# Existing SBIC Program and Proposed New Markets Equity Investment Programs

## COMPARISON OF PROGRAMS

| Key Program Characteristics | | Existing SBIC Program | SBIC LMI Investments | New Markets Venture Capital |
|---|---|---|---|---|
| **Characteristics of Targeted Small Businesses** | Size of Business | Small | Small | Very Small |
| | Growth Targets | Oriented towards very high growth firms, often low tech, whether for later stage or early stage financings | Oriented towards modest growth firms, usually low tech, whether for later stage or early stage financings | Serves businesses that may not have strong market niches or modest growth prospects, plus service businesses |
| | Maximum After Tax Profit | $6M | $6M | $2M |
| | Maximum Net Worth | $18M | $18M | $6M |
| | Geographic Restrictions | Anywhere in U.S. – Limited Foreign | LMI Zones or 35% of employees reside in LMI Zones | 80% in LMI Zones |
| | Employee Requirements | None | | None |
| **Small Business Management's Familiarity with Equity Financing** | Management's Experience with Equity-Type Financing | Businesses have some understanding of the financing process, and can pay consultants, accountants and lawyers to prepare for a financing | Businesses may or may not have some understanding of the financing process, probably cannot pay consultants, accountants or lawyers to prepare for a financing | Businesses unfamiliar with financing process and cannot pay consultants, accountants or lawyers to prepare for a financing |
| | Management's Experience in Growing Companies | Modest to High Experience | Modest Experience | Low Experience |

| Key Program Characteristics | | Existing SBIC Program | SBIC LMI Investments | New Markets Venture Capital |
|---|---|---|---|---|
| **Role of Fund Manager** | Funding for Technical Assistance Support | Not Required | Not Required | Raise at least $1.5M for Technical Assistance, payable over 5 years |
| | Assistance by Fund Managers | Fund managers provide mostly strategic assistance, except when in serious trouble fund managers take over daily management | Fund managers will provide hands-on assistance, but not day-to-day involvement | Fund managers will provide considerable business management assistance before and after financing |
| | Control by Fund | No control except for startups & to rescue investments | Control permitted for term of financing, up to 5 years | No Restrictions |
| **Size and Terms of Investment** | Investment Size | Targeted investment size: $300,000 to $5,000,000 | Targeted investment size: $150,000 to $1,000,000 | Targeted investment size: $50,000 to $300,000 |
| | Minimum Term of Investment | 5 years | 1 year | No Restrictions |
| **IRRs & Exit Mechanisms** | Methods of Achieving IRRs | A principal component of IRR is achieved through sales of equity investments to strategic acquirers or in IPOs | Investment returns will usually be generated from the business's internal profitability rather than through sale to strategic acquirers or in IPOs | Investment returns will usually be generated from the business's internal profitability rather than through sale to strategic acquirers or in IPOs |
| | Goals of Investors | Optimal Profits | Optimal profits with community development benefits | "Double Bottom Line"- Focus on community development, plus profits |
| **Capital Structure & Fees** | Minimum Private Capital Requirements | $5M for Debentures; $10M for Participating Securities | Same as SBIC | $5M for Debentures; $1.5M for Technical Assistance |
| | Government Role | Government Provided Leverage | Government Provided Leverage | Government Provided Leverage & Technical Assistance Grants |

| Key Program Characteristics | | Existing SBIC Program | SBIC LMI Investments | New Markets Venture Capital |
|---|---|---|---|---|
| **Capital Structure & Fees** | Leverage Securities Available | Debentures, Participating Securities | Debentures including 7 & 5 Year terms/ 5 year zero coupon; Participating Securities | Debentures: 10 Year term/ 5 year zero coupon |
| | Amount of Leverage Possible | Up to 300%, Approx. $100M Maximum | Up to 300%, Approx. $100M Maximum | Up to 100% |
| | Leverage Rate | Approx. 70-200 b.p. over 10 Yr. Treasury | Approx. 70-200 b.p. over 10 Yr. Treasury | Approx. 70-200 b.p. over 10 Yr. Treasury |
| | Leverage Fees | 1% Commitment Fee, 2% User Fee, 100 b.p. Annual Charge, 50 b.p. Underwriting Fee | 1% Commitment Fee, 2% User Fee, 100 b.p. Annual Charge | No Annual Charge, No Underwriting Fee |
| | Annual Operating Expenses | Almost all SBICs are limited to 2.5% of total assets for management fees | Same as SBIC | Anticipate annual fund operating expenses up to 8.0% of total assets, including management fees |
| **Program Size** | Authorized Program Level | $1.9B (FY99 SBIC Debentures and Participating Securities) | Included within SBIC Program | $100M (Projected) |
| | Current Outstanding & Committed Government Assets | $3.5B* | Included within SBIC Program | $100M (Projected Program Level) + $30M Technical Assistance (Projected) |
| | Total Committed Private & Government Assets | $11.5B* | Included within SBIC Program | $260M (Projected) |
| **Participation** | Relationship with SBA | Licensed | Licensed | Contractual |

*As of 8/12/99

106th Congress 1st Session

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**A BILL**

To amend the Small Business Act and Small Business Investment Act of 1958.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

## TITLE I

**New Markets Venture Capital Program**

Section 101. New Markets Venture Capital Program. Title III -- SMALL BUSINESS INVESTMENT COMPANIES of the Small Business Investment Act of 1958 (15 U.S.C. 661 et seq.) is amended by:

(1) striking the words "SMALL BUSINESS INVESTMENT COMPANIES" after TITLE III;

(2) inserting in lieu thereof "INVESTMENT DIVISION PROGRAMS";

(3) inserting "PART A – SMALL BUSINESS INVESTMENT COMPANIES" before section 301; and

(4) adding the following at the end of section 320:

"PART B - NEW MARKETS VENTURE CAPITAL PROGRAM

Sec. 350. DEFINITIONS

As used in this part --

(1) the terms "New Markets Venture Capital company" and "NMVC company" mean a company that has been approved by the Administration under section 353(e) to operate under the New Markets Venture Capital Program and that has entered into a participation agreement with the Administration; and

(2) the term "low- or moderate-income geographies" means-

(A) any population census tract if:

(i) the poverty rate for such tract is at least 20%, or

(ii) the median family income for such tract does not exceed 80% of the metropolitan area median family income (or in the case of a tract not located within a metropolitan area, 80% of statewide median family income), and

(B) any area located within:

(i) a HUBZone (as defined in 13 CFR § 126.103),

(ii) an Urban Empowerment Zone or Urban Enterprise Community (as designated by the Secretary of the Department of Housing and Urban Development), or

(iii) a Rural Empowerment Zone or Rural Enterprise Community (as designated by the Secretary of the Department of Agriculture).

In the case of an area which is not tracted for population census tracts, the equivalent county division as defined by the Bureau of the Census for purposes of defining poverty areas shall be used for purposes of determining poverty rate and median family income.

(3) the term "participation agreement" means an agreement between the Administration and a New Markets Venture Capital company, detailing the company's

operating plan and investment criteria and requiring that investments be made in smaller enterprises at least 60% of which are located in those low- or moderate-income geographies defined in paragraph 2(A) of this section.

Sec. 351. PURPOSES

The purposes of the New Markets Venture Capital Program are --

(1) to encourage venture capital investment in smaller enterprises located within urban and rural areas; and

(2) to establish a venture capital program to be administered by the Small Business Administration --

(A) to enter into a participation agreement with each NMVC company,

(B) to guarantee debentures of each NMVC company to enable each such company to make venture capital investments in smaller enterprises within urban and rural areas, and

(C) to make grants to each NMVC company for the purpose of providing marketing, management and technical assistance to smaller enterprises financed, or expected to be financed, by such company.

Sec. 352. PROGRAM ESTABLISHMENT

There is established a New Markets Venture Capital Program, under which the Administration may --

(1) enter into a participation agreement with each NMVC company for the purposes stated in section 351;

(2) guarantee debentures issued by each NMVC company as provided in section 354; and

(3) make grants to each NMVC company as provided in section 355.

Sec. 353. SELECTION OF NMVC COMPANIES

(a) ELIGIBILITY TO APPLY. --A company shall be eligible to apply to participate in the New Markets Venture Capital Program if it --

(1) is a newly formed for-profit entity, which may be a newly formed for-profit subsidiary of an existing entity;

(2) has a management team with experience in community development financing or venture capital financing; and

(3) files its application within a time period established by the Administration.

(b) APPLICATIONS. --As part of its application for participation in the New Markets Venture Capital Program, each applicant shall provide the Administration with --

(1) a business plan that describes how the applicant will make successful venture capital investments in low- or moderate-income geographies (as such term is defined by the Administration) within identified geographic areas;

(2) the qualifications and general business reputation of the company's management;

(3) a description of how the applicant will interface with community organizations;

(4) a proposal describing how grant funds provided under this part would provide marketing, management and technical assistance to smaller enterprises expected to be financed by the company;

(5) measurement criteria by which to evaluate the company's performance in meeting program objectives;

(6) the management and financial strength of any parent or affiliated firms, or any firms essential to the success of the NMVC company's business plan; and

(7) such other information as the Administration may request.

(c) SELECTION CRITERIA FOR CONDITIONAL APPROVAL. -- The Administration shall review the applications and shall select companies to be conditionally approved to operate under the New Markets Venture Capital Program. The selection shall be based upon the merits of the application and each company's proposed geographic area of investment so as to promote investment nationwide. The selection criteria shall include:

(1) the likelihood that the applicant will meet the goals of its business plan;

(2) the experience and background of the company's management team;

(3) the need for equity investments within the investment areas;

(4) the extent to which the applicant will concentrate its activities on serving its investment areas;

(5) the likelihood that the applicant will be able to satisfy the conditions under subsection (d);

(6) the extent to which the proposed activities will expand economic opportunities within the investment areas; and

(7) other factors deemed appropriate by the Administration.

(d) CONDITIONAL APPROVAL.—The Administration shall give each conditionally approved company a period of time, not to exceed 24 months, to satisfy the following two conditions --

(1) Capital Requirement. Each company must raise at least $5 million of contributed capital or binding capital commitments from one or more investors (other than an agency of the Federal government) which meet criteria established by the Administration; and

(2) Technical Assistance Matching Requirement.

(A) In order to provide marketing, management and technical assistance, each company:

(i) must have binding commitments (in cash or in-kind) from any source(s) other than the Administration which meet criteria established by the Administration, payable or available over a multi-year period acceptable to the Administration (not to exceed 10 years), in an amount equal to 30% of the capital and commitments raised under subsection (d)(1); or

(ii) must have purchased an annuity from an insurance company acceptable to the Administration, using funds (other than the funds raised to satisfy subsection (d)(1)) from any source other than the Administration, which would yield cash payments over a multi-year period acceptable to the Administration (not to exceed 10 years), in an amount equal to 30% of the capital and commitments raised under subsection (d)(1); or

(iii) must have binding commitments (in cash or in-kind) of the type described in subsection (d)(2)(A)(i) and must have purchased an annuity of the type described in subsection (d)(2)(A)(ii), which in the aggregate make available, over a multi-year period acceptable to the Administration (not to exceed 10 years), an amount equal to 30% of the capital and commitments raised under subsection (d)(1); or

(B) In the discretion of the Administrator and based upon a showing of special circumstances and good cause, the Administrator may consider an applicant to have satisfied the requirements of this subsection (d)(2) if it has a viable plan that reasonably projects its capacity to raise the amount (in cash or in-kind) required under subsection (d)(2)(A).

(e) APPROVAL TO OPERATE AS AN NMVC COMPANY. -- The Administration shall grant final approval to operate as an NMVC company to any company selected under subsection (d) that --

(1) has satisfied the conditions under such subsection; and

(2) has entered into a participation agreement with the Administration.

Sec. 354. DEBENTURES

The Administration is authorized, when authorized in appropriations Acts, to guarantee the timely payment of principal and interest as scheduled on debentures issued by NMVC companies. Such guarantees may be made by the Administration on such terms and conditions as it deems appropriate. The full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guarantee under this part. Such debentures may be issued for a term of not to exceed fifteen years and shall bear interest at a rate approved by the Administration. The total face amount of guaranteed debentures that may be outstanding at any one time shall not exceed 150 percent of the contributed capital of the NMVC company, as determined by the Administration. Contributed capital shall include capital that is deemed to be Federal funds contributed by an investor other than an agency of the Federal government. The debentures shall also contain such other terms as the Administration may require.

Sec. 355. TECHNICAL ASSISTANCE GRANTS

(a) GRANTS. -- The Administration is authorized to make grants to each NMVC company subject to the following:

(1) IN GENERAL. --Each NMVC company shall be eligible to receive grants to be paid upon the direction of the Administration over a multi-year period not to exceed 10 years, containing such terms as the Administration may require, to provide marketing, management and technical assistance for the benefit of smaller enterprises financed, or expected to be financed, by the NMVC company.

(2) GRANT AMOUNT. --The amount of the grant(s) provided by the Administration to each NMVC company under this subsection (a) shall be equal to the NMVC company's technical assistance match (in cash or in-kind) under section 353(d)(2) unless the Administration determines, in the best interests of the program, that the grant(s) should be paid despite the NMVC company's failure to provide the matching amount.

(3) PRO RATA REDUCTIONS. – If the amount made available to carry out this section is insufficient for the Administration to provide grants in the amounts

required under subsection (a)(2), the Administration shall make pro rata reductions in the amounts otherwise payable to each NMVC company under such subsection.

(b) SUPPLEMENTAL GRANTS. – The Administration is authorized to provide supplemental grants to any NMVC company, containing such terms as the Administration may require, to provide additional marketing, management and technical assistance for the benefit of smaller enterprises financed, or expected to be financed, by the NMVC company. The Administration may require, as a condition of any supplemental grant made under this subsection (b), that the NMVC company provide a match (in cash or in-kind) from sources other than the Administration equal to the amount of the supplemental grant.

Sec. 356. ISSUANCE AND GUARANTEE OF TRUST CERTIFICATES

(a) The Administration is authorized to issue trust certificates representing ownership of all or a fractional part of debentures issued by NMVC companies and guaranteed by the Administration under this Act: Provided, That such trust certificates shall be based on and backed by a trust or pool approved by the Administration and composed solely of guaranteed debentures.

(b) The Administration is authorized, upon such terms and conditions as are deemed appropriate, to guarantee the timely payment of the principal of and interest on trust certificates issued by the Administration or its agent for purposes of this section. Such guarantee shall be limited to the extent of principal and interest on the guaranteed debentures which compose the trust or pool. In the event that a debenture in such trust or pool is prepaid, or in the event of default of a debenture, the guarantee of timely payment of principal and interest on the trust certificates shall be reduced in proportion to the amount of principal and interest such prepaid debenture represents in the trust or pool. Interest on prepaid or defaulted debentures shall accrue and be guaranteed by the Administration only through the date of payment of the guarantee. During the term of the trust certificate, it may be called for redemption due to prepayment or default of all debentures.

(c) The full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guarantee of such trust certificates issued by the Administration or its agent pursuant to this section.

(d) The Administration shall not collect a fee for any guarantee under this section: Provided, That nothing herein shall preclude any agent of the Administration from collecting a fee approved by the Administration for the functions described in subsection (f)(2) of this section.

(e) (1) In the event the Administration pays a claim under a guarantee issued under this section, it shall be subrogated fully to the rights satisfied by such payment.

(2) No State or local law, and no Federal law, shall preclude or limit the exercise by the Administration of its ownership rights in the debentures residing in a trust or pool against which trust certificates are issued.

(f) (1) The Administration may provide for a central registration of all trust certificates sold pursuant to this section.

(2) The Administrator may contract with an agent or agents to carry out on behalf of the Administration the pooling and the central registration functions of this section including, notwithstanding any other provision of law, maintenance on behalf of

and under the direction of the Administration, such commercial bank accounts or investments in obligations of the United States as may be necessary to facilitate trusts or pools backed by debentures guaranteed under this Act, and the issuance of trust certificates to facilitate such poolings. Such agent or agents shall provide a fidelity bond or insurance in such amounts as the Administration determines to be necessary to fully protect the interests of the Government.

(3) The Administrator is authorized to regulate brokers and dealers in trust certificates sold pursuant to this section.

(4) Nothing in this subsection shall prohibit the use of a book-entry or other electronic form of registration for trust certificates.

Sec. 357. FEES

Except as provided under section 356(d), the Administration shall charge such fees as it deems appropriate with respect to any guarantee or grant issued under this part.

Sec. 358. BANK PARTICIPATION

Any national bank, or any member bank of the Federal Reserve System or nonmember insured bank to the extent permitted under applicable State law, may invest in any 1 or more NMVC companies, or in any entity established to invest solely in NMVC companies, except that in no event shall the total amount of such investments of any such bank exceed 5 percent of the capital and surplus of the bank.

Sec. 359. FEDERAL FINANCING BANK

Section 318 does not apply to any debenture issued under this part by an NMVC company.

Sec. 360. REPORTING REQUIREMENTS

Each NMVC company will provide such information as the Administration may request, including reporting on the measurement criteria that the NMVC company proposed in its program application.

Sec. 361. EXAMINATIONS

Each NMVC company shall be subject to examinations made at the direction of the Investment Division of the Administration, which may be conducted with the assistance of a private sector entity that has both the qualifications to conduct and expertise in conducting such examinations, and the cost of such examinations, including the compensation of the examiners, may in the discretion of the Administration be assessed against the company examined and when so assessed shall be paid by such company. Fees collected under this section shall be deposited in the account for salaries and expenses of the Administration and are authorized to be appropriated solely to cover the costs of examinations and other program oversight activities.

Sec. 362. INJUNCTIONS AND OTHER ORDERS

(a) Whenever, in the judgment of the Administration, an NMVC company or any other person has engaged or is about to engage in any acts or practices which constitute or will constitute a violation of any provision of this Act, or of any rule or regulation under this Act, or of any order issued under this Act, the Administration may make application to the proper district court of the United States or a United States court of any place subject to the jurisdiction of the United States for an order enjoining such acts or practices, or for an order enforcing compliance with such provision, rule, regulation, or order, and such courts shall have jurisdiction of such actions and, upon a showing by the Administration that such NMVC company or other person has engaged or is about to engage in any such acts or practices, a permanent or temporary injunction, restraining order, or other order, shall be granted without bond.

(b) In any such proceeding the court as a court of equity may, to such extent as it deems necessary, take exclusive jurisdiction of the NMVC company and the assets thereof, wherever located; and the court shall have jurisdiction in any such proceeding to appoint a trustee or receiver to hold or administer under the direction of the court the assets so possessed.

(c) The Administration shall have authority to act as trustee or receiver of the NMVC company. Upon request by the Administration, the court may appoint the Administration to act in such capacity unless the court deems such appointment inequitable or otherwise inappropriate by reason of the special circumstances involved.

Sec. 363. UNLAWFUL ACTS AND OMISSIONS BY OFFICERS, DIRECTORS, EMPLOYEES, OR AGENTS; BREACH OF FIDUCIARY DUTY

(a) Whenever an NMVC company violates any provision of this Act or regulation issued thereunder by reason of its failure to comply with the terms thereof or by reason of its engaging in any act or practice which constitutes or will constitute a violation thereof, such violation shall be deemed to be also a violation and an unlawful act on the part of any person who, directly or indirectly, authorizes, orders, participates in, or causes, brings about, counsels, aids, or abets in the commission of any acts, practices, or transactions which constitute or will constitute, in whole or in part, such violation.

(b) It shall be unlawful for any officer, director, employee, agent, or other participant in the management or conduct or the affairs of an NMVC company to engage in any act or practice, or to omit any act, in breach of his fiduciary duty as such officer, director, employee, agent, or participant, if, as a result thereof, the NMVC company has suffered or is in imminent danger of suffering financial loss or other damage.

(c) Except with the written consent of the Administration, it shall be unlawful –

(1) for any person hereafter to take office as an officer, director, or employee of an NMVC company, or to become an agent or participant in the conduct of the affairs or management of an NMVC company, if –

(A) he has been convicted of a felony, or any other criminal offense involving dishonesty or breach of trust, or

(B) he has been found civilly liable in damages, or has been permanently or temporarily enjoined by order, judgment, or decree of a court of competent jurisdiction, by reason of any act or practice involving fraud or breach of trust; or

(2) for any person to continue to serve in any of the above-described capacities, if –

(A) he is hereafter convicted of a felony, or any other criminal offense involving dishonesty or breach of trust, or

(B) he is hereafter found civilly liable in damages, or is permanently or temporarily enjoined by an order, judgment, or decree of a court of competent jurisdiction, by reason of any act or practice involving fraud or breach of trust.

(d) The Administration may serve upon any person identified in this section a written notice of its intention to remove him from office whenever, in the opinion of the Administration, such person –

(1) has willfully and knowingly committed any substantial violation of-

(A) this Act,

(B) any regulation issued under this Act, or

(C) a cease-and-desist order which has become final, or

(2) has willfully and knowingly committed or engaged in any act, omission, or practice which constitutes a substantial breach of his fiduciary duty, and that such violation or such breach of fiduciary duty is one involving personal dishonesty on the part of such person.

(e) The Administration may remove or suspend any person upon whom the Administration has served a notice under subsection (d) by following the procedures set forth in section 313 of this Act.

Sec. 364. MISCELLANEOUS

The Administration is authorized to issue such regulations as it deems necessary to carry out the provisions of this part in accordance with its purposes.

Sec. 365. AUTHORIZATIONS

The Administration is hereby authorized to be appropriated such subsidy budget authority as may be necessary to guarantee up to $100 million of debentures, and up to $30 million to make technical assistance grants, for the purposes pursuant to this part, to remain available until expended. This authority shall be in effect for the period commencing with fiscal year 2000 through fiscal year 2005."

Section 102. Bankruptcy Exemption for New Markets Venture Capital Companies.

Section 109(b)(2) of title 11, United States Code, is amended by inserting after "homestead association," the following: "a New Markets Venture Capital company as defined in section 350 of the Small Business Investment Act of 1958,".

Section 103. Federal Savings Associations.

Section 1464 (c) (4) of title 12, United States Code, is amended by adding at the end thereof the following: "(F) New Markets Venture Capital companies. A Federal savings association may invest in stock, obligations, or other securities of any New

Markets Venture Capital company as defined in section 350 of the Small Business Investment Act of 1958. A Federal savings association may not make any investment under this subparagraph if its aggregate outstanding investment under this subparagraph would exceed 5 percent of the capital and surplus of such savings association."

DRAFT 6/23/99 OGC/HUD H:\GLL\APIC\APIC20A.BIL

A BILL

To license America's Private Investment Companies and provide enhanced credit to stimulate private investment in low-income communities, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States in Congress assembled,*

**SEC. 101. SHORT TITLE.**

This Act may be cited as the "America's Private Investment Companies Act".

**SEC. 102. CONGRESSIONAL FINDINGS AND PURPOSES.**

**(a) Congressional Findings.**

**(1)** People living in distressed areas, both urban and rural, characterized by high levels of joblessness, poverty, and low incomes continue to miss out on the economic expansion experienced by the Nation as a whole.

**(2)** Unequal access to economic opportunities continues to make the social costs of joblessness and poverty to our Nation very high.

**(3)** There are significant untapped markets in our

Nation, and many of these are in areas that are underserved by institutions that can make equity and credit investments.

**(b) Purpose**.--The purposes of this Act are to:

**(1)** license private for profit community development entities that will focus on making equity and credit investments for large-scale business developments that benefit low-income communities;

**(2)** provide credit enhancement for those entities for use in low-income communities; and

**(3)** provide a vehicle under which the economic and social returns on financial investments made pursuant to this Act may be available both to the investors in these entities and to the residents of the low-income communities.

**SEC. 103. DEFINITIONS.**

As used in this Act, certain terms have the respective meanings set forth herein.

"Agency" is an entity as defined in section 551(1) of title 5, United States Code.

"APIC" means an America's Private Investment Company, a business entity that has been licensed under the terms of this Act, and the license of which has not been revoked.

"Administrator" means the Administrator of the Small Business Administration.

"Community development entities" has the meaning set forth in section _____ of the Internal Revenue Code of 1986 in connection with New Markets Tax Credits.

"Cost" has the meaning set forth in section 502(5) of the Federal Credit Reform Act of 1990.

"Debentures" means debt instruments the terms of any of which may be specified by the Secretary.

"Low-income communities" has the meaning set forth in section ___ of the Internal Revenue Code of 1986 in connection with New Markets Tax Credits.

"HUD" means the Secretary of Housing and Urban Development or the Department of Housing and Urban Development, as the context requires.

"New Markets Tax Credits" are tax credits as set forth in section _____ of the Internal Revenue Code of 1986.

**"Participating securities" means [RESERVED].**

"Qualified low-income community investments" has the meaning set forth in section ____ of the Internal Revenue Code of 1986 in connection with New Markets Tax Credits.

"Secretary" means the Secretary of Housing and Urban Development, unless otherwise specified in this Act.

**SEC. 104. AUTHORIZATION.**

**(a) Licenses.**--The Secretary is authorized to license America's Private Investment Companies, in accordance with the terms of this Act.

**(b) Regulations.**--The Secretary is authorized to regulate APICs for compliance with sound financial management practices, and the program and procedural goals of this and other related Acts, and other purposes as required or authorized by this Act, or determined by the Secretary. The Secretary may issue regulations, Federal Register notices, and other guidance or directives to carry out licensing and regulatory and other duties under this Act.

**(c) Use of Credit Subsidy for Licenses.**

**(1) Number of Licenses.**--The Secretary is authorized to have outstanding at any one time the number of licenses for APICs that may be supported by the amount of the budget authority appropriated in accordance with the Federal Credit Reform Act of 1990 for the subsidy cost and the investment strategies of such APICs.

**(2) Use of Credit Subsidy After Initial Appropriation to HUD.**--With respect to any appropriation of budget authority for the credit costs after the initial appropriation, the Secretary may license additional APICs, or as hereinafter provided, increase the credit subsidy allocated to an APIC as an award for high performance under this Act.

**(d) Cooperation and Coordination.**

**(1) Program Policies.**--The Secretary is authorized to coordinate and cooperate, through memoranda of understanding, an APIC liaison committee, or otherwise, with the Administrator, the Secretary of the Treasury, and other agencies in the discretion of the Secretary, on implementation of this Act, including regulation, examination, and monitoring of APICs under this Act.

(2) **Operations**.--The Secretary may carry out this Act--

(A) directly, through agreements with other Federal entities under section 1535 of title 31, United States Code, or otherwise, or

(B) indirectly, under contracts or agreements, as the Secretary shall determine.

(e) **Fees and Charges**.--The Secretary is hereby authorized to impose fees and charges for application, review, licensing, regulation, commitments for credit enhancement, credit enhancement, or other actions or operations under this Act.

(f) Funding.

(1) **Authorization for Appropriation of Cost of Annual Loan Guarantee Commitment**.--For each of fiscal years 2000, 2001, 2002, and 2003, there is authorized to be appropriated up to $36,000,000 for the cost of annual loan guarantee commitments under this Act. The Secretary may make commitments to guarantee loans only to the extent that the total loan principal, any part of which is guaranteed, will not exceed $1,000,000,000, or the amount specified in appropriations Acts in each such fiscal year. Amounts appropriated under this paragraph shall remain available for 5 years.

(2) **Authorization for Appropriation of Administrative**

**Expenses.**--For each of the fiscal years 2000, 2001, 2002, and 2003, there is authorized to be appropriated $1,000,000 for administrative expenses for carrying out this Act. The Secretary may transfer amounts appropriated under this paragraph to any appropriation account of HUD or another agency, to carry out the program under this Act. Any agency to which the Secretary may transfer amounts under this Act is authorized to accept such transferred amounts in any appropriation account of such agency.

**SEC. 105. SELECTION OF APICs.**

**(a) Notice of Competitions.**--The Secretary shall select APICs for licensing on the basis of competitions. Such competitions shall be announced by a Federal Register notice that invites applications for APIC licenses. Each such notice shall set forth application requirements, and such other terms of the competition not otherwise provided for, as determined by the Secretary.

**(b) Licensee Selection Criteria.**--The Secretary shall select among applicants for licenses on the basis of the extent to which an applicant may be expected to achieve the goals of the Act by satisfying the requirements set forth in this subsection.

**(1)** The applicant shall be a private for profit entity that qualifies as a community development entity for the purposes of New Markets Tax Credits.

**(2)** The entity must, as of the time that the license is approved, have reasonably available to it, as determined by the Secretary, a minimum of $25,000,000 in equity capital, as determined by the Secretary.

(3) The entity must demonstrate that its managers are qualified, and have the knowledge, experience, and capability necessary to raise large amounts of capital and make investments for community economic development in distressed areas.

(4) The entity must demonstrate that, as a matter of sound financial management practices, it is structured to preclude financial conflict of interest between the APIC and a manager or investor.

(5) The entity must prepare and submit an investment strategy that includes benchmarks for evaluation of its progress.

(6) The entity must prepare and submit a statement of public purpose goals. The statement shall include elements specified by the Secretary, including proposed measurements and strategies for meeting the goals. The goals shall promote community and economic development, and include at least--

(A) making investments that are qualified investments in low-income communities;

(B) creation of jobs that pay decent wages in low-income communities and for residents of such areas; and

(C) involvement of community-based organizations and residents in community development activities.

**(7)** The entity must demonstrate a capacity to cooperate with States or units of general local government and with community-based organizations and residents of low-income communities.

**(8)** The entity must agree to comply with applicable laws, including Federal executive orders, Office of Management and Budget circulars, and Treasury requirements, and such operating and regulatory requirements as the Secretary may impose from time to time.

**(9)** The entity must satisfy other application requirements that the Secretary may impose by regulation or Federal Register notice.

**(c) Communications Between HUD and Applicants During Selection Process.**

**(1)** The Secretary shall set forth in regulations the procedures under which HUD, on the one hand, and applicants for APIC licenses, and others, on the other hand, may communicate. Such regulations shall--

**(A)** specify by position the HUD officers and employees who may communicate with such applicants and others;

**(B)** permit such officers and employees to request and discuss with the applicant and others (such as banks or other credit or business references, or potential investors, that the applicant specifies in writing) any more detailed information that may be desirable to facilitate HUD's review of the applicant's application;

(C) restrict such officers and employees from revealing to any applicant--

(i) the fact or chances of award of a license to such applicant, unless there has been a public announcement of the results of the competition; and

(ii) any information with respect to any other applicant; and

(D) set forth requirements for making and keeping records of any communications conducted under this subsection, including requirements for making such records available to the public after the award of licenses under an initial or subsequent notice, as appropriate, under subsection (a).

(2) Regulations under this subsection may be issued as interim rules for effect on or before the date of publication of the first notice under subsection (a), and shall apply only with respect to applications under such notice. Regulations to implement this subsection with respect to any notice after the first such notice shall be subject to notice and comment rulemaking.

**(3)** Section 12(e)(2) of the Department of Housing and Urban Development Act is amended by inserting before the period at the end a comma and "or any license provided under the America's Private Investment Companies Act".

**SEC. 106. OPERATIONS OF APICs.**

**(a) In General.**

(1) An APIC shall have any powers or authorities--

**(A)** that the APIC derives from the jurisdiction in which it is organized, or that the APIC otherwise has;

**(B)** as may be conferred by a license under this Act; and

(C) as the Secretary may prescribe by regulation.

(2) Nothing in this Act shall preclude an APIC or its investors from receiving an allocation of New Market Tax Credits if the APIC satisfies the applicable terms and conditions under the Internal Revenue Code of 1986.

**(b) Investment Limitations.**

**(1) "Qualified Low-Income Community Investments".--** Substantially all investments that an APIC makes must be qualified low-income community investments if the investments are financed with--

**(A)** amounts available from the proceeds of the issuance of an APIC's debenture guaranteed under this Act;

**(B)** proceeds of the sale of obligations described under subsection (c)(3)(C)(iii); or

**(C)** the use of equity capital, as determined by the Secretary, in an amount specified in the APIC's license.

**(2) Investment Limit.**--An APIC shall not, as a matter of sound financial practice, invest in any one business, an amount that exceeds an amount equal to 35 percent of the sum of--

**(A)** the APIC's equity capital, plus

**(B)** an amount equal to the percentage limit that the Secretary determines that APIC may have outstanding at any one time, under subsection (c)(2)(A).

**(c) Borrowing Powers--Debentures.**

**(1) Issuing.**--An APIC may issue debentures that the Secretary may guarantee under the terms of this Act.

**(2) Leverage Limits.**--In general, as a matter of sound financial management practices--

**(A)** the total amount of debentures that an APIC issues under this Act that an APIC may have outstanding at any one time shall not exceed an amount equal to 200 percent of the equity capital of the APIC, as determined by the Secretary: Provided, That the Secretary may by regulation increase the foregoing percentage to up to 300 percent for all APICs, or any reasonable class of APICs; and

**(B)** an APIC must not have more than $300,000,000 in face value of debentures **and participating securities** issued under this Act outstanding at any one time.

(3) **Repayment.**

**(A)** An APIC must have repaid, or have otherwise been relieved of indebtedness, with respect to any interest or principal amounts of borrowings under this subsection no less than 2 years before the APIC may dissolve or otherwise complete the wind-up of its business.

(B) An APIC may repay any interest or principal amounts of borrowings under this subsection at any time: Provided, That the repayment of such amounts shall not relieve an APIC of any duty otherwise applicable to the APIC under this Act, unless the Secretary orders such relief.

**(C)** Until an APIC has repaid all interest and principal amounts on APIC borrowings under this subsection, an APIC may use the proceeds of investments described in subsection (b)(1) only to--

**(i)** pay for proper costs and expenses the APIC incurs in connection with such investments, not including any interest, dividend, or other distribution to or on behalf of an investor in the nature of a return on capital, or the withdrawal of equity capital;

**(ii)** pay for the reasonable administrative expenses of the APIC;

**(iii)** purchase Treasury securities; or

**(iv)** repay interest and principal amounts on APIC borrowings under this subsection.

**(D)** After an APIC has repaid all interest and principal amounts on APIC borrowings under this subsection, and subject to continuing compliance with subsection (a), the APIC may use the proceeds from the investments described in subsection (b)(1) to make interest, dividend, or other distributions to or on behalf of investors in the nature of returns on capital, or the withdrawal of equity capital.

**(d) Reuse of Debenture Proceeds.**--An APIC may use the proceeds of sale of Treasury securities purchased under subsection (c)(3)(C)(iii) to make qualified low-income community investments, subject to the Secretary's approval. In making the request for the Secretary's approval, the APIC shall follow the procedures applicable to an APIC's request for HUD guarantee action, as the Secretary may modify such procedures for implementation of this subsection. Such procedures shall nevertheless include the description and certifications that an APIC must include in all requests for guarantee action, and the environmental certification applicable to initial expenditures for a project or activity.

(e) **Antipirating.**--Notwithstanding any other provision of law, an APIC may not use any equity capital required to be contributed under this Act, or the proceeds from the sale of any debenture under this Act, to make an investment, as determined by the Secretary, to assist directly in the relocation of any industrial or commercial plant, facility, or operation, from 1 area to another area, if the relocation is likely to result in a significant loss of employment in the labor market area from which the relocation occurs.

(f) **Bankruptcy Restriction--Exclusion of APIC from Definition of Debtor.**--Section 109(b)(2) of title 11 of the United States Code is amended by inserting before "credit union" the following: "America's Private Investment Companies licensed by the Department of Housing and Urban Development under the America's Private Investment Companies Act,".

**SEC. 107. CREDIT ENHANCEMENT BY THE FEDERAL GOVERNMENT.**

(a) **Issuance and Guarantee of Debentures.**--Consistent with the Federal Credit Reform Act of 1990, the Secretary is authorized to make commitments to guarantee and guarantee the timely payment of all principal and interest as scheduled on, debentures issued by APICs. Such commitments or guarantees may be made by the Secretary on such terms and conditions, including but not limited to amounts, expirations, number, priorities of repayment, security, collateral, amortization, payment of interest (including the timing thereof), and fees and charges, as the Secretary determines to be appropriate, in documents that the Secretary approves for any commitment or guarantee, or pursuant to regulations issued by the Secretary. Debentures guaranteed by the Secretary under this subsection shall be senior to any debt obligation, equity contribution or earnings, or the distribution of dividends, interest, or other amounts of an APIC, notwithstanding any Federal or other law. Debentures may be issued for a term of not to exceed 21 years and shall bear interest during all or any part of that time period at a rate or rates approved by the Secretary. The debentures shall also contain such other terms as the Secretary may fix.

(b) **Issuance of Trust Certificates.**--The Secretary, or an agent or entity selected by the Secretary, is authorized to issue trust certificates representing ownership of all or a fractional part of guaranteed debentures issued by APICs and held in trust.

(c) **Guarantee of Trust Certificates.**

(1) **In General.**--The Secretary is authorized, upon such terms and conditions as the Secretary determines to be appropriate, to guarantee the timely payment of the principal of and interest on trust certificates issued by the Secretary, or an agent or other entity, for purposes of this section. Such guarantee shall be limited to the extent of principal and interest on the guaranteed debentures which compose the trust.

(2) **Substitution Option.**--The Secretary shall have the option to replace in the corpus of the trust any prepaid or

defaulted debenture with a debenture, another full faith and credit instrument, or any obligations of the United States, that may reasonably substitute for such prepaid or defaulted debenture.

(3) **Proportionate Reduction Option.**--In the event that the Secretary elects not to exercise the option under paragraph (2), and a debenture in such trust is prepaid, or in the event of default of a debenture, the guarantee of timely payment of principal and interest on the trust certificate shall be reduced in proportion to the amount of principal and interest that such prepaid debenture represents in the trust. Interest on prepaid or defaulted debentures shall accrue and be guaranteed by the Secretary only through the date of payment of the guarantee. During the term of a trust certificate, it may be called for redemption due to prepayment or default of all debentures that are in the corpus of the trust.

**(d) Full Faith and Credit Backing of Guarantees.**--The full faith and credit of the United States is pledged to the timely payment of all amounts which may be required to be paid under any guarantee by the Secretary pursuant to this section.

**(e) Subrogation and Liens.**

(1) In the event the Secretary pays a claim under a guarantee issued under this section, the Secretary shall be subrogated fully to the rights satisfied by such payment.

(2) No State or local law, and no Federal law, shall preclude or limit the exercise by the Secretary of its ownership rights in the debentures in the corpus of a trust under this section.

**(f) Registration.**

(1) The Secretary shall provide for a central registration of all trust certificates issued pursuant to this section.

(2) The Secretary may contract with an agent or agents to carry out on behalf of the Secretary the pooling and the central registration functions of this section notwithstanding any other provision of law, including maintenance on behalf of and under the direction of the Secretary, such commercial bank accounts or investments in obligations of the United States as may be necessary to facilitate trusts backed by debentures guaranteed under this Act and the issuance of trust certificates to facilitate formation of the corpus of the trusts. The Secretary may require such agent or agents to provide a fidelity bond or insurance in such amounts as the Secretary determines to be necessary to protect the interests of the Government.

(3) Book-entry or other electronic forms of registration for trust certificates under this Act are authorized.

**(g) Timing of Issuance of Guarantees of Debentures and Trust Certificates.**--The Secretary may, from time to time in the Secretary's discretion, exercise the authority to issue guarantees of debentures under this Act or trust certificates under this Act.

**SEC. 108. APIC REQUESTS FOR GUARANTEE ACTIONS.**

**(a) All APIC Requests for HUD Guarantee Action.**--An APIC may request that the Secretary guarantee a debenture that the APIC intends to issue, in accordance with the Secretary's regulations. All such requests shall include a description of the manner in which the APIC intends to use the proceeds from such debenture. All such requests shall also include certification by the APIC that the APIC is in substantial compliance with --

(1) this Act and other applicable laws;

**(2)** all terms and conditions of its license, and of any penalty or condition that may have arisen from examination or monitoring by the Secretary or otherwise, including the satisfaction of any financial audit exception that may have been outstanding;

**(3)** all requirements relating to the allocation and use of New Markets Tax Credits; and

**(4)** any other requirements that the Secretary may specify under regulations.

**(b) Requests for Guarantee of Debentures that would Include Funding for Initial Expenditure for a Project or Activity.**--In addition to the description and certification that an APIC is required to supply in all requests for guarantee action under subsection (a), in the case of an APIC's request for a guarantee that includes a debenture, the proceeds of which the APIC expects to be used as its initial expenditure for a project or activity in which the APIC intends to invest, and the expenditure for which would require an environmental assessment under the National Environmental Policy Act of 1969 and other related laws that further the purposes of such Act, such request for guarantee action must include evidence satisfactory to the Secretary of the certification of the completion of environmental review of the project or activity required of the cognizant State or local government under subsection (c). If the environmental review responsibility for the project or activity has not been assumed by a State or local government under subsection (c), then the Secretary is responsible for carrying out the applicable responsibilities under the National Environmental Policy Act of 1969 and other provisions of law that further the purposes of such Act that relate to the project or activity, and the Secretary must execute such responsibilities before acting on the APIC's request for the guarantee that is covered by this subsection.

**(c) Responsibility for Environmental Reviews.**

**(1) Execution of Responsibility by the Secretary.**--This subsection shall apply to guarantees by the Secretary of debentures under this Act, the proceeds of which would be used in connection with qualified low-income community investments of APICs under this Act.

**(2) Assumption of Responsibility by Cognizant Unit of General Government.**

**(A) Guarantee of Debentures.--** In order to assure that the policies of the National Environmental Policy Act of 1969 and other provisions of law that further the purposes of such Act (as specified in regulations issued by the Secretary) are most effectively implemented in connection with the expenditure of funds under this Act, and to assure to the public undiminished protection of the environment, the Secretary may, under such regulations, in lieu of the environmental protection procedures otherwise applicable, provide for the guarantee of debentures, any part of the proceeds of which are to fund particular qualified low-income community investments of APICs under this Act, if a State or unit of general local government, as designated by the Secretary in accordance with regulations issued by the Secretary, assumes all of the responsibilities for environmental review, decisionmaking, and action pursuant to the National Environmental Policy Act of 1969 and such other provisions of law that further such Act as the regulations of the Secretary specify, that would otherwise apply to the Secretary were the Secretary to undertake the funding of such investments as a Federal action.

(B) **Implementation.**--The Secretary shall issue regulations to carry out this subsection only after consultation with the Council on Environmental Quality. Such regulations shall--

(i) specify any other provisions of law which further the purposes of the National Environmental Policy Act of 1969 and to which the assumption of responsibility as provided in this subsection applies;

(ii) provide eligibility criteria and procedures for the designation of a State or unit of general local government to assume all of the responsibilities in this subsection;

(iii) specify the purposes for which funds may be committed without regard to the procedure established under paragraph (3);

(iv) provide for monitoring of the performance of environmental reviews under this subsection;

(v) in the discretion of the Secretary, provide for the provision or facilitation of training for such performance; and

(vi) subject to the discretion of the

Secretary, provide for suspension or termination by the Secretary of the assumption under subparagraph (A).

**(C) Responsibilities of States and Units of General Local Government.**--The Secretary's duty under subparagraph (B) shall not be construed to limit any responsibility assumed by a State or unit of general local government with respect to any particular request for guarantee under subparagraph (A), or the use of funds for a qualified investment.

(3) **Procedure.**-- The Secretary shall approve the request for guarantee of a debenture, any part of the proceeds of which is to fund particular qualified low-income community investments of APICs under this Act, that is subject to the procedures authorized by this subsection only if, not less than 15 days prior to such approval and prior to any commitment of funds to such investment (except for such purposes specified in the regulations issued under paragraph (2)(B)), the APIC submits to the Secretary a request for guarantee of a debenture that is accompanied by evidence of a certification of the State or unit of general local government which meets the requirements of paragraph (4). The approval by the Secretary of any such certification shall be deemed to satisfy the Secretary's

responsibilities pursuant to paragraph (1) under the National Environmental Policy Act of 1969 and such other provisions of law as the regulations of the Secretary specify insofar as those responsibilities relate to the guarantees of debentures, any parts of the proceeds of which are to fund such investments, which are covered by such certification.

**(4) Certification.**-- A certification under the procedures authorized by this subsection shall -

**(A)** be in a form acceptable to the Secretary;

**(B)** be executed by the chief executive officer or other officer of the State or unit of general local government who qualifies under regulations of the Secretary;

**(C)** specify that the State or unit of general local government under this subsection has fully carried out its responsibilities as described under paragraph (2); and

**(D)** specify that the certifying officer -

**(i)** consents to assume the status of a responsible Federal official under the National Environmental Policy Act of 1969 and each provision of law specified in regulations issued by the Secretary insofar as the provisions of such Act or other such provision of law apply pursuant to paragraph (2); and

**(ii)** is authorized and consents on behalf of the State or unit of general local government and himself or herself to accept the jurisdiction of the Federal courts for the purpose of enforcement of the responsibilities as such an official.

**SEC. 109. EXAMINATION AND MONITORING OF APICs.**

**(a) In General.**--The Secretary shall, under regulations, through audits, performance agreements, license conditions, or otherwise, examine and monitor the operations and activities of APICs for compliance with sound financial management practices, and for satisfaction of the program and procedural goals of this Act and other related Acts. The Secretary may undertake any responsibility under this section in cooperation with an APIC liaison committee, or any agency that is a member of such a committee, or other agency.

**(b) Monitoring, Updating, and Program Review.**

**(1) Reporting and Updating.**--The Secretary may establish such annual or more frequent reporting requirements for APICs, and such requirements for independent audits, and the updating of the statement of public purpose goals, investment strategy (including the benchmarks in such strategy), and other documents that may have been used in the license application process under this Act, as the Secretary determines necessary to assist the Secretary in monitoring the compliance and performance of

APICs.

(2) **Examinations.**--The Secretary shall, no less often than once every 2 years, examine the operations and portfolio of each APIC licensed under this Act for compliance with sound financial management practices, and for compliance with this Act.

(3) **Examination Standards.**

(A) **Sound Financial Management Practices.**--The Secretary shall examine each APIC to ensure, as a matter of sound financial management practices, substantial compliance with this and other applicable laws, including Federal executive orders, Department of Treasury and Office of Management and Budget guidance, circulars, and application and licensing requirements on a continuing basis. The Secretary may set any additional sound financial management practices standards by regulation, including standards that address solvency and financial exposure.

(B) **Performance and Other Examinations.**--The Secretary shall monitor each APIC's progress in meeting the goals in the APIC's statement of public purpose goals, executing the APIC's investment strategy, and other matters.

**SEC. 110. INCENTIVES AND PENALTIES.**

(a) **Incentives.**--From amounts of budget authority appropriated after the initial appropriation for the cost of annual loan guarantee commitments under this Act, the Secretary may increase the credit subsidy allocated to an APIC, in the Secretary's discretion, as an award for high performance of the APIC in carrying out its investment strategy and statement of public purpose goals.

**(b) Penalties.**

**(1) In General.**--The Secretary may penalize any APIC, or any manager of an APIC, in the event such APIC or a manager of the APIC commits an act of fraud, mismanagement, or noncompliance with this Act or regulations thereunder or a condition of the APIC's license under this Act. The Secretary in regulations shall identify, by generic description of a role or responsibilities, any manager of an APIC that is subject to this subsection.

**(2) Penalties Requiring Notice and Hearing.**--With respect to an act of commission or omission under paragraph (1) for which the Secretary may penalize an APIC or a manager, the Secretary may, following notice in writing to the APIC or the manager, and opportunity for administrative hearing--

**(A)** assess a civil money penalty against an APIC, or a manager of an APIC, the amount of which may exceed $10,000;

**(B)** require an APIC to divest any interest in an investment, on such terms and conditions as the Secretary imposes; or

**(C)** revoke the APIC's license.

(3) **Penalties Requiring Notice and an Opportunity to Respond.**--With respect to any act of commission or omission under paragraph (1) for which the Secretary may penalize an APIC or a manager, following notice in writing and an opportunity for the APIC or manager to respond, impose any reasonable penalty. Such a penalty may, in addition to any others, be--

**(A)** a civil money penalty of $10,000 or less;

**(B)** the suspension of an APIC's license, or the conditioning of the use of an APIC's license, for up to 90 days, including the deferral for the period of the suspension of a commitment to guarantee any new debenture of the APIC; or

**(C)** any other penalty that the Secretary determines to be less burdensome to the APIC than a penalty that requires notice and an administrative hearing under this Act.

**(c) Procedures.**

**(1)** No award under this section shall be made until notice thereof is published in the Federal Register.

**(2)** No civil money penalty, or other penalty under subsection (b), except suspension or conditioning of an APIC's license under subsection (b)(3)(B), shall be due and payable, or otherwise take effect, or be subject to enforcement by an order of a court, until notice thereof is published in the Federal Register.

(3)(A) The Secretary may suspend or condition an APIC's license for up to 45 days without prior notice in the Federal Register, but such suspension or conditioning shall take effect only after the Secretary has issued a written notice (including a writing in electronic form) of such action to the APIC. Such written notice shall be effective without regard to whether the APIC has been accorded the opportunity to respond. Such suspension or conditioning shall be subject to enforcement by an order of a court when the Secretary has issued such written notice.

(B) After such suspension or conditioning takes effect, the Secretary shall promptly cause a notice of suspension or conditioning of such license for up to 90 days to be published in the Federal Register. The APIC shall be entitled to respond to such notice. In counting the time period of the suspension or conditioning, the first day shall be the day that written notice under this paragraph is issued.

(C) During the time period of such suspension or conditioning, the Secretary may proceed under subsection (b)(2), and in accordance with the procedures applicable to such subsection, to revoke the APIC's license. Only if the Secretary so proceeds, notwithstanding any other provision of this section, the Secretary may extend the suspension or conditioning of the APIC's license by publishing a notice of such action in the Federal Register--

**(i)** for the first such extension, before the up to 90 days under subparagraph (B) expires; and

**(ii)** for any subsequent extensions of up to 90 days, before the preceding period of up to 90 days expires.

**(D)** The suspension or conditioning of an APIC's license by the Secretary under this paragraph shall remain in effect in accordance with its terms until final adjudication in any litigation undertaken to challenge such suspension or conditioning, or revocation, of an APIC's license.

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## APIC 20A -- TABLE OF CONTENTS

New Markets Tax Credit

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DRAFT

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(Original Signature of Member)

106TH CONGRESS
1ST SESSION

# H. R. ____

IN THE HOUSE OF REPRESENTATIVES

Mr. RANGEL introduced the following bill; which was referred to the Committee on ______________

# A BILL

To amend the Internal Revenue Code of 1986 to provide a credit against income tax for certain investments in businesses located in low-income communities.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "New Markets Tax Credit Act of 1999".

**SEC. 2. NEW MARKETS TAX CREDIT.**

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to business-related credits) is amended by adding at the end the following new section:

**"SEC. 45D. NEW MARKETS TAX CREDIT.**

"(a) ALLOWANCE OF CREDIT.—

"(1) IN GENERAL.—For purposes of section 38, in the case of a taxpayer who holds a qualified equity investment on a credit allowance date of such investment which occurs during the taxable year, the new markets tax credit determined under this section for such taxable year is an amount equal to 6 percent of the amount paid to the qualified community development entity for such investment at its original issue.

"(2) CREDIT ALLOWANCE DATE.—The term 'credit allowance date' means, with respect to any qualified equity investment—

"(A) the date on which such investment is initially made, and

"(B) each of the 4 anniversary dates of such date thereafter.

"(b) QUALIFIED EQUITY INVESTMENT.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified equity investment' means any equity investment in a qualified community development entity if—

"(A) such investment is acquired by the taxpayer at its original issue (directly or through an underwriter) solely in exchange for cash,

"(B) substantially all of such cash is used by the qualified community development entity to make qualified low-income community investments, and

"(C) such investment is designated for purposes of this section by the qualified community development entity.

Such term shall not include any equity investment issued by a qualified community development entity more than 5 years after the date that such entity receives an allocation under subsection (f). Any allocation not used within such 5-year period may be reallocated by the Secretary under subsection (f).

"(2) LIMITATION.—The maximum amount of equity investments issued by a qualified community development entity which may be designated under paragraph (1)(C) by such entity shall not exceed the portion of the limitation amount allocated under subsection (f) to such entity.

"(3) SAFE HARBOR FOR DETERMINING USE OF CASH.—The requirement of paragraph (1)(B) shall be treated as met if at least 85 percent of the aggregate gross assets of the qualified community development entity are invested in qualified low-income community investments.

"(4) TREATMENT OF SUBSEQUENT PURCHASERS.—The term 'qualified equity investment' includes any equity investment which would (but for paragraph (1)(A)) be a qualified equity investment in the hands of the taxpayer if such investment was a qualified equity investment in the hands of a prior holder.

"(5) REDEMPTIONS.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this subsection.

"(6) EQUITY INVESTMENT.—The term 'equity investment' means—

"(A) any stock in a qualified community development entity which is a corporation, and

"(B) any capital interest in a qualified community development entity which is a partnership.

"(e) QUALIFIED COMMUNITY DEVELOPMENT ENTITY.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified community development entity' means any domestic corporation or partnership if—

"(A) the primary mission of the entity is serving, or providing investment capital for, low-income communities or low-income persons,

"(B) the entity maintains accountability to residents of low-income communities through representation on governing or advisory boards or otherwise,

"(C) at least 60 percent of the aggregate gross assets of the entity are invested in qualified low-income community investments or in residential property located in low-income communities, and

"(D) the entity is certified by the Secretary for purposes of this section as being a qualified community development entity.

"(2) SPECIAL RULES FOR CERTAIN ORGANIZATIONS.—In the case of any specialized small business investment company (as defined in section 1044(c)(3)) and any community development financial institution (as defined in section 103 of the

Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702))—

"(A) the requirements of paragraph (1) shall be treated as met, and

"(B) priority shall be given to such companies and institutions in making the allocations under subsection (f).

"(d) QUALIFIED LOW-INCOME COMMUNITY INVESTMENTS.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified low-income community investment' means—

"(A) any equity investment in, or loan to, any qualified active low-income community business,

"(B) the purchase from another community development entity of any loan made by such entity which is a qualified low-income community investment if the amount received by such other entity from such purchase is used by such other entity to make qualified low-income community investments,

"(C) financial counseling and other services specified in regulations prescribed by the Secretary to businesses located in, and residents of, low-income communities, and

"(D) any equity investment in, or loan to, any qualified community development entity if substantially all of the investment or loan is used by such entity to make qualified low-income community investments described in subparagraphs (A), (B), and (C).

"(2) QUALIFIED ACTIVE LOW-INCOME COMMUNITY BUSINESS.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'qualified active low-income community business' means, with respect to any taxable year, any corporation or partnership if for such year—

"(i) at least 50 percent of the total gross income of such entity is derived from the active conduct of a qualified business within any low-income community,

"(ii) a substantial portion of the use of the tangible property of such entity (whether owned or leased) is within any low-income community,

"(iii) a substantial portion of the services performed for such entity by its employees are performed in any low-income community, "(iv) less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles (as defined in section 408(m)(2)) other than collectibles that are held primarily for sale to customers in the ordinary course of such business, and

"(v) less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property (as defined in section 1397B(e)).

"(B) PROPRIETORSHIP.—Such term shall include any business carried on by an individual as a proprietor if such business would meet the requirements of subparagraph (A) were it incorporated.

"(C) PORTIONS OF BUSINESS MAY BE QUALIFIED ACTIVE LOW-INCOME COMMUNITY BUSINESS.—The term 'qualified active low-income community business' includes any trades or businesses which would qualify as a qualified active low-income community business if such trades or businesses were separately incorporated.

"(3) QUALIFIED BUSINESS.—For purposes of this subsection, the term 'qualified business' has the meaning given to such term by section 1397B(d); except that—

"(A) in lieu of applying paragraph (2)(B) thereof, the rental to others of real property located in any low-income community shall be treated as a qualified business if there are substantial improvements located on such property,

"(B) paragraph (3) thereof shall not apply, and

"(C) such term shall not include any business if a significant portion of the equity interests in such business are held by any person who holds a significant portion of the equity investments in the community development entity.

"(e) LOW-INCOME COMMUNITY.—For purposes of this section—

"(1) IN GENERAL.—The term 'low-income community' means any population census tract if—

"(A) the poverty rate for such tract is at least 20 percent, or

"(B) the median family income for such tract does not exceed 80 percent of the metropolitan area median family income (or, in the case of a tract not located within a metropolitan area, 80 percent of statewide median family income).

"(2) AREAS NOT WITHIN CENSUS TRACTS.—In the case of an area which is not tracted for population census tracts, the equivalent county divisions (as defined by the Bureau of the Census for purposes of defining poverty areas) shall be used for purposes of determining poverty rates and median family income.

"(f) NATIONAL LIMITATION ON AMOUNT OF INVESTMENTS DESIGNATED.—

"(1) IN GENERAL.—There is a new markets tax credit limitation of $1,200,000,000 for each of calendar years 2000 through 2004.

"(2) ALLOCATION OF LIMITATION.—The limitation under paragraph (1) shall be allocated by the Secretary among qualified community development entities selected by the Secretary.

"(3) CARRYOVER OF UNUSED LIMITATION.—If the new markets tax credit limitation for any calendar year exceeds the aggregate amount allocated under paragraph (2) for such year, such limitation for the succeeding calendar year shall be increased by the amount of such excess.

"(g) RECAPTURE OF CREDIT IN CERTAIN CASES.—

"(1) IN GENERAL.—If, at any time during the 5-year period beginning on the date of the original issue of a qualified equity investment in a qualified community development entity, there is a recapture event with respect to such investment, then the tax imposed by this chapter for the taxable year in which such event occurs shall be increased by the credit recapture amount.

"(2) CREDIT RECAPTURE AMOUNT.—For purposes of paragraph (1), the credit recapture amount is an amount equal to the sum of—

"(A) the aggregate decrease in the credits allowed to the taxpayer under section 38 for all prior taxable years which would have resulted if no credit had been determined under this section with respect to such investment, plus

"(B) interest at the overpayment rate established under section 6621 on the amount determined under subparagraph (A) for each prior taxable year for the period beginning on the due date for filing the return for the prior taxable year involved.

No deduction shall be allowed under this chapter for interest described in subparagraph (B).

"(3) RECAPTURE EVENT.—For purposes of paragraph (1), there is a recapture event with respect to an equity investment in a qualified community development entity if—

"(A) such entity ceases to be a qualified community development entity,

"(B) the proceeds of the investment cease to be used as required of subsection (b)(1)(B), or

"(C) such investment is redeemed by such entity.

"(4) SPECIAL RULES.—

"(A) TAX BENEFIT RULE.—The tax for the taxable year shall be increased under paragraph (1) only with respect to credits allowed by reason of this section which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carryforwards and carrybacks under section 39 shall be appropriately adjusted.

"(B) NO CREDITS AGAINST TAX.—Any increase in tax under this subsection shall not be treated as a tax imposed by this chapter for purposes of determining the amount of any credit under this chapter or for purposes of section 55.

"(h) BASIS REDUCTION.—The basis of any qualified equity investment shall be reduced by the amount of any credit determined under this section with respect to such investment.

"(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out this section, including regulations—

"(1) which limit the credit for investments which are directly or indirectly subsidized by other Federal benefits (including the credit under section 42 and the exclusion from gross income under section 103),

"(2) which prevent the abuse of the provisions of this section through the use of related parties,

"(3) which provide such modifications to the 60-percent-of-assets requirement of subsection (e)(1)(C) as may be appropriate in the case of start-up entities, and

"(4) which impose appropriate reporting requirements."

(b) CREDIT MADE PART OF GENERAL BUSINESS CREDIT.—

(1) IN GENERAL.—Subsection (b) of section 38 of such Code is amended by striking "plus" at the end of paragraph (11), by striking the period at the end of paragraph (12) and inserting ", plus", and by adding at the end the following new paragraph:

"(13) the new markets tax credit determined under section 45D(a)."

(2) LIMITATION ON CARRYBACK.—Subsection (d) of section 39 of such Code is amended by adding at the end the following new paragraph:

"(9) NO CARRYBACK OF NEW MARKETS TAX CREDIT BEFORE JANUARY 1, 2000.—No portion of the unused business credit for any taxable year which is attributable to the credit under section 45D may be carried back to a taxable year ending before January 1, 2000."

(c) DEDUCTION FOR UNUSED CREDIT.—Subsection (c) of section 196 of such Code is amended by striking "and" at the end of paragraph (7), by striking the period at the end of paragraph (8) and inserting ", and", and by adding at the end the following new paragraph:

"(9) the new markets tax credit determined under section 45D(a)."

(d) CLERICAL AMENDMENT.—The table of sections for subpart D of part IV of subchapter A of chapter 1 of such Code is amended by adding at the end the following new item:

"Sec. 45D. New markets tax credit."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to investments made after December 31, 1999.

POTENTIAL ORIGINAL SPONSORS FOR NEW MARKET LEGISLATION
[L] indicates likely lead sponsor
* indicates a commitment or strong indication of interest

| **Bill** | **House Committees** | **Senate Committees** |
|---|---|---|
| *Tax* | ***Ways and Means*** | ***Finance*** |
| | Rangel (D-NY-Ranking)* [L] | Rockefeller (D-WV) [L] |
| | Becerra (D-CA) | Moynihan (D-NY)-??? |
| | Jefferson (D-LA) | Robb (D-VA) [L] |
| | Cardin (D-MD) | Baucus (D-MT) |
| | | |
| | Houghton (R-NY) * | Chafee (R-RI) |
| | Lewis (R-KY) * | Jeffords (R-VT) * |
| | Ramstad (R-MN) | Roth (R-DE) |
| | Johnson, N (R-CT) | |
| | Portman (R-OH) | |
| | | |
| | ***Other*** | ***Other*** |
| | Roybal-Allard (D-CA) | Daschle (D-SD) |
| | Ford (D-TN) | Lieberman (D-CT) |
| *NMVC* | ***Small Business*** | ***Small Business*** |
| | Velazquez (D-NY-Ranking)* [L] | Kerry (D-MA-Ranking) *[L] if BA/TA issue is resolved |
| | | Edwards (D-NC) [L] |
| | Reyes (D-TX) | Levin (D-MI) |
| | | Lieberman (D-CT) |
| | | Wellstone (D-MN) |
| | | |
| | Talent (R-MO-Chair) | Burns (R-MT) |
| | Hill (R-MT) more likely | Crapo (R-ID) |
| | | ~~Enzi (R-WY)~~ |
| | | |
| | ***Appropriations*** | ***Appropriations*** |
| | Roybal-Allard (D-CA) | Byrd (D-WV-Ranking) * |
| | Mollahan (D-WV) | Lautenberg (D-NJ) |
| | Serano (D-NY) | Leahy (D-VT) |
| | | |
| | | Stevens (R-AK-Chair) * |
| | | McConnell |
| | | |
| | Other | Other |
| | LaFalce (D-NY) | |
| | Watts (R-OK) | |
| *APIC* | ***Banking and Finance*** | ***Banking, Housing and Urban Affairs*** |
| | Frank (D-MA-Subcomm. Ranking) | Sarbanes (D-MD – ranking) [L] |
| | Hooley (D-OR)* | Kerry (D-MA) |
| | Kanjorski (D-PA-Subcomm. Ranking)* | Bayh (D-IN) – personally expressed interest |
| | LaFalce (D-NY-Full Comm. Ranking) | Edwards (D-NC) [L] |
| | Vento (D-MN) | |
| | | |
| | Baker (R-LA-SubComm. Chair)* | Shelby (R-AL) |
| | Leach (R-IA) | [Santorum (R-PA)] |
| | | |
| | ***Appropriations*** | ***Appropriations*** |
| | Mollohan (D-WV-Subcomm. Ranking) | Byrd (D-WV-Ranking) |
| | Price (D-NC) | Lautenberg (D-NJ) |
| | | Leahy (D-VT) |
| | | |
| | | Stevens (R-AK) |
| | | |
| | | ***Other*** |
| | | Harkin (D-IA) |

## Statement of Needs and Purposes

**New Markets Venture Capital Program.**

The SBA's Small Business Investment Company (SBIC) program has proven to be an exceptionally effective vehicle for meeting the growth capital needs of America's small businesses. Last year alone, SBICs invested $3.2 billion in 3,456 financings, 89 percent of which were equity oriented. This is estimated to be 45 percent of the total number of institutional venture investments made during 1998. However, despite this overall success, the SBIC program is much less effective in addressing the growth capital needs of the smaller businesses located in urban and rural areas. A new program is needed for that -- the New Markets Venture Capital program.

The proposed New Markets Venture Capital legislation would authorize SBA to provide financial assistance to entities that agree to make equity-type investments in and to provide technical assistance to smaller enterprises (as defined in 13 CFR §107.710(a)) located in low- or moderate-income (LMI) geographies.These entities would be known as "New Markets Venture Capital companies" or "NMVCs." LMI geographies are characterized by high poverty or low or moderate income levels, and include areas located within HUBZones, Empowerment Zones or Enterprise Communities.

Investment by NMVCs in smaller enterprises located in LMI geographies would be expected to build wealth and to provide increased employment opportunities in these locations. The NMVCs would provide specialized technical assistance to help the businesses grow.

SBA representatives have spent more than a year researching the concepts and structures of development venture capital, in the U.S. and abroad, to develop this proposal. Three separate SBA-sponsored roundtables were convened, and numerous individual and small group meetings with practitioners and academicians were held. Representatives from banks, licensed SBIC/SSBICs, community development funds, and the academic and legal communities provided particularly valuable assistance in refining the concepts.

From these efforts, a number of conclusions were reached:

1. Need for venture capital in LMI geographies. The availability of equity-type capital is essential for viable small businesses to grow vigorously since it is the foundation upon which most debt financing is structured. While an embryonic venture capital community is starting to develop in many urban and rural areas, it is fragmented and seriously undercapitalized. An SBA program could contribute significantly to institutionalizing this activity and expanding it nationally, much as the SBIC program did for the general venture capital industry.

2. Structural flexibility of program. Any program that is developed to reach both urban and rural areas must be flexible enough to meet the special needs of the various types of targeted small businesses found in these different locations. The program also must be flexible enough to be delivered through different types of community-based venture development organizations, which tend to be uniquely structured.

3. Potential return on investment. Development-oriented venture investments in selected urban and rural small businesses should be able to provide a positive, although modest, financial return. Such a return is needed to sustain the investment vehicle.

4. Need for technical assistance. Intense, highly focused technical assistance to the small business is essential if equity-type investments for this market are to be viable. Technical assistance encompasses one-on-one business or financial consulting as well as substantive assistance in all elements of business operations.

5. Minimizing cost of program. The cost of an NMVC program can be lowered through the utilization of existing local resources. Currently there are a number of organizations that successfully employ venture capital to develop and build viable small businesses in their communities with the objective of providing employment and creating value. The NMVC program should leverage off of the skills, experience, and entrepreneurial infrastructure that existing groups have already developed.

Overview of the Proposed Program

SBA would select firms to participate as NMVCs. Unlike SBICs, NMVCs would not be licensed by SBA. Instead, SBA would enter into an agreement with each NMVC setting forth the specific terms of that firm's participation in the program. Each agreement would be tailored to the particular NMVC's operations and would be based on the NMVC's own proposal, submitted as part of the NMVC's application form. SBA would provide two types of financial assistance to NMVCs – (1) guaranteed debenture leverage, and (2) grant funds to supplement the NMVC's own technical assistance resources. SBA would examine the NMVCs at regular intervals to determine compliance with the SBA contract.

Commencement of the Program

If the necessary legislation is enacted, SBA will announce the commencement of the NMVC program and will make application packets available to parties interested in applying to participate as NMVCs.

Criteria for Selection of Participants

It is proposed that program participants satisfy the following requirements:

Each NMVC must be a newly-formed for-profit entity, which may be a newly formed for-profit subsidiary of an existing entity, with at least $5 million of contributed capital or binding capital commitments from non-Federal investors.

Each NMVC's management team must be experienced in some form of community development financing or venture capital financing.

Each NMVC must have binding commitments (in cash or in-kind) for technical assistance and overhead, payable or available over a multi-year period not to exceed 10 years, in an amount equal to 30% of its committed and contributed capital. These commitments may be from any non-SBA source and the cash portion may be invested in an annuity payable semi-annually over a multi-year period not to exceed 10 years. This ensures that the NMVC has sufficient resources to perform its functions of oversight and technical assistance during the most critical years when monies are being invested. Based upon a showing of special circumstances and good cause, SBA could approve a company that has a viable plan to raise the required amount for marketing, management and technical assistance.

SBA would select the program participants. Specific selection criteria would be developed by SBA and would be designed to ensure that a variety of investment models are chosen and that appropriate public policy goals are addressed. Geographic dispersion would be taken into account in the selection process.

SBA's Commitment of Resources to the NMVCs

SBA's commitment of resources to each NMVC would combine SBA-guaranteed supplemental funding (leverage) and grant(s) to supplement the NMVC's technical assistance and overhead funds.

Leverage

It is expected that the leverage would consist of SBA-guaranteed debentures with a ten-year term, zero coupon for the first five years (i.e., no interest payable during the first five years). In other words, the instruments would be discounted at issuance, and after five years they would achieve their face value with interest payable semi-annually until maturity.[1] The face value of the debentures would be payable at maturity.

The debenture interest rate would be established in a similar way to the SBIC debenture leverage (a spread over the 10-year Treasury rate).

[1]At a 6% discount rate, the proceeds would be $74.41 per $100 face value.

Technical Assistance Grant

Each NMVC would be eligible for one or more grants, on a matching basis, in an aggregate amount equal to the amount the NMVC makes available for technical assistance. The technical assistance grant would be made available to the NMVC semi-annually over a multi-year period not to exceed 10 years. SBA also would be authorized to provide supplemental grants to NMVCs.

Total Program Amount

The program will require such subsidy budget authority as may be necessary to guarantee up to $100 million of debentures, and will require up to $30 million to make technical assistance grants, for the purposes of this program, to remain available until expended. At a 15% subsidy rate for the guaranteed leverage, the program would require a $45 million one-time appropriation -- $15 million for guarantees and $30 million for technical assistance grants.

The budget authority must be available for at least the three-year period required to establish the program, and preferably longer to allow the NMVCs to commence operations.

NMVC Program Administration and Oversight

Oversight of the NMVC program would be modeled after that developed for the SBIC program and administered by SBA's Investment Division. It would include a close working relationship between SBA analysts and NMVC management teams, detailed reporting requirements, frequent on-site examinations to evaluate performance and conformance with the operating plan, and careful analysis of the firm's economic impact.

# THE NEW MARKETS INITIATIVE: BUDGET IMPACT

The New Markets initiative will prompt approximately $15 billion in new investment in urban and rural areas over five years through:

**The New Markets Tax Credit** --To help spur $6 billion in new equity capital for investment in Americas New Markets, the New Markets Tax Credit will be worth up to 25 percent for investments in a wide range of vehicles serving these communities, including community development banks, venture funds and corporations, new investment company programs (targeted SBICs, NMVC firms, and APICs -- see descriptions below), and other targeted investment funds. Credits would be allocated to the targeted investment vehicles which could use the tax credits to attract investors. The investment funds would make their own decisions about what investments or loans to make to help create and grow businesses in the New Markets. A wide range of businesses could be financed by these investment funds, including small technology firms, inner-city shopping centers, manufacturers with hundreds of employees, and retail stores.

***Budget Impact:*** ***The New Markets Tax Credit will cost approximately $980 million over five years.***

**America's Private Investment Companies (APICs)**. For years, America has supported OPIC, the Overseas Private Investment Corporation, to promote growth in emerging markets abroad. Now we must do the same thing in America's New Markets. Under this program, investors will put equity into new private investment partnerships to be known as America' s Private Investment Companies (APICs). HUD and SBA working together will provide up two times the private capital in loan guarantees for each. APICs will make equity investments in larger businesses that are expanding or relocating in inner cities and rural areas. Under the financing structure, the private investors' funds are at risk ahead of the government.

***Budget impact:*** ***APICs will cost $36 million in credit subsidy (at a rate of 3.6%, allowing up to $1 billion in government guarantees) and $1 million for HUD's administrative costs.***

**SBICs Targeted to New Markets.** Over 40 years, the SBA's small business investment company (SBIC) program has provided roughly $20 billion in equity and debt financing to more than 85,000 different companies, helping them at a critical stage to grow from small businesses to household names, like AOL and Staples. However, too little of the capital invested has benefited our cities and rural distressed communities. Last summer, the Vice President challenged the SBA to find ways to meet better the needs of minority firms and underserved markets. In response, SBA determined that, under existing legislation, the Agency can offer more flexibility and new financing terms to make it more attractive for SBICs to invest in businesses in low and moderate income (LMI) areas. Specifically, SBICs making LMI investments will be eligible for a new type of federally guaranteed loan to augment their capital for business investment. Interest on the guaranteed funding will be deferred for the first five years of the 10-year term to give SBICs more time to nurture their investments in small businesses before they must produce a return. In addition, SBA will conduct an aggressive outreach campaign around the country to promote LMI investments.

<u>*Budget impact:*</u> ***No new loan subsidy budget authority is required for this initiative as the SBIC debentures program has a 0% credit subsidy rate. However, the commitment level for the SBIC debenture program must be increased (from $640 million in FY 99 to $800 million in FY 2000) in order to ensure that the new targeted activity does not crowd out activity by traditional SBICs.***

<u>**New Markets Venture Capital Firms (NMVCs)**</u>. There are thousands of inner-city and rural entrepreneurs who need both capital and expert guidance to transform their small businesses and great ideas into thriving companies. SBA will select ten-to-twenty NMVC firms whose management has successful records in community-based venture capital. The equity funds of private investors will be matched with loan guarantees of up to $10 million per NMVC, with interest on the debt deferred. Investors must also provide at least $1.5 million in technical assistance over five years to the target firms, matching SBA's grants of technical assistance. The program should provide long-term, patient growth capital and facilitate critically needed technology and management skills development for smaller businesses in new markets.

<u>*Budget impact:*</u> ***The NMVC firms will cost $15 million in credit subsidy for loan guarantees (at a credit subsidy rate of 15%, allowing $100 million in government guarantees) and $30 million for technical assistance grants.***

<u>**New Markets Lending Companies (NMLC)**</u>. For the first time in many years, SBA will approve approximately 10 new non-bank lenders -- firms authorized to originate loans under SBA' s largest loan program -- the 7(a) General Business Loan Guaranty program. Under the 7(a) program, SBA guarantees up to 80% of a loan that is made by a lender to a creditworthy small business that cannot otherwise secure financing on reasonable terms. The firms selected must have a strategy to target their lending to underserved areas.

<u>*Budget Impact:*</u> ***No additional budget authority is necessary to license these new non-bank lenders.***

<u>**Continued Growth for CDFIs.**</u> Community Development Financial Institutions (CDFIs), locally-based institutions with expertise in lending and investment in underserved areas, represent an important vehicle for greater investment in new markets. The federal contribution to building these institutions must continue to grow.

<u>*Budget impact:*</u> ***The CDFI Fund will cost $125 million in FY 2000, including $15 million for new microenterprise activities under the Program for Investments in Microentrepenuers (PRIME) Act (now pending with***

***bipartisan support before Congress) and an increase of $15 million over FY 99 levels.***

**Microenterprise Lending and Technical Assistance.** Microenterprise initiatives in the FY 2000 budget include: (1) PRIME, under which the CDFI Fund will provide microenterprise technical assistance and capacity building program to award grants on a competitive basis to microenterprise development organizations and programs that focus on low-income entrepreneurs; (2) doubling support for technical assistance in SBA's Microloan Program, which links loans entrepreneurs with the provision of training and technical assistance; (3) doubling support for SBA lending to leverage over $75 million in new microlending; (4) doubling funding for Individual Development Accounts (IDAs), to empower lower-income individuals to start a new business, invest in a first home, or save for post-secondary education; and (5) tripling funding for SBA's One-Stop Capital Shops, which offer microenterprise development (including direct access to microlenders), personal finance, and even credit repair services in Empowerment Zones.

***Budget impact:*** ***(1) As described above, PRIME will cost $15 million in FY 2000; (2) SBA's microloan technical assistance and training will cost $ 32 million in FY 2000 (up from $16 million in FY 99); (3) SBA's microlending will cost $5 million in credit subsidy (up from $3 million in FY 99); (4) IDAs will cost $20 million in FY 2000 (up from $10 million in FY 99); and (5) One-Stop Capital Shops will cost $10 million in FY 2000 up from $3.1 million in FY 99.***

**BusinessLINC.** The President's budget provides resources to expand BusinessLINC -- an innovative public-private partnership launched by Vice President Gore and led by Treasury Secretary Rubin and SBA Administrator Alvarez --to new markets in economically distressed communities. BusinessLINC (Learning, Information, Networking and Collaboration) is designed to encourage large businesses to work with small business owners and entrepreneurs in order to improve the economic competitiveness of smaller firms located in distressed areas, both urban and rural. The funds will be used to leverage private sector efforts to spur new BusinessLINC partnerships at the national and local level.

***Budget Impact:*** ***BusinessLINC will cost $3 million in FY 2000.***

**Specialized Small Business Investment Companies (SSBICs).** The President's budget will expand current tax incentives to increase the amount of equity capital available to economically disadvantaged people by making it easier for Specialized Small Business Investment Companies (SSBICs) to qualify as tax-favored regulated investment companies.

***Budget Impact:*** ***This change to tax rules will have a negligible budget impact.***

# America's Private Investment Companies: HOW APIC WILL WORK

June 1999

hud
YOUR COMMUNITY PARTNER

## America's Private Investment Companies: HOW APIC WILL WORK

**America's Private Investment Companies (APICs)** will provide capital to large-scale businesses in low and moderate income areas, both urban and rural.[1] Just as America's support for the Overseas Private Investment Corporation (OPIC) helps promote growth in emerging markets abroad, the APIC program will encourage a dramatic increase in private investment in this country's untapped markets. It will be jointly administered by the **U.S. Department of Housing and Urban Development (HUD)** and the **U.S. Small Business Administration (SBA)** to combine HUD's expertise in large-scale revitalization with SBA's venture expertise and financing tools. APIC is part of the **New Markets Initiative** announced by The White House in January of this year.

The APIC program is designed to address the capital needs of a broad array of firms and industry sectors, including commercial real estate. For example, an individual APIC could help finance:

- Establishment of a new facility, such as a call center, data processing "back office," or factory, by a large company (or small company joint venturing with a large one).
- Expansion of an existing facility (or "campus"), the upgrading of equipment , or the expansion of staff by a mid-size manufacturing company seeking to increase production.
- Expansion of the service area of a mid-size service company, such as a trucking company, building contractor, or home health care firm.
- Development of a multi-tenant shopping center, or opening or expanding a large retail company in a new geographic area.
- Buyout of a company to be revitalized in its existing facility.
- Acquisition of the property of a departing large company and development of an incubator or industrial park.
- And more.

A requested budget authority of $36 million in credit subsidy for Fiscal Year 2000 will guarantee an estimated $1 billion in debt. Combined with $500 million in private equity, the program would have a total impact of $1.5 billion per year or $7.5 billion over the next five years. Designed to fit hand-in-glove with the proposed **New Markets Tax Credit**, an APIC selected to receive an allocation of tax credits could offer investors a tax credit on their equity (up to 6% per year over 5 years for a net present value of up to 25%).

[1]Eligible areas include those census tracts in which 20% or more of the population was in poverty or in which the median family income for the tract was less than 80 percent of the area median family income. For rural (nonmetropolitan) communities, "area" refers to the statewide median.

## The Steps: How the Program will Work

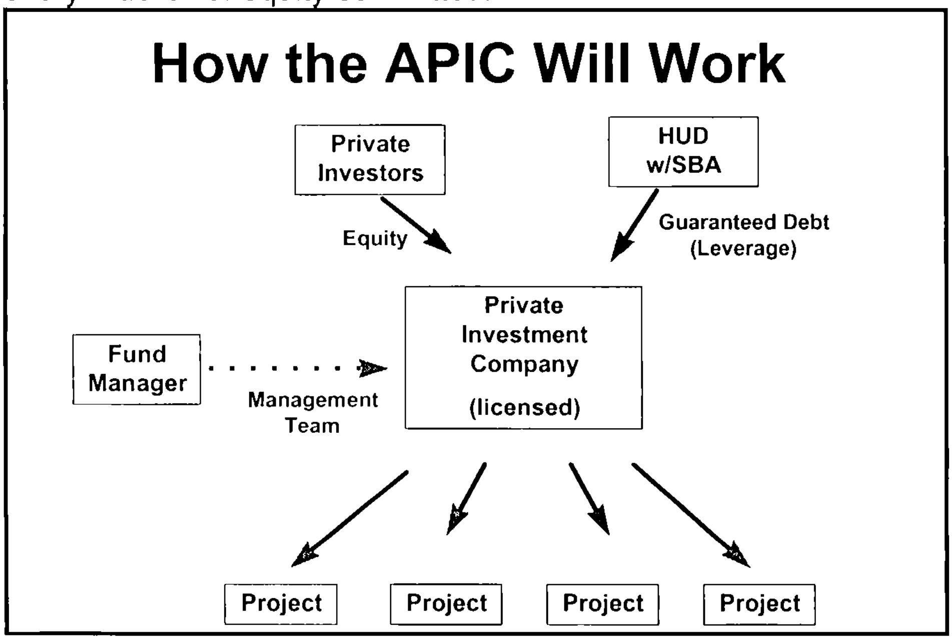
The APIC program is not a direct loan or grant program from government to the businesses. Instead, modeled after the successful SBA Small Business Investment Companies (SBICs) and OPIC Investment Funds programs, APIC will create a new generation of large-scale private investment companies that find and invest in promising untapped market opportunities in distressed areas. Low and moderate income areas of urban and rural America are especially starved for equity capital—the first money into a deal and the first at risk. APIC is designed to address that equity gap, in particular, although the investment companies will be able to invest both equity, debt and, if they choose, securities that combine the features of debt and equity.

Here's how APIC will work, step-by-step...

### *Step 1*

**The fund manager lines up potential investors willing to invest in an APIC.**

Fund managers seeking to license and operate investment companies under the APIC program will begin by obtaining commitments of private equity capital. The program offers government-guaranteed leverage on that equity at a ratio of 2 dollars of debt for every 1 dollar of equity committed.




**Who will these investors be? What's in it for them?** APIC is designed to appeal to a wide array of investors—individuals as well as institutions. Investors could include:

- Corporations

- Banks (such investments could receive favorable consideration under the Community Reinvestment Act)
- Insurance companies
- Pension funds
- States and local governments, plus other public and quasi-public economic development entities
- Individual investors, including "social investors"
- Foundations (as program-related investments)
- Other nonprofits

**Benefits to the Investor, Protection for the Tax Payer.** The program offers debt at favorable, government-guaranteed rates, which improves the return on investor equity. In addition, for individuals and for tax-paying institutions, an allocation of the New Markets Tax Credit could further boost return. The private equity investment, in turn, act as a "shield" for the tax payer dollar—every dollar of equity capital must be lost before any of the government-guaranteed debt is lost. This structure has created a tremendous financial discipline in the successful SBA and OPIC programs after which APIC is modeled—and leveraged significant job creation at very low cost to the tax payer.

**How big will the funds and the deals they finance be?** With a minimum equity capitalization of $25 million and an expected maximum of $150 million, APICs will create large-scale investment companies with combined capital (private equity plus government-guaranteed debt) of $75 - $450 million. It is expected that each APIC would carry about 9-12 large-scale deals (of about $5 - $50 million apiece) in its portfolio, diversifying and spreading risk across those projects. Finally, the investors' return is the blended return across these deals.

Together, the new and existing tools in the Administration's **New Markets Initiative** address the wide range of financing needs, from start-up through mature companies, and all are eligible for the New Markets Tax Credit:

| Program | Agency | Business Target | Features |
|---|---|---|---|
| New Market Venture Companies | SBA (proposed) | Start-ups and existing businesses | Technical assistance, guaranteed debt |
| Small Business Investment Companies/LMI Investments | SBA (launched) | Small businesses up to $18M in net worth | Guaranteed debt and participating securities |
| America's Private Investment Companies | HUD/SBA (proposed) | Large, mature companies | Guaranteed debt |
| New Markets Tax Credit | Treasury (proposed) | *All of the above* | Tax credit on equity invested |

Many prospective APICs will probably begin to identify deals before they have applied for a license—as part of developing an investment strategy and information network.

## *Step 2*

**The Secretary of HUD invites applications for APIC licenses.**

HUD will issue a "call for proposals" announcing selection criteria that will guide the licensing of each APIC. The key criteria will be:

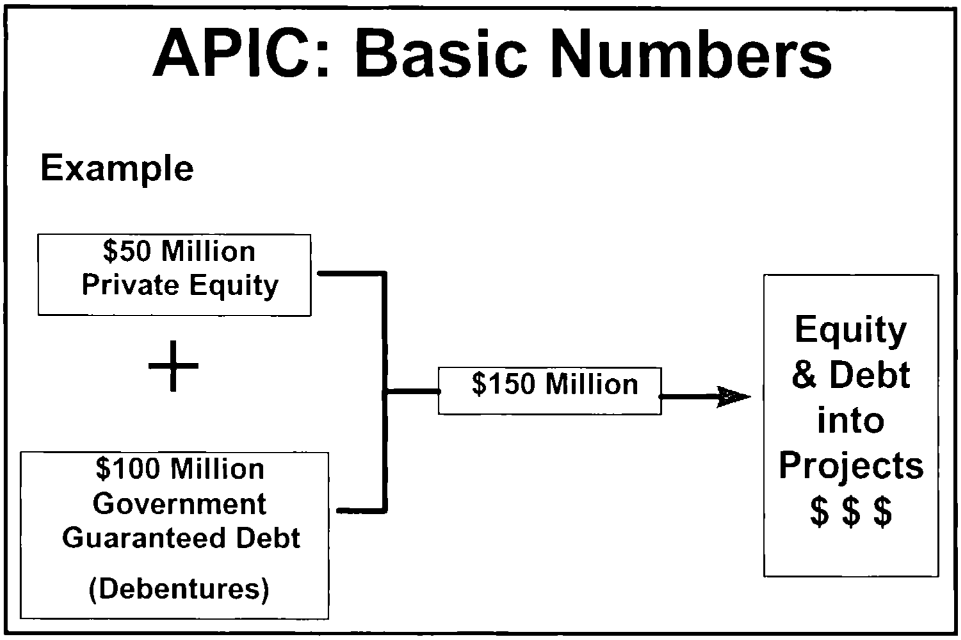
- Quality of the management team (track record in direct equity investment and portfolio management, including expertise in community development settings).
- Quality of an investment strategy—a kind of "business plan" that describes how the APIC will focus its activity.
- A plan to achieve its public purpose goals that address such performance targets as high-wage jobs and community development impacts.

The first two criteria —financial expertise together with a strong plan – are the key factors driving licensing of SBICs by SBA and of OPIC's Investment Funds. The third criterion reflects the public policy aims of the APIC program: to create jobs and promote the development of low and moderate income areas.

## *Step 3*

**HUD and SBA jointly review proposals, and HUD selects those APICs that best respond to the call for proposals. The chosen investment companies receive a license, an allocation of credit subsidy commitments and, if further designated, an allocation of New Markets Tax Credits.**

Each selected APIC will receive a license to operate under the terms of the program and receive: (a) an allocation of credit subsidy commitment (enough to guarantee debt up to twice the amount of the APIC's equity capital); and (b) APICs selected to also receive an allocation of New Market Tax Credits could offer investors tax credits on their equity investments.




*Step 4*

**The APICs find qualified investment opportunities (deals) in low and moderate income areas.**

What will these deals look like? Just as APIC is designed to appeal to a wide array of investors, it is also designed to address the capital needs of a broad array of firms and industry sectors, including commercial real estate. The diversity of the potential financing deals highlighted on the first page show the range of ways that an APIC can promote growth in emerging markets.

**Will state or local governments or other public entities play a role?** Public and quasi-public entities with economic development objectives can play a number of important roles in the APIC program. As we've begun to outline above, they can assist by:

- Finding interested fund managers and encouraging them to develop an APIC proposal that addresses the needs of a particular region or sector.
- Investing as an equity partner in an APIC.
- Helping licensed APICs identify promising investments—acting as part of the APIC's information network. In this way, APICs will provide state and local governments and other stakeholders with a market-savvy vehicle to vet a wide variety of large-scale business development proposals.

On the other hand:

- The program will not encourage states and localities to "pirate" large employers from one jurisdiction to another. The APIC legislation has been drafted to include an anti-pirating provision to ensure that the investment companies are helping to grow the economy and help businesses expand, not make unprofitable investments simply to move a firm from one place to another.

## *Step 5*

**The APIC prepares to issue debentures (debt) in order to raise funds to invest in a deal.**

When an APIC has found a deal or deals that it wishes to invest in, the APIC will submit to HUD four basic certifications that the investment or investments meet program guidelines:

1. The project is in an LMI area.
2. The project meets the terms of the New Markets Tax Credit (is in a real operating business that employs people, for example).
3. For any debenture issue that includes an APIC's first funding of a project (but not for subsequent funding of the project), that the project meet the requirements for review under the National Environmental Policy Act (or is one of the broad array of "exempted" or "excluded" investment types not likely to have a significant impact on the human environment).
4. Beyond the features of the individual investment, the APIC itself must be in compliance with the terms of its license.

Like OPIC and SBA for their analogous programs, HUD will not conduct a project-by-project review of the APIC's proposed investment—HUD will not look at financial projections, for example, since the equity investors themselves will be focused on the potential financial risk and reward. The certifications, and HUD's expedited review of the same, are merely to ensure that the government guarantee on debt, which will enable large-scale investments that may have significant economic and human impacts, is indeed being extended to activities in keeping with the aims of the program.

**Where the "leverage dollars" come from.** Following HUD's review for sufficiency of the APIC's program certifications, the APIC would issue debentures, that the U.S. government would guarantee, to a financial intermediary (e.g., the Federal Home Loan Bank of Chicago plays this role in SBA's SBIC program). Upon buying the debentures, the intermediary would transfer the proceeds, less fees, to the APIC. Periodically, the intermediary would pool the debentures, and issue a trust certificate backed by the pool. The certificate would also be guaranteed and it would then be sold to investors on Wall Street. If less expensive than this market financing, the Federal Financing Bank in the U.S. Treasury is authorized to perform these debenture financing roles.

## *Step 6*

**The APIC provides capital to the business, contributing to job creation and community development, and begins to repay the debentures.**

The APIC is now in full operation with fund invested in active businesses. HUD expects to set terms of the debt financing (debentures) that respond to the cash flow realities of many promising investments in low and moderate income areas—especially the most distressed rural and inner-city communities. Favorable terms might include "zero coupon" or other features that defer interest payments early in the life of the investment to give it a chance to grow, or participating securities that include repayment features based on the APIC's overall profitability.

*"Rolling over" investment proceeds.* What if an APIC wishes to sell its interests in a given deal and "roll over" the proceeds into new qualified investments in targeted areas, instead of repaying the debenture right away? An APIC with significant "deal flow" (strong investment prospects outstanding) could re-invest in a new deal by following these steps. The APIC would first purchase Treasury securities with the proceeds of the sale of its investment. It would then submit to HUD the same certifications that apply to a new debenture issue, according to Step 5 above. Upon review for sufficiency and approval by HUD, the APIC would then sell the securities and apply the proceeds to the new investment. This manner of roll over of proceeds avoids the need to issue new debentures. It would also allow the APIC to maintain a larger, more risk-diversified portfolio than it would have if, when it sold off an investment, it had to repay debenture(s) outstanding.

## *Step 7*

**The APIC will regularly collect data on its investments and report progress.**

Like any well-run private investment company, the APIC will collect data on the performance of the businesses in which it has invested. Periodically, each APIC will be reviewed by HUD for sound financial management practices, for financial solvency and exposure, and for performance against the APIC's self-defined public purpose goals—the goals defined at the time of the APIC's successful application for a program license.

Breaches of sound financial management, as well as fraud or mismanagement or violations of license terms, may lead to penalties. On the other hand, high performance consistent with APIC's public purpose goals may be rewarded, for example with the opportunity for greater leverage of the APIC's equity – perhaps 3 dollars of debt for every 1 dollar of equity committed.

### *Step 8*

**The APIC "winds up"—selling its investments, paying off debentures, and returning profits to its investors.**

The "life cycle" of an APIC will vary. If the SBICs are any indication, some APICs will make investments, watch them mature, and sell them off—perhaps long before the maximum debenture period of 21 years. Others will sell off their interests in particular businesses earlier still and then "recycle" the proceeds into new businesses that meet the program's targeting criteria. Ultimately, however, the APIC will sell off all interests, fulfill any remaining debt obligations, and return profits to its investors.