LINKING LENDERS AND COMMUNITIES

SUMMER 2006

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Community Development Venture Capital

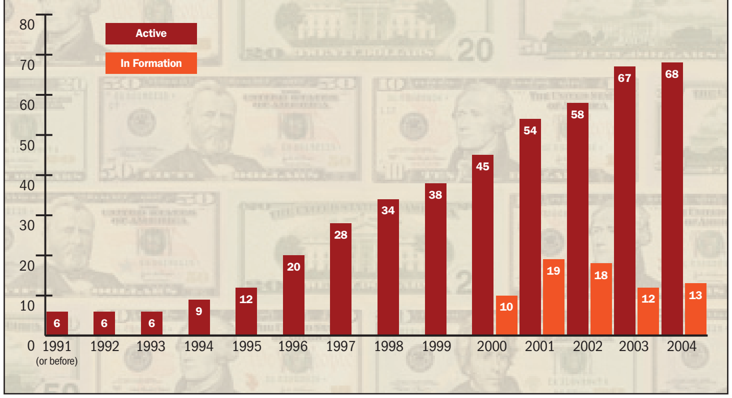
Producing Results for Entrepreneurs, Investors and Communities

By Amy Simpkins
Community Affairs Specialist
Federal Reserve Bank of St. Louis

Access to capital, particularly equity capital, is a barrier faced by many entrepreneurs looking to start and expand businesses in low-income and rural areas. However, these are the very areas where innovation and business expansion may have a significant impact on the health and vitality of local economies.

Community development venture capital (CDVC) is an equity financing tool that benefits both entrepreneurs and communities. (See related story on p.3.) Sometimes called "double bottom line" investing, CDVC funds invest in businesses in low-income areas, adding equity, entrepreneurial experience and ingenuity to underserved markets.

Growth of CDVC Industry: Number of Funds Active or In Formation



In the following interview, Kerwin Tesdell, president of the Community Development Venture Capital Alliance (CDVCA), answers questions about the CDVC industry and the power such equity investment can have on many local economies that need social and financial returns.

1. What do you mean by double bottom line investing?

Most venture capital funds have a single bottom line: financial returns to investors. CDVC funds are serious about providing market financial returns to investors, but they also focus on a second, developmental bottom line: creation of good, entry-level employment and the provision of equity capital to businesses in underinvested areas. This second bottom line does not have to detract from the first. Our funds seek out businesses whose success and rapid growth will satisfy both bottom lines.

2. Why do you think venture capital is an important part of community development?

Community economic development is fundamentally about making things happen in a business and in an economy that would not otherwise happen. Venture capital financing does that. When a smaller business wants to develop a new product line or finance a new plant, it cannot do so prudently with debt alone; it needs

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equity capital to expand. But equity capital is in short supply in most inner city and rural areas of the nation. Traditional venture capital is almost nonexistent, and low-wealth communities tend not to have the wealthy family members and angel capitalists who finance most businesses.

A dedicated source of equity capital can be a powerful force for economic development in a low-wealth area. Equity capital can help leverage larger amounts of more senior debt financing. In addition, CDVC funds become partners in the businesses in which they invest, sitting on their boards of directors, helping them with marketing plans, lining up customers, attracting other financing, and providing other assistance necessary to make sure the businesses succeed. The combination of equity capital and intensive business building is the most powerful model of economic development I know.

3. Where do CDVC funds typically operate? Are there geographic areas of focus?

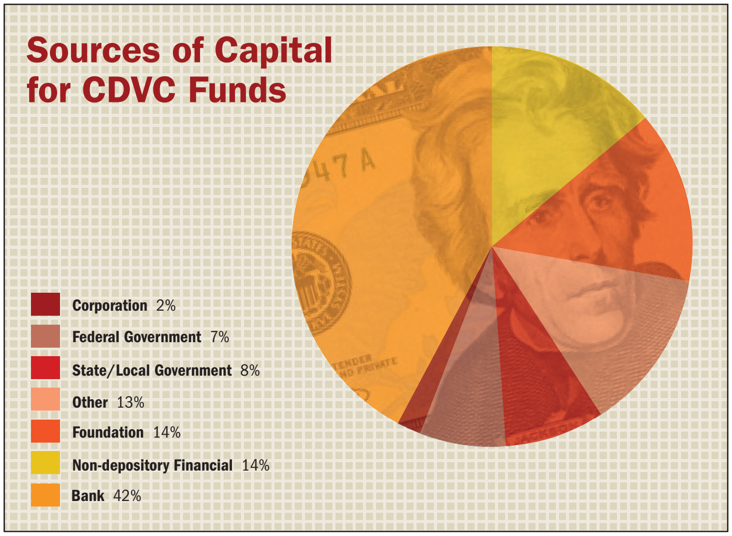
CDVC funds operate in underinvested inner-city and rural areas throughout the United States. Some operate in a single state or area, while others work in broader, multistate regions. In addition, CDVC funds are being established in other parts of the world, including eastern and western Europe, Asia, Africa and Latin America.

4. Is there a structure that is common in CDVC funds?

The vast majority of CDVC funds are established as for-profit LLCs or LPs with 10-year lives and traditional venture capital terms. These offer investors familiar financial terms. In addition, many CDVC funds have affiliated not-for-profit organizations that enhance the social value of the fund's investment activity by providing extensive pre-investment and post-investment support to companies, mentoring opportunities to entrepreneurs, and workforce development and wealth-building services to employees. Some CDVC funds, themselves, are organized as not-for-profit organizations.

5. Who typically invests in CDVC funds?

Banks are by far the largest group of investors, accounting for approximately 42 percent of all CDVC investments, and this percentage is increasing over time. Other important investors in CDVC funds include nondepository financial institutions, such as pension funds and insurance companies; foundations; federal, state, and local government; and wealthy individuals.



Banks often invest in community development venture capital (CDVC) funds as a way to help meet their CRA investment test criteria. Additional information about CRA-qualified investments may be found at www.frbsf.org/cdinvestments and at www.ffiec.gov/cra/default.htm.

6. What is the average return on investment for CDVC funds and how do you measure the double bottom line?

CDVC is a young industry. No funds structured as limited partnerships or LLCs with limited life spans have wound up, so no definitive statistics regarding financial returns to LPs—comparable to the NVCA Yearbook statistics—can currently be compiled for this industry. However, to provide a preliminary answer to the question of financial returns in the industry, CDVCA assembled a model portfolio of all exited investments from the three oldest CDVC funds in the nation. We looked at all exits of investments made between 1972 and 1997. These include 24 full and partial exits and seven complete write-offs. This model portfolio yielded a 15.5 percent annual internal rate of return, weighted by dollars invested, including write-offs. Because the three funds studied were all perpetual life funds, and two of the three were not-for-profits, we would expect that returns for the newer for-profit funds with pressure to exit within a limited period of time will produce higher financial returns.

CDVCA and the CDVC industry have made great strides in the development of methods to measure social impact. In 2005, CDVCA released its Measuring Impacts Toolkit, which is a sophisticated methodology and survey instrument for measuring the social returns of CDVC investments. Among other things, the toolkit measures job creation, job quality and availability of jobs to low-income people. It also looks at such factors as where investments are located, dollars leveraged and tax dollars produced. For example, administration of this methodology shows that the average increase in employment in CDVC-financed companies is 89 percent, with a 124 percent

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To Timbuk2 and Back: Money Flows Both Ways

When Pacific Community Ventures (PCV) first came to know Timbuk2, it was a small firm specializing in the niche market of bicycle messenger bags. But the fund managers at PCV saw something special in this small company and decided to invest in the business, its leadership and the employees.

What PCV saw was an investment opportunity poised for both financial and social returns. Timbuk2 had a thriving, high-margin e-commerce business, strong brand equity and scalable production capacity. Timbuk2's location in San Francisco's Mission District, a low- to moderate-income area, also appealed to PCV. The company employed 40 low- to moderate-income workers in its urban manufacturing facility, and 100 percent of its employees received health insurance, job training and strong wages.

Four years ago, PCV made its initial investment in the company. PCV is a 501(c)3 organization managing two profit-making investment funds with $20 million under management. PCV targets areas that have traditionally not received venture capital, investing in and developing selected businesses that provide substantial economic benefits to low-income communities. These benefits are measured in terms of the number of jobs with good wages, comprehensive benefits and marketable skills that portfolio companies are able to provide to low-income individuals.

With PCV's investment and hands-on technical assistance, Timbuk2 reorganized its operations and management, expanded its product offerings distribution, and achieved profitability. In the process, the company's annual revenue more than tripled. The company now has distributors in Canada, Japan and Europe and its product line includes computer carrying cases and other urban-lifestyle bags and accessories, in addition to its well-known custom messenger bags offered on its "Build Your Own Bag" web site.

Through this infusion of capital and resources, the company was positioned for significant expansion that not only made a solid return for investors, but created a considerable benefit to employees and the low-income community where the business is located.

Initial investors saw a return of nearly four-and-a-half times their original investment in just three years. PCV's exit through the sale of the company to a private-equity investor group will provide the financial resources and strategic marketing expertise to fuel the next growth phase.

This exit does not mean the company will be leaving the community so many of its employees call home. In an era of outsourcing, the company is committed to maintaining its manufacturing presence in the Mission District. This dedication to the local economy means stabilization of jobs in an area with traditionally low employment rates and low wages.

The sale of the company is not only good for investors, but employees as well. The transaction triggered a significant cash bonus to Timbuk2's nonmanagement employees, who all participate in the company's Employee Wealth Sharing Program. The company program was established by the CEO and PCV as a part of their double bottom line investment strategy. Through this, lower-income workers share significantly in the financial value they helped create.

As a reward for their hard work and dedication, the wealth creation program distributed more than $1 million to 40 employees in a one-time bonus. The cash payout to each employee was based on a formula accounting for tenure, grade level, annual salary and performance and was as much as twice employee's annual pay.

More than half the employees receiving the payout work in factory and warehouse positions and reside in low- to moderate-income communities targeted by PCV. In addition, PCV conducted on-site financial management workshops for employees receiving cash payouts to help them understand options for investing and saving the money through programs such as the company's 401(k) retirement fund, 529 education savings accounts and other personal investment tools.

PCV's cofounder and president, Penelope Douglas, sees the sale of Timbuk2 as a success in the community development venture capital field. Not only have considerable financial returns to investors been realized, but in providing equity capital to businesses in underinvested markets, significant returns have been made to the community through the creation and stabilization of good jobs, wealth-building opportunities and entrepreneurial capacity.

"Investment funds are judged on the quality of their investments and the ability to secure financially successful exits," Douglas says. "This double bottom line success will have important implications for the credibility of the community development investment movement as a whole. This is proof the model works."

—By Amy Simpkins

TimBuk2 employees receive a replica of a check for $1 million, the amount of a cash bonus they divided when the company was sold. The payout was a result of the company's Employee Wealth Sharing Program. (Photo courtesy of* Sing Tao Daily.*)

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increase in low-income employment and a 37 percent increase in middle- and higher-income employment.

7. Can you briefly describe any industry trends in CDVC?

Average fund size and investment size are increasing. CDVC funds are becoming more sophisticated, with more staff members having traditional venture capital experience. At least seven fund management groups in the industry have successfully formed second and third funds, indicating investor acceptance of the model. There is increasing co-investment, both within the CDVC industry and between the CDVC industry and traditional venture capital funds. While dollars from investors who are primarily socially motivated continue to increase in absolute terms, in percentage terms, market-rate investors such as banks, pension funds and insurance companies now dominate the industry. While in certain respects the CDVC industry is moving toward traditional venture capital in form, our data indicate that it is not losing its social impact.

8. What are the major challenges you see in making successful CDVC investments in the current market?

Quality deal flow is key to successful venture-capital investing of any type, and this is particularly true of CDVC investing. CDVC funds are expanding their geographic scopes and using increasingly sophisticated methods of deal-flow generation to meet this challenge. Management teams in portfolio companies are often less fully developed and experienced, requiring substantial entrepreneurial and managerial assistance from fund staffs. Exits present a challenge for the smaller companies and markets where initial public offerings are less common, and investment bankers are not roaming the streets looking for acquisition targets. These factors make the job of the community development venture capitalist even more challenging than that of the traditional venture capitalist. At the same time, CDVC funds tend to be smaller than traditional funds because of the limited availability of double bottom line investment capital, yielding smaller management fees to pay staffs. The industry needs more $100 million funds with the scale to fully fund the operation of a developmental venture capital fund.

9. If an organization is interested in forming a CDVC fund, what are the first steps you would recommend? What resources or tools could you recommend?

Think carefully about the goals of such an effort, the resources available and the market to be served. Learn from those who have gone before you. A first stop is CDVCA's web site, www.cdvca.org. Fund profiles and links to the web sites of leading CDVC funds provide a good introduction to the industry and contacts with leaders in the field. Twice a year, CDVCA offers an introductory training session designed for new entrants to the field, and our annual conference offers broad exposure to the industry. Finally, for more in-depth assistance, CDVCA offers consulting services to help organizing groups perform market studies, design funds, write business plans and offering documents, apply for government funding, and identify management teams.

About CDVCA

CDVCA is a network for the growing CDVC industry. CDVCA supports and promotes the CDVC industry through advocacy, investment, research, consulting, and communications.

CDVCA promotes using venture capital to create jobs, entrepreneurial capacity and wealth among low-income people and the economies of distressed communities.

CDVCA represents more than 100 member organizations from across the country.

Main Street Arkansas Cities Gain Jobs in 2005

The numbers for 2005 are in and the 17 Main Street Arkansas cities saw a net gain of 222 jobs for the year. The source of the jobs is 39 new businesses and 34 expansion and relocations into downtowns. Investment in 91 façade renovations, building rehabilitations and new construction projects totaled $3.6 million. Another $1.1 million was generated for public improvement projects.

Main Street Arkansas is a program of the Arkansas Department of Arkansas Heritage. The agency's programs are featured in the *Little Rock Area Resource Guide for Small Business* and include the Conservation Easement Program, Historic Preservation Restoration Grant, Historic Preservation Tax Incentives Program, and the Model Business Grant.

For more information on the programs, contact the Arkansas Department of Arkansas Heritage at (501) 324-9880 or visit www.arkansaspreservation.com.

For a copy of the *Little Rock Area Resource Guide for Small Business*, contact Julie Kerr at (501) 324-8296 or via e-mail at julie.a.kerr@stls.frb.org.

Market Value Analysis

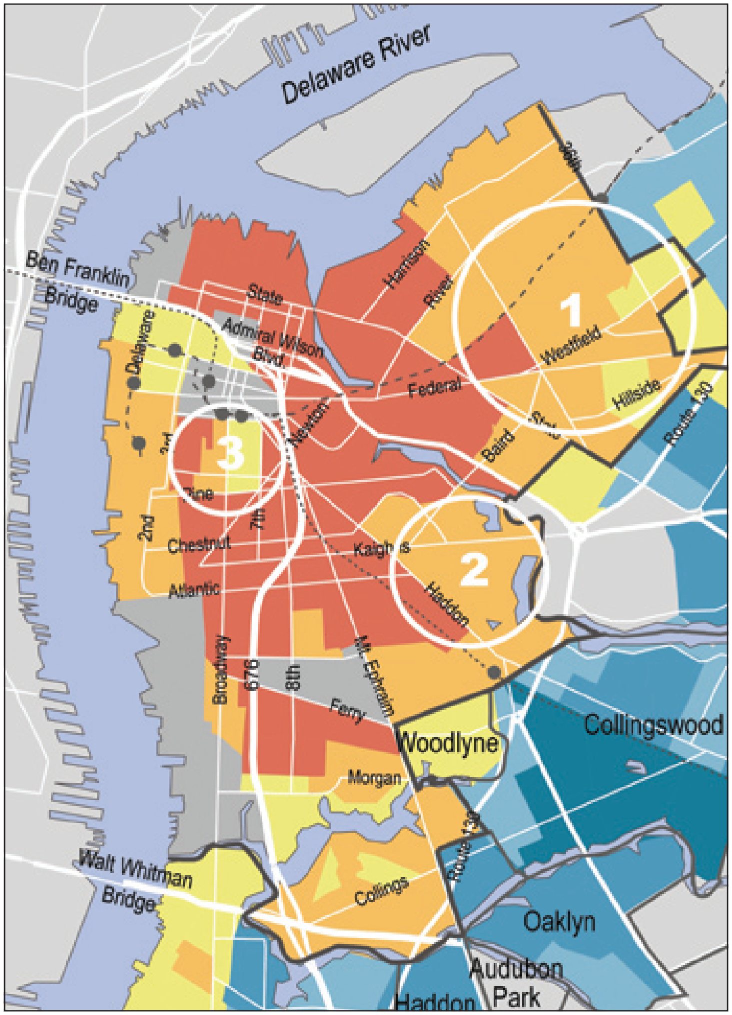
Understanding Where and How to Invest Limited Resources

By Ira Goldstein, Director, Policy and Information Services, and C. Sean Closkey, Executive Vice President, The Reinvestment Fund

Building 100 affordable homes in the middle of an area of distress and disinvestment may help only the 100 families who receive the homes. But those same 100, built in another location and bundled with other related activities, may help not only those 100 households, but the hundreds of residents around them. The Market Value Analysis (MVA) is an effective instrument to help create that kind of impact. The MVA identifies where and how to invest limited resources that can transform urban real estate markets into revitalized neighborhoods.

Pioneered by The Reinvestment Fund (TRF), a financier of neighborhood and economic revitalization projects, the MVA was first applied to Philadelphia's Neighborhood Transformation Initiative. An MVA has since been created for Camden, N.J.; Baltimore; and other cities in the mid-Atlantic region.

The MVA creates an innovative data-driven framework for restoring market viability and wealth in distressed urban real estate markets. It helps governments, private investors



The Reinvestment Fund's Market Value Analysis for Camden, N.J., recommended three investment target areas abutting stronger markets (yellow and orange).

and philanthropies target and prioritize actions that leverage investment and revitalize neighborhoods.

TRF's approach to urban analysis and investment rests on four assumptions: (1) public subsidy is scarce and it alone cannot create a market where there is none; (2) public subsidy must leverage or clear the path for private investment, depending upon market circumstances; (3) when working in distressed markets, public subsidy should be used to build off local nodes of strength, such as significant transportation hubs, parks or other environmental amenities and large institutions such as hospitals, universities or other institutions with a long-term local commitment; and (4) decisions about places must be made based on facts.

There are two steps to the MVA process. The first is a citywide cluster analysis; the second is a targeted project analysis.

Citywide Cluster Analysis

The cluster analysis is a statistical procedure that identifies groupings of areas with similar market characteristics (typically using Census block groups), but at the same time highlights differences across these groupings. After analysis and physical inspection of the areas, the result is displayed on a citywide map and illustrates market areas, which are more analytically refined than traditional neighborhood boundaries. TRF staff spends considerable time in the field with local market experts to ensure that what data sets describe about a place comports with what a knowledgeable observer would see. In Baltimore, for example, staff

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Typical data items used in the Market Value Analysis include:

- residential sale prices
- housing tenure
- presence/extent of subsidized housing
- age of housing
- housing vacancy/abandonment
- demolition
- presence of residential properties with building code violations
- mixture of commercial and residential uses
- credit scores/mortgage foreclosures/ratio of prime to subprime mortgage loans originated

The micro-level data collected and used in the targeted project analysis step includes:

- MVA cluster analysis (and all of its components)
- publicly owned properties by address
- area incomes by block groups
- building permit and amount by property address
- social and physical features
- crime data by property address
- age, race, ethnicity and education by block group
- public school performance and catchments
- aerial photography
- housing square footage by property address
- zoning and land use
- building conditions and vacancy by property address

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from TRF and the Baltimore City Department of Planning traveled throughout the city with drafts of the MVA map verifying the accuracy by which it characterized local markets. The MVA is instructive not only because it describes the aspects of a place, but also because it emphasizes forces upon a market and the likely direction of change.

The MVA uses data sets that are publicly available and known to be reliable. In addition, although not part of the MVA itself, we collect information about the physical and social features of the neighborhood and its residents, which is useful for project planning.

By identifying the market conditions of an area and adjacent areas, municipalities can better prescribe interventions and incentives that influence the amount and type of investment needed for revitalization. In short, the MVA allows municipalities, philanthropies and private investors to leverage investments and rebuild neighborhoods.

Assuming municipal government has a role in every market in its jurisdiction, the MVA is not only used to define its role and target and prioritize investments, but is also used to allocate resources among individual areas. The Table offers an example of governmental roles across a range of market types.

The initial applications of the MVA were at a large scale (i.e. census tracts and block groups) and were designed to analyze cities and local submarkets. The analysis has since been refined to help target municipal and foundation resources. As our experience with the MVA evolved, we used it to answer the question: "What should we do with this specific property or set of properties?"

Targeted Project Analysis

The targeted project analysis, the second step in the MVA process, answers questions related to specific property investment and uses. This is done by collecting and analyzing more micro-level data specific to individual properties within a block group and is accomplished with local community-based organizations. By simultaneously analyzing how a place relates to the larger market, the MVA identifies the best investment and property uses in specific locations.

With the micro-level information and analysis complete, the MVA uses traditional planning principles to understand the potential for development and explores the question: What opportunities are there to reorient the growth pattern to move in a direction that connects the local space to the larger market? As such, the MVA process will often call for an investment sequence that:

- physically opens up a market to nearby strength
- supports investment along critical thoroughfares, but does not extend past major physical barriers (i.e., significant intersections, highways)

Table

Market Type	Government Investment Strategy
Strong and growing	Serve as a market promoter and facilitate healthy functioning of the private market.
Stable, but low growth	Rapidly respond to signs of physical or economic deterioration; introduce preservation programs. In cities that experience broad price appreciation, affordable housing preservation is important.
Weak and declining	Identify ways to invest in strongest areas of a distressed market. Create conditions for private investment by demolishing failing structures and assembling larger tracts of developable land. Identify people-based investment strategies that support the residents of distressed places not yet ripe for housing investment.

- prioritizes investments (first in a stronger market, then moving to weaker areas)

The Wachovia Regional Foundation in Philadelphia is one of many partners and clients TRF works with on the MVA process. TRF assists the foundation with evaluating grant applications and providing comments on proposals. TRF also provides direct assistance to its planning and development grantees. Not only does TRF help them build capacity by gathering information about their communities, it also helps embed local plans into the larger market. In the future, baseline information provided by the MVA and the organization's own data gathering exercise will afford grantees and the foundation an opportunity to measure the broad-based impacts of the investment.

About TRF

TRF identifies the point of impact where capital can deliver its greatest financial and social return. TRF's investments in homes, schools and businesses help reclaim and transform neighborhoods, driving economic growth and improving lives throughout the mid-Atlantic region. Since its inception in 1985, TRF has made $500 million in community investments.

Its policy and research products help sharpen investment strategies for TRF, as well as other public and private investors. For more information, visit www.trfund.com.

Dates to Remember

For information on both events, visit www.stlouisfed.org/community.

July 19, 2006 · 11:30 a.m. to 1:15 p.m.

Hilton St. Louis Frontenac, 1335 S. Lindbergh Blvd., St. Louis, Mo.

In almost every city, there are neighborhoods that grow—attracting businesses and jobs—and those that do not. What attracts employers to one community and not another? Fed economist Chris Wheeler studied 15,000 neighborhoods across 361 metropolitan areas to find out. He will present the results of his research during this luncheon meeting.

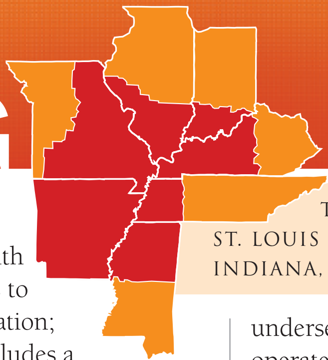
Oct. 24, 2006 · 7:30 a.m. to 9:30 a.m.

Hilton St. Louis at the Ballpark, One South Broadway, St. Louis, Mo.

The number of Americans filing for bankruptcy has risen dramatically in the past 25 years. The most common cause is an unexpected shock to their incomes, such as job loss, medical bills or divorce. Thomas A. Garrett, research officer at the Federal Reserve Bank of St. Louis, will present his study on the role other factors—such as availability of credit and bankruptcy laws—play in making Americans even more susceptible to bankruptcy.

The study includes filing statistics in counties in the Federal Reserve's Eighth District.

SPANNING THE REGION



THE REGION SERVED BY THE FEDERAL RESERVE BANK OF ST. LOUIS ENCOMPASSES ALL OF ARKANSAS AND PARTS OF ILLINOIS, INDIANA, KENTUCKY, MISSISSIPPI, MISSOURI AND TENNESSEE.

CDVC Funds Available in Bank's Eighth District

Several community development venture capital funds offer investment opportunities in states served by the Federal Reserve's Eighth District. The following is a sample of some of those funds. Please contact each fund directly for more information.

Adena Ventures

Adena Ventures is a venture capital firm serving high-growth businesses in traditionally under-invested rural areas. Its goal is to demonstrate that attractive investment opportunities exist in "unlikely places." Adena Ventures is the nation's first New Market Venture Capital Company designated by the U.S. Small Business Administration.

Adena's mission is to support sustainable economic growth while generating market-rate returns for investors. By working with private sector firms and universities, Adena has provided an equivalent of more than $3 million worth of operational assistance to nearly 60 companies. These services include business planning, executive recruitment and financial modeling.

Geographic focus: Kentucky, Ohio, West Virginia and Maryland.

Industry focus: A wide range of industries, from video game development to health care services to higher education; portfolio includes a combination of true technology companies and tech-enabled service companies.

Fund size: Overall has raised more than $34 million

Investment size: $500,000 to $2.5 million.

Contact: Lyn Gellermann
(740) 597-1470
www.adenaventures.com

Advantage Capital Partners

Advantage Capital Partners provides capital and value-added services to emerging and rapidly developing companies and entrepreneurs. Advantage invests in small companies and other ventures in low-income communities under the Treasury Department's New Market Tax Credit (NMTC) program. BizCapital, Advantage Capital's wholly owned nondepository financial institution licensed by the federal government to make SBA and USDA loans, administers the NMTC small business finance fund. The goals of the fund are job creation and community development.

Advantage Capital Partners seeks to develop businesses and create a venture capital infrastructure in traditionally underserved areas. Advantage operates with a dual bottom line of measuring success: economic development goals and profitability of the investments. In addition, Advantage offers its portfolio companies business development assistance, active guidance and mentoring.

Geographic focus: Variety of places but most active in Missouri, Louisiana, Alabama, Colorado, Florida, Hawaii, New York, Texas, Wisconsin and Washington, D.C. Typically focuses on markets that are underserved by other private equity funds.

Industry focus: Communication, information technology, life science and energy sectors. Invests in companies at all stages except seed financing.

Fund size: Overall has raised more than $700 million

Investment size: $1million to $10 million. Also provides straight debt investments to small and medium-sized businesses that may not be suitable for typical private-equity investments, ranging from $100,000 to several million dollars. These are made possible through BizCapital.

Contact: Carter Dunkin
(314) 725-0800
www.advantagecap.com

Lewis & Clark Private Equities Fund

Lewis and Clark, Private Equities (LCPE) is a Participating Securities Small Business Investment Company (SBIC) as designated by the U.S. Small Business Administration. LCPE is managed by InvestAmerica Investment Advisors, a venture capital management company with offices in Cedar Rapids, Iowa; Kansas City, Mo.; Fargo, N.D.; St. Paul, Minn.; and Portland, Ore.

As an SBIC, the LCPE Fund targets small towns and rural areas for investment. InvestAmerica specializes in bringing in co-investors with the goal of raising outside capital and experienced investors in these underserved areas. InvestAmerica also offers technical assistance, management experience and mentoring to its portfolio companies.

Geographic focus: Nationwide, with an emphasis on small cities and rural areas

Industry focus: Variety of industries that include smaller businesses, many with annual sales of less than $10 million.

Fund size: $32 to $36 million

Investment size: $1 million to $3.5 million

Contact: David Schroder (319) 363-8249; www.investamericaventuregroup.com

Meritus Ventures

Kentucky Highlands Investment Corp. of London, Ky., and Technology 2020 of Oak Ridge, Tenn., established Meritus Ventures, LP, as a rural Business Investment Corporation as approved by the Department of Agriculture. Meritus focuses on investment in expansion-stage companies in rural areas in the Appalachian region.

Meritus Ventures is a private, for-profit, venture capital fund that makes equity investments in private companies in underinvested rural areas. The fund's mission is to generate market-rate returns for its investors while promoting sustainable business growth throughout its target region. The fund managers also offer operational assistance, active board participation and mentoring to Meritus' portfolio companies.

Geographic focus: Appalachian regions of Ohio, West Virginia, Virginia, North Carolina, South Carolina, Georgia, Alabama, Mississippi, and the entire states of Kentucky and Tennessee.

Industry focus: Broad industry focus that includes manufacturing, technology and software.

Fund size: $30 million

Investment size: $250,000 to $2,000,000 in each portfolio company; generally invests in two or more rounds based on the accomplishment of milestones by the portfolio company.

Contact: Ray Moncrief Kentucky Highlands Investment Corp., (606) 864-5175 www.khic.org

Southern Appalachian Fund

Southern Appalachian Fund (SAF) is a venture capital fund that provides equity capital and operational assistance to qualifying businesses. Established by a joint effort between Technology 2020 and Kentucky Highlands Investment Corp., SAF is one of six New Markets Venture Capital (NMVC) companies in the United States. The NMVC program is a developmental venture capital program of the U.S. Small Business Administration that promotes economic development and the creation of wealth and job opportunities in low-income geographic areas.

SAF's mission is to generate market-rate returns for its investors while promoting shared and sustainable economic development throughout its target region. In addition to equity investments, SAF can provide operational assistance to its actual and potential portfolio companies at no cost.

Geographic focus: Kentucky, Tennessee and the Appalachian counties of Georgia, Alabama and Mississippi

Industry focus: Early- and expansion-stage companies across a wide variety of industries.

Fund size: $12.5 million

Investment size: $200,000 to $600,000 and will generally hold that investment for four to seven years.

Contact: Ray Moncrief, Kentucky Highlands Investment Corp., (606) 864-5175 www.southappfund.com

Equity Fund Seeks Investors in Southern Illinois Businesses

Small businesses in Southern Illinois have not had many opportunities to get funding through venture capital or angel investors; but, now, Southern Illinois University Carbondale is working to change that. The university's Office of Economic and Regional Development has created Shawnee Ventures, LLC, an equity fund that is expected to increase deal flow to high-growth, scalable businesses in the region.

The fund has set a goal of raising $5 million through institutional and private investment by selling memberships. To date, it has obtained $250,000 through private investors, including Illinois Ventures for Community Action, and is negotiating with the Illinois Department of Community and Economic Opportunity for an additional $250,000 investment.

John Farrell, chief executive officer of Illinois Ventures for Community Action, is the fund manager.

Shawnee Ventures offers a "double-bottom line" approach that provides investors with market returns and the opportunity to help promote economic growth in Southern Illinois. The fund is similar to others that have financial institution investors and may allow bankers to reap an additional benefit—CRA credit. For more information, visit www.shawneeventures.com.

Low-Income Housing in Kentucky Gets Boost

The Kentucky Affordable Housing Trust Fund has a new source of revenue since the approval of a new law, effective July 12. The law establishes an annual, estimated $4.4 million or more in dedicated public revenue for the housing fund. The money will come from a $6 increase in the fees counties charge to record various documents, including deeds and mortgages.

The final version of the state budget also specified that the Kentucky Housing Corporation will continue to contribute $500,000 to the fund annually.

The Affordable Housing Trust Fund provides housing for very low-income Kentuckians. For information, visit www.kentuckyhousing.org.

Nonprofits Look to Business for Funding Model

How organizations come up with the money to pay for development projects has been on a path of change for some time, and the pace is accelerating.

There is a long history of grant funds from government and philanthropic organizations to pay for projects. In fact, charitable giving was the first source of funds for community development.

However, stakeholders have learned that a principal ingredient for community development—in addition to social, moral and economic motivation—is an adequate, sustainable supply of financial capital. So, many community development corporations (CDCs) are adopting models more typically used by for-profit businesses. Terms such as revenue, growth, sustainability, equity investors, self-sufficiency, earned income, and access to capital are becoming commonplace.

Although this approach may be new for many community development organizations, it's a tradition for other nonprofits. Some have been selling products and services for years as a way to generate their own source of funding. For example, the Girl Scouts annual cookie drive generates enough revenue for Girl Scout Councils across the nation to continue offering programs, training and special events for thousands of young girls and adults. Likewise, the revenue that Goodwill Industries of America makes from selling donated items in its stores sustains programs, such as job training and counseling, for people with disabilities and other disadvantages. More than half its revenue comes from retail sales.

Franklin School Apartments were developed by River City Housing in Louisville with the help of tax credits and the Commonwealth Bank & Trust Co.

A nationwide collaborative of 84 regional organizations, the Housing Partnership Network (HPN), creates efficiencies, increases product, and enhances the performance and social impact of nonprofit community developers. The partnership is based on a European model of co-ops and mutual organizations. HPN enterprises include:

- Housing Partnership Insurance Co.—a $10 million captive insurance company owned by 18 of the regional nonprofits. The premium savings is about 15 percent, so each of the 18 participants has more money to spend on programs.
- Housing Partner Securities—a $100 million 501(c)3 bond conduit with Freddie Mac that delivers a more efficient source of capital for the housing producers.
- A new mortgage services company that will do $18 million in loans to 200 new home owners in 2006.

A future HPN enterprise is a community development financial institution (CDFI) investment bank that will be a liquidity outlet for large-scale CDFIs.

"Why do we care? HPN saves us money; HPN increases our competitiveness; HPN solves problems too big for a single member," says Nancy Andrews, president and CEO of the Low Income Investment Fund and an HPN board member. Together, the member organizations have produced or financed 600,000 housing units.

Several local CDCs—United Housing and Cooper Young Development Corporation in Memphis, for example—are building and selling market-rate houses as a secondary activity for the sole purpose of creating a revenue stream to fund their primary mission: affordable housing. These market-rate houses are sold to buyers who are not income-restricted since the CDCs are using sources of funds that do not dictate price or income qualifications.

Habitat for Humanity's ReStore operations provide another example. Located in many cities—including St. Louis, Louisville, Little Rock and Memphis—these retail operations sell donated new or gently used tools, furniture, building supplies and other items for the home. Sales revenue helps Habitat continue building affordable homes.

According to Diane Kirkpatrick, executive director of Habitat for Humanity in Louisville, ReStore produces community-wide benefits in addition to creating revenue for Habitat. Materials are donated instead of being sent to landfills, donors receive a tax deduction for the fair-market value of the donated items, jobs are created for community residents, and items are sold at a deeply discounted price.

As demonstrated by HPN, building collaborations and coordination is critical. This is also true at the local level, and using tax credits is one way to engage the private, for-profit market in affordable housing development. River City Housing in Louisville, Ky., did this when it acquired and sold historic tax credits and low-income housing tax credits to convert an abandoned school into 12 affordable rental units for the elderly. Commonwealth Bank & Trust Co. was the investor. The project cost $1.8 million, with more than $1.2 million financed through a combination of historic and low-income housing tax credits.

All these organizations have discovered models that provide them access to capital. Whether selling products or tax credits, the revenue generated is helping CDCs reach scale and sustainability.

(Information for this article was compiled by Federal Reserve Bank of St. Louis community affairs staff members Matthew Ashby, Lisa Locke and Glenda Wilson.)

CALENDAR

JULY

31-Aug. 4

Community Development Institute—Conway, Ark.
Sponsor: University of Central Arkansas
(501) 450-5372
www.uca.edu/aoep/cdi

AUGUST

8

Entrepreneurship Workshop—Memphis
Sponsor: Federal Reserve Bank of St. Louis
www.stlouisfed.org/community

9

Improving Access to Community Development Capital Series: Emerging Neighborhood Markets—St. Louis
Sponsor: Federal Reserve Bank of St. Louis
www.stlouisfed.org/community

10

Youth Entrepreneurship Showcase Teacher Training—Little Rock, Ark.
Sponsors: Arkansas Council on Economic Education, Arkansas Capital Corp.
(501) 374-9247

14-18

NeighborWorks Training Institute—Washington, D.C.
Sponsor: NeighborWorks
www.nw.org/network/home.asp

SEPTEMBER

6-8

Hats Off to Economic Development—San Antonio, Texas
Sponsor: National Rural Economic Developers Association
www.nreda.org. (Click on "Events".)

7

Community Development Roundtable—Pine Bluff, Ark.
Sponsor: Federal Reserve Bank of St. Louis
(501) 324-8296

16-19

Grassroots and Groundwork: What Communities Are Doing to Get Out and Stay Out of Poverty—St. Paul, Minn.
Sponsor: Northwest Area Foundation
www.grassrootsandgroundwork.nwaf.org

19

Affordable Housing Bus Tour & Forum—Memphis
Sponsor: Federal Reserve Bank of St. Louis
www.stlouisfed.org/community

25-27

Governor's Conference on Economic Development—St. Louis
Sponsor: Missouri Department of Economic Development
www.ded.mo.gov

25-29

Community Development Training Conference—Little Rock, Ark.
Sponsor: Arkansas Coalition of Housing and Neighborhood Growth for Empowerment (ACHANGE)
www.makingachange.us/

28-29

Governor's Conference On Housing—Springfield, Mo.
Sponsor: Missouri Housing Development Commission
www.mhdc.com

OCTOBER

11

Improving Access to Community Development Capital Series: Exploring Social Return on Investment—St. Louis
Sponsor: Federal Reserve Bank of St. Louis
www.stlouisfed.org/community

24

The Rise of Personal Bankruptcy—St. Louis
Sponsor: Federal Reserve Bank of St. Louis
www.stlouisfed.org/community

BRIDGES

Bridges is a publication of the Community Affairs department of the Federal Reserve Bank of St. Louis. It is intended to inform bankers, community development organizations, representatives of state and local government agencies and others in the Eighth District about current issues and initiatives in community and economic development. The Eighth District includes the state of Arkansas and parts of Illinois, Indiana, Kentucky, Mississippi, Missouri and Tennessee.

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If you have an interesting community development program or idea for an article, we would like to hear from you. Please contact the editor.

Free subscriptions and additional copies are available by calling (314) 444-8761 or by e-mail to communityaffairs@stls.frb.org.

RESOURCES

Tennessee One-Stop Business Resource—Business startups in Tennessee can use this online tool to file applications with the state and to obtain various permits, licenses and a state tax identification number. Go to the state's web site at www.tennessee.gov.

National Association of Seed and Venture Funds—The web site for this organization provides a wealth of information on state programs related to venture capital. Visitors to the site will find a 2006 Report on State Capital Programs, a State Venture Capital Program Directory (by subscription), Highlights of the 2006 State Capital Programs Survey Results, the 2006 State-by-State Dollar Commitment to Venture Capital Programs, and a survey form for the organization's Survey of State Venture Capital Programs. The web address is www.nasvf.org/web/nasvfinf.nsf/pages/svcp.html.

Microenterprise FIELD Guides—This series of publications identifies ways donors can support the domestic microenterprise industry. The series begins with three guides—*Fulfilling the Microenterprise Promise: Background for Funders; Microenterprise: Making a Difference;* and *Moving Forward: Industry Challenges, Funder Opportunities.* The guides are produced by Fund for Innovation, Effectiveness, Learning and Dissemination (FIELD). Visit http://fieldus.org/publications/index.html.

Entrepreneurship in Missouri—Information on Missouri's entrepreneurs is available at http://oseda.missouri.edu/meric/. The Missouri Office of Social and Economic Data Analysis, in collaboration with the Missouri Economic Research and Information Center, compiled data by regions and various characteristics.

Have you HEARD

Grants Available Through USDA

Nonprofit organizations, colleges and universities have until Sept. 15, 2006, to apply for $4.5 million in grants from the Rural Business-Cooperative Service of the Department of Agriculture. Grantees will receive awards of up to $225,000 each.

The grants must be used to establish rural centers for cooperative development that will create new cooperatives and improve the operations of existing cooperatives. The centers will conduct research and provide training, loans, grants and technical assistance to cooperatives.

For more information, visit www.rurdev.usda.gov/rbs or call (202) 720-4323 and press option 1.