Catalytic Capital *for* BIPOC Wealth Creation

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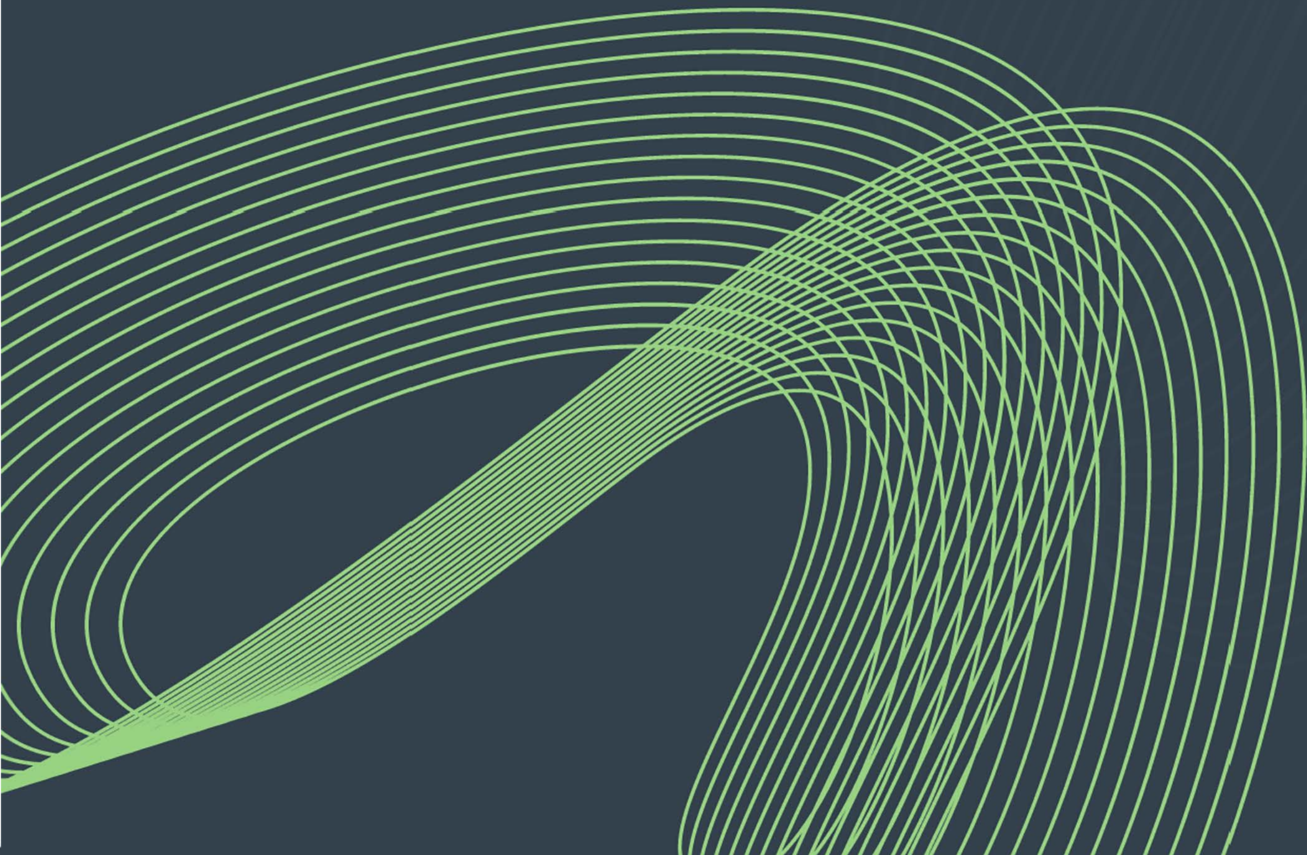

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ABOUT NGIN

New Growth Innovation Network (NGIN) is a knowledge, insight, and innovation hub, supporting economic development practitioners advance inclusive economic growth in their region. Established in 2018, NGIN works to close structural opportunity gaps to ensure that economically disenfranchised people of color, women, and neglected geographies are a core part of regional economic growth and prosperity.

AUTHORS

Strategic input and guidance throughout the project was provided by Erika Seth Davies, CEO of Rhia Ventures and founder of The Racial Equity Asset Lab (The REAL) and Lyneir Richardson, Executive Director of The Center for Urban Entrepreneurship and Economic Development (CUEED) at Rutgers Business School and co-founder and CEO of Chicago TREND.

The research, insights, and recommendations for this project were developed by M. Yasmina McCarty and Swati Ghosh on the NGIN team with input from Keena Smith of Catalyst Strategic Impact Advisors and Bryan Fike.

PROJECT METHODOLOGY AND EXPERT STAKEHOLDERS

New Growth Innovation Network engaged expert practitioners (named in the appendix) as well as shared preliminary findings for review at practitioner roundtables. This project relied on desk research, analysis and stakeholder engagement with BIPOC leaders, investors, philanthropy, and economic development practitioners working to advance economic justice. NGIN is grateful to the stakeholders whose insights and contributions shaped this work.

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Executive Summary: Key Findings and Opportunities for Action

The Catalytic Capital Consortium (C3) provided a grant to New Growth Innovation Network (NGIN) under the "Strengthening the Evidence Base" grant program. C3 is an initiative created and led by the John D. and Catherine T. MacArthur Foundation, The Rockefeller Foundation, and the Omidyar Network. The grant provided funding to synthesize evidence on catalytic investments that have aimed to address the racial wealth gap and catalyze additional capital flows through investments in a range of sectors and asset classes.

In this project, NGIN endeavored to:

1. Analyze catalytic investments focused on wealth creation for BIPOC.
2. Analyze the conditions and previous catalytic investments that enabled private sector racial justice capital commitments in 2020.
3. Translate insights into investor-relevant evidence on catalytic capital for community and economic infrastructure that supports BIPOC wealth creation.

The project was delivered by the team at NGIN and advised by two leading experts, Erika Seth Davies, CEO of Rhia Ventures and founder of The Racial Equity Asset Lab (The REAL), and Lyneir Richardson, Executive Director of The Center for Urban Entrepreneurship and Economic Development (CUEED) at Rutgers Business School and co-founder and CEO of Chicago TREND.

A. KEY FINDINGS

As the country rebuilds from the economic toll of the covid-19 pandemic, investors, business leaders and citizens are looking for investments which explicitly focus on wealth creation for Black, Indigenous and Persons of Color (BIPOC) and investments which will deliver a more equitable and inclusive economy. The insights in this project lifted up three key findings:

1. **Racialized definitions of risk continue to hold back capital -** Racialized definitions of risk and return are ubiquitous. These overstated levels of risk hold back traditional capital flows to BIPOC households, business owners, entrepreneurs, and fund managers, forcing catalytic capital and other impact capital to fill this gap. Catalytic capital has an important role to play, but efforts should still be made to correct the biases entrenched in traditional capital to unlock investment capital at scale. Additionally, the definition of catalytic

capital itself should be evaluated whether it is based on stereotypical understanding of risk and return, even as it aims to target capital towards communities and individuals that are traditionally underinvested.

2. **2020 financial commitments can mostly be viewed as market corrections rather than catalytic** – Although many corporations and financial institutions made significant financial commitments in the summer of 2020 to address racial disparities, early evidence indicates that commitments have not translated into equitable outcomes. Increasing the amount of capital available in certain product areas, especially housing and small business lending, is merely a market correction. Lack of product innovations, narrow investments in single asset class/issue area (e.g., home ownership), and limited shared risk/reward equity products limit longer term wealth creation potential for BIPOC. Structural change is what is needed to unlock the potential for BIPOC wealth creation.

3. **There is evidence of catalytic capital investments which can be scaled –** New funds, bold investors, and cutting-edge investment thesis are in the market and working as catalytic capital. This report captures examples of investors who have led catalytic capital transactions as well as investees and the models they are advancing for BIPOC wealth creation. These structures and approaches can be further scaled and the actions of the early investors are likely to unlock additional funding in the field.

B. OPPORTUNITIES FOR ACTION

These findings point to three potential areas for action:

1. **Remove racialized risk frameworks and individual biases** which continue to limit capital flows by overstating risk levels associated with BIPOC individuals and asset owners. Catalyze more traditional capital investments that advance BIPOC wealth creation by identifying and removing racial bias in risk assessment at the systems level (e.g. home appraisals), input data and financial analysis for underwriting (e.g. credit scoring), norms within the finance industry (e.g. undervaluing BIPOC fund managers), and retail investment products (e.g., overstating perceived risk of a BIPOC entrepreneur).

2. **Continue to innovate investment products** which truly advance BIPOC wealth creation. Consider more innovative structures and investment products in asset

classes which build wealth, e.g., innovate equity product offerings where debt products are dominant (i.e., home ownership and entrepreneurship). And consider catalytic capital as a foundational investment in place-based investments which produce individual and community real estate wealth, e.g., place-based, community-led projects or community-owned models which truly build BIPOC wealth.

3. **Invest at scale and underpin equity investments with operational capital**. The field is calling for investments at scale, especially for funds led by BIPOC and for funds with an investment thesis which advances BIPOC wealth, i.e., community wealth building models, employee ownership, real estate developers of color, etc. Given the limited fund sizes in the field, operating capital is also required to accompany equity investments, as the fees generated from assets under management (AUM) is not significant enough to invest in adequate team capacity.

Project Background

Policies and institutional practices in the United States have resulted in a staggeringly high and persistent racial wealth gap. Blacks constitute thirteen percent of America's population but hold less than three percent of its wealth. The average wealth of white American families is seven and five times that of Black and Latino families, respectively.

The seismic events of 2020—the covid-19 pandemic and the national demand for racial justice—unlocked sizeable private sector financial commitments to advance racial equity. This capital is welcome and needed, but its narrow focus on housing and small business makes it insufficient to dismantle the racial wealth gap. Professor William Darity Jr. and others have highlighted that narrow investment targets are inadequate to address the systemic underinvestment which has resulted in the racial wealth gap. "None of the myths commonly offered to explain away the racial wealth gap–a need for greater educational attainment, homeownership, or entrepreneurship…a lack of financial literacy …come close to accounting for the vastness of the gap."

As the country rebuilds from the economic toll of the covid-19 pandemic, investors, business leaders, and citizens are looking for investments which explicitly focus on wealth creation for Black, Indigenous and Persons of Color (BIPOC) and investments which will deliver a more equitable and inclusive economy. These investors are willing to move beyond existing investments in housing and small businesses and make bolder investments to advance BIPOC wealth, but there is insufficient data to guide investment decisions. Few efforts have aggregated and synthesized insights from "catalytic capital"[1] which is focused on closing the racial wealth gap and creating wealth for BIPOC. This lack of evidence holds back a significant opportunity for further investment at an urgent moment.

In this project, NGIN endeavored to:

1. Analyze catalytic investments focused on wealth creation for BIPOC, synthesizing the positive outcomes and impact and where funding has acted as catalytic. This retrospective element was the primary focus of the learning agenda.

[1] We use the Tideline definition of catalytic capital as "debt, equity, guarantees, and other investments that accept disproportionate risk and/or concessionary returns relative to a conventional investment in order to generate positive impact and enable third-party investment that otherwise would not be possible."

2. Analyze the conditions and previous catalytic investments that enabled private sector racial justice capital commitments in 2020, focusing on the 220+ companies with external commitments most aligned to economic justice.
3. Translate insights into investor-relevant evidence on catalytic capital for community and economic infrastructure that supports BIPOC wealth creation.

The approach to this project included desk research, analysis and stakeholder engagement with BIPOC leaders, investors, philanthropy, and, economic development practitioners working to advance economic justice. The ambition of the project was to quantitatively analyze specific transactions / sets of transactions to provide insights on the financial terms of catalytic investments, however, this primary data proved challenging to come by. While the focus of the research was mostly retrospective, the project also aimed to identify additional investment opportunities for catalytic capital to enable greater wealth creation for BIPOC, target the racial wealth gap and advance an inclusive economic recovery from covid-19.

Drivers of the Racial Wealth Gap

The drivers which produced the racial wealth divide are not exactly the same as areas where investment is needed to support wealth creation but are an important starting point. A non-comprehensive list of financial policies and asset destruction which contributed to the racial wealth gap include:

- **Restricted access to home ownership for BIPOC** – Home ownership is the principal way American families create wealth, both historically and today. Discrimination and restrictions on BIPOC homeownership are a huge contributing factor for the modern racial wealth gap. Policies like redlining meant BIPOC homeowners couldn't invest and/or refinance their home to strengthen their asset; contractual agreements in places like Chicago locked neighborhoods in long-term rental agreements; and covenants across U.S. neighborhoods prevented BIPOC families from owning assets in neighborhoods where property values were appreciating. Many such policies were in place until as recently as 1968 when the Fair Housing Act ended legal discrimination in renting and selling homes.
- **Occupational segregation and pay disparities** – Rules, policies, and norms greatly limited the professional fields where BIPOC could work and move into senior leadership positions, which accelerates wealth creation. Occupational segregation, i.e., overrepresentation of BIPOC workers in certain types of occupations, mostly lower paying with no or limited benefits, is still strong today in many regional labor markets, leading to limited opportunities for

generating higher incomes and passing down wealth to younger generations among BIPOC families. Even within professional fields and higher paying occupations, discrimination results in Black and Latino workers earning less than their white counterparts.

- **Lower returns on higher education and underinvestment in education systems** – Black Americans earn less than white counterparts across all levels of educational attainment, showing that education attainment alone does not always translate to higher incomes. More broadly, research shows patterns of underinvestment in HBCUs and underinvestment in K12 schools in majority-BIPOC communities despite serving the same number of students, demonstrating the continued patterns of disinvestment in pathways for wealth creation for BIPOC.
- **Asset destruction** – The most egregious examples of economic injustice are outright destruction of BIPOC-owned land and businesses and/or assets taken away forcefully. Examples like the Greenwood District in Tulsa, the Rosewood Massacre in Florida, or Bruce's Beach in California all show tangible ways that economic assets which produced income and could have accreted into long-term inter-generational wealth creating assets were destroyed.

The exclusion and restriction of BIPOC from wealth generating opportunities has been systematic and systemic. Even if BIPOC access each of the three broad pathways of wealth creation – education, entrepreneurship and homeownership – actions taken unilaterally by BIPOC individuals and families are insufficient to close the racial wealth gap. Bold anti-racist policies at the national and local level are needed that address these historic economic injustices.

Role of Catalytic Capital in Advancing BIPOC Wealth Creation

A. DEFINITION OF CATALYTIC CAPITAL

“Catalytic Capital” accepts disproportionate risk and/or concessionary return to generate positive impact and enable third-party investment that otherwise would not be possible, as defined by Tideline.

The key elements of this definition are:

- **Disproportionate risk and/or concessionary return** – real vs perceived risk
- **Positive impact** – appropriate metrics aligned to desired impact
- **Third-party investment** - from those who cannot accept high levels of risk
- **Additionality** - "but for" requirement

Importantly this definition is linked to sources of capital, and the spectrum of accepted risks and expected returns, whereby catalytic capital is in between impact investment and philanthropic grantmaking.

CONVENTIONAL INVESTING
RESPONSIBLE INVESTING
SUSTAINABLE INVESTING
IMPACT INVESTING
PHILANTHROPIC GRANTMAKING

Seek market-rate, risk-adjusted financial returns
Mitigate Environmental, Social, and Governance (ESG) risks
Pursue ESG opportunities
Contribute to measurable, targeted impact solutions
Catalytic capital: Fill capital gaps for impact enterprises and facilitate additional investment

Source: Catalytic Capital Unlocking more investment and impact. March 2019. Tideline.

For additional information on catalytic capital, please refer to Appendix 2.

At the heart of this definition, catalytic capital investments are able to take disproportionate risk and/or accept concessionary returns. **But the terminology on "disproportionate risk" must be interrogated, to tease out quantifiable investment risk versus perceived risk. Indeed, disentangling racial bias – which leads to racialized definitions of risk – and its impacts on risk assessment is essential to determining where traditional investment capital is being unnecessarily constrained versus where catalytic capital may truly be needed.**

B. RACIAL BIAS IN RISK ASSESSMENTS AND INVESTMENT NORMS

NGIN considered to what extent "perceived risk" limits investment or worsens investment terms for assets and enterprises owned and/or led by BIPOC and how racial bias may influence capital transactions at the individual level. NGIN also considered where racial bias influences decision making within the finance sector, especially key input data, e.g., credit scores, zip code, appraisal data, etc. which determine investment outcomes. Lastly, NGIN considered both individual racial bias (i.e., when an individual critical to the investment decision process has a bias that assigns additional risk to a BIPOC individual or undervalues their asset(s)) and systemic racial bias (i.e., when input data and analysis rubrics undervalue BIPOC assets and/or overstate risk).

Below are four ways racial bias and investment norms manifest to limit the traditional capital flows to advance BIPOC wealth creation:

1. Perceived risk and/or racial bias at the individual level:
    - Discrimination at retail banking level, e.g., home lending – Consumer Financial Protection Bureau (CFPB) indicates that Black applicants were more than twice as likely as white applicants to be denied conventional home-purchase loans in 2019. Additionally, Black borrowers who did receive loans were charged higher rates on both conventional and nonconventional loans.
    - Systematic devaluation of individuals/lack of "creditworthiness" – Black and Latino borrowers are denied access to credit more often than white borrowers, even when controlling for income, requested loan amounts, and neighborhoods.

- Undervaluing BIPOC led small- and micro-businesses and/or their assets – small businesses led by BIPOC face significant barriers to access capital, such as fewer Black-owned businesses receive loans in their founding year as compared to white businesses, are denied loans more often than their white peers, pay higher interest rates when they do get loans, etc.
- Undervaluing high-growth BIPOC-led firms – Despite receiving record levels of venture capital funding in 2021, Black founders received barely more than 1% of all VC investment in 2021.

2. Perceived risk and/or racial bias within the finance sector:
   - Overlooking and undervaluing fund managers of color – Funds owned by people of color and women face higher levels of scrutiny and receive lower investments than their white-male counterparts from asset allocators, who collectively manage close to $70 trillion globally.
   - Sampling Bias - "sampling bias" exacerbates the issue of racial bias in definitions of risk and returns. The low number of BIPOC-led funds restricts broader, longitudinal analysis and perpetuates the idea that they are not the norm and therefore must be riskier, even though research shows that BIPOC-led funds perform equally well as white male-led funds. On the small business side, BIPOC are disproportionately underrepresented in high-growth sectors and are over-represented in micro-business, impacting the returns potential in BIPOC-led entities, thereby being overlooked for investment.
   - Lack of familiarity – As decision makers and asset managers are often white and male, there is a great deal of unfamiliarity with BIPOC as individuals and asset owners, which can become self-perpetuating.

3. Perceived risk and/or racial bias in analysis frameworks and input data systems:
   - Appraisals of homes in majority Black neighborhoods - A 2018 study from Brookings found that homes in majority Black neighborhoods were appraised for 23 percent less than properties in mostly white neighborhoods, leading to a$156 billion cumulative loss in value nationwide.
   - Collateral availability for Indigenous families who may be unable to mortgage their home on trust lands, impacting ability to borrow and/or collateralize a loan.

- Undervaluation of businesses owned by persons of color or businesses in zip codes – Brookings research finds that highly rated businesses (irrespective of race of the business owner) in majority-Black neighborhoods perform more poorly in terms of revenue growth as compared to less highly rated businesses in other neighborhoods. This leads to loss of billions of dollars in unrealized revenue for businesses in Black neighborhoods.
- Credit Score – Most credit scoring agencies do not incorporate payments of rent, utilities and phone bills to calculate credit scores, but rather rely on higher-value debt-based transactions like car ownership and homeownership. This underestimates credit worthiness of lower income households, where on time payments of monthly expenditures such as rent could greatly enhance credit scores.

4. Investment norms - Finally, there are investment norms that hold back investments in firms and assets owned by people of color. These are not hard coded investment rules, but widely used to guide investment decisions:

- VC's look favorably on entrepreneurs who have invested their own money into their start up, which can exclude entrepreneurs who do not benefit from generational wealth or were not high earners before starting their company.
- Investors look favorably on fund managers who invested their own money in the fund, which is a norm that could exclude BIPOC fund managers if they launched their fund before they had that level of wealth to invest.
  - Fund managers may not have the "typical" background for a first-time fund manager – only 3% of investment partners at venture capital funds are Black.
  - Women and people of color manage less than 2% of the nearly $70 trillion global value in mutual funds, real estate, private equity, and racialized perceptions of risk in the asset management industry may be part of the reason why.
  - Personal fund contributions from fund managers are an important tool for general partners to demonstrate alignment of interests with limited partners. Given a 1% expected contribution and an average size of $24 million for first-time funds, fund managers would need to contribute $240,000 to meet this industry norm. Racialized wealth gaps, social networks, and lack of intergenerational wealth can be major barriers to potential Black fund managers raising their first funds.

- Confluence Philanthropy's report "Advancing Racial Equity in Impact Investing through Manager Diversity" showed that investors look for multiple endorsements from across their professional network, which can also exclude BIPOC fund managers outside of those networks.

Looking across investment contexts, there is clear data showing racialized definitions of risk. **These overstated levels of risk are holding back traditional capital flows to BIPOC households, business owners, entrepreneurs and fund managers.** Because traditional capital is overstating risk for BIPOC individuals and assets, it forces catalytic capital and other impact capital to fill this gap. Catalytic capital has an important role to play, but efforts should still be made to correct the biases entrenched in traditional capital to unlock investment capital at scale.

C. 2020 RACIAL EQUITY CAPITAL COMMITMENTS: MARKET CORRECTIONS OR CATALYTIC CAPITAL?

America's corporations, especially financial institutions, and their foundations collectively committed $66 billion in the immediate aftermath of George Floyd's murder. These investments were welcome announcements, given their scale. Additionally, these commitments brought in new stakeholders and built new capacity in finance departments on the positive role corporate balance sheets could play to advance racial equity.

Looking across the commitments, there was a range of tactics proposed:

- Pathways and capital access to home ownership
- Investing in the growth of businesses owned by BIPOC
- Procuring from businesses owned by BIPOC e.g., Best Buy committed to spending $1.2 billion with BIPOC and Diverse Businesses By 2025
- Investments to strengthen CDFI balance sheets, enabling their scale and/or their ability to take increased risk e.g., Netflix invested in Hope Credit Union

> "Profit-driven corporations will not propel transformational change with money alone, experts say. That will require corporate and government policy changes aimed at addressing the historic destruction of Black wealth said Mehrsa Baradaran, a law professor at the University of California at Irvine."

Approximately half of the commitments focused on capital access for housing. JPMorgan Chase and Bank of America made significant commitments to supporting BIPOC home ownership, aiming to reach an estimated 100,000 households over five years and Wells Fargo committed to reach 250,000 over 10 years. However the

National Fair Housing Alliance considers the racial-gap in home ownership to be approximately 5 million households, so these commitments are small in relation to the market gap. Additionally, while the commitments and press releases describe a race-explicit commitment on housing, the lending policies are not always race-explicit. Many banks focus on making home loans available in low- and middle-income neighborhoods and/or making loans available in predominantly Black and Latino neighborhoods, hoping to reach potential BIPOC homeowners, but recognizing that anyone can use these lending tools.

Approximately a quarter of the commitments focused on capital for small businesses. Many commitments in this category expanded lending capacity of fixed-term small business loans. Fewer commitments offered flexibility in terms (collateralization, tenure, interest rates, etc.) or offered product innovation (shared risk/reward models, revenue-based financing). It was unclear if new approaches and anti-racist processes were comprehensively adopted by financial institutions to ensure equitable access to this new small business capital.

While the national corporate engagement on racial equity in 2020 was welcome, it is important to consider whether these investment approaches are catalytic. NGIN considered whether these commitments were "market corrections" to unlock traditional capital, or catalytic capital to advance BIPOC wealth. This increase in volume of capital of existing products rather than product innovations or investment process improvements, suggest "market corrections" of missing capital supply. The focus on fixed-term debt products within housing and small business lending also suggests an increased allocation of traditional capital rather than investments meeting the definition of catalytic capital. These new commitments appear as market corrections to remedy historical failures in housing and small business capital markets than catalytic capital to truly advance BIPOC wealth.

Catalytic Capital Examples for BIPOC Wealth Generation

In considering which investments to lift up as examples of catalytic capital aimed at BIPOC wealth generation, NGIN considered two areas in recent history: Investments in Community Development Finance Institutions (CDFIs) and investments in diverse asset managers. Philanthropy invested an estimated $300+ million to the earliest CDFI pioneers and other promising groups which helped build a durable infrastructure for impact at scale. When the covid-19 pandemic hit, some 1,300 certified CDFIs across the country were managing $220+ billion in assets. Additionally, well known and successful asset managers of color are highlighted as early catalytic capital investments, such as John W. Rogers, Jr.,

Chairman, Co-CEO & Chief Investment Officer of Ariel Investments and Eddie C. Brown, Founder, Executive Chairman, and Senior Portfolio Manager of Brown Capital Management. Both firms were founded in 1983 and remain leading funders in the field.

But the success of the Asset Manager pioneers in the 1980s did not unlock a wave of funding into subsequent asset managers of color. And while CDFIs play a vital role in their communities to create capital access, there are criticisms that the sector today is unable to take on higher risk and/or make higher impact investments, given the credit and risk constraints CDFIs face from their capital sources.

NGIN therefore, looked to more recent catalytic capital investments which could illuminate the ways catalytic capital is specifically targeting opportunities for BIPOC wealth creation.

INVESTOR / INVESTMENT	APPROACH TO BIPOC WEALTH CREATION	CATALYTIC ROLE OF THE INVESTMENT
Surdna Foundation's investments in 1863 Ventures and Founders First Capital Partners	1863 Ventures accelerates New Majority Founders with a vision to generate $100 billion of New Majority wealth by 2030. Founders First Capital Partners provides revenue-based financing for inclusive businesses (led by women, people of color, LGBTQ+, military veterans) and businesses located in low to moderate-income areas.	**Seeding:** Surdna Foundation supported early-stage BIPOC fund managers and efforts to diversify the finance sector.
Rockefeller Zero Gap Fund's investment in Apis & Heritage Capital Partners	Apis & Heritage is attacking the racial wealth gap and helping to restore dignity and status to the American Worker with the preservation and wealth creation power of employee ownership.	**Scaling**: The Zero Gap Fund seeks catalytic opportunities that demonstrate scale over 5 – 10 years.

Expanding Black Business Credit and Black Vision Fund	Expand lending to BIPOC-owned small businesses. Expand capacity and balance-sheets of CDFIs.	**Seeding and Scaling:** A Wells Fargo grant helped seed the fund; Other investors helped scale it while providing attractive terms for the CDFIs.
Black Economic Development Fund	Grow capacity of Minority Depository Institutions (MDIs), Black-owned businesses and real estate developers, as well as Black-led anchor institutions to catalyze additional investment and scale.	**Seeding and Sustaining:** The funding is catalytic in building what the fund manager characterized as "network wealth".

Case studies are based on desk research and primary stakeholder engagement rather than analysis of term sheets and transaction data, which was not available. Each case study captures information on the investment as well as the catalytic capital concession(s) built into the catalytic capital using the "five P's framework" first articulated by MacArthur Foundation's Debra Schwartz and synthesized in Tideline Catalytic Capital March 2019 report.

Price - accepting an expected rate of retyrn that is below-market relative to expected risk.

Pledge - providing credit enhancement via a guarantee.

Position - providing credit enhancement via subordinated debt or equity position.

Patience - accepting a longer or especially uncertain time period before exit.

Purpose - accepting non-traditional terms to meet the needs of an investee (unconventional or no collateral, self-liquidating structures, smaller investment sizes, higher transaction costs, etc.)

1. **1863 Ventures and Founders First Capital Partners**

In 2017, Surdna Foundation launched a $100 million commitment to impact investing with a combination of mission-related investments (MRIs) and program-related investments (PRIs). The MRIs yield risk-adjusted returns and the expectation that some of these investments will be additive to the endowment. PRIs in Surdna's Inclusive Economies Portfolio include investments that facilitate

innovation and help build track records for emerging funds and BIPOC fund managers.

1863 Ventures - Surdna Foundation invested $1 million of a $10 million fund in 1863 Ventures that invests in high potential business owners of color to provide them with the capital and business know-how to become high-growth businesses and close racial wealth gaps. 1863 Ventures was a first-time fund manager at the time of the investment and therefore based on the perceived risks and norms of first-time fund managers, this investment could be classified as catalytic capital. The more significant catalytic effect, according to Surdna Foundation, was the crowding-in of other investors.

Founders First Capital Partners – Surdna Foundation, Rockefeller Foundation and others supported Founders First Capital Partners, which invests in diverse businesses using a revenue-based financing product. A $11 million Series A financing round in Founders First Capital Partners accelerated deployment of a $100 million credit facility from Community Investment Management.

There were price, pledge and purpose concessions built into these catalytic capital investments:

- **Price and Pledge:** At Surdna, Program Related Investments (PRIs) are typically low- to no-interest loans and other financial instruments, including guarantees.
- **Purpose:** In traditional due diligence processes and industry norms, the fund managers' financial contribution to the fund is an important factor. For BIPOC/first time/other fund managers without significant wealth, it can be a barrier. Managers can be perceived as not aligned with investors or riskier if they don't have "skin in the game". Surdna Foundation broke through this barrier with its investments.

2. Apis & Heritage Capital Partners

The Zero Gap Fund (ZGF) is an impact investing collaboration between The Rockefeller Foundation and the John D. and Catherine T. MacArthur Foundation. ZGF sources portfolio companies that advance BIPOC wealth creation by deploying innovative financial strategies that boost business growth, scaling and sustainability. Since 2018, ZFG has invested/committed over $18 million, leveraging more than $582M in private capital for a catalytic leverage ratio of 32x.

The current portfolio includes Founders First Capital Partners (previously discussed) and Apis & Heritage Capital Partners (A&H). A&H finances an innovative Employee Stock Ownership Program (ESOP), they have named the "Employee-Led Buyout" or ELBO© model. The Fund focuses on purchasing and converting profitable, majority-owned companies with at least 33% BIPOC workforce, promoting wealth and healthier retirement savings. A&H provides technical assistance and support for transitioning culture and governance.

A&H projects that an average worker benefiting from an A&H-assisted buyout will be able to retire with savings of $70,000 to $120,000. This is in contrast with the National Institute of Retirement Security (NIRS), which reports people of color nearing retirement age have average savings of $30,000, and A&H reports that 60% of Black and 65% of Latino workers in America have $0 in retirement.

3. Expanding Black Business Credit and Black Vision Fund

Expanding Black Business Credit (EBBC) was formed in 2016 initially as a CEO peer learning network by leaders of seven Black-led/focused Community Development Financial Institutions (CDFIs) and four additional allies to share best practices. The vision was to bridge the racial wealth gap with the primary goal of demonstrating that Black-owned small businesses could successfully borrow and repay substantial sums of money. A desired outcome was to pique the interest of other lenders, banks and other CDFIs to reduce racialized lending disparities. The Black Vision Fund (BVF) resulted from the group's early data collection effort to prove the value of leveling the playing field in lending to Black-owned small businesses. BVF provides capital to EBBC member CDFIs that in turn invest in Black-owned small businesses through loans, in addition to support services.

Wells Fargo, Packard Foundation (PRI), Amalgamated Bank, LISC (the parent of the fund manager), Ceniarth, and Opportunity Finance Network (OFN,) invested to (1) expand capital lending to minority-owned small businesses as a way to address the racial wealth gap and (2) expand EBBC member CDFIs' capacity and capital available to lend.

Each EBBC member CDFI utilizes its own terms and processes to lend to small businesses in their community. The investment capital is used to scale Black-owned small businesses, build business credit, and expand operations. In addition to capital, many member CDFIs also provide support services through roundtables and trainings to support the business owners in their efforts to grow their businesses.

BVF was seeded through a $10 million grant by Wells Fargo, which the fund managers believe to be the truly catalytic investment into the fund. BVF is very long

term, low rate (2.2%) unsecured debt. Its original goal was to raise debt in the amount of $50 million, and net assets or equity (in other words, grant funding) for the balance, a little under $30 million. The founders believe both tranches are catalytic, especially the grant portion to meet the CDFI nonprofit industry standard leverage of 4%.

The fund closed in February 2022 and the first round of loans were made by the fund in April. The fund manager is New Market Service Corporation, or NMC, a subsidiary of LISC. The loans will be disbursed over two and a half years as long-term low- rate debt to six CDFIs totaling $30 million. Products offered by CDFIs are debt instruments. The mezzanine fund, by providing subordinated debt, is providing a product with a slightly higher risk profile.

There were position, patience and purpose concessions built into this catalytic capital investments:

- **Position:** Through negotiations, EBBC agreed to put $8 million of the Wells Fargo money in as $7.5M subordinated debt and $500,000 as grant-funded equity.
- **Patience and Purpose:** The founders believe the very long-term unsecured debt in the debt fund was also somewhat catalytic in that it was unsecured ten-year interest only until year six and then interest and principal between years six and ten.

4. Black Economic Development Fund

Part of LISC's Project 10X, a $1 billion strategy to address the racial wealth and health gap, The Black Economic Development Fund (BEDF) is a $250 million fund with the primary goal of growing capacity in Minority Depository Institutions (MDIs), African American-owned business and real estate developers, as well as Black-led anchor institutions to catalyze additional investment and scale results.

BEDF will support Black-led banks by purchasing loans from bank portfolios, to provide liquidity or income to the bank. BEDF is innovative in intentionally working on a place-based solution with Black developers to provide financing that is, according to fund managers, hard to find in the marketplace, and at reasonable rates over a five-year period. For Black real estate developers and Black-led anchor institutions, predevelopment, acquisition and new construction loans are accessible. Direct bridge financing for goods and services to Black-led businesses is available.

The funding acts as an impact multiplier, indirectly supporting subcontractors of color and spurring economic development in underserved communities where diverse developers are likely investing. The funding is catalytic in building what the fund manager characterized as "network wealth". Most aptly compared to start-up or "friends and family" funding, this type of first-in funding is atypical for Black businessowners, while quite common for their white counterparts. The resulting gap in start-up financing cripples entrepreneurs of color from the outset, an obstacle they can't easily overcome. LISC's BEDF approach provides a leg-up for success, increasing the chances of achieving a proven track record needed for more conventional financing.

As of March 2022, BEDF had provided financing for real estate developers, high-impact community development projects, and mission-driven lenders in 15 cities. Investor(s) include Netflix, PayPal, Square, HubSpot, Aflac, Costco, Dicks Sporting Goods, ThermoFisher Scientific, Wayfair, McKinsey & Company, and Dupont.

There were position and purpose concessions built into this catalytic capital investments:

- **Position**: The fund is uniquely structured to de-risk the investment as an "inverted stack" that encourages investment of subordinated debt with a higher interest rate.
- **Purpose:** Additionally, LISC prides itself on managing the funds from an "impact first" perspective. Each investment agreement contains clauses that allow LISC to make decisions based first on impact, within reason and with approval from the advisory board, even if it is not the most economically advantageous for the fund. This aspect of the fund lends itself to supporting community transformation rather than being merely traditionally transactional. The LISC fund manager suggests this would be a productive role for large foundations to consider increasing catalytic capital funding.

Conclusions and Way Forward

Catalytic capital accepts disproportionate risk and/or concessionary return to generate positive impact and enable third-party investment that otherwise would not be possible. Investors, business leaders and citizens are looking for investments which explicitly focus on wealth creation for BIPOC and investments which will deliver a more equitable and inclusive economy.

NGIN's research highlights three opportunities for action:

1. **Remove racialized risk frameworks and individual biases** which continue to limit capital flows by overstating risk levels associated with BIPOC individuals and asset owners. Catalyze more traditional capital investments that advance BIPOC wealth creation by identifying and removing racial bias in risk assessment at the systems level (e.g. home appraisals), input data and financial analysis for underwriting (e.g. credit scoring), norms within the finance industry (e.g. undervaluing BIPOC fund managers), and retail investment products impacting individuals (e.g., overstating perceived risk of a BIPOC entrepreneur). Racial Equity Impact Assessment tools may be useful in this exercise.

    - Work is needed at all levels to remove racial bias at the individual decision maker level, data input system level, investment analysis level, etc.
    - Improved risk analysis methodologies and input data are needed to provide an alternative to existing racialized systems.
    - Invest in building evidence frameworks which will support the industry to evolve traditionally accepted investment norms which are punitive to BIPOC asset owners.
    - Invest in first time fund managers, especially BIPOC, to build greater evidence on perceived risk vs real risk.

2. **Continue to innovate investment products** which truly advance BIPOC wealth creation, through new structures (e.g., expand equity product offering where debt is dominant, i.e., home ownership and entrepreneurship) and through expanded investment purposes (e.g., place-based, community-led projects or community-owned models which truly build BIPOC wealth).

- Community wealth building models such as employee ownership have the opportunity to produce wealth and not only income. Dedicated funds have emerged but there is scope for more capital for such wealth generating models.
- Community-centered organizations like CDFIs should have access to catalytic capital to enable them to center community and BIPOC wealth creation in their decision making and risk appetite. Recent efforts are underway to ensure that CDFIs are advancing racial equity and wealth for BIPOC.
- Use catalytic capital as a foundational investment in place-based investment structures which produce individual and community real estate wealth, e.g., Chicago TREND which accelerates and finances strategic retail development to drive neighborhood transformation, creates individual investment opportunities for community members to participate in the commercial real estate value accretion.
- Use catalytic capital to expand access to savings, retirement, pension products and investment products for workers as a way to advance BIPOC wealth creation.
- Innovate the equity product offering for business owners rather than just increasing debt products for business owners, i.e., revenue-based financing.

3. **Invest at scale and underpin equity investments with operational capital**. When and where there are examples of catalytic capital, they are smaller investment amounts and at the margins of the broader financial system. The field is calling for investments at scale, especially for funds led by BIPOC and for funds with an investment thesis which advances BIPOC wealth.
    - Given the limited fund sizes in the field, operating capital is required to accompany equity investments, as the fees generated from AUM is not significant enough to invest in adequate team capacity.
    - Advance the metrics and definitions on racial equity in investments, to attract institutional investor capital.
    - Identify whether there is an opportunity to unlock additional capital sources for catalytic capital i.e. Donor Advised Funds, which are now at $142 billion in assets.

Appendices

APPENDIX 1: LIST OF INTERVIEWEES

NGIN would like to acknowledge the contributions of the following experts, practitioners, and stakeholders who were interviewed for the project. Their time and insights are greatly appreciated.

NAME	AFFILIATION
Ben Thornley	Tideline
Bill Best	PNC Bank
Birgit Klohs	New Community Transformation Fund
Donna Daniels	Heron Foundation
Erin Robert	JPMorgan Chase
George Ashton	Local Initiatives Support Corporation (LISC)
Kurt Chilcott	CDC Small Business Finance
Lorenzo Mendez	Rockefeller Foundation
Mary Houghton	Black Vision Fund
Mekaelia Davis, Adam Connaker and Matthew Walegir	Surdna Foundation
Nwamaka Agbo	Kataly Foundation and Restorative Economies Fund
Rob Young	Brown Capital Management
Victoria Watkins	Ariel Investments
Zoila Jennings and Akobe Sandy	Robert Wood Johnson Foundation

Additional insights and input have been provided through project donors Urmi Sengupta and John Balbach at MacArthur Foundation and Chris Jurgens at Omidyar Network.

Finally, insights in this report were influenced by NGIN's April 2022 report "Capital for Inclusive Development in Small and Midsize Cities," which engaged 25 individual expert stakeholders as well as partnering with inclusive capital teams at Blueprint Local, Common Future the Council of Development Finance Agencies, and Urban Institute.

APPENDIX 2: DEFINING CATALYTIC CAPITAL AS IT RELATES TO BIPOC WEALTH CREATION

Individual, corporate, and institutional investors are expressing greater interest in investment products which advance racial equity and support BIPOC wealth creation. Given the complexity and comprehensiveness of racial bias/ discrimination, catalytic capital is needed across sectors, asset classes, and geographies. Catalytic capital can play a critical role as a capital source for those transactions, taking disproportionate risk and/or accepting concessionary returns, but also in advancing the investment field to realize more equitable outcomes through BIPOC wealth creation.

Roles of catalytic capital	Forms of catalytic capital	Use of catalytic capital
• **Price**: below risk-adjusted rate of return • **Pledge**: credit enhancements, guarantees • **Position**: subordinated debt or equity positions • **Patience**: longer or more uncertain duration to exit compared to market-rate capital • **Purpose**: accept non-traditional terms to meet investee needs	• Seeding: capital to launch new enterprises • Scaling: expand capacity and impact of new entities • Sustaining: maintain mission-focus of existing entities; fund ongoing operations	• Facilitating **innovation** • Building **track record** • Leveraging **additional investment** (blended finance) • Signaling impact potential of new enterprise/asset class

Source: Adapted from distilled insights from Catalytic Capital Unlocking more investment and impact. March 2019. Tideline.

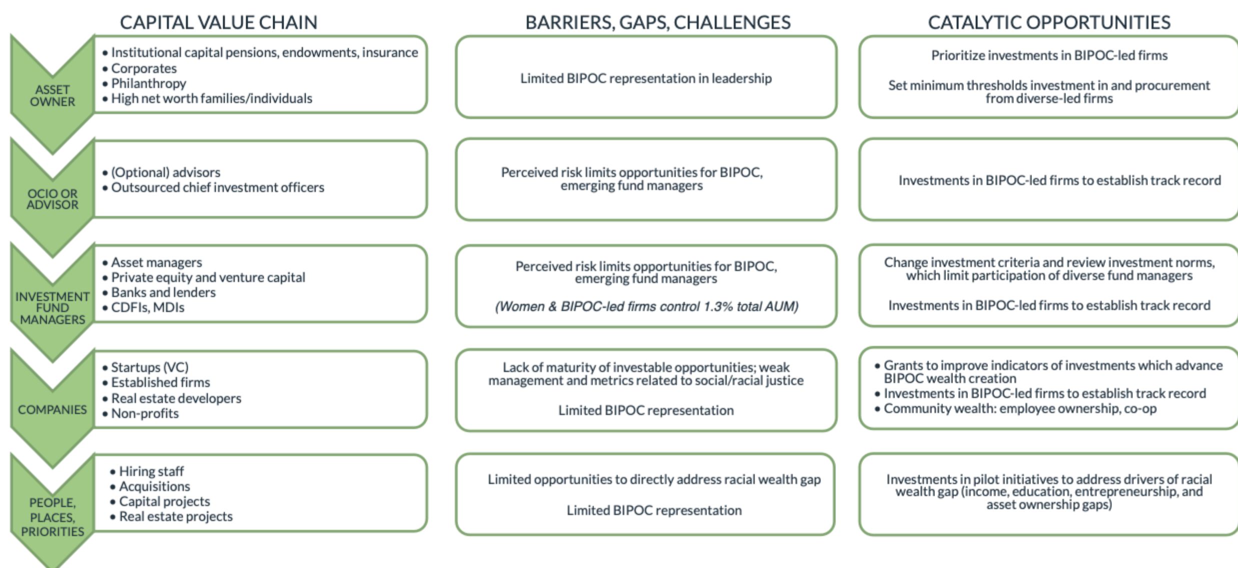
There are forms of catalytic capital, roles of catalytic capital and uses of catalytic capital.

Considering "uses of catalytic capital," some examples to advance BIPOC wealth creation include:

- Innovating - Use catalytic capital to redefine risk and returns frameworks of traditional capital investors in ways that reject racial (and gender) bias and discrimination.

- Building track record - Use catalytic capital to expand market-level evidence of risks and returns of new / BIPOC fund managers.
- Leveraging additional investment – Using catalytic capital as a way to de-risk large scale, place-based community investments for CDFIs. When CDFIs only have traditional sources of capital, they are well positioned to reach into community, but no better able to take risk than the capital they are on-lending.
- Signaling impact potential of new enterprise / asset class – Investments in employee ownership models (e.g. Apis & Heritage Partners), high-growth entrepreneurship models (e.g. 1863 Ventures) and using equity instead of debt (e.g. equity investments in growth businesses, shared risk/reward for down payment on home purchases, etc.) show the emerging opportunity of an asset class.

Capital Value Chain – Looking across the capital value chain from asset owner to fund manager, to companies and to investments, there are many opportunities for action to advance BIPOC wealth creation through catalytic capital:



Source: This graphic prepared by NGIN builds on the Impact Capital Chain captured in the Impact Investing Handbook. 2020.