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Regenerative Finance: A New Asset Class for Values-Driven Investors Prioritizes Problem-Solving and Impact

By Erika D. Williams



INVESTMENTS & WEALTH INSTITUTE®

Regenerative Finance

A NEW ASSET CLASS FOR VALUES-DRIVEN INVESTORS PRIORITIZES PROBLEM-SOLVING AND IMPACT

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It would not be foolish to contemplate the possibility of a far greater progress still.¹

—John Maynard Keynes

Values-driven investors have sparked an explosion in the number of available public-equity products built on environmental, social, and governance (ESG) measures. That has revealed two truths. First, many people want their capital to be solving problems, not causing them; a record \$649 billion poured into ESG-focused funds worldwide through November 30, 2021.² Second, it is extremely difficult to assess the impact of stock funds.³ Perhaps not coincidentally, interest is growing in a new asset class that allows wealth holders to invest directly in models for solving systemic problems: regenerative finance.

Funds built on a regenerative finance framework allow investors to diversify portfolios in a way that prioritizes impact. Although the scope of publicly traded national and global corporations gives their positive actions potentially enormous effects, we've seen that their incentive structures work against significant changes that might harm share prices—just look at the disappointing results of the Business Roundtable's pledge to deliver value to all stakeholders.⁴ Regenerative finance funds balance the scales by investing in community-led development and private enterprises that exist to address urgent issues such as climate change mitigation and adaptation, food system health, and racial and gender equity.

Often these enterprises engage with interlocking issues. For example, Lotus Foods, one of the largest providers of heirloom and organic rice and rice ramen in the United States, is a fair-trade importer and incentivizes an innovative approach to rice farming that uses 50 percent less water and 90 percent less seed but produces two to three times more rice. Similarly, Guayaki Yerba Mate sells organic, fair-trade yerba mate tea leaves and canned drinks and plows a portion of profits into its goal to restore 2 million acres of South American rain-forest by 2030. In the United States, the company built a distribution operation that uses electric vehicles and employs formerly incarcerated people.

Powerful solutions often start with smaller initiatives. Investors in regenerative finance funds can play a central role in seeding enterprises that demonstrate the effectiveness of experimental approaches and initiate positive global market changes, which ultimately may show up in the investors' ESG holdings. Because of its integrated nature, regenerative finance encourages wealth holders to align their investing and giving by directing both investment and philanthropic funds toward their impact goals.

REGENERATIVE FINANCE DEFINED

Regenerative finance is a nascent and growing asset class, so investors can expect to see some definitional fluidity. Simply put, regenerative finance uses financial and social capital as a tool to solve systemic problems and regenerate communities and natural environments.

RSF Social Finance has mapped out a definition comprising four interrelated strategies drawn from Capital Institute founder John Fullerton's principles of regenerative economics:⁵

Holistic analysis. Investments and giving are based on a whole-system analysis that accounts for interlocking causes and effects. Holistic analysis undergirds all regenerative finance strategies.

Integrated capital. This financing structure blends various types of capital to give social enterprises, community-led projects, and restorative cultural and environmental initiatives funding that is tailored to maximize success.

Equitable deployment. Regenerative financing deploys capital more equitably by eliminating repayment terms and collateral requirements that extract resources from communities, revising exclusionary credit standards, involving core stakeholders in decision-making, and otherwise rebalancing the scales of economic control.

Trust relationships. Regenerative finance transcends the transactional. It is based on relationships of trust and shared values, an attribute that may sound limited or fanciful but makes execution of the other strategies practical.

At our firm, these principles are the foundation for three funds. The RSF Social Investment Fund supports debt financing for enterprises working to create long-term social and environmental benefits.

Our donor-advised fund (DAF) program accommodates philanthropy and holds ungranted assets in an impact portfolio.⁶ A third product provides loans, grants, and guarantees to innovative, early-stage entrepreneurs who otherwise would not have access to affordable funding.

HOLISTIC ANALYSIS

Regenerative finance approaches problems, opportunities, and potential funding solutions from a holistic perspective. It doesn't address just one element of a system without considering how it interacts with others and how proposed changes might affect the whole system. The goal is to generate positive changes throughout a system and avoid net negative impacts.

Regenerative agriculture is one of the most active areas for regenerative finance, partly because it expresses the holistic approach so well. Rather than focusing solely on, say, reducing water use, eliminating pesticides, or improving soil health, regenerative agriculture aims at getting all elements of the farm and food system working in harmony and continually replenishing natural resources and human health. The challenge is that agriculture is a capital-intensive sector with strong price pressures and often poor labor conditions. Converting to a regenerative approach will require philanthropic, public, and private funding.⁷

One regenerative finance solution is a five-year initiative called Funders for Regenerative Agriculture (FORA),⁸ which seeks to address these challenges by collaborating on systemic solutions that put people who steward the land first. FORA members—a mix of private investment firms, foundations, and food system organizations—commit to taking on more risk, in line with the level of difficulty and the urgent need for action, and to assess potential negative impacts.

A smaller-scale collaboration, capitalized in part by our firm's DAF holders, supports a small and ambitious initiative

called Soul Fire Farm. The 80-acre farming enterprise near Albany, New York, seeks to end racism and injustice in the food system by using—and teaching—regenerative Afro-indigenous farming methods; empowering farmers who are Black, Indigenous, and people of color (BIPOC); addressing the lack of access to fresh food in impoverished neighborhoods; and advocating for land reparations.

Soul Fire has been able to do this work with the help of more than \$350,000 in grants from our DAFs. The grants have enabled the enterprise to train hundreds of aspiring BIPOC farmers each year and to incubate the Northeast Farmers of Color Land Trust, which works to advance permanent, secure land tenure for the BIPOC farmers.

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INTEGRATED CAPITAL

Integrated capital is the coordinated and collaborative use of different forms of capital (e.g., equity investments, loans, gifts, recoverable grants, loan guarantees, etc.), often from multiple funders, to support a developing enterprise that's working to solve complex social and environmental problems.

Integrated capital addresses the funding challenges social enterprises face in several ways. Employing philanthropic and investment capital can get enterprises through the so-called "valley of death," where a promising high-impact venture needs more capital to realize its

potential but doesn't qualify for traditional financing.

One example is Belay Enterprises, a Colorado incubator of budding social enterprises. Belay can do this incubator work in part because its flagship project, the home-improvement thrift store Bud's Warehouse, is remarkably successful. Bud's also employs and trains people struggling to find work after experiencing homelessness, incarceration, or addiction.

In 2016, Bud's Warehouse had outgrown its rented facility and faced a hefty increase in rent. Belay found a 50,000-square-foot warehouse that would cost \$2.9 million to buy and renovate, but Belay didn't have the 30-percent down payment its bank required for a loan. We proposed an integrated capital financing. Our organization would provide a \$2-million loan and work with Belay to bring in community organizations willing to put down significant sums of money to fund the project through creative subordinated debt that would not be repaid if Belay defaulted.

Belay raised \$250,000 through donations, and five Denver organizations provided secondary loans for the remaining \$650,000. The purchase provided Bud's Warehouse with twice its original operating space for less money than it was paying to rent its old facility. Following Belay's recent loan refinancing, many of the community members who contributed money for the purchase have been repaid and can now reinvest in other social enterprises. Others donated their entire principal investment to Belay, enhancing its financial backbone.

EQUITABLE DEPLOYMENT

Regenerative finance can redress how conventional finance creates and maintains inequality and fund community-driven projects and enterprises led by BIPOC entrepreneurs. Across the spectrum of funding, BIPOC enterprises routinely are overlooked or underfunded by conventional investors, venture

capital firms, and commercial banks. Founders of color also face significantly higher hurdles in obtaining capital than their white counterparts, including exclusionary credit standards. Regenerative finance initiatives seek to rebalance the economic scales by expanding the universe of people funded and reforming the funding process to eliminate structural biases and invite stakeholders into decision-making roles.

A signal example is the Boston Impact Initiative Fund,⁹ which supports entrepreneurs using integrated financing that focuses on economic justice. The fund invests in enterprises throughout Eastern Massachusetts that address the racial wealth gap and ecological challenges. The fund is based on the belief that persistent poverty and injustice won't change unless people have the opportunity to own and control their future. Therefore, potential investments are considered through the lenses of an enterprise's ownership, opportunities for meaningful livelihood and advancement, and the degree of worker participation in allocating resources and setting directions.

Candide Group's Olamina Fund is a national effort to address the historical lack of access to capital in Black and Native communities. This fund provides impact-oriented loans to various women- and BIPOC-led private debt providers, such as community development financial institutions, nonprofit loan funds, and other institutions that invest in community resources such as small business development, worker cooperatives, and low-income housing. The fund's design includes a community advisory board that consults on strategy, reviews opportunities from a community wealth-building perspective, and participates in credit decisions.¹⁰

Our firm similarly engaged community-connected advisors when it launched its Racial Justice Collaborative in 2021.¹¹ The philanthropic fund provides integrated capital financing to U.S.-based social enterprises with BIPOC owners

and leaders. A working group of RSF staff and external advisors with community wealth-building and racial justice expertise makes funding decisions, which helps ensure accountability to the communities the Collaborative seeks to serve.

The first four enterprises funded by the Racial Justice Collaborative illustrate regenerative finance principles, as described below:

Downtown Crenshaw. This is a Black-led project and movement to preserve one of the last predominantly Black neighborhoods of Los Angeles. Headed by Downtown Crenshaw Rising, a nonprofit community corporation and activist group, the project aims to purchase a 40-acre mall in Crenshaw and redevelop it into a 21st-century urban village built upon principles of community wealth building. The plan is to create an environmentally sustainable urban village with a mix of cooperative businesses, retail, restaurant, grocery, housing, office, hotel, entertainment, and green spaces that results in a regenerative, restorative, and reparative local economy.¹²

CA BIPOC Farmer & Land Steward Relief Fund Collaborative. This collaborative distributed \$835,000 in pandemic relief grants to 80 BIPOC farmers and land stewards in California during 2020. In its second round of grants, the group brought the community into the decision-making process by inviting farmers from the first round to support others in their community; this allowed grants to go quickly to those most in need.¹³

Higher Purpose Co. Higher Purpose works to build community wealth with Black residents in Mississippi by promoting the ownership of financial, cultural, and political power. The nonprofit provides loans and support to Black businesses and is planning a new headquarters designed to serve as a hub for Black entrepreneurs, farmers, and artists in the Delta.¹⁴

East Bay Permanent Real Estate Cooperative. This co-op, a community real estate developer that supports BIPOC communities' access to land and housing, is revitalizing the historic Black arts and business corridor along West Oakland's Seventh Street corridor. Its goal is to create a hub for the Black arts community for generations to come, including a fine arts and movement arts space, three units of cooperative artist housing, a juice bar and café, an outdoor festival space, a community stage, and a weekly Black farmers market.¹⁵

TRUST RELATIONSHIPS AND TRUST UNDERWRITING

Building trust relationships is a core strategy of regenerative finance. Some communities have long experienced extractive finance, a pattern of pulling natural and capital resources out of a community that leads to environmental harm, social and economic injustice, and unbalanced systems. These communities have good reason to suspect the intentions of people with power who propose projects to them. In addition, the anonymous and mechanistic quality of conventional finance obscures how systems work, which is one reason many of our society's support systems are so broken.

Regenerative finance is a collaborative and experimental endeavor that requires trust among partners. For example, we put relationships at the center of our work, with the idea that financial transactions should be more direct, transparent, and personal. Our experience has been that when we get to know our borrowers, clients, and other partners, we develop a deeper understanding of their needs and capabilities. Over time, we build trust, which allows us to finance projects that contribute to our shared mission without the need for extensive due diligence. We call this "trust underwriting."

Guayakí and other fair-trade companies in the Social Investment Fund loan portfolio are good examples of how trust

underwriting has supported regenerative finance goals. Since its launch in 1996, Guayakí has gone to great lengths to ensure its supply chain promotes the well-being of land and people. Yerba mate grows on shaded land in the Upper Paraná Atlantic Forest, which stretches across Argentina, Paraguay, and Brazil in regions heavily deforested since the 1900s. Guayakí works with small-scale local growers to farm responsibly by raising solely shade-grown plants and reforesting devastated areas with native hardwoods. Guayakí also pays farmers a premium price to grow yerba mate, allowing living wages, creating healthy working conditions, and helping to fund community development projects for local Indigenous communities.

As demand for fair-trade products grew, Guayakí saw an opportunity to help its suppliers capture more of the value chain by financing drying facilities for their yerba mate leaves. This fills a capital gap for smaller-scale fair trade suppliers.¹⁶ Smaller loans are riskier, but they take as much time and expertise to underwrite as large loans—sometimes more—resulting in unaffordable loans.

Trust underwriting solves this problem. Where we have a trust relationship with a fair-trade borrower, and that borrower has trust relationships with its suppliers, we offer borrowers loans at reasonable rates to fund their suppliers' capital needs. By relying on trust and community, trust underwriting reduces transaction costs, which are a common barrier to supply chain financing for both lender and borrower.

THE REGENERATIVE APPROACH TO PHILANTHROPY

Trust relationships also inform the philanthropic aspect of regenerative finance. In collaboration with donors, we have field-tested several forms of participatory grantmaking, including the following three community-governance strategies:

Flow funding. Flow funding involves handing over grantmaking power to

nonprofit leaders, social entrepreneurs, or community leaders with lived experience in a particular field. The donor typically chooses the issue area and invites community leaders to distribute funding directly or through a strategic partner. More people share the power of giving through this process, and donors gain exposure to many more organizations or projects than they could identify alone.

Shared gifting. This approach invites a small group of local nonprofit leaders—usually six to 10, selected through a community nomination process—to spend a day together and decide how to distribute financial resources among themselves, based on their own criteria. They review each other's proposals and ask questions about each other's work. The group also decides how participants will report back on their use of the gift. The process encourages discussion of needs and offers, and often the nonfinancial resources that emerge—potential partners, network connections, introductions to new resources—are considered as valuable as the funding.

Community-led funds. Community-led funds put community leaders fully in charge. Donors connect directly or through a strategic advisor with community leaders working in the donor's area of interest. Those leaders identify community advisors who collaborate on funding decisions, develop a funding process, and work with a fund administrator on carrying out the work. Donors provide ongoing financial support, and community leaders have sustained autonomy over distributing the funds.

REGENERATIVE FINANCE MEETS THE MOMENT

The magnitude of the challenges facing our planet can be overwhelming, even for those least directly affected. Consider the United Nations' 17 sustainable development goals (SDGs), an urgent call for action globally. The SDGs recognize that ending poverty and other deprivations must go hand-in-hand with

strategies that improve health and education, reduce inequality, and spur economic growth—all while tackling climate change and working to preserve our oceans and forests. So values-driven investors have plenty of targets, but individual efforts can feel disconnected to problems so vast.

Regenerative finance offers a direct, transparent, and personal way to invest in solving social and environmental problems. Although it is just one strategy in a much larger tool kit, regenerative finance can inspire system-level change due to its focus on who gets funded and how. That shift gives communities that have long been excluded and exploited the power to advance their own solutions.

For values-driven investors who look beyond the financial returns of an investment to consider the true costs of the environmental, social, and governance challenges we face, regenerative finance is an opportunity to create long-term positive change collectively.

If we embrace this opportunity to diversify portfolios with high-impact investments, we can uplift local communities and hasten progress on a global scale—and make far greater progress still on issues that affect us all. ●

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