

# UNLOCKING CATALYTIC CAPITAL:

## U.S. DOMESTIC INVESTMENT FUND (USDIF)

Thanks to generous support from the Tipping Point Fund on Impact Investing, the Sorenson Impact Center authored a series of three white papers exploring federal policy options to scale the impact investing market by unlocking catalytic capital. Please see the full paper for this policy and others at <https://www.sorensonimpact.com/policies-unlock-catalytic-capital>

**Existing federal efforts to direct public and private resources to small businesses and low-income communities face limitations in meeting the needs of underserved communities and populations.** A new U.S. Domestic Investment Fund (USDIF) can address these limitations and promote greater and more resilient inclusive economic growth. The USDIF would be dedicated solely to providing public catalytic capital to enable scaling of private investment to address domestic social and economic development needs and national economic priorities.

### OVERVIEW

The COVID-19 pandemic has highlighted vulnerability throughout the small business sector as well as structural inequities that disproportionately impact women, communities of color, and low-to-moderate income communities (LMI). A robust recovery effort to support these communities and the nation's economic priorities illustrates a deep and growing need for catalytic capital.

#### CATALYTIC CAPITAL

Investment capital that is patient, flexible, risk-tolerant, and sometimes concessionary. Catalytic capital enables either or both third-party traditional capital investment or follow-on investment that would not otherwise be possible.

While the CARES Act provided a foundation for crisis response, we believe the proposed long-term solution of the creation of a U.S. Domestic Investment Fund, which leverages private resources alongside public dollars, can create transformative change for a more inclusive, resilient and secure American economy.

#### EXISTING FEDERAL EFFORTS

Existing federal efforts such as the Small Business Administration (SBA), Community Development Financial Institutions Fund (CDFI Fund), and the Development Finance Corporation (DFC) perform important functions, but are not specifically addressing a critical need to foster an inclusive, resilient recovery and long-term equitable growth.

### PROPOSED POLICY

***We propose the creation of a USDIF dedicated to providing public catalytic capital to enable scaling of private investment to address domestic social and economic development needs and priorities.***

**Mission:** USDIF would provide domestic catalytic capital to facilitate private investment in an inclusive economic development framework, aligned with national economic policy priorities.

**Examples of Qualifying Catalytic Capital:** Equity and equity-like investments, subordinated debt, longer-term financial instruments, recoverable and non-recoverable grants, limited and partial guarantees and other insurance products designed to facilitate private sector investment into impact investment.

**Capital in times of Crisis:** The USDIF could be authorized to expedite direct capital investment into intermediary organizations, providing rapid liquidity.

**Restrictions:** The USDIF would not invest directly in companies, entrepreneurs, or nonprofit organizations, and the investments would be subject to size limitations.

**Feasibility:** Congress has historically established entities similar to the USDIF, such as the DFC and the CDFI Loan Fund.

**Implementation:** The USDIF could be housed in the Department of Treasury or Commerce. We recommend a separate entity, rather than expanding the mandate of existing agencies.

**Governance:** A governance structure would include an Investment Committee; an Interagency Council to coordinate the activities of the USDIF with other agencies; a Community Advisory committee; and Congressional Oversight.



**Example:** The Bank of North Dakota (BND) was established in 1919 with \$2 million in capital from the sale of state bonds. BND offers loans, bank services, student loans and refinancing options. Over the last ten years, the amount of lending per capita by small community banks in North Dakota has averaged about \$12,000, compared to \$3,000 nationally; additionally, North Dakota community banks averaged 434% more lending for small businesses over the last decade than the national average.

## THE USDIF FILLS CRITICAL GAPS

The USDIF would fill gaps left by the private markets, SBA, CDFI Fund, and DFC with:

- + An explicit domestic development mission, aligned with national economic policy priorities, with requirements for inclusive and equitable asset allocation with respect to geography, need, and populations.
- + An investment goal to become sustainable over time through the recycling of loan repayments and gains.
- + Greater flexibility to provide capital to project financing, a broader range of eligible organizations and local communities.
- + Broader eligibility of authorized investment instruments.
- + A sufficient business line for grant programs, which are oftentimes unavailable to historically marginalized communities.

### Comparison of SBA, CDFI Fund and the Proposed USDIF

	SBA	CDFI Fund	Proposed USDIF
<b>Range of Products and Tools</b>	Small business loan guarantees, loans to SBICs, small grant program	Grants, debt, financial and technical assistance, small proportion as equity	Equity and equity-like investments, subordinated debt, longer-term financial instruments, recoverable and non-recoverable grants, limited and partial guarantees and other insurance products
<b>Range of eligible organizations and projects</b>	For profit small businesses	CDFIs	Intermediary organizations, local investment funds and Special Purpose vehicles that invest in low-income communities and communities of color; Local government or community organizations to support local public-private partnerships.
<b>Focus on Underserved Populations and Communities</b>	3% of 7(a) loans went to Black Americans; 14% to 50%+ women owned businesses; 27% of SBIC capital went to LMI communities.	75% of local CDFI lending portfolios were targeted to LMI communities	Explicit focus on LMI communities, communities and people of color and women.

## POTENTIAL TO UNLOCK CATALYTIC CAPITAL

While it is difficult to precisely estimate the amount of private investment that every dollar of catalytic capital would incentivize, we can look to examples of existing public dollars that have a track record of catalyzing private investment.

**\$1 : \$3-4**

Estimated \$1 of DFC investment catalyzed \$3-\$4 of private sector investment

**\$1 : \$8**

\$1 of State Small Business Credit Initiative (SSBCI) capital leveraged \$8 of private sector investment

**\$1 : \$4**

\$1 of development funding in blended finance structures catalyzed \$4.1 of private capital.

