ONTARIO NONPROFIT NETWORK

Principles for Community Financing in Ontario: A Discussion Document

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On Behalf of the Ontario Social Economy Roundtable, including:

Canadian Alternative Investment Cooperative
Canadian Community Economic Development Network
Centre Canadien pour le Renouveau Communautaire
Centre for Social Innovation
C Lang Consulting
Conseil de la cooperation de l'Ontario
Eko Nomos
George Brown Law
Iler Campbell LLP
Ontario Co-operative Association
Ottawa Community Loans Fund
PARO Centre for Women's Enterprise
Pillar Nonprofit Network
Social Economy Centre
Social Innovation Generation @ MaRS
Toronto Enterprise Fund

A Constellation of the Ontario Nonprofit Network

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Context

Innovative social finance in Ontario has a long history, though the field has only recently begun to gain higher profile. As the role of the government, nonprofit and for-profit sectors change, further innovation and growth in this area is much anticipated. However, there is little hard data for such claims to rely on, and with the ongoing influx of new energy, we are all guessing as to what shape such growth could take. One thing, though, we need not guess about: for any widespread expansion of the field, nonprofit organizations must be ready and able to engage in community financing initiatives. They are stewards of community, providing solutions that strengthen the social and financial viability of our province.

This presents quite an opportunity, and quite a challenge, for those seeking to support and enable community financing in Ontario. Collectively, we need to determine what structures can best enable nonprofits and charities to kick-start, continue, or expand their engagement in community financing and build assets for the common good. In order to identify emerging infrastructure for the sector that would support rather than hinder, the Ontario Social Economy Roundtable (OSER), a constellation of the Ontario Nonprofit Network, has researched and considered the topic of community financing.

OSER has collectively discussed the potential purpose and value of different frameworks and structures for a formative field, in particular considering if, when, and what kind of approaches to regulation may be useful. Together we have determined that above all, principles are required for the community financing field to grow with the integrity and flexibility that will allow it to flourish. Like saplings, perhaps community financing needs a period of time to bend and flex in order for the most effective growth patterns become clear.

We believe that at this stage of development, a measured, principles based approach, rather than an increased regulatory regime, is the most appropriate way to advance the field of nonprofit and community financing in Ontario. This will create protection for both the investors and the organizations they invest in, in a way that complements the existing regulatory regime. We believe a principles based approach will:

- Strengthen a developing field that is important for economic and social development in Ontario;
- Lay a foundation for common language and clarity of purpose among policy makers;

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- Support organizations, investors and nonprofits in the field; and
- Ensure that any initiatives to structure the sector are firmly grounded in case studies and a clear understanding of the potential impact of different risk management strategies.

We also anticipate that a principles based approach will provide a way for ourselves and other interested parties to work together when appropriate, ground our work in careful assessment, and build critical supports for nonprofit financing in Ontario.

The following pages outline eight foundational principles for community financing, which we hope will contribute to greater understanding and engagement in the field of community based financing, in Ontario and in other jurisdictions.

Principles for Community Financing: A Strategic Approach

Principles flow from core values and are the basis for developing more detailed guidelines in the future. One of the Ontario Nonprofit Network (ONN)'s core missions is to "*develop a sense of shared interests and common purpose within the sector in order to strengthen the role of nonprofits in Ontario*"[1]. Articulating principles based on this mission is the first step in developing guidelines for community financing to assist the nonprofit sector in building sustainable community wealth. Since investing is a two-sided transaction, these principles will also be a useful basis for community investors to reference when considering community financing instrument proposals.

The Ontario Nonprofit Network therefore hopes that these principles will:

- Be a step towards establishing **best practice** guidelines for community financing;
- Increase the **appeal** of community financing to the broader public by improving its legitimacy;
- Assist in the development of **enabling legislation and policy**[2]

[1] http://www.theonn.ca/who-we-are/ , Ontario Nonprofit Network

[2] Social Impact Assessment, International Principles, INTERNATIONAL ASSOCIATION for IMPACT ASSESSMENT, www.**iaia**.org/**publicdocuments/special-publications/SP2.pdf**

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The eight principles to guide a community financing instrument offering within the nonprofit sector are:

Integrity	**Accessibility**
Verifiability	**Accountability**
Transparency	**No third party soliciting of investment**
Social Impact	**Trustee administration**

Principles of Community Financing

1) Integrity

Organizations considering community financing must develop the case for investment in an honest and open way which is respectful of the organization's culture. The case for support should be strong, compelling and well understood and supported by all key stakeholders in the organization. This case includes:

a) A clear set of **organizational operating principles**. It is important that any project be considered in light of these principles and any conflicts identified and resolved.

b) **Organization wide commitment** to all facets of the planning process: to manage (or on a more practical level pitch) the project, senior management must have a deep and fundamental understanding which can only come from active involvement in the planning process

c) Honest assessment of new demands the project will place on **organizational capacity** – any deficiencies need to be addressed and rectified. For example organizations considering a social enterprise need access to industry knowledge.

d) Space within the planning process to **vigorously debate and vet the project** so that when it comes time to move beyond debate to action, all voices have been heard and there is support to proceed.

e) **Board of Director input** – Ultimately it is the **nonprofit's board that is responsible for the nonprofit and its activities** including the decision on why and how to seek financing. Board member involvement in the planning process will provide additional insight and

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sober second thought, and is essential if the nonprofit is going to seek financing from the general public.

f) **Straightforward promotion** of the community financing instrument – in advertising and promoting of the community financing instrument issue, organizations should present honest and complete information about both the benefits and risks of the investment.

2) Verifiability

Any type of planning process involves assumptions. It is important that these assumptions are able to stand up to scrutiny. All of the project's assumptions need to be documented and wherever possible be the result of independent or empirical evidence provided from:

a) **Third party experts** – (i.e. appraisers, contractors, architects).
b) Individuals with **industry knowledge** (for example, for social enterprises, individuals may include managers and accountants who understand the market and business model).
c) **Organizational knowledge** – the nonprofit may have first-hand knowledge, for example if it has been operating a building or social enterprise, that can be used as a basis for assumptions (these should be vetted to ensure consistency with industry norms).

3) Transparency

The organization should be as **open** as possible **with investors**. Investors' decision to invest in a nonprofit is not solely a financial decision. They may be forgoing a financial return for a social return. They are putting their trust and faith in the organization. Absolute honesty with investors through the debt issuing process is key to a long term, mutually satisfactory relationship. The organization should be clear about:

a) **The terms and conditions** of the community finance instrument and the **roles of the parties** involved.
b) **Risks of project failure** – There needs to be a full, clear and plain disclosure of potential risks that the project will not succeed. This would include an analysis of their **likelihood, potential impact and possible mitigations** of these risks**.**
c) **Shared risk –** although investors are the primary financers the **organization should have a financial stake in the project**. It is not only good public relations, it reinforces the organization's commitment to succeed.

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d) **Financial projections** that explore different scenarios (best, worse and most likely cases) so that outcomes can fully demonstrated.
e) Organizational capacity **strengths** and how **weaknesses** are being addressed.
f) **Exit strategy** for investors to recoup investment if the project fails.
g) All together, this should amount to **straightforward promotion** of the community financing instrument – in advertising and other promoting of the community financing instrument.

4) Social impact goals of the project

Social impact goals need to be clear and unambiguous.

a) Why is this project being undertaken? If successful what will it **achieve for the organization and the community** in 1 year, 5 years or 10 years? How is the project aligned with mission objectives?
b) How will social impact **be measured**?
c) What **community assets** will be created?

5) Accessibility

Community financing is a tool that allows community members to invest in assets which provide benefit to and are retained in the community. It is important that these investments are accessible to all community members (regardless of means):

a) Debt issues should **be affordable** to a significant portion of the community
b) Debt issues should be **RRSP or TFSA eligible** when practical

6) Accountability

Issuing community financing will bring in a new stakeholder: the investor, who will require assurance that the investment remains sound and that social impact objectives are being met. The reporting requirements and investor rights need to be articulated in the investor agreement and should include the following:

a) **Regular communication** with the investors.
b) **Third party verification** of reporting should be sought wherever practical.

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c) Sufficient **empirical data** (i.e. financial results) so that the investor has a clear picture of progress to date.
d) Measurement of the actual results **against the original planned data** with clear, frank explanations of any differences.
e) **Revised projections and related action plans**.
f) Project's **unintended impact** or **consequences** to the organization.
g) Opportunity for **interaction with management**, if investors feel it is warranted.

7) **No third party soliciting of investment** ("third party" is defined as individuals who "sell" the community financing instrument to the public for a flat fee or a percentage of the amount raised)**.** However, the use of credit unions and other community-based financial institutions charging small administration fees to facilitate the debt sale for Registered Retirement Savings Plan and other tax administration purposes can be quite beneficial and should be explored.

a) A nonprofit issuing community finance instruments should be willing to sell and promote the instruments on its own. This ensures that the organization is **committed to the plan**, how it is financed and ultimately **to the investor**.
b) The organization **interacts directly** with the investor. Trust and an investor's commitment to the nonprofit's mission can only be built through direct contact. This connection is vital to how community financing create community based assets.

8) Use of trustee to facilitate the transaction

To provide additional assurance to investors, a trustee should be used to administer funds and act on the investors behalf. The trustee's role will be set out in a trustee agreement and will include such tasks as:

a) **Collect and administer** all investor funds during the solicitation stage.
b) **Register the mortgage charge** or other security, and **execute and maintain all related legal documentation.**
c) **Hold the security** on behalf of the individual investors.
d) **Convene investors' meetings** and act on their instructions.
e) **Exercise all investors' rights** under their security.

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The nature of trusteeship is a matter of scale: smaller community financing initiatives may have a less administratively intensive relationship with their trustee.

Conclusion

Nonprofit Community Financing Instrument guidelines should be further developed, including nuance on the above principles based on the actual experiences of the nonprofit community. As guidelines and standard practices are adopted, they need to be rooted in the principles outlined above in order to develop Community Financing Instrument proposals which meet the **needs of the community investor and are true to the values of the nonprofit sector**. A common set of standards will be a key tool to be used by both the nonprofit and the investor to propose and evaluate community financing initiatives. [i]

This paper is intended to provide a foundation for collective action and discussion on the topic of nonprofit financing. We welcome your comments, thoughts, related references, and suggestions. Please contact the Ontario Nonprofit Network (http://www.theonn.ca/who-we-are/contact/).

[i] The principles included in this paper have drawn components from:

1. Province of Nova Scotia's Community Economic Development Investment Fund program Nova Scotia Community Economic Development Fund http://www.gov.ns.ca/econ/cedif/
2. Principles & Practices for Nonprofit Excellence "A guide for non-profit board members, managers and staff", Minnesota Council of Nonprofits *www.minnesotanonprofits.org/nonprofit.../principles-and-practices*
3. THE COMMUNTY BOND, An innovation in Social Finance, Centre for Social Innovation, 2011 Authors: Tonya Surman and Scott Hughes

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