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Corporate Civic Investment Funds: New Models for Community Development Finance?

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SECTION I. INTRODUCTION

Over the 1990s, community development finance was transformed from a purely community-based and government-driven process to a set of initiatives that incorporate private sector, profit-motivated efforts to alleviate poverty and revitalize distressed communities. This convergence between the social sector[1] and private sector interests and efforts has resulted in an important union: the growth of corporate-led civic alliances that address community and economic development. While prominent corporate partnerships, such as San Francisco's Bay Area Council, have operated for decades, the mission and strategies of these entities have shifted. Early on, these alliances tended to focus their efforts on expanding business and marketing opportunities and improving the physical environment, including public infrastructure and facility provision. While these interests remain, today many corporate partnerships now look to the economic strengths and weaknesses within their defined boundaries and work to identify ways to promote neighborhood revitalization and the overall economic viability of the larger region. In focusing their attention on the economic development of their communities, these alliances engage the social sector as partners in a range of community development activities that benefit both sides of the equation.

The evolution of corporate civic alliances and the emergence of new economic development initiatives have been influenced by the emergence of several trends. First, there has been a significant increase over the last several years in socially responsible investing – from the advent of socially conscious mutual funds at many of the major brokerage houses to a significant increase in individual investments in these funds. Second, venture philanthropy has become an accepted, expanding phenomenon, as shown by the increase in grants and Program Related Investments made by foundations to increase nonprofit capacities to obtain and manage funding. Third, corporations have also intensified their philanthropic efforts, particularly over the late 1990s when the economy was more robust, as evident in the fact that many Fortune 500 companies have created subsidiaries focused on providing management expertise to non-profit leaders as well as making monetary investments in these organizations. These efforts, coupled with an always-strong private sector profit motive, have led business leaders to embrace the potential of double bottom line investing – the notion that businesses can do well *and* do good at the same time.

These corporate civic alliances are generally financed through the establishment of fund subsidiaries that use business tools and methods to implement the partnerships' community-focused strategies. These funds typically are labeled as Corporate Civic Investment Funds (CCIFs) due to their explicit linkages with corporate and civic organizations and a commitment to a community-focused mission. CCIFs generally resemble the function and investment methods of Community Development Venture Capital Funds (CDVCs) – one of the first types of tools used by the private sector to invest in projects and businesses perceived as riskier than others. To a lesser degree, CCIFs resemble Community Development Loans Funds (CDLFs) – revolving funds that were developed years ago to provide low-income communities with access to much-needed capital. CDVC funds and CDLFs are both examples of Community Development Financial Institutions (CDFIs) – a rapidly growing segment of the marketplace that has helped to highlight the need for expanded sources of funding and new types of financing.

[1] The term social sector is used here to include the nonprofit sector plus governmental and quasi-governmental entities.

This paper addresses the emerging role of private, often for-profit, community development investment funds that have developed under the umbrella of corporate civic alliances and work in partnership with these organizations. The remainder of the paper is organized into seven sections. Section II briefly describes the background and evolution of community development finance generally, exploring changes in sources of funds, strategy, and types of participating organizations and their roles. Section III addresses the evolving role of the private sector in community development, focusing on trends that have influenced the development of CCIFs. Section IV summarizes recent trends in corporate civic alliances and within the CDVC industry. Section V presents brief case studies of eight CCIFs that have been in existence for several years. Section VI summarizes the experiences of the funds examined in order to distill key lessons learned from their operations. Section VII concludes with an assessment of the near term potential of CCIFs and similar vehicles to exert the impacts they set out to have.

SECTION II. THE CONTEXT: A THUMBNAIL SKETCH OF THE EVOLVING COMMUNITY DEVELOPMENT SECTOR

From its bricks and mortar roots, community development has evolved to encompass a community-building based approach to addressing the problems of low- and moderate- income households and distressed communities. Multiple players and funding sources, as well as emerging community needs, have driven changes in solution and program formulation, financing, and implementation. This section briefly describes the general evolution of the community development sector in the United States and focuses on the shifting priorities, players, and funding sources involved in the execution of community development initiatives.

Background

Over the past 30 years, the sector has altered significantly. Originally regarded primarily as an avenue for local infrastructure projects, such as downtown improvement or water and sewer projects, the sector's mission initially focused on community economic renewal in distressed areas through physical development solutions. Over the past two decades, the concept of community development expanded and become more holistic. Government and nonprofit programs began looking beyond bricks and mortar to social services at the neighborhood level and then more recently at building the assets of individuals and the communities within which they reside. Community development has become part of a more comprehensive strategy, emphasizing community leadership, participation, and leveraged funding as building blocks for successful programs (von Hoffman 2001).

The Influence of the Federal Agenda

Federal policy and funding for community development activities has shifted as well. Prior to the 1980s, community developers depended primarily on long-term federal contracts for financial security. Specialized capital sources were not common, and very few community development organizations had sophisticated programs in the field. Lending initiatives, even from financial intermediaries such as the Local Initiatives Support Corporation (LISC) and the Enterprise Foundation, were limited. Local financial institutions and foundations had not yet placed community investments on their radar screens (Andrews 2001).

As a result, the federal government, the most significant source of sector funding, largely formulated policy and practice. The federal government primarily funded large, nationally driven and financed housing programs, along with area-specific rehabilitation and revitalization programs such as Model Cities and Urban Development Action Grants. At the outset, federal programs paid scant attention to specific local needs, and most programs were ill-designed to respond to the diverse needs of neighborhoods. Key players at the community level included municipal and regional governmental entities and Community Development Corporations (CDCs). The concept of private sector partnerships was not well articulated, as collaborating typically connoted alliances of community groups for purposes of soliciting funding from local or state housing and economic development agencies for grants or for use of tools such as tax-exempt revenue bonds.

By the mid-1970s, the federal government adopted new programs that delivered funds to other administrative bodies. The Housing and Community Development Act of 1974 saw the replacement of categorical programs such as urban renewal and model cities with Community Development Block Grants. Notably, the CDBG program provided local governments increased discretion to administer resources as they saw fit while at the same time consolidating earlier programs in a manner that reduced aggregate HUD funding for housing and community development.

Over time, other federal housing programs underwent significant changes themselves. For example, the Section 8 Housing Certificate program saw a sharp decline in funding. Comprehensive program strategies were being formulated for homeless service delivery. Ongoing fiscal debates brought into sharp focus questions on continuing progress about important national goals by using federal spending more effectively. As federal programs continued to devolve and diminish, the government's spending goals emphasized obtaining the greatest public benefit for the least federal dollars. As a consequence, new federal programs to localities (such as the HOME Investment Partnership Program (HOME) and the Low Income Housing Tax Credit (LIHTC)) were purposefully structured to leverage private sector funding. These changes in federal funding requirements translated to collaborative public/private partnerships. Moreover, the ability to demonstrate that they could deploy these limited subsidy funds wisely became an even greater priority for local governments.

The Evolution of New Players

As federal agendas continued the devolution of responsibilities to state and local governments, and as federal funding sources became less abundant, the need for private sector participation in community development and reinvestment became increasingly apparent. In response, new partnerships and collaborations began to formulate. Initially, foundations and socially motivated insurance companies responded by providing grants and loans for individual projects. Later, the national intermediaries (e.g., LISC and the Enterprise Foundation) began to assemble capital to make loans to these local groups and projects. In 1987, the LIHTC and the private sector partnerships it requires emerged as a major catalyst to community development partnerships. Still, the role of government in community development has remained significant. While providing less large project financing and more seed-funding, the public sector remains a critical partner in many community development activities, particularly affordable housing.

However, the government's intent in funding community development activities has altered dramatically. While the initial generation of government-funded community development activities worked to correct or supplement the market (filling funding gaps with public money or

on terms well below market rates), the role that has more recently evolved is explicitly focused on working with the market, leading or facilitating private investment in ways that help achieve community development goals.

One of the most notable recent federal initiatives has been the creation of the Community Development Financial Institutions (CDFI) Fund in 1994 by the U.S. Treasury Department. The CDFI program centers on the concept of leveraging private sector resources and has exerted significant impacts on the community development field. As of 2001, a recent National Community Capital Association (NCCA) sampling reveals that 81 CDFIs managed $1.8 billion in assets and provided more than $2.9 billion in financing (NCCA 2001). That financing created or retained more than 137,000 jobs and 121,000 affordable housing units. Currently, 550 CDFIs manage more than $6.5 billion in assets (Pinksy 2001). CDFI Core Program funding has facilitated this growth. The passage and subsequent enforcement of Community Reinvestment Act (CRA) regulations has prompted financial institutions to become more involved in lending activities, as demonstrated in the case studies in Section V. Additionally, state and local governments have created various community development funding programs that emphasize leveraging and flexibility, such as tax credit programs. Fundamentally, all players have realized that the transaction costs of doing business have increased over time, and that successful community development projects now require well-packaged combinations of private finance and, where necessary, subsidy from a multitude of diverse partners (Andrews 2001).

Community Development Today

Leading community developers have expanded their vision of what they want to do. Community developers now recognize that no single strategy will resolve the problems of poverty and neighborhood disinvestment. Developers, communities, and lenders have begun to focus on comprehensive solutions, with multiple program components. Unlike earlier years, today an identifiable community development industry exists, complete with a diverse set of production companies, financial intermediaries, and support mechanisms.

Private financial institutions, corporations, and foundations are now active players in the community development field. Community development has become a line of business for many banks and use of varied sets of financial tools is commonplace. Institutions have created new vehicles for lending including limited partnerships, multi-bank lending consortia, and equity pools. Secondary market agencies, national intermediaries, revolving loan funds, and, increasingly, venture capital have become common in community development finance. Finally, the more the banking community has learned about low- and moderate- income areas, largely as a result of their response to CRA obligations, the more they have found economically viable ways to meet the financial needs of consumers and businesses located there.

Community development is an industry that has experienced explosive growth and extraordinary levels of innovation over the past 15 years. A decade ago, the field was populated with “one project at a time” organizations. Today, a sizeable number of high producing, high social impact institutions, and partners have emerged that conduct their investments strategically. As new, market-leading vehicles for community development finance, such as the New Markets Tax Credit, are adopted, they will continue to reshape the ways in which the community development finance industry evolves to help economically disadvantaged people and communities. This paper hypothesizes that community development venture capital and corporate civic investment funds offer such vehicles.

SECTION III. RECENT TRENDS IN COMMUNITY DEVELOPMENT FINANCE

In part, because the sector has experienced high levels of growth and innovation in the past decade, today's community development organizations, with their expanded social missions and operations, require increased access to new sources of capital to support their activities. The need for long-term, patient, but flexible funding is becoming more urgent, and the public sector, foundations, corporations, and financial institutions have been developing methods to respond.

The Public Sector

As public sector resources diminish, community developers are increasingly working to get the most out of their public sector dollars. Successful communities have developed a variety of approaches to leverage public sector dollars, most of which include increased private funding components. In a time when public sector dollars are limited and must be leveraged significantly, the ability to form partnerships with other stakeholders is essential to the process of community development finance.

While the LIHTC continues to be a powerful source for new construction and rehabilitation financing, two new programs may hold the future for public sector community development finance. The New Markets Tax Credit (NMTC), enacted in December 2000, creates a new incentive for CDFIs, CDCs, and other organizations that finance businesses in distressed markets to draw on to raise capital. The tax credits will provide a roughly 30 percent net-present-value tax credit for investments in qualifying CDFIs and other community development entities, including those owned by banks. Although the credits available over the next five years for up to $15 billion in new investments are very small relative to demand, with subsequent rounds the NMTC could begin to fundamentally reshape the community development finance industry (NCCA 2001).

Congress also enacted the New Markets Venture Capital (NMVC) program in 2000. NMVC's mission is to stimulate economic development in low-Income areas through public-private partnerships between the Small Business Administration (SBA), newly formed NMVC Companies (NMVCCs), and existing Specialized Small Business Investment Companies (SSBICs). The program is structured to meet the equity needs of local entrepreneurs through venture capital investments. The program also provides upfront technical assistance to small businesses, aiming to create quality employment opportunities for low-income area residents, and build wealth in these distressed neighborhoods. An investor in an NMVCC or an SSBIC may be able to take advantage of a New Markets Tax Credit if the investment meets all of the requirements of the federal tax code. This would provide a credit against the investor's federal income taxes equal to 39 percent of the amount invested over a seven-year period (Small Business Administration 2002).

Finally, new and innovative programs are also emerging at the state and local level. While the current fiscal crisis in many states is affecting community development financing, innovative state tax credit programs could prove to be a viable new form of investment. One example of an innovative tax credit is in the State of California's CDFI Tax Credit. The first state to pass this type of legislations in support of its growing community finance network, California's new law provides for a 20 percent tax credit for investments or non-interest bearing deposits in any California CDFI. The deposits must remain in a CDFI for at least five years at a minimum investment of $50,000. The program has been most popular with financial institutions, which receive credit toward CRA requirements as well as the tax credit. The future direction of tax

credit programs and their value to investors will depend on factors such as the proposed elimination of taxes on corporate dividends.

Community Development Finance Institutions (CDFIs)

The CDFI industry today covers a wide range of investment targets, including business start-ups and expansions, affordable housing, and community institutions, ranging from childcare centers to arts facilities. CDFIs also support microenterprises, single- and multi- family rental and home purchase, and consumer and venture capital. In addition, those CDFIs that are regulated financial institutions also take deposits.

Over the last two decades, the number of CDFIs has grown considerably, not only in number but also in capital. The 2001 NCCA statistics show that the total capital growth at individual CDFIs (for which data existed) increased at an average of 19 percent per CDFI. Data also showed that CDFIs continue to put their capital to work for disadvantaged people and communities. Eighty-one percent of the capital deployed by CDFIs (outstanding or committed) was for community development projects throughout the country. The deployment ratio has remained steady during the past several years even as capital has increased (NCCA 2001).

The market for CDFIs, including microenterprise and social enterprises, is growing. CDFIs have proven that financing small businesses is possible, that managing risk through technical assistance can work, and that community-centered groups can organize capital and manage it responsibly. With the growth of CDFIs, there are also a number of apparent gaps or opportunities for community development finance, such as equity capital (or its equivalent) for social enterprises and charities. Over the next five to ten years, tough challenges include managing through economic turbulence, adapting products to rapidly evolving markets, rethinking service delivery systems, and justifying the continuing existence of CDFIs. The fundamental issue for CDFIs may not just be growth (as measured by size and number of institutions), but also enhancing core capabilities, niches, and positioning vis-à-vis mainstream capital markets (Moy and Okagi 2001).

Venture Philanthropy

Venture philanthropy is a relatively new field that has no single accepted approach or commonly agreed definition. Loosely defined as a process of adapting strategic investment management practices to the nonprofit sector to build organizations able to generate high social rates of return on their investments, venture philanthropy is emerging as a viable financing source for community development. This approach is modeled after the high end of venture capital investors – those who work to build great organizations as well as provide capital.

Using a venture capital model, investors base funding on results-oriented business plans. Investors work directly with nonprofit community leaders to understand community and nonprofit issues, solve problems, and structure their investments. One such example is Social Venture Partners (SVP), a leader in the burgeoning field of venture philanthropy. SVP raised $2.5-million from 250 donors in three years and persuaded many of the investors to offer their business and professional expertise to 20 social service and educational organizations in the Seattle area. Supporters of venture philanthropy generally express confidence in its potential but acknowledge that it may take several years before the movement makes significant progress in alleviating community problems. As this new movement does begin to take shape,

community development financing may find great benefit not only in its funding sources but also the investor partnerships.

Corporate Philanthropy

Corporate philanthropy has traditionally provided some, although relatively smaller, contributions to community development. However, current statistics show that corporate philanthropy is declining. Charitable contributions by US companies fell by 14.5 percent in 2001. Over the last decade, corporate giving as a percentage of profits has dropped by about half. Given often demanding pressures from communities for corporations to be socially responsible, coupled with increasing investor pressure to remain as profitable as possible, companies are finding themselves in difficult situations. In terms of bottom line benefit, expenditures on philanthropy are become increasingly difficult to justify (Porter and Kramer, 2002).

As corporations continue to re-evaluate where and how they support various organizations, new models of involvement will continue to emerge and become the vehicles for investment in community development. Local organizations and communities will find a continuing need to work with these corporations to help them understand the value of their targeted assistance and its measurable impact on the community.

Researchers have found that new partnerships are being forged among business interests apart from individual businesses contributing to the community (Porter 2002). Under Corporate Civic Investment Funds, business interests come together to work out a specific problem and provide specific commitments to implement a plan. The most significant effect of these funds is that they will continue to bring new investors and leaders into community development financing.

Socially Responsible Investment

Today, socially responsible investing represents the cutting edge of the investment industry. As of November 1999, the Social Investment Forum (SIF) reports that one in eight dollars of assets under management in the United States, a total of $2.16 trillion, resided in investments that integrate social and environmental concerns. Of those dollars, $5.4 billion represented community investment dollars.

As socially responsible investment becomes more mainstream, social investors are looking to maximize the impact of their dollars. Many are beginning to turn to community investing (Social Investment Forum 2002). Community investment funds provide capital to people who are underserved by conventional lending institutions or have difficulty obtaining capital through conventional channels. A strong and growing network of financial institutions and organizations are committed to spending the time, energy and care necessary to structure responsible financing options that deliver small businesses, jobs, affordable housing, and community facilities. These opportunities cover a wide field, from insured depository institutions such as community development banks or credit unions, to uninsured loan funds and micro-enterprise funds, to community development venture capital.

The future of socially responsible investment lies in the investors themselves. Organizations such as the Social Investment Forum have formulated various programs such as the “One Percent in Community” Initiative. These initiatives are designed to encourage corporate and individual investors to shift their investment focus toward community development projects.

Such shifts can create a permanent tier of capital to serve communities and ultimately become a viable vehicle for community development finance.

Where We Are Today

As explored in the next section, segments of the CDFI industry – CDVC and CCIFs – today are rapidly bringing together new players and the potential for increased flows of private capital from corporations, financial institutions, institutional investors, and foundations and other nonprofit entities that are in a position to invest in projects that further social objectives. More is needed than increased capital flows, however. New capital to the sector needs to be structured in ways that promote successful investments (flexible and patient capital), investments need to be carefully vetted and nurtured to ensure that exits occur on schedule, and the financial and social returns flowing off these investments must meet investor expectations.

SECTION IV. COMMUNITY DEVELOPMENT INVESTMENT FUNDS: THE CCIF AND CDVC MODELS

The community development sector offers numerous finance models and scenarios that draw on resources that include federal funds, foundation grants, and CDFI-sponsored multi-sector packages, as discussed in the preceding section. Increasingly, private capital is a significant component of this resource mix, invested through vehicles such as Community Development Loan Funds (CDLFs) and Community Development Venture Capital Funds (CDVCs).

In recent years, CDVC funds have been the most rapidly growing segment of community development finance. At the same time, a growing number of civic groups in cities and rural areas have established funds that share most of the characteristics of CDVC funds but incorporate a more expansive mission and, in some cases, an emphasis on gap financing rather than the provision of venture capital. Taken together, these funds have attracted new sources of private funding and have begun to establish track records that provide the basis for increased private capital flows to community and economic development.

This section explores the characteristics of and trends in both types of community development investment funds. Because the civic funds have not been tracked consistently over time and the community development venture capital industry has had a member-led forum (Community Development Venture Capital Alliance (CDVCA)) since 1995, the figures on industry trends apply to CDVC funds only.[2] However, of the eight funds profiled in Section V, three currently are CDVCA members and all operate with the strategies, business models, investor bases, and operations that characterize CDVC funds.

Background

Although the CDVC industry has taken root only over the past decade, since the late 1960s a handful of efforts to bring equity and debt financing to projects that addressed urban and rural poverty paved the way for the evolution of the industry. Two of those funds remain in existence today and are highlighted in Section V, the Kentucky Highlands Investment Corporation (KHIC)

[2] All industry data is provided by the CDVCA. CDVCA does not aim to represent civic funds, although civic funds such as the New York City Investment Fund are CDVCA members.

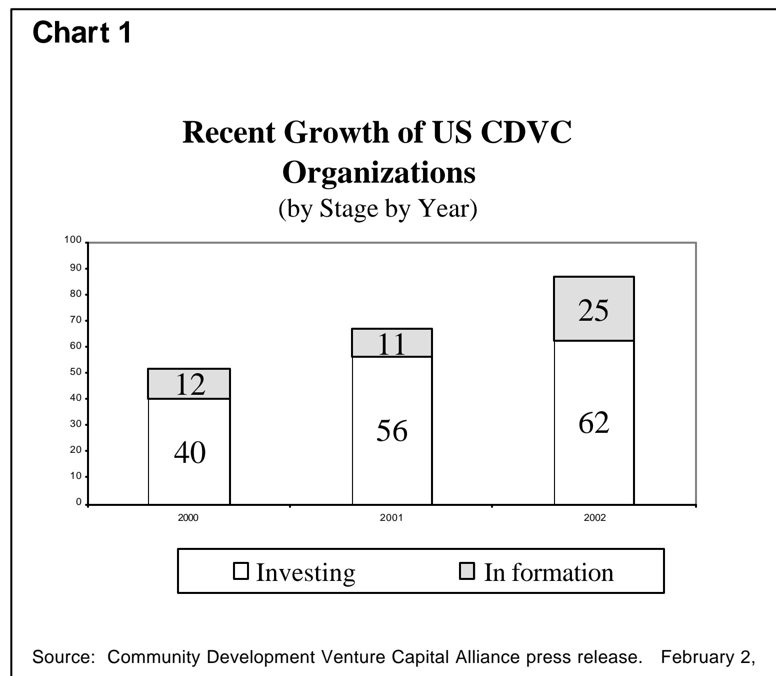
and Northeast Ventures (NEV), an organization based in northeastern Minnesota. KHIC, founded in 1968, is the oldest fund member of the CDVCA. About the same time, Massachusetts established a state-sponsored venture capital fund, the Massachusetts Community Development Finance Corporation to invest in projects that benefit low- and moderate- income populations (Rubin 2001). A decade later, in 1989, Northeast Ventures was established by concerned community and corporate leaders – and notably without the assistance of a parent organization or state government – to bring equity financing to promising new ventures in an economically-distressed region.

Recent Evolution

Wider use of CDVC funds did not occur until the early 1990s. In less than 10 years, the CDVC industry had grown to include 87 organizations, including those already actively investing as well as those still in the formation stage. Recent growth of the industry is illustrated in Chart 1. At the end of 2000 there were 52 U.S. CDVC funds, managing an estimated $300 million. The growth over the following two-year period occurred within the context of an overall economic downturn and the economic impacts of the 9/11 disaster. The CDVCA estimates that the 87 funds in existence as of December 2002 were managing $525 million. Given the difficulty in raising funds over this time period, the growth of CDVC funds is noteworthy, especially given the relative risk of venture capital investments. The continued growth of this industry and the success in capitalizing these funds has generally been driven by the increasing attractiveness of these investments to investors interested in the social benefits as well as CRA-driven contributions from bank investors.

The industry has also expanded in response to the lack of traditional venture capital in many regions of the country. Analyzing 10 years of state-level venture capital investments, a recent study demonstrated the persistent concentration of venture capital investments in only five states,[3] as well as the almost complete lack of traditional venture capital or management expertise outside of urban areas (Schmitt 2002). This analysis provides an estimated annual shortfall of up to $3.5 billion in rural counties. CDVC funds have begun to address these imbalances, but the industry remains too small and too new to do so effectively.

Chart 1



Source: Community Development Venture Capital Alliance press release. February 2,

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[3] The five states are California, Massachusetts, New York, Texas, and Colorado – with levels of concentration increasing over time.

The CDVC Model

The U.S. CDFI Capital Study estimates the demand for CDFI capital through 2005 to be as much as $8 to $10 billion (Brody Weiser Burns 2000). This estimate includes the need for permanent, core capital, operating subsidies, and for long-term, below market-rate debt and for equity funds.

Given the need for flexible, patient capital for non-profit community development organizations and for the investees of community development funds, the CDFI industry in general, and CDVC funds in particular, have mushroomed over past decade. CDVC funds promote economic revitalization, using the tools of venture capital in order to create jobs, increase entrepreneurial capacity, and generate wealth to benefit low-income persons and distressed communities (Rubin 2001).

Basically, CDVC providers are mission-driven to invest in businesses that promise rapid growth or promote such growth. The returns that flow from these investments are regarded as double bottom line investing, generating financial returns for the fund and for its investors, as well as social returns measured, for example, by jobs created for low-income individuals. Notably, these funds draw on disciplined investment practices to provide equity capital, near equity, and other products such as subordinated loans to investees. Typical investments carry risk profiles that make them unacceptable for mainstream financing. Key characteristics of CDVC funds include:

- Socially-conscious investment strategies. Strategies typically center on investments in for-profit businesses that promise rapid growth; jobs with living wages, benefits, and career potential for employees; and economic revitalization potential. In addition, CDVC funds look to investments in geographic areas, such as distressed inner city neighborhoods and rural regions, which remain overlooked by traditional venture capital funds.

- Emphasis on equity investments and flexible terms. Assistance includes provision of equity, near equity, or debt finance. Equity investments dominate, typically investing cash in exchange for ownership interest in companies (typically taken as common or preferred stock). Near equity includes debt with warrants, convertible debt, and debt with royalties. Terms are structured by considering the need for flexibility and patience in making the investment succeed. Thus, unlike an amortizing loan, equity investments will not require that repayment begin immediately, nor follow a fixed schedule.

- Varied fund structure. Organizationally, CDVC funds assume a variety of corporate structures, although more than half have chosen to become for-profit entities. In these cases, the typical venture capital structure is adopted, either forming as limited partnerships (LPs) or as limited liability companies (LLCs) with a defined life for each fund. Because investors understand this structure, they can more easily focus on other aspects of the fund, such as the social impact of the investments. Frequently funds mix structures. For example a nonprofit community development organization or fund may establish a for-profit subsidiary fund, and a separate subsidiary to manage the fund (e.g., Pacific Community Ventures, Inc. is a non-profit that manages two CDVC funds).

  Importantly, CDVCA recently found that of 31 CDVC funds incorporated as LPs or LLCs at the end of 2001, nearly three quarters of them were affiliated with a non-profit, thus

allowing the non-profit affiliate to seek grant funds to cover some of the labor-intensive technical assistance typically required by CDVC investees in distressed areas (CDVCA 2001).

- Banks are primary source of capital. The principal sources of funds are private banks, accounting for 58 percent of total committed capital as of the end of 2000. Corporations and foundations, on the other hand, accounted for only 13 percent of total funding through that same time. CRA-motivated banks have fueled the growth of funds over the 1990s. Foundations helped pioneer the CDVCA concept, providing seed grants and PRIs toward initial capitalization of many funds. Today, the federal government has come back into the picture, with the CDFI fund and market-facilitating initiatives such as the New Markets Venture Capital and New Markets Tax Credit programs.

  Banks account for nearly 40 percent of all equity and 21 percent of debt investments made by CDVC funds. Foundations account for 17 percent of equity and 27 percent of debt investments (reflecting their PRI contributions); government accounts for roughly 18 percent and 21 percent respectively, and corporations and other sources for approximately 26 percent and 31 percent.

- Nonfinancial assistance. The provision of pre-investment advice and post-investment management advisory services and coaching to ensure success is a defining characteristic of the investment model. As is the case in venture capital funds, CDVC providers extend intensive nonfinancial assistance in developing investment opportunities, providing pre-investment and post-investment management and technical assistance, and linking the businesses in which they invest to customers and suppliers and potential partners. In short, they work to make their investments succeed.

  In addition, CDVC fund managers extend significant levels of assistance to companies in which they never invest. This assistance, although not quantified, provides advice and training to numerous entrepreneurs within the fund's investment area. As CDVCA emphasizes, this aspect of technical assistance is especially valuable, as member funds tend to operate in regions where business management experience is lacking (2001).

- Emphasis on high-growth businesses and manufacturing. While traditional venture capital funds generally are sector focused on high technology and now biotechnology, CDVC funds look across sectors to high-growth businesses. Manufacturing accounted for 49 percent of all CDVC portfolio companies as of 2001. Manufacturing firms are frequent investment targets as companies offer opportunities for value-added production and for creating relatively large numbers of jobs for low-income individuals who are not yet highly skilled (CDVCA 2001). Service firms comprise 17 percent of CDVC investments, with small percentages dispersed among retail, wholesale, healthcare, transportation/communication/utilities, software development, Internet firms, and agricultural businesses.

- Double bottom line returns. Because the CDVC industry is very young and no fund has as yet completed a full cycle of investing and exiting from its investments, internal rates of return by fund cannot be calculated. The CDVCA notes that to date, anecdotal evidence indicates that gross returns are running in the range of 8 to 12 percent, a range confirmed by the funds interviewed for this paper. Those funds requiring market-rate

returns, such as the New York Community Investment Company, are obtaining returns in the range of 15 to 16 percent.

Social returns are potentially high, but difficult to measure. Moreover, social impacts frequently take time to develop. Most funds, however, are able to provide estimates of job impacts: CDVCA finds that investments by its reporting members yielded one full-time equivalent job for every $14,342 invested. Compared to the outcomes of Small Business Investment Companies, which have been estimated as creating one job per $35,000 invested, this is a fairly good result. Should time and data support these figures, the job-related returns on CDVC investments will provide additional inducements to investment in community development venture capital funds.

As yet there is no consistent, systematic process to collect and aggregate social returns. Returns are generated on a project-specific basis, especially as the expected social returns differ from investment to investment.

- Operational considerations. Fund staff require significant private financial experience, especially on the equity side, as well as connections to local corporate and financial leaders (including public economic development agencies). As venture capital industry compensation for identical skills is markedly higher than that offered by CDVC funds, CDVC funds tend to attract and retain staff who are committed to achieving the fund’s social goals. In CCIFs where funds operate closely with CEOS, staff retention may be facilitated by the benefits of working closely with major corporate and financial industry leaders.

The CCIF Model

CCIFs share all or most of the characteristics of CDVC funds; however, these funds also tend to look to investment opportunities that catalyze community development investments from other parts of the community. As such, CCIFs not only invest in businesses, but also in real estate that can house new or expanding firms, in investments or co-investments that improve the business climate and overall competitiveness of the region, and in investments that achieve multiple types of social and financial objectives.

The Detroit Investment Fund's investment helped a developer acquire and redevelop the former Detroit Board of Education Leland Orthopedic School Building. The Antietam Charter School will occupy the renovated building, which will accommodate more than 700 students, teachers, and support staff.

The funds described in this paper include pure CDVCs as well as CDVC/Community Loan Fund hybrids. Nevertheless, the investments they make share key similarities: flexible funding, patient capital components, and dual bottom line returns.

Where the Industry Is Today

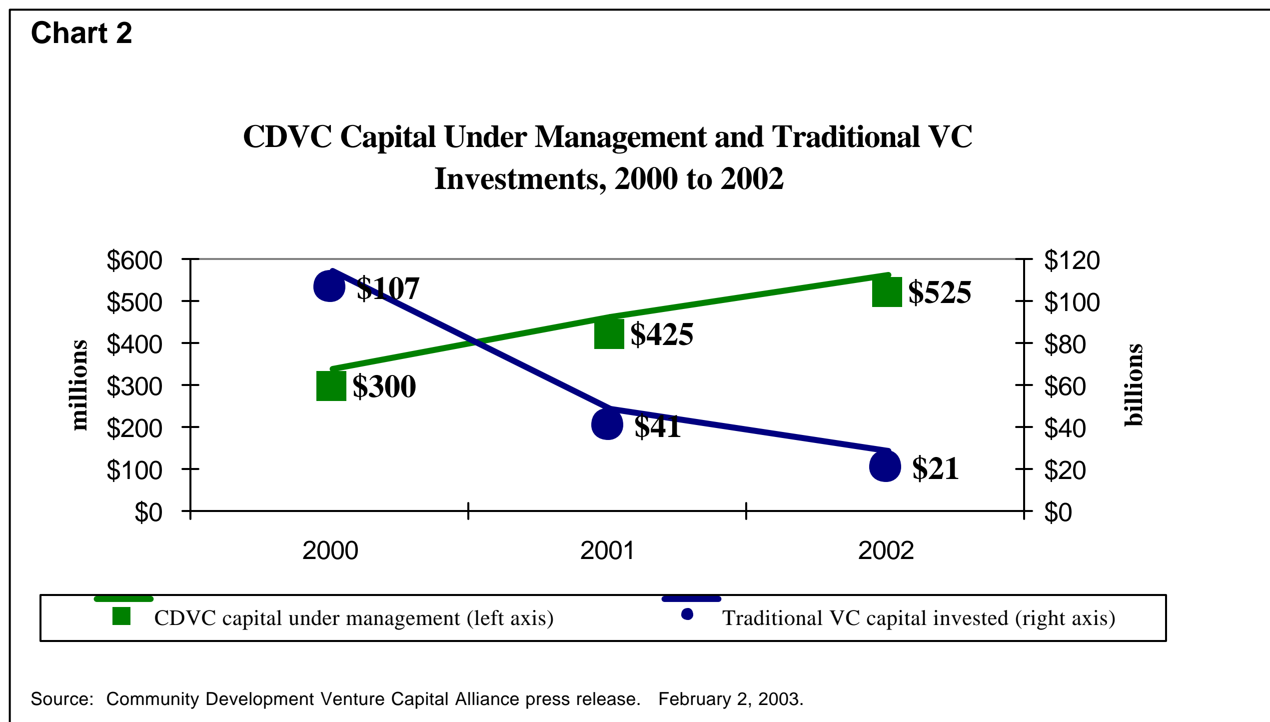
Chart 2 plots trends in CDVC managed capital and venture capital investments from 2000 through 2002. While the traditional venture capital industry dwarfs CDVC, the changes over the past three years are startling. Although the slowdown and fallout from 9/11 have affected

CDVC funds, start-ups are not dropping off and managed capital has increased dramatically. In the current economic environment, where raising money is difficult, CDVC funds on the whole have performed very well.

In general, the attractiveness of socially responsible investments and double bottom line returns has contributed to this positive performance. Also contributing is a marked shift in emphasis by some funds toward expanded capitalization, bigger deals, and increased geographic scope – trends that point toward increasing opportunities and deal flow. The partnership model used by both CCIFs and CDVC funds undoubtedly facilitates performance, as illustrated by the case studies in Section V. The partnership model helps ensure that investments are fully understood and vetted and that all necessary resources – financial and nonfinancial – are brought to bear. Three funds began raising second rounds in 2001.

Banks will continue as the major source of CDVC funds, not only to earn CRA credit, but also because CDVC investment helps expand and develop new markets for bank services. Foundations will continue to provide grant and PRI funding; however, their relative contribution may diminish with the recent stock market-driven diminution of endowments as well as the probable increase in capital from institutional investors, especially pension funds should the scale of their investment needs be matched by larger community development opportunities. Federal, state, and local contributions, which have grown more modest over time, has become more significant with the advent of the CDFI fund (through the Core Awards Program), the New Markets Venture Capital program of the Small Business Administration, and the U.S. Treasury Department's New Markets Tax Credit Program. In addition, in order to assure adequate levels of social returns, it is likely that funds will also increasingly turn to programs such as the NY State Department Insurance tax credit program for that allows insurance companies to contribute to a Certified Capital Company (CAPCO) that invests in small businesses in exchange for tax credits.

Chart 2



Source: Community Development Venture Capital Alliance press release. February 2, 2003.

SECTION V. CASE STUDIES

Overview

The universe of funds that exemplify new models for increasing the flow of private capital to community development is not easy to define. CDVC funds may be included in this group along with funds that classify themselves as CCIFs. Some CCIFs may function identically to CDVC funds, while others may have functions more analogous to community development loan funds, or they may involve elements of both. Other types of emerging entities that have similar purposes and strategies may also be included in this group. This paper focuses on those funds that regard themselves as CCIFs or that serve as models for CCIFs and CDVC funds. The funds described in the pages that follow were selected on the basis of their relative maturity (compared to other similar funds, many of which are less than two years old) as well as their corporate civic investment foci and CDVC-type operations.

Brief case studies are presented on these funds, as information has not been consistently or systematically collected due to the immaturity of the funds and their consequent lack of performance outcomes. As noted in Section IV, industry associations such as the CDVCA and the NCCA have begun to monitor and collect data on the CDVC and the CDFI industries respectively. As funds complete their full investment cycles, it will be possible to compare investments and double bottom line outcomes across funds and over time. At present, the case study approach remains the best option for exploring fund characteristics, emerging outcomes, and their potential to address the problems of low-income households and communities. Table I following the case studies summarizes the major characteristics of each fund profiled.

The purpose here is to paint a broad picture, suggestive of how these types of funds – working through partnerships – are starting to fill a gaping need in the community development finance industry. The studies are provided to show ways in which these funds act as catalysts to increased private funding – as well as to transfer business practices and management advisory services to firms that otherwise would never have to access that kind of assistance. The funds highlighted include two rural CDVC funds that have established track records and have been successful in nurturing the revitalization of economically distressed regions. The two have similar approaches, centering on the provision of equity capital. Four funds are also included that target city-specific revitalization working under corporate civic alliances and demonstrate the range of investment strategies and vehicles for metropolitan areas. Finally, two other large city funds that began with more explicit venture capital objectives are included in order to show how for-profit funds looking for commercial rate returns function in achieving double bottom line returns.

The Bay Area Council's Family of Funds, San Francisco

Today, the Bay Area Council is a business-sponsored, CEO-led organization that serves as the umbrella organization for the Bay Area Family of Funds – a relatively new, privately financed initiative to revitalize targeted areas of poverty and distress within the San Francisco region. Founded in 1945, the Bay Area Council has worked to develop the region's infrastructure while

working with economic development organizations, community groups, and government officials to leverage investments and address the challenges that impact the business community.

In the mid-1990s, the Bay Area Council initiated an ongoing process of assessing the regions strengths and weaknesses, and benchmarking those characteristics to other major areas of the country. Initially, this process identified five key challenges to maintaining both a competitive business environment in the region and the region's long-term economic well-being. Challenges included: the cost and availability of housing, especially in proximity to jobs; the overly congested transportation system; environmental concerns (primarily in brownfields areas); increasing poverty; and education quality and workforce preparation. These challenges suggested the need for a more integrated approach to regional development.

At the same time, a multi-stakeholder coalition – including the Bay Area Council – was being formed to develop and implement a sustainability action plan for the region that centered on creation of a prosperous Economy, a quality Environment, and social Equity. As a key element of this process, stakeholders focused on the resources that could be brought to bear to alleviate pockets of persistent poverty within the area. This concern led to the creation of the Community Capital Investment Initiative (CCII), which seeks to attract private investment to pockets of extreme poverty, working in partnership with local communities.

CCII aims to alleviate poverty and promote smart growth, using market-based solutions and drawing on the resources of Bay Area business leaders in partnership with the leaders of community, government, and environmental organizations. The key goal is twofold: 1) promoting large-scale investments in pivotal projects that generate livable wage jobs and community revitalization while 2) providing equity investments in 46 of the poorest Bay Area neighborhoods. CCII is co-chaired by Sunne Wright McPeak, the President and CEO of the Bay Area Council and by James Head, President of the National Economic Development and Law Center. This leadership structure ensures that both business and community interests are represented through the initiative.

The decision to establish an investment fund arose from the CCII resource assessment as well as from the revitalization needs associated with 12 area military base closures. Both pointed to the need for more capital to be available to distressed neighborhoods within the region. In 1999, after conferring with major employers and fiscal intermediaries such as the Local Initiative Support Corporation, the National Housing Trust Fund, pensions funds, and insurance companies, and after realizing that no source currently existed for financing in this area, CCII began the process of establishing its own source. Working with two related fund efforts, CCII developed a memorandum of understanding among various partners and stakeholders, and began to capitalize three funds that became known as the Bay Area Family of Funds.

Organization Structure

The Bay Area Family of Funds is coordinated through an Executive Coordinating Committee, housed in the Bay Area Council. Each fund has representation on the Executive Coordinating Committee, along with representatives from CCII and the primary investors. The Managing Director for the CCII Business Council and the Family of Funds is also housed in the Bay Area Council.

Fund Structure

While CCII presents keystone developments and business investments that meet its criteria to all three funds, each fund has its own organizational structure and fund managers who make final investment decisions. Although the Bay Area Council hopes to have greater diversification in its capitalization structure and sources in the future, banks currently dominate capitalization of the funds.

- The Bay Area Smart Growth Fund makes equity, equity-related, and debt investments in real estate developments in the 46 neighborhoods in the Bay Area with the most concentrated and persistent levels of poverty, as well as in areas affected by military base closings. This includes investment in mixed-use and mixed-income projects and commercial, housing, and industrial projects that can be made commercially viable but are not sufficiently attractive to private developers. The Smart Growth Fund is managed by Pacific Coast Capital Partners, which was selected through a nationwide search and at the time of selection had experience in managing $5 billion in real estate portfolios. The fund is organized as a Limited Liability Corporation (LLC) sponsored by the Bay Area Council. The $66.5 million raised for the Smart Growth Fund has come primarily from CRA-motivated banks (accounting for 70 percent of funds raised to date) insurance companies and a foundation.

The Bay Area Family of Funds
- Bay Area Smart Growth Fund: Real estate investment
- Bay Area Community Equity Fund: Business development
- California Environmental Redevelopment Fund (CERF): Environmental remediation and redevelopment

- The Bay Area Community Equity Fund operates as a community development venture capital fund and invests equity in profitable growing businesses capable of generating substantial job and wealth creation in the 46 target neighborhoods. The fund closed in 2002 with $45 million but ultimately is expected to be capitalized at $75 to $100. The projected rate of return is blended:

  - Ten percent of the fund is held as patient equity, in a manner similar to many community development projects, investing in smaller businesses which are essential to the development of a neighborhood;

  - Ninety percent of the fund targets emerging growth companies in primary consumer specialty products, technology and healthcare sectors, which are in mid or late stages.

  - The Fund managers have agreed to share their profits with the Bay Area Alliance for Community Development, since Bay Area community organizations will provide the Fund's entrepreneurs with additional support such as job training and site location assistance that help to ensure that the investment's social returns are met. JP Morgan, H&Q, which will invest at least $5 million of its own capital, manages the fund. The asset management fee is 2.5 percent per year, with 2 percent to the manager and 0.5 percent to the Bay Area Council.

- The California Environmental Redevelopment Fund (CERF) invests in environmental remediation and redevelopment through the state of California. CERF had its first closing at $36.3 million. Investors will invest $50 million to $75 million in debt and equity in the fund, which will in turn be invested, primarily in the form of debt, in environmental clean-

up activities. CERF projects high single digit returns. Twenty-five percent of CERF funds are targeted to the Bay Area.

The three funds in the Family of Funds reinforce each other to produce economically viable market rates of return while reducing risk for each individual fund. The memorandum of understanding governs this relationship; the three funds work together to raise money as well as to support their individual portfolio investment. For example, CERF will clean up land for the Smart Growth Fund while the Smart Growth Fund invests in the creation of space for growing firms financing by the Community Equity Fund.

Investment Strategy

Each fund is managed differently. Most of the money invested in all three funds, however, is intended to make money, not just to address regional concerns. The funds aim to deliver a double bottom line, providing investors with competitive market rates of return while producing substantial, measurable community benefits for distressed neighborhoods and the region as a whole. Each fund will operate guided by financial, social, and environmental investment criteria that are consistent with CCII due diligence criteria.

The specific criteria for the Smart Growth fund are delineated in the Bay Area Smart Growth Fund Draft Term Sheet. Deals for the Smart Growth fund will range from $5 to $15 million of equity and/or debt, with a projected financial rate of return from the mid to high teens. Emphasis is placed on development projects that provide an economic engine in the 46 target neighborhoods and those that offer investors the best opportunities for capital appreciation. To be considered for investment, real estate development projects must be in neighborhoods in which family incomes are less than 80% of the median family incomes in the surrounding county. The Investment Manager develops targeted marketing strategies appropriate to the particular demographics, culture, and infrastructure of several key regions in the Bay Area. The Fund has the flexibility to make any appropriate investment involving equity or debt, including mezzanine capital with equity components. Potential portfolio projects are generally in partnership with a developer with a demonstrated capacity to manage increasingly complex commercial, industrial, and mixed-use development projects. Special consideration is given to developers indigenous to the community who are capable of producing risk-adjusted returns expected of the Fund. Joint ventures with community partners are also given priority.

The Smart Growth Fund targets its investments geographically and takes into account the composition of the development team for projects, the benefit to the community, the involvement of the community in investment decision-making, and connections to existing local initiatives, in addition to the monitoring and evaluation of the Fund's performance (Plastrik 2003).

The ninety percent of the Community Equity Fund's financing that supports mid to late stage growth companies is expected to make investments ranging from $3 million to $5 million, with projected financial returns that track historical venture capital returns of 15 to 20 percent. The remaining ten percent of the Fund will be invested as patient capital, the deals for which investment are expected to range from less then $1 million. Investments for the CERF are limited to $5 million for any deal and currently have a projected financial return of 9 percent. These project rates of return, however, are subject to fluctuation as the Family of Funds offers market rate returns on investments.

The Executive Coordinating Committee utilizes a number of social criteria it looks at when making investment decisions. First, it seeks investments that create livable wage jobs and/or jobs with upward potential for low-income persons and low- income persons in distressed communities. The funds also look to invest in enterprises owned by minorities and women, and enterprises whose business operations or products have positive social and environmental impacts. Each investment includes a plan for producing social benefits. And although the benefits are goals, not mandates, fund managers are required to demonstrate substantial compliance with social criteria.

Exit strategies include the repurchase of stock by the portfolio company; repayment of subordinated debt by the company; mergers; complete or partial acquisition, or initial public offerings that provide higher rates of return. One key metric for success, in fact, is that the fund financing can be replaced with mainstream financing.

Outcomes

Although all three funds are too new to be able to generate returns and other outcomes, the Family of Funds has seen success in the working of its partnerships and thus far in its investment decisions. One major reason for its success is the decade-long close working relationship among the key actors in the fund development. In addition, foundations like the James Irvine, Ford, MacArthur, Hewlett, Bank of America, Turner, and Surdna Foundations have supported the fund development through research and feasibility assessments, capacity-building/operating funds, grants for design of funds, money for the fund-building effort, and initial investments in the funds themselves.

The Cincinnati Equity Fund

Cincinnati Equity Fund (CEF) is a private fund specializing in gap financing of real estate projects considered critical to the revitalization of downtown Cincinnati. The fund began its operations in May 1996, but the efforts to start the fund began several years earlier. David Phillips[4], the chairman of Downtown Cincinnati Inc. (DCI), recognized the need for a separate private pool of investment capital. His vision was reinforced by studies conducted in Cincinnati and other cities that indicated that a private equity fund moving in a non-governmental direction and applying financial screens in addition to social screens ("double button line") would attract many new investors.

Proctor & Gamble and some major local real estate developers supported Phillips' idea. Proctor & Gamble was concerned about lack of development around the center of the city. The company initially considered providing grants, but later realized that a private fund would make a more significant contribution toward downtown development. Other corporate executives, such as Neil and Arn Bortz of Towne Properties, also felt that further private development was necessary to support existing downtown properties.

Recognizing their common objective, DCI, Proctor & Gamble and Towne Properties joined efforts to develop a business plan for the fund and to solicit investments from companies committed to revitalization of downtown. Their joint efforts subsequently led to the creation of the fund.

[4] David Phillips is also a retired partner at Proctor & Gamble.

Organization Structure

CEF is a for-profit investment organization. The fund manager, Steve Massie, emphasizes that while CEF is affiliated and works closely with DCI, which is a non-profit service and advocacy organization, the fund is a separate and distinct entity that expects a return on its investments.

Similar to other comparable funds, CEF's full time staff is small, consisting of only two employees. The fund manager identifies investment opportunities, evaluates proposals and conducts due diligence analysis. The Board of Directors oversees the fund's operations and approves all investment decisions. The Board consists of nine members – seven are fund investors, one is a real estate expert, and one is the "community member" with finance background.

Fund Structure

CEF is currently capitalized at $46 million. These investments were raised in the initial round of funding from corporate investors. Proctor & Gamble contributed approximately 50 percent of investments. The minimum investment requirement was $250,000. The fund opted not to raise any government or foundation funding.

Selected CEF Investors

- The Proctor & Gamble Co.
- Bank One, N.A.
- Cintas Corporation
- KeyCorp
- PNC Bank
- Taft Broadcasting Company
- The Western-Southern Life Insurance
- Cincinnati Development Group

CEF is an evergreen fund, in which realized gains are reinvested in new projects. The investors made an unsecured loan to the fund for a period of twenty-five years and expect only nominal returns on their investments. An option to share profits on current projects was considered, but the Board of Directors voted to reinvest all profits to maximize funds available for revitalization.

In 2001, the fund planned to conduct a second round of funding. Because of the economic downturn and low demand for new developments, the second round was not initiated.

Investment Strategy

- CEF provides loans for real estate projects critical to downtown revitalization. Projects can include new real estate developments or redevelopment. The fund however does not conduct real estate transactions (buying and selling properties). CEF invests exclusively in the Cincinnati Central Business District and adjacent areas. CEF has a very effective investment strategy because investments in the limited geographic area tend to reinforce each other.

- CEF uses a variety of investment vehicles. The fund serving as either primary or secondary lender determines the investment mechanisms based on the needs of each particular projects, including equity, land leases, options, guarantees, or equity and debt interests.

- CEF only invests in projects if other sources of funding are not available. The fund does not compete with other private or public sources of capital.

- CEF leverages its resources to finance as many projects as possible. To accomplish this goal the fund participates only in small percentage of any particular project and serves as a "gap" lender. The fund does not invest more than 20 percent of its capital in any single project. The fund usually makes only short-term investments but will consider

long-term investment if a project is deemed worthwhile in terms of its social, economic and financial outcomes.

- Consistent with its civic mission, CEF has stringent requirements on construction quality. The fund also will not participate in changing architecturally significant buildings.

- CEF requires all applicants to submit a business plan. The plans must outline financing plan, reasons why CEF financing is needed, repayment plan, and anticipated returns to the fund

Investments To Date

CEF's investments are not focused on any specific property type. To date investments have included residential, office and retail spaces and even a sports arena. The fund, however, does not invest in subsidized housing because many other sources, such as government grants, are available to fund these types of development. The current economic downturn in the past year forced the fund to slightly shift the concentration of its investment towards the residential market as the demand for new office space has decreased. As of February 2003 the fund has committed over $26 million to15 projects.

Selected CEF Downtown Projects
- Gano Alley Commercial Property
- 235 E. 8th St. Lofts (apartments)
- 17th E. 8th Street (commercial and apartments)
- Palomino Euro Bistro (restaurant)
- Cincinnati Convention Center
- Emery Center (apartments)
- The Power Building (commercial, parking, and apartments)

Non-Financial Assistance

To ensure that CEF participates only in small percentage of any particular project, the fund assists developers in finding additional sources of funding. The fund helps them identify tax credit opportunities, public funding sources, and connects them to potential senior lenders. This networking function has been especially valuable to CEF clients.

Outcomes

Financial Outcomes

Three loans made by CEF have paid in off in full so far and one loan was written off. Other loans are in the process of repayment but some did not perform as well as expected. One of the major reasons some loans have not been paying off is the repayment structure for some deals where the borrower guarantees the fund a percentage of the project's cash flow once a specified level of cash flow is reached. A few borrowers have not been able to generate enough profit to reach the required level of cash flows so far.

Social/Civic Outcomes

CEF helped fund projects that have resulted in hundreds of thousands of square feet of vacant and non-productive real estate downtown Cincinnati being reclaimed and renovated. According to the fund manager Steve Massie, the projects funded in part by CEF had the following cumulative impact:

- 416 apartment units funded

- 27,000 office square footage funded

- 100,000 commercial/retail/entertainment square footage funded[5]

Cleveland Tomorrow and the Cleveland Investment Funds

Cleveland's economic decline, starting in the 1960s with the deterioration of the manufacturing industry has been well-documented. Between 1950 and 1980, the city's population plummeted by 40 percent. As noted by Austin (1998), unemployment within the city rose, incomes dropped, the poor nonwhite population became the city's majority, crime increased, racial tensions exploded, the tax base eroded dramatically, budget deficits increased, and the quality of the school system declined. Ultimately, in 1978, Cleveland defaulted on its loans – taking the city from the brink well into a crisis situation.

In response, Cleveland's business leaders began to form the Cleveland Tomorrow project in 1980, operating with a grant from the Gund Foundation and pro bono economic assistance from McKinsey. The original core of Cleveland Tomorrow consisted of 36 CEOs whose mission was to define an agenda for action to help address the City's economic and social woes. The rationale behind the CEO focus of Cleveland Tomorrow was to amass the strategic vision of major players in the local economy, as well as their capacities to direct financial and nonfinancial resources towards Cleveland Tomorrow's evolving recovery agenda. Cleveland Tomorrow was formed as a nonprofit corporation, with member dues ranging from $7,000 to $30,000.

As became the case in other similar civic efforts, Cleveland Tomorrow initiated its agenda with research to diagnose the City's problems and to start to outline solutions, focusing on major constraints to economic revitalization. The McKinsey team that provided pro bono services also had conducted a similar study for the New York City Partnership. As has been the case with other efforts to engender revitalization, Cleveland Tomorrow articulated its mission as a catalyst for economic recovery. In practice, this mission indicated a heavy reliance on partnerships with business, nonprofits, and all levels of government in order to achieve its objectives. In order to function as a catalyst to investment, Cleveland Tomorrow's strategy became mobilization of partner capital by leveraging the organization's financial resources as well as its contacts and influence.

Today, because Cleveland Tomorrow is limited to CEO membership, the organization has sometimes has been perceived as elitist and exclusive (CEOs for Cities website). Given the current environment around the corporate scandals, this criticism may sharpen for many of the corporate-allied funds. This context highlights the continuing need for working with broad-based partnerships as a critical strategy for Cleveland Tomorrow and other similar organizations in carrying out their mission and projects.

The partnership focus has been especially important in terms of Cleveland Tomorrow's and its subsidiaries' investments. Among the many other projects undertaken by or facilitated by Cleveland Tomorrow are those undertaken by three investment funds. These are listed below with their recent levels of committed capital.

- Primus Venture Partners ($350 million venture capital fund)

[5] Does not include Firstar Center, the sports arena that was a write-off investment.

- Cleveland Development Partnership ($60 million real estate development fund)
- Cleveland Civic Vision Housing Fund ($15 million in capital)

Of these initiatives, the Cleveland Development Partnership (CDP) not only has been corporate led, but also has had a social investment purpose. For that reason, this case study focuses on CDP and the relatively new Cleveland Civic Vision Housing Fund. Primus Venture Partners today functions as a separate, traditional venture entity.

Organization Structure

In 1989, Cleveland Tomorrow began to explore real estate investments that would catalyze regeneration, working through the physical development initiative of the organization. Cleveland Development Advisors was established as a for-profit entity to fund real estate-oriented developments that would provide infrastructure for the expansion of industries, such as entertainment, that concentrated in the central city area. Although for-profit, Cleveland Development Advisors (CDA) worked with a "more modest expectation of profit" than other commercial development entities.

Today CDA has a board of nine members, many of whom are Cleveland Tomorrow members or related to the umbrella organization. The board and executive staff of the fund conduct their processes with the discipline of a for-profit firm and secure their investments similarly, but do so with a degree of flexibility that helps bring their investment opportunities to fruition. CDA most often is a lender, but they also are allowed to provide equity or near equity financing. Like other dual bottom line-type funds, CDA offers returns but at a below-market rate.

The small staff of 2 professionals provides market research and other due diligence services to potential investment opportunities as well as provides general planning advice and facilitation to get projects underway prior to looking for mainstream financing.

Fund Structure

CDA operates several distinct funds. Cleveland Development Partnership I was capitalized in 1990 at roughly $45 million, followed by a second round, Cleveland Development partnership II in 1995, capitalized at $15 million. Investors were explicitly made aware that the funds would be lending out in relatively risky positions. As a result, some investors made their contributions directly to the nonprofit Cleveland Tomorrow, some wrote them off, while others still retain on their books as investments. The minimum contribution to CDPI was $500,000 and to CDPII was $250,000. The minimum contribution declined for the second round due to the fund's smaller target size of $20 million, because the first round was scaled upwards in anticipation of a large-scale investment in a sports arena, and because many of the investors for the second round had contributed to the first round.

In 2000, CDA created the Cleveland Civic Vision Housing Fund. Although the CDP funds had been involved in housing investments – and in fact housing had been one of their portfolios' better performing investments – the CDP investments had taken on subordinated fund roles. Moreover, in the early 1990s, returns on housing for the funds were very low – in the range of 2 percent to 3 percent. By the late 1990s, returns for CDA types of housing investments were

averaging 6 percent to 8 percent. Thus, CDA established a third fund solely focused on housing investment.

Due to the economic environment after 2000, CDA felt they could not raise money as they had for the earlier funds. The Civic Vision Housing Fund was capitalized at $15 million, with two types of investors: 1) a $10 million pool of Class A investors who receive preferred returns of 225 basis points off the 10 year Treasury rate (effectively yielding 8 percent) and 2) a less risky Class B fund capitalized with $5 million from CDP, the Fannie Mae Foundation through CDP, and CRA conscious banks. The return on the Class B funds is roughly 3 percent. Civic Vision takes these two sources and blends them to provide a 6 percent to 7 percent return. The fund already has a track record, having paid back some of the original investments. When principal is paid, it is returned to the investors, thus operating like a mainstream real estate fund, but on a shorter time frame than purely private funds.

Investment Strategy

Both funds look to investments that improve the physical infrastructure of the city in a way that facilitates or promotes expanded investment in the area.

Investments To Date

Civic Vision has 10 investments. None have been written off to date and two loans will pay back this year. CDP has 56 loans outstanding. They have written off only two, although they have reserved against several others. Of the two written off, one was an early $28 million loan in 1990 to build Jacobs Field, a spectacularly large loss for the fund but one which quickly focused their investments on smaller scale, less risky avenues to promote Cleveland's revitalization. A second sports facility investment has been successful, but today CDP looks to smaller, more diversified real estate investments.

Outcomes

The funds anticipate that their investments will generate social and economic benefits, allowing businesses to locate and expand which in turn generates jobs and housing and promotes area revitalization. However, neither fund tracks social outcomes. With a small staff and social outcomes that are indirect, the social bottom line is not currently quantified.

Detroit Investment Fund

The Detroit Renaissance was formed in 1970 to provide financing to "brick and mortar" projects addressing the strategic needs of the City of Detroit. The Detroit Renaissance is a non-profit civic organization comprised of CEOs from the big three automotive companies, banks, utilities, large retailers, and other major companies in the region.

Initially, the Detroit Renaissance undertook investment activities, including the development of the Renaissance Center—one of the largest privately financed real estate projects in history. However, inflationary economic conditions during the early 1980s made investing in real estate development difficult. As a result, that aspect of the agenda became stagnant. Recognizing that physical development is not the only way to improve the quality of life in a city, the Detroit Renaissance changed direction to showcase the city through events, rather than direct investments. Events planned and sponsored by the Detroit Renaissance included the Detroit Grand Prix, the Montreux Detroit Jazz Festival, and the International Freedom Festival.

The organization changed focus again in the early 1990s based on a consultant's report that the group could have a greater impact on the city by focusing on areas of "strategic importance." It concluded that while event management certainly produces benefits for the City of Detroit, it should not be the main focus of the organization. The organization realized that by offering subordinated debt, it could invest in projects, create returns, and advance development with a more sustainable impact. The organization also placed supporting and partnering with local banks as important aspects of its new community investment strategy.

Subsequently, it created the Detroit Investment Fund (DIF), which began activity in 1996, as a for-profit venture capital agency to raise funds and invest in projects in the City of Detroit. In addition to supporting physical and economic development, the Detroit Renaissance now also reviews and takes positions on public policy questions that are relevant to its agenda.

Organization Structure

Currently, DIF functions with a full-time staff of five, a Board of Directors, and an Investment Oversight Committee. In 2002, its operating expenses were approximately $1 million. The 17-member Investment Oversight Committee must approve all projects. Proposed investments undergo an extensive economic development impact review. First, staff members generate internal write-ups that assess the economic development impact based on a checklist that weighs factors such as the project's affect on the tax base and job creation. During the second step of the process, this information is compiled and pitched to the Investment Oversight Committee. Qualified proposals undergo additional vetting with further due diligence by committee members and, in some cases, third-party reviews. For accepted investment proposals, committee members, who work on a pro bono basis, provide extensive mentoring assistance to accepted projects.

Fund Structure

Like the Pittsburgh Strategic Investment Fund, DIF is a for-profit entity that provides patient capital for community and economic development projects meeting its investment criteria. Investments by 27 members of the Detroit Renaissance raised an initial capitalization of $52 million in 1995. Corporations were the main source of investments. While there was no minimum investment, investors were required to provide either 100 percent of their promised funding or at least 25 percent and pay in the rest at the federal funds rate. Investors receive a nominal rate of return. DIF is planning to capitalize a second round of funding in 2005.

Investment Strategy

For the first three years after capitalization, DIF invested primarily in early stage businesses. Ironically, the leadership at that time had a background in real estate, but chose to pursue business ventures. Of the 12 transactions, 11 were industrial/commercial. However, this strategy was not successful. The fund received a high number of defaults on loan payments and wrote off $5 million in 2001. Under the leadership of a new president who actually had a background in business finance, DIF shifted gears to do more real estate investments. It continued to do provide loans to some business ventures, but only more mature companies. Since 1998, the fund has undertaken 12 transactions, 11 of which were in real estate—a complete flip-flop from its earlier investment strategy. The current president, David Blaszkiewicz, joined the fund after being CFO of the Detroit Renaissance.

The fund makes subordinated loan investments between $500,000 and $3 million. However, according to President David Blaszkiewicz, it considers the best, so-called "sweet-spot," investments to be between one and two million dollars. Along those lines, DIF no longer looks

for big "home-run" investments that carry a higher risk of making or breaking it. Instead, the fund seeks smaller, "base-hit" projects where gap financing from the organization helps leverage owner equity. These types of projects also have lower default rates. To address the needs of small businesses that face obstacles to traditional financing, DIF and the Detroit Renaissance started the Detroit Community Loan Fund (DCLF), in which DIF invested one million dollars. Motor City Casino and National City, CDC provided additional funds. DCLF provides business loans primarily between $75,000 and $100,000.

The fund undertakes a 40-40-20 strategy in real estate, business growth, and strategic projects, respectively, to manage its portfolio. Recognizing that quality real estate development and redevelopment are essential to Detroit's revitalization, the fund works closely with professional real estate developers to invest in both commercial and residential opportunities in areas of demonstrable growth. DIF also invests in well-managed, growth-oriented companies in order to promote job creation and expand the tax base in the city. Strategic projects are defined as ones that are critical to Detroit's revitalization over the long-run, even if they don't produce the highest returns over the short-term. In addition, DIF only invests in projects within the Detroit city limits, focusing mainly on revitalizing the downtown core area.

Investments To Date

As discussed earlier, DIF invests in a wide range of projects and offers several types of loan products. Examples include the Inn on Ferry Street, to which DIF provided a revolving construction line of credit to bridge the timing requirements for draws off of a Section 108 loan. Based in several cities, including Pittsburgh, Philadelphia, and Cleveland, the Allegheny Child Care Academy (ACCA) provides subsidized childcare in low-income areas. For the ACCA centers in Detroit, DIF provided financing for operations and renovations. Other investments have included financing for mixed-use developments, predevelopment financing for housing, and financing for the expansion of distribution for Stroh's Ice Cream.

Outcomes

The fund is currently working on measuring the social outcomes of its investments on the community and does not yet have any data. In terms of financial performance, DIF hasn't written off anything since 2001. At year-end 2002, it had made $7.2 million worth of investments and expects to increase that figure to $17.2 million by the end of 2003. As there has not yet been any assessment of how DIF investments have impacted the community, the outcomes are described in terms of lessons learned by the fund. The overarching theme is that a more sustainable impact can be achieved by investing in smaller, lower risk projects than shopping around for one shining star, according to the fund president. In addition, while subordinated debt may not be perceived as a high yield particularly glamorous financing activity, it generates a high positive impact by supporting regional banks by making up the gap between amounts needed and offered by traditional financing.

Kentucky Highlands Investment Corporation

The Kentucky Highlands Investment Corporation (KHIC) is the oldest and largest community development venture capital fund and is widely regarded as a model for effective rural economic development. The Kentucky Highlands Investment Corporation (KHIC) was formed under the name Job Start in 1968, with goals of stimulating growth and creating employment opportunities in the nine counties of Bell, Clay, Clinton, Harlan, Jackson, McCreary, Rockcastle, Wayne, and

Whitley in Southeastern Kentucky.[6] The geography of the initial corporation was determined by the service areas of the six participating community action agencies.

As one of the original Title VII Community Development Corporations (CDCs) funded by the federal Office of Economic Opportunity, KHIC was also one of the first CDCs to make equity investments in externally owned companies. At that time of its formation, there were few job opportunities in the region outside of the local school systems, farms, and coalmines. KHIC was based on the premise that economic growth was the only way to realize significant poverty reduction in the area. As a result, the organization took on the challenge of both developing businesses that provide job opportunities and discovering entrepreneurs who could lead the businesses.

In 1972, KHIC initiated its first venture capital efforts. With the help of grants from the federal Office of Economic Opportunity and a contract with the Institute for New Enterprise Development, KHIC began a program that found the most promising aspiring entrepreneurs and financed new businesses located in the target area and committed to hiring unemployed residents. In return for start-up capital and a reasonable financing package, KHIC took ownership positions, a process that began to be known as "development venture capital", distinguished from traditional venture capital investing by active participation in the management of the business and by the investments' social criteria. Today, KHIC also develops industrial property, operates a business incubator on-site and maintains a public business library and telecommunications center in the building to further assist its small businesses.

KHIC continues to operate in an environment in need of economic revival; its nine-county target area has lost about 200,000 jobs over the past 10 years. Most of the area's residents had held jobs in sewing, coalmines, or tobacco, or were on public assistance. The decline of the coal and tobacco industries - combined with the passage of NAFTA (which reduced employment in the area’s textile industry) and the overall decline in public assistance - left the area in need of economic restructuring and stimulus. KHIC seeks to facilitate that process.

Organization Structure

KHIC is organized as a nonprofit corporation. It was founded as a 501(c)(3) organization, but soon found that it could not fulfill the IRS requirement that the organization receives 30 percent of its operating revenues from grants. The parent company KHIC converted to a 501(c)(4), which prevents the organization from giving tax deductions for charitable donations. In response, KHIC set up a subsidiary Kentucky Highlands Community Development Corporation as a 501(c)(3) community development program. KHIC has two other subsidiaries: the Kentucky Highlands Management Corporation and the Kentucky Highlands Development Corporation. The Management Corporation is a for-profit corporation that serves as a corporate barrier between KHDC and the advice given by the KHIC employees or volunteers assigned to provide technical assistance to companies. Advisory services are fee compensated. The Kentucky Highlands Development Corporation is a for-profit holding company with two of its own subsidiaries: Mountain Ventures, Inc., a for profit SBIC that makes venture capital investments; and the Kentucky Highlands Real Estate Corporation, a for-profit that develops and maintains an inventory of available industrial sites and buildings that it leases or sells KHIC business opportunities.

[6] The name of Job Start was switched to the Kentucky Highlands Investment Corporation in 1975 in order to emphasize its business development-oriented mission, and the target area is currently (2003) 12 counties in Kentucky.

KHIC is governed by a seventeen-member Board of Directors whose professions range from a high school janitor to a District judge and includes a state highway worker, a small farmer, bankers, employees of the state, and college professors. The Board is responsible for approving and overseeing all investments made by the KHIC. The Board is self-appointed and thirty percent of its members are low-income individuals. Jerry Rickett, President of KHIC, describes the board of directors as a "committed and diverse group of individuals who have been critical to the success of KHIC." KHIC additionally maintains a staff of 17 employees.

When an entrepreneur or a management team approaches KHIC about a potential investment, the process begins with a staff member reviewing the business plan. If the plan is complete, the staff member proceeds with due diligence. If the plan is incomplete but the staff member has confidence in the management of the plan, KHIC helps to revise and complete the business plan before proceeding with due diligence. The due diligence process includes an evaluation of a company's management, market, customers, and supply of necessary inputs (raw material, equipment, labor, and capital). It also includes a review of the financial structure of the business as well as contacting potential co-investors. Once a deal passes due diligence, a recommendation is made to the KHIC board.

KHIC was one of the seven New Markets Venture Capital companies approved by the U.S. Small Business Administration, is a core member of the Rural Local Initiatives Support Corporation, holds a Small Business Investment Corporation (SBIC) license from the SBA, was one of the original Community Development Financial Institutions (CDFI) approved by the U.S. Treasury Department, was one of the eight rural Tax Credit CDC's, and was the first non-bank lender in the nation approved by the U.S. Department of Agriculture's Business & Industry Guarantee program.

Fund Structure

KIHIC has received over $14 million in federal money through the Title VII program. While there was a period in the 1980s when KHIC has received no public funding at all, the organization more recently has accepted grants from HUD and OCS, including grants for Enterprise Zone development. In addition, KHIC received $30 million from the USDA for loan programs and funds from the SBA Microloan program. KHIC also works with the private sector to leverage funding, partnering with the Bankers Trust Company in a tax credit program and with 20/20 out of Oakridge, TN. It has also partnered with numerous CDCs to provide equity financing.

In 1994, KHIC worked with three counties to apply for one of three rural empowerment zones approved nationwide. They received $40 million and have now made $1 million in loans to farmers (150 loans), as well as loans to local communities for everything from vocational schools and learning centers to fire trucks or funding to find alternative crops. Thus far a total of $19 million has been loaned out and $2 million has been extended in grants.

Investment Strategy

KHIC provides wide variety of equity investments and loans for as little as $500 and as much as $5 million. They have experimented with the development of sector-specific strategies but found that their dire economic situation required the consideration of a broad spectrum of industry opportunities. While KHIC does not have a specific industry focus, it does look for manufacturing or other investments that provide higher quality jobs, considering both wages and benefits associated with the industries. Increasingly, KHIC is investing in more service-oriented businesses. For example, KHIC recently funded an adult day care organization that has hired 15 local people. KHIC is also willing to invest in businesses at all stages of development,

including the early start-ups. Most importantly, companies must be located, or willing to relocate, in the KHIC region and they must generate jobs for low-income residents of Appalachian Kentucky.

Investments To Date

KHIC provides equity financing and debt, ranging from $500 microloans up to $10 million guaranteed loans. Products range from secured term debt to revolving operating lines to convertible stock options.

Outcomes

Since its creation, KHIC has invested over $90 million in over 175 enterprises, which have created more than 8,000 jobs in the area. The companies that KHIC has invested in have produced goods and services in excess of $1.6 billion, and paid more than $600 million in salaries and wages. These wages have produced an estimated $120 million in tax revenues. The 8,000 jobs comprise approximately 9.2 percent of the official labor force of the area. An estimated 10 percent of the households in the service area have an employee of a Kentucky Highlands Investment Corporation investee company. KHIC has partnerships with 38 groups, both local and national, that include foundations such as the Ford or MacArthur Foundations, as well as the Federal Home Loan Bank of Cincinnati. Of the many loans that KHIC has made, only three of them have struggled significantly, and only one loan total has been liquidated.

Northeast Ventures

Northeast Ventures (NEV) is a community development venture capital fund that was created in 1989 to be a catalyst to economic revitalization and job creation and to provide opportunities for local ownership and local control of businesses. NEV's investment initiatives are targeted to northeastern Minnesota, a rural region covering approximately a quarter of the state but with a population of only about 300,000 persons. Duluth (population 85,000) is the region's only city. The region's economy traditionally has been based on extractive and timber industries, providing raw products to other industries such as steel. As a result, the bulk of the value added from northeast Minnesota's industries accrued outside the region. According to Greg Sandbulte, President of Northeast Ventures Corporation -, this resulted in a situation where "most of the industries' leaders were located elsewhere – as a result there was no vibrant entrepreneurial tradition" within the region.

The idea for Northeast Ventures initially arose in the mid-1980s in response to the decimation of northeastern Minnesota's iron mining industry, which had accounted for over a third of the region's economy in mining and linked industries. Some areas had unemployment rates at the time of up to 75%. As the mining industry subsequently began to restructure, its employment requirements were less than half their previous levels.

Early on, Nick Smith, president of the region's largest law firm, identified the lack of equity capital as a major constraint on efforts to renew economic vitality and began to advocate for creation of a venture capital fund to nurture and support business opportunities with the potential to diversify and expand the regional economy. Northeast Ventures was proposed as a strategic intervention by private firms, foundations, and quasi-public entities to reduce the region's dependence on the mining industry in the face of reduced and fluctuating demand from

the steel industry for iron ore. That intervention was to provide equity capital to new and expanding businesses in the northeastern Minnesota region.

In 1985, the Charles K. Blandin Foundation initiated a conference of regional leaders from government, corporations, and concerned nonprofits that met over a three month period to generate “homegrown’ solutions to the region’s economic crisis, including the feasibility of the venture capital fund idea. A major outgrowth of this conference was seed funding support from the Blandin Foundation to explore establishment of the equity fund. Ultimately, in 1989, the Northeast Venture Corporation was established, with Nick Smith as president.

Organization Structure

Northeast Venture Corporation was begun as a holding company with two subsidiaries, the Northeast Venture Development Fund, a for-profit C corporation, and the Northeast Entrepreneur Fund (NEEF) a nonprofit originally established with a separate location and board of directors. Northeast Venture Development Fund thus was constituted as a permanent institution. The fund was to be evergreen, focusing on venture capital investments. Its mission remains “to provide a permanent source of accessible venture development capital, combining investment discipline with a nurturing and emphatic approach” (Northeast Ventures Report 1996).

In contrast, NEEF’ s mission centered on microenterprise development, providing loans and technical assistance to very small ventures. Its mission was to foster entrepreneurial spirit and encourage self-sufficiency through the growth of small businesses and self-employment opportunities for residents of the region.

Northeast Ventures Corporation began with five common stockholders (the Charles K. Blandin Foundation, Minnesota Power, Minnesota Technology, Inc., the Northland Foundation, and the Northwest Area Foundation) and a series of program-related investments from the Ford Foundation and the John D. and Catherine T. MacArthur Foundation. These investors provided $4.7 million in voting common stock (the bulk of which was allocated to the Northeast Ventures Development Fund) that is held by the same investors today. With other contributions such as foundation PRIs, NEV initial capitalization totaled $5 million. Although the original goal was to capitalize at $10 million by 1991, but that goal was not achieved until 1996 as the fund established a reputation and a track record.

In 1994, the holding company and the for-profit venture capital firm merged and became Northeast Ventures Corporation. The board of the development fund became the new corporation board. Two years later NEV incorporated Iron Range Ventures into is family of subsidiaries. Iron Range Ventures is a nonprofit structured to raise grant capital to support NEV’s activities. Iron Range is managed by NEV in exchange for a fee of 6 percent of Iron Range’s capital under management (RUPRI, 2001). In 1999, NEEF became a freestanding entity, although NEV elects the board of NEEF.

NEV operates this structure with a small, highly trained and experienced staff of six. The staff focuses on maintaining this structure and on its investment activities through a process of relationship-building. That focus underscores the long-term nature of NEV’s commitment to revitalization in the region. An NEV vice-president serves as the president of Iron Range Ventures.

Performing due diligence on opportunities is extremely labor-intensive with a small staff; however, the NEV staff performs these activities in-house. The NEV board also serves as its investment committee, providing a streamlined decision-making process. The board is required to authorize any investments greater than $25,000, although smaller investments can be made with the approval of the President and Chairperson only. The decision process averages three to four months.

Fund Structure

Today NEV has total committed capital of $15.7 million, with a goal of $25 million by 2005. Today, on the equity side, the fund operates with the original $4.7 million plus a CDFI component of $1.25 million invested in noncommon voting stock, plus approximately $6 million in PRI debt from the Ford and MacArthur Foundations. Iron Range Ventures operates under a $3.25 million in grants from CDFI and from the Iron Range Resources and Rehabilitation Board plus three small grants from the US Department of Housing and Urban Development.

NEV does not do debt financing (except as part of second round or interim financing to existing investees). Its investments have ranged from $10,000 to $300,000, with an average investment of $423,000 per company over time (RUPRI, 2001). While 85 percent of the fund's portfolio must include investments within the region, 15 percent can be invested outside the area. As a result, NEV has undertaken strategic investments in the Twin Cities area in order to establish partnerships with other equity investors. However, today, NEV focuses almost exclusively on companies that are or will be located in northeast Minnesota.

Investment Strategy

- NEV utilizes double bottom line investment criteria, and has from the outset of its operations. On the financial side, NEV would like to see expected internal rates of return of at least 25 percent. However, NEV will consider investments that promise significant job creation benefits but lower returns. There are no specific requirements for social criteria. No minimum wage level is set for expected jobs. Nevertheless, NEV expects portfolio companies to provide health insurance to fulltime employees (the programs do not have to be fully funded by the company however) and looks favorably on companies offering relatively higher wages. In addition, companies are required to identify potential employees through the Minnesota job service (RUPRI, 2001). Environmental impacts also can be considered.

- *NEV does not utilize sector-specific strategies.* Instead, NEV looks broadly for opportunities as over time they have found that their location limits deal flow. According to Gary Sandblute, NEV has become a generalist within a confined investment region. NEV looks to business concepts that are unique in some way and to companies that serve national or international markets. Given NEV's in-depth knowledge at this point of the region and what types of businesses are likely to work well there, casting a wide net is not as labor-intensive a strategy as it might be in more complex regions.

- NEV looks for companies that have good business reasons to operate in northeastern Minnesota, and who want to be there over the long-term.

- *NEV invests in firms at all stages of development, but increasingly focus on early stage and start-up investments.* Over time, NEV found that if they wanted to make good equity investments, they have to do so early on for investments in their region. Mid-range,

mezzanine-type investments were more difficult to nurture, as NEV found through early experience attempting to work with 29 later stage investment opportunities, only two of which were profitable. Today, NEV tells business to come in very early in their development cycle.

- *NEV does not do debt financing.* Their equity focus helps fill out the regional capital structure need. NEV chose not to provide subordinated loans, as do many other funds, because sources of debt financing existed at the time NEV was created.

- *NEV relies on interdependencies and partnership arrangements to identify opportunities and structure financing.* Since its inception, when the 1985 conference identified local leadership as a significant need through implementation of the equity fund as an accessible source of competent leadership and equity financing, NEV has recognized the benefits of working with a representative board and in association with other fund sources.

Investments To Date

As of mid-2002, NEV's portfolio investments totaled $7.7 million. Total investments since 1989 total approximately $15 million. In their current portfolio, NEV and Iron Range Ventures are invested in 29 businesses. The balance of their investment remains in the portfolio in 15 companies, in various stages of performance. NEV continues to work intensively with all of them to facilitate performance.

Non-financial assistance.

NEV takes a very active role in the companies it finances, sitting on portfolio company boards and working with management teams to provide a significant level of pre- and post-investment services. Rather than requiring business plans from potential investees up front, NEV prefers to work with promising opportunities (although nearly a third of opportunities come in as business plans). Board seats and observation rights in companies are filled by four of the six NEV fulltime staff. NEV does not develop business plans, but works with management teams in helping formulate long-term strategy as well ad with day-to-day tactical decision-making.

NEV supplements direct staff assistance through advisory and other services provides from its network of partners in order to assist its portfolio companies over the life of NEV's investments.

Outcomes

Financial Outcomes

NEV has profitably invested in six companies, and has written off five investments. The returns on the six exits ranged from zero returns and full principal payoff to about 34 percent return on investment. Of the write-offs, three companies were in the pre-business formation stage and did not go forward. Thus losses were very small ($10k to $50k).

Social outcomes

The investments made by NEV have helped to create 1,500 jobs.

The New York City Investment Fund

New York City Investment Fund (NYCIF) is "a private fund with a civic mission." The fund makes strategically-directed investments in for-profit and not-for-profit firms that benefit low-income and economically disadvantaged areas, minority-owned firms, and firms that position New York at the cutting edge of growth sector industries.

The fund began its operations in late1996 under auspices the nonprofit New York City Partnership (NYCP)[7]. At that time New York City experienced relatively high unemployment, slow economic growth and lacked components of the business infrastructure necessary to support new growth industries. In addition, many low-income neighborhoods were isolated from the city's economy. (Plastrik and Wylde 2001). The fund's founder, Henry R. Kravis, also the founding partner of Kohlberg Kravis Roberts & Co., felt that the creation of the fund was a necessary step to mobilize the city's financial and business leaders to help build a stronger and more diversified local economy. To accomplish this goal he brought together top experts from the investment and corporate communities, creating a network of volunteers who help identify and support New York City's most promising entrepreneurs. NYCIF raised its funds solely from individual and corporate investors.

In response to the September 11th 2001 terrorist attack NYCIF created a separate Financial Recovery Fund designed to help small businesses negatively impacted by the WTC attack. This fund will be discussed as apart of NYCIF's fund structure.

Organization Structure

NYCIF is a private for-profit organization. While the fund often works together with government agencies, it is owned and operated exclusively by business leaders. A Board of Directors which consists of 16 prominent members of the New York City business community oversees the fund's operations. The fund's has 10 full-time staff members. According to the fund's Vice President Maria Gotsch, a primary of the staff is maintaining investor relationships and supporting the network of volunteers. NYCP staff also often supports NYCIF operations.

NYCIF's distinguishing feature is the network of over 250 volunteers drawn largely from the fund's investor network. The volunteers are organized in Sector Groups based on their industry expertise. They tend to hold high-level positions (Vice President or higher) in their respective companies. The Sector Groups review proposals, work with portfolio companies offering business advice, and develop the fund's investment strategies. Some volunteers are also members of the Portfolio Review Committee which was created this year to monitor portfolio performance over time.

The volunteers are recruited through numerous presentations made to the fund investors and other New York City's business leaders. NYCIF assesses the volunteers' technical and substantive knowledge, willingness to commit time and resources, and ability to evaluate proposals before asking them to join a Sector Group. Only one person per firm can be a part of a Sector Group. NYCIF has found that leveraging volunteer talent is key to the success of each of the Sector Groups.

[7] NYCP is comprised of a group of New York City top 200 CEOs who work with government, labor and the nonprofit sector to enhance the economy and maintain New York City's position as the global center of commerce, culture and innovation. In 2003 the partnership changed its name to the Partnership for New York City to reflect the fact that it does not act as Chamber of Commerce. Henry Kravis and Jerry Speyer are the co-chairs of the partnership.

Access to the volunteer network greatly benefits the portfolio companies because it not only allows them to receive help from leaders in their industries, but also connects them to potential customers and suppliers. The Sector Groups often consist of individuals that the portfolio companies are trying to reach, which puts them "in the door" from the onset of their business operations. The volunteer network strategy has evolved to provide a very effective way of "shot-circuiting" the investment process, keeping staff size small, and minimizing operating expenses.

Fund Structure

CEF is capitalized at nearly $100 million. Aggregate capitalization was accumulated from three distinct sources, which each share about a third of the fund's total assets:

- Limited Liability Company (LLC). The assets for LLC were raised through unsecured interest free loans made to the Fund for fifteen years. The majority of contributions to the LLC came from top New York companies and amounted each to $1 million.

- Civic Capital Corporation (CCC). CCC is a 501(c)(3) public charity established to manage the charitable assets of the New York City Investment Fund. A large part of contributions to CCC had come from individuals. CCC is as an eligible intermediary under the Community Reinvestment Act and the contributions are tax-exempt. Investments using CCC funds are restricted to eligible charitable activities such investment in nonprofit firms and firms contributing to economic development.

- New York Small Business Fund (NYSBF). NYSBF was created in collaboration with New York Community Investment Company (NYCIC). The assets raised by this fund are divided equally between NYCIC and NYCIF. The fund is a Certified Capital Company (CAPCO) organized to participate in a New York State program that provides tax credits to insurance companies that invest in eligible activities. NYSBF funds are invested in early stage venture capital businesses that foster job creation, are located in low or moderate-income areas or are minority owned.

Multiple sources of funding provide NYCIF with significant flexibility to finance different types of projects. This structure also allows the fund to deal innovatively with tax liabilities on gains from investments funded by the Limited Liability Company. A portion of gains can be contributed to the CCC to minimize taxes paid by the for-profit subsidiary.

NYCIF from its onset has been structured as an evergreen fund. Its profits are reinvested in other worthwhile projects making it possible for the fund to retain its original capitalization. However, the funds raised from Limited Liability Company can be retained for only fifteen years after which they must be returned to investors free of interest.

Investment Strategy[8]

- The single most important criterion for investment is that the project is likely to generate benefits for New York City and its communities. NYCIF focuses on job creation potential, growth potential, economic development potential, cutting-edge technology, and woman/minority ownership.

[8] Source: NYCIF, 2003

- NYCIF provides equity or debt, structured to meet the needs of the project. It will invest at any stage of business development, but is seeking to exit in about five years.
- NYCIF's investments into venture capital firms are expected to generate market rate returns. Returns on investments in nonprofit projects are expected to be below market rates. The fund, however, does not make grants.
- NYCIF invests in technology sector firms alongside an experienced lead investor. The fund usually participates in small percentage of any particular technology sector project and invests only in early stage companies.
- NYCIF does not typically invest in real estate projects. The fund will, however, consider such investment if there is a significant potential impact in terms of job creation, business development or community revitalization.
- The fund provides subordinated debt to leverage other private capital or to maintain maximum ownership for management of minority-owned companies.

Investments To Date

To date the fund has committed $48,900,000 to 50 projects (NYCIF 2003). The following charts show NYCIF's investments by market, size and sector.

Market Objective	Size of Commitment	Sector
- Technology – 27% - Growth Sector – 35% - Economic Development – 38%	- Less than $500,000 – 9% - $500,000 to $1million – 13% - More than $1 million – 78%	- Retail – 8% - Finance/Insurance/ Real Estate – 14% - Communications – 16% - Education/ Information Services – 16% - Health – 16% - Media – 16%
Source: NYCIF, 2003.	Source: Shorebank Advisory Services, 2002	Source: Shorebank Advisory Services, 2002

Non-Financial Assistance

The network of over 250 volunteers provides portfolio companies with expert advise and mentoring, connects companies with potential customers, and helps companies to find additional equity or debt financing. Some volunteers also sit on companies' boards or assist them to recruit qualified candidates for senior management positions. Finally, many volunteers become buyers or suppliers to companies.

Outcomes

Financial Outcomes

Very little information is available on NYCIF's financial performance to date, as its investments are relatively recent. However, 13 liquidity events or investment have occurred to date (NYCIF 2003).

Social/Civic Outcomes

The investments by NYCIF to date resulted in an estimated 3300 jobs created through 50 projects, 20 of which are minority or women-owned, 15 are in economically distressed areas, and 8 are enterprise ventures of nonprofit organizations (NYCIF 2003).

Financial Recovery Fund[9]

The Financial Recovery Fund (FRF) was created by NYCYF in November of 2002 to assist small businesses affected by the World Trade Center attacks. Since then the fund has made over $10 million in recoverable grants to 73 small businesses in Lower Manhattan. The grants ranged from $25,000 to $250,000. The funding for this effort (over $12 million) was raised as charitable donations through the Civic Capital Corporation. FRF grants must be paid back free of interest within five years but if a particular company's financial situation does not allow it to repay the grant, then the company is exempt from this obligation.

Volunteers who unlike the main group of NYCIF volunteers did not come from the city's business leadership supported FRF operations extensively. In fact, many of them lost their jobs in the technology sector prior to September 11th, and some have volunteered on full-time basis staying as long as nine months. As a result, the volunteers have transferred a significant amount of knowledge to the companies receiving assistance.

NYCIF and New York Community Investment Company

New York City is one of the few cities in the United States where two independent private community funds – New York City Investment Fund (NYCIF) and New York Community Investment Company (NYCIC) – operate side by side. The case of NYCIF is described in detail above. NYCIC is the smaller of the two funds and is capitalized at nearly $30 million. It provides long-term capital up to $1 million to select growing businesses in New York. The fund has a special interest in financing companies that are minority-owned, woman-owned, or located in lower-income areas. The fund was created by a consortium of eleven New York's major banks, the New York Clearing House Association, as a creative and socially useful way to help them meet their Community Reinvestment Act obligations. The fund offers equity, near-equity, and debt; long-term commitment of funds; customized terms; competitive pricing; access to additional financing sources; and advisory services on financial, organizational and other strategic issues (NYCIC 2003). NYCIC invests in businesses in a variety of industry sectors. NYCIC does not invest in nonprofit firms. The fund is not an evergreen fund and the funds' investors expect returns on their investments. According to NYCIC president Howard Sommer, the fund expects a minimum of 15-16 percent returns on its investments. He points out that while the fund accepted some below market rate returns in its early years, market-rate returns are necessary today to meet obligations to the funds' investors and to sustain the fund's operations. The fund's full-time staff consists of seven employees. In 1998 NYCIC partnered with NYCIF to create the New York Small Business Venture Fund, certified capital company

[9] NYCIF data and statistics presented in this paper do not include Financial Recovery Fund.

(CAPCO), to raise investment capital from insurance companies, which would thereby be entitled to state tax credits.[10]

While NYCIF and NYCIC have similar missions and have partnered to create a small business venture fund, there are a number of significant differences that exist between the two funds. First, two different driving forces led to the creation of each fund – the leaders of New York business community behind NYCIF and a consortium of New York banks behind NYCIC. Secondly, the two funds have different relationship with their investors as NYCIF investors make charitable contributions or interest free loans and commit nonfinancial resources as well, while NYCIC investors expect market rate returns and are not as directly involved in fund operations as is the case in the NYCIF. These relationships greatly influence the types of investments each fund makes. Thirdly, NYCIC makes long-term commitments of funds while NYCIF typically commits to shorter-term projects. Finally, NYCIF relies on the network of volunteers to evaluate investments and assist portfolio companies while NYCIC relies solely on resources of its own staff. While both funds are relatively young and it is too early to compare the two funds in terms of their successes and failures, their coexistence in the City of New York provide community development investment researchers with a unique opportunity to assess the effectiveness of funds' investment strategies and compare their sustainability over the long run.

Pittsburgh Strategic Investment Fund

The Pittsburgh Strategic Investment Fund (SIF) began as an outgrowth of the Allegheny Conference in 1996. The Allegheny Conference is a nonprofit organization started in 1944 to sponsor and coordinate community development efforts in the greater Pittsburgh region.

In the early 1990s, the Conference started to identify what was needed to turn around the region. This effort resulted in the release of a 1994 report by the Regional Economic Revitalization Initiative entitled, Working Together to Compete Globally. According to the report, the economic restructuring of the 1970s and 1980s left abandoned industrial property, run-down retail districts, vacant buildings, and under-used riverfront property throughout the downtown and adjacent areas. The report concluded that the regional economy was one of the worst in the nation and emphasized that recovery should be focused strengthening the core of the region—downtown Pittsburgh. Specifically, the report adverted that economic development draw upon the region's strengths be focused around the following four major areas:

- Tourism and recreation;
- Housing;
- Office and industrial space; and
- Retail.

To develop a framework to address the issues identified in this report, the Mayor of Pittsburgh, the Allegheny County Commissioners, and the Allegheny Conference on Community Development formed the Strategic Investment Partnership. The Partnership's 1995 report, Investing in the Future, provided a detailed strategy for creating jobs in the region. The report

[10] To learn more about New York Community Investment Company please go to http://www.nycic.com/.

extended that investment should be targeted towards preserving and strengthening the downtown core through investments in the four focus areas and redeveloping industrial sites to create technology centers and business expansion opportunities, and connect these sites to key core areas.

Recognizing that one of the key barriers to implementing any strategy under the plan would be inadequate without financing, Pittsburgh leaders conceived of the Pittsburgh Strategic Investment Fund. The intent of the fund was to fill the financing gaps for economic development projects. Since 1995, the fund has provided loans to economic development projects based in the City of Pittsburgh and 10 surrounding southwestern Pennsylvania counties. The fund provides secondary financing or gap financing to real estate projects that are viewed as crucial to Pittsburgh's redevelopment. SIF is the largest entity doing this type of financing in the region – economic development agencies use federal programs such as CDBG and "sprinkle around" the proceeds, but these funds are not subsequently available for reinvestment and the investments themselves generally are too small and discrete too bring projects to scale.

Organization Structure

SIF takes a proactive approach to finding worthwhile projects that need assistance. President Bob Stephenson screens all inquiries. An advisory committee reviews opportunities and the Board of Directors reviews all loan requests. The six-member advisory committee was put in place in September 1996. Two of the members are from area foundations and all have backgrounds in finance and investing. The Board is selected from individuals with major regional corporate finance and CEO experience—including CEOs of the Allegheny Conference Board, the chairmen of PNC, Mellon, Citizens banks and of USX, the CEO of National City Bank, and the executive vice president of Heinz. In addition, the board has a member from Allegheny Technologies and from the McCune Foundation. Its composition of high level community members has given the fund a high level of visibility, which has helped boost its profile to local and national investors.

Fund Structure

The SIF is a private, for-profit entity, but has a hybrid funding structure. Corporate and nonprofit entities have provided funds. In the for-profit partnership under the first fund, corporations and individuals are considered Class A investors and foundations and charitable organizations are Class B investors. Under the second fund, corporations comprise Class C investors—there were no individual investors— and foundations comprise Class D investors. Initially, SIF also utilized grants as well to set up the structure for SIF, Inc. a 501c(4) corporation, which managed the fund.

The first fund was capitalized in 1996 with approximately $40.4 million from 33 investors. A second fund closed in May 2002 with 26 investors, including 7 that were not part of the first fund. The second fund was capitalized at $30 million.

SIF provides patient, flexible, funding. Under the first fund, SIF provides loans with up to 15-year terms and loans cannot be made for more than 10 percent of project costs. Recipients typically are not required to pay back the loan until years 10 through 15, which, in the case of business loans, gives the businesses time to develop. During the payback period, proceeds are distributed back to the investors, with interest. The return is at a submarket rate, but positive. For the past three years, the net returns provided to investors based on these rates have been 4.1 percent to 4.9 percent. The return for the past year has been 3.2 percent. The fund has a target rate of 4.5 percent. In order to hedge the risk of investments that may need more time to

become profitable, the fund has a provision to extend the five-year payback period to 10 years if necessary.

The loan structure has been modified somewhat for loans made out of the second round of funding. These loans will have a 20-year term and payback will take place during the last five years.

Investment Strategy

As a result of the findings in the Working Together to Compete Globally and Investing in the Future reports, SIF seeks to invest in projects than fall into two general categories:

- Regional core investments, and
- Industrial site reuse and technology development investments.

The first guideline includes investments that are viewed as making significant contributions to downtown revitalization, while the second focuses on making investments in the region that redevelop former industrial sites and connect key assets to business growth. Each time the fund does a loan, it gets an opinion of counsel for foundation investors, as regulations require. The staff also does pro rata from each pool.

Investments To Date

Thirteen million dollars from six loans and one equity investment has been paid back. The fund has $26 million in outstanding loans. The equity deal was a selective site acquisition, of which the organization may do more. Projects supporting the regional core have included the development of the Regional Enterprise Tower and the Marriott Renaissance Hotel in the Central Business District, apartment development in the Cultural District, and office space in the Hill District. In terms of industrial site reuse and technology development, the fund has provided assistance to a total of 15 projects in Strip District and South Side of Pittsburgh, as well as in Oakland, McKeesport, and Butler, Armstrong, Greene, and Fayette counties.

Non-Financial Assistance

SIF encourages borrowers to come in early so it can work with them, but the organization provides less intensive pre- and post-investment technical assistance than comparable funds because it invests solely in real estate, not venture capital.

Outcomes

The investments made by SIF have played an important role in helping the region redevelop and create attractive real estate, which in turn encourages job growth. The secondary financing provided by the fund helped many projects succeed that would not have been financially viable otherwise.

Table I. Selected Corporate Civic Investment Funds

	Bay Area Council	Cincinnati	Cleveland	Detroit	KHIC	NEV	NYCIF	Pittsburgh
Target area	San Francisco Bay area, specifically, targeted low-income neighborhoods in 9 Bay Area counties	Central business district and adjacent	Originally city of Cleveland, now whole region	City of Detroit	12 counties in Appalachian Kentucky	Northeast Minnesota, covering 20,000 square miles (rural)	New York City (5 boroughs)	City of Pittsburgh and 10 southwestern counties
Date (Corporate Group)	1945		1943	1970	N/A	1985		1944
Date (Fund)	1999 (first official launch October 12th, 2000)	1996	1989	1995	1968	1989	1996	1996
Mission	Jobs and economic/environmental revitalization	Downtown revitalization (real estate)	Economic revitalization (real estate)	Economic Development (real estate)	Promote the economic self-sufficiency of a rural region that had been reliant on external economic influences. Focus on fostering economic diversity and creating job opportunities.	Jobs and economic revitalization	Jobs and targeted sector growth	Economic development (real estate-driven)
Parent Organization	Bay Area Council	Downtown Cincinnati Incorporated (DCI)	Cleveland Tomorrow	Detroit Renaissance	None	None (corporate leaders on the Board)	Partnership for New York City	Allegheny Conference
Fund Structure	Family of for-profit funds that work together through an MOU	One equity fund (that does loans)	For-profit with 2 for-profit fund subsidiaries: Cleveland Development Partnership (since 1990) and Cleveland Civic Vision Housing Fund (since 2000).	One real-estate based for-profit, and one for-profit community loan fund	Non-profit (501(c)(4)) with three for-profit subsidiaries and one CDC (501(c)(3))	For-profit corporation, for-profit fund, and a non-profit all linked	LLC (for-profit), Civic Capital Corporation (non-profit charity), New York Small Business Fund (for-profit), 9/11 Financial Recovery Fund	One for-profit fund
Total capital	Approximately $145 million to date in three funds.	$46 million	$75 million ($45 million, $15 million, $15 million)	$52 million	$47.1 million	$15.7 million	$97 million and additional $12.3 million for Financial Recovery Fund	$40.4 million
Sources	Banks, insurance companies, individual, foundations, corporations	Corporate	Corporate, some individual, foundations	Twenty-seven investors. Mostly corporations, a few individuals. All members of the Detroit Renaissance.	Government, corporate, foundation (Ford, MacArthur)	Foundation, corporate, quasi-public, some government (CDFI funding through Treasury)	Individual, corporate, insurance companies	61% corporate, 39% foundation

	Bay Area Council	Cincinnati	Cleveland	Detroit	KHIC	NEV	NYCIF	Pittsburgh
Expected Returns to Investors	Market-rate returns on investments. Smart Growth Fund: mid to high teens Community Equity Fund: For the ninety percent of the Fund that supports mid to late stage growth companies, expected returns are 15%-20%. Expected returns are market rate for investment of a smaller size. CERF: expected returns are in high single digit to double digit percentages	Evergreen fund. Committed to return principal and nominal interest to investors in 25 years. Investors have an option to share profits but so far voted to reinvest them in new projects.	Returns on the CDP fund have averaged 6-8% from late 1990s up through downturn. Today, the organization is looking to NMTC to bolster returns offered. The CCV Housing Fund currently provides 6-8% through blend of two investor classes.	Investors will receive a nominal return assuming that investments are profitable	Lending is in prime plus one range. Returns on equity investments expected at 15%-25%.	Evergreen fund	Evergreen fund set up with contribution of $1 million per investor, to be returned after 25-year life of fund with no interest.	For the past three years, rates of return were between 4.1% and 4.9%. This year, the return was 3.5%. Target is 4.5%.
Strategy	Tri-annual strategic effort to find need in area. Base investments off of that effort. Focus in smart growth in poorer neighborhoods, environmental issues like brownfields, and business development (depending on the Fund).	Invests in projects critical to downtown revitalization. No simple transactions, every investment requires an element of revitalization. Invests along with others. Prefers its participation percentage to be small compared to other lenders in project. Lender of last resort. Will do any real estate investment except subsidized housing.	Economic revitalization through commercial real estate and housing investments. Increasing focus on smaller, more neighborhood-based projects.	40% market-rate housing, 40% commercial/industrial, 20% special projects (projects strategic to Detroit's revitalization)	Primary focus on manufacturing (and increasingly service industry) investments that provide higher-quality jobs to region.	No specialization. Equity focus. No subordinated loan funds because those existed when NEV was created. Broad focus as location limits deal flow.	Priorities include job creation, revitalization of distressed area, innovation, or products that position NYC at the cutting edge of growth sector industries. No real estate investments except where fits above criteria.	Regional core investments and industrial site reuse and technology development investments

	Bay Area Council	Cincinnati	Cleveland	Detroit	KHIC	NEV	NYCIF	Pittsburgh
Types and financial terms of Investments	The Community Equity Fund provides patient equity, start-up venture capital, and mezzanine funding. The Smart Growth Fund provides early investment in real estate developments in targeted neighborhoods within the region. CERF provides equity and debt financing for environmental remediation.	Loans. Any type of real estate investments for underwriting purposes. Short-term projects but if project is worthy, will stay for long-term. Deals structured based on need of project. Returns are often tied to portfolio companies cash flow (after company makes specified profit it has to pay percentage of cash flow)	Usually loans but the fund will do equity or near-equity. Real estate investments to provide buildings for factories/businesses.	All subordinated debt loans.	Provides debt and equity financing from $500 micro-loans up to $10 million guaranteed loans. Products range from secured term debt to revolving operating lines to convertible stock options. Corporation develops industrial property, operates a business incubator on-site and maintains public business library and telecommunications center in building.	Primarily invest in equity (with some debt elements possible but no debt financing) and take an active role in company's finances.	Provides subordinated debt to leverage other private capital or maintain maximum ownership for management of minority-owned companies. Returns in VC deals are expected to equal those of other at-risk parties. Returns for non-profit typically below commercial terms.	All subordinated debt loans.
Organization	Funds are coordinated through an Executive Coordinating Committee, housed in the Bay Area Council. Each fund has representation on the Executive Coordinating Committee, along with representatives from CCII and the primary investors. The Managing Director for the CCII Business Council and the Family of Funds is also housed in the Bay Area Council.	The fund has full-time staff of two, the fund manager and his assistant.	Full-time staff. Nine member board, most of whom drawn from or related to Cleveland Tomorrow.	Full-time staff of five. Investments Oversight Committee and Board of Directors, all of who work on a pro-bono basis.	Governed by a seventeen-member Board of Directors that is responsible for approving and overseeing all investments made by KHIC. KHIC additionally maintains a full time staff of seventeen.	Full-time staff of six.	Full-time staff of 10 people. 16 member Board of Directors. In addition more than 250 industry experts volunteer their time to develop investment strategies, conduct due diligence and monitor portfolio investments.	President plus Board of Directors and Advisory Committee.

	Bay Area Council	Cincinnati	Cleveland	Detroit	KHIC	NEV	NYCIF	Pittsburgh
Organization (operating expenses)	Funds operate within themselves and is independent while attached to CCII. Operating budget for Bay Area Council staff originally came from one grant for the Bay Area Alliance for Sustainable Communities. Now that funds are closed, Bay Area Council uses a percentage from income generated from investments.	Just under $300,000 (2002).		$1 million	Operate out of income from loans and rental property. Some public financing goes to operating expenses as well, for example from SBA through micro-loan program.			$390,420 (2001 total expenses)
Non-Financial Assistance	Bay Area Council does provide technical assistance in the form of job creation and wealth creation networks. They operate a Government Advisory Council that helps with the time-consuming process approval. Also, the Bay Area Community Investment Network (BACIN) lives underneath the business council section of CCII and works like a business network in providing a deal flow referral network that includes investors and experts within community reinvestment as well as builders, developers, bankers, etc.	Often helps to identify other sources of funding such as tax credits, public sources and senior lenders.	The fund views itself as an “activist lender”, involved early on to provide advisory services and market knowledge to potential investees.	Investment Oversight Committee member are assigned to mentor accepted projects.	KHIC provides technical assistance (for example, through a small business incubator and through their micro-loan program that has a large TA program)	NEV takes a very active role in the companies it finances, sitting on portfolio company boards and working with management teams to provide a significant level of pre- and post-investment services.	The network of over 250 volunteers provides portfolio companies with expert advise and mentoring, connects companies with potential customers, and helps companies to find additional equity or debt financing	

	Bay Area Council	Cincinnati	Cleveland	Detroit	KHIC	NEV	NYCIF	Pittsburgh
Financial Performance	Too early to tell	Three loans paid off in full and one loan was written off. Some developers are doing well but some projects haven't made enough profit to start paying percentage of their cash flow.	CDO has 56 loans outstanding. Only two have been written off, one at beginning of program. CCV has 10 investments, with 2 loans paid back in 2003.	Fund had made $7.2 million in loans at year-end 2002.	The over 175 companies that KHIC has invested in have produced goods and services in excess of $1.6 billion and paid more than $600 million in salaries and wages which in turn have produced an estimated $120 million in tax revenue.	NEV has profitably invested in six companies, and has written off five investments. The returns on the six exits ranged from zero returns and full principal payoff to about 34% ROI. Of the write-offs, three companies were in the pre-business formation stage and did not go forward. Thus losses were very small ($10k to $50k).	50 projects totaling $48.9 million. 13 liquidity events or investment exits to date. Returns are not public information.	For the past three years, rates of return were between 4.1% and 4.9%. This year, the return was 3.5%. Target is 4.5%.
Social/civic outcomes	Too early to tell	15 projects, 416 apartment units, 27,000 sq. ft. office space, 100,000 sq. ft. commercial/retail/entertainment, over $26 million capital committed.		DIF has started measuring outcomes. Information should start to be available in May 2003.	Invested over $90 million in over 175 enterprises that have created more than 8,000 jobs. An estimated 10 percent of the households in the service area have an employee of a KHIC investee company.	The investments made by NEV have helped to create 1,500 jobs.	3300 jobs created through 50 projects, 20 of which are minority or women-owned, 15 are in economically distressed areas, and 8 are enterprise ventures of nonprofit organizations.	Too early to tell.

SECTION VI. LESSONS LEARNED FROM THE FUNDS

The fund cases presented in Section V include a mix of locations, situations, investment strategies, and outcomes. The common denominator across these funds is their use of private capital for social purposes. In addition, each fund employs modern business planning and practices to raise capital, assess opportunities, and make and monitor investments. Taken together, these cases suggest more than just another weapon in the community development finance arsenal - rather they offer an effective model for catalyzing coherent, targeted community development investment.

Equally important, these emerging funds are proving to be effective vehicles for marshalling private capital to community investments. Bridging the gap between community development and mainstream finance and increasing the flow of private funding has been a concern of the community-oriented nonprofit sector for nearly two decades. Working with partners, especially the corporate sector, these funds have generated synergies that provide a timely and direct path to focused investments that achieve desired social and economic objectives.

Key lessons learned from the experiences of the eight funds described in Section V are summarized below. These experiences are augmented by insights from industry associations such as CDVCA and the National Community Capital Association, and corporate groups such as CEOs for Cities and the ICIC, on the potential of CCIFs, CDVC funds, and similar finance sources such as CDLFs.

Catalysts for Community Development Finance

The overarching lesson generated by the experiences of these funds is that they have the potential to – and increasingly do – operate as catalysts for community investment. Regardless of rural or urban location, metropolitan or regional economic circumstance, or investment strategy, each fund was created to lead the market to strategic investments and bring to bear expertise to ensure that investments succeed. Although they are a very recent addition to the community development sector, the funds' foci and their operations increasingly provide high-level prototypes for expanded community development investment.

Each fund functions to mobilize resources, galvanize participants, and provide flexible solutions to their target area's financing needs as they evolve. In an extreme example, the wake of the 9/11 disaster, the NYCIF immediately set up an operation that provided funding and management assistance to Lower Manhattan firms impacted by the tragedy. Donations to the fund were targeted to recovery for small businesses in the area and to high technology firms that had been evolving in Lower Manhattan. The $12.5 million recoverable grant program set up by NYCIF wrapped up in January 2003. In addition to the grants provided, NYCIF was able to orchestrate a substantial transfer of knowledge and experience to funded businesses through an extensive volunteer management assistance component.

Partnerships: Corporate and Civic Alliances

The partnerships within which the various funds operate have been critical to helping them secure investors' commitments of financial resources and their time. The latter has proven to be as necessary as investor financial commitment in promoting the funds' successes and sustainability. Umbrella organizations such as Detroit Renaissance, the Bay Area Council, and the Allegheny Conference in Pittsburgh not only provide focus, strategy, and resources

(financial and nonfinancial), but also in-depth knowledge of the market area and its conditions. To the extent that members of the umbrella entity participate on the boards of the funds (which they typically do), the funds have immediate and ongoing access to both information and connections that help them effectively adjust strategies. The boards can also provide advice and networking opportunities to their investees that in many cases may be worth more than the value of the financial investments. For example, the Partnership for New York City—the umbrella organization for the NYCIF—brought together a group of CEOs who have not only remained the strongest group of investors, but who also offer a pool of volunteers to review proposals, develop strategies, and give portfolio advice.

Partnerships, especially those including corporate civic alliances, also make possible high level collaborative planning. Bringing together the business sector, community groups, and other stakeholders raises awareness, establishes credibility, and generates the synergy to achieve social goals. The Bay Area Council's success in this partnership building will be the cornerstone of the success of its Family of Funds.

Fund Organization and Structure

Each fund is extremely labor intensive in its operations. Boards and investors need to be engaged and nurtured, as do investment opportunities and investees. And the investment process is long, for it is time-consuming to capitalize funds, find and vet opportunities, make decisions, and monitor investments before they are brought to fruition. To add to the labor intensity of fund operations, each of the funds discussed in Section V have an extremely small staff, although operations are certainly augmented by volunteers with financial and management skills. When developing the Bay Area Family of Funds, for example, the Bay Area Council had a full-time staff of only four members, and it now has a staff of around eleven. The Cincinnati Equity Fund and the Pittsburgh fund have two staff members each while the Detroit fund has five full-time members. The NYCIF, a fund that manages over $100 million in working capital, has ten full-time staff members. It primarily relies on its 250 volunteers to provide the bulk of portfolio management and assistance to firms.

Each fund utilizes business methods and inculcates them in its investments while leveraging public and nonprofit funds. At Bay Area Council, the Government Advisory Council identifies and coordinates federal, state, regional, and local sources while the Partnership for Regional Livability coordinates foundation funds. Bay Area Council works hard, as do many of the funds, to ensure that its activities do not compete with other initiatives or sources of funding. Very often, for-profit funds will operate with one or more nonprofits to achieve its double bottom line goals.

Investment Strategies

It takes time to evolve and adjust strategy, as the Cleveland and Detroit cases illustrate. The funds have employed a variety of investment strategies, ranging from sector-specific to area-specific to open-ended search for opportunities (especially in areas where deal flow is weak, such as Kentucky and northeastern Minnesota). For example, NYCIF created sector groups comprised of experts in a certain field. This structure allows group members to focus on their areas of expertise when looking at investments and maximizes their effectiveness while minimizing the amount of volunteer time needed.

Gap financing is an activity that many funds have taken on as the most practical way to effect change within their communities. The Cincinnati Equity Fund, in fact, only participates in gap financing—and assists the developers it finances in accessing other sources of funds and to structure their finance packages. None of the funds wish to compete with other available sources of funding, which is a factor in how the funds choose to structure their investment strategies and financing plans. The mix of debt, near equity, and/or equity that funds choose to offer is usually a function of fund strategy, current and anticipated market opportunities, and market conditions.

To achieve social goals, funds tend to focus on either a jobs/business expansion strategy or on strategies that indirectly make jobs or business expansion possible through the provision of necessary physical infrastructure (for example, commercial buildings such as space for industrial activities). Residential development also is supported by several of the funds (e.g., Cincinnati, Cleveland, and the SIF in Cleveland). Residential investments are seen as supporting the business climate as well as providing housing opportunities in proximity to jobs.

Outcomes to Date

The extreme newness of most of these funds precludes detailed assessment of track records over time. Most funds, in fact, have not yet proceeded through their initial investment cycle. For example, NYCIF and Cincinnati have both been in existence for about six years and neither has committed more than half of their total capital. Bay Area Council only recently closed their first rounds of funding. Therefore, outcomes can only be presented in terms of investments to date, exits and losses to date, and expected average returns across each fund, from aggregate data from industry associations or the fund managers.

In addition, each fund inevitably experiences some loss at start-up. For example, both Cleveland Tomorrow and the Cincinnati Equity Fund experienced significant losses on early investments in sports facilities in their respective cities. For Cleveland, that early experience helped fine-tune CDP investment strategy toward investments that constitute smaller proportions of total available funds.

Over time, funds that have the resources and scope to stay with their investments and reinvest tend to produce higher returns, as has been demonstrated by the more seasoned funds such as NEV and KHIC. Where funds are represented on the boards of the companies in which they invest, they also can influence returns – both financial and social as well as to make sure that their social criteria continue to be fulfilled after exit. Returns generally include the original capital plus modest to market-rate financial returns and the promise of significant social returns. Many funds encounter difficulty in measuring the social returns, especially the less quantitative social returns such as neighborhood or quality of life improvements. Some funds are grappling directly with the issue of appropriately measuring social returns (e.g., the Bay Area Council Family of Funds is undertaking an in-depth effort to develop metrics for monitoring and evaluating the social outcomes of its funds' portfolios). Others, such as Cleveland, provide for social benefits indirectly through investments that make job creation and business expansion possible. Consequently they do not offer social return measures as the can only be estimated indirectly and without sufficient precision to merit the effort.

Funds have, however, become brokers of information on market activity through their networks, due diligence activities, and partnership connections, which vastly increases their value to new businesses and to other investment opportunities. Nonfinancial assistance offered by funds has

also proven to be critical. Unlike standard lenders and other investors, the funds are actively involved in their portfolio companies. For example, fund staff sit on boards and often participate in day-to-day management decisions. KHIC, NEV, and NYCIF frequently have fund staff or representative volunteers on the boards of their companies.

To date, evidence indicates that it appears possible to achieve desired social returns while also generating economically viable rates of return (that is, rates projected by the funds themselves to preserve their capitalization and ensure operations).

Social criteria used by the funds include the following:

- Creation of livable wage jobs with benefits for low-income persons, especially for low-income persons in distressed communities.
- Ownership and management by minorities and women.
- Beneficial social and environmental impacts from business operations and from the products and services produced by the businesses funded.
- Production of affordable and mixed income housing.
- Location in areas of high poverty and distress.

However, developing accurate measurements for some outcomes is problematic given the many other factors influencing these outcomes. Clearly, jobs created by portfolio companies and their ownership characteristics can be ascertained easily. Net new jobs created in communities or impacts on business climate are more difficult to assess and fund staff are unlikely to be able to address these issues given the degree to which staff resources are committed to management of their portfolios. This remains an area with which funds will have to grapple as social return-motivated investors demand evidence of double bottom line returns. Fortunately, in the case of CCIFs and similar CDVC funds, where investors are community business leaders, the investors are able to observe social and economic impacts as they unfold.

Nevertheless, in order to achieve the larger objective of drawing more private resources to these investments, social returns will need to be provided. The Roberts Enterprise Development Fund is a leader in developing and disseminating methodology to estimate social returns on investment (www.redf.org). However, a significant amount of research remains to be undertaken in this area to ensure that measurements accurately reflect what the funds set out to provide in terms of social outcomes.

Risks

Corporate civic investment funds face many risks, the largest of which are that investments may not succeed financially. In addition, social risks (e.g., that investments may contribute to gentrification and displacement in some areas) and concerns that the funds may not meet their social equity criteria have the potential to impact the sustainability of these types of funds and the initiatives they promote. Another risk consideration is that the funds might draw on resources that could otherwise be used by other community development efforts. Monitoring and addressing financial risks remains the primary function of the funds over the life of their investments. However, monitoring and addressing social risks is generally beyond the capacities of the funds and, indeed, their operations often increase these risks. For example, the NYCIC's and the Bay Area Council's Community Equity Fund's focus on providing high rates of return to investors creates some risks that the funds might be diverted from their social mission.

As noted above, this is an area that requires additional research in order to provide metrics for monitoring purposes. The funds have taken actions to address potential social risks. For example, the Bay Area Council Family of Funds includes in its term sheets specific prohibitions against displacement unless full replacement housing is provided in or near the neighborhood where the development or business is located

Implications for the Future

The future of the corporate civic investment fund can, in many ways, be ascertained from the experiences of these funds. First, tensions between community group interests and commercial interests will remain central to the ongoing operations of these funds. Social advocates often do not appreciate the needs of the funds to generate financial returns, while many investors do not know how to be social entrepreneurs. Experience demonstrates that it can be difficult to generate community trust when using market forces to alleviate poverty. However, positive successes of investments in communities, and their ramifications over time in terms of jobs, business expansion, and neighborhood reinvestment, will do a lot to alleviate such tensions.

Ensuring that the funds are regarded as businesses as well as engines of community development is very important for sustainability of fund efforts. The Cincinnati Equity Fund has found that the people to whom they lend do not see their loans as "real loans" and aren't as concerned about paying back the loans, while the senior investors do not care as much about the social mission of the fund. The corporate structure surrounding these funds or the alliances they have with businesses can help maintain the funds credibility as well as utilize their networks to educate potential new investors on the importance of the double bottom line.

Raising money will also continue to be a real challenge for the funds, particularly in the current economic environment. The Central Fund, recently started by CDVCA, was established as a response to member needs for co-investment in CDVC projects that require additional funds to proceed. At the same time, however, the largely successful experience of these emerging funds should enhance the ability of CDFIs generally to raise funds by demonstrating new markets and by showing that financial and social returns can be attained.

Regarding the future role of public funding, while it is important to provide both private and public resources, in today's economy it can be difficult to match public and private money. New program directions and funding opportunities provided by the federal government through the NMTC, the NMVC program, and the CDFI Fund offer more flexible and appropriate sources for funds such as those highlighted here. The KHIC recently was selected as one of the first 7 community development entities to be designated as a NMVC fund. Cleveland's CDP fund has assembled a second round funding package contingent on receipt of a NMTC allocation. In the CDP case, the credit, if awarded, will help assure receipt of between $20 and $25 million in new commitments.

An ongoing issue will be attracting and retaining qualified fund staff. The financial and managerial skill mix required by the funds is identical to that required – and highly compensated – by the traditional VC industry. Although the funds are able to provide compensation well beyond that levels normally offered by nonprofit CDFIs, compensation cannot match VC levels as the financial returns flowing from fund investments generally are at single-digit levels. As a result, some funds are becoming more entrepreneurial and considering the adoption of fees for services for pre-investment planning and advice, including from firms in which the funds do not

invest. Today, across the board, fund staff are extremely well-skilled with deep levels of financial experience. A major factor that appears to keep them on board is their commitment to their funds' mission and to their ability to nurture complex investments that provide social benefits as well as financial benefits.

Finally, maintaining corporate interest and involvement will remain an ongoing challenge for the funds. CEOs' commitment of time and financial resources will decrease and become more dispersed unless challenging local initiatives are on the table and positive financial and social investment performance can be demonstrated. Engaging and sustaining the focus on headquarters and "hometown" may become more challenging.

Other Lessons from the Funds

Additional lessons can be gleaned from the following observations provided by the eight funds. These represent an amalgamation of comments received across the funds.

- Community development finance requires a sustained and coherent effort over an extended period of time and development opportunities require active, aggressive, labor-intensive pre-development work. All of the fund staff interviewed stressed that the entire spectrum of fund activities—from raising funds, to keeping investors and other stakeholders informed and engaged, to finding opportunities and working with firms, to creating investment packages, to monitoring and providing post-investment advice and assistance, to replenishing funds—are extremely labor intensive.

- Fund staff members and boards quickly become centers for creating relationships and providing information on market activity through their networks and investments in the area. And all funds stressed the importance of doing "homework" in terms of due diligence. There is, in fact, a consideration among a few of the funds to consider adopting fees for due diligence services and other nonfinancial assistance provided in the pre-investment phase to help cover operating costs.

- Because of the various fund activities, the funds require highly skilled staff with strong finance and venture capital skills and experience. Compensation is normally less than in traditional venture capital firms, but most of the staff members of these firms find the work much more rewarding. Volunteers can be a great asset, and are easier to recruit in funds where volunteering brings exposure to business leaders and opportunities. The recruitment of volunteers to NYCIF was certainly aided by the fact that so many skilled individuals were out of work after the dotcom failure and 9/11. Most funds stressed that knowing the market well cannot be overemphasized. As a result, many funds have deliberately chosen to limit the geographic scope of their investments – in contrast to venture capital funds that typically take in a wider area.

- Initiatives that address community development in a comprehensive, holistic manner have the best chances of producing desired double bottom line results. This is the result of having a well-considered, longer-term strategy that makes possible:
  - Provision of a deal generation and deal flow infrastructure;
  - Access to a critical mass of investment capital, and;

- Public/private/community collaboration to improve the quality of life and the business climate of the entire target area.

- The double bottom line assures a financial return, but offering returns at less than market rates can hurt the quality and quantity of investments over time. Enhancements such as tax credits packaged with a deal can make returns more attractive to investors. Thus, the sector is seeing increased use of government incentives for investment in community development. If the fund is set up as a nonprofit, it is important that they use proven business methods for operation. For-profit funds often operate with an allied nonprofit or in conjunction with other nonprofits to carry out community investment projects. The cross-fertilization that occurs in the joint pursuit of financial and social returns across partners and subsidiaries is bringing new understanding to all participants of the benefits of market processes and the achievement of social goals.

SECTION VII. CONCLUSION

This paper examines the evolving roles of hybrid for-profit/nonprofit entities and for-profit funds that channel private resources directly to community development initiatives. The specific focus centers on the emerging role and impacts of corporate civic investment funds and their subsidiaries. The first sections of the paper assess the spectrum of organizational types investing in community development today as well as the challenges and opportunities they face in making community development-related investments, drawing on secondary sources, case studies, and interviews with business alliances, CDFIs, CDVC funds, and other relevant national organizations.

In order to explore the performance of corporate civic funds, eight examples are presented: Kentucky Highlands Investment Corporation, Northeast Ventures, Cleveland Tomorrow and its relevant funds, the Bay Area Council Family of Funds, the New York City Investment Fund, Pittsburgh's Strategic Investment Fund, the Detroit Investment Fund, and the Cincinnati Equity Fund. Because most of these funds are very new (established in the mid to late 1990s), performance information remains limited. However, results so far indicate that corporate civic funds can provide: 1) mainstream perspectives, financial and social criteria, and resources that bridge for-profit and traditionally nonprofit approaches to community development; 2) debt, equity, and near equity financing based on sound investment criteria; 3) an effective way to galvanize and structure private and public resources around important local development needs; 4) connections and credibility for investees; 5) a degree of market knowledge and information necessary for strategic decision-making as well as for assistance to individual investees; 6) management and technical assistance to investees over the life of investments that has been shown to reduce investment risks significantly; and 7) flexibility in responding to local, regional, and global market conditions that affect their mission and investments.

Corporate civic funds and alliances have been most successful in identifying sector-specific needs and opportunities that support small businesses, helping retain and expand existing businesses through provision of business infrastructure, and creating job opportunities with advancement potential for the local labor force. To date, experience with corporate civic investment funds demonstrates the following. First, reliable market information and business assistance are critical in developing successful strategies, maintaining investment performance, and sustaining subsequent rounds of funding. Second, in the case of for-profit funds, financial returns are often below-market but also offer social returns that are difficult to quantify. Even

so, where the funds are building more competitive business environments through their cumulative investments and providing evidence of other social returns, they have been able to sustain and acquire successive rounds of funding. Third, the provision of management assistance provides key feedback to the funds on strategy and new business opportunities while helping monitor investments. Fourth, partnerships are essential to the success of corporate civic strategies, especially in supportive initiatives such as developing the business infrastructure, recruiting employees, and upgrading the environment of distressed areas. Finally, and most importantly, corporate civic funds and alliances provide a level of leadership and visibility that can facilitate the flow of funds to and support of other local community development initiatives.

Areas for future research relevant to the types of funds examined within this paper include the following:

- Of the types of investments undertaken by CCIF/CDVC funds, identifying and evaluating the mechanisms that actually lead to reductions in poverty and desired outcomes for economic revitalization.

- Developing appropriate metrics for benchmarking the performance of these types of funds, particularly with regard to social returns on investments.

- Documenting the merging experience and potential of community development co-investments. A significant potential that CCIFs offer is the ability to bring together finance sources to help bring needed investments to scale. However, these structures have not been studied in detail as of yet.

- Exploring the potential of CCIF and CDVC funds to facilitate securitization of community development investments through their potential in standardizing investment processes and information, providing transparent performance information for their investors, and their developing record of tracked investments.

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