KNIGHT FOUNDATION

CHANGING GEARS IN THE MOTOR CITY

A Financial and Social Impact Assessment of the Detroit Development Fund

April 2017

AERIS

FIELD at the Aspen Institute

knightfoundation.org | @knightfdn

INTRODUCTION

Background

Even before Detroit's bankruptcy in July 2013, the city had been devastated by the aftermath of the Great Recession. Detroit's small businesses—particularly in low-income, moderate-income and black neighborhoods—were struggling to access capital because few banks were lending. Indeed, the Federal Reserve Bank of Chicago noted in 2014 that "perhaps nowhere is the need for business development, financing and community revitalization more pronounced than in the city of Detroit." [1]

Among Knight Foundation's investments to support business development in Detroit has been its work with the Detroit Development Fund. The fund is a community development lender that invests in underserved small businesses to revitalize neighborhoods in the city. In total, the Detroit Development Fund has made $43 million in loans since it was founded in 1996. It has been a key player in the redevelopment of retail hubs in formerly desolate parts of the city such as Midtown and West Village. Knight Foundation first invested in 2006, underwriting a program-related investment (PRI).

> ***"At the time, everyone knew DDF was the only game in town. I heard about them through a friend. You couldn't get a small business off the ground in Detroit without them."***
>
> — small business owner / Craft Work

In 2015, Knight converted a $2.5 million loan (a program-related investment) to the Detroit Development Fund into a grant. The rationale for this move was, first, to further bolster the fund's ability to serve small businesses in Detroit given the existing shortages of capital access from traditional lending institutions. In addition, the conversion had a positive impact on the Detroit Development Fund's overall funding picture. Alongside Knight, other major funders pursued parallel funding models: Ford Foundation maintained its longstanding program-related investments with the fund, and W.K. Kellogg Foundation invested in a new pool geared toward minority small businesses (with JPMorgan Chase & Co. offering an equity cushion as further support).

---

1 An analysis of SBA loans in lower-income and black neighborhoods in Detroit and Michigan," ProfitWise News and Views, Federal Reserve Bank of Chicago, Spring 2014.

Key Findings

Against this backdrop, this review examines the financial impact of the conversion to a grant in August 2015, as well as the Detroit Development Fund's broader social outcomes. Among the key findings:

- **POSITIVE ECONOMIC IMPACT:** The Detroit Development Fund is contributing to the intended impact of economic development. Capital is reaching businesses that show early signs of persistence and that are ultimately adding employees to the rolls.

- **IMPROVED FINANCIAL STABILITY:** The conversion had the immediate effect of strengthening the Detroit Development Fund's balance sheet and halting negative trends in its net worth. The fund has also leveraged its stronger net asset position by raising additional financing resources.

- **HEIGHTENED PROSPECTS FOR GROWTH:** The Detroit Development Fund had projected various growth pathways post-conversion, and data show it is meeting aggressive growth projections.

- **GAINS IN DIVERSITY WITH ROOM FOR IMPROVEMENT:** An analysis of 2015 and Q1 2016 baseline borrower data shows significant shifts in race/ethnicity and gender, as well as the Detroit Development Fund's ability to reach underserved smaller businesses with fewer assets. While baseline data suggest the fund was probably underperforming in reaching a pool of borrowers that represent Detroit, more recent data point to concrete improvement.

Approach and Methodology

This review was conducted in two parts. First, **Aeris**, a rating and information service for community investors, undertook the financial component, asking:

- To what extent did the PRI conversion allow the Detroit Development Fund to access additional debt capital to grow its loan fund?
- Did the conversion place the organization in a stronger financial position to manage growth?

To determine the answers to these questions, the analysis assessed the immediate and aftereffects of the conversion on the organization's balance sheet.

Second, the **Aspen Institute** explored the social impact, examining such issues as:

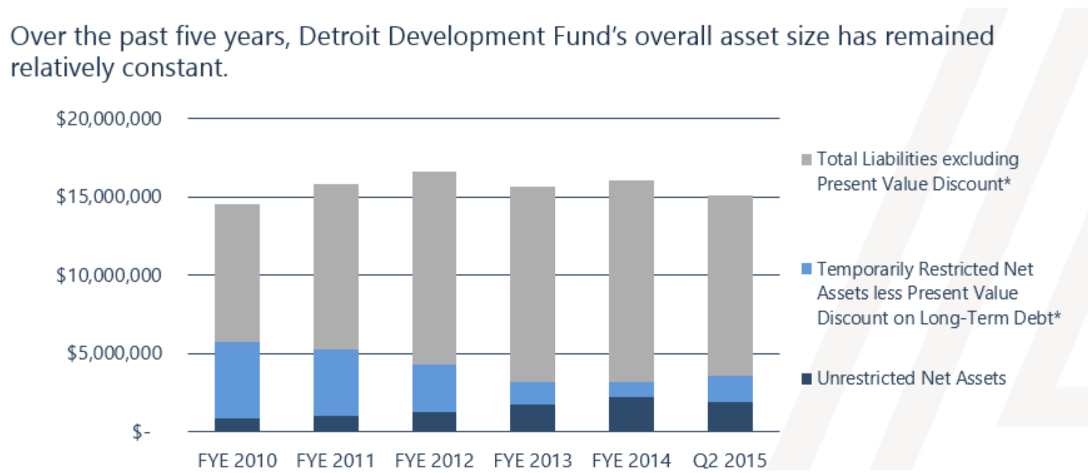
- Has the Detroit Development Fund been able to increase deployment of capital to underserved small businesses?
- To what extent have the businesses that it has supported produced longer-term measures of success, such as net new jobs, revenue growth and business survival?

Aspen established a baseline of borrower outcomes for the Detroit Development Fund and trained the organization on improved data collection methods to track client outcomes.

FINANCIAL ANALYSIS

The first part of the review, conducted by Aeris, explored various dimensions of the conversion's impact on the Detroit Development Fund's financial position and outlook. By early 2015, the Detroit Development Fund's balance sheet had been moving in the wrong direction. Trend analysis since 2010 showed that the organization's overall asset base was relatively constant but that it had a shrinking equity cushion and increasing debt as the fund made more loans (see Figure 1). This shrinking net asset base represented more risk to potential investors, and as a result, was hindering the fund's ability to attract new investment to grow its capital base. This is not atypical for community lenders, especially for organizations that are growing quickly as demand for their products grow; their liabilities typically begin outpacing their net asset base.

FIGURE 1. CAPITAL STRUCTURE—HISTORICAL BASELINE

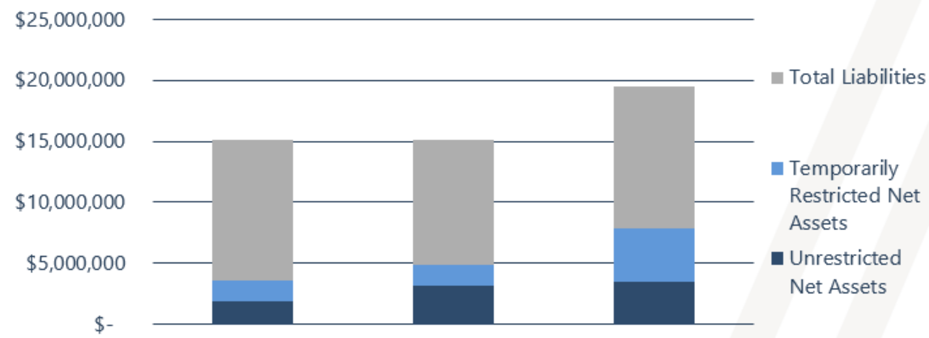


Improved Capital Structure

The conversion had the immediate effect of strengthening the Detroit Development Fund's balance sheet and halting negative trends in its net assets (see Figure 2). Aeris conducted two analyses to understand the impact of the conversion (at Q3 2015) and its effect on the organization's balance sheet a year later (at Q2 2016). From 2010 to 2015, the Detroit Development Fund's leverage ratio had more than doubled. Immediately after the conversion, the leverage ratio decreased from 3.2 to 1.5 (aided, in part, by a large $3.5 million equity infusion from JPMorgan Chase) and, as of the end of Q2 2016, has remained steady at 1.6. Typically, a leverage ratio greater than 2 could be considered unhealthy from an investor's perspective.

FIGURE 2. CAPITAL STRUCTURE—FORWARD-LOOKING

Knight Foundation's PRI conversion helped halt the trend of DDF's contracting net asset base.



($ unless noted)	6/30/15 Actual	6/30/15 with conversion*	9/30/15 Actual	1-Quarter Change
Total Assets	**15,114,324**	**15,114,324**	**19,553,667**	**29.4%**
Unrestricted Net Assets	1,900,235	3,150,235	3,507,285	84.6%
Temporarily Restricted Net Assets (less Present Value Discount)	1,704,778	1,704,778	4,368,318	156.2%
Net Assets	**3,605,013**	**4,855,013**	**7,875,603**	**118.5%**
Net Asset Ratio	**23.9%**	**32.1%**	**40.3%**	
Total Liabilities (Book Value)	11,509,311	10,259,311	11,678,064	1.5%
Leverage Ratio	**3.2**	**2.1**	**1.5**	

AERIS

Although the PRI conversion occurred after June 30, 2015, we show the hypothetical impact on DDF's second-quarter balance sheet to isolate the effect of other third-quarter changes to DDF's capital composition, which included the receipt of a **$3.5 million grant from JPMorgan Chase (included in Temporarily Restricted Net Assets)*

Investor Diversification

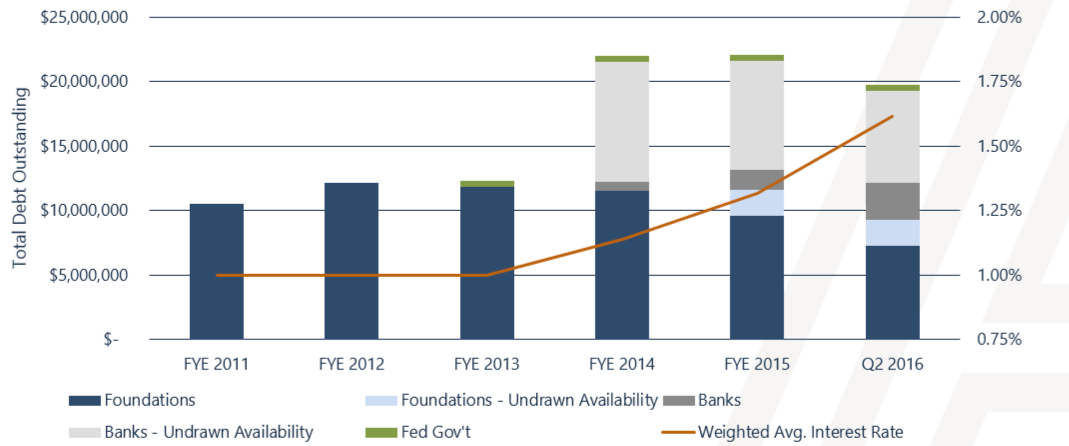
The goal of the conversion was to assist the Detroit Development Fund in growing and diversifying its capital base to serve more small businesses and aid in Detroit's redevelopment. Historically, the fund has been heavily reliant on investment from major foundations. With its improved balance sheet, the fund has been successful in securing more financing resources (see Figure 3).

Most notable has been the creation of the Entrepreneurs of Color Fund which seeks to target more minority-owned businesses. JPMorgan Chase & Co. and the W.K. Kellogg Foundation invested $6.5 million in this specific initiative.

Since the conversion, the Detroit Development Fund has also secured commitments on three new lines of credit totaling $13 million. In the past year, it has begun to diversify its investor base to include corporate sources of debt, and government funding (that is, Community Development Block Grant money). The trade-off of this diversification has been more expensive loan capital, something the fund will have to closely monitor as it grows its outstanding portfolio.

FIGURE 3. CAPITAL STRUCTURE—INVESTOR DIVERSIFICATION

Detroit Development Fund continued to diversify its sources of debt capital. In prior years DDF was almost wholly reliant on foundation debt, but has begun to draw on its two new lines of credit from financial institutions, and has considerable capital availability under those lines.



The tradeoff has been a slight increase in DDF's average cost of capital, as the two bank lines of credit charge a higher interest rate than DDF's foundation and government lenders:

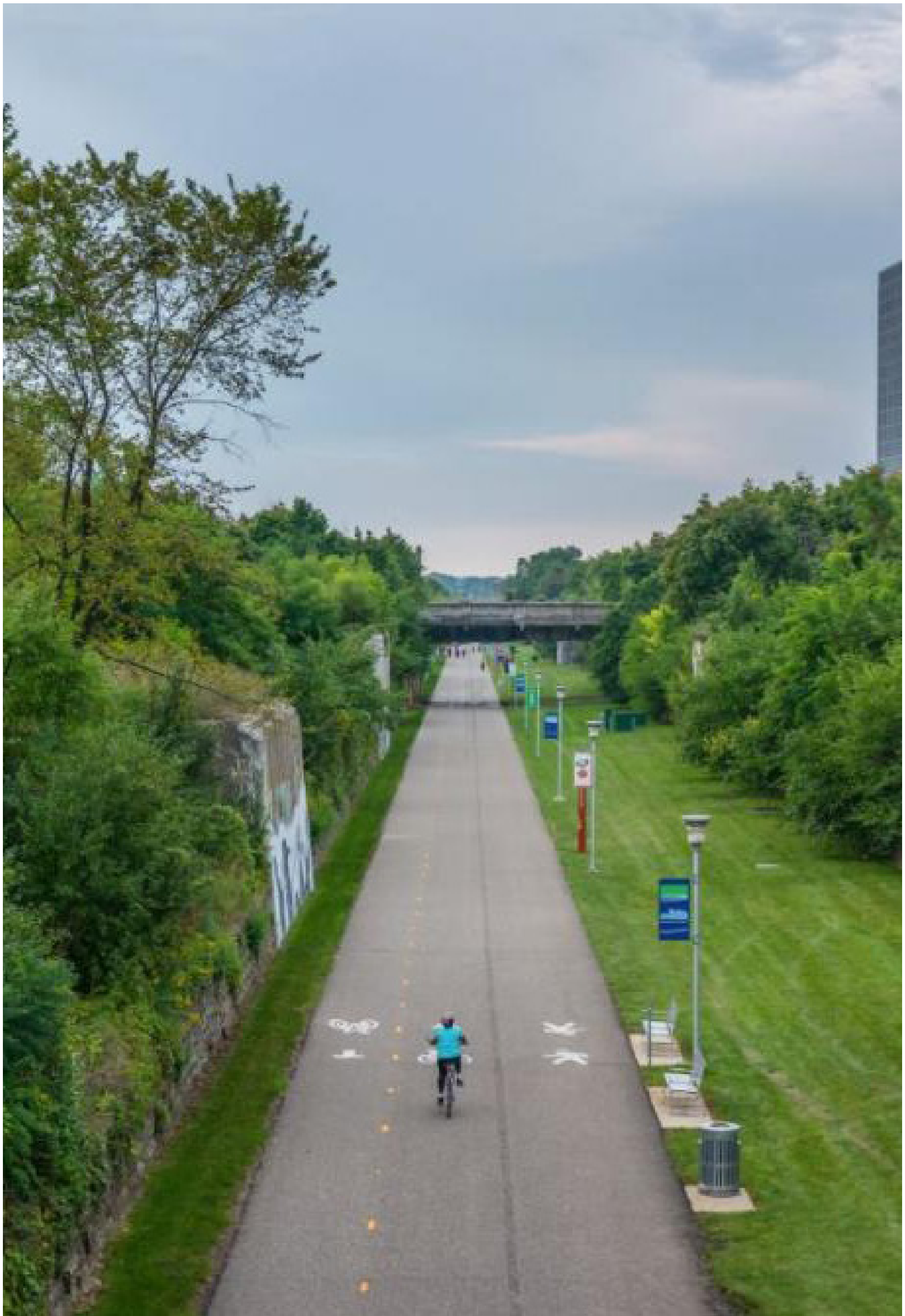
- Goldman Sachs = 3.75%
- Huntington Bank = 3.0% (fundraised subsidy reduced rate to 1.0%)
- All other lenders = 1.0% interest rate *(as of June 30, 2016)*

AERIS

The analysis establishes the clear interrelationship between various types of philanthropic and corporate support. Several other foundations (such as Ford Foundation) were already investing with the Detroit Development Fund or, like Kellogg, were interested in working with it, and the conversion likely had an impact on their decision-making and approach. The improved capital position from the conversion helped strengthen Detroit Development Fund's plan for growth as the organization took on debt from Kellogg, Goldman Sachs and Huntington Bank.

Taken together, all these various investors were interested in the Detroit Development Fund's performance in reaching a "higher-impact" borrower—typically meaning one that is higher risk and, in Detroit, likely a person of color with a lower income. Kellogg supported the Entrepreneurs of Color Fund with a $3 million PRI to grow those minority-owned business investments, while JPMorgan Chase made a substantial $3.5 million grant to boost the loan loss reserves related to that lending. Ultimately, many of the investment decisions made by other funders post-conversion enhanced Detroit Development Fund's ability to increase its impact while maintaining financial stability.

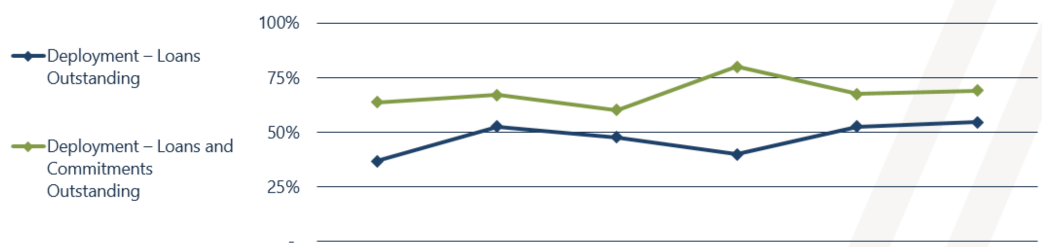
The resulting diversification has made some longtime investors more optimistic about DDF's future prospects. Ford Foundation, which was the Detroit Development Fund's first investor, views the change as beneficial for local entrepreneurs seeking capital – and Detroit's revitalization.



Portfolio Growth

The analysis also included various projected growth pathways: conservative, moderate and aggressive. Data collected through Q2 2016 show it is meeting its aggressive growth projections (see Figure 4).

FIGURE 4. FINANCING ACTIVITY



($ Unless Noted)	FYE 2011	FYE 2012	FYE 2013	FYE 2014	FYE 2015	Q2 2016
Total financing funds	13,446,069	15,086,505	14,886,213	14,915,396	16,666,633	17,890,337
Total loans outstanding	4,955,604	7,938,884	7,112,324	5,959,163	8,797,507	9,798,091
Loans committed but not disbursed	3,634,777	2,188,000	1,870,000	5,988,029	2,481,177	2,590,420
Deployment ratio	*36.9%*	*52.6%*	*47.8%*	*40.0%*	*52.8%*	*54.8%*
Deployment w/ commitments	*63.9%*	*67.1%*	*60.3%*	*80.1%*	*67.7%*	*69.2%*
Loans closed during fiscal year	5,616,955	3,954,015	4,414,053	7,015,500	5,337,724	2,789,441
# of loans closed during fiscal year	31	27	26	24	37	32
Loans disbursed during fiscal year	3,896,635	2,313,824	4,732,053	4,983,841	8,771,311	2,898,684

AERIS

Loans disbursed nearly doubled in FY 2015, far exceeding DDF's historical performance. Some of that growth resulted from loans previously closed in FY 2014. However, DDF closed **$5.3 million in new loans** during FY 2015, exceeding its goal of $4.0 million.

The first half of 2016 showed similar performance, with loans closed on pace to reach $5.8 million for the year. The 32 new loans closed were just shy of the 37 closed in all of 2015.

Loans disbursed reached an all-time high in FY 2015 of $8.8 million, a 76 percent increase over 2014. Total loans outstanding grew by 47.6 percent over the same period. Notably, the Detroit Development Fund closed $5.3 million in new loans during FYE 2015, exceeding its goal of $4 million. The first half of 2016 showed similar performance with total disbursements on pace to reach $5.8 million in new loans, with a greater emphasis on smaller deals. Portfolio quality (including delinquency rates, net charge-offs and restructured loans) has remained relatively even over the period but still warrants continued monitoring as more recently disbursed loans have not yet matured.

SOCIAL IMPACT ANALYSIS

Conducted by Aspen Institute, the second part of the analysis examined the Detroit Development Fund's social impact, including who is being reached and how businesses are being helped.

Reaching High-Impact Populations

The Detroit Development Fund has also shown recent progress in achieving impact among populations most in need of support. Aspen conducted a baseline analysis of 2014 fund borrowers, which revealed a borrower pool that was moderate-income, skewed male and was less than half (40 percent) minority-owned.

To address this, the Entrepreneurs of Color Fund is intended to reach smaller-sized businesses that are more reflective of the city's demographic makeup—and early results suggest that it is succeeding. An analysis of borrower trend data from 2014 to Q1 2016 (see Table 1) shows significant shifts in race / ethnicity and gender, potentially attributable to the recent growth in lending from the Entrepreneurs of Color Fund. The fund carries a substantial ($600,000) loan loss reserve, which allows it to work with riskier businesses or those with fewer assets. Median loan size is a proxy indicator for the size of the businesses receiving funding and whether lenders are servicing higher-risk clients, and data point to a shift toward a lower median loan size over the period studied. It should be emphasized that these gains are early and bear monitoring.

TABLE 1. DETROIT DEVELOPMENT FUND BORROWER DEMOGRAPHICS

	FY 2014	FY 2015	Q1 2016
Male	74%	73%	21%
Female	26%	27%	79%
Person of color (%)	40%	54%	71%
Household income (median)*	No data	$77,000	No data
Loan size	$100,000 (avg.)	$50,000 (median)	$70,000 (median)

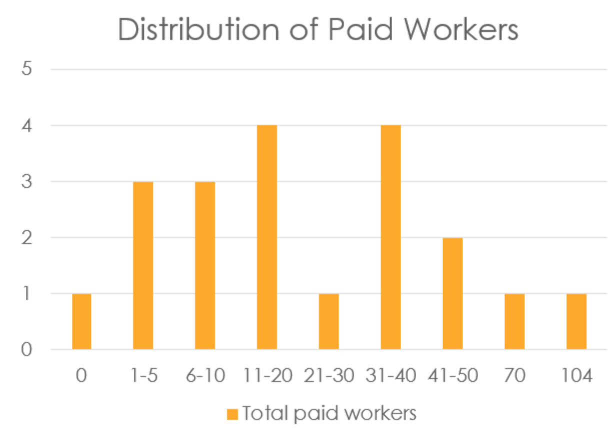
*Missing data on household income in 2014 because the Detroit Development Fund did not collect that data point (collected adjusted gross income). Missing in Q1 2016 because the data are aggregated annually, not on a quarterly basis.

Employment

The Detroit Development Fund appears to be supporting job growth. The Aspen Institute surveyed the Detroit Development Fund's 2014 clients to understand changes to key social outcomes such as job creation 12 to 18 months after they received support from the fund. All but one of the businesses surveyed (95 percent) had at least one paid worker in 2015. As Figure 5 highlights, surveyed businesses had a total of 532 paid employees among the 20 small businesses reporting.

FIGURE 5. SMALL BUSINESS EMPLOYMENT IN 2015

	Total Paid Workers
Median	18.5
Mean	26.6
Minimum	0
Maximum	104
Sum	532
N=	20



To understand these businesses' contribution to employment growth in neighborhoods where the Detroit Development Fund is lending, it is important to look at net new jobs. Among the new and existing businesses reporting employment change data, these businesses added 51 net new jobs, a 50 percent increase in paid workers (see Table 2). These workers earned an average hourly wage of $12 per hour among Detroit Development Fund clients, which is 47 percent above Detroit's 2015 minimum wage rate of $8.15 per hour (see Figure 6)[2].

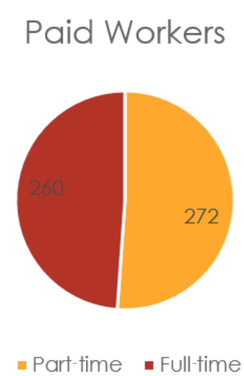
2 See http://www.michigan.gov/lara/0,4601,7-154-11407_32352-140972--,00.html.

TABLE 2. SMALL BUSINESS EMPLOYMENT CHANGE

	Change in Paid Workers– Baseline to Survey
Median	2.5
Mean	1.4
Minimum	-40
Maximum	37
N=	14

FIGURE 6. SMALL BUSINESS EMPLOYMENT IN 2015

	Full-Time Paid Workers	Part-Time Paid Workers	Average Hourly Wage
Median	8.5	8	$10.00
Mean	13	14.32	$12.00
Minimum	0	0	$6.25
Maximum	65	100	$25.00
Sum	260	272	
N=	20	19	13



Business Survival and Optimism

Another key indicator of economic development is the survival rate of new businesses and whether they can last. The survey found that all business owners were still operating their businesses, with 82 percent growing revenue year over year. The median change (or growth) in business revenue among this group was $159,117 (see Table 3).

TABLE 3. SMALL BUSINESS REVENUE CHANGE

	Change in Revenue–Baseline to Survey
Median	$159,117
Mean	$895,199
Minimum	-$408,247
Maximum	$7,603,778
N=	11

Business owners were also asked questions related to their outlook on growth in 2016 to gauge their perception of the current business environment. Ninety percent of the business owners surveyed thought that business revenue would increase in 2016, and 10 percent thought revenue would stay about the same. This suggests that many of the Detroit Development Fund's clients perceive the business environment as relatively stable and on the upswing.

CONCLUSION

The evaluation looked at the impact of the Detroit Development Fund's PRI conversion from both a financial and social impact perspective, and it found an organization on stronger financial footing with a path toward growth and funder diversification. An analysis of the social outcomes found early, yet promising, indications that the fund is growing a more diverse client base that can generate positive employment opportunities in Detroit's redeveloping neighborhoods.

The challenge now for the fund is to accelerate growth while managing its lending infrastructure in a rapidly changing environment. For example, new predatory online lenders have emerged to target Detroit businesses. To stay competitive, the Detroit Development Fund is upgrading its technology infrastructure for tracking its existing portfolio and social impact and recently hired a consultant to help streamline the process while maintaining a healthy portfolio.

> ***"We went to the community and asked them what they wanted. They said, 'We want a coffee shop.' Three years later, it's [West Village] turned into a retail hub."***
>
> — Ray Waters, president of DDF

Finally, while this evaluation focused on the Detroit Development Fund's conversion, it showed that coordination with other local funders can help bolster the fund's local impact. Knight Foundation has also made a series of substantial investments to support Detroit's redevelopment in concert with other local stakeholders. The Detroit Development Fund is just the latest example of how working in collaboration with other investment efforts in Detroit can provide multiple levels of return and social impact.

METHODOLOGY

FINANCIAL ANALYSIS: Aeris reviewed five years of Detroit Development Fund's historical financial data to establish a baseline of growth for comparative purposes. Key performance indicators (KPIs) were summarized to establish a baseline as of June 30, 2015, including net worth ratios, capital composition and diversity, average cost of funds, average term of debt, loans closed and disbursed, average deployment rate, and financing income as a percentage of total revenues. Changes to DDF's balance sheet were evaluated at Sept. 30, 2015 and June 30, 2016, as a result of the PRI conversion and projections to balance sheet, lending volume, and portfolio size were based on historical and increased leverage capacity.

CLIENT OUTCOME ANALYSIS: The goals of FIELD at the Aspen Institute's work with Detroit Development Fund (DDF) were to measure the outcomes of borrowers who received financing from DDF during its fiscal year 2014 (through survey), and to build the organization's capacity to track outcomes of borrowers who receive financing in 2015 and beyond.

Aspen worked with DDF to conduct longitudinal surveys with its client base and achieved a 58 percent response rate, which it considered robust. With a small universe of clients like DDF's, Aspen wanted to achieve a response rate of at least 50 percent, ideally closer to 70 percent. However, programs conducting follow up surveys for the first time rarely achieve much greater than a 50 percent response rate. DDF attempted to survey all of its small business borrowers, therefore there was no concern for sampling bias.

JOHN S. AND JAMES L. KNIGHT FOUNDATION
Suite 3300
200 S. Biscayne Blvd.
Miami, FL 33131–2349
Telephone: (305) 908–2600