as co-participants. This was a preferable alternative to the typical structures of CDFIs either lending directly from their own balance sheets or creating a special-purpose entity with its own accounting, reporting, and obligations.

These additional investments, along with capital from the CDFIs (including what remained of the initial funds), were rolled into a limited liability company called HealthCo, raising the total lending capacity to USD 55 million. The Kresge Foundation’s original guarantee was extended to cover this larger pool (except for Rockefeller’s first-loss capital), lowering the guarantee’s level of coverage from 20% to roughly 10%. Transferring the USD 5 million guarantee to HealthCo helped preserve the Kresge Foundation’s resources (compared to increasing the guarantee size) while demonstrating that the loans were

The New Markets Tax Credits (NMTC) Program provides tax credit incentives for investors to invest equity into Community Development Entities, certified organizations that have the primary mission of investing in low-income communities. The credit pays the investor 39% of the investment over seven years.

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### Key Details

<table>
<thead>
<tr>
<th><strong>BASIC INFORMATION</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OVERVIEW</strong> – The Kresge Foundation provided an unfunded guarantee to support co-lending among three CDFIs for health centers.</td>
</tr>
<tr>
<td><strong>YEAR</strong> – 2012: The Collaborative for Healthy Communities initiative was launched, 2014: HealthCo was structured to funnel additional investment into the initiative</td>
</tr>
<tr>
<td><strong>SIZE OF GUARANTEE</strong> – USD 5 million</td>
</tr>
<tr>
<td><strong>SIZE OF LOAN POOL</strong> – Up to USD 132 million total, including USD 55 million in debt and up to USD 77 million in capacity through New Market Tax Credits (NMTC) equity and other sources</td>
</tr>
<tr>
<td><strong>IMPACT THEMES</strong> – Access to quality and affordable healthcare</td>
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<tr>
<th><strong>KEY CONSIDERATIONS</strong></th>
</tr>
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<tbody>
<tr>
<td><strong>OBJECTIVES OF THE GUARANTEE</strong> – The guarantee was intended to expand financing for healthcare centers in high-need states. It did this by mitigating risk for CDFIs who were unfamiliar with the sector and therefore did not have established underwriting guidelines.</td>
</tr>
<tr>
<td><strong>TYPE OF RISK ADDRESSED</strong> – The guarantee mitigated the risks of lending in an unfamiliar sector and geographies.</td>
</tr>
<tr>
<td><strong>COVERAGE LEVEL</strong> – The initial guarantee provided 20% top loss, pooled. In 2014, the coverage level was reduced to 10%. The guarantee stipulated that Kresge would take the first loss, the CDFI lenders would take the next portion, and further losses up to 75% of each loan would be covered by the guarantee.</td>
</tr>
<tr>
<td><strong>FINANCIAL RETURN</strong> – The unfunded guarantee allowed the funds to stay invested elsewhere as part of Kresge’s endowment, and was recorded as a contingent liability on their balance sheet. A fee of 10 basis points of the total value of the guarantee was charged annually, which helped with accounting (see the text box on accounting practices for guarantors, on page 26).</td>
</tr>
<tr>
<td><strong>TRIGGERS AND ACCESS</strong> – In the event of nonpayment, LIIF and TRF were required to work with the borrower for 90 days to attempt to reach a resolution. After this point, the guarantee could be called.</td>
</tr>
</tbody>
</table>
credit-worthy. The willingness of the CDFIs and lenders to accept the lower coverage level indicates their increasing understanding of and comfort with FQHC financing.

### ESTIMATED POTENTIAL CAPACITY AT THE TIME THE GUARANTEE WAS IMPLEMENTED

<table>
<thead>
<tr>
<th>Debt</th>
<th>USD 52M Senior debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD 5M Guarantee</td>
<td>(9.6%)</td>
</tr>
<tr>
<td>USD 33M New Markets Tax Credit equity</td>
<td></td>
</tr>
<tr>
<td>USD 44M Other sources</td>
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Note: ‘Other sources’ could include state and local contributions, HRSA grants, and other philanthropic capital.

### Negotiations

Strong existing relationships and layers of risk-sharing facilitated relatively smooth negotiations for this deal. During the first phase from 2012 to 2014, the CDFIs developed a track record of originating loans to FQHCs, which made the deal less risky from the perspective of Goldman Sachs. The small amount of first-loss capital from the Rockefeller Foundation in the structure also helped Goldman Sachs make the decision to invest. As Dan Nissenbaum of Goldman Sachs said, “Our perspective was that the projects were small, bespoke deals, and we would be taking borrower risk, operating risk, and real estate risk, all in areas new to the CDFI originators, but we got comfortable knowing the strength of our partners, their track records, backed by the limited credit enhancement.”

### Results

The Kresge Foundation’s guarantee provided LIIF and TRF with the opportunity to assess the specific underwriting and credit-quality challenges of the FQHC sector. Noting the risks involved, Kimberly Latimer-Nelligan of LIIF commented that “the guarantee was critical in us deciding we could do it and obtaining board approval.” She further explained that it ultimately enabled them to get “comfortable enough with lending to the clinic space, so we felt that we could scale back the level of the guarantee (so we went from 20% to 10%) and raise more money to achieve greater leverage for the guarantee”. It also allowed LIIF to offer more favorable pricing and terms to the health centers, consistent with those of other CDFIs.

The Kresge Foundation’s USD 5 million guarantee was leveraged to bring up to USD 132 million into affordable healthcare investments in low-income communities. By the end of the origination period in mid-2016, the partners had deployed almost USD 40 million in debt and an additional USD 64 million in financing backed by NMTC and other sources. Equally important, the guarantee helped LIIF and TRF prove from 2012 to 2014 that the FQHC financing sector was credit-worthy. As a result, they felt more comfortable lending to the sector with a lower level of guarantee coverage, with private-sector players investing more capital into these impactful deals. HealthCo has to date financed over 460,000 square feet of FQHC expansion, with these health centers serving approximately 230,000 patients per year, most of whom are low income. The CDFIs now plan to deploy the remaining capital, outside of the formal HealthCo structure, with the support of the remaining Kresge guarantee.

### Conclusion

Since 2012, LIIF has adopted underwriting standards and products for lending to the FQHC market. Kimberly Latimer-Nelligan of LIIF explained, “we have come up to speed, we’ve developed staff knowledge, and we understand the sector better. So we will be better able to underwrite clinics without a guarantee in the future.” One of the eight issued loans has been repaid in full, none have defaulted, and all are expected to be repaid.

Many interviewees in this research identified opportunities to use guarantees to channel private-sector capital into impactful deals in the affordable healthcare sector (see the section, “Promising Sectors for Use of Guarantees,” on page 39). The success of HealthCo presents an example for impact investors interested in improving health outcomes in low-income and medically underserved communities.
Background

**Fannie Mae:** The Federal National Mortgage Association (“Fannie Mae”) is a government-sponsored enterprise that ensures a secondary market for home mortgages by purchasing home loans and packaging them into securities for sale to investors. Fannie Mae accounts for about 20% of the outstanding U.S. multifamily mortgage debt, playing a critical role in its liquidity, stability, and affordability. In an effort to use this leadership to make multifamily properties more environmentally friendly, sustainable, and affordable, Fannie Mae began developing its Multifamily Green Financing business in 2010. Since then, Fannie Mae has built expertise in estimating energy- and water-efficiency savings, developing product offerings that translate those savings into larger loans for borrowers and earnings for investors.

**New York City Energy Efficiency Corporation (NYCEEC):** Founded in 2011, the New York City Energy Efficiency Corporation (NYCEEC) is a nonprofit finance company that provides financing and technical assistance to help building owners and tenants improve energy efficiency and realize the associated savings. NYCEEC provides direct loans, as well as loan loss reserves and other forms of credit enhancement. Because energy efficiency financing is still new to many financial institutions, credit enhancement is an important tool for NYCEEC. In the years after its founding, the organization was especially keen to use its credit enhancement capacity for large-scale opportunities. As CEO Susan Leeds put it, “We looked for large institutions who we felt that by providing them a credit enhancement in the form of a cash-funded loan loss reserve, we could perhaps induce them to terms and conditions in their existing loan product that would make them more amenable to financing energy efficiency technology.”
The need for a guarantee

This case study focuses on an NYCEEC pilot program called Multifamily Property Improvements to Reduce Energy (M-PIRE). M-PIRE leveraged a guarantee from NYCEEC to build capacity at Fannie Mae that eventually led to the launch of a subsequent product called Green Rewards, which has been successful without any external credit enhancements. For context, the case study also describes a predecessor product, Green Preservation Plus.

Developing a new green business line entailed risk for Fannie Mae, its Delegated Underwriting and Servicing (DUS) lenders, and the investors that ultimately buy its mortgage-backed securities. Fannie Mae and the U.S. Department of Housing and Urban Development (HUD) jointly developed its first green product, Green Preservation Plus. Green Preservation Plus enables Fannie Mae’s multifamily lenders to offer larger loans than they could otherwise offer based on traditional assessments of capital needs and historical cash flows, allowing owners of affordable housing to use the additional loan proceeds to finance energy- and water-efficiency improvements. Since this was Fannie Mae’s first foray into lending against projected energy savings, HUD agreed to take the first loss of these larger loans.

Key Details

- **BASIC INFORMATION**
  - **OVERVIEW** – A programmatic guarantee supported mortgage loans for energy-efficiency improvements that did not meet Fannie Mae’s typical lending parameters. In particular, it enabled lenders to factor energy savings into calculations of the loan amount, which are traditionally based on estimated cash flows from the property.
  - **YEAR** – 2014
  - **SIZE OF GUARANTEE** – USD 5 million
  - **SIZE OF PROGRAM** – The program was able to lend up to USD 200 million, of which an estimated USD 10 million was related to energy-retrofit financing and therefore covered by the USD 5 million NYCEEC guarantee.
  - **IMPACT THEMES** – Increased energy efficiency through green retrofits

- **KEY CONSIDERATIONS**
  - **OBJECTIVES OF THE GUARANTEE** – The guarantee (and broader partnership with NYCEEC) aimed to enable Fannie Mae to gain expertise and comfort with underwriting projected cost savings from energy- and water-efficiency, allowing them to further develop their green financing products.
  - **TYPE OF RISK ADDRESSED** – The guarantee helped mitigate the risk associated with lending to an unfamiliar sector, along with risk related to the “unproven business model” of new green loan products.
  - **COVERAGE LEVEL** – The guarantee covered 50% of the incremental loan amount associated with energy and water efficiency investments.
  - **FINANCIAL RETURN** – The guarantee was funded in the form of a collateral custodial account held at U.S. Bank, which earned interest. NYCEEC charged a fee that would be paid when loans were originated under the program.
  - **TRIGGERS AND ACCESS** – Fannie Mae had the right and ability to unilaterally draw on the guarantee funds, as long as there were collateralized losses as specified in the Master Program Agreement between Fannie Mae and NYCEEC. The account was also subject to a Collateral Pledge Agreement among NYCEEC, U.S. Bank, and Fannie Mae, which further specified the conditions for access to the account.

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22 This case study draws from a forthcoming white paper by NYCEEC on the M-PIRE pilot.

23 Fannie Mae, Green Preservation Plus (Term Sheet), 2016. [https://www.fanniemae.com/content/fact_sheet/greenpreservationplus.pdf](https://www.fanniemae.com/content/fact_sheet/greenpreservationplus.pdf)
Though a successful product, Green Preservation Plus applied only to a limited portion of the housing market—owners of properties that are affordable due to a federal, state, or local subsidy or property-based rent restriction. To reach the broader commercial market and expand its green product offerings to additional types of housing, such as co-ops and market-rate multifamily buildings, Fannie Mae needed to further develop its capacity. Fannie Mae—and its DUS lenders and investors—needed to gain comfort with the technical assessment of projected cost savings from energy- and water-efficiency in different types of properties. New green loan products carried “unproven business model” risks associated with making correct assessments.

**ESTIMATED POTENTIAL CAPACITY AT THE TIME THE GUARANTEE WAS IMPLEMENTED**

<table>
<thead>
<tr>
<th></th>
<th>USD 200M</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD 190M</td>
<td>Mortgage debt</td>
</tr>
<tr>
<td>USD 10M</td>
<td>for energy-retrofit financing</td>
</tr>
<tr>
<td>USD 5M</td>
<td>Guarantee (50%)</td>
</tr>
</tbody>
</table>

NYCEEC provided a funded guarantee in the form of a collateral custodial account held at U.S. Bank. The guarantee would cover losses for the first four years of any loan equaling up to 50% of the amount the loan increased as a result of underwriting the energy-efficiency cost savings. Key sticking points in the negotiations included the calculation of fees to be paid to NYCEEC once the guarantee was deployed for a loan, the method of tracking energy performance over time, and the extent to which NYCEEC would be involved in the lending process. Extended negotiations resolved these issues over the course of more than a year, during which the organizations learned about each other’s core businesses and different perspectives. NYCEEC learned to understand the requirements and processes of Fannie Mae and its DUS lenders, while Fannie Mae benefited from NYCEEC’s technical expertise in energy-efficiency audit protocols.

**Results**

The M-PIRE product included three significant innovations. First, the loans could underwrite up to 50% of the projected cost savings resulting from energy retrofits, thus directly tying additional loan amounts to the financial benefits of energy and water efficiency. Second, the projected savings included not just those accruing to property owners but also those realized by tenants. This was important because tenants are responsible for their units’ utility bills in many properties; with the benefits of retrofits accruing to tenants, owners have lower incentives to invest in energy efficiency. New underwriting tools were a third critical element of the program. Typically, Fannie Mae–backed mortgages require that properties have a physical needs assessment to identify required financing. M-PIRE loans integrate an ASHRAE Level II audit into the physical needs assessment process to identify potential energy-conservation measures for implementation as part of the capital plan, which lays out the building’s financing needs.

The M-PIRE program originated only one loan for USD 865,000 to enable a property owner in the Bronx.

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24 ASHRAE is a membership and standard-setting organization focused on sustainable technology for the built environment. [http://www.ashrae.org/](http://www.ashrae.org/)

to switch from heavy heating oil to natural gas and to improve pipe insulation. Due to specific considerations in the New York City real estate market, demand for the M-PIRE loan product was low. In the New York City real estate market, the main competitive factor is interest rate, while the main benefit of the M-PIRE product for borrowers was higher loan amounts. Given its policies and market conditions, Fannie Mae had little room to adjust pricing. However, the partnership with NYCEEC provided a valuable opportunity for Fannie Mae to further develop its expertise in green financing, lessons applied to a subsequent, nationwide loan product called Green Rewards. The Green Rewards program, which includes many of the same innovations and benefits developed in M-PIRE, has enjoyed significant success without credit enhancement. In 2016, Fannie Mae closed USD 3.6 billion in green financing, including Green Rewards.

Conclusion

As a result of the M-PIRE collaboration, Fannie Mae was able to further develop a new product line that included adjustments to their typical credit parameters. The pilot also established best practices for incorporating energy- and water-efficiency audits into routine property assessments. In summary, the NYCEEC guarantee enabled a test program that allowed Fannie Mae to gain comfort with underwriting projected energy-efficiency cost savings—and ultimately to launch a successful, nationwide business line that reduces energy and water use throughout the United States. Chrissa Pagitsas noted that Fannie Mae is “realizing social benefit, environmental benefit, and, obviously, financial benefit through the green financing business.”

CASE STUDY

HOUSING PARTNERSHIP EQUITY TRUST

Note: This case study features an innovative structure that—although not a guarantee—uses a contract to address liquidity risks associated with an investment, catalyzing the flow of additional capital into impactful investments in affordable housing.

Background

The Housing Partnership Equity Trust (HPET) provides low- and moderate-income communities with access to sustainable and affordable rental housing throughout the United States. Founded in 2013, HPET is a social-purpose real estate investment trust (REIT) sponsored by the Housing Partnership Network (HPN), a Boston-based membership organization of nonprofits focused on housing and community development. HPET partners with 14 nonprofit housing developers, offering them low-cost, long-term capital to acquire multifamily residences across the country. The trust is capitalized with USD 85 million in equity from Charles Schwab, Citi, Morgan Stanley, Prudential Financial, the John D. and Catharine T. MacArthur Foundation, the Ford Foundation, HPN, and its nonprofit members.

HPET and its partners purchase existing multifamily rental properties to ensure that they remain affordable.27 The Trust targets buildings that are currently affordable for residents with incomes between 50 and 80 percent of area median income and that are at risk of being acquired and redeveloped into higher-priced apartments. HPET also targets properties developed under the Low Income Housing Tax Credit program that are nearing the end of

their 15-year period of restrictions on rent and income use. HPET's nonprofit partners implement practices and deliver on-site services to enhance building sustainability and resident well-being, such as health and wellness resources and educational opportunities. To reduce the carbon footprint of its buildings, HPET partners install Energy Star appliances, retrofit apartments with low-flow faucets, implement recycling programs, and utilize energy-tracking and reporting software.

The risk addressed

At its launch, HPET was capitalized with common equity and corporate debt. Citi played a key role in the establishment of HPET, providing a sizeable amount of debt as a line of credit. The MacArthur Foundation, Ford Foundation, Prudential, and HPN and its members contributed common equity. By 2015, HPN and HPET set out to raise preferred equity to scale their operations and enable the purchase of properties with fewer restrictions than debt required. HPN approached the original debt investors—Citi and Morgan Stanley—as well as Charles Schwab Bank, which was interested in participating in part because such an investment could help the bank meet

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**Key Details**

**BASIC INFORMATION**

**OVERVIEW** – The MacArthur Foundation provided a standby purchase agreement to ensure a liquidity source for senior investors.

**YEAR** – 2013: HPET, established 2015: MacArthur’s facility was developed to induce a round of private equity funding

**SIZE OF LIQUIDITY FACILITY** – USD 12.5 million

**SIZE OF REAL ESTATE INVESTMENT TRUST (REIT)** – USD 85 million in equity

**IMPACT THEMES** – Affordable housing, energy efficiency

**KEY CONSIDERATIONS**

**OBJECTIVES OF THE LIQUIDITY FACILITY** – To induce preferred equity investment into HPET to address its need for long-term capital

**TYPE OF RISK ADDRESSED** – Lack of liquidity for investors

**COVERAGE LEVEL** – A 25% liquidity facility on USD 50 million of preferred equity

**FINANCIAL RETURN** – The liquidity facility was an unfunded contract, recorded as a contingent liability on MacArthur’s balance sheet. The contract allowed MacArthur to keep the funds invested in its endowment. Investors did not pay a fee for the facility.

**TRIGGERS AND ACCESS** – The MacArthur liquidity facility stipulated that five years after investing, investors could redeem 12.5% of their original investment. If that capital was not liquid and available, MacArthur agreed to buy the shares, ensuring a secondary market for preferred equity investors. After year five and up until year 10, investors can redeem an additional 2.5% of their investment annually. In addition, 20% of each new dollar invested is set aside to buy stakes from HPET’s existing investors, if they choose.
its Community Reinvestment Act mandate to serve the credit needs of low- and moderate-income communities. According to Rebecca Regan of HPN, investors were also interested in HPET’s innovative and collaborative model. HPET sought long-term capital to support its mission to hold and operate real estate rather than selling properties for a profit. However, investors are often more comfortable with shorter time horizons. As Michael Solomon, a Vice President at Charles Schwab explained, “10 years is a long time to not get any portion of your money back…. How do I convince people at Schwab that we’re going to be in there for 10 years and not get any of our money back?” An additional risk was that HPET had a mere two-year track record, despite its good performance to date.

To attract preferred equity investments, HPET needed to address the liquidity issues arising from the uncertainty that there would be a secondary market to allow investors to exit. The MacArthur Foundation had been committed to the model from the beginning, especially given its “collaborative leadership and cooperative style of ownership. They liked the long-term nature of our goals and the investment not just in real estate but ultimately, in the members themselves as they received dividends as a diversified source of revenue,” said Rebecca Regan of HPN.

MacArthur agreed to enhance liquidity for senior investors through a standby purchase agreement to buy stock beginning in year five of the investment cycle, allowing the first group of preferred equity investors the option to partially redeem shares over time. The standby purchase contract stipulated that in year five, senior investors could sell 12.5% of their original investment to MacArthur, followed by an additional 2.5% annually thereafter. Additionally, 20% of each new dollar invested in HPET is set aside to provide a redemption option to these seed investors.

The deal was structured as a blended capital stack that included first-loss positions. Preferred equity investments are sheltered by a layer of common equity funded by the nonprofit members and program-related investments (PRIs) from the two foundations. This structure, with senior and subordinate risk tranches, provided Charles Schwab (and other investors) the opportunity to invest in a high-impact program while staying within their liquidity requirements and risk tolerances.

**ESTIMATED POTENTIAL CAPACITY AT THE TIME THE FACILITY WAS IMPLEMENTED**

<table>
<thead>
<tr>
<th>USD</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>85M</td>
<td>Preferred equity</td>
</tr>
<tr>
<td>50M</td>
<td>Liquidity facility (25%)</td>
</tr>
<tr>
<td>17M</td>
<td>Common equity (later converted to preferred)</td>
</tr>
<tr>
<td>18M</td>
<td>Common equity</td>
</tr>
</tbody>
</table>

**Negotiations**

Sticking points included triggers for payment and the term and amount of the liquidity facility. These were resolved through the “negotiating process by hard work, relationships, and the tenacity to make this vehicle get to the next stage,” said Rebecca Regan of HPN.

**Results**

MacArthur leveraged its balance sheet to ensure liquidity for the fund’s senior investors, enabling them to participate in high-impact, affordable, and sustainable housing investments. This USD 12.5 million facility unlocked an additional USD 50 million of capital without requiring MacArthur to immediately liquidate investments in their endowment. Ultimately, the instrument’s impact reaches far beyond the additionally unlocked investment capital, because it enabled HPET to continue building a track record and provided resources to purchase additional properties. As of September 2016, HPET owns 2,600 units in twelve properties across six states worth a total of USD 244 million.
“When you meet with an investor, if you have this tool, it takes the perceived risk off the table. Every transaction has both real and perceived risk. And if you can take this perceived risk off the table—the ‘what don’t I know?’—then often that’s going to be the thing that gets the deal done. And this absolutely did that.”

REBECCA REGAN, EXECUTIVE VICE PRESIDENT AND PRESIDENT OF CAPITAL MARKETS AT THE HOUSING PARTNERSHIP NETWORK

One especially effective aspect of HPET is that the large amount of ready capital allows nonprofit partners to close competitive deals quickly, within a period of two-to-three months. Tax credit deals, by contrast, which are often used to fund affordable housing projects, can take up to two years to finalize. HPET’s nonprofit partners are able to act swiftly, competing with for-profit, market-rate developers to successfully acquire buildings that might otherwise not remain affordable.

Another benefit of this liquidity facility is that it allows investors to redeem even if everything goes well, while in contrast, guarantees protect against potential losses and are only called in the event of an investee being unable to pay. HPET’s structure allows for both downside and liquidity protection through the first-loss capital stack and the standby purchase commitment, respectively.

Conclusion

The need for liquidity is a commonly cited concern among impact investors, yet impact investments often require patient, long-term capital to achieve their impact objectives. Respondents to the GIIN’s 2016 Annual Impact Investor Survey listed a “lack of suitable exit options” as the third-most-critical challenge to the growth of the impact investing industry. Many investors perceive long-term capital to be risky, preferring more liquid investments. As Michael Solomon commented, “the two things you have to make sure of are exit strategy and liquidity.”

The GIIN’s report Scaling U.S. Community Investing explains that, “in many cases, there is a resulting mismatch between what investors want and what the field can provide—such that some kind of subsidy from philanthropic or government sources would be needed to substantially increase investment activity (such as a credit or liquidity enhancement).” Innovative structures like that used by HPET help alleviate liquidity risk, which often poses a barrier to entry for risk-averse investors. Many other sectors face similar liquidity risk and could benefit from the use of a similar tool to help solve this challenge.

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Guarantors should plan for the possibility of an eventual call leading to a payout on any guarantee they provide—whether funded or unfunded. In doing so, guarantors need to strike a balance between mitigating their own risk of incurring losses and taking on enough risk to play a useful role in the impact investing ecosystem. The following examples illustrate some insights gleaned from guarantors who have experienced calls on their guarantees.

**SHARED INTEREST**

In Southern Africa, Shared Interest guarantees commercial loans to low-income communities and their local financial institutions to create businesses, jobs, affordable homes, and services. Shared Interest has worked with 75 local institutions since 1994, providing a total of USD 28 million worth of guarantees to back USD 121 million of commercial loans. Of this total, since inception it has had 4.5% of its guarantee funds called. Shared Interest’s policies guide the level of risk it knowingly takes and the sufficiency of loss reserves to cover projected risk. When there is a call, the local lending institution presents proof of the loss to Citibank, where the payment is made from Shared Interest’s deposit account within 72 hours. Shared Interest requests notification by the local bank before making a call.

Shared Interest has found that the process of making payments on guarantees helps them to build a relationship with the lending institution and better understand and strengthen their internal procedures and due diligence processes. Moreover, guarantee calls that fall within the organization’s risk parameters are a signal that Shared Interest is fulfilling its role—sharing risk to enable investors’ capital to reach local banks that generate positive impact through expanded lending to underserved clients. Founding Executive Director of Shared Interest Donna Katzin commented, “We have protected our investors’ capital. But if there had been no calls, we would not be doing our job.”

**THE ABELL FOUNDATION**

The Abell Foundation’s grant-making, investing, and publishing activities aim to enhance the quality of life in Maryland, with a focus on Baltimore. The foundation has been providing guarantees for more than 15 years to a variety of organizations whose work supports their mission. Their guarantees have resulted in access to bank financing for charter schools, theaters, affordable housing projects, a composting business, companies that enhance job opportunities for low-skilled workers, and other organizations that help revitalize Baltimore neighborhoods. In most cases, the recipients of the guarantees (usually banks) have the right to call upon default, though they typically attempt to mitigate their loss before calling the guarantee. The Abell Foundation also reserves the right to “step into the shoes” of the lender when the guarantee is called—to take over the loan themselves. This is useful when, for example, a charter school facility needs to find a new school as a tenant. Taking over the loan enables the foundation to play this role rather than the bank. In general, the Abell Foundation has found that its guarantees and direct investments are a useful complement to its grant-making; as Eileen O’Rourke, CFO, said, “there are many other tools in the toolbox that can make positive change, and we want to use them all.”
Challenges to Using Guarantees at Scale

Guarantees are typically structured in a rather bespoke way to accommodate specific impact expectations and structural requirements, and this has hindered scaled application of the tool. Interviewees emphasized two primary challenges to scale: (1) difficulty structuring guarantees and (2) challenges aligning the expectations and interests of various stakeholders. This section describes these challenges in greater detail, and the “Recommendations” section presents approaches to mitigate them (page 34). Three other challenges worth noting are also discussed briefly below.

Difficulty of Structuring Guarantees
Interviewees (especially guarantors and recipients) most often cited challenges related to the complexity of structuring guarantees, which leads to a time- and resource-intensive deal process. As with many other types of impact investment opportunities, guarantee-backed deals are often customized to achieve specific impact objectives and may involve business models that don’t fit into conventional buckets for many investors. The variation seen in the “Landscape” section of this report (page 7)—in terms of type of risk, impact objectives, coverage levels, and other structural features—demonstrates a lack of standardization in the use of the instrument. While it is important to maintain the flexibility to structure transactions in ways that achieve intended impact and draw in new sources of capital, the lack of standardization can also lead to high legal fees and other transaction costs, not to mention more time spent negotiating by the parties directly involved.

Aligning Expectations
All types of interviewees frequently cited another challenge, related to the above, in aligning the expectations and interests of the multiple parties involved, including the long-term goals of each party vis-à-vis the sector of investment, the expected impact of the deal and how it will be measured, risk-sharing, and timelines for closing a deal. Parsing expectations about roles and costs can also be difficult, such as determining which party will cover legal costs and which will manage underwriting. Guarantees necessarily add complexity by including at least one third party—and in many instances can include several guarantors and lenders with different preferences and objectives.

Additional Challenges
In addition to these two main challenges, three others are worth noting.

- **Lack of awareness about guarantees**: Internal and external stakeholders may lack experience with guarantees, requiring education about why and how they would be useful. Such stakeholders include board members, credit committees, and new potential guarantors, recipients, and intermediaries.

- **Perception issues**: Interviewees noted several types of perception issues that can hinder the use of guarantees. First, foundations might be reluctant to be seen only as a last-resort option to “bail out” deals gone bad, which could be addressed in part by holding a diverse impact investing portfolio of investments and loans in addition to downside protection. Second, some observers critique guarantees as a form of subsidy for private investors. Third, some are concerned that guarantees might distort the market by creating the perception that a certain sector or deal type is not investable on its own, without some sort of credit enhancement.

- **Few providers of guarantees**: Some interviewees noted that only a limited number of organizations are willing and able to provide third-party guarantees at the scale and with the structure and coverage levels needed. This is partially because a limited number of foundations have endowments large enough to back unfunded guarantees. Another factor is that calls on guarantees can be unpredictable, which may make the instrument unattractive to some foundations. Not all foundations make impact investments, further narrowing the eligible pool. Moreover, of those that do use their endowments for impact investing, only a portion are experienced with assessing, structuring, and accounting for guarantees.
Recommendations

This section presents recommendations intended to help scale the use of guarantees in terms of the number and size of guaranteed transactions. It should be noted that, depending on the goals of an investor, scale is not always appropriate or desirable—such as for guarantors seeking impact through specific organizations or in very narrow geographic areas (e.g., specific neighborhoods). Given the variety of impact objectives and stakeholder parameters in play, some customization is inevitable. However, this research has shed light on ways to make guarantee structuring more efficient and sectors that are ripe for increased use of this powerful tool. Based on those findings, recommendations follow in three areas: (1) key considerations for streamlining the structuring of guarantees; (2) guidance for standardizing guarantees to achieve scale; and (3) promising sectors for the increased use of guarantees.

Key Considerations for Structuring Guarantees

As noted above in the “Challenges” section (page 33), guarantees can vary in structure and complexity depending on the needs and preferences of those involved. To keep structuring efficient, it is advisable to focus narrowly on a few key considerations for achieving the objectives of the deal. The most critical factors are presented below, along with how these considerations apply differently to various stakeholders.

FIVE KEY CONSIDERATIONS:

1. Objectives of the guarantee
2. Type of risk addressed
3. Coverage level
4. Financial return
5. Triggers and access

1. OBJECTIVES OF THE GUARANTEE

As described in the “Landscape” section of the report under “Motivations and Types of Risk” (page 9), guarantors have various motivations and objectives for providing guarantees, including proving a new business model, addressing misperceptions of risk, lowering the cost of capital, and enabling liquidity for investors or investees, among others. While these objectives all relate to risk in some form, the nuances of a guarantor’s goals affect structuring, since a guarantee’s structure sets the incentives and terms for the investors (or lenders) and investees (or borrowers).

For example, if a provider is offering a guarantee to enable an investor to gain familiarity and comfort with a particular deal type, the coverage level, triggers, and access need to be attractive enough to make the deal fall within the investor’s risk-return parameters, but should not go beyond that threshold. Too much protection might lead the investor to evaluate the risk less rigorously, thereby denying a realistic experience of underwriting the deal. Also, without sufficient skin in the game, the lender might make less credit-worthy loans. On the other hand, if the provider’s objective is to lower the cost of capital so that particular impact can be achieved, the guarantee needs to lower the risk to the recipient enough that they can offer the desired capital pricing (which is a function of the risk rating).

This research has shed light on ways to make guarantee structuring more efficient and sectors that are ripe for increased use of this powerful tool.

Recipients’ objectives can also affect structuring. Again, motivations for recipients generally relate to reducing risk of some type, but more specific objectives might include ensuring options for liquidity, entering a new market, earning a government tax credit, or participating in deals that meet client demand for positive impact or enhance their reputation in other ways. Where recipients’ objectives are longer-term (e.g., testing a new market), they may be interested in a coverage level that declines over time with good performance—though internal credit policies or external regulations may restrict such flexibility for some recipients. This scenario is useful for achieving scale, since it means future guarantees will be unnecessary if the deal is successful.
2. TYPE OF RISK ADDRESSED

The “Landscape” section of this report (page 7) describes several common types of risk involved in community development investment that guarantees can help address (see Figure 11). Perceptions of risk can vary, and all stakeholders involved in a transaction should be clear about the types of risk they judge to be present in a deal. In addition to inherent risk factors, investors’ or guarantors’ level of experience with similar deals can also influence their perceptions of risk. In some transactions studied for this report, the guarantors had previously made grants to the prospective investee or borrower. This prior collaboration can give a guarantor a more nuanced understanding of the risks involved than the investor’s (or lender’s) understanding based on their typical underwriting criteria. Although the lender (or investor) may be unable to change their risk rating, it is useful for each party to be clear about how they arrived at their assessment of the type and severity of risks involved. Such clarity and mutual understanding can help streamline an often-lengthy negotiating process.

3. COVERAGE LEVEL

The degree to which losses will be covered is a key point of negotiation in a guarantee-backed deal. As discussed in the “Landscape” section under “Economics” (page 11), this is often expressed as a percentage guaranteed of the relevant loan, investment, or fund, but coverage can also take other forms, such as a number of months of payments or operating expenses or an agreement to purchase assets at a set price.

Guarantors need to decide what level of protection they are willing to provide, which will mainly depend on two key factors: (1) their own appetite for the risk that will be transferred to their balance sheet and (2) what incentives they want to create for the recipients of the guarantee. In terms of incentives, the coverage level is fundamental to the value of the guarantee in the eyes of the recipient—and must therefore be high enough to reduce the recipient’s risk to an acceptable level for their expected return. On the other hand, when a guarantor aims to increase investor comfort with the sector or deal type over the long term, the investor must have enough skin in the game to gain the desired understanding of the risks with and experience in evaluating the deal.

Although recipients generally tend to prefer higher levels of coverage, there are nuances in the levels of coverage required to surpass specific risk hurdles. For example, recipients assess levels of risk compared to deals with similar returns and may need just enough coverage to reduce risk to the same level as the comparable deal. Also, in some cases, a recipient might be looking to enter a new market in which they believe actual
risk could be relatively low but for which they have not yet developed underwriting guidelines. In such cases, recipients may accept lower levels of coverage, especially if risk is mitigated in other ways, such as through triggers, expected cash flows, or characteristics of the borrower (or investee) itself.

As described in the “Landscape” section (page 7), most guarantees either have low coverage levels (less than 25%) and are funded or have high coverage levels (above 75%) and are unfunded. These two types are compared in Table 1 in terms of their ability to scale.

### 4. FINANCIAL RETURN

Guarantee providers have varying objectives for financial return depending on the strategy they pursue, even within their own portfolios. Unfunded guarantee contracts can be attractive in terms of both financial and impact returns; as the guarantee catalyzes additional capital into impactful deals, capital can remain invested in another vehicle, from which the returns can be used to fund further programmatic work.

In other cases, a funded guarantee is preferred, perhaps because the guarantor is more focused on capital preservation than high returns and/or the lenders require the assurance of a funded guarantee. A funded guarantee can also offset the recipient’s reserve requirements, which is often a key consideration particularly for regulated financial institutions.

The cash for a funded guarantee can be kept in a deposit account with the recipient, an intermediary, or the investee or borrower itself. In the current low-interest-rate environment, cash deposits are likely to earn a very small percentage return. Some guarantors also charge a fee on the guarantee to supplement this return. See the box on the following page for some common accounting practices for providers of guarantees.

Recipients’ objectives for financial return also vary. From their perspective, the value of the guarantee affects the return they are willing to accept. A more attractive guarantee (higher coverage level, easier access to the capital if needed, or a highly creditworthy guarantor) can reduce the risk profile of the investment, which often affects the acceptable level of return to a certain extent.

### 5. TRIGGERS AND ACCESS

Triggers are the conditions that must be met for the guarantee to be paid out, possibly including nonpayment of loan interest and/or principal for a certain period of time, a documented loss, lack of available capital at the time of required redemption, or failure of a fund to pay out an investor when it winds down. Triggers can also include cure provisions—steps the investor or lender must take to try to be repaid before calling the guarantee. Access to a guarantee also depends on whether the

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**TABLE 1: COMPARING COVERAGE LEVELS AND FUNDING**

<table>
<thead>
<tr>
<th>Low coverage, funded</th>
<th>High coverage, unfunded</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ADVANTAGES FOR SCALE</strong></td>
<td><strong>DISADVANTAGES FOR SCALE</strong></td>
</tr>
<tr>
<td>• Minimal risk to guarantors could enable them to provide more guarantees</td>
<td>• Guarantor needs to front the capital, meaning it cannot be used elsewhere</td>
</tr>
<tr>
<td>• Visible capital and clear access are attractive to recipients</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Guarantors are constrained in terms of total outstanding liability, potentially limiting their support to a few deals</td>
</tr>
<tr>
<td></td>
<td>• High coverage is attractive to most recipients and therefore may bring in significant additional capital</td>
</tr>
<tr>
<td></td>
<td>• Coverage level can decline over time and may eventually be unneeded</td>
</tr>
<tr>
<td></td>
<td>• No up-front liquidity required from guarantor</td>
</tr>
</tbody>
</table>

Source: GIIN
guarantee is funded or unfunded and, if funded, on where the
reserve is held. Triggers and access determine how difficult or
costly it will be to access the guarantee if it is needed, which are
important considerations for both recipients and guarantors.
For guarantors, triggers determine the timing of potential
payouts from guarantees. To manage cash flows and
disbursements—especially for unfunded guarantees—
guarantors may want to consider what the maximum payout in
a particular time period might be, as well as when a guarantee
payout would count toward grant distributions (which has
implications both for taxes and, potentially, for the yearly
program budget). One interviewee related an example of how
they manage this dynamic. Using basic risk modeling, they
estimate when in time the real risk might hit, using this estimate
to manage the potential payouts in any given year. In addition,
even where a guarantee applies to a whole fund or portfolio,
coverage can be limited on a per-project or per-loan basis to
limit the risk that the entire guarantee will be called at once.
Guarantors should also consider how the process for accessing
the guarantee affects the recipients’ incentives. As with
coverage level, often a delicate balance must be struck between
making the guarantee attractive and ensuring that the investor
or lender has incentives to make reasonable attempts to recover
losses before utilizing the guarantee.

Clarity and focus on the key considerations
described above may help stakeholders move more
quickly toward agreement on the structure
of guarantees, thus facilitating their use at scale.

Accounting Practices for Guarantors

1. **Do your due diligence.** Guarantors must thoroughly assess the risk of the underlying loan or equity investment, including understanding the financial health of the borrower or investee.

2. **Record unfunded guarantees as a contingent liability** until the point at which it seems likely to require a payout, when it needs to be included in the liabilities section of the balance sheet.

3. **Consider different valuation methods.** If a fee is paid, a guarantee’s liability value can be based on that fee. Some guarantors charge a nominal fee to facilitate valuation. If no fee is paid, the liability can be estimated based on the value of the savings to the borrower (calculated as the difference between the borrower’s interest rate and the rate the borrower would have received without the guarantee).

4. **Make sure the loan or investment fits charitability guidelines** to count any future payouts as a grant or program-related investment.

5. **In general, disclose relevant information** related to outstanding guarantees and timings of potential payouts in financial statements.
Standardization

As the “Landscape” section of this report showed (page 7), structural features of guarantees range widely. Guarantees’ high degree of customization limits their use by making them costly to negotiate and execute. Three ways to approach the standardization of guarantees emerged from this research.

1. MOVE FROM THE LOAN OR PROJECT LEVEL TO THE FUND OR PROGRAMMATIC LEVEL

Slightly more than 40% of the guarantees in our database apply to a single loan, and a further 8% apply to a particular project. Slightly fewer than 40% apply to a fund or portfolio that makes various loans or investments. Programmatic guarantees represent the best potential for scaled use of the instrument, but comprise only about 13% of the sample. Fund- and program-level guarantees enable standard terms to be applied across larger sets of investments or loans. They also help to avoid the question of which to secure first—the financing or the guarantee for it; this is especially relevant for investees.

Fund- and program-level guarantees enable standard terms to be applied across larger sets of investments or loans.

The government programs described on pages 14-15 offer some insight into how programmatic guarantees might be structured, as does the case study of the Fannie Mae M-PIRE pilot. In their experience with government guarantee programs, interviewees valued the predictability afforded by abundantly clear eligibility criteria, despite the paperwork required. This predictability helps lenders originate loans at greater scale.

Private guarantors can also model their guarantees after these government programs. For example, in Charlotte, North Carolina, roughly 15 banks and other funders collaborated to create a local program that mimics the structure and terms of the SBA 7(a) loan-guarantee program. The program improves access to finance for local small businesses that are considered good deals but that do not meet all of the SBA’s requirements because, for example, their uses of loan proceeds fall outside SBA-eligible uses.

The M-PIRE Pilot case study shows how a programmatic guarantee can be catalytic. The piloted model led to a subsequent product offering that is being utilized at scale to make energy-efficiency improvements to multifamily properties around the country. The M-PIRE case is somewhat unique in that the recipient was a very large-scale organization (Fannie Mae) acting on behalf of its 25 originating lenders and many investors who purchase its mortgage-backed securities. However, intermediaries might play a similar role where no such organization exists. In situations where developing a program is not possible, a guarantee wrapped around a fund or loan pool could also achieve greater scale than loan- or project-level guarantees. The other case studies in this report represent fund-level approaches.

One challenge associated with fund- and program-level guarantees is to determine the right criteria at the right level of specificity. Specificity helps ensure that the capital will be used to achieve the guarantor’s intended impact. However, an overly narrow set of criteria can make the pipeline of potential deals too small, leading the fund or program to fail to achieve its goals. Some funds and programs strike this balance by setting limitations based on target geographies, sectors, or investee types while leaving other conditions open.

To summarize, guarantors should consider creating standard guarantee criteria and terms that are attractive to a range of recipients across multiple deals, perhaps within, for example, a specific sector or geography. This programmatic approach can offer greater leverage (amount of capital mobilized per dollar of guarantee), help spread transaction costs across a larger number of deals, and therefore achieve greater impact. Guarantors can limit their total potential liability by setting a cap on the total guaranteed amount. Guarantee criteria, as noted above, must balance specificity to meet the guarantor’s impact goals with breadth to enable a large enough deal pipeline for scaled application of guarantees.

2. STANDARDIZE DOCUMENTS

A lack of standardized deal terms has been noted as a limitation across the impact investing industry. To some extent, each guarantee should be structured in such a way as to align incentives for the specific institutions involved and to maximize desired impact. However, many interviewees agreed that some standard templates or documents might be developed...
as a starting point to increase the efficiency of structuring guarantees. At present, it might be most feasible for this to take the form of a standard “menu” of options from which guarantors might choose rather than boilerplate terms to which multiple guarantors agree for any project.

Toward this end, the Working Group associated with this project (described in the “Methodology” section on page 4) has developed resources for structuring guarantees, including (1) an outline of the information required by the various parties to a guarantee-backed deal when considering participation and (2) a matrix of key considerations to ensure stakeholders are aware of each other’s expectations for the investment and aligned where necessary to underwrite successful outcomes.

Both resources can be found in the “Supplement” at the end of this report.

3. POOL GUARANTEE CAPACITY

The number of institutions that can act as guarantors limits the possible use of guarantees at scale, as described in the “Challenges” section. Large, nationally active foundations are well-positioned to provide substantial unfunded guarantees based on their sizeable balance sheets. For smaller foundations, relationships in their communities can enable them to provide unfunded guarantees on a local scale. Either way, a foundation can only have limited liability outstanding relative to its total balance sheet.

There may be opportunities for aggregators to establish pools of guarantee capacity for that could be used to fully or partially fund guarantees—perhaps for a price. This pool could be raised from various sources of capital (high-net-worth individuals, family offices, larger foundations) and could be accessed by smaller foundations or directly by borrowers or investees for projects that meet certain basic criteria.

There may be opportunities for aggregators to establish pools of guarantee capacity.

For example, Virginia Community Capital has worked with groups of individual community members who came together in different ways to guarantee loans for small businesses and community development projects. The group of programmatic guarantors in Charlotte, North Carolina, described above also highlights opportunities for various funders to join forces and pool their guarantee capacity. Both examples have two features that likely facilitated collaboration: (1) the deals or programs were limited to a particular community or city and (2) the guarantors knew each other well and were aligned in terms of their objectives and assessment of the value of the deals to be financed.

Promising Sectors for the Use of Guarantees

As noted in the “Landscape” section above (page 7), the use of guarantees in USCI has been concentrated primarily in affordable housing projects, with a handful of deals targeting other objectives and sectors such as health, education, and energy (both renewables and efficiency improvements related to real estate). The research team asked interviewees to identify sectors in which the use of guarantees could help drive significant amounts of capital to impactful investment opportunities. Interviewees primarily cited possibilities in energy efficiency, renewable energy, and healthcare, as well as projects in the food industry and improving access to finance for small businesses. While these areas could benefit from guarantees, few examples in our database have targeted these sectors thus far. With likely room for greater use of guarantees in these areas, each opportunity is described in greater detail below.

Energy efficiency: Various types of capital improvements can make new and existing buildings more energy efficient, for example by improving heating and ventilation systems or by better insulating buildings. Although such improvements can generate significant savings on energy bills over time, they often require significant up-front capital investment. Only five of the 58 guarantees analyzed for this study targeted energy efficiency or renewable energy.

While large and new commercial or residential buildings are often able to access financing for these improvements from traditional sources, properties located in underserved areas—such as low-income residential buildings or community facilities—often cannot. Financing may also be difficult for smaller or existing buildings due to a lack of collateral. In many cases, the collateral for such loans is the energy equipment itself, which reduces in value over time. For smaller buildings, the savings also take longer to accrue, requiring financing
over longer terms, which increases perceived repayment risk for lenders. For these reasons, interviewees of various types saw an opportunity to use guarantee capacity to help make financing for energy-efficiency upgrades available in single- and multi-family housing, as well as in community facilities. See the M-PIRE case study in this report (page 24) for an example of using a guarantee to develop a product that enables underwriting for cost savings from improvements to energy and water efficiency.

**Renewable energy:** As with energy efficiency, the financial benefits of access to renewable energy require significant upfront investment and accrue over time, limiting their access by many communities in need. Some interviewees mentioned the potential of community-based solar projects, while others noted the possibilities of battery backup, co-generation, and microgrids. These projects involve new business models that could benefit from credit enhancement while in the testing and proving stages. Community solar projects often require financing on longer terms than bank restrictions allow (e.g., 10-year terms). Guarantees could be used in such cases to cover refinancing risk.

**Healthcare:** Results related to improved physical health were targeted by only six of the 58 guarantees in the database. However, many interviewees mentioned opportunities to expand investment in access to affordable, high-quality healthcare, particularly in underserved areas. The Affordable Care Act increased funding for Federally Qualified Healthcare Centers (FQHCs) from 2010 to 2015 and increased demand for healthcare services by expanding the insured population beginning in 2014. This combined growth has created opportunities for new investors to finance the construction and expansion of FQHCs in communities throughout the United States. Regardless of the evolving policy and regulatory landscape that makes the future of these specific changes uncertain, a need has been identified to support business models that can improve health for low-income and marginalized populations in the United States, both through the delivery of healthcare and by addressing the social determinants of health, as well as through the development of new healthcare technologies.

**Food industry:** Five of the guarantees in the database aimed to improve access to healthy food, particularly in low-income communities. An important contributor to community development, the food industry is connected to both access to healthy food and the economic vitality of neighborhoods. Grocery stores require significant up-front capital investment and operate with low margins, and for areas that are distressed or have unclear development prospects, the risks of a grocery project tend to be too high for mainstream financiers. Interviewees identified needs for increased access to fresh and healthy food in both rural and urban areas.

**Small businesses:** Six of the 58 guarantees in the database aimed to increase access to finance for small businesses, which are an important engine of community-based economic growth and job creation. However, small businesses often face challenges in accessing financing to operate and grow due to a lack of acceptable collateral, lack of credit history, and risks involved in establishing new businesses. These barriers are especially acute for historically marginalized populations, such as minorities and women, and in economically distressed communities, where market risk is higher. The Small Business Administration 7(a) loan-guarantee program (described on page 14) provides a significant boost in access to capital for small businesses. Several interviewees noted that there is opportunity to reach beyond this to those businesses that are ineligible for the 7(a) program, or simply to reach more small businesses that currently only have access to predatory lenders.
Conclusion

Analysis presented in this report illustrates the wide range of ways guarantees might be used in USCI to address various impact objectives and risk types, as well as surveying the diversity in structural features, such as coverage levels and funding mechanisms. The case studies demonstrate creative uses of guarantees to leverage additional capital into impactful projects across the United States. Greater use of this tool in new sectors and at greater scale has significant potential to encourage more risk-averse investors to engage in impact investing. Three lessons emerged for more efficient, strategic, and scaled use of guarantees.

1. **Ensure that expectations and requirements of the various parties involved in a guarantee-backed transaction are clear.** Expectations and requirements can include impact objectives, long-term interest in investing in the sector or deal type, and perceptions of the type and severity of risk. Misalignment on these fundamental factors can lead at best to inefficient and at worst to failed negotiations. The “Key Considerations” matrix attached to this report offers a guide to ensure that these important considerations are discussed in initial conversations.

2. **Focus on key considerations, and keep it simple.** A very large number of features and terms can be negotiated into guarantee agreements. While including many “bells and whistles” may be tempting—indeed, there may even be good reason for some—keeping the terms of agreement simple will help avoid protracted negotiations and high legal bills. Many interviewees with experience providing and receiving guarantees noted that, in retrospect, they may have been better served by keeping things simple rather than adding complicated protective clauses, especially since thorough due diligence was completed before making any guarantees. The set of five key considerations provided in this report are a good starting point, alongside complementary additions when necessary to accomplish the goals of the guarantee. Aligning goals up front (as described above) and keeping those goals front and center may help stakeholders stay focused only on the most important features.

3. **Develop fund- and programmatic-level guarantees.** As noted in the “Standardization” section (page 38), negotiating guarantees that apply to a relatively broad set of opportunities can drive efficiencies and create a larger leverage effect. Where possible, guarantors should look for ways to utilize their guarantee capacity at the levels of funds, portfolios, or, better yet, broad-based programs. Of course, such programs require some degree of specificity to ensure guarantees back deals that create the impact sought by the guarantor. Such specificity can be achieved by limiting application to a particular sector, city, or deal type, rather than to a set of specific pre-identified borrowers or investees.

Guarantees and other forms of credit enhancement play a critical role in the impact investing industry. They help to test new business models, increase investor familiarity with community investing, and make capital available on appropriate terms for different types of impactful deals. Such structures also reflect the power of collaboration in a field that encompasses an array of investors with diverse capacities and priorities. Using guarantees, these players can complement one another to achieve greater impact than would be possible alone, thereby addressing the social and environmental challenges of underserved communities in the United States and beyond.
Appendix 1: List of Interviewees

Daniel Soliman  
AARP Foundation

Eileen O’Rourke  
Abell Foundation

Tracy Kartye  
Annie E. Casey Foundation

Cynthia Muller  
Arabella Advisors

Dean Hand  
Ashburton Investments

Charles Goodwin  
BNY Mellon

Michelle Holleran  
The California Endowment

Catherine Godschalk, Lauri Michel  
Calvert Foundation

Michael Swack  
The Carsey School of Public Policy, University of New Hampshire

Michael Solomon  
Charles Schwab

Sean Birney  
Chase Community Development Banking

Jeffrey Meyers  
Citigroup

Michael Hokenson  
Community Investment Management, LLC

Toby Rittner  
Council of Development Finance Agencies

Julia Shin  
Enterprise Community Partners

Chrissa Pagitsas  
Federal National Mortgage Association

Tyler Van Gundy, Brian Segal  
Forsyth Street Advisors

Dan Nissenbaum  
Goldman Sachs Urban Investment Group

Annette Aquin  
Hamilton Community Foundation

Rebecca Regan, Katie Rodriguez  
Housing Partnership Network

Jeff Brenner  
Impact Community Capital

Carmen Heredia-Lopez  
Kellogg Foundation

Kimberlee Cornett, Kim Dempsey  
Kresge Foundation

Brian Nagendra  
Living Cities

Kim Latimer-Nelligan  
Low Income Investment Fund

Allison Clark, Urmia Sengupta  
John D. and Catharine T. MacArthur Foundation

Matthew Slovik, William McGaughey, Bob Taylor  
Morgan Stanley

Craig Holland, Melissa Weigel  
NatureVest

Susan Leeds  
New York City Energy Efficiency Corporation

Alfred Griffin, Sarah Davidson  
New York State Green Bank

Donna Fabiani, Robin Odland  
Opportunity Finance Network

Brinda Ganguly  
The Rockefeller Foundation

Matthew Hemelt  
RSM US LLP

Bob Schall, Karen O’Mansky  
Self-Help Venture Fund

Donna Katzin  
Shared Interest

Bill Young  
Social Capital Partners

Susan Newton-Rhodes  
Summit Consulting, LLC

Teri Lovelace, Wayned Waldrop, Caroline Nowery  
Virginia Community Capital
Several existing research reports on the broad topics of risk and credit enhancement in impact investing were reviewed as background for this study. The research team also consulted many individual organizations’ annual reports and case studies, as well as articles on narrower themes within this topic. A full list of resources consulted can be found in Appendix 3.

In 2013, the Global Impact Investing Network published a study on another form of credit enhancement, Catalytic First-Loss Capital.31 Focused on purpose-driven capital that is incorporated into a capital structure to absorb first losses up to a specified threshold, the brief found that catalytic first-loss capital is most useful in two types of investment opportunities: (1) “leverage-for-impact,” areas with strong promise for social or environmental impact but where competitive risk-adjusted rates of financial return are not feasible and (2) “market development,” where some investors have greater knowledge of a market than others, leading to very different risk assessments (i.e., investors with less experience in the sector perceive it to be riskier than those who know it well).

In 2014, Bridges Impact+ (the advisory arm of Bridges Ventures, an impact investment fund manager) published Shifting the Lens: A De-Risking Toolkit for Impact Investment.32 Through 70 interviews, the authors identified five main risk factors associated with impact investments, exploring methods for mitigating these risks and describing examples of financial products that involve de-risking features. The five risk factors are: (1) capital risk; (2) exit risk; (3) unquantifiable risk; (4) transaction cost risk; and (5) impact risk. The de-risking features are downside protection (such as credit enhancements), bundled products, increased liquidity, development of a track record, placement and distribution, technical assistance, and impact evidence. The study concluded that increasing participation by asset owners in impact investing will require greater numbers of lower-risk opportunities, as well as better communication between asset owners and product developers to understand each other’s practical needs.

The World Economic Forum published the Blended Finance Toolkit in 2015 to support the use of blended finance approaches in emerging and frontier markets.33 The report defines “blended finance” as “the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets, resulting in positive results for both investors and communities.”34 The series of reports in the toolkit offers a broad view of the ecosystem of players, including development finance institutions, philanthropic funders, and the private sector. The toolkit includes primers, how-to guides, and results from an “Insight Survey” showcasing the use of blended finance by 74 funds and facilities. The results of that survey indicate that blended finance had catalyzed significant capital to help reach or exceed impact targets without sacrificing financial return.

DANIDA, the Danish development agency, released a 2016 report on how development finance institutions can mobilize private sector capital in support of the Sustainable Development Goals, especially in emerging markets.35 The report considers guarantees, as well as structured funds (i.e., funds with multiple layers of capital), results-based financing, and early-stage financing. These approaches are all currently used to mitigate risks and achieve impact at scale. The report placed special emphasis on how layered funds can aggregate capital from investors with different risk-return requirements.

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Appendix 3: References


NYCEEC. Green Mortgage Programs (Case Study). October 2016.


Appendix 4: Guarantees Working Group Participants

Annie E. Casey Foundation
Arabella Advisors
BNY Mellon
California Endowment, The
Calvert Foundation
Citi
Community Investment Management LLC
Deutsche Bank
Enterprise Community Partners
Ford Foundation
Gary Community Investments
Impact Community Capital
J.P. Morgan Chase & Co.
John D. and Catherine T. MacArthur Foundation
Kresge Foundation
Nature Conservancy
Nonprofit Finance Fund
Orrick, Herrington & Sutcliffe LLP
Overseas Private Investment Corporation (OPIC)
Shared Interest
Tideline
Virginia Community Capital
W.K. Kellogg Foundation
Supplement to *Scaling the Use of Guarantees in U.S. Community Investing*

**RESOURCES FOR STRUCTURING GUARANTEES**

**ABOUT THIS SUPPLEMENT**

Running from August 2016 through May 2017, the Guarantees Working Group comprised 23 GIIN members engaged in a series of activities intended to scale the use of guarantees in the impact the U.S. community investing market. Through quarterly convenings, the group identified key barriers preventing the scaled use of guarantees, including the lack of standardization in structuring guarantee-backed deals and frequent misalignment or misunderstanding of motivations among stakeholders. To address these barriers, the Working Group developed two resources intended to streamline the structuring and negotiation process undertaken by investors and investees entering into guaranteed-back investments.

The List of Main Components for of Guarantee-backed Investments provides categories of information required by investors (i.e. providers and recipients of guarantees) and investees when considering participation in and design of guarantee-backed investments. Any of the three parties can initiate data collection and analysis to determine the need for and structure of a guarantee-backed investment; however, it is recommended that all parties be involved throughout the process. (Note: the list below assumes only one guarantee per investment structure; however, multiple guarantees are frequently structured around one transaction to address different risks.)

The Key Considerations for Stakeholders Matrix provides a list of key considerations and questions aims to ensure stakeholders are aware of each other’s expectations for the investment and align interests where necessary to underwrite successful outcomes. Ideally, stakeholders would use this resource at the onset of investment discussions and negotiations.
List of Main Components of Guarantee-backed Investments

COMMUNITY DEVELOPMENT
NEED AND SOLUTION
- Need being addressed
- Description of project or program addressing need, including whether approach is new or proven
- Impact objectives achieved through intervention and how to measure results
- Timeline of impact
- Revenue streams and cash flows of project or program
- Policy context (if applicable)
- Other risks

INVESTMENT MODEL
- Financial model and key assumptions
  - Guarantee (see details in next section)
- Timeline of investment
- Market conditions and dynamics
- Risk factors
- Exit strategy

GUARANTEE
- Impact objectives of investment
- Motivation for guarantee
- Type of risk being mitigated
- Targeted financial return
- Level of coverage
- Funded or unfunded
- Creditworthiness of provider
- Triggers and access
- Costs and fees (e.g., legal, underwriting)

BACKGROUND OF PARTIES INVOLVED
- Investee or project manager/sponsor and track record
- Recipient(s) of guarantee and their respective objectives
- Provider(s) of guarantee and their respective objectives
- Other parties
- Assigned responsibility for each component of blueprint to appropriate party (e.g., underwriting, legal counsel, portfolio monitoring)
# Key Considerations for Stakeholders Potentially Engaging in a Guarantee-backed Investment

This list of key considerations and questions aims to ensure stakeholders are aware of each other’s expectations for the investment and align interests where necessary to underwrite a successful outcome. Ideally, this resource would be utilized at the beginning of investment discussions and negotiations.

## Components

<table>
<thead>
<tr>
<th>Components</th>
<th>STAKEHOLDERS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Impact Objectives of Investment</strong></td>
<td>- What are my impact expectations?</td>
</tr>
</tbody>
</table>
| **Motivation for Guarantee & Type of Risk Mitigated** | - What is the long-term goal of providing this guarantee (e.g., to enable liquidity, to lower the cost of capital, to prove a new business model, to address a misperception of risk, to make a specific type of investor comfortable with this kind of deal)?  
- What specific type(s) of risk need to be mitigated (e.g., unproven model or market, cash flow risk, borrower creditworthiness)?  
- Does this structure mitigate that risk?  
- How will I manage my own risk in the event a guarantee is called? |
| **Financial Return**               | - Am I willing to provide a funded or unfunded guarantee?                    |
| **Level of Coverage**             | - What is the maximum level of coverage that I would be willing to provide?  
- What is the level of coverage that will create the desired incentives for the recipient of the guarantee, but not lead to moral hazard or market distortion?  
- Will coverage decline over time? |
| **Triggers and Access**           | - Am I comfortable with the triggers and methods to access the guarantee?  
- Are the triggers helping to achieve my motivations?  
- What is the timing at which I might have to make payouts, based on the triggers? |
<p>| <strong>Roles</strong>                         | - What core competencies can I leverage to contribute to the structuring of this guarantee-backed investment (e.g. underwriting) and during post-investment activities (e.g. portfolio monitoring)? |</p>
<table>
<thead>
<tr>
<th>STAKEHOLDERS</th>
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<tr>
<td><strong>RECIPIENT OF GUARANTEE</strong></td>
<td><strong>INVESTEES</strong></td>
</tr>
<tr>
<td>What are my impact expectations?</td>
<td>What are my impact expectations?</td>
</tr>
<tr>
<td>What is the long-term goal of participating in this investment (e.g., ensure liquidity options, enter a new market, prove creditworthiness of this deal type to internal stakeholders)?</td>
<td>How will this capital help me achieve my long-term financial and impact goals?</td>
</tr>
<tr>
<td>What specific type(s) of risk needs to be mitigated (e.g., unproven model/market, cash flow risk, borrower creditworthiness)?</td>
<td>What type of risk does the investor see in my model, and have I taken steps to mitigate it (e.g., collateral, financial management processes)?</td>
</tr>
<tr>
<td>How much risk am I willing to take on?</td>
<td>Are there additional restrictions that will be placed on me as a result of the guarantee?</td>
</tr>
<tr>
<td>What financial return does my firm require for the given level of risk?</td>
<td><strong>AM I WILLING TO PAY FOR A GUARANTEE?</strong></td>
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<tr>
<td>Am I willing to pay for a guarantee?</td>
<td><strong>WHAT LEVEL OF RETURN CAN I PROVIDE?</strong></td>
</tr>
<tr>
<td><strong>WHAT LEVEL OF COVERAGE DO I REQUIRE?</strong></td>
<td><strong>HOW MIGHT THIS GUARANTEE LOWER MY COST OF CAPITAL?</strong></td>
</tr>
<tr>
<td>What level of coverage do I require? Would I foresee this changing throughout the course of the investment (e.g., decreasing coverage as perceived risk decreases)?</td>
<td>Are there tradeoffs between level of coverage and restrictions enforced by the guarantor (e.g., narrowed geographic scope)?</td>
</tr>
<tr>
<td>What other risk mitigants are there?</td>
<td></td>
</tr>
<tr>
<td><strong>AM I COMFORTABLE WITH THE TRIGGERS AND METHODS TO ACCESS THE GUARANTEE?</strong></td>
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<tr>
<td>Am I comfortable with the triggers and methods to access the guarantee?</td>
<td>Am I comfortable with the triggers and methods to access the guarantee?</td>
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<tr>
<td>How creditworthy is the guarantor?</td>
<td>If the access involves my loan being sold, am I comfortable with the guarantor becoming my lender?</td>
</tr>
<tr>
<td><strong>WHAT CORE COMPETENCIES CAN I LEVERAGE TO CONTRIBUTE TO THE STRUCTURING OF THIS GUARANTEE-BACKED INVESTMENT (E.G. UNDERWRITING) AND DURING POST-INVESTMENT ACTIVITIES (E.G. PORTFOLIO MONITORING)?</strong></td>
<td></td>
</tr>
<tr>
<td>What core competencies can I leverage to contribute to the structuring of this guarantee-backed investment (e.g. underwriting) and during post-investment activities (e.g. portfolio monitoring)?</td>
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More information about the Global Impact Investing Network

This brief is a publication of the Global Impact Investing Network (GIIN), the leading nonprofit organization dedicated to increasing the scale and effectiveness of impact investing. The GIIN builds critical market infrastructure and supports activities, education, and research that help accelerate the development of the impact investing field.

IRIS
IRIS is the catalog of generally-accepted performance metrics that leading impact investors use to measure social, environmental, and financial success, evaluate deals, and grow the credibility of the impact investing industry.
iris.thegiin.org

ImpactBase
ImpactBase is the searchable, online database of impact investment funds and products designed for investors. Fund or product profiles on ImpactBase gain exposure to the global impact investing community.
impactbase.org

Training
The GIIN training program offers practical coursework to help investors build applied skills to successfully attract, deploy, and manage capital.
thegiin.org/training

Career Center
The GIIN Career Center is a source for job openings from members of the GIIN Investors’ Council and other impact investing leaders.
jobs.thegiin.org

Membership
If your organization is interested in deepening its engagement with the impact investing market by joining a global community of like-minded peers, consider GIIN membership. To learn more about membership and to access interviews with leading impact investors, research from the field, and more examples of impact investments, visit www.thegiin.org.
Additional GIIN Research

The GIIN conducts research to provide data and insights on the impact investing market and to highlight examples of effective practice. The following selection of GIIN reports may also be of interest:

Since 2011, the GIIN has conducted an **Annual Impact Investor Survey** that presents analysis on the investment activity and market perceptions of the world’s leading impact investors.

**Scaling U.S. Community Investing: The Investor-Product Interface** provides an in-depth landscape study of the U.S. Community Investing (USCI) field.


**The Private Equity Impact Investing Benchmark** analyzes the financial performance of over 50 Private Equity and Venture Capital impact investing funds. See the Knowledge Center for additional financial performance research.

**Catalytic First-Loss Capital** details the motivations, benefits, and considerations behind the use of first-loss capital as a credit-enhancement tool in impact investing.

**The Business Value of Impact Measurement** demonstrates how investors and their investees use social and environmental performance data to improve their businesses.

Find more resources from the GIIN and other industry leaders in the GIIN Knowledge Center at [https://thegiin.org/knowledge-center](https://thegiin.org/knowledge-center).