Ninth District corporation is awarded CDFI funds

Editor’s Note: This article focuses on one Ninth Federal Reserve District organization and the money awarded to it by the U.S. Treasury Department’s Community Development Financial Institutions (CDFI) Fund. For those unfamiliar with CDFIs, they are just as their name implies: financial institutions that have community development as their primary focus. For a more in-depth look at this type of financial institution, see “CDFIs focus on community development” on page 4 of this issue of Community Dividend.

On July 31, 1996, U.S. Treasury Secretary Robert Rubin announced the selection of the first round of the Community Development Financial Institutions (CDFI) Fund awards. Among the community development organizations selected to receive an award was Duluth, Minn.-based Northeast Ventures Corp. (NVC), which received $1.25 million in equity. NVC was the only organization based in the Ninth District to receive funds.

NVC targets investments that create and retain jobs, create local ownership and diversify the economic base of northeastern Minnesota. The corporation was started by concerned northeastern Minnesotans to counter the economic decline prompted by the shrinking mining industry, the region’s historical economic base. NVC has achieved measurable success since its inception in 1990. It helps communities to achieve their social objectives of identifying and investing in businesses with significant growth potential.

Community Dividend recently had a conversation about the organization with NVC Chairman Nick Smith and President Greg Sandbulte, who relayed a story about how a group of local residents decided to work for the kind of community they wanted.

CD: How did NVC get started? What was the impetus behind its formation?

Smith: First, let me give you some history of the area. Northeastern Minnesota historically had been dependent on extractive industries, mainly iron mining. Because the mines fueled our economy, we saw ourselves as employees rather than employers, and there were very few entrepreneurial role models.

In the early 1980s, a couple of things happened. Foreign ores were being priced significantly lower than the ore mined out of northern Minnesota, and at the same time, the national steel industry was in trouble. As a result, we went from having a very low unemployment rate to pockets of 100 percent unemployment. People who had been paying on their mortgages all their lives were finding that their homes were literally without value, and they were going to the bank and dropping off their house keys. There was an attitude of hopelessness during that period.

Total CDFI Fund awards

<table>
<thead>
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<th>Type</th>
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<tbody>
<tr>
<td>Equity</td>
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<tr>
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<tr>
<td>Loans</td>
<td>$6,660,000</td>
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<td>Technical Assistance</td>
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Northeast Ventures Corp.

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<tr>
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</tr>
<tr>
<td>Products</td>
<td>Venture capital</td>
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<tr>
<td>Contacts</td>
<td>Nick Smith, Chairman, Greg Sandbulte, President, Mary Mathews, President, Northeast Entrepreneur Fund</td>
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</table>

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**COMMUNITY DIVIDEND**

**CONTINUED FROM COVER**

**CD:** What happened to change this attitude?

**Smith:** The Blandin Foundation from Grand Rapids, Minn., called community leaders to a series of meetings to devise economic strategies for northeastern Minnesota, and I attended those meetings. The meetings were an example of a crisis producing some significant energy that wouldn’t have been generated otherwise. We decided very quickly that any economic solutions for northeastern Minnesota were going to come from those of us in the region. We adopted a whole bunch of strategies—all the way from working with the mining companies to working with our educational institutions and transportation, tourism and timbering industries. One strategy was to diversify the economy, partly from home-grown, home-owned companies.

At that time, I had been practicing law for about 25 years, working primarily with small- and medium-sized businesses. Much of my time was spent trying to find equity adequate to capitalize my clients’ businesses. I would end up talking to my clients about their rich uncle or aunt or friends. Financing a business was more a matter of luck than a result of any kind of structured access to capital. So I said that if we’re serious about diversifying the economy, we’re going to have to have a structured source of equity capital and it’s got to be large enough to be permanent and have competent staff.

**CD:** Were there any bankers at those meetings? If so, what did they say?

**Smith:** Yes. They quickly agreed with this line of thinking and echoed my experience with access to capital. So I started going around the country looking for anyone who had used venture capital as an intervention strategy in a distressed area. But there wasn’t a ready-made model for accessing venture capital that we could use. I talked to a pretty exhaustive list of people: foundation executives, economic developers, venture capitalists and bankers. Many of them cautioned that if I tried to mix social motives with venture capital, I was just going to waste the money.

It was my conviction—and I think the evidence shows—that if you apply traditional business discipline and skill, you can apply some social motives and not waste the money. But you must not allow “goal confusion.”

**Northeast Ventures Corp.’s President Greg Sandbulte and Chairman Nick Smith**

**CD:** What do you mean by “goal confusion?”

**Smith:** Sometimes the number of jobs becomes the focus, and you forget that what you’re really trying to do is create sustainable, prosperous enterprises.

**CD:** So tell us about your goals.

**Smith:** Our primary goal was to create an equity fund that would be a permanent source of equity capital in the region, and we wanted it to be large enough that we would be very competent. A group of people—including some bankers, a couple of economic development people and a couple of foundation people—formed an advisory group, and I began writing a business plan. Out of that plan came NVC, which has two completely separate parts. One is the venture capital fund aimed at high-growth businesses in the region; it is this fund that received the award from CDFI. The other part is Northeast Entrepreneur Fund, a microenterprise loan fund aimed at creating businesses that will provide a living for business owners and their families. By providing a little bit of money and a lot of training, this fund has helped start about 250 businesses.

**CD:** What are the goals you set out for the venture capital fund?

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**Smith:** Local creation of wealth is one of our major goals. We want to leave behind us growing, prosperous, healthy businesses that are providing quality employment for our citizens. We want to help create an entrepreneurial environment. However, I want to point out that we are but one of many community development efforts in northeastern Minnesota; we alone are not a panacea.

At NYC, we do not focus on one type of industry or business. If we did that in a large, rural region such as northeastern Minnesota, we would not make a meaningful difference. We see about 150 deals a year, and we invest in two or three. Ultimately, our capacity will be about four deals a year, probably about the ratio of any venture capital fund. So, you can see how we cannot narrow ourselves down to a certain industry.

This business is about spotting a deal that you think has market potential, doing a lot of due diligence on the markets and the management team, and then writing a check and working extensively with the company. What really distinguishes equity from debt is that with equity, there should be intensive involvement with the company after the investment. In fact, that's where we spend about three-quarters of our time.

**CD:** How will the CDFI money be used?

**Smith:** These funds enable us to reach our desired level of capitalization and move us closer to critical mass. We always had a goal of $10 million of funds to invest. This $2.5 million of additional funding—which is what it is with the match from the Iron Range Resources and Rehabilitation Board—puts us at $10.2 million, which enables us to do our job better and longer. This money also allows us to do larger deals.

**Sandbuilte:** Before the award, our policies restricted our average investments to about $300,000. Now that amount can be $500,000. The difference between $300,000 and a half-million dollars on an initial investment is very significant. Often, it will mean that we can be the lead investor, not so much as to call the shots but to have a very strong influence in determining how that deal is structured.

Ultimately, if our deals go the way we would like, we wouldn't play the lead role forever. But as lead investor at the start, we can exert more influence over the company when the culture is determined and key management is hired.

**Smith:** We play a very active role in companies. Every deal we do has to pass our regular financial screen and it has to pass a social screen. It has to have the potential for creating wealth and employment in northeastern Minnesota; it has to have good, sound environmental practices; its jobs have to have benefits and it has to agree to use the state’s employment service as a first source for employees.

We never see a deal that is perfect. We may have to recruit the CEO or convince the principal they need a CFO or that their management team is flawed. At any rate, because of our mission, we do investments in companies that a traditional venture capital firm would turn down.

**CD:** How do you help companies find competent senior management?

**Smith:** We’ve done it a number of different ways. We’ve used professional head hunters and our own network of contacts. If we can find a local person who has the skills we need, we prefer that. If we can’t find the right person, we use head hunters.

We’ve gotten a lot of help from the Twin Cities metro community. People just want to help us. We are a business-social experiment. A lot of people think community development venture capital will be part of a core solution to some of the problems going on in the rural areas and in the cities, and they want us to succeed.

**CD:** Overall has the fund been profitable?

**Smith:** Yes. However, when I talk about our performance, I say that the signs are encouraging but the jury is still out. As of now, we have invested about $5.5 million in 18 companies. These companies directly employ 450 people. This figure is lower in terms of employment than we would have expected at this point. Harvard University became very interested in what we were doing and wrote a case study about us. This case study said that, compared to what we said we would do when we got a loan from the Ford...
CDFIs focus on community development

Community development financial institutions, or CDFIs, are a diverse set of organizations, but they all share a commitment to community development as their primary mission. CDFIs have lending and investment as their principal business activities; they also assist underserved communities and maintain community accountability. Private and nonprofit groups, including start-up organizations, are eligible to apply for awards from the CDFI Fund. The fund was established as part of the Community Development and Regulatory Improvement Act of 1994 to expand the availability of credit, investment capital, financial and other services in distressed urban and rural communities. Government agencies are specifically excluded from CDFI funding consideration.

CDFIs serve an important function in their communities by meeting needs for financial services and products that are currently not being met through the traditional financial market. Examples of the services and products provided by these organizations include mortgage financing for first-time home buyers, commercial loans and investments to start or expand small businesses, loans to rehabilitate rental housing and basic financial services. CDFIs form partnerships with private and community sources to leverage significant private dollars, which brings needed capital and credit into distressed areas.

Round One

The first round of CDFI funding was highly competitive; only 31 of 268 applicants received awards. Of the nearly $35.5 million in funds awarded, 53 percent was awarded in the form of grants and 26 percent in the form of equity investments. Furthermore, 19 percent was awarded in loans and about 2 percent will be used for technical assistance (see Total CDFI Fund awards on page 1). Northeast Ventures Corp., featured in this issue of Community Dividend, is just one type of organization to receive a CDFI Fund award.

A diverse group of organizations was selected for program funding, including four community development banks, six credit unions, 12 loan funds, three venture capital funds and two microenterprise loan funds. Also selected were two multifaceted CDFIs, a Native American regional housing organization and a national community development intermediary. These organizations have a substantial geographic reach, serving communities in 46 states and the District of Columbia. About 50 percent of the organizations serve predominately urban areas, 25 percent serve mostly rural areas and the remaining 25 percent assist both urban and rural communities.

The CDFI Fund management expects that the $35.5 million of awarded funds over time will be leveraged to bring in at least $350 million in lending and investing in poor and distressed communities. Using these resources, CDFIs and their community partners work to improve affordable housing, encourage entrepreneurship, create jobs and revitalize neighborhoods. Reinvestment in these areas creates stronger, healthier communities that benefit CDFI program recipients, neighbors and the larger community.

Reaching for Success

CDFIs have already made significant contributions to underserved communities, and those who established the CDFI Fund recognize the powerful and positive effects of access to credit and investment in poor and distressed communities. Two well-known CDFIs are the South Shore Bank of Chicago (Shorebank) in Illinois and the Southern Development Bancorporation (Southern) in Arkansas. These institutions have strong records of meeting the needs of underserved businesses and community members through a diverse set of programs and strategies tailored to the needs of the people and communities served.

The success of these organizations provides examples for the types of programs that can work in communities throughout the country. For example, Shorebank has rehabilitated run-down buildings, attracted new businesses to poor neighborhoods and

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helped tenants organize to create safer and more livable neighborhoods. Southern has assisted in the creation of housing for low- and moderate-income people, provided microenterprise loans to rural residents and provided technical assistance to small businesses. These and similar organizations have proven that the CDFI model can work well in distressed central cities and poor rural areas if there is a focus on community building, innovative ideas and access to resources.

The recent CDFI Fund awards will encourage investment and development in communities where there is much more work to be done, as well as in neighborhoods where there are many more opportunities and dreams yet to be realized.

For information about the next round of CDFI funding, interested organizations can contact:

The Community Development Financial Institutions Fund
U.S. Department of the Treasury
1500 Pennsylvania Ave. N.W., Room 5116
Washington, DC 20220
(202) 622-8662

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“Lending in Indian Country: Cultural and Legal Issues” Video and Guidebook

This five-part video series, produced by the Federal Reserve Bank of Minneapolis, is a live seminar recorded on video. The video explores cultural differences, land and title issues, tribal powers, sovereign immunity, tribal courts, collateral, remedies and other issues of interest to those seeking to do business in Indian Country. The package is available for $135, and payment must accompany order.

For a brochure and order form, call toll-free (800) 553-9656, extension 6008.
Foundation—one of our original funders—we were behind. That's true. We are almost exclusively invested in newly formed companies and that defers the effect in terms of jobs. The other side is that Ford is very happy with what we are doing. And by all accounts—good, bad and indifferent—we have become recognized nationally as one of two or three leading community development venture capital funds. I am hopeful that at the end of the day, we and others like us are going to be able to demonstrate that there are some predictable returns that can come out of a competently managed community development venture capital fund.

**CD:** What level of returns are you thinking of?

**Smith:** Everybody thinks venture capital earns 30 percent to 40 percent, but the median return in 1995 on venture capital firms was around 9 percent to 11 percent.

**CD:** Does the fund still rely on outside contributions?

**Smith:** Yes. Right now, we are dependent on philanthropic and corporate “good guy” dollars. Ultimately, we have to go to pension funds and other traditional funding sources.

**CD:** How will you “pitch” your fund to these traditional funders?

**Smith:** We will tell them that we will not provide the highest return on investment they might earn but that we will provide a decent return and that what we’re doing is very important.

**CD:** Do you think the success of the community development venture capital industry will depend on tapping these funds?

**Smith:** Yes. What we are doing in northeastern Minnesota is important, and it is my primary focus. But community development venture capital can help revitalize a lot of communities in America, and I think we have an obligation to try to help that happen. There are not going to be huge government dollars. Considering that only two other venture capital funds received an award from the CDFI fund, we were fortunate. The fund barely survived the ax in Congress; it had $400 million worth of applications and $35.5 million was awarded. We need to tap the traditional venture capital funders.

**CD:** We understand there is now a national community development venture capital alliance. Please tell us about it.

**Smith:** We started meeting other people with similar ventures, and we realized we could be learning from each other. Furthermore, each of us was getting a lot of calls from people around the country who wanted to start community development venture capital funds. We began to hold meetings with some training and discussions about this idea called community development venture capital. We now have a formal alliance, the Community Development Venture Capital Alliance (CDVCA). One of CDVCA’s purposes is networking so people in the field don’t feel unique and lonely. We also offer training for people who want to go into the field, as well as for those of us who are already in it.

The critical success factors for community development venture capital funds are size and competence. If you only have one or two million dollars, it is difficult to staff the company and you are less able to withstand the almost unavoidable early loss or two. This is a really hard business, and you have to have people who know how to do venture capital.

There is tremendous interest in using venture capital as a means for revitalizing both rural and inner-city communities. We had 75 attendees at the CDVCA meeting this past June and 105 attendees this past December. At this point, however, there is a lot more interest in community development venture capital than there is funding and skill. Through the alliance, we hope to help address these issues.

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For more information on upcoming meetings of the Community Development Venture Capital Alliance, contact CDVCA, 700 Lonsdale Building, Duluth, MN 55802; (218) 722-0861; fax (218) 725-8900.
Resources

For free copies of recent issues of *Community Dividend* or other community development articles and newsletters from other Federal Reserve Banks, contact Community Affairs at the Federal Reserve Bank of Minneapolis at (612) 340-2277.

Fall 1996: *What is Community Affairs?*

Summer 1996: *Community Development and the CRA*

Winter 1995-96: *A Guide to State-Sponsored Housing Programs*

CDFI NEWS, *A Report on Community Development Financial Institutions.* To subscribe to this newsletter, contact the CDFI Coalition, 924 Cherry St., Second Floor, Philadelphia, PA 19107; (215) 923-5363; Fax (215) 923-4755; e-mail CDFI@aol.com.

*Doing the Undoable Deal,* published in the Summer 1996 issue of *Community Reinvestment,* is a resource guide to financing housing and economic development. For more information, contact the Kansas City Community Affairs Department at (816) 881-2867.

**Community Reinvestment - Meeting Your Community’s Credit Needs: Does Your Bank Measure Up?** is a guide to understanding CRA regulations and obtaining bank CRA ratings. Published in August 1996 by the Federal Reserve Bank of Atlanta. For more information, contact the Atlanta Public Affairs Department at (404) 521-8020.

*The Banker’s Quick Reference Guide to CRA,* published by the Federal Reserve Bank of Dallas, is a handy guide to the revised CRA regulation and examination procedures. For more information, contact the Dallas FRB Community Affairs Office at (214) 922-5276.

Where to get lists of future CRA evaluations

Many of the schedules for future CRA evaluations are posted on the Internet.

**Federal Reserve Bank of Minneapolis**

On the Internet at [http://woodrow.mpls.frb.fed.us/banking/develop/cra-exam.htm](http://woodrow.mpls.frb.fed.us/banking/develop/cra-exam.htm)

**Office of the Comptroller of the Currency (OCC)**


**Federal Deposit Insurance Corporation (FDIC)**

On the Internet at [http://www.fdic.gov](http://www.fdic.gov)

**Office of Thrift Supervision (OTS)**

Attention: Ms. Ella Allen
1700 G Street N.W.
Washington, DC 20552
(202) 906-6000, ext. 6924

**Urban Redevelopment, Displacement & the Future of the American City** by C. Theodore Koebel (35 pages, May 1996). For more information, contact the Federal Reserve Bank of Richmond Public Affairs Department at (804) 697-8109.

**The New Economic Equation,** a report on the Radcliffe Public Policy Institute’s multiyear project examining economic and work changes in America and their effects on families and individuals, is available for $5 from the institute, 10 Garden St., Cambridge, MA 02138; (617) 496-3478, e-mail rppi@radcliffe.harvard.edu.

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Calendar

Feb. 17-21
Contact: (800) 438-5547.

Feb. 24-26
Contact: (202) 223-4735.

Feb. 26-March 1
Contact: (202) 223-4735.

Feb. 26-28
Contact: (202) 223-4735.

March 11-15
Contact: (202) 872-1500.

April 3
Contact: Jackie Steele, (301) 588-8110.

April 9-10
Housing Conference 1997, From Myths to Realities: The REAL Facts about Public/Private Housing in the Community. Sponsor: Los Angeles County Department of Mental Health. In Los Angeles.
Contact: Joann Metoyer, (213) 738-4150.

April 13-16
Contact: Gerald Sherman, (406) 255-5317 for conference information, or Angelique Real Bird, (406) 252-2550 for registration information.

May 12-13
Contact: Kimberly Tillock, (202) 223-4735.

June 22-24
Contact: (202) 223-4735.

July 21-25
Contact: (800) 438-5547.

Sept. 21-24
Contact: (202) 223-4735.

Sept. 20-24
Contact: (800) 438-5547.

Sept. 25-26
Contact: (202) 223-4735.

Nov. 10-14
Contact: (800) 438-5547.
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☐ Good Food and Entertainment
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Others interested in the conference, call Gerald Sherman at First Interstate Bank, (406) 255-5317, or Maylinn Smith at University of Montana Law School, (406) 243-2544. For registration information only, call Angelique Real Bird at (406) 252-2550.
The Community Development Financial Institutions Fund recently announced the first round of funding awards for the Bank Enterprise Awards (BEA) program. Although less well-known than the CDFI program, the BEA program also promotes neighborhood revitalization through the increased provision of lending opportunities, financial services and technical assistance in distressed communities. More than 50 banks and thrifts applied for BEA funding, and 38 eligible institutions received awards totaling $13.1 million for their increased support of community development. Organizations receiving BEA awards are located in 18 states and the District of Columbia.

The BEA program rewards participating insured depository institutions for making equity investments in CDFIs and increasing their direct lending and service activities in designated economically distressed communities. The first round of BEA awards leveraged nearly $66 million in private-sector investments in CDFIs. In addition, it leveraged $60 million in direct lending and services provided by the award recipients in the economically distressed neighborhoods they serve.

After the BEA program awards, the remaining funds were transferred to the CDFI program. Those funds allowed three CDFIs to receive new or additional award allocations.