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COMMUNITY AND ECONOMIC DEVELOPMENT DISCUSSION PAPER

Partnerships between Community Development Financial Institutions and Workforce Development Organizations

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Primary issue:
Current sources of workforce development funding are not sufficient to meet the needs of workers and employers. Additionally, the systems in place to distribute these funds struggle to meet the demand of their clients. As the workforce development system is moving to create lasting impact, stakeholders should consider the important role that community development financial institutions (CDFIs) can play as a source of workforce development financing for training and education partners.

Key findings:
Based on three case studies selected to highlight how CDFIs can play a variety of roles in transactions, this paper offers innovations that increase workers' access to and the affordability of credit, training, and services.

- A local credit union offers a more affordable student loan alternative through a small-dollar loan product to individual job seekers needing in-demand credentials.
- A national CDFI helped a community college use the New Markets Tax Credit program to accelerate investment in facilities required for a new culinary arts education program.
- A group of CDFIs financed a working capital loan to help a nonprofit staffing firm focused on housing-insecure or formerly incarcerated workers expand into a new market.

Takeaways for practice:
Understanding different ways that CDFIs can finance workforce development can help address the longstanding trend of dwindling federal workforce development funding and funding gaps that have persisted for training and education, especially outside of postsecondary education. CDFIs can develop strategies tailored to financing workforce development through lending and other financing activities by reimagining existing expertise in product design and custom underwriting by attracting diversified financing partners. Workforce development practitioners can build relationships with CDFIs that work in their communities and learn more about how to obtain a CDFI loan, especially from CDFIs that offer borrowers technical assistance. Successful partnerships between CDFIs and workforce training providers are critical to scaling CDFIs financing workforce development.

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Partnerships between Community Development Financial Institutions and Workforce Development Organizations

Abstract:

Inability to secure capital to improve worker skills or expand training programs can prevent growth in a local economy. This paper presents the role CDFIs can play to fill a need for financing in the workforce development sector. While the transactions presented in this paper are unique, they highlight the importance of partnerships between the two industries. Shared missions and an overlapping client base between CDFIs and workforce development practitioners creates a natural pairing for collaboration. In addition, CDFIs are uniquely able to serve as test beds for innovation because of their different method of underwriting deals and higher financial risk tolerances compared to traditional financiers. The authors present case studies involving small-dollar personal loans to finance skill development, new market tax credit transactions to expand educational facilities, and business acquisition and working capital loans to support nonprofit workforce developers.

JEL classification: G29, J240

Key words: community development financial institutions, CDFI, workforce development, workforce funding, workforce training, education, loans, financial innovation, workforce finance, community colleges

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Many community development practitioners focus on helping people find jobs that pay a living wage. However, access to these jobs increasingly requires postsecondary and continuing education.[1] Having enough workers available with the right skills for today's industries increases the global competitiveness of the US economy. This need has fueled policy and practitioner debate on how to effectively develop a robust and skilled American workforce.[2] Much of this debate centers on what types of training programs are most effective in delivering a better job or which credentials lead to industry-aligned skill development. However, little discussion is focused on how to pay for it.

Historically, students and job seekers have been responsible for financing their own education, training, or upskilling opportunities. For the average student attending two- or four-year colleges, less than 25 percent is covered through grants or scholarships, while the remainder is paid for through savings, loans, personal income, and contributions from parents.[3] Student loan debt is not just a problem for degree holders. The average student debt for people with no degree was over $17,000.[4] Some students choose not to pursue postsecondary education because they do not have adequate financial aid.[5] When the responsibility for financing training lies primarily on workers, fewer workers, earn credentials or finish school because they can't pay for it.

Over the past decade, policymakers have experimented with new ways to finance training for skill development where the risk is distributed among stakeholders. Business

[1] Anthony P. Carnevale, Stephen J. Rose, and Ban Cheah, *The College Payoff: Education, Occupations, and Lifetime Earnings*, Georgetown University Center on Education and the Workforce, 2011, https://1gyhoq479ufd3yna29x7ubjn-wpengine.netdna-ssl.com/wp-content/uploads/collegepayoff-completed.pdf.

[2] Stuart Andreason, Todd Greene, Heath Prince, and Carl E. Van Horn, "Investing in America's Workforce," introduction in *Investing in America's Workforce, Volume 1: Investing in Workers*, ed. Stuart Andreason, Todd Greene, Heath Prince, and Carl E. Van Horn (Kalamazoo, MI: Upjohn Institute, 2018), https://www.investinwork.org/book.

[3] Melanie Hanson, *How Do People Pay for College?*, Education Data Initiative, April 23, 2022, https://educationdata.org/how-do-people-pay-for-college.

[4] Melanie Hanson, *Student Loan Debt by Income Level*, Education Data Initiative, May 8, 2022, https://educationdata.org/student-loan-debt-by-income-level.

[5] Horatio Alger Association of Distinguished Americans Inc., *The Pandemic's Financial and Emotional Impact of Student Futures*, 2021, https://www.horatioalger.org/wp-content/uploads/2021/07/HAA-Survey-Inforgraphic-2021-SINGLE.pdf.

leaders, investors, and philanthropists have experimented with social-impact bonds and income-share agreements as innovative financing options.[6, 7]

Though income-share agreements and social-impact bonds can be effective for many workers, they are not sufficiently available to meet the rapid pace of technological advancements that require constant workforce reskilling. More innovations in workforce finance are needed to create a nimble and sustainable system that will promote career stability and growth for all workers to remain competitive.[8] As the workforce development system continues to work on achieving lasting impact, stakeholders should consider the important role that CDFIs can play as a source of workforce financing with training and education partners.

This paper examines three case studies where CDFIs meaningfully engage with the workforce development system to advance accessibility to and affordability of workforce development within their communities. In these case studies, CDFIs increase access to credit for the physical infrastructure needs of training programs, offer working capital and technical assistance for new social enterprises, and create equitable access to tuition loans not traditionally available to certain segments of the population, particularly low-income borrowers.

Because they are mission-oriented financial institutions dedicated to building organizational capacity and increasing prosperity in underserved neighborhoods and populations, CDFIs are willing to accept higher risks in their programs and reach deeper into their communities than are traditional financing partners. The overlapping clients and missions of CDFIs and workforce development providers creates a natural pairing to improve and scale training programs.[9]

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[6] Nirav Shah, "Improving Workforce Outcomes with Pay for Success," chap. 5 in *Investing in America's Workforce, Volume 3: Investing in Systems for Employment Opportunity 3*, ed. Stuart Andreason, Todd Greene, Heath Prince, and Carl E. Van Horn (Kalamazoo, MI: Upjohn Institute, 2018), https://www.investinwork.org/book.

[7] Miguel Palacios, "Financing Human Capital through Income-Contingent Agreements," chap. 6 in *Investing in America's Workforce, Volume 3: Investing in Systems for Employment Opportunity 3*, ed. Stuart Andreason, Todd Greene, Heath Prince, and Carl E. Van Horn (Kalamazoo, MI: Upjohn Institute, 2018), https://www.investinwork.org/book.

[8] See US Chamber of Commerce Foundation, *Talent Finance: A New Consensus and Return-to-Investment*," 2020, Center for Education Workforce Talent Finance Report, https://www.uschamberfoundation.org/sites/default/files/CEW%20Talent%20Finance%20Report-web.pdf.

[9] Elizabeth Sobel Blum and Steven Shepelwich. "Partnering with Banks in Workforce Development," chap. 2 in *Investing in America's Workforce, Volume 3: Investing in Systems for Employment Opportunity*

These three case studies examine the potential roles CDFIs could play to help training systems better support the economic mobility of low- and moderate-income (LMI) workers. The first section of this paper offers a review of the current state of funding for training, followed by a brief introduction to the CDFI industry. The bulk of the paper illustrates through the case studies how CDFIs can finance students as well as public- and private-sector training providers. The paper concludes with discussion on fostering collaboration between CDFIs and the workforce development system – including but not limited to partnerships with training providers, job placement and job developer services, and institutions of higher learning.

Section I: Background

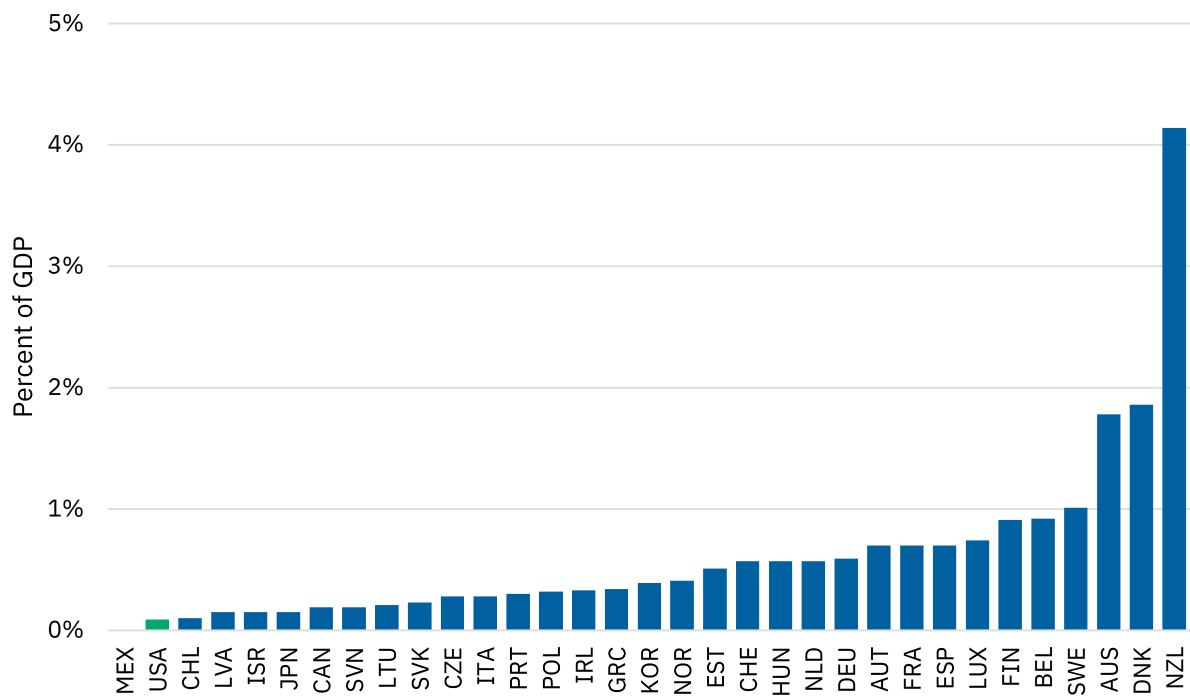
The State of Workforce Funding

Many entities are responsible for the training of adult workers in the United States, funded through public and private sources. The United States has a highly decentralized approach to adult worker training and allocates fewer public dollars to such programs than do most other industrialized countries. According to data from the Organisation for Economic Co-operation and Development (OECD), the United States spends a quarter of a percent of its gross domestic product (GDP) on workforce development and training, compared to approximately 2 percent in Denmark and 4 percent in New Zealand (figure 1).[10] The bulk of US federal workforce dollars come from Pell grants and federal student loans. However, students cannot use those funds for nonaccredited training programs that offer the technical training that some employers are looking for.

3, ed. Stuart Andreason, Todd Greene, Heath Prince, and Carl E. Van Horn (Kalamazoo, MI: Upjohn Institute, 2018). https://www.investinwork.org/book.

[10] Organisation for Economic Co-operation and Development, OECD (2022), *Public spending on labour markets (indicator)*, 2019, https://data.oecd.org/socialexp/public-spending-on-labour-markets.htm.

Figure 1: Public Spending on Labor Markets as a Percent of GDP (excluding out-of-work income and early retirement) (2019)



Source: Organisation for Economic Co-operation and Development, *Public spending on labour markets (indicator)*, 2019, https://data.oecd.org/socialexp/public-spending-on-labour-markets.htm

The key training programs and funding available in the public sector include:

(1) Workforce investment boards (WIBs), sometimes referred to as workforce development boards, which are managed by state and local governments and federally funded through the Workforce Innovation and Opportunity Act, or WIOA

(2) Career and technical education, which is generally provided through community and technical colleges and funded through every level of government

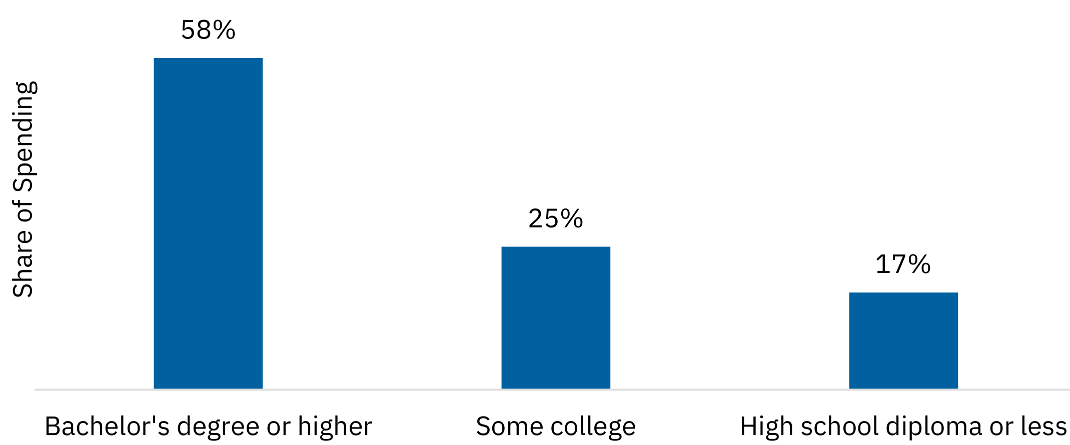
(3) Apprenticeships, which are managed by federal and state governments in coordination with private employers and funded by the US Department of Labor.

(4) Adult basic education, which is funded by an array of federal and state funding sources including WIOA and Supplemental Nutrition Assistance Program Employment and Training (SNAP E&T).

(5) Federal student loans programs and the Pell grant program, which offer individuals grants or low-cost loans to pay for education or training.

Private sources of funding are also available for training. However, more than half of that funding ends up going to workers with a bachelor's degree seeking postsecondary degrees or other professional certifications, with the rest going to workers without a college degree (see figure 2).[11] For instance, employers may offer tuition reimbursement or other funding opportunities, often structured as an employee benefit, usually requiring the worker to pay education costs upfront and await employer reimbursement. These opportunities are not generally available to lower-paying, often "frontline," jobs so the reimbursement approach can put additional strain on financially fragile workers who may not be able to afford to pay for these programs up front.

Figure 2: Employer spending on formal training by employee education level (2013)



Source: Anthony P. Carnevale, Jeff Strohl, and Artem Gulish, *College is Just the Beginning*, Georgetown University Center on Education and the Workforce, 2015, https://cew.georgetown.edu/cew-reports/college-is-just-the-beginning/

An Introduction to the CDFI Industry

Community development financial institutions, or CDFIs, are financial institutions that maintain a focus on both their earnings and their social impact, sometimes referred to as a "double bottom line." The US Department of the Treasury's Community Development Financial Institutions Fund designates a financial institution as a CDFI if it offers both financial services and development services to a financially underserved population. CDFIs can be for profit, like banks, or not for profit, like credit unions and loan funds.[12] While CDFI loan funds comprise approximately half of CDFIs by number, they are on average 10 times smaller than their

[11] Anthony P. Carnevale, Jeff Strohl, and Artem Gulish, *College is Just the Beginning*, Georgetown University Center on Education and the Workforce, 2015, https://cew.georgetown.edu/cew-reports/college-is-just-the-beginning/.

[12] As of June 14, 2022, there are 1,373 CDFIs, comprised of 570 loan funds, 469 credit unions, 176 banks or thrifts, 143 depository institution holding companies, and 15 venture capital funds. Access the full list of certified CDFIs at https://www.cdfifund.gov/programs-training/certification/cdfi. This list is updated monthly.

regulated depository bank and credit union CDFI counterparts.[13] A CDFI's client base may overlap with the same LMI workers who are targets of workforce development and training initiatives.

CDFIs have a long track record of providing mortgage, small business, and consumer loans to LMI borrowers. Their work also includes an array of development services such as financial education, business assistance, credit counseling, and technical assistance. However, to date, CDFIs have focused less on workforce development and training.

In 2019, the Federal Reserve Bank of Richmond administered a survey to 557 CDFIs and found that 57 percent of them reported that they engaged in workforce development activities.[14] However, much of CDFI workforce development lending—60 percent—goes directly to businesses to help improve the supply of quality jobs. The second largest portion, 49 percent, reported that they offer technical assistance to businesses to improve the supply of quality jobs.[15] In fact, a much smaller portion of CDFIs indicated they support the traditional workforce development system—34 percent of respondents provided technical assistance and 25 percent of respondents provided loans to organizations that provide job training or placement services (figure 3).

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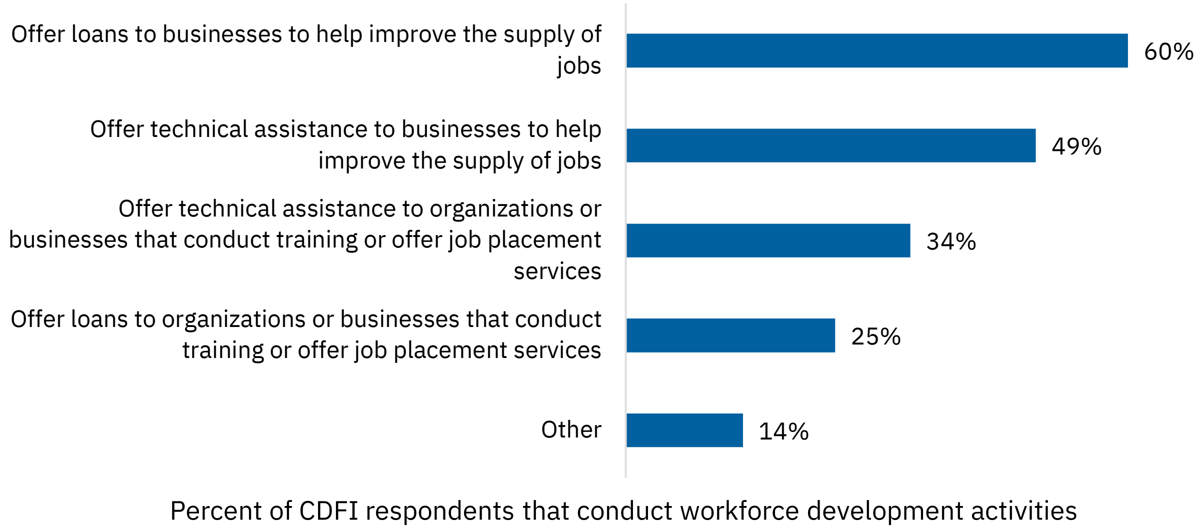
[13] *CDFI Annual Certification and Data Collection Report (ACR): A Snapshot for Fiscal Year 2020* (US Department of the Treasury's Community Development Financial Institutions Fund, 2021) found that "certified CDFI credit unions and banks/thrifts have average assets of $416 million and $356 million, respectively. Loan funds and venture capital funds have average assets of $43 million and $18 million, respectively."Access the report at https://www.cdfifund.gov/sites/cdfi/files/2021-10/ACR_Public_Report_Final_10062021_508Compliant_v2.pdf.

[14] Emily Wavering Corcoran, *Community Development Financial Institutions (CDFIs) by the Numbers: Federal Reserve CDFI Survey Key Findings Chart Book*, Federal Reserve Bank of Richmond, 2019, https://www.richmondfed.org/-/media/RichmondFedOrg/community_development/resource_centers/cdfi/pdf/CDFI_report_2019.pdf.

[15] According to the Federal Reserve Bank of Richmond (private communication), the "quality jobs" definition in the CDFI Survey is based on Pacific Community Ventures, *Defining and Measuring The Creation of Quality Jobs*, 2016, https://www.pacificcommunityventures.org/wp-content/uploads/sites/6/2016/04/Quality-Jobs_Moving-Beyond-Job-Creation.pdf. This report states that a quality job must offer three of the following five key elements: a living wage, basic benefits, career-building opportunities, wealth-building opportunities, and a fair and engaging workplace.

Figure 3: CDFI Workforce Development Activities (2019)



Source: Emily Wavering Corcoran, *Community Development Financial Institutions (CDFIs) by the Numbers: Federal Reserve CDFI Survey Key Findings Chart Book*, Federal Reserve Bank of Richmond, 2019, https://www.richmondfed.org/-/media/RichmondFedOrg/community_development/resource_centers/cdfi/pdf/CDFI_report_2019.pdf

Because CDFIs can attract mission-aligned investments and funding as well as take risks on new business models, they could help support the transformations currently under way in workforce development and help meet the need for additional financing. First, they are experts in developing financial products that are sustainable and affordable to an LMI client base and to organizations that work on behalf of LMI clients. They study their clients' available sources of repayment and the financial risks they face and use that information to design products with reasonable payment options and risk management systems tailored to those financial risks. This means that CDFIs can develop customized, tailored underwriting systems.

Second, CDFIs are designed to maintain a low enough cost of capital that keeps their prices affordable to their client base. This comes in part from their ability to manage different classes of investors, particularly those who are less focused on the traditional bottom line, including investors trying to meet regulatory requirements (such as banks), social investors (including philanthropists), and investors seeking a diversity of projects. Investors who seek a social return are often willing to take a lower financial return or a higher risk of loss if they feel the investment could achieve the desired social impact. Using a structure referred to as a capital stack, CDFIs combine funds from social investors and higher-return-seeking investors to create a larger pool of funding for LMI clients. Capital stacks allow funders with different risk tolerances to participate in the same deal, which results in CDFIs being able to offer lower interest rates to their clients than a non-CDFI might offer. Moreover, some CDFIs are experts at accessing particular sources of incentivized private funding, such as New Markets Tax

Credits (NMTC) or Community Reinvestment Act-motivated activities,[16] that could bring low-cost funding to training systems.[17]

Section II: Opportunities for CDFIs to Participate in Workforce Development

CDFIs can play a role in reimagining workforce financing since they already focus on economic mobility, have deep expertise in finance, and have well-established working relationships with many types of financing partners. This portion of the paper offers three examples of CDFIs with workforce development programs. The programs include small-dollar consumer loan options, lending for facility enhancements, and working capital and acquisition loans. Each program targets a specific rung in the workforce ladder, and each CDFI was able to adapt an existing product to the workforce development market.

The analysis draws on interviews conducted with representatives of the CDFIs involved and describes how each CDFI structured its product. In each case, strong partnerships were important in building relationships with not only the borrower but also other key stakeholders. The case studies also examine the benefits to borrowers and the workforce development sector from CDFIs financing these transactions.

Education and Small-Dollar Consumer Loans

One barrier to career mobility is education. Having a postsecondary education, credentialing, or licensing increases a worker's competitiveness in the job market and can lead to higher wages as well as better job stability and career growth.[18] Often, those who have the greatest financial need for loans to access these types of training are constrained to products with high interest rates. A CDFI can provide affordable loans without strapping a student to high-interest debt. The following case study features a partnership in Virginia in which an education provider and a CDFI came together to help workers earn credentials that are valued in the labor market.

Freedom First Credit Union (FFCU) is a CDFI that provides various workforce development loans, modified from their traditional unsecured personal consumer loan

[16] The 1977 Community Reinvestment Act requires regulators, such as the Federal Reserve, to promote lending that meets the credit needs of low- and moderate-income communities. For more information, see https://www.federalreserve.gov/consumerscommunities/cra_about.htm.

[17] Sobel Blum and Shepelwich 2018

[18] Jean Grossman, Linda Kato, Tony Mallon, Sheila Maguire, and Maureen Conway, *The Value of Credentials for Disadvantaged Workers: Findings from The Sector Employment Impact Study*, Aspen Institute, 2015, https://www.aspeninstitute.org/wp-content/uploads/files/content/docs/pubs/Value%20of%20Credentials.pdf.

product. FFCU focuses on financing tuition costs for in-demand certifications or licensures. These loans have terms up to 36 months and are made in amounts up to $5,000 to cover tuition as well as costs associated with the training, such as testing fees, specialized tools, and uniforms. FFCU decided to offer the loan because a range of quality workforce training courses in high demand—including truck driving, welding, and some nursing programs—do not qualify for federal student aid programs and because they wanted to help students avoid high-cost, predatory lenders that often market to the credit-challenged or lower-income student body.

Initially, the workforce development loan was developed to serve individuals pursuing truck driving licenses at Commercial Driver Services (CDS), a truck driving school serving FFCU's market (the Roanoke and New River Valleys, Virginia). This truck driving loan ranges from $1,500—for Virginia residents who can receive state workforce credential program subsidy grants to cover up to two-thirds of tuition—to $4,500 for those not meeting residency standards. FFCU designed certain modifications to meet the profile of a CDS student, including marketing the loan specifically as a workforce development loan rather than a personal consumer loan.

Borrowers tend to be individuals looking for a career change or individuals returning to the workforce. The first loan payment is deferred up to 60 days, recognizing that many students may not be earning a paycheck while they are in the four-week, full-time course. While FFCU uses credit scores to determine the price of the loan, they use custom underwriting that reviews a borrower's credit history closely, looking at things such as bill payment history to determine creditworthiness. While there is no minimum credit score to qualify for the loan, the average credit score of borrowers was 679 in the program's first months, which is higher than FFCU's other impact lending programs.

Most borrowers receive an interest rate of 10–12 percent for the loan. Federal credit union regulation caps the interest rate at 18 percent,[19] which contrasts with CDS's prior third-party student loan program. That program offered a fixed 25 percent interest rate regardless of credit score. In addition, FFCU and CDS have taken key steps to ensure successful repayment of the loans. FFCU disburses loans through CDS rather than directly to the student, which guarantees the money goes to its intended purpose. In addition, in the event that a student drops out of the program, CDS sends any reimbursement for the class back to FFCU to help repay the loan.

FFCU's strong partnership with CDS has been fundamental to the program's success. CDS has a reputation as a high-quality training provider that helps its students and graduates

[19] The National Credit Union Administration (NCUA) has maintained an 18 percent interest rate ceiling on federal credit union loans since 1987. For more information, see NCUA's June 2021 bulletin at https://www.ncua.gov/newsroom/press-release/2021/capitalization-interest-rule-assist-financially-distressed-borrowers and NCUA's June 2021 "Supplemental Information and Interest Rate Statistics" at https://www.ncua.gov/files/agenda-items/AG20210624Item1b.pdf.

with job placement services. CDS graduates have high placement rates of over 90 percent following training completion, which means that the majority of borrowers will have income to support their ability to repay loans. The instrumental role CDS played in helping FFCU build trusting relationships with borrowers has resulted in borrowers not viewing FFCU simply as a profit-maximizing company, but rather as a well-intentioned partner.

With CDS managing borrower relationships, the product reached more borrowers with lower delinquency rates than in the past. Ultimately, the two companies designed an end-to-end process where CDS promotes the loan to its students, directly provides borrower referrals, and supports repayment collections.

The challenge to scaling this program is in finding the right high-quality training providers and building relationships with them, something FFCU continues to do. FFCU has successfully partnered with a local health care provider to offer loans for some nursing certifications. Health care employers often offer their employees financial support for completing these programs, generally as a reimbursement once the certification has been successfully completed. Because many employees lack the funds to pay the upfront training cost, FFCU's nursing loans provide cash-flow financing that the nurses can pay back once they receive their employer's reimbursement.

Sustainability and Scalability

Forming the right partnerships, FFCU believes, is the key to a product's sustainability. Getting buy-in from the leaders of prospective partner organizations was one of the challenges FFCU faced. Partnership development often takes a considerable amount of time and resources during CDFI product development.

Early in the program, higher than expected delinquency and charge-off rates, which are rates of past-due loans and loans removed from the books and charged against loan loss reserves, were a challenge. To help with the repayment process and student financial health, FFCU designed a financial education curriculum, which they called "On the Road Finance," customized to the life of a truck driver that CDS offered during training to all students. In addition to implementing the mandatory financial course, FFCU worked to build more trusting relationships with its mostly remote borrowers. FFCU created a video for borrowers that explained how FFCU is a socially motivated financial institution, not an ordinary for-profit finance company. The video imparted a "pay it forward" mindset: by repaying on a timely basis, borrowers make sure the funds are available to future students. After the video introduction was rolled out, delinquency rates fell 9.4 percent, to 2.1 percent, as of mid-year 2019, which is at the low end of FFCU's expected range.

FFCU was able to fund its product development, in part, by winning a $1.725 million 2015 Opportunity Finance Network NEXT Award. This national CDFI industry innovation award was part low-cost loan and part grant. FFCU used this money to hire a dedicated staff member to work on the program, fund loan loss reserves for the product, and provide a low-cost source of lending capital. The product became profitable and self-sustaining, in part because workforce development was a popular draw for their personal loan product and helped potential borrowers see more clearly the value of the loan.

Social Impact

The workforce development loan has several benefits for its borrowers. First, the credit is paired with financial coaching to improve long-term financial stability. FFCU's "On the Road Finance" curriculum addresses the unique challenges that truck drivers face when managing their finances, given a lifestyle of frequent travel. Second, FFCU offers a lower price than CDS's prior third-party lender and many other competitors offer. According to FFCU and CDS, their customers would likely turn to predatory lenders like title lenders or high-cost sources like credit cards in the absence of the FFCU workforce development loan.

The FFCU loan program offers students the opportunity to develop a lasting relationship with a financial institution. FFCU has a suite of programs targeting LMI households' financial needs, from credit-building programs and homeownership counseling to auto loans and mortgage products. In return, the program helps FFCU diversify its membership and loan portfolio, which is beneficial from a financial safety and soundness perspective. FFCU is hopeful that the borrowers will remain loyal customers following repayment and continue to turn to FFCU to meet other financial services needs in the future.

New Markets Tax Credits in Real Estate

Job seekers, especially in low-income communities, who want to upskill often experience access challenges because many training and education facilities are not located in neighborhoods that are easily accessible to them. This case study highlights one solution through an Indianapolis real estate project assisted by Local Initiatives Support Corporation (LISC) and one of its subsidiaries, New Markets Support Company (NMSC), in 2012 using NMTC.

LISC is a CDFI and nonprofit community development intermediary whose work includes both the financing of community development activities and the implementation of community development programs. NMSC is an impact fund services company supporting community investing through structured investment vehicles as both a fund manager and administrator. It manages LISC's NMTC program investing. This project initiated by Ivy Tech Community College included purchasing and developing property in a majority Black neighborhood, historically challenged by disinvestment and high unemployment rates. Tax credit financing gave Ivy Tech access to low-cost capital to complete the first phase of construction and begin culinary training in its new facility.

The US Treasury CDFI Fund launched the NMTC program in 2000 to encourage economic development in low-income, underserved communities. Funds flow from private investors into specialized intermediaries known as community development entities (CDEs), many of which are also CDFIs that make loans to local businesses.[20] Tax credit financing like NMTC attracts private capital into conventionally higher-risk deals. NMTC financing allows the CDEs to reduce the interest rate a borrower pays because part of the investors' return on investment comes from a reduction in their tax liabilities.

The Ivy Tech project centered on restoring a legacy community asset, the former Stouffer Hotel, which had once been the commercial heart of the Mid-North Indianapolis area. The site was vacant and in need of major renovations after years of underinvestment. The property was also a state-designated brownfield site, meaning that the property had a risk of contamination from hazardous substances or pollutants.[21] Ivy Tech wanted to use the site as a new culinary arts training center and to house some of its workforce development programming and administrative support.

Figure 4 depicts the structure of the deal. One of Ivy Tech's donors, Lilly Endowment Inc., supported this project and donated $23.5 million to the Ivy Tech Foundation to provide support for Ivy Tech Community College beyond state appropriations and student fees. Lilly Endowment Inc., a large private foundation headquartered in Indianapolis, is a longtime

Ivy Tech NMTC Transaction Details

Local Initiatives Support Corporation (LISC) and its subsidiary New Markets Support Company (NMSC) used New Market Tax Credits (NMTC) to develop a new culinary training facility at Ivy Tech Community College.

The $33.5 million investment fund was financed with $23.5 million from the leverage lender, Ivy Tech Foundation, and $10 million from the tax credit investor, Chase Community Equity. Ivy Tech Foundation received a donation from Lilly Endowment Inc., which helped fund the leverage loan.

The investment fund made investments into the three intermediaries—called "Community Development Entities" (CDEs), of which LISC was one. The CDEs are the NMTC tax credit awardees that in turn made investments called "Qualified Low Income Community Investments" (QLICIs) into Ivy Tech Properties Inc., which Ivy Tech Foundation created as a "Qualified Active Low Income Community Business" to receive the funds.

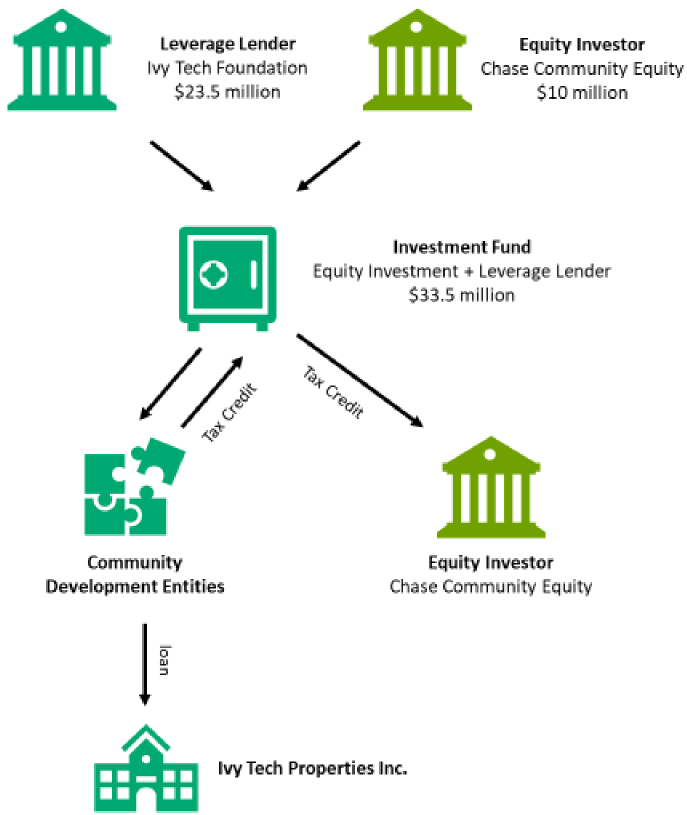
After deducting fees, expenses, and loan loss reserves associated with the financing structure, Ivy Tech received a $32 million loan, or QLICI. The QLICI loan was interest-only for seven years, with approximately $8.5 million effectively canceled after seven years through an option contract with the investor.

[20] US Department of the Treasury Community Development Financial Institutions Fund, *New Markets Tax Credit Program*, https://www.cdfifund.gov/programs-training/programs/new-markets-tax-credit.

[21] LISC New Markets Support Company, *Project Summary: Ivy Tech Corporate College and Culinary Center*, March 2016.

supporter of community development work in Indianapolis's Mid-North neighborhood and connected Ivy Tech to LISC. This project aligned with LISC's wider strategy to engage universities and colleges as anchor institutions capable of providing transformative investment in their communities, including business opportunities and programming such as workforce development and training programs. As a result, LISC offered upfront technical assistance on the NMTC process. LISC also contributed $11.1 million of the NMTC allocation and helped connect Ivy Tech to private capital.

Figure 4: Ivy Tech NMTC Structure



Source: Based on interviews with LISC Indianapolis

LISC used its relationships with financial partners to work through the NMTC program structuring, compliance, and financing processes. The tax credit equity investment came from Chase Community Equity, a subsidiary of JPMorgan Chase Bank, one of LISC's long-time bank partners. As in this transaction, NMTC investors typically pool the NMTC equity with other financing sources into an investment fund, with the investor's tax credits equaling 39 percent of the amount invested into the CDE. To help manage the NMTC compliance requirements, Ivy

Tech Foundation created a new entity, Ivy Tech Properties, Inc., to be the recipient of the tax credit financing. NMSC, with its expertise in NMTC transactions, managed the compliance requirements of the program.

Sustainability and Scalability

Community colleges are a key source of workforce development training in many local communities and have ongoing real estate development and equipment loan needs. According to LISC, real estate-based projects are a good fit for NMTC financing because being physically located in a NMTC-qualified census tract will often ensure eligibility for the NMTC program.

NMTC transactions can have high fixed costs, specifically at closing and through annual administration to ensure that the transaction complies with NMTC regulations. High fixed costs are due to extensive legal and accounting expenses needed to manage the program's compliance requirements at the onset. As a result, most NMTC investors focus on deals of $10 million or more in qualified equity investments. NMTC are limited and competitive: the US Department of the Treasury issued $5 billion in credits in 2021.

NFF and Workforce Development

Nonprofit Finance Fund (NFF) is a nonprofit CDFI that focuses on providing financing and consulting to other not-for-profit enterprises and to connect nonprofits to promote partnerships and knowledge sharing. NFF is focused on providing investment for communities of color that have been historically disinvested.

NFF was founded in 1980 to provide technical assistance to nonprofits with high energy costs and has been expanding access to capital for a variety of missions. The bulk of their client demand comes from health care-focused nonprofits and human services agencies, but NFF is interested in expanding their relationship with the workforce development sector. Previous workforce development projects were with organizations that offered many services to its clients, including but not principally workforce development.

NFF has not seen demand for financing from the workforce development sector in the way that it has for health care organizations, charter schools, and human services agencies. NFF has a goal of improving financial stability for mission-driven organizations and sees potential for training providers to work with CDFIs to accomplish overlapping goals.

Social Impact

With the NMTC program providing the necessary gap capital to refurbish the real estate portion of the project, the college's leaders could focus on raising funds for follow-up programs and related initiatives.[22] The fully completed facility now houses the school's central culinary program with seven culinary labs, a restaurant, a bakery and café, full catering operations for

[22] LISC New Markets Support Company, *Project Summary: Ivy Tech Corporate College and Culinary Center*, March 2016.

the conference center, and a corporate college.[23] The new facility allowed Ivy Tech to double its hospitality program enrollment.[24] Kevin Honigford, assistant treasurer for Ivy Tech Foundation, said that the project "created job opportunities right away, and ensures thousands of others receive the training they need to find jobs and prosperity in the future."[25]

To LISC, Ivy Tech's acquisition of the building supports two important objectives to stabilize the local community—removing a blighted property by bringing the site back to productive use and facilitating job training for local residents. Ultimately, this strengthens Ivy Tech as an anchor institution in the Mid-North neighborhood, which had lost many longstanding commercial establishments in recent years—this included the restaurant on the top floor of the Stouffer Hotel that Ivy Tech reestablished.

Using NMTC offered several benefits to Ivy Tech. Most directly was the cost savings of having a below-market interest rate, due to the tax credit. The transaction structure kept Ivy Tech's debt-servicing costs low, effectively canceling a debt of approximately $8.5 million. This overall cost saving permitted Ivy Tech to begin and complete the project without running a capital campaign first and allowed the project to be completed faster than a typical real estate project for the community college.

Business Expansion Loans to Workforce Development Providers

Financing is not only a struggle for workers, but it can also be a challenge for nonprofit providers of workforce training. This case study focuses specifically on a business expansion loan that Nonprofit Finance Fund (NFF) participated in to support First Step Staffing in expanding its operations from Atlanta to Philadelphia. NFF is a nonprofit CDFI loan fund that provides financing and consulting for nonprofits, with a focus primarily on organizations that work in health care, education, human services, and criminal justice.

First Step is a nonprofit social enterprise and the largest light industrial staffing agency in the United States offering transitional employment for people experiencing homelessness and other housing-insecure job seekers. First Step launched in Atlanta by purchasing a for-profit staffing company and converting their business model to a nonprofit social enterprise that directly employed people at risk of experiencing housing insecurity by quickly placing

[23] Ibid.

[24] "Ivy Tech Community College celebrates grand opening of newest building," Ivy Tech News, October 5, 2012, https://news.ivytech.edu/2012/10/05/ivy-tech-community-college-celebrates-grand-opening-of-newest-building/.

[25] James Briggs, "Indianapolis gets $55M for neighborhood development," *IndyStar*, January 24, 2017, https://www.indystar.com/story/news/local/marion-county/2017/01/24/indianapolis-gets-55m-neighborhood-development/96984428/.

them in jobs. First Step saw this social enterprise approach as a way to reach a higher volume of clients, have a higher rate of job placement for their clients, and operate in a financially sustainable manner.[26] The new model allowed them to directly employ their clients and offer wraparound services such as job coaching and mentoring, transportation, and housing assistance to help their clients succeed in their jobs and to increase their housing stability.

Once First Step had successfully piloted its concept in Atlanta, it sought to expand and replicate its model in Philadelphia. At the end of 2016, it identified a for-profit staffing firm to acquire: On Time Staffing. The acquisition would give First Step access to On Time Staffing's Philadelphia-area customers and employers who provide job opportunities in warehouse, packaging, and manufacturing jobs. NFF saw First Step's early success following the Atlanta acquisition and believed the mission to be aligned with its own.

NFF joined a consortium of four CDFIs—co-led by NFF and Reinvestment Fund and joined by LISC, and Philadelphia Industrial Development Corporation (PIDC)—to underwrite the deal, which closed in January 2018. To help First Step expand, NFF in partnership with Reinvestment Fund, a Philadelphia-based CDFI, offered both technical assistance and financing to First Step. Before the deal with First Step, NFF had not worked to underwrite any loans to staffing agencies, and generally provided working capital loans rather than expansion or acquisition loans to nonprofits. The loan had the unique risk of underwriting a deal for an acquisition by an entity without real estate collateral or operating history in the Philadelphia market.

The unique features meant the Philadelphia deal required very intensive underwriting and technical assistance from the CDFIs. NFF's willingness to invest time and resources in the deal, however, came from the deep mission alignment between NFF and First Step on issues relating to supporting employment for individuals experiencing homelessness.

First Step needed approximately $8 million to acquire On Time Staffing, convert it to its Atlanta model, and provide working capital to run the new social enterprise. The deal involved a consortium of financing partners, including CDFIs, foundations, and social impact investors. Financing was underwritten based on the future revenues of the expansion site, which was unique because First Step created a financially independent affiliate that would both purchase and operate the Philadelphia-based staffing firm. The financing was underwritten on the strength of the new affiliate, which had no existing tangible assets, but had valuable customer lists for First Step and First Step's Atlanta track record. The $4.85 million CDFI loan was structured as a working capital term loan and underwritten on the following elements to

[26] For more on First Step's nonprofit model, see University of New Hampshire Carsey School of Public Policy, 2019 Financial Innovations Roundtable Summary, https://carsey.unh.edu/sites/default/files/media/2019/09/2019-financial-innovations-roundtable-summary.pdf.

determine the repayment capacity: (1) First Step's projected cash flows—developed in part from On Time Staffing recent sales and expenses, and (2) the demonstrated success of First Step's Atlanta management team.

The CDFI consortium also provided technical assistance to First Step related to managing and structuring the transaction. This included support navigating potential partners First Step might want to work with in Philadelphia across local government, philanthropy, and social services. Reinvestment Fund was particularly helpful in making introductions between First Step and leaders in local government and philanthropy.

The group of four CDFIs was the largest source of financing in the form of senior debt, which is the highest priority for repayment in the case of bankruptcy and therefore has the lowest risk and typically lower interest rates. However, the deal could not have been done without the rest of the financing partners who took on higher risk positions. The overall financial structure of the capital stack included the following: (1) senior debt from a group of four CDFIs: Nonprofit Finance Fund (NFF), Reinvestment Fund, LISC, and PIDC; (2) subordinated debt from a group of foundations and social impact investors; (3) grants from the Barra Foundation and the City of Philadelphia; and (4) seller financing from On Time Staffing (see figure 5).

Figure 5: First Step Philadelphia Capital Stack

Sources: Interviews with NFF; ImpactPHL, *Investment Case Study: First Step Staffing*, 2019, https://firststepstaffing.com/wp-content/uploads/2019/05/IMPACT-PHL-First-Step-Staffing-Case-Study.pdf

The philanthropic investments of both grants and subordinated debt were essential parts of the capital stack in this deal. Without these capital sources, First Step would not have had enough cash to complete the acquisition and have adequate working capital. The grants were also instrumental to reducing the debt load and interest expense to First Step.

Sustainability and Scalability

The loan between First Step and NFF was unique in its financing of an acquisition. Other deals considered by workforce development providers may not face the same challenges, since First Step takes a different approach to new markets by creating new startups through acquisition, rather than creating branches of their existing business model. This acquisition model adds challenges to financing because the new market cannot raise capital based on the financial performance of the established parent company or affiliates, but rather based on the performance of the acquired business and the successful track record of First Step's management. Although this transaction is one that equity investors might consider, in this instance, given the nonprofit nature of First Step, the new social enterprise would not generate sufficient profits to meet the financial or market-rate return expectations of a for profit equity investor.

However, NFF notes that the role social investors played in the capital stack for this social enterprise is something that could be replicated. In NFF's view, there is an opportunity for socially motivated investors to work with CDFIs to help structure financial investments in training systems. In the CDFI industry's history, these social investors have often worked with CDFIs in similar circumstances, when there was a financing challenge related to supporting the economic advancement of low-income people or communities. NFF noted that investors, foundations, and government agencies motivated by the Community Reinvestment Act could consider offering incentives to CDFIs, such as convertible debt or other credit enhancements that lower a business's credit risk, to help mitigate the financial risks in financing workforce development and training providers.

As most of NFF's clients are in health care, education, and human services, they had to familiarize themselves with the temporary staffing industry by researching the sector to better understand what risks to expect or mitigate. Even though First Step takes a social enterprise approach to the traditional staffing agency model, they needed to understand financial risks involved with securing start-up capital. Once NFF was confident that First Step had a viable strategy, it could confidently underwrite and structure the loan. With this knowledge, NFF has expanded its ability to consult workforce development providers and provide other business expansion loans within the sector.

Social Impact

First Step measures its social performance by tracking the proportion of its clients who are veterans, formerly incarcerated, or recently experiencing homelessness, as well as their clients' wages, the length of their employment, and their housing status and stability.[27] At the end of 2018, in its first year of operation, First Step of Philadelphia employed over 1,300 individuals recently experiencing homelessness.[28] Overall, First Step had an average of 600 workers employed weekly and paid more than $14.5 million in its first year.

In addition to offering the traditional services of a staffing agency, First Step provides wraparound services—including job and life coaching, connections to subsidized transportation, and housing placement assistance—that enable people with unstable life circumstances to succeed in job placements. First Step also works with its job seeker and employer clients to track the retention and mobility workers experience in the labor market. With operations now in Atlanta, Philadelphia, Nashville, and California's San Bernardino County, First Step can fill 98 percent of the job orders it receives from employer clients. In 2020, First Step paid $50.4 million in wages and employed 8,303 workers, 5,011 of whom were experiencing homelessness.[29]

One of the major benefits of this transaction was the expansion of a high-performing nonprofit into a new city through an acquisition. First Step's hybrid social enterprise model that combines revenue generation and wraparound services to expand in a cost-effective manner is a unique approach. In 13 months, the CDFIs helped First Step negotiate and structure a capital stack that could meet the financing and risk mitigation needs of a noncollateralized acquisition and also allow the nonprofit to meet its social impact goals.

Section III: Discussion and Conclusion

Too often, financing barriers stand in the way of workers who seek education for long-term career pathways and of training providers who want to build a stronger system to advance LMI workers. New strategies for workforce financing are increasingly relevant because of the rising cost of education, the rapid pace at which technology disrupts job functions, and the effect these changes have on the critical skills and competencies workers need to be competitive in the labor market, all of which requires workers to constantly upskill and re-skill. Furthermore, the workforce system as funded through the Department of Labor

[27] According to the 2020 annual report, First Step Staffing paid $50.4 million in wages to 8,303 workers. See First Step Staffing, *Annual Report 2020*, https://firststepstaffing.com/wp-content/uploads/2021/05/2020_FSS_AnnualReport.pdf.

[28] First Step Staffing, "First Step Philadelphia Celebrates One Year Anniversary and the Power of Employment to Transform Lives," *First Step News*, January 31, 2019, https://firststepstaffing.com/blog/first-step-philadelphia-celebrates-one-year-anniversary-and-the-power-of-employment-to-transform-lives/.

[29] First Step Staffing, *Annual Report 2020*, https://firststepstaffing.com/wp-content/uploads/2021/05/2020_FSS_AnnualReport.pdf.

has experienced decades-long divestment (since 2001 there has been a 40 percent reduction in WIOA), which creates an environment in which public funding alone is not sufficient to meet the demand of job seekers and employers.[30]

The case studies in this paper demonstrate that CDFIs have the tools to finance training, education, and infrastructure for workforce development, which enable sustainable growth in local labor markets. These examples highlight how CDFIs can modify existing loan products that extend credit access to players in the workforce field by attracting diverse funders and distributing their risks suitably, while designing underwriting standards that improve affordability and flexibility for borrowers. They also exemplify how CDFIs can forge relationships with key players in the workforce development system.

Each CDFI in these case studies played a different role within the workforce development system, demonstrating that CDFIs can be well equipped to address a variety of system financing needs. Freedom First Credit Union offered a student loan alternative through a small-dollar loan product to individual job seekers needing credentials. LISC helped Ivy Tech Community College use the NMTC program to accelerate investment in the facilities needed for a new culinary arts education program. The Nonprofit Finance Fund helped finance a business loan for facilities and operations to help First Step Staffing build a staffing firm for housing-insecure and formerly incarcerated people detached from the labor market. In each situation, the CDFI was a successful test bed for innovation and supported new workforce financing strategies to help workers find better jobs.

CDFIs and workforce development organizations are primed to expand collaboration given their shared goal to increase economic inclusion. The case studies discussed in this paper illustrate how CDFIs worked within the workforce system by expanding their subject matter expertise into previously unfamiliar industries and contributing their strengths as financiers to advance LMI communities into the mainstream economy. They also worked closely with borrowers to provide individualized consulting, technical assistance, and wraparound services. CDFIs' willingness to make these essential investments to finance workforce development creates space for innovation, expansion, and growth in the field.

In light of the COVID-19 pandemic federal response, CDFIs are well positioned to markedly increase their support of workforce development within their community development mission. The Consolidated Appropriations Act of 2021 committed a historic $12 billion investment to increase the capacity of community-focused financial institutions, recognizing that these institutions are uniquely capable of providing financial services to

[30] Larry Good and Earl Buford, *Modernizing and Investing in Workforce Development*, Corporation for a Skilled Workforce, 2021, https://skilledwork.org/wp-content/uploads/2021/03/Modernizing-and-Investing-in-Workforce-Development.pdf.

underserved communities that have been disproportionately impacted by the pandemic.[31] A critical component of pandemic recovery is helping unemployed and displaced workers reenter the workforce through quality jobs. This is especially applicable to those who need upskilling, the long-term unemployed, and those who face other barriers to employment, such as reliable transportation. Ensuring equitable access to upskilling, employment support, and placement during the recovery will require sufficient financial support and new partnerships allowing risk and reward to be shared among a diverse set of stakeholders.

The emergence of more partnerships between CDFIs and workforce development organizations will help address reskilling and upskilling to enable LMI workers to succeed in the workforce. While each CDFI faced different challenges in the case studies discussed, the recurring theme was bringing key partners—borrowers and funders—into the project. CDFIs and workforce development organizations can work together to bring diverse players, and consequently more funding, into the workforce development system by raising awareness of successful partnerships and developing a stronger shared interest across stakeholders. Doing so leads to opportunities for innovation and collaboration that provide more financing opportunities for training and education. A robust system of workforce development participants that includes workers, trainers, and funders will drive the sustainability and scalability of these transactions.

[31] This includes $3 billion in total CDFI Fund grant funding through the Rapid Response Program (with a first tranche of $1.25 billion). The CDFI Fund will make available up to $1.75 billion for grants to minority lending institutions and investment in low- and moderate-income minority communities in 2021. In addition, the Treasury Department created the Emergency Capital Investment Program, a direct capital investment program of up to $9 billion to depository CDFIs and Minority Depository Institutions. For more information, see US Department of the Treasury, CDFI Rapid Response Program, https://www.cdfifund.gov/programs-training/programs/rrp; US House of Representatives Committee on Financial Services, COVID-19 Stimulus Package, https://financialservices.house.gov/uploadedfiles/cdfi_mdi_stimulus_1-pgr_12.20.20.pdf; and US Department of the Treasury, Emergency Capital Investment Program, https://home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses/emergency-capital-investment-program.