Butte Historic Trust Board Meeting

May 20, 2021, Minutes

(No agenda for meeting as it was a meeting with Cutting Edge Capital)

The meeting was held via zoom and was called to order at 7:08 p.m. Attending were board members Jason Silvernale, Hattie Thatcher, Tom Boyle, Levi Mork, Nancy Woodruff, and Sheri Broudy. Mary McCormick was unable to attend. Emma Cunneen attended as staff. Kim from Cutting Edge Capital joined us to share about potential investment fund options.

Meeting called to order @ 12:10

Cutting Edge Capital (CEC) works primarily with community center capital raise, revenue driven nonprofits, co-ops, and impact focused organizations.

Their team all are from big law initially and left to be a part of CEC to help impact focused organizations. They do both strategy work and legal work.

A fund strategy allows community investors to come in, see the impact in their community, and get a return on their investment.

The biggest legal hurdle for community investment funds that are not grant and mutual type funds is to not be governed by the Investment Company Act. For community scale funds, they look for ways to be exempt to this act.

Kim defined the for fund for this conversation.
Fund: investment comes in, its pooled together, and goes out into investment securities.
Real estate is not considered a fund because real estate is not considered investment in securities.
To further explain, if the charity holds the property, you are not investing out. It is investing coming in, the nonprofit generates revenue, so it is technically not a fund. We would not have to worry about adhering to the exemption as much, because it does not fit into the purview of the investment act itself.

<u>TYPES OF FUNDS</u>

<u>Private Fund</u> – limited to 100 people or fewer. Need to be accredited investors. To be an accredited investor, you must have certain worth: 1 million in net assets, excluding homes, cars, and furnishings to be accredited investors, or $200k a year, or $300k a year for a household.
In a Private Fund, terms and returns are set by you, the organization.

<u>Charitable Loan Fund</u> – (nonprofit only) Nonprofits have no equity, so in this fund type, people invest by debt-in and debt-out with pay back terms and interest. You receive a note from investors with terms that typically depend on the project and what your projections allow, as well as how the money will be used in loan terms. There is not a limit on the interest rate, but if it is too high, it could be seen as questionable and be considered profit sharing. Profit sharing is not allowed as a nonprofit.

Community Real Estate Fund – This is a more complicated approach, but you are able to do multiple options, and are able to offer highest return on investment. Community Real Estate Fund would be a for-profit model and would be set up as a sister entity to the nonprofit.
The nonprofit could control the mission and voting of the for-profit, but it would allow for a different investment return. This would also allow for a higher return on investment.
Profit sharing is an option in this route because the fund would be run by a for-profit entity, but again, you cannot do profit share as a nonprofit.

One option that Kim mentioned was to start with a "private raise" that would go straight into the nonprofit without having a subsidiary outside of the nonprofit investments. She said this method would be fairly straight forward. Then, as we grow and bring in members of the community who want to invest, we could then morph into a fund and follow the exemptions of the investment act. We could also move from nonprofit to a for-profit entity at a later time.

It gets complicated if you are expecting funding from grants for the nonprofit and then you also set up a for-profit. You must be careful about the flow of money between the two and be intentional with the use of grant funds. Having both adds a layer of complexity. It may be easier to start with the Charitable Loan Fund approach.

One thing to consider with the Charitable Loan Fund, is that all assets of the nonprofit would be available for liquidation if there is a loan that has defaulted and needs to be paid back.

If we go for the "for-profit route", then Kim recommends to have the for-profit fund own some share of the properties, if that is not an option, then she would recommend the for-profit fund giving a construction loan to the nonprofit.

The ideal and easiest way to do things is to keep everything within the nonprofit.

Once we meet exemption, we need to discuss how we are going to bring money in from investors and who our investors are.

METHODS OF RAISING FUNDS

Private Raise:
We can keep our investment raising private, although that is typically limited to accredited investors.
If we want to do a broad raise that is open to the community, there is an additional exemption at the federal level and for many states that allows us to not do a full registration of our offering materials with the FCC or with the state in order to offer publicly for non-accredited investors to invest.

Charitable Exemption:
From Kim's brief look at Montana law, there is a charitable exemption meaning that nonprofits can raise capital from their community publicly. There is also exemption filing with the state that needs to be done in order to notify them.

Kim recommends that we put together the materials for registration whether we register or are exempt. This will make our lives easier both presently and in the future.
These materials would entail some type of offering material, whether it is a slide presentation or a memo, and would include the financial condition of the organization, projections about how the money will be used and how the revenue will be generated in order to provide the return that you're offering. There also needs to be an investment agreement drafted that includes the terms you are going to offer to investors.

Intrastate:
This option is only used in the Community Real Estate Fund (for-profit entity)
This is a federal exemption that basically says "if you are going to raise capital in just Montana through a for-profit enterprise, then you don't need to register at the federal level, you just have register with the state and abide by their lawss. Almost all states have additional disclosures that are done for real estate investment. This is a more expensive method to do for-profit real estate investment.
There are also "blind trusts" which require even more disclosures.
(blind trust is to invest in something that is not yet determined)

Regulation Crowdfund:
This is another option, but you can not use it as a nonprofit. This is a convenient method, however, as it is less expensive to get because it has a standard set of disclosures that does not vary. It is designed for all 50 states, and is an available method to use even if you plan to just raise in one state. Investors and the organization have to use a portal that is approved by the government. They have to post your offering and they get to take a success fee which is usually 7%, but it does lower other costs. (another for-profit option)

After going through these options, both the board and Kim agree that the easiest method of those presented would be to start with the Charitable Exemption Fund.

TIMING AND COSTS FOR CHARITABLE EXEMPTION FUND:

For a nonprofit like our to raise capital through a charitable exemption fund, Kim would have to take a deeper dive into statutes in Montana and what the requirements are needed in the offering materials.

The cost for startup varies upon the approach. A full memo involves many different details. The more the details, the higher the cost. We are allowed to draft sections of the materials for them to cut down cost. We can also have it in a PowerPoint document instead of a memo. Kim and CEC would help us outline it. They would also compose a separate document on risk factors. For CEC to compose a fairly straight forward note, it would likely cost less than $10,000. This would include: Investment contract (the note purchase agreement between the nonprofit and investor), the negotiable instrument (the note), risk factors, and strategy work on how to structure the note and disclosures based on our business plan.

Re-filing annually would be easy and less expensive after the initial startup cost and work. Once we have a template, we adjust it after our first year. The costs become lower because it is less paperwork, just slight editing.

Additional costs to consider: the time and money on marketing about the investment and getting the opportunity out to the right investors. People often underestimate how much work it takes to get the word out to the right people.

ADDITIONAL INFORMATION:

A funding cycle would be year to year, not project to project, because filing with the state is typically good for one year. Kim also recommends that we do not restrict the investments to just one project. If invested money is a three year note and we finish the project in one year, (depending on rules that we set up) we could recycle the note into the next project and so on until the term of the note is up. This is a good idea as we will be collecting interest on the note for three years, so we should earn the investors money for three years.

Question to consider:
If you are going to spend $10k to raise $100k, is that cost of 10% reasonable? Your cost of capital will be lower the next time you file, as it will be much less work from CEC and just some editing before we file.

Next steps:
Following the decision to go with the Charitable Exemption, Kim would talk to a regulator in Montana and make sure that they are on board and don't panic when our paperwork comes across their desk. There will need to be more exploratory work before asking the BHT board for approval on the expense. Kim recommends we raise more money than the before mentioned $100,000, so that the $10,000 we spend in startup won't seem like so much. But we also want to raise more money than we can spend and invest, because we would lose money by just holding onto it in a pot and not growing it, because we will still owe our investors the promised growth.

Kim recommends going to a few key potential investors and ask them about the different investment notes that we are looking at and getting their opinions. We need to take some time to feel out what terms, years, and percent return to use. For example; one could offer three options: a one year not with 1% interest, a 3 year note with 3% interest, and a five year note with 5% interest.

Kim also recommends that for our first project, we reach out to a few investors that will come in at a smaller, more reasonable amount, (not do a full-blown offering), and use just a term sheet and a note and purchase agreement; get one project done, and then do a public community offering. In this scenario, we can then say to the public "Look, we already did this once and it worked. Here is what our work looks like and what you would be investing in. We are successful and trustworthy, so you should invest in us." By doing this, our raise campaign involves a finished product, and we can better inform our investors on what our process looks like.

There is also a way to do a private raise with non-accredited investors, however, its riskier to the organization. Federal law says, if you do not offer the raise publicly and you just offer it to people who are suitable for the offering, then it is exempt from registration. Then the federal law says that if you do "these extra things" and meet certain disclosure requirements, that you then get a presumption that what you have done (raised privately) is a fair private offering. If there is a legal dispute later, through this method, you have a leg up on the opposing party.

We do not want an investor that is going to put all their eggs in our one basket. Smaller investments are better for non-accredited investors. We do not want someone with $20,000 in savings to put all $20,000 into our fund, according to Kim. If the investment amounts from a non-accredited investor are small, then we are less likely to be brought into a legal dispute later on. However, there is a limit on the number of non-accredited investors that you can have. Kim is not sure how many that is per Montana law, but she can find out. In that scenario, everything is exempt and there is no filing that is needed to be done.

<u>Thoughts of board after presentation:</u>

Jason thinks the Charitable Loan Fund is something that we should think about in the future.

Nancy's impression is that a Charitable Loan Fund is what people do in many other states because they cannot do what we can do in Montana, which is give a return from a co-op.
Things we should further explore:
Given that we can do a co-op in Montana, is there any advantage of going with the Charitable Loan Fund?
With a co-op, we can give up to a 6% return. Are there any pros that put a charitable Loan Fund above a co-op?
With the Charitable Loan Fund, every time we do an offering, we have to pay money.
If we can accomplish the same thing through the co-op, then the co-op is a more feasible way to go, but it is unclear how complicated that startup will be.

<u>Additional Updates:</u>

John Whick said we could use both logos, but he recommends having consistency, which is easier with one logo.

Emma is getting moving quotes from Tammietti and Derek Jacques. We may have found a good location up on Center Street, they are 3-5 lots off North Main. The property has utilities already, lots are listed for an affordable price, but we need moving quotes first.

Sheri got a call today about a lot at 1251 E. First Street, a lot that is going to be listed for sale. The lot may not be wide enough and is probably a 30' lot. We would need to get permission from the owners of the properties on both sides to get an easement.

Emma and Sheri are going to the Arizona Street Church today, May 20th, at 2 pm. The owners reached out to a realtor, so we will she what their realtor and Sheri come up with.