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Equity-Focused Capital for Community-Powered Real Estate

Field Scan & Research Findings for the Strong, Prosperous and Resilient Communities Challenge (SPARCC)

Mural by Kane-One

Acknowledgements

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I. Executive Summary

This report summarizes the research findings of a project to develop new capital products and approaches to finance racial equity-focused real estate practitioners and projects, building off the approach of the Strong, Prosperous and Resilient Communities Challenge (SPARCC). The consultant team's internal research included significant desktop research and interviews with 14 external parties: seven equity-focused real estate capital users (developers and project sponsors) and seven capital providers who have had success lending to and investing in equity-focused real estate projects. The goal of this research was to complement learnings from the SPARCC program in informing recommendations for new capital products and an approach to implementing those products to support real estate projects that disrupt traditional practices through emerging and experimental models.

It is important to recognize that this segment of the real estate and community development field is undergoing significant growth and expansion – new approaches to using real estate as a tool to advance racial equity and community empowerment continue to emerge and evolve. Through our interviews with external parties, as well as a review of projects and sponsors in the SPARCC pipeline, we identified four overarching categories:

1. **Community Land Trusts (CLTs)**
   Nonprofit organizations that acquire land and property for the purpose of developing and stewarding permanently affordable rental, shared equity homeownership, commercial, and other community-serving land uses. CLTs vary in their approach, market conditions, strategic focus, and structures of community control, but share a common commitment to democratic governance and balancing the goals of affordability with wealth-building.

2. **Community Investment and Ownership Vehicles**
   While CLTs tend to *primarily* focus on providing or preserving affordable for-sale or rental housing, other community ownership vehicles (which often own non-housing real estate assets) are more focused on giving community members the opportunity to build wealth as real estate values in their communities appreciate, and to have control over how key parts of the built environment in their communities are managed. These include Community Investment Trusts (CITs), Community Stewardship Trusts, and other portfolio-based models that vary in their degree of democratic participation and emphasis on generating returns to community-based investors.

3. **Inclusive Developer Training and Incubation Programs**
   Another approach to building community power in real estate is to prepare and assist residents of marginalized BIPOC communities to become real estate developers. This approach is especially popular in cities experiencing ongoing gentrification: if community

residents become developers, they can participate in the increase in real estate values caused by gentrification, thereby keeping some of the wealth generated by that process in the community. These programs include development skill-building, mentorship, and supportive referrals to key third parties to help build networks and gain hands-on experience. Given the focus on wealth-building, inclusive developer training tends not to focus on explicitly affordable housing or other subsidized real estate. However, some programs focus on developers who are committed to building in areas with significant abandoned housing stock or vacant land, where rents and prices are lower, and center community engagement in their training content.

4. **Community-Driven Development**
   The final category of community-centered development is the most diverse of all: it encompasses all developers who are rooted in community and making community benefit a key pillar of their development strategy. These developers have all created strategies based on their own view of how they can best help their communities through real estate development and the appropriate balance between commercial success and community benefit. Their strategies are all unique: tailored to the circumstances of the communities they work in, the developers' own strengths, and their personal outlooks and worldviews. Projects in this category are primarily focused on commercial and mixed-use development, as opposed to the creation of affordable housing opportunities or community space.

As varied as these models may be, they share a common goal of shifting development and investment practices away from the extractive and destructive patterns that have been all-too-common in the traditional real estate finance sector. Thus, they are the exact sort of experimental, entrepreneurial approaches to real estate that a catalytic lender or investor must be able to finance in a way that enables their growth: approaches that others can learn from in both their successes and their failures.

COMMUNITY BENEFIT AND COMMUNITY POWER

One way to think about different approaches to equity-focused real estate that we find useful is the degree to which they center community benefit or community power. By "**community benefit**," we mean the goals of traditional community and economic development programs—adding affordable housing units, creating good jobs, increasing access to health care services, and the like. By "**community power,**" we mean focusing on putting economic and capital power in the hands of communities, for them to use as they see fit.

Traditional non-profit community development real estate practice has typically focused on community benefit: affordable housing developers, for example, have typically been controlled by people outside the communities they operate in and have defined success in terms of outcomes such as units added. Furthermore, these approaches have relied extensively on government programs that are designed and managed centrally, with limited input from the communities where they take effect.

A typical feature of newer, more innovative approaches to equity-focused real estate is a recognition of the importance of communities being involved in capital decisions that affect them. However, there are many different ways to put this into practice. These range from explicit community governance mechanisms, to community consultation mechanisms and community advisory boards, to putting capital in the hands of community residents and institutions. Furthermore, while nearly every equity-focused real estate practitioner would say that community benefit and community power are complementary—that building one builds the other, such that the whole is greater than the sum of its parts—practitioners tend to emphasize one or the other. For example, many developer training programs focus on putting capital in the hands of community residents to develop their own projects, but do not have an expectation that those projects will deliver specific, measurable community benefits: they believe that the benefit comes organically from having communities gain economic power over how they are developed. Similarly, many organizations (including some community land and investment trusts) focus primarily on outcomes goals such as delivering affordable housing, with community consultation or advice centering on exactly how they work for those outcomes.

This diversity of approaches is a strength of the field of equity-focused real estate—there are many practitioners testing and experimenting with different ways to build racial equity through real estate capital. The good news for capital providers interested in supporting this work is that practitioners across this spectrum are largely unanimous in their views of what kind of capital they need: flexible capital that is designed to catalyze projects and developers at a very early stage. While traditional developers typically fund these sorts of expenses at their outset (before they have a reliable development fee stream to pay for new deal development) through personal funds or investments on friendly terms from friends and family, many emerging real estate developers do not have access to this sort of funding, so there is a clear opportunity for mission-aligned sources to provide it.

TRADEMARKS OF EQUITY-FOCUSED CAPITAL

Beyond the theme of early-stage financing support, we identified seven features that capital users cited as most helpful to them in capital products:

- **Patient:** Capital products should have long terms or be structured without hard maturity dates, to allow practitioners time and flexibility to learn and work through problems.
- **Flexible Underwriting Approaches:** Because equity-focused practitioners often create highly innovative project plans, capital providers cannot be beholden to underwriting approaches that are too rigid.

- **First Loss:** Capital users need first-loss capital that can catalyze other capital sources more than senior debt capital.
- **Non-Dilutive:** Capital users are looking for repayment structures on equity-like products that do not involve giving up significant common equity ownership of projects.
- **Delivered Through Broader Supportive Relationships:** Capital should be provided as part of a broader relationship that supports the capital user through mentorship, training, connections, and other supports. These supports both advance the capital user's mission and de-risk the capital provider's investment by increasing the chances that a project succeeds.
- **Entity-Level:** There is a need for capital that can help practitioners support and grow their own companies or organizations, outside of the project-level structure; capital providers should seek to develop ways to provide this capital.
- **Balance Sheet Support:** Practitioners would benefit from capital providers who are willing to sign loan carve-out guarantees and/or put up their own balance sheets to help meet net worth and liquidity requirements.

We also identified five common features of the most successful equity-focused capital providers:

- **Clear Equity Focus Throughout Organization:** Successful capital providers know why they are investing and lending to support equity-focused real estate. They also typically have a more narrow focus (geographically or thematically) to help them concentrate their efforts and know their market well.
- **Center Building & Maintaining Borrower Trust**: Capital providers use several strategies and practices to build and maintain trust with borrowers and communities: this is key because early-stage capital providers need to know and trust their investees and borrowers, and because communities of color have a trust deficit with capital providers of all types that needs to be repaired.
- **Capital is Part of a Broader Relationship:** The capital providers we spoke to think of capital as just one element of their strategy and how they achieve their mission, and find ways to support their borrowers and investees beyond funding.
- **Form Follows Function in Product Design:** The capital providers we spoke to represent a very broad array of different capital products. However, while they lend and invest very differently, they all had a clear explanation and rationale for why their specific approach is the best approach for their own community and market.
- **Ability to Iterate and Think Long Term:** Many of the capital providers we spoke to had made material changes and course corrections to their products and approach based on learning and feedback, and expressed comfort with doing so.

Equity-focused capital exists along a spectrum and shows up in a variety of forms and practices. As a result, providers would be best served by focusing on their approach and making sure it fits these five criteria, rather than focusing on finding the perfect capital product to advance equity. A critical component of honing that approach involves building trusting relationships with communities. This requires humility, an openness to experimentation, and a willingness to listen.

Introduction

OVERVIEW OF PRODUCT DESIGN PROJECT

Starting in 2017, the Strong, Prosperous and Resilient Communities Challenge ("SPARCC") has been working in six cities (Atlanta, Chicago, Denver, Los Angeles, Memphis, and the Bay Area) to build and support local efforts to exert community control over real estate and infrastructure investments. The SPARCC Tables in those cities are made up of key local organizations, and work to ensure that investments in the built environment reduce racial disparities, build a culture of health, and respond to the climate crisis. SPARCC, an initiative of Enterprise Community Partners, the Low Income Investment Fund ("LIIF"), and the Natural Resources Defense Council, has been supporting those Tables with capital, support in advocacy, and other resources.

Capital is one of the most important components of the SPARCC project. At inception, SPARCC expected that its capital work would primarily involve facilitating conventional CDFI loans underwritten by Enterprise and LIIF into projects developed by the SPARCC Tables in each of the six cities. Only $3 million was available to make more flexible capital grants (either recoverable or non-recoverable) outside of traditional CDFI loan structures. SPARCC's initial expectation was that the Tables would have multiple real estate projects at advanced stages of pre-development that were not proceeding because of a gap in their capitalization; SPARCC's approach to capital was designed to fill these gaps.

SPARCC found that catalytic capital was generally needed earlier in the process than expected—rather than needing flexible capital to fill gaps in the capitalizations of fully-conceived projects, projects needed both partnership from SPARCC staff to help understand and develop project goals and capital to fund pre-development to allow projects to progress to a stage at which they were eligible for project-level debt and equity. This project pre-development, which includes market analysis, project team development, siting (and securing site control), design and budgeting, entitlements, and other elements, requires significant time, attention, and money—which partners with promising project ideas were struggling to commit. While the majority of SPARCC's $70mm capital pool was not designed to provide this type of capital, the $3mm capital grant portion was, and SPARCC deployed it successfully into a wide array of projects. In 2019, SPARCC raised $3mm in follow-on capital grant capital and rolled over existing loan guarantee and PRI capital for "SPARCC 2.0", which among other things focused more on early-stage predevelopment investments. By the end of 2022, SPARCC will have made capital investments (including grants, PRIs, and loan guarantees) totaling over $8mm into projects across its six geographical areas.

In late 2021 SPARCC sought to distill the lessons from its successful early-stage project funding experiences into a capital product and program that could be deployed at scale. We have worked with SPARCC to develop a program with the following four features:

- Flexibility: the ability to adapt to unique capital needs and circumstances at the neighborhood level
- Early-Stage: the program must be appropriate for early-stage developers and enterprises that do not yet have the capacity to develop and market a traditional real estate capital stack.
- Focus on Initial Project Stages: the program must help developers finance the pre-development, construction, and initial operating stages of real estate projects
- Life-Cycle Approach: the program must have the capacity to finance early-stage developers and enterprises to sustainability.
- Financial Sustainability: the non-grant elements of the program must have a clear financial value proposition for investors, and the grant elements must be targeted with a clear justification for grant funding.

METHODOLOGY

We developed and implemented the following plan to create that program, in collaboration with SPARCC staff:

1) Internal SPARCC research

We performed a comprehensive review of SPARCC program documents, including tools used by SPARCC staff to evaluate prospective investments and documentation related to SPARCC investments. We also interviewed SPARCC staff about the program.

Our goals in this phase were twofold: first, we wanted to understand how SPARCC approached capital deployment, and how that approach performed. We wanted to learn if SPARCC felt that they were successful in enabling community-supported real estate projects that would not otherwise have been capitalized to move forward. We also wanted to learn what lessons SPARCC staff drew from the evolution of their program and the changes they had made during the course of the program.

Second, we wanted to understand how SPARCC staff worked with the community Tables in each of their six regions. SPARCC's core goal has been to help communities exert power and influence over their own built environments; we wanted to understand how SPARCC acted to center community power in its own relationships with communities. This includes formal governance and decision-making, but also to the staffing, process, and organizational decisions that governed the day-to-day relationship between central SPARCC staff and the SPARCC Tables.

2) External research and field scan

The goal of our external research was also twofold. First, we wanted to understand the perspective of prospective users of a pre-development capital product, namely early-stage, small real estate developers and operators. We wanted to understand whether they felt a need for pre-development capital, what obstacles they experienced to growing their businesses, and how they would want pre-development capital to be structured and priced.

Second, we wanted to learn about the experiences of capital providers who have done or are doing early-stage real estate lending, and capital providers who center racial equity and community power in their lending and investment practices. We wanted to learn what best practices they have identified thus far, and where they have had to change course. We also wanted to learn about how they have brought capital and community together—how they have brought community voices in, and how they have sought to bridge the trust gap between capital providers and communities of color.

We spoke to a total of 14 external parties unrelated to SPARCC: seven users or prospective users of pre-development capital and seven innovative, racial equity-focused capital providers. We identified these parties based on research and team knowledge, with a primary goal of talking to companies and organizations that have been most innovative and impactful in deploying and using capital for real estate projects that advance racial economic power and equity. We also sought geographic diversity, not just by region, but by real estate market conditions. Some real estate markets (such as New York, Los Angeles, and the Bay Area) have very high land and real estate prices and limited supply; others (such as Baltimore, Philadelphia, and Detroit) have significant underutilized real estate supply and large underinvested areas in need of capital; others (such as Atlanta) sit somewhere between these two extremes. These significant market differences lead to significant differences in practitioners' approaches, so we made sure to have representation from multiple market types. Finally, we sought to speak to companies and organizations where the consulting team had strong existing relationships, as we thought that would lead to better interviews and more information; however, we did speak to some groups where we had no or limited pre-existing relationships.

We interviewed the following companies/organizations:

- Cooperative Fund of the Northeast (capital provider; Northeastern US)
- Seed Commons (capital provider; national)
- Denkyem Co-op (capital provider; Seattle area)
- African Development Center (capital provider; Minnesota)
- Boston Impact Initiative (capital provider; Boston)
- Mission-Driven Finance (capital provider; national)
- Invest Detroit (capital provider; Detroit)
- Boston Neighborhood Community Land Trust (capital user; Boston)
- Urbane Development (capital user; New York/Philadelphia)
- The Guild (capital user; Atlanta)
- Partners in Equity (capital user; Southeast US, primarily North Carolina)
- Black Squirrel Collective (capital user; Philadelphia)
- Urban Oasis Development (capital user; Atlanta)
- Chicago TREND (capital user; Chicago, Baltimore)

We conducted one-hour interviews with each group. The interviews were semi-structured; we did not use a set question list, but focused our questions on a handful of areas. For both capital providers and capital users, we sought to understand their capital operations with a high degree of granularity. For capital providers, we focused our questions on how they had addressed capital gaps for early-stage inclusive real estate operations and projects, through product development, operational changes, or any other ways. For capital users, we asked about how they would like early-stage capital products to be designed and implemented, and where they experience the most gaps and difficulties in capital access (or where they see those for partners who are at an early stage). Interviewees were informed that they would receive a $250 honorarium for their participation.

Our research covered equity-focused capital users and capital providers comprehensively, but we did not speak to members of a third key group: "wholesale" capital providers. These investors and lenders at scale include banks, insurers, pension funds, foundation and university endowments, and other capital sources that provide capital to lenders and investors that interface directly with projects, developers, and companies. While they are an important part of the capital ecosystem, and their views and values play an important role in determining how capital flows, considering them was outside the scope of this study. Understanding wholesale capital provider attitudes and identifying those who are most sympathetic to the goal of advancing racial economic equity through capital would be an important and valuable complement to this research.

3) Capital Product Co-Design

After performing external and internal research and information-gathering, we worked with SPARCC staff to co-design a suite of capital products and implementation approach based on learnings from the SPARCC program and from the field. The consultant team first drafted a co-design framework that included learnings from internal and external research, a proposed framework for thinking about new capital products, a summary of proposed capital products, key process considerations, and areas for further discussion. The consulting team and SPARCC staff then held three meetings over a two-week period to discuss the framework and possible capital options. Finally, the consulting team drafted this implementation playbook, which includes a written synthesis of internal and external learnings, sketches of potential financial structures for new capital products, and an implementation guide.

4) Racial Equity Analysis

In tandem with our co-design process, we worked with The REAL to ensure that our recommendation development was informed by a view on how racial inequity is built into traditional real estate and real estate financing structures and how to build explicitly anti-racist alternatives. Because of how deeply racism is built into existing economic and capital systems, attempting to change those systems without a racial equity framework risks creating merely cosmetic changes. We used The REAL's Racial Equity Assessment Framework (included as Appendix A) to guide our product and process recommendation development, and analyzed our conclusions using that framework as a guide.

Research Findings

INTRODUCTION: FIELD DESCRIPTION

SPARCC was created as a response to racial income inequality, and to work to change the economic systems and structures that created and sustain that inequality and racist economic inequities. These structures include many of the of the most important determinants of real estate ownership and development in cities, including land use policy, government economic development policy, access to development expertise and political influence over the development process, and access to capital.

SPARCC has challenged these structures in the six geographies where it has operated by working to put the tools necessary to change them into the hands of people and communities of color. Its Tables have brought together community leaders, business and policy entrepreneurs, and experts, provided spaces for them to collaborate in unique ways, and capitalized and otherwise supported the results of those collaborations.

In doing this work, SPARCC is part of a growing movement to challenge the existing economic power structures that enable racist economic inequities and the racial wealth gap, and build and grow new structures that support a growing, vibrant economy that works for everyone. This movement is broad and encompasses many different types of actors and approaches. It is also growing and changing very quickly—many promising community-centered real estate initiatives did not exist when SPARCC began in 2017. This growth has been partly catalyzed by growth in interest in ESG and impact investing, but has many features that set it apart from more mainstream approaches to impact investing.

In the real estate space, which is SPARCC's capital focus, racial equity-focused capital deployment takes many different forms. These include community investment trusts, community land trusts, other vehicles to enable community ownership or control of key real estate assets, development initiatives to help community residents become developers, and many other approaches. These approaches sometimes dovetail with more traditional community development approaches (such as affordable housing development financed with LIHTC or NMTC credits), but usually focus on finding creative financial tools that can produce the outcomes communities want rather than tailoring their projects to the subsidies available.

Equity-focused capital users are united by a common conviction that projects that affect the built environment in BIPOC communities that do not take these communities into account in a deep way are extractive and unjust. However, there is an important difference in focus and approach between how practitioners respond to this reality—a difference that must be kept in mind in financial product design. Some initiatives focus primarily on producing economic benefits for communities of color—such as affordable rental housing, opportunities to purchase homes affordably, affordable incubator space for small businesses, and others. Others focus primarily on building community economic power—such as by helping community members to become developers (even if the expectation is that they will develop market-rate projects) or giving community members an ownership stake in projects.

This is not an either-or distinction—many equity-focused projects aim to produce both community power and community benefit. Furthermore, it is not zero-sum: many projects are designed in such a way that community power is expected to produce economic benefit, or vice versa. However, quite often the innovative elements of equity-focused projects are more oriented toward community power or community benefit. This is important in the context of discussing capital products to serve equity-focused real estate because capital providers need to have products and approaches that work for both of these different types of innovative projects. It is important now, as practitioners experiment with different approaches, that capital providers approach their work as enablers of innovation rather than picking winners and losers. Rather than picking one definition of impact and theory of change and only capitalizing projects and partners that fit that box, they should strive to offer a spectrum of products that allow community practitioners to define goals and work with stakeholders in their own way—so that they whole field can learn from different approaches.

The universe of lenders and others who are providing early-stage, catalytic capital to equity-centered real estate projects is small, but growing. It is also highly emergent and experimental—while the idea that communities of color should have control and power over their own built environment is certainly not new, it is relatively recent that capital providers have felt any urgency or pressure to allocate capital to initiatives dedicated to making that idea a reality. As a result, it is simply too early for any analysis of the field to make confident pronouncements about best practices. Furthermore, the racial disparities highlighted by COVID-19 and the 2020 racial reckoning, a response to the murder of George Floyd, were catalysts in a new focus on racial equity from corporations, financial institutions and philanthropic funders—but it is yet to be seen whether these events will be impetuses for long-term change or a short-term placation of communities of color. If they prove to be the latter, actors with a long-term commitment to racial economic equity will have to further change their approach to respond to more resource scarcity. However, right now, many different capital providers are approaching this space in different ways, and it is too early to say definitively what approaches are most effective—so any capital provider who enters into the space should do so in a spirit of experimentation and iteration. The reward for that, however, is involvement in a space that is undergoing significant growth.

Capital providers for early-stage inclusive real estate include traditional CDFIs as well as non-CDFI mission-driven loan funds. One thing that unifies them is clarity of mission—they are driven by clearly-stated missions to use capital to advance racial equity. Quite often, those missions are geographically narrow—many successful lenders focus on specific communities or areas, allowing them to develop strong knowledge of the landscape in those areas. Lenders that operate nationally tend to accomplish this through partnerships—identifying good prospective partners in specific places whose work is complementary to capital provision, developing strong relationships with them, and working through those relationships to build knowledge and trust with communities.

These capital providers are comfortable making relatively small (sub-$1mm, often as small as $50,000) loans and investments, as minimum sizes that are too high are a deterrent to capitalizing early-stage capital users. However, in spite of these small sizes, they by and large report both strong growth in originations and capital raising and strong credit results. Finally, they are often led by people of color—of the 14 organizations that we interviewed, nine were led or co-led by people of color and the other five had people of color in high-level management positions in lending and investing.

CHARACTERISTICS OF CAPITAL USERS

Types of Capital Users

There are a large number of different approaches to using capital in real estate in service of racial equity. Below, we describe some common approaches that we have encountered in our research:

1. Community Land Trusts

Community Land Trusts (“CLTs”) are a relatively well-established approach to community-driven real estate; the first modern CLT was established in 1969. Structurally, they are relatively simple: a charitable trust, capitalized by donations or public subsidies, acquires real estate and manages it for community benefit. Many CLTs focus on homeownership: they buy land (or receive it as a donation), build residential dwellings on that land, and then sell those homes (but not the underlying land) at affordable prices, in structures that allow for limited equity-building (but limit appreciation to ensure long-term affordability). Other CLTs (such as interviewee Boston Neighborhood Community Land Trust and SPARCC capital grant recipients Northern California Community Land Trust and Los Angeles Community Land Trust) focus more (at least initially) on affordable rentals—they buy existing rental properties and maintain them as affordable housing. The former approach is common in markets with lower land and housing costs, the latter (which requires more subsidies) is more common in higher-cost markets where land acquisition and development are more difficult and expensive. Many CLTs also use a combination of these approaches.

CLTs likewise take different approaches to community control and ownership. Some CLTs have explicit community control through a membership structure: members pay nominal dues and receive votes to elect a portion of the board of directors. Others have less formalized community control mechanisms, such as a practice of appointing community residents to the board of directors.

2. Community Investment and Ownership Vehicles

Many racial equity-centered real estate approaches are focused explicitly on securing ownership of key real estate assets in a community for community residents. While there are some similarities between these approaches and CLTs, these approaches differ in putting ownership and wealth-building at the center of their missions. While CLTs typically are primarily focused on providing or preserving affordable for-sale or rental housing, other community ownership vehicles (which often own non-housing real estate assets) are more focused on giving community members the opportunity to build wealth as real estate values in their communities appreciate, and to have control over how key parts of the built environment in their communities are managed.

One relatively well-known example of this approach is the East Portland Community Investment Trust, which was organized in 2020. The East Portland CIT used impact investment capital and a conventional commercial mortgage to purchase a 29,000 unanchored strip retail center in outer southeast Portland, and since then has been bringing area residents in as investors. Mercy Corps, which organized the CIT, runs an educational program to help residents learn how investment works; they invest between $25 and $100 per month in shares in the property, which pay dividends based on property performance. The Guild (who we interviewed for this report) is currently developing its Groundcover project in Atlanta, which will be a mixed-use property owned in a similar structure. Other promising community ownership projects are focused on building community-owned portfolios of 1-4 family rental properties.

As with community land trusts, there are many different approaches to community investment and ownership vehicles. One key area of difference is how community governance works: the East Portland CIT's shares are currently non-voting, with governance controlled centrally, while the Guild plans to incorporate explicit community governance from the beginning of the project. There are also different approaches to affordability, given that prioritizing affordability is in tension with the goal of building community wealth through ownership. The East Portland CIT's property charges market rents (although it prioritizes renting to businesses valued by the community or owned by community members); the Guild is exploring different approaches to affordability. Many community ownership strategies take a hybrid approach, pricing their spaces below market but still at levels above traditional affordability thresholds at low percentages of area median income.

3. Inclusive Developer Training and Incubation Programs

Another approach to building community power in real estate is to prepare and assist residents of marginalized BIPOC communities to become real estate developers. This approach is especially popular in cities experiencing ongoing gentrification: If community residents become developers, they can participate in the increase in real estate values caused by gentrification, thereby keeping some of the wealth generated by that process in the community. These programs can teach prospective developers how the development process works (covering elements such as zoning, design, planning, contracting and subcontracting, negotiations, leasing, and sales), provide mentorship to help new developers deal with unpredictable situations, and provide referrals and assistance working with key third parties (both service providers such as architects and contractors and the government stakeholders who are always key to development projects).

The Black Squirrel Collective, who were interviewed for this report, are an example of this approach. They provide all of the services described above to their cohort members; they have also secured funding to assist them with predevelopment costs and have developed a relationship with the Philadelphia Land Bank to help their cohort members secure sites. The Incremental Development Alliance also provides developer training, although their approach is more limited: they run one- to two-day trainings on the basics of real estate development throughout the country.

Developer training is usually primarily focused on community wealth building; furthermore, many developer training providers lack both expertise in the complex government financing programs used by affordable housing developers and the internal and external resources to navigate the complex application processes and compliance requirements associated with these programs. As a result, inclusive developer training tends not to focus on explicitly affordable housing or other subsidized real estate. However, many developer training programs focus on developers who are committed to building in areas with significant abandoned housing stock or vacant land, where rents and prices are naturally lower; furthermore, many programs (including Black Squirrel's) center community engagement in their training content.

4. Community-Driven Development

The final category of community-centered development is the most diverse of all: it encompasses all developers who are rooted in community and making community benefit a key pillar of their development strategy. These developers have all created their own strategies based on their own view of how they can best help their communities through real estate development and the appropriate balance between commercial success and community benefit. Their strategies are all unique: tailored to the circumstances of the communities they work in, the developers' own strengths, and their personal outlooks and worldviews.

Examples of this type of development that we spoke to include Chicago TREND, which is currently focused on acquiring non-anchored strip retail centers in urban neighborhoods with a population that is over 50% Black. Chicago TREND focuses on bringing in businesses owned by community members as tenants, establishing equity partnerships with service providers (such as landscapers, property managers, and others) owned by community residents, and bringing in investment from community residents through crowdfunding. This strategy was developed opportunistically, based on the low sales prices of these types of assets (especially during the COVID pandemic), Chicago TREND's principal's expertise in retail real estate investment and operations, and the importance of these centers to communities (and the negative effects that an abandoned, derelict or poorly managed retail center can have on a neighborhood). Similarly, Urbane Development's unique strategy focused on neighborhood retail incubation as a core component of mixed-use development is an outgrowth of its principal's retail incubation expertise. Another unique example which we did not interview is Southwest Florida Impact Partners, which is pursuing a strategy focused on the historically Black Dunbar neighborhood of Fort Myers, which links development and incubation of core retail services that have left the neighborhood (such as a community bank, a pharmacy, and a supermarket) with a real estate development strategy.

All of these approaches are highly unique, and they were all developed opportunistically: entrepreneurial leaders saw a need and an opportunity, and set out to fill it. As all of these ventures are early stage, it is unclear how successful they will be, either commercially or in making positive impacts in their communities. However, one thing that is certain about these approaches is that they are very different from the traditional real estate development and investment practices that have proven so extractive and destructive to communities. Thus, they are the exact sort of experimental, entrepreneurial approaches to real estate that a catalytic lender or investor must be able to finance in a way that enables their growth: entrepreneurial, experimental approaches that others can learn from in both their successes and their failures.

5. Community Benefit vs Community Power

There are many different approaches to equity-focused real estate, many of which resist easy categorization. One way to think about different approaches that we find useful is to consider whether they center community benefit or community power. By "community benefit," we mean the goals of traditional community and economic development programs—adding affordable housing units, creating good jobs, increasing access to health care services, and the like. By "community power," we mean focusing on putting economic and capital power in the hands of communities, for them to use as they see fit.

Traditional non-profit community development real estate practice has typically focused on community benefit: affordable housing developers, for example, have typically been controlled by people outside the communities they operate in and have defined success in terms of outcomes such as units added, that will benefit those communities. Furthermore, these approaches have relied extensively on government programs that are designed and managed centrally, with limited input from the communities where they take effect.

A typical feature of newer, more innovative approaches to equity-focused real estate is a recognition of the importance of communities being involved in capital decisions that affect them. However, there are many different ways to put this into practice. These range from explicit community governance mechanisms, to community consultation mechanisms and community advisory boards, to putting capital in the hands of community residents and institutions. Furthermore, while nearly every equity-focused real estate practitioner would say that community benefit and community power are complementary—that building one builds the other such that the whole is greater than the sum of its parts—practitioners tend to emphasize one or the other. For example, many developer training programs focus on putting capital in the hands of community residents to develop their own projects, but do not have an expectation that those projects will deliver specific, measurable community benefits: they believe that the benefit comes organically from having communities have economic power over how they are developed. Similarly, many organizations (including some community land and investment trusts) focus primarily on outcomes goals such as delivering affordable housing, with community consultation or advice centering on exactly how they work for those outcomes.

This diversity of approaches is a strength of the field of equity-focused real estate—there are many different practitioners testing and experimenting with different ways to build racial equity through real estate capital. In trying these different approaches, they are learning what works and seeing what impacts they produce on their communities, capital sources, and other stakeholders. Capital providers who seek to capitalize equity-focused real estate do not need to endorse a particular orientation towards equity or benefit, or a particular combination of the two—at this stage, they should instead focus on making sure that they have a broad menu of capital options such that they can capitalize early-stage, innovative approaches across the benefit-power spectrum.

The good news on this front is that innovative practitioners across this spectrum, and across the spectrum of approaches generally, are largely unanimous in their views of what kind of capital they need: flexible capital that is designed to catalyze projects and developers at a very early stage. They all need capital to fund the earliest stages of real estate deal development: purchase or option contract negotiations, preliminary due diligence, conceptual planning and other similar costs, and to capitalize their business operations. Traditional developers typically fund these sorts of expenses at their outset (before they have a reliable development fee stream to pay for new deal development) through personal funds or investments on friendly terms from friends and family; many emerging real estate developers do not have access to this sort of capital, so there is a clear opportunity for mission-aligned sources to provide it.

Characteristics Of Capital Demand

1. Patient

A consistent feature of the innovative equity-centered approaches to real estate that we considered during our research is that they take time. This is due to a confluence of factors. Real estate development is slow and has unpredictable timeframes at the best of times. Innovative approaches can require more time to work out how they will approach the unforeseen issues that come up in every real estate transaction. Building community relationships and trust to the point required for real estate practices that are truly generative and collaborative takes time. Most importantly, one of the main goals of many innovative real estate approaches is to put power and agency in real estate development into the hands of people and communities who have historically been denied that power—unfortunately, one of the byproducts of that denial of power is less experience with the real estate development process, which can lead to delays as developers learn through experience.

As a result, patience and flexibility in repayment timing was very important to the capital users we spoke to. They expressed a preference for revenue-based repayment terms so that capital repayments were due when projects generated revenue (or financing proceeds) to cover those repayments. If fixed loan or financing terms are necessary, those should typically build in more cushion than traditional pre-development loans to give developers more time to work with communities, iterate, and work through unforeseen issues.

2. Flexible underwriting approaches

Traditional pre-development and development financing is underwritten and sized based on relatively standard approaches: pre-development lenders typically seek to ensure that they can be taken out by a standard construction loan, while construction lenders underwrite to the size of a permanent loan to refinance them. While these approaches are often effective in underwriting innovative real estate transactions, it is important for lenders to be able to think more broadly about loan repayment sources in their underwriting.

This is particularly important for borrowers with non-standardized sources of subsidy capital, such as many of the Community Land Trust borrowers that we spoke to (and that SPARCC has provided capital grants to). CLTs that focus on affordable rental housing often receive subsidies to cover the portion of their property acquisition costs in excess of the conventional mortgage amount that can be supported by the properties' projected NOI. These subsidies are often state and local programs (rather than the federal tax credit programs that affordable housing lenders are familiar with); as a result, their requirements, structures, and approval and payment processes differ significantly across geographies. Furthermore, they are often relatively slow to pay out. This creates significant difficulties for the CLTs that use these subsidies, which often operate in hot real estate markets where the ability to close quickly is very important—they often see promising acquisition opportunities snatched up by extractive commercial developers who are able to close more quickly.

As a result, these CLTs have a pressing need for early-stage bridge capital, which they can deploy to perform due diligence, make contract deposits, and even close quickly, with repayment coming from subsidies when they are received. However, the pre-development loan products offered by many mission-oriented capital sources are not always able to meet this need, for two main reasons: because the non-standard subsidy sources do not fit with the way they underwrite repayment sources, and because to be effective they need to reach a higher loan-to-cost ratio (potentially up to 100%) than pre-development lenders typically are comfortable with. Capital products with underwriting criteria tailored to this business plan that avoid these issues are sorely needed to help these innovative CLTs grow.

Borrowers also need early-stage capital that can allow them to be entrepreneurial. For example, in our research we encountered reports of innovative capital users being offered appealing acquisition opportunities by values-aligned sellers on an ad-hoc basis, conditioned on them being able to close quickly. In these cases, the prospective buyer typically does not have enough time to develop the full package of business and construction plans typically required for a predevelopment loan. Capital sources that are willing to underwrite based on property value and trust (and potentially work with) the developer to create a business plan are thus very valuable to innovative capital users.

3. First loss

As the mission-oriented capital space has developed, capital providers have focused primarily on debt products. It is understandable that capital providers entering a new, innovative space would seek to do so in structures that give them some protection in the event of projects not being successful. Furthermore, many mission-oriented capital providers (such as CDFIs) are structurally focused on debt. However, currently there is an extreme discrepancy between the supply of debt products for innovative development and the supply of equity or equity-like capital products that can take a first-loss position.

This type of capital is particularly critical because it is catalytic in real estate transactions: equity capital unlocks debt and other types of capital, not the other way around. Furthermore, equity-focused real estate strategies are intended to enable approaches to real estate development and ownership that are impossible in a purely return-focused, extractive capital environment; thus, it is unsurprising that practitioners of these strategies would lack in-house equity capital from previous successful investments to capitalize deals on their own.

Furthermore, as many practitioners pointed out, their struggles with sourcing first loss capital and lack of a capital base of their own are symptomatic of the historical and ongoing racial inequality in real estate and finance that they themselves are struggling to overcome. Centuries of underinvestment in and extraction from BIPOC people and communities have led to both a lack of seed capital in BIPOC communities and a skewed perception of the risk involved in investing in these communities. Any capital provider that seeks to use their capital to help redress this unequal and unjust situation must recognize that the lack of first-loss capital for equity-focused products is both a symptom and a cause of the situation, and thus be squarely committed to providing first loss capital.

The practitioners who we interviewed very consistently requested capital that can fill a subordinated position in the capital structure, as they identified that capital as both the most catalytic and the hardest to raise. They also consistently expressed a willingness to pay more for that capital. In general, these capital users understand the commercial need for providers of higher-risk capital to earn a higher return to offset losses and volatility, but are frustrated by the limited willingness of mission-oriented capital sources to discuss that sort of capital at any price.

4. Non-dilutive

While the practitioners who we spoke to were willing to pay higher returns for flexible, first-loss equity-like capital, they were averse to selling significant amounts of common equity in their projects. They believe that traditional GP development (in which the capital provider receives the bulk of the returns and the developer is compensated only through promote) is excessively extractive, and will not build the capital for equity-focused developers that is necessary for them to become self-sustaining and grow. They suggested several alternatives for how returns on early-stage flexible capital investments could be structured:

<u>Revenue-Based Repayment:</u> Generally, capital users were comfortable with structures based on revenue-based financing, in which the capital provider receives a pre-agreed percentage of project revenue up to a multiple cap. This structure has many of the advantages of equity (such as no maturity date and flexible repayment timing) without transferring ownership in the project. Furthermore, it can be structured based on any IRR target agreed to by the capital provider and user. Most revenue-based financing currently is for operating companies, and the structure would likely have to be fine-tuned to appropriately capture typical sources of return for real estate investors such as refinancing, but these changes do not seem difficult from a business perspective.

<u>Financing-Linked Repayment:</u> Users also suggested that providers of flexible pre-development capital that also make traditional construction loans could provide pre-development capital in exchange for an agreement that the capital user will also take a construction loan from that capital provider at a premium price to the market for construction loans. This could generate material returns for the capital provider: capital users estimated that the typical early-stage capital need is 1-5% of total project cost, so at the top of that range an additional 1% interest on an 80% loan-to-cost construction loan would translate into a 16% annual return on pre-development capital.

<u>Option-Like Structures:</u> While capital users were not willing to give up traditional common equity capital at the project level, some were open to option-like return structures, giving capital providers a small portion of equity above a relatively high “strike” value of their projects or development companies. This would ensure that, in the event that early catalytic capital support is successful in enabling developers to build very successful projects or companies that grow exponentially in value, that the providers of that support participate in some of that value creation. This approach would be modeled after the popular Simple Agreement for Future Equity (“SAFE note”) structure that has become popular in venture capital. While this approach is uncommon in real estate, it has some clear advantages for early-stage capital provision: it is simple, flexible, puts capital users under limited pressure, and is associated with significant upside returns in the event that capital users are successful.

5. Delivered through broader supportive relationship

Many of the capital users who we spoke to pointed out that capital is only one piece of helping real estate projects and developers succeed at an early stage. Developers need advice, sometimes training, and—probably most importantly—connections and referrals. Successful real estate projects require significant amounts of collaboration, and having capable, trustworthy collaborators involved is quite often the difference between success and failure for a project.

Capital providers can play an important role in helping early-stage developers with these supports. As discussed in more detail in subsequent sections of this report, a broader relationship is very important for successful capital provision to equity-based capital users because it helps build the trust necessary for success; however, it also helps capital users—and thereby helps capital providers by making projects more likely to be successful. As one of our interviewees pointed out, social and political pressures for more equitable development are causing early-stage equity-focused developers to be awarded significant development opportunities through RFP and other processes—but often these developers need support to successfully complete the projects they have been awarded. Capital users differed in whether these broader supports are best delivered by capital sources directly or through partnerships and relationships, but either is preferable to a fully arms-length relationship.

6. Entity-level

In addition to project-level capital, many capital users expressed a desire for investments or loans at the capital-user entity level. This capital would finance their deal search and very early-stage deal development activities, provide a permanent capital base that could be used for equity investments, and help them sustain their operations until they are able to build a development and management fee income stream that is sufficient to keep them operating day-to-day. There are very few sources of this capital, which is essentially venture financing for innovative real estate practitioners.

Underwriting and extending this capital would require a different approach to underwriting and investment management from what project-level investors and (especially) lenders are used to. Underwriting an investment of this type requires capital providers to evaluate the capabilities of a management team, rather than understand the prospective value of a defined development or repositioning. Furthermore, liquidity provisions that are narrowly tied to a project schedule do not work well for entity-level investments. Despite these obstacles, the catalytic value of these investments is very high, as they enable innovative developers to build the infrastructure and internal capabilities necessary to improve their effectiveness and efficiency while partially insulating them from the constant pressure to chase projects to develop new sources of fee revenue. LIIF's Black Developer Capital Initiative (BDCI) introduced in 2020 is one example of CDFIs attempting to support Black developers at the entity-level; other CDFIs have also begun offering or piloting initiatives with that goal.

7. Balance sheet support

In addition to cash support at the entity level, many innovative developers expressed a desire for capital facilities to help them meet net worth and liquidity requirements to qualify for construction financing. Most construction loans require developers to put up significant contingent loan guarantees, including completion and non-recourse carve-out guarantees. These guarantees can only be called by lenders in a very limited set of circumstances (and quite often are not called even in these circumstances), but lenders nonetheless require borrowers to provide evidence of net worth and liquidity sufficient to perform on these guarantees if they are called. This is a significant barrier for many small developers; it particularly prevents them from stepping up to larger projects after being successful on a small scale, including in circumstances like those discussed before in which inclusion-focused, BIPOC-led developers are awarded development opportunities due to political and community pressure for inclusive development.

Balance sheet support from capital providers to stand behind these contingent guarantees would be very helpful to enable inclusive developers to grow. These guarantee supports can be stand-alone or included with other types of capital provision.

CHARACTERISTICS OF SUCCESSFUL INCLUSIVE CAPITAL PROVIDERS

The universe of capital providers that have had consistent success lending to and investing in inclusion-focused developers is small. Most of the practitioners we spoke to have had to cobble together capital from many different sources in labor-intensive, ad-hoc ways. They have used one-off grant funding, bespoke CDFI loans and foundation PRI investments, individual investments (usually sourced through existing relationships), crowdfunding, and their own resources. There is no centralized market or exchange for investments in inclusive development, and few intermediaries who raise capital for these investments.

Nonetheless, there are enough examples of successful or promising approaches to financing inclusive real estate to identify some commonalities between these approaches. Furthermore, there are many successful inclusive capital approaches that do not focus exclusively or even primarily on real estate but are still important sources of learning for real estate capital providers. The capital sources financing the cooperative economy, or neighborhood-driven business and entrepreneurship development, have much to teach real estate capital sources. Below, we discuss the clearest and most important shared characteristics of successful inclusive capital providers that we identified; we believe that any new or existing lender or investor seeking to focus more on inclusion and racial justice should focus on these themes when designing their products and practices.

Racial Equity Framework

In identifying the most important themes in successful equity-focused capital provision, we have been aided and guided by the Racial Equity Assessment Framework developed by the Racial Equity Asset Lab ("The REAL," a collaborator on this project). This framework helps investors and lenders evaluate the extent to which they have integrated racial equity into their operations by identifying nine key elements of capital provider operations where racial equity can be integrated (or not) and helping them determine the extent to which racial equity plays a role in their practices around each element. The nine elements, further descriptions of which are included in Appendix A to this report, are:

- Stated Commitment (to racial equity);
- Race-Informed & Race-Explicit Policy;
- Accountability Mechanisms;
- Data Practices & Disaggregated Data;
- Shareholder Engagement;
- Outcomes Oriented;
- Learning Culture & Community of Practice;
- Narrative Change & Communications; and
- Systems Change.

For each of these nine elements, the Assessment directs capital providers to consider their practices and determine where they fit along the following continuum:

- **Color-Blind:** “Color-blind” describes an organization that tends to think what’s good for “everyone” will necessarily be good for BIPOC
- **Diversity Only:** “Diversity-only” organizations are working on representation but not inclusion or equity
- **Race-Tentative:** “Race-tentative” organizations have a stronger sense of inclusion but don’t know what to do and don’t want to get it wrong
- **Equity-Focused:** “Equity-focused” organizations start from a race informed place and move into other forms of inequity such as gender, sexual orientation, and a more nuanced approach regarding ethnicity.

This framework has been very helpful to us in interpreting our observations from our research and conversations with lenders. It has helped us interpret the common threads that we see in their practices. It has also helped us develop our recommendations, as we seek to design capital products and processes that are equity-focused in as many elements of the framework as possible.

Key Characteristic #1: Clear Equity Focus Throughout Organization

In performing our research and interviews, it became clear that the lenders and investors who are successfully developing and implementing strategies to center equity in their lending practices have been successful because their missions were both deeply connected with equity and deeply ingrained in their practices. They have missions that both center service to BIPOC borrowers and communities and are organically integrated in their organizational identities and practices. The strength and coherence of their missions serves as a clear guide for them as they consider their practices—in talking to the leaders of these capital providers, their choices about how to lend and what changes and innovations to pursue more often than not felt organically connected to their missions and their understanding of their communities.

The REAL’s Racial Equity Assessment framework makes stated commitment to racial equity its first element in part because of its importance—without a clear stated commitment to equity coming from the highest levels of a capital provider, it is hard to align more granular practices with equity successfully; it is particularly hard when such alignment requires questioning or revising traditional capital provision practices. Conversely, a clear, coherent equity-centered mission that is understood and accepted from the top of an organization down is very helpful to capital providers trying to innovate and navigate a rapidly changing capital landscape. It helps them prioritize approaches to focus on, interpret and understand their relationships with stakeholders, and course correct if they find themselves losing focus.

Many of the capital providers we spoke to (and other successfully equity-focused capital providers we are aware of) define their missions geographically (Boston Impact Initiative, Invest Detroit, and Denkyem Co-op are good examples of this approach). A narrow geographic focus is helpful in maintaining commitment to an equity-focused mission because it makes the reference point for that mission clear, and creates clear opportunities for feedback and checks and balances if a capital provider is departing from its mission—if staff are constantly working in a specific community, they will learn fairly quickly if people in that community question their continued commitment to their mission. However, many of the capital providers who we spoke to operate nationally or regionally. These tend to have missions that are focused in other ways than geography—such as, in the case of the Cooperative Fund of the Northeast and Seed Commons, a commitment to worker ownership.

Key Characteristic #2: Center Building and Maintaining Community and Borrower Trust

The capital providers and capital users who we spoke to were united in saying that building and maintaining trust—both specifically between lender and borrower or investor and investee in the capital provision process and generally between capital providers and the communities in which they operate—is critical for successful equity-centered capital provision. There are two main reasons for this: the inherently relationship-based nature of early-stage capital provision, and the history of extractive real estate capital provision practices in communities of color.

For a loan to or investment in an early-stage real estate developer or project to be positive for both the capital provider and capital user, they must work together in ways that are not narrowly defined by loan or investment documents. Situations are always changing in real estate investment and development, and capital users must trust their capital sources not to use unexpected hiccups as an excuse to act extractively. Conversely, early-stage investors or lenders lack the hard asset base that protects later-stage capital, so to a degree they must rely on representations from capital users in evaluating investments—and must be able to trust those representations. Thus, effective capital providers must be able to make decisions and take actions based on trust to a greater degree than traditional lenders.

For capital provision that centers racial equity, and thus seeks to capitalize BIPOC-led enterprises in BIPOC communities, the importance of trust is complicated by the history of mistrust between people of color and capital sources. The history of capital—including ostensibly friendly capital—being used to extract resources from communities of color and economically exploit people of color is long and ignominious; as a result of that history, many people of color are extremely hesitant to accept any outside capital for their businesses (even if the value of that capital is clear). This lack of trust is present for mission-driven capital sources as well as conventional capital sources.

There are several strategies that capital providers we spoke to used to build and maintain trust:

1) Show Up: Simply being present in the communities they seek to serve was an important part of trust-building for many of the capital providers we spoke to. Invest Detroit, for example, puts a high priority on visibility in the Detroit neighborhoods it works in and is constantly attending community events of all types. Prior to the pandemic, Denkyem Co-op sourced loan opportunities primarily by walking into businesses and introducing themselves. Most of the equity-focused capital providers we spoke to have staff whose job is exclusively to show up—to work with, assist, and understand their markets outside of the loan or investment underwriting process.
2) Work Through and Empower Partners: For capital providers who have a regional or national mandate (and so would struggle to show up physically everywhere they want to be), partnerships with trusted local organizations are a good way to build trust. In these relationships, partners act as the "front end", connecting prospective borrowers and investees in a community to capital providers. The key to success in these partnerships is empowering partners as much as possible. Most capital providers are very hesitant to give up power or authority, but some innovative capital providers have effectively farmed out many origination and underwriting functions to partners without causing negative credit results. Seed Commons does all of its origination through a large national network of affiliates, which are primarily responsible for credit decisions. Nusenda Credit Union's Co-op Capital initiative (which we did not interview for this project) similarly devolves credit decisions to its regional non-profit partners, and has experienced very low loan loss rates.
3) Solve Problems and Deliver on Promises: While showing up is important, it is not enough to build trust: capital sources must show up and make their best possible efforts to solve the problems that prospective capital users are encountering. During our conversations, it became clear to us that the successful capital providers we spoke to share a deep commitment to aligning their practices with the needs that they hear from the communities they operate in, and to working to eliminate obstacles to this alignment. If they learned about a clear capital need, they worked hard to design a program to meet that need, and if their capital base or internal structures made it difficult to deliver that program, they worked hard to raise different capital or change their structures. The Cooperative Fund of the Northeast's experience with its Launch Loan program (discussed in our case study) is an example of this. In addition to having other benefits, as described in greater length below, this iterative, client-focused design and implementation process helps build trust because partners and prospective partners see the capital provider working hard to solve their problems.
4) Different Approach to Risk: All lending and investing, no matter how it is structured, involves risk. In order to earn a return in excess of the risk-free rate, capital providers accept risk that their investments will not be repaid in full or that their profits will be less than projected. Nonetheless, many capital providers (particularly lenders) seek to eliminate risk entirely, by

structuring loans to transfer risk to borrowers or refusing to make loans with any meaningful apparent risk factors. This can lead to an adversarial relationship, as lenders seek to shift risks in a zero-sum way or view their underwriting processes as focused on rooting out concealed risks that (they believe) prospective borrowers may have obfuscated. While the capital providers we spoke to seek to limit and responsibly manage risk, their focus on trust naturally leads them to see risk in a different way—as a reality in their business that should be shared between capital users and capital providers in a fair way, and that both have a responsibility to mitigate in partnership. The capital providers we spoke to reduce their own risk by helping borrowers succeed through technical assistance and other supports, raising risk-appropriate capital where necessary, and cultivating honest relationships with borrowers that allow problems to be worked out collaboratively, and reduce adversarial tactics when possible.

As should be clear from the above, building and maintaining trust involves practices across many different elements of a capital provider's product design and operations—thus, it relates to many different elements of the Racial Equity Assessment Framework as well. Race-Informed Policy, Accountability Mechanisms, Stakeholder Engagement, Outcomes Orientation, Narrative Change & Communications, and Systems Change are all elements of the framework that relate directly to trust-building—and the other elements can relate indirectly to trust-building as well.

Key Characteristic #3: Capital is Part of a Broader Relationship

As discussed above, many equity-focused capital users are seeking a relationship with their capital providers that goes beyond arms-length check-writing. The most successful equity-focused capital providers have built practices that do this. Sometimes this means explicit technical assistance and mentorship. However, even if capital providers do not emphasize this, they still benefit from building broader relationships with capital users by making their lending processes about more than just moving through an underwriting process to closing.

The capital providers we spoke to base their lending practices on a sense of mission alignment with those they are capitalizing—which means that the underwriting process sheds many of its adversarial characteristics and becomes a conversation between partners who play different roles in achieving the same goal. This means an iterative, relationship-based approach to underwriting, where the goal is for both capital provider and capital user to learn and improve as a result of the underwriting process. In this formulation, problems during the underwriting process do not lead to a straightforward credit or investment denial—they lead to a conversation about how capital provider and capital user can work together to solve the problems and move toward a positive resolution.

An important element of this approach that several capital providers mentioned is very high-volume communication with existing and prospective borrowers or investees. These capital providers (particularly Seed Commons and Boston Impact Initiative) described high-volume, ad hoc communications in which they prioritized being responsive and helpful. Being prepared and staffed for this type of relationship is an important element of their practices. Patience is also important if this approach is to succeed. Relationships take time to develop, and a collaborative underwriting process can take longer than traditional underwriting as well—although this is not necessarily the case, especially when you factor in the value that building a relationship can have later in the process (especially if changes in approach are required).

In order to successfully implement this relationship-based approach, lenders must be on the ground in the communities where they are trying to build these relationships. This means that the approach lends itself well to geographically-focused lenders, but this is by no means a requirement for success. As described above, working through partnerships can deliver many of the benefits of a direct on-the-ground presence. SPARCC's experience developing and working with its Tables (its partner groupings of key local organizations in each of its six geographies) is an example of the power of local partnerships that complements the experience of the other capital providers we spoke to.

This element ties in very well with the Race-Informed or Race-Explicit Policy element of the Racial Equity Assessment Framework. In order to implement this relationship-based approach, capital providers need to have policies in place that enable lending staff on the ground to make decisions that center relationships. It is also related to the Outcomes Orientation element, as capital providers need to think about key outcomes in a way that centers relationships (rather than being purely focused on loan or investment production).

Key Characteristic #4: Form Follows Function in Product Design

The innovative capital providers we spoke to deploy capital in a very wide variety of ways. Some make traditional loans, others make revenue-based finance investments, and others have a suite of products that includes common equity. Some have standardized their capital products, others take an expansive, blank sheet approach to deal structuring. Furthermore, in their discussions of future plans, they described a very wide array of new capital products that they would like to offer. It became very clear to us that there is no simple answer to the question of what the right capital product is to support equity-oriented real estate.

While there is very wide variation in the types of loans or investments these providers make and the ways in which they make them, the common characteristic across their practices is a strong connection between their product offerings and what their customers and communities want and need. They have developed their capital offerings and approaches based on deep engagement with their communities, and are constantly seeking to refine them based on changing community circumstances. Thus, the difference in offerings across the capital providers we spoke to has a clear connection to the difference in circumstances between their customers.

We saw this market-based variation in capital providers' current offerings, in their description of how their offerings have changed and evolved, and in their descriptions of their capital-raising strategies. Seed Commons, for example, created a revenue-based note to allow them to offer a flexible, revenue-based loan product to their borrowers. The Cooperative Fund of the Northeast developed several innovative design approaches to fit its standard debt product to the unique needs of cooperatively-owned borrowers. Invest Detroit has developed the capability to deploy its own capital opportunistically to support other elements of its programming (such as acquiring assets on its own balance sheet for development by graduates of an affiliated developer training program). This customer-driven approach, which is consistent with the concepts of stakeholder engagement and outcomes orientation in our Racial Equity Framework, helps the capital providers we spoke to be more effective and also helps them make internal strategic decisions.

Key Characteristic #5: Ability to Iterate and Think Long-Term

Virtually every capital provider we spoke to shared examples and stories about how its approach has changed over time, often in response to either changes in its customers' needs or its growing understanding of those needs (as discussed above in Key Characteristic #4). In addition to having an approach and outlook that allows them to change in the right way, these examples show the importance of having structures that allow for and enable change, iteration, and learning from experience.

Many capital providers struggle to learn from mistakes and iterate. There are many reasons for this, including excessive management layers, a lack of openness to new ways of doing things from leadership, and excessively restrictive capitalization. These capital providers change practices only reluctantly—and when they do, can often use any outcomes other than complete success as reasons to revert back to their traditional approaches. The capital providers we spoke to, several of whom have large asset bases in the world of mission-oriented finance (Invest Detroit, for example, has a $111mm loan portfolio), are nonetheless nimble, willing to experiment, and reluctant to give up on a new approach too quickly.

CASE STUDY: COOPERATIVE FUND OF THE NORTHEAST

Entity Type: Capital Provider (debt)

Portfolio Size: $50mm (year-end 2021)

Geography: MA, NY, ME, NH, VT

Description:

The Cooperative Fund of the Northeast (CFNE) was founded in 1975 with the mission of filling a capital gap for the food sector prior to the development of CDFI's. Now a registered CDFI with over $50M of assets under management CFNE lends to grocery co-ops, housing cooperatives, and worker-owned cooperative businesses across industries. CFNE has a 7-person lending team and a 12 person staff. Where some CDFI's might separate origination and underwriting CFNE instead has 5 loan officers, each with geographic coverage areas, who handle deals end to end.

CFNE offers term loans in the range from $10k to $2mm as well as amortizing lines of credit up to $300k. The CFNE team decided in 2020 to add a new product, The Launch Loan, to plug a perceived capital gap in its mix of product offerings.

Key Relevant Features:

Launch Loan 1.0

The Launch Loan was initially launched by CFNE to provide very early-stage pre-development dollars and the capital that could be used as equity for early-stage businesses.

The Launch Loan was introduced by CFNE in 2020 funded by a mixture of grant and CDFI FA dollars with the goal of filling the "friends and family gap." The friends and family gap refers to the absence of wealthy friends and family who can provide seed capital to early-stage businesses in BIPOC communities due to the racial wealth gap created by lending policies like redlining. The Launch Loan was designed to help entrepreneurs explore feasibility, develop business plans, and receive training. The Launch Loan would be available up to $50k without a set repayment structure (not a traditional term loan, more akin to revenue-based repayment) would charge interest, and would waive expectations on collateral. If there was collateral available CFNE would place an all assets lien, but if it was not available they would not let the lack of collateral stop their approval process for an application. The goal of the product in the customer lifecycle was to help a borrower receive a conventional amortizing term loan through a refinancing in 1-3 years.

The product was launched with the goal of deploying $500k over 2-3 years but due to insufficient awareness of the product they only made a handful of loans. Some of these Launch Loans have converted to more traditional debt products and some have not. The team at CFNE was hesitant to advertise the Launch Loan broadly out of concern that they would quickly deplete their limited resources and as a result they made some communication stumbles to alert the market to the product.

Launch Loan 2.0

Currently the team at CNE is collecting market feedback to make sure they are accurately understanding the demand to make sure they re-launch with product-market fit. This has looked like CFNE setting up focus groups and interview with 10-12 current borrowers and co-op developers who work in the communities where they feel their may be demand for this product. CFNE brings these focus groups with a hypothesis on the product's design and asks them for clarity around what the problem is for early-stage capitalization in the markets they are focused on better serving.

The Launch Loan 2.0 will be a staged product with two components. Stage 1 will be a loan up to $50k for soft costs in early-stage business development (legal, business plan development, feasibility, etc). One innovation of the Stage 1 loan is that CFNE will not charge any interest, but instead meet with the borrower to review monthly benchmarks. Much like having information rights in an equity investment, the stage 1 offering could be thought of as sitting somewhere between non-voting equity and debt (or more conventionally as a recoverable grant). Stage 2 will be a product that can extend up to an additional $100k for startup costs for businesses like pre-revenue labor expenses. The goal of the stage 2 offering is to allow borrowers to step away from pre-existing jobs to dedicate their time and focus to getting the business off the ground. The stage 2 product will charge 2% interest (350 bps below their base rate of 5.5% for conventional debt) and they are expecting a 3-year repayment/amortization period.

Both stage 1 and stage 2 of the Launch Loan 2.0 will be a loss leader for CFNE and a way to develop clients in low-wealth communities and allow them to take risk and experiment. CFNE currently has sufficient net assets in its portfolio that it has chosen to allocate some of this profit to the the higher losses it anticipates from this product. Over 3 years CFNE intends to deploy $1mm in Launch Loans and sees the Launch Loan as part of its broader loan portfolio not a side vehicle. Following this 3-year period CFNE intends to learn from the performance of the loans and show proof of concept to foundations to raise more capital to grow this product segment.

CASE STUDY: CHICAGO TREND

Entity Type: Capital user (community-driven development)

Geography: Primarily Chicago and Baltimore (majority-Black neighborhoods)

Description:

Chicago TREND is a social enterprise focused on equitable real estate development and operations founded by Lyneir Richardson (an experienced developer and retail real estate operator). It provides a number of services, including market research, retail operations advisory, and other real estate services to charitable organizations, mission-oriented developers, and social enterprises; it also makes real estate investments for its own account.

Currently, Chicago TREND's investment activities center on acquiring and operating existing unanchored strip retail centers in majority-Black neighborhoods. Chicago TREND's first acquisitions have been in Chicago and Baltimore, but it seeks to build a national portfolio of similar assets. As an investor, Chicago TREND seeks to center community benefit and community wealth-building by operating its centers with a focus on community need and community demand, giving key neighborhood-based Black-owned service providers and tenants opportunities to earn equity in its properties, and occasionally giving neighborhood residents direct ownership opportunities (through crowdfunding).

Key Relevant Features:

Community-Driven Development approach

Chicago TREND is a good example of the approach we have called community-driven development—it has a clear orientation to community voice and benefit, and operates in an area that has been overlooked by traditional capital, but implements its orientation in a more iterative way than some other approaches in the space. It is consistently entrepreneurial in seeking attractive opportunities to invest capital for community benefit and iterative in developing approaches to working with communities. Its capital need is for investors and lenders who can be flexible enough to respond to these iterations.

Need for early-stage capital

Chicago TREND has consistently expressed its need and desire for high-LTV or first-loss capital that will work with creative business plans and accept a reasonable fixed return. Chicago TREND targets assets that are not well-understood by capital markets and as a result are often shunned by lenders and investors (even though they generate strong cash flow and can be acquired at low valuations); they need capital sources who are willing to be collaborative and work with them as they implement the early stages of an iterative strategy to acquire and operate these properties. As a relatively small developer and property owner, they also need early-stage diligence and deal development capital, as they do not have a huge war chest to fund these activities out of pocket.

Ability to pay meaningful return

Chicago TREND is acquiring properties at high-single-digit or low-double-digit cash flow yields. As a result, they have the ability to pay meaningful fixed returns to investors or other capital sources. They are extremely reluctant to give up any kind of uncapped upside interests in their projects, as that dilutes their wealth-building objective and reduces the amount of equity that can go to the community, but they are able to support market-range returns on subordinated debt or preferred equity investments.

CASE STUDY: INVEST DETROIT

Entity Type: Capital provider (debt & equity)

Portfolio Size: $111mm (year-end 2020)

Geography: Select neighborhoods in Detroit

Description:

Invest Detroit was founded in 1995 with a mission to support equitable growth in Detroit by bringing capital to neighborhoods that have been underinvested (with a focus on majority-Black neighborhoods and Black borrowers). It makes real estate, small business, and commercial & industrial loans, and venture equity investments. The majority of its portfolio (68%) is made up of real estate loans

Invest Detroit works closely with the City of Detroit through its Strategic Neighborhood Fund program, which helps Invest Detroit couple loan and investment capital with municipal investments in park and streetscape improvement, commercial corridor development, and affordable single-family home stabilization.

Key Relevant Features:

Strategic Neighborhood Teams

The Strategic Neighborhood Fund described above is staffed at Invest Detroit by Strategic Neighborhood Teams, which are interdisciplinary teams focused on building relationships and developing plans for focus neighborhoods in collaboration with neighborhood institutions/stakeholders. These teams have the ability to deploy Invest Detroit's lending and other capital, but are tasked with resourcing and solving problems for specific neighborhoods—not only with lending volume goals. This organizational structure helps Invest Detroit to work more closely with communities—and its structural community commitment helps build trust, because it shows neighborhoods and neighborhood leaders that Invest Detroit is a long-term, committed partner.

Creative approach to structuring & deploying capital to support broader goals

While the majority of Invest Detroit's capital deployment is through relatively traditional loan structures, it has also made a number of creative, opportunistic investments in support of its mission. For example, on one occasion it bought several prime redevelopment sites in one of its focus commercial corridors outright to prevent them from being purchased for extractive redevelopment. It plans to sell the sites at cost to graduates of a partner equitable developer training program so that those graduates can run redevelopment; in this way, it used capital both to keep key assets in community control and to strengthen community developers.

Collaboration with other CDFIs operating in Detroit

Invest Detroit has developed strong relationships with other CDFIs that operate in Detroit. These CDFIs meet periodically to coordinate and explore partnerships, and through their collaborative relationship have developed strong programs that are complementary to each other. For example, the developer training program whose graduates will develop the properties that Invest Detroit bought on a speculative basis (described above) is run by another CDFI.

APPENDIX A: THE REAL: RACIAL EQUITY ASSESSMENT FRAMEWORK^{SM}

The following Racial Equity Assessment Framework, which guided some of the analysis of the research team, was developed by Erika Seth Davies of the Racial Equity Asset Lab. For more information, please visit: https://racialequityassetlab.org

RE Features	Color-Blind	Diversity-Only	Race-Tentative	Equity-Focused
Stated Commitment	The explicit commitment an institution has made to advancing racial equity in its values, mission or work. is the statement grounded in a structural analysis to incorporate racial history and policy, practice, and cultural norms driving disparate outcomes or creating advantage and disadvantage along the lines of race.			
Race-Informed & Race-Explicit Policy	Over time, laws, public policy, and institutional process have been instrumental in making racism structural; therefore, policies that are not informed by or explicitly name racial equity are going to exacerbate or reinforce existing disparities and generate racialized results. Defining policy as any written document that guides decision-making (e.g., HR or investment policy, consultant agreements, position descriptions, committee charters, etc.), do you explicitly prioritize or address racial equity in your policies?			
Accountability Mechanisms	Do you have clear decision-making matrix regarding who has responsibility for different aspects of decision-making processes and clarity of expectations related to racial equity? Do you have metrics and reporting requirements to measure progress and areas for growth?			
Data Practices & Disaggregated Data	Are you collecting and disaggregating data regarding race, gender identity, orientation, etc. related to your internal workforce and leadership or ownership as well as external partners, vendors, or stakeholders? Do you leverage an intersectional analysis in your reporting? Do you analyze the data to understand outcomes and use it to inform your policy and decision-making?			
Stakeholder Engagement	Are you engaging with stakeholders closest to experiencing the issue or those most marginalized by systemic barriers and/or participating in settings where people are organizing around these issues? How intentional is your engagement designed to build trust regarding what stakeholders can expect? Are you incorporating feedback and learning from your engagement in your process?			
Outcomes Oriented	Have you defined an aspirational outcome for your process or intervention through a racial equity lens? (E.g., % of assets managed by diverse-owned firms, percentage of impact capital toward racial justice investments)			
Learning Culture & Community of Practice	Is there continuous learning regarding racial equity within your organization at all levels and among your Board and Committees? Are you involved in communities of practice ?			
Narrative Change & Communications	Are you sharing information about your journey or data regarding progress toward racial equity in your investment process? Have you developed strategies for intentional narrative framing and storytelling that centers people and their aspirations? Does your narrative around data connect root cause and systemic drivers to disparities?			
Systems Change	To what extent do you leverage your role in the broader ecosystem to influence change toward racial equity among other actors in the system?			

APPENDIX B: FULL CONSULTANT BIOGRAPHIES

Sean Campbell is the founder of Capital for Communities, an advisory and consulting firm that works to broaden access to capital and create a just, equitable financial system that supports thriving communities and works for everyone. He partners with The Sankofa Group periodically on projects. His engagements include advice on fund and financial product structuring, strategic advice on the financial markets, and advice on and management of individual project financings; his clients include social enterprises, government agencies, financial institutions, and non-profit organizations. He is also a technical advisor to Common Future. Prior to founding Capital for Communities, Sean worked for 15 years in investment management, most recently as a managing director in the principal investing group at Macquarie. Sean has made and managed hundreds of millions of dollars of equity and credit investments, and has invested in debt and equity in the public and private markets. As a result, he brings a strong technical background in lending, investing, and financial markets generally to his engagements. He holds degrees from the University of Chicago and Oxford University, where he was a Rhodes Scholar.

Eric Horvath is a partner at The Sankofa Group. He is also Director of Capital Strategies at Common Future, a national non-profit that is a leader in developing, testing and advocating for an inclusive economy. In his role at Common Future, he has spearheaded several innovative lending and capital deployment projects aimed at testing and developing an evidence base around innovative ways to lend to and invest in communities of color. He currently serves on the Finance Committee for the North Star Fund, a community foundation based in New York City that funds social and racial justice movements. Prior to Common Future, he was the Program Manager for Community & Social Justice Partnerships at Transform Finance, an organization that helps advocates and organizers understand and more productively engage with the broader financial system. He has also worked at a family foundation, serving as a funder and impact investor. He holds a BA from Fordham University and a Master of in Public Administration from the Maxwell School at Syracuse University; he is currently a part-time student in the MBA program at New York University's Stern School of Business.

Lucas Turner-Owens is the founding partner of The Sankofa Group, where he specializes in advising emerging managers, impact investors, and CDFI's with a focus on racial equity. Lucas is an incoming Principal at the venture capital fund TMV and a Board Member of the Cooperative Fund of the Northeast. Previously, he served as the Fund Manager for the Boston Ujima Project where he was responsible for launching the fund, raising capital, underwriting investments, and providing technical assistance to entrepreneurs. Prior to joining Ujima, Lucas worked as a Loan Officer for Cooperation DC, providing technical assistance and loan packaging for women-of-color-led worker-owned co-operatives; and at Next Street Financial & The Bridgespan Group, supporting clients in impact investing and the social sector. Lucas holds a BA from Wesleyan University and a Master of Business Administration from the Georgetown McDonough School of Business.