

# Innovate Michigan!

## 2024 Co-Learning Plan Series

### Strategy to Develop a Diversified Community Investment Fund

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U.S. ECONOMIC DEVELOPMENT ADMINISTRATION

# Building Local Wealth:

**Diversified Community Investment Funds for Main Street Start-Ups**

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## INTRODUCTION

The Strategy to Develop a Diversified Community Investment Fund (DCIF), seeks to reverse the habitual outsourcing of dollars back to the main streets of Houghton and Keweenaw counties in Michigan's Upper Peninsula, where locally owned businesses have gradually shuttered throughout the last five decades.

A Diversified Community Investment Fund is a type of community-scale fund that invests primarily in real estate, but also invests in local businesses and can do so with investment capital raised publicly from within the fund's own community, including non-accredited investors. A DCIF can distribute profits to its community investors, creating wealth-building opportunities while contributing to a more vigorous local economy. This CLP proposes to introduce people to crowd-capitalization, build infrastructure for large community conversations, and use knowledge gained to establish a local Diversified Community Investment Fund.

## BACKGROUND

A Community Investment Fund is created by people who care about the economic health of their community. It is a professionally managed financing tool that invests in local projects, people and businesses with money sourced from within the community.

The Investment Company Act of 1940 lays out the structure through which investments can legally occur in the United States. For communities with populations of under 50,000, establishing a Community Investment Fund is not feasible because the cost of compliance with Security Exchange Commission requirements precludes it as an option.

Section 3 of the Investment Company Act sets forth the definition of an investment company, and also delineates exceptions to the definition, or exemptions. Section 3 (c)(5)(C) reads as follows, with Sections 3. (a)(1)(A) and 3. (a)(2)(B) added for context:

**SEC. 3. (a)(1)(A)** When used in this title, “investment company” means any issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

**SEC. 3 (a)(2)(B)** Notwithstanding paragraph (1)(C) of subsection (a), none of the following persons is an investment company within the meaning of this title: **SEC. 3 (c)(5)** Any person who is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one or more of the following businesses: ... **(C)** purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Therefore, as long as the primary function of the organization is real estate acquisition or development, secondary investments can be made without the business being defined as an investment company and it is classified as a Real Estate Fund.

The two-pronged statutory definition of a Real Estate Fund is qualitative and quantitative. Again, the qualitative requirement is that the fund's primary business is purchasing, developing and managing real estate; and the quantitative test is that the fund must be composed of at least 60% real estate assets. The

other 40% can go towards projects of the developer's choosing. A Real Estate Fund Exemption simplifies the process for local investment and makes it far less expensive, thus creating an accessible local wealth-building opportunity.

These kinds of transactions have been taking place in the United States by private investors for over a century. People have invested in real estate fund partnerships that included startups and related business development as part of their portfolios. A Diversified Community Investment Fund (DCIF) replicates the strategy of the Real Estate Fund. A DCIF is similarly structured, but it opens the offering up to the general public instead of only to accredited investors, who must make over \$200k annually or have \$2M in assets. Traditionally, the general public have been referred to as “unaccredited investors,” but now they are more commonly called “retail investors.”

Through the 2013 Michigan Invests Locally Exemption (MILE) Act, a Michigan resident can now invest up to \$10,000 in a crowd-financed project. Professional investors prioritize getting a 12 to 22% return on their investment. Other investors have that priority as well, but if the opportunity presents itself to improve the economic condition of their community, perhaps is a business they'd like to see in their neighborhood *and* it looks like a good investment, they may be willing to allocate some percentage of their portfolio to investments that may not offer an immediate or particularly hearty return. Other residents who are unfamiliar with the investing process may have some disposable cash and a not-as-aggressive profit priority and choose to invest because they want to see improvement and growth in their area's main street economy.

This project seeks to put together a group that differs from yet shares attributes with local investing clubs and investing networks. A local investing club pools their money and makes collective investing decisions; whereas an investing network doesn't pool their money but still learns about investments together. This project is building the needed infrastructure for a group discussion that will have a large-tent general theme of improving our local economy. I'll discuss ways to support and emerge small business startups, discover what people think are viable market needs in our area, and examine abandoned real estate that professional developers have passed up. The plan is to find people who are interested, present them with intriguing information and questions regarding our local economy, and

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invite them to inform the structure of the discussion with their input. Participants will be introduced to the prospect of utilizing a DCIF and viewing area real estate tracts through that lens. The group will have all the earmarks of a local investing club or investing network, but the focus will be on our community, its assets and its needs.

### LOCAL EXAMPLE: KEWEENAW FOOD COOPERATIVE

The area's food cooperative has been interested in moving to a larger facility for many years.

In August 2021, the Keweenaw Food Cooperative signed a purchase agreement on a property they desired in downtown Hancock. That fall, they formed a capital campaign team and by spring of 2022 they had determined that they needed \$7 million to transform the property into a fully stocked grocery store. They designated a Capital Campaign Manager who also held a board seat. The campaign took place over a year, and by May 2023 the Keweenaw Cooperative had raised \$1,025,000. The project was also awarded a number of grants totaling \$1.75 million supporting healthy food access, downtown development, and local food systems. With this \$1.775M, Superior National Bank financed the rest of the funds needed for the move.

The Co-op's success with this capital raise relied heavily on educating its members about the MILE Act. Promotional pieces were carefully tailored to inform potential investors about the risk involved. It is an inspiration for our community and owner/members to see validation of a successful crowd-financing campaign. Excitement is building as the new location goes online.



## PHASE I – RESEARCH.

May 2023 was spent learning about the DCIF model and its emergence in the United States. It appears that no DCIF has been established yet in the United States, and that efforts towards building them are pilot projects. This is a harder, yet not impossible sell to our area, which could be characterized as very financially conservative. The Kachuwa Impact Fund, an investment cooperative located in Colorado, is using the DCIF model, but not as an offering open to the public.

## CONVERSATION WITH DAVID PALMER, CEO KITE & KEY PARTNERS, LLC.

David Palmer outlined the strategy for a project in southwest Detroit called MiSide, focused on rebuilding downtown neighborhoods from the ground up using the DCIF model to enable residents, owners and managers of small businesses in the area to have preferred equity shares (Class A shares) and majority vote in the proposed DCIF. The Class A shares will get the highest return on their dividends for the most minimum investment, a \$200/share requirement. Class B shares are allocated to City of Detroit residents at \$500/share, and Class C shares are available to all Michiganders and are open for a \$1k minimum. Residents who purchase the Class A shares will be the first ones to be paid back. MISide hosted “Community Convenings” to introduce and educate area residents and small businesses about the project and the structure surrounding a potential investment.

### *STRUCTURE.*

The MISide project has chosen to create a C corporation (as opposed to an LLC) because the financial disclosure process is more rigorous, suiting their intent. C Corps issue yearly 1099s to their investors, making the reporting of disbursement of revenues/annuities occur on an annual basis. The return on this investment is anticipated to yield 2.5% interest after 7 years.

## CONVERSATION WITH CHRIS MILLER AND SYDNEY DAVIS

Chris Miller, National Coalition for Community Capital Chair, is researching another exemption within the law called a 'Supplementary Fund,' whereby a 501c3 could crowd finance a raise and not require the real estate as a component. Sydney Davis, U.S. Economic Development Administration Economic Recovery Corps (ERC) Fellow suggested the Western Upper Peninsula Planning and Development

Region's (WUPPDR) Comprehensive Economic Development Strategy should have language in it that shows how their mission aligns with the formation of a DCIF. Areas to look at include upward mobility for all sectors and sustaining and growing business. The region's housing situation is a pinch point for WUPPDR, a problem for which they are allocating significant resources towards solving.

## CONTEXTUALIZING DCIFS WITHIN A REAL ESTATE FRAMEWORK

Brian Beckon, Attorney, Pathlight Law and NC3 board member, gave thorough explanations regarding essential processes, and also normalized a DCIF within real estate transactions. Beckon pointed out that the same types of investment have been happening for a century in private offerings, which have their own ratios of accredited and non-accredited investors. He addressed ‘the mythology of risk’ regarding the Investment Companies Act of 1940 and Investment Advisors Act. Lawyers, he stated, are not introduced to crowd-financing and its strategies in their education; in fact, they are not taught the Investment Company Act of 1940 in law school. This results in a reflexive response that it must be risky - if they aren't taught about it, it must not be possible. Also, the perception is that it is riskier to raise capital from retail investors because there are more regulatory hoops to jump through. “Anything that involves regulators looking at it is perceived as risky – but it is better when regulators *are* looking at it because it assures everyone that the offering is being done correctly, further ensuring its future success.”<sup>1</sup> Finally, it is interesting to note that there have been no lawsuits brought by a non-accredited investor in Brian Backon's career as an attorney at PathLight Law.

## DCIF PROJECTS DEVELOPING IN THE STATE OF MICHIGAN

*MI-SIDE (FORMERLY SOUTHWEST SOLUTIONS), DETROIT.*

A coalition of local nonprofits is working to develop 800+ parcels, to include single- and multi-family, mixed-use and commercial structures, and fill them with Detroit residents and small businesses. In response to a United Way challenge to create a “transformative project,” the coalition worked with community members to identify the project scope and engaged the National Coalition for Community Capital (NC3) to guide the creation of a DCIF where community investors are prioritized. NC3

anticipates the initial community capital raise will occur in 2024 (This is the project for which David Palmer provided excellent background information).

***PETOSKEY.***

A group of advocates convened to initiate community-based projects including workforce housing, ecotourism, and local business. Over the past year, the group has worked through the details of what type of community investment fund they would like to form and who will manage it, and they have decided to create a DCIF managed by a newly created 501c3. The group also identified their first project site: a 24-unit apartment building in Petoskey, which they hope to purchase and maintain as an affordable workforce housing site.

***DETROIT MUSIC COLLECTIVE, DETROIT.***

Three record company executives with decades in the industry have engaged NC3 to guide them through the creation of a Diversified Community Investment Fund to facilitate the financing of a set of community assets that would make Detroit a true ‘Music City’. The three executives are native Detroiters and have set a goal to bring their expertise and connections to the project which envisions an artist community in the city complete with performance venues, a music school, recording studios, a talent-owned record company, affordable housing for aspiring artists, and a record production facility.

## PHASE II: INFRASTRUCTURE SET UP

A press release was sent to Upper Peninsula media outlets to announce this project, organized to reverse the habitual outsourcing of dollars back to the main streets of Houghton and Keweenaw communities, where many locally owned businesses have gradually shuttered over the past five decades. It was posted in *Marquette Monthly*<sup>2</sup> and Houghton's *Daily Mining Gazette*<sup>3</sup>.

Two social media platforms were created to facilitate organized and topically driven discussions for the convenience of participants.

- Phone users will need to search their app store and download “Viber,” then look for the channel, ‘Build LOCAL’.
- Desktop users can find it on Mastodon, by searching <https://mastodon.social/@BuildLocal>.

A landing page was also added to New Power Tour's website with links to both platforms located at <https://www.newpowertour.com/local>. The page features a video of Chris Miller's February 2024 talk on DCIFs, sponsored by the Keweenaw Chamber of Commerce's monthly Lunch'n'Learn. Informational brochures and flyers were printed to post and hand out to individuals and at municipal meetings (see appendix A & B).

## ACTIVITIES - MEETINGS

Outreach also took place where public bodies were introduced to DCIFs and informational flyers were distributed:

Keweenaw Chamber of Commerce

City of Houghton Downtown Development Authority

City of Hancock City Council

City of Hancock Downtown Development Authority

City of Hancock Farmer's Market

City of Hancock Planning Commission

City of Houghton City Council

City of Houghton Planning Commission

*NEXT STEPS: PLANNED MEETINGS*

- **110<sup>th</sup> District Representative Greg Markkanen.**

Strategize with Chris Miller and Jenan Jondy on the best way to present the full concept of DCIF to Representative Markkanen. Identify additional state representatives and senators to connect with to advance the take-up of DCIFs in their districts.

- **Western Upper Peninsula Planning and Development Region + Baraga Chamber of Commerce.**

Lisa McKenzie, Regional Planner (WUPPDR) and Debbie Stouffer, Baraga Chamber of Commerce meeting (in September or October) to explore DCIF for an 80-acre parcel located in the City of L'Anse and L'Anse Township.

- **Northern Initiatives, Marquette**

Elissa Sangalli (CEO) or Amanda Blondeau, Chief Strategy Officer, Northern Initiatives' mission is to “provide loans and business services to Michigan entrepreneurs and small business owners who add jobs and help their communities thrive...A small business loan isn't just a loan: it represents a chance at building community wealth, improving quality of life, and creating positive, sustainable change.”<sup>4</sup> This conversation will explore the opportunity to support the development of a Diversified Community Investment Fund in the Western Upper Peninsula.

**Michigan State University Center for Regional Economic Innovation Annual Meeting, Innovate!**

**Michigan Summit (Lansing)**

Additional information was gained during a 45-minute presentation on the research, background and current possibilities stemming from this project. After the presentation, one query dealt with how a DCIF would be professionally managed, given the corporate climate of large fund managers. Chris Miller and David Palmer informed attendees that smaller DCIFs would not be able to afford the services of these types of managers and that - at that level - they can be managed by a designated board of five or

six people who are locally-qualified and tasked with keeping close tabs on projects, frequently reporting on developments to their investors.

It also became clear that within the two scenarios of crowd-investing, debt and equity, debt-financing doesn't actually build long-term wealth in a community. Equity investments yield profits over the long term, thereby building local wealth. Lastly, at this event, an informal poll revealed that in a room of about thirty people, only three knew about the existence of crowd-financing.

## LOCAL PROSPECTS: WESTERN UPPER PENINSULA LANDSCAPE

WUPPDR's Regional Planner Lisa McKenzie has a background as a local Realtor, is a member of the Hancock City Council, and was the former Mayor of the City of Hancock. WUPPDR works closely with the Michigan State Housing Development Authority (MSHDA). New Power Tour, Inc. (501c3) is currently partnering with WUPPDR on a MSHDA-funded project called MI HOPE, the Michigan Housing Opportunities Promoting Energy Efficiency program.

WUPPDR was awarded three separate rounds of funding totaling \$1.5M to replace roofs and windows and insulate the homes of sixty income-qualified Western Upper Peninsula residents. NPT manages contractor walk-throughs and final inspections for the program and MSHDA's program funds are able to extend further through NPT's partnership with utility programs that replace aging and failing furnaces, boilers and water heaters for income-qualified residents.

Previous project collaborations include a Community Energy Management grant through the Michigan Environment Great Lakes and Energy office. NPT performed an energy audit of the assets owned by Grant Township, located at the northernmost tip of Keweenaw County and includes the unincorporated community of Copper Harbor.

The State of Michigan released its Statewide Housing Plan (see appendix C) in 2022 "to address a broad array of intersecting challenges limiting access to safe, healthy, affordable, accessible, and attainable housing for all in a community of their choice...The comprehensive Plan lays out our state's challenges and offers a blueprint for how a statewide network of committed housing leaders and advocates can come together to address the goals and priorities and change Michigan's housing ecosystem for the

future by creating a connected and collaborative housing ecosystem of Regional Housing Partnerships.”<sup>5</sup> In 2022, Lisa McKenzie organized monthly stakeholder meetings for developers, contractors and municipal stakeholders to participate in gathering the data for WUPPDR's “Regional Housing Study and Strategy.” (see appendix D)

In 2023, WUPPDR was designated as the lead agency for MSHDA's Regional Housing Partnership for Region A, the Upper Peninsula. In that year, they also were awarded a Rural Readiness Grant from the Office of Rural Development, Michigan Department of Agriculture and Rural Development. The \$50,000 grant is being used to establish and activate a nonprofit community development corporation (CDC) in the L’Anse, MI area, and to work with L’Anse Township and the Village of L’Anse to prepare a jointly owned village and township tract of land for housing development. Of more than 90 applicants, WUPPDR is one of 21 recipients in the State of Michigan for Round 1 of the Rural Readiness program, including three in the Upper Peninsula.

A CDC can conduct a wide variety of community development activities, but the initial focus of the L’Anse Area CDC will be housing. Years of feedback from Baraga County stakeholders have indicated a severe shortage of attainable high-quality housing in the area, which limits employment and business expansion opportunities. A CDC can foster development by coordinating the “packaging” of parcels, financing sources, and other prerequisites for housing development, ultimately leading to physical development of sites by either nonprofit or for-profit developers.

WUPPDR’s lead local partner organization in the grant project is the Baraga County Chamber of Commerce, which has committed in-kind personnel and financial support. Other key partners, many of whom are also generously providing financial support, include: L’Anse Township and Village, Baraga County Board of Commissioners and Economic Development Corporation, Baraga County Memorial Hospital, Keweenaw Bay Indian Community, Superior National Bank and Trust, and Invest UP.

During Chris Miller’s visit in February 2024, Miller met with WUPPDR executive director Jerry Wuorenmaa, Lisa McKenzie, and Mary Babcock (manager, City of Hancock) to introduce them to the Diversified Community Investment Fund concept. Debbie Stouffer (Baraga Chamber of Commerce)

attended the presentation Miller also made at the Keweenaw Chamber of Commerce Lunch'n Learn. She reached out to Miller to talk about integrating a DCIF into their emerging housing development project, who then, in turn, referred her to this project.

*CONVERSATION WITH WUPPDR AND BARAGA CHAMBER OF COMMERCE.*

Both Lisa McKenzie and Debbier Stouffer were both thinking that a DCIF might be an appropriate investment vehicle for raising capital in periodic financing for the previously mentioned 80-acre parcel in L'Anse. Currently, the parcel doesn't have municipal services (water, sewer, electric). They are working to get the property platted while it is still partially owned by the township as it will be less expensive to do so at this point in time. They explored the possibility of using the \$50k MDARD award to fund this step. After that, they need to raise the needed \$110k to acquire the land through either personal solicitation or through a crowd-funding platform. McKenzie and Stouffer are analyzing ways to structure the ownership, as current understanding is still that a DCIF can't be housed under a 501c3. They both envision the role of the DCIF as a way to involve local retail investors in the project and plan sequential offerings/raises at key milestones for expanding the development of the property. Especially popular was the concept of working with the community to find out what kinds of businesses they would like to see within walking distance for those who will eventually live there.

A motivation for this development is to provide affordable housing for first-home buyers and Asset-Limited, Income-Constrained and Employed (ALICE) people in a real estate market that has recently seen significant appreciation with the rise of the short term and vacation rentals taking houses off the market.

Another avenue that this group is exploring is the creation of a Community Land Trust. A typical community land trust enables a family or individual to purchase a house that sits on land owned by the trust. The price of the house is more affordable because the homeowner is only buying the house, not the land. The homeowner leases the land from the community land trust in a long-term, renewable lease. The homeowner agrees to sell the home at a restricted price to keep it affordable in perpetuity, but they may be able to realize appreciation from improvements they make while they live in the house.



The developers can designate a percentage of the housing to income-qualified first-home buyers, which would make the new neighborhood more diverse. But a community land trust also is required to operate under a 501c3 designation, while again, a DCIF must be a for-profit business. During the research of establishing a DCIF, the importance of the structure of the board of directors of the (probably) C Corporation keeps reappearing as one of the most important areas of vulnerability, which makes this the most exacting area to structure at the outset of creating a Diversified Community Investment Fund.

## CONCLUSION

Real estate is a hard asset, considered to be a stable and long-term investment that can provide rental income and appreciate over time. A Diversified Community Investment Fund can provide local investors with the opportunity to own shares in properties and projects that yield recurring dividends over time, building and concentrating local wealth. A DCIF is an investment tool that is not proscribed by the expensive requirements of the United States Securities and Exchange Commission. This investment tool is an avenue for those who want to help stabilize their communities and invest in businesses and projects that improve the quality of life in their own neighborhoods. The membership makeup of the C Corporation's Board of Directors is critical to its future success and staying on track with its mission.

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