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A big barrier to minorities in a big Chicago industry

We examine the problem of access to capital in development and construction here.

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Bill Williams of KMW Communities has done millions of dollars' worth of deals in his 16-year development career but found landing capital always to be a struggle.

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Lennox Jackson had enjoyed success in 16 years as a developer, building affordable and market-rate housing on the South Side, including a gated community of 18 condos and townhouses in Bronzeville and 21 single-family homes in South Shore.

But the 2008 recession wrecked his balance sheet. He had to set aside his business, Urban Equities, take a salaried position for a few years and then relaunch.

Jackson is among a group of ambitious Black developers looking to grow their businesses and make an impact but face daunting challenges raising capital and equity. They often come from families of modest means and typically don't have the nest egg to get started. Tapping friends and family for money isn't an option. As a result, it takes a long time to build capacity, first raising capital and then waiting for a payout, one project at a time.

"Some people start at the 50-yard line in life. Others start at the goal line, 100 yards back," Jackson says. "I had made it up to the 50-yard line, but I got pushed back into the end zone again."

Only 6 percent of area construction firms are owned by Black entrepreneurs, according to a 2018 study by Next Street and the Community Reinvestment Fund, and there are fewer developers to take on the larger risk of envisioning, funding and marketing a project.

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Access to capital was a top need, the study found.

One of the biggest barriers to Black and minority entrepreneurship stems from long-held beliefs by banks and other financial institutions that these entrepreneurs are higher-risk candidates, according to research by William Towns, an adjunct lecturer of social impact at the Kellogg School of Management at Northwestern University and managing director of a private equity fund at 4S Bay Partners that targets minority businesses in the region.

Much lending is based on relationships, and there aren't a lot of minorities in private equity and venture capital, Towns notes. "People invest in the communities they know, in the areas they have experience," he says.

When the developers succeed and move to larger projects, say from single-family homes to multiunit buildings, they face a new set of skeptical lenders. "You're almost starting again," Towns says.

Bill Williams of KMW Communities has done millions of dollars' worth of deals in his 16-year development career but found landing capital always to be a struggle. Sometimes loan terms would be too stiff, or there would be a restrictive covenant, a higher interest rate or a demand that the developer raise more equity. "The rejection is more nuanced," Williams says.

Building on the South and West sides most often requires a subsidy to compensate for the higher risk of investing in lower-income neighborhoods. There are tools available that can go into the "capital stack" to fund a project, such as tax credits, tax-increment financing and opportunity zones. But they can be difficult to navigate and not always easy to come by. The competition for federal tax credits awarded by state and city agencies is fierce, developers say.

And mortgage lending—the loans that enable developers to sell their projects—historically was constrained. An analysis last year by WBEZ and City Bureau found that of dollars lent for housing purchases between 2012 and 2018, 68.1 percent went to majority white neighborhoods, while just 8.1 percent went to majority Black communities and 8.7 percent went to majority Latino neighborhoods.

The lending landscape may be improving in the reckoning following George Floyd's killing a year ago. Banks and nonprofits have announced initiatives to advance racial equity and to specifically support minority entrepreneurs. JPMorgan Chase in February committed $200 million to a venture with Ariel Investments to help fund minority-owned businesses.

The Chicago Community Trust launched a fund to help developers with early-stage costs.

"The banks are starting to loosen up a bit," Williams says. "If we're able to provide a return to investors and transform communities, this can be an inflection point. "It's up to us to turn the page so we don't return to the old status quo."

The art of the capital stack

One of the most successful Black developers is Leon Walker, whose company DL3 Realty is known for the breakthrough Englewood Square shopping center with a Whole Foods, Starbucks and Chipotle.

Walker moved back to Chicago in 2000 from a lucrative job with JLL in Los Angeles. He used working capital from his family's education business to convert a child care facility to a retail center in Roseland.

His next deal, a 27,000-square-foot medical office building near Roseland Community Hospital, was more of a stretch, and Walker started assembling a patchwork of capital from different sources. He attended a conference in Washington, D.C., to learn about New Markets Tax Credits, which were new at the time. He says he was the first to use them in Chicago for new construction.

Chicago Community Trust Pre-Development Fund

What it is	Funding for residential, commercial and mixed-use projects on the South and West sides
Launched	September 2020
Seeded	$1.8 million
Received	46 submissions
Funded	10 projects
Grants awarded	$718,500
Average grant size	$71,500
Average project size	$11.7 million
Estimated market value of 10 projects	$105 million

Source: Chicago Community Trust · Get the data · Created with Datawrapper

Walker went on to incorporate tax credits in the funding of other South Side projects, including the $20 million Englewood Square, which opened in 2016. It came together with a funding mashup that included tax-increment financing and funding from the Chicago Community Loan Fund, PNC and the Chicago Development Fund. Walker even raised $500,000 in a crowdfunding campaign. "I wanted to see if crowdfunding could be a durable piece of our capital stack in future deals," he says.

Making the case for Starbucks was a challenge. A conventional demographic study of the neighborhood at the time showed the average household income within a one-mile radius was less than $29,000, compared to the citywide median income of $62,000.

But when you look deeper, you find that there are 1,000 families that make more than $50,000 a year, and "they can afford a cup of coffee every day," Walker says. "Then the lights go on."

Black developers also have found success teaming with well-capitalized white companies.

A partnership also paved the way for developer Philip Beckham III to launch 43 Green, a mixed-use apartment and retail project near the 43rd Street Green Line stop in Bronzeville. Beckham teamed with Habitat's affordable-housing management and community development arm. Groundbreaking is planned for late summer.

Beckham founded development firm P3 Markets in 2018 after years of running his family's school bus business. "If you're working on the South or West sides, you already have a red flag from lenders. If you come in by yourself as a Black or Brown developer, it's difficult," he says. "If you come with an established joint venture, everything is OK."

Williams of KMW also has had luck connecting with deep-pocketed firms. He's a partner in the joint venture development of a 6.3-acre Cabrini Green site that's led by El Paso, Texas-based Hunt Development. Williams is leading the for-sale housing component of the project.

"The partnership is mutually beneficial," he says. "They needed a diverse team. Without the balance sheet of the Hunt company, we never would have been able to participate."

Tax credits and other kick-starter incentives are valuable for projects on the South and West sides, but Williams says he doesn't want to be pigeonholed for these ZIP codes. "The South and West sides need to be built up, but I want to have a crane in the sky downtown. The real money is made when you're participating across different markets."

Williams figured the solution would be to raise a fund in the $80 million to $100 million range so that he wouldn't have to scramble each time an opportunity came along. Adding leverage to that base would provide sufficient resources for transformational projects, he says.

Even then, he was frustrated when investors suggested he limit the size of the fund and stick to smaller projects, which he views as less profitable. But in recent weeks Williams was encouraged by his contacts at Citibank, JPMorgan Chase, Clayco's investment banking arm and the family office 4S Bay Partners, who have expressed interest in investing in his fund. He hopes to assemble a hybrid model that would focus some projects in depressed neighborhoods but also enable him to tap emerging areas such as Woodlawn and Humboldt Park, as well as the broader market. "They're listening," Williams says of the potential investors.

John R. Boehm

Developer Lennox Jackson, left, of Urban Equities and Michael Davidson of the Chicago Community Trust.

Speeding up the cycle of philanthropy

Jackson, the developer, also is encouraged by recent developments. He expects to receive $90,000 from the Chicago Community Trust Pre-Development Fund for the initial stages of a $7 million mixed-use project in Austin, a partnership with the nonprofit Austin African American Business Networking Association. Located on Austin's Chicago Avenue corridor targeted under the city's Invest South/West program, the project proposes 30 condos and 10 retail spaces. It's not competing under the initiative's formal request-for-proposal process.

The pre-development fund was seeded last year to help minority developers with upfront expenses such as land acquisition, site planning or architectural drawings. These are critical funds because lenders want to see detailed plans before they commit to funding a full project, "a cake that's ready to be served," as Jackson puts it.

"For a long time, people like Lennox and the nonprofits were saying to us, 'Why doesn't philanthropy support pre-development? You support the other parts of development,' " says Michael Davidson, senior director of community impact for the Chicago Community Trust. "I didn't have a good answer. So we created a fund (seeded with $1.8 million) and named it. We figured if we promoted it, maybe other foundations would also begin to support pre-development."

Davidson says he's speaking with banks about the pre-development fund. "I don't know if we'll get money from them, but they get it," he says. "If we get corporate philanthropy from banks, that's terrific. But we need changes on the commercial side of the bank. Systemic changes need to happen."

The major banks have made encouraging announcements post-George Floyd. JPMorgan Chase in February committed up to $200 million to be co-invested with Ariel Investments to help fund minority-owned businesses. Chase's commitment with Ariel is part of its $30 billion drive to advance racial equity. Ariel this year formed an investment vehicle, Ariel Alternatives, which aims to raise more than $2 billion to invest in Black- and Latino-owned firms, Crain's has reported.

Earlier, Bank of America pledged $200 million to minority entrepreneurs, businesses and funds out of a $1 billion commitment to advance racial equity. BMO Financial Group pledged $300 million toward expanded resources for minority-owned small businesses, part of a $5.1 billion commitment to counter the racial wealth gap.

Developers need funding, but they also need faster decisions. "I need to get in and get out in a reasonable window," Jackson says. "That enables me to come up with a formula where I can scale and repeat as much as possible."

Philanthropy usually moves slowly, Davidson acknowledges. "We've tried to move off our cyclical pattern, the typical refrain of 'come back to us this summer after we meet with our board.' " Davidson's team now meets every other week to review proposals and writes checks every other month. "That's very fast and doesn't allow us a lot of time for due diligence," he says. "It's important for us to know we're not giving money to a project that's going to fail. But if philanthropy can't take risks, who can?"

One program to advance minority developers was launched last year by LISC Chicago and Urban Land Institute Chicago. The partnership, Yield Chicago, aims to identify, mentor and fund entrepreneurs of color who have plans to develop projects in their South and West Side neighborhoods. Funded by JPMorgan Chase and the Pritzker Traubert Foundation, the partnership launched its first cohort of emerging developers who are paired with experienced developers from the ULI community.

Another initiative that aims to advance minority developers is the Chicago Emerging Minority Developer Initiative, or CEMDI, launched last year by Leon Walker, attorney Graham Grady and Gwendolyn Hatten Butler, president of real estate investment company Capri Investment Group. The group aims to "source and build a pipeline of community-focused developers from African-American, Latinx and other minority communities to participate in commercial real estate development projects citywide," including projects under the Invest South/West initiative.

One promising developer identified by CEMDI leaders is Floyd D. James Jr., who has worked as a general contractor on single-family home additions and renovations as well as projects for the Chicago Housing Authority. He's aiming to build single-family homes and two-flats in North Lawndale, Englewood and Bronzeville with smart technology that controls energy use. Rooftop hydroponics would enable residents to grow food in neighborhoods short on supermarkets.

James says he is seeking investors and is working with several aldermen in the hope of getting help from the city in the form of donated vacant lots. A spokesman for the Chicago Department of Planning & Development says the city works outside the RFP process to help small minority developers that don't have capacity, part of the broader initiative to revitalize the South and West sides.

For his part Jackson says he is eager to cultivate other developers "who look like me." More soldiers are needed in the quest to rebuild depressed neighborhoods, he says, adding, "I can show you how to do this, and how to get beyond the 50-yard line."

Inline Play

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