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# Debt, Equity, and Free Money: How Local and State Governments Can Promote Minority Small Business Capital Access

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# EXECUTIVE SUMMARY

Economic development programs in California, like elsewhere, tend to support starting, growing, and relocating businesses within high-growth, regionally strategic sectors. Generally, the programs do not have explicit community development objectives (e.g., limiting gentrification and displacement of low-income and minority populations) and are not industries in which minorities are concentrated. Yet, across California and the rest of the country, local and statewide governments are testing new programs to advance minority small business capital access, create jobs, and promote community development as part of broader and more long-term competitive regional strategies. New programs leverage a range of capital products and many call for the participation of private-sector partners to co-fund and help execute. Income-based, place-based, and industry-specific structures allow government entities to reach underserved populations despite legal prohibitions related to discrimination against, or preferential treatment for, protected classes—including race and ethnicity.

However, there are pitfalls that may doom even the most innovative of programs. The following recommendations for local and state government will safeguard ongoing efforts to create impactful and sustainable minority small business capital access programs:

**Establish measurable impact goals and share outcomes** – A key shortfall among many programs is the lack of data collection or public access to existing data. Anecdotal evidence from the field is helpful, but legislators, economic development workers, and communities alike need data to identify areas of opportunity, to measure impact, and to ultimately justify support for future funding.

**Support and leverage federal programs** – Some federal economic development programs are at risk of losing their funding, including the Community Development Block Grant program and the Community Development Financial Institutions Fund, which underscores the recommendation to increase the evidence base for these programs through data collection. Where funding remains in place, and including new opportunities such as investment in the newly created Opportunity Zones, cities and states can be cost efficient and maximize impact by leveraging federal programs.

**Take the lead to coordinate programs across jurisdictions and sectors** – Strategies that integrate public funding from multiple levels of government with private capital—both institutional and, in the case of crowdfunding, from individual contributors—have greater buy-in across stakeholder groups and foster a sense of ownership among communities. These collaborations are also a necessity given general government budget limitations. Local and statewide legislators have the most familiarity with local infrastructure, public works, and economic development projects and are perhaps best positioned to marshal all parties and channel resources in their direction.

**Identify and address local implementation barriers** – Whether it be zoning requirements or tax policy, an unfriendly business climate may impede both the implementation of well-intentioned capital access plans and the ability of Black and Hispanic business owners to take advantage of them. Legislators are encouraged to assess the larger business climate in which businesses operate in order to ensure that entrepreneurs and small businesses have the best chance to succeed once capitalized.

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# BACKGROUND AND INTRODUCTION

In this brief, we explore how local and statewide governmental institutions can increase access to capital among Black and Hispanic entrepreneurs and small-businesses owners. The work is in conjunction with the Partnership for Lending in Underserved Markets (PLUM), a Milken Institute and Small Business Administration initiative to develop actionable solutions to address barriers that constrain Blacks and Hispanics from accessing capital to start and grow businesses. In addition to our national research and policy efforts, we are concluding pilot programs in Baltimore and Los Angeles to understand how local dynamics affect capital access in a given market. What follows is an outgrowth of our PLUM Los Angeles Public Policy Working Group (see Appendix A) to identify government solutions to increase local minority small business capital access.

Despite federal policies to prevent discrimination against minorities and low- and moderate-income borrowers, including through fair lending laws (the Equal Credit Opportunity Act and the Fair Housing Act), the Home Mortgage Disclosure Act, and the Community Reinvestment Act, Black and Hispanic entrepreneurs continue to experience higher loan denial probabilities and pay higher interest rates than White-owned businesses, even after controlling for differences in creditworthiness.[1] Limited credit history, lower net worth, and lack of assets to leverage as collateral also exacerbate capital access barriers.[2] These inequities extend to equity financing. For example, among U.S. venture capitalists, Black founding teams raise the smallest rounds of funding compared to all-White or mixed founding teams.[3] Only 15.3 percent of the entrepreneurs that presented their business concepts to angel investors were minority owned.[4] Blacks and Hispanics in Los Angeles County and California overall (both are majority-minority geographies) face the same disparities as the nation as a whole.[5]

[1] Robert Fairlie, Alicia Robb, and David T. Robinson, "Black and White: Access to Capital among Minority-Owned Startups," *Stanford Institute for Economic Policy Research*, December 2016. https://siepr.stanford.edu/sites/default/files/publications/17-003.pdf.

[2] Robert W. Fairlie and Alicia M. Robb, "Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs," *U.S. Department of Commerce, Minority Business Development Agency*, January 2010. http://docplayer.net/6498188-Disparities-in-capital-access-between-minority-and-non-minority-owned-businesses-the-troubling-reality-of-capital-limitations-faced-by-mbes.html.

[3] "Data Driving Important Discussions," presentation at the Diversity Data Roundtable at CB Insights' Galvanize SF, June 2015. https://www.slideshare.net/slideshow/embed_code/key/gL299OELEtADdQ.

[4] Jeffrey Soul, "A Cautious Restructuring of the Angel Market in 2016 with a Robust Appetite for Seed and Start-Up Investing," *Center for Venture Research*, May 2017. https://paulcollege.unh.edu/sites/paulcollege.unh.edu/files/cvr-reports/2016AnalysisReportFinal_0.pdf.

[5] Spencer M. Cowan, "Patterns of Disparity: Small Business Lending in the Chicago and Los Angeles-San Diego Regions," *Woodstock Institute*, January 2017. https://d3n8a8pro7vhmx.cloudfront.net/mainstreetalliance/pages/1/attachments/original/1485233286/Chicago_and_LASD_Report_FINAL.pdf?1485233286; "State of Latino Entrepreneurship," *Stanford Latino Entrepreneurship Initiative*, 2015. http://lban.us/wp-content/uploads/2015/11/Final-Report-.pdf.

And while there are federal programs to foster economic and small-business growth, many are at risk of losing funding over the coming years.[6] There is an urgent need for state and local policymakers to address barriers to minority small businesses capital access.

Economic development programs in California, like elsewhere, tend to support starting, growing, and relocating businesses within high-growth, regionally strategic sectors. In California this includes advanced manufacturing, biotech, healthcare, green infrastructure, and film and television.[7] Generally, the programs do not have explicit community development objectives (e.g., limiting gentrification and displacement of low-income and minority populations) and are not industries in which minorities are concentrated. In fact, some have been identified as industries that Black and Hispanic workers have difficulty entering. For example, the California Film Commission administers the $1.55 billion Film & Television Tax Credit Program 2.0, which provides tax credits based on qualified expenditures for eligible productions that are made in California.[8] Per a 2017 Milken Institute study on the entertainment industry, not only are minorities underrepresented in the industry, there is an opportunity gap for minority populations seeking to enter the industry.[9]

Federal and state laws do prohibit governmental institutions from discriminating against, or granting preferential treatment to, any individual or group on the basis of race, sex, color, ethnicity, or national origin in the operation of public employment, public education, or public contracting.[10] Still, while not targeting minorities specifically, there are government programs that can reach minority populations via income-based, place-based, or industry-specific programs. And while racial and ethnic impact data are not readily available in the public domain, government and community stakeholders alike report that programs like the California Capital Access Program for Small Businesses (CalCAP) and the now-defunct California Organized Investment Network (COIN) ultimately do, and did, effectively serve minority populations.

[6] "An American Budget: Major Savings and Reforms Fiscal Year 2019," *White House Office of Management and Budget*, 2019. https://www.whitehouse.gov/wp-content/uploads/2018/02/msar-fy2019.pdf.

[7] "Incentives by Industry," California Business Portal, accessed June 25, 2018, http://www.businessportal.ca.gov/incentives/incentives-by-industry/.

[8] "Film & TV Tax Credit Program 2.0," California Film Commission, accessed June 14, 2018, http://film.ca.gov/tax-credit/the-basics-2-0/.

[9] Jessica Jackson, Kevin Klowden, Joe Lee, Rebecca Simon, and Perry Wong with Mike Bernick, "New Skills at Work: Keeping Los Angeles at the Cutting Edge in an Evolving Industry," *Milken Institute*, 2017. http://www.milkeninstitute.org/publications/view/860.

[10] Cal. Const. art. I, sec. XXXI.

# BACKGROUND AND INTRODUCTION

Throughout California and across the country, local and state governments are experimenting with innovative solutions to promote minority small business and economic development. Some are creative approaches to financing and others more deliberately take on racial and ethnic disparities and seek to correct historical inequalities. To identify these solutions, the Milken Institute surveyed past and existing California programs and assessed promising programs from other markets. We supplemented the research with extensive qualitative interviews with stakeholders from federal, state, and local public, private, and nonprofit organizations (see Appendix B).

# CASE STUDIES

Inclusive economic growth advances capital access and economic opportunity for all segments of society. Below, we highlight innovative government programs that have the potential to support minority entrepreneurs and small businesses through a range of public and private partnerships and from a spectrum of capital providers and channels.

## DEBT

First are some example of debt programs in which businesses borrow money under the condition that it is to be paid back at a later date, usually with interest.

**Loan Loss Reserve Funds**

Historically, governments have incentivized small-business lending through loan loss reserve funds that enable lending institutions to take on riskier loans by guaranteeing to cover all or a portion of a loss.

Started in 1994, the California Capital Access Program for Small Businesses (CalCAP) provides participating institutions 100 percent coverage on losses as a result of certain small-business loan defaults.[11] Prior to 2010, CalCAP was entirely funded from the California Pollution Control Financing Authority (CPCFA) Small Business Assistance Fund (SBAF), a funding source established by fees collected from large companies financed through CPCFA's Pollution Control Tax-Exempt Bond Program.[12] In October 2010, the state legislature appropriated $6 million from the state General Fund to supplement CPCFA's funding. In 2011, CalCAP expanded rapidly due to receiving an allocation of federal funds through the State Small Business Credit Initiative (SSBCI), made available by the Small Business Jobs Act of 2010. CPCFA was awarded half of the total $168 million California allocation.[13] As of the end of 2015, CalCAP had provided $11 million in SSBCI contributions to loan loss reserves

[11] "California Capital Access Program (CalCAP) for Small Business," Office of the State Treasurer, accessed, https://www.treasurer.ca.gov/cpcfa/calcap/sb/index.asp.

[12] "California Capital Access Program (CalCAP) 2017 Annual Report to the Legislature," California Pollution Control Financing Authority, 2017, accessed, https://www.treasurer.ca.gov/cpcfa/calcap/annual/2017.pdf.

[13] Ibid.

[14] Ibid.

to provide credit enhancement for 6,592 transactions.[14] These investments leveraged $237 million in loans, provided a leverage ratio of almost 20 to 1, created 3,341 jobs, and retained 29,031 jobs, according to business owners. CDFIs have accounted for 86 percent of all CalCAP transactions.[15]

With federal funds currently exhausted, the State General Fund monies are again the main source of funding for loans enrolled in CalCAP for Small Business.[16] The state has begun funding its share of the reserve for newly enrolled loans through the “recapture” of reserves attributable to loans that have matured, thus reducing the growth of the reserve.[17] Lenders who would not agree to recapture have not been allowed to enroll for new loans, further reducing the program’s size and its ability to support its own administration.[18] Senate Bill 551, currently under review in the Assembly, would require that funds from the CalCAP portfolio and the Collateral Support program portfolio, as well as funds that have been returned or recaptured, be transferred from the CPCFA to the California Small Business Finance Center within the California Infrastructure and Economic Development Bank under Governor’s Office of Business and Economic Development.[19] The bill’s supporters believe this would better position the program to access new state funding.[20] While the bill does not request additional funding for the program, it will allow lenders to continue providing loans even if or when state funds are exhausted, which would make existing funds last longer and improve program sustainability.[21]

### Microloans

Despite recent movement among federal regulators to encourage small-dollar lending, large banks still do not find it cost effective to do so.[22] Yet, microloans—typically defined as very small, short-term loans with low interest rates, extended to self-employed individuals, new startups with very low capital requirements, or small businesses with only a few employees—are in high demand.[23] Microlending organizations, such as Kiva, Grameen America, and

[15] “California Capital Access Program (CalCAP) 2017 Annual Report to the Legislature,” California Pollution Control Financing Authority, 2017, accessed, https://www.treasurer.ca.gov/cpcfa/calcap/annual/2017.pdf.

[16] Ellen Siedman, “Capital Access Programs: CDFI Case Study on the California Capital Access Program,” *Urban Institute*, 2018. https://www.urban.org/sites/default/files/publication/98051/capital_access_programs_cdfi_case_study_on_the_california_capital_access_pograms_0.pdf.

[17] Ibid.

[18] Ibid.

[19] Ibid.

[20] Ibid.

[21] Ibid.

[22] Rachel Witkowski, “Pressure Mounts on FDIC, Fed to Follow OCC’s Small-Dollar Lead,” *American Banker,* July 2018. https://www.americanbanker.com/news/pressure-mounts-on-fdic-fed-to-follow-occs-small-dollar-lead.

[23] “What are Microloans?” Fundera, accessed July 2, 2018, https://www.fundera.com/business-loans/guides/microloans.

Opportunity Fund are helping to fill market demand by offering microloans between $500 and $50,000 in financing—Small Business Administration (SBA) microloans average about $13,000 each. Now cities are establishing their own microloan funds as well.

The City of Los Angeles established a Los Angeles Revolving Microloan Fund for microenterprises and small businesses in February of 2018 that aims to give out a total of $250,000 in loans annually and fund approximately 75 loans of $5,000 to $50,000, totaling $1,250,000, over the next five years through the Economic and Workforce Development Department (EWDD).[24] Funded through federal Community Development Block Grant (CDBG) dollars, the Fund will invest in microenterprises and small businesses that have difficulty obtaining financing through private lending institutions by applying more flexible underwriting criteria and loan terms (e.g., borrowers with a bankruptcy as recent as 12 months or businesses with a short operating history.[25]

Assistance for small businesses will require that the business meet an additional public benefit test of one job created for each $35,000 of assistance (or portion of $35,000 of assistance). This means that a small business borrowing $10,000 would be required to create one job, while a microenterprise borrowing the same amount would not have to meet this requirement. As a result, while the microloan program is available to small and microenterprises, the EWDD expects the program will be more attractive to microenterprises.[26] Still, the long-term goal is to support the economic growth and revitalization of Los Angeles communities by strengthening locally owned and operated microenterprises and small businesses that create and/or retain jobs for low- and moderate-income Los Angeles residents.[27] Based on a study conducted by the Opportunity Fund, the City estimates that every dollar loaned to a small business or microenterprise will generate approximately two dollars of economic activity and could generate $2,500,000 in stimulus to the Los Angeles economy.[28]

[24] "Los Angeles City Council Meeting Agenda," meeting of the Los Angeles City Council, February 2018. http://lacity.granicus.com/MediaPlayer.php?view_id=2&clip_id=17729; Jan Perry, "Amended Committee Transmittal: Economic and Workforce Development Department Recommendations to Establish a Revolving Microloan Fund Program," letter to the Honorable Eric Garrett, Mayor of the City of Los Angeles, November 2016. http://clkrep.lacity.org/onlinedocs/2015/15-1041-S3_rpt_EWDD_11-04-2016.pdf.

[25] Ibid., "Los Angeles City Council Agenda Friday, February 23, 2018."

[26] Perry.

[27] Perry.

[28] "Ripple Effect: The Macroeconomic Impact of Small Business Lending, A Case Study of Opportunity Fund's Small Business Microloan Program from 1995 to 2015," *Opportunity Fund*, June 2016. http://www.opportunityfund.org/assets/docs/Ripple%20Effect_The%20Macroeconomic%20Impcact%20of%20Small%20Business%20Lending_Opportunity%20Fund_2016.pdf.

### Alternative Underwriting

Generally, lenders make small-business credit decisions based on factors such as debt service coverage ratios, personal credit, company net worth, debt to asset ratios, and personal financial status.[29] Alternative criteria considers new types of information such as cash flow data and social media analytics, and even qualitative factors such as the business owner's character and the needs of the community.[30] Historically, Community Development Financial Institutions (CDFIs) have worked with entrepreneurs and small businesses with limited or poor credit to access capital, including making loans. Today, with many FinTech firms taking the lead, the entire financial services sector is testing new technologies and data to drive more responsive, responsible, and inclusive lending. Cities are taking note and applying alternative criteria to their own lending programs.

At the City of Long Beach's Microenterprise Revolving Loan Fund, underwriters consider more than credit scores when borrowers apply for fixed-rate loans (starting at $25,000) to finance equipment, fixtures, furniture, and working capital. Local, established businesses with five or fewer employees are evaluated also on "the character of the borrower and the strength of their business proposal."[31] Per the City, minority- and women-owned businesses make up approximately 70 to 80 percent of the loans in the $2.2 million portfolio and have low default rates.[32]

### Crowdfunding

Crowdfunding is the practice of obtaining needed funding, such as for a new business, by soliciting contributions from a large number of people, especially from the online community. There are different types of crowdfunding, including rewards-based, equity, and debt-based crowdfunding, and local and federal legislation for each type continues to evolve in real time. Crowdfunding can be a powerful tool for minority entrepreneurs who have a particularly difficult time securing financing and who are looking for startup funding.

[29] Meredith Wood, "What's the Small Business Loan Underwriting Process?" Fundera, accessed February 23, 2018, https://www.fundera.com/blog/small-business-loan-underwriting.

[30] Lael Brainard, "Community Banks, Small Business Credit, and Online Lending," speech from Governor Lael Brainard of the Federal Reserve System, September 2015. https://www.federalreserve.gov/newsevents/speech/brainard20150930a.htm.

[31] "City Loan Programs," Long Beach Economic Development, accessed May 30, 2018, http://www.longbeach.gov/economicdevelopment/business-development/city-loan-programs/.

[32] Seyed Jalali (economic development officer, Long Beach Economic Development), in discussion with the author. May 25, 2018.

Kiva, an international nonprofit microfinance company, is pairing microlending and debt-based crowdfunding to provide capital to small businesses and promote community development. In 2016, the City of Oakland partnered with Kiva to create the Oakland Kiva Loan Fund to facilitate local residents in providing zero percent interest crowdfunded loans to hundreds of area small business with a social mission and business owners who historically have been excluded from mainstream lending.[33] Oakland residents browse through business owners' profiles and can lend $25 or more towards a borrower's full loan request. Once residents have funded 100 percent of the requested loan amount, the borrower can access the capital.[34] Once repaid, lenders can relend their funds to another business or choose to withdraw their money.[35] The City of Oakland, OBDC Small Business Finance, Capital One, and the Miller Family Foundation match every dollar that individuals lend to an Oakland borrower, up to $225,000 per loan.[36] As of April 2018, Kiva has closed more than 530 zero percent interest loans, of which 90 percent supported businesses owned by people of color, and 70 percent were owned by women of color.[37]

The City of Long Beach has adopted a similar model, partnering with Kiva and the Los Angeles Local Initiative Support Corporation (LA LISC) to provide zero percent interest crowdfunded loans with up to a 36-month repayment period.[38] Borrowers can obtain loans between $500 and $10,000 through the program and LA LISC will match loan contributions made to Long Beach-based businesses.[39]

### Linked Deposit Programs

Several states, including New York, Missouri, and Kentucky, offer linked deposit programs that help small businesses obtain reduced-rate financing by lowering lenders' cost of capital.[40] Banks can lend money to those who meet the necessary requirements and have the capital to fund the loan replaced by deposits of state funds.

[33] Jason Riggs, "Kiva Oakland Launches to Support the Small, Local Business Owners Who Make Oakland Unique," *Kiva*, accessed May 30, 2018, https://www.kiva.org/blog/kiva-oakland-launches-to-support-the-small-local-business-owners-who-make-oakland-unique.

[34] Ibid.

[35] Ibid.

[36] Ibid.

[37] Brentin Mock, "Oakland Mayor Libby Schaaf is not Backing Down." *CityLab*. April 30, 2018. https://www.citylab.com/equity/2018/04/oakland-mayor-libby-schaaf-is-not-backing-down/559202/

[38] "City Loan Programs." Long Beach Economic Development.

[39] Ibid.

[40] "Linked Deposit Program." Empire State Development, accessed June 14, 2018, https://esd.ny.gov/linked-deposit-program; Eric Schmitt, "Missouri First,"Office of Missouri State Treasurer Eric Schmitt, accessed June 14, 2018, https://www.treasurer.mo.gov/content/low-interest-loans; and "Linked Deposit Loan Program." *Think Kentucky*, accessed June 14, 2018, http://www.thinkkentucky.com/kyedc/linkdeposit.aspx.

The lender charges the qualified borrower less than the normal rate of interest and the lender is reimbursed for this loss of interest by receiving a reduction in interest charged on a deposit in the amount of the loan.

A model with some staying power, Washington State's Linked Deposit Loan Program, has been providing reduced-rate financing to minority-, women-, and veteran-owned businesses for more than two decades. The deposit of state funds is made at below-market rates and the cost of capital savings are then passed on by the bank to the linked deposit borrowers in the form of an interest rate reduction not to exceed 2 percent.[41] As of spring 2018, over 490 certified firms had held $169 million in linked deposit loans that were in repayment or had available lines of credit.[42] These loans have helped to increase the number of businesses and employment opportunities for minority-, women-, and veteran-owned businesses throughout the state of Washington.[43]

## EQUITY

Many entrepreneurs prefer to issue stock in their companies, especially where cash flow is difficult to predict, making it tough to forecast repaying debts. Equity is typically secured from angel investors or venture capital firms. However, local and state governments are starting to partner with private-sector investors to strategically channel equity capital for community and economic development.

### Venture Capital

Venture capital, which provides seed funding for startups at their earliest stages of growth, has proved a strong impetus for small-businesses growth and creation, and cities and states are now using this channel to advance minority entrepreneurs and small businesses and ensure all populations reap the benefits.

[41] "Linked Deposit Program." Washington State Office of Minority & Women's Business Enterprises. https://omwbe.wa.gov/resources-small-businesses/linked-deposit-loan-program.

[42] "2015 Annual Report." Washington State Office of Minority and Women's Business Enterprises. https://app.leg.wa.gov/ReportsToTheLegislature/Home/GetPDF?fileName=OMWBE%20FY%202015%20Annual%20Report_fb07d4f9-4985-4421-ab7a-7fc27bdc21fe.pdf.

[43] Kathryn Akeah (communications consultant, Washington State Office of Minority and Women's Business Enterprise) in conversation with the author. June 21, 2018.

The $2 million New York State Minority and Women-Owned Business Investment Fund supports innovation, job creation, and high-growth entrepreneurship by investing in early-stage state-certified Minority- and/or Women-Owned Business Enterprises that are in emerging technologies and have a proprietary or differentiated product or service.[44] Since 2016, the State (through a competitively selected fund manager) has invested equity capital in six minority- or women-owned startups with matched private funder(s).[45] At the end of 2017, companies reported 98 jobs, two-thirds of which were newly created and can be attributed to the investment capital from this program.[46]

In August 2016, Elevate Capital announced that it had completed the first close of its $3 million Portland Elevate Inclusive Fund and $10 million Portland Elevate Capital Fund and had made investments in its first cohort of six women- and minority-led startups.[47] Elevate Capital is a Pacific Northwest-based venture firm that invests in early stage underrepresented entrepreneurs, including women and minorities that include communities of color, veterans, and entrepreneurs located in underserved regions. Investors in the Elevate Inclusive Fund were led by a $250,000 commitment from the State of Oregon, $500,000 from Multnomah County, and $500,000 from the Portland Development Commission, as well as additional investments from in- and out-of-state entrepreneurs. The fund provides $25,000 to $75,000 in early seed investments from its Inclusive Fund and up to $500,000 in seed and series A stage type investments from the Capital Fund. It will have additional funds available for follow-on investments from both funds. Per the City of Portland, the target founder demographics of the investments are 40 percent Black and/or Latino, 40 percent women, and 20 percent other underrepresented (e.g. veteran, LGBTQ).[48]

[44] "Minority and Women-Owned Business Investment Fund." New York Empire State Development, accessed June 13, 2018, https://esd.ny.gov/minority-and-women-owned-business-investment-fund.

[45] Sharon Rutter (senior director fund of funds, NY Ventures, Empire State Development) in conversation with the author. May 30, 2018.

[46] Ibid.

[47] "PDC partner Elevate Capital announces investments in minority and women-owned startups." *Prosper Portland*. August 31, 2016. https://prosperportland.us/pdc-partner-elevate-capital-announces-investments-in-minority-and-women-owned-startups/; "Inclusive Startup Fund," *Prosper Portland*. https://prosperportland.us/portfolio-items/inclusive-startup-fund/.

[48] Katherine Krajnak (entrepreneurship project manager, Prosper Portland) in conversation with the author.

## INCENTIVES AND SUBSIDIES

From a business perspective, nothing beats free money, and the public sector has a variety of tools to both incentivize institutional capital to invest in small businesses and subsidize small businesses directly.

### Tax Credits

Tax credits can promote community and economic development by reducing the amount of tax companies owe to the government for investing in businesses in specific locations, classifications, or industries. Unlike deductions and exemptions (which reduce the amount of taxable income), tax credits reduce the actual amount of tax owed.

The California Organized Investment Network (COIN), created in 1997, was a collaborative effort among the California Department of Insurance, the insurance industry, community affordable housing and economic development organizations, and community advocates.[49] The voluntary program attracted and leveraged private capital into CDFIs that yielded economic and social benefits for California's underserved markets by administratively facilitating insurance industry investments that benefited California's environment and its low-to-moderate (LMI) income and rural communities.[50] COIN awarded state tax credits to insurers and others investing in COIN-certified CDFIs equal to 20 percent of the qualified investment amount. These investments had to be $50,000 or more, have a minimum duration of 60 months, and be structured as equity, equity-like debt, or zero percent interest deposits.[51]

In 2016, Governor Jerry Brown vetoed Assembly Bill 2728, a proposal to renew the COIN CDFI Tax Credit Program as part of a package of bills that would have created new tax breaks or expanded existing tax breaks through 2017-2018.[52] While the COIN program initially had political support from community groups, insurance

[49] "About Us." California Department of Insurance, accessed May 8, 2018, http://www.insurance.ca.gov/0250-insurers/0700-coin/05-About-Us/.

[50] Ibid.

[51] Ibid.

[52] "Governor Brown Vetoes Legislation in Order to Help Maintain California's Fiscal Stability." Office of Governor Edmund G. Brown Jr. September 13, 2016. https://www.gov.ca.gov/2016/09/13/news19534/.

lobbyists were against new requirements for insurers to report on their investments.[53] And when the bill failed to include the Community Investment Survey (CIS) Data Call requirement for insurance companies with California premiums of over $100 million to report their investments, community groups ultimately withdrew their support as well.[54]

During its years in operation, state legislators increased the total amount of tax credits available through COIN from $2 million to $10 million, paralleling increased demand for the program, which ultimately outpaced supply. This increasing demand underscores the important role that COIN played in unlocking institutional capital for the benefits of underserved communities in the state of California.[55] Through the collaboration insurers wrote $124+ billion in premiums, invested $8 billion in green projects, and $6 billion in COIN high-impact holdings. Assuming 2014-2015 growth rates, state internal estimates of current COIN holdings are $28 billion to $29 billion.[56]

### Fee Waivers

The costs of starting a business often include local permitting, licensing, or other fees, which may be prohibitive to an early stage entrepreneur. Fee waivers reduce the cost burden and, especially when paired with technical assistance or other startup funding or services, may provide sufficient support to get a business up and running.

California's cannabis equity programs use fee waivers and other tools to support investment in a growing industry (annual sales are projected to reach $5.1 billion in 2019) and concurrently address the disproportionate impacts of cannabis law enforcement in disadvantaged communities.[57] In 2017, the City of Oakland created the nation's first cannabis Equity Permit Program that minimizes barriers to cannabis licensing for Oakland residents "who have been the most victimized by the war on drugs."[58] To qualify as an equity applicant, residents have to make less than 80 percent of the

[53] "Nonprofit Leaders Call on Insurance Lobbying Group to Support Transparency in COIN Reinvestment Program." August 17, 2016. California Reinvestment Coalition. http://www.calreinvest.org/news/nonprofit-leaders-call-on-insurance-lobbying-group-to-support-transparency-in-coin-reinvestment-program.

[54] "Letter Regarding Withdrawal of Support for Assembly Bill 2728." California Reinvestment Coalition. http://www.calreinvest.org/system/resources/.

[55] "California Organized Investment Network Impact Report." *Pacific Community Ventures*. June 2016. http://www.insurance.ca.gov/0250-insurers/0700-coin/10-Pub-News/upload/COIN-Impact-Report-Final-Digital.pdf.

[56] "Insurers Investing in a Better California." California Organized Investment Network. October 2016. http://www.insurance.ca.gov/0250-insurers/0700-coin/05-About-Us/upload/Social-Economic-Benefits-Infographic-V-10-2-16-FINAL.pdf.

[57] Jeremy Berke, "California's cannabis market is expected to soar to $5.1 billion — and it's going to be bigger than beer," *Business Insider*. February 28, 2018. http://www.businessinsider.com/california-legalizing-weed-on-january-1-market-size-revenue-2017-12 .

[58] "Become an Equity Applicant or Incubator." City of Oakland. http://www2.oaklandnet.com/government/o/CityAdministration/cannabis-permits/OAK068455

city's area median income—$56,300 for a one-person household in 2016—and either have had a conviction of a cannabis crime or lived for 10 years in a neighborhood where officers arrested people for cannabis-related offenses at disproportionately high rates.[59] The City's cannabis regulations reward general applicants that "incubate" equity applicants who provide a minimum of 1,000 square feet of free space for three years, plus security measures with prioritized permitting.[60] As of June 2018, Oakland had 185 equity applicants in incubation and was in the midst of developing a zero interest revolving loan fund for equity applicants using the first $3 million it has collected in business tax from non-dispensary cannabis businesses to date.[61]

The cities of San Francisco, Los Angeles, and Sacramento have likewise adopted equity programs for cannabis businesses growth.[62] In San Francisco, equity applicants may additionally qualify for permits if they lost housing after 1995 through eviction, foreclosure, or subsidy cancellation; attended school in the San Francisco Unified School District for a total of five years from 1971 to 2016; or lived in San Francisco census tracts for a total of five years from 1971 to 2016 where at least 17 percent of the households had income at or below the federal poverty level.[63] Equity applicants in San Francisco do not have to pay the $5,000 permit fee and can also benefit from an incubator partnership that provides rent-free space for three years or technical assistance to run their business. The City of Los Angeles cannabis social equity program will do a 2 to 1 match between equity businesses and companies that are already in existence and is focused on assisting owners who plan to hire at least half of their workforces from local residents.[64] Sacramento's program similarly offers applicants business and technical assistance to help start and grow their operations.[65]

[59] "Become an Equity Applicant or Incubator." City of Oakland. http://www2.oaklandnet.com/government/o/CityAdministration/cannabis-permits/OAK068455.

[60] Ibid.

[61] "Initial Permitting Phase Restrictions in Place Until Revolving Loan Fund Established and Implemented." City of Oakland. June 18, 2018. https://www.oaklandca.gov/news/2018/initial-permitting-phase-restrictions-in-place-until-revolving-loan-fund-esablished-and-implemented; Riley McDermid, "Oakland adds residency requirement for pot business owners." *San Francisco Business Times*. https://www.bizjournals.com/sanfrancisco/news/2017/03/09/oakland-residency-marijuana-businesses.html.

[62] Brentin Mock, "California's Race to the Top on Cannabis." *City Lab*. February 2018. https://www.citylab.com/equity/2018/02/the-racial-equity-race-to-the-top-on-cannabis-in-california/551912/.

[63] "Equity Applicant," San Francisco Office of Cannabis. https://officeofcannabis.sfgov.org/equity/applicant.

[64] "Overview of California Cannabis Equity Programs," Bureau of Cannabis Control, State of California. https://bcc.ca.gov/about_us/meetings/materials/20180301_equ_overview.pdf.

[65] "Law and Legislation Committee Report on Ordinance Establishing an Equity Program for Cannabis Businesses." City of Sacramento. November 14, 2017. http://sacramento.granicus.com/MetaViewer.php?view_id=21&clip_id=4090&meta_id=507341.

### Individual Development Accounts

Individual Development Accounts (IDAs) are matched savings accounts that enable low-income families to save money for a particular financial goal, including starting or expanding a small business.[66] Generally, IDAs operate similarly to other types of "matched savings" plans, such as 401(k) retirement accounts, whereby the account holder deposits money into a savings account and the funds are matched depending on the rules of the particular program or state law.[67] Federal funding for IDAs was zeroed out in May 2017, but states continue to operate their own programs.[68]

The Oregon Individual Development Account (IDA) Initiative is a state funded program managed by the statewide 501(c)3 nonprofit organization, Neighborhood Partnerships, in coordination with Oregon Housing and Community Services (OHCS).[69] It is supported by funding raised through the Oregon IDA Tax Credit. Donors, who can be individuals or businesses, receive up to a 70 percent Oregon state tax credit on their donation to the program. Participants typically receive a 3 to 1 match on their savings once they have completed all program requirements. In the 2016 program year, the IDA Initiative provided $6.4 million in matching funds to 1,140 participants who saved approximately $2.8 million. In 2016, about 325 participants (29 percent) used their funds to start or expand a microenterprise. Minorities leveraged the savings opportunity disproportionately to their population: Black residents (who make up four percent of the state's low-income population) represented 10 percent of participants and Hispanic residents (who account for 20 percent of the state low-income population) made up 23 percent of program users.[70]

[66] "Individual Development Accounts and Banks: A Solid 'Match.'" FDIC. 2007. https://www.fdic.gov/bank/analytical/quarterly/2007-vol1-1/idas.pdf.

[67] "Individual Development Accounts Fact Sheet." Prosperity Now. https://prosperitynow.org/sites/default/files/resources/Individual_Development_Accounts_1-pager.pdf_.

[68] "AFI Fact Sheet." U.S. Department of Health and Human Services. March 29, 2017. https://www.acf.hhs.gov/sites/default/files/ocs/afi_fact_sheet_march_2017.pdf_.

[69] "Oregon Individual Development Account Initiative Program." Oregon Housing and Community Services, accessed June 26, 2018. https://oregonidainitiative.org/overview/.

[70] "Oregon IDA Initiative Evaluative Report." Oregon Housing and Community Services. January 2018. https://oregonidainitiative.org/wp-content/uploads/2018/02/NP_Evaluation-Report_Jan-2018_v071.pdf.

# CONCLUSIONS AND RECOMMENDATIONS

Across California and the rest of the country, local and statewide governments are testing new programs to advance minority small business capital access, create jobs, and promote community development as part of broader and more long-term competitive regional strategies. New programs leverage a range of capital products and many call for the participation of private-sector partners to co-fund and help execute. Income-based, place-based, and industry-specific structures allow government entities to reach underserved populations despite legal prohibitions related to discrimination against, or preferential treatment for, protected classes—including race and ethnicity.

The following recommendations for local and state government will support ongoing efforts to create impactful and sustainable minority small business capital access programs:

**Establish measurable impact goals and share outcomes** – From CalCAP to COIN and new venture capital schemes to legacy IDA programs, a key shortfall among almost all programs is the lack of data collection or public access to existing data. Anecdotal evidence from the field is helpful, but legislators, economic development workers, and communities alike need data to identify areas of opportunity, measure impact, and ultimately justify support for future funding.

**Support and leverage federal programs** – Some federal economic development programs are at risk of losing their funding, including Community Development Block Grants (which fund, for example, the Los Angeles Revolving Microloan Fund) and the Community Development Financial Institutions Fund (beneficiaries of numerous debt programs), which underscores the recommendation to increase the evidence base for these programs through data collection.

Where funding remains in place, including new opportunities such as investment in the newly created Opportunity Zones, cities and states can be cost efficient and maximize impact by leveraging federal programs.

**Take the lead to coordinate programs across jurisdictions and sectors** – Strategies that integrate public funding from multiple levels of government with private capital—both institutional and, in the case of crowdfunding, from individual contributors—have greater buy-in across stakeholder groups and foster a sense of ownership among communities. Most of the programs reviewed in this brief demonstrate some level of multisector engagement (e.g., municipal partnerships with the nonprofit Kiva and cross-jurisdiction cooperation with Portland's Elevate Funds). These types of collaborations are also a necessity given general government budget limitations. Local and statewide legislators have the most familiarity with local infrastructure, public works, and economic development projects and are perhaps best positioned to marshal all parties and channel resources in their direction.

**Identify and address local implementation barriers** – Whether it be zoning requirements, tax policy, or excessive administrative fees, an unfriendly business climate may impede both the implementation of well-intentioned capital access plans and the ability of Black and Hispanic businesses to take advantage of them. Legislators are encouraged to assess the larger business climate in which businesses operate in order to ensure entrepreneurs and small businesses have the best chance to succeed once capitalized.

# APPENDIX

## APPENDIX A: PARTNERSHIP FOR LENDING IN UNDERSERVED MARKETS (PLUM) LOS ANGELES POLICY WORKING GROUP

With thanks to the PLUM Los Angeles Policy Working Group for their leadership and editorial feedback and ongoing commitment to improve minority capital access in Los Angeles:

- Chair: Tunua Thrash-Ntuk, Executive Director, Local Initiatives Support Corporation (LISC)
- Robin Billups, Director, The Billups Group
- Ronald Lowe, Former Senior Director of Finance, Office of the Los Angeles Mayor's Minority Business Development Agency
- Sam Taussig, Head of Policy, Kabbage

## APPENDIX B: STAKEHOLDER INTERVIEWEES

This brief would not be possible without the invaluable input of the following individuals:

- Kathryn Akeah, Communications Consultant, Washington State Office of Minority and Women's Business Enterprises. June 21, 2018.
- Monica Guevara, Managing Director of Programs, VEDC. March 19, 2018.
- Carolyn Hull, Vice President of Industry Cluster Development, LAEDC. March 15, 2018.
- Seyed Jalali, Economic Development Officer, City of Long Beach. May 25, 2018.

• Brian Keil, Senior Director, Fund of Funds, NY Ventures. May 30, 2018.

• Gail Lara, Director, Women's Collaborative Mentoring Program, The Valley Economic Alliance. April 26, 2018.

• Stacie Olivares-Castain, Senior Advisor, Impact Investments and Blockchain, State of California. March 20, 2018.

• Everett Sands, CEO, Lendistry. March 28, 2018.

• Jesse Torres, Deputy Director, Small Business and Innovation, California Governor's Office of Business and Economic Development. March 30, 2018.

• Sharon Rutter, Senior Director, Fund of Funds, NY Ventures, Empire State Development. May 30, 2018.

# ABOUT US

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- Matt Horton, Associate Director, California Center
- Sam Hanigan, Programming and Outreach Coordinator

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