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Executive Summary

Financial model for leveraging philanthropy toward regional development in the Negev and Galilee

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Fellows Program alumni can be found in senior positions in the public and private sectors. Some serve as advisers to government ministries while others work at private-sector companies or go on to advanced studies at leading universities in Israel, the United States, and Great Britain. Within the program's framework, more than 80 research papers have been published, catalyzing reforms, reducing barriers, bringing about economic growth, and improving the quality of life for Israeli citizens.

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Introduction

The Negev and Galilee regions are economically underdeveloped and lag behind Israel's central region in almost every respect. All over the world, governments often earmark resources for the development of peripheral regions and provide special mechanisms to encourage capital investment, thereby reducing the risks investors may encounter. However, Israel, like many governments, is dealing with limited resources in this time of economic stress, creating the need to attract private capital by leveraging public-sector or philanthropic money, whether the funds are new or already being channeled into those regions.

This paper examines ways to join forces with the philanthropic sector to address the financial needs of regional projects that lack access to sufficient credit and investment flows. It proposes establishing a regional investment fund that will leverage government and philanthropic money to attract private investment to the Negev and Galilee. Among the projects envisioned are renewable energy and waste treatment facilities, technology parks and corporate incubators, applied research centers and the expansion and relocation of factories.

The Issue

High financing costs, strict demands for collateral and short loan durations make it difficult to launch or expand projects. These funding barriers are even higher in Israel's south and north – regions that suffer from underdevelopment. As a result, they remain backwaters for economic activity and capital flows, intensifying investors' doubts and leading to demands for greater risk premiums.

A regional investment fund should demonstrate an effective model for supporting businesses and respond to the challenges of development in the periphery, among them limited investor interest, underutilized public and philanthropic resources, unfavorable loan terms. Also, the fund should be an efficient conduit for investors and philanthropists abroad who want to make their money work inside Israel.

The New Philanthropy

A new trend is emerging in global philanthropy known as social investment. Donations are being leveraged, used and reused in new ways. One can view the change as an evolution from the traditional culture of giving to a culture of investing.

Social investment comes in a variety of forms: low-cost loans, credit enhancement by providing guarantees or establishing a loan-loss reserve fund, and other approaches.

Examples of these investments:

- Greater Miami Jewish Federation in Florida is making a $685,000 loan to the Yerucham Fund for the construction of 46 units in a Holiday Village project. The loan is a second mortgage; the first was provided by Bank Hapoalim.
- The Negev Funding Coalition gathers nine Jewish federations across the United States that sought to pool their resources for greater impact. The coalition is now supporting the Eilat-Eilot renewable energy initiative with a $100,000 grant.

These examples underscore ongoing changes in the thinking of North American Jewish philanthropists:

1. **Understanding the need for cooperation and pooling of resources to make a broader impact.**
2. **Seeing economic development as a tool for raising quality of life:** Although some of the federations already have small business loan funds, this operation supports larger-scale projects.
3. **A plan to reuse donors' money:** Although in the Eilat-Eilot case, the money will be granted rather than loaned or invested as equity, the parties agreed that a portion of the project's future profits will be used for scholarships for students from the region.

Simultaneously, Israel's charitable sector is also evolving toward the new philanthropy, which promotes the values of entrepreneurship, the adoption of businesslike practices and leveraging donations rather than simple "checkbook philanthropy." Many of these new philanthropists are filling corporate managerial positions and involved in high technology and venture capital.

The table below analyzes five important financial tools used by philanthropists. They are also part of the model presented later in this paper.

Philanthropic toolbox

	Grant	Equity	Direct Loan	Guarantees and Bank Loans
Description	Direct grant for enhancing project's equity	Joining as a partner	Direct loan to the project	Providing full or partial guarantee to enable the project to receive a loan and on preferred terms
The issue	No investors, low capital base	No investors, low capital base	Difficulties getting a loan, strict collateral requirements	Difficulties getting a loan, illiquid assets used as collateral
Examples		Ringelblume Cafe in Beer-Sheva	Boston-Haifa fund	Koret funds, Jewish agency funds
Type of connection	One-time grant	Continues partnership	Loan	Guarantee
Cost of money (for the project)	No cost	Low yield / subordinated equity (last to get money) Market yield	No interest Low interest Market interest	Currently, providing guarantee will allow the lender a loan of 1.4% to 1.95% above prime
Advantages	"Free" money -- no need to return	Option for long-term partner with financial stability. Option for using dividends for further goals	Independence in choosing projects and loan terms	The bank is reliable and professional in project's due diligence and loan monitoring

	Grant	Equity	Direct Loan	Guarantees and Bank Loans
Disadvantages	Money is not reused. May prevent innovation and development of new business models suited to local market challenges	Requires risk assessment and diversification	Requires risk assessment and diversification and professional staff for due diligence and loan monitoring	Frequently, the risk sharing favors the banks. Double costs of mechanism (bank and fund). Short-term loans only
Taxation	The project should hold a 46a permit (for tax-exempt donations) for the philanthropic fund to maintain its own 46a permit	The project's dividend distributions are taxed. Of limited use for philanthropic funds that wish to preserve their tax-exempt permit (46a)	Of limited use for philanthropic funds that wish to preserve their tax- exempt permit (46a)	
Option for reusing the money	Does not exist	Exists	Exists	Exists
Risk	-	High	Medium	Low
Tool availability in Israel	High availability	-	Exists only for small businesses up to 160,000 NIS	Mainly exists for small businesses up to 1.2M NIS
Additional variations	Recoverable grant	Subordinated equity	Subordinated debt	

The Philanthropic Opportunity

There are 6,377 funds and funding entities registered in Israel, with only 60% of them active. Also,an estimated 1,500 foreign funds are active in the country. Israeli philanthropic funds' expenditures totaled 6.7 billion NIS in 2006, equal to 1.03% of GDP and 2.38% of government expenditures that year. That amount is greater than the budgets of the Ministry of Welfare and Ministry of Industry, Trade and Labor combined. In 2002, there were transfer payments from public treasuries of $1.5 billion, which by 2007 had grown to $2.44 billion. Also, according to the Bank of Israel, private donations in Israel total 1.2 billion NIS.

In the U.S., the sum of philanthropic funds' assets is $646 billion, of which $47 billion is distributed annually. In 2008, 24% of the distributed amount went outside the U.S. The endowment funds of the Jewish Federations of North America contained$16.4 billion as of 2011. Moreover, private independent funds that are unaffiliated with the Jewish federations should be added into the equation. Their total assets are unknown, however. Unlike the rest of the American philanthropic sector, the Jewish communities holding these funds have a special connection to Israel and are motivated to be part of its progress and development.

All of the above indicates that a significant amount of money can be channeled into the Negev and Galilee to fuel change.

The Solution

The following proposed model is one way philanthropy can be more involved in regional economies and address the difficulties of developing peripheral regions. In the center of the model, a revolving investment fund pools assets from various sources. Also, the fund holds a credit reserve to cover bad loans and projects that default.

The sources for the credit reserve fund are charitable contributions and philanthropic and government guarantees. For the financing pool, two major groups contribute: philanthropic investors and market rate investors such as banks, insurance companies, pension funds and corporations. The philanthropic investors will expect below-market-rate returns. Funds raised from these sources will be given to regional projects as loans or other appropriate financial tools, and the loan back payments will be distributed to the investors.

Strengths of this model:

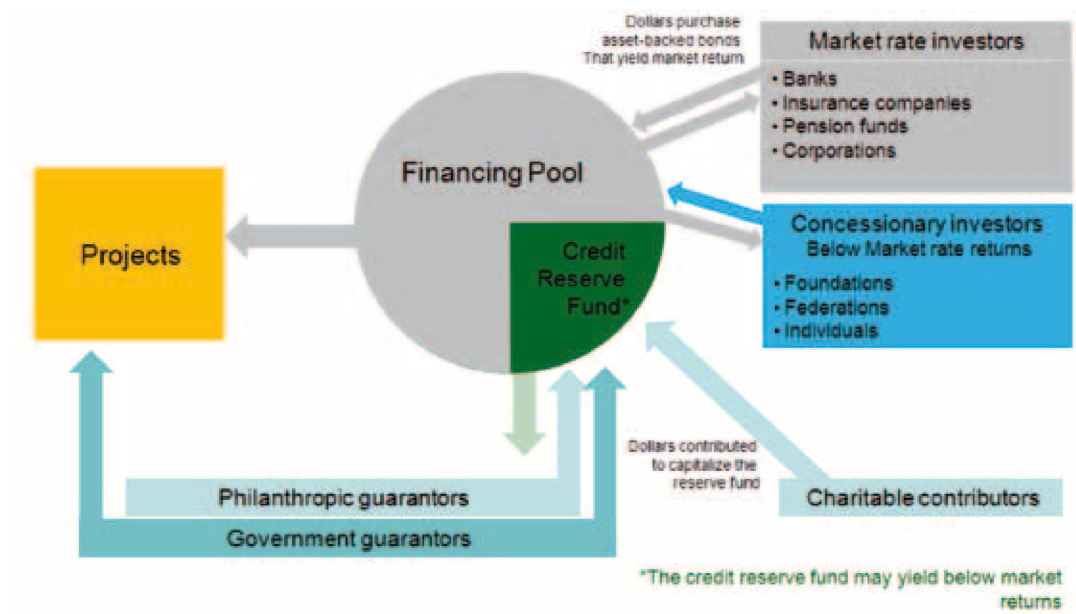
1. Connects all the regional players: central and local government, business sector, philanthropic and community organizations

2. Effective leveraging of capital and risk diversification by holding a portfolio of various industries and commitment sizes

3. Local expertise

4. Varied financing solutions for projects

FIGURE 1. PHILANTHROPIC LEVERAGE MODEL



Source: Milken Institute, 2011.

Recommendations

For this model to work effectively, the following actions are recommended:

1. **Israeli tax authorities should grant the regional investment fund the same exemption applied to a donor,** despite that its main activity is business-oriented. This is to create a tax incentive for contributors to the fund, justified by the fund's service to a national goal.

2. **Israeli tax authorities should exempt the regional investment fund from corporate and value-added taxes** on the loan interest payments the fund receives. That way, the fund can offer better terms and a lower interest obligation to the projects. While this exemption encourages philanthropic lending, it could also ultimately increase tax revenue by stimulating the growth of new businesses.

3. **Increase philanthropists' awareness of the social effect of economic development.** This means jobs, social stability, self-sufficiency and independence.

4. **Increase philanthropists' awareness of tools other than grants.** Meetings with funds who "did it," sharing success stories and providing legal counseling can ease concerns about embracing change.

5. **Forming a regional roundtable or using an existing platform for connecting government, business and nonprofit sectors.** Such a conversation can mold disparate regional stakeholders into a team, combining their strengths and using their resources more efficiently. To implement the model successfully, the three sectors must join forces.

While addressing the needs of its stakeholders, the regional investment fund offers a new tool for boosting economic development in the Negev and Galilee. Via the reuse of philanthropic money and pooling resources, it cultivates economically worthy projects,efficiently leverages government money, reduces the need for grants and transfer payments, increases liquidity in regional markets and lays the ground for new ones. In the process, the government makes the business and philanthropic sectors partners in the national goals of developing the Negev and Galilee regions and shrinking the social and economic gaps across Israel.

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