

# Community Investment Funds

A How-To Guide for Building Local Wealth, Equity, and Justice



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## Preface:

# Ce(See)ding Power through Impact Investing

We are pleased to partner with Brian Beckon, Amy Cortese, Janice Shade, and Michael Shuman on what we initially thought would be a successor publication to our 2013 handbook, *Creating a Community Investment Fund: A Local Food Approach*. There we documented our decision-making process in creating PVGrows, a local patient capital fund for local food businesses in the Pioneer Valley of Western Massachusetts. For this handbook, we originally planned to document the challenges and accomplishments of that experiment after six years. However, so much has happened across the United States since 2013, we decided to share the story not only of PVGrows but also of other initiatives, some directly inspired by PVGrows and some that have evolved independently. All are representative of an emerging field we call “aggregated community capital.”

In the 2013 handbook, Jenny Kassan and Michael Shuman wrote:

There is an urgent need to create more of these funds all across the country, to move more capital into local businesses in a way that brings down the risk of investing in a single company. And there’s a need to make these funds simple to understand, easy to invest in, and efficient to run by professionals, so that investors feel confident that their dollars are being stewarded to optimal community outcomes.<sup>1</sup>

This urgency remains.

Some readers might believe the need for new capital sources has been solved by the explosion of activity in “impact investing.” The Global Impact Investing Network estimates that in 2018 impact investing assets under management at 1,340 organizations worldwide totaled \$502 billion.<sup>2</sup> According to an article in *Barron’s*, the broader market for “sustainable investing practices, which includes investing in public companies with best practices against environmental, social, and governance (ESG) metrics, was pegged at about \$12 trillion in 2018.”

For those of us committed to financing a Just Transition or a Green New Deal, gigantic numbers like these seem puzzling. As Charles Wallace of Impactivate argues, “[S]ome asset managers engage in ‘impact washing’ to attract investors while making investments that don’t meaningfully address environmental, social, or governance (ESG) issues.”<sup>3</sup>

What exactly is the standard for impact investing? Those of us preparing this volume believe that, at a minimum, it should be place-based investments that are both patient and catalytic. Too many impact investors are comfortable supporting global companies that match or even better the rates of return from

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<sup>1</sup> Shuman, Michael H., et al. *Creating a Community Investment Fund: A Local Food Approach*. Community-Wealth.org. (Oakland, Cutting Edge Capital, 2013). <https://community-wealth.org/content/creating-community-investment-fund-local-food-approach>

<sup>2</sup> Schultz, Abby, “Impact Investments Under Management Total \$502 Billion,” *Barron’s*, April 1, 2019. <https://www.barrons.com/articles/impact-investments-under-management-total-504-billion-01554145026>

<sup>3</sup> Wallace, Charles, “New Impact Management Principles Aim to Safeguard against Impact Washing,” Impactivate, March 26, 2019. <https://www.impactinvestingexchange.com/new-impact-management-principles-aim-to-safeguard-against-impact-washing/>

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Wall Street. Patient capital, in contrast, seeks to create positive impact, even if it means a lower rate of return, more term flexibility, or a greater tolerance for risk.<sup>4</sup> Community capital also seeks to catalyze positive social outcomes by focusing on communities where capital usually cannot be found.

This is not meant to critique impact investment, but rather to highlight an important difference. As you'll see throughout this handbook, investment structures look very different when you start with the needs of distressed communities and the entrepreneurs who live in them. Those looking at "blended social and financial returns" rarely do this. As Oxfam and Sumerian Partners observed in a recent thought-provoking report about impact investing's blind spots: "The views, experiences, and needs of the downstream enterprises (demand for capital side) working with or otherwise benefiting people living in poverty are not broadly represented in the literature. As such, the field is evolving with a one-sided view of what is possible, resting heavily on investor needs, not enterprise realities."<sup>5</sup>

The community investment funds described here *start* with a mission – not to enrich investors, but to finance significant social change in communities and serve end users, while giving investors an opportunity to make a modest rate of return.

At the many impact-investing conferences I attend, and sometimes convene, I find myself speaking with investors enthusiastic about financing local food systems or closing the racial wealth divide, but who nevertheless insist that they should get the same rates of return they receive from Wall Street. Here's how the discussion usually goes:

Imagine a crowded swimming pool, with little floaties bumping against one another—that's what it looks like as we begin the conversation about risk and return. As I explain that these investments might provide lower return than "market rate," the crowd thins. I add, almost apologetically, that these investments also come with higher risk and less liquidity. Now the pool isn't so crowded. I add that they often require grant support for infrastructure and ongoing technical assistance, and the lending process is more costly. Plenty of room to swim now. Finally I add, candidly, that we have yet to test all of the impact metrics and maybe we're even a little unsure about some of them. That's when we look up to find ourselves alone in an empty pool.

This is the wrong way to think about the field. The goal is not to make community investments appeal to market-rate-seeking impact investors, who might be willing to bend the usual investment terms. By starting with the needs of end users, conducting capital-gap assessments, and focusing on the impacts, we can begin solving for serious environmental and community needs and find the investors who want to support that change. As the case studies here attest, a growing number of grassroots investors truly want to participate in these kinds of initiatives.

Most of the funds described here focus not just on impact but also on place. While place-based investing has a long history, via banking and other targeted economic development strategies, the Occupy Movement and the "Move Your Money" campaign that followed have accelerated interest in the field. As large numbers of people objected to the way Wall Street governed their lives, they wondered why it wasn't easier to invest

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<sup>4</sup> As many have pointed out, all investments create some type of "impact." The field of impact investment generally refers to positive social or environmental impacts.

<sup>5</sup> "Impact Investing: Who are We Serving? A case of mismatch between supply and demand," Oxfam, April 3, 2017, <https://www.oxfamamerica.org/explore/research-publications/impact-investing-who-are-we-serving/>

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in their own communities. Individuals, especially those who had ample opportunity to express their values as consumers, sought opportunities to express their values as investors. This has been a long time coming, and the desire to “democratize capital” is now showing up in efforts to allow nonaccredited investors to participate in community funds.

The jury is still out on whether aggregated community capital and community-governed capital are efficient ways to promote economic development. Aggregation definitely spreads risk, but also comes with costs. It’s important that investors who enter this field prepare themselves for the relatively high costs of administering funds and supporting the investees.

There’s recently been a flurry of interest in the role that impact investment can play in closing the racial wealth divide. Here again, additional drivers and innovations are required. We believe that the most important is the willingness to cede control over the fund’s design, success metrics, and day-to-day operations. The preface title, “Ce(See)ding Power,” is meant to suggest that we cannot hope to address systemic, institutional bias and racism without ceding power to the communities of color we seek to support.

As Rodney Foxworth, executive director of Common Future (formerly The Business Alliance for a Local Living Economy, or BALLE), has asked, “What if we challenged individuals and institutions with wealth and power to chart a new way forward that doesn’t perpetuate social inequalities? What if we invited them to join us in creating new practices and processes for investing in community wealth and economic equity?”<sup>6</sup>

If we do not cede power, we risk perpetuating the systemic inequalities we want to remedy. “To sum it up,” writes Edgar Villanueva in his explosive book, *Decolonizing Wealth: Indigenous Wisdom to Heal Divides and Restore Balance*, “when it comes to getting or giving access to money, white men are usually in charge and everyone else has to be twice (or more) as good to get half (or less) as much.”

Three funds described in this handbook explicitly focus on racial equity. The Ujima Project and Boston Impact Initiative, both located in Boston, and the REAL People’s Fund in California’s Bay Area, approach racial equity in different ways, but each starts with the premise that the *who* and the *how* matter.

One insight from the funds described here is the potential importance of having several layers of capital. To achieve their full impact, funds might need strategic grant dollars, high-risk investment dollars, and grassroots investment dollars. By matching each layer to the ability of the donors or investors to carry the risk, we can envision a different kind of efficiency. Grant makers can use their catalytic grant dollars to support community activists and help leverage the impact of traditional capital. Impact investors can enter at the right level of risk, mitigated by professional expertise and the pooling of risk offered by the fund. Community investors can participate in small dollar minimums, supporting their neighbors and businesses in a low-risk and transformative way.

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<sup>6</sup> Foxworth, Rodney, “Impact Investing Can Fight Racism and Wealth Gaps – if Conducted in New Ways,” *Chronicle of Philanthropy*, August 8, 2018, <https://missioninvestors.org/resources/impact-investing-can-fight-racism-and-wealth-gaps-if-conducted-new-ways>

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This handbook shows a wide range of approaches you might apply to your own community. It is not a call to action, but a manual for those who have already been called. We hope it inspires the reader to stay focused on the mission, rather than subordinate that mission to the needs of traditional capital providers.

Jeff Rosen, Solidago Foundation

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## Acknowledgments

As the four co-authors of this handbook, we wish to express our appreciation to Jeff Rosen of the Solidago Foundation for initiating, underwriting, and collaborating with us every step of the way. Solidago has been doing pioneering work in the local investment field for more than a decade, and we hope that this handbook – a successor to its 2013 handbook detailing the process of creating the PVGrows Fund – will push the boundaries of the field further.

We also wish to thank the board of the National Coalition for Community Capital (NC3) for giving us broad creative latitude with this project. NC3 was created to grow the local investment field, especially at the state and local level. (All of us were involved in NC3's creation, and two of us serve on its board).

We are also grateful: to Pierre Joseph of Solidago for his wise suggestions and his preparation of the REAL People's Fund case study; to Audrey Dumentat for her skilled preparation of the Goodworks Evergreen and PVGrows case studies; to Jonathan Littel and Nate Schaffran for creating templates of their state-of-the-art financial models (which can be downloaded from NC3's website); to Michele Spring-Moore for first-rate editing; and for Chris Landry for excellent design work. They rounded out a team that was able to produce this handbook on a tight budget and fast schedule.

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- Janelle Orsi, Sustainable Economies Law Center
- Lucas Turner-Owens, Boston Ujima Fund
- Loral Ruggles, Northeastern Vermont Regional Hospital and NEK Prosperity Fund
- Noni Session, East Bay Permanent Real Estate Cooperative

We would like to thank each other for a rewarding collaboration. While we each took charge of different parts of the handbook – introduction and general coordination (Michael), Chapter 1 (Amy), Chapter 2 (Janice), Chapter 3 (Brian) – we edited and contributed to one another's work.

Finally, we would like to thank you – for taking the first, important step to consider creating your own community investment fund.

Brian Beckon  
Janice Shade

Amy Cortese  
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# Introduction

The term “community empowerment” usually sparks images of sit-ins, protests, rallies, campaigns, elections, and a thousand other actions associated with politics. You’re probably not imagining a half dozen smart people sitting around a table and planning how to creatively invest the pool of several million dollars gathered from local investors. But look at the missions of funds like PVGrows or the Boston Ujima Fund, and you see a radical effort to help revitalize distressed neighborhoods by supporting struggling small businesses, often led by women and people of color. Funds like these are increasingly being used to open grocery stores in food deserts, build affordable housing, launch worker cooperatives, and enhance the energy efficiency of old commercial and residential structures.

Capital is a critical tool for community problem-solving. Advances on paychecks help families put food on the table and keep a roof over their heads. Student loans allow talented young people to attend college. Municipal bonds underwrite vital infrastructure, everything from local water and sewer systems to roads and internet. Crowdfunding enables entrepreneurs to develop new businesses that bring new income, wealth, and jobs into their communities. While money alone cannot solve every local problem, it’s a necessary component for any serious approach to community empowerment.

This handbook shines a spotlight on an emerging generation of practical, intelligent activists who are reinventing local financial systems. Even as they criticize capitalism, they are using – and mastering – its financial tools to solve local challenges. In the pages ahead you’ll find an emerging set of tools we call community investment funds. Our purpose and hope in preparing this guide is that you’ll consider creating one of these funds for your own community.

To clarify, when we talk about community investment funds, we’re not referring to the nearly 10,000 mutual funds in the United States that invest primarily in Fortune 500 companies and are largely disconnected from community problem-solving. Nor are we referring to the thousands of economic-development funds or microenterprise funds that are underwritten by municipalities, large banks, and foundations, which provide virtually no role for the vast majority of us who are not wealthy enough to participate.

In our view, a community-friendly investment fund has three essential characteristics:

- **Local sourcing:** Capital for a community investment fund should come from people living in the community and, if possible, from grassroots investors. Yes, deep-pocket investors are welcome, but so is everyone else, including the 95% of us called “unaccredited investors.”
- **Local investing:** The fund should put its capital exclusively into local people, projects, and businesses, with a mission of significant social change. Sure, part of the mission of investing is generating a rate of return for investors, but just as important is the social rate of return for the community. Particularly important is investing in people, projects, and businesses run by those with the fewest resources and the least power.



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- Local decision making: A board of people broadly representative of the community should decide how to deploy the capital. Those without power or resources whom the fund is targeting also need to play a role in the decision-making.

One additional characteristic, essential to any fund, is that it should be designed to provide investors with a positive rate of return. Even if the fund is run by a nonprofit, as many of our examples are, it can and should pay something to the investors for the use of their capital. A successful community investment fund will benefit both the investors and the community.

For our purposes, “local” means that investors and investment recipients live in close proximity, so they can have a truly meaningful relationship with one another. This could be in a neighborhood, town, city, or small region. A locally owned business is one where most of the ownership is held by people living in this close proximity. It can be a sole proprietorship, a family company, a co-op, a small nonprofit, or even a public enterprise. The only kind of business that’s clearly not local is a publicly traded company whose owners are spread across the globe – where most Americans’ money is currently invested.

Very few investment funds operating today meet these criteria perfectly. But the centerpiece of this handbook, in Chapter 1, is a set of descriptions of 10 funds that are innovative with respect to at least one of these criteria. We foresee many other funds building on these pioneering models.

## Why local investment matters

Local investment is mostly about people putting money into small businesses they know and love. The importance of local investment cannot be exaggerated, because local businesses are the key to a community’s prosperity. Compared to an absentee-owned business, a locally owned business spends more of its money locally and imparts a more beneficial “multiplier effect” – the more times a dollar circulates in a community, the faster it circulates, and the more income, wealth, and jobs that community enjoys.

A study done in British Columbia in 2013 compared the impact of a dollar spent on locally owned restaurants and retailers versus a dollar spent on national and international chains.<sup>7</sup> For every dollar British Columbians spent on locally owned restaurants and retailers, about 45 cents were re-spent on other businesses in the province. Chains, however, re-spent locally only about 18 cents of every dollar they received. That means that for every dollar a British Columbian mindfully spent in a local restaurant and retailer rather than in a chain, the province enjoyed two-and-a-half times the economic stimulus. In fact, about two dozen studies have compared the impacts of local versus similar non-local business, and all have shown that every dollar spent at local business generates two to four times the jobs and other economic-development impacts.

Community economists have long argued that poverty is not just the absence of money or wealth, but the absence of a multiplier effect. When money comes into a community and immediately leaves, the result is

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<sup>7</sup> This report nicely summarizes nearly 100 relevant studies: Mitchell, Stacy, “Key Studies: Why Local Matters,” Institute for Local Self-Reliance, January 8, 2016, <https://ilsr.org/key-studies-why-local-matters/>

economic misery. A growing body of evidence demonstrates that regions with higher densities of local businesses prosper. For example:

- A 2010 study appeared in the *Harvard Business Review* under the headline “More Small Firms Means More Jobs.”<sup>8</sup> The authors wrote, “Our research shows that regional economic growth is highly correlated with the presence of many small, entrepreneurial employers – not a few big ones.”
- Another study published shortly thereafter in the *Economic Development Quarterly* similarly found, “Economic growth models that control for other relevant factors reveal a positive relationship between density of locally owned firms and per capita income growth, but only for small (10-99 employees) firms, whereas the density of large (more than 500 workers) firms not owned locally has a negative effect.”<sup>9</sup> In other words: if you want higher wages, focus on small, local businesses.
- That was also the message of a paper published in 2013 by the Federal Reserve in Atlanta, which performed a regression analysis of counties across the United States and found statistically significant “evidence that local entrepreneurship matters for local economic performance... [T]he percent of employment provided by resident, or locally-owned, business establishments has a significant positive effect on county income and employment growth and a significant and negative effect on poverty...”<sup>10</sup>

Local businesses contribute to a strong community in other ways as well:

- Economic stability: A community with one big factory run by outsiders is vulnerable to decisions made in board rooms hundreds or thousands of miles away. As many company towns in the United States have learned – especially those producing resource-dependent products like fish, paper, wood, oil, or coal – if a global corporation takes over the company and decides it can get a slightly higher return by moving a plant elsewhere, the community can collapse overnight. A community with a diversity of local businesses, in contrast, is better able to adapt gradually to inevitable changes in the national and global economy.
- Public health: One of the first sectors people focus on when they “buy local” is food, perhaps because they can taste the difference in fresh, local food and embrace the pride in certain traditional local foods (like Wisconsin residents who love their cheese). Public

<sup>8</sup> Glaeser, Edward L. and William R. Kerr, “The Secret to Job Growth: Think Small,” *Harvard Business Review*, July-August 2010, <https://hbr.org/2010/07/the-secret-to-job-growth-think-small>

<sup>9</sup> Fleming-Muñoz, David A. and Stephan J. Goetz, “Does Local Firm Ownership Matter?,” *Economic Development Quarterly* 25, No. 3 (2011). doi: 10.1177/0891242411407312.

<sup>10</sup> Rupasingha, Anil, “Locally Owned: Do Local Business Ownership and Size Matter for Local Economic Well-Being?,” Federal Reserve of Atlanta Discussion Paper 2013-1, August 2013.

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health studies now show that as communities replace highly processed, heavily packaged nonlocal foods with fresh, lightly processed local foods, rates of obesity and Type II diabetes – both at epidemic levels nationally – go down. Some of the funds we describe explicitly focus on nurturing public health through more local food businesses.

- **Charity:** For every dollar of sales, local businesses give significantly more to charitable organizations and causes.
- **Tourism:** Visitors are especially attracted to restaurants, shops, and museums that are unique to a community, which means local businesses are what really drives tourism.
- **Sustainability:** Because the owners of local businesses are part of the community, the businesses tend to act more responsibly. A federal Environmental Protection Agency study has shown that when you compare two similar factories, one locally owned and one not, the locally owned factory generates about one-tenth as much pollution. A community that's self-reliant also has less need to import things, which brings down the local carbon footprint.
- **Resilience:** The fewer local businesses you have, the more you're vulnerable to oil embargoes, wars, famines, hurricanes, or other catastrophes. A community with a diversity of local businesses and more self-reliance, in contrast, can control its own destiny.
- **Social justice:** The greater economic stability of communities filled with local businesses means greater employee loyalty and fewer residents leaving town.<sup>11</sup> In 1946, two noted social scientists, C. Wright Mills and Melville Ulmer, compared communities dominated by a couple of large manufacturers versus communities characterized by large numbers of small businesses. They found that small-business communities "provided for their residents a considerably more balanced economic life than did big business cities" and that "the general level of civic welfare was appreciably higher."<sup>12</sup> Thomas Lyson, a professor of rural sociology at Cornell University, updated this study in 2001 by looking at 226 manufacturing-dependent counties in the United States. He concluded that these communities are "vulnerable to greater inequality, lower levels of welfare, and increased rates of social disruption than localities where the economy is more diversified."<sup>13</sup>

The goal of any community eager to improve its quality of life is to start, nurture, and expand its local businesses. Local investment therefore gives you and your neighbors the ability to become significant economic developers.

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<sup>11</sup> Tolbert II, Charles M, "Small, Local, and Loyal: How Firm Attributes Affect Workers' Organizational Commitment," *Local Economy* 29, No. 8 (October 2014), doi: 10.1177/0269094214556980.

<sup>12</sup> Quoted in Thomas A. Lyson, "Big Business and Community Welfare: Revisiting A Classic Study," Cornell University, monograph, 2001, 3.

<sup>13</sup> Lyson, 14.

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But local investment is not just about local businesses. Similarly large multiplier effects can occur with investments in individuals or municipal projects, which also re-spend money they receive locally. “Investing” in your neighbor to get her out of credit card debt, perhaps with a smaller-interest personal loan, can prevent her from going bankrupt and keep the interest payments circulating locally. Investing in city projects, like a museum or a zoo, can keep your money moving in the hands of local construction companies and staff.

## **A grassroots investment revolution**

For the vast majority of Americans with meager savings, investment historically meant making small loans to family members or friends. Many had accounts at a bank or credit union, not always appreciating that this was also an investment activity. They put their money on deposit, and then their local financial institutions would lend the money out to help neighbors buy a home or launch a business.

Community banking was once the norm of American life. An institution with a single branch, or perhaps a handful of branches in a small city, would recycle local deposits to grow the local economy. But like so many other industries, banks have consolidated over the last generation at a dizzying pace. As the geographic reach of any given bank grew, its lending drifted to what were perceived as better prospects – from small businesses to large companies, from distressed neighborhoods to wealthy ones, from rural regions to urban centers, and most disturbingly, through redlining, from communities of color to white neighborhoods.

Periodically, the federal government has stepped in to reverse these alarming trends and make banking more available to those excluded. The War on Poverty in the 1960s created hundreds of community development corporations (CDCs) to bring capital into inner cities and rural towns. The Community Reinvestment Act, enacted in the 1970s, created obligations for bigger banks to end redlining and make capital available to lower-income neighborhoods (lest they lose federal approval for interstate expansions or mergers). In the 1990s, the Treasury Department implemented a new program to spread Community Development Financial Institutions (CDFIs), which provide technical assistance and low-cost capital in distressed communities.

The legacy of these federal programs has been mixed. More communities of color and low-income communities have access to financial institutions. But because of the proliferation of mergers and acquisitions, fewer communities now have access to a locally owned bank. This has meant less credit in the communities where the financial needs are greatest, and contributed to the growing wealth gap in the United States. Development of new kinds of community-friendly financial institutions is urgently needed.

For the rich, investment options have historically extended far beyond savings banks. The financial industry created a wide range of tools to serve the wealthy, including investment banks, stock markets, municipal bonds, venture capital funds, real estate investment trusts, and hedge funds. Even 401(k)s, widely used today for retirement, were initially developed to serve highly paid managers in big corporations. Most of these tools funneled investor dollars exclusively into big business. For most financial institutions, it's more profitable to invest in a few big businesses than many small ones, because every deal requires significant transaction costs—due diligence, middlemen, lawyer reviews, and so forth.

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Starting in the late 1800s, the financial industry invited more Americans to buy stock, and many did so on dozens of regional stock exchanges. By the Roaring '20s, the biggest stock markets were booming as millions of Americans borrowed on high margins to get rich quickly. After the stock market crashed in 1929, the federal government enacted three laws to regulate the emerging field of “securities.” (To simplify, a security refers to almost any kind of investment that promises a financial return.) The Securities Act of 1933 governed how securities are issued, the Securities Exchange Act of 1934 governed how they can be re-sold and traded, and the Investment Company Act of 1940 governed how they can be pooled. Similar laws were enacted by state governments. Taken together, these laws represent a dense thicket of dos and don'ts that demand extensive and costly work by lawyers before even the simplest of investment transactions can occur.

A central concept in these securities law is the “accredited investor.” Any individual earning more than \$200,000 per year, any couple earning more than \$300,000 per year, or any family with more than \$1 million in wealth (excluding the value of a home) is regarded as accredited. In short, to be accredited, you need to be among the richest 95% of Americans.<sup>14</sup> Securities law assumes that if you're wealthy, you know what you're doing and can afford to lose your investments. Accredited investors are permitted to invest in almost anything, with very little paperwork required.

The rest of us are “unaccredited.” Because we are presumed to be uninformed, naïve, and vulnerable to swindling, we're not allowed to put a penny into a business until it has performed legal work that easily could cost \$25,000, \$50,000, or even \$100,000. True, we're still allowed to invest casually in friends and family, but the relationship has to be close (not just a social media friend).

The result of these laws has been a stunning capital market failure. Even though local businesses are responsible for 60% to 80% of the economy, with literally millions of them being profitable, the securities marketplace has all but shunned them. Americans have roughly \$56 trillion invested in stocks, bonds, insurance funds, pension funds, and mutual funds, almost entirely invested in publicly traded corporations. Put another way, we are overinvesting in Wall Street and underinvesting in Main Street. Many of the challenges with which communities struggle – economic, environmental, social, or political – could be remedied, or at least made more manageable, if we changed how we invest our savings.

In a properly functioning marketplace, the 60% to 80% of the economy that's locally owned would receive 60-80% of the investable capital. That would mean about \$30 to \$40 trillion moving from Wall Street to Main Street. Just taking the lower end of this range: A neighborhood of 1,000 would have \$100 million more in

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<sup>14</sup> How many Americans are actually accredited?

On the income criteria, data from the Internal Revenue Service are helpful. In 2016, the most recent year for which data are available, the total number of tax filings above \$200,000 (adjusted gross income) is 6,900,372. According to the U.S. Census, the population in 2016 was about 323 million. Even assuming that every filer above \$200,000 were single, accredited investors would constitute 2.1% of the population. In fact, the number of taxpayers filing as a couple was 5,893,163 – about 85% of the total – and these taxpayers would be subjected to the higher threshold of \$300,000. Because the IRS data are presented in a large bracket of \$200,000 to \$500,000, we can only guess what the reduction would be. But a fair assessment would say that, by income, 1%-2% of the population is accredited.

On the wealth criterion, the website DQYDJ.com, which specializes in providing financial data, suggests that \$1 million in wealth, excluding your home, puts you in the 91st percentile of American households. As there are about 125 million American households, the site argues that 12,417,040 are “accredited investor households.” The number of accredited investors would include the head of the household plus spouses. According to the 2010 Census, 48% of households have a spouse. This would suggest about 18 million accredited investors, or about 5.5% of the population.

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capital for its local businesses; a town of 10,000 would have \$1 billion; a city of 100,000 would have \$10 billion.

An important turning point for remedying this market failure came on April 5, 2012, when President Barack Obama signed a revolutionary law legalizing crowdfunding. The term “crowdfunding” refers to many people each putting small amounts of money into an exciting business or project. Until that point, the only kinds of crowdfunding permitted was donations through websites like Kickstarter or interest-free loans through nonprofits like Kiva. You could get a perk like a T-shirt or a product sample, but actually making money – what most investors seek to accomplish – was forbidden.

The Jumpstart Our Business Startups (JOBS) Act changed all that. It created an affordable, legal pathway for small businesses to raise investment capital from every American. Unlike donation crowdfunding, investment crowdfunding allows businesses to borrow money from their fans and pay interest. Or sell stock to them and pay dividends. Or provide royalty payments on revenues or profits. Or enter into dozens of other kinds of investment arrangements. And now everyone can play, not just the rich. Every American, regardless of income, can invest up to \$2,200 per year (and more if their incomes are above \$107,000). Small businesses can seek grassroots investors through federally licensed web sites called “investment portals.”

According to the 2018 State of Regulation Crowdfunding, between 2017 and 2018, the number of unique offerings grew from 474 to 680, the total raised from \$71 million to \$109 million, and the number of investors from 77,558 to 147,448. Six in ten companies that tried crowdfunding succeeded, with the average raise of \$270,966.<sup>15</sup> This is a huge revolution in the making. But in the larger scheme of things this revolution is practically invisible. Of the 330 million people living in the United States, fewer than one in a thousand are taking advantage of it.

There are lots of explanations why crowdfunding is spreading so anemically: news travels slowly, people resist change, new concepts need time to prove themselves. But the central challenge from our vantage point is this: Most of us do not have the time to find, review, grade, and then allocate our investment dollars. We prefer to have someone else do this work for us. That’s where investment funds fit in.

## **The role of investment funds**

Investment funds are institutions where investors put their money into a pool, and the managers running it make prudent investment decisions on their behalf. Most of us are happy to put our retirement savings into mutual funds, because we prefer having a reliable expert make tough investment choices. We’re also put at ease by knowing that unlike investing in one company, where we can lose everything, an investment in a diversified pool is less likely to be wiped out. If one investment goes bad, 100 good investments in the pool will balance it out. (Or so we hope!)

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<sup>15</sup> “The 2018 State of Regulation Crowdfunding: U.S. Securities-Based Crowdfunding under Title III of the JOBS Act,” Crowdfund Capital Advisors, January 24, 2019, <https://cdn.crowdfundinsider.com/wp-content/uploads/2019/02/CCA-2018-State-of-Regulation-Crowdfunding-Summary-FINAL.pdf>.



But the evolution of community investment funds also has been slow. While the JOBS Act made it easier for small businesses to issue securities to grassroots investors, no comparable legal reforms have been initiated for funds serving small businesses. And the existing law poses challenges.

As we detail in Chapter 3, the Investment Company Act of 1940 makes it exceedingly expensive to create and operate investment funds, especially if they accept money from any unaccredited investors. Just the set-up cost for a mutual fund, for example, could be hundreds of thousands of dollars. Many fund managers prefer to take advantage of one of many exemptions to the Act, which lowers the cost of legal compliance. For example, the “hedge fund” exemption provides that any fund with fewer than 100 investors, if they are all accredited, can operate largely unregulated.

Starting in the 1970s, despite the legal impediments, a few investment funds tried to be more community-friendly through “socially responsible investment” (SRI) strategies. The idea was to screen out companies selling goods and services harmful to communities, such as tobacco or nuclear weapons. Firms like Pax World, Parnassus, and Calvert convinced millions of Americans to shift billions in retirement savings this way. As the SRI industry matured, it shifted from negative screens to positive ones, enabling grassroots investors to put their money into funds that emphasize, say, renewable energy or sustainable farming. The nexus between socially responsible and community-focused, however, remains imperfect at best, because all the companies in these SRI funds are large and publicly traded. Local businesses have been and remain largely excluded.

In the last decade, a few funds, such as Calvert Impact Capital, have enabled grassroots investors to support community-friendly banks, CDCs, CDFIs, and related pools of small businesses across the country. The Clinton administration introduced New Markets Tax Credits for wealthy investors who wished to support distressed communities, and new funds have emerged to serve as intermediaries. The tax reforms Congress enacted in December 2017 encourage wealthy investors with capital gains to place them in new Opportunity Zone funds to revitalize distressed communities. While it’s too early to know how exactly the law will unfold – the biggest beneficiaries so far appear to be luxury condos, chain stores, and large redevelopment projects – it’s possible that some of the beneficiaries could be local businesses. But because only richer investors worry about sheltering their capital gains, these funds are largely unavailable to unaccredited investors.

Until recently, the number of funds investing in local businesses that were open to unaccredited investors could be counted on one or two hands. Some of the earliest examples are the Vermont Community Loan Fund, the New Hampshire Community Loan Fund, and the Mountain BizWorks Fund of North Carolina. Most took advantage of an exemption in the Investment Company Act for nonprofits. (If a nonprofit creates a fund to provide modest loans in the service of its mission, it can set up a fund relatively easily and inexpensively.)

Featured Funds		
Fund name	Location	Focus
Boston Impact Fund	Boston, MA	Businesses with economic-justice mission



Featured Funds		
Boston Ujima Fund	Boston, MA	Entrepreneurs of color
Community Vision Lending	San Francisco, CA	Community enterprises in California
East Bay Permanent Real Estate Cooperative	Oakland, CA	Affordable housing
Economic Community Development Institute	Columbus, OH	Local businesses
Iroquois Valley Farmland REIT	Evanston, IL	Farms in 14 states
Mountain BizWorks	Asheville, NC	Local businesses
New Hampshire Community Loan Fund	Concord, NH	Small businesses in New Hampshire
New York City Real Estate Investment Cooperative	New York, NY	Affordable housing
Northeast Kingdom Prosperity Fund	St. Johnsbury, VT	Small Businesses in northeast Vermont
Northeast Real Estate Investment Cooperative	St. Paul, MN	Affordable housing
PV Grows Investment Fund	North Deerfield, MA	Food businesses in the Pioneer Valley
Runway Project	Oakland, CA	Loans to entrepreneurs of color
Vermont Community Loan Fund	Montpelier, VT	Small businesses in Vermont

A few national nonprofits, committed broadly to community development, did this as well. The Rudolf Steiner Foundation created the RSF Social Investment Fund to allow grassroots investors to put money into its schools, and gradually expanded the fund to focus on cutting-edge food and arts programs. The Calvert Foundation issued “community investment notes” that it pooled and then reinvested in community-development financial institutions and community development corporations in low-income communities. Neither of these pools were local, per se, but they attempted to allocate investment to states and regions proportionally to the residence of their investors.

The small number of community investment funds is due to several factors. Because small business securities – the investments that could make up a pool – have been rare, small-business funds have been rarer still. And valuation of these securities is often difficult. You know the value of a small business loan, but what’s the probability of that business failing? And how can you know what the value of local stock is without local stock exchanges, which don’t exist?

But in just the last few years, the number of new funds opening with a community focus has accelerated, many with striking and promising new features. This reflects the growth of public interest in local investing, a growing distrust of Wall Street, and the emergence of crowdfunding alternatives. The rest of this handbook

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details the most cutting-edge of these funds, and provides you with specific strategies for creating your own.

## **The handbook's contents**

**Chapter 1:** We provide short profiles of 10 funds that showcase the wide range of models and experiments underway.

**Chapter 2:** We describe the basic steps a community needs to take to develop a community investment fund. This section will cover resources, costs, capital requirements, management challenges, governance, board composition, partnerships, organizing strategies, and timelines.

**Chapter 3:** We provide a comprehensive legal primer on the types of community investment funds currently possible, some of which exist and are thriving, while others can and should be developed – perhaps by you.

**Resources:** A list of books, articles, organizations, law firms, and others that can assist you in your effort to launch community investment funds.

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## Chapter 1:

# Ten Models of Community Investment Funds

In 2015, a handful of citizens in the Pioneer Valley of western Massachusetts launched a small fund open to local residents to help grow the local food economy. Since then, PVGrows and its 70 investors have plowed \$2 million into local food ventures. Along the way, the fund has inspired others, and helped spark what is shaping up to be a community-led financial revolution.

In the following pages, we profile 10 community investment funds. The first thing you'll notice is that they look very different from the mutual funds and private equity funds of Wall Street or the venture capital funds of Silicon Valley. They take different forms, from democratically controlled cooperatives to real estate investment trusts to holding companies. They serve regions as divergent as California's East Bay, south Boston's working class communities, and rural Montana. Yet they all share a similar goal: to empower communities to invest in themselves and in the change they want to see in the world.

These funds are flipping old assumptions on their heads, about who capital should serve, who should bear the risk, and who should call the shots. And they are rethinking commonly understood notions of "risk" and "return." At a time of rising inequality, a warming planet, and economic and social disruption, this work could not be more urgent.

"For so many years we've done it only one way," notes Meg Masten, chief relationship officer at Boulder-based holding company CoPeace. "We're really trying to change the narrative and say there are other ways of doing this and it's imperative to find other ways of doing this."

The following examples offer a glimpse of the innovation and evolution that has unfolded in just a few years. Some of the community investment funds are still new and untested, and many promising models remain unexplored, as Chapter 3 makes clear. Like all pioneers, these funds face steep obstacles in raising money, covering operational costs, and getting people comfortable with a new way of doing things. But together, these emerging funds point to what is possible when communities come together and claim their power.

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## Boston Impact Initiative

**Based:** Boston, Massachusetts

**Website:** <https://bostonimpact.org/>

**Founded:** 2017

**Size:** \$10 million (target)

**Type:** Charitable loan fund

**Focus:** Economic justice; eastern Massachusetts

**Investors:** Unaccredited investors, institutions

**Decision-making:** Representative of the community

**Portfolio:** Care Academy, CERO, Democracy Brewing, Maven Construction

**Deal size:** \$50,000 - \$250,000

**Target returns:** 1% - 4%

### Reallocating power and profits to the community

The Boston Impact Initiative started with a question: “Could we take a place-based, integrated capital approach to closing the racial wealth divide?” recalls Deborah Frieze, its co-founder and president. Frieze and her father launched a pilot program: from 2013 to 2017, they put \$3 million of their own capital into 30 different investments in eastern Massachusetts. Satisfied with the results, Frieze began looking at creating a fund that would be open to outside investors. It was important, she says, that it be available to unaccredited investors in the area as well as wealthy ones. “We wanted to create opportunities for investors to put money in their own backyard and address wealth inequality.”

That led her to PVGrows, a fund in the state’s western Pioneer Valley that at the time was one of the few locally-focused funds accessible to everyday investors. “Jeff Rosen [of Solidago Foundation] came in and talked to us about their process and thinking and how they structured it,” Frieze says.

Building on the PVGrows model, Frieze worked with a law firm to create the Boston Impact Initiative (BII) Fund, a 501(c)(3) charitable loan fund. It took two years and 30 lawyers, but the resulting document, says Frieze, can serve as a model for others. The Boston Ujima Fund, for example, was able to get up and running in a few months by building on that work. The BII offering launched in May 2018, and by November 2019 had raised \$6.5 million of a \$10 million target (\$2 million of that will be earmarked to absorb losses).

The fund deploys a creative mix of debt and equity financing to achieve its goals, and turns accepted notions about investment on their heads. For example, rather than lavishing perks on its biggest investors, BII prioritizes the most vulnerable investors.

“Those that can least afford to lose the money should be de-risked the most,” says Frieze. “And those who have the most can take on more risk.”

That belief is baked into the fund’s design. BII offers three types of notes. Community Notes, targeting unaccredited investors in the state, are 3-year notes paying 3% interest. Fifty percent of the principal is protected via a loan loss reserve, so if community members invested the minimum \$2,000, they could lose only \$1,000 in a worst-case scenario.

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The bulk of the fund will come from Solidarity Notes, aimed at accredited and institutional investors anywhere in selected states. They come in two flavors: a 3-year, 3% note and a 7-year, 4% note. Both have reserve protection of 10%. (The reserve protection, Frieze explains, is to balance out the fund's riskier equity investments and bring the note in line with all-debt CDFI notes that institutional investors are more familiar with).

A third tier is a Philanthropic Note, a 5-year, 1% note, akin to a recoverable grant, that funds half of the \$2 million loan loss reserve (the remaining reserve is funded by grants). A similar dynamic is at play on the investment side, where new ventures working to advance racial equity typically receive more favorable terms than more established, financially secure ventures.

At the core of BII's work is a conviction that it's not enough to reallocate capital to the underserved; power must also be reallocated to those who historically haven't had it. BII's investment committee is made up of people who represent a mix of financial and grassroots backgrounds. Investment decisions are ratified by the board, which is majority controlled by three partner organizations with deep roots in social justice: the Center for Economic Democracy, which is also home to the Ujima Project; City Life/ Vida Urbana, a housing justice organization; and RSF Social Finance.

The fund has deployed \$3.3 million so far in 30 ventures, including Maven Construction, a woman- and minority-owned general contracting firm in Dorchester; Mobile Cuts, a mobile barber shop; and Democracy Brewing, a worker-owned brewery and pub in Boston. The portfolio also includes ventures that BII supported in its pilot phase, such as Cooperative Energy Recycling and Organics (CERO), a worker- and people-of-color-owned recycling cooperative. BII has supported CERO through grant funding, a zero-interest loan in 2013, a direct investment in the co-op's direct public offering in 2014 and a working capital loan in 2017.

Naturally, the question of scale has come up. BII's intent was always to create a model that others could replicate, but that doesn't mean that one size fits all. "The heart of our work is about power and localization," says Frieze. "You can't just roll the BII model into Atlanta. Atlanta has a very different need than we do and a very different history. What we can do is share what we're learning, share tools, create a community of practice."

BII helped to incubate the Boston Ujima Fund, and it recently hosted a group from Grand Rapids, Michigan, to learn about the BII model. Frieze is planning to launch in 2020 a cohort of 12 communities from around the country that are ready to develop similar funds. "Our vision is to help catalyze a network of many place-based funds across the country that redirect financial assets, particularly at community foundations, from Wall Street back to Main Street and address structural inequity."

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## Boston Ujima Fund

**Based:** Boston, Massachusetts

**Website:** <https://www.ujimaboston.com/>

**Founded:** December 2018

**Size:** \$5 million (by end of 2021)

**Type:** Charitable loan fund

**Focus:** Entrepreneurs of color in the historically underserved neighborhoods of Roxbury, Dorchester, and Mattapan

**Investors:** Unaccredited investors and institutions in Massachusetts and select other states

**Decision-making:** Democratic, community-driven process

**Target returns:** 2% to 3%

**Portfolio:** N/A

### Where grassroots organizing meets capital

Grassroots assemblies and cooperative structures are not typically associated with investment funds. But at the Boston Ujima Fund – the nation’s first democratically governed investment fund – they are central design features. That’s not surprising given the fund’s grassroots pedigree: it’s an initiative of the Boston Ujima Project, a democratically-run group formed in 2015 to organize residents and local businesses to create a community-controlled local economy. It was incubated at the Center for Economic Democracy, along with partners Boston Impact Initiative and City Life/ Vida Urbana.

Ujima’s name and mission embodies the Kwanzaa principle of collective work and responsibility. As its website explains, “Ujima inspires us to take responsibility for our communities, to see our neighbor’s problems as our own, and to build collective power to solve them together.” The Ujima Project’s initiatives include a “good business” certification and alliance, a worker empowerment network, a local currency, and campaigns to persuade the area’s anchor institutions to direct purchases and investment toward local businesses in the alliance.

In December 2018, the group launched the Ujima Fund. Its mission: “to make patient, collaborative sources of financing available to Boston’s black, indigenous, and other communities of color, while enabling members of these communities to build assets as investors in their own economy.”

Ujima members hope to raise \$5 million by 2021 from community members as well as businesses, nonprofits, high-net-worth individuals, and institutional investors. They’ve raised \$1.3 million toward that goal. Like its sister fund, the Boston Impact Initiative Fund (BII), upon which it’s modeled, the Ujima Fund uses multi-tiered notes to accommodate those diverse needs.

The fund is nontraditional in several ways. Like BII, it puts the interests of its low-income community members ahead of more well-heeled investors. The fund terms (see box) reflect a belief that a \$100 investment by a working-class investor may be much riskier than a \$10,000 investment by a wealthy investor. The minimum investment for the community “Kujichagulia” notes is \$50. “It was important to us

that we made a really low bar so that folks could invest in the fund,” says Ujima fund manager Lucas Turner-Owens, noting that the average annual income in Roxbury is about \$25,000.<sup>16</sup>

Ujima Notes						
INVESTMENT TYPE	INVESTOR TYPE	INVESTMENT RANGE	RETURN TARGET	TERM	RIGHTS	FUNDRAISING GOAL
Kujichagulia Note (Self-Determination)	Non-Accredited Investors (Massachusetts only)	\$50 - \$10,000	3.0 % Annually	3 yrs.	Partial Security	\$500,000
Umoja Note (Unity)	Non-Accredited Investors (MA, CT, ME, RI only) and Accredited Investors (Anywhere in US, UK, Canada)	\$1,000 - \$250,000	2.0 % 3.0 % At Maturity	3 yrs. 7 yrs.	Partial Security	\$3,250,000
Nia Note (Purpose)	Philanthropic Investors (Accredited Investors only) (Anywhere in US, UK, Canada)	\$5,000+	1.5 % Annually	7 yrs.	Partial Security, Subordinated Debt	\$750,000
Imani Gift (Faith)	Donors and Foundations	\$5+	None	None	Gifted, Not Repayable	\$500,000

The fund is democratically controlled by community members. “We’re pretty unique in that we are committed to democratic governance and democratic co-creation of the fund,” Turner-Owens says.

Everything at Ujima is community-driven. Despite its own grassroots street cred, Ujima makes an effort to partner with local organizations already working in the community. It hosts planning assemblies—with food, music and childcare—that draw hundreds of local residents. At the assemblies, attendees are asked about local businesses they love, businesses that are needed in the community, and ones they’d like to replace. That input informs the group’s investment strategy.

The local businesses that make the first list are invited to join the Ujima business alliance and asked what kind of assistance they need, whether capital, legal, marketing or bookkeeping. Before businesses are admitted to the alliance, they must pass an environmental and social screen that was voted on by the community. The screen covers such topics as good jobs, healthy workplaces, high quality and affordable services, and other characteristics that community members have identified as important.

“I think a lot of folks in our space struggle with the question of how to measure impact,” Turner-Owens says. “We try to get out of the way of that question and place power in the hands of the ones that will have to work with and shop with these businesses.”

<sup>16</sup> “Roxbury,” Boston Planning & Development Agency Research Division, June 2017, <http://www.bostonplans.org/getattachment/70aaac6d-0459-4b1f-b91f-fe19ba5437cc>



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If an alliance member is seeking capital, it then goes to the investment committee to be vetted. “Like other funds, we’re evaluating historical financials, the organization, their pipeline, their plans for growth, and how that growth might increase their social and environmental impact,” Turner-Owens explains.

The due diligence is boiled down into a report that’s presented to voting members. Fifty-one percent of voting members must participate; of those, a majority must support the investment for it to go forward. As of this writing, Ujima members are considering their first investment in a local composting cooperative.

According to Ujima’s website: “As we raise our first \$5 million, Ujima will make investments of \$25,000-\$250,000 to advance our Investment Plan. For our first deals, we’ll offer working credit and growth capital to popular food, retail, and service providers, already identified by members as essential to the fabric of our neighborhoods. With an ‘integrated capital’ approach that offers debt, equity, and other blended products, the Ujima Fund will offer custom terms to fit the diverse enterprise stages and sectors present in our communities.”<sup>17</sup>

Ujima also takes a proactive approach to filling gaps in the local economy. Through input from the initial assemblies, Ujima identifies local community needs – urban farms, community land trusts, and community-owned internet are a few that have come up. It then evaluates the feasibility of investing in those areas, and invites interested entrepreneurs or existing providers to come forward and apply for investment. A certain de-risking can happen when the community is engaged in such a way.

“We’re doing market validation in assessing the size of the need,” Turner-Owens says. “If we hear from 400 folks that there’s a need for community-owned internet, we have the belief that those folks will become subscribers of that service if we can provide it.”

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<sup>17</sup> Boston Ujima Project, 2018, <https://www.ujimaboston.com/>

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## CoPeace

**Based:** Denver, Colorado

**Website:** <https://www.copeace.com/>

**Founded:** 2018

**Size:** \$5 million (target)

**Focus:** Mission-driven businesses (no particular geographic focus)

**Type:** Holding company

**Investors:** Accredited investors initially

**Decision-making:** Small investment committee

**Portfolio:** Uncharted Power, Advanced Sustainable Technologies, CoPeace Finance

### Amplifying the collective impact of social enterprises

As a Berkshire Hathaway shareholder, Craig Jonas was always intrigued with the holding company model. So when he was ready to transition from sports, where he spent 25 years as a basketball coach and executive, to impact investing, Jonas decided to apply the Berkshire Hathaway model to social enterprises. CoPeace – short for Companies of Peace – is “a modern holding venture for profitable companies doing measured good works.” Founded in 2018, it is a Public Benefit Corp. as well as a B Corp.

Holding companies vary in structure. They generally involve an umbrella organization that acquires and helps operate business entities. The idea isn’t new, but it hasn’t been applied to social enterprises – or locally-rooted businesses, for that matter. The structure allows CoPeace to deploy up to 40% of its capital for strategic investments where it holds a minority stake, and at least 60% for companies in which it holds a majority share.

CoPeace targets “growing, successful companies that support our interdependent future through sustainable and socially responsible practices.” Jonas, CoPeace’s CEO, sees an opportunity for the holding company to assemble a portfolio of synergistic companies and amplify their collective impact. CoPeace will also provide financial and marketing support to the portfolio companies and help them scale – a need that the CoPeace team identified as they evaluated potential candidates.

The firm is targeting an internal rate of return, or IRR, of 20%. CoPeace shareholders are paid dividends and also may benefit from any appreciation of the shares.

Although CoPeace hadn’t yet made its official debut at the time of this writing, it has made three investments: a strategic investment in Uncharted Power, a Harlem-based B Corp and provider of clean, low-cost energy; and majority or wholly owned stakes in Advanced Sustainable Technologies, a hazardous waste management company, and CoPeace Finance, which provides financial modeling services.

So far, CoPeace has raised money privately. But Jonas wants CoPeace to be open to all investors, as Warren Buffett’s Berkshire Hathaway is. CoPeace is currently exploring options, such as a direct public offering. “We want to allow people to be part of this,” says Jonas. “Inequality continues to grow in part because people don’t have access to building wealth. This is our little way of changing that.”

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## East Bay Permanent Real Estate Cooperative

**Based:** Oakland, California

**Website:** <https://ebprec.org/>

**Founded:** 2017

**Focus:** Community ownership and preservation of real estate in Oakland, California

**Type:** Cooperative

**Investors:** Local residents and unaccredited investors as well as accredited and philanthropic

**Decision-making:** By committee and, eventually, by member vote

**Portfolio:** Coop 789, East Oakland Accessory Dwelling Unit, Uwazi Commons at West Oakland BART

**Target returns:** 1.5% return on a 10-year, up to \$1,000 investment (legal limit of the law)

**Partners:** Sustainable Economies Law Center, the [People of Color Sustainable Housing Network](#) (POCSHN)

### Part co-op, part land trust, part community organizer: Keeping property in community hands and creating collective wealth in Oakland

In May 2019, a dozen residents became owners of their 4-unit building in East Oakland. It was the first property acquisition by the East Bay Permanent Real Estate Cooperative, a multi-stakeholder housing cooperative that buys real estate to keep it in the community. More than 12 projects are currently in the works. The goal, the group says, is to build community sovereignty and collective wealth among underserved and historically disenfranchised communities of color.

The notion of community ownership and control of assets, particularly real estate, is gaining momentum across the country. But nowhere is the movement as deep, thoughtful, and urgent as in California's East Bay, where long-time residents, primarily people of color, are being displaced by rapid development that is exacerbating inequality, homelessness, and economic instability. According to the Urban Displacement Project, a research and action initiative of the University of California, Berkeley, 93% of low-income neighborhoods in Oakland are at risk of or are already undergoing gentrification. The figure is 75% for low-income neighborhoods in neighboring Berkeley.<sup>18</sup>

East Bay Permanent Real Estate Cooperative (EB PREC) is leading the way, with innovative models incorporating community engagement, empowerment, and ownership. "We can't just do it the way the real estate industry has always done things," says Noni Session, the group's director. The goal is to "decommoditize" land. Doing so, says Session, "reminds us of what land is for and how it functions as legacy. As African Americans, we have not had a land base from which to elaborate and grow."

The co-op was incubated at the [Sustainable Economies Law Center](#) (SELC). Working with the People of Color Sustainable Housing Network, it slowly and deliberately developed its model and a grassroots foundation in the two years before acquiring its first property.

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<sup>18</sup> Zuk, M. and Chapple, K., "Urban Displacement Project," University of California, Berkeley, 2015, <https://www.urbandisplacement.org/map/sf>

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EB PREC crowd-finance its projects through the sale of membership shares to community members and investors. It chose to be a cooperative to take advantage of a recently passed California law, the California Cooperative Corporation Statute, that allows co-ops to raise up to \$1,000 per individual through the sale of memberships without requiring securities registration. Investment is open to California residents only. Investors receive shares that aim to pay a 1.5% annual dividend (they may also choose to forgo dividends to support the cause). The group has cultivated philanthropic funders to support its staff and operations so that those costs are not passed along to individual projects or their resident-owners.<sup>19</sup>

The cooperative structure also aligned with the spirit and values of the initiative. Cooperatives suggest mutual aid rather than charity, as a nonprofit structure would, explains Janelle Orsi of SELC, who helped get California's co-op law passed and was deeply involved in the creation of the EB PREC.

Potential real estate acquisitions are identified by local residents and tenants, and each project typically has a resident lead. "We select for people of color or people of color-allied democratic and justice-based goals," says EB PREC director Noni Session. Ideally they're mixed-use projects combining residential and commercial space, to diversify the revenue stream.

In the rapidly-gentrifying East Bay, there's no shortage of interest. EB PREC has a 5-person due diligence committee. To keep up with the demand, the co-op has created an input form to help screen proposals. If a project meets the co-op's criteria, a conversation takes place, followed by a site visit and deeper examination of the ownership situation, including under what terms the current owner is willing to sell. (EB PREC is in the process of finalizing its property and owner selection criteria with its members. In the future, acquisitions may be decided by vote.)

The group leverages partners, such as the Northern California Community Land Trust, and runs investment campaigns targeting 200 investor-owners, or roughly \$200,000, for each project.

Once purchased, the buildings are placed in a community land trust, permanently removing them from the speculative market and creating permanent affordability. The residents, often at risk of displacement, are able to secure long-term affordable housing and build equity ownership over time. They also participate in a resident training program to learn how to democratically run the property. "It's really empowering, and it adds a level of responsibility we never had before," Tia Taruc-Myers, a resident of an EB PREC property, told a local newspaper. "Instead of saving money for a rainy day, because I never knew when the landlord would sell and when I might become homeless, now I'm saving for roof repairs."<sup>20</sup>

To date, efforts to take control of land and buildings for community use have been sporadic or one-offs. EB PREC envisions its role as a facilitator, providing technical assistance, templates, and expertise as well as capital aggregation in support of such community-led projects, with the hopes of creating a widespread network of community-owned real estate and politically engaged residents. Or, as Session puts it, creating a

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<sup>19</sup> "AB-816 Cooperative corporations: worker cooperatives (2015-2016)," California Legislative Information, August 12, 2015, [https://leginfo.ca.gov/faces/billTextClient.xhtml?bill\\_id=201520160AB816](https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201520160AB816)

<sup>20</sup> Baldassari, Erin, "People power: A growing number of groups are flipping the Bay Area's insane housing market on its head," Times-Herald, August 25, 2019, <https://www.timesheraldonline.com/2019/08/25/people-power-a-growing-number-of-groups-are-flipping-the-bay-areas-insane-housing-market-on-its-head/>

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structure around the vision of local residents and activists. “We have a belief in the capacity to put folks in charge of their own deals,” she says.

West Oakland projects in the works include the development of a cluster of tiny homes on an abandoned plot, an accessory dwelling unit, and the creation of a cultural corridor on 7th Street. The group is also designing a pioneering new “housing justice easement” with SELC and the Oakland Community Land Trust.

Session is a third-generation Oaklander and a grassroots organizer, experience that comes in handy for the sort of deep work the cooperative is doing. “We look at the land development model as a community development model,” she says. “We activate people from the ground up.”

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## Goodworks Evergreen

**Based:** Missoula, Montana

**Founded:** 2019

**Size:** \$5 million (presently); \$20 million medium-range target; \$100 million long-term target

**Focus:** To transition businesses in Montana to new leadership that might otherwise disappear and take hundreds of jobs with them as founding proprietors retire

**Type:** Individual angel investor (presently); impact investment fund or similar (medium-range target); publicly traded perpetual holding company (long-term goal)

**Community decision-making:** Advisory board to be created for phase two

**Portfolio:** Don's Home Center, Tripp Lumber

**Returns:** N/A (presently), 5% target for impact investment fund (medium-range)

### Sustaining legacy businesses for Montana's future

When Goodworks Ventures began researching Montana's legacy businesses, it revealed some troubling insights: approximately \$1 billion of assets are at risk of being lost as their owners contemplate retirement. And the acquisition price to keep most of these businesses alive was too large for a few local investors and too small for most institutional buyers, says Dawn McGee, CEO of the Missoula-based impact fund.

Across the country, Baby Boomers are retiring en masse, many without a succession plan. The effects are often felt most keenly at the local level.

McGee related the story of a high-end tarp manufacturer in rural Montana who had passed away and left 10 employees suddenly without livelihoods. The state had lost a vital piece of its manufacturing economy. The story tore at Goodworks founder Mary Stranahan's heart and provided inspiration for her next project.

Since 2007, Stranahan had used her personal inheritance from Champion spark plugs to fund Goodworks Ventures, LLC, a Montana-focused impact fund that aims to "support, nurture, and empower visionary people and organizations that are creating the world we want to live in," as the website states. The fund has provided loans, equity capital, or hybrid investments to 35 diverse, largely Montana-based companies with strong leadership and innovative business concepts in the technology, sustainability, sciences, and food sectors.

The goal, says McGee, is to build an entrepreneurial ecosystem.

The 35 businesses have thrived and attracted talent back to Montana. They've been so successful, McGee jokes, they are now starting to "poach each others' employees."

With Goodworks Ventures working well, Stranahan is now launching Goodworks Evergreen to preserve Montana's legacy businesses. Phase one will involve acquiring, managing, and improving up to five companies with an emphasis on keeping and retaining jobs, paying a living wage, and reinvesting in rural economies.

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Goodworks Evergreen's first acquisition was Don's Home Center in early 2019. "We bought a hardware store and learned how to run it," McGee says. "Every one of Goodworks' employees has spent time behind the counter, because the people who work for us have to see our commitment."

Goodworks Evergreen also was able to do a complete makeover of Don's. The Evergreen staff bought new equipment to deliver lumber more efficiently than the old labor-intensive technique used before. They cleaned and reset shelves, got rid of dead inventory, started tracking SKUs, bought a billboard, started a social media campaign, and put out value pack flyers. They also hired and fired two managers before finding the right one on the third try. Since taking over Don's Home Center, Goodworks Evergreen has raised the prevailing wage to \$15 per hour, provided health insurance to full-time employees, and increased staff by 50%, and is finalizing a retirement plan for employees.

Goodworks Evergreen's second acquisition was a lumber remanufacturer which had been in business for three decades. Unlike Don's Home Center, lumber remanufacturing is highly technical and requires a transition period for the legacy owner to transfer his skills and industry contacts to the new manager. Two months after acquisition, the company's founder handed day-to-day operations to a new general manager, and a revamp of outreach and web presence was in full swing, along with an expansion of product offerings.

Evergreen has negotiated the purchase of a third business but has yet to release details. Although the Goodworks Evergreen model is unusually labor intensive, McGee feels that it is working, simultaneously improving the target companies and strengthening the regional economy. The next stage is to raise \$20 million from accredited individuals interested in acquiring an additional 15 businesses. Phase three is envisioned to be a perpetual holding company of \$50 to \$100 million, available for public investment to anyone interested in broad-based Montana ownership of these legacy companies.



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## Iroquois Valley Farmland REIT

**Based:** Evanston, Illinois

**Website:** <https://iroquoisvalley.com/>

**Founded:** 2008

**Size:** \$50 million

**Focus:** Organic farmland

**Investors:** Open to unaccredited as well as accredited investors nationally

**Decision-making:** Investment committee with farmer representation

**Type:** Real estate investment trust (REIT)

**Portfolio:** More than 50 farms in 14 states, comprising nearly 10,000 acres

**Returns:** <1% annual dividend initially and long-term appreciation of shares (for direct public offering investors)

### Restoring soil and paying dividends to the planet and health

Mono-cropping, genetically modified organisms, and other industrial agriculture practices have degraded soil and wreaked havoc on natural resources and human health. Iroquois Valley Farmland is trying to reverse that damage, one farm at a time.

The real estate investment trust, or REIT, pools money from investors to finance the conversion of conventional farmland to organic. It does that by providing “farmer-friendly” leases and mortgages to organic farmers. Since it was founded in 2007, Iroquois Valley – which is also a Public Benefit Corp. and B Corp. – has invested \$50 million in organic agriculture, representing more than 40 families and 12,000 acres in 14 states.

Certified organic farmland represented less than 1% of the 911 million acres of total U.S. farmland in 2016, according to the Department of Agriculture.<sup>21</sup> A new generation of farmers – and owners who lease out their land – recognize the importance of sustainable farming. But converting farmland depleted by chemical agriculture to organic is a costly, multi-year process.

“These farmers are ready, willing, and able – what they don’t have is the capital. That is still the biggest impediment to change,” says Iroquois Valley CEO David Miller, who founded the company a decade ago after buying his uncle’s farm and converting it to organic.

Until recently, Iroquois Valley’s investors were wealthy individuals, trusts, foundations, non-profits, corporations, and family offices, with an average investment of \$100,000. But the company wanted to broaden its investor base. “We always knew we wanted to reach out to the public,” says Miller. “There was nothing more frustrating than getting the public excited at some event and then have to tell them ‘No, we can’t take your money.’”

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<sup>21</sup> Bialik, Kristen and Kristi Walker, “Organic farming is on the rise in the U.S.,” Pew Research Center, January 10, 2019, <https://www.pewresearch.org/fact-tank/2019/01/10/organic-farming-is-on-the-rise-in-the-u-s/>

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In August 2019, regulators gave Iroquois Valley a green light to proceed with a \$50 million direct public offering conducted under Regulation A+ of the JOBS Act. The minimum investment is \$10,000 – not mass market, but still more accessible than it had been. DPO investors receive equity shares in the REIT that will, at least initially, pay a modest financial dividend as the farmers begin the arduous process of restoring the soil to health. The shares may appreciate (or decrease) in value **over time based on the** value of the land. “It’s a good, long-term investment that pays dividends to the planet and your health, and should be paying more to your pocketbook over time,” says Miller. “This is patient capital.”

The DPO will satisfy pent-up demand from unaccredited investors. It will also provide an important source of growth capital for Iroquois Valley and its farmers. “We feel good about enabling the public to invest for public health,” said Miller. “We need that capital to make changes – and lots of it. Our vision is to have an impact on these dead monocultures, so we have to raise tons and tons of capital.”

Iroquois Valley’s farmers grow everything from corn to cattle. Some, like the Northfield, Minnesota-based Main Street Project, have a broader mission. Main Street Project received mortgage financing from the REIT for a 100-acre demonstration farm to showcase poultry-centered regenerative agroforestry and train rural Latino immigrants to become free-range poultry farmers.

A 5-member investment committee that includes Miller, the board chair, the CFO, and two farmers approves deals under \$2.5 million. Anything over that requires approval of the full board, which also has farmer representation.

In just the first week of its DPO, the Iroquois Valley REIT had attracted investors from 42 states. The REIT will have ongoing financial reporting requirements similar to that of a public company, even though it isn’t traded on an exchange. Miller thinks the trade-off is worth it. “Given that type of big vision and impact we want to have, I think we’re on the right track with how we’ve set this up.”

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## Northeast Kingdom Prosperity Fund

**Based:** St. Johnsbury, Vermont

**Website:** [www.nekprosper.org](http://www.nekprosper.org)

**Founded:** 2019

**Size:** \$2 million (target)

**Focus:** Businesses contributing to the health and prosperity of the 3-county Northeast Kingdom

**Investors:** Unaccredited and accredited investors in Vermont

**Decision-making:** CDFI vetting and representative investment committee

**Type:** Pooled income fund (charitable)

**Portfolio:** N/A

**Returns:** Tax deduction plus lifetime income

### In rural Vermont, an innovative structure allows residents and stakeholders to invest in local enterprises and support community health

The Northeast Kingdom is a 3-county area in a verdant corner of northeastern Vermont. Covering Essex, Orleans, and Caledonia counties, its grand name obscures the reality of the residents, who are among the state's poorest and least healthy. A group of local stakeholders, including health care organizations, financial institutions, and government agencies, are hoping to change those dynamics with a new fund that will invest in job-creating local ventures.

The Northeast Kingdom Prosperity Fund aims to boost the well being of residents in five categories: housing, healthy food, financial security, and mental and physical health, according to Laural Ruggles, vice president of marketing and community health improvement for Northeastern Vermont Regional Hospital, which spearheads the effort. Research links poverty to poor health, so the fund views economic development and the creation of good-paying jobs as central to its mission.

The NEK Prosperity Fund grew out of an effort financed by the Robert Wood Johnson Foundation to explore innovative and stable ways of financing long-term programs that lead to better health outcomes (an acknowledgement of the short-term and often fickle nature of grant funding). The Kingdom already had an impressive network of health care, nonprofit, and government organizations working together via NEK Prosper!, an "accountable health community." Through the foundation-funded work, the coalition was expanded to include financial institutions, including the heads of Passumpsic Savings Bank, Northern Counties Investment Corporation (NCIC), a CDFI, and local economic developers.

The group decided to create a fund financed by local residents and stakeholders. With the help of a local consultant, Janice Shade, they identified several criteria for the fund. It should:

- be open to any number of investors of any level of wealth (i.e. unaccredited, accredited, and institutional investors)
- be community-scale, meaning "big enough to make a difference, but right-sized to be manageable"

- allow for equity and equity-like investments in addition to loans, since the region was already well-served by loan funds
- involve minimal legal and regulatory burdens
- offer an opportunity for investors to make both a financial and social return on investment

After conversations with a lawyer about how best to achieve those aims, they settled on a novel approach: a pooled income fund (PIF), a type of charitable trust that offers a large degree of flexibility. As the lawyer, Cutting Edge Counsel's Brian Beckon, explained in a blog post<sup>22</sup>: "The idea of a PIF is that a contributor puts money or assets into a trust, where it is pooled with the contributions of other contributors and jointly invested. Income from the investments is distributed to the contributors (and often their spouses or other beneficiaries) for their lifetimes." A portion of the initial contributions are tax deductible. And upon the death of a beneficiary, their portion of the fund goes to the charity that sponsors the trust.

Typically, PIFs are used by very large foundations, universities, and charities as planned giving devices, with the funds invested in conventional stocks and bonds. In this case, the NEK Prosperity fund will be scaled for the community and invested in local ventures that deliver a financial and social return for the community. "Anything that's going to create more better-paying jobs in our region is something we would fund," Ruggles says. "Extra credit if they are using the funds to create affordable housing or make it easier for people to access healthy food."

The fund has the flexibility to meet the needs of a wide range of ventures, via equity shares, convertible notes, revenue-sharing, loans, and real estate investment. "We're finding this structure is really well-aligned with the fund's long-term outlook and mission for patient community capital," says Shade. The PIF will be housed and managed by NCIC, the St. Johnsbury-based CDFI that serves the area. NCIC will handle the initial screening and due diligence. A committee elected by and from the investor community will review the selections for alignment with the fund's mission and desired outcomes.

The group is hoping to raise \$2 million over two years. Investors will be able to contribute as little as \$500. Some of the biggest investors may be local stakeholder organizations, including the hospital's investment funds. "We will put some part of that [into the fund] and put our money where our mouth is," says Ruggles.

As an initial step, NCIC will begin making loans out of its existing fund to candidates that have been screened to fit with the five "desired outcome" categories set by an NEK Prosper Advisory Committee. The loans will be back stopped by a loan-loss reserve fund made up of charitable contributions from NEK Prosper members, community supporters, and philanthropic donors to allow NCIC to make loans to viable candidates outside its typical risk profile. This interim step will also allow NCIC to ease into the increased operational capacity that will be necessary to eventually administer a PIF.

The NEK Prosperity Fund is an example of what can happen when a broad mix of community stakeholders with different skills and perspectives come together to take action—and when old forms of funding are given

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<sup>22</sup> Beckon, Brian, "Reimagining the Pooled Income Fund: A Community-Scale Mutual Fund, Cutting Edge Counsel, November 29, 2018, <https://www.cuttingedgecapital.com/?s=pooled+income+fund>

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a fresh twist. As Beckon writes: “Sometimes innovation isn’t about doing something new, but rather doing something old in an innovative way.”

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## Pioneer Valley Grows Investment Fund

**Based:** Pioneer Valley, western Massachusetts

**Founded:** 2015

**Size:** \$2 million raised to date (\$2.6 million target)

**Focus:** Finance and technical assistance to Pioneer Valley farm and food businesses

**Type:** Non-profit fund open to accredited and non-accredited investors

**Community decision-making:** Advisory board determines if a business fits the mission of the fund and assesses technical assistance needs

**Portfolio:** 35 loans to businesses for equipment, working capital, technical assistance, renovations, and acquisition

**Returns:** 2% to Community Investors of \$1,000-\$10,000 for 5 years; 4% on Patient Capital notes of \$10,000-\$250,000 for 8 years

### The secret sauce to unlock the local food sector

The PVGrows Investment Fund (PVGIF) is unlocking the social and community potential of the Pioneer Valley's local food system. Seventy investors, including individuals, a church, a private school, and nonprofits, have so far invested \$2 million.

"You won't come to us if all you are looking for is return on your money," PVGIF Program Manager Rebecca Busansky explains. "You have to value other things. Our investors want to hear the stories of the newest companies we're supporting." Investors are motivated by improving local access to healthy food, protecting the environment, and generating jobs for the region.

PVGrows began as a collaborative network in 2009 to connect people and organizations involved in the Pioneer Valley food sector. The network's 9-member Finance Working Group, made up of community lenders, foundations, and agricultural technical assistance providers, identified an urgent need for gap financing, particularly to help viable farms and food businesses that were not fully "bankable." A 5-year pilot offered a small number of loans thanks to grants from two local foundations.

In 2015, the Working Group launched PVGIF, a registered nonprofit administered by the Franklin County Community Development Corporation. Its offering memorandum states that the objective is "to provide financing and technical assistance at the right time and right terms to mission-driven and finance-ready farm and food entrepreneurs and businesses."

The Working Group now serves as PVGIF's Advisory Committee and assesses PVGIF applicants for mission fit and technical assistance needs. Busansky considers this a strength of PVGIF's business model, noting that the Advisory Committee serves as "nine sets of eyes looking at how the fund can help the farm or food business succeed."

The committee recommends what support the business will require in addition to funds, such as strengthening the business plan, applying for subsidiary grants, training staff, and so forth. The final package combines the loan with financial and technical assistance.

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“We don’t just give them money and say goodbye,” Busansky says. “We enter into a relationship with our businesses. It takes that kind of wrap-around services for many of our entrepreneurs to succeed.”

This is one way PVGIF is able to take on greater risk than traditional lenders. So far, so good – the default rate on the 35 packages given in the past four years is zero.

One success story is Mycoterra Farm, a producer of gourmet and medicinal specialty mushrooms. The loan allowed founder Julia Coffey to convert an old horse stable in South Deerfield into a new and larger mushroom facility to meet growing market demand. Busansky recently held an open house at the farm for the investors and potential investors, and likened the experience to entering the city of Oz: “The huge indoor horse arena is just overflowing with mushrooms, and Julia will impress you with mycelium facts.” These events, held twice a year at PVGIF-supported businesses, keep investors energized and engaged. So do periodic newsletters and a steady flow of social media messages.

Not everything has gone as expected. The founders had anticipated a rush of “Community Investors” but that the deep-pocket “Patient Investors” would require more extensive outreach and marketing. Instead, larger investors contributed \$1 million to PVGIF within the first six months, and most of the marketing was needed to attract Community Investors. The fund also needed to provide more technical assistance to companies than was originally envisioned to ensure that they’re finance-ready.

Remarkably, the pipeline of available funds has steadily met the needs of qualifying businesses. Now that PVGIF’s initial offering has nearly been reached, a new offering is in the works. Although its mission will be similar, the new offering may include different interest rates than the first and may include options for people to donate interest or principal at the end of the term.

## **Ten Lessons from the PVGrows Investment Fund (By Jeff Rosen)**

The PVGrows Investment Fund was created to strengthen the local food economy with patient capital from both accredited and non-accredited investors. Thus far, it has gone very well. The fund, which was administered by a local community development corporation (CDC), has raised and deployed capital as intended. Yet the difference between pilot goals (aspirations) and implementation (perspiration) is worth sharing, to highlight the real challenges you might confront if you create your own community investment fund:

### **1. Carrying cost**

By setting a target rate of return of 4% for patient capital investors and committing ourselves to paying that interest annually, there has been significant pressure to get loans out the door. Funds received but not deployed imposed a significant carrying cost.

### **2. Deal flow**

Initially, the fund struggled to find adequate “deal flow.” However, deal flow in a patient capital fund is about more than deploying capital to proven business models. It’s also about applying technical assistance, early and often. The CDC and the advisory board were fortunate to know many of the early



applicants and to steer them to the right forms of technical assistance. Even as the pressure of the carrying cost of capital mounted, we were able to resist making bad investment decisions.

### **3. Technical assistance**

Early on, we had the benefit of a technical assistance (TA) fund provided by the Fair Food Fund and some of our philanthropic partners, which enabled us to award grant dollars to our TA providers. The fund will enter its next phase without this TA support. Several of the participants on the mission screening committee are representatives of loan funds that share their own limited TA resources, but it may not be enough. As the fund scales, we may need to find new resources for needed TA.

### **4. Non-accredited investor flow**

Part of the PVGrows Investment Fund's mission is to democratize capital by providing nonaccredited investors the chance to invest in their local food system. To protect these investors, the philanthropic partners provided \$100,000 of first loss reserves, designed to be 20% of the total pool of capital. We were surprised that didn't attract more unaccredited investors. In retrospect, we probably needed a better marketing campaign.

### **5. Patient capital terms**

To date, none of the investments made by the PVGrows Investment Fund rely upon innovative financing structures, such as revenue sharing or warrants. (We have, however, given several businesses 3 to 6 month periods when they only needed to pay interest.) This can be seen as good news, indicative of the PVGrows Investment Fund filling a gap with a simple loan structure. Yet this also might mean that the fund hasn't taken enough risk and has relied too much on traditional underwriting criteria in structuring investment terms. Does the fact that the fund has yet to experience any losses mean that it's not fulfilling its essential mandate to provide catalytic capital? Additionally, without some creative financing structures that provide higher returns to the PVGrows Investment Fund during the stages when beneficiary companies grow, the fund will continue to struggle to maintain its operating cost margins.

### **6. Investor returns**

The offering memorandum promises patient capital investors a target rate of return up to 4%. The Investor Agreement allows the investor to choose a lower interest rate on their investment. During the first four years, very few investors took that option, so the Fund is paying 4% on most Patient Capital investments and 2% on most Community Investments. This means the Fund has a low margin between the cost of capital and the lending rate, which is 7% to 8%. Given the limited capital pool, this small margin is not enough to cover operating costs without the support of philanthropic partners.

### **7. Racial wealth divide**

Given our mission, any project that improved food access or addressed issues of racial equity in the food system would score well on the mission screening review. However, addressing racial justice requires engagement with impacted communities from the outset. While the Pioneer Valley includes rural and urban areas with significant communities of color, the fund has received few applicants from these

communities and awarded only one loan to a person of color. Efforts to reach the entrepreneurial communities of Springfield and Holyoke, where there are large populations of people of color, haven't been successful. Our next fund may seek to incorporate some of the design features of other funds in this handbook, such as Boston Ujima, Boston Impact Initiative, and the Runway Project.

## 8. Administrative fees

The fund seeks to provide catalytic capital to the community while providing investors, particularly patient capital investors, and a target rate of return up to 4%. But it's important that all documentation make it clear to those investors that costs and losses must be covered first, and the final rate of return is contingent on the efficiency of the administration and the performance of the portfolio. The administrative costs of the PVGrows Investment Fund are covered by grant income, the spread on loan, origination fees, and other loan fees. The prospectus also spells out that the administrating CDC can take a 2% administrative fee from the investments, although to date, it hasn't done so.

The key assumption embedded in the 2% is that impact investors need to cover the true risks and true costs of administering a higher-touch, higher-risk pool. Another way to approach the problem is if a philanthropic partner steps forward to cover these costs from the outset. However, it's also important to remind catalytic impact investors that they need to pay for the work that goes into the outcomes they seek.

## 9. Timing and segregation of investments

Our original design envisioned two distinct investor tranches. Community Investors were to enjoy a 20% loan loss reserve and would be paid at the end of their 5-year commitment. Patient Capital investors were to be in for eight years and would receive principal repayments from the investment pool, as early as year 3, up to 4% annual interest annually, and a final reconciliation at the end of Year 8. This has not really gone according to plan. The fund continues to accept patient capital and community investments, even as it approaches Year 5. Since the investors are on variable terms, the fund continues to make investments, some of which would not be fully repaid by the end of Year 8.

Our plan is to ask Community Investors to roll over their investment for another term (maybe another five years), and these funds could be used to refinance loans and pay back other Community Investors exiting at the end of Year 5. We also could refinance by switching the Community Pool funding with the Patient Capital Pool funding or with another loan fund the CDC operates.

Because the payments to the Patient Capital Investors are not determined and paid until Year 8, their capital further insulates Community Investors from any loss. Even if losses occur in the first years, those do not have to be attributed until the final pool reconciliation. There's an inadvertent elegance to this. The long time frame might allow the PVGrows Investment Fund to support earlier-stage investments, smaller-dollar investments, or more investments in communities with less collateral, such as Springfield and Holyoke. This in turn would help the fund better close the racial wealth divide.

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## 10. Conversion to revolving loan fund

Since one of the goals for aggregating community capital is to scale the movement, it's important that we figure out how to make this a revolving loan fund. But this remains challenging. Startup loan funds require some scale and predictable cash flows before they become revolving. Liquidity is a constant issue. Can the fund ensure that it always has enough reserves to repay investors, if they elect not to renew the investment? An additional challenge is how to fairly apportion expenses and losses to investor pools who enter the fund each year.

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## The Runway Project

**Based:** Oakland, California; expanding to other cities

**Website:** <https://www.therunwayproject.org/>

**Founded:** 2017

**Size:** \$1 million (Oakland); \$10 million (target; national fund)

**Type:** Loan fund

**Focus:** Seed funding for entrepreneurs of color

**Investors:** Unaccredited and accredited investors; charitable donors

**Decision-making:** Credit committee composed of Runway team

**Deal size:** \$10,000-\$20,000

**Portfolio:** Vegan Mobb, Esscents of Flowers, Azteca Negra

**Returns:** CD market rates

### Filling a gap for “friends and family” funding

When starting a new venture, entrepreneurs have long been told to reach out to their friends and family for seed capital. Yet the concept of friends and family funding can be perplexing to entrepreneurs who aren't from privileged backgrounds or didn't attend the “right” schools. And it can be downright maddening to many African Americans, who, after decades of systematic discrimination, trail behind whites in household wealth. The median wealth of a Black household in 2016 was just \$17,600, compared to nearly \$171,000 for white households.<sup>23</sup>

The Runway Project was created to fill the gap for early-stage friends and family funding for entrepreneurs of color and to help close the racial wealth gap. “This is ‘believe in you money,’ the kind of money that says ‘I believe in taking a risk on you and want to give you a chance to explore,’ ” says cofounder Jessica Norwood. That's a powerful statement for entrepreneurs of color to hear, she says, and one that can start to change the narrative about Black entrepreneurship.

Norwood, along with leaders from the Association for Enterprise Opportunity, the Self-Help Credit Union, and Impact Hub Oakland, launched the Runway Project in 2017. From the start, they knew they needed to do things differently.

“Traditional underwriting does not work” for communities that have been denied the opportunity for wealth creation for generations, says Konda Mason, a cofounder of Impact Hub Oakland and Runway Project. “We're decolonizing the underwriting process.” That means not relying on collateral, credit scores, and other conventional risk assessments. Instead, they focus on character, relationships, and business training to mitigate risk.

“We're building on the deep relationships that exist in Oakland,” says Nina Robinson, the fund's executive director.

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<sup>23</sup> Hanks, Angela, Danyelle Solomon, and Christian E. Weller, “Systematic Inequality: How America's Structural Racism Helped Create the Black-White Wealth Gap,” Center for American Progress, February 21, 2018, <https://www.americanprogress.org/issues/race/reports/2018/02/21/447051/systematic-inequality/>

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Runway raised money via a targeted certificate of deposit (CD) that anyone could invest in with as little as \$500. The 5-year CDs are held at the Self-Help Credit Union, and correspond to the 5-year term loans that Runway makes. Investors receive a typical CD rate of return, around 2%, and the satisfaction of knowing that their money is helping an entrepreneur in their community. The loans are up to \$20,000 at an interest rate of 4%. The first two years are interest-only, to give entrepreneurs a chance to find their footing.

To make the model work, Runway also raised \$500,000 in philanthropic donations for a collateral fund, which is held in a separate account at the credit union. The money, roughly \$1 for every \$1 loaned, takes the place of collateral from borrowers and protects credit union investors from losses. Philanthropic funding also covers operating costs.

The third leg of the model is the wrap-around service provided to entrepreneurs via the Uptima Business Bootcamp, a member-owned accelerator based at Impact Hub Oakland. Borrowers approved to participate in the multi-week bootcamp delve into topics such as business plans, cash flow, and profit margins, and immerse in peer networking and support. “It was important to have services that are culturally relevant and serve the whole person,” Robinson says.

As of October 2019, the Runway Project had financed 26 entrepreneurs and fully deployed its first fund. The businesses range from a vegan BBQ restaurant to fashion design to wealth management services.

With a successful 2-year pilot under their belts, the Runway team is preparing for their next phase of growth. The program’s success has attracted interest from other cities, and Runway Project is replicating the fund in Boston via a partnership with Berkshire Bank.

The Runway team is preparing to raise a second fund, with a \$10 million target. This time around, they’re looking to expand the types of funding they can deploy. Of particular interest: equity-like financing that won’t require entrepreneurs to sell their companies or “exit,” such as revenue-sharing agreements or structures that allow the entrepreneur to buy back equity shares over time. They’re also looking at the tiered funding models deployed by Boston Impact Initiative and the Ujima Fund to support that mission.

To sustain itself, Runway is generating new revenue streams. It will provide underwriting and fund management services for the planned REAL People’s Fund, which will make bigger loans to entrepreneurs of color.

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## The REAL People's Fund

**Based:** Alameda and Contra Costa Counties, California

**Website:** <http://realpeoplesfund.org/>

**Founded:** 2019

**Size:** \$10 million minimum (target)

**Focus:** Provide catalytic capital, primarily to entrepreneurs of color

**Investors:** Accredited investors initially

**Decision-making:** Mission screening, governance, and oversight by community representation with lending decisions and administration provided by Community Vision

**Type:** Charitable loan fund

**Portfolio:** N/A

**Returns:** Various investment tranches

**Investment Partners:** Community Vision Capital & Consulting, Runway Project, and Uptima Business Bootcamp

**Community Partners:** Asian Pacific Environmental Network, Communities for a Better Environment, Oakland Rising, Restaurant Opportunities Center United, and Restore Oakland

**Philanthropic Partners:** Solidago Foundation (design and implementation), California Endowment (design), Common Counsel (design), and East Bay Community Foundation (implementation and power building)

### Getting REAL: Organizing and building power for a just East Bay

The Revolutionary Economy for All Local People's Fund is a California nonprofit public benefit corporation and a community-controlled capital fund, conceived and governed by a network of democratically managed community organizing groups as a means to build economic power for historically disinvested communities in the East Bay.

The REAL People's Fund, currently in development, will offer innovative financial products and business advisory services, with a focus on financing entrepreneurs of color and creating quality jobs while reducing barriers to employment. Its offerings will include microloans to low-wealth entrepreneurs in the early stages of launching a business; small business loans of up to \$500,000, underwritten with conscious effort to eliminate sources of structural bias; and revenue-based financing to fund growth-stage business without the extractive terms of traditional venture capital. It will be a closed-ended fund with a 10-year fund life.

The Bay Area is known nationally for its thriving innovation economy, but the booming technology sector has driven sharp rises in the cost of living, and its employment and wealth-creation opportunities have largely bypassed low-income communities. The result has been a stark increase in inequality and displacement of communities of color. Oakland has been called "ground zero" for gentrification; its Black population, nearly 50% in 1980, fell to 28% in 2010 and is projected to continue declining. "Soon there will not be a community left to organize," says Tash Nyugen, a member of Restore Oakland, and the Network Coordinator of the REAL People's Fund.

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Nyugen and other local organizers sought to complement their civic engagement work with an economic-power-building strategy to help stabilize their communities. They recognized that locally owned small businesses are the engine for wealth building and meaningful job creation, and decided to launch a community capital fund to provide mission-aligned businesses with capital and serve as a long-time partner in the efforts to advance a more just East Bay economy.

The fund would have the ability to lend to businesses meeting any of these objectives: creation of quality jobs, community wealth building, democratic governance, improvement of health and quality of life, social and environmental sustainability, strengthening of the local economy, and building “people power.”

In a multi-year, community-led design process, including a monthly full-day retreat to build trust among the participants, the group sketched out the contours of the fund. They selected Community Vision, a Bay-Area-based CDFI, as the fund administrator, and directed Community Vision to partner with the Runway Project and Uptima Business Bootcamp. The partnership is a critical design element of the project and a template for other communities and entities looking to pursue similar efforts.

The fund expects to offer four primary loan types that address particular needs:

Loans underwritten by The Runway Project:

- Up to \$20,000 to early-stage entrepreneurs: This is the loan product the Runway Project has successfully tested since it launched its Oakland pilot in 2017 (see case study on page 39). These loans serve as a replacement for “friends and family” money for entrepreneurs from low-wealth backgrounds. Borrowers participate in Uptima Business Bootcamp’s program, including pre-loan advisory services and post-loan mentoring and peer support.
- \$20,001 to \$50,000 to emerging entrepreneurs: Many borrowers in this segment will require capital to purchase inventory to meet larger orders, buy specialized equipment, or add staffing. Runway clients have often had to combine microloans from multiple sources; this offering will enable them to meet credit needs through a single lender.

Loans underwritten by Community Vision:

- \$50,000 to \$500,000 to established small businesses to support business financing needs including equipment purchase, tenant improvements, inventory or working capital. Borrowers may not be served by existing lenders for reasons including personal credit history, lack of a guarantor, inadequate collateral, or loan size.
- Revenue-participation loans of \$50,000 to \$250,000 to growth-stage businesses. These loans represent a new type of flexible financing for early-stage companies with strong growth potential. By providing equity-like flexibility while allowing the entrepreneur to retain control, revenue-based loans – paid back with a set percentage of revenue over time – may be a good fit for borrowers with potential for fast growth.



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## Chapter 2:

# Steps to Create a Community Investment Fund

No single formula exists for creating a community investment fund. But in this chapter, we'll walk you through the important questions that will inform your decision making and guide you through the process of setting up a fund.

Two overarching points before we begin:

Community investment funds are, well, funds, so the legal and financial legwork will be similar to setting up a more conventional fund. However, we have a chance to do things differently and use the levers of finance to create non-extractive funds that benefit communities. All of the following steps begin with a fundamental philosophy of engaging the community. "When you're in conversation with a community about what's actually needed, you have a better chance of developing a solution that will have a lasting or sustainable impact," says Lucas Turner-Owens of Boston Ujima Fund.

Second, while setting up a fund may seem daunting, there's no need to reinvent the wheel; we have a growing body of work and experience – and an ethos of sharing – to draw upon. Many of the funds profiled in the previous chapter built on others' success. PVGrows helped inform the strategy for the Boston Impact Initiative (BII), which in turn helped launch the Ujima Fund. A direct line runs through the work of these early pioneers and some more recent funds, like the REAL People's Fund. It took "two years and 30 lawyers" to create BII, says Deborah Frieze. She's now forming a community of practice to share what BII has learned "so no one has to go through this same exercise again."

This handbook is a how-to resource for community builders. But we encourage you to talk to others, adapt existing models for your own purposes, and experiment with new ideas and models that move the field forward.

The critical areas for setting up your fund follow these five questions:

- Who's on your team?
- What are your fund's objectives?
- What's your business model?
- What's your legal structure?
- How can you troubleshoot the process, once it's underway?

Since the first question involves putting together a team, here's a suggestion: Focus on this area of the chapter first and skim the rest for now. Once your team is in place, review each following step as a group and use your answers as a team-building exercise.

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## 1. Who's on your team?

Starting a local investment fund is a long-term endeavor. It takes time, planning, and a committed team of forward-thinking community builders. While the expertise, networks, and other attributes of individuals are important, team building begins with the right organizations at the table. People may come and go as their jobs and lives change, so having key anchor or springboard institutions committed to the team will ensure continuity and longevity—and potentially some seed funding.

Anchor institutions include grassroots organizing groups deeply rooted in the community, nonprofits, CDFIs, local community foundations, or other place-based entities such as hospitals, universities, or even corporations. These institutions have the resources to engage in long-term planning and can help open doors. More important, they're often motivated to improve the long-term well-being of their communities.

You'll want to round out your team with representatives from the following entities (some of which are anchor institutions):

- Financial institutions, such as banks/ credit unions, CDFIs, loan funds, and other traditional lenders, which can impart sound business thinking to your fund
- Philanthropic institutions, such as community foundations and donor networks, which can help mobilize early capital contributions
- Major community nonprofits, such as churches, food banks, or grassroots groups, which can help to identify the top needs of the community
- State and local government agencies, which can help integrate the fund into their economic development strategies
- Health care providers (hospitals, home health care, mental health professionals, etc.) and educational institutions (universities, continuing education, entrepreneur-focused organizations), which in many communities are the largest employers

It's important that the team reflect the community members that the fund aims to serve, and prioritize their input.

Initially your team will be all volunteer. But finding some early funding, even if just for business planning by a consultant, will be invaluable. Engaging an attorney and a finance expert can help structure the fund properly.

Keep in mind, however, that not all attorneys and finance people will be a good fit. Look for those with expertise in the field of funds who are also simpatico to the objectives of making funds community friendly. It's common, unfortunately, for conventional legal or financial professionals to advise that community finance strategies are impossible or not advisable.

One person on your team will need to step forward as the project champion. Your leader should be committed to running things at least through launch and early fundraising efforts. The leader will act as point person for scheduling meetings, delegating to committees, finding and managing consultants, and other leadership tasks.

Other factors to consider as you build your team are the members' personal strengths, work experience, networks, and leadership styles. There will be plenty of work to do, so a team with only leaders and without implementers could stall. Think about how to ensure that all the following attributes and roles are covered as you recruit members to your team.

Key attributes:	Key roles:
<ul style="list-style-type: none"><li>• Visionary</li><li>• Problem solver</li><li>• Influencer</li><li>• Doer</li><li>• Bridge builder</li><li>• Barrier remover</li></ul>	<ul style="list-style-type: none"><li>• Leadership</li><li>• Marketing/ community outreach</li><li>• Finance/ accounting</li><li>• Logistics/ operations</li><li>• Advisory</li></ul>

## 2. What are your fund's objectives?

Once you've assembled your team, the fun part begins. What's your fund's purpose? Among the questions you'll want to answer as precisely as possible: What is your theory of change? What geographic area constitutes your community focus? What's your economic mission? What kind of risks and rewards do you want to provide to investors?

### Theory of change

A theory of change is "a comprehensive description and illustration of how and why a desired change is expected to happen in a particular context."<sup>24</sup> It goes beyond what your fund does, and helps define how your actions will achieve your long-term goals. Figuring this out is a great team-building exercise and will help keep your priorities aligned and focused.

For example, consider NEK Prosperity Fund's Theory of Change: "We believe that, if we engage investment from citizen investors and institutions to finance businesses and/or projects, then this will enhance the region's health and prosperity by providing for a social return to the community and a financial return to investors."

### Geographic focus

What are the appropriate geographic boundaries for your community investment fund? How local do you want your local fund to be? Define an area that fits well with your envisioned market of investors and businesses.

Investing in just your town may not be at a large enough scale to facilitate the fund's financial success. But expanding the geographic range has risks and challenges too. Your region may begin to overlap with other funds that could be competitors. If you expand your region too far, you'll be less capable of intimately

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<sup>24</sup> Center for Theory of Change, accessed December 1, 2019, <https://www.theoryofchange.org/what-is-theory-of-change/>

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knowing the businesses you're serving, and your investors will be less capable of establishing their own relationships with the businesses.

As your team works through this step, clarify whether your geographic boundary pertains solely to your target businesses, your target investors, or both. Do you want to allow investment from residents and institutions outside your region? The Northeast Kingdom Prosperity Fund addressed this issue by stating that investment in its fund is open to anyone who “loves the Kingdom, whether you live here or not,” in recognition of the many potential investors who have deep emotional ties to the region but who are former residents, second homeowners, and the like.

In some cases, a “community” may transcend geographic boundaries. Iroquois Valley Farmland REIT, for example, pools money from investors across the country who are interested in supporting family-run, organic farms that are restoring soil health.

## **Economic mission**

Your economic mission will flow from your theory of change. But there are other questions to ask: Which social or economic problems are you trying to solve? What kinds of local businesses do you wish to support? Or do you prefer focusing not on businesses at all but rather on nonprofits, municipal projects, or individuals?

The answers will require an analysis of your local economy – its history, strengths, needs, barriers, and existing infrastructure. This analysis might take the form of formal research or asset mapping. PVGrows, for example, sharpened its mission by commissioning a study to determine what it would take to expand the Pioneer Valley's local food system by 25%. The team members already knew the economic problem it was trying to solve – scaling up a vibrant, resilient, local food economy – but they used the study to help set realistic goals.

The Boston Ujima Project grew out of a gathering of grassroots organizations in 2014 to explore how participants could turn their organizing power into economic clout. Ujima gained further momentum following a 2015 Federal Reserve report arguing that Boston's enormous wealth gap was driven by historical barriers to home ownership and exacerbated by unequal access to education, employment, and entrepreneurship. By the following year, the group had launched a pilot that extended loans to five local Black- and immigrant-owned businesses.<sup>25</sup>

## **Addressing gaps**

A fund's economic mission will acknowledge the unique capital challenges facing target businesses. A common response from traditional funding sources when presented with the proposition of a community investment fund is: “There's already plenty of money in (your region's name here), we just need better businesses to lend to.” To which we say: it's not a pipeline issue, it's an access to capital issue!

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<sup>25</sup> Larson, Sandra, “Community Fund Launched: Ujima Project founded to raise \$5m investment fund for local businesses,” Bay State Banner, December 19, 2018, <https://www.baystatebanner.com/2018/12/19/community-fund-launched/>

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That was the impetus for The Runway Project, a loan fund created to fill a gap for “friends and family” seed funding for Black entrepreneurs and battle a legacy of generations of redlining, predatory lending, and exploitation. “What friends? What family?” exclaimed Jessica Norwood when she launched the fund in 2017.<sup>26</sup> Norwood calls the small loans that Runway offers “believe in you” capital.

To ensure the success of these first-time entrepreneurs, Runway offers culturally relevant technical assistance via a business boot camp program run by Uptima, a cooperative incubator run by a woman of color. The training covers everything from business plans to marketing and cash flow. Just as important, it offers vital peer support.

Even if capital were theoretically available for every worthwhile business, which is rarely the case, it’s often not the right kind of capital. Massachusetts’ Pioneer Valley had plenty of lending resources, but no coordinated effort to provide farming and food entrepreneurs with a layer of patient, risk-tolerant capital. That’s what PVGrows set out to provide.

In the NEK Prosperity Fund’s region of Vermont, where lending resources also were abundant, the founding team determined that debt financing was not always the best form of capital for the types of businesses they wanted to support. They chose to fill the gap with more “equity-like” investment structures. Runway’s loans are interest-only for the first two years to give entrepreneurs a chance to get on their feet.

A final consideration regarding mission is how it will resonate with a critical mass of local investors. What issues do people care deeply about? Is gentrification driving local residents out? Might it be worthwhile to conduct some focus groups of potential local investors to find out?

## **Risk and return**

Balancing risk and return is a core issue for every fund – and the subject of the next set of questions. How much risk is the fund prepared to tolerate? What kind of returns are needed to attract investors? Ultimately, these decisions must be presented to the target investors: Are they prepared to lose their money, and how much money do they want to make?

Nearly all mainstream investment funds are for-profit companies that aim to maximize returns. Most venture capital funds won’t touch a startup that doesn’t have the potential to return at least 10 times their investment, for example. But even funds run by nonprofits strive to achieve a modest return and have no desire to lose their investors’ money. A community investment fund may want to take on enough risk to serve those who cannot access more mainstream sources of capital, but not so much risk that business failures wipe out the fund. Balancing investor risk with the community’s values is not easy.

No one knows for sure how likely it is that a given company or portfolio of companies will succeed or fail. Even the best research cannot predict the future. Any number of unforeseen factors can impact a company’s market, management, or prospects. To mitigate these risks, a fund should develop expertise in

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<sup>26</sup> Cortese, Amy, “A New Funding Tool Aims to Fill the ‘Friends & Family’ Gap for African American Entrepreneurs,” Locavesting, September 23, 2016, <https://www.locavesting.com/new-economy/a-new-funding-tool-aims-to-fill-the-friends-family-gap-for-african-american-entrepreneurs/>

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a particular sector, learn as much as it can about applicant companies and entrepreneurs, specialize in one or two styles of local investing, and focus on first-rate execution.

How else can you mitigate risk? A well-defined geographic community can help by making it easier to understand local market conditions, get to know local entrepreneurs, and tap into the “wisdom of the community.”

There are other ways to reduce the chance of losses. You could focus on existing businesses that wish to expand, rather than startups. Or if you want to fund startups, you can provide mentoring and technical assistance, as the Runway Project and many CDFIs do. Wrap-around services like these can be valuable for growing businesses as well. Hands-on, relationship-based lending has helped keep default rates low for CDFIs, for example.

In some cases, however, the mission will dictate a need for patient risk capital. Some nonprofit funds are going to require a layer of philanthropic capital to absorb losses and even to fund operations and pay for those technical support services. The Boston Impact Initiative and Ujima Funds, for example, have raised charitable monies for these purposes. These two funds have designed multi-tiered investor models that protect small-dollar community investors while leveraging the ability of high-net-worth investors and philanthropic organizations to shoulder more risk and take a lower return.

Now let’s turn to anticipated rewards. If your fund makes loans that generate a fixed interest rate or a share of revenues, and makes a reasonable assumption about the default rate, you can probably estimate likely returns. But if the fund makes equity, or equity-like, investments, the return will be very uncertain. Most of the securities your fund holds will be difficult, perhaps even impossible, to resell. For some securities, like stock, you have no idea what an eventual payout might look like until there’s an actual liquidity event – for example, if the business is sold. (It’s also possible to make equity investments that allow the entrepreneur to buy back the shares over time, eliminating the need for a sale of the company).

Unfortunately, little data exists on the return rates of direct local investments within a particular community. This means that most of your investors must be willing to accept returns below market rates, at least at the early stages of the fund. Perhaps the smartest strategy is to promise small, and deliver big.

Jed Emerson, a pioneer in the field of impact investing, argues the virtues of promising a “blended return” – even if the financial return is low or negative, the investment might nevertheless be of value because of the positive returns to the local economy, local ecosystems, and local labor force. To measure, manage, and optimize your fund’s impact, you might use the Global Impact Investing Network’s IRIS+ methodology and web-based tools. According to the IRIS+ website, “In the same way that the accountancy profession has standardized accounting principles with GAAP, IRIS+ provides a generally accepted impact accounting system.”<sup>27</sup> The IRIS Catalog of Metrics is a free, publicly available resource. Then again, sometimes you just know impact when you see it. And the best way of communicating that impact to your investors is through storytelling and events.

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<sup>27</sup> “IRIS+ System,” Global Impact Investing Network, accessed December 1, 2019, <https://iris.thegiin.org/history/>

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Here are some ways your team might consider maximizing social impact, while managing risk:

- Know your sector well enough to judge the future performance of your portfolio businesses.
- Screen out exceptionally high risks, like pre-launch companies, or at least only allocate a small portion of assets to such high-risk investments.
- Invest only in entrepreneurs and companies you know reasonably well.
- Place clear, stringent performance standards on all clients, and develop clear plans in advance for what happens if anything goes wrong.
- Provide technical assistance (or connections to technical assistance providers) to help client businesses address potential weak points and take advantage of opportunities.
- Create a portfolio of local businesses that are buying and selling to one another, so that the success of each one boosts the others.
- Encourage your investors, especially if they include anchor institutions, to buy from the supported businesses, because as “brand ambassadors” they can increase the businesses’ chances of success.

## Priority investments

Beyond the risk and return, what kinds of local businesses are your highest priorities for financing? How should you decide?

These questions are best answered by your theory of change and your economic mission, ideally with input from the community. Our own theory of change, as Jeff Rosen laid out in the Preface, is that impact investing urgently needs to address inequality and racial injustice. This imperative is driving some of the most ambitious new funds profiled in Chapter 1, which are shifting power to communities to set priorities and allocate capital. The Ujima Fund’s investment priorities are set by community members who attend local assemblies.

Funds are also specializing in particular sectors. If alleviating food insecurity is important, as it is for PVGrows, you must focus on farming, value-added food manufacturing, food service, and food distribution. If access to safe, affordable housing is key, as it has been for the East Bay Permanent Real Estate Cooperative, you’ll concentrate on real estate. This fund has also partnered with local CDFIs to leverage community land trusts to keep property in rapidly gentrifying areas affordable.

Narrowing your investment targets will help facilitate your evaluation of each deal. You can then design a sector-specific screening mechanism for applicants, and engage peer businesses in the review process. As a planning exercise, your team might brainstorm prototypes of the desired investment opportunities and share these as “case studies” on your website and in your marketing materials. Ujima Fund even puts out requests to community members to propose businesses they have identified as “desirable but lacking” in the area to attract entrepreneurs. Clear communication about your fund’s focus will help keep applicant intake manageable and your fund’s management team aligned with your mission.



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## Priority investors

What kind of investors are you looking for? How involved do you want them to be?

Ultimately, your fund must succeed as a business, which means it needs to attract a critical mass of investors. Your “product” is the opportunity to invest in businesses, projects, or people that will contribute to the prosperity of a community. Who will be drawn to your theory of change, your economic mission, and your package of risks and rewards? Community investment funds are not a good fit for everyone.

One place to start recruiting investors is your team’s anchor institutions. Their leadership, members, employees, contributors, and other constituencies effectively connect you to hundreds or even thousands of potential investors who will be aligned with your fund’s economic mission. Another group of potential investors is current and retired owners of local businesses. With a “pay it forward” approach, they can be encouraged to help new businesses get a community boost they may have wished for themselves when they were first starting out. Every sector, of course, has its unique customer and fan base, and your choice of sector will determine how you inspire its stakeholders to invest in your fund. Recruit food funders, for example, in a great local restaurant.

Your team will need to do community outreach even before your fund is formally accepting investors. This is why having team members with marketing expertise is helpful.

In addition to questions about risk and return, expect questions from investors about “exit.” How long must investors commit to participating in the fund before they’ll see a return on their investment? Many funds insist on commitments of at least one, and sometimes two or more, years before any payouts are made. A longer commitment, perhaps even for five or ten years, may give the fund more time to absorb and recover from any losses. Given that many local businesses are being “built to last,” not “built to grow fast and sell to the highest bidder,” it makes sense to encourage your investors to think about investing on a long-term basis.

## Unaccredited investors

Whether to include unaccredited investors in your fund is another important choice. From our perspective, this is a defining feature of a community investment fund. But the inclusion of unaccredited investors in a fund presents federal compliance challenges – and operational challenges. Your fund could end up with hundreds, even thousands, of unaccredited investors rather than a few dozen accredited ones. The more people involved, the more administrative hassles, the more customers to “care for and feed,” and the more things that can go wrong.

However, the suggestions and examples provided in this handbook illustrate that the inclusion of grassroots investors also brings myriad benefits. Grassroots participation can generate community excitement about local businesses, which in turn helps them – and you – recruit more investors. Small investors are usually less demanding about the rate of return and more appreciative of the community’s social return on investment than wealthy investors (including those who profess to be “social impact” investors). Grassroots investors can also mitigate the risks of your businesses failing. By becoming “brand ambassadors,” who buy the products and help spread the word about portfolio companies, they become part of a virtuous circle that improves the chance of success for the businesses, which in turn improves returns to the fund.

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Many business owners increasingly want to share their financial success with their customers, rather than a handful of already wealthy investors. And business operators, too, appreciate the marketing and reputation benefits grassroots investors can bring.

If a fund's mission is to address the racial wealth gap or promote community prosperity, it's hard to make a case for excluding community members, most of whom are likely to be unaccredited. Allowing community members to invest even small sums provides them an opportunity to share in the wealth that's created. "If we're interested in closing the wealth divide, yes it matters how we deploy capital, and who gets the capital," says Deborah Frieze. "But it also matters who has the opportunity to invest."

## Investor participation

Beyond the use of their money, how would you like your investors to participate? Traditional investment funds have a strict division of responsibilities. The managers invest funds according to their best judgment. The investors leave the managers alone, read the managers' statements and newsletters, and occasionally ask questions by email or phone. Managers are active; investors are passive. This framework is clean, simple...and boring.

We believe there is good reason to engage your investors more actively. Crowdfunding has become popular because investors want a deeper relationship with their companies. RSF Social Finance, for example, has gotten high marks from its investors for organizing annual gatherings where lenders and borrowers come together to negotiate appropriate interest rates, known as "RSF Prime." Common Capital, a community loan fund in Springfield, Massachusetts, has committees that vet investments with community representatives. A key feature of the Ujima Fund in Boston (see following page) is "to have a broader impact in the investment community by creating an emergent and replicable model for the democratization of place-based impact investing for social and economic justice in the U.S."<sup>28</sup>

## 3. What's your business model?

As we see in the case study section, current fund targets range from \$2 million to \$50 million, although most tend toward the lower end of the range. Setting a target amount for your fund will be an iterative process among your team members that answers these questions:

- How much can we reasonably expect to raise from our community?
- Is it enough to make significant change in our community?
- Are there enough investment opportunities to deploy a significant amount of the fund?
- Do we have the ability to manage the expected activity at the envisioned scale?

To answer the first question, your team can take a page from the nonprofit fundraising world. You might construct a table to estimate the number of investments you'll need at varying amounts to reach your target.

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<sup>28</sup> Boston Ujima Project Offering Memorandum, 20, accessed December 1, 2019, <https://www.ujimaboston.com/invest>

## The Ujima Fund Investment Process

### 1. Identifying and Selecting Opportunities

Community members and stakeholders gather for **Neighborhood Assemblies**, **Citywide Assemblies** & **Business-to-Business Assemblies** to update the Community Standards and determine the Collective Investment Priorities.



### 2. Screening and Analysis

Businesses that meet the Community Standards are incubated and/or admitted to the **Business Alliance**, where they can apply for capital in response to the Collective Investment Priorities.



### 3. Due Diligence

The **Investment Committee & Fund Manager** conduct due diligence, help to draft Term Sheets, and support **Voting Members** in deciding whether each applicant is a good fit for the Fund portfolio.



### 4. Fund Allocation

**Voting Members** approve or recommend additional revisions to draft Term Sheets. Approved investments are finalized by the **Fund Manager** and sent to The C.E.D. Board for final approval.



### 5. Monitoring and Support

The **Business Alliance Coordinator**, **Fund Manager** & **Investment Committee** work collaboratively to anticipate and address investment risks for businesses in the Fund's portfolio, for the benefit of the Fund and the ecosystem as a whole.



The **Business Alliance** supports its members with technical assistance, marketing, advocacy and other creative organizing solutions.

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Here's an example of this kind of table for a \$5 million fund:

Investment Fund Goal: \$5,000,000			
Investment	# Required Investors	Subtotal	Cumulative Total
\$250,000	3	\$750,000	\$750,000
\$100,000	10	\$1,000,000	\$1,750,000
\$50,000	20	\$1,000,000	\$2,750,000
\$25,000	30	\$750,000	\$3,500,000
\$10,000	50	\$500,000	\$4,000,000
\$5,000	100	\$500,000	\$4,500,000
\$1,000	250	\$250,000	\$4,750,000
\$500	500	\$250,000	\$5,000,000
Total	963	\$5,000,000	

Start with a rough estimate for your Investment Fund Goal, based on your team's initial thinking on the optimal size. Next, determine the minimum investment amount that your fund will allow from individual investors, and from there build a range of varying investment amounts up to the maximum amount you believe is achievable. Then start plugging in numbers in the Required Investors column until you reach your target.

To make the participation of unaccredited investors possible, you'll want to choose a minimum investment amount that's accessible to many community members, while keeping in mind the total number of investors you'll end up managing over time. The Boston Ujima Fund, for example, offers investment minimums as low as \$50 to allow members of the low-income communities where it operates to participate. In the example above, investments are expected to range from \$500 to \$250,000, and creating a \$5 million fund would require nearly 1,000 investors. An investor base of that size will add cost and complexity to fund management, but also bring the benefits noted above. If your total investor number feels too high, simply adjust the Required Investors figures accordingly. Keep in mind, however, that a larger number of high-dollar investors may be harder to find and almost as costly to manage.<sup>29</sup>

A next step for the team is a discussion of the likelihood of achieving each end of the spectrum. How hard will it be to find 750 investors at \$500 to \$1,000 levels? What about three investors pitching in \$250,000? It may be helpful to draw on the experience of nonprofit fundraising professionals in your region and to consult socio-economic data on numbers of households at different wealth levels to provide "reality checks."

Once the number of investors and size of the fund are generally agreed upon, evaluate the potential impact of your fund and what will be the costs to manage it. The potential impact will be determined by the size,

<sup>29</sup> Bear in mind, however, that in a for-profit fund with assets over \$10 million, it is important to not have more than 500 unaccredited equity investors, nor more than 2,000 total equity investors. If either of these limits is exceeded, the fund could become an SEC-reporting company, which means it would need to incur significant ongoing costs to comply with a variety of reporting requirements. However, some investors may not count toward these limits, including investors that come in through a Reg CF offering or a Reg A offering.

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number, and types of investments you make. For example, will you focus on startups and early-stage businesses that need launch capital in amounts of \$10,000 to \$100,000? These are typically more risky investments and may be best structured as equity or equity-like investments (perhaps convertible debt). Or will you focus on established businesses that are seeking growth capital? These investments may be larger (\$150,000 to \$500,000), and could take the form of debt or royalty agreements. Or perhaps you want to do some combination of all of the above to meet the needs of your community as well as to diversify your portfolio.

Again, there's no right answer or magic formula to follow. It really depends on your theory of change and economic mission, as well as the business needs and investment appetites within your community. This is the stage where it may be beneficial to engage legal, financial, and tax advisors to help your team work through the details. The Operational Structure Checklist at the end of this chapter will help you identify these and other cost drivers associated with designing, launching, and managing your fund.

## 4. What's your legal structure?

The next chapter, on legal models for community investment funds, will provide the information you need to decide on the best structure for your fund. Some key questions you'll want to answer:

- Again, will you include unaccredited investors?
- Will you focus on certain types of businesses that carry special legal challenges, such as real estate?
- Will you be structuring investments as debt, equity, revenue share, or some combination thereof?
- How many investors will you include?
- Will you be sharing profits with investors?
- What are the regulatory burdens imposed by your state?

### CIF Comparison chart

To help you decide which is right for your community, the following chart provides a comparison of some of the most common legal structures of funds.



**Community Investment Fund Model Comparison**  
(Chart from the Initiative for Local Capital, [www.localcap.org](http://www.localcap.org))

<b>Benefits/ Restrictions</b>	<b>Pooled Income Fund</b>	<b>Charitable Loan Fund</b>	<b>Diversified Business Fund</b>	<b>Real Estate Revitalization Fund</b>	<b>Investment Club</b>	<b>Supplemental Fund</b>
Allows unaccredited investors	Yes	Yes	Yes	Yes	Yes	Yes
Type of investment (what investors get)	Donation + Income for life	Debt	Equity/Debt	Equity/Debt	Equity	Equity/Debt
Investment restrictions (how funds are invested out)	No restriction	Debt*	< 40% can be invested in investment securities (not including majority positions)	Mostly real estate	No restriction	No restriction
Profit sharing with investors?	Yes	No	Yes	Yes	Yes	Yes
Easy to describe to investors (scale 1-5; 1 = easiest)	2	1	5	1	2	3
Easy to set-up/ legal structure (scale 1-5; 1 = easiest)	1	2	4	4	1	5
Requires charitable purpose for outgoing investments	No	Yes	No	No	No	No
Competition with other charitable giving	High	Med	Low	Low	Low	Low
Competition with other investment options	Med	High	High	High	High	High
Requires 501(c)(3)	Yes	Yes	No	No	No	No
Can it do a public offering to raise funds?	Yes	Yes	Yes	Yes	No	Yes

\*Equity and other non-debt investments are possible but are typically avoided because of their unpredictable cash flow.

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## 5. What's your operational structure?

The final step in defining your business model is to determine the human and financial resources required to manage the fund's day-to-day operations. This will depend greatly on the legal structure you choose, and the size and extent of your financial goals. While it's beyond the scope of this handbook to describe all the forms your operational structure could take, we offer some insights below into the legal and compliance costs that accompany various fund types. We also share some important questions your team might answer to determine your fund's initial framework and management team. This is followed by an Operational Structure Checklist to help identify many of the resources and costs required to manage your fund. We provide a number of templates and tools on the NC3 website ([www.comcapcoalition.org/CIFhandbook](http://www.comcapcoalition.org/CIFhandbook)) to help you develop robust financial models, forecasts, asset allocations and more.

### Initial legal and compliance costs

As elaborated in the next chapter, you will need an attorney to help set up your fund and operate compliantly. How much you need to budget for that work will vary considerably by the type of fund.

For most of the funds described in Chapter 3, the lion's share of initial legal costs will go toward the selected capital-raising strategy, particularly if that strategy is a direct public offering registered with state securities regulators (or, in the case of a Regulation A offering, which allows you to raise up to \$50 million from the general public, with the federal SEC). For an exempt charitable offering, these costs could be as little as \$15,000 to \$20,000; a direct public offering registered with a state might cost around \$25,000 to \$35,000 (and somewhat more for real estate funds, because of additional regulations that apply). For a Reg A offering, it could be \$50,000 to \$75,000 plus considerably more in notice filing fees if the offering is nationwide.

For most of these options, the ongoing compliance costs in subsequent years can be fairly minimal, perhaps a few thousand dollars annually. But for a fund that has conducted a Reg A offering, the ongoing legal costs are higher, perhaps \$20,000 or more, plus the costs of an annual audit. A fully registered offering, including a business development company or a registered mutual fund, would likely incur \$100,000 or more in annual compliance costs. A mutual fund, due to its heavily regulated nature, would also likely incur another \$200,000 in annual compliance costs.

A host of other expenses will be required to start and run a fund. Another way to look at the cost of different types of funds is to consider the size at which they become cost-effective. In other words, at what scale do the fund's revenues cover the operating costs and provide the desired return to investors? Here's our hunch based on what we've seen:

- Charitable loan funds can achieve break-even at around \$1 million to \$2 million in portfolio size, if they're part of an existing nonprofit such as a community foundation or a community development corporation. The fund then can use the nonprofit's infrastructure and staff, with only incremental additional operating costs.



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- A stand-alone exempt fund that hires its own staff might need to reach around \$10 million in assets before it breaks even – or higher if it's offering very-low-interest loans along with technical assistance.
  - A fully registered mutual fund would likely need to have at least \$20 million in assets to break even.

These, of course, are rough ballpark numbers and don't take into account cash-flow issues or any of the peculiar challenges that arise when a fund is doing something innovative. Most of the costs of setting up a fund will be incurred before revenue comes in, which means there are special needs for start-up funding to cover the initial costs, including any operating losses until the fund breaks even.

## Operational costs

As a business, your fund will have ongoing operational costs. These will be determined by your answers to four questions:

- Who will manage the fund?
- How will the voice of investors and community members be included in investment decisions?
- What's the lifetime of the fund?
- What's the level of risk you're assuming?

The first question concerns management. Some models of community investment funds, such as a charitable loan fund or a pooled income fund, can be run within existing nonprofits. An investment club requires the active management of all member-investors. Democratically-run structures rely on member votes. Other structures may require the involvement of a registered investment advisor.

You can bring down your costs if you can hire, part-time, an existing manager associated with an established CDFI, a fund management organization, or another financial professional in your region. Some funds have partnered with CDFIs or other such experts to manage the fund. Their proven investment expertise and familiarity with your community's needs might facilitate your fund's quick set-up and launch, and their professional credibility will build confidence with potential investors.

Regardless of whether you source management from within your community or bring in an outside expert, mission alignment will be critical. As noted earlier, you'll need good legal counsel whose responsibilities include making your operations as transparent to the community as possible.

On the second question, the decision to include a large number of unaccredited investors increases costs of marketing, communications, and accounting, and a further decision to engage many of these people in your operations will add to the costs. The Boston Ujima Fund is a pioneer in the effort to create a democratically managed fund at such a large scale.

The third question focuses on fund longevity. Will you have a defined end point for investments in/ out of the fund, or will it be designed to operate in perpetuity? A fund with a short lifetime will be less complicated to administer and manage, although this might hamper the fund's ability to deliver on its mission. Balancing budget with mission is an important challenge.

The last question, on risk, also fits into the operational cost picture. Among the risks to consider: That the fund is launched but no one invests. That the fund is launched and funded, but not enough businesses in your region seek investment. That the fund is launched, funded, and deployed, but more businesses fail than anticipated.

The following checklist is designed to be a comprehensive, but not exhaustive, list of the new and existing resources you may need in order to launch, manage, and maintain fund compliance. For each item, identify an existing resource within your community or chosen fund management partner, and list the individual's name or job title next to that item. Some items may require a new hire, a new process or software, or a combination of these. Once you've identified the new and existing resources, you can assign estimated costs that can then be transferred into the financial model templates found on the NC3 website ([www.comcapcoalition.org/CIFhandbook](http://www.comcapcoalition.org/CIFhandbook)) to forecast the financial sustainability of your proposed model.

Operational Structure Checklist — Required Resources			
	New	Existing	Estimated cost
<b>Investor Relations Management</b>			
Processing checks, wire transfers, etc.			
Documents signed/ delivered to investors			
Documents recorded and filed			
Distributions management (e.g. interest, dividends, cash out requests)			
Ongoing inquiries & "customer service"			
<b>Investee Process Management</b>			
Application process design/ communication			
Applications received and processed			
Due diligence/ underwriting			
Term sheet/ investment proposal			
Negotiation			
Legal counsel			
Document/ payment processing			
On-going investee oversight			

Operational Structure Checklist — Required Resources			
	New	Existing	Estimated cost
Technical assistance			
Collections			
<b>Community Outreach - Investors &amp; Investees</b>			
Materials design & distribution			
Social media management			
Website updates			
Events			
Social impact measurement			
Social impact reporting			
<b>Compliance/ Reporting</b>			
Tax filing/compliance/audits			
Tax document distribution to investors			
Annual/periodic reports to investors			
<b>Infrastructure Maintenance</b>			
Record keeping & document storage			
Website maintenance			
<b>Financial Management/ Other Admin</b>			
Bookkeeping			
Financial sustainability and forecasting			
Cost management			
Personnel management/HR			

As with any start-up endeavor, the fund may not reach financial sustainability until the second or third (or later) year of operation. Don't despair! Just as you're providing much-needed creative financing solutions to entrepreneurs and businesses in your region, you may need to get creative with grant funding or other philanthropic support to get your fund established and growing. Seek organizations or individuals with a focus on economic development, resilient communities, or economic justice for potential capacity-building grants to fund your launch. We also believe it's important for your fund to strive for financial sustainability. A self-sustaining fund will free its management to focus on what's really important: mission and impact.

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## Chapter 3:

# Possible Legal Structures

Until this point, we've largely talked about community investment funds as if they were a uniform structure. In fact, many different kinds of funds are possible under the law, and this chapter aims to provide you and your team with a thorough overview.

Nearly 100 years of legislation and regulations determine what is and isn't possible, as well as the likely costs and difficulties of setting up and operating a fund. While state laws matter, the field's framework is largely set by the federal Investment Company Act of 1940 (the 1940 Act). The costs of setting up and meeting ongoing compliance burdens for funds, such as mutual funds, can be extremely high. The key to structuring a fund that can be economically operated at a community scale is to find an exemption in the 1940 Act so that it will not be subject its heavy compliance burden. The good news is that a number of exemptions are available for communities – at least 15, in fact!

We'll describe these 15 distinct models or “compliance strategies,” organized in seven categories: private funds, nonprofit funds, government-sponsored funds, funds not primarily in the securities business, business development companies, intrastate funds, and registered mutual funds. We'll define these categories as we go along, and give examples of each (if they exist), and point out which strategies remain hypothetical (but nevertheless promising!). Omitted are a few models that, in our view, are not likely to have a useful place in a community capital strategy.

With the exception of the private funds, all the strategies below raise community capital through some kind of public offering, which means the offering can be publicized and non-wealthy investors can participate. In addition to complying with the 1940 Act, most of the strategies below involve issuing securities to investors, which means the fund also must comply with the Securities Act of 1933. In most cases, a community investment fund will do this through a direct public offering registered with state securities regulators (or through an exempt offering for charitable funds in many states). In some cases, this could be done through a crowdfunding offering (Regulation Crowdfunding of the JOBS Act) or Regulation A.

While a detailed description of these offering strategies is beyond the scope of this handbook, you'll want to discuss them with an attorney before creating a fund. Yes, as we noted in Chapter 2, you will need an attorney to launch your fund. But we're getting ahead of ourselves. Right now, as you read about the available legal options, just think about which model fits most closely with your community's needs.

### Private funds

Private funds are generally not particularly community friendly, because they're only open to accredited investors —that is, the richest 5% of the American public.<sup>30</sup> We mention them, however, because it might be smart to start a community capital fund as a private fund. In our experience, if a fund develops a track

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<sup>30</sup> See the Introduction for the definition of an accredited investor.

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record and a basic portfolio of business before it opens up to the broader community, it's more likely to succeed.

There are two relevant types of private funds, plus investment clubs (which are effectively small private funds). What all three have in common is that they can raise capital only through *private* offerings, which typically means that advertising and general solicitation<sup>31</sup> are prohibited.<sup>32</sup> Investors in these funds must be approached personally, with restrictions on who can be approached and how.

## **Under 100 investors**

A private fund with no more than 100 investors is exempt under the 1940 Act.<sup>33</sup> This is a commonly used exemption traditionally used by hedge funds, venture capital funds, and private equity funds. While in theory these funds could accept investment from a few nonaccredited investors, as a practical matter they open themselves only to accredited investors, because offerings with even one nonaccredited investor are more onerous and expensive.

*Real life examples: Thousands, including venture capital funds, hedge funds, and private equity funds, and including many social impact funds.*

## **Qualified investors**

A private fund that is open only to “qualified” investors is also exempt under the 1940 Act.<sup>34</sup> A qualified investor generally means a very wealthy individual or institution, beyond “accredited,” with at least \$5 million in investments or an entity with at least \$25 million in investments.

*Real life examples: Many venture capital funds, hedge funds, and private equity funds.*

## **Investment clubs**

An investment club is a unique type of pooled investment vehicle that operates under a different legal theory than other private funds: it's excluded from the 1940 Act, because it does not issue securities. An investment club is typically structured as a member-managed limited liability company in which all of the capital is provided by the LLC's members. This type of investment is intended to remain outside the definition of a security (including the definition of an investment contract).<sup>35</sup>

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<sup>31</sup> “General solicitation” is a broad concept that includes advertising, but can also include any solicitation of investment from someone with whom there isn't a substantive pre-existing relationship. See E.F. Hutton & Company, SEC No-Action Letter (Dec. 3, 1985).

<sup>32</sup> Traditionally, private offerings are, by definition, offerings that do not involve advertising or general solicitation. These offerings are exempt from registration under Section 4(a)(2) of the Securities Act of 1933, or under the safe harbor provided by Rule 506(b) of Regulation D under the Securities Act. But ironically, since the JOBS Act was signed into law by President Barack Obama in 2012, it's been possible for a private fund (but not an investment club) to use general solicitation without losing its status as a private fund, thanks to Rule 506(c), which is essentially a type of private offering that allows for general solicitation. This leads to the somewhat anomalous result that this type of private fund can advertise for investors, albeit only for accredited investors.

<sup>33</sup> Investment Company Act of 1940, Section 3(c)(1), U.S. Securities and Exchange Commission, last modified October 3, 2013, <https://www.sec.gov/answers/about-lawsshtml.html#invcoact1940>

<sup>34</sup> 1940 Act, Section 3(c)(7).

<sup>35</sup> The definition of “security” in Section 2(a)(36) of the 1940 Act includes a long list of things that are considered to be securities. This includes traditional securities like stocks and options, but also includes a broad category called “investment contracts.” An

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The key to making an investment club work is that every member-investor must be actively engaged in the LLC's management. In addition, there can be no general solicitation of member-investors, because that would probably constitute a securities offering. Hence, investment clubs are usually composed of small groups of friends and neighbors, maybe 10 to 15, who know each other and share a common investment objective.

*Real life examples: There are many investment clubs throughout the country.*

## Nonprofit funds

Now we move into the fund strategies that are open for investment by the community and can be offered publicly. Let's begin with the two types of charitable funds:

### Charitable loan fund

A fund that is itself a charitable organization, where the fund is used to carry out the charity's mission, is exempt under the 1940 Act.<sup>36</sup> Because compliance is relatively simple, this is the most common type of community investment fund: By virtue of being a charity, it is automatically exempt not only from the 1940 Act but also from registration under the Securities Act of 1933. It is also exempt from registration under the securities laws of most (although not all) states. Some states allow a charitable loan fund to be launched on a public basis with no filings with any securities regulator, while others require simple notice filing.

But a charitable loan fund has two key limitations: First, its outgoing investments must have a charitable purpose. A fund that is serving a predominantly disadvantaged population will probably meet this requirement easily, though the purpose must be more than just sustaining the charity. The second limitation is that investors in a charitable loan fund can only make loans to the fund, and there can be no sharing of profits with investors. Charitable loan funds typically issue investment notes with a fixed interest rate. Adding to the notes a revenue or profit share component would generally be inappropriate.

*Real life examples: RSF, Calvert Foundation, Community Vision, PV Grows, Boston Ujima Project, EDFC, and many others.*

### Charitable equity fund

A lesser known variation is a fund managed by a charity that uses all the income from the investments as part of its charitable resources.<sup>37</sup> In this case, the fund can make investments that don't necessarily have a charitable purpose. Several types of funds fit into this model:

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investment contract has been defined by the U.S. Supreme Court in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) to mean an investment of money in a common enterprise with an expectation of profits from the efforts of others. While this definition has many nuances, the idea behind the investment club is that as long as all of the members of the LLC (the club) are actively engaged in managing the LLC's business (particularly its investing activities), they are not expecting profits from the efforts of others but from their own efforts, and therefore their investment in the LLC is not an investment contract nor a security. However, this implies that if even one of an investment club's member-investors takes a passive role and is not actively engaged in decision making, the whole investment club may find itself in violation of the 1940 Act.

<sup>36</sup> 1940 Act, Section 3(c)(10)(A)(i).

<sup>37</sup> 1940 Act, Section 3(c)(10)(B).

- **Joint investment vehicle for charities:** Multiple charities, perhaps affiliates, can pool their endowment assets into a single entity to jointly manage their investments. The purpose is to improve the organizations' efficiency and thereby increase net returns. The funds invested are all charitable assets. Profits are shared exclusively among the charities that invest. No non-charitable investors can participate.

Real life example: American Heart Association (for its affiliate organizations).

- **Pooled income fund (PIF):** This structure has long been used as a planned giving vehicle. Contributors transfer assets to the fund, which is a trust administered by a public charity. Each contributor (or the life beneficiaries designated by the contributor) receives income for their life based on the fund's performance. Upon the death of a life beneficiary, his or her assets are then distributed out of the trust to the charity.

The PIF is a promising vehicle for community investment, because it allows anyone to participate, can invest in virtually any kind of asset, and distributes profits (but not capital gains) to its lifetime beneficiaries. The fund could take minority equity positions in local businesses, for example. While it does not allow investors to get their money back, it allows donors to do more with their money than just make a donation. It offers a tax deduction at the time of investment (measured by the actuarial value of the remainder interest that will eventually go to the charity). It also allows investors to avoid capital gains tax on the transfer of appreciated assets (but not land) into the fund. PIFs have the further advantage that their offerings are exempt from registration under federal and state securities laws, which makes them relatively easy to deploy.

Real life example: NEK Prosperity Fund (in progress). Many PIFs have been established by universities, community foundations, and other charities, although they have seldom been deployed for local community investment.

## Government-sponsored fund

Another exemption to the 1940 Act, yet to be used, is a government-sponsored fund.<sup>38</sup> Any government agency or authority, or any corporation wholly owned by one or more government entities, could set up a community investment fund. Two types of funds seem possible: a joint powers authority, created by two or more government agencies acting in concert; or a corporation wholly owned by a single government agency, such as a city or county.

In either case, the fund could not issue equity shares to community investors. But it could raise debt capital through a community offering, similar to a charitable loan fund. The difference is that the capital invested would not have to be deployed in a way that furthers a charitable purpose, and debt notes issued to investors could include a revenue-sharing element that would be functionally similar to profit sharing.

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<sup>38</sup> 1940 Act, Section 2(c).



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*Real life examples: None to our knowledge.*

## Funds not primarily in the securities business

The 1940 Act was designed to regulate companies that raise capital from investors and are in the business of investing in securities. The law, however, carves out several categories of funds that are exempt because they're not primarily in the business of investing.

### Supplemental Fund

If a company is primarily in a business other than investing in securities, it will be exempt from the 1940 Act.<sup>39</sup> For example, if a consulting firm wants to invest in its clients, it can raise community capital to fund both the primary consulting business and the supplemental investment fund. This would work in any number of primary business models, including a business incubator, a co-working space, or a food co-op.

The courts have established a 5-prong test to determine whether a company relying on this strategy really is in a primary business other than investing.<sup>40</sup>

- Company history: A company with a history as an operating company in some primary business other than investing is less likely to be deemed an investment company subject to the 1940 Act.
- How it represents itself to the public: If investors are likely to invest in the company because of the investment portfolio, investing is more likely to be considered its primary business.
- Activities of its officers and directors: Whatever the officers and directors spend most of their time doing is likely to be considered the primary business.
- Nature of its assets: The more of a company's assets that are associated with its non-securities business, the more likely that will be considered its primary business. However, courts have recognized that some businesses are asset-light, and that fact should not by itself transform an operating company into an investment company.
- Sources of its income: Both net and gross income should be considered. An activity that produces a majority of both will likely be considered the primary business.

No single one of these factors is determinative. The SEC tends to look first at the last two factors, assets and income, as they're the most objective.<sup>41</sup> If the company's primary business isn't clear from those objective factors, the SEC will focus on the subjective factors, the most important of which is investors' perceptions and motivation.

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<sup>39</sup> 1940 Act, Section 3(b)(1).

<sup>40</sup> *In re Tonopah Mining Co.*, 26 S.E.C. 426 (1947).

<sup>41</sup> The SEC has stated, for example, "As a general rule, if a company has no more than 45% of its assets invested in securities and derives no more than 45% of its income from securities, it will not be regarded as being primarily engaged in investing in securities." (Financial Funding Group, Inc., SEC No-Action Letter (pub. avail. Mar. 3, 1982) 1982 WL 28965.)

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Note that the primary business could be conducted through one or more subsidiaries, but only if they are wholly-owned. The further requirement, however, is that the subsidiaries must be formed or acquired for the purpose of carrying out the business activity rather than being resold.

*Real life examples: None currently; several are considering this model.*

### **Section 3(a)(1) holding company or diversified business fund**

A variation on the supplemental fund is suggested in the definition of “investment company” in Section 3(a)(1) of the 1940 Act.<sup>42</sup> An investment company is a company that is primarily in the business of investing in securities or holds investment securities valued at more than 40% of the total value of its assets (excluding government securities and cash). If a company does neither of these, it doesn’t meet the definition of an investment company under the 1940 Act and doesn’t need an exemption.

As a practical matter, this model is similar to the supplemental fund, since both rely on the company being in a primary business other than investing in securities. But in this model, that primary business could be conducted through majority-owned subsidiaries.<sup>43</sup>

This model is sometimes called a diversified business fund, in recognition that since no more than 40% of its assets can comprise investment securities, it will likely have a fairly diversified portfolio of assets. It is important that the holding company’s investments be made for the purpose of entering into the subsidiary’s line of business, and not with a view to selling the subsidiary for a profit.

*Real life examples: Orthogonal and CoPeace (both use holding company models),*

### **Section 3(b)(2) holding company**

This variant on the holding company model is based on Section 3(b)(2).<sup>44</sup> Under this model, if a fund controls or holds a majority stake in a subsidiary, the subsidiary’s activities are deemed to be the activities of the fund. As with the previous model, the holding company’s investments must be made for the purpose of entering into the subsidiary’s line of business, and not with a view to selling the subsidiary for a profit.

This appears to be the model used by Berkshire Hathaway—which is why Warren Buffet’s company is not regulated as a mutual fund. Berkshire Hathaway, of course, is a large publicly-traded company registered with the SEC, but the model also could work for a community-scale fund.

This type of holding company is somewhat more flexible, since its focus is not on an allocation of assets but rather on the nature of the fund’s business. If, like Berkshire Hathaway, a fund invests mostly in controlling or majority interests for the purpose of actively engaging in those businesses, it’s deemed to be in the

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<sup>42</sup> 1940 Act, Section 3(a)(1).

<sup>43</sup> Section 3(a)(2) of the 1940 Act goes on to explain that the phrase investment securities as used in the definition in Section 3(a)(1) does not include majority-owned subsidiaries. Majority ownership is defined in the 1940 Act to mean 50% or more of the voting securities. The term investment securities also does not include any asset which doesn’t constitute a security at all, which could include such assets as real estate, loans secured by real estate, and a managing membership interest in an LLC.

<sup>44</sup> Section 3(b)(2) provides an exemption from the 1940 Act for: “Any issuer which the Commission, upon application by such issuer, finds and by order declares to be primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities either directly or (A) through majority-owned subsidiaries, or (B) through controlled companies conducting similar types of businesses.”

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business of whatever those subsidiary companies are doing, and not in the business of investing in the securities of its subsidiaries.

For purposes of this model, ownership of 25% of the voting securities of a target company is presumed to constitute control. A qualifying holding company need only acquire 25% of most of its target companies. However, the wording of the exemption suggests that any portfolio company that is merely controlled (and not majority owned) should be in a type of business similar to that of a majority-owned company in the fund's portfolio.

To rely on this exemption, the company would need to get an exemptive order from the SEC. This will add to the cost and cause some certainty. But unlike with exemptive orders under the intrastate exemption (discussed below), the SEC doesn't appear to have the power to impose additional rules on the fund, so this is a one-time ask and a one-time cost.

Two strategies, built around either Section 3(a)(1) or Section 3(b)(2), can be used for holding companies, but with two key differences: Section 3(b)(2) requires an exemptive order from the SEC, while Section 3(a)(1) does not. And Section 3(b)(2) affords more flexibility as to the composition of the fund's portfolio, in that it doesn't limit investment securities to 40% of the holding company's assets. This suggests that if a holding company can meet the 60-40 test, Section 3(a)(1) is the preferable strategy. Section 3(b)(2) should be reserved for holding companies that don't meet that test.

Under either strategy, it may be challenging for a fund structured as a small business holding company to find suitable investment targets that are willing to give up a majority or controlling interest in their company. However, the strategy may become increasingly useful over the next decade as baby-boomer business owners retire. Traditionally, mom-and-pop business owners have trouble finding a buyer, and many such businesses simply close, which often represents a significant loss to the community. A holding company model could acquire small businesses and strengthen them, perhaps incorporating an element of worker ownership. Eventually, the holding company could spin off these businesses and could facilitate an eventual transfer of ownership to their employees or to a cooperative of employees, but as noted earlier, it is important that they be acquired with an intent to keep them and not with the intent to sell them. This would be a strategy to preserve the character of a community.

*Real life examples: None to our knowledge are using Section 3(b)(2) at a community scale, although Goodworks Evergreen (see Chapter 2) may intend to do so.*

## **Microfinance fund**

Under another exemption of the 1940 Act, a fund will be exempt if "substantially all" of its business is "confined to making small loans, industrial banking, or similar businesses."<sup>45</sup> The SEC interprets "small loans" to mean consumer loans—that is, loans for personal or household uses, not for business uses. Similarly, an "industrial bank" is a type of banking institution that makes loans to consumers. (Industrial banks traditionally also made loans to small businesses, but the SEC does not interpret this exemption as encompassing loans to small businesses.)

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<sup>45</sup> 1940 Act, under Section 3(c)(4).

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While consumer lending is itself heavily regulated, this strategy would appear to accommodate a fund that makes:

- Loans to homeowners to install rooftop solar power systems or other energy-related equipment
- Other purchase financing loans, such as for cars or RVs
- Unsecured short-term loans (such as payday loans)

*Real life examples: None to our knowledge.*

## **Receivables or Seller Financing Fund**

The 1940 Act exempts a company whose primary business is one or some combination of the following:<sup>46</sup>

- Loans to finance the sale of goods or services
- Acquiring receivables representing the sales price of goods or services
- Acquiring real estate or mortgages

We'll discuss a real estate fund in a moment. As for the other two, we have seen two concepts use this model – both concerning renewable energy, although there are opportunities in other sectors. One is a fund that makes loans to solar installers who own the rooftop solar energy systems, either leasing the systems to the homeowner, or selling the energy to the homeowner through a power purchase agreement. For this exemption, the loan must be for financing the sale of goods or services, not a general loan to the producer of the goods or services.

A second (and more complicated) concept might be a fund that would finance commercial-scale solar or wind projects. It would acquire the revenue stream from commercial power purchase agreements between developers and utilities.

*Real life examples: None to our knowledge; two in discussion.*

## **Real Estate Fund (or REIT)**

The 1940 Act exempts a fund that is primarily in the business of acquiring mortgages and real estate.<sup>47</sup> We address it separately because of its importance. Housing and commercial properties lie at the very heart of community development, and shifting ownership of real estate is an important strategy for shifting power within a community.

A community real estate fund could be used for several different purposes:

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<sup>46</sup> 1940 Act, Section 3(c)(5).

<sup>47</sup> 1940 Act, Section 3(c)(5).

- An urban revitalization fund could acquire blighted downtown properties, renovate them, and lease them to new tenants. This would have the effect of eliminating blight, increasing foot traffic, improving safety, and increasing sales tax revenues for the city.
- An affordable housing fund could develop housing in the “missing middle” between subsidized low-income housing and high-end “market rate” housing. In severely housing-constrained regions like California, this would meet a critical need and ease the upward pressure on housing prices.
- An agricultural land fund could acquire and hold land for agricultural uses, thus saving the land from development and thereby preserving a community’s agricultural character. This could be done alongside an agricultural land trust, which uses charitable money to acquire a preservation easement and reduces the net cost of the land to the fund. Land could be leased to farmers at affordable rates, while community investors earn a decent return.

The SEC has taken the position that this exemption strategy is available to a fund if three criteria are met:

- At least 55% of its assets consist of mortgages and interests in real estate (which appears to include holding real estate through an LLC as long as the fund is the managing member);
- Not more than 20% of its assets have no relationship to real estate; and
- The rest of the company’s assets consist of “real estate-type interests” – which includes securities issued by other real estate funds.

Even without this express exemption, a fund that’s primarily in the business of acquiring, improving, leasing, and selling real estate is probably not in the securities business, and therefore such a fund would also be exempt under Section 3(b)(1), noted above, even if some of its portfolio consists of securities investments. So a real estate fund could rely on either of these 1940 Act strategies. Of the two, the Section 3(b)(1) strategy is more ambiguous, as it depends on analysis of what the “primary” business of the fund is. Therefore, a real estate fund that can meet the numerical criteria noted above may be better off using the express real-estate strategy.

Unfortunately, regulation crowdfunding (Reg CF, or Title III of the JOBS Act) is not available for any fund that relies on the real-estate exemption. Instead, a real estate fund that raises capital via Reg CF would need to rely on Section 3(b)(1).

When an offering for a real estate fund is registered with state regulators, there is typically an additional layer of regulation that can increase legal and compliance costs.<sup>48</sup> The rules for real estate funds are more stringent, for example, if they haven’t yet identified their specific acquisition targets at the time they register the offering. For this reason, a real estate fund may want to start off with an identified property that it already owns or to which it has secured rights, perhaps through an option contract. These state rules for real estate

<sup>48</sup> [http://www.nasaa.org/wp-content/uploads/2011/07/h-Real\\_Estate\\_Programs.pdf](http://www.nasaa.org/wp-content/uploads/2011/07/h-Real_Estate_Programs.pdf)

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fund, however, do not apply at the federal level. Therefore, a community real estate fund might consider raising capital via Reg CF or a Regulation A Tier 2 offering rather than a state-registered offering.

It should be noted that a real estate investment trust (REIT) is a type of real estate fund. Most real estate funds are structured as partnerships or limited liability companies (LLCs), because of the tax pass-through treatment. But if a real estate fund has at least 100 equity investors and meets certain other requirements, it can convert to a REIT, which is a corporation but with some of the tax characteristics of a partnership or LLC.

*Real life examples: Tulsa Real Estate Fund, Northeast Investment Cooperative, Iroquois Valley Farmland REIT.*

## **Opportunity Zone Fund**

A community real estate fund may also qualify as an Opportunity Fund under the new tax law adopted in December 2017.<sup>49</sup> An Opportunity Fund offers a way for an investor with unrealized capital gains to roll over the gains into the fund and defer (and partially eliminate) the capital gains tax. It also allows investors to avoid paying capital gains tax on their investment in the fund.<sup>50</sup> Such investments must go into a fund that focuses on areas duly designated by the state governor as struggling and in need of special attention.

To be clear, the Opportunity Fund structure is a creation of tax law, not securities law, and therefore doesn't provide any new strategies under the 1940 Act. Hence, an Opportunity Fund that invests in real estate is, from a securities perspective, simply a real estate fund.

To qualify as an Opportunity Fund, 90% of the assets of a community real estate fund would need to be located in one or more designated "Opportunity Zones." In addition, the qualifying property would have to be substantially improved, which means that additions to its tax basis exceed its original basis (excluding the value of the underlying land).

We share the concerns of other critics that the Opportunity Fund structure provides incentives almost entirely to wealthy investors for projects that could promote gentrification of low-income neighborhoods without benefiting existing residents. From a community capital perspective, a real estate fund should be responsive to the needs of its community, especially existing residents.

*Real life examples: Golaski Labs.*

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<sup>49</sup> Beckon, Brian. Opportunity Knocks: New Tax Incentives for Community Investment Funds, Cutting Edge Capital, February 15, 2018, <https://www.cuttingedgecapital.com/opportunity-knocks-new-tax-incentives-community-investment-funds/>

<sup>50</sup> Note that there is some confusion on this point. The new Opportunity Zone provisions are contained in Subchapter Z of the Tax Cuts and Jobs Act of 2017. Section 1400Z-2 of that new law provides for three tax benefits of investing in a qualified opportunity fund (QOF): Clause (a) provides for a deferral of tax on rolled-over capital gains until the end of 2026. Clause (b) provides for a 10% or 15% step up in basis for rolled-over capital gains held in a QOF for at least five or seven years by the end of 2026. Clause (c) provides that any investment held in a QOF for at least 10 years will get a step up in basis to market value upon a sale of the investment.

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## Diversified microfinance/ real estate fund

This exemption builds on the last several strategies discussed and sets up a kind of hybrid fund strategy.<sup>51</sup> A fund could be exempt if it is primarily engaged in any combination of microfinance, receivables/ seller financing, or real estate. These activities could be conducted directly by the fund or through majority-owned subsidiaries. There are two requirements. First, at least 25% of the fund's gross income must be derived from these specified activities. Second, if the fund is involved in some additional business (that is, other than microfinance, receivables/ seller financing, or real estate), that additional business cannot be investing in securities.

The SEC also has taken the position that to qualify for this exemption, 55% of the fund's assets must be in one or a combination of the specified business types.

This strategy opens the door for some creative combinations. For example, a single fund, perhaps focused on one distressed community, could make consumer purchase loans and other personal unsecured loans, along with mortgage loans and even some small business loans. Or a real estate fund could also acquire receivables.

*Real life examples: None to our knowledge.*

## Business Development Companies

A business development company (BDC) is a fund that offers "significant managerial assistance" to its portfolio companies.<sup>52</sup> While exempt from registration as an investment company under the 1940 Act, a BDC must register under the 1933 Act and is subject to a wide range of rules. Hence, this model is worth noting, but probably can't be economically executed on a community scale. One could imagine, however, a national BDC with local subsidiaries.

*Real life examples: There are approximately 45 BDCs; but we're not aware of any that are community-focused*

## Intrastate funds

The 1940 Act provides an exemption for intrastate funds which, while promising in concept, has proven to be largely useless because of the special restrictions.<sup>53</sup> This exemption applies to a fund that meets three criteria:

- The fund must be closed-end, which means that investors can only invest in one offering (not continuously over the life of the fund) and that there may be no exit until the fund sells its assets and dissolves;
- The fund must offer no more than \$10 million of securities; and

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<sup>51</sup> 1940 Act, Section 3(c)(6).

<sup>52</sup> 1940 Act, Section 6(f).

<sup>53</sup> 1940 Act, Section 6(d).



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- The fund must be open only to residents of its state.

But the fund can proceed only after it applies for and obtains an exemptive order from the SEC. When it does this, the SEC has the power to impose on an intrastate fund any of the burdensome requirements that apply to mutual funds. Historically, that's exactly what the SEC has done—imposed onerous requirements on intrastate funds. As a result, we're unaware of any example of this exemption even being applied for since the 1970s.

*Real life examples: None.*

## Registered Mutual Funds

A survey of the strategies available under the 1940 Act would not be complete without mentioning the possibility of creating a fully registered mutual fund. While difficult and expensive, a mutual fund containing exclusively local securities could be created. There are firms<sup>54</sup> that specialize in helping registered investment advisors build mutual funds, including the documentation and registration with the SEC.

A key requirement of mutual funds is that 85% of their assets must be liquid, meaning that there is a ready market for them. If someone wants to sell their shares, the fund must be able to sell and accommodate the redemption quickly. Thus, as a practical matter, only 15% of a mutual fund's assets can be invested in local businesses that don't offer liquidity. But it might be possible for a local mutual fund to hold 85% of its investments in liquid municipal bonds.

*Real life examples: Thousands of registered mutual funds in the U.S., including socially screened funds offered by Calvert and Domini.*

## Final thoughts

Unless you're an attorney – and sometimes even if you are one – choosing among these options can be daunting. While most of the community investment funds we're aware of use the charitable fund exemption, the more significant reality is that there's too little experience with all these exemptions to know, with confidence, which will be best, easiest, and cheapest. The jury is still out. You and your team should review these options with your attorney, and choose based upon how you answered the various questions in Chapter 2. But more important, share your decision and experiences with other communities experimenting with their own funds.

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<sup>54</sup> One example is [Gemini](#).

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## Conclusion: Ten Next Steps

If you're inspired by the ideas and examples presented here, we encourage you to act. Consider including a community investment fund (CIF) in your own social-change agenda. You'll be providing your community with great new tools and resources for promoting sustainability, economic justice, and prosperity, and serving as a beacon for other communities to follow.

We appreciate that launching a community investment fund (CIF) is challenging, especially because there are so few precedents. But the more you – and we – pool resources, the more likely we all are to succeed. We encourage you to join with us, at the National Coalition for Community Capital, to share your work, your challenges, and your results. Please don't wait until you have launched a fund—anyone engaged at any stage can add meaningfully to our community of knowledge.

We're especially eager to exchange answers to the following 10 questions. These are the questions that continue to vex us, and our collective answers will help determine the long-term success of CIFs as tools for social change.

### 1. What's the appropriate ROI for CIFs?

As Jeff Rosen argued in the Preface, too many social impact investors have sought to match or exceed the returns they get on Wall Street. So, what then is an appropriate rate of return for a CIF? How can a CIF attract investors without putting undue burden on entrepreneurs? There ultimately may need to be a range of CIFs. Those operating in distressed neighborhoods may need outside support to keep interest rates low. Others, like holding companies, may be capable of achieving a higher rate of investor return. Given that local small businesses often have better profit rates than global companies, is there a way of organizing local investment – in certain sectors or with certain types of entrepreneurs – that can increase the rates of return for investors beyond 2% to 3%? Is there a larger scale at which CIFs are likely to be more successful? Can a new generation of fund managers train to better fine-tune local investment?

### 2. Can funds of funds help?

In the world of mainstream finance, financial professionals often bundle funds together to expand their coverage and make the risk more acceptable for investors. Could this happen in the world of community finance? Imagine if grassroots investors could spread their money over 50 CIFs in New England, or in thousands of community-owned renewable energy businesses across North America. The Candide Group recently announced it was forming a \$40 million fund to support the Runway Project and other CIFs focused on racial justice. Will other such pools of pools emerge? And will they begin to penetrate the universe of employee pension funds?

### 3. Should investments include more than local business?

Our models in Chapter 1 mostly focus on local businesses. But there are plenty of other important local investment opportunities: In local infrastructure like water and renewable energy systems. In affordable housing and commercial space. In brownfield cleanup. In relieving the debts hanging over student-loan-burdened young people. Focusing on these opportunities might be another key to improving the

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effectiveness and returns on CIFs. Funds that help move people off credit cards with 25% interest rates or predatory loans, for example, could easily deliver better returns than those offered by Wall Street.

#### **4. What's the appropriate role of philanthropy?**

If CIFs cannot be made more profitable on their own, should community foundations step in and provide more of the risk capital? Many of the models here, including PVGrows and the Ujima Fund, required major investments from foundations and deep-pocket donors to launch the funds and make acceptable the risks for grassroots investors. These kinds of CIFs may also need ongoing assistance to subsidize their slim operating margins. But what does this mean for the thousands of communities in America without community foundations or a committed cadre of wealthy investors? And even in those communities with strong philanthropic support, how can these institutions be weaned away from short-term problem solving and into long-term investing? Foundations are so comfortable giving grants each year that the opportunities for program-related investment (PRIs) – which the IRS provides to substitute investment for grant-giving – involves a pitiful one-tenth of one percent of their assets. Should we call upon funders to step up?

#### **5. What are the ethics of mobilizing grassroots investors?**

It's a worthy goal to want community members to share in the value being created in their neighborhoods. But until the risk issues mentioned above are resolved, is it reasonable for CIFs to convince grassroots investors to gamble with their money? As Pierre Joseph, formerly a program officer at the Solidago Foundation, says, "Community investment is a great notion, but I personally would not want to ask folks [to invest] if they're just struggling to get by." Sure, a symbolic \$100 investment from anyone is probably fine. But \$1,000? \$10,000? CIFs will need to balance the goals of "democratizing finance" with the reality of economic justice, which demands that those with greater wealth and who have not experienced a lifetime of discrimination take on more of the risk.

#### **6. How can pension funds be deployed?**

Most Americans have their wealth locked up in 401ks, 403bs, IRAs, and other retirement instruments. Few believe they have investment options beyond Wall Street stocks and bonds. They're unaware of the emerging opportunities to take control of their retirement savings through Self-Directed IRAs and Solo 401ks. Our friends at the Next Egg ([thenextegg.org](http://thenextegg.org)) are solving this problem, for employers and savers alike. We wonder how CIFs can take advantage of these new sources of capital.

#### **7. What's the best legal framework for CIFs?**

Most of the models we shared in this handbook have taken advantage of a small number of the nearly two dozen exemptions from the onerous requirements of the Investment Company Act of 1940. In Chapter 3, we pointed out several models that have yet to be tried. Might these models bring down costs and risks, and raise rates of return? Might some, like those linked with business incubation, fit particularly well in some kinds of distressed communities?

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## 8. Should the law be changed?

Many of us were involved in changing federal law and the laws in 37 states legalizing investment crowdfunding. We were surprised at the openness of both progressive and conservative legislators to unify around reforming securities laws. Perhaps we should continue this approach and overhaul the laws governing CIFs. Some simple amendments to the Investment Act of 1940, which governs funds, could empower states and localities to engage in more experimentation.<sup>55</sup> And the Securities and Exchange Commission has the power to create new exemption strategies without any Congressional action. For example, a new exemption for small mutual funds could unleash thousands of new initiatives.

## 9. Can other public policies help?

The Canadian province of New Brunswick recently enacted a 50% tax credit for local investment. For every dollar over \$1,000 a resident invests in a local business, they receive 50 cents off their provincial taxes. Sometimes it takes a mule-kick like this to convince people to change their decades-old habits. There is no reason U.S. states couldn't enact similar incentives now. Even local governments could do so as credits against property taxes.

## 10. What about public education?

Ultimately, the success of CIFs will depend on better educated local businesses and better educated local investors understanding local capital. Today, 99% of Americans think that the best way to invest in their future is to place their money in global companies on Wall Street – even the tens of millions who distrust Wall Street. They're unaware of the alternatives surrounding them. Diverting just a small part of the \$56 trillion going into stocks, bonds, mutual funds, and pension funds could have a huge impact on community well being. This is certainly worth modest state and local government initiatives or foundation grants to help residents become informed and savvy local investors.

We don't have good answers to these questions – at least not yet. But maybe you will. Please share your ideas and insights – the sooner, the better. As Walt Kelly once said, “We are confronted with insurmountable opportunities.”

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<sup>55</sup> See, e.g., the letter of Brian Beckon, Principal of Cutting Edge Counsel, to the Securities and Exchange Commission, September 24, 2019.

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# Resources

## Related to this handbook

- More resources are available on the National Coalition for Community Capital website at [www.comcapcoalition.org](http://www.comcapcoalition.org). To go directly to the supporting documents for the CIF Handbook, you may visit [www.comcapcoalition.org/CIFhandbook](http://www.comcapcoalition.org/CIFhandbook).

## Books on local investing

- David Barnett, *Invest Local: A Guide to Superior Investment Returns in Your Own Community* (Amazon Digital, 2014).
- Hal Brill, Michael Kramer, Christopher Peck, *The Resilient Investor: A Plan for Your Life, Not Just Your Money* (Berrett-Koehler, 2015).
- Amy Cortese, *Locavesting: The Revolution in Local Investing and How to Profit from It* (New York: Wiley, 2011).
- Anand Giridharadas, *Winners Take All* (Knopf, 2018).
- Carol Peppe Hewitt, *Financing Our Foodshed: Growing Local Food with Slow Money* (Gabriola Island: New Society, 2013).
- Janice Shade, *Moving Mountains: The Power of Main St. Americans to Change Our Economy* (Onion River Press, 2020).
- Morgan Simon, *Real Impact: The New Economics of Social Change* (Bold Type Books, 2017).
- Michael H. Shuman, Jenny Kassan, Jeff Rosen and Tom Wilits. *Creating a Community Investment Fund: A Local Food Approach*. Community-Wealth.org. (Oakland, Cutting Edge Capital, 2013). <https://community-wealth.org/content/creating-community-investment-fund-local-food-approach>
- Michael H. Shuman, *Local Dollars, Local Sense: How to Shift Your Money from Wall Street to Main Street and Achieve Real Prosperity* (White River Junction: Chelsea Green, 2012).
- Michael H. Shuman, *Put Your Money Where Your Life Is: How to Invest Locally Using Self-Directed IRAs and Solo 401ks* (San Francisco: Berrett-Koehler, 2020).
- Woody Tasch, *Inquiries into the Nature of Slow Money: Investing as if Food, Farms, and Fertility Mattered* (White River Junction: Chelsea Green, 2008).
- Elizabeth U, *Raising Dough: The Complete Guide to Financing a Socially Responsible Food Business* (White River Junction: Chelsea Green, 2013).
- Edgar Villanueva, *Decolonizing Wealth: Indigenous Wisdom to Heal Divides and Restore Balance* (Berrett-Koehler, 2018).

## Organizations promoting local investing

- Center for Economic Democracy, <https://www.economicdemocracy.us/>
- Common Future, <https://commonfuture.co/>
- Cutting Edge Counsel, [www.cuttingedgecapital.com](http://www.cuttingedgecapital.com)

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- Democracy Collaborative, <https://democracycollaborative.org/>
  - Initiative for Local Capital, <https://www.local-investing.com/>
  - Locavesting, [www.locavesting.com](http://www.locavesting.com)
  - National Coalition for Community Capital, [www.comcapcoalition.org](http://www.comcapcoalition.org)
  - New Economy Coalition, <https://neweconomy.net/>
  - Next Egg, [www.thenextegg.org](http://www.thenextegg.org)
  - Slow Money, [www.slowmoney.org](http://www.slowmoney.org)
  - Solidago Foundation, <https://solidago.org/>
  - Sustainable Economies Law Center, [www.theselc.org](http://www.theselc.org)
  - Transform Finance, <http://transformfinance.org/>

Programs for financial professionals and fund creators

- Boston Impact Initiative Fund-Building Cohort, <https://bostonimpact.org/field-building/>
- RSF Integrated Capital Fellowship, <https://rsfsocialfinance.org/integrated-capital-institute-2/>

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## Contributors

**Brian Beckon** is an attorney with more than 25 years of experience working for nonprofits, start-ups, and publicly-traded companies. As a principal of Cutting Edge Counsel, Brian focuses his work on direct public offerings, corporate structuring, and strategies for community capital to help build a more equitable economy. He has served as general counsel for RSF Social Finance and Clean Power Finance, and before that as corporate counsel for Sybase and Catellus Development Corporation. He earned his J.D. from the University of the Pacific McGeorge School of Law and started his legal career with the North Bay law firm of Gaw Van Male. Brian is a member of the California Bar Association and serves on the boards of the National Coalition for Community Capital, Neto Community Network, and Cowell Homeowners Association.

**Amy Cortese** is an award-winning journalist and author. A former editor at *Business Week* and frequent contributor to *The New York Times*, she is currently a senior editor at ImpactAlpha, a digital news site focused on impact investing. Her work has also appeared in *Conscious Company*, *Stanford Social Innovation Review*, *Crain's New York*, *Daily Beast*, *Edible Brooklyn* and other publications. Her book, *Locavesting: The Revolution in Local Investing and How to Profit From it* (John Wiley & Sons, 2011), was one of the pioneering books about the emerging community capital movement, exploring how a small shift in investment toward locally-owned enterprises can reap enormous economic and social benefits for individuals, their communities and the country. She is also founder of the media and education site [Locavesting.com](http://Locavesting.com), and cofounder of [investibule.co](http://investibule.co), a discovery platform for community-based investments spanning Kiva loans to JOBS Act crowdfunding and emerging funds. Amy has been named a “top crowdfunding thought leader,” and was present at the historic April 2012 Rose Garden signing of the JOBS Act by President Barack Obama. Based in Brooklyn, New York, she is a frequent guest speaker, panelist, and moderator.

**Jeff Rosen** is the Chief Financial Officer for the Solidago Foundation and its affiliated Foundations, where he oversees all of the financial systems as well as managing the MRI and PRI portfolios. Jeff is a graduate of Cornell University's School of Industrial and Labor Relations and holds a Masters in Resource Economics and Policy from the University of Maine, where he worked to pioneer sustainability focused impact assessment techniques. He has worked in the private sector as a serial entrepreneur, developing and selling food sector businesses, and as a chief financial officer for several restaurant chains and food manufacturers. He is an active, founding member of PVGrows, a local food system collaboration located in Western Massachusetts, where he is part of a group focused on financing the regional food economy.

**Janice Shade** is a social entrepreneur, financial innovator, and author with 30 years' experience building brands, businesses, and movements. After an early career in brand management at Procter & Gamble, Welch's, and Seventh Generation, she began to explore new models of conscious commerce and community capital. Since 2006, she has launched or co-founded for-profit and nonprofit ventures that share themes of democratic access to capital, economic justice, and local economic resilience. These include TrueBody, a natural personal care products company with a mission to make natural products affordable and accessible to all. Her pioneering efforts to raise money for TrueBody were the forerunner of current



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crowdfunding techniques, and led her to co-found Milk Money, one of the first “invest local” crowdfunding platforms in the U.S.

Janice currently works as the founder of The Initiative for Local Capital, a nonprofit innovation lab; and is a founding board member of the National Coalition for Community Capital. Her entrepreneurial and capital-raising experiences are the basis of an upcoming book that explores the impact of traditional capital markets on social entrepreneurship and provides a vision for how Main Street investors can be a positive force for change in their communities. An experienced public speaker, Janice has delivered workshops on a variety of topics, been featured as keynote speaker, and led panel discussions; she regularly guest lectures at the college/ graduate school level.

**Michael H. Shuman** is an economist, attorney, author, and entrepreneur, and a leading visionary on community economics. He’s Director of Local Economy Programs for Neighborhood Associates Corporation, and an adjunct professor at Bard Business School in New York City. Shuman is also a senior researcher for Council Fire and Local Analytics, where he performed economic-development analyses for states, local governments, and businesses around North America. He is credited with being one of the architects of the 2012 JOBS Act and dozens of state laws overhauling securities regulation of crowdfunding. He has authored, coauthored, or edited 10 books; the three most recent are *Put Your Money Where Your Life Is: How to Invest Locally Using Solo 401ks and Self-Directed IRAs*, *The Local Economy Solution: How Innovative, Self-Financing Pollinator Enterprises Can Grow Jobs and Prosperity* and *Local Dollars, Local Sense: How to Shift Your Money from Wall Street to Main Street*. One of his previous books, *The Small Mart Revolution: How Local Businesses Are Beating the Global Competition* (Berrett-Koehler, 2006), received a bronze prize from the Independent Publishers Association for best business book of 2006. A prolific speaker, Shuman has given an average of more than one invited talk per week, mostly to local governments and universities, for the past 30 years in nearly every U.S. state and more than a dozen countries.

