GroundBreak Coalition

BIPOC ENTREPRENEURSHIP

SUBJECT MATTER EXPERTS: Alex West Steinman, the Coven & Lyneir Richardson, ChicagoTrend Corporation & Rutgers University

WORKING GROUP CO-CHAIRS: Greg Cunningham, US Bank; Commissioner Steve Grove, MN DEED; Ravi Norman, Norman Global Enterprises

WORKING GROUP MEMBERS: See appendix

What are the problems that these prototypes are trying to solve?

- Statistically, many BIPOC-owned companies have fewer access points to necessary seed capital from “friends and family” than white-owned companies, due in part to historical and current systems of exclusion that have resulted in a racial wealth gap.
- There is an uneven pool of resources and government support for BIPOC-owned companies (as evidenced by the Paycheck Protection Program distributions).
- BIPOC-owned businesses suffer lower home ownership rates and under-valued real estate to provide collateral for business credit, which may be borne of appraisal racial discrimination.
- Access to bank lending and uncertainty of approval for BIPOC entrepreneurs. Federal Reserve research that shows that 80.2% of white business owners receive at least a percentage of funding requested from a bank, compared to 66.4% of BIPOC business owners;
- Address collateral barriers by tying entrepreneurs’ requirements solely to business assets and/or enables unsecured lending;
- Eliminate higher rates/less favorable terms often faced by BIPOC-owned businesses; and
- Address dilution required for equity investments.

BACKGROUND & METHODS

The following written reports served as the foundation for the work and the initial definition of the problem:

» **The Demand for Capital for Minority and Immigrant Owned Businesses,** *Northside Economic Opportunity Network & New Impact Fund (2017)*

» **2021 Minnesota Small Business Profile,** *US Small Business Administration*

» **Small Business Success, Chet Bodin,** *State of Minnesota DEED (2017)*

» **The Kauffman Indicators of Entrepreneurship,** *Minnesota (2020)*

» **Access to Capital for Entrepreneurs: Removing Barriers,** *Kauffman Foundation, October 2021*

» **Despite recent gains, Minnesota's entrepreneurs of color face persistent barriers,** *Federal Reserve Bank of Minneapolis (May 2021)*

» **Minority Owned Firms in Minnesota,** Rachel Vilsack, *Minnesota DEED (2015)*

With that foundation, a broad array of data was collected through five months of intensive Working Group meetings (June-October) and associated research and support by subject matter experts. Data included, but was not limited to, a comprehensive assessment of the current conditions, barriers to achieving desired outcomes, existing solutions, and interviews with current actors across sectors. Useful summaries of data raised and considered especially as to obstacles to be overcome through solutions can be found in Working Group meeting summaries.

The Working Group was comprised of 30+ participants, recommended by Steering Committee members, reflecting financial institutions, government, philanthropy, corporations, nonprofits and community members long working in this field. While the Working Group is committed to supporting entrepreneurs throughout the entire life cycle of their business. The proposed solutions in this phase focus on start-up and growth phases of the business life cycle. We defer developing prototypes to attract equity/angel capital for 'high growth' enterprises to a later GBC phase.

At Working Group "design sessions" in October, members engaged in a user-centered process to rapidly develop proposed prototypes that addressed the Working Group problem statement. Following that session, subject matter experts synthesized Working Group members' ideas into a comprehensive suite of proposed prototypes.

In November, detailed feedback on the proposed prototypes was provided by Working Group members from all participating sectors. These included: Bella Lam (Coconut Whisk), Phuong O'Neill (Knight Foundation & Mosaic Event Space), Andy O'Leary (MEDA), Dorothy Bridges (MEDA), Mary Rick (City of St. Paul), AJ Austermann (Huntington Bank), Erik

Hansen (City of Minneapolis), Katie Mattis Sarver (Bell Bank), & Tawanna Black (Center for Economic Inclusion). Working Group co-chairs also provided feedback.

Finally, all Working Group members provided a final round of feedback in December 2022, and subject matter experts incorporated that feedback into final recommendations.

CAPITAL PROTOTYPES: BIPOC ENTREPRENEURSHIP

What is the underlying context for this work?

The BIPOC Entrepreneurship Working Group is tasked with recommending a set of capital solutions that will enable GroundBreak Coalition (GBC) to achieve its goal of creating parity between BIPOC-owned and white-owned businesses, with 20% of those businesses hiring 5 or more people.

The measurable result will be the creation of at least 11,000 BIPOC-owned businesses and 24,000 new jobs. For Black entrepreneurs specifically, the initial focus of GBC, that equates to an additional 5,000 entrepreneurs creating more than 8,000 jobs within the next five years

Ultimately, the solutions will:

» Address the fact that Black entrepreneurs have very little equity or access to inter-generational wealth;

» Support these entrepreneurs through the whole life cycle of their business; and

» Create regional, universal financial products available at all participating GBC partners with a 'common application'.

The proposed solutions in this phase focus on start-up and growth phases of the business life cycle. We defer developing prototypes to attract equity/angel capital for 'high growth' enterprises to a later GBC phase.

What capital prototypes are being proposed now?

We are proposed this suite of three capital prototypes:

1. Start-up grants/forgivable loans;
2. Early-stage Special Purpose Credit Program loan up to $250,000 (with guarantee); and
3. Growth stage Special Purpose Credit Program loan from $250,000-$1 million (with guarantee)

Capital Prototype #1: Start-up Grants/Forgivable Loan

What are the key elements that must be part of the prototype ?

- Flexible capital (along the order of magnitude of $5,000 to $50,000) shortly after business formation to make inventory purchases, institute marketing and e-commerce platforms or pay for staff and other start-up costs.
- Obtain on an unsecured basis and without three or more years of successful operating history.
- "Nimble and non-restricted" financing that does not require personal guarantees/ collateral or credit checks.
- Avoid what can be prohibitive interest rates and burdensome fees early in their business's operating history as they grow their respective client base and revenue.

How would capital solution work?

Grant/forgivable loan would provide up to $50,000 grants to entrepreneurs who:

- completes any TA program offered by a local business services provider in the ecosystem;
- submits a GBC 'Common Application'; and
- obtains a letter of recommendation from the ecosystem-based TA provider stating that their organization has reviewed the plan outlined in the GBC Common Application and believes the plan and revenue projections are reasonable.

What else needs to be considered?

- We need to track the success/failure of those receiving funds and agree on success metrics.
- Applicants will have to have some letter of validation of their business approach in order to be considered; defining 'validation' remains to be done.

Capital Prototype #2: Early-Stage Special Purpose Credit Program Loan for Business Stabilization

What is the goal for this prototype?

Ready access to a $50-$250,000, early-stage business loan product for Black entrepreneurs from all GBC participating lenders.

How would capital solution work?

GBC participating lenders would provide the business loan, as set out below, and part of a Special Purpose Credit Program with an accompanying loan guarantee.

Loan from participating lender	Guarantee/credit enhancement
» $50,000-$250,000 loan to begin to build business; » 7 years term; prime rate of interest; interest only for 36 months; » Collateral is business-owned product or property, if exists; and » 1 year of experience with cash flow and shows realistically will have cash flow for debt (with tax returns) » Personal collateral not required for loans	» Each loan would be secured with credit enhancement/guarantee equal to 50% of outstanding funds » Credit enhancement would be removed upon achievement of key performance indicators (KPIs) that had been agreed to upon inception of program. » Product would be offered without guarantee once KPIs met as critical part of regional systems change.

What types of capital would each source be expected to provide to this solution?

- Lenders (financial institutions and CDFIs) would be expected to provide business loans; and
- Guarantees would be issued by GBC based on a guarantee mechanism likely created with government and philanthropic resources.

Capital Prototype #3: Special Purpose Credit Program Loan for Later Stage Growth

What is the goal for this prototype?

Ready access to a $250,000-$1,000,000 later-stage business loan product for Black entrepreneurs from all GBC participating lenders.

How would capital solution work?

GBC participating lenders would provide the business loan, as set out below, as part of a Single Purpose Credit Program with an accompanying loan guarantee.

Loan from participating lender	Guarantee/credit enhancement
» $250,000-$1,000,000 loan » 7–10-year term; prime rate with option of revenue-based repayment » 2 years of business experience required; and » Collateral is product or property, if exists.	» Each loan would be secured with credit enhancement/guarantee equal to 25% of outstanding funds » Credit enhancement would be removed upon achievement of key performance indicators (KPIs) that had been agreed to upon inception of program. » Product would be offered without guarantee once KPIs met as critical part of regional systems change.

What types of capital would each source be expected to provide to this solution?

- Lenders (financial institutions and CDFIs) would be expected to provide business loans; and
- Guarantees would be issued by GBC based on guarantee mechanism likely created with government and philanthropic resources.

What Other Elements Should be Addressed/Coordinated with this Prototype to increase its effectiveness?

- Technical assistance (TA) providers to support emerging entrepreneurs
- Sustainable network of lenders, TA providers for early-stage grants/forgivable loans, early and late-stage loans

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COMMERCIAL DEVELOPMENT

SUBJECT MATTER EXPERTS: D'Angelos Svenkeson & Cameran Bailey, NEOO Partners

WORKING GROUP CO-CHAIRS: David Reiling, Sunrise Banks; Dorothy Bridges, US Bank; Jim Mulrooney, Bremer Bank

WORKING GROUP MEMBERS: See appendix

What are the problems that these prototypes are trying to solve?

- Majority of community-desired, commercial developments are neighborhood projects (between $.5mm and $10mm; less than 30,000 sf)
- Black developers of these projects want to hold them for their business, long term
- Black developers don't have the personal wealth/equity or amount of development experience currently required for mainstream funding and the luxury to afford to piece together multiple and uncertain funding sources
- They need time to develop property, build business, stabilize both
- They need to be able to efficiently and reliably secure 90-95% of financing
- These all assume that the black developer has a revenue model that expects to have revenues exceed expenses; and to put excess revenue back into the enterprise and pay debt (profit or non-profit)

BACKGROUND & METHODS

The foundation for this work and the dimensioning of the problem came from conversations with an array of local actors and institutions, such as Neighborhood Development Corporation, Northside Economic Opportunity Network, Lake Street Council, Lake Street Leadership Recovery Coalition, Minneapolis Foundation, and Twin Cities LISC, who have been working to scale commercial development in critical cultural corridors for decades.

Efforts to raise capital and awareness around this issue after George Floyd's murder, such as Restore/Rebuild/Reimagine, the Community Asset Transition (CAT) funds and later Main Street resources from the State, all contributed to the identification of at least 100 community-priority projects. Kate Speed at LISC, who has helped harness and deploy CAT and Main Street funds, worked with D'Angelos Svenkeson at NEOO Partners to help us categorize and dimension the resources needed to complete them.

With that foundation, a broad array of data was collected through five months of intensive Working Group meetings (June-October) and associated research and support by subject matter experts. The Working Group was comprised of 30+ participants reflecting financial institutions, government, philanthropy, corporations, nonprofits and community members long working in this field. Data included, but was not limited to, a comprehensive assessment of the current conditions, barriers to achieving desired outcomes, existing solutions, and interviews with current actors across sectors. Useful summaries of data raised and considered especially as to obstacles to be overcome through solutions can be found in Working Group meeting summaries.

At Working Group "design sessions" in October, members engaged in a user-centered process to rapidly develop proposed prototypes that addressed the Working Group problem statement. Following that session, subject matter experts synthesized Working Group members' ideas into a comprehensive suite of proposed prototypes.

In November, detailed feedback on the proposed prototypes was provided by Working Group members from all participating sectors (Kate Speed, LISC-Twin Cities; Mike Lowe, Huntington Bank; Ken LaChance, Wells Fargo Bank; Jim Terrell, City of Minneapolis and Fortis Capital; and Marcq Sung, the McKnight Foundation) as well as Working Group co-chairs.

Finally, all Working Group members provided a final round of feedback in December 2022, and subject matter experts incorporated that feedback into final recommendations.

CAPITAL PROTOTYPES: COMMERCIAL DEVELOPMENT

What is the goal for this suite of prototypes?

» An integrated system of capital that can efficiently package the financing needed for 60 Black-developed projects over next three years and many more of the same character, in perpetuity

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What is the integrated capital solution?

- Special Purpose Credit Program Senior debt from financial institutions for 60% of costs (with guarantee)
- Junior debt from 3rd party financier for 35% of costs (funded with low-cost patient capital) with guarantee: and
- Owner/developer equity for 5% of costs (potentially with 2% of it from recoverable grants)

How would each element of the integrated capital solution work?

Special Purpose Credit Program Senior Debt:

- Financial institution provides first mortgage for 60% of costs
- 10-year term, market rate of interest
- Underwrites at 'stabilized' year plus two or three years, given 3rd party financier commitment of 35%
- Possibly even spread risk among other financial institutions
- Loan secured with credit enhancement equal to 10% of outstanding funds
- Credit enhancement would be removed upon achievement of key performance indicators (KPIs) that had been agreed to upon inception of program.
- Product would be offered without guarantee once KPIs met as critical part of regional systems change.

Second Mortgage:

- Third party financier (entity managing the pool of low-cost patient capital) provides second mortgage
- Can do debt or equity for 35% of costs (depending on owner intent)
- 10-year term, market rate of interest
- Underwrites at the year that the property is expected to be 'stabilized' (likely 2 or 3 years beyond current industry norm)
- Can delegate underwriting to community partners, financial institutions, CDFIs
- Third party financier may serve as a clearinghouse that houses the capital, matchmakes Black developers with development team expertise and technical assistance; helps secure market rent paying tenants
- Loan secured with credit enhancement equal to 20% of outstanding funds

Owner/Developer's Equity:

» Owner/developer give/get 5%

» Possibly able to access recoverable grant funds (a one-time, strategic investment) to supplement assets

What are the sources of funds for the Third-Party Financier?

» Investors with patience (at least ten-year term) seeking blend of social (growth of Black developers and community-desired commercial developments) and financial returns (market rate)

- Could be raised in multiple ways, e.g., bond proceeds, private investment fund

» Investments secured with credit enhancement equal to x% of outstanding funds (to be finalized at later stage)

- Credit enhancement could be provided by grants, guarantees, similar mechanisms (on Financier's balance sheet or not)

How would the Third-Party Financier work?

» Financial institutions participating in GBC who are interested in providing the first mortgage would approach the Third-Party Financier or any delegated underwriter (may be first mortgage provider itself) about providing the second mortgage

» The two institutions would agree upon the pre-defined process for using substantially the same underwriting of the developer and the complete transaction, and maximizing other financing mechanisms that could further reduce costs and risks, e.g., Property Accessed Clean Energy (PACE), tax increment financing (TIF), GreenBank (even if other financing mechanisms come in later to take out initial second mortgage, in part)

» Closing would be simultaneous.

How will these prototypes take into account the potential that the transactions won't have a lot of room for additional debt or ways to address operating challenges if occurred in the first few years?

This would be addressed in four ways:

» **Capital:** The junior debt (funded with impact investment dollars) would be available to address this in two ways: (1) The amount of principle repayments made on the junior debt would be made available to the developer as a line of credit if needed to address hiccups; and (2) additional junior debt might be extended under extenuating circumstances;

- **Building developer capacity:** We would be clear that this suite of products is meant for a set of developers that we believe are technically able to 'leapfrog' the current system and manage these types of risks;
- **Augmenting development capacity:** We would need to have a ready stable of experienced developers who could be added to the developer's development team to provide expertise and confidence to lenders, as needed; and
- **Building a pipeline of market paying tenants:** All of these risks are reduced the more the community can help the developer attract stable tenants willing and able to pay market rents.

What Other Elements Should be Addressed/Coordinated with this Prototype to increase its effectiveness?

- Streamlined financing across all tranches to save time, money, risk
- Coordinated site acquisition and land banking with local governments and partners
- • Maximum use of complementary financing mechanism:
  - PACE: property assessed clean energy
  - TIF
  - Green Bank, once developed
- Matchmaking of experienced development teams and technical assistance
- Matchmaking with market rent paying tenants to reduce risk

What additional context do we need to consider?

- This targets one of three categories of commercial development, that which we've defined as "neighborhood scale" (projects up to 30,000 sf).
- This is focused on increasing substantially the number of successful Black developers and is meant to provide the financing necessary to bridge from development to stabilization.
- This defers to later GBC phases:
- Community-scale (30,000-50,000 sf) and Anchor scale (75,000+ sf) developments
- Capital prototypes to attract equity at scale more appropriate to larger scale developments with more cash flow
- Products that mirror, more closely, Minneapolis Commercial Property Development Fund (CPDF) and/or provide even longer-term financing (30-40 years) and even greater stability.