Palladium
IMPACT CAPITAL

A STUDY ASSESSING INVESTMENT CAPACITY FOR APPALACHIAN COMMUNITY CAPITAL AND ITS MEMBERS

Palladium Impact Capital and Woodstock Institute

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Executive Summary

Appalachian Community Capital (ACC) is a network of 24 community development financial institutions (CDFIs) and other mission-based lenders located throughout the Appalachian region that works to increase small business lending by providing underserved communities with new sources of capital. Started in 2013, ACC is a CDFI lending intermediary that raises and deploys capital through its members. It serves as a clearinghouse that links its members and their clients with information, funding, training, and technical assistance. It has grown from 11 founding members to 24 members in 2021. It has deployed over $18.5 million in leveraged debt that funded 92 small business loans and helped to create or retain about 2,000 jobs.

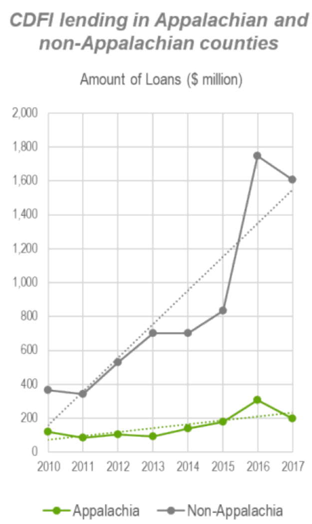
In the summer of 2020, ACC engaged Palladium Impact Capital (PIC) and Woodstock Institute to conduct an investment assessment of ACC members. The initial project goal was threefold:

- to assess ACC and its members in the context of the Appalachian region
- to identify capital sources and impact investors interested in investing in Appalachia.
- to create a narrative on the impact of capital investments on economic mobility

The objectives of the project were further refined in conversation with ACC's CEO in the course of the engagement, including putting more emphasis on some areas than others as the project evolved. This report presents the findings of our assessment.

Appalachian region

Appalachia is one of the poorest regions in the United States. The poverty rate in Appalachia is 12% above the national average. For comparison, the poverty rate in neighboring non-Appalachian counties (within the states that include Appalachian counties) is only 4.5% higher than the national average. The Region does have many rural counties with primarily white populations and those counties are some of the poorest in the country. However, 34.8% of the population in the Appalachian states is non-white and often suffers from poverty levels as severe. The minority population is growing and is concentrated in southern Appalachian states and in metro areas.



Appalachia has historically been financially underserved compared to the rest of the country. The lower access to credit and financial services has disproportionately affected small businesses. Since 2010, the trend for Appalachia has moved in a positive direction but the data shows that in the same period CDFI lending increased significantly more in the non-Appalachian counties. 20% of loans in Appalachia go to women-owned businesses versus 19% in non-Appalachian counties. 18% of those loans in Appalachia go to minority-owned businesses versus 24% in non-Appalachian counties.

ACC members

ACC members are growing in size and economic reach. As of YE 2019, total assets from ACC Aeris-reporting members were more than $740 million representing a 13% compound annual growth rate between 2015 and 2019. Despite the challenges of the pandemic, ACC members significantly increased loan volume and grew their balance sheets in 2020. However, the need for grant support and capital continues to be significant.

One of the most important roles played by ACC members is serving as a financing vehicle for small businesses and non-profits that do not fit traditional bank credit requirements. Each member defines their loan products and targets borrowers based on their assessment of unmet credit needs in their market. The decreased presence of community banks in rural areas and their overall move to larger loans in urban areas makes ACC members critical to the region's economic development. ACC members fill credit gaps and define their loan products to meet unmet credit needs in their markets. ACC members are a critical part of the infrastructure needed to rebuild local economies in rural Appalachia.

The ability to build trusted relationships with borrowers is the main competitive advantage of ACC members and one of the key ingredients to their business model. The relationships they develop with borrowers improve communication between lender and borrower and result in repeat borrowers, high numbers of client referrals and low levels of defaulted loans. This relationship community lending is by definition more expensive to underwrite and to service but typically leads to lower levels of defaulted loans, even though target clients may be viewed as riskier for traditional banks. Instead of competing, ACC members often forge partnerships and collaborate with other CDFIs and banks that appreciate having an outlet for borrowers that they cannot service. To further enhance their ability to reach deeper into unmet credit needs, ACC members develop partnerships with state and local governments to deliver programs that serve specific markets.

The majority of ACC members are not large enough to achieve economies of scale in their loan operations and financial performance is stressed by the cost of doing smaller hand-crafted loans to relatively unsophisticated borrowers. ACC members typically operate through structures allowing them flexibility in underwriting, product design and revenue streams. As such, ACC members develop targeted solutions across several business lines: (1) community lending, (2) program/fund management, (3) fee for service, (4) technical assistance and (5) policy and advocacy.

ACC members are distinguished by having highly committed boards and strong management teams, relative to size of the institutions. They have seasoned staff with a wealth of experience that would, however, be relatively hard to replace since talent with relevant background is hard to find, attract, and train in their service areas. ACC members have varying capacities in terms of technology; for some it is key advantage, for others – especially small ACC members - it is rather a challenge they need to address. Nonetheless, the majority of ACC members see digitization as an opportunity and are working on developing digital strategies.

Self-sufficiency is often unachievable due to the scale and business model of many ACC members, but they typically have robust levels of self-sustainability that are supported by reliable sources of grant funding. More unrestricted funding is needed to increase the ability of ACC members to grow and invest in the institutional capacity.

Appalachian Community Capital

ACC is a CDFI lending intermediary that raises and deploys capital through its member network of 24 community lenders. Its goal is to be a cost effective and highly impactful intermediary that helps funnel impact investment dollars to its members who then relend to Appalachian small businesses in need of access to affordable capital to support the revitalization of their communities. ACC's activities go beyond its primary purpose and can be divided into three functional areas: (A) capital intermediation, including capital raising and deployment, portfolio management and investor relations, (B) member services, including member acquisition and community management, member services and knowledge sharing, marketing, and communications, and (C) internal functions.

An engaged and growing membership base, a well performing portfolio and a highly regarded CEO are among the key strengths of ACC. There are also a few challenges that need to be addressed and turned into opportunities for ACC to thrive. For that to happen, ACC would benefit from renewed commitment from founding and existing funders as well as new ones that are willing to support development of the Appalachian region by taking ACC to the next stage. Besides investment capital, ACC should seek grant funding that would help reinforce its human resources and update its strategic plan to further build on its strengths and exploit the current attention and market opportunity for community lenders.

To reach this next stage and expand its impact, ACC will use the grant funding to create a concrete roadmap, alongside the updated strategic plan, to recapitalize and fund more robust operation in a continuous and sustainable fashion. It is expected the plan will include detailed projections of the capital needed in the short and long term by ACC and its members, an enhanced impact narrative aligned with the current market opportunity, considerations of alternative revenue sources and longer term staffing needed to execute on the plan.

It is the right time for ACC and its members to be taking this step forward alongside mission-driven funding and thought partners that are committed to attract more capital into the Appalachian region.

1. Introduction

Appalachian Community Capital (ACC) is a network of 24 community development financial institutions (CDFIs) and other mission-based lenders located throughout the Appalachian region that works to increase small business lending by providing underserved communities with new sources of capital. Started in 2013, ACC is a CDFI lending intermediary that raises and deploys capital through its members. It serves as a clearinghouse that links its members and their clients with information, funding, training, and technical assistance.

ACC has a broad and impactful goal: "to increase small business lending by providing ACC member institutions that serve underserved people and communities with new sources of capital." ACC envisions its commitment "to providing reliable and sufficient capital for all its members" will lead "to a growing economy, increased entrepreneurship, higher quality jobs and increased local wealth in the Appalachian region."[1]

ACC members are growing in size and economic reach. As of YE 2019, total assets from ACC Aeris-reporting members were more than $740 million. This represents approximately a 13% compound annual growth rate between 2015 and 2019. As of YE 2019 total loans outstanding from the reporting ACC members totaled more than $475 million, approximately a 15% increase between 2015 and 2019, and disbursed more than $750 million.[2] Despite the challenges of the pandemic, ACC members significantly increased loan volume in 2020.

In summer of 2020, ACC engaged Palladium Impact Capital (PIC) and Woodstock Institute to conduct an investment assessment of ACC members. The project goal was to assess ACC and its members in the context of the Appalachian region, identify capital sources and impact investors interested in investing in the Region and create a narrative on the impact of capital investments on economic mobility. The objectives of the project were further refined in conversation with ACC's CEO in the course of the engagement, including putting more emphasis on some areas than others as the project evolved. This report presents the findings of our assessment. Details on the methodology are outlined in the Appendix A.1.

1.1. The Appalachian region

Geography and demographics

The ACC service area focuses on the Appalachian region as defined by the Appalachian Regional Commission (ARC). The region includes 420 counties comprising all of West Virginia, and portions of Alabama, Georgia, Kentucky, Maryland, Mississippi, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, and Virginia.

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[1] See more at: https://appalachiancommunitycapitalcdfi.org/

[2] Based on data reported to Aeris by the following 13 ACC members: Access to Capital for Entrepreneurs (ACE), Carolina Small Business Development Fund, CommunityWorks, Finance Fund Capital Corp., Kentucky Highlands Investment Corporation, LiftFund, Mountain Association, Mountain BizWorks Inc., Natural Capital Investment Fund Inc., Pathway Lending, South Carolina Community Loan Fund, Southeast Kentucky Economic Development Corp., and Virginia Community Capital.

The Appalachian region spans over 205,000 square miles (about twice the area of Arizona) in 13 states[3] and is home to over 25 million people (about the population of Texas). It is primarily a rural area with larger towns and a sprinkling of mid-sized cities that serve as regional supply hubs and retail centers. The economy of Appalachia was built on resource extraction, primarily coal mining, logging, and agriculture.

Poverty

Appalachia is one of the poorest regions in the United States. According to the Appalachia Region Commission, the Appalachian average poverty rate is 15.8% almost 2% higher than the U.S. average of 14.1%.[4] Unemployment in the region has been high for decades. In the 1950s and 1960s a high school graduate could get a good paying job in the coal mines and earn enough to raise a family and buy a house. Since the 1950s, there has been a steady decline in coal mining jobs and unemployment and poverty rates have risen as a result. The 2017 unemployment rate in Appalachia ranged from 3.1% to 15.7%. The pandemic crisis has worsened unemployment and caused many small businesses to close.

The issues of rural poverty are very evident in inferior housing, inadequate medical care, and low education levels. A U.S. Department of Education study noted that "overall, educational attainment is generally lower in the region than nationally, with the proportion of students obtaining a bachelor's degree or higher lower in all but one state".[5]

Despite the progress made over the last decade, Appalachian states had nearly 5% higher poverty rate than the U.S. average in 2014-2018 (see Table 1.1). Moreover, the poverty rate in the Appalachian counties within those states is on average 12% higher than the U.S. average and, as such, nearly 8% higher than in its non-Appalachian counterparts in the Appalachian states.

While the culture and the history of unemployment and low education levels may lead to the perception that Appalachia is stuck in time, the region has been undergoing a quiet economic resurgence over the last decade driven in large part by the ARC's efforts in economic development. Key economic indicators of poverty, per capita income, and high school graduation rates are improving, as well as the number of Distressed Counties[6] in the region – in 2021 there were 78 Distressed Counties out of 420 which is the lowest number since the pre-recession year of 2007.

Diversity

There are many stereotypes that exist about Appalachia, including that there are few to no residents of color. The Region does have many rural counties with primarily white populations and those counties are some of the poorest in the country. The most severely affected areas are Appalachian counties in Kentucky (179.7% of U.S. average poverty rate), Ohio (121.1%) and West Virginia (126.4%). Unfortunately, there is no easily available data on the diversity breakdown between

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[3] The 13 states are referred in this report as 'Appalachian states' although not all their counties are situated in the Appalachian region. Or in other words, they include both 'Appalachian counties' forming the 'Appalachian region' and 'non-Appalachian counties.

[4] ARC, Poverty Rates, 2014-2018.

[5] U.S. Department of Education, 2016. *Identifying and Addressing Regional Education Needs*.

[6] Distressed County is an index-based economic classification based on (1) three-year average unemployment rate, (2) per capita market income and (3) poverty rate that is calculated by the ARC and compared against other counties nationwide. Distressed Counties are those that rand in the worst 10 percent of the nation's counties. See more at: https://www.arc.gov/distressed-designation-and-county-economic-status-classification-system/

Appalachian and non-Appalachian counties. However, there are observable trends in the state-level data. For instance, 34.8% of the population in the Appalachian states is non-white and often suffers from severe poverty levels. Mississippi's poverty rate is 46.3% and Virginia's is 34.4%, both well above the U.S. average. The minority population is growing and is concentrated in southern Appalachian states and in metro areas. For example, Memphis, Tennessee now has a majority minority population with African Americans representing 62% of the population

Table 1.1: Appalachian demography and poverty rates

State	Population[7]		Minority population[8]	Poverty Rate, of U.S. avg[9]		
	State-wide	Appalachia	State-wide	State-wide	Appalachia	Difference
Alabama	4,742,208	3,038,330	34.5%	124.5%	115.4%	-9.1%
Georgia	10,024,689	3,137,027	47.4%	114.1%	90.6%	-23.5%
Kentucky	4,302,315	1,128,997	15.4%	127.7%	**179.7%**	52.0%
Maryland	5,862,050	233,931	49.3%	67.2%	95.1%	27.9%
Mississippi	2,890,347	608,053	43.4%	147.7%	**146.3%**	-1.4%
New York	19,108,993	977,515	44.9%	104.2%	114.7%	10.5%
North Carolina	9,881,292	1,694,665	37.0%	109.7%	114.6%	4.9%
Ohio	11,319,092	1,941,714	21.1%	103.5%	**121.1%**	17.6%
Pennsylvania	12,380,149	5,487,525	23.6%	90.8%	92.6%	1.8%
South Carolina	4,814,032	1,220,566	36.4%	113.9%	104.1%	-9.8%
Tennessee	6,488,786	2,796,656	26.1%	114.8%	118.6%	3.8%
Virginia	8,162,107	717,491	38.3%	77.9%	**134.4%**	56.5%
West Virginia	1,776,501	1,776,501	8.0%	126.4%	**126.4%**	-
Total	**101,752,561**	**24,758,971**	**34.8%**	**104.5%**	**112.2%**	**7.8%**

1.2. Financial access in Appalachia

The Appalachian region has historically been financially underserved compared to the rest of the country. A study commissioned by the ARC to assess the effects of the Great Recession provides this summary:

"Access to banking remained a problem in Appalachia […]. While there was a modest increase in bank branches in Appalachia between 2007 and 2010, the rate of lending was still much lower than nationwide, despite regional bank assets of nearly $500 billion. In 2010, banks issued 41 small business loans per branch across the nation, while in Appalachia, banks provided 25 loans per

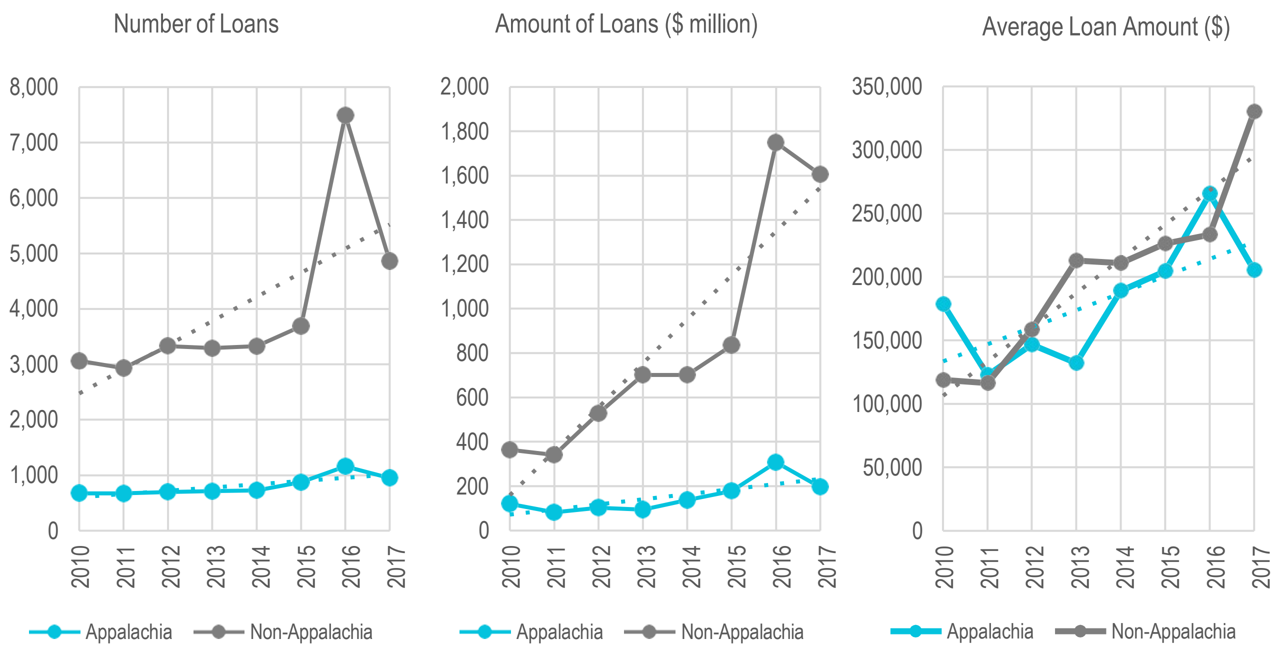
[7] ARC, Poverty Rates, 2014-2018.
[8] U.S. Census Bureau, 2017.
[9] ARC, Poverty Rates, 2014-2018.

branch. Furthermore, the increase in branches of banks not headquartered in Appalachia disproportionally occurred in the economically advantaged counties. As a result of all these trends, small business owners in Appalachia […] were more likely to rely on credit cards and personal savings to finance their businesses [than their counterparts in the nation as a whole]."[10]

Moreover, the lower access to credit and financial services in the Appalachian region, especially in the years following the Great Recession, disproportionately affected small businesses. According to the ARC-commissioned report, "Small-business lending declined sharply in Appalachia between 2007 and 2010 — from over 800,000 loans totaling $24 billion to 255,000 loans totaling $13 billion. As a result, the percentage of small businesses receiving loans in Appalachia during this period trailed the percentage for the nation as a whole."[10]

Since 2010, the trend for Appalachian counties has moved in a positive direction – both the number and total dollar amount of CDFI loans in these counties has significantly increased (see Chart 1.1). Between 2010 and 2017, the total number of loans increased by 41% (5% CAGR) and their dollar amount by 62% (7% CAGR) while the average loan amount increased by 15% (2% CAGR). Despite the positive trend, data from the U.S. Treasury Department's CDFI Fund shows that in the same period CDFI lending increased significantly more in the non-Appalachian counties (in Appalachian states).

Chart 1.1: CDFI lending by year in Appalachian and non-Appalachian counties, 2010-2017[11]



[10] ARC and National Community Reinvestment Coalition, July 2013. *Access to Capital and Credit in Appalachia and the Impact of the Financial Crisis and Recession on Commercial Lending and Finance in the Region*. Quote from the Press Release to the report with edits from the authors, see more at: https://ncrc.org/ncrc-releases-report-on-capital-and-credit-access-for-small-businesses-in-the-appalachian-region/

[11] Data from the Community Investment Impact System (CIIS) collected by the CDFI Fund, 2010-2017.

The data shows a similar picture for CDFI lending for the entire period of 2010-2017 (see Table 1.2). In the 13 Appalachian states, the Appalachian counties received fewer loans by number (on average 7% less) as well as a lower dollar amount of loans (on average 9% less) compared to the population percentage living in those counties. Similarly, the average loan amounts originated in the Appalachian counties are lower (on average by 11%) than those being disbursed in the Appalachian states in aggregate (i.e., including both Appalachian and non-Appalachian counties).

Table 1.2: CDFI lending in Appalachia by state, 2010-2017[12]

State	Population	Number of loans		Amount of loans		Average loan amount
	Appalachia	Appalachia	Difference	Appalachia	Difference	Difference
Alabama	64%	72%	8%	70%	6%	-2%
Georgia	31%	24%	-7%	14%	-17%	-41%
Kentucky	26%	77%	51%	84%	58%	8%
Maryland	4%	2%	-2%	6%	2%	170%
Mississippi	21%	7%	-14%	7%	-14%	-6%
New York	5%	5%	0%	2%	-3%	-63%
North Carolina	17%	49%	32%	23%	6%	-53%
Ohio	17%	5%	-12%	6%	-12%	13%
Pennsylvania	44%	31%	-14%	33%	-11%	7%
South Carolina	25%	9%	-16%	2%	-23%	-73%
Tennessee	43%	18%	-25%	27%	-16%	51%
Virginia	9%	20%	12%	9%	0%	-56%
West Virginia	100%	100%	0%	100%	0%	0%
Total	**24%**	**17%**	**-7%**	**15%**	**-9%**	**-11%**

[12] Data from the Community Investment Impact System (CIIS) collected by the CDFI Fund, 2010-2017. ‘Difference’ shows the difference between Appalachian and non-Appalachian counties.

In the Appalachian region, only 36% of the number of loans and 20% of loan amounts go to women-owned businesses (see Table 1.3). In terms of number of loans, Appalachia lags behind the state-wide average (by 5%) but is slightly above the state-wide average in total dollar amount of loans (by 1%). There is a clear disparity in the loan amounts to women-owned businesses compared to loans going to male-owned businesses across the Appalachian states. The loans in non-Appalachian counties to women are on average half the amount of loans to men; the situation is marginally better in the Appalachian counties with 'only' a 43% difference.

Table 1.3: CDFI Lending to women in Appalachia by state, 2010-2017[13]

State	Number of loans		Amount of loans		Average loan amount	
	State-wide	Appalachia	State-wide	Appalachia	State-wide	Appalachia
Alabama	45%	42%	21%	19%	-53%	-56%
Georgia	43%	37%	33%	42%	-24%	12%
Kentucky	36%	28%	24%	14%	-33%	-51%
Maryland	37%	N/A	19%	N/A	-50%	N/A
Mississippi	49%	43%	18%	3%	-64%	-92%
New York	45%	27%	37%	11%	-16%	-58%
North Carolina	42%	46%	15%	28%	-64%	-39%
Ohio	35%	14%	25%	8%	-28%	-43%
Pennsylvania	40%	36%	15%	24%	-62%	-32%
South Carolina	48%	49%	28%	31%	-42%	-36%
Tennessee	28%	26%	13%	8%	-54%	-70%
Virginia	32%	40%	33%	23%	5%	-42%
West Virginia	33%	33%	15%	15%	-56%	-56%
Total	**41%**	**36%**	**19%**	**20%**	**-54%**	**-43%**

[13] Data from the Community Investment Impact System (CIIS) collected by the CDFI Fund, 2010-2017; including only loans with 'male' or 'female' gender information.

On average, minority populations (35% across Appalachian states) receive proportionately a higher number of loans (57% of state-wide total) than white populations but with much lower dollar amounts (24% of state-wide total; see Table 1.4). That also results in average loan amounts to minority borrowers being more than three quarters lower than white borrowers. The relative levels of minority lending are significantly lower in the Appalachian counties than in the Appalachian states in aggregate (inclusive of non-Appalachian counties). On the other hand, the difference between average loan amounts for minority and majority borrowers is not that large in the Appalachian counties. This is probably due to the lower average loan amounts in those communities overall (refer to Table 1.2).

Table 1.4: CDFI lending to minority population in Appalachia by state, 2010-2017[14]

State	Minority population[15]	Number of loans		Amount of loans		Average loan amount	
	State-wide	State-wide	Appalachia	State-wide	Appalachia	State-wide	Appalachia
Alabama	35%	67%	64%	73%	69%	33%	26%
Georgia	47%	62%	41%	52%	28%	-35%	-45%
Kentucky	15%	11%	5%	14%	6%	32%	22%
Maryland	49%	67%	N/A	41%	N/A	-65%	N/A
Mississippi	43%	36%	92%	17%	94%	-64%	31%
New York	45%	79%	66%	45%	87%	-79%	234%
North Carolina	37%	50%	34%	19%	16%	-76%	-64%
Ohio	21%	49%	29%	25%	12%	-64%	-66%
Pennsylvania	24%	42%	28%	18%	19%	-70%	-40%
South Carolina	36%	56%	67%	31%	46%	-64%	-58%
Tennessee	26%	32%	13%	17%	10%	-55%	-29%
Virginia	38%	33%	3%	31%	1%	-9%	-65%
West Virginia	8%	7%	7%	8%	8%	19%	19%
Total	**35%**	**57%**	**29%**	**24%**	**18%**	**-76%**	**-48%**

[14] Data from the Community Investment Impact System (CIIS) collected by the CDFI Fund, 2010-2017; excluding loans with ‘blank’ race information.
[15] Includes only loans going to non-white borrowers.

2. Assessment of ACC and its members

2.1. Appalachian Community Capital

ACC was launched in 2013 as a wholesale finance intermediary with the mission to increase small business lending in the Appalachian Region by providing its members and other high-performing loan funds in the region with new sources of capital. Any capital intermediated by ACC to its members must be deployed in the 420 Appalachian counties as defined by ARC.

By year-end 2020, ACC had deployed over $18.5 million in leveraged debt that funded 92 small business loans in Appalachia that helped to create or retain about 2,000 jobs. 40% of the loans were made to minority- or women-owned businesses.

In addition to its primary focus on bringing new sources of capital to Appalachia, ACC has been providing a broad range of other services designed to strengthen the organizational capacity of member (and non-member) institutions, providing them with technical assistance, facilitating knowledge sharing, and promoting the important work for their communities through conferences and thought leadership.

ACC was recognized by Forbes as one of the top 20 Opportunity Zone catalysts in the country in 2020.

2.1.1. Functional areas and capacity

ACC's activities can be divided into three functional areas: (1) Capital intermediation, (2) Member services, and (3) Internal functions. "Internal functions" involves everyday administrative tasks as well as strategic planning.

Table 2.1: ACC's functional areas[16]

Functional area	Functions	Selected activities	Lead	Support
Capital intermediation	Capital raising	▪ Debt: From solicitation to closing ▪ Grant: Proposal writing	CEO	CONT
	Capital deployment and portfolio management	▪ Loan committee meetings ▪ Portfolio analysis	CEO	CONT
	Investor relations and reporting	▪ Regular investor interactions ▪ Report preparation and upload	CEO	
Member services	Member acquisition and community management	▪ Growth of membership ▪ Membership communications	CEO	
	Member services and knowledge sharing	▪ Workshops, trainings ▪ Technical assistance	CEO	
	Marketing and communications	▪ Articles, success stories ▪ Conferences, events	CEO	CONT

[16] Legend: CONT = Contractor; SVP FIN = Senior Vice President, Finance; OA = Opportunity Appalachia.

Internal functions	Special projects	▪ OA, emergency grants	CEO	
	Strategy and governance	▪ Strategic plan, board meetings	CEO	CONT
	Finance and admin	▪ Budget, audit, admin	CEO	SVP FIN

ACC currently has only one full-time employee, its CEO, who is supported by a pool of contractors, such as a Senior VP-Finance, underwriters, and grant writers, as well as Virginia Community Capital, a CDFI that provides back office support. Nonetheless, the majority of the functional areas is led and staffed solely by the CEO.

2.1.2. Strategic plans and business model

ACC was launched with a strategic plan anticipating that it would raise $6 million in grant and $42 million in debt capital. ACC's initial fund-raising efforts fell short of these goals. In 2015, when ACC closed its initial fundraising campaign, it had raised $3.4 million in grant and $12 million in debt capital. Since 2015, ACC has been able to attract additional grant capital and disburse a total of $18.2 million in loans to its members.

In 2019, ACC revised its strategic plan and set targets to attract an additional $28.4 million in new capital that would allow it to diversify its portfolio (by increasing its share in loan participations) and improve earned revenues. It prioritizes Capital intermediation, with ACC's fundraising strategy being the main area of focus.

The plan outlines a fundraising strategy with a clear timeline and targets. Very limited consideration is given to alternative revenue streams, membership growth, type and level of Member services and the human capital capacity needed to deliver on the plan. Similarly, the projections for the 2019 plan do not provide a more detailed breakdown of financial assumptions and results by functional area. Specific points for consideration include whether and when Capital intermediation may be self-sufficient – on its own and when including expenses related to Internal functions – and how Member services can be funded – whether solely through grants, or through a combination of grants, membership fees, and contributions from Capital intermediation.

A clearer delineation of needed revenue streams and functional expenses would allow ACC to better justify its asks to donors for strategic activities and help its members better understand what value they receive for their membership fees. The latter is particularly relevant as larger ACC members that have capacity to raise their own capital do not view themselves as strategically dependent on ACC for capital raising and have less incentive to provide additional resources for ACC to build its capacity. On the other hand, smaller ACC members that are more dependent on ACC for capital raising do not have the resources to invest in ACC's capacity.

Despite limited insight into assumptions underlying the strategic plan, the outlined fundraising strategy seems rather ambitious given ACC's existing resources, yet it may not bring ACC to the desired level of financial self-sufficiency based on earned income from Capital intermediation.

2.1.3. Key strengths and weaknesses

ACC has a solid membership base composed of impressive and diverse institutions serving the Appalachian region. Furthermore, over the past few years it has succeeded in attracting new members – increasing the membership from 11 founding members in 2014 to 19 members in 2019 and 24 members in 2021.

Although levels of engagement vary across the membership, member participation in sessions organized by ACC is high and members find value in them. During interviews conducted as part of this assessment, ACC members spoke very positively about ACC and the role it plays in supporting their efforts. The strength of ACC's membership is further evidenced by the good performance of its portfolio of loans to members. To date, ACC has experienced no charge-offs or non-accruals as it continues to lend in underserved communities in Appalachia.

ACC is led by a well-connected CEO who is one of the highest regarded leaders of the CDFI industry. Through its CEO, ACC is often showcased at various conferences, events, and forums.

However, ACC has not been successful in raising the amounts of capital as planned. The reasons for that are both external, e.g., the general limited interest in investing in Appalachia by traditional CDFI investors, and internal, particularly due to limited human and financial resources.

2.2. ACC members

ACC members span the Appalachian region, from New York state in the Northeast (Alternatives FCU) to Mississippi in the South (Three Rivers Planning and Development District). ACC members for the most part have a focused footprint that rarely crosses state boundaries. They serve communities as diverse as the Appalachian region itself, from urban markets in the metro areas of Georgia and Tennessee to remote rural areas of Kentucky. The majority of ACC members operate in Appalachian counties alongside other, often adjacent, markets. A minority of ACC members focus exclusively on the Appalachian counties (e.g., Mountain Association, Mountain BizWorks, Kentucky Highlands Investment Corporation).

The markets served strongly influence the nature of the CDFIs. Most ACC members serving predominantly rural areas remain relatively small, with the exception of Kentucky Highlands, and face challenges attracting the right talent to serve remote, rural areas. These rural areas tend to be composed of lower income communities and have smaller, and in some cases no, minority populations compared to the urban areas. All medium to large ACC members serve some urban areas which has allowed them to scale more easily. However, serving urban areas comes with another set of challenges including increased competition for clients and talent.

Geographic focus and size are key criteria in a more detailed analysis of the ACC membership (see Table 2.2) and allows us to better understand their diversity, stage of development, and the related challenges they typically face.

Table 2.2: Categorization of ACC members by geographic focus and size

Category[17]	Members	Description
Small rural	▪ Mountain Association ▪ Mountain BizWorks ▪ People Inc ▪ SKED ▪ Three Rivers Planning and Dev ▪ Woodlands Com Lenders	▪ Small institutions serving exclusively rural markets ▪ Facing limitations of local talent pools and low capacity to invest in systems ▪ Mostly reliant on grant funding and below market debt capital
Small General	▪ Appalachian Dev Corp ▪ Appalachian Growth Capital ▪ CommunityWorks ▪ Piedmont Business Capital ▪ Sabre Finance	▪ Small institutions serving urban markets and adjacent rural areas
Medium	▪ Access to Capital for Entrepreneurs ▪ Carolina Small Biz Dev Fund ▪ Finance Fund Capital Corp ▪ Natural Capital Inv Fund ▪ SC Community Loan Fund	▪ Institutions serving multiple rural and urban markets ▪ On the trajectory to scale up and become more self-sufficient ▪ Looking for new capital for further growth
Large	▪ Alternatives FCU ▪ Bridgeway Capital ▪ Kentucky Highlands Inv Corp ▪ Pathway Lending ▪ Virginia Community Capital	▪ Established institutions with refined business models and strong teams and systems ▪ Being or close to becoming self-sufficient ▪ Stable capital raising channels and seeking diversification

2.2.1. Target markets and peers

The markets that ACC members serve are highly differentiated. Some members are lending in rural areas traditional banks are leaving creating “banking deserts”. For example, Mountain BizWorks serves 26 counties in North Carolina which are rural and mountainous. More than 60% of community banks in this area have closed branches over the last six years and the remaining banks are retreating from originating smaller loans. The gap left by the more traditional institutions is being filled by alternative lenders, such as payday lenders and (to a lesser extent) digital platforms that provide only standard products that are often usurious and not best suited to the client needs.

Some ACC members, on the other hand, are lending in urban areas where larger and well capitalized borrowers are well served by traditional banks. There are few large national banks with a footprint in the region but there are strong regional banks that are expanding and compete with some local community banks for commercial customers. However, traditional underwriting standards limit their lending to the most profitable customers. Community banks, on the other hand, often work in partnership with ACC members. For example, Pathway Lending serves four urban markets in

[17] Classification to small, medium, and large is made based on the size of the institution’s loan portfolio (LP) with the following criteria. Small: LP < $15m; Medium: $15m < LP < $40m; Large: $40m < LP. Classification to rural and general is based on responses of the ACC members participating in a survey conducted by the authors; members unable to participate in the survey were classified based on publicly available information.

Tennessee and two in Alabama. It often lends to borrowers that do not meet traditional bank credit criteria and about 75% of its loan applications are referred by community bank partners.

Table 2.3: Market characteristics by ACC member category

Category[18]	Market competition	Competition type	Competitive offerings
Small rural	▪ Competition only for most profitable customers (80%)	▪ A wide range of financial service providers ▪ Higher levels of payday lenders and digital platforms	▪ Only very standard products available (60%)
Small general	▪ Very few lenders (75%)	▪ Mainly banks and CUs ▪ Higher levels of payday lenders, not digital platforms	▪ Wider range but too conservative underwriting (75%)
Medium	▪ Varying levels of competition	▪ Mainly mainstream banks	▪ Wider range but too conservative underwriting (75%)
Large	▪ Extremely competitive (67%)	▪ A wide range of financial service providers ▪ Not digital platforms	▪ Wide range of product offerings

ACC members fill credit gaps and define their loan products to meet unmet credit needs in their markets. Both CommunityWorks and Mountain Association specialize in micro loans to sole proprietors and very small businesses. Other ACC members seek out historically underserved businesses with a particular focus on minority- and women-owned businesses. The decreased presence of community banks in rural areas and the overall move to larger loans in urban areas makes ACC members critical to the region's economic development.

2.2.2. Business model

The vast majority of ACC members are non-profit loan funds, and they tend to share a similar business model. ACC members are not only community lenders, but also typically have multiple business lines to support their communities and to improve their own operational sustainability.

Relationship community lending

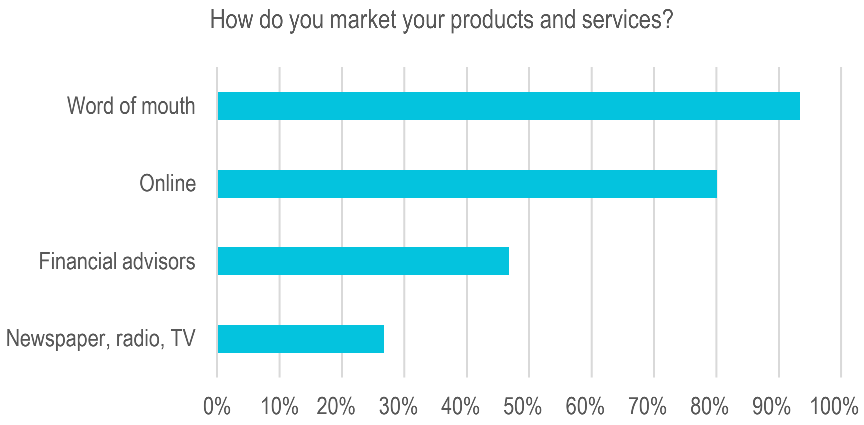
ACC members are relationship lenders that work with borrowers to build trusting partnerships that provide the business insight needed to supplement standard underwriting processes while managing risk. They secure grant funding and debt capital to support their lending and to help defray the cost of technical assistance.

The ability to build trusted relationships with borrowers is the main competitive advantage of ACC members. The partnerships they develop improve communication between lender and borrower and result in repeat borrowers and low levels of defaulted loans. The strong relationships with existing

[18] Classification to small, medium, and large is made based on the size of the institution's loan portfolio (LP)with the following criteria. Small: LP < $15m; Medium: $15m < LP < $40m; Large: $40m < LP.

clients result in high numbers of new client referrals. Over 90% of ACC members rely on word-of mouth marketing.

Chart 2.1: Marketing channels of ACC members



ACC members provide significant flexibility on payment terms and work closely with borrowers when they encounter obstacles in repaying their loans. However, ensuring the stability of the loan portfolios is key to the survival of the institution so delinquency and default rates are monitored closely so that they stay within typical CDFI ranges.

Structures allowing flexibility

Two ACC members are structured as regulated financial institutions: Virginia Community Capital is a state-chartered bank in Virginia and Alternatives FCU is a federally chartered credit union based in New York. All other ACC members are structured as unregulated community loan funds. This structure provides them the freedom to offer flexibility in underwriting and product design. To provide itself with that flexibility, Virginia Community Capital has a nonregulated revolving loan fund as a companion lender to its bank.

Forging partnerships

ACC members do not compete based on price or product. They often collaborate with other CDFIs and banks. Local, regional and community banks are an especially important source of debt capital and grant funding for many ACC members. Because banks are obligated under the Community Reinvestment Act to meet the credit needs of low- and moderate-income communities in their service areas, local banks refer borrowers to ACC members to expand their outreach to businesses that need smaller loans and take more time to underwrite. Filling this niche is the goal of ACC members and the banks appreciate having an outlet for borrowers that they cannot service.

The majority of ACC members are certified CDFIs and can secure capital and grant funding from the CDFI Fund as well as other federal government sources. Most ACC members have a good relationship with state government which is a source of debt capital and referrals. The goal of one

ACC member, for instance, is to serve as the distribution channel for municipal funds for small businesses.

All ACC members reported they partner with other institutions including banks, foundations, non-profit organizations, state agencies, municipalities, and other technical assistance providers. Sixty percent of ACC members have one or more close affiliates that support them in furthering their mission.

Designing targeted solutions across several business lines

ACC members are often required to design a special loan pool, a special loan product, and/or open new loan offices to secure needed capital. This requires investment to support increased lending and build the needed infrastructure. As a result, ACC members now mostly require companion grant funds to support their lending, not just debt capital. Two members reported that it takes about three years to get a new loan office to break even at the cost of $250,000 a year. Without grant support they cannot afford to expand.

This requires investment to support increased lending and to build the needed infrastructure to meet the conditions of the funder. As a result, some ACC members now require companion grant funds to support their lending, not just debt capital. Two members reported that it takes about three years to get a new loan office to break even at the cost of $250,000 a year. Without grant support they cannot afford to expand.

Some specialized loan pools are place-based. Pathway Lending has four loan pools targeted at specific geographies: Memphis, Knoxville, Knox County, and Alabama. Some are designed to meet specific impact goals. Mountain Association offers energy audits coupled with loans for needed upgrades to save on energy bills. Their business customers have installed solar panels, energy efficient equipment, and realized thousands of dollars in energy bill savings. CommunityWorks offers affordable housing loans to community developers and non-profit organizations. Some are focused on specific demographics. Many operate business development centers for women and at least one for minority-owned businesses.

Technical assistance is another competitive advantage for ACC members. The assistance they offer helps strengthen small business customers and provides the support they need to grow and thrive. ACC members provide technical assistance to borrowers before and after loan origination to backstop unsophisticated business plans and insufficient record keeping. Technical assistance can include advice on business processes, help with debt structures, and cash flow priorities.

Table 2.4: Business lines of ACC members

Business lines	Description	Key features	Funding sources
Community lending	▪ Traditional community lending based on strong relationships, providing affordable financing with focus on small businesses	▪ Strong relationships ▪ Flexible terms	▪ Debt, incl. CRA ▪ Grants (various sources)
Program / fund mgmt.	▪ Management of state and municipal programs (may include both debt and grant funding, processing applications and managing related interventions)	▪ Leveraging on-the-ground knowledge, underwriting and portfolio management expertise	▪ State ▪ Municipalities
Fee for service	▪ Consultancy and other professional services leveraging ACC members' proximity to communities and ability to design and implement impactful solutions	▪ Tailored solutions for target communities	▪ Municipalities ▪ Corporations

Technical assistance	▪ Provision of business and other trainings to the clients ▪ Often includes affiliated accelerators and development centers	▪ Typically provided alongside other business lines	▪ Grants (various sources)
Policy and advocacy	▪ Influencing and advising policies critical for delivering impactful community interventions ▪ Promoting the case for community lenders	▪ Policy changes unlock or hamper impact at scale ▪ High level of uncertainty and 'indirect' outcomes	▪ Grants (various sources)

ACC members serve as a bridge between the unmet credit needs of small businesses and impact investors. They have the capacity to identify specialized niches, design specialized loan products and move quickly to meet the needs of their borrowers. They also often partner with local governments to design and implement economic development programs in their communities.

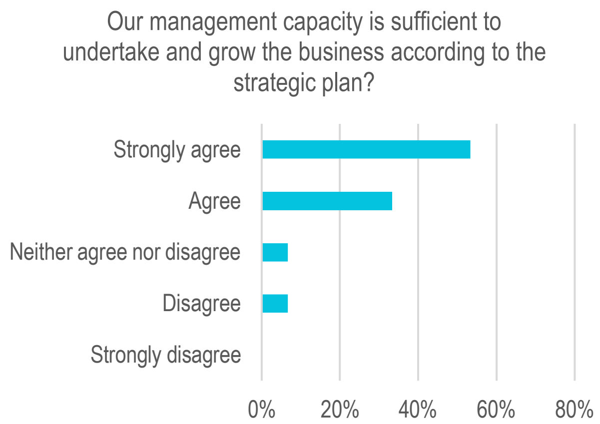
2.2.3. Operations

This section looks at some key operational considerations of ACC members across four broader areas.

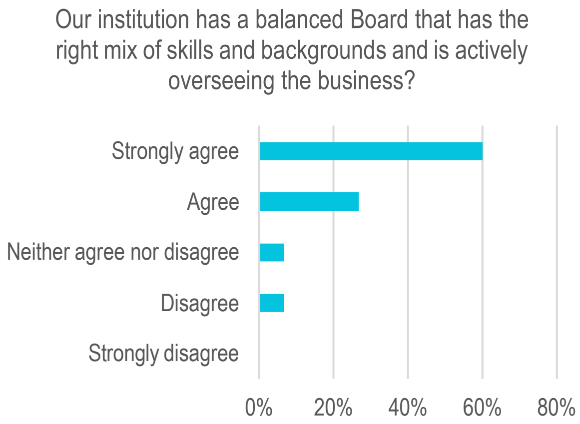
Governance and management

ACC members have strong governing boards that provide strategic guidance, fiduciary oversight, and market intelligence (see Chart 2.1). The CEOs value their board's advice and guidance. The area where some ACC members want to strengthen board skills is loan portfolio management. They are anticipating weaknesses in their loan portfolios in 2021 due to the impact of the pandemic on the overall economy and see value in board members who have experience to augment staff skills in managing higher delinquencies and defaults.

Chart 2.2: ACC members have balanced Boards and strong management teams[19]



19 Based on survey conducted for this report across ACC members. See Appendix for more detail about the methodology.



Strategic planning is a well-established discipline among ACC members although several have delayed the creation of a new strategic plan until later in 2021 when the impact of COVID becomes clearer. The capacity for strategic planning is heavily dependent on the size of the institution – wider teams at larger ACC members allow for well thought-through strategies, whereas smaller institutions suffer from the lack of capacity in their current team. Capacity development grants for strategic planning will be helpful in 2021 particularly to those institutions. All the CEOs interviewed anticipate balance sheet growth and institutional expansion over the next three years. Despite the potential negative impact of COVID on the economy in 2021 they remain optimistic about the future.

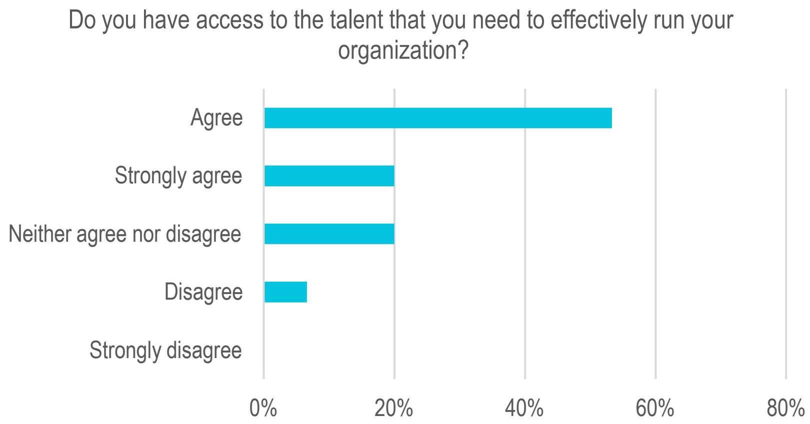
Organizational structure and talent

Due to the specific features of the ACC members' business models, they need to attract and retain mission-aligned and high-quality talent. While ACC members report that they have access to the talent they need (see Chart 2.2), many face challenges in recruiting new talent to grow the team or replace departing staff. The barriers to recruitment include the inability to compete with banks on total compensation; the perceived and real disadvantages of rural locations, especially in finding talent with required financial and technical expertise; and the need to find staff that are committed to the mission of the organization. Several ACC members would appreciate having more CDFI training opportunities for their employees, for both junior and senior staff. Often staff come from outside the CDFI industry and training in CDFI principles and practice would be helpful.

Several ACC members are reliant on seasoned, long-term core staff who would be extremely hard to replace should they leave the organization. They recognize this risk, but limited budgets make it difficult to deepen their talent pool.

Chart 2.3: Access to talent by ACC members[20]

[20] Based on survey conducted for this report across ACC members. See Appendix for more detail about the methodology.



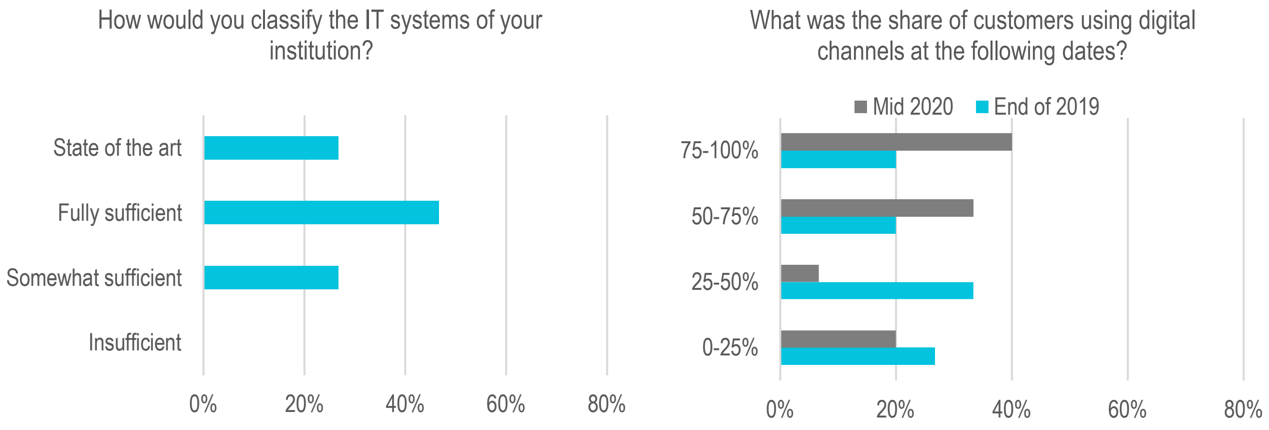
Technology

Operational capacity differs across the membership with probably the most glaring variance in technology infrastructure. The immediate need to switch to remote working due to the pandemic spotlighted the technology gaps between members. Several members have invested in technology upgrades over the years and were well positioned to quickly pivot to remote working and online lending. For example, Pathway Lending began to invest in its technology platform in 2002. It originates loans through Salesforce and has real time dashboards for financial reporting. It has had lenders working remotely across its broad service area for years. The impact of the pandemic on its workforce was lessened by its strong technology infrastructure.

Others have older technology and are looking to improve both their back-end and front-end systems. On the back end, some do not have robust digital systems to manage loan processing and servicing in a remote work environment. On the front-end, the key challenge is subpar client-facing web interface and inadequate means of collecting impact and financial information from clients. A few ACC members face challenges integrating the various digital platforms used. Being smaller players with limited IT support and reliance on third party providers causes additional challenges. ACC members appreciate that with ongoing digitization comes increased IT risk that they need to manage.

Since the COVID crisis forced a pivot to remote working, ACC members' clients have significantly increased the usage of digital communication channels. Most ACC members now accept online loan applications, and many are able to process, disburse and/or service loan requests online.

Chart 2.4: Technological capacity[21] of ACC members and uptake of digital channels by clients



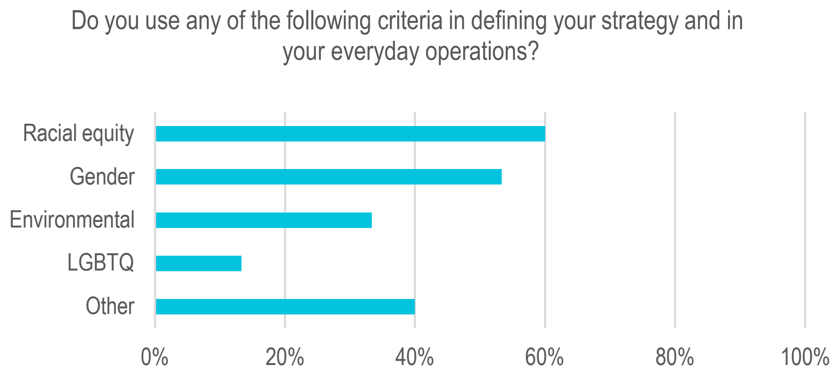
While some ACC members report dealing with less than adequate technology, 87% of ACC members are developing new digital strategies and planning to invest in technology. Two thirds of ACC members expect the move towards digital financial services to benefit their institutions. ACC members are resilient and have found ways to adapt to COVID including with quick technology upgrades, but this is one area where capacity grants in 2021 would be helpful.

Impact Management

ACC members' impact management and measurement are mostly driven by investor requirements, with only a few ACC members having a fully developed impact framework tightly aligned with their strategy. Many ACC members measure their efficacy primarily through financial and business indicators and report their impact on a case-by-case or anecdotal basis. Borrower stories are a common impact reporting measure and one that impact investors appreciate. A few ACC members measure the achievement of their mission against a wide range of impact metrics. The most prevalent impact measure is the number of jobs sustained. Sixty percent of ACC members report racial equity metrics and over 50% report gender metrics.

[21] Full versions of the offered response options read: State of the art (one of the key strengths of the institution), Fully sufficient (able to meet the needs of the institution but not exceeding the basic requirements), Somewhat sufficient (causing occasional challenges), Insufficient (causing regular operational challenges).

Chart 2.5: Selected impact criteria/ metrics used in everyday operations

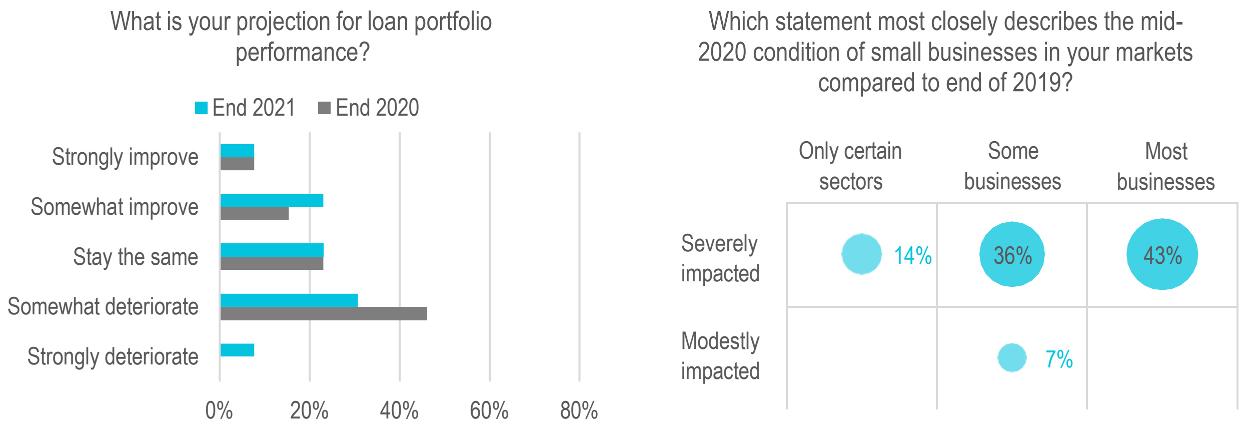


2.2.4. Loan portfolio

The loan portfolios of ACC members have similar delinquency/default characteristics as other CDFIs. Although the 30-day delinquencies are higher than those of traditional banks, they remain solid given the risk profile of their target clients. Between 2017 and 2019 the average 30-day delinquency rate for ACC members was 3.0% and average net charge offs were only around 1.0%. The cited drivers of bad loans between 2017-2019 were local market conditions (62%) and macroeconomic factors (38%). This changed with the pandemic, in 2020 the key driver of delinquencies was the impact of COVID 19 (62%) followed by local market conditions (46%).

COVID has negatively impacted ACC member loan portfolios. In the spring of 2020 loan deferrals were high, and some members did routine deferrals to help borrowers survive the crisis. Since April 2020, ACC members originated high volumes of Paycheck Protection Program (PPP) loans and Rapid Recovery loans funded by state CARES Act money. These relief loans reduced the number of loan deferrals and, in some cases, improved delinquency rates relative to 2019. Several ACC members reported that the small number of loans that were on their watch lists during the COVID crisis were already troubled before the pandemic started.

Chart 2.6: Effects of COVID on ACC members' target clients and portfolios



The CARES Act is a major reason that borrowers and ACC members have been able to weather the COVID crisis. Most ACC members (71%) received a PPP loan and/or a Rapid Recovery loan. Many made PPP loans and/or Rapid Recovery Loans to their borrowers (71%). Several became distribution channels for local and state pandemic relief loans and grants. While these loans helped borrowers to weather the initial financial impact of the shutdown, ACC members see a need for working capital loans and grant funding for their clients in 2021.

The institutional impact of the rapid deployment of new loan capital and grant funds has been significant. 2020 loan volume has often been several times higher than in previous years, but staff have responded very positively. During 2020, many ACC members have doubled, or tripled loan originations compared to 2019. Simultaneously they have created new partnerships and products and reinvented their working methods. One example is the Carolina Small Business Development Loan Fund that in seven months originated 210 loans with an average loan size of $26,000. At the same time as they ramped up lending, they became a distribution channel for grants from local government and developed new partnerships with local universities, city, county and state governments and private foundations.

As a result of the dramatic increase in the number of loans originated and the decrease in loan delinquencies, 2020 revenues have increased significantly. Many of the ACC members are wisely increasing their loan loss reserves.

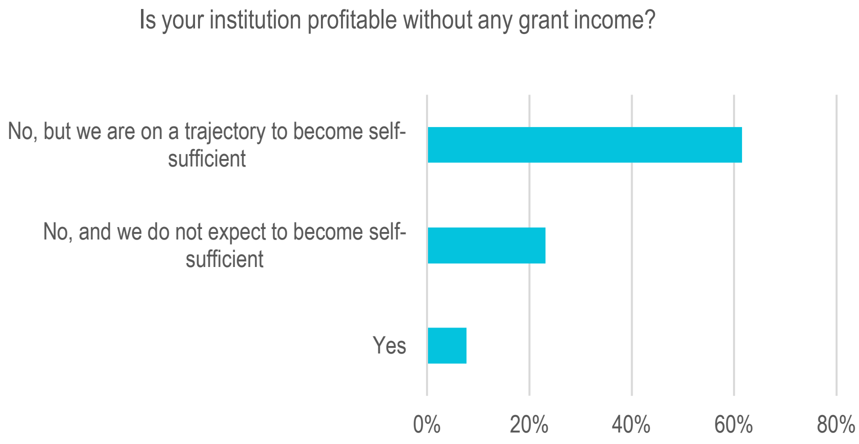
In addition to the hands-on approach that allows close monitoring of loans and facilitates risk mitigation, most ACC members have good risk management systems. While none are at a size where they undertake enterprise-wide risk assessments, all carefully monitor portfolio risk.

Chart 2.7: Levels of risk management systems of ACC members

2.2.5. Financial information

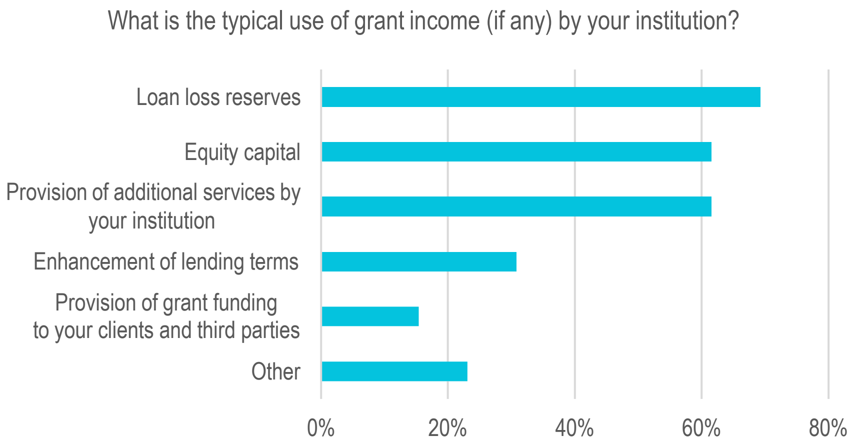
Financial self-sufficiency is an elusive goal for most ACC members (see Chart 2.8). Less than 10% are profitable without grant income. The majority are not large enough to achieve economies of scale in their loan operations. Financial performance is stressed by the cost of doing smaller hand-crafted loans to relatively unsophisticated borrowers. While many of the members originate larger loans that are profitable, their mission is to fund those borrowers that are not well served by traditional banks, and this requires more staff time to originate and service the loans. The loans they make are by definition more expensive to underwrite and to service.

Chart 2.8: Levels of self-sufficiency among ACC members



Profitability is further stretched by the remarkable amount of technical assistance that ACC members provide for their borrowers. The provision of technical assistance is critical to supporting entrepreneurs, particularly minority- and women-owned businesses that are key to building local economic resilience, but it is not easily funded through revenue generated from loan portfolios. Grant funding will continue to be needed to support the cost of technical assistance (see Chart 2.9). ACC members should, however, strive to measure self-sufficiency by their business lines, in addition to aggregate numbers, so that they can better evaluate and report on their financial sustainability.

Chart 2.9: Use of grant income by ACC members



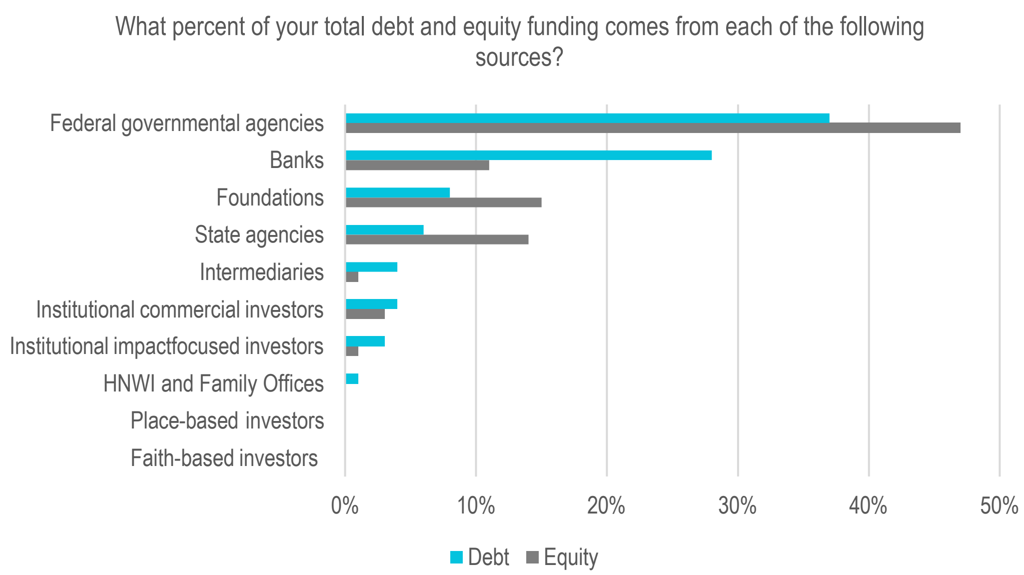
The limited profitability resulting from lower levels of self-sufficiency makes it difficult for ACC members to increase equity capital and to add to loan loss reserves from loan operation revenues. It is again grant funding that has been used to bolster both equity capital and loan loss reserves (see Chart 2.9).

Most ACC members enjoy a robust net interest margin of 4-6%. Their cost of funds is generally low from 0-5% (with the majority being around 3%) and the interest rates they charge are at 5-12%. In some cases, margins are over 6%. They benefit from not only low-cost but also patient capital that comes from CDFI Fund capital grants, low interest debt financing from community banks, and grant and debt funding from local, county and state governments, including special purpose loan funding available at concessionary rates. Loan interest rates are risk weighted but are not as high as those required by traditional lenders. Nonetheless, even these margins will not ensure the level of profitability needed by ACC members for sustainable growth unless these margins are coupled with scale.

ACC members need to help funders understand the specifics of their credit model, especially as it relates to the cost of underwriting small-dollar loans that are unique to each borrower and the cost of technical assistance needed to help borrowers build their business skills (and any other related costs inherent in the model). It is this credit model, often including hands-on technical assistance before and after a loan is made, that ensures outstanding portfolio performance. Further clarity and distinction between individual cost elements (e.g., cost of funding, credit margin, cost of technical assistance, and any other costs) should help with funders' understanding and enable conversations about the appropriate cost of debt funding, or inclusion of companion grant funds to support the lending.

The majority of ACC members secure capital from multiple sources, although many individual ACC members do not have a diverse funding base (see Chart 2.10 and Section 3 for more detail). They tend to be overly reliant on one source of funding, which in some cases is government and in other cases is banks. There is a clear interest in continuing support for capital raising from ACC, especially among the smaller ACC members. One member has no fallback plan for capital gaps except ACC.

Chart 2.10: Debt and equity funding sources by ACC members

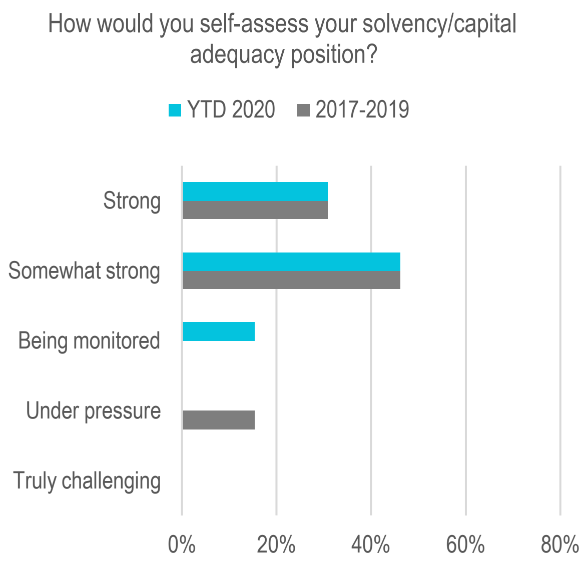


Two of the members interviewed believe there needs to be a fundamental restructuring of the relationship between investors and ACC members. ACC members need to find ways to live with lower margins and the investors need to lower their pricing. The historic expectation of a 3-4% return for debt capital does not make sense when the Federal Reserve rate is close to zero and there are new sources of ‘softer’ money flowing to the sector (see more in Section 3).

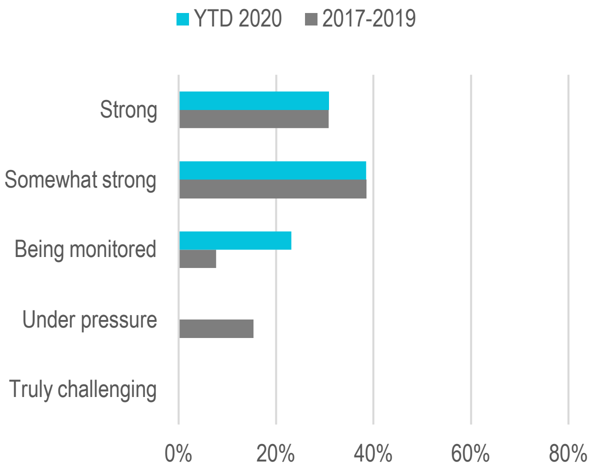
Relatively low levels of unrestricted funding hampers flexibility in times of crisis. ACC members demonstrated an ability to absorb and disburse more capital during the pandemic. They originated PPP loans and deployed significant amounts of capital provided by state agencies that do not require typical portfolio management capacity.

Despite some of the challenges mentioned above, ACC members are healthy financial institutions with strong levels of liquidity and solvency positions. Only about 15% of ACC members reported having their liquidity and solvency indicators ‘under pressure’ in 2017-2019, and even these organizations reported improved liquidity and solvency positions due to grants and increased earned revenues in 2020. Additionally, the majority of ACC members have optimistic expectations regarding their financial performance in 2020 and beyond.

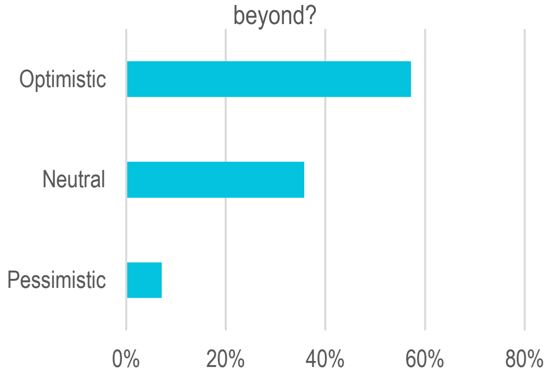
Chart 2.11: Financial health and performance outlook by ACC members



How would you self-assess your liquidity position?



What are your expectations regarding the financial performance of your organization in 2020 and beyond?



2.2.6. Outlook, strategic plan, and capital needs

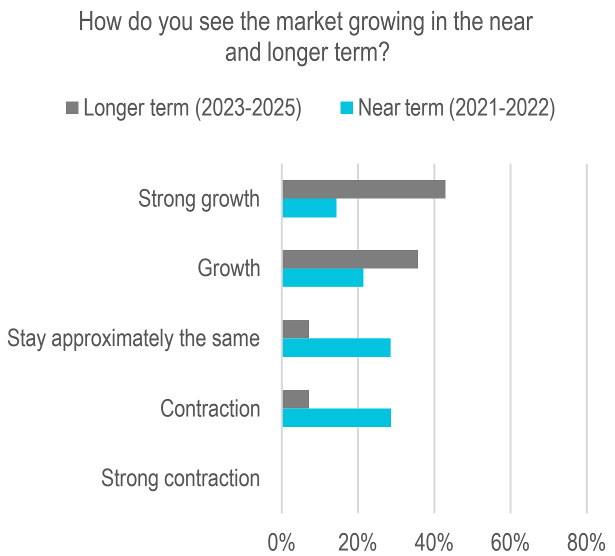
Most ACC members are expecting 2021 to be a difficult year in spite of increased lending activity in 2020. There is a lot of uncertainties in the speed of vaccine distribution, and there was uncertainty about the ability of Congress to pass a supplemental CARES Act at the time of the interviews. Business sectors experiencing the deepest negative impact are hotels, restaurants, music venues and businesses that serve the tourist industry, which is a major economic driver in the region. Not all ACC members have large exposure to these types of businesses but those that do are concerned about the future. Other ACC members are concerned about the impact on borrowers if there is no additional stimulus money. Most ACC members believe the overall economy will be in a recession in 2021.

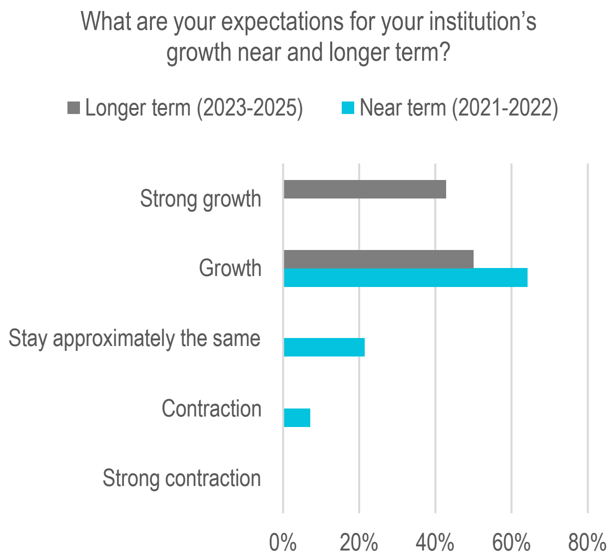
Despite this negative view of short-term prospects, CEOs remain optimistic about future growth and expansion. They appreciate that consumers and business behaviors are changing, and it may take time for the markets to rebound. However, they expect that there will be more capital and their capacity to deploy that capital will be improved. Most ACC members expect their growth and the need for their services to outpace the market over the next three years (see Chart 2.12). Those expectations are rooted in their proven ability to raise and distribute record amounts of capital in 2020 while keeping solid financial positions to weather the anticipated future economic downturn.

"[I }strongly believe that the pandemic has alerted more organizations to the needs that CDFIs fill and that more capital and grants will be available to our industry once the economy begins to recover and panic is over."

- ACC member

Chart 2.12: ACC members' outlook



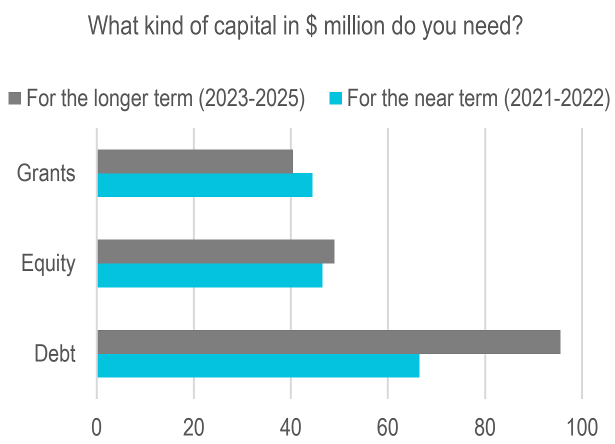


3. Capital demand and supply, and mobilization barriers among ACC members

3.1. Capital demand: Funding growth plans of ACC members

ACC members are seeking new capital both in the short term and in the long term. Responses to the survey and phone interviews demonstrated a need for equity and debt capital as well as grant funding to support technical assistance and to build internal capacity. On average, ACC members have the highest need for debt capital ($6.5 million each in near and $9.5 million in longer term), which is closely followed by equity capital (approximately $6 million each both in near and longer term) and grants ($5 million each in near term and slightly less than that in longer term; see Chart 3.1).

Chart 3.1: Average capital need by capital type (in $ million)



In aggregate, ACC members will require a capital infusion of more than $173 million in the near term (2021-2022) and more than $328 million in the longer term (2023-2025). The key driver for the near-term capital requirement is portfolio growth ($138.5 million). Large ACC members report a need to make capital improvements in their businesses ($4.1 million). Medium sized ACC members report a need for $20 million in additional working capital to bolster income generated from operations.

Table 3.1: Short Term Capital Needs by Purpose (in $ million)

2021-2022	Small Rural	Small General	Medium	Large	**Total**
Portfolio growth	8.5	10.0	49.0	71.0	**138.5**
Capex	0.1	-	0.5	3.5	**4.1**
Working capital	0.5	-	16.5	3.0	**20.0**
Other	-	0.5	-	10.0	**10.5**
Total	**9.1**	**10.5**	**66.0**	**87.5**	**173.1**

Anticipating that the economy will recover from the negative impact of COVID restrictions in 2023, ACC members project a capital need of $327.9 million. Like near-term capital needs, this request is driven by expected portfolio growth ($279 million). Large institutions need $200 million for portfolio growth and $10.5 million for capital expenditure (Capex). The majority ($22 million) of the amount of working capital needed is requested by Medium sized ACC members.

Table 3.2: Longer Term Capital Needs by Purpose (in $million)

2023-2025	Small Rural	Small General	Medium	Large	Total
Portfolio growth	11.0	10.0	58.0	200.0	279.0
Capex	-	-	0.5	10.5	11.0
Working capital	0.4	-	22.0	5.0	27.4
Other	-	0.5	-	10.0	10.5
Total	**11.4**	**10.5**	**80.5**	**225.5**	**327.9**

To fund new loan originations, ACC members need more than $65 million in debt capital and $62.5 million in deposits in the near term (2021-2022). Over the longer term (2023-2025) they project a need for an additional $95 million in debt capital accompanied by deposit growth of $62.5 million. To stabilize their institutions, ACC members project a need for $95.4 million in equity capital between 2021 and 2023. The Medium sized ACC members require $33 million in grants in the near term and an additional $26 million in grants over the long term.

The Small ACC members are looking to ACC for support in raising new capital. While Medium and Large ACC members require more capital than Small members, they report having better capacity and resources to raise the capital on their own. ACC members typically rely on continuing capital inflows from existing partners and speak about exploring new sources of funding alongside those typical sources. However, they rarely have a comprehensive fundraising plan or strategy that would allow them to raise all the capital needed. Moreover, because the current range of investor prospects is limited, ACC members can find themselves in competition with each other to secure capital from regional and national investors.

The most sought-after types of capital are unrestricted grant capital and unsecured debt capital. One interesting development is an early move by some ACC members to insist that debt capital come with grant funding to offset the cost of deployment, increase reserve, and help build organizational capacity. Community banks, which are a common source of debt capital for ACC members, are often not equipped to provide generous grant funding.

Table 3.3: Short Term Capital Needs by Purpose (in $ million)[22]

2021-2022	Small Rural	Small General	Medium	Large	**Total**
Debt	3.5	-	38.0	25.0	**66.5**
Equity	5.0	10.0	11.0	20.5	**46.5**
Grants	2.4	-	33.0	9.0	**44.4**

[22] Tables 3.1, 3.2, 3.3 and 3.4 include figures as submitted by ACC member participating in the survey and do not correct for any discrepancies in the answers.

Deposits	-	-	-	62.5	**62.5**
Total	**10.9**	**10.0**	**82.0**	**117.0**	**219.9**

Table 3.4: Long Term Capital Needs by Purpose (in $ million)

2023-2025	Small Rural	Small General	Medium	Large	**Total**
Debt	5.0	-	43.0	47.5	**95.5**
Equity	0.4	10.0	3.5	35.0	**48.9**
Grants	2.4	-	26.0	12.0	**40.4**
Deposits	-	-	-	62.5	**62.5**
Total	**7.8**	**10.0**	**72.5**	**87.5**	**247.3**

3.2. Capital supply: Investor categories and trends

Federal government and state agencies have been the main source of equity funding, especially for Small ACC members where more than 90% of both equity and debt capital comes from federal sources. ACC members with larger balance sheets and bigger geographic footprints have diversified their capital sources. Foundations and banks are the main source of capital for Large ACC members.

Chart 3.2: Sources of debt capital

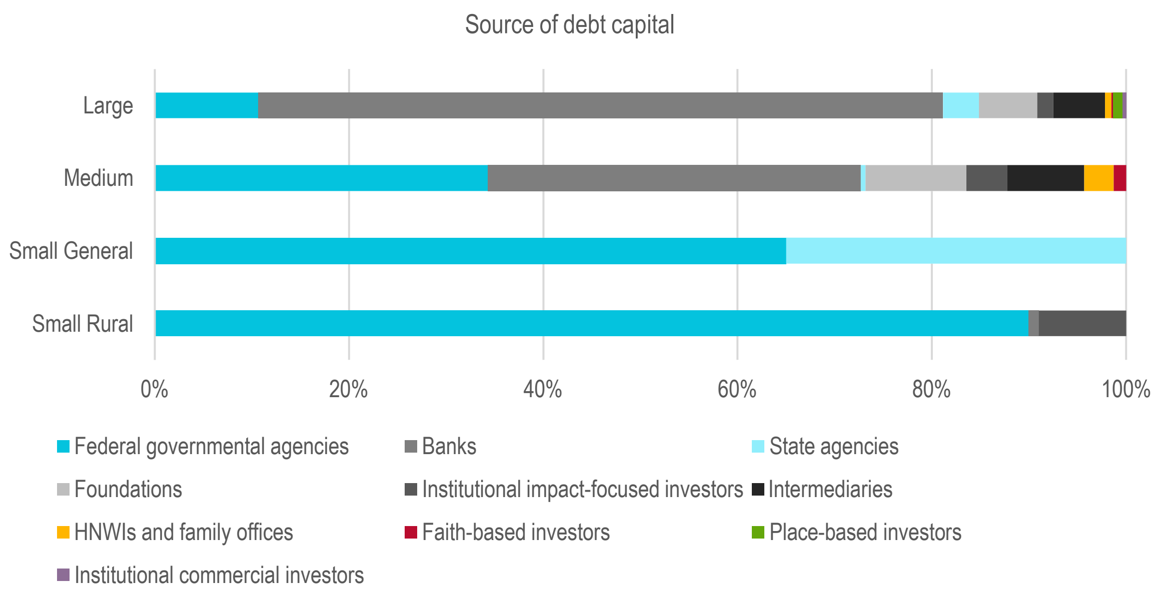
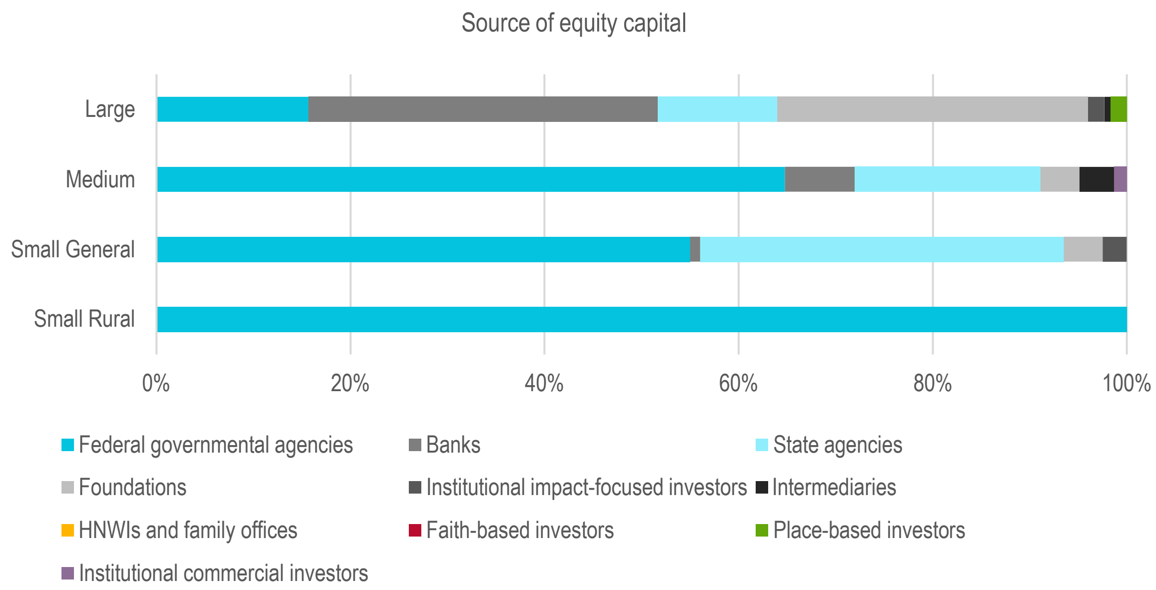


Chart 3.3: Sources of equity capital



Capital from state agencies and banks is typically restricted to certain geographies and may also include other limiting conditions. Besides the inability to deploy restricted capital across their portfolios, this type of funding often comes with a limited opportunity for ACC members to invest in capacity building. Additionally, there are only limited rural areas where ACC members could fully exploit CRA-motivated investments.

Over the last 1-2 years the national CDFI industry has seen increasing investment interest from corporations and healthcare organizations. Interest from these nonbank sources increased in 2020 in response to the COVID crisis and the spotlight shown on racial inequities. This new interest in impact investing through grants and other low-cost structures combined with the near zero federal funds rate has put pricing pressure on many traditional CDFI investors. This could lead to a restructuring in pricing with impact investors or possibly a reduction in funding from traditional CDFI investors.

An example of increasing corporate engagement is the Business Roundtable, which has challenged its members to make philanthropic investments, update employment practices, and innovate within their businesses. Several Business Roundtable members have made significant grant and investment commitments to large CDFIs and to national intermediaries with a particular emphasis on supporting minority-led CDFIs and lending programs focused on minority-led businesses. Partially enabled by the influx of new philanthropic capital, innovative structures have been developed in 2020, such as the New York Forward Fund. There has also been an increased number of bond issuances by large, national CDFIs and intermediaries, such as LISC and Capital Impact Partners.

ACC has an opportunity to partner with national intermediaries and some large national CDFIs to bring new sources of capital to Appalachia. Most national intermediaries have mandates to regrant/invest in rural lending and need distribution channels like ACC to ensure that the funds are deployed as funders require. There is also an opportunity to further explore the interest in philanthropic capital from corporations that have a footprint in, business exposure to, or a strategic interest in the Appalachian region.

Table 3.5: Potential ACC investor categories

Category	Institutions	Description
Banks	***National*** ▪ JPMorgan Chase ▪ Wells Fargo ***Regional*** ▪ Regions Bank	▪ Partnerships with banks are vital for all ACC members despite the typical limitations on funding to CRA areas, especially national banks have (nearly) no footprint and CRA obligations in the region. ▪ ACC members should continue developing their relations with local and regional banks, ACC will continue liaising with main bank supporters of the CDFI industry
Foundations and HNWI[23]	***National*** ▪ Ceniarth ▪ Surdna Foundation ▪ Candide Group / Olamina Fund ***Regional*** ▪ Appalachia Funders Network	▪ Several large national foundations have played a critical role in developing the CDFI industry and continue their support during these challenging times, often with additional emphasis on racial equity, but possibly lower exposure to the Appalachian region. ▪ ACC, in collaboration with its members, should create a list of local and regional foundations to systematically create relationships founded around their proximity to the communities served. ▪ The CDFI industry has seen increased interest from Family Offices and HNWI which should be further explored either directly or through their investment advisors.
Government agencies	***National*** ▪ SBA ▪ CDFI Fund ▪ Commerce/EDA ▪ USDA ▪ HHS ***Regional*** ▪ State/ county agencies ▪ Appalachian Regional Commission	▪ Government agencies have been the key funder for the ACC members in the past and still remain the main source of capital for smaller ACC members. ▪ ACC members typically have close relationships with state, county agencies and municipalities and are often able to co-design and influence the features of community programs and interventions being implemented. ▪ Attracting new sources of capital shall take into account these key relationships and where possible explore synergies with the governmental funders.
Corporations	***National*** ▪ Google ▪ Starbucks ▪ Twitter ***Regional*** ▪ Kentucky Fried Chicken (KY) ▪ Coca-Cola (GA)	▪ Large U.S. corporations have recently become the most visible investor into the CDFI sector. ▪ They are able to write large checks with favorable terms but often require large investments of time and effort to fund raising efforts and educating them about the specifics of the CDFI model. ▪ ACC should target corporations that have current, past, or potential exposure and interest, for instance by having their headquarters or significant operations, in the Appalachian region.
Other	▪ OFN ▪ LISC ▪ Fahe ▪ Enterprise	▪ There are other strong partners and close allies that ACC can leverage in accessing capital for its members. ▪ Apart from advice and introductions, there is potential for utilizing the platform developed by the leading institutions of the CDFI space.

3.3. Mobilization barriers

The ACC members surveyed disbursed more than $2 billion in loans since their inception. However, they all report limited capacity to raise capital outside of their current investors.

Most ACC members rely on existing investors and sector relationships as a source of additional capital (see Chart 3.4). Other broadly used platforms for building relationships with new investment sources include membership organizations, including ACC itself, or conferences and events, such

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[23] HNWI stands for a high-net-worth individual, typically having investable assets in excess of $1 million.

as the OFN Conference. Only a few of ACC members have a clearly defined and permanent capital raising function. Building new relationships requires significant investment in relationship building and often educating potential investors about the CDFI model. Smaller ACC members have limited capacity to engage at this level and pursuing this path only makes sense at larger transaction sizes than they can accommodate. As noted in Section 2.1, one of the barriers to achieving this goal is the lack of investment in ACC's capacity.

Chart 3.4: Means of sourcing new investors

4. Impact narrative and investment case

As part of the assessment, on February 25, 2021, PIC ran a workshop for ACC members to introduce them to the Impact Management Project (IMP) framework summarizing the impact investing industry consensus and set of norms about measurement and management of impact. Understanding how impact investors expect impact to be measured is a key part of becoming investment-ready, especially among CDFIs, who typically use measurement methods that investors do not (such as Aeris). Beyond the framework introduction, the workshop provided a forum for ACC members to discuss how to best communicate their impact narrative with investors and how to select and define priority impact types following the IMP's five dimensions of impact. Lastly, it provided the ACC members with an overview of tools and templates to build their own impact story and inspire them in development of a comprehensive Impact Management and Measurement System according to the IMP framework.

In our interviews with ACC members, we found that they understand very well their impact but typically measure it based only on funding requirements. A number of ACC members noted that they are often required to report on metrics that are not fit-for-purpose. This is not ideal either for managing the impact they generate or for communicating about their impact with stakeholders or potential investors. We believe that adopting the IMP framework would enable ACC members to frame their impact stories in a way that investors can better comprehend and help them to work with such investors to report on metrics that are more suitable.

While the focus of the workshop was on impact of individual ACC members, it may serve well as a basis to further refine presentation of ACC's impact as a group. There is tremendous diversity among ACC members which makes the creation of a comprehensive, unifying story about why impact investors should invest in ACC and ACC members sometimes challenging. The IMP framework can help create a comprehensive and unifying story and align the top-line impact narrative across ACC and its members while allowing individual narratives to be as diverse as the ACC members themselves.

4.1. Impact narrative

The Impact Narrative should communicate the core elements of Why, Why Now, What, and How its social and environmental impact works:

- **WHY** is the impact ACC members strive to achieve important for the future we want to create? What are the problems to solve?
- **WHY NOW** – why is today a unique opportunity to focus on getting this right?
- **WHAT** specific changes are ACC members working on? How does ACC's strategy embed the Why and Why Now?
- **HOW** do ACC member activities bring about change and deliver on the why and what?

When articulating the narrative, there are a few key points to have in mind. Impact creation should always be linked with making the business case for the specific intervention and the organization more broadly. Telling the story shall be supported by producing and presenting data wherever possible. Committing to provide data-based evidence of the impact shall also help to drive accountability. The narrative needs to highlight what success looks like for it to materialize even for readers that do not have direct experience of it (e.g., investors who are new to Appalachia).

Impact narratives typically go across multiple layers. It is critical to ensure that investor communications provide sufficient context and provide appropriate detail at each layer. Investors tend to have different levels of knowledge and priorities and communications can be tailored to best meet individual investor expectations. Chart 4.1 shows a few layers that may be relevant to ACC and its members – many investors will start with Why Appalachia, compared to other regions in the US. Some may already be convinced about why access to finance for small businesses is important, others may need more explanation. ACC needs to be able to speak about the impact of its members, especially as achieved through ACC's investments in them, and also about ACC's direct impact on its members.

Chart 4.1: Multiple layers of the Why

Why Appalachia	Why access to finance for small business	Why ACC members / community lenders	Why ACC
Appalachia has one of the highest poverty rates in the nation. Many of its people live in isolated rural areas, its poverty is largely unseen by the majority of Americans. Yet the region has been on a slow but steady track to diversify its economy and decrease its unemployment rates. Investment in the region now will help push the region forward.	Small businesses are the major driver of new job creation. Appalachia has many small businesses with potential to grow and thrive; they are the lifeblood of the new economy in Appalachia. Banks in the region are pulling back from rural areas and from smaller loans, leaving a gap in access to capital.	ACC members fill the credit gap and provide a bridge between target borrowers and banks, government programs, and other investors. ACC members build trusted relationships with borrowers that improves communication between lender and borrower. ACC members provide technical assistance to borrowers, including business advice, help with debt structures or cash flow priorities. In 2020 ACC members demonstrated significant resilience and capacity to grow and expand.	ACC is a cost effective and highly impactful intermediary that helps funnel impact investment dollars to its members. ACC supports its members to build required capacity.

Below we include two snapshots of the impact narrative framework – one based on input received from ACC members during the workshop that combines the narratives across those ACC members (Chart 4.2) and one as completed by the authors of this assessment that gives an example of one hypothetical ACC member (Chart 4.3). Development of an impact narrative is typically an iterative process that ensures that only the most relevant impact themes are emphasized, and it needs to evolve together with activities and focus of the institution.

Chart 4.2: Impact narrative – Workshop input from ACC members

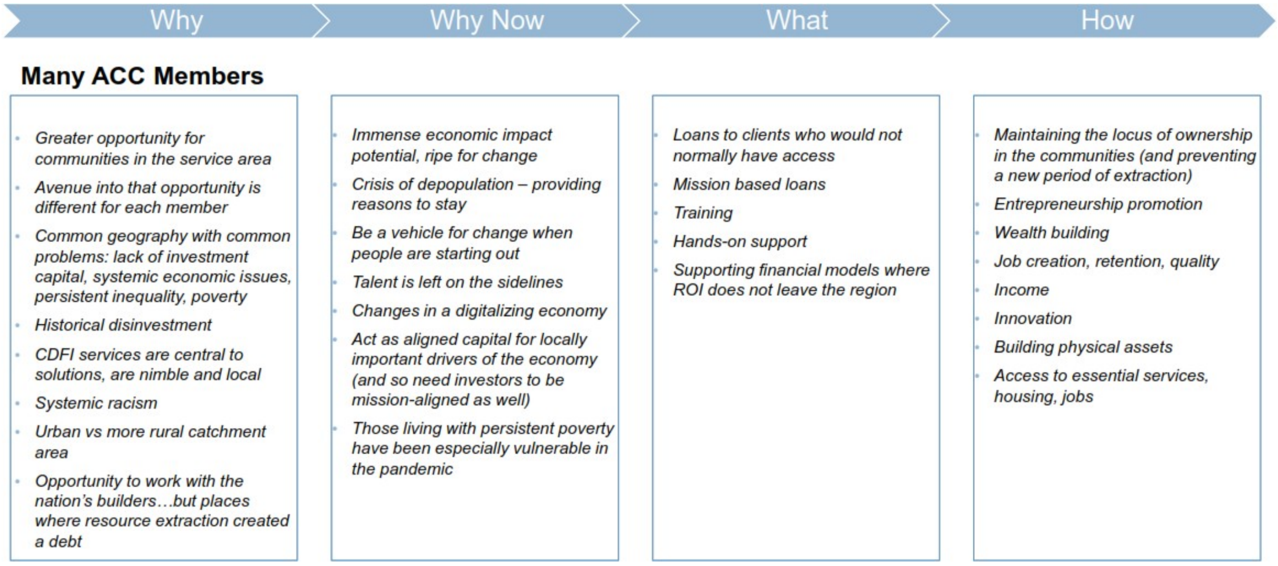
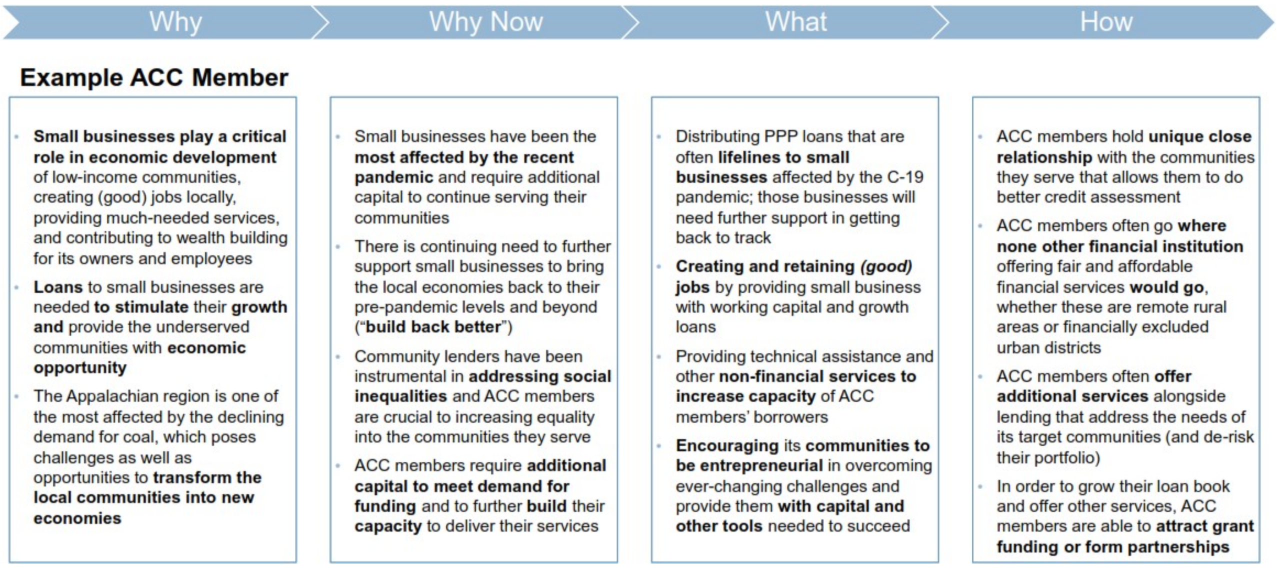


Chart 4.3 Impact narrative – Example by the authors



4.2. Priority impact types

Prioritization is critical for effective impact measurement and management. Choosing two to three priority impact types is the hardest part, but it is very important for clarity in communications with investors and reducing the reporting burden on organizations tracking their impact performance. ACC and its members should select the types in alignment with their broader impact narrative and taking into consideration:

- Which social and environmental impact is the most common across ACC members
- Which types of impact have the longest history for ACC members
- Is it a type of impact that can be measured
- Is the burden for measuring the impact reasonable (both in time and money)
- Which investors are the best fit for ACC members and what do they care about
- Whether IMP's five dimensions of impact can be clearly communicated

Selection of Priority impact types helps to clearly define the right impact goals that focus on a concrete target group and is directly linked with the institution's primary business activity. The Priority impact types can cut across categories, as outlined in Chart 4.4, and priority should be given to such types where there is clear contribution of, or direct link between, the particular activity and the impact generated.

Chart 4.4: Sample categories for selection of priority impact types by ACC and its members

Direct → Indirect

Target groups	
Small businesses	Small businesses serving the Appalachian region
	Minority- and women-owned/led businesses
Individuals	Employees having stable income
	Individuals and households building wealth
Communities	Financially excluded communities in rural vs urban areas
	Communities living in poverty

Impact goals
Strengthening and growing small businesses
Investing in businesses that contribute to social equity
Jobs and income generation
Wealth creation (community-wide and intergenerational)
Access to basic services (healthcare, broadband, etc.)
Just transformation from coal to new economy

Business activities	
Financial services	▪ Lending ▪ Other financial services
Non-financial services	▪ Program / fund management ▪ Fee for service ▪ Technical assistance
Advocacy	▪ Policy ▪ Local development initiatives
Ecosystem building	

Once the Priority impact types are selected, ACC members should ensure they can address all five IMP dimensions of impact to create a holistic overview of the priority impact and how the ACC member works to achieve that impact. The basic impact dimensions of Who, What, How Much and Contribution should be described, and then relevant impact metrics can be chosen where proof is required. Due attention should also be given to defining the Risk of not achieving the desired impact and strategies for mitigating such risks.

Chart 4.5: IMP's five dimensions of impact

Impact dimension	Impact questions each dimension seeks to answer
What	•What outcome occurs in the period? •How important is the outcomes to the people (or planet) experiencing them?
Who	•Who experiences the outcome? •How underserved are the affected stakeholders in relation to the outcome?
How Much	•How much of the outcome occurs - across scale, depth and duration?
Contribution	•Would this change likely have happened anyway?
Risk	•What is the risk to people and planet that impact does not occur as expected?

Source: Impact Management Project

4.3. Investment case

We believe that having a unifying story for all ACC members as well as a positive ACC strategy integrated with a clear impact framework would allow ACC to strengthen the investment case for investing in Appalachia through ACC. Besides the clear impact narrative and impact goals set around the Priority impact types, any investment case needs to be supported by a strong business case. Investors like to make investments that lead to a step change where contribution of such investment can be measured by generation of meaningful impact as well as business development of the institution invested in. Similar to the impact framework, the business case needs to be comprehensive in its content, realistic and detailed in its assumptions and goals, and well structured.

A draft abbreviated version of the investment case for ACC is as follows:

ACC is a cost effective and highly impactful intermediary that helps funnel impact investment dollars to its members who are close partners to Appalachian small businesses in need of access to affordable capital to support the revitalization of their communities.

The business case for an investment needs to follow the same criteria as the impact framework. It needs to be prioritized, comprehensive, and evidence-based. In that sense, all parts of the investment case – such as, for instance, the mentioned 'cost effectiveness' – should be properly substantiated. Investors expect the strategic plan to be sufficiently detailed, substantiated, and be based on realistic assumptions. For instance, the type and amount of capital required by ACC should be based on estimated member demand and operational expenses with clearly defined use based on ACC's strategic goals.

5. Summary and recommendations for ACC and its members

The summary and recommendations that follow are based on assessment findings, conversations with ACC's CEO, ACC members, and industry experts as well as on PIC's transaction expertise. Some of the recommendations reflect an approach PIC would take should it be involved in capital raising for an institution like ACC. Whereas the summary covers both ACC and its members, the recommendations relate to ACC only.

5.1. Summary and recommendations for ACC and its members

5.1.1. ACC

Since its launch in 2013, ACC has increased membership to 24 high performing CDFIs. It has deployed over $18.5 million in leveraged debt capital to support small business in Appalachia. Availability of capital has, however, not grown as fast as its membership base. Beyond capital, ACC has provided invaluable member services, including technical assistance, knowledge sharing, and advocacy. The majority of ACC's activities are driven, managed, and staffed by one person, its CEO, with support from a pool of contractors and Virginia Community Capital, which manages ACC's back office functions (e.g., accounting, loan servicing, data processing, etc.).

The authors believe that to be more successful in increasing the capital available for its members and to meet its other strategic goals, ACC should increase its investment in human capital. ACC's reliance on interest income earned on its suboptimal capital base and grants that typically cannot be used to expand its internal capacity has hindered its ability to make the investments in its internal capacity to successfully solicit additional grant and debt capital.

In addition, ACC would benefit by providing more granularity in the assumptions and expectations for its activities beyond fundraising. Finally, we believe that more consideration should be given to identifying alternative revenue sources to support a more robust company.

We appreciate that other external factors are at play, such as the generally limited interest in investing in Appalachia compared to other regions, but we believe that investing in ACC's human capital will increase chances of greater success with investors. ACC has a strong foundation on which to build: solid portfolio performance, a highly regarded CEO, and an engaged membership that generates incredible impact in their communities. These strengths are critical building blocks in attracting new capital.

5.1.2. ACC members

ACC members are a diverse group of community lenders. In our opinion, size is the primary factor limiting ACC members' capacity to raise additional capital and their financial performance. ACC members manage a number of business lines that require specific skills and capital sources – from community lending to technical assistance to public policy and advocacy. They offer a wide range of products and services, from micro and small business loans to green lending and affordable housing.

The business model employed by ACC members to close the access to finance gap is built on deep client relationships that enable better assessment and management of risk. ACC members typically do not compete on price or product but rather partner with other lenders, and organizations. In addition to lending ACC members typically engage in technical assistance and other services for target clients.

ACC members are distinguished by having highly committed boards, although with occasional expertise gaps, and strong management teams, relative to size of the institutions. They have seasoned staff with a wealth of experience that would be hard to replace since talent with relevant background is hard to find, attract, and train. A major challenge is that ACC members have varying capacities in terms of technology; for some it is key advantage, for others – especially Small ACC members - it is a major challenge. Nonetheless, the majority of ACC members see digitization as an opportunity and are working on developing digital strategies.

At present, impact management and measurement are mostly driven by investor requirements. Only a few ACC members have a fully developed impact framework tightly aligned with their strategic plan. Gender and racial equity lens are used by a majority of ACC members. Support for Black and other minority-owned businesses has seen increased attention from impact investors significantly growing the capital flowing to CDFIs, but demographic contextualization matters. Given its demographic profile, Appalachia may not be able to fully benefit from this recent trend.

All ACC members enjoyed steadily growing loan portfolios prior to 2020. The pandemic and racial equity events significantly boosted loan originations in 2020, in some cases by 2-3 times 2019 levels. Businesses served by ACC members generally were severely hit by the pandemic, but relief programs helped them weather the storm. As a result, loan portfolio quality of ACC members remained strong through year-end 2020. The national economic situation and availability of further stimulus funding will be key factors for portfolio quality in the near future.

Self-sufficiency is often unachievable due to scale and business model of many ACC members. However, more clarity and granularity about business lines would help determine how close those individual business lines, including lending operations, are to achieving more robust levels of self-sustainability. Historically healthy net interest margins have been driven by a low cost of funds, but expectations on the price of debt capital between ACC members and investors do not always align, often resulting in a capital gap and limiting growth. Low levels of unrestricted funding hampers flexibility in times of crisis and the ability of ACC members to invest in the institutional capacity.

The Covid-19 pandemic has raised awareness of the centrality of community lenders to economic recovery in underserved communities. That resulted in increased capital flows into the sector in 2020, but these capital flows have been uneven with most reaching established urban lenders. Whereas 2021 may be a difficult year, ACC members expect the longer-term outlook to be generally optimistic.

5.2. Recommendations for ACC

Based on the findings, below we have listed considerations that should enable ACC to progress towards attracting more capital for its members and the Appalachian region in a continuous and sustainable fashion, instead of relying on an opportunistic approach.

A. Plan

- ***Refinement of ACC's business plan***
    - Building on points raised in Section 2.1, further refinement and level of detail may be needed to make ACC's business model a solid basis for investment business case. Areas of focus should include:
        - <u>Projected self-sufficiency of individual functional areas</u>
            - In order to better specify the use and justify the size of additional capital needed, particularly grant funding for ACC's capacity building, the business plan should include more detail about the individual functional areas (i.e., Capital intermediation, Member services and

Internal functions) and their budgets, projected funding, and performance.

- <u>Alternative revenue streams</u>
    - ACC's current strategic plan considers earned income from Capital intermediation as the only substantial revenue stream. ACC should consider whether new revenue streams can be introduced. This could include charging for some technical assistance, reassessing the level of membership fees and contracting with state and local governments to help deploy capital.
- <u>Adequate capacity</u>
    - Based on our assessment, ACC's 2019 strategic plan seemed to underestimate the resources needed to achieve the target growth and to deliver on its fundraising strategy.
    - Refinement of the plan in the above areas will help better estimate the need for additional staff capacity and increase the likelihood of raising the funding needed to build (likely funded by a grant) and retain (funded by an increase in earned income) such capacity.
    - Multiple options for addressing the capacity needs should be considered. Besides recruitment directly by ACC, in the short-term capacity can be enhanced with external sources, or pooling resources from ACC members.

- ***Size and type of capital being raised***
    - Size and type of requested capital need to be based on the refined business model and plan.
        - <u>Addressing key objectives</u>
            - Building capacity, achieving self-sufficiency within a reasonable time horizon and other key objectives should be main drivers of the total size and type of requested capital.
            - Besides ACC's internal objectives, the request needs to consider the capital and capacity needs of ACC members, from Small to Large.
        - <u>Alignment of capital demand and supply</u>
            - The size and type of capital should both address key internal objectives and be broadly aligned with capital supply in the market, both in terms of size and type.
            - Whereas more traditional CDFI investors typically make investments in the several-million-dollar range, other investors such as corporates may be more interested in an opportunity to deploy much larger amounts.
            - The structure of the ask is no less important. Based on the needs of ACC and its members it should consist of: (A) low-to-no interest debt capital, (B) significant portion of working capital grants and (C) a portion of grants for investment into capacity development of ACC and its members.
- ***Structure considerations***
    - A simple structure, such as a program managed by ACC, is strongly preferable but a more sophisticated, fit-for-purpose structure may be considered, either as a standalone or in partnership with other intermediaries.
        - <u>Investment directly to ACC</u>
            - Default option of ACC acting as the vehicle for receiving and on-lending of the capital raised.
        - <u>A standalone funding structure</u>

- A standalone funding structure allowing ACC to isolate the capital raised for a special purpose and mitigate the associated risks. It is more costly but sometimes may be better suited for investors' objectives. This structure should only be used for large amounts to limit the transaction costs.

- <u>Partnership with other capital providers or intermediaries</u>
  - Another option is for ACC to enter into partnership(s) with other capital providers or intermediaries. For instance, ACC could consider managing funds on behalf of other partners, such as city and state governments or regional funds of private investors. These funds would stay off balance sheet of ACC and avoid the need for additional capital, while earning it management fees.

B. Prepare

- ***Marketing materials***
  - Leveraging from existing materials as well as input from this assessment, ACC should develop an updated set of marketing materials that align with the revised business plan. The marketing materials would combine key aspects of both the business and impact investment case.
    - <u>Impact narrative</u>
      - The impact narrative should follow the Impact Management Project framework, introduced to ACC members during the workshop that was organized as part of this engagement.
      - There are certain specific themes that should be explored, either as a standalone initiative or as an integral part of ACC's impact narrative. Those themes include support for racial equity and support for a just climate transition of the economy of the Appalachian region.
- ***Target investors and coordination with ACC members***
    - <u>Target investors</u>
      - Target investors include both existing/ founding and new investors. It is critical to identify potential sources of grant funding for capacity building – it is expected that existing/ founding investors may be willing to consider contributing to support the overall effort.
      - Clarity is needed as to what investors should be targeted by ACC and what investors may be better accessed through individual ACC members.
      - Prospect lists of target investors should reflect the type of capital sought and consider what type of structure they may prefer. For instance, corporations are often concerned about risk – they want their investment back - but they are not price sensitive. Large national intermediaries, such as OFN or LISC, are negotiating to act as a distribution channel for corporate money and may be willing to partner with ACC in attracting more capital for its members.
      - This is an opportune time for ACC to strengthen its position as the distribution channel for Appalachian CDFIs and to raise its profile with the Business Roundtable. One way to do that is to develop a relationship with a large corporation with a business tie to the region and ask for help building support with other corporations. For example, Coca-Cola is based in the region and is a member of the Business Roundtable. Walmart has many stores in the region and its CEO is one of the co-chairs of the Business Roundtable. This immediate

opportunity is further enhanced by the fact that many states have unspent CARES funds which could be paired with philanthropic capital to help fund organization capacity and/or to increase the amount of capital available.

- ***Investment readiness***
  - Information availability
    - While this assessment has gathered readily available information; further information may be needed to help investors make an informed decision regarding any significant investment.
    - ACC should consider defining a standard set of impact and financial information from all its members to build a comprehensive knowledge base that would facilitate conversations with investors (while not overburdening its members). Such knowledge base would also allow internal benchmarking and information sharing that could be valuable for ACC members.
  - Standardization
    - Standardization of terms and conditions of funding arrangements both between investors and ACC, and ACC and ACC members to enable easier scaling up of funds raised and deployed.
    - The information available will need a certain level of standardization, especially around pertinent aspects of ACC members' business models, such as overall financial self-efficiency[24] by business line, strategic planning etc.

C. Pursue

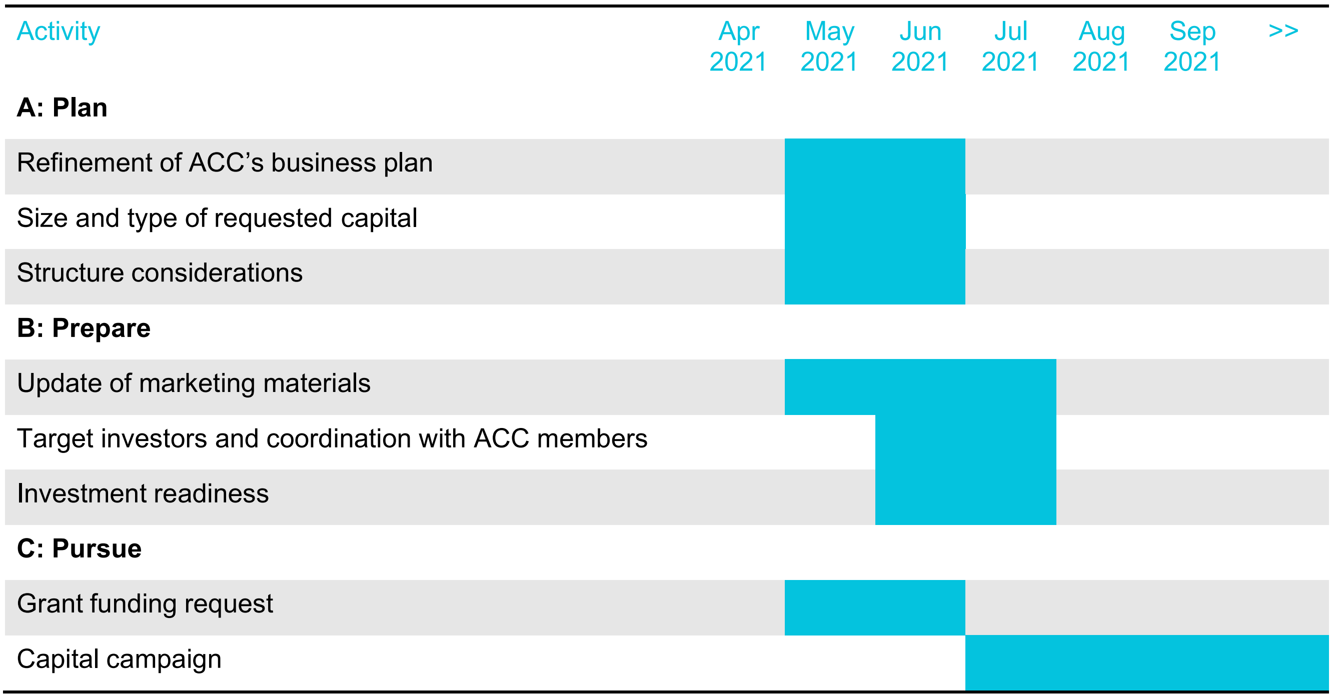
- ***Momentum and need***
  - The surveys and interviews conducted as part of this assessment clearly indicated that there is both need on the side of ACC members and momentum on the side of certain investors, particularly corporations, that should be exploited in the near term.
  - Impact themes such as racial equity and just climate transition have been getting attention from both private and public investors. ACC should position itself as able to play an important role in channeling funds to those impact areas in Appalachia.
- ***Realistic roadmap***
  - A realistic roadmap needs to be developed to provide clarity about the steps to be taken, and in what sequence, to set ACC for success in longer-term, continuous, and sustainable fund raising. We suggest splitting it into three broader steps:
    - Plan and prepare
    - Seek grant funding to increase internal capacity
    - Launch a capital campaign
  - The authors appreciate that ACC will need to respond to opportunities that may emerge from time to time in real time. These opportunities should be evaluated for their alignment with ACC's strategic direction and its capacity and pursued where

[24] Financial self-sufficiency is reliant on several elements. First ACC members must have the scale for loan portfolio yields to cover costs. Second, the cost of technical assistance cannot be supported by loan revenues and will always need grant funding. Third, loan loss reserves need to be maintained to cover the cost of risk and perceived risk which also drains revenues.

appropriate. The recommendations in this report promote a longer-term, more systematic approach to fund raising that should ultimately increase ACC's capacity to respond to and exploit such occasional opportunities.

It is important to note that sequencing of the recommendations matters (see Chart 4.4 for a draft roadmap) and that further investment – in internal capacity and possibly in – internally and possibly in external contractors – would be required to implement some of the recommendations. During our interviews with investors, we have sensed willingness to contribute to the development of ACC staff capacity as long as the request is based on a clear plan that would lead to increased capacity and meaningful self-sufficiency for ACC. Activities under Plan and Pursue are expected to be pre-conditions to receiving any grant support but can run alongside other activities and may benefit from co-creation with potential funders. Increased capacity of the ACC team is not explicitly mentioned in the timeline but shall be added following refinement of the business plan.

Chart 4.4: Draft roadmap



APPENDIX

A.1 Methodology

This investment assessment has been conducted using a variety of sources.

1. **Assessment of ACC members and peers**

- *Desk research – ACC and ACC members*

Initial desk research of ACC members was conducted based on publicly available information and additional information received through surveys and interviews. Assessment of ACC was done by reviewing the materials shares, survey completed and conversations with the CEO.

- *Desk research – market and benchmark*

We have identified two data sources that are both accessible and useful for this study[25]:

The CDFI Fund Community Investment Impact System database provides a breakdown of CDFI lending by census tract and provides information on women- and minority-owned businesses.

The CRA database provides a breakdown of small business lending by federally regulated financial institutions by census tract. The CRA database shows loans of $100,000 or less, loans between $100,000 and $250,000, and those between $250,000 and $1 million, but it does not breakdown the loans by the minority- and women-owned status of the business.

- *Survey and interviews with ACC members*

We asked ACC members to complete a survey in two parts, one for CEO and one for CFO, and received 16 CEO surveys and 13 CFO surveys (excl. surveys submitted empty).

We have completed 9 phone interviews with CEOs of the ACC members and regularly consulted with the CEO of ACC.

See more details in Table A.1 below.

2. **Identification of investment capital supply and mobilization barriers**

- *Desk research – investor list*

A draft investor list was created as per the scope of work, but it was agreed that its expansion and finalization shall be deprioritized based on preliminary findings suggesting that insufficient number of prospects is not among the key challenges.

- *Interviews with investors*

We conducted interviews with Catherine Godschalk of Calvert, Maurice Jones of LISC, Dan Letendre of Bank of America, and George Surgeon of GSJ Advisors.

[25] We are not using the database of PPP lending. This database is not complete and has some issues with accuracy.

3. Impact of capital investments on economic mobility

- *Overview of available methodologies*

Instead of providing a static overview of available methodologies, the authors agreed to conduct an interactive Impact Narrative/ Framework Workshop on February 25, 2021.

- *Testing alignment between ACC and impact investors*

Part of the interviews with investors.

Table A.1: Overview of survey responses received, and interviews conducted

Name[26]	Code	Category	Interview	CEO Survey	CFO Survey
Appalachian Community Capital	ACC	ACC		Y	Y
Access to Capital for Entrepreneurs	ACE	M		Y	Y
Alternatives Federal Credit Union	AFCU	L			
Appalachian Development Corporation	ADC	SG		Y	Y
Appalachian Growth Capital	AGC	SG		Y	Y
Bridgeway Capital	BC	L		Y	Y
Carolina Small Business Development Fund	CSBDF	M	Done		Y
CommunityWorks	CW	SG		Y	
Finance Fund Capital Corporation	FFCC	M		Y	
Kentucky Highlands Investment Corporation	KHIC	M	Done	Y	Y
LiftFund	LF	M			
Mountain Association	MACED	SR	Done	Y	
Mountain BizWorks	MBW	SR	Done	Y	Y
Natural Capital Investment Fund	NCIF	M	Done	Y	Y
Pathway Lending	PL	L	Done	Y	Y
People, Inc	PPL	SR		Y	Y
Piedmont Business Capital	PBC	SG	Done		
Sabre Finance	SF	SG		Y	
SC Community Loan Fund	SCC	M	Done	Y	
Southeast Kentucky Economic Dev. Corp.	SKED	SR		Y	Y
Three Rivers Planning and Development	TRPD	SR			
Virginia Community Capital	VCC	L	Done	Y	Y
Woodlands Community Lenders	WCL	SR			
Total			**9 / 10**	**17**	**13**

[26] Hampton Roads Ventures and Bronze Valley are ACC's newest members joining after the survey and interviews were concluded and therefore did not take part in this assessment.