SASKATCHEWAN COMMUNITY BONDS A Case Report

by Stewart E. Perry

In July 1990 the Province of Saskatchewan broke new ground in Canadian provincial programs for local development. It instituted a guarantee program for a class of bonds to be issued by local community development groups for financing the creation or expansion of a business venture in their communities.

The idea was stimulated by a series of townhall meetings in 1988-89, a period of economic crisis in Saskatchewan due to successive droughts and a grain price war. The meetings were conducted by the Ministry of Public Participation (actually a department which dealt primarily with refinancing or privatization of crown corporations). They revealed that there was a lot of local capital, which, despite the severe economic situation, was available in rural areas for refinancing or privatizing provincial ventures.

Two other influences led to the idea. The provincial government wanted to promote economic renewal in rural and other settings, but fiscal restraints were severe. At the same time, there was survey evidence to the effect that people were not interested in conventional economic development programs as a solution to the depressed conditions. The same survey had revealed a public readiness to get involved, as well as local interest in local investments for nonfinancial benefits, such as youth employment.

Graham Parsons, a deputy minister in the department, conceived the idea of tapping that local capital for local ventures by encouraging its mobilization through a provincial guarantee of the investment. Reviewed with government and private sector representatives and thereafter adopted in the next year, the program was launched primarily for its potential to assist rural communities. Actually, it is equally available and appropriate for urban settings. The program is extremely simple, and it has attracted efforts toward replication in Manitoba, Alberta, and Ontario. Nova Scotia is currently exploring the model, too.

The Design

A local group organizes itself as a "Community Bond Corporation" or CBC, and decides to raise capital for a single venture which fits local economic needs, especially for jobs and for interactive reinforcement of existing businesses. Alternatively, the group may simply decide to raise a capital pool first, with the intention of later deciding on the ventures to be financed out of that pool.

The choice of a target company has been approached in a variety of ways. At first the province offered any community that established a CBC access to a list of potential companies. But this was abandoned. Now, the community ordinarily searches out a potential investment and proposes it to the province. A company may also approach community leaders and suggest to them that they establish a CBC for investment purposes.

The group obtains the target company's business plan, including the proposed investment, and submits it for approval in a bond issue application to the provincial Community Bonds Office (Ministry of Economic Development). The Office reviews this initially for compliance to regulations. Originally the Bonds Office also thoroughly examined the viability of the proposed venture. It still makes a "due diligence" review, but now it requires an independent third party to assess viability. The ultimate decision remains with the province through its Bonds Office and a review committee. They take the final step of giving the CBC the go-ahead to market its bonds.

The CBC then chooses a period of up to ninety days to sell the bonds. Upon application, it may receive a ninety-day extension from the Bonds Office, if progress in the initial period warrants it. There is always a minimum amount that must be sold in that period for the project to go forward. Bonds may be bought only by Saskatchewan residents or by corporations based in the province. (Municipalities may also buy bonds, but venture capital companies may not.)

The CBC is permitted to hire brokers to market its bonds, but ordinarily they are sold by the board members themselves and the volunteers they recruit, who are much more effective as salespersons. The local marketeers are given a short training course organized by the Bonds Office. They may also be given a 2%-4% commission on their sales, paid by the target company. In that event, it is usual for the commissions to be donated by the individual to a local charity.

Once the bond sale proceeds are loaned to the venture, the buyers of the bonds are guaranteed repayment of their principal by the province when the investment matures—if the venture itself does not repay the loan to the CBC, which would then repay the investors. As a fee for its guarantee, the province recently instituted a charge to the CBC of 0.75% of the value of the total bonds issued.

There is no guarantee of any interest or other return to the bondholders. Their return will depend on the profitability of the business and the terms of the loan negotiated by the CBC and the business. The term of the bond is usually five years, but may be extended by any bondholder for an additional five years. After five years or the extended term, the bonds are redeemable by the borrowing company. Depending on the deal, a bondholder may also be permitted to convert the investment to stock or other capital instruments of the business. The guarantee is then terminated. If, when the bonds are due (at the end of five years or the extended period), the company does not redeem them, the province repays the bondholders.

Bonds are issued in $100 denominations, and no more than $50,000 (or, if less, 10% of the total issued) may be purchased by any single buyer. Any one CBC can promote only a single issue of no more than $2 million (unless a greater value is specifically approved by Cabinet), but a locality may organize subsequent CBCs for other projects. If the CBC has sold bonds for a pool rather than for a single venture, then each investment from the pool must go through the same review by the Community Bonds Office.

The CBC will initially have a minimum of six directors, at least one of which must always be a young person between the ages of 16 and 25. At least one director must be nominated by the municipality in which the business is to be located. (The municipality must have previously approved the establishment of the corporation.) After the sale of the bonds is complete, the bondholders will elect replacements for the directors, each bondholder voting according to the number of $100 bonds purchased. If the local Rural Development Corporation, a Saskatchewan municipal structure for local economic development, has formally sponsored the CBC, it must initially have a representative on the board, but not necessarily after elections are held for a new board.

While there are no regulations against it, the CBCs do not hire staff. All the work is done by the volunteer board and its associates. This includes monitoring the investment after it is made. The CBC may not engage in other activities and is not allowed to own real property or other assets. Thus it will have no source of income for its operations, other than the interest earned on the deposit of bond sale proceeds in a bank account prior to investment. Minor expenses of the CBC (such as annual corporate reports and mailings for member meetings) are either defrayed out of that interest or may be paid by the company the CBC has invested in.

Special Conditions

Only some kinds of ventures are eligible for this financing, in order to emphasize the creation of new wealth. No retailing or wholesaling businesses can be promoted, and the bonds may not be used to buy out a bankrupt company or to bail out a troubled venture. Moreover, tourism projects are ineligible, unless they are so-called destination projects: major attractions or facilities located at least 80 km. from the majority of users.

In the original legislation, co-operatives were not eligible (on the decision of the minister of the day), despite staff recommendations for their inclusion. However, with the change in government, an amendment opened the way for this form of business. (So far, no co-operatives have been financed, although in one case a venture proposed by a co-op has been financed, but as a subsidiary corporation.)

Financing by the community bonds offering cannot be more than 50% of the total capital required for the project, and the entrepreneurs/owners must themselves invest at least 25%. These requirements may be more restrictive if the venture is receiving other provincial financial assistance.

Results

As of mid-March 1993, 150 local groups have been organized to explore the CBC approach. Of these, 48 are actively pursuing incorporation or have actually started operations. Half their number (24) have already raised at least their minimum target funds—totaling now about $12.5 million, raised from a total of about 5500 investors. Among the other groups that are well along the way, five are currently engaged in marketing their bonds; three more have just had their projects approved but have not yet begun marketing their bonds. Almost all the investments have been made in the form of preferred shares in the company, with a fixed and cumulative dividend. A total of 300 jobs have been created or maintained through the 24 businesses financed by the CBCs.

So far, only three CBCs have been unable to raise the funds they sought. However, the majority of the CBCs have required more than the 90 days, so they requested and received additional time within which to achieve their minimum targets.

Although the program was initially adopted for its rural focus, it has not prompted the sponsorship expected from the local Rural Development Corporations. Only three of the twenty-four fully financed CBCs were sponsored by their local RDC. Generally, the sponsor is simply an informal group of local community businesspeople and other leaders.

Five groups have proposed the pool format. The largest is a $2 million effort in Saskatoon, which has just recently been concluded. For a time this was the only pool and the only urban CBC. It appeared to be one of those presenting the most difficulties in marketing, receiving two extensions when the estimates of short marketing periods proved over-optimistic.

In the past year, there has been a significant fall off in interest and activity in this program, probably due to the fact that the Bonds Office staff has been downsized and its tasks reformulated. Formerly, more than a dozen staff spent a good deal of time in the field, talking with local leaders about the program and assisting the local groups with their plans. This work is now delegated to regional field offices of the department. The central office staff, reduced to four, merely process the paperwork and provide the approvals. The departmental field offices have traditionally had other priorities and responsibilities and are probably not oriented towards the new duties.

For a more intimate look at the CBC process, two cases will be helpful.

Rosetown and District CBC

The **Rosetown and District Community Bond Corporation** was the first CBC to get off the ground. Rosetown is a regional agricultural service centre of 2,800 people located 115 kilometers south of Saskatoon. The Rosetown group worried about the loss of young people who could not find local jobs. Two of the future CBC board members had heard of a small farm-implement manufacturer in Saskatoon that was looking to expand away from the city's higher real estate costs. They knew that reasonably priced land and construction was locally available. Also, the financing that a CBC could offer was available at a time when banks were not actively lending. The company's needs fitted the needs of the community for diversification and jobs. Thereupon the group (businesspeople, farmers, and others) and the company made application to the Community Bonds program.

It took two months for the Community Bonds Office to review and approve the deal. Most of this time was spent by the provincial officials in negotiations with the owner on the terms of the agreement. The owner reports today that it was a very lengthy and strenuous process, apparently because the government representatives were very cautious with this first deal. While the CBC itself was pretty much out of the negotiation (which nonetheless concerned in part the amount of control the CBC would exercise in company decisions), the provincial negotiators sought to include CBC veto power for some issues.

At the end, the local CBC board reviewed and approved the investment agreement, but they felt they had little control over the shape it took. As one CBC board member reported, "All we did was sell the bonds; the rest was done by the government. They were, anyway, indemnified—and we were not. In fact, in the end we hesitated to sign off on the deal because as directors we would still be held liable by the bondholders. But the government people spent a lot of time on the project to make it go, because they wanted a project completed before the coming election."

Raising the money in ninety days was a challenge, but sixty residents of Rosetown and the three adjacent rural municipalities fanned out in a highly systematized (even computerized) campaign. A local small businessman who had once worked with a securities dealer and was himself licensed as a securities salesman organized and led the effort. But the whole sales force—including the chairman's wife—undertook the province's training course in order to explain to their friends and neighbours what the bonds really were.

Perhaps 70% of the campaign period was spent in pre-selling activities, public meetings, coffee shop discussions, and the like. Then the sales force began making personal sales contacts. The market was ready for them. A recent survey indicated that there were local bank deposits of $120 million ($40 million alone in the credit union) so the minimum sales target of $800,000 seemed reasonable.

The group held weekly sales meetings. Sometimes the company owner would attend to answer questions that had been raised by prospective buyers. He commented on a later occasion, "You can't imagine the rumours! 'The company was going broke,' etc. In a small town everybody thinks they know or should know your business." But this sort of problem was actually minimal. At the meetings, each worker would report her or his progress, and prospects might be transferred among themselves, according to who was thought to have a better chance of making the sale with which resident. Two days before the end of the campaign, they were still $20,000 short. So they called "everyone in the telephone book who had still not been personally contacted," and the goal was met in the 90-day period.

The average investor was in the 50-60 age group, but even high school students bought bonds. There were, in all, over 600 investors, with an average purchase of $1300. One retired resident bought $40,000 worth, specifically to help create jobs for the younger generation. A corporation with local interests bought the maximum $50,000. Expenses for the campaign had run to $14,000, all covered by interest earned on the proceeds of the sales before the investment was formally made.

The CBC made the investment in the form of preferred stock with an annual dividend set at 9%. The dividend was not paid in the first year (1991), but today the CBC board and the company owner anticipate, after a very successful Year Two, that the company will be paying the 1992 dividend return to the investors. For most of the residents, however, the most important result of the project is that it brought to the area a company with $400,000 annual payroll for a peak staff of 40 during the summer (when many students are hired), and a wintertime total of 15-20. Perhaps two-thirds of the basic employees are Rosetown residents, and the rest come from surrounding municipalities. The owner himself and the plant manager have moved to the area, and only three staff (including the company accountant) still live in Saskatoon and commute as necessary.

The experience had another singularly positive result besides the new business. It led to the formation of a local economic development agency. Historically, the municipalities concerned had not worked well together. The success of the CBC led them to create a joint agency that is the equivalent of a community development corporation: it focuses on social aspects of the local economy as well as on business development. A visitor to the town will see economic development suggestion boxes everywhere in shops and restaurants, soliciting ideas from everyone. The board of the agency, including some of the original organizers of the CBC, is actively pursuing a strategic planning exercise. Rosetown and its surrounds seem to have an energetic new life.

Coteau Hills Prairieland Pork CBC

The fourth CBC to get into business was the **Coteau Hills Prairieland Pork Community Bond Corporation**. It differs from the Rosetown case in a number of ways. First, it was formally sponsored by the local Rural Development Corporation. The RDC was based in Lucky Lake, a village of a few hundred residents lying 114 kilometers south of Rosetown. Cruising south, the traveler drives along many a long stretch of straight highway through flat farmland. Coteau Hills is a name adopted by the surrounding region for tourism purposes (there *are* a few rolling hills thereabouts). Prairieland Pork is the name of the hog-raising company that was established with the aid of the Community Bonds.

Again, the investment was made in the form of preferred stock, but the company was already in the area, and not re-locating. Actually, the investment is in a new, separate corporation. But in concept it is an independent facility in a complex owned by principals who also own and operate another pig production facility some miles away in Birsay. The Lucky Lake facilities are separate, in part, to meet the hygienic and genetic requirements of the contracts offered by an Alberta firm, PIC, the largest pig breeding company in Canada. The separate corporation in Lucky Lake limits the risks of the investment from losses occurring at the Birsay facility. Another complication is that the CBC investment was made in tandem with separate limited partnership shares offered to outside investors, who provided the major share of equity in the firm. In addition, the project is one element in a larger strategy of agricultural diversification, irrigation and water supply facilities, and other economic development promoted by the local Rural Development Corporation.

Again, the deal was negotiated by the provincial civil servants. As a Rural Development Corporation leader noted, "It's hard to say 'no' to a local person, so it was comforting to have the Community Bonds Office take the responsibility, and also good to have an independent assessment of the business plan." But in this instance, as with Rosetown, the local group did not even have their own lawyer to review the documents for them. Perhaps because the deal was fairly complicated, the CBC board seemed to be content to have the province take full responsibility for making sure that it was correctly structured.

Coteau Hills CBC had expected to conclude its bond offering (a minimum of $100,000 to a maximum of $400,000) in the period May-July 1991. In the end the CBC required an extension into September, by which time it had $250,000 from 208 mainly local investors. The sales process was carried out by 20 residents who had undergone the provincial training program. They urged on their friends and neighbours by pointing out the successful campaign of nearby Rosetown for twice the amount that Coteau Hills was seeking.

“We hit everyone in the community,” said one CBC director, noting that 250 family units were visited. And indeed in a village of less than 1,000 population, every family may well have bought at least one $100 share, although farmers in the surrounding area also participated. The largest purchase was $8,000, and the average was $1,200. Even one Grade Three boy bought a hundred dollar share, with a loan provided by his parents. A dozen or so buyers were friends and relatives from outside the area. The CBC was unable to tap into the retirement funds of local residents, which did not seem accessible enough for investment in the time period.

The pig facility was important to the local people not just because of the six or eight permanent jobs for residents (for which a couple of people actually moved back to the area). The facility also offered a steady market for barley, a major local crop. Long-term plans foresaw expansion to perhaps four more installations. Dividends were expected to range from 5%-9%, and indeed in the first year a 5% dividend was paid out, even though it had not been in the financial projections. Now, say the organizers, it would be much easier to sell bonds with that record. Also, as a CBC director points out, the political complexion of the current government matches that of most of the locals, who were somewhat skeptical of the previous government and its bond idea. Some of the small hog operators were opposed to aid going to a bigger company, and political opponents of the then-government had made the most of that. In any event, the experience has been so positive that the local leadership has been working on another venture to finance by a CBC offering, this time for a manufacturing firm using recycled plastic.

Implications for Policy & Practice

The Community Bonds program clearly contrasts with the venture capital support programs that are usually found in provincial government departments. As originally designed and administered, the Saskatchewan program appears to have been viewed as an initiative directed towards the support of communities rather than simply the support of businesses. That is a crucial point for this model for community economic development (CED).

The initial success of the effort in the rural areas of the province bespeaks the significance of community in such settings. By contrast, the larger setting of Saskatchewan’s cities has not made much use of the CBC tool until recently, and this bears closer examination than this report can now provide. The CBC campaign in Saskatoon has just been concluded, but it does not seem to have been as enthusiastically received as CBCs elsewhere. One reason may well be that the urban community base is more difficult to mobilize. Another may be that the municipal department of economic development was a major sponsor, so that it became more a government activity than a community-based campaign.

However, it may also be that the handicap lies the choice of promoting the creation of an amorphous capital pool, instead of specific projects as per Rosetown and Coteau Hills. For people who seek to make their dollars work in a social or community cause, rather than simply to obtain a return, the actual character of the investment is an important part of the satisfaction it offers. Experience seems to show that social investors want to see where their money will have an effect. Thus an undesignated capital pool is less attractive.

The U.S. experience with the so-called Community Loan Funds (CLFs) is instructive here. CLFs are local capital pools for community economic development investments. (To date, CLFs hold a total of about $75 million.) The capital usually takes the form of loans and usually for housing. Individual and institutional (e.g., churches) provide the CLFs with funds at an interest rate below that at which the CLF will lend the money to local projects. The investors know that their dollars will go, for example, to affordable housing for local people. From the record of their particular CLF, they will know just what sorts of affordable housing will be financed.

This knowledge is an important attraction for the purpose of recruiting investors. Moreover, a CLF will have projects on the drawing board which can be vetted by prospective investors to get a clear idea of what a deposit in the fund can produce. The single-project CBC satisfies that need for information and personal satisfaction; the undesignated CBC pool may not. Thus the pool alternative chosen by the Saskatoon CBC may be a significant brake on its campaign.

(It is true, nevertheless, that two other urban pools—though in much smaller cities—have successfully concluded their sales. In one, the bonds were originally sold for a specific $250,000 project. The investment was not ultimately made. Instead, the CBC sought and got the bondholders’ approval to look for other opportunities. In the second case, the CBC already had some investments under consideration as it campaigned.)

Apart from the problem of undesignated funds, the Saskatoon marketing approach has stressed the eligibility of the investment for RRSP purposes. Again, this is an appeal to individual concerns, and must stand or fall on the attractiveness of the investment as such, and not the project. The approach puts a priority on individual, rather than community benefits.

If the Community Bonds model is to be effective in urban areas, the CBC will probably arise from a clear sense of mutual identity and common reliance upon a development effort—in short, from the sense of community. That sense might well arise in smaller cities or from a particular neighbourhood where the residents are more closely related, and not from a major urban area in which residents do not experience such interrelationship. Alternatively, the sense of common identity might be evoked by a particular group within the city, such as women raising the funds for women’s enterprise. In the case of the CLF, people already involved generally in the development of affordable housing marketed their interest to social investors. The Saskatoon campaign does not appear to have depended on any version of that essential community feeling. A review of the experience in Saskatoon at a later point will be useful.

At this point, paradoxically, a recognition of the significance of the dimension of community helps to highlight a community handicap in the CBC approach. *A CBC campaign is not a comprehensive development strategy for the designated community*. It addresses only one local issue (new or expanded business), and usually with only one local investment. To be more powerful, the CBC approach requires a setting in which the residents can view the investment as a part of their longer-term and more ambitious concerns for local revitalization.

In community economic development, selecting a single project or only a single sector of interest (youth, housing, post-psychiatric patients, assistance to entrepreneurs, or whatever) by itself may be valuable for local development. But the impact will be minimal or reduced if the project is not performing a role within a larger web of diverse, strategically-linked activities. In short, community economic development must always be recognized as a multi-pronged approach, involving concurrently many different mechanisms for local revitalization.

Needless to say, you have to start somewhere. Community leaders, having learned to collaborate on a single project, may move on to create a CDC which addresses many interrelated community issues. Can Community Bonds stimulate a more comprehensive and strategic approach? The case of Rosetown seems to indicate that it can. The success and the spirit produced by the campaign to finance and bring the farm implement manufacturer to the Rosetown area was undoubtedly critical to the continuation of municipal collaboration in a broader economic development committee. (Prior to the CBC episode, an economic development office in the local municipality received little support and was phased out.)

In the case of Coteau Hills, the local people were already very active in designing a major strategic plan. So the one-shot financing of a single venture was not isolated project. Yet here too one must imagine that the success of the CBC was a powerful stimulus to continued work on the locality's comprehensive strategy.

The provincial restrictions on the structure and activity of the CBC as an institution would seem to reduce its potential for stimulating a broader impact. By law, the CBC is not allowed to engage in any other activity or to own assets that might be useful for development purposes. The Rosetown case demonstrates that this is not a fatal restriction: the Rosetown and District Community Bond Corporation stimulated the spin-off of a more powerful, multipurpose institution. However, a less restrictive structure might make it easier for a local group to press ahead with additional development activities. In any event, the CBC as an instrument of community economic development must, from a policy standpoint, be understood and used as a means to a larger end than merely the financing of a single venture.

Even within the limitations of the Saskatchewan model there are opportunities for promoting the development of local capacity to do more than simply sell bonds for a single project. Key to any local development spirit is the sense of grabbing hold of the community's destiny and shaping it to local ends—a feeling of self-reliance. But the way in which the provincial administrators handled the deals described here can restrain the growth of self-reliance.

Because the province negotiated the deals in both Rosetown and Coteau Hills, there is today a very limited sense of local ownership of the deals. In each instance, the leadership expresses a lack of ability to monitor the progress of the companies concerned. In one instance, a leading CBC director even suggested that the province should provide a sophisticated representative on the company board to do the monitoring. In neither case did the CBC have a chance to understand the intimate details of the business, as they would have had to learn them in the course of negotiating the deals.

There is the further problem that the local board may be held responsible, and thus require indemnification insurance or other protection. Their lack of intimacy with the details of the business might indeed make them liable at a later time—and throw the whole concept of the bonds into doubt. In short, because the critical element of increased local capacity does not seem to be addressed in this provincial process, the full value of the program is not realized.

No doubt in the early cases, any interest in local capacity-building was subordinated to the government's need to shape the first deals properly, and perhaps to get the deals completed in time for an upcoming election. There is probably no way to eliminate all political considerations in a government-supported program—federal or provincial or municipal. However, the effect of such considerations in any particular moment should not be allowed to shape the program itself in its subsequent operations. Establishing a pattern of provincial negotiations on a local deal instead of local negotiations vitiates a fundamental part of the community economic development process—local capacity building. The CBC technique will be a more powerful instrument if it can be administered as a means to encourage and capacitate broader local efforts.

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