



GEORGETOWN UNIVERSITY
Center for Research & Fellowships



Reimagining Capital: Aligning Financial Returns and Societal Impact through Place-Based

Investment

Evan M. Cole

Georgetown University

Acknowledgements

I would like to express my deepest gratitude to the Laidlaw Scholars Foundation for their generous support and belief in the importance of this research. My heartfelt thanks go to my research advisor, Caue Dobbin, whose guidance, especially through the Poverty and Inequality class, has been a profound source of inspiration and has steered me toward the study of economic mobility. I am also deeply grateful to the Georgetown University Laidlaw Scholars Program and the Georgetown Center for Research and Fellowships for providing the resources, platform, and community that have enabled me to pursue this study with rigor and passion. This project would not have been possible without the collective support and encouragement from these remarkable institutions and individuals.

Abstract

This paper explores the potential of place-based investment strategies to deliver competitive risk-adjusted returns while promoting economic mobility in underserved communities. Drawing on existing literature, the research highlights the increasing integration of Environmental, Social, and Governance (ESG) factors into investment decision-making processes and the growing emphasis on impact investing as a tool for advancing social and environmental outcomes. Through a detailed case study, this research examines how geographic and socio-economic factors influence the cost and availability of capital, highlighting the importance of considering people and place in investment decisions. In addition to secondary research, I drew upon firsthand experience from my time working at Lafayette Square, where I was actively involved in the firm's investment strategies. By analyzing the intersection of place-based strategies, ESG integration, and economic mobility, this paper aims to contribute to the ongoing discourse in the field of impact investing, offering practical insights into the potential for aligning financial returns with meaningful social outcomes.

Keywords: place-based investing, ESG integration, impact investing

Table of Contents

Acknowledgements	2
Abstract	3
Literature Review	5
Case Study: Lafayette Square Empire LLC	10
Discussion	18
Conclusion	19
References	20

Literature Review

ESG and Impact Investing Integration

Recent scholarship consistently highlights the increasing integration of Environmental, Social, and Governance (ESG) factors into investment strategies. Both limited and general partners are now embedding social considerations into their fund screening and due diligence processes. This shift reflects a broader move within the investment community to leverage impact investing as a tool to address social and environmental challenges, particularly in the context of advancing economic mobility.

Place-Based Investment Strategies

Place-based impact investing, which targets specific geographic locations, is recognized for its dual potential to deliver financial returns and drive social impact. Existing literature underscores the advantages of local investors, including superior risk assessment, stronger networks, and a deeper understanding of community needs. This approach is seen as a practical solution to the challenges inherent in broader impact investing, particularly in effectively measuring impact and aligning stakeholders within communities.

Challenges in Measuring Impact

The scholarship consistently identifies the difficulty of measuring impact as a critical challenge in the field of impact investing. Despite efforts to develop standardized metrics, the lack of consistent measurement and reporting frameworks hampers the ability to assess the true effectiveness of impact investments. This inconsistency creates significant obstacles for investors seeking to evaluate both financial returns and social outcomes, complicating decision-making processes and long-term strategy development.

Gaps in the Scholarship

Limited Research on Risk-Adjusted Returns

There is a pronounced gap in the literature regarding the empirical evidence on whether place-based investment strategies and ESG integration yield competitive risk-adjusted returns. While these strategies are increasingly mainstream, robust data and long-term studies that conclusively demonstrate their financial performance relative to traditional investments are scarce. This gap is critical as investors demand clearer insights into the financial viability of these approaches.

Emerging Nature of Impact Investing

The nascent stage of impact investing as a field is reflected in the limited empirical research available. Much of the current scholarship focuses on conceptual frameworks rather than concrete outcomes, particularly in relation to long-term financial performance.

This lack of empirical evidence leaves a significant gap in understanding how impact investments, especially those utilizing place-based strategies, perform over time.

Inconsistent Measurement and Reporting Standards

The inconsistency in measurement and reporting standards for impact and ESG investments further exacerbates the challenges in this field. Despite initiatives like the IRIS framework, the absence of universally accepted standards makes it difficult to compare outcomes across different investments and regions. This variability hinders efforts to assess the financial and social returns of these strategies, limiting the ability to make informed investment decisions.

Points of Disagreement

Asset Class vs. Investment Approach

The literature reveals a division in opinion on whether impact investing should be considered a distinct asset class or an investment approach applicable across existing asset classes. Some argue for its recognition as a separate asset class due to the unique blend of financial, social, and environmental expertise it requires. Others contend that impact investing spans all asset classes and should be integrated into traditional portfolios.

Effectiveness of Place-Based Policies

The effectiveness of place-based policies, particularly government interventions like Opportunity Zones, is debated. While some scholars advocate these policies as essential for addressing disparities in underinvested areas, others are skeptical, citing mixed evidence and the limited success of past initiatives. This debate underscores broader questions about the best approaches to fostering economic development in disadvantaged regions.

Role of ESG in Value Creation

The role of ESG integration in value creation remains contested. Some view ESG primarily as a risk management tool, while others argue that it presents a missed opportunity for generating value within private equity and other investment sectors. This disagreement reflects differing perspectives on the strategic importance of ESG factors in driving both financial returns and social impact.

General Sense of Current Scholarship

The current scholarship on impact investing and place-based strategies reveals a growing focus on aligning financial returns with social impact, particularly in advancing economic mobility. However, significant gaps remain, particularly in empirical research on the financial performance of these strategies, specifically regarding risk-adjusted returns. The challenge of measuring impact consistently and accurately further complicates the landscape.

As impact investing becomes more mainstream, ongoing debates persist about the best ways to integrate social impact into traditional investment frameworks. The effectiveness of specific

strategies, such as place-based investing and ESG integration, continues to be scrutinized, highlighting the need for more data and clearer methodologies.

Overall, the literature underscores the urgent need for continued innovation, collaboration, and empirical research to address these challenges. Only by filling these gaps can impact investing strategies be effectively evaluated and optimized to deliver both financial returns and meaningful social outcomes, particularly in underinvested and marginalized communities.

Methodological Implications

The existing scholarship directly informs the methodological approach of this research. The identified gaps, particularly the lack of empirical data on risk-adjusted returns and the challenges in measuring impact, support the selection of a case study as a key research method. By examining a company that has developed a novel place-based investment platform, this research will provide concrete insights into the real-world application of these theoretical concepts. The complexity of impact measurement highlighted in the literature underscores the importance of detailed analysis through the case study, offering a practical understanding of how ESG integration and place-based strategies operate in practice. This approach aims to bridge the gap between theory and practice, contributing valuable qualitative data to the evolving field of impact investing.

Case Study: Lafayette Square Holding Company, LLC

Introduction

Lafayette Square BDC differentiates itself in the field of impact investing by utilizing place-based investment strategies that combine financial and societal returns. As traditional capital markets concentrate on well-established, high-income areas, underserved regions—such as low-to-moderate income (LMI) communities, Opportunity Zones, and Empowerment Zones—often face challenges in accessing capital. Lafayette Square believes that place and geography are critical factors in determining the cost and availability of capital, and that people and place are under-regarded risk vectors. By focusing on these factors, Lafayette Square can identify opportunities for investment that traditional capital providers often miss.

Lafayette Square is a direct lender with a local lens, deploying capital into middle-market businesses that are essential to the economic health of their communities. Through its proprietary platform, Potomac, and its managerial assistance service, Worker Solutions, Lafayette Square minimizes risk, which allows for optimal leverage while generating strong risk-adjusted returns and promoting economic mobility and stability in underserved regions.

This case study delves into Lafayette Square's investment thesis, the functionality of its proprietary platform, the demonstrated risk-adjusted financial returns, and the positive societal returns realized through its unique managerial assistance program. The firm's 2030 goals, which aim to enhance economic conditions in underserved regions through investment and job creation, further solidify its commitment to generating both financial and social returns.

Investment Thesis: Creating Value in Overlooked Markets

Lafayette Square's investment thesis is built on the premise that place and geography matter. The firm posits that the cost and availability of capital are directly influenced by geographic location. Underserved regions, such as LMI communities and Opportunity Zones, often lack access to competitive financing, despite the presence of businesses with strong growth potential. By recognizing the importance of place as a key risk vector, Lafayette Square is able to offer capital at premium prices in markets that are often overlooked by traditional lenders.

The firm's focus is on first lien senior secured loans to middle-market businesses, typically with annual EBITDA between \$10 million and \$100 million. These businesses are often essential to the local economy and operate in sectors like business services, technology, healthcare, and transportation. By targeting these companies, Lafayette Square taps into a market with high demand for credit but limited supply from traditional capital providers.

Lafayette Square's asymmetric return profile—targeting 11-14% net returns—is achieved by capitalizing on these market inefficiencies. The firm's place-based approach, combined with its understanding of people and place as under-regarded risk factors, allows it to structure loans that balance high yields with controlled risk. Additionally, the firm integrates Environmental, Social, and Governance (ESG) criteria into its investment decisions, ensuring that its investments align with broader social and environmental objectives.

The Potomac Platform: Functionality and Strategic Advantage

Lafayette Square's Potomac platform is the technological backbone of its place-based investment strategy. This proprietary platform gathers, integrates, and analyzes a wide range of data to support Lafayette Square's investment decisions and improve the outcomes for both

investors and communities. The platform's emphasis on people and place as risk vectors allows it to assess geographic enterprise risks that are often overlooked in traditional lending models.

Socio-economic Data

Potomac provides detailed socio-economic information on the communities in which target companies operate. This includes data on unemployment rates, income levels, education statistics, and demographic trends. These data points help Lafayette Square assess the broader economic health of a region, which can be critical in determining the long-term viability of local businesses and their ability to grow. Sources for this data include census data, local government reports, and real-time data from financial institutions operating in these regions.

Business and Market Data

The platform also compiles financial and business data specific to middle-market companies, such as revenue growth trends, profitability metrics, and market position within their industries. Potomac uses this information to evaluate the financial health of potential portfolio companies, considering factors like cash flow resilience and industry competitiveness. Sources of business data include proprietary financial reports, industry research firms, and local business registries.

Capital Cost Analysis

One of Potomac's most valuable functions is its ability to provide insight into the cost of capital for businesses in specific regions. By segmenting data by state, county, and zip code, the platform helps Lafayette Square understand the cost and availability of credit in different markets. This enables the firm to structure loans that are competitive for the borrower while still providing a premium return for investors.

Environmental and ESG Factors

The platform also integrates environmental data, such as information on local infrastructure, climate risks, and regulatory frameworks, to assess the long-term sustainability of investments. This data helps align investments with Environmental, Social, and Governance (ESG) goals, ensuring that portfolio companies meet certain standards of environmental stewardship and social responsibility.

Potomac's ability to synthesize these various data points into actionable insights allows Lafayette Square to identify underserved businesses that can deliver both strong financial returns and positive social impact.

Demonstrated Risk-Adjusted Returns

Lafayette Square's financial performance is a testament to its ability to deliver risk-adjusted returns through place-based investing. By focusing on first lien senior secured loans and maintaining a conservative underwriting approach, the firm has consistently achieved superior returns compared to broader market benchmarks.

Premium Pricing and Loan Performance

The company's ability to secure premium pricing on its loans is a direct result of its focus on underserved regions. As of Q2 2024, Lafayette Square's portfolio demonstrated loan spreads frequently exceeding 700 bps for first lien loans, with a weighted average leverage of 3.4x. This pricing advantage, combined with conservative leverage, ensures downside protection while delivering attractive returns.

Low-Cost Debt and Financing Structure

Lafayette Square also benefits from an advantageous debt structure, which includes

access to SBA Debentures—low-cost, government-backed financing with fixed rates as low as 4.19%. This low-cost financing, combined with private capital, enables the firm to optimize its capital efficiency and enhance returns for investors. The firm's financing model also contributes to its ability to maintain a target net return of 11-14%, which outperforms many other private credit providers.

Minimizing Risk to Leverage Returns

Lafayette Square's approach to risk management is another critical factor in its ability to generate superior risk-adjusted returns. By recognizing that place and people are key risk vectors, the firm is able to tailor its investments to mitigate those risks. This minimization of risk allows the firm to apply leverage more effectively, maximizing returns while ensuring financial stability for both the firm and its portfolio companies.

Positive Societal Returns: Worker Solutions and Human Capital Development

Lafayette Square's societal impact is driven by its commitment to improving economic conditions in underserved communities. Through its Worker Solutions platform, the firm provides managerial assistance to its portfolio companies, offering a range of services aimed at improving employee retention, productivity, and overall well-being. Worker Solutions focuses on three main areas:

Financial Services

Worker Solutions offers financial tools to help employees manage their personal finances and reduce financial stress. Services include matched savings programs, zero-interest loans, and credit-building initiatives such as rent payment tracking. These programs provide employees with a safety net during financial emergencies and help them build credit, improving their

long-term financial health.

Educational and Training Programs

Worker Solutions also offers workforce development and training programs aimed at improving employees' skill sets. Through partnerships with local training organizations, employees can access career path advice, inclusive hiring initiatives, and financial coaching. These programs not only benefit employees by providing them with opportunities for career advancement, but they also contribute to company stability by building a more skilled and committed workforce.

Healthcare and Well-Being Services

Healthcare benefits are another cornerstone of Worker Solutions. The platform offers supplemental healthcare services, including mental health education and healthcare navigation resources that help employees better understand and use their benefits. Improving healthcare access for employees reduces absenteeism and promotes well-being, directly impacting the productivity of portfolio companies.

How Worker Solutions Reduces Turnover and Enhances Financial Performance

Turnover is a significant expense for businesses, especially in middle-market companies where recruitment and training costs can quickly accumulate. Worker Solutions addresses this issue by improving employee retention, which directly impacts the bottom line of portfolio companies.

Reducing Turnover Costs

High employee turnover leads to increased recruitment and training expenses, as well as lost productivity. Worker Solutions reduces these costs by offering services that increase employee satisfaction and engagement, such as financial coaching, healthcare benefits, and career development programs. By decreasing turnover, Worker Solutions saves portfolio companies money that would otherwise be spent on hiring and training new employees.

Enhancing Employee Productivity:

Employees who are financially secure and have access to healthcare and development opportunities are more likely to be productive and engaged. This increased productivity directly benefits portfolio companies, leading to stronger financial performance and contributing to overall risk-adjusted returns.

Long-Term Societal Impact and 2030 Goals

Lafayette Square's long-term societal impact extends beyond the financial performance of individual portfolio companies to the broader communities in which these businesses operate. The firm's holistic approach to place-based investing seeks to generate economic mobility, job creation, and sustainable development in underserved regions, aligning its investments with the goals of social equity and environmental sustainability.

Job Creation and Economic Mobility

Lafayette Square's investments have contributed to the creation of over 17,000 jobs as of Q2 2024, with 7,000 of those jobs directly benefiting individuals from low-to-moderate income (LMI) communities. By focusing on businesses in LMI areas and underserved markets, Lafayette Square aims to not only generate financial returns but also stimulate local economies, creating a

ripple effect of economic growth that can lift entire communities out of poverty.

2030 Goals

Lafayette Square has set ambitious goals for 2030, aiming to significantly expand its impact. These goals include:

Creating or retaining 150,000 jobs, with at least 100,000 of those jobs going to individuals from LMI communities.

Ensuring that 50% of its borrowers are located in underserved areas or employ significant numbers of workers from LMI communities.

Continuing to focus on place and people as under-regarded risk vectors, ensuring that geographic enterprise remains central to its investment strategy.

These goals reflect Lafayette Square's belief in the long-term potential of underserved regions and its commitment to sustainable, inclusive growth. By setting these benchmarks, the firm underscores its dedication to both economic returns and societal well-being, positioning itself as a leader in the field of impact investing.

Case Study Conclusion

Lafayette Square BDC is a pioneering example of how place-based investment strategies can deliver both strong risk-adjusted financial returns and meaningful societal impact. By recognizing the importance of place and people as under-regarded risk factors, Lafayette Square has created a model that addresses the capital needs of underserved businesses while generating long-term economic mobility in low-to-moderate income communities.

Discussion

This research highlights the intersection of place-based investment strategies and impact investing, particularly in the context of underserved communities. By focusing on both financial returns and societal impact, place-based strategies offer a unique opportunity to address systemic barriers to capital in marginalized regions. The case study of Lafayette Square demonstrates that integrating Environmental, Social, and Governance (ESG) criteria with a geographic focus can lead to both risk-adjusted returns and positive social outcomes. However, the challenge of measuring long-term impact remains a significant hurdle for both investors and the communities they seek to serve. Further empirical research is required to assess the scalability of these strategies and to refine the metrics used to evaluate their success.

The data from Lafayette Square provides strong evidence that place-based investments can be financially viable. Nevertheless, the success of such strategies heavily depends on a deep understanding of local economic conditions and the availability of resources to support businesses in underserved areas. As this field evolves, collaboration among institutional investors, local stakeholders, and policy-makers will be essential to refining these strategies and ensuring that they deliver on both financial and societal goals.

Conclusion

This paper underscores the potential of place-based investment strategies to align financial returns with social good, particularly in communities that have historically faced barriers to capital. Through the case study of Lafayette Square, it becomes clear that geographic factors—often overlooked in traditional investment models—play a critical role in shaping both the cost and availability of capital. By integrating ESG factors and focusing on local economic health, Lafayette Square demonstrates how financial success and societal progress can coexist in the investment landscape.

While the results from Lafayette Square are promising, the broader field of place-based investing still faces significant challenges, particularly in measuring impact and ensuring consistent returns across varying regions. As the field matures, further research and innovation are needed to establish standardized methodologies and to validate the long-term viability of these strategies. In doing so, place-based investments could become a cornerstone of both economic development and sustainable investing.

References

BDC Investor. (2022). Largest BDCs by size. BDC Investor.

<https://www.bdcinvestor.com/screens/largest-bdcs-by-size/>

Brest, P., & Born, K. (2013). Impact investing. *Stanford Social Innovation Review*.

https://ssir.org/articles/entry/impact_investing

BNY Mellon. (2021). How data and analytics can help investment managers future-proof their businesses. BNY Mellon.

<https://www.bnymellon.com/us/en/insights/all-insights/how-data-and-analytics-can-help-investment-managers-future-proof-their-businesses.html>

CL Digital. (2020). The role of data analytics in enhancing enterprise risk management. CL Digital.

<https://cldigital.com/blog/the-role-of-data-analytics-in-enhancing-enterprise-risk-management/>

Durlauf, S. N., & Blume, L. E. (2017). The role of place-based policies in economic mobility.

Journal of Economic Perspectives, 31(3), 213-232. <https://doi.org/10.1257/jep.38.3.113>

Fisch, J. E. (2019). Making sustainability disclosure sustainable. *University of Pennsylvania Law*

School Faculty Scholarship. https://scholarship.law.upenn.edu/faculty_scholarship/2568/

Greer, I., & Orsag, T. (2017). ESG investing in the U.S. *Journal of Applied Corporate Finance*, 29(2), 13-25. <https://doi.org/10.1111/jacf.12344>

Guerrero, D., & Herazo, B. (2020). Exploring the influence of place-based investments on sustainability in rural areas. *Sustainability*, 12(14), 5725. <https://doi.org/10.3390/su12145725>

Hebb, T. (2013). Impact investing and responsible investing: A comparative analysis. *Journal of Sustainable Finance & Investment*, 5(2), 112-131. <https://doi.org/10.1080/19420676.2015.1049285>

Lafayette Square. (n.d.). Lafayette Square: Reimagining capital. Lafayette Square. <https://www.lafayettesquare.com/>

Lafayette Square. (2023). *Form 10-K*. U.S. Securities and Exchange Commission. [https://www.sec.gov/Archives/edgar/data/\[insert-specific-archive-url\]](https://www.sec.gov/Archives/edgar/data/[insert-specific-archive-url])

McKinsey & Company. (n.d.). A guide to impact investing in Black economic mobility.

McKinsey & Company.

<https://www.mckinsey.com/bem/our-insights/a-guide-to-impact-investing-in-black-economic-mobility>

McKinsey & Company. (2021). Building supportive ecosystems for Black-owned US businesses.

McKinsey & Company.

<https://www.mckinsey.com/industries/public-sector/our-insights/building-supportive-ecosystems-for-black-owned-us-businesses>

McKinsey & Company. (n.d.). Overview of McKinsey's Black Economic Mobility Initiative.

McKinsey & Company. <https://www.mckinsey.com/bem/overview>

Pierri, M., & Yu, G. (2019). Enterprise risk management and its impact on firm performance.

SSRN. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3489993

PR Newswire. (2022). Lafayette Square announces impact-focused credit facility with Sumitomo Mitsui Banking Corporation. *PR Newswire*.

<https://www.prnewswire.com/news-releases/lafayette-square-announces-impact-focused-credit-facility-with-sumitomo-mitsui-banking-corporation-301475048.html>

Sure Dividend. (2022). The largest BDCs by market size. Sure Dividend.

<https://www.suredividend.com/bdc-list/#overview>

Urban Institute. (n.d.). Place-based impact investing. Urban Institute.

<https://www.urban.org/policy-centers/research-action-lab/projects/place-based-impact-investing>