

Financing Rural Innovation with Community Development Venture Capital: Models, Options and Obstacles

Julia Sass Rubin

Rutgers University

Access to equity capital is a critical component of business entrepreneurship. Young companies lack the cash flows necessary for debt repayment. They need patient capital, such as equity and near-equity, to develop and get their products ready for market. As Barkley and Henry confirm in this issue of the *Review*, the creation and growth of such companies is the path to economic prosperity for many rural regions. It also is a means to economic opportunity for rural residents.

Rural economies, however, rarely attract traditional venture capital (see Lipper and Moncrief in this issue). This is due in part to the structural impediments they pose for the traditional venture capital model. Because the primary driver of traditional venture capital is profit maximization, the industry tends to gravitate to geographies that maximize potential investment opportunities and minimize operating costs. Areas such as Silicon Valley in California and Route 128 in Massachusetts embody such geographies and consistently draw a disproportionate share of traditional venture dollars.

Such geographies have a critical mass of potential investment opportunities and the supporting infrastructure in the form of technological, managerial, legal and financial expertise necessary to take ideas to market. Their proximity to desirable quality-of-life amenities also enables these geographies to attract venture capitalists, who can minimize travel time and operating expenses by living near their investments.

By contrast, rural geographies are characterized by limited deal flows and supporting infrastructures, and large distances that make oversight difficult. Because of these structural impediments, the venture capital that exists in rural areas tends to be developmental in nature. Unlike traditional venture capital, which has a primary objective of financial returns for investors, developmental venture capital is designed to foster both social and financial returns. In the case of rurally-focused developmental venture capital firms, the social returns are often in the form of economic growth, either general or specifically targeted at helping low-and moderate-income populations.

Community development venture capital (CDVC) is one form of developmental venture capital that has evolved in rural areas. Like traditional venture capitalists, CDVC providers make equity and near-equity investments in small businesses.¹ However, their investments

¹ Equity investments consist of preferred and common stock. Near-equity investments consist of debt that is convertible to equity and debt with warrants, royalties or participation payments. Near-equity can be structured to act like equity, with deferred payments that give young firms the patient capital they need in their early years.

are predicated on a company's potential for high-quality job creation for low- and moderate-income individuals as well as its likelihood of rapid economic growth. As a result of this dual-bottom-line, CDVCs are willing to invest in companies in numerous industries, stages of development, and locations. This flexibility, as well as the operating model that it has fostered, further differentiates CDVC funds from traditional venture capital, and makes this model particularly well suited to address the structural impediments that rural areas present.²

The earliest community development venture capital funds, formed during the 1970s and 1980s, had a primarily rural focus. They included the Kentucky Highlands Investment Corporation (KHIC), Northeast Ventures, Coastal Ventures Limited Partnership, Development Corporation of Austin, and the Minnesota Technology Corporation Investment Fund (MIN-Corp). While most of the subsequent CDVC funds targeted broader geographies, the industry also has seen the creation of new CDVC funds focused on the rural regions of Oklahoma, New Mexico, Ohio, Tennessee, Virginia, West Virginia, North and South Carolina, Georgia, Alabama, and Mississippi.

The obstacle to growing more rurally-focused CDVC funds is this model's need for subsidy. The present economic, political and normative environments seem hostile to overtly subsidy-based models, particularly those intended to benefit low- and moderate-income populations. This has limited both the growth of new CDVC funds and the capitalization levels of existing ones. This hostility must be overcome in order to foster the innovation and entrepreneurship that will enable rural areas to participate in the knowledge economy.

The CDVC Model

In order to understand the CDVC model, it is helpful to contrast it with traditional venture capital. Although CDVCs differ from traditional venture capital funds in a number of ways, these differences all stem from CDVCs' double-bottom line objective. The social bottom-line for rurally-focused CDVCs is their commitment to economically developing a particular non-metro geography. To do so, they must find ways to overcome the structural limitations such geographies present for venture capital investing.

The first structural limitation of rural geographies is their lack of the supporting infrastructure that venture capital requires. In particular, small populations often translate into few experienced company managers with the knowledge to guide young firms. CDVCs address this limitation with technical assistance, either directly from CDVC fund staff or indirectly from outside experts. In either case, this technical assistance translates into higher costs for the fund.

Another structural limitation of rural geographies is a scarcity of high-quality deal flow. By definition, rural areas have smaller populations, which translate into fewer entrepreneurs and fewer firms. While traditional venture capitalists may review hundreds of potential

² This section draws on the author's ongoing research on community development venture capital.

investments in order to select the most promising one, a venture fund operating in a rural geography may have only a few dozen investment options to consider. Additionally, the quality of their investment options may not be comparable to those reviewed by a traditional venture fund.

One way that rurally-focused CDVC funds maximize their investment options is by investing in a broad range of industries. This differentiates them from traditional venture funds, which concentrate their investments in those technologically intensive sectors that offer the greatest promise for significant returns. As discussed by Barkley and Henry, such high-tech investments are particularly difficult to find in rural areas. Thus, most of the investments made by rurally-focused CDVC funds have been in lower-tech, primarily manufacturing firms. These investments lack the potential financial volatility, both positive and negative, of traditional venture, but meet the social objective of economic development and job creation.

The lack of deal flow in rural areas also means CDVC funds must invest in companies at various levels of development. In particular, rural CDVC funds have had to “create deals” by investing in early-stage firms. Traditional venture capitalists are reluctant to make early stage investments because they are higher risk than those in firms that have demonstrated their market potential.³ Early stage investments also are more expensive for venture capitalists because they involve both longer timeframes and intensive oversight to develop a successful company. This can result in additional costs related to delayed exits – when the company can be sold to investors or another company.

All venture capitalists must exit their investments in order to make a profit and free up capital for new investments. The longer it takes a venture fund to exit an investment, the more operating costs it accrues. Unless the longer holding time results in a higher exit price, it also translates into lower returns for the venture fund, which cannot re-invest the capital until it exits its original investment.

In general, exits are critical to the ability of venture capitalists to make a profit. The majority of traditional venture funds make a profit by exiting a few investments so successfully that the returns are sufficient to offset losses on the rest of their portfolio. Such exits, whether by initial public offering or buy-out by another firm, are not uncommon when investing in the technologically-intensive industries favored by traditional venture funds.

³ Seed/start-up stage investments accounted for only 2.11 percent of all dollars invested by traditional venture capitalists in 2005 (PriceWaterhouse Moneytree 2006). While comparable figures are not available for CDVC funds, almost fifty percent of rural CDVC fund investments through the end of 2000 were in seed/start-up stage firms. Even these statistics understate the differences between CDVC and traditional venture capital funds because of the variation in how each defines seed/start-up stage investments. Rural -CDVC funds, for example, are willing to invest in business opportunities that they identify themselves and subsequently find entrepreneurs to help develop. By contrast, PriceWaterhouse Moneytree defines the Seed/Start-Up Stage investments for traditional venture funds as those in companies that usually have been in existence less than 18 months and have a concept or product under development that is probably not fully operational.

Their high-quality deal flow also enables traditional fund managers to invest only in those firms that have the greatest promise of rapid growth, thus further maximizing the possibility of a highly profitable exit.

While exits are challenging for all community development venture capitalists, they present a particular challenge for rurally-focused CDVC funds. In large part, this reflects the primarily low-tech, moderate-growth, early-stage firms in which rural CDVC funds invest as a result of their limited deal flow. Such companies are not likely to qualify for initial public offering and have fewer potential buyers (Rubin 2001).

An additional factor complicating exits for CDVC funds is the unwillingness of many CDVC fund managers to force an exit that would be detrimental to their social objectives of high-quality job creation for low- and moderate-income individuals and economic development for rural geographies. Managers of rurally-focused CDVC funds must always weigh the social and financial benefits of any exit opportunity against its social costs. If, for example, an acquiring firm closes down a facility or moves it to another location, the social benefits to a rural area, in the form of jobs created by that firm, would be negated. This would detract from the financial benefits that the exit might provide for the fund (Rubin 2001).

As this section has demonstrated, the innovations rurally-focused CDVC funds have adopted to overcome the structural limitations of their environments have resulted in higher operating costs and lower financial returns. These have reinforced the difficulty these funds face in raising investment capital from the pension funds, endowments, financial institutions, and wealthy individuals that make up the bulk of traditional venture capital investors. Such investors are interested primarily in profit-maximization and perceive rurally-focused CDVC funds' commitment to a specific geography and their dual bottom line as diversions from that objective.

To date, sources of capital for rural CDVCs have consisted of investors who prize the social objective primarily or equally with the financial one. These have consisted mostly of federal, state and local governments and foundations, as well as a few local utilities, wealthy individuals, and commercial banks aiming to fulfill their Community Reinvestment Act (CRA) obligations. These "social" sources of capital have been fairly limited in the dollars they were willing to invest in CDVC funds (Rubin forthcoming; Rubin 2001).

The difficulty that rurally-focused CDVC funds have encountered in raising capital has left them with smaller capitalization levels than traditional venture funds. While the median fund size for a traditional fund is now \$209 million (VentureOne 2006), most of the large CDVC funds raise between ten and twenty million dollars. Because they have less capital to invest, and because their portfolio companies lack the growth potential to justify a large investment, CDVC funds make smaller investments than traditional venture funds. However, venture capital costs are labor-based, driven by the number versus size of investments that fund managers must select and manage. Thus, rather than resulting in cost savings, the smaller fund and investment sizes of CDVCs have contributed to higher operating expenses as a percentage of investment capital (Rubin 2001).

Traditional venture funds cover their operating expenses via an annual fee equal to two to three percent of capital under management. While this is a substantial amount for a two hundred million dollar fund, it provides much less financial flexibility for a twenty million dollar one. Thus, most CDVC investors require a subsidy to fund their operations. This subsidy can take the form of lower salaries for CDVC fund managers, lower returns to investors, or foundation and government grants to a non-profit partner that provides technical assistance on behalf of the CDVC. Most rurally-focused CDVC funds require all three forms of subsidy.

The current economic and political environments are not friendly to subsidy-based models (Rubin forthcoming). This has created significant challenges for the capitalization of new CDVC funds. The next section reviews existing sources of CDVC capital as well as potential new funding opportunities for the industry.

Existing Sources of CDVC Capital

Community Development Financial Institutions (CDFI) Fund

The CDFI Fund of the U.S. Department of the Treasury is an important source of capital for community development venture capital. Under the Bush Administration, the Fund has seen a dramatic reduction in funding from \$118 million in 2001, the last budget under President Clinton, to \$55 million in 2006 (CDFI Coalition 2006). In addition to reducing overall funding levels, the administration also has limited the Fund's flexibility in utilizing its allocation by pushing it to focus more of its resources on evaluation, and by prioritizing NMTC administration and the Bank Enterprise Award (BEA) program over other spending. For example, at least \$11 million of the \$55 million the Fund received for 2006 may be used for BEA and an additional \$13.5 may be used for administration of the NMTC, leaving only \$30 million for all other Fund activities.

New Markets Venture Capital

The New Markets Venture Capital (NMVC) program was designed to increase the supply of equity and near-equity capital flowing into distressed communities. The program, which is administrated by the Small Business Administration of the U.S. Department of Commerce, was intended to provide 10 to 20 new NMVC Companies with matching capital -- \$100 million in debt for making investments and \$30 million in grants to offset overhead expenses. The program would have resulted in a significant expansion of the financial resources available to the CDVC industry.

Six NMVC Companies were given final approval in the first round of the program, four of which included a focus on rural geographies. The SBA expected to run a second round of the program starting in the spring of 2003. In March of that year, however, funding for the second round was deleted from the 2003 Fiscal Year Omnibus Appropriations Bill during the budget reconciliation process. Efforts to obtain future allocations for the NMVC program have been unsuccessful to date.

Rural Business Investment Program

The Rural Business Investment Program (RBIP) was designed to promote developmental venture capital investments in smaller enterprises located in rural areas. It was created by the 2002 Farm Bill and modeled on the NMVC program. The original legislation indicated that the program would make available approximately \$280 million of investment as well as operational grants to provide technical assistance to portfolio companies. In 2003, the U.S. Department of Agriculture reached an agreement with the SBA to have the latter administer the program.

The 2005 budget allocated \$10 million for the program, which would have supported two to three Rural Business Investment Companies. The SBA conditionally approved three RBIP Companies, giving them a year to raise the \$10 million in equity capital required to become fully approved. Upon full approval, each of the companies would have been eligible for \$20 million of government guaranteed debentures for making investments and a \$1 million operational assistance grant for the provision of technical assistance to those companies that received investments.

Only one of the three, Meritus Ventures, was able to raise the necessary capital and become a Rural Business Investment Company. The Budget Reconciliation Act of 2005 subsequently rescinded funds appropriated for the program that were not obligated by October 1, 2006 and repealed the authority to spend funds in the future, ending any future funding for the program.

New Markets Tax Credit Program

The New Markets Tax Credit (NMTC) program was designed to combine public and private sector resources in order to bring \$15 billion in new investments to impoverished rural and urban communities. The program came into existence with strong encouragement and support from the CDVC industry. When the program was being designed, there was great hope that it would be a significant new source of equity capital to fund business lending and investments. Due to several statutory and regulatory provisions, however, the program has so far been used almost exclusively to finance real estate-related transactions (Rubin & Stankiewicz 2005; 2003). The highly competitive nature of the program and the expense and expertise required to meet its legal and compliance requirements have also precluded all but the largest and most sophisticated organizations from being able to take advantage of an NMTC allocation.

Conventional Financial Institutions

Commercial banks have been a very important source of capital for CDVCs, particularly since the 1995 regulatory revisions to the Community Reinvestment Act (CRA), which instituted the investment test and expressly recognized community development financial institutions as qualifying CRA investments and borrowers (Barr 2005; Pinsky 2001). Both of

these changes gave commercial banks a significant incentive to financing CDVCs (Benjamin, Rubin and Zeilenbach 2004). Recent changes to the CRA, however, have reduced the number of banks expressly evaluated for their investment activities. This change, in combination with the dramatic consolidation in the banking industry and the growth of alternative options that meet the investment test while providing a market-rate return, has made it much more difficult for CDVCs to raise capital from banks.

The CRA was passed by Congress in 1977 in order to encourage regulated financial institutions to meet their “continuing and affirmative obligations to help meet the credit needs of the local communities in which they are chartered” (NCRC 2005). In 2004 and 2005, the four federal agencies that enforce the CRA issued amendments to the Act that, in part, created a new category known as intermediate small banks, which consists of institutions with assets of between \$250 million and \$1 billion, which would no longer be evaluated on their investment and service activities. Instead they would be eligible for evaluation under the small bank lending test and a flexible new community development test. The new regulations did not change the evaluations for banks with assets of more than \$ 1 billion or less than \$250 million (Marsico 2006).

The National Community Reinvestment Coalition found that as a result of the intermediate small bank category changes “1,508 banks with 13,643 branches and total assets of \$679 billion were no longer subject to the more rigorous lending, investment, and service tests for large banks” (Marsico 2006, 540). This has significant implications for CDVCs. The CRA investment test has played a critical role in motivating banks to invest in the industry (Rubin forthcoming; Benjamin, Rubin and Zeilenbach 2004). Any reduction in the number of banks that must meet the investment test makes raising new CDVC funds more challenging. This is particularly true for rural-focused CDVC funds, which were already disadvantaged in being able to attract bank investments because of the paucity of larger bank branches in rural areas (Rubin 2001).

Over the last few decades, the U.S. banking industry has gone through significant consolidation through mergers of increasingly large organizations. The ten biggest US commercial banks now control 49 percent of all domestic banking assets, a substantial increase from the 29 percent they controlled a decade ago (*Economist* 2006).

This consolidation has had both positive and negative affects for the CDVC industry. On the positive side, banks planning to acquire or be acquired have been more likely to be concerned about their CRA rating and thus to make community-development related investments, even unprofitable ones (Bostic et al 2002; Avery et al 2000). This benefit has been watered down somewhat by the recent decrease in large-bank mergers.

One of the negative consequences of consolidation has been a reduction in absolute sources of capital for community development finance that occurs when large institutions merge. Anecdotal evidence indicates that the post-merger institutions do not provide as much community development capital as the total of what the two merging entities did separately, resulting in a reduction of overall capital availability. Mergers among larger banks

also leave fewer sources of capital for CDVCs to approach, reducing the overall odds of them being able to obtain a capital commitment.

Bank consolidation also has resulted in an increased emphasis on profitability by the larger banks, which have felt pressure to justify the mergers to their shareholders. This has led them to consolidate activities and cut costs (Tully 2006). The increased profitability pressures have translated into less subsidized capital available for CDVCs as banks increasingly view their CRA-related activities as profit centers (Rubin forthcoming). This is made easier by the recent increase in investment options created specifically for the purpose of providing financial institutions with market-rate or near-market-rate returns while enabling them to receive investment test or similar credit under the CRA. These include mutual funds, such as the Access Capital Community Investment Fund and the CRA Qualified Investment Fund, which invests in economically and geographically targeted fixed income instruments. They also include separately managed accounts that groups such as CRA Fund Advisors can set up to suit the particular investment objectives of banks, pension funds, and foundations.

Even developmental venture capital alternatives have mushroomed. The minority-focused venture capital industry has grown significantly in the last decade (Bradford, Bates and Rubin 2005), and funds such as UrbanAmerica, LP, the Canyon-Johnson Urban Fund, and the Genesis Family of Funds invest in inner-city real estate with the goal of achieving both market-rate returns and economic development for their under-served residents. These options pose a significant competitive challenge for CDVCs by promising investors higher rates of financial return for comparable levels of risk.

CDVCs seeking bank investments must also contend with higher interest rates, which translate into a higher cost of capital for banks, and subsequently for their borrowers. Higher interest rates mean banks are looking for higher rates of return on equity investments to offset the higher cost of capital. This makes CDVCs a tougher sell, since they have yet to document sufficient financial returns to justify their longer holding periods.

The losses that many banks experienced from their Small Business Investment Company (SBIC) investments following the market correction of 2001 have also hurt CDVCs' ability to raise capital. Although CDVCs have not pursued the internet-related investments that led so many SBICs to lose money, they have been hurt by the connection some bankers have made between them and SBICs, as equity investments in both enable banks to meet the CRA investment test (Rubin forthcoming).

Foundations

Foundations have been a small but important source of capital for CDVCs. Over the last decade, a handful of large foundations, including The Ford Foundation, The John D. and Catherine T. MacArthur Foundation, and the F.B. Heron Foundation, have made numerous investments in the industry, while others have supported specific organizations and/or initiatives.

In the last few years, foundation support for community development venture capital has declined. This is due partly to the stock market decline that began in 2000, which shrank foundation assets and led to an overall reduction in foundation giving. More significant, however, have been decisions by the most active foundation investors to change the nature of their support for the sector or to withdraw support entirely. Foundations generally view their dollars as seed money, intended to catalyze other sources of capital and ultimately lead to organizational or project sustainability. For CDVCs, this has meant that the subsidized dollars that foundations provided to many organizations in the industry's beginnings have become rare or unavailable.

Even those few foundations that have continued to fund individual CDVCs evaluate these investments relative to the range of other community development options available, such as the fixed instrument and equity funds discussed previously. As one foundation official pointed out, "There has been a lot of activity in the last five years and its reshaped the landscape a lot and signaled to foundations and banks that they can have the same impact with a better return" (Rubin forthcoming).

Nor do the dollars that foundations commit to CDVCs from their charitable disbursements equal those they invest in more market-rate funds via their endowments. This is true even for those foundations, such as F. B. Heron, which commit a portion of their endowment investments to mission related opportunities. In 2004, for example, the foundation invested \$1.5 million in four CDVC funds via program related investments, and \$10 million of endowment funds in six socially-oriented market-rate equity funds, such as UrbanAmerica, L.P. (F.B. Heron 2004).

New CDVC Funding Opportunities

State and Local Governments

State and local governments have been a source of capital for CDVCs since the industry's beginnings, accounting for eleven percent of all capital raised by the industry as of the end of 2000 (Rubin 2001). As alternative sources have dried up, however, states have become an increasingly attractive option for CDVC funds trying to raise new capital. This may be particularly true for rurally-focused CDVC funds, as state governments may be closer and thus more accountable to their rural constituents than the federal government.

The power of state-level initiatives is best illustrated by California, where public-sector activity over the last decade has encouraged the creation of numerous innovative sources of capital to fund community development finance. In 1996, The Community Organized Investment Network (COIN) was established in the state at the request of the insurance industry as an alternative to state legislation that would have required insurance companies to invest in underserved communities. As of 2003, it had facilitated over \$740 million in insurer investments in affordable housing and economic development projects. The COIN program also certifies California Community Development Financial Institutions, which then become eligible for investments from the COIN managed pool of capital.

In May 2000, the State's Treasurer Phillip Angelides launched The Double Bottom Line: Investing in California's Emerging Markets initiative, "to direct investment capital – through state programs and the State's pension and investment funds – to spur economic growth in those California communities left behind during the economic expansion of the past decade" (Angelides 2001, 1). As part of this initiative, Angelides successfully encouraged the boards of two of California's largest public pension funds, on which he serves, to invest in real estate and businesses in the state's poorest communities. The two pension funds, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), have so far allocated \$4.34 billion to real estate and \$1.09 billion to business investments in such communities (Angelides 2006).

One indication of how successful these initiatives have been is a forthcoming report by the Milken Institute that found—contrary to national trends—that developmental finance institutions in the state are not experiencing any difficulty raising capital (Zeidman 2006). Not surprisingly, the three-year-old Bay Area Equity Fund, the largest CDVC fund raised to date, is based in California.

Pension Funds

U.S. pension funds control over seven trillion dollars in assets (Anand 1998). Historically, most pension fund assets have been very conservatively invested in fixed income, public equities and real estate. In the last few decades, however, pension funds have expanded their parameters to include "alternative" investments such as venture capital. Pension funds now account for over 50 percent of all the capital placed in venture funds (National Venture Capital Association 2006).

Some of the public and Taft-Hartley pension funds have also incorporated economically targeted investments (ETIs) into their portfolios. ETIs are "investment programs designed to produce a competitive rate of return as well as create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy" (McNeill and Fullenbaum 1995 as quoted by Small Business Administration, 1). Conservative estimates place the ETI commitments of public pension funds at more than \$43 million (Democracy Collaborative 2005).

To date, most of the pension fund ETI investments have been in fixed income and real estate. Pension funds generally have been reluctant to make private equity ETI investments, for reasons of both cost and risk. Only a few of the most innovative pension funds have expanded their ETI investments to include private equity. The most notable among these is the CalPERS' \$500 million California Initiative to target companies in the state's underserved markets (Hess 2006). In 2001, the California Initiative selected ten private equity firms to receive a capital commitment of \$475 million (Hess 2006). Pacific Community Ventures, a San Francisco based CDVC, was among these ten and received a \$10 million investment (Pacific Community Ventures 2005). The CalPERS investment makes Pacific Community

Ventures the second CDVC to receive pension capital. The Reinvestment Fund attracted investments from Taft-Hartley pension funds for its CDVC funds (Kostelni 2003).

While pension investments in CDVCs are still the exception, they are likely to increase if the CDVC funds can demonstrate an appropriate risk-adjusted rate of return and an ability to absorb larger investments. Despite CalPERS' willingness to invest \$10 million in Pacific Community Ventures, pension funds generally prefer to make larger investments as the costs of due diligence are the same regardless of investment size.

More pension funds also are adding private equity to their ETI portfolios, including the New York City Employees' Retirement System (NYCERS), which set out a policy in August of 2005 to move into private equity investments and to target low-moderate income areas in the five boroughs of New York City (Hess and Hagerman 2005). Given the geographic nature of most public pension fund ETI investments, community development venture capital funds that invest in states whose public pension funds are willing to make private equity ETI investments have a much greater chance of attracting pension fund capital.

Individual Investors

Although some CDVC funds have been able to attract investments from individuals, they accounted for only six percent of all CDVC investments as of 2000, the last year for which this data is available. As the field of social investing continues to evolve, however, CDVCs increasingly are looking at individuals as a potentially important source of future capital.

Individuals can invest directly in most limited-life CDVC funds (those structured as limited partnership or limited liability corporations) via equity investments of \$50,000 or more (MacDonald 2005). SJF Ventures, a fund that invests in companies whose competitive advantages include environmental or workforce innovation, has found individual investors increasingly receptive to investing in its funds. Many of these individuals have experience as angel investors and have found it easier and safer to invest via a CDVC. Although their investments are generally smaller than those of commercial banks, such individuals are high value-added investors because they provide additional due diligence on individual deals and refer potential portfolio companies to the fund. Individuals also can invest in CDVCs via the Community Development Venture Capital Alliance, the industry's trade association, which has a central fund that accepts individual loans of as little as \$10,000 for a period of ten years.

Conclusion

Given the important role that patient capital plays in entrepreneurial development, the future economic vitality of rural communities rests, at least in part, on their ability to access such capital. Community development venture capital is a particularly adept model for overcoming the structural obstacles that rural geographies present for venture capital investors. This model, however, requires subsidy to offset the extra costs that overcoming such obstacles involves.

Historical sources of subsidized capital, including the federal government, foundations, and commercial banks, have all declined since the 1990s, making it extremely challenging for new CDVC funds to form. Changes in public policy are necessary to encourage the federal government and commercial banks to continue their support for the industry.

There also are several funding sources that could play a greater role in capitalizing new CDVC funds, including state governments, pensions funds, and individual investors. Once again, public policy is essential in providing incentives for these actors to play a greater role. As the California example demonstrates, a well-coordinated policy approach can result in significant resources for economic development from the public and private sectors, which helps create healthy and vibrant communities.

Julia Sass Rubin, Ph.D., is an assistant professor of public policy at the Edward J. Bloustein School of Planning and Public Policy at Rutgers University. Dr. Rubin received her Ph.D., MBA, MA and BA from Harvard University. Her research interests are in community economic development and community development finance.

BIBLIOGRAPHY

- Anand, Vineeta. "Market Contributions Boost Pension Assets." Pensions & Investments, October 19, 1998.
- Angelides, Philip. "The Double Bottom Line: Investing in California's Emerging Markets." Ideas to Action, June 2001.
- Angelides, Philip. "Double Bottom Line Investment Initiative Five Years Later: Delivering on Both Bottom Lines," 2006. http://www.treasurer.ca.gov/publications/dbl/five_years.pdf
- Avery, Robert B, Raphael W. Bostic & Glenn B. Canner. "The Performance and Profitability of CRA-Related Lending," Economic Commentary, Federal Reserve Bank of Cleveland, November 2000.
- Barr, Michael S. (2005). "Credit Where it Counts: The Community Reinvestment Act and Its Critics." New York University Law Review, Vol. 80 (May 2005): 513.
- Bates, Tim, William Bradford & Julia Sass Rubin. "The Viability of the Minority-Oriented Venture-Capital Industry Under Alternative Financing Arrangements." Economic Development Quarterly, Vol. 20, No. 2 (2006): 178-191.
- Benjamin, Lehn, Julia Sass Rubin, and Sean Zielenbach. "Community Development Financial Institutions: Current Issues and Future Prospects." Journal of Urban Affairs 26, no. 2 (2004): 177-95.
- Bostic, Raphael, Hamid Mehran, Anna Paulson and Marc Saidenberg. "Regulatory Incentives and Consolidation: The Case of Commercial Bank Mergers and the Community Reinvestment Act." Federal Reserve Bank of Chicago Working Paper 2002-06, (2002).
- CDFI Coalition. "CDFI Coalition Newsletter." February 7, 2006. <http://www.cdfi.org/Uploader/Files/e-news2-7.html>.
- Democracy Collaborative. *Building Wealth: The New Asset-Based Approach to Solving Social and Economic Problems*. Washington, DC: The Aspen Institute Nonprofit Sector Research Fund, April 2005.
- Economist*. "Thinking Big." *Economist*, Volume 379, Issue 8478 (2006): 3-6.
- F. B. Heron. "2004 Annual Report." <http://www.fbheron.org/2004ar.pdf>

- Hebb, Tessa. "Public Pension Funds and Urban Revitalization. California Case Study A: Private Equity CalPERS' California Initiative." (2006). <http://urban.ouce.ox.ac.uk/research.html>
- Hess, Tessa and Lisa Hagerman. "Best Practices in Pension Fund Urban Investments." Presentation at the Pension Funds and Urban Revitalization seminar, Hartford, Connecticut, October 25, 2005. <http://urban.ouce.ox.ac.uk/notes051025.pdf>
- Kostelni, Natalie. "Fund Seeks Profits and New Jobs." Philadelphia Business Journal. September 9, 2003.
- MacDonald, G. Jeffrey. "For Investors With a Conscience, Options Grow." The Christina Science Monitor, September 19, 2005.
- Marsico, Richard D. "The 2004-2005 Amendments to the Community Reinvestment Act Regulations: For Communities One Step Forward and Three Steps Back." NYLS Clinical Research Institute Paper No. 05/06-20, (2005).
- McNeill, Mariana and Richard Fullenbaum. "Pension Funds and Small Firm Financing." M&R Associates, Rockville, MD, 1995.
- NCRC. "Policy." NCRC, <http://www.ncrc.org/policy/cra>, (2005).
- National Venture Capital Association. "The Venture Capital Industry – An Overview." National Venture Capital Association, <http://www.nvca.org/def.html>, (2006).
- Pacific Community Ventures. "About Us: Our Team. Our Commitment to Public/Private Partnerships." <http://www.pacificcommunityventures.org/aboutus/statementofcommitment.html>, (2005).
- Pinsky, Mark. "Taking Stock: CDFIs Look Ahead After 25 Years of Community Development Finance." Capital Xchange, December 2001. <http://www.brookings.edu/metro/capitalxchange/article9.htm>
- PriceWaterhouse MoneyTree. "MoneyTree Report." <http://www.pwcmoneytree.com/moneytree/nav.jsp?page=historical>
- Rubin, Julia Sass. "Financing Organizations With Debt And Equity: The Role Of Community Development Loan And Venture Funds," In Community Development Finance, Edited by Julia Sass Rubin. New York, NY: Russell Sage Foundation, forthcoming.
- Rubin, Julia Sass. "Community Development Venture Capital: A Double-Bottom Line Approach to Poverty Alleviation." In Proceedings of the Changing Financing Markets and Community Development, Second Federal Reserve System Community Affairs Research Conference: 121–154. Washington, DC: Federal Reserve System, April 2001.
- Rubin, Julia Sass and Gregory M. Stankiewicz. "The New Markets Tax Credit Program: A Midcourse Assessment." Community Development Investment Review, San Francisco Federal Reserve, Volume 1, Issue 1 (2005).
- "Evaluating the Impact of Federal Community Economic Development Policies on their Targeted Populations: The Case of the New Markets Initiatives." Paper Presented at the Sustainable Community Development: What Works, What Doesn't and Why, Third Federal Reserve System Community Affairs Research Conference, Washington D.C. (2003).
- Tully, Shawn. "In This Corner! The Contender." Fortune/CNN.com, March 29, 2006:10:24AM EST. http://money.cnn.com/magazines/fortune/fortune_archive/2006/04/03/8373068/index.htm
- VentureOne. "U.S. Venture Capital Funds Raise \$4.26 Billion In First Quarter, 69% More Than A Year Ago." Press Release. May 3, 2006. http://www.ventureone.com/ii/V1_1q06_USFundsPR.pdf
- Zeidman, Betsy. Interview with author, June 2006.