ECOTRUST CANADA'S COASTAL LOAN FUND

A BOLD INSTITUTIONAL EXPERIMENT

1998-2009

ecotrust canada

A BOLD INSTITUTIONAL EXPERIMENT

IN 1998, fewer than four years after beginning operations as a stand-alone conservation and development organization in British Columbia, Ecotrust Canada took the first tentative steps in what would become a ten-year experiment in development finance on the BC coast.

In partnership with its US affiliates, Ecotrust and ShoreBank, Ecotrust Canada launched a Coastal Loan Fund (CLF) that sought to move beyond mere rhetoric about sustainable or triple-bottom-line development, and get about the business of actually doing it. The CLF aimed to direct capital and technical resources to the task of diversifying coastal economies away from their dependency on industrial-scale resource development, including supporting new Aboriginal enterprises arising from affirmation of Aboriginal title and rights. Given that there was no significant tradition of development lending in Canada at the time, which meant no legislation or capital market to support it, and – it must be said – no real appreciation at Ecotrust Canada about the complexity of the task, this was ground-breaking work.

The underlying purpose of Ecotrust Canada's mission was and still is to build a *conservation economy* — to balance the interests of wealth generation, environmental health and social/cultural equity. Integral to fulfilling that mission is the hard work of providing proof of possibility that there are viable alternatives to traditional, 'single E' economic development — alternatives that improve rather than degrade ecologies and communities while still achieving financial success. Not all of Ecotrust Canada's work has been centred on business lending – far from it – and we never had any illusion that a loan fund was the only thing required to make the transition to a conservation economy. But the CLF was an important, early-stage declaration of intent that Ecotrust Canada was serious about social change, and that brokering in technical expertise and new forms of capital to support triple-E economic development was a unique contribution that we could make in B.C.

In the ensuing ten years, the CLF made 87 mission-based loans. With a capital base that rose from zero to about $4-million, the CLF disbursed $10.7 million in total loans, leveraged $40 million in additional loan capital, and created, cost effectively, almost 900 jobs, while suffering default rates and loan losses at the low end of the scale for comparable organizations. And almost more importantly, the fund demonstrated that, if we want to support social enterprise and market innovation, we need to find ways to deploy capital in new ways.

In 2009 Ecotrust Canada undertook a ten-year review to assess whether the CLF was tracking towards its goal of self-sustainability. Against a backdrop of the downstream effects of the global financial crisis, it was apparent that the fund could not be scaled quickly enough to operate effectively independent of the charity. Ecotrust Canada's Board of Directors made the difficult but prudent decision to wind down the lending program rather than risk financial harm to the charity itself.

The financial crisis took an enormous toll on the development finance sector generally, perhaps no more visibly and discouragingly than on ShoreBank itself, which ceased operations in 2010. But it also underlined the need for social finance solutions to fill the market gaps where conventional financial institutions can not or will not go. ***While tiny in the overall scheme of things, Ecotrust Canada's Coastal Loan Fund stands out as an important wayfinder in Canada's social finance landscape***, and the lessons from its rise and fall are considered to be salutary to students of the field, and more importantly, to practitioners seeking to leverage private and public capital for greater public good.

Time will undoubtedly bring more loan funds, more social venture capital investments, and hopefully more beneficial tax treatments and policies. Even though no longer a capital lender, Ecotrust Canada remains committed to contributing to the national development of social finance, by offering up insights from our experience as lending practitioners, by acting as an intermediary between capital markets and emerging opportunities, and also through our work as an incubator and generator of social enterprises.

In May 2011, we published *Reflections: Lessons Learned from our Coastal Loan Fund* in which we stated that for loan funds of this type to prosper, there is "*an urgent need to build the right incentives, and to determine the level of support required given mission risk, mission impact and desire outcomes.*" We were fully aware that our *Reflections* left many important questions either unanswered, or under-examined. In acknowledging that, we expressed our intention to publish a longer, more analytical examination of the performance history of the CLF, "*to support and advance discussions in Canada about the need for a comprehensive social finance program that is well designed, adequately supported by governments, and able to engage national and regional financial institutions as well as private capital sources to support social change*." This paper fulfils that intention, and is made possible through the generous support of the J.W. McConnell Family Foundation, which shares our interest in the informed evolution of social finance innovation in Canada.

We quickly discovered that answering critical questions of *effectiveness* – 'did the loan fund do what it set out to do?' – and *efficiency* – 'did the loan fund perform as well as it could with the resources at hand?' – was not possible using the common measurement tools of loan volume, job creation, funds leveraged, loan-loss rates, and profitability of operations. We realized that new, context-specific tools of examination were needed to properly assess the CLF's success (or failure), and that these tools needed to:

◊ articulate the special 'position' occupied by mission-based lending in the overall context of capital markets; and

◊ provide a way to reconcile the complexities of the competing mission and credit objectives often at play in a loan fund of this kind.

This report therefore sets out to define the particular niche occupied by a mission-based fund and to build an analytical framework with which to display indicators that take both mission and credit pressure into consideration.

High risk and high impact are the operative words here. Administrators of mission funds know all too well that there are built-in trade-offs between taking risks for maximum mission impact and showing low losses and good financial results on the other. This report is designed to assess our successes and failures on both these metrics.

Dr. Dominique Collin, whose long history in finance innovation in Canada uniquely qualifies him to undertake this analysis and reporting, did an exhaustive mining of Ecotrust Canada's lending database and used client files and credit reports to create a profile of demand risk, mission characteristics, and direct/indirect measures of mission effectiveness. Financial records were used to assess the efficiency of our lending operations, including the tightrope between meeting mission objectives and ensuring fund viability. All of the early assumptions arising from the data sets were verified through interviews with staff and board members.

Because numbers can never tell the entire story, the statistical section of the report is augmented by a section that explores mission success more qualitatively. Here we examine the extent to which elements of Ecotrust Canada's broader mission permeated its credit culture, and vice-versa. Case studies offer a glimpse of some of the key ingredients for success and failure that were identified along the journey.

Dr. Collin's analysis is, we believe, an original and provocative attempt to capture the true complexity of mission-based lending and market formation in what was a largely indifferent and often sceptical environment. It is our sincere hope that the report will add evidence and insights – based on data harvested and lessons learned from the real world, and it will also serve as cautions, encouragements and waypoints for those undertaking social finance journeys of their own.

Brenda Kuecks
President
Ecotrust Canada

***Photo**: Ucluelet's working harbour, Clayoquot Sound*

Table of Contents

Photo: *The Value-Added Wood Sector was an important part of the CLF's portfolio*

This Report has been produced by Ecotrust Canada

March 2013

With special thanks to Dr. Dominique Collin for his leading-edge research and analysis. With acknowledgement and thanks to Mary Houghton, John Berdes and Jacqueline Koerner for their pioneering spirit in all-things social finance including the wonderful, crazy notion to use lending at EC as a way to kick-start conservation entrepreneurs. And thank you to Ian Gill for his role as EC's President at the time the CLF was founded, as well as for his editorial contributions to this report.

.

Thank you to the J.W. McConnell Family Foundation for their financial support to pursue this evaluation.

Also thanks to Ron Grzywinski, Bill Girard, Pieter van Gils, and Emily Beam who agreed to interviews that helped us understand the data and place it in the necessary context of time and purpose.

Finally, thank you to Abby Yellen, because without her multi-tasking in the background, this report might never have seen the light of day.

WHY SOCIAL FINANCE?

CONVENTIONAL sources of commercial capital represent the lion's share of financing available for economic activity. Commercial finance is values-neutral, focused on economic returns alone.

In a perfect world, conventional sources of commercial capital – bank loans, venture capital and institutional investments, securities and financial markets – should be able to respond to the demand for all double or triple-bottom-line investments that meet the first bottom line, market levels of return.

Unfortunately, the world is not perfect, and nor are markets. Conventional sources of commercial capital generally prefer to invest in externally audited firms with proven management, operating in familiar sectors of economic activity where risk is assessed on hard results from past performance, and/or with conventional forms of security in place. Even if there is a solid case for risk-adjusted returns, conventional capital tends to avoid investments that involve innovation, new and unproven sectors, jurisdictions with unfamiliar regulations, and smaller, high-touch investments that require more intensive due diligence and monitoring. An exception is where capital providers are afforded government guarantees, such as small business loan guarantee programs.

Photo: *'Namgis Totem Poles in Alert Bay, BC*

Increasingly, financial markets are being populated with innovative tools in response to conventional capital's failure to take these kinds of business and market realities and opportunities into account.

These commonly called 'social finance' instruments span three distinct but inter-related categories: ***commercial***, ***developmental*** **and** ***incubation*** social finance instruments. Each type of instrument has its own risk and return profile, risk tolerances, and investment culture.

Figure 1 illustrates the relationship between these three categories, by putting risk and return on the 'Y' axis and mission on the 'X' axis. These axes are segmented by two risk-return cut-off lines: the first for market risk tolerance, and the second for sustainability risk tolerance—or fund survivability.

Operating boundaries for each category are illustrated with hazy lines to reflect a degree of overlap between the instruments. Overlap exists largely because risk measurement is a matter of perception and practice rather than an exact science. ***Conventional commercial finance*** is mission neutral and covers the entire ground above the market risk tolerance zone, but tends to gravitate towards the lower risk end of this spectrum. ***Commercial social finance (market funds)*** is largely a subset of conventional capital and seeks the same levels of risk-adjusted returns, but may stretch beyond conventional capital where there is a combination of mission benefit and risk control. In some cases government guarantees or investment incentives enable a market fund to invest in areas where conventional commercial finance will not venture. ***Developmental social finance (mission funds)***, the zone occupied by the CLF, occupies the space between market risk tolerance and sustainability risk tolerance. The sustainability risk tolerance of a mission fund is determined by the level of support made available to it by governments or charitable agencies in the form of cost-free capital, operating subsidies, loan loss reserves, etc. While a market fund needs to generate a market level of return, a mission fund may aim for break-even given available support.

Incubation social finance (seed money) addresses the need in the marketplace for grants, contributions, and concessionary (lower than market) financing for valuable but early-stage initiatives that need time to mature.

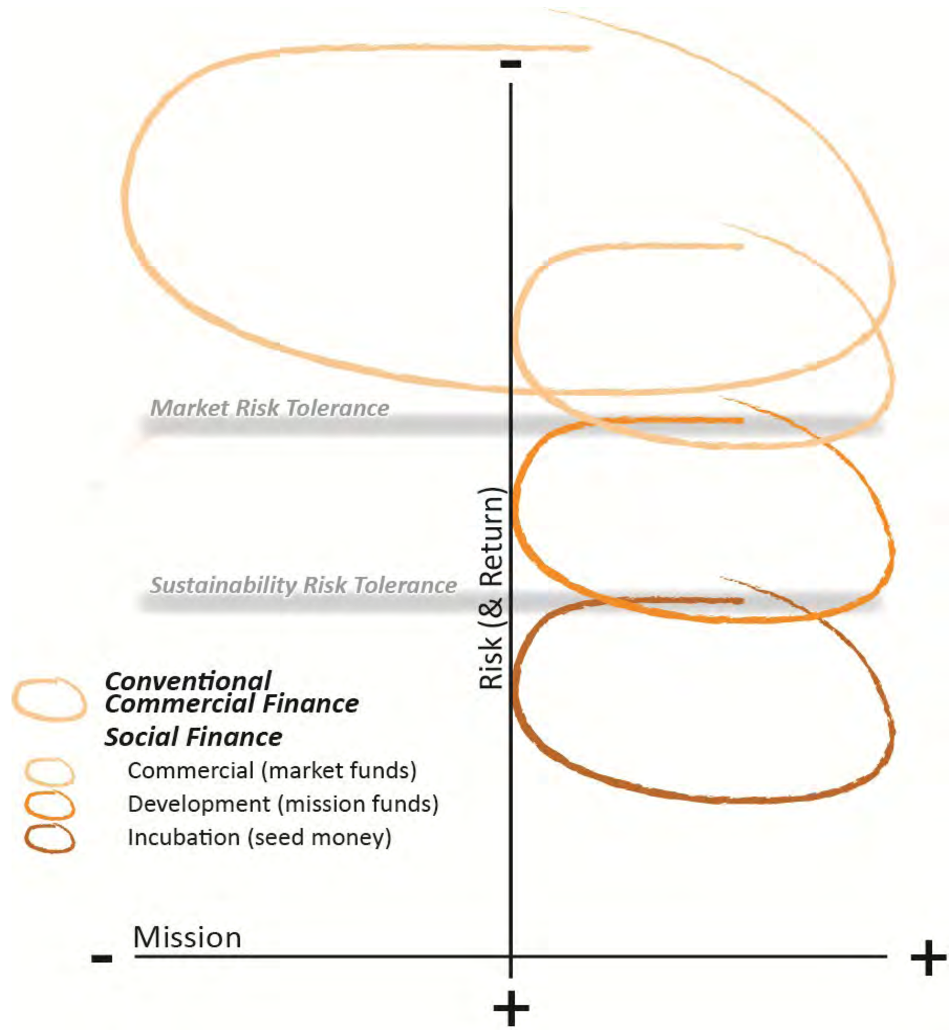


Figure 1 (above)

Figure 1 illustrates the relationship between various types of social finance in the marketplace

As ideas progress from being start ups, to young enterprise, to market-ready business, different social finance instruments support each developmental phase, acting synergistically as it were, like a mission escalator.

Incubation social finance (seed money)

Provides capital in various forms to enable innovative ideas and early-stage technologies that require proof of concept, market development and/or improved financial literacy on the part of the entrepreneur. This work cannot be financed through high-interest bearing business loans. Repayable contributions and other forms of cost-free or concessionary financing are needed and failing that, philanthropy has a role to play. Once a concept and a business plan have been developed and management expertise secured, some combination of these instruments can be used to offset risk to the point where a portion of the financing can be accommodated by developmental social finance lenders. This is often the case for the first steps of small and remote community development efforts, and for enterprising non-profits.

Developmental social finance (mission funds)

Mission funds pick-up where incubation financing stops, and extend as far as their support mechanisms enable them to go. They include government and/or charity-supported instruments such as the US network of Community Development Financial Institutions (CDFIs), and international micro-lending funds. In the Canadian context this space is occupied by some labor-sponsored venture capital funds, Community Futures Development Corporations, Aboriginal Capital Corporations, and the numerous Québec Chantier de l'économie sociale and Desjardins funds that accept above-market risk or below-market returns in pursuit of mission impact.

For these investment vehicles, support may take the form of contributed capital, interest-rate buy-downs, investment tax credits, operating subsidies, training and support programs, and/or loan loss insurance. Although interest rates tend to be higher than commercial lending rates as a reflection of increased risk, fees are often insufficient to cover the actual cost of service delivery. In most cases, without external assistance, few if any of these instruments are financially sustainable.

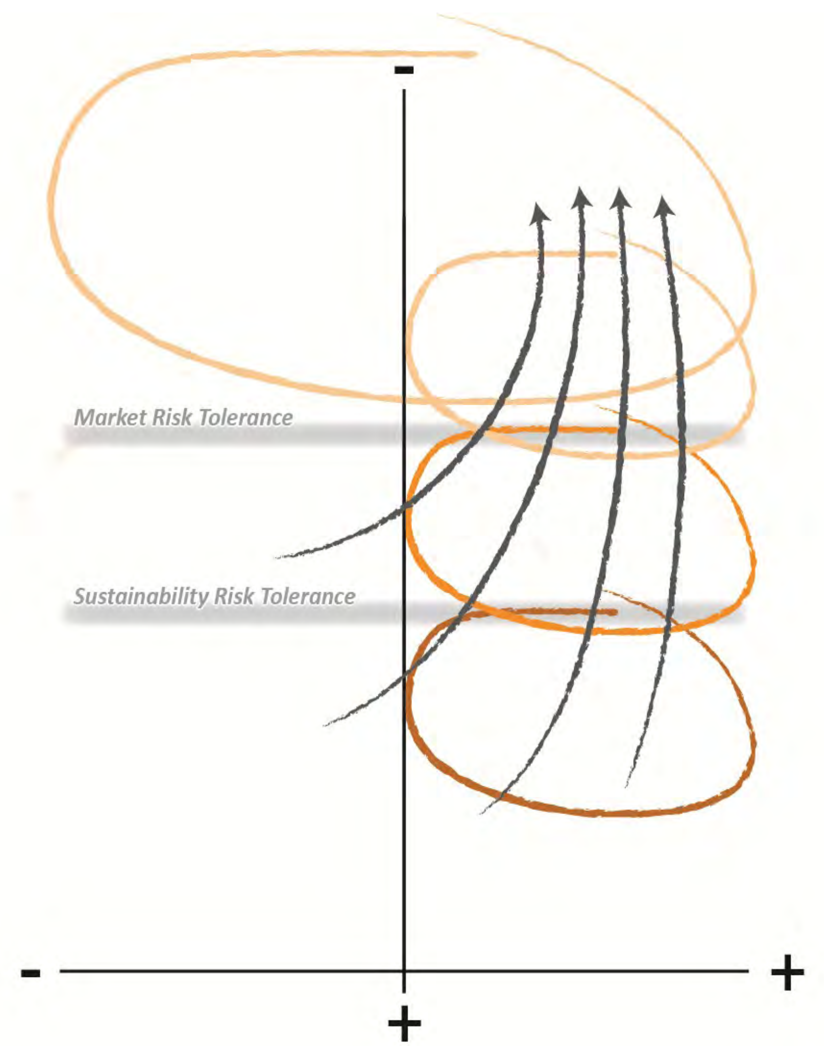
The developmental social finance space corresponds to early growth investment opportunities. These include start-ups that promise mission benefits but have unproven concepts or limited capacity; start-ups with lending requirements too small to be of interest to conventional banks; businesses with a limited track record; a weak security position; and/or management inexperience. In exchange for the additional risk represented by this market segment, clients are prepared to pay a premium for loans, but otherwise follow normal market loan discipline.
This space provides what might be thought of as ‘catalyst capital’ for leading-edge mission enterprises that need to mature in niche environments before getting to the growth/stability stage necessary to qualify for less expensive conventional financing. Effective investment in this type of enterprise requires high touch — careful due diligence and significant after-care, as well as an understanding of local conditions (including relevant regulations and sector knowledge).

Investment vehicles in this space are time-intensive and non-standard. There is limited access to conventional security, requiring the development of creative alternatives for each loan. In many cases, developmental social finance vehicles are reminiscent of character lending and other trust- and relationship-based community banking practices that were the rule for small business lending before centralized credit history and credit scoring techniques were introduced. A good understanding of local operating conditions, the use of moral suasion to ensure repayment; and the operator’s ability to provide technical or professional support to early entrepreneurs all contribute to their success or failure.

Commercial social finance (market funds)

As enterprises mature, they are able to qualify more readily for commercial social finance, where investors include credit unions, socially responsible investment funds, pension funds and impact investors who have an interest in innovation and social /environmental benefits. Often these investors are well-positioned to realistically gauge risk because of their familiarity with a specific client base or sector, which enables them to stretch commercial investment capacity and respond to a demand for capital from innovative mission-based enterprises that have matured and come to scale. Firms using new technologies or exploring new ways of doing business, minority-owned businesses, remote enterprises, going concerns that have yet to prove scalability, and First Nation enterprises that operate in a differently regulated environment but meet or exceed normal market return expectations, are examples of investments that might qualify for commercial social finance.

However, the ability of commercial social finance investors to respond to mission-driven capital demands is limited by many factors. Regulated deposit-taking institutions and pension funds are held, by law, to tight limits on risk exposure. Funds under management are regulated by financial market authorities. The cost of due diligence and servicing for instance on loans for innovative projects; for small loans or loans in unfamiliar terrain; or for high-touch loans requiring aftercare, is sometimes so high relative to interest earnings that – even if the enterprise is commercially viable – the loan demand cannot be handled by commercial instruments of any kind unless sufficient government guarantees, loan-loss protections or investment tax-credits are made available.



<u>Figure 2 (above)</u>

Figure 2 illustrates how the various types of social finance work synergistically as a mission “escalator".

ECOTRUST CANADA'S LOAN FUND — A MISSION FUND

ECOTRUST Canada's mission is to create a conservation economy in British Columbia. The innovation required to trigger this kind of economic transformation – everything from early proof-of-concept pilots that require incubation instruments, to large-scale, established businesses positioned to attract commercial impact investment or mainstream conventional financing – cuts across the entire spectrum of social finance needs.

The Coastal Loan Fund (CLF) was initially established to:

◊ address the full suite of social finance capital needs – incubation, developmental and commercial; and

◊ support Ecotrust Canada's mission by focusing lending activity on triple bottom line business development with two primary target groups: rural entrepreneurs involved with conservation-based businesses; and coastal First Nations interested in shifting their local economy towards a conservation economy.

This report uses the definition of social finance articulated by the Canadian Social Finance Task Force. "an array of instruments made available for investments that produce a combination of net, measurable financial, social and/or environmental benefit, and that in most cases offer a financial return".

The fine and important subtleties crafted into this definition include:

1. **no mention of market-level returns, which is the only way most capital markets define success;**
2. **introduces the concept of net benefit; and**
3. **calls for measuring these three benefits in combination as the way to define success.**

The fund was also expected to achieve financial self sufficiency within ten years. This combination of ingredients in a single fund created a demanding set of expectations for the CLF that cannot be readily compared to any other social finance fund operating in Canada.

Due to the size of the fund ($2 million from philanthropic investment and $2 million from interest-bearing mission-related loans), and the absence of operating subsidies, ***the CLF had to ultimately narrow its lending to activities deemed to be in the developmental social finance arena***. However, Ecotrust Canada as an organization, continued (and continues to this day) to react to the needs for capital across the full social finance spectrum, often playing an important intermediary role by engaging senior commercial social finance players, raising incubation social finance capital, and/or providing technical assistance to entrepreneurs and communities.

Given the scope of Ecotrust Canada's ambitions – and its ability (or otherwise) to enlist supporters or partners along the way – the performance of its ***Coastal Loan Fund is worthy of serious analysis, especially in light of the growing interest in social finance in Canada and abroad.*** To that end, the very practice of measuring the multiple tensions that must be managed in the creation and operation of a mission fund demands its own orthodoxies, since using conventional means to measure the performance and impact of unconventional finance instruments is, perforce, an unsatisfactory exercise.

In an effort to address the challenge of measurement, we chose to design, as outlined in the following section, a new model for assessing the performance of mission-based funds.

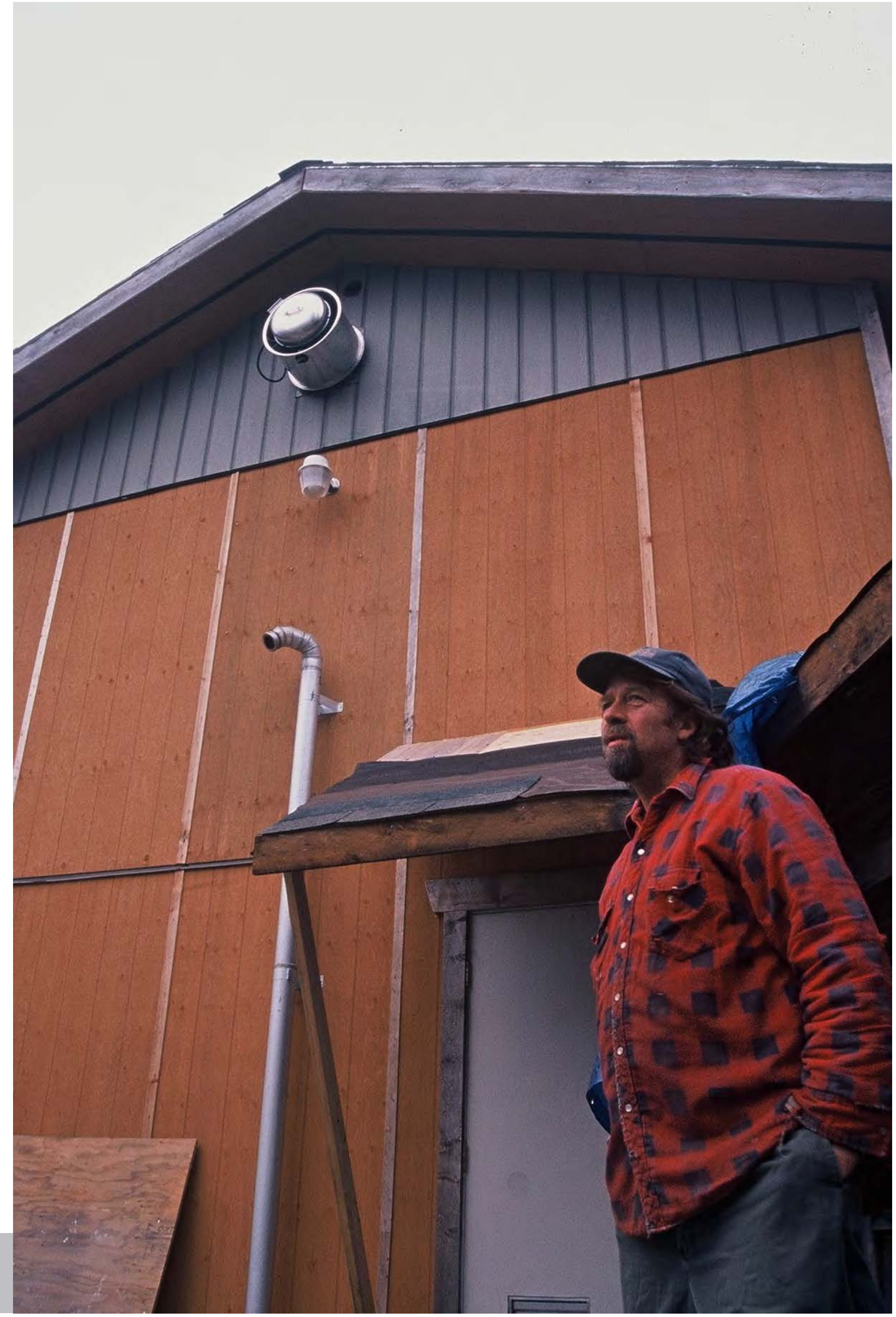


Photo: *Proprietor, Pacific Sun Kelp Drying Facility, Ucluelet, BC. CLF Client*

QUIRKS & QUADRANTS: A NEW MODEL FOR ASSESSING A MISSION FUND

ASSESSING the effectiveness* and the efficiency** of a mission fund is a complex challenge. In part this is because of the inherent tension between the two.

Deep and lasting mission impact requires a willingness to accept the higher risks and costs associated with innovation, with less experienced managers, or with remote locations. In some instances it also requires capital that is 'more patient' — willing to wait for innovations to mature so that their full impact and outcomes (particularly the social and environmental outcomes) can be measured. Additionally, external factors such as interest and exchange rates, or sectoral economic conditions not under the control of management can influence both outcomes and costs.

The conventional metrics used to assess effectiveness, such as 'employment development', tend to blur the difference between surface or short term impact and long term outcomes. For example, one stable long-term job in an emerging sector and one underpaid job in a vulnerable traditional sector are numerically equal but qualitatively very different. The conventional metrics for measuring efficiency, like loan loss rates and fund profitability, tend to blur the relative impact of management ability, the relative cost of getting things done given the challenge addressed, the level of risk accepted, and economic factors not under a fund's control. ***A high loss rate for example, can be the result of any combination of an economic downturn, lax loan management practices, or a decision to invest into deep mission impact.***

Comparisons (and financial support) based on such indicators create mission drift pressure by rewarding mission funds that shy away from the more difficult challenges and focus instead on lower cost and lower risk activities.

———————————————————————

*Effectiveness, meaning 'did the fund do what it was meant to do?'
** Efficiency, meaning 'were resources well allocated; was maximum value derived for costs; were policies and procedures well designed; and was the loan portfolio professionally managed?'

To address these deficiencies, and to allow a more comprehensive assessment of the CLF experience, a further refinement of the developmental social finance space was required.

By dividing the developmental social finance arena into four quadrants, using the same high/low risk and high/low mission axes as before **(Figure 3)**, it is possible to analyze more accurately the performance of the CLF as a mission fund.

QUADRANTS IN DEVELOPMENTAL SOCIAL FINANCE SPACE

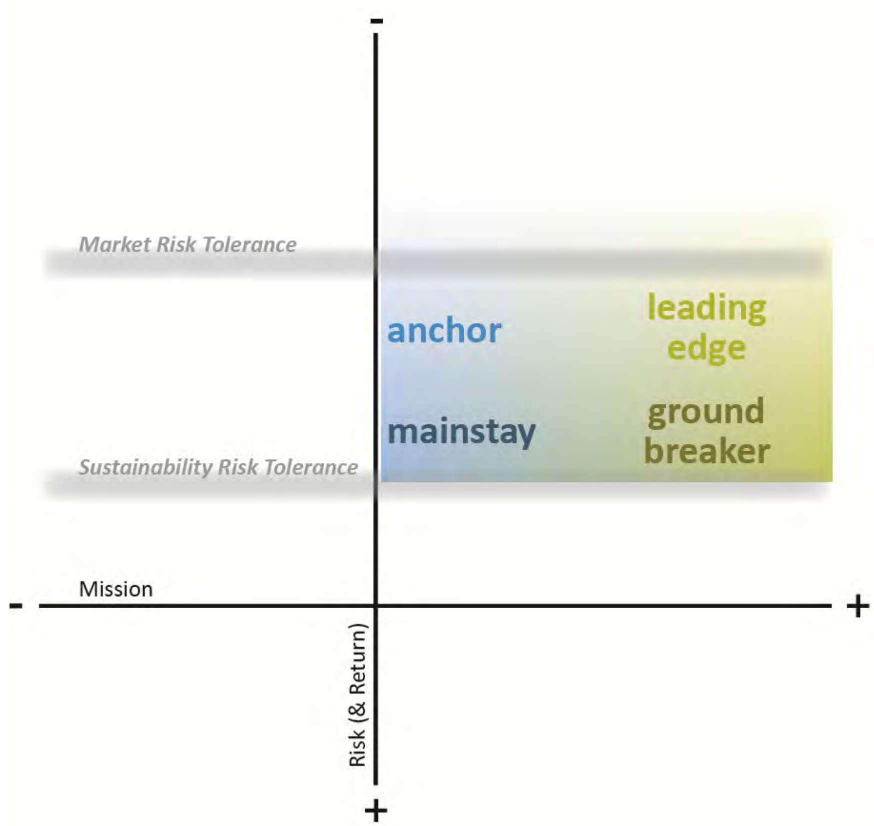


Figure 3 (above)

Figure 3 *illustrates the operating zone for development social finance funds (mission funds) and divides this zone into 4 quadrants to allow for a more accurate analysis of results.*

ANCHOR quadrant *(lower risk, lower mission)*

includes more traditional activities and a lower, albeit still positive and measurable mission focus. These loans tend to be larger and better secured. More experienced management reduces the cost and effort associated with due diligence. Activities in this quadrant provide a stable income and require little effort, thereby providing an anchor-point from which to invest in higher mission impact activity.

LEADING EDGE quadrant *(lower risk, higher mission)*

is the obvious and preferred investment target for most mission investors. Here, because it combines high mission impact and controlled risk, deal competition can be fierce. One dynamic common to this quadrant is that borrowers with this profile are more likely to qualify and move quickly into cheaper conventional forms of financing, unless they are barred as a result of specific obstacles like isolation, or Indian Act restrictions on security. In the case of the CLF, several stable high-impact loans in the leading edge category moved to less expensive commercial sources of financing before the end of their loan term.

GROUND BREAKER quadrant *(higher mission, higher risk)*

represents mission driven, innovative or high mission impact investments which are generally riskier, earlier stage ventures. This type of investment addresses the capital requirements of early adopters of new technologies; of marginalized social groups; or of leaders setting sector trends. They are frequently smaller in size and higher in touch. Markets and/or business concepts may be unproven. Management often untested, with limited financial literacy. The venture's security position weaker. Loans in this quadrant, when they succeed, tend to have the most dramatic growth and mission impact potential.

MAINSTAY quadrant (lower mission, higher risk)

includes more traditional business lines that offer less impact. Ventures in this quadrant are often early stage businesses needed to diversify a local economy or create new employment. As such, they represent an important part of the demand-profile for a mission fund even though at first glance, they may seem less relevant or important from a mission perspective. Thoughtfully constructed, investments of this nature can offer an opportunity to create new models for otherwise conventional activities – like pioneering the use of non-polluting materials, targeting employment for underserved populations, or introducing new governance practices.

Risk and Mission Profile

Most developmental lenders stake out their ground in the developmental social finance space (mission funds) to reflect the needs and realities of their target clients, taking into account their own risk tolerance as an organization. "*Mission shift*" is common to many mission and microcredit funds, as pressure from funders and financing bodies to produce market returns causes a decreased appetite for risk **(Figure 4).**

Along with analyzing the overall economic environment in which a fund is operating, understanding the results from a developmental fund portfolio, or comparing the performance of two or more funds requires a clear assessment of the aspects of the developmental social finance space they are covering as a result of their market and mission (eg. remote as opposed to rural terrain; or single resource based economies as opposed to a diversified economic base).

Indeed, the same performance measure (for example, high loss rates that are commonly taken as a measure of efficiency), can reflect: good loan management of an effective high risk and high impact fund taking on mission risk and operating in a difficult, but critical mission environment; poor loan management of a fund operating in a safer environment, with lower impact objectives and less risk; or even the impact of major regional or sector downturns in the economy, as independent from management.

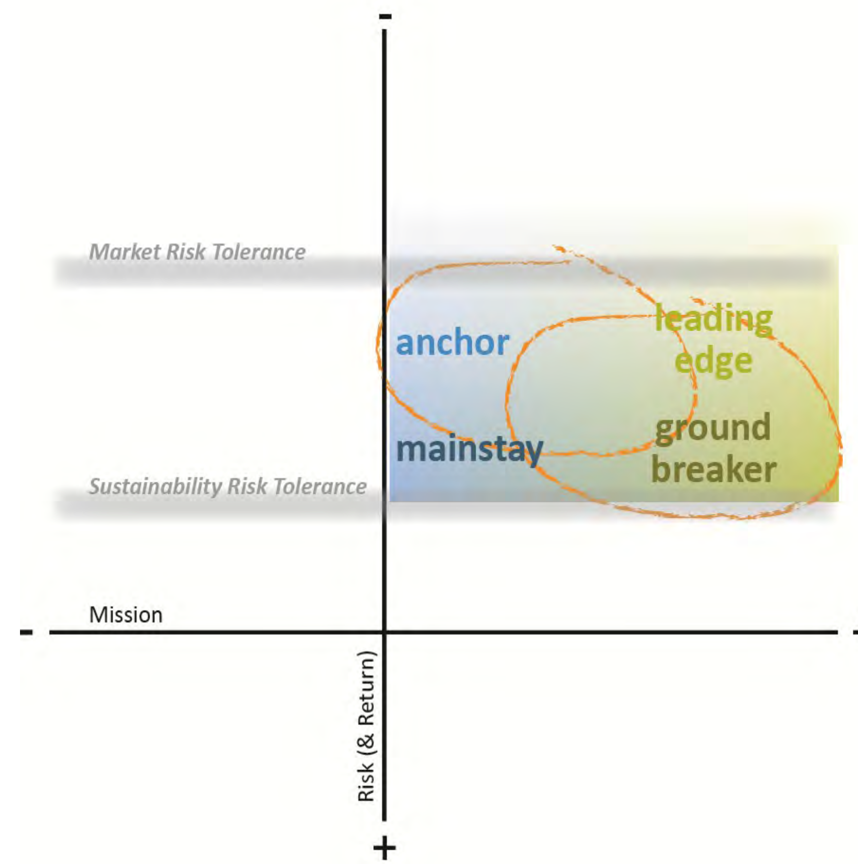


Figure 4 (above)

Figure 4 *illustrates the "mission shift" that is common to many mission and microcredit funds .*

EC's COASTAL LOAN FUND — BY THE NUMBERS

A FIRST attempt to analyze the CLF's basic loan data was completed in 2011, and took into account the year, disbursement amounts, and risk and mission scores for a subset of 54 electronic loan records.

That report by Dr. Alan Mehlenbacher, *Ecotrust Credit and Mission Scoring Descriptive Statistics*, confirmed the need to revisit risk, and more importantly mission scoring efforts, based on a review of primary materials and interviews with loan account managers. These additional tasks were undertaken to produce this report.

The quantitative data was sourced first from the CLF's electronic loan management records, and then supplemented by hard file material. A revised data set was produced using a combination of several sources including: a review of the original risk and mission scoring where available; the project summary recommendation forms; file content; and Ecotrust Canada's communications material that often revealed strong mission considerations that were not reflected in the original score. The revised scores were used to create 16 sets of loans defined by a combination of mission impact levels (stars, high, mid and low) and risk exposure (low risk, mid risk, high risk, very high risk). The revised scores by sets were then refined based on interviews with the CLF staff and management.

For the final analysis, these 16 sets were collapsed into four groups corresponding to the social finance space quadrants described earlier: "*leading edge* loans" (high mission and low risk), "*ground breaker* loans" (high mission, high risk), "*anchor* loans" (low mission, low risk) and "*mainstay* loans" (low mission and high risk).

Photo: *Commercial Fisherman—Pacific Coast Fishermen's Conservation Company, CLF Client*

CLF's Growth Curve

The growth curve of the CLF over 10 years is illustrated in **Figure 5**. In the initial phase the fund was managed out of Washington State by an institutional partner, ShoreBank Enterprise Pacific (hereafter called by its current name, Craft3). With its transfer to Ecotrust Canada in 2001/02, activity in the fund decreased slightly while local staff and systems came on-stream. As additional capital was sourced through program and mission-related investments, and with access to a loan loss reserve program* to protect capital, a second growth phase began in 2004 and then leveled off in 2006. The CLF wind-down was initiated in 2009 and concluded in 2011.

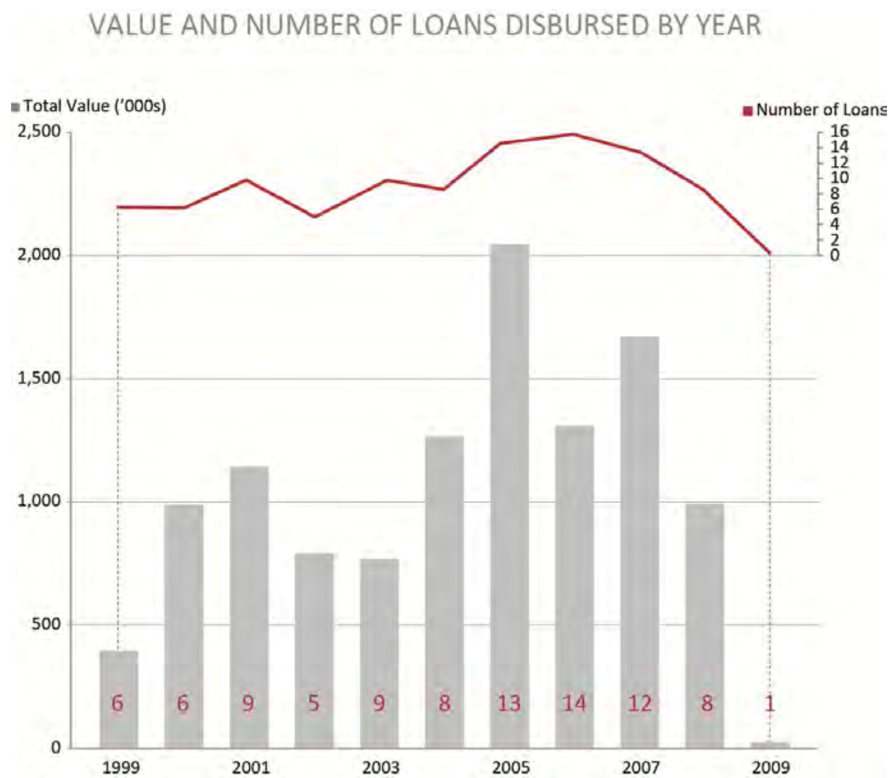


Figure 5 (above)

***Figure 5** illustrates the growth curve of the CLF over 10 years. For a variety of reasons 2004-2007 were the peak years of operation for the fund.*

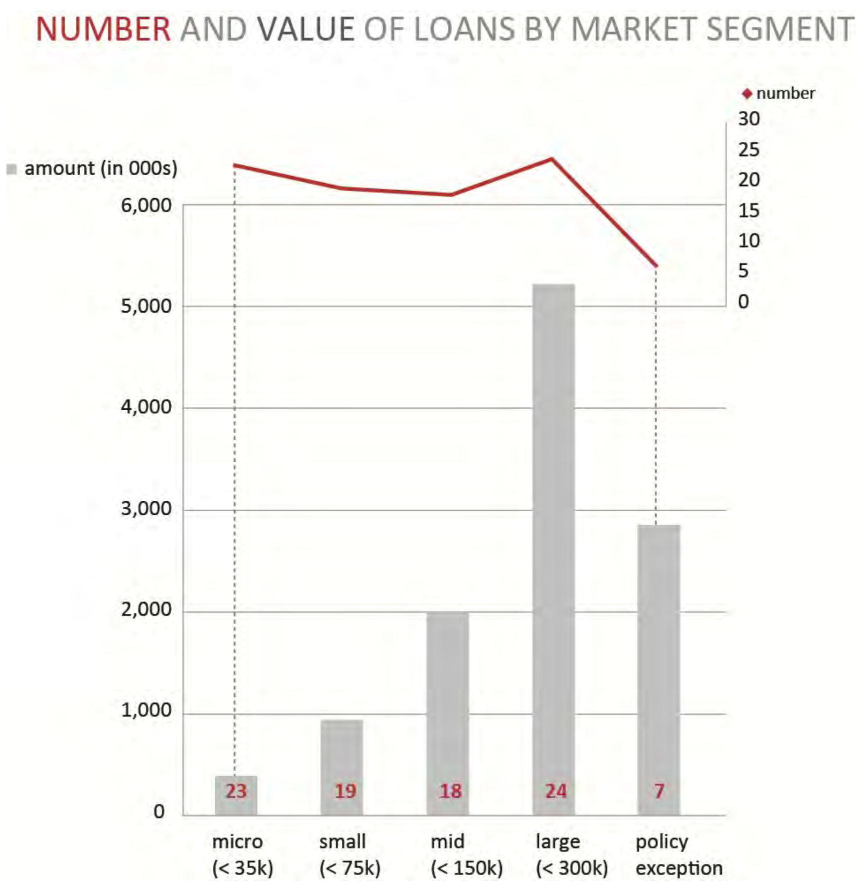
***Photos:** (top) Proprietors — Seaside Waters Co., CLF Client*
(bottom) The Nimkish Hotel, Alert Bay, BC, CLF Client

———————-

* The Loan Loss Reserve Fund established by the federal government and delivered by Western Economic Diversification was applied to the CLF loans between 2001 and 2006, at which time the program was terminated due to a federal policy shift.

Loans were clustered by size into four groups (**Figure 6**), which corresponded to four different types of loans:

- ◊ *micro-loans* (25% of the loans, 3% of disbursement);
- ◊ *small and medium sized loans* (41% of loans, 25% of disbursement);
- ◊ *large loans* (26% of loans, 46% of disbursement); and
- ◊ loans that required an exception to the maximum loan size policy (7% of loans, 25% of disbursement).



Managing the Portfolio

Each loan type has its own characteristics. ***Medium, small and micro-loans*** tend to be high touch, expensive to serve, riskier, and generate little interest income. ***Large and very large loans*** tend to be safer, because they involve more mature businesses or projects, including more experienced management, more reliable financial information and better security. These loans also require less processing time on average relative to the revenues they earn for the fund. This combination of factors often creates a strong incentive to focus on larger loans at the expense of the smaller loans that are an important part of meeting mission demand.

However, portfolio risk is usually best controlled by maintaining a large number of small and well-diversified loans, rather than by holding a concentration of extra-large loans. ***In fact, small loan funds are so well known to be highly vulnerable to single investment mistakes that funding authorities routinely impose maximum loan size policies.***

For a fund the size of the CLF, common practice is to establish a loan-size policy at 5% of portfolio, with exceptions up to 7.5%, and a cap on the total amount of exceptions. If the CLF had used this policy, this would have created in a maximum loan size of $200K with limited exceptions up to $300K.

Instead the CLF management team established a maximum loan size of $300K and placed no limit on the number or the size of exceptions. Over the life of the fund, the largest single loan exposure involved $1.1 million to a single client (2 loans, one for $600K).

Figure 6 (left)

Figure 6 *illustrates the way the loans were distributed in the portfolio by size.*

The CLF portfolio thus presented an unusually high risk concentration due to large loans. However, it must be noted that this investment strategy enabled the CLF to invest the income from larger loans to service the demand for much smaller loans – where two thirds of the loans accounted for one third of the monies disbursed.

Mission and Risk Distribution

To better understand the mission and risk profile of the CLF's mission fund portfolio, the fund's basic lending activity numbers are displayed in **Figure 7** using the same x/y axes of risk and mission, and the four quadrants previously defined.

<u>Figure 7 (above)</u>

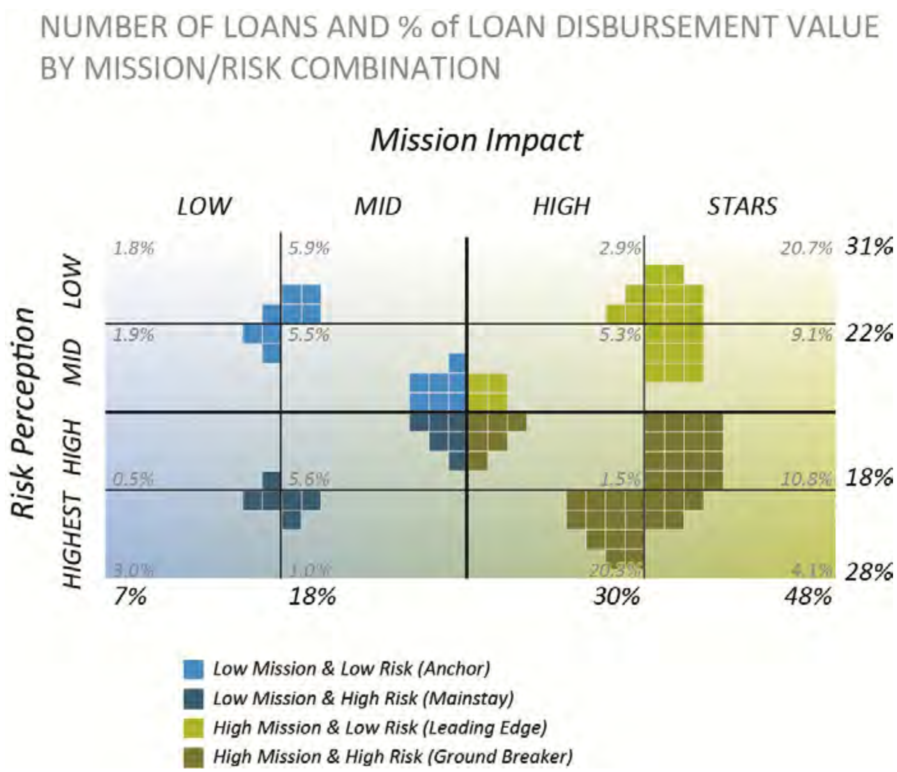
***Figure 7** illustrates the CLF's portfolio of loans by quadrant.*

Close to 75% of the CLF's effort was directed at high mission impact investments, with risk exposure roughly balanced between higher and lower risk. In numerical terms: 74.8% of monies loaned were high mission and 25.2% were low mission; 47% of monies loaned were high risk and 53% were in the lower risk space. The number of loans by mission and risk followed a similar pattern. High mission loans tended to be larger on average than low mission loans, and low risk loans tended to be larger than high risk loans. The leading edge social finance space quadrant showed the single highest average loan size, and the largest number of loans occurred in the ground breaker quadrant. ***The make-up of this portfolio overall, reflects a management strategy to focus on high mission impact while balancing individual loan risk exposure***.

***Photo:** Proprietor, Life Books Inc., CLF Client*

These results are confirmed by showing a more detailed breakdown of loans by risk and mission categories in **Figure 8**. ***In value of loans, the effort increased dramatically with the level of mission impact***, from 7% (low impact), 18% (mid-impact), 30% (high impact) and 45% (stars).

Using this breakdown of mission and risk we next examined in **Figure 9,** the market segments identified earlier, focusing this time on the number (rather than the value) of the loans**.** A first observation from this perspective was that the highest proportion of loans that were high mission occurred in the micro-loans and exception loan segment of the portfolio. In fact all of the exception loans were high mission. Micro-loans, occurring predominantly in the ground-breaker quadrant, represented the highest proportion of high-risk loans.



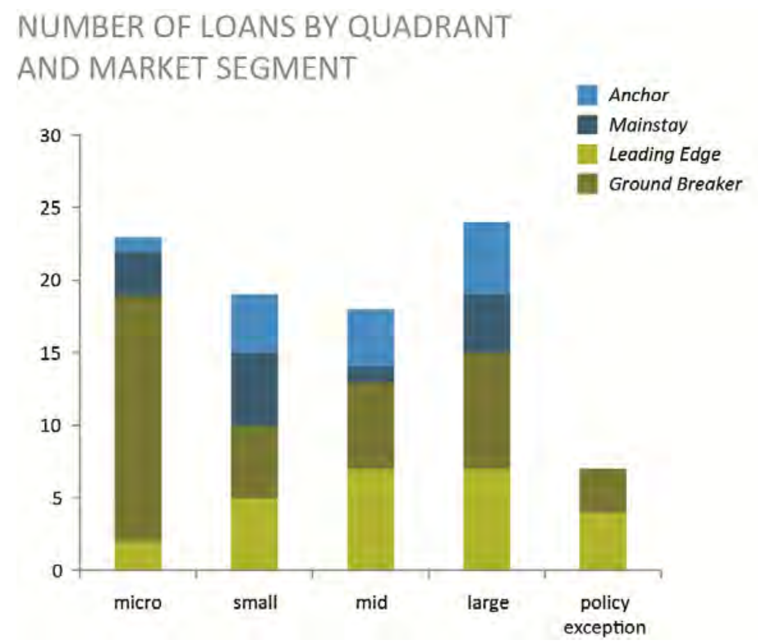


Figure 8 (above)

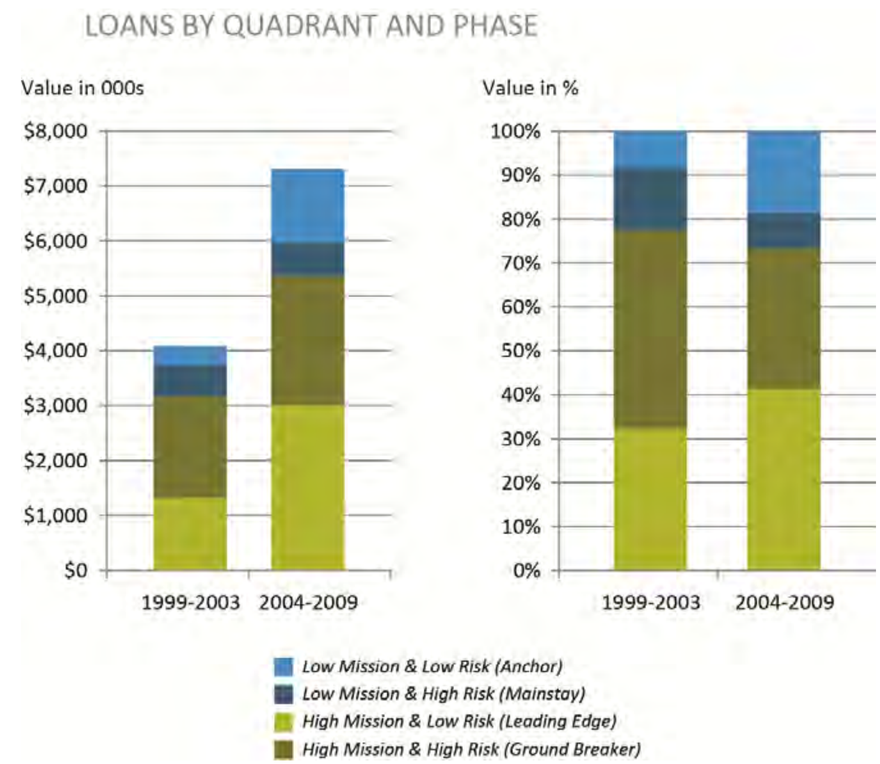
Figure 8 *illustrates the performance of the CLF portfolio by the mission/risk combination.*

Figure 9 (above)

Figure 9 *illustrates the number of loans in the portfolio by size and quadrant.*

This data suggests a strategy to use the individually safer, extra-large, leading edge loans to increase the capacity of the fund to respond to the demand for higher-risk innovation micro-lending.

This is a risky strategy. Even if the larger loans are safer and less likely to default, a single default can have major consequences. ***These extra-large loans introduced a high level of vulnerability to the overall portfolio***. This vulnerability was compounded for the CLF portfolio by the lack of geographical and sector diversification among the larger loans. A safer, more conventional strategy, and the one used by most funds of similar type and size, is to limit micro loans and offset the cost of the small high mission loans with a wider array of large (as opposed to extra-large) and well-diversified anchor and leading edge loans. ***The decision suggests a willingness to accept a higher risk premium in service of more aggressive mission pursuit***.



Evolution of the portfolio

Comparing loan disbursement figures between the first 5 years and last 5 years of activity revealed a slight increase in the **number** of loans (from 43 to 48) and a dramatic increase in the **value** of loans (from $4,087K to $7,310K) (**Figure 10, over**). Most of this increase can be attributed to leading edge loans which doubled in absolute value, moving from 32% to 41% of loans approved. Anchor loans increased in value, moving from 8% to 19% of the portfolio; ground breaker loans increased slightly in value, but decreased from 45% to 32% of loans approved; and mainstay loans remained stable in value, but decreased by 50% in terms of the percentage of loans approved across the portfolio.

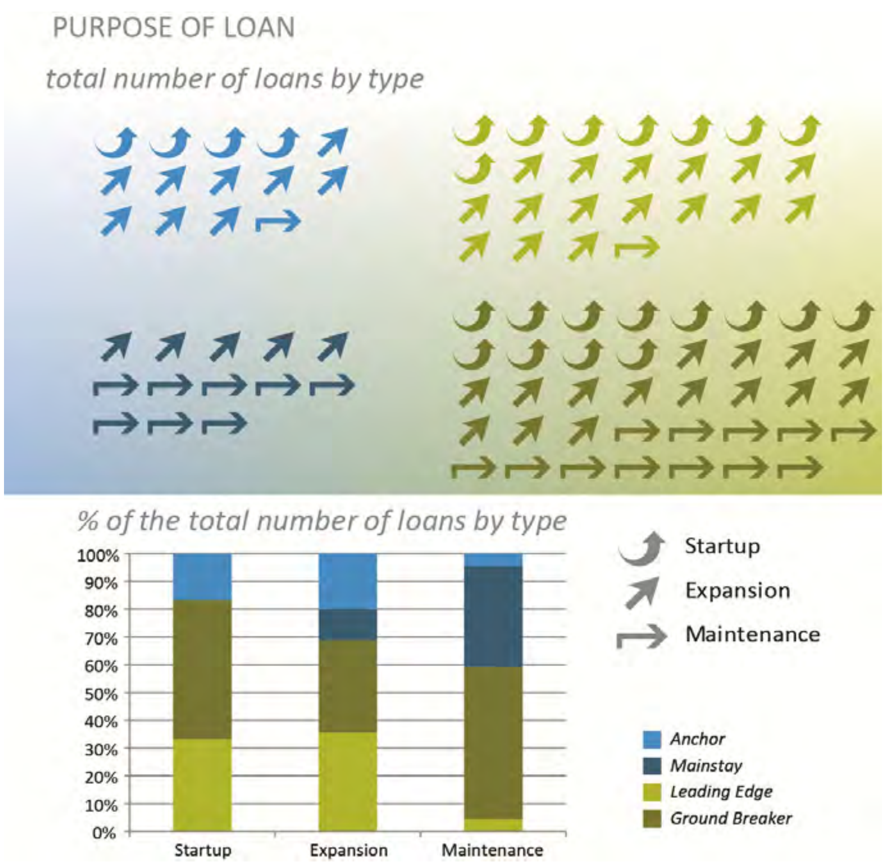
Figure 10 (above, right)

Figure 10 illustrates loan disbursement in each quadrant, by $ value and by % of the overall portfolio during the first and last five years of operations.

Overall, high-mission loans decreased slightly in the percentage of loans disbursed during the second half of the CLF's tenure, from 77% to 73%. However, by excluding from the analysis the two high mission loans to a single client totalling $1.1 million, serious indications of mission drift began to appear in the second half of the life of the fund. Also, the level of risk exposure was dramatically altered across the two five-year periods, with high-risk loans representing 59% of loan value during the fund's first phase and 40% in the last phase. ***This may be a result of the reduced risk policy implemented by management following termination of the federal loan-loss reserve program.***

Loan Composition Across the Portfolio – purpose, region, sector

Purpose: **Figure 11** illustrates that half of the total loans in the CLF portfolio were related to business expansion. The remaining loans were evenly distributed to start-ups and maintenance activity. The start-up loans were almost entirely in the high mission quadrant. With the exception of the large First Nation energy loans, these high mission start-ups were smaller in size (averaging $70K), and evenly distributed between high and low risk.



Expansion loans tended to be higher in value, averaging over $150K for loans in three of the quadrants and $94K in the ground breaker quadrant. Maintenance loans were concentrated in the ground breaker quadrant, representing 50% of the number of loans made and more than 80% of the value.

This distribution of loans across the portfolio is counter-intuitive for two reasons:

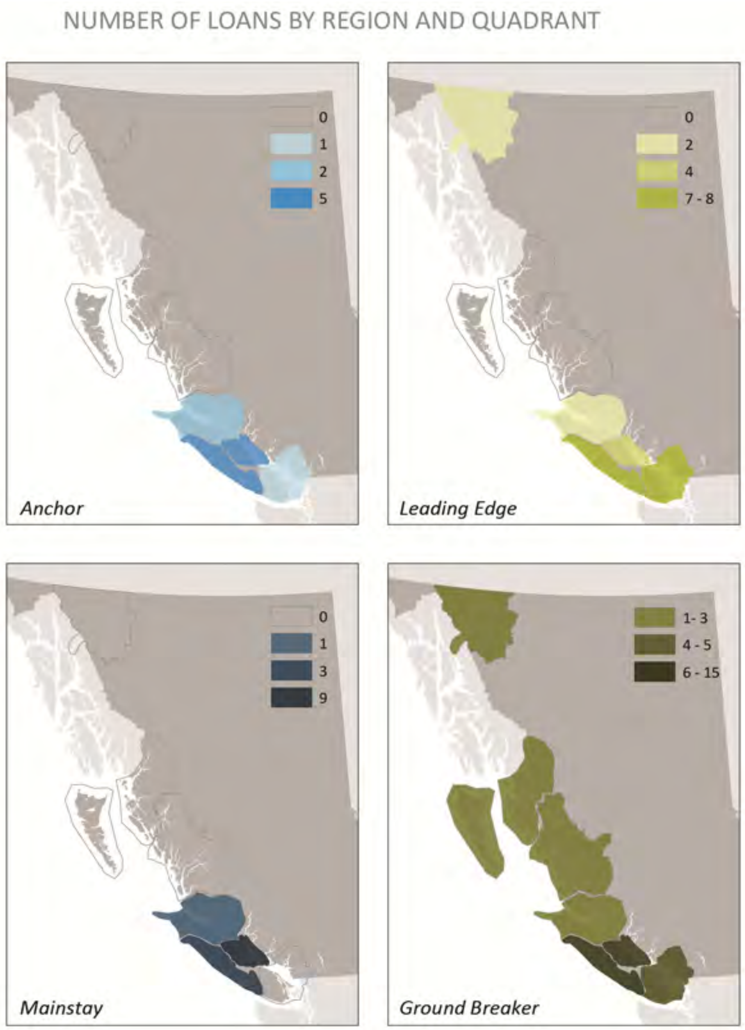
- ◊ Start-up loans are notorious for risk and would not be expected to qualify as low- risk leading edge loans. This may perhaps be explained by a number of large start-up loans issued to broadly-owned enterprises (cooperatives, First Nations or groups of First Nations) with solid financial track-records, good management and sufficient security from project-independent sources (i.e. independent power projects).
- ◊ Expansion and maintenance loans tend to be lower risk and would be expected in the anchor or leading edge quadrants, yet more than 50% of the CLF loans were in the higher risk mainstay and ground breaker quadrants. This appears to be the result of a concentration of micro and small ground breaker loans issued to scale up experienced, privately owned micro-businesses in the shellfish aquaculture sector.

Whether or not this lending trend was part of an explicit strategy is not evident from documentation, but regardless of intention, ***placing riskier ground breaker loans in an existing entrepreneurial environment, while restricting start-up financing for larger and more capable organizations proved a successful way to contain risk.***

Figure 11 (left)

***Figure 11** illustrates the distribution of CLF loans issued for start-up, expansion and maintenance activity.*

Region: **(Figure 12)** Data for 88 of the 91 loans showed a heavy concentration of loans on Vancouver Island. The Central Island accounted for 37% of all loans, had the highest concentration of high risk loans (72%), and the lowest concentration of high mission loans (58%). The Alberni-Clayoquot region, which was a also a focal point for Ecotrust Canada's program activity during the tenure of the CLF, accounted for 30% of all loans, with 70% of these in the high mission category and evenly balanced for risk.



Sector: **(Figure 13)** Of a total of 89 loans, close to 80% were issued in three sectors: 29% in tourism and related services; 27% in forestry; and 23% in fisheries and aquaculture. The latter two sectors were, perhaps not coincidentally, also priorities of Ecotrust Canada's programming at the time.

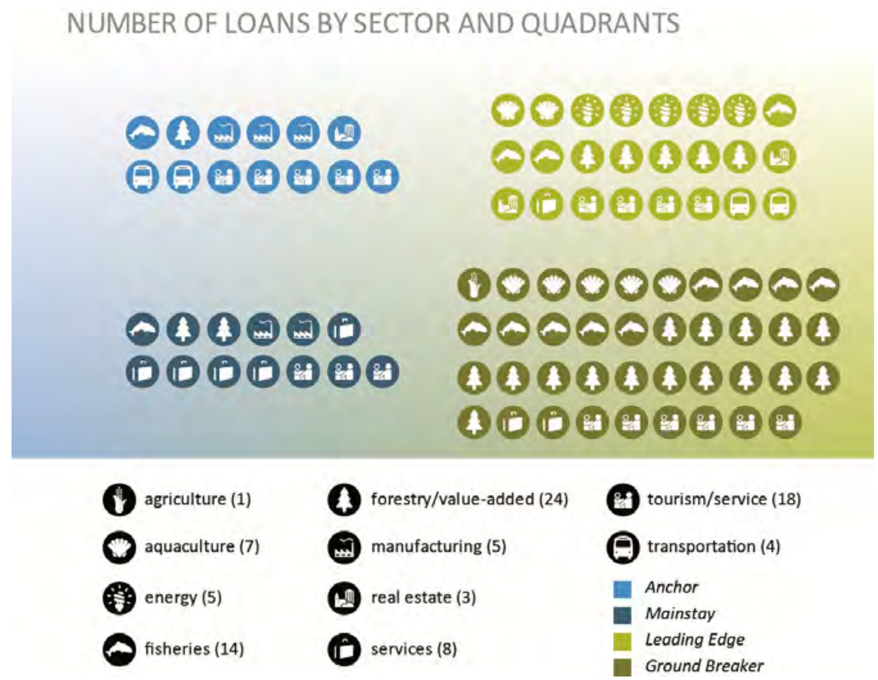


Figure 12 (left)

Figure 12 *illustrates the CLF loans by region and quadrant.*

Figure 13 (above)

Figure 13 *illustrates CLF loans by economic sector.*

Mission benefits

Local Ownership: The single most important mission impact area affected by the CLF was in the arena of local ownership (94% of loans for 97% of loan value). This result clearly reflects the CLF's change strategy — moving remote economies to a conservation model by investing in locally-owned businesses with a demonstrated interest in sustainability. This change strategy also resulted in a strong effort to increase First Nation participation in the fund (25% of loans for 37% of loan value).

Employment: Because statistics for job creation were available for only 69 loans, establishing the total employment impact for all 91 loans required some projection (**Figures 14 & 15, over**). The analysis revealed a total employment impact of 919 jobs over the life of the fund*, and an average number of jobs per loan of approximately 10.7. These jobs were delivered at an average cost of $12,400 per job which is well below the national average for employment development**. The average number of jobs created was roughly comparable for all categories except for anchor loans which produced 50% fewer jobs than the other three categories, and with the cost per job almost double that of mission loans. Mainstay loans showed the lowest cost per job. Job impact was lowest for start-ups (4.6 jobs per loan on average), and highest for expansion loans (15.2 jobs per loan), with maintenance loans achieving 12.8 jobs per loan.

By considering the average cost per job in each quadrant and the value of loans made to First Nation's enterprises, we estimate the First Nation employment impact across the portfolio at 229 jobs.

———————————————————

* assuming 3 part time jobs = 1 full time

** Roy & Wong, HRSDC, Can. Public Policy Report, Job Creation Effectiveness 1998

Fewer jobs created in the large, capital intensive investments are likely offset by the higher job creation impact of investments made in the resource sectors. Data is not available to gauge employment for other groups.

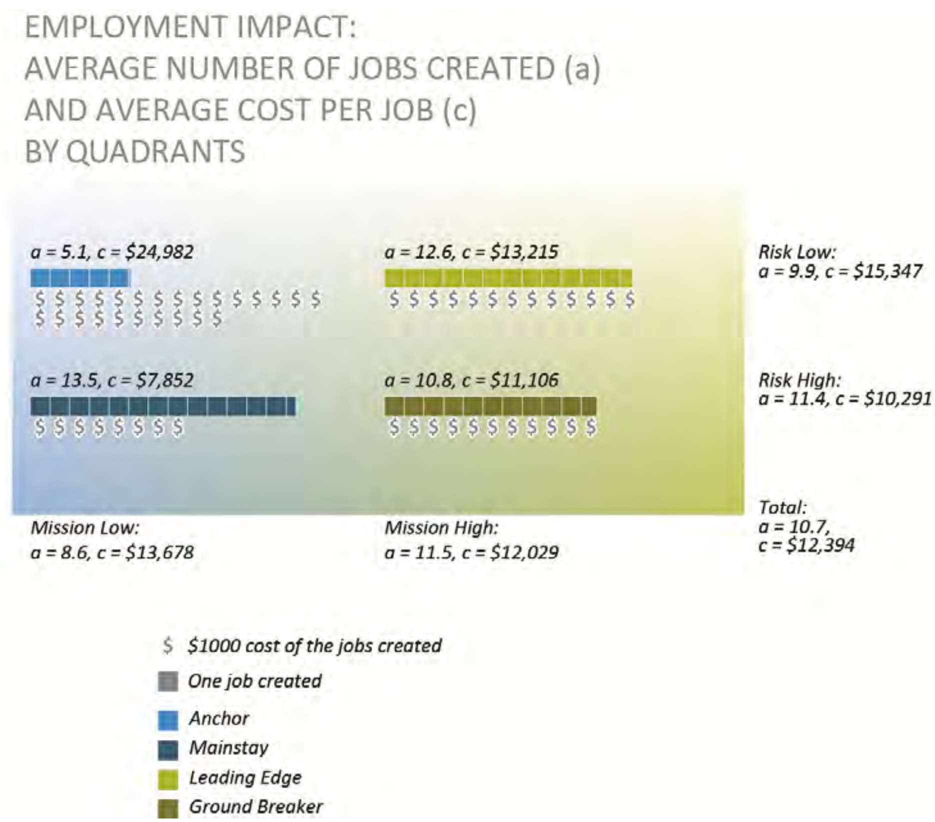


Figure 14 (above)

Figure 14 illustrates the employment impact of 69 loans by quadrant.

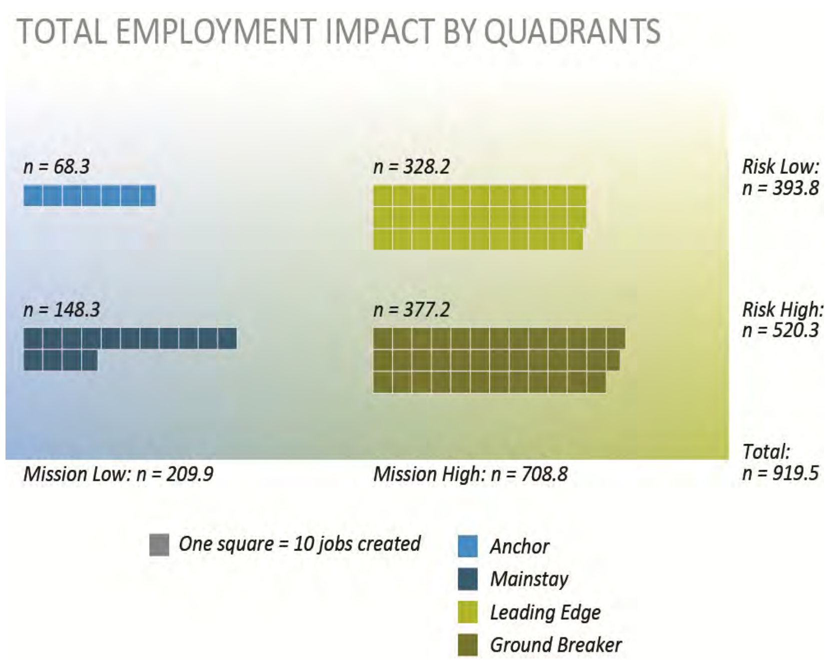


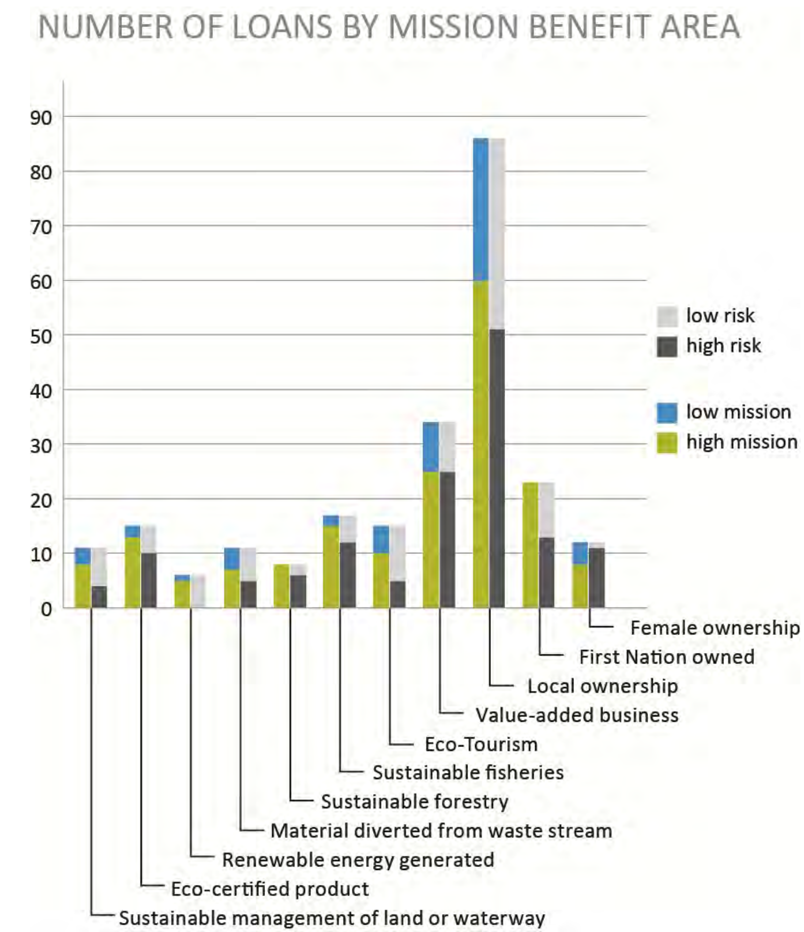
Figure 15 (above)

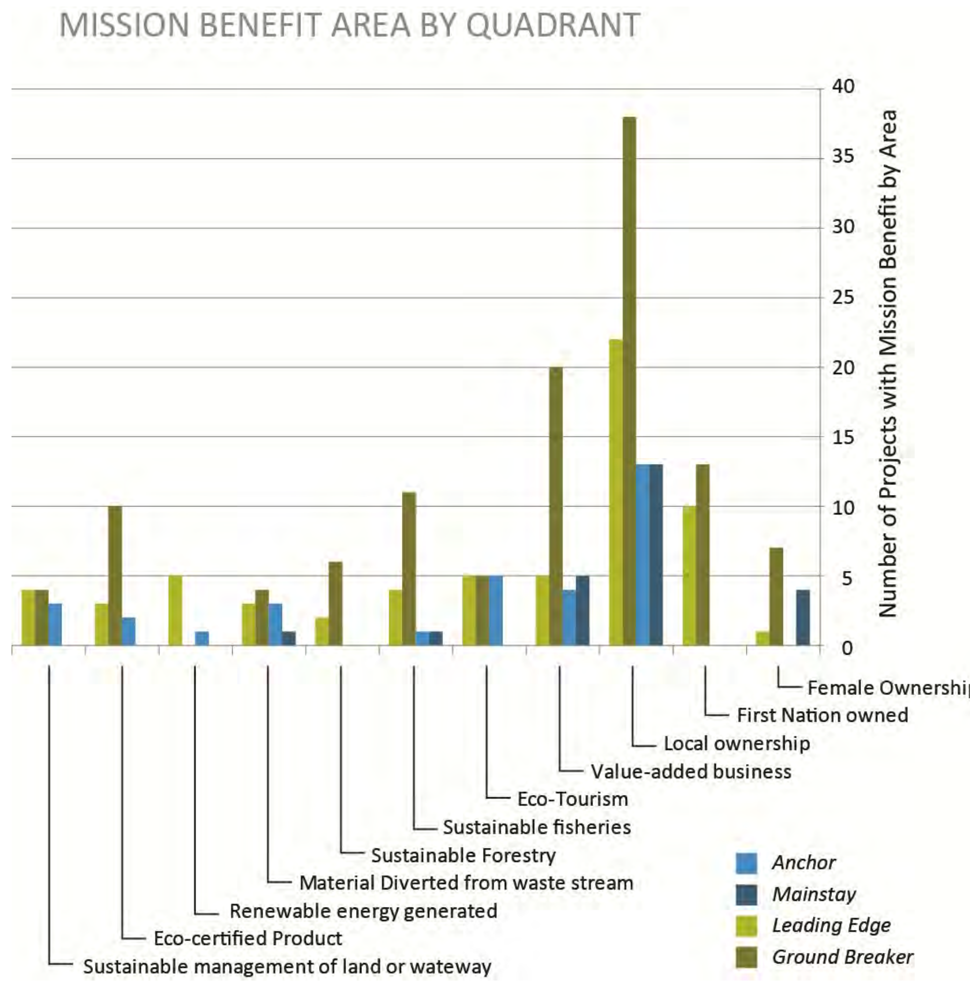
Figure 15 illustrates total employment impact by quadrant.

Local Economy: The combination of loans investing in local ownership (94% of loans for 97% of loan value); loans investing in value-added businesses (94% of loans for 97% of loan value; and loans to First Nations enterprises (25% of loans for 37% of loan value) suggests that there was an emphasis placed on growing local economies throughout the life of the CLF.

Photo: *Shellfish Aquaculture, Vancouver Island, BC. CLF Clients*

Mission Benefit Areas: Ground breaker loans led significantly in eight impact areas, and were only absent in renewable energy – a clear demonstration of high mission focus and the level of additional risk that accompanies strong mission focus. Leading edge loans were present in all 11 impact areas, often with much greater loan value, but only led in the renewable energy area **(Figures 16 and 17)**





<u>Figure 16 (above)</u>

Figure 16 *illustrates the number of loans by mission benefit area.*

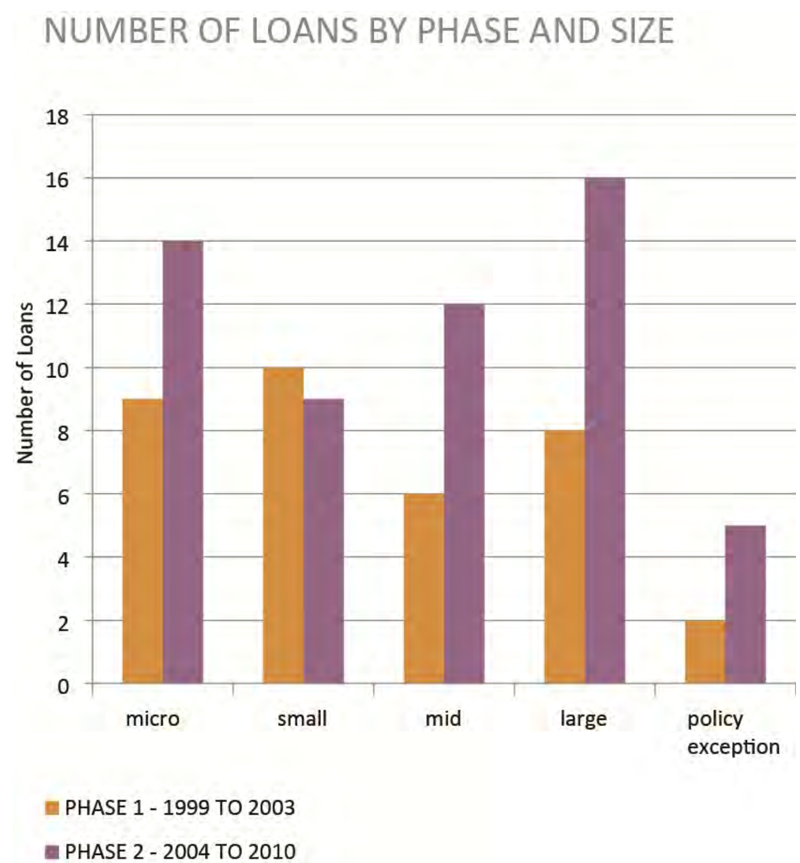
<u>Figure 17 (above)</u>

Figure 16 *illustrates mission benefit by quadrant..*

Write-offs, Rates and Value —
considering risk and mission impact

The CLF start-up benefited from the capital base of Craft3 and following transfer of the fund to Canada at year three, it received support for a few years from a federal loan-loss reserve program that covered 80% of individually insured losses up to 15% of the insured portion of the portfolio. The loan-loss insurance tool enabled the fund to take somewhat higher risks and increase its mission profile. When the loan-loss protection ended, management determined the necessity to place more emphasis on larger and safer loans. High mission (and high risk) micro-loans remained stable throughout the life of the fund, representing 25% of all loans approved.

Figure 18 demonstrates this shift in emphasis, with more large loans made in the second half of the fund's lifecycle. This portfolio structure reflects a decision to use the increased risk tolerance created by an increase in larger-loans to support more micro-lending.



<u>Figure 18 (above)</u>

Figure 18 illustrates the number and size of loans made during the two five-year phases of the fund.

In 2008, the CLF began to slow its activity and in 2009 the Board of Ecotrust Canada made the decision to wind up the fund. Staffing was decreased by attrition and viable loans were either discounted and closed out, or sold. As the portfolio became weaker, an understandable increase in losses occurred.

The overall historical write-off ratio for the CLF stands at 12.7% (or 5.8% net of the federal loan-loss contribution). A total of 25 loans (27% of loans) involved some degree of write-off, a third of these for relatively small amounts in proportion to the total value of the loan.

Given the availability of the loan-loss program for only the first half of the fund's life, these numbers must be interpreted with extreme caution. With an additional caveat that the validity of assuming comparability across funds with different risk and mission profiles is challenging at best, the write-off rate in the CLF appears in the same range as for Aboriginal Financial Institutions of a similar size.*

The write-off rates by quadrant (**Figure 19, over**) are instructive, and show why a single overall loss rate can be seriously misleading. These numbers also demonstrate why comparisons across development social finance funds are virtually impossible without an understanding of the mission and risk characteristics of each portfolio**.** As can be expected, write-off rates for the low risk loans were lower than they were for high risk loans (6.1% and 20.2% respectively). This margin is even more pronounced where the losses absorbed by the loan-loss program are ignored (1.8% and 10.2%). On the other hand, overall write-off rates were quite comparable for low-mission and high-mission loans. This is largely due to the fact that the loan-loss reserve was used primarily to increase the fund's high risk lending activity. With 96% of the loan- loss program contributions drawn down during the life of the fund, a difference of 10% is observed in the loss rate for high-mission loans.

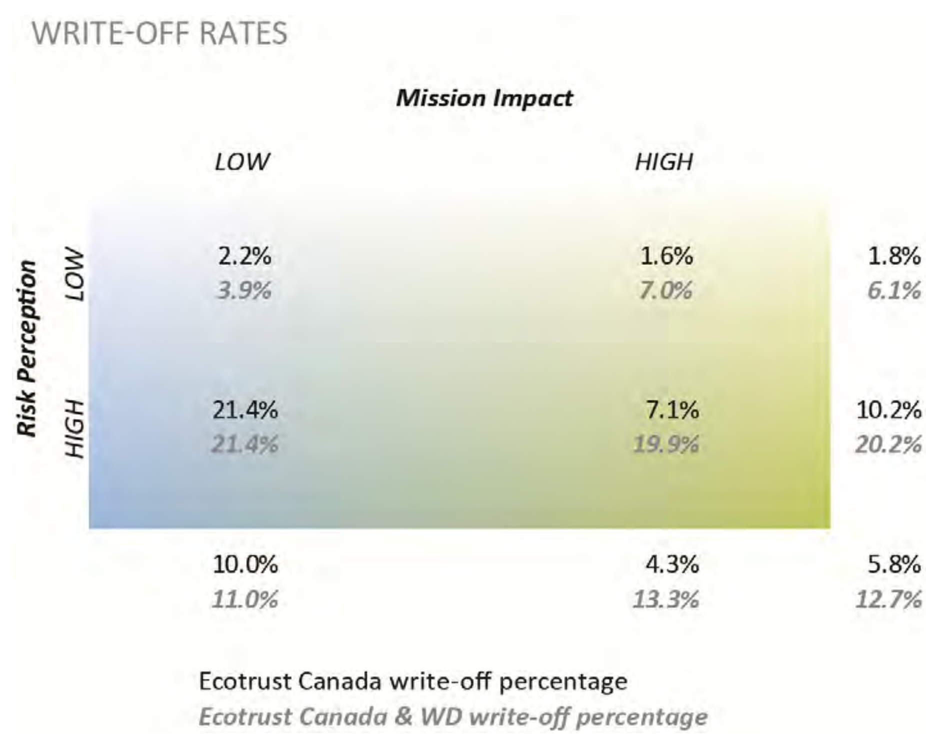


Figure 19 (above)

Figure 19 illustrates write-off rates for the CLF portfolio

*ACCs of a similar size, according to the 2010 summary of AFI results published by the National Aboriginal Capital Corporation Association, had a 12.4% historical write-off rate.

Loan write-offs fell into two discrete categories:

- ◊ ***light losses***, occurring often well into loan life and offset with a recovery on securities. The CLF had 18 bad loans, with more than half of these showing losses under $15K, accounting for less than 19% of the total write-off amount; and
- ◊ ***very heavy losses***, often early in the life of a loan, with few recovery options. For the CLF, 13 loans, representing just over 50% of all write-offs, involved write- downs in excess of 70% of the value of the loan. Ten of these were high-mission loans.

CLF's vulnerability to single project losses is evidenced by the fact that three bad loans (all of them high-mission) accounted for 52% of total losses to the fund.

Figure 20 (over) illustrates loan write-off numbers and value, including the loan loss provision, by quadrant. The succession of loan risk policies, with and without WED, appears clearly in this diagram. Insured loans, one third (1/3) of the total number of loans issued, represented two thirds (2/3) of all losses incurred. Uninsured loans, which comprised two thirds (2/3) of the total number of loans issued, accounted for one third (1/3) of all losses. In value, losses on mission-loans represented 78% of total losses. Losses on the higher risk ground breaker loans represented 57%, and high-risk loans as could be expected, were responsible for 75% of losses. Anchor loans played their part well, with low loss rates — 4.5% of the losses against 15% of loans made. Leading edge loans performed as expected, with 21% of the losses against 38% of the loans, and with the federal loan-loss program absorbing almost all of them. The leading edge First Nations hydro loans were the safest single subgroup of loans in the portfolio.

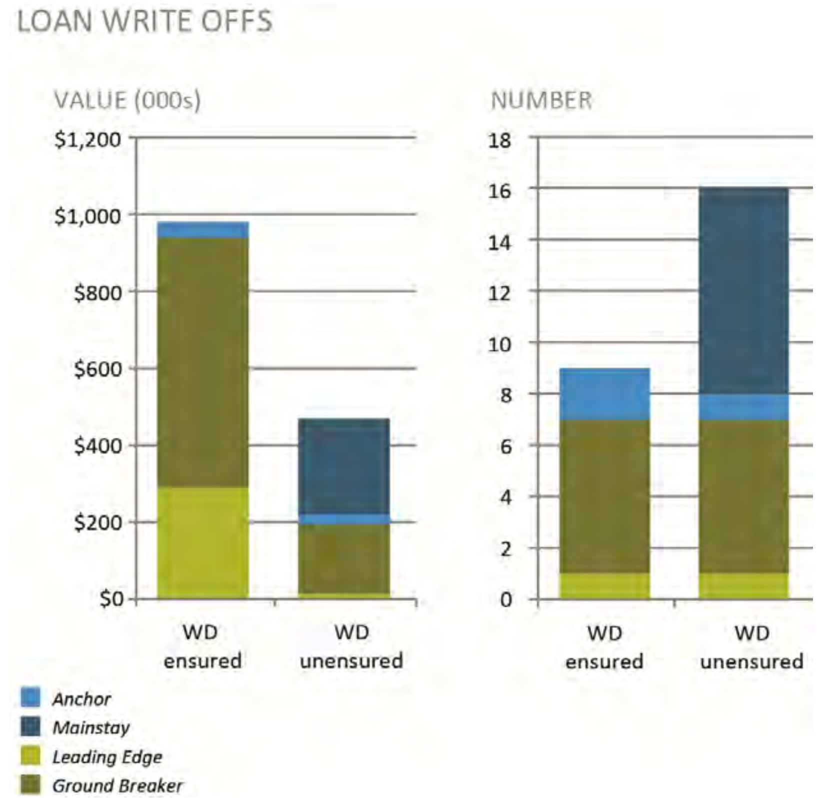


Figure 20 (above)

Figure 20 illustrates loan write-off numbers and value—including the contribution from the federal loan loss reserve program, by quadrant.

A problem is indicated by the disproportionate losses on mainstay loans, with over 17% of the losses incurred on 10% of issued loans. This is due in part to the decision to focus the use of the loan-loss reserve on mission-high loans, but it may also be a reflection of the pressure to grow the fund enough to be self sufficient. By diversifying into new economic sectors for which there was a lack of expertise, it is possible that the ability to perform good due diligence of some loans was hampered. All but one of these losses to a sawmill operation, occurred outside Ecotrust Canada's core areas of program expertise in fields such printing, office supplies, air travel, photography and the export of technical books.

The Characteristics of Bad Loans

When placed into our analysis framework, the distribution of losses in the CLF shows a concentration in two areas: micro projects (in all four quadrants); and large projects which were, with the exception of the problem mainstay loans, all mid-sized and mission congruent. (**Figure 21, over**)

Few losses occurred in the small-loan group and no losses occurred for the loans that required an exception to the loan size policy. In the micro-loan group, a large number of small losses caused this group to be the single highest risk category—with 25% of micro-loans registering a write-off, which accounted for 68% of the total number of loans with a default. In terms of the actual monies lost, micro loans, which represented 3% of monies loaned, accounted for 16% of the losses. The mid-size and large-size loans had fewer losses overall, but of larger amounts. The three largest bad loans alone accounted for 52% of total losses.

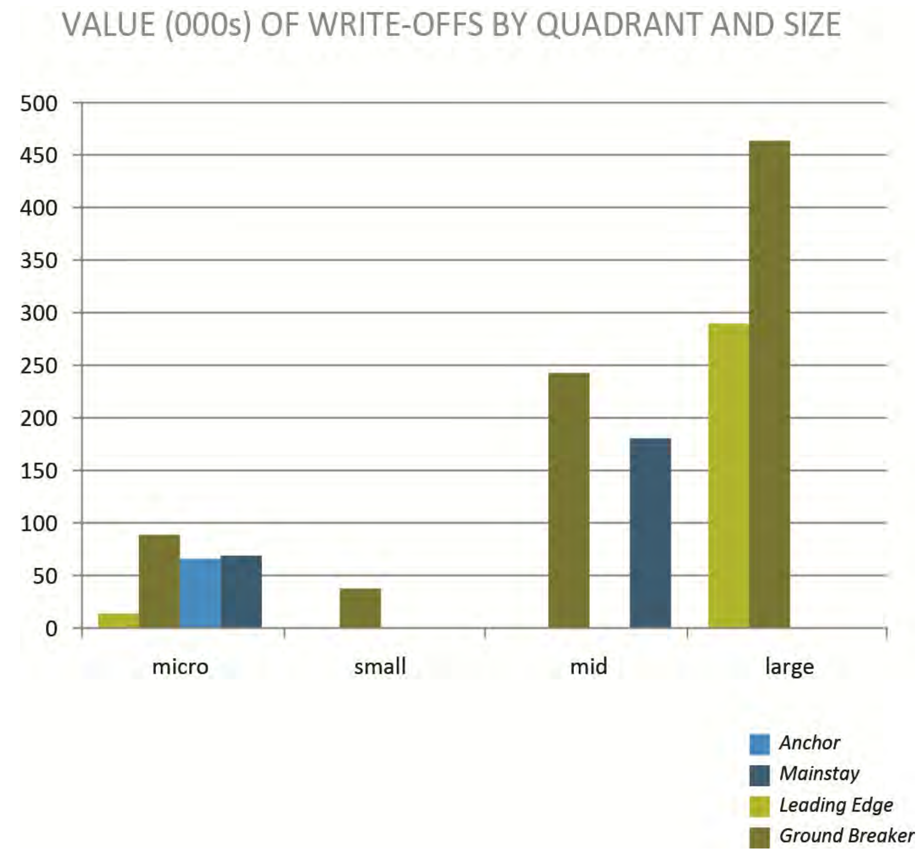


Figure 21 (above)

Figure 21 illustrates the value of the write-offs by quadrant and size.

Write-offs by Region: **Figure 22** shows a heavy concentration of activity in the Central Island. 17 of the 25 loans issued in this region did not complete. Most of these loans were smaller in size (37% of investments and 58% of losses including 6 of the 8 problem mainstay loans).

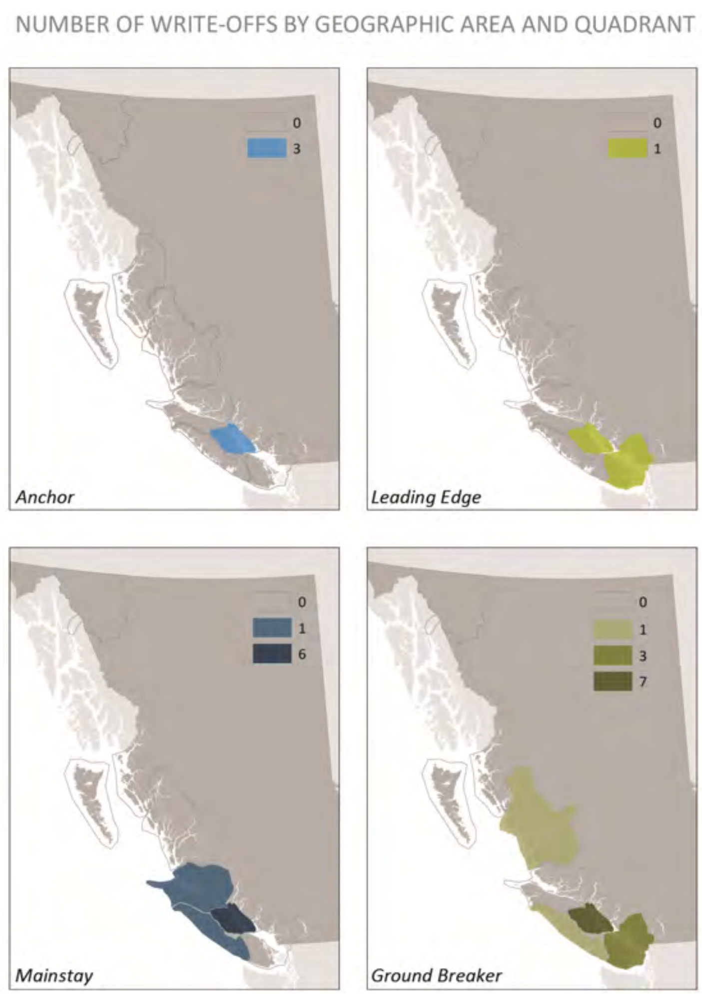


Figure 22 (above)

Figure 22 illustrates the regional distribution of loan losses during the life of the fund.

Write-offs by Sector: **Figure 23** shows the sector distribution of loan write-offs. There was an over-representation of loans made in the service and tourism sectors. With a total of 30% of the loans in the portfolio in these 2 sectors, 40% failed to complete. Notably (and luckily) these loans were primarily micro in size so the total write-offs barely represent 13% of the total amount written off during the life of the fund. Resource-based investments did much better in terms of the ratio of loans to loans gone bad. Of the 27% of CLF loans in forestry, 20% went bad. In fisheries, representing 16% of the portfolio, 12% were written off. However, forestry loans, which were much larger on the average, represented over 38% of total losses. Meanwhile, one large transportation sector loan accounted for 20% of the portfolio's total write-off.

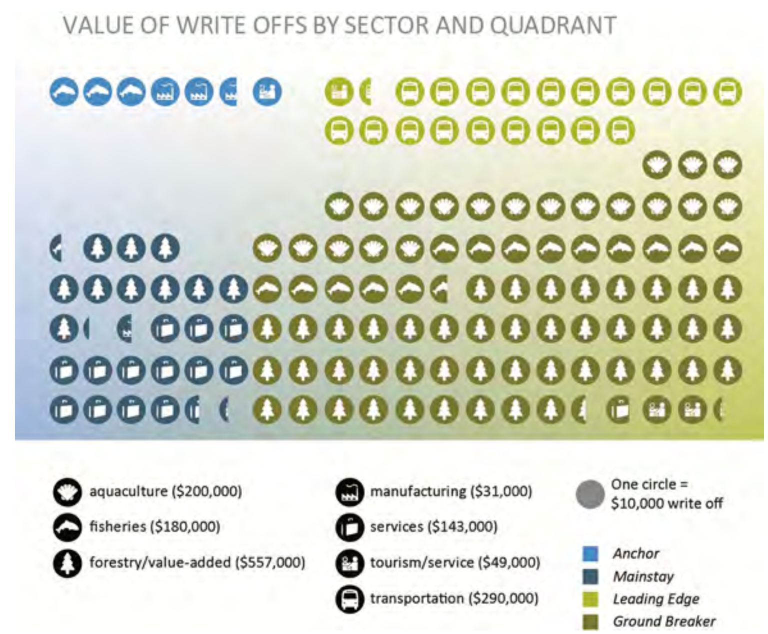


Figure 23 (above)

Figure 22 illustrates loan write-offs by industry sector.

Administration and Operations

Operating statistics proved difficult to interpret because of the multiple changes that occurred in the management of the CLF during its lifecycle. Initially managed externally by Craft3, the fund was moved into Ecotrust Canada in its third year of operation. This move meant that the CLF lost both the management experience and the economies of scale associated with operating under the aegis of that large and well established organization. What was gained however, was the internalization of capacity into Ecotrust Canada the charity, which was ground-breaking in the Canadian context. Later still, operations were moved into a wholly-owned subsidiary corporation, Ecotrust Canada Capital, created to address Canadian Revenue Agency requirements. Then, in its wind down period, the fund was moved back under Ecotrust Canada's direct management. The early growth and wind-down periods do not provide readily comparable operational data. However, the 2006 to 2008 period, at the peak activity level for the fund, provides some useful insights.

Management and operating expenses represented 17% of the Gross Loan Portfolio (GLP). An Aboriginal Finance Institution (AFI) comparison group reports 24% of GLP on expenses. Salaries, as the largest single line item in the CLF, represented 8.7% of GLP or 65.5% of total expenses. The AFI comparable for salaries is 7.8%. There was $1.5 million worth of loans being managed by one full time employee at the CLF. One loans officer in the AFI system will handle $1.8-$2 million worth of loans, suggesting that an increased volume of loans may have been possible at the CLF without incurring additional staffing expense.

Comparing operating costs across institutions is problematic because the same services can differ by a factor of more than ten between remote and urban service areas. The CLF activity was in the upper cost range, with most of its portfolio in remote locations, so the fact that its expenses were not correspondingly high speaks well of cost control management and efficiency.

With deployment rates (the proportion of total monies loaned out) fluctuating around 95%, much above comparable AFIs, interest income for the 2006-08 period averaged 11.5% of the gross loan portfolio. For reference, the prime rate for the same period increased from 5% to a peak of 6% in 2007, before declining gradually to just over 4.5% in 2008. During that period, fees and interest from loans represented 87% of the total income for the CLF. The AFIs show less than 30% of total income from interest earnings*, with government subsidies and program earnings representing over 50% of income. It is important to note that the Community Development Financial Institutions (CDFIs) in the USA do not survive on fee and interest income alone. Craft3, one of the most successful CFDI funds, and also pursuing a conservation economy mission, with a portfolio of $133 million, and a total of $166 million under management, estimates that only 70% of its income originates from non-grant income. By those standards, then, the sustainability of the CLF in its peak years was very good, given the absence of government subsidies and other unearned income.

The CLF did investigate the feasibility of becoming financially self sufficient and determined that without operating subsidies or contributed capital, at least $20 million in capital was required. Hoping that this level of capitalization might be achieved by focusing the fund on lower risk high impact investments, the CLF, in 2009, partnered with two Aboriginal Capital Corporations to create the *First Nation's Regeneration Fund* which focused on structuring loans that would allow Aboriginal communities to take an equity stake in renewable energy projects in their territories.

* AFIs in smaller regions average 24% total income from interest earnings, according to the 2010 NACCA overview.

In retrospect, it seems clear that even given more time, there was limited likelihood that the CLF could have simultaneously retained its attention to mission, and met its goal for break-even or profitable operations in the absence of financial support from government. Lending in areas with low population density, combined with the limited diversity of economic sectors in its operating geography, and the high costs associated with serving remote communities was a tough proposition at best. Achieving self sufficiency would likely have required some combination of an expanded geography, a more diversified client base, an increase in lower-risk anchor loans, and a curtailing of higher-risk mission lending activities, such as micro-lending.

For comparison purposes, Craft3 estimates that the critical mass and density requirements for successful use of their regional 'market repair' tactics is a geographical unit with a population of 50,000, within a one-hour-drive radius of the loan delivery center. The CLF's primary market was well below that population requirement and well-above that maximum distance.

Photo: *Port McNeil Shake and Shingle Mill, Vancouver Island, BC, CLF Client*

QUALITATIVE OBSERVATIONS

NUMBERS and indicators based on individual loans and on overall portfolio performance only provide a partial picture of the effectiveness and efficiency of a fund, even when displayed on the basis of a risk and mission matrix.

Through the process of exploring loan files, and mining corporate memory for meaningful non-numerical features of the fund, a number of important considerations were identified.

Loan Distribution

The fund included the following investment profiles and patterns:

◊ ***Leading edge loans*** on the whole tended to be larger loans that were broadly- owned as opposed to solely-owned, and they bore inherent additional risk. All of them were conservation economy drivers with at least some business track record, and they were using borrowed capital either to take their business to scale or to branch out to new opportunities from a solid organizational and credit base. These were often businesses demonstrating new ways to do business and build markets, and their business activity frequently had strong synergy with Ecotrust Canada's program activity.* The compensation for the CLF's increased risk position in these loans was the potential that they represented in terms of achieving mission results. Risk was mitigated for a time by the use of the federal loan loss instrument. Several of these leading edge loans were paid out before the end of their term as initiatives matured and migrated to less expensive commercial finance.

◊ ***Ground breaker loans*** represented the riskier, earlier phase of this same market segment. Loans were much smaller in size, and primarily to individual entrepreneurs. They required a much higher-touch approach. A lack of management experience, including financial literacy was the most frequent cause of difficulty. During the first 5 years, the loan loss reserve provided a hedge against additional risk, but overall the higher interest rate charged for loans in this category did not adequately cover the losses incurred. This category of loans represented the single highest source of loans in difficulty, and reflected the conscious choice of Ecotrust Canada to invest in higher risk mission lending to forward its mission objective to build the conservation economy.

◊ ***Anchor loans*** were fewer in number, and tended to be the largest and safest loans in the portfolio (not including the First Nation hydro loans). Borrowers in this category were primarily involved in more traditional economic activities and making some effort to improve their conservation practices. Unlike the leading edge loans, the tendency here was

———————————————*

These included a Forest Stewardship Council certified lumber cooperative, fishing vessels and gear, eco- certifications, and market development. Mission synergy was especially visible in First Nation investments, especially in the Clayoquot Sound area.

to complete the borrowing term. Anchor loans did not use the loan loss assistance program.

◊ ***Mainstay loans*** were few in number as a percentage of the overall portfolio, although they did increase somewhat with pressure to grow the fund during the second half of its life. These loans tended to be for traditional types of business activity. In many cases, mainstay loans were justified by the stated goal of diversifying local economies to break the dependency on single-resource industries.

Assessing the portfolio's ***loan distribution by number and size suggests that four distinct market segments were served, each with unique risk and mission patterns***. Two things stand out about the overall portfolio – first, the large number of high-touch, high-risk, high-mission micro-loans that experienced a significant write-off rate which did not negatively impact the portfolio; and second, the small number of large, low-risk, high-mission loans which exceeded the maximum investment limit and performed well.

Mission Congruence and Mission Measurement

◊ ***Congruence:*** Over its ten years of operation, the CLF portfolio leaned heavily towards higher mission investments. During the first half of its life, with the assistance of the loan loss insurance facility, the fund was deployed almost exclusively to support high-mission lending. It maintained an evenly distributed appetite for risk, and micro-loans were most abundant. When the loan loss program was terminated by government, the fund became more risk averse and less mission focused. This shift is evident in the decline in both the number and proportion of micro-loans and high-mission loans in the portfolio. In fact, without the two extra-large independent power production loans approved to grow the fund to break-even size, the value of high-mission investments would have dropped sharply.

This suggests a double mission drift with respect to the original concept of the fund. The first evidence of mission drift was the move away from the clusters of small and micro high-risk high-mission loans, largely due to pressure from the board and management to contain losses. The second was the emphasis placed on the development of a new market for lower-risk investments — power production loans. These loans were ultimately much larger than what was anticipated when the fund was launched (the largest loan being in effect more than three times the maximum loan size provided for by policy.

Mission scores continued to be included in project summaries sent to the credit committee, but the credit committee, comprised of credit experts, understood its own role as one of 'overseer of lending risk' rather than 'guardian of mission relevance.' This dynamic became apparent when a loan recommendation came forward to the credit committee with a conflicting report on mission relevance from program and lending staff. The committee voted against the loan on the basis of its technical merits only, and expressed their reluctance to make the final call on mission relevance. This in effect made senior management the guardian of mission relevance.

The aggressive mission approach to development and the proactive nature of the fund nevertheless ensured a high mission content of loans (75% of total loans); but the nature of what "mission" meant evolved over time. Mission assessment moved away from a project by project measure of each deal's relevance against a graded list of conservation economy

———————————————————-

* This helps explain why the original mission scorings proved of limited use in the first attempt to produce descriptive statistics on the basis of mission and risk.

elements, and towards the perceived fit and synergies with strategic mission priorities. Changing program priorities for Ecotrust Canada the charity, which were often accompanied by new expertise and partnerships in new sectors (shellfish, for example) resulted in high-mission value scores ascribed to loans that reflected these priorities.

Especially in the case of anchor loans judged necessary to maintain the overall risk profile of the portfolio, ***mission narratives were sometimes 'stretched' by staff beyond their face value***. In such cases, a rating approach that considered the benefit of each loan to light of the status of the overall portfolio balance would have been useful.

Policies and Procedures

Ecotrust Canada's loan policies and procedures were initially adopted as written by Craft3, and then adapted as the CLF portfolio and management experience grew. There were two main issues with the policy framework of the CLF:

◊ The first was the decision to decrease risk exposure after the cancellation of the loan loss reserve program. This was a fairly straightforward if painful decision that resulted, as this assessment confirmed, in a decrease in capacity to respond to the demand for micro and small ground breaker loans.

◊ The second was the decision to accept a number of loans that exceeded the maximum loan size policy — two of them for the same project *, and representing in total close to 25% of the entire portfolio. This decision created a risk concentration far in excess of what is permitted for most developmental social finance funds.

Not counting multiple loans to the same client, eight loans were approved for amounts of $300,000 or more, six of them occurring in the second half of the CLF's life. At least two more loans were approved but not disbursed for their full amount. These 'exception' loans were the object of much debate between management and the credit committee over risk exposure, and decisions to override policy were taken in spite of the risk because of 'deemed' exceptional mission benefits. All of the exceptions were rated mission-high, and all but three loans were low risk. Only one exception loan, disbursed for less than the approved amount and covered by loan loss insurance, was written off.

Photo: *Taku River Micro-Hydro project*

____

* $1.1million for the Taku River run-of-river power project

Most developmental social finance mission funds in Canada are built around standard lending policies, procedures and priorities set by their founders, with input from funding agencies in areas such as loan approval processes, credit committee composition, eligibility, purpose of loans, conflict of interest, maximum loan size, etc. Amendments to these policies are rare and usually conditional on approval from funding agencies. As the CLF was not established or funded through external agency agreements, it had the freedom to set and amend its policies and procedures at will, within its risk tolerance parameters. There is evidence that throughout the life of the CLF considerable internal dialogue and debate took place over lending practices and policies as opportunities, needs, results and change tactics evolved. ***The CLF was a in many ways a 'work in progress'.***

An analysis of the CLF's lending policies, processes, procedures, loan documentation and reporting provides confirmation of strong professional credit management throughout the life of the fund. The CLF was spared the steep and costly learning curve that most developmental social finance mission funds undergo and showed consistent credit management efficiency throughout its life. This is largely the consequence of the enduring presence of the senior and experienced social finance lender-Craft3, which brought well-honed systems and policies from the start, hired and supervised capable staff, and then played a key role in the management of the portfolio as a credit committee member.

The CLF's policies and procedures (available on request) were comprehensive and adjusted to the specific needs of the organization. All indications are that they were followed closely, with allowable exceptions well documented. Loan approval mechanisms, including an external credit committee functioned well, with all loan files containing evidence of compliance with the loan approval processes.

The CLF loan files contain detailed evidence of thorough due diligence, including project recommendation summaries (available on request). Each file was found to be complete, including an analysis of security, a strategy for risk mitigation, and appropriate legal documentation including securities registration. In the case of all non-performing loans, evidence of early warning systems and immediate actions were apparent. Quarterly management reports list all non-performing loans, with descriptions of action taken and updates on individual loans and overall portfolio risk exposure. Default loans were fully documented; remediation and recovery efforts were systematic and documented.

An additional credit control that was not instituted by the CLF but should be considered by similar funds is the practice of regular third party audit compliance reviews. Craft3 is one of the few CDFI loan funds in the US to follow this practice at its own initiative. ACC funds in Canada have routinely been required by government funding sources to undergo external audit reviews before obtaining additional capital for their funds.

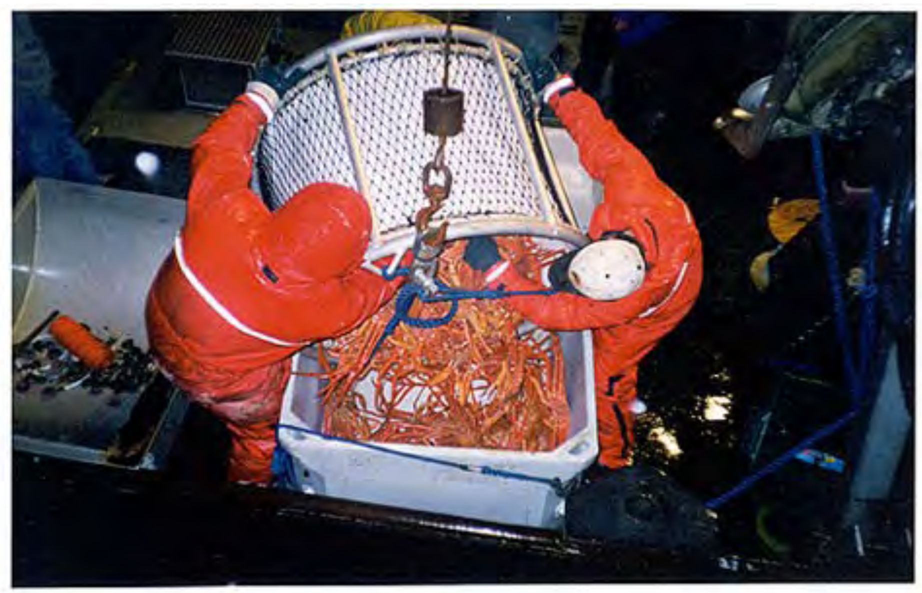


Photo: *Ketlic Seafoods, Port Hardy, BC, CLF Client*

THE ART OF MARRYING MISSION AND RISK

IN MANY WAYS it is the question of how one balances risk and mission that gets to the heart of how a development loan fund functions and the tensions that can almost inevitably arise between program objectives and credit/risk considerations. Here, for the CLF and other funds of its kind, lies the challenge and the cutting edge.

Most social finance funds pursue *double bottom line* results — described as a combination of financial and social returns where *value* is measured in terms of financial return and also in terms of the social benefits accrued from the funded activity. Things such as employment creation, local empowerment, or target group participation are examples of the side-benefits often achieved through social finance-type investment. Social benefits are measured by looking at both activities and outcomes. Some of the larger social benefit enterprises append a social audit to their financial statements to measure progress against stated social objectives.

Photo: *Faller, Iisaak Forest Resources Ltd, CLF Client*

Ecotrust Canada's mission however involves an assessment of a more complex and demanding *triple-bottom-line* benefit – measuring the financial, social *and* environmental returns achieved through the investment. Accordingly, the CLF's mission benefit calculations involved assessing the complex combination of likely social and environmental gains in addition to the financial ability to complete the loan. ***No project was approved that did not contain elements of each.***

Managing Triple-Bottom-Line Expectations

The triple-bottom-line requirement affected the CLF's portfolio lending risk in two ways:

◊ it restricted the number of eligible investments; and

◊ it narrowed the regional and sectoral scope of lending activity, which is effectively the opposite of creating a diversified portfolio. A density of investment in a target area tends to expose a fund to vulnerability patterns which are not dissimilar to sector-focused investment banking and venture capital. However, the latter mitigates risk with scale and high payoff options — neither of which were options for the CLF.

The CLF's credit committee used a combination of scoring and reporting to assess each loan's potential triple-bottom-line mission impact, focusing primarily on the nature of the proposed business activity and its contribution to aspects of conservation economy development. ***This approach largely worked on a loan-by-loan basis, and what is evident from looking at the portfolio overall is that the mission impact of the CLF was as much a result of how loans were made as it was for what.***

It is clear that the $4 million dollar capital base of the fund was well below the viability threshold for non-subsidized operations and even when making equity loans or doing mezzanine financing, the CLF was never structured to participate in profits. In addition, except for the loan loss reserve fund in place for half its life, there were no risk mitigation instruments to support the fund's activity.

This meant that the CLF operated with a much more constricted risk tolerance capacity than other funds in Canada, and when it was allocating funds on a mission basis, close monitoring and clear policy direction was required. Ongoing assessment was done through quarterly risk exposure reports prepared for the credit committee, action reports for all non-performing loans, and the continual recalibration of both individual loans and the priorities for the portfolio overall.

Photo: *Small businesses adding value to seafood products comprised an important part of the CLF portfolio.*

Creative Design and Flexible Terms

In many cases approved loan clients were provided with non-standard repayment terms including mezzanine-type conditions (for instance, interest-only payments for a given period, or capital repayments reflecting income levels, without taking the 'upside' that usually accompanies such arrangements). Clients in difficulty were frequently given the opportunity to turn their situations around and in a few cases, non-performing loans were written off without exercise of recourse options to enable the survival of a high-mission-value business. One of the 'watch-list' aspects of the CLF was the need to continually monitor the line between good lending practice and over-lenient lending practice in the service of mission.

Technical Support

As is true of most developmental social finance lenders, the CLF did not operate as a passive agency receiving and assessing loan demands. Achieving its mission objectives also frequently required that client assistance be provided, sometimes at a very early stage, to prepare enterprises to be loan-ready, and to structure creative financing solutions. This often involved bringing other lenders to the table, which is a time-consuming service not often provided by commercial lenders, and again not financially compensated within the structure of the CLF.

Approved projects benefited from technical assistance, advice on resources to remediate management shortcomings, ongoing after-care, and introductions to partner organizations offering related or complementary services. Again, as with the issue of loan design, the tension between offering technical assistance and exerting lending diligence had to be closely monitored to ensure that conflict of interest was avoided. Keeping the 'lender hats' and the 'program hats' distinct from one another required constant vigilance.

Credit Objectives and Program Synergies

The exercise of trying to keep program and lending functions separate in order to inure the fund from additional risk born of mission zeal, not surprisingly led to a perception among both program and lending staff is that synergies were limited, with little cross-fertilization between program and credit cultures. This situation was exacerbated by the creation of the subsidiary corporation Ecotrust Canada Capital, to house the CLF. This decision effectively separated the management and operations of Ecotrust Canada, the charity, from Ecotrust Canada Capital, the lender.

Program staff expressed concern about what they perceived to be an unnecessarily arduous due diligence process for clients, especially when these clients were identified through field-programs. They also protested loans approved in low-mission areas while promising, though unproven innovations were rejected. Lending staff complained about project development efforts that raised unrealistic funding expectations, especially where initiatives were really in need of grants not loans.

Interestingly however, is the fact that this widely-held perception inside the organization is not entirely borne out by loan documentation and interviews relative to specific client files. In fact, a significant portion of the loan demand originated from programs run and relationships built by the charity's community development work. For instance, Ecotrust Canada program staff sat on the board of Harrop Proctor years before a loan request came forward to ECC, and both Trilogy Fish and the EcoLumber Coop were designed first as program innovations and only secondarily, and at a later date, became loans.

In those cases***, the files show evidence of extended, proactive, high-touch, development work by the credit staff in response to program-side demand, something that conventional, passive business development loan funds are reluctant to do.***

In some cases the lending ability increased Ecotrust Canada's relationship-building potential; more often, lending, and the moral suasion that kept loan losses down, resulted from prior relationship building by program activities, such as mapping and opportunity identification. Smaller loans increased engagement and often led to a larger role for Ecotrust Canada when major economic opportunities presented themselves. This was the case for the Taku River Tlingit loans.

The most significant evidence of strong synergy between program and credit imperatives is in the number of loans to related enterprises, or ***sector and geographic clusters*** established with clear mission purpose. Cluster lending in the sectors of shellfish, forest stewardship certification, and Clayoquot Sound all involved only mission-high loans, usually with a combination of high-and-low-risk attributes.

This cluster approach to lending helped the CLF to mirror Shorebank Pacific's successful engagement with First Nations in support of regional conservation efforts. The CLF is one of the few non-Aboriginally owned mission funds in Canada which achieved a significant proportion of loans to First Nations, for a total of 22 loans totalling $3.9 million and comprising 34.4% of the portfolio.

Cluster lending remained a select strategy for the fund until the end, at which point the First Nation independent energy cluster had reached 25% of the outstanding portfolio value.

The clear external impression is that there was actually strong synergy between program and credit, and that each reinforced the other. Availability of credit enhanced program capacity to influence policy, and sector expertise and local presence was invaluable in the work of building deal pipeline, assessing risk conditions and providing aftercare.

This may not have been apparent to the participants or to the Ecotrust Canada board because corporate expectations were not informed by a clear understanding of the pressures of credit activity, and the charity was set on pursuing an even higher degree of synergy. The board expected the fund to be able to finance a higher proportion of high-risk innovative conservation initiatives, while generating a positive return on the investments.

As a result, program staff exerted pressure for easier access to mission capital and resented the rigorous due diligence credit process and the proportion of funds used for lower impact anchor loans, while credit staff, concerned about overextension of risk tolerance, insisted on sound lending processes and a balanced portfolio. Hence the perception that synergies were minimal and that the respective priorities of each part of the organization did not permeate each other.

Photo: *Atleo River Air Service, Tofino, BC, CLF client*

CONCLUSIONS AND RECOMMENDATIONS

ECOTRUST CANADA, through its ten-year experiment in coastal lending, showed, at a great internal cost, that an aggressive hybrid structure with program expertise and credit culture – focusing risk tolerance on maximum mission impact – can be both effective and efficient.

This becomes clear when conventional impact and performance measures are displayed in a way that reflects the combination of mission and risk. Ecotrust Canada did not have the resources to match its ambition, nor the time to grow to scale. The lack of support instruments available in other jurisdictions (the US CDFI model, for example) caused it to curtail lending activities after a decade, albeit with a lasting legacy in its primary areas of investment. The program expertise, the understanding of change tactics, as well as the institutional partnerships it built, remain intact even if credit culture has eroded over time. This suggests that Ecotrust Canada is well positioned to play an important intermediary role with the full array of social finance investors in its region and sectors of expertise, but that it should not consider re-entering small business lending activities until and unless appropriate support instruments are in place.

For others in the field or contemplating a fund of this type, and/or for supporters of expanded social finance approaches to repair markets underserved by conventional capital, recommendations arising from Ecotrust Canada's experience include:

◊ Ensure a full array of commercial, developmental and incubation social finance instruments are available to work in sync, and yet are contained to their appropriate sphere and function. Developmental social finance mission funds should be seen as transition tools, picking up where incubation support is not needed anymore and commercial sources not yet available. Change tactics include financial literacy development, growth to scale, market development, proof of concept, density and clustering of investments to create momentum for change.

◊ Encourage hybrid structures pursuing mission goals, despite the difficulty of reconciling and cross-fertilizing mission and credit cultures.

◊ Focus on multiple change strategies: pursue *innovation* through clustered high impact *leading edge* and *ground breaker* investments, while seeking a high volume of independent investments with small but incremental mission benefit (ie. reduce dependency on fossil fuel) for the much larger body of conventional activities with *anchor* and *mainstay* investments. Balance the risks between them.

◊ Ensure support programs to mission funds do not reward mission drift by failing to address the combination of mission impact (effectiveness) and financial/technical efficiency given comparable cost of delivery. Ongoing, or after-the-fact sources of assistance tend to do this better than up-front forms of support (free contributed capital). In other words, it is important not just to attract free or low-cost capital, but to seek investment incentives to attract 'smart' (monies that come with skills and oversight) or to source interest-rate buy-downs, loan loss reserves, reserve funds accessible for accredited mission funds, and/or adjustable operating subsidies based on impact and risk.

◊ Ensure realistic and clear board, management, funder and client expectations based on an understanding of the costs and possible impact of mission funds. Monitor the balance between **reach** (allocation of risk tolerance in terms of maximum mission impact), **depth** (clusters around specific mission objectives, density of presence, and critical mass of interventions to drive change), **diversity** of tactics, and **risk** of the portfolio given available risk mitigation support.

◊ Establish national accounting conventions (including provisions for loan losses and treatment of non-performing loans), benchmarks, risk and mission measurement frameworks to replace one-dimensional impact and performance indicators, basic lending policies and practices, reporting frameworks and external audits. Provide for a peer-controlled mechanism to accredit participating developmental social finance mission funds, so as to have access to comparable data to establish portfolio health, comparability of mission impact, financial risk, delivery efficiency, and differential cost of offering the same level of services for funds with low density, remote, or distant service areas.

◊ Establish a secondary market for developmental social finance mission fund investments, possibly through a national fund-of-funds hedged mechanism for bulk commercial social finance investments, reinvestment of surpluses, joint investment by participating institutions, etc. This would require the benchmark and certification mechanisms described above.

Photo: *Proprietor, Woodland Flooring, Comox, BC, CLF Client*

IN SUMMARY

Over ten years, with a $2M seed investment Ecotrust Canada's mission fund put out 91 loans for $11.4M in loans to high risk high-impact innovative triple- bottom-line businesses, creating nearly 900 jobs in coastal BC.

But retrospectively, the CLF's signal achievement was the way a highly efficient lending and financial management structure was combined with the strategic placement of capital in pursuit of mission impact.

The key was finding ways to accept and manage risk, not avoid it. The constant work to avoid making 'safe' bets instead of 'mission-fit' bets proved to be an art as well as a science.

In the absence of tools and instruments to support social finance activities in a charitable organization, Ecotrust Canada deployed a number of strategies including:

◊ leveraging mission-related investments to double the size of the fund,

◊ using extra-large safer high-impact loans to offset the losses from a large number of small high risk innovative loans,

◊ limiting the use of a loan loss reserve to the highest impact loans,

◊ combining on-the-ground sectoral expertise from the program side with credit expertise from the lending side to build pipeline and support loan clients, and

◊ investing in dense clusters of loans all along the value-chain to tip a region's progress towards conservation economics.

The CLF was also part of demonstrating the feasibility of Aboriginal participation in the private energy sector in BC and spearheaded a coalition of lenders to build a dedicated fund, the First Nation's Regeneration Fund, still active today.

It was indeed a bold institutional experiment, one that has taught the team at Ecotrust Canada well; to keep an eye on financial objectives as well as programmatic ones at all times; to use capital strategically in support of mission outcomes over time; and to plan short term outputs in light of the long term impacts desired.

Photo: *Proprietor, Lagoon Island Mariculture Co, CLF Client*

Impact greater than the loan itself

During the loan portfolio review, a few loans stood out as 'star loans', Not so much because of their direct value or immediate outcomes, but more because they demonstrated some of the less tangible, but incredibly important impacts of a mission fund. In the next few pages, we offer a case study of 3 loans that were selected to help tell this more subtle story of mission impact that numbers cannot adequately reveal.

Photo: *Judith Sayers, Past Chief Councillor*

1. **Star Investment: UPNIT POWER CORP**

   Loan Amount: $250,000

   Client: Hupachasath First Nation, Port Alberni, BC

The Upnit loan is a good example of mission impact not easily captured by numbers. First, the benefit to the client resulted less from the monies loaned than from the development support, the risk readiness, and the social finance partnerships established. Second, the loan helped set in motion what has now become an industry of its own across Canada.

The Upnit loan consists of a $250,000 investment into an $8.5-million debt syndicate facility assembled by Vancity Capital, for construction of a 100-per-cent First Nations-owned, conservation-conscious, $13.7-million micro-hydro power station at China Creek, near Port Alberni, BC.

The loan performed well and was fully repaid by 2011, having earned over $70K in interest and fees.

This might appear to be a good *anchor* investment. Its mission relevance had less to do with the activity itself – run-of-river hydro – which in fact gave rise to some internal debate over the wisdom of using scarce investment monies for a fairly conventional energy project. Its mission impact was more in the value of demonstrating support to local and First Nation ownership of power projects in order to ensure maximum integration of conservation best practices. For reasons that will become apparent, this investment, and two others of greater magnitude for the same type of project, were not only coded mission high, but largely contributed, by their size, to the overall mission profile of the Coastal Loan Fund.

Ecotrust program staff began working with the lead First Nation (the Hupacasath) five years earlier in areas of traditional land use research, mapping and geographic information systems (GIS), economic development planning, and renewable energy projects – a classic Ecotrust Canada program approach.

When BC Hydro announced plans for a natural gas generation plant, the First Nation opposed it for environmental reasons, and set about to explore alternatives. This resulted in a proposal for a light footprint run-of-river power plant, for which the Hupacasath eventually obtained a long-term Energy Purchase Agreement from BC Hydro in the 2002/03. To realize the project, substantial equity and commercial financing had to be found.

As a result of previous engagement with the Nation through its program side, Ecotrust Canada was one of the early lenders contacted by the Hupacasath. The CLF indicated a willingness to consider financing an important part of the riskier equity requirement, enabling the First Nation to secure government contributions to develop the project further. Commercial financing however, proved to be a major challenge, given high engineering risks and the absence of experienced and well-capitalized energy production partners prepared to share in the financial risk.

Ecotrust Canada was instrumental in engaging Vancity Capital Corporation, which recognized the mission benefit of the project and invested considerable senior staff resources, including the frequent on-site presence of their vice-president, to develop a financing approach that resulted in the debt syndicate, and provided the impetus for government programs to provide a significant portion of the equity requirements. Thus did the project become feasible.

The social finance investment benefit here is not so much the measure of monies invested – Ecotrust Canada ultimately invested only $250K of the $500K that was approved by the CLF credit committee, filling in the last gaps in the syndicate needs and foregoing loan loss insurance in the process and Vancity invested $1 million of the total $8.5 million debt syndicate. But almost more importantly, the deal was ultimately structured in such a way that it became attractive to a commercial lender. In fact, a senior commercial bank that had indicated no interest in the earlier stages of development, now saw an important investment opportunity and offered a last minute term sheet in an effort to undercut VanCity. Upnit however, because of the working relationship, chose to do their deal with Ecotrust and VanCity.

The social finance impact thus proved to be the value of the initial risk acceptance, and the development work that made the financing of the deal possible. This happened at a cost to Vancity and Ecotrust Canada who incurred extensive time and travel expenses to construct the deal that would not be justified from a commercial lender's perspective.

Mission benefits well beyond the loan itself also proved formidable: clear demonstration that better environmental practices can result from local and First Nation ownership; and more importantly, the first demonstration in Canada of a 100% First Nation owned power plant (only three First Nation joint-venture run-of-river projects, all in eastern Canada, were in operation at that time, of which only one had actively been driven by a First Nation; none of them involved explicit *triple bottom line* benefits).

This demonstration was quickly replicated, and Ecotrust Canada responded to the demand for funding for a run-of-river project with the Taku River Tlingit First Nation. Increasing interest by other First Nations in BC led to the creation, by Ecotrust Canada and Aboriginal partners, of a specialized investment fund, the *First Nations Regeneration Fund*, seeded by a government of Canada pilot project (fully disbursed as of 2012). This pilot was itself replicated some four or five times across Canada when Aboriginal Affairs and Northern Development Canada transformed the pilot into a national program, the Major Resource and Energy Development program, announced in 2008.

In sum, a loan that may not seem of high mission interest on the basis of quantitative data alone, reveals itself to be one of the most impactful investments ever made by the CLF, including the demonstration and stimulation value that has resulted in the creation of a special fund and the replication of approach at a national level.

2. Star Investment: TAKU WILD

Loan Amount: $200,000

Client: Taku River Tlingit First Nation, Atlin, BC

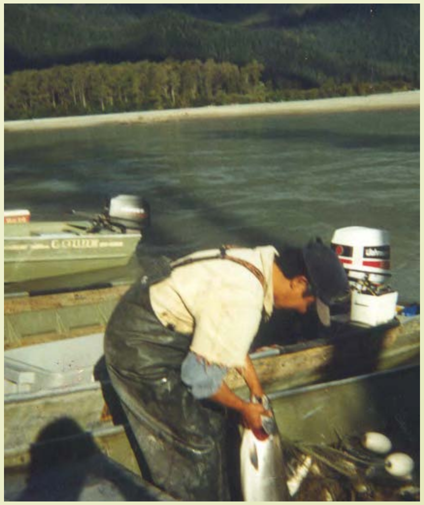


***Photo:** Taku River Landing Station (top) and Planning for Power (bottom)*

Ecotrust Canada's program relationship with the Taku River Tlingit started in 2002, when the First Nation attempted to resist the development of mining activity on its traditional land and sought to explore sustainable conservation economy alternatives.

In 2004, Taku Wild, a Tlingit-owned fish company, cut out a long-standing middleman from its fishing operations on the Taku River in northwestern BC. The result? The next year Taku Wild increased the amount of fish landed from 28,000 pounds to 200,000 pounds, taking up most of the commercially caught fish on the lower Taku River.

Fishing on the Taku River is done in small open boats with limited capacity for storing the catch, so fish must be unloaded at a landing station to be weighed and packed in ice. In 2004, Taku Wild opened its own landing station in competition with what had previously been the only landing station on the river. At the end of the fishing season, the Taku Wild station became the sole station on the river.

Landing stations play an important part in monitoring the status of the fish runs. In 2006, the CLF provided a $100K loan to Taku Wild to improve the landing station operation and, in 2007, a $50K working capital loan, renewed in 2008. Running the landing station allowed Taku River Tlingit to collaborate more closely with DFO to monitor the status of the fish runs.

Taku Wild became an important part of the Taku River Tlingit's salmon conservation and enhancement program, which has been in place since the early 1980s. It enabled the Taku River Tlingit First Nation to maximize the economic value of the fish to the benefit of the fishermen on the river.

Operating the landing station also benefited independent fishermen on the river. It allowed them to operate at hours that were most convenient for them, and provided them sound assurance that they were getting the best price for their catch.

By taking these bold entrepreneurial steps, Taku Wild increased the Taku River Tlingit's role not just in harvesting, but also in landing and selling the catch.

All three loans made by the CLF were coded as *ground breaker* loans. All performed well.

What is often not recognized however is that the relationship with the Tlingit First Nation resulted in a major role for Ecotrust Canada in the 2008 financing of the First Nation's $13-million micro-hydro project (two *leading edge* loans for a total of $1.1 million).

Photo: *Cam Brewer, Proprietor, CLF Client*

3. Star Investment: ECO-LUMBER COOP

Loan Amount: $275,000

Client: Eco-Lumber Coop, Vancouver, BC

Founded in June 2003, the Eco-Lumber Co-op was established to buy, sell and broker reclaimed lumber and Forest Stewardship Council (FSC)-certified wood, which is harvested in an ecologically sustainable manner. The Co-op operated out of a warehouse in Richmond, and showcased products that included flooring, doors, plywood, decking, paneling, log home packages and custom furniture. It was formed by a group of like-minded folk – small-scale woodlot operators such as the Harrop-Proctor community-forest operation near Nelson, and two value-added manufacturers.

As Cam Brewer, the Co-op's Executive Director and co-founder, explains it, "the enterprise wasn't started as a way to pit parks against clear-cuts. Instead, it was founded on the principal that forests must be sustainably managed in order to survive."

At the time the Co-op was launched, less than 20 percent of FSC-certified wood actually reached the marketplace branded with an FSC logo and the Co-op played a crucial role in linking FSC-certified suppliers in BC to local and global markets.

Connecting small, eco-certified wood suppliers, such as Iisaak Forest Resources on Vancouver Island (another Ecotrust CLF client), to eco-certified manufacturers and ultimately to environmentally conscious consumers was done in an effort to raise awareness of sustainable forestry, provide consumers with a choice in the marketplace, and offer a coordinated point of sale for smaller producers.

A growing number of architects, for example, are sourcing FSC-certified wood for LEED (Leadership in Energy and Environmental Design) buildings, which is increasingly becoming the industry norm. However, finding where to buy FSC certified material proved to be challenging for many contractors and architects – and the Co-op was able to fill that gap. Vancity, for instance, was able to supply a new bank branch with wood sourced through the Co-op.

The Co-op, through its advocate members, also campaigned to change industrial logging practices and shift consumer demand to eco-certified wood products. Along with Greenpeace, Silva Forest Foundation and David Suzuki Foundation, Ecotrust Canada was a founding member of the Eco-Lumber Co-op.

The Co-op has since closed its Richmond warehouse, office, and manufacturing facility. However, Moriah Stutt, who was Sales Manager since 2005, continues to connect FSC-certified materials from our members and partner organizations.

Ecotrust provided two *ground breaker* loans to the Eco-Lumber Co-op:

1. A *start-up* loan in 2003 ($75K of total $200K requirement, at 10% over 66 months, with six-month interest-only payments)
2. An *expansion* loan in 2004, to purchase inventory of lumber ($200K of $500K requirement, at 10%, repayment in proportion to sales).

When operations ceased, the loans had been nearly paid off; the write-off was less than $7K.

These loans were deemed high risk from the start, with an expected two years to create a market and reach break-even, with unproven but motivated and energetic management. Ecotrust Canada program staff sat on the board and were instrumental in the development of the business plan. The start-up loan was seen as "the culmination of Ecotrust Canada's first strategic attempt to create an FSC market in BC" and, accordingly, deemed mission high.

A total of $425K (loan and equity) was leveraged through member loans, a regional mission fund, and a commercial social finance source. Employment: 6.7 jobs.

Related Ecotrust funded-projects: Iisaak (BC's largest FSC forestry operation), Tsleil-Waututh for the purchase of forest lands awaiting FSC certification; Harrop-Proctor Cooperative (FSC forestry operation; board member) and Woodland Flooring, a FSC value added operation. The expansion loan was for lumber inventory build-up purchase from Iisaak and was expected to accelerate profitability.