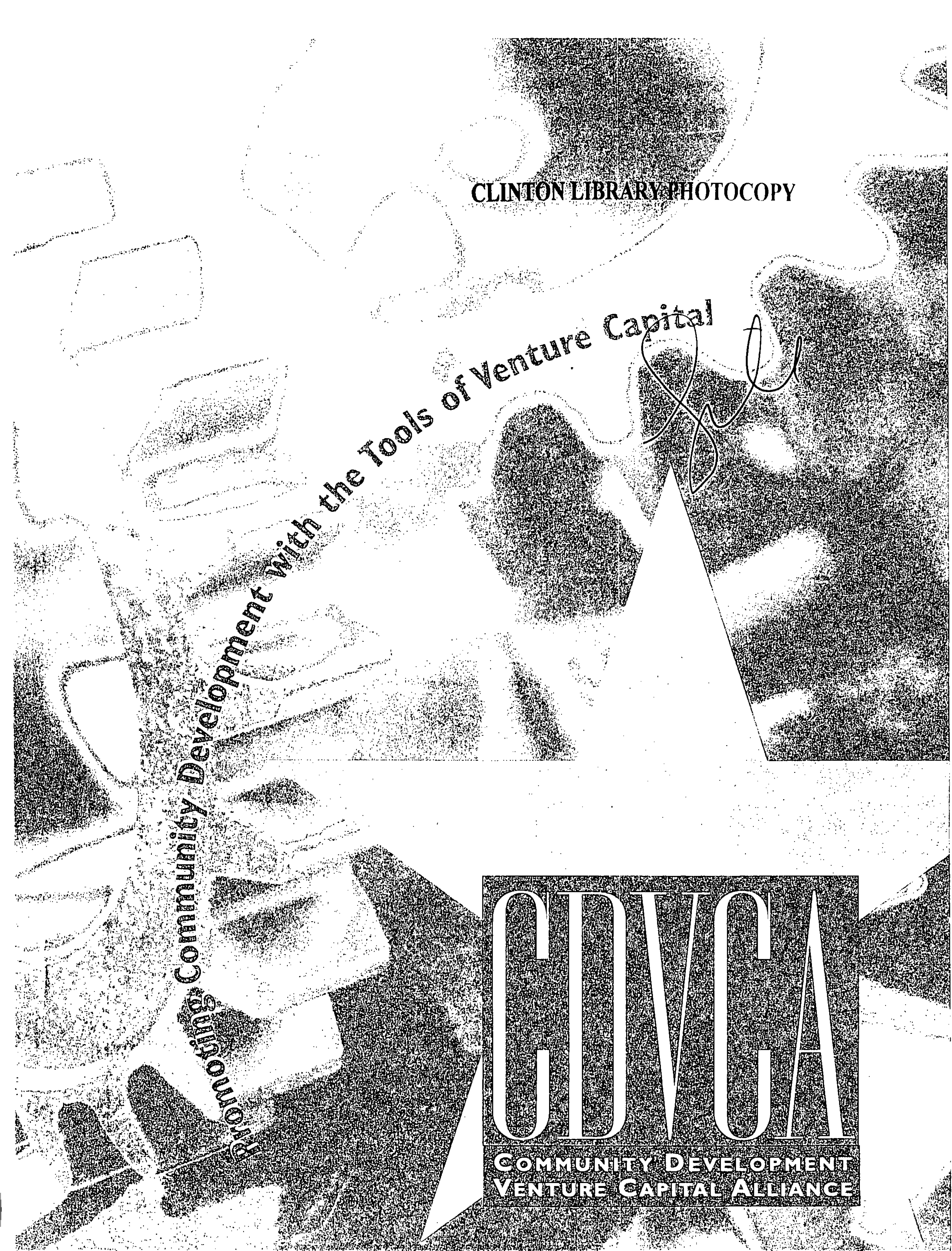

Promoting Community Development with the Tools of Venture Capital

CDVCA

Community Development Venture Capital Alliance

KENTUCKY HIGHLANDS
INVESTMENT CORPORATION

L. Ray Moncrief
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Booklet, "New Markets and Stronger Communities," 16 pgs.

NEW MARKETS and STRONGER COMMUNITIES

the case for a community development tax credit

Community Development Tax Credit Coalition

Community Development Tax Credit Coalition
1250 Eye Street NW, Suite 902, Washington DC 20005
tel: 202-393-5225 • fax: 202-393-3034

COMMUNITY DEVELOPMENT
VENTURE CAPITAL ALLIANCE

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PROMOTING COMMUNITY DEVELOPMENT WITH THE TOOLS OF VENTURE CAPITAL

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CDVC Fund Profiles

Examples of Community Development Venture Capital Funds at Work Today:

Boston Community Venture Fund, Massachusetts

Coastal Ventures Limited Partnership, Maine

Community Development Ventures, Inc., Maryland

Kentucky Highlands Investment Corporation, Kentucky

New York Community Investment Company, New York

Northeast Ventures, Minnesota

Boston Community Venture Fund

30 Germania Street
Jamaica Plain, MA 02130
(617) 522-6768
Elyse Cherry, President

* * *

Total Assets: $5.5 million

# of Businesses in Portfolio: 7

Legal Structure: For-profit limited liability corporation.

Geographic Focus: Primary focus is state of Massachusetts. Can invest outside the state.

* * *

Boston Community Venture Fund (BCVF) is a community-based venture capital fund that makes equity investments in high-potential, emerging businesses in low-income communities in metropolitan Boston and eastern Massachusetts.

Established in 1996 by **Boston Community Capital**, BCVF invests in seed stage and growth stage companies as a means of providing stable employment, livable wages and career mobility to low-income people. By investing in growing businesses in distressed urban neighborhoods, BCVF aims to improve the long-term economic health of communities and help integrate them into the larger economy.

Founded on the conviction that "financial return and social return need not be mutually exclusive," BCVF focuses on investments which have a clear means of returning the fund's invested capital with a reasonable profit. It looks for strong management, a growth-oriented business strategy, a target hurdle rate of 20 percent, and an anticipated return of investment in five to seven years.

BCVF is currently capitalized at $5.5 million. The fund anticipates increasing that capitalization to over $8 million by the end of 2001 and expanding its investment portfolio to 20 companies.

BCVF Portfolio Company:

SpringBoard Technologies
Tony Dolphin, President and CEO
Springfield, Massachusetts

In 1993, Tony Dolphin, an African-American entrepreneur, saw an opportunity to create his own business when Digital Equipment Corporation announced that it would close the division in which he was working. Tony had been a General Manager at Digital for more than 10 years and decided to approach the company with a proposal to buy out its hard drive repair division.

*Digital agreed, and Dolphin formed **SpringBoard Technologies,** carving out a niche in the competitive computer repair business, providing computer systems, network products and peripherals to service providers and large computer manufacturers. Despite early successes, Dolphin knew that, to stay competitive, the company would have to be able to respond rapidly to a quickly-changing market. "In this business," says Dolphin, "it's either acquire or be acquired. We need to continually expand our technology capabilities if we are going to stay relevant within this industry."*

*But to make the kind of investment necessary to keep his business competitive, Dolphin had to secure substantial equity capital financing. The company sought and obtained $500,000 from **Boston Community Venture Fund.** More than 60% of SpringBoard's employees live within a two-mile radius of the company, which is located in Springfield, Massachusetts. SpringBoard is committed to workforce training and development and is working closely with the local community college to create a technical training partnership. This round of community development venture capital financing will create 45 new jobs. "We want to bring people in from the community, give them some basic skills, and help them to advance within the company," says Dolphin. "SpringBoard's inner-city employees have not only the opportunity for good jobs at good pay, but also potential for career advancement."*

"Boston Community Venture Fund is different," observed Dolphin. "They go beyond the money. Once they understood our business, they identified opportunities, directed us to the person to speak with, and facilitated the discussion. That's the value-added piece. That's why their investment is so important to us."

Coastal Ventures Limited Partnership

2 Portland Fish Pier, Suite 302
Portland, ME 04101
(207) 772-5356
Nathaniel V. Henshaw, President

* * *

Total Assets: $5.5 million

Current Equity Investments: $1.9 million

Investment Size: The fund seeks to make equity investments of between $50,000-$500,000 in growing Maine companies.

# of Businesses in Portfolio: 10

Legal Structure: For-profit limited partnership. Subsidiary of a non-profit 501 (C) (3)

Geographic Focus: State of Maine. Can invest small portion of assets outside the state.

* * *

In 1996, **Coastal Enterprises, Inc. (CEI)**, a non-profit community development corporation with a 20-year track record of providing financial and technical assistance to small businesses and housing and social service providers in Maine, established **Coastal Ventures Limited Partnership (CVLP)**, a for-profit limited partnership, to raise, manage and invest socially responsible venture capital funds. CVLP was capitalized at $5.5 million by investments from more than 20 institutional investors, including eight Maine banks, several national foundations and CEI, which serves as a general partner.

CVLP makes equity investments of up to $500,000 in growing Maine companies that can generate above-average equity returns over five to seven-years, while creating quality jobs and meeting other social goals. In addition to the investment of capital, CVLP provides management assistance and strategic planning, financing and introductions to service providers in the local and national business communities.

CVLP requires businesses that it invests in to sign an Employment Training Agreement (ETAG), committing the company to train and hire low-income individuals as a result of the growth the fund is financing. Companies are expected to offer a living wage and some level of health care coverage to their employees. CVLP also gives preference to businesses in the poorest sections of Maine.

CVLP Portfolio Company:
Cuddledown of Maine
Christopher Bradley, President
Portland, Maine

Cuddledown of Maine *was founded in 1973 by Ellen Manson. Manson frequently traveled to Europe, where she discovered fine down-filled comforters and high-quality bedding products. She brought samples back to Maine and friends began asking Manson to bring some back for them as well. Recognizing a good business opportunity, Manson placed ads in U.S. magazines and began selling products by mail order.*

By 1985, Cuddledown sales had grown to $1.2 million, exceeding Manson's comfort level and leading her to sell the business. However, the new owner lacked the necessary dedication and experience, and sales declined. In August 1988, a family investor group headed by Christopher Bradley purchased Cuddledown and began turning the company around.

As a growing business, Cuddledown needed capital. However, the company's existing debt level meant that they couldn't approach traditional sources of financing. That's when Bradley turned to ***Coastal Enterprises****. He had heard about CEI's commitment to growing Maine businesses through debt and equity investments.*

CEI worked to secure a $1.2 million financing for Cuddledown, in coordination with the Atlantic Bank, the Small Business Administration, and the Finance Authority of Maine. By 1998, Cuddledown needed additional capital and Coastal Ventures, a community development venture capital fund, came through with a $300,000 equity investment. In addition, CEI assisted in hiring a chief financial officer for Cuddledown by doing the initial screening and supplying a list of the most promising candidates.

Currently, Cuddledown is growing at more than 25% a year. It employs 83 people and expects to add many more positions in the next few years. All employees receive a benefits package, including a health insurance plan. Wages and working conditions are also excellent and there is very little turnover.

Community Development Ventures, Inc.

MMG Ventures, L.P.
826 East Baltimore Street
Baltimore, MD 21202
(410) 333-2550
Anthony Williams, Executive Director

* * *

Total Assets: $8 million

Investment/Loan Size: $100,000 to $500,000 for a term up to 10 years.

Legal Structure: Not-for-profit 501 (C) (3)

Geographic Focus: Makes investments in businesses located in and around Baltimore's Empowerment Community and Enterprise Zones.

* * *

Community Development Ventures, Inc. (CDV), utilizes "socioeconomic" investing as a means to improve the well-being of economically or socially disadvantaged individuals and businesses. Its mission is "to strengthen the economic base of distressed communities through business and entrepreneur development."

CDV was created in 1998 by MMG Ventures, L.P, which is owned and operated by four African-Americans highly skilled in finance. CDV fuels economic development through a combination of venture capital, management and technical assistance, training and entrepreneurial development. CDV provides senior and subordinated debt and equity to businesses located in and around Baltimore's Empowerment Community and Enterprise Zones that are in need of growth or start-up capital. It also offers a Management & Technical Assistance Program (M&TAP) to Baltimore businesses and a Youth Entrepreneurial Program that promotes entrepreneurial awareness and skills among high school students.

To date, CDV has raised a total of $8 million from a variety of sources, including The Ford Foundation, Prudential Insurance Company, and Empower Baltimore Management Corporation. CDV has also received $1.25 million from the U.S. Department of Treasury's Community Development Financial Institution (CDFI) Fund.

CDV Portfolio Company:

Ntegrity Telecontent Services, Inc.
Dwayne Goldsmith, CEO
Baltimore, Maryland

In 1997, Dwayne Goldsmith and Theresa Osborne, quit their executive jobs at Chicago's Ameritech Corporation to launch ***Ntegrity Telecontent Services, Inc.****, a telecommunications company that provides local and long-distance phone service to small business and residential customers.*

Capitalizing on a spate of deregulation in the telecommunications industry, Ntegrity was established as a Competitive Local Exchange Carrier – or reseller – of local and long-distance phone service, enabling it to provide bundled communication services, including paging, voice messaging and Internet service, to its customers.

With a customer base in New Jersey, Pennsylvania and Maryland and the right to resell phone service in Massachusetts and New York, this minority-owned start-up could have been headquartered in any number of northeast cities. But the group decided to move to Maryland after CDV offered it $500,000 in subordinated debt, providing a significant portion of the total $2 million the company needed to meet its working capital, equipment and office development needs.

While Ntegrity did attract the attention of a number of traditional venture capitalists, Ntegrity executives pursued the CDV offer largely because of the consultative services and management assistance that came with it – something Ntegrity executives believed gave the firm "a strategic advantage to other sources of funds."[1]

In the summer of 1998, Ntegrity Telecontent Services, Inc., moved into its new offices in Baltimore's Empowerment Zone, bringing 41 job opportunities to the area. As part of its agreement with CDV, it has agreed to fill a portion of these jobs with Empowerment Zone residents. Four neighborhood residents have already been hired. Ntegrity's first year revenues are expected to reach $4.5 million.

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[1] Source *The Daily Record*, Saturday, January 30, 1999, quote from Keith Machen, Ntegrity vice president.

Kentucky Highlands Investment Corporation

P.O. Box 1738
London, KY 40743-1738
Phone: (606) 864-5175
L. Ray Moncrief, Executive Vice President and Chief Operating Officer

* * *

Total Assets: $31 million

Investment Size: $100,000 to more than $1 million

Legal Structure: Not-for-profit 501 (C) (4) Community Development Corporation with several for-profit subsidiaries.

Geographic Focus: Nine counties of southeast Kentucky in Appalachia

* * *

Kentucky Highlands Investment Corporation (KHIC) invests in start-up and expanding non-retail business enterprises located or willing to move to a nine-county area of southeast Kentucky in Appalachia, where income, employment and education levels are still significantly below national averages. Founded in 1968 as a Community Development Corporation, KHIC now has a multi-million dollar capital pool and a portfolio of investments ranging from $100,000 to more than $1 million.

KHIC provides a multitude of services to businesses in its region including subordinated equity, debt, real estate construction and management, and management consulting services. In many cases, KHIC will actually create new businesses from the ground up if it sees a market need. On several occasions, KHIC leadership has written a business plan, financed the plan and recruited a CEO to run the business.

In 1994, KHIC was designated the "Lead Entity" for a Rural Empowerment Zone for an area covering three of its counties. As the Lead Entity, KHIC directs the use of $40 million in Empowerment Zone funding and is responsible for the administration and implementation of a strategic plan for the region.

KHIC Portfolio Company:

American Health Management, Inc.
Kelly Upchurch, President
Richmond, KY

At the age of 32, Kelly Upchurch had an ambitious vision: to open a network of adult "day care" centers that would offer supervised daytime care for the elderly throughout rural Kentucky. Nationally, there are more than 6,000 such centers – usually in metropolitan areas – but Mr. Upchurch believed that rural Kentucky had a tremendous need. So in 1997, he quit his job at a local hospital to start ***American Health Management, Inc.***

A psychologist, with extensive experience in the field of rehabilitation, Mr. Upchurch needed financing to get started and business expertise to ensure lasting success of his business. At ***Kentucky Highlands Investment Corporation (KHIC)****, he found that exact combination. Ray Moncrief, Executive Vice President and Chief Operating Officer at KHIC (and a CDVCA board member), was impressed with Mr. Upchurch's vision. "I thought his idea was a natural fit for us because it would create professional jobs in a rural area where we need more professional jobs."*

KHIC provided American Health Management, Inc. with a $75,000 equity investment and $15,000 in working capital for its first center, The Clinton Adult Day Health Care, which opened in January 1998 in Kelly's hometown of Albany. As part of the deal, KHIC owns a percentage of the company, which Upchurch can buy back over a five-year period. The KHIC team also provided countless hours of technical assistance, helping Mr. Upchurch develop his business plan, set up an accounting and cash management system, make financial projections, and plan for the future growth of the business. According to Mr. Upchurch, technical assistance was the real appeal of Kentucky Highlands. "I'm strong in health care systems, but they were strong in things I didn't have experience in. Basically, they assigned me a team and gave me the name of a person I could call anytime to ask for advice."

After one year, American Health Management was able to use modest profits from its first center to finance the opening of a second in Monticello, Kentucky. Ultimately, Upchurch plans to open 16 centers and grow American Health Management into Kentucky's largest adult health care center, creating more than 100 quality jobs – recreational therapists, nurse's aides, registered nurses – in a state where good jobs are scarce. All staff are hired from within each community and receive competitive wages and health insurance. But Upchurch is just as proud of the fact that these centers enable their patients' caregivers to remain employed. "We give people the opportunity to take good jobs and go to work each day with peace of mind."

New York Community Investment Company

120 Broadway, 36th Floor
New York, NY 10271
(212) 693-0870
Howard Sommer, President

* * *

Total Assets: $10 million

Legal Structure: For-profit limited liability corporation

Geographic Focus: Initial $10 million must be invested in New York City. Subsequent $15 million can be invested anywhere in the state of New York.

* * *

The **New York Community Investment Company (NYCIC)** was created in 1996 by a consortium of New York City commercial banks to provide creative financing solutions to New York's small business community – particularly businesses located in low-and moderate-income neighborhoods and businesses owned by women and members of minority groups.

Member banks set up and capitalized the corporation with $10 million to identify potential new deals for the banks to invest in, but also to help meet their federal Community Reinvestment Act obligations.

NYCIC provides equity and subordinated debt to companies with sales from $1 million to $10 million that are located in the five boroughs of New York City. The fund focuses especially on women- and minority-owned businesses, as well as on businesses located in lower-and middle-income areas of the city, but does not restrict itself to these criteria.

To date, each dollar invested by NYCIC has leveraged a dollar and a quarter in additional financing.

NYCIC Portfolio Company:

Square One Design
Anne Jaroszewicz, President and CEO

For years, people in the home furnishings industry told Anne Jaroszewicz to come out from behind the curtain of "private label" design and start her own product line. Her New York City-based company, ***Square One Design,*** *had established a reputation over more than 10 years, developing home furnishing accessories for some of the biggest retailers in the country. But market forces were pushing more and more retailers to bring their work in-house and Square One's business was beginning to flatten.*

Starting her own product line, however, would be tantamount to building a business from the ground up. Ms. Jaroszewicz would need financing for a whole new infrastructure, to warehouse and manage her inventory, establish systems for tracking orders and billing, and hire staff to manage the anticipated growth. And although Square One had an impressive track record -- with customers as notable as Pier I Imports and Pottery Barn -- few banks were interested in financing the expansion of a small business. Fortunately, one bank gave Ms. Jaroszewicz a hot tip, suggesting she send her business plan to the ***New York Community Investment Company (NYCIC).***

Ultimately, ***NYCIC*** *provided Square One with $250,000 in the form of convertible debt that can, at NYCIC's option, be converted to shares of the company. As a direct result of this financing, Chase Manhattan Bank loaned Square One an additional $325,000. With this new infusion of cash, Ms. Jaroszewicz launched her own line,* ***Annie J.***

In addition to financing, NYCIC staff also helped the company develop a plan for upgrading the company's accounting and management information systems. To ensure that the company can keep up with the growing demand for its product, Square One has created several new jobs at a range of skill requirements, from warehouse jobs – paying nearly double the minimum wage with benefits – to a national sales manager position. The company rented 7,000 square feet of warehouse space in Red Hook, Brooklyn, hired a manager and two full-time staff to staff it, and is currently recruiting additional warehouse workers and an on-site customer service representative. In the Manhattan showroom, Square One will also add a number of support and professional staff positions.

"NYCIC's money came into the business at the right moment, allowing us to fuel this growth," said Jaroszewicz. "Right now, we are more than 24 percent ahead of our most optimistic projections and if we are able to stay on this trajectory, we will more than double the business we did last year."

Northeast Ventures

802 Alworth Building
Duluth, MN 55802
(218) 722-9915
Greg Sandbulte, President and Chief Operating Officer

* * *

Total Assets: $11 million

Investments to date: $8.3 million

# of Businesses in Portfolio: 23

Jobs created: 695 jobs created or saved since 1989

Legal Structure: For-profit corporation

Geographic Focus: Northeastern Minnesota. Up to 15% of assets can be invested in the rest of the state.

* * *

Northeastern Minnesota is a largely rural area that historically has relied on iron ore production for its economic base. When the domestic steel industry encountered significant foreign competition in the 1980s and began shutting down obsolete facilities and using cheaper foreign ore, the region was left with few economic opportunities. In 1989, **Northeast Ventures (NEV)** was established as a for-profit community development venture capital fund to help diversify the region's economic base and spur entrepreneurship by making equity investments in local companies.

In addition to providing capital and technical assistance, it makes its portfolio companies aware of government placement services that can make it easier for them to hire low-income workers.

NEV was capitalized by a combination of program-related investments from the Ford and MacArthur foundations; equity investments from the Blandin and Northwest Area foundations, Minnesota Power utility, and Minnesota Technology (a state development organization); and a grant from the Community Development Financial Institutions Fund.

NEV Portfolio Company:

Powerain Systems, Inc.
Stephen Kerr, President and CEO
Tower, Minnesota

In 1990, a group of entrepreneurs approached Northeast Ventures about setting up a car wash equipment manufacturing facility in Tower, a town of 508 people in one of the poorest parts of Northeastern Minnesota. NEV thought the market opportunity was attractive and that the business could create jobs and bring economic vitality to a region. However, the company had an incomplete business plan and lacked a Chief Operating Officer.

Other assistance was needed before NEV could provide financing for the effort. Northeast worked closely with Powerain's founders to revise the business plan and identify a strong CEO candidate for the company. Northeast also invested $200,000 in equity in the business. Northeast's involvement did not stop after making its first investment.

Over a multi-year period, NEV has talked daily with Powerain CEO regarding subjects as diverse as sales, executive recruitment, strategic planning, distributor relationships and the financial structure of debt deals. NEV has even worked to locate suitable housing for senior management of the company. NEV has assisted Powerain in all subsequent rounds of financing, totaling $826,932.

Powerain had a record sales year in 1998 and is expecting another record year in 1999. The company currently employs 20 full-time people, and expects to increase that number significantly in the future. The company provides ongoing training to its staff and entry-level positions begin at $8 an hour, with full benefits. Most employees earn well in excess of $10 an hour.

Community
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Community Development Venture Capital Alliance

The Community Development Venture Capital Alliance (CDVCA) promotes use of the tools of venture capital to create jobs, entrepreneurial capacity and wealth to advance the livelihoods of low-income people and the economies of distressed communities.

CDVCA has more than seventy members, including approximately fifty community development venture capital funds. CDVCA's membership is made up of organizations located throughout the United States and throughout the world who seek to apply the powerful engine of growth that has driven the economic expansion in Silicon Valley and other hotbeds of business development to the economic needs of low-income communities. We believe that the combination of equity capital and related intensive entrepreneurial and managerial assistance that community development venture capital funds can provide is a critical part of promoting the growth of local businesses and good jobs in distressed communities.

Community development venture capital is a new field that presents real opportunities to make enduring changes in the lives of low-income people. While the model is promising, there is still much to explore and learn. CDVCA plays a crucial role in fostering this rapidly growing field by:

- providing training and specialized technical assistance
- increasing access to capital and other resources
- collecting and distributing information
- developing standards and best practices
- offering opportunities for peer exchange and learning among professionals
- advocating for the field
- encouraging traditional venture capitalists and individual angel capitalists to become more involved in community development finance.

For more information about CDVCA contact: Christina Mayo (e-mail: cmayo@cdvca.org).

Strategy – use the bully pulpit, create a groundswell of support

NEW MARKETS BACKGROUND
For May 5 Cabinet Breakfast Meeting

I. **Impetus for the New Markets initiative**: We have extraordinary economic growth but it is not reaching everywhere -- e.g., parts of Appalachia and inner cities are left behind. As President said in SoTU, if we can't use this opportunity to try to redirect some of the economic engine to address underlying problems, when will we ever be able to do so.

Want bi partisanship don't want this to be a political battle

II. **Goals of the initiative:**

A. **Incentives for private investment in communities.** Gov't can't do it alone. We have been more successful in the lending area, at creating incentives for the private sector to lend in underserved communities (CRA and CDFIs, for example). But, there isn't much that we do to prompt the private sector to make equity investments in businesses in underserved communities.

ACR

B. **Building relationships.** There is a whole world of venture capitalists who have clubs that meet to hear investment proposals from small businesses. But their contacts and relationships are in suburbs, not necessarily inner cities. On the other hand, we have a small but growing community of community development experts in CDCs and CDFIs and state community development agencies. But never the two shall meet. This program is designed to give the investment community strong incentives to build ties to the community development community because, if they do so, they can get generous gov't-guaranteed leverage and tax credits to enhance the returns on their investments.

$1.5 billion

mentor through training

C. **Building capacity of small businesses.** In addressing the needs of really small businesses and microenterprises in underserved areas, it becomes clear that they need more than just capital -- they need expertise. (E.g., a good CFO, a new accounting system, methods to analyze their costs, etc.) Many have real growth potential but they need not only investment but a helping hand. A central innovation of this initiative is that, for smaller businesses, we marry technical assistance with investment -- having the investors decide how best to apply the technical assistance to yield maximum returns on their investment.

Research Office Urban

III. **How we developed the new markets proposal:** With those goals in mind, we looked around the Federal government at tools in the arsenal and found one that had promising potential -- the SBIC program.

A. 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. It really helped to create the venture capital market in the United States.

Mentor? SBA

- ***How SBICs work:***

    - A private venture capital manager applies to SBA for approval of a new venture capital fund (the SBIC) based on a business plan and their financial management expertise.
    - SBA's approval means that for every dollar the fund gets from private investors the SBA will guarantee debt of two dollars, up to ____. (Average size of an SBIC is $36 million.) So, if private investors put up $10 million, the government will guarantee debt of $20 million, creating a fund of $30 million to invest in growth businesses.
    - Because of the government guarantee, the $20 million in debt demands a lower rate of return, thus enhancing the return available to the private investors on their $10 million dollars.
    - With the fund of $30 million, the fund manager finds an array of businesses with growth potential and provides them equity capital with which to grow.
    - Returns are expected on the debt and the federally guaranteed debt must be fully repaid before returns are paid to the private investors. As a result, our losses have been few and, because guarantee fees are charged, guaranteeing the debt costs the government very little.

B. But we found that, while it had been successful, only about 20% of its work served underserved communities. That wasn't acceptable. So the VP challenged the SBA to find new ways to retarget the SBIC program to meet the needs of underserved communities. They responded to that challenge with extraordinary creativity and dedication.

IV. Elements of the New Markets Proposal:

A. ***SBICs for Low-Mod Communities.*** First SBA figured out how to provide incentives to make it more attractive for the venture capital firms created under the SBIC program to invest in low-mod communities.

- Specifically, SBICs making investment in low and moderate income communities will be eligible for a new financing that does not require a return on their investment for the first five years (although interest accrues during that period). ***Patient capital*** -- allowing businesses time before they have to show a return on the investment.
- In addition, SBA will provide greater leverage -- 3x rather than 2x.

- Finally, SBA will make the investment rules more flexible to better meet the needs of companies in underserved areas.
- ***(SBA will be implementing these program modifications this year without legislation.)***

B. ***New Market Venture Capital Firms.*** Next, SBA realized that SBICs won't work for the smaller firms and those that need expertise as well as capital. So they proposed a new program -- know as New Market Venture Capital Firms -- modifying the SBIC concept to meet the needs of smaller businesses in underserved areas.

- SBA will select 10-20 firms, whose management has a solid track record with community development.
- The equity funds of private investors will be matched (one-to-one) with government debt of guarantees up to $10 million per fund, creating up to $20 million dollar investment funds. Interest on this debt will also be deferred for the first five years.
- In addition, investors must provide at least $1.5 million in technical assistance over the first five years to the target firms. SBA will match that with up to $1.5 million in federal funds. This $3 million will not require any rate of return. With this additional investment in the firms not requiring any return, the return produced by the company enhances the return to the investors, making it worth their while to help small firms needing intensive technical assistance.
- (This will require new legislation.)

C. ***APICs:*** But that left us with a challenge. To really make an impact on a community -- to create 100, 200, 400 jobs at a time -- you need to deal with larger firms that are growing and creating new facilities or relocating. So we enlisted the help of HUD and designed a program to create ***American Private Investment Companies (APICs).***

- For years, America has OPIC -- the Overseas Private Investment Corporation -- which has an investment fund program like the SBIC program on a larger scale, to promote growth in emerging markets abroad. We needed a tool to promote growth in emerging markets at home.
- Under this program, fund managers would seek approval for government guarantees for debt of up to $200 million, to equal private investment of up to $100 million, to create investment funds of $300 million. That is large enough to allow investments in significant sized firms that have opportunities to grow.

- The APIC could invest in a corporate subsidiary set up to fund a new plant or back-office operation in an underserved area or become joint venture partners in a business spin-off from an existing firm.
- Unlike the New Markets and SBIC programs, where we rely on the financial incentives of the investors to protect the government's interest, in APICs, the specific investments will be approved by HUD and SBA to ensure they serve public purposes.
- (APICS also require new legislation.)

D. ***Tax Credit:*** Finally, we considered how to ensure that these new great investment vehicles (as well as existing vehicles like CDFIs, Community Development Corporations, and state enterprise funds) have investors rushing to their doors to take advantage. The fact is that large companies and wealthy investors don't want to know the details of SBICs, NMVCs and APICs -- they just want to invest with qualified fund managers who can promise a healthy rate of return. Let the managers then worry about which investments they use. The solution we propose -- ***a tax credit.***

- Equity investments in investment vehicles serving underserved communities are eligible for a tax credit worth up to 25% of the equity invested. (The credit is actually 6% a year, which has a net present value of approximately 25% of the amount invested.)
- Credits would be allocated to the targeted investment funds that could use the tax credits to attract investors.
- Eligible investments are in areas with either (a) a poverty rate of at least 20%; or (b) median family income which does not exceed 80% of metropolitan area income (or for rural areas, 80% of the median income of non-metropolitan areas statewide). (***See nationwide map.)***
- This is a very generous definition of underserved -- and we picked it so that these programs will work well with other governmental programs that target areas with greater needs.

E. ***Other pieces as well:***

- Increasing by two and a half times the U.S. commitment to microenterprise, including doubling the level of microenterprise lending and a huge new commitment to technical assistance for microenterprise under a proposal for new legislation known as PRIME.
- A $30 million increase in funding levels for CDFIs.
- New small business lending firms targeted to underserved markets.
- BusinessLINC -- an initiative of the Vice Presidents to encourage large businesses to work with small business owners and entrepreneurs to

improve the economic competitiveness of smaller firms in distressed areas.

V. **Example: flexibility to meet the needs of the investor, the fund managers, and the businesses getting the investment.** Say an investment manager wants to create an investment fund targeted to the needs of a specific community. Here's what he'd do.

A. ***Develop an investment strategy and a small investment management team (with community development capacity) to create an APIC, for example (or an SBIC-LMI or NMVC firm, depending on the business strategy).***

B. Get approval from SBA/HUD, which will provide them with the commitment to guarantee debt to match private investment.

C. Get an allocation of tax credits from the agency that approves the vehicle. (Treasury will allocate credits to SBA, for example, to suballocate to funds.)

D. With tax credit and guarantee in hand, the fund manager than seeks investors, able to provide firm estimate of expected rates of return, knowing effect of tax credit and low cost leverage.

E. ***APIC manager finds business opportunities.***

F. Government pools their debt and places it with investors lowering the cost of borrowing.

VI. **Or an investment manager could assemble a "fund of funds" that includes an APIC, an SBIC targeted at low-mod areas, an NMVC firm, and other targeted investments, some or all of which would be eligible for the tax credit allocation. Large investors, in particular, may find the "fund of funds" the best way to spread their risk.**

VI. **Bottom line:** This package of programs should leverage $15 billion in investment in underserved areas with 5 years of program activity (although some of the investment will be in out years).

- Includes $6 billion leveraged through tax credit
- $12 billion leveraged through investment vehicles
- Assume 50% overlap of tax credit so to prevent double counting -- estimate $15 billion.

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.

Budget impact: ***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.***

New Markets Venture Capital Firms (NMVCs). 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.

Budget impact: ***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.***

New Markets Lending Companies (NMLC). 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.

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

Continued Growth for CDFIs. 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.

Budget impact: ***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.***