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Case studies

THE BALTIMORE FUND

Investor Meeting in Baltimore

Patrice McConnell Cromwell, Program Development Fellow of the Open Society Institute (OSI), prepared her notes for her 9:00 AM meeting. Investors of the Baltimore Fund would soon be gathering in OSI's Baltimore, Maryland office to hear the latest financial and workforce development report from the Fund's investment manager. As she gathered her notes, Cromwell reflected on the major challenges the group had faced since April 2001 when they had initiated work on the fund.

Getting the Fund off the ground had not been easy. To meet billionaire George Soros' challenge of securing $10 million in funds from at least two other sources, Cromwell and her colleagues had turned to private sector institutions as well as small and large foundations in the Baltimore region. Given the difficult state of the local and national economy, encouraging these institutions to make social investments had been challenging. Additionally, once investors had been secured, responding to the individual needs of each had resulted in an extremely complex deal structure. The structure had to reflect the various organizational concerns and cultures of the different participants – both for-profit and nonprofit – including certain private foundation investors that intended to characterize their participation as a Program Related Investment (PRI).[1] As a result, handling all of the legal papers to capitalize the Fund had become more costly and difficult than expected.

Despite these challenges, OSI raised the needed capital and the Baltimore Fund was capitalized at $15 million in July 2002. After much consideration, the group made the decision to structure their investments as a "fund within a fund." The capital was placed in the Urban Growth Partners Fund (UGP), a multi-state initiative managed by The Reinvestment Fund (TRF). UGP is a $48.5 million fund that invests in enterprises with the potential to generate a financial return for its investors and job opportunities for low-income urban workers. TRF had agreed to earmark 31% of its funds for investments in businesses in the Baltimore metropolitan area; a percentage proportionate to the sizeable amount of funds the Baltimore Fund had committed ($15M of the $48.5M) to UGP.

At the morning's meeting, TRF would report on its investments to date including their first Baltimore-based investment. As the administrator of the Fund, Cromwell knew her co-investors would be anxious to hear TRF's update as many of them still had questions.

[1] A PRI is an investment by a private foundation to support a charitable project or activity. It can be counted toward the 5% minimum payout foundations are required to give annually. The key aspect of a PRI is its charitable purpose. If an investment fails to maintain this purpose, a PRI investor must withdraw its funds or run the risk of the investment being classified by the IRS as a "jeopardizing investment". This classification could potentially subject the foundation (and in certain instances, foundation managers) to tax penalties.

This Yale School of Management case study was prepared by Research Associates Carin Rosenberg and Ricardo Joseph and edited by Rebecca Martin under the supervision of Prof. Sharon Oster. It has been developed for use solely as a learning tool. Yale School of Management case studies, including this one, are not intended to furnish primary data, serve as endorsements, or to approve or disapprove of management techniques or strategies. Confidential data have been altered or omitted.

Was it possible to earn a financial return for investors while meeting the social mission of the Fund? Would there be substantial enough deal flow from the Baltimore area to find good investment opportunities? With the types of businesses that the Fund targeted would there be an appropriate exit strategy? Given the small size of the Fund the carrying costs would be quite substantial. Would this cost be bearable given the goals of the initiative? What type of metrics could they use to measure success?

The Open Society Institute's Idea

Established in 1993 by financier and philanthropist George Soros, OSI serves as a private operating and grantmaking foundation. OSI develops and implements a range of programs in civil society, education, media, public health, and human and women's rights while at the same time focusing on social, justice, and economic reform. OSI has a number of offices internationally, as well as its headquarters in New York City and an American field office in Baltimore.

In April 2000, the OSI National Board and Baltimore staff came together for a National Board meeting in Baltimore. As part of a series of meetings and events, the board members, along with local business and community leaders, took a tour of the city. It was difficult for those touring to ignore the paradox of new growth and opportunity adjacent to poor communities and high unemployment. Yale Law School professor John Simon, a long time member of the OSI National Board and a pioneer in the field of PRIs, began speaking to Board Member Michael Gaines about creating a new way of tackling the poverty issues facing the city.

Simon believed that OSI-Baltimore might have a unique opportunity. To date, the Baltimore office had focused its grant making primarily on job training, placement, and retention efforts. But, what about job creation? He knew of organizations such as Kentucky Highlands Investment Corporation and Coastal Enterprises Inc. that had been successful in using equity funds to further community economic development. Simon believed that community development venture capital (CDVC) serving as a job creation engine could complement OSI's current workforce development strategies in Baltimore. Simon and Gaines brought their ideas to the local OSI staff. As interest grew internally, Diana Morris, Director of OSI-Baltimore, and Patrice Cromwell initiated a review of community development venture capital efforts taking place in other cities. The hope was to find a model that might be replicable in Baltimore.

After an initial investigation of current economic factors affecting Baltimore and the general landscape of the CDVC world (See Exhibit 1), Cromwell and Morris decided to move forward with their efforts to develop a venture fund. Cromwell discovered that CDVC funds had experienced some success in exiting investments, a common concern in the venture capital (VC) world.[2] This flexibility, combined with job creation costs of less than $10,000[3] of invested capital per job, looked promising to Cromwell. She recognized that there were risks as well, as the average performance reflected a range of individual company successes and failures. As of 2000, 182 investments had been made by 14 CDVC funds resulting in 33 successful exits, 16 bankruptcies and 7 partial or complete write offs.[4] Although risks existed, there was no doubt that Baltimore was in need of a job creation tool to help develop high quality jobs.

[2] Rubin, Julia Sass, Harvard University, "Community Development Venture Capital: A Report on the Industry" (developed in concert with the Community Venture Capital Alliance), September 2000.

[3] Ibid. According to the Rubin report, this data compares favorably to the $35,000 per job creation of the Small Business Investment Companies. In addition to these numbers, these funds often created manufacturing jobs with livable wages and benefits in economically depressed regions.

[4] Ibid.

In November 2000, OSI Baltimore presented their proposal for a social venture fund to Soros and the National Board. After carefully listening and reviewing their business plan, Soros made a commitment and a challenge to the organization. He would approve in principal $5 million to develop a CDVC pool in Baltimore contingent on two requirements. First, OSI Baltimore would need to raise additional funds totaling at least $10 million from a minimum of two other donors. Second, they would need to develop a business plan setting forth the governance and structure for the funding to the satisfaction of Soros and the other investors.

Baltimore's Needs[5]

In 1998, OSI opened its Baltimore office to focus on critical national urban issues on a local level. The office's mission was to grapple "with issues of national consequence that took on the limitations and opportunities created by local social, economic, and political conditions."[6] During its tenure in Baltimore, the organization had learned much about the city and its ongoing issues and concerns.

During the last thirty years, the Baltimore economy had shifted from manufacturing to services and advanced technology. Between 1970 and 1997, manufacturing employment declined by approximately 60,000 jobs.[7] The national consolidation of the financial and business services in the early 1990s contributed to the loss of another 11,000 jobs in the city.[8] Despite this bleak history, Baltimore was showing new signs of life.

Significant growth had recently occurred in the services, health services, high technology, and retail/entertainment industries. In addition to the growth in these industries, there was a new, energetic young mayor in office, who was focused on improving neighborhoods. More than $300 million in commercial development had begun along Baltimore's shoreline that would, over the next five years, produce shops, restaurants, offices, condominiums, rental apartments and museums.[9] Moreover, investments in building Baltimore's "digital harbor" and rehabbing of old manufacturing plants and warehouses had begun. The city's growing sector of information technology companies was quickly leasing these new development properties as soon as they were placed on the market. Outside of the Inner Harbor, the downtown office building market was coming back and the occupancy rate had grown from 45% to 90% in just a few months.[10]

The challenge was clear. How could the city spread this economic growth and resulting jobs into the neighborhoods that were struggling with poverty? In Baltimore, 24% of the population was living below the official poverty line, including 36% of the children.[11] The official unemployment rate was 7.3% versus 4.1% in the region. Yet these 20,000 unemployed residents did not include the 8,500 individuals returning from the criminal justice system each year, the 2,000 students that both drop out of school and are unemployed each year, and the thousands of people on public assistance. Some neighborhoods had true unemployment rates of over 30-40%.[12] The city's labor participation rate was only 57%, 10% below the state and 20% below several suburban counties.[13]

5 The information in this section is from a November 2000 Memo written by OSI Baltimore.
6 OSI Baltimore Website - http://www.soros.org/baltimore.
7 University of Baltimore, Jacob France Center, Report on Access to Jobs in the Baltimore Region, Citizens' Planning and Housing Association, 1999.
8 Ibid.
9 Gunts, Edward, "Rolling Out the Welcome Mat," The Baltimore Sun, January 9, 2000.
10 Cohn, Meredith, "Newcomer Takes Risk in Courting Start-ups," The Baltimore Sun, September 22, 2000.
11 U.S. Census Bureau Report, "Poverty in the United States," 1997.
12 Data from OSI Baltimore memo.
13 U.S. Bureau of the Census - http://www.census.gov.

OSI wanted to help those neighborhoods that were not participating in the current economic growth. With leadership and capital to invest, OSI believed that helping to create high quality jobs could narrow the gap between Baltimore's rich and poor.

Approval & Challenge

To meet Soros' challenge, OSI-Baltimore hired the Community Development Venture Capital Alliance[14] (CDVCA) to perform a market study of the financing needs of businesses in the Baltimore area and to write a business plan detailing how to design a potential venture capital fund.

The business plan and market study presented by the CDVCA made a sound argument for investment in the region. Although there were other investment funds with social objectives to promote business growth in Maryland (See Exhibit 2), there remained a need for further equity capital strictly focused in the Baltimore region. Additionally, other funds focused on different social objectives and did not include workforce development for low-income workers as a primary objective. The CDVCA report highlighted the importance of providing business counseling and human resources assistance to emerging companies, as well as leveraging local community expertise and existing city initiatives.

The CDVCA's report also recognized some potential challenges to developing such a fund that concerned OSI. There was the potential for a scarcity of good investment opportunities in Baltimore. Lack of deal flow was certainly a concern to Stewart Paperin, Executive Vice President of OSI. A former senior corporate executive, Paperin understood firsthand the risks involved with investing in early stage companies and was concerned about potential losses associated with launching a venture fund. He also questioned whether high-growth industries would create a significant number of entry-level jobs. Morris and Cromwell acknowledged that this initiative would not come without significant risk, but based on their research they also believed that with a strong fund manager and a well-built workforce development program, the Fund could be successful.

Early Design and Thoughts on the Baltimore Fund

Despite some ongoing questions, the OSI National Board gave Baltimore the green light. In the spring of 2001, Soros came to Baltimore to meet with and hear the views of local business and philanthropic leaders who had read the business plan. Feedback at this meeting was encouraging, but cautious. In order to strengthen OSI's efforts, Soros invited interested leaders (See Exhibit 3) to offer their expertise and form a Baltimore Fund Advisory Board. This group would help recruit potential investors, structure the fund, and choose its manager.

In July of 2001, the Board began approaching potential investors in order to secure commitments for additional funding. The first organization to lend support was The Annie E. Casey Foundation (Casey). With a commitment of $5 million to the Fund, Casey pledged to join OSI in its leadership of the Baltimore Fund. The mission to connect low-income workers with jobs that provided family supporting wages and health care opportunities was in line with Casey's mission to "build better futures for disadvantaged children and their families in the United States." Additionally, Casey's Board of Trustees had recently allocated $20 million of the Foundation's endowment for Program and Mission Related Investments, a type of investment that the Foundation had not made to date. The Baltimore Fund enabled the organization to begin deploying these funds.

[14] Community Development Venture Capital Alliance is the trade association for this quickly growing industry.

> "Casey was eager to participate in a project with co-investors that would allow us to leverage our mission. Social investments allow us to do things that are more innovative and non-traditional – the Baltimore Fund is an example of this. It allows us to use the balance sheet side of the Foundation to supplement what we are doing through the income side of the Foundation."
>
> Burt Sonenstein
> VP of Finance, Annie E. Casey Foundation

With a substantial portion of the fundraising done and a number of foundations expressing interest, the Board began to think about an initial design of the Fund. They hoped it would be capitalized at $15 million and believed investments could be made over a three to four year period. They would use equity and equity-like instruments to make investments in primarily early to middle stage growth companies. The Fund would aim to achieve an annual return in the neighborhood of 8-10% and to return investors' capital in approximately 10 years. The Fund's social goal would be focused on workforce development. It would invest exclusively in companies in the Baltimore region that could create quality jobs for low-income residents. Only companies that would provide family supporting wages, health benefits, and opportunities for advancement would be considered.

The Board believed that providing support services to the portfolio companies would be a key component in the success of meeting the social mission of the Fund. In fact, having observed best practices of other CDVC funds, the Board planned to raise an additional $750,000 to fund a separate, non-profit support organization to work in collaboration with the Fund. This organization would assist the portfolio companies in building human resources practices and accessing customized training for their new employees. They would also ensure that employees were receiving appropriate health care benefits as well as any subsidies or tax credits for which they might be eligible. Specifically, this organization would act as an intermediary between the portfolio companies and the non-profit service providers, which these companies would not normally expend time or resources to find.

Fund Structure & Manager Hiring Process

The Advisory Board wanted a management team that not only had expertise in achieving both financial and social goals, but also had the ability to mobilize technical assistance for the portfolio companies. In order to achieve this, the Board implemented a proposal process to choose the fund management team.

The Baltimore Fund considered three general management structures:

- *Establish a new direct investment fund.* In order to do this, the Baltimore Fund would create a non-profit or limited liability corporation that would serve as the community venture capital fund. It would be an independent entity separate from the investors and operate with a board of directors and a professional staff of its own to set policy, disburse funds and broker technical assistance.

- *Allocate pool of funds to already established investment institutions.* In this scenario, the funds would be disbursed through an asset allocation plan to experienced financial institutions that currently did not have adequate capital or the scope to invest in community development ventures. In this case, the Baltimore Fund would allocate portions of its funding to different financial institutions, without having any direct control over the actual investments. If the Baltimore Fund chose this structure, they would also disburse grant dollars to non-profit organizations that would provide complementary technical assistance to the portfolio companies.

- *A hybrid of the two*. The investors could create a new pool of community development capital funding and commit it to an experienced entity (non-profit or limited liability corporation) that would serve as a pass-through organization distinct from the investors. This entity would have a board of directors and a staff to set policies on asset allocation and broker technical assistance. In this scenario, the Baltimore Fund would maintain some sort of governance over the fund's investments. In addition, the Fund would select a non-profit to manage complementary technical assistance.

The Advisory Board disseminated a Request for Proposal (RFP) to over thirty organizations that had expressed interest in managing the Fund. Using a scoring sheet prepared by the CDVCA and additional guidance from Neal Moszkowski, a Partner of Soros Private Equity Partners, members of the Advisory Board reviewed the very competitive proposals they received. Fund managers were evaluated on both financial and social impact criteria (See Exhibit 4), and the top four organizations were invited to Baltimore to make presentations to the Board. In November 2001, the Board settled on a structure that they had not realized would be available to them. They chose to become a partner in a multi-state venture capital fund initiated and managed by The Reinvestment Fund (TRF). Board members believed that with TRF's experienced team as their fund manager, they would be able to address the technical challenges of the venture while still retaining some governing functions.

Since its inception in 1985, TRF had provided capital and technical assistance to over 500 businesses, financed more than 5,800 units of affordable housing, and developed 2.5 million square feet of commercial real estate. In 1998, TRF formed its first private equity fund, DVCRF Ventures that as of September 2002 had made nine investments earning a 12% internal rate of return.[15] With this fund they had created more than 1,200 new skilled jobs in the Philadelphia region, resulting in an average of one new job created for each $8,300 invested.[16]

The Baltimore Advisory Board had been impressed with these results and believed that adding their capital to TRF's new UGP fund would allow them to benefit on multiple levels. They were encouraged by the regional diversification UGP offered and believed it would help increase deal flow, reduce risk, and provide adequate liquidity. Also, having the Baltimore Fund rolled up into UGP, an entity with experience with this dual bottom line, would allow OSI's New York office to feel more comfortable with Baltimore's decision to pursue the fund.

Some Baltimore Fund investors had concerns about UGP not being locally focused. Given UGP's home base of Philadelphia, they worried that there would be competition for money among its target cities. In order to allay these concerns, UGP and the Baltimore Fund agreed that 31% of the investment funds (proportionate to the Baltimore Fund's committed capital to UGP) would be targeted towards companies in the Baltimore region. A balance test would be conducted once UGP had distributed 50% and then 75% of the total capital, to ensure that the 31% ratio goals had been maintained. If it were found that less than 31% of the capital had been invested in the Baltimore region, there would be an opportunity for the Baltimore Fund to change the terms of its commitment to UGP.[17]

15 All data provided about DVCRF Ventures is as of September 2002.
16 Ibid.
17 TRF Urban Growth Partners, Investment Policies, September 2002.

Potential Investors

Foundations and PRIs

Both OSI and Casey had decided to invest in the Fund using PRIs. PRIs, pioneered by the Ford and MacArthur Foundations, had been gaining momentum over the last thirty years.[18] With the goal of supporting charitable projects or activities, PRIs are traditionally structured as loans, but can also be designed as equity investments or loan guarantees. PRIs are similar to a recyclable grant as the repayment of a loan or the return of the equity can eventually be recycled for another charitable purpose.[19] In order to be considered a PRI, the Internal Revenue Service requires that an investment meet the following criteria: its primary purpose must be to further some aspect of the foundation's charitable mission; the production of income or the appreciation of property cannot be the primary purpose of the PRI; and finally, it may not be used to support any lobbying or political campaign.[20]

With a fund manager in place and Casey as a lead partner, the team contacted local foundations to join the Baltimore Fund. These organizations, mostly family-based with smaller endowments, were not very familiar with PRIs or CDVC funds. OSI and Casey believed that the PRI approach would appeal to these organizations — many of which had historically focused solely on grant making — as a means to align their investment practices with their mission, and took the opportunity to educate them on the idea.

Timothy D. Armbruster, President and CEO of The Goldseker Foundation, was excited by the opportunity to participate in the Fund as it allowed his local foundation to further leverage its potential impact by partnering with other organizations. Additionally, the opportunity to make a PRI enabled the organization to align its mission with its investments for the first time. Betsy Ringel, Executive Director of the Blaustein Philanthropic Group, explained that the idea of using investment funds rather than grant money for the Baltimore Fund appealed to the Group because it allowed them to "keep the ever-shrinking pool of grant money intact" while still increasing what the organization could do on behalf of the Baltimore community.

Ultimately, OSI and Casey made an offer that many of the other foundations could not refuse. They would absorb the costs of all legal matters[21] including those fees associated with initiating the Fund. Casey would also serve as the fiscal agent for the Baltimore Fund, while OSI would manage all communications, coordination, and administrative needs of the partnership. For the Blaustein Philanthropic Group, this was the deal clincher.

> "The leadership role that OSI and Casey played in doing all the leg work made the deal a complete package – all the work was done for us. It came to us already baked. Then, the icing on the cake was that they offered to pay what turned out to be significant legal fees for the documentation. Would we have gone out on this on our own? No way. This allowed us to join in on something that looked pretty easy, was not going to take a lot of staff time, and was fairly straightforward. It was risky, but not so risky that we could not

[18] Enactment of section 4994c of the Tax Reform Act of 1969, guaranteeing tax-exempt status for organizations adopting PRIs, made this type of investment attractive to foundations.
[19] Ford Foundation, "Answers to the 10 most-asked questions about PRIs"
[20] Ibid.
[21] OSI hired the national law firm of Wilmer, Cutler and Pickering to assist in their efforts.

engage in it. Additionally, we knew that participating in this would allow us to be on the demand side of workforce development in an area where we were accustomed to being on the supply side."

Betsy Ringel
Executive Director, Blaustein Philanthropic Group

Banks

Banks were the first and most natural resource to tap for the Baltimore Fund. Not only were they an acknowledged source of capital for investing, but also they were more accustomed to private equity investment work than local foundations. Additionally, they were required to comply with the Community Reinvestment Act (CRA) which encouraged depository institutions to help meet the credit needs of the communities in which they operate, including low and moderate-income neighborhoods.[22] The CRA requires that each depository institution's record be evaluated periodically and be taken into account when considering the institution's application for deposit facilities.

TRF, OSI, and Casey were disappointed at the response from the local banks. Once considered the primary community leaders, many of the banks in Baltimore were no longer locally based or oriented and thus received little or no CRA credit for taking on such leadership in this City. Despite the lack of local participation, the Baltimore Fund was able to encourage Deutsche Bank to join the mix of national financial institutions that UGP had already secured such as JP Morgan Chase, Citigroup, Fleet and Prudential. Garry Hattem, Managing Director of Deutsche Bank Trust Company Americas, explained his interest in participating, "Deutsche Bank is an investment bank here in the US, so we have no retail activity and thus no way to do any direct lending (to underserved populations). As such, facilities that provide that opportunity are of interest to us." For Hattem, the Baltimore Fund seemed to combine a pragmatic investment strategy with a clear sense of a social mission. Hattem also explained that OSI and Casey were major draws for the bank. He concluded, "The Fund had an appropriate structure for what we were trying to accomplish, there was good management, and The Reinvestment Fund had a track record that was solid and verifiable. There was significant enough experience to give us reason to want to participate."

Closing Papers

The Baltimore Fund

The Baltimore Fund LLC was officially launched in July 2002 with 15 investors representing foundations and individuals, as well as a financial institution and John Hopkins University. The Fund was organized with OSI's original goal in mind of directing investment dollars into businesses that would "provide high-quality job opportunities[23] and employment training to low income residents of Baltimore." It was agreed that OSI and Casey would manage the legal structure with guidance from the other investors.

[22] The Community Reinvestment Act 12 U.S.C. 2901was enacted by the Congress in 1977 and implemented by Regulation BB, 12 CFR 228. Federal Reserve website: http://www.federalreserve.gov/dcca/cra/.

[23] This includes family supporting wages ($8/hour or more), benefits, and career advancement opportunities.

A Fund within a Fund

In early September 2002, the Baltimore Fund became a limited partner in UGP (See Exhibits 5 & 6). The structure of the investments, equity ownership and return for the Baltimore Fund would follow the same terms and conditions as all of UGP's other limited partners. With the deal in place, some of UGP's early stage investors worried about the presence of a new partner holding 31% of the fund interest, $11.5M of which was invested as PRIs (See Exhibit 7 for a list of UGP investors). By law, organizations using PRIs are required to reverse their participation in an investment if it strays from the original social mission. If this occurred, the remainder of the investment group would need to attempt to recoup the funds in question from the portfolio companies before exiting themselves.

Another issue arose regarding board representation. TRF had agreed to have Baltimore Fund representation on both the UGP Board of Directors as well as its Investment Committee. This offer was not extended to other UGP investors and became a bone of contention that TRF had to handle delicately. Finally, the Baltimore Fund investors had agreed to incur the costs of TRF opening a Baltimore office and hiring local staff.

Structure and Staffing

Both the Baltimore Fund investors and TRF believed that having a strong, Baltimore-based professional staff would be critical to meeting the Baltimore Fund's goals of a 10% IRR and the generation of 900 jobs. In early November 2002, TRF/UGP opened its Baltimore office and hired Erik Johnson to serve as Principal for the Fund's operations in Baltimore and to work in tandem with Joseph Killackey, Managing Director of UGP and Linda DeJure, also Managing Director and Executive Vice President of Economic Development at TRF. Johnson had lived and worked in Baltimore for many years and TRF believed that his community development finance experience would give him the know-how to tap into needed community resources and to bring significant deal flow to the table. Overseeing the workforce development process, Margaret Bradley and Patricia Muraresku would be responsible for developing and implementing customized workforce development solutions for the portfolio companies.

Governance, Reporting, and Monitoring

UGP would have full authority to manage the Baltimore Fund subject to the limited partners' conditions agreed on in a side letter. The Baltimore Fund had authority to invite two representatives to sit on UGP's Board of Managers and designated Neal Moszkowski of Soros Private Equity Partners and Christa Velasquez, Senior Fellow for Social Investments at Casey. Among other governance activities, Velasquez and Moszkowski would oversee the Fund's investments, approve portfolio company valuations, and approve distributions to partners. With experience in economic development and private equity in Baltimore, Greg Barger, Senior Vice President of the Mercantile Bank, and Mike Mobley, President of Mobley Consulting, were chosen to serve as Baltimore Fund representatives on the UGP Investment Committee (See Exhibit 8 for a list of its members as well as of the Board of Managers). This Committee was charged with reviewing and approving all new investments made by UGP.

According to an agreement between TRF and the Baltimore Fund, UGP would issue a quarterly Fund and Portfolio Summary Report as well as financial statements, K1 reports and workforce development impact reports to each investor. Casey would provide each investor with an individualized report pertaining to his or her investment. The Baltimore Fund would require UGP to keep appropriate records and accrual accounting books during the term of the partnership and for at least three years following its dissolution. Finally, UGP would hold quarterly meetings in Baltimore for all Baltimore Fund participants to review current investments and ask questions.

Budgeting

The start-up costs of a venture capital fund were high. There would be the standard 2.5% fee charged by UGP on the Baltimore Fund's total committed capital, a fee that all UGP investors paid. Additionally, the Baltimore Fund investors had agreed to also pay a premium 1.5% management fee that would be taken before the capital was invested. This fee would cover the costs of hiring Baltimore-based staff and maintaining a Baltimore office. The investors chose to fund the premium management fee as well as the funds needed to support the workforce development component (not included in the management fees) with grants. It was important to UGP managers and the Baltimore Fund investors that these services were supported by separate funds so as not to dilute investment dollars themselves. (See Exhibit 9 for UGP annual budget and estimated start up costs).

Doing the Deals

Deal Flow

One of the primary responsibilities of the fund managers was to generate a consistent flow of business plans and access them according to UGP's screening criteria. TRF believed the best way to develop a brand identity and create a deal flow was to work through local sources including financial institutions, venture funds, and local economic development entities. They would also participate in entrepreneurial associations and special events, make presentations at public meeting aimed at small businesses, and utilize contacts and referrals from TRF, DVCRF Ventures and the Advisory Board.

By March 2003, TRF reported that they were finding a consistent level of interest from local Baltimore companies, entrepreneurs, and business owners. They already had 20 investment requests of which three had led to term sheets. Utilizing a ten-step structured due diligence process UGP hoped to make its first Baltimore investment by the beginning of the second quarter of 2003.

Requirements for Portfolio Companies[24]

Like many VCs, TRF's Urban Growth Partners followed explicit investment policies (Exhibit 10). The Fund would only make investments in small businesses that had the capacity to create quality, entry-level jobs for low-income people (on average at a rate of 30 jobs for every $500,000 invested by the partnership). In general, these companies had faced difficulties securing such financing from conventional sources and were seeking equity capital in the range of $500,000 to $4 million. Additionally, these forms should have the capacity to grow annual revenues to a minimum of $15 million in a five-year period.

From a workforce perspective, UGP looked for companies with the following criteria:

- Strong leadership – Are they truly committed to investing in their workforce?
- Job Creation – How many jobs will be created?

[24] This section was extracted from the Urban Growth Partner's Investments Policies, September 2002.

- Quality of jobs – Will the jobs provide reasonable wage rates, advancement opportunities and benefits?

- Job accessibility – Will workers be able to use public transportation or other means to get to work?

- Human resources structure – Does the company have or is it prepared to develop appropriate HR infrastructure?

- Diversity in the workplace – Is the company accepting of a diverse workforce?

If a company met all the financial and workforce criteria, an Investment Memo would be sent to the Ventures Investment Committee. After a thorough due diligence process, TRF would enter into an Employment & Training Agreement (ETAG) with the company (Exhibit 11). Once the deal was closed and the ETAG was signed, UGP would assume the role of a traditional venture capital firm with regard to monitoring its investments and the company would be linked with TRF's Human Capital Group. This group would facilitate the placement and retention of low-income people including providing access to job placement, training services, and assisting with childcare and transportation needs. The hope was that the combined efforts of all parties would result in employment opportunities where low and moderate-income people could succeed and a company that could be as competitive and successful as possible.

Baltimore Dredges

To date, UGP had invested in three companies outside of the Baltimore region (See Exhibit 12). Additionally, they had recently made their first Baltimore based investment in Baltimore Dredges Enterprises, LLC (Dredges), a company that had been manufacturing dredges in Baltimore for over 120 years. At its peak the company had employed 125 skilled and semi-skilled workers, but in recent years employee numbers had fallen to 50. To make the investment viable, UGP worked with the Dredges' management team for nine months to create a new business model that would move the company away from its concentration on foreign sales and its use of limited proprietary technology. TRF's Killackey took a seat on Dredges' board with the goal of helping to increase the profitability of the company and boosting revenues by more than 50% in the first year.

UGP also performed a detailed workforce assessment of Dredges' human resources practices and job creation goals. This process included tours and interviews at Dredges' facilities to evaluate safety and environmental practices, training and career advancement opportunities, and public transportation accessibility. While the assessment found that future jobs would be concentrated at the mid-skill level, UGP acknowledged that better wage jobs would mean an advancement path for workers currently in entry-level positions. Both the Baltimore Fund investors and UGP managers felt it was valuable for portfolio companies to be able to provide advancement opportunities for incumbent workers in addition to being able to create open positions for new employees to fill.

Over the coming months, the UGP workforce team would work with Dredges' management team to offer free, on-site tax-filing assistance for low-wage workers that would help employees boost their income.[25] They would also facilitate access to other public benefits for which employees might qualify.

[25] Earned Income Tax Credit (EITC) and other tax benefits put money back in the pockets of qualified working individuals. For example, according to a Baltimore Cash Campaign Report on 2003 Earned Income Tax Credits, in Baltimore City, 15 - 25 % of eligible residents do not apply for the EITC even though they qualify. Additionally, as a result of their services the Baltimore Cash Campaign was able to generate a total tax refund of $1,466,682 representing an average of $1,710 per family.

With the restructuring, UGP expected an increase of the current workforce by 100 to 120 people over the next five years, of which 70 of these jobs would be based in the Baltimore area. It was also believed that within the same period, the company would be an attractive acquisition target for a larger company in the industry or a strategic investor. Nonetheless, the term sheet was structured to guarantee that UGP would be in a position to exit the investment by 2007.

Metrics & Success

There were some concerns regarding how to measure the success of UGP and the Baltimore Fund. Investors knew that only looking at the quantity of jobs and the financial return on their investment would possibly mean overlooking the broader impact of their efforts. OSI's Paperin believed that "scalability" of the initiative to other cities would be the ultimate test of success. In his mind, being successful in Baltimore would not be enough to encourage ongoing initiatives. He wanted to see some evidence that this effort would be replicable and that there would be a social and economic impact on the impoverished communities beyond strictly job creation.

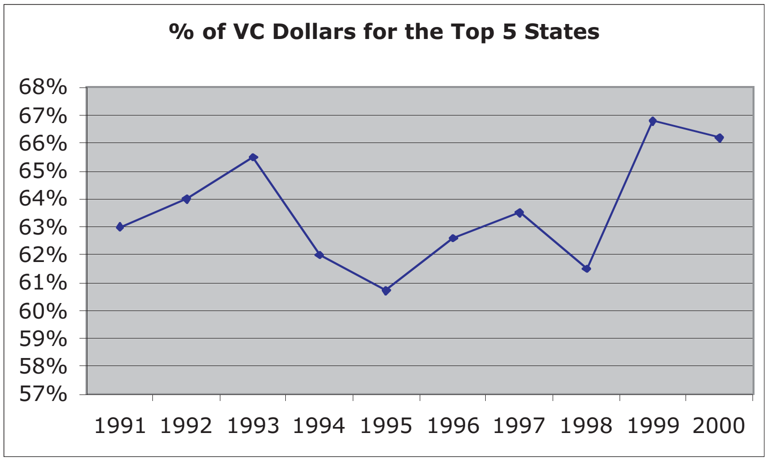
At TRF, Margaret Bradley suggested that given the focus on improving opportunities for employees, another measure of success would be the longer-term impact on workers. TRF had recently introduced a new survey instrument to gauge outcomes from both a firm level and from the worker-level. Using self-administered surveys, company payroll records, and demographic data from the US Census, TRF was able to compare how workers fared over time in relation to a comparable sample from the region. Indicators included employee retention and advancement, firm productivity and profitability, and customer satisfaction. She cautioned however, that the field was still young and companies would need to reach a larger size before such analysis would be appropriate.

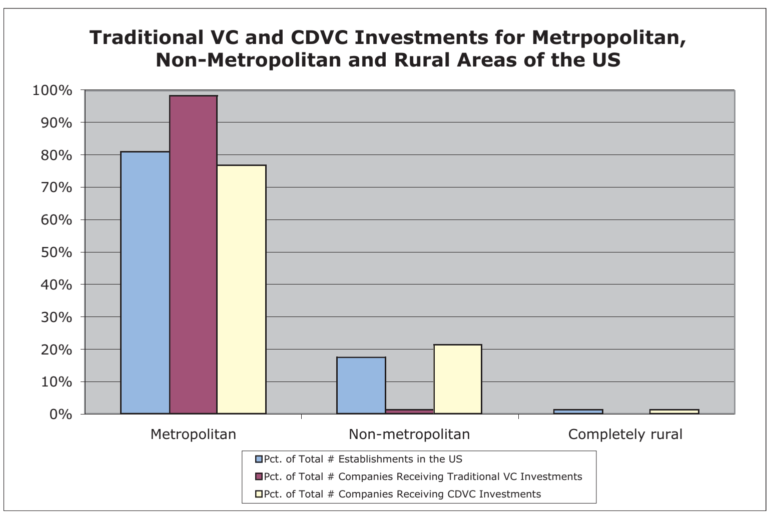
Cromwell and Sonenstein reminded their colleagues that it was important to stick to the fundamental goals set forth in the beginning: quality job creation and sound financial return. To measure the broader and long-term impact of the Fund would be difficult as ideas of how to calculate a Social Return on Investment were still being explored.

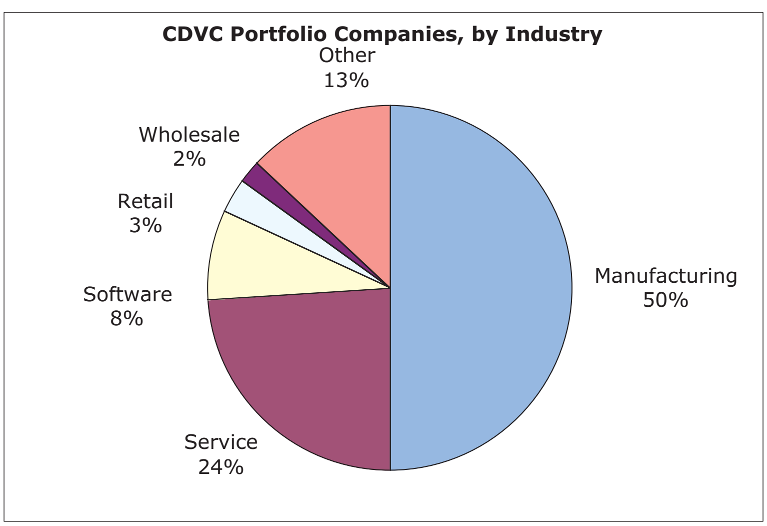
The majority of the local foundations agreed that the creation of 900 jobs in the Baltimore area, no matter what kind or for whom, would mean success. In the long term, there was still the question of whether OSI and Casey were utilizing their money in the most efficient way to tackle the resilient poverty of Baltimore. However, in the short term, they had been successful at launching and overseeing the Baltimore Fund initiative. Not only had the two organizations gathered the financial capital necessary to make the investment happen, but they also had established a trust within the group of investors that would serve them in their decision-making processes going forward.

Equally important was the diverse constituency of investors that had been patchworked together. OSI and Casey were pleased with the process to date and believed that they had built a network in Baltimore that could fuel economic development in the future. Indeed, a second funders' collaborative, focused on non-profit ventures, was already taking shape. OSI and Casey hoped the model they had developed could serve as a catalyst to social change both on a local and national level.

Exhibit 1. Community Development Venture Capital Industry Outlook







Source: Community Development Venture Capital Alliance.

Exhibit 2. Baltimore Area Community Development Venture Funds

Fund Name	Equity or Debt	Funds Available	No.of Invest-ments Made	Avrg Invest-ment ('000)	Geographic Region Targeted	Industry Focus	Social Objective	Staff	I.R.R. Achieved	Fund Manager
Abell Ventures	Equity	$30,000	13	$1,000	Baltimore County	Software, Telecom Services	Job Creation	2	N/A	Abell Foundation
Challenge Investment Program	Equity	$1,500/yr	100	$75	Maryland	IT, Telecom, Biotech Tech w/patents	Minorities, Women, Rural Aereas	2	N/A	State of Maryland
Community Development Ventures	Equity/ Mezz	$12,000	13	$383	Baltimore & MD	Various	Job Creation	2.5	N/A	Meridian Mgmt. Group
Development Credit Fund	Debt	$11,000	349	$86	MD, VA, DE	Various	Minorities, Women, Job Creation	5	10.5%	Community Lending Group
Enterprise Investment Fund	Equity	$5,000/yr	35	$250	Maryland	IT, Telecom, Biotech Tech w/patents	Minorities, Women, Rural Aereas	2	85.0%	State of Maryland
MD Small Bus. Dev. Financing Authority	Equity/ Mezz	$4,500	15	$121	Maryland	Various	Small, Minority	2.5	N/A	Meridian Mgmt. Group
MMG	Equity/ Mezz	$23,500	14	$1,300	Mid-Atlantic	Telecom, IT, Health Services	Small, Minority	2.5	N/A*	Meridian Mgmt. Group

Source: OSI Market Study conducted by CDVCA.

Exhibit 3. Baltimore Advisory Board

Mr. Timothy D. Armbruster, Ph.D.	President	Morris Goldseker Foundation
Mr. Clinton Bamberger, Esquire	Trustee	Open Society Institute-Baltimore
Mr. Greg Barger	Senior Vice President	Mercantile-Safe Deposit & Trust Co.
Mr. Kenneth Bourne	Executive Vice President	Mercantile-Safe Deposit & Trust Co.
Mr. Denis Callaghan	Board Member	Retired, Former Executive at Alex Brown
Ms. Cheryl Casciani	Program Director	Baltimore Community Foundation
Ms. Dana Smith Cooksey	Vice President	Deutsche Bank
Ms. Patrice Cromwell	Program Fellow	OSI-Baltimore
Mr. David Davenport	Vice President & Chief Information Officer	Citigroup
Mr. Robert C. Embry, Jr.	President	The Abell Foundation
Mr. Michael Gaines	President	MD Center for Arts & Technology
Dr. Robert Giloth	Senior Associate	The Annie E. Casey Foundation
Mr. Joshua Hall	Managing Director	Legg Mason Merchant Banking Inc.
Ms. Laura Hall	Program Officer	Blaustein Foundations
Mr. Gary Hattem	President	Deutsche Bank Foundation
Mr. LeRoy Hoffberger	Chairman	Hoffberger Foundation, Inc.
Ms. Sandra Jibrell	Director	The Annie E. Casey Foundation
Michael Lewin	Managing Director	Legg Mason Merchant Banking Inc.
Mr. Alex Mason	Chief Operating Officer, North America	Deutsche Bank
Mr. Brian Morales	Manager of Investments	The Annie E. Casey Foundation
Ms. Diana Morris	Director	OSI-Baltimore
Mr. Neal Moszkowski	Senior Partner	Soros Private Equity Partners
Mr. Doug Nelson	President	The Annie E. Casey Foundation
Mr. Mike Riley	Senior Vice President	Allfirst Bank
Ms. Betsy Ringel	Executive Director	Blaustein Foundations
Ms. Jan Rivitz	Executive Director	Aaron Straus & Lillie Straus Foundation
Mr. Burton Sonenstein	Vice President, Finance	The Annie E. Casey Foundation
Mr. Louis Thalheimer	Trustee	Alvin and Fanny Thalheimer Foundation
Ms. Nora Zietz	Executive Director	The Abell Foundation

Source: The Baltimore Fund documents.

Exhibit 4. Score Sheet for Fund Manager Selection

Financial:

The fund manager should have demonstrated experience and expertise in achieving financial returns. A prescribed formula will be presented according to the venture capital industry standard practices for calculating returns (Venture Economics reporting format).

- 50 points

Social:

The fund manager should demonstrate its experience in investing companies that create jobs for low-income people. A standard form will be presented for consistent reporting.

- 10 points

The fund manager should have the ability to interface with the prospective portfolio companies and present a persona that is inviting to those who feel marginalized by existing resources of equity capital in order to get the deal flow required to source good investments in the niche of the market.

- 10 points

The fund manager should have experience investing in the areas (neighborhoods) and in the types of businesses that the Fund targets (5 points); and The fund manager should have worked in the type of structure that is planned for this fund (i.e., third party manager reporting to advisory board and securing investment approval from an investment committee).

- 10 points

The fund manager should have the ability to work effectively with the sources of technical assistance that are in place and should be able to demonstrate the creativity, vision and ability to mobilize new resources to provide business consulting beyond those resources that currently exist.

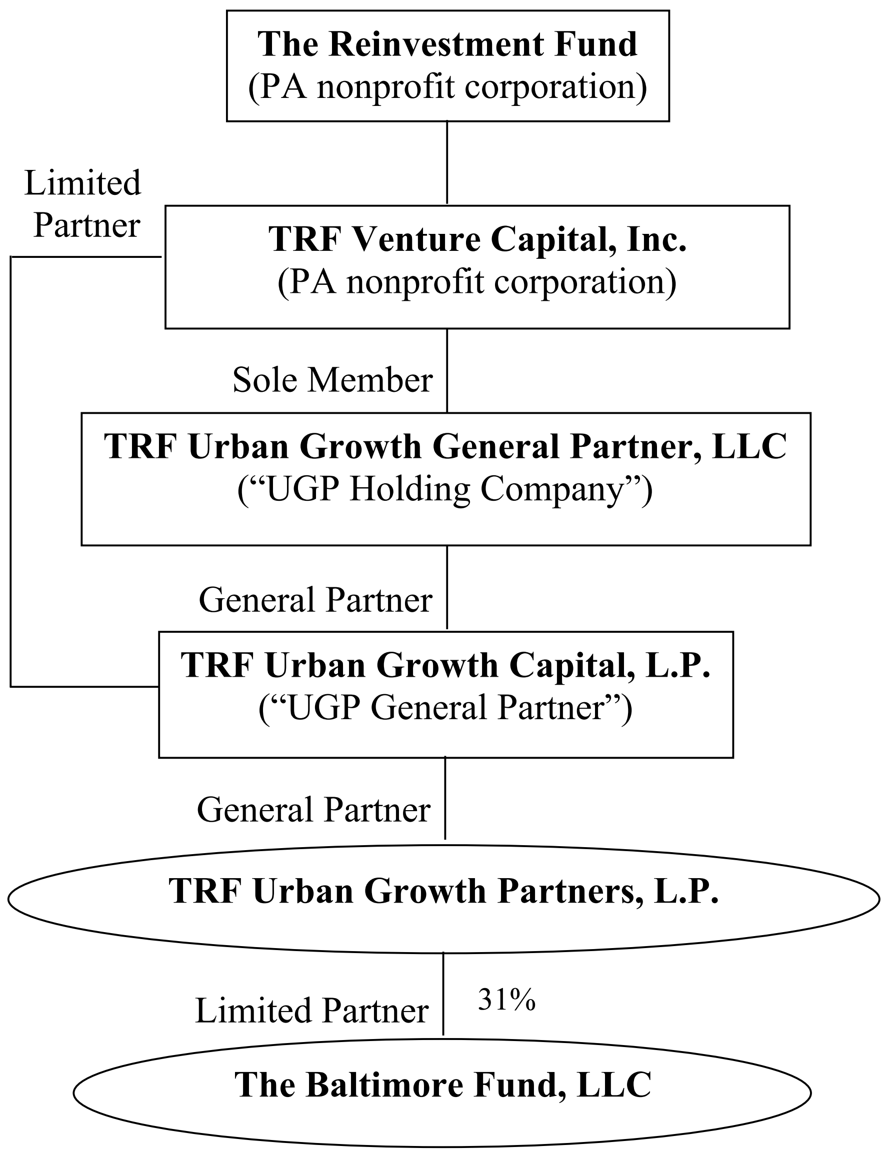
- 10 points

The fund manager should demonstrate an innovative approach to creating linkages between the targeted population of investee companies, on the one hand, and the broader financial community, on the other hand, in order to provide access to follow on investment for start up and early stage portfolio companies.

- 10 points

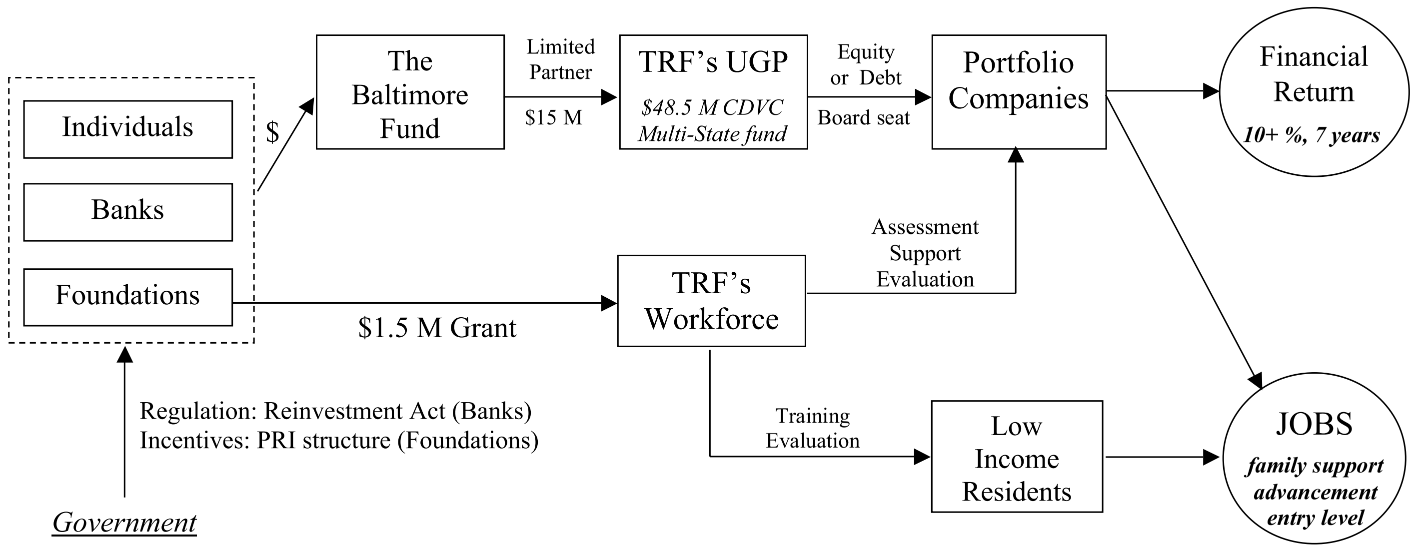
Source: The Baltimore Fund documents

Exhibit 5. A Fund within a Fund



Source: The Reinvestment Fund documents.

Exhibit 6. General Overview of The Baltimore Fund under the Urban Growth Partners fund



Source: Elaborated by the authors.

Exhibit 7. Urban Growth Partners Investors

Baltimore Fund Investors	**$MM**
Open Society Institute	5.000
The Annie E. Casey Foundation	5.000
Jacob and Hilda Blaustein Foundation, Inc.	0.750
Deutsche Bank Trust Corporation	0.500
France-Merrick Foundation, Inc.	0.500
Morris Goldseker Foundation of Maryland, Inc.	0.500
Hoffberger Foundation, Inc.	0.250
Hoffberger Family Fund, Inc.	0.250
The Johns Hopkins Institutions	0.500
The Zanvyl and Isabelle Krieger Fund, Inc.	0.400
The Fund for Change, Inc.	0.100
The Aaron Strauss and Lillie Strauss Foundation, Inc.	0.500
The Alvin and Fanny Blaustein Thalheimer Foundation, Inc.	0.500
The Baltimore Community Foundation, Inc.	0.125
Anonymous Individuals	0.125
Total	**$15.000**
Additional Investors	
Chase Community Development Corp.	3.000
Citicorp North America, Inc.	3.000
Community Foundation of New Jersey	0.100
Fleet Development Ventures	2.000
MBNA Community Development Corporation	3.000
Merrill Lynch Community Development Company	1.500
PNC Community Partners	2.000
The Ford Foundation	3.000
The John D. and Catherine T. MacArthur Foundation	3.000
The Prudential Insurance Company of America	3.000
Wachovia Affordable Housing Community Development Corp.	3.000
TRF Urban Growth Capital, L.P.	3.000
TRF Urban Growth Capital, L.P. (Grant from The City of Philadelphia)	2.000
International Brotherhood of Electrical Workers Local 98 (Phil.)	1.495
Individuals and others	0.419
Total	**$ 33.514**
UGP Total	**$ 48.514**
Grantmakers	**$MM**
Open Society Institute	0.390
The Annie E. Casey Foundation	0.640
Morris Goldseker Foundation	0.250
T. Rowe Price Foundation	0.075
Harry and Jeanette Weinberg Foundation	0.250
Baltimore Community Foundation	0.050
Total Baltimore Fund Grants	**$ 1.655**

Source: The Baltimore Fund documents.

Exhibit 8. TRF Urban Growth Partner, LLC Board of Managers and Investment Committee Members

TRF Urban Growth Partner, LLC Board of Managers

Della Clark	West Philadelphia Enterprise Center
Michael Crist	The Reinvestment Fund
Linda DeJure	The Reinvestment Fund
Scott Jenkins	S.M. Jenkins & Co.
Robert Keith	TL Ventures
Jeremy Nowak – Chairman	The Reinvestment Fund
Daniel McElhatton	McElhatton & Associates, P.C.
Neal Moszkowski	Soros Private Equity Partners / The Baltimore Fund
Christa Velasquez	Annie E. Casey Foundation / The Baltimore Fund

TRF Urban Growth Partner, LLC Investment Committee

Greg Barger	Mercantile Bank / The Baltimore Fund
James Bromley	Bromley Consulting Services
Michael Crist	The Reinvestment Fund
Linda DeJure – Vice Chairman	The Reinvestment Fund
Leonard Grossman	Entrepreneur
Scott Jenkins	S.M. Jenkins & Co.
Erik Johnson	Urban Growth Partner
Robert Keith – Chairman	TL Ventures
Joseph Killackey	The Reinvestment Fund
Mike Mobley	Mike Mobley / The Baltimore Fund
Jeremy Nowak	The Reinvestment Fund
Robert Reilly	PNC Bank

Source: The Reinvestment Fund documents.

Exhibit 9. UGP Baltimore Annual Budget

Revenue	
Management Fee	$ 375,000
Grant Supplement	$ 200,000
Expenses	
Staff	$ 521,000
Occupancy	$ 30,000
Professional Services	$ 95,000
General Administration	$ 20,000
TRF Allocated Support [1]	$ 145,000
SURPLUS (DEFICIT)	$ (236,000)
TBF Fee (1.5%)	$ 240,000
Cumulative Surplus/ Deficit	$ 4,000
Assumptions:	
Fund Size	15,000,000
Management Fee	2.5%
Management Fee direct from TBF	1.5%
Staffing: (Full Time Employees)	
Investment Staff	1.50
Workforce Coordinator	1.00
Analyst	0.30
Administrative Assistant	1.00

[1] Includes Accounting and MIS support, executive oversight, marketing and investor relations and other infrastructure costs.

Pre-closing Cost Estimate

Revenue	
Grants	$ 125,000
Expenses	
Consultants/ Legal	$ 110,000
Occupancy	$ -
Marketing and Outreach	$ 5,000
Travel and misc.	$ 10,000
TRF Allocated Support	$ -
SURPLUS (DEFICIT)	$ -

Source: The Reinvestment Fund documents.

Exhibit 10. UGP's Investment Criteria

In general a prospective Portfolio Company will:

- be located in Pennsylvania, New Jersey, Delaware, or the Baltimore, Maryland/ Washington, DC areas
- have the capacity to grow annual revenues to a minimum of $15 million in a four or five year period;
- demonstrate the capacity to create at least 30 new, quality jobs for low-income people (as defined below) as a result of each $500,000 invested by the Partnership. A quality job shall be defined as those paying at least $8.00 per hour with employer supported health benefits (the "New Quality Jobs"). Certain exceptions with a lower minimum wage rate may qualify providing that the jobs would offer work experience and skill-building opportunities for new entrants to the workforce;
- demonstrate the capacity to create such jobs so that they are accessible to low-income people (defined as those whose household income prior to getting the job is 80% or less of the relevant region's (SMSA) median household income for a household of like size as set forth in the Department of Housing and Urban Development's "Section 8 Income Limits" each year);
- need financing of between $500,000 and $4,000,000 in "equity" capital;
- be unlikely to obtain all of the financing sought from conventional financing sources under acceptable terms and conditions;
- demonstrate outstanding entrepreneurial management and in general a commitment to creating opportunities for skill upgrades and advancement for local wage workers;
- complete an extensive due diligence process in conjunction with the Partnership's staff and Investment Committee, including an appropriate workforce services review;
- not be engaged in the operation of a "media company, except as allowed by the Partnership Agreement;
- offer a reasonable exit scenario that will allow the Partnership to liquidate its investment in the company within a five to seven year period; and
- <u>not</u>
    - engage, directly or indirectly, in any activity described in Section 170(c) (2)(D) of the Internal Revenue Code;
    - engage in a manner which would constitute a "taxable expenditure" within the meaning of Section 4945(d) of the Internal Revenue Code if such proceeds, or any earnings thereon or therefrom, were so applied by a "private foundation" described in Section 509(a) of the Internal Revenue Code;
    - influence the outcome of any specific public election, or carry on, directly or indirectly, any voter registration drive (within the meaning of the Section 4945 (d) (2) of the Internal Revenue Service; or
    - participate in or intervene in (including the publishing or distribution of any statements) any political campaign on behalf of (or in opposition to) any candidate for public office.

Source: UGP / The Reinvestment Fund, *Closing Papers*.

Exhibit 11. Employment and Training Agreement (Sample)

Employment and Training Agreement between TRF Urban Growth Partners, L.P. ("TRF-UGP") and ________________________ (the "Company")

The parties to this Employment and Training Agreement by and between TRF Urban Growth Partners and the Company (this "agreement") support and promote community development through the creation and retention of quality jobs and wealth among economically disadvantaged populations and in economically distressed regions of the Mid-Atlantic region of the eastern United States.

The parties to the Agreement acknowledge and understand that TRF-UGP is vitally interested in the Company's activities having a positive impact on Mid-Atlantic communities and their residents. The Company understand and acknowledges that but for the commitment of the impact on economically disadvantaged populations and neighborhoods in the Mid-Atlantic region, TRF-UGP would not enter into the [___________ (type)] Agreement dates as of the date hereof by and among the Company, TRF-UGP and the other investor named therein and the agreements attached as exhibits thereto (the "Investment Documents"). Accordingly, as a material inducement for TRF-UGP to make the [$________] investment contemplated by the Investment Documents, the Company hereby commits to pursue the Company's business plan in such a fashion as to achieve such positive impacts. The Company and TRF-UGP anticipate that the Company will achieve the following:

Job creation. To create [____] new full-time, entry level and lower-skilled jobs in [the Mid-Atlantic Region] during the first 60 months after TRF-UGP's investment. ("Qualtity jobs" are defined as full-time positions compensated at or above livable wages, paying at least $___ per hour).
Recruitment Sources. To provide on-going Company training and development to the Company's employees and to utilize local agencies for job training and placement services for former low-income individuals and welfare-to-work participants.
Benefits. To provide employer-supported health insurance for all full-time employees within three months of the TRF-UGP investment (specify any other benefit such as ESOP or tuition assistance or other advancement assistance).
Other Benefits (Specify other related economic or community development intended impact.)

Attached hereto as Exhibit A is a description of the process under which the jobs will be posted and candidates from The Reinvestment Fund's ("TRF") approved job placement and training programs considered for each opening **[Exhibit to be customized for each transaction.]**

Attached hereto as Exhibit B is a description of the reporting requirements related to the employment goals of this investment. **[Exhibit to be customized for each transaction].**

Attached hereto as Exhibit C is a description, if applicable, of a customized job-training program or other workforce interventions that will be implemented with the Company to help candidates meet the requirements for the positions or to advance within the company which TRF may provide support for through its Workforce Services Department. **[Exhibit to be customized for each transaction.]**

The Company will report on employment goals quarterly and provide updates on other intended benefits as appropriate during the term of TRF-UGP's investment.

The parties to this Agreement hereby acknowledge that, in addition to business and financial achievements of the Company, TRF-UGP will strongly consider the Company's employment achievements in evaluating any follow-on financing or investments in the Company.

Agreed to this _______ day of _________ by and among:

Company

By:____ (Name and Title)

TRF Urban Growth Partners, L.P.

By: TRF Urban Growth Capital, L.P. (its general partner

By: TRF Urban Growth General Partner, LLC (its general partner)

By: ____ (name and title)

Source: UGP / The Reinvestment Fund, *Closing Papers*.

Exhibit 12. Urban Growth Partners Job Report

Urban Growth Partners Job Report

As of 06/30/2003

	CURRENTLY EMPLOYED				PROJECTED
Company Name	Low Income	Part-time	All Others	Total	ETAG Projected Jobs 5 Years
Ricochet Manufacturing Comp.	10	1	4	15	66
Sun and Earth	16	5	4	25	75
Verilaw Technologies, Inc.	1	2	18	21	40
Baltimore Dredges	0	0	0	0	110
Total	***27***	***8***	***26***	***61***	***291***

Company Name	**Investment**	**Expected Jobs**	**Investment per Job**
Ricochet Manufacturing Comp.	$2,000,000	66	30,303
Sun and Earth	$2,500,000	75	33,333
Verilaw Technologies, Inc.	$500,000	40	12,500
Baltimore Dredges	$1,500,000	110	13,636
Total	$6,500,000	$291	22,337

Source: UGP / The Reinvestment Fund.