COMPARISON OF PROPOSED "NEW MARKETS TAX CREDIT" WITH TAX PROVISIONS OF THE "RENEWAL COMMUNITIES" PROPOSAL

Both the Administration's proposal for a New Markets Tax Credit (contained in the President's FY 2000 Budget request) and the tax provisions of the proposed American Community Renewal Act of 1999 (H.R. 815, by Reps. Watts, Davis, Talent and more than 80 others) would direct tax benefits to individuals and enterprises to promote desirable activities in economically distressed communities.

NEW MARKETS TAX CREDIT:

The Administration's proposal would encourage $6 billion in new investments into low- and moderate-income communities over 5 years. It would do that by providing tax credits for investments of $1.2 billion annually. The investments would be made by banks, foundations, companies or individuals. These investors would acquire stock or other equity interests in selected community economic development entities whose primary mission is serving distressed communities. In other words, the investments that are encouraged by the tax credit are investments in the entities (CDCs, CDFIs, venture funds, SBICs, others) whose mission is to carry out economic development in distressed communities and whose record of doing so warrants their selection by Treasury. Urban and rural communities with high poverty and low median income would be targeted.

The tax credits would be issued by Treasury to the selected entities. These entities in turn would sell or syndicate the credit to investors. The tax credit ultimately delivered to the investor would be in the amount of 6 percent annually of the amount of the investment, for an approximate aggregate value to the investor of 25 percent of the "present value" of the original investment over the 5 years. A "qualified investment" by an investor would be a cash purchase of stock or other equity in a selected entity, which must be held for at least 5 years. Substantially all of the investment would be required to be used by the community development entity to make "qualified low-income community investments," which would be equity investments in, or loans to, qualified active businesses in the low-income communities. "Qualified active businesses" would be businesses with, among other requirements, at least half their activities in low-income communities.

RENEWAL COMMUNITIES TAX PROVISIONS:

The tax portion of the Watts-et-al bill would direct a range of tax benefits to individuals and businesses operating in "renewal communities." Renewal communities (RCs) would be up to 100 newly designated areas (50 of which would be in EZs or ECs) with pervasive poverty, unemployment and general distress. HUD would designate the RCs based on criteria similar to those in the Administration's New Markets proposal. For designation, state and local governments would also have to agree to certain tax reduction, crime prevention, regulatory relief and privatization of social services measures.

The bill would provide to individual investors an exclusion from gross income of any capital gain from a stock, business property, or partnership interest newly acquired in a renewal community business and held more than five years. It would allow a deduction to qualified individuals for amounts paid in cash to a family development account (used for postsecondary education, first home purchase, business capitalization, medical expenses and qualified rollovers). Qualified individuals would be those who resided in an RC and were allowed an earned income credit for the preceding taxable year. Such accounts would be excluded from taxation.

The bill would create a "work opportunity" tax credit to businesses to help offset costs of hiring people on welfare, high-risk youth or individuals in need of vocational rehabilitation. The credit would be worth 15 of employee's wages, up to $10,000. It would establish a tax credit of 20 to 50 percent of the commercial revitalization expenditures regarding a revitalization building. It would increase, for an RC business, the dollar limit on expensing certain depreciable business assets. It would permit taxpayers to treat RC environmental remediation costs as not chargeable to a capital account and as a deduction.

COMPARISON:

Whereas the aim of the two proposals is similar, the New Markets Tax Credit would target tax credits in a more focused way. The credits would be for private equity capital delivered to and through specific economic development entities with a primary mission and record of promoting job and wealth creation in distressed communities. The New Markets Tax Credit presumes that already successful community development entities can succeed in delivering additional economic benefits to the communities where they currently operate. In these communities, there is both urgent need and great opportunity for new, private equity capital. However, the needed private dollars currently are lacking due to market dysfunction. With modest government incentive, the New Markets Tax Credit can help attract such new investment capital to viable enterprises in economically distressed communities.

The renewal communities proposal would also provide tax benefits for a number of economic activities in distressed communities. And many of the activities would likely have some of the same positive economic effects in those communities as activities encouraged by the New Markets proposal. However, because a broader range of individuals and firms would receive tax benefits, it could be much more difficult to determine which of the activities might have taken place without the tax incentives.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MEMORANDUM

To: Emil Parker

From: Cliff Kellogg CK

Date: June 18, 1998

Re: OPIC Equity Funds

This memo summarizes our preliminary finding on the OPIC investment funds. There is much additional research we could pursue, but we should confer beforehand to focus any additional research efforts.

OPIC Funds

The Overseas Private Investment Corporation (OPIC) grew out of USAID in 1971, with the purpose of aiding developing countries other than though direct government-to-government aid. OPIC describes itself as financially self-sustaining and profitable every year, with no net cost to taxpayers. The agency is in the executive branch of the federal government, and its authorization to operate is subject to renewal every two years by Congress.

OPIC strives to supplement the private market by "stepping in" where the private sector is "not fully available to finance or insure investments." OPIC offers three types of services: direct loans, loan guarantees (both for bank loans and for a portion of the capital in equity funds), and political risk insurance. It charges market rates for these services.

- Direct loans, ranging from $2 million to $30 million, are targeted to industrial companies with annual sales below $198 million, or non-industrial businesses with stockholders' equity of less than $67 million.

- Loan guarantees are typically used for larger projects (up to $200 million).

- OPIC guarantees the debt portion (2/3) of 26 private investment funds with investable capital of more than $3 billion (explained more fully below). The funds are active in 140 countries around the world, and invest in a broad range of industries, including agriculture, energy, construction, infrastructure, natural resources, telecommunications, transportation and distribution, banking, services, and others.

OPIC states that its loan recovery rate on these collective investment activities is 97%, but more analysis would be necessary to understand the performance of the individual activities.

How the OPIC Funds are structured

OPIC creates a private investment fund when the agency either approaches or is approached by a fund management firm, usually one that has experience in venture capital investing. OPIC does not seek Congressional pre-approval prior to establishing a fund. The management firm presents a proposal involving a certain amount of private equity, which the manager has gathered. If the proposal is approved, OPIC will issue a loan guarantee for up to two times the equity raised by the managers. This can be done in one of two ways.

- With the "leverage" approach, the manager can pool the private equity and then borrow from an American bank up the OPIC guarantee amount. If the fund is unsuccessful, the investors lose their equity, but must pay back as much of the OPIC-backed loans as possible. In other words, the equity providers absorb the losses fully before the debt providers (usually banks).

- With the second, or "unit" method, investors' money is designated one-third as equity and two-thirds as debt. In this case, OPIC insures two-thirds of each investor's contribution, treating the debt portion of each investor's contribution just as it would a financial institution. This approach lessens each investor's risk, and since the investor has effectively acted as a lending institution, he or she is entitled to collect interest on the "loan." If enough time has passed, the accrued interest might even cover the loss in equity.

OPIC's guarantees for these funds are typically for ten years, with the option to extend for one or two years. Rates are set at U.S. Treasuries plus a certain amount of basis points. Interest may be paid either in a "balloon" payment or semi-annually, depending on the fund managers' preference. Fund managers usually receive a management fee of around 2 1/2% of the total amount of the fund, plus whatever carried interest (usually 18-20% of each transaction) they earn from investments.

OPIC fund managers make all investment decisions, with OPIC screening only for environmental and human rights considerations, and to ensure that no American jobs are relocated overseas. Institutions investing in the funds must be at least 51% American-owned. Different funds often focus on different markets, choosing to target either small to medium size businesses or larger, industrial projects. Fund managers target investments that will earn returns of between 25% and 40% annually.

OPIC's sub-Saharan Africa Funds

There are three OPIC private investment funds that are targeting sub-Saharan Africa:

The **Africa Growth Fund** is managed by *Equator* services. It has $25 million in investable capital and focuses mainly in mining, manufacturing, and financial services in the sub-Saharan region.

The **Modern Africa Growth Fund** is managed by *Modern Africa Fund Managers*. They manage $150 million in capital, and invest in all sub-Saharan countries excluding South Africa. The fund has direct equity investments ranging from $5 to $20 million in mining, telecommunications, and manufacturing (mainly agribusiness and pharmaceuticals).

The **New Africa Opportunity Fund** is managed by *New Africa Advisors*, which is a subsidiary Sloan Financial Group, the largest black-owned asset management firm in the world. The fund totals $120 million, and although it mainly targets South Africa, it also has investments in Angola, Botswana, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Swaziland, Tanzania, Zambia, and Zimbabwe. Its portfolio includes consumer products, services, telecommunications, health care, financial services, light manufacturing, and construction. The Fund is looking for mainly small to midsize businesses.

Both the Modern Africa Fund and the New Africa Fund are attempting to capture the emerging black market in Africa by providing products and services that had heretofore been inaccessible to the majority population and that are suited to the needs of a rising middle class. Both encourage participation of black shareholders and management.

cc: Gene Sperling

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MEMORANDUM

To: Emil Parker
cc: Gene Sperling

From: Cliff Kellogg cgk

Subject: State Department/AID Enterprise Funds

Date: June 13, 1998

We have completed about half of our background research into the Enterprise Funds discussed in the meeting with Rev. Jackson. This memo summarizes what we have gathered to date, with more to come in the next few days. We are also investigating the status and structure of the 26 OPIC Funds and will send this information to you also in the next few days.

<u>Overview of Enterprise Funds</u>

There are currently ten Enterprise Funds with a total of $1.3 billion in authorized capital, of which $700 million has been disbursed. The 1989 SEED Act (Support for Eastern European Democracy) created seven of the funds (Polish, Czech, Bulgarian, Romanian, Albanian, Baltic, Hungarian) with $655 million in authorized capital. The 1992 FSA Act (Freedom Support Act) created three more. The Funds' initial investment came completely from USG funds through AID. AID taps into an account called the 150 account in the State Department.

Each Fund is a separate, private, not-for-profit organization. The USG appoints a Board of Directors, which hires a management board, that in turn looks for projects. Projects could be in the form of market rate loans or private equity investments. AID does not give the money all at once, but dispenses it to the Funds in "dribs and drabs" yearly. For example, the full $256 million for the Polish American Enterprise Fund was disbursed over 7 years.

It appears that each Fund has the discretion, with the approval of its Board of Directors, to structure its subsidiaries as it sees fit to meet market need. The subsidiary structure may be quite complex: for example, PAEF's organizational chart shows 11 subsidiary activities, which may include wholly-owned corporate entities, partial interests in corporate entities, or simply program areas operated directly out of PAEF.

Each Fund's management looks for potential investments and performs its own due diligence, a process that may take 3+ months to complete. The Fund's management then takes project proposals to its board for approval. Based on the management's screening and due diligence prior to submitting a proposal, the Boards approve the vast majority of the project proposals. The Funds file annual reports (there are also semi-annual reviews) outlining the projects and how much they will cost. The State Department then advances to the Funds via a letter of credit, which they draw on throughout the year.

by whom? for whom?

The investment parameters appear very flexible. The Fund is subject to all the AID rules of investment (e.g., no military projects, abortion equipment, or weather modification equipment), but otherwise, the Funds may invest in whatever they deem profitable and promising.

The Funds strive to keep their portfolios diverse. They are investing mainly in small and medium-sized businesses, along with micro enterprises (as small as $1000 loans), perceiving these segments as the "engines of growth." Underwriting criteria follow business fundamentals: they look at the company's market and management, and whether the company will be profitable and foster development.

Polish American Enterprise Fund

The Polish American Enterprise Fund (PAEF), which is generally considered the most successful Fund in terms of disbursing its funds into commercially viable businesses and home mortgage credit, was appropriated $256 million. The Polish American Enterprise Fund raised an additional $265 million in private money (who invested is classified information, but investors include pension funds, large institutional organizations, large banks, etc.)

The Fund's report says they have assisted 12,346 enterprises through its various credit programs. PAEF's business investment programs that may be relevant to the discussions with Rev. Jackson include the following:

1. The Enterprise Credit Corp. issues loans to small businesses, with 40 branches around the country. It has basically merged with the First Polish-American Bank, which now administers its accounts. The Bank was purchased by the Fund when it was about to become insolvent. The merged firm is now traded on the Polish stock market.

2. The Polish Private Equity Funds encompass 3 funds created with the non-USG private money ($265 million) that the Fund raised. These equity funds are for-profit and cost little or nothing to U.S. taxpayers. These Funds charge fees to manage private money and are exclusively devoted to private equity investments. The first fund was jump-started by $50 million from the original fund, plus some money from the European Bank of Reconstruction and Development. Private investors include the GM pension fund and other similar large corporations.

3. The PAEF's direct investments in Polish industries include 32 equity investments totalling $155.3 million. PAEF expects to turn $24.7 million in profits from these investments.

[Alisa Kaplan of our office performed most of this research, based on literature searches, the PAEF Annual report and phone interview with Gary Imhoff of the State Department.]

DRAFT

Background paper on OPIC
June 18, 1998

OPIC has three basic programs:

1. Political risk insurance. Offers U.S. international investors insurance against political risks -- currency inconvertibility (inability to convert profits, debt service, etc. from local currency into dollars and transfer the dollars out of the host country), expropriation by a foreign government, and political violence (loss of assets due to war, revolution, or terrorism). OPIC does not insure investors against ordinary business risk, nor does it insure against currency devaluations.

2. Project financing. Provides medium and long-term financing for overseas projects involving significant equity participation by U.S. businesses. Loan guarantees are generally used for larger projects, while direct loans can be made for smaller ventures. OPIC can lend up to $200 million per project. Loan terms vary from five to fifteen years, plus a grace period during which no interest payments are due. OPIC requires that projected cash flow be sufficient to cover all operating costs, service all debt and provide an adequate rate of return. Support from OPIC is available for but not limited to ventures that cannot secure conventional financing.

3. Investment funds. Guarantees long-term loans to private equity investment funds that finance joint ventures and other enterprises in eligible emerging markets. The funds, for example, can provide capital for privatization of government-owned businesses. The investment funds are privately owned and managed -- the OPIC-guaranteed loans supplement the private capital committed by investors. OPIC charges fees for the loan guarantees it provides to the funds.

OPIC currently supports 26 funds operating in sub-Saharan Africa, North Africa, India, the Middle East, other parts of Asia, the Pacific region, Latin America, Central and Eastern Europe and the former Soviet Union.

General criteria/restrictions. OPIC financing (including through funds) and insurance is limited to private sector projects in 140 developing countries or emerging markets (loosely defined) that promise significant developmental (economic and/or social) benefits for the host country. To be eligible, projects must not have an adverse impact on U.S. employment or the host country's environment and must not contribute to violations of internationally recognized worker rights.

Points relevant to Trillion Dollar discussions:

1. Fund managers must seek OPIC approval for each of their investments, to ensure that it meets the general criteria above -- i.e., each fund investment must meet the standards that apply to projects directly financed or insured by OPIC.

2. Generally, the OPIC-guaranteed loan to a fund must be fully repaid (with interest) before the fund's investors see any profits. The OPIC loan is also secured with project assets, but not with the fund's remaining uncommitted private capital.

3. Earlier, OPIC chose funds for financing through both competitions and consideration of unsolicited proposals received. Henceforth, all OPIC funds will be selected/established through a competitive process.

4. Political risk insurance is OPIC's primary activity, as measured by financial exposure and revenues, but project financing and investment funds also represent significant components of OPIC's business. As of March 31, 1998 OPIC had a maximum financial exposure of $17.6 billion (total of insured amounts, maximum loans and loan guarantees extended -- the amount drawn down is considerably lower). Of this amount, $11.1 billion is in the insurance program and about $6.5 billion in the project financing and investment fund programs. The $6.5 billion is split evenly between project financing and the investment funds -- the investment fund program has grown from about $100 million to over $3 billion during the last five years.

OPIC Southern Africa Funds

In fiscal year 1997, in response to a call from Congress and the Administration to encourage U.S. private investment in sub-Saharan Africa, OPIC announced a $100 million loan guaranty for the Modern Africa Growth and Investment Company, supplementing the Fund's $50 million in private equity. In addition, OPIC is currently soliciting proposals (due date of June 30) for one or more private equity investment funds, with up to $500 million in capital, focusing on investments in sub-Saharan African infrastructure projects such as roads, harbors, rail systems, waste treatment and power plants. A portion of the $500 million would be private capital, with the remainder loaned to the fund as senior secured debt guaranteed by OPIC.

OPIC had already (in 1996) provided an $80 million loan guaranty to the New Africa Opportunity Fund. The New Africa Fund, which is managed by a unit of the Sloan Financial Group (headed by Maceo Sloan), made its first investments in 1997, including $5 million in Afinta Motor Company, which manufactures light commercial buses to facilitate commuting by a population that now travels to work largely by taxi. The New Africa Opportunity Fund invests in projects located in Southern Africa (e.g., South Africa, Botswana, Namibia, Zimbabwe, Lesotho, and Mozambique) and is subject to the rules applicable to other funds -- for example, each New African Opportunity Fund investment must be approved by OPIC.

Q: Why don't we have a domestic equivalent of OPIC? Why do we subsidize investment overseas but not here at home?

As many of you know, the Overseas Private Investment Corporation (OPIC) has three basic activities:

1. Political risk insurance. Insuring U.S. international investors against political risks -- currency inconvertibility, expropriation by a foreign government, and political violence (loss of assets due to war, revolution, or terrorism). OPIC does not insure investors against ordinary business risk, and charges premiums for the risk insurance provided.

2. Project financing. Providing medium and long-term financing for overseas projects involving significant equity participation by U.S. businesses. Loan guarantees are generally used for larger projects, while direct loans can be made for smaller ventures. OPIC can provide loan guarantees of up to $200 million per project. OPIC requires that projected cash flow be sufficient to cover all operating costs, service all debt and provide an adequate rate of return. Support from OPIC is available for but not limited to ventures that cannot secure conventional financing.

3. Investment funds. Guaranteeing long-term loans to private equity investment funds that finance joint ventures and other enterprises in eligible emerging markets. The funds, for example, can provide capital for privatization of government-owned businesses. The investment funds are privately owned and managed -- the OPIC-guaranteed loans supplement the private capital committed by investors. OPIC charges fees for the loan guarantees it provides to the funds.

OPIC currently supports 26 funds operating in sub-Saharan Africa, North Africa, India, the Middle East, other parts of Asia, the Pacific region, Latin America, Central and Eastern Europe and the former Soviet Union.

- The average OPIC fund has about $124 million in capital (private equity plus guaranteed loans). Roughly half of the funds (11 of 26) have less than $100 million in total capital, while the remaining 15 have between $100 million and $300 million.

OPIC vs. SBIC

There are strong similarities between the SBIC program (that John Gray discussed during the first panel) and OPIC, although we would not go so far as to call the SBIC program a domestic OPIC.

- OPIC provides loan guarantees to funds that make investments overseas; the SBIC program guarantees the debt issued by funds that make investments in small and medium sized businesses here.

- The average size of an OPIC fund is about $124 million; the maximum size for an SBIC-supported fund is $150 million ($50 million in private capital and $100 million in SBA-supported debt or participating securities held by SBA).

- Generally, the OPIC-guaranteed loan to a fund must be fully repaid (with interest) before the fund's investors see any profits on their equity investment; the investors in an SBIC must lose all their equity before the SBA-guaranteed funding is at risk.

- Both have a public policy mission: OPIC financing (including through funds) and insurance is limited to private sector projects in 140 developing countries or emerging markets that promise significant developmental (economic and/or social) benefits for the host country; SBICs can invest in businesses with up to $6 million in profits and $18 million in net worth, to ensure that the program remains focused on its mission of promoting the development of small and medium-sized businesses.

The majority of SBICs investments are in the $500,000 to $5 million range -- too much for wealthy individual investors but too little to interest traditional, institutionally-funded venture capital firms.

Category	OPIC	SBIC
Form of support to investment funds	Loan guarantees	Guaranteeing the principal and interest on debt issued by the funds, and acquiring preferred securities in the funds that promise the preferred stock rate of return plus a share of the profits. The private equity is at risk before these securities.
Order of risk	Generally, private investors must lose all their equity before OPIC incurs a loss	Private investors must lose all their equity before SBA incurs a loss
Size of funds	Average of $124 million	Maximum of $150 million, average of $30 million[1]
Limits on investment	Each investment must be approved by OPIC, but it need only meet certain general criteria (promote social/economic development of the country, not have an adverse effect on the environment, worker rights or U.S. employment).	Investments are limited to firms with $6 million or less in after-tax income (profits) and $18 million or less in net worth. The SBIC program is otherwise not involved in fund investments.
Total capital	$3.2 billion	$7.6 billion
Number of funds	26	320

- We generally prefer to make better use of an existing program rather than creating a new one; the Vice President may talk a bit later about our plans to improve the performance of the SBIC program with regard to investments in under-served communities.

- Nonetheless, we have been and will continue to explore cost-efficient ways to stimulate

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[1]This average does not include the specialized small business investment companies, formerly the minority enterprise SBICs, which are smaller than standard SBICs.

investment in less advantaged areas (could refer to neutral principles); the answer may be better use of existing programs, new proposals or a combination.

Draft

SUMMARY COMPARISON

	Enterprise Funds	OPIC Funds
Total # of funds	11: 7 in Eastern Europe, 3 in former USSR, 1 in Southern Africa.	26; operate in140 countries.
Total investable capital	$1.7 billion	> $3 billion
Type of management	Board of Directors hires fund manager.	Private management firms work with OPIC.
Manager's compensation	Fund manager's yearly salary capped by Congress at $150,000, which is drawn from Fund account. Board of Directors is uncompensated.	2.5% of Fund's available capital + 2.5% of the cost basis of investments, net of any write-downs or write-offs.
Eligible investees	Subject to USAID requirements: human rights and environmental concerns, ban on military industries etc.	OPIC screens for human rights and environmental interests.
How decisions are made	Fund's Board and manager make all investment decisions, subject to USAID review	Fund's management firm makes all investment decisions, within OPIC guidelines.
Funding source	USAID provides 100% of initial capital.	Fund manager gathers private equity, OPIC issues loan guarantees up to 2x the amount of equity.
Most "successful" fund	Polish-American Fund. Initial USG grant was $256 million, but Fund managed to raise $265 million more in private capital. Net assets (FY '97): $267.8 million. Success credited to star Board, good management, large initial investment, favorable market conditions.	

OPIC Overseas Private Investment Corporation

OPIC's DIRECT INVESTMENT FUNDS

June 1, 1998

1100 New York Avenue, N.W.
Washington, D.C. 20527-0001
(202) 336-8400
FAX (202) 408-9859

FUND NAME & SPONSOR	ADDRESS & CONTACT NUMBERS	FUND SIZE COUNTRIES/REGION	STATUS	PRIMARY INVESTMENT FOCUS
Africa Growth Fund Equator Services	Joe Jandreau Managing Director The Africa Growth Fund 45 Glastonbury Blvd. Glastonbury, CT 06033 860-633-9999 860-633-6799 Fax	$25 million Sub-Saharan Africa	Investing	Equity investments in mining, manufacturing and financial services.
Agribusiness Partners International America First Companies	Mr. Robert Peyton America First Companies 1004 Farnam Street Omaha, Nebraska 68102 402-444-1630 402-345-8966 Fax	$100 million NIS/Baltics	Investing	Equity investments in agriculture, food firms, infrastructure projects, privatizations, food storage and distribution facilities.
AIG Brunswick Millennium Fund American International Group Brunswick Capital Management Ltd.	Mr. Peter Yu AIG Capital Partners, Inc. 70 Pine Street New York, NY 10270 212-770-7000 212-514-9628 Fax	$300 million NIS/Baltics	Investing	Equity investments in large infrastructure projects including power, transportation, natural resource development and related industries.
Allied Capital International Small Business Fund Allied Capital Advisers	Mr. Cabell Williams III President Allied Capital Advisers, Inc. 1666 K Street, NW, 9th Fl. Washington, DC 20006 202-331-1112 202-659-2053 Fax	$20 million Global	Investing	Equity investments in basic manufacturing and service industries sponsored by qualifying U.S. small businesses.
Aqua International Partners Texas Pacific Group	John Sylvia, CEO/Aqua Texas Pacific Group 6000 California St. #1850 San Francisco, CA 94108 (415) 616-0400 (415) 616-0420 (FAX)	$300 million Global	Raising Capital	Equity investments in operating and special purpose companies involved in the treatment, bulk supply and distribution of water in emerging market countries.
Asia Pacific Growth Fund Hambrecht & Quist	Mr. Ta-lin Hsu ,Chairman One Bush Street San Francisco 94104 (415) 576-3300 (415) 576-3621 (FAX)	$75 million Philippines, Malaysia, Thailand, Taiwan and other countries in Southeast Asia	Investing	Equity investments in light manufacturing, financial, construction and telecom services.
Bancroft Eastern Europe Fund The Bancroft Group	Mr. Fred Martin President The Bancroft Group 54 rue de Varenne 75007 Paris, France 33-1-53-63-28-28 33-1-53-63-28-29 Fax	$100 million Central Europe	Investing	Equity investments in distribution networks, basic manufacturing, consumer goods and related service networks.
Caucasus Fund Commonwealth Property Investors Junction Investors, L.L.C.	Irakli Rukhadze Commonwealth Property Investors 53 State Street, 16th Floor Boston, MA 02109 617-261-9300 617-261-9333 FAX	$46 million Armenia, Azerbaijan and Georgia	Raising Capital	Equity investments in real estate, agribusiness and transportation.

OPIC's DIRECT INVESTMENT FUNDS

June 1, 1998

FUND NAME & SPONSOR	ADDRESS & CONTACT NUMBERS	FUND SIZE COUNTRIES/REGION	STATUS	PRIMARY INVESTMENT FOCUS
CEENIS Property Fund Auburndale Central Europe Realty Management Inc.	Mr. Greg Hunt Auburndale Realty Management Inc. 372 Washington Street Third Floor Wellesley, MA 02181 718-431-2600 718-431-1007 Fax	$240 million Central Europe/NIS	Investing	Investments in light manufacturing, office, warehousing and distribution property development projects.
Draper International India Draper International	Mr. William H. Draper, III Draper International 50 California Street Suite 2925 San Francisco, CA 94111 415-616-4050 415-616-4050 Fax www.drapervc.com/intl	$55 million India	Investing	Equity investments in information technology, telecommunications and consumer goods.
Emerging Europe Fund Templeton Direct Advisors SG Europe Ltd.	Mr. Jamie Halper Templeton Direct Advisors 30 Elm Street Greenwich, CT 06830 203-625-4515 203-625-6671 Fax	$60 million Central Europe	Investing	Equity investments in sustainable development industries.
First NIS Regional Fund Sovlink-American Baring Asset Management	Mr. Alistair Stobie Sovlink Corporation 10 Uspenski Pereulok Moscow, Russia 103006 011-7095-967-1300 011-7-095-967-1308 FAX	$200 million NIS/Baltics	Investing	Equity investments in natural resource-related companies, telecommunications, light manufacturing and consumer products and services.
Global Environment Emerging Markets Fund GEF Management	Mr. H. Jeffrey Leonard President GEF Management Corp. 1201 New York Ave Suite 200 Washington, DC 20005 202-789-4500 202-789-4508 Fax	$70 million Global	Investing	Equity investments in environment-oriented sectors relating to the developing, financing, operating or supplying of infrastructure relating to clean energy and water.
Global Environment Emerging Markets Fund, II GEF Management	same as above	$120 million Global	Raising Capital	Equity investments in environment-oriented sectors relating to the developing, financing, operating or supplying of infrastructure relating to clean energy and water.
India Private Equity Fund Oppenheimer & Co. Chase Capital	Mr. Bob Schwabe Vice President Oppenheimer & Co. World Financial Center New York, NY 10281 212-667-4580 212-667-4468 Fax	$140 million India	Investing	Equity investments in consumer goods, basic manufacturing and related industries.
InterArab Investment Fund InterArab Management, Inc.	Dr. Fuad Abu Zayyad InterArab Management, Inc. 340 Golden Hills Drive Portola Valley, CA 94028 415-851-9371 415-851-9373 Fax	$45 million West Bank/Gaza, Jordan, Oman	Investing	Equity investments in basic industries that create intra- and inter-regional synergies

OPIC's DIRECT INVESTMENT FUNDS

FUND NAME & SPONSOR	ADDRESS & CONTACT NUMBERS	FUND SIZE COUNTRIES/REGION	STATUS	PRIMARY INVESTMENT FOCUS
Israel Growth Fund Apax - Leumi Partners	Mr. Allan Barkat APAX-Leumi Partners, Inc. 2 Weizman Street P. O. Box 33031 Tel Aviv 61330, Israel 011-972-3-696-5990 011-972-3-696-5977 Fax	$40 million Israel	Investing	Equity investments in technology, telecommunications, consumer retailing and consumer products
Modern Africa Growth and Investment Fund Modern Africa Fund Managers, LLC	Steve Cashin Modern Africa Fund Managers, LLC 1101 Connecticut Ave., NW, Suite #700 Washington, DC 20036 202-887-1772 202-887-1788 Fax e-mail: mafmdc.mafm.com	$150 million Africa	Raising Capital	Equity investments in all sub-Saharan countries excluding South Africa with focus on manufacturing, telecommunications and natural resources.
New Africa Opportunities Fund New Africa Advisers	Mr. Justin Beckett President & CEO New Africa Advisers 103 West Main Street Durham, NC 27701 919-688-8092 919-688-9095 Fax	$120 million Southern Africa	Investing	Equity investments in diversified manufacturing, financial and service industries.
Newbridge Andean Partners, L.P. ACON Investments	Mr. Bernard Aronson ACON Investments, L.L.C. 1133 Connecticut Ave., N.W. Suite 700 Washington, D.C. 20036 202-861-6060 202-861-6061 Fax	$160 million Bolivia, Ecuador, Peru and Venezuela	Investing	Equity investments in diversified manufacturing, financial and service industries.
New Century Capital Partners, L.P. New Century Advisors	Mr. George Rohr President NCH Advisors 712 Fifth Avenue, 46th Floor New York, NY 10019-4108 212-641-3200 212-641-3201 Fax	$250 million Ukraine, Armenia, Belarus, Estonia, Georgia, Kazakstan, Latvia, Lithuania, Moldova, and Russia	Investing	Equity investments in diversified manufacturing, consumer products, financial and service industries.
Poland Partners, L.P. Poland Partners Management Co.	Mr. Landon Butler Poland Partners Management Co. 700 Thirteenth Street, NW Suite 1150 Washington, DC 20005 202-737-7300 202-737-7604 Fax	$65 million Poland	Investing	Equity investments in manufacturing, consumer goods, distribution networks, merchandising and related service networks.
Russia Partners Siguler Guff & Co. International Economic Cooperation	Mr. Drew Guff, VP Siguler, Guff & Co. 630 Fifth Avenue, 16th Floor New York, NY 10111 212-332-5100 212-332-5120 Fax	$155 million NIS	Investing	Equity investments in natural resource-related companies, telecommunications, light manufacturing and consumer products and services.

OPIC's DIRECT INVESTMENT FUNDS

June 1, 1998

FUND NAME & SPONSOR	ADDRESS & CONTACT NUMBERS	FUND SIZE COUNTRIES/REGION	STATUS	PRIMARY INVESTMENT FOCUS
South America Private Equity Growth Fund WestSphere Capital Associates	Mr. Eduardo Borhoquez President & CEO WestSphere Equity Assoc. LP 55 East 59th Street 13th Floor New York, NY 10022 212/317-3600 212-317-0739 Fax	$180 million South America	Investing	Equity investments in diversified manufacturing, financial and service industries.
South Asia Capital Ziff Brothers Investments	Ms. Terrye Dewey, CFO Ziff Brothers Investments, 153 East 53rd Street, 43rd Floor New York, NY 10022 212-292-6622 212-292-6644 Fax	$150 million Bangladesh, India, Indonesia, Laos, Philippines, Sri Lanka, Thailand	Investing	Equity investments in infrastructure, telecommunications, agro-industry, health-care and consumer products and services
West Bank/Gaza & Jordan Fund Capital Investment Management Corporation	Scott Stupay Capital Investment Management Corporation 6862 Elm Street, Suite 720 McLean, VA 22101 703-847-0870 703-847-3068 Fax	$60 million West Bank/Gaza & Jordan	Raising Capital	Equity investments in basic service and manufacturing companies.

OPIC
Overseas Private Investment Corporation

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INVESTMENT FUNDS DEPARTMENT

Summary Program Description

OPIC supports the creation and capitalization of investment funds that make direct equity and equity-related investments in new, expanding or privatizing companies in emerging market economies. By providing long-term, patient growth capital and facilitating critically needed technology and management skills development, these privately-owned, privately-managed funds act as a catalyst for private sector economic activity in developing countries.

Along with OPIC's insurance and project finance activities, these investment funds serve to carry out OPIC's mission, which has three primary objectives:

- Support for the achievement of U.S. foreign policy objectives, including privatization of state-owned businesses and economic development of emerging markets in order to increase political and economic stability and provide opportunities for U. S. commerce;
- Development of new markets for American companies, facilitating early access to new consumers in the emerging economies and the developing world;
- Creation of U.S. jobs through support of business in emerging markets which have relationships with U.S. companies such as joint ventures, franchising, supply or distribution arrangements, or the procurement of U.S. goods and services.

The direct equity investments of OPIC-supported funds complement OPIC's insurance and project finance activities. By supplementing the capital of funds which are privately financed and managed by experienced private investment professionals, OPIC supports investment activities which have a profit objective, and which include management guidance to enhance the development of companies in which investments are made. A particularly important aspect of this program is its use as a source of risk capital and financial expertise for small and medium-sized U.S. companies seeking to enter new emerging markets.

Fund Formation

OPIC's participation in the funds takes the form of long-term, secured loans and loan guaranties that supplement the fund's privately-raised equity. OPIC's guarantee, backed by the full faith and credit of the U.S., may be applied only to the debt portion of the fund's capital. OPIC does not offer any guarantee of the fund's equity, and all equity investments in OPIC-backed funds are fully at risk.

OPIC-supported direct investment funds are organized and structured like other U.S.-based private equity investment entities, usually as limited partnerships or limited liability companies. The fund general partners are experienced sponsors of previous U.S.-based investment vehicles, and raise the funds' equity capital through private placement of limited partnership interests with sophisticated institutional, corporate and high net worth investors. Funds are typically managed by the fund general partner or its affiliate.

OPIC supplements the private equity capital by lending or guaranteeing long term debt (typically 10 to 12 year maturity) to the funds, in an amount up to twice the private equity capital invested in the fund. OPIC-guaranteed debt must be held by "eligible investors" as defined in OPIC's governing statute. In general, eligible investors include: U.S. citizens; U.S. corporations, partnerships, or the like which are more than 50% beneficially owned by U.S. citizens; and foreign entities wholly owned by U.S. citizens.

OPIC receives commercially-based fees as compensation for its participation in a fund; the program is structured to ensure that the fees and profit participation will fully cover the cost of the program.

Selection Criteria

OPIC's evaluation of prospective funds is based primarily on the following criteria:

- Responsiveness of the proposed fund to current foreign policy objectives of the United States in countries and market segments which are eligible for OPIC participation, and in which there is a shortage of private U.S. investment capital.

- Credibility and thoughtfulness of the fund's strategic concept and business plan, including the fund manager's ability to link qualified U.S. business partners or suppliers to prospective investments.

- Experience and depth of the proposed management, both in the U.S. and in the countries in which investments are to be made. OPIC seeks fund managers with an experienced track record in direct equity investments and relevant regional experience. The fund manager is expected to add value to the portfolio investments by providing management expertise, improved marketing and access to international manufacturing technologies, and to have a strategy for the eventual liquidation of investments.

- Ability of the fund sponsors to raise the required private capital in a reasonable period of time.

OPIC Statutory Requirements and Policies

In accordance with OPIC's statutory criteria and policy guidelines, the funds will only make investments in opportunities that satisfy OPIC's policy considerations, including worker rights, the environment and U.S. economic impact. Fund investments are expected to have a connection with U.S. companies which will benefit the U.S. economy.

~~OPIC does not participate in investment decisions made by the fund.~~ However, each proposed fund investment must be submitted to OPIC for review to determine whether such investment is consistent with OPIC's statutory and policy criteria.

Cost and Terms

OPIC is a self-sustaining government agency. All of OPIC's programs are market-based and charge market-based fees. Fees associated with OPIC's investment funds program include:

- retainer and commitment fees
- an annual fee based on the outstanding loan balance
- a participation in cash distributions from the fund after the OPIC-guaranteed loan has been repaid and investors have recovered their full investment in the fund.

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NEW MARKETS TAX CREDIT FACT SHEET

The New Markets Tax Credit is designed to encourage $6 billion in private sector equity investment for business growth in low- and moderate-income rural and urban communities.

As a part of this initiative in President Clinton's budget proposal for FY2000, investors would be able to claim a tax credit worth 25% of the amount of capital invested over five years in community development organizations. To provide flexibility and attract a range of investors, diverse community development organizations would be available to assist investors.

Why is equity investment important?
As stated in a report published by the Federal Reserve Bank of Richmond, "We now realize that we are dependent on the health of the entrepreneurial segment, and economic pressures often threaten the health of these small firms. The availability of capital for small business plays a vital role for this segment and without it, small businesses cannot grow." [1]

Small businesses, defined as those with fewer than 500 employees,

- employ 53% of private non-farm work force
- contribute 47% of sales in the country
- generate 51% of private GDP
- were responsible for 64% of 2.5 million new jobs created in 1996.[2]

How does community development improve a distressed region?
Often the economies of rural and urban neighborhoods lack the infrastructure and basic services to support large scale investment, such as is typical in equity capital. Community development, encouraged through loans and investment, acts as a catalyst for the establishment and growth of businesses which might otherwise locate elsewhere, or not exist at all. Many regions have become distressed due to past or ongoing dependence on a specific industry, which has since become less productive or obsolete. Community development, through new types of investment, diversifies the local economy, generates new jobs, and creates new income.

If banks and private investors exist in abundance in urban areas, why does so little money go to inner cities?
Banks and private investors assist entrepreneurs, but entrepreneurs themselves must also have funds of their own available. In low-income urban areas, entrepreneurs have little excess capital to invest and leave in a new business. Many traditional investors believe that these areas have an underdeveloped sense of entrepreneurship, making investment too risky. Entrepreneurs in these areas receive most of their start-up financing from community development organizations.

Why do rural areas receive a low percentage of investment?
Bank loans and private equity investments allow small businesses to start-up and survive. ***Banks*** in rural areas are often limited in size. They may also have restricted lending capacities and a narrow scope of local expertise. All three characteristics are due to factors existing in rural environments, such as remoteness and low population density. Because many rural areas are especially focused on farming and/or natural resource-based industries, local expertise is often limited to these enterprises. This makes diversifying the economy extremely difficult. ***Private investors*** use community development organizations to distribute their money to small businesses; however, most of these vehicles exist in urban areas. Investing in rural areas becomes too risky for private investors -- it is time consuming (the urban vehicles are readily accessible) and the remote locations can make the investment difficult to oversee.

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[1] Access to Capital: Start to Finish, page 3, Federal Reserve Bank of Richmond, Sept. 15, 1998

[2] Ibid

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PricewaterhouseCoopers reports that the majority of national venture capital for the 4th quarter of 1998 was invested in urban areas. Almost 50% went to Silicon Valley and New England. Another 16% went to the DC and New York metropolitan areas and L.A./Orange County. These areas received approximately $2.4 billion out of the $3.67 billion invested. *Only 5.7% of all investments went to the (primarily rural) South Central, Southwest, and Northwest Regions combined.*[3]

Hasn't equity investment increased dramatically in recent years?
PricewaterhouseCoopers reports that national venture capital investment increased last year by 24% to $14.27 billion. But where is this money going? *"Of the $2.7 billion increase in total investments between 1997 and 1998, $2.5 billion flowed into technology companies [i.e. 93%].... As a whole, technology-based companies accounted for $10.8 billion or 76% of all 1998 venture capital investments."* Small businesses located in rural and low-income urban areas, with their economies primarily in retail and natural resource-based industries, generally are not benefitting from this enormous support for technology-based development. Only 3.5% of 1998 fourth quarter funds went to support retail and industrial investments, a total of $127 million, paling in comparison to the $2.79 billion invested in technology companies during the same three months.[4]

How can the New Markets Tax Credit change the odds of investment in high-risk areas?
The New Markets Tax Credit provides an incentive of a 25% tax credit over five years on equity investments in low- and moderate-income rural and urban communities. This tax credit will encourage private investors who may never have considered investing in high-risk areas to do so. $1.2 billion would be available from the federal government, encouraging a potential $6 billion in these high-risk areas. Because community development vehicles may not redeem the equity interest for at least five years, capital stays in the community. The New Markets Tax Credit will create new relationships between investors, community development vehicles, and small businesses, which will foster continued support and lasting investment.

Where can private investment make a profit for the investor and a difference for the community?
By investing in the community through local businesses, private investors can explore new markets and improve the quality of life for people in the area. Community development organizations may use the funds from private investors to develop:

- micro-enterprise
- manufacturing businesses
- commercial facilities
- community facilities, like child care centers and senior centers
- co-operatives.

Two examples of <u>successful</u> community development equity investment
Coastal Ventures L.P. of Coastal Enterprises, Inc. is Maine's first socially responsible venture capital fund. CVLP seeks to foster employee-owned management practices, and to help create socially beneficial products and services. *Cuddledown of Maine*, nationally known for its premium-quality bed-and-bath merchandise, received a capital investment from CVLP, enabling the Portland-based company to triple its manufacturing space while maintaining its commitment to creating quality jobs with above-average wages and benefits.

Kentucky Highlands Investment Corporation, described by the *Wall Street Journal* as having a "rare mix of altruism and hard-nosed capitalism," is a community development corporation that has invested in Appalachia since 1968. KHIC recently invested in a family tent-manufacturing business that needed to diversify its products. This business, originally started with KHIC's help, was able to expand and include automotive airbags because of a new investment from KHIC. The company is thriving, employing nearly 300 people and operating two jobs programs for the handicapped.

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[3] Web site - http://www.pwcglobal.com - PricewaterhouseCoopers: MoneyTree Survey Report, Feb. 24, 1999

[4] Ibid

General Explanations of the Administration's Revenue Proposals

Department of the Treasury
February 1999

791-2965

Making Health Care More Affordable

Expand Education Initiatives

Making Child Care More Affordable

Provide Incentives to Revitalize Communities

Promote Energy Efficiency and Improve the Environment

Promote Expanded Retirement Savings, Security, and Portability

Extend Expiring Provisions

Simplify the Tax Laws

Miscellaneous Provisions

Electricity Restructuring

Corporate Tax Shelters

Financial Products

Corporate Provisions

Provisions Affecting Pass-through Entities

Tax Accounting

Cost Recovery

Insurance Provisions

Exempt Organizations

Estate and Gift Taxation

International

Pensions

Compliance

Miscellaneous

Other Provisions That Affect Receipts

Provide Incentives To Revitalize Communities

INCREASE LOW-INCOME HOUSING TAX CREDIT PER CAPITA CAP

Current Law

A tax credit is allowed in annual installments over 10 years for qualifying low-income rental housing, which may be newly constructed or substantially rehabilitated residential units. In order for a credit to be claimed with respect to a building, the building owner must receive a credit allocation from a State or local housing authority. The low-income housing credit is allocated by State or local government authorities subject to an annual limitation for each State. The annual State housing credit limitation, expressed in terms of first-year credits, is currently equal to the sum of $1.25 per capita, the amount of unused housing credit (if any) for the preceding calendar year, the amount of housing credits (if any) returned to the State or local authority in the calendar year, and the housing credit amounts (if any) allocated to such State by the Secretary of the Treasury out of a pool of returned credits. The $1.25 per capita amount, used in determining a State's total amount of available first-year credits, was set in 1986.

Reasons for Change

The need for decent low-income housing exceeds the amount markets provide at affordable rents. Most State agencies receive qualified proposals for far more low-income rental housing than they can support with available credits. Without the tax credits, these projects will not be undertaken. A modest increase in the per capita amount will allow additional low-income housing to be provided but still will require that State agencies choose projects that meet specific housing needs.

Proposal

The annual State low-income housing credit limitation would be increased to $1.75 per capita, effective for calender years beginning after 1999.

PROVIDE TAX CREDITS FOR HOLDERS OF BETTER AMERICA BONDS

Current Law

State and local governments may issue tax-exempt bonds without limit for environmental purposes so long as no more than 10 percent of the bond proceeds are: 1) used by private entities in a trade or business and payments or security associated with that use are available to pay interest and principal on the bonds, and 2) no more than 5 percent of the bond proceeds are lent to private businesses or individuals. If these private activity tests are met, tax-exempt private activity bonds may nonetheless be issued, subject to State-by-State volume caps, for the following environmental purposes: water, sewage, solid waste disposal facilities, hazardous waste facilities, environmental enhancements of hydro-electric generating facilities and redevelopment infrastructure in blighted areas if the bonds are supported by incremental property taxes. The federal subsidy indirectly provided by tax-exempt bonds is limited by market forces to the differential in interest rates between tax-exempt bonds and taxable bonds of similar risk and maturity. Deeper subsidies are provided to Qualified Zone Academy Bonds, the entire interest on which is paid in the form of tax credits.

Taxpayers are allowed to expense, rather than capitalize or amortize, certain environmental remediation costs with respect to certain areas referred to as brownfields.

Reasons for Change

Significant public benefits are provided by protecting open spaces; creating forest preserves near urban areas; rehabilitating land that has been degraded by toxic or other wastes or destruction of its ground cover; improving parks and reestablishing wet lands. These benefits include creating more livable urban, suburban, and rural environments, protecting public health, repairing environmental damage and, in the case of reforestation, absorbing greenhouse gases. Local governments are typically unwilling to assume the major financial burdens required to take the actions necessary to secure these benefits because the benefits are so widely diffused. Tax-exempt bond financing may not provide a deep enough subsidy to induce State and local governments to undertake beneficial environmental infrastructure projects. Moreover, the expensing provision does not provide an incentive for environmental remediation of property owned by governments and intended for future public use or for use by a tax-exempt entity.

Proposal

State and local governments (including Native American tribal governments and U.S. Possessions) would be able to issue Better America Bonds (BABs) to the extent of authority to do so allocated by the Administrator of the Environmental Protection Agency (EPA). The volume of authority to issue BABs that may be allocated by the EPA Administrator in each of the five years, beginning in 2000, would be $1.9 billion. Amounts unallocated for any year may be allocated in the following year. Allocated amounts unissued in the year of allocation may be issued up until the end of the third following year.

As part of an annual competition, States (including Native American Tribal governments and U.S. possessions), and local governments could apply to the EPA for authority to issue BABs. Applications would be submitted following guidelines which EPA would publish prior to January 1, 2000. Those guidelines would indicate the criteria to be used for approving applications. EPA, in consultation with other federal agencies, would review applications and award bond allocations in conjunction with the Community Empowerment Board. A government could issue BABs under an agreement with the sponsor of an approved application. Issuers would be responsible for repayment of principal to the holders of BABs upon their maturity.

The structure of BABs as tax credit bonds would be identical to that proposed for Qualified School Modernization Bonds and Qualified Zone Academy Bonds. The holder of a tax credit bond would receive annual federal income tax credits equal to the applicable credit rate multiplied by the amount held on its anniversary date. Because the annual credits compensate the holder for lending money, they would be treated as payments of interest for federal income tax purposes, and accordingly would be included in the holder's gross income. The credit rate would be set equal to a measure of the yield on outstanding corporate bonds, specified in Treasury regulations, for the business day prior to the date of issue. The maximum term of the bonds would be 15 years. Any taxpayer would be able to hold a tax credit bond and thereby claim the tax credit. Treasury would provide regulations regarding the treatment of credits that flow through from a mutual fund to the holder of mutual fund shares. Unused credits could be carried forward for 5 years. The proposal would require information returns to be provided with respect to holders (including corporations) that are entitled to credits.

Issuers must reasonably expect, as of the date of issue, that 95 percent of the proceeds will be expended for qualifying purposes within three years and that any property financed with bond proceeds will be used for a qualified purpose for at least a 15-year period after the date of issuance. For purposes of the requirement that 95 percent of tax credit bond proceeds be used for qualifying purposes, any investment earnings (and earnings on those earnings) associated with unexpended proceeds during the three-year period following the date of issuance are treated as proceeds, i.e., they must also be used for qualifying purposes. During the three-year period, unexpended proceeds may only be invested in bank accounts or U.S. Treasury securities maturing in three years or less. If the issuer establishes a sinking fund to repay principal, sinking fund assets must be held in State and Local Government Securities (SLGS) issued by the Treasury. Issuers must incur a binding obligation with a third party to expend at least 10 percent of the proceeds of the issue within 6 months of the issue date and allocate the sale proceeds to expenditures with due diligence. If 95 percent of proceeds are not expended by the end of the three-year period for qualifying purposes, unexpended proceeds must be used to retire a portion of the bonds within 90 days. No depreciation deductions would be allowed with respect to property financed with tax credit bonds.

Acquisition of land and facilities is only a qualifying purpose if the property is intended to be available, and is in fact reasonably available, for use by members of the general public. Any agreement, other than a management contract that would be a qualified management contract if the land or facilities had been financed with tax-exempt bonds, conveying priority rights or other preferential benefits to a private person violates the general public use provision and would not constitute a qualified purpose. Furthermore, repayment of principal may not be secured or paid with monies derived from private persons in any capacity other than that of the general public.

Bonds would cease to be qualified bonds and would accrue no further tax credits after the date the use of any bond-financed facilities changes to a non-qualifying use. The issuer would be obligated to reimburse the federal government (with interest) for any credits accruing prior to that date. If this obligation is not timely paid by the issuer, the federal government has the right to recover the credit amount from the current holder of the bonds. In the event the issuer fails to satisfy one of the other tax-related requirements, no further tax credits would accrue and the issuer would be obligated to reimburse the federal government (with interest) for all past credits claimed with respect to the bonds. In the event this obligation is not timely paid by the issuer, the federal government has the right to recover the credit amount from current bond holders.

The qualifying purposes for BABs are:

a. Acquisition of land for open space, wetlands, public parks or greenways to be owned by an eligible issuer or by a 501(c)(3) entity whose exempt purpose includes environmental preservation.

b. Construction of visitor facilities, such as campgrounds and hiking or biking trails, in connection with such acquired land or other open space, wetlands, or parks that are owned by an eligible issuer or by a 501(c)(3) entity whose exempt purpose includes environmental preservation.

c. Remediation of land acquired under (a) above or of publicly owned open space, wetlands or parks (for example, for enhancing water quality) by planting trees or other vegetation, creating settling ponds to control runoff, undertaking reasonable measures to control erosion or protect endangered species, and remediating conditions caused by the prior disposal of toxic or other waste.

d. Acquisition of easements on privately owned open land that prevent commercial development and any substantial change in the use or character of the land. Such easements must be in a form which, if contributed by the owner of the open land, would qualify under section 170(h).

e. Environmental assessment and remediation of contaminated property -- brownfields – owned by State or local governments because it was abandoned by the prior owner, e.g., for non-payment of taxes. The property would have to be an area at or on which there has been a release (or threat of release) or disposal of any hazardous substance within the meaning of section 198. For this use, and this use only, private use (by an entity which is not a 501(c)(3) entity) of proceeds as well as private payment of bond principal is permitted. For example, the cost of environmental remediation of such property could be financed with BABs and the land subsequently sold to a private entity with the proceeds of the sale used to repay principal through the use of a sinking fund. The federal government would not be a qualifying private entity. No expenditures financed with BAB proceeds would be eligible for expensing under section 198.

To encourage continuing use of property financed with BABs, such property could not be converted to a non-qualifying use after the expiration of the 15-year compliance period without a reasonable amount of time being allowed for any 501(c)(3) entity whose exempt purpose includes environmental protection to exercise an option, granted upon issuance of the bonds and recorded in property records, to purchase the property at the price originally paid in conjunction with the expenditure of bond proceeds so long as the purchasing entity covenanted to retain the property in a qualifying use in perpetuity.

Issuance of BABs would be subject to the public approval rules of section 147(f). BABs could be issued in a pool bond format so long as the 3-year spend-out rule was observed.

The proposal would be effective for bonds issued on or after January 1, 2000.

PROVIDE NEW MARKETS TAX CREDIT

Current Law

In general, there are limited tax incentives for investing and making loans to businesses in low-income communities. For example, current law provides for targeted tax incentives that are intended to encourage investment in specialized small business investment companies that are licensed by the Small Business Administration to make loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged.

Reasons for Change

Businesses in our nation's inner cities and isolated rural communities often lack access to equity capital to grow and succeed. To help attract new capital to these businesses, a new tax credit for equity investments in these businesses is proposed.

Proposal

In general.--Taxpayers would be allowed a credit against Federal income taxes for qualified investments made to acquire stock or other equity interests in a selected community development entity. The credits would be allocated to selected community development entities by the Department of Treasury, pursuant to regulations to be issued by that Department. For each year during the period 2000-2004, the Treasury Department would be permitted to authorize selected community development entities to issue an aggregate of $1.2 billion of equity interests with respect to which credits could be claimed under the proposal (a total of $6 billion of new equity investment). If the selected community development entity fails to sell equity interests to investors up to the amount authorized within five years of the authorization, then the remaining authorization would be canceled, and the Treasury Department would have up to two years to authorize another community development entity to issue equity interests for the unused portion.

The credit allowed to the investor (either the original purchaser or a subsequent holder) would be a six-percent credit for each year during the five-year period after the equity interest is purchased from the selected community development entity. A taxpayer holding a qualified investment would be entitled to a credit on each credit allowance date (meaning each one-year anniversary, during a five-year period, of the date the investment was originally purchased from the community development entity). The taxpayer's basis in the investment would be reduced by the amount of the credit. The credit would be subject to the general business credit rules.

Qualified investments.--"Qualified investments" which entitle the investor to a credit must be common stock or other similar equity interest acquired from a selected community development entity in exchange for cash.[7] The stock or other equity interest must not be redeemed (or otherwise cashed out) by the selected community development entity for at least five years. Substantially all of the proceeds of the investment must be used by the community development entity to make "qualified low-income community investments," meaning equity investments in, or loans to, qualified active businesses located in low-income communities.[8] Qualified low-income community investments could be made directly by a selected community development entity, or could be made indirectly through another community development entity.[9]

Community development entities.--"Community development entities" that could apply for credit allocations would include (but would not be limited to) Community Development Financial Institutions, Community Development Corporations, Small Business Investment Corporations-LMIs, New Market Venture Capital Firms, America's Private Investment Corporations, or other investment funds (including for-profit subsidiaries of nonprofit organizations). To be selected for a credit allocation, the community development entity's primary mission must be serving or providing investment capital for low-income communities or low-income persons, the entity must maintain accountability to residents of low-income communities (through representation on governing or advisory boards, or otherwise), and at least 60 percent of the aggregate gross assets of the entity must be invested in "qualified low-income community investments" or residential property located in low-income communities.[10]

As part of the credit allocation process, the Treasury Department would certify entities as eligible "community development entities." Certified entities would be required to file annual

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[7] To ensure that credits are available only for new equity investments in selected community development entities, the term "qualified investment" would not include any stock or other equity interest acquired from a community development entity which made a substantial stock redemption or distribution (without a bona fide business purpose therefor) in an attempt to avoid the purposes of the proposal.

[8] If at least 85 percent of the aggregate gross assets of the community development entity are invested (directly or indirectly) in equity interests in, or loans to, qualified active businesses located in low-income communities, then there would be no need to trace the use of the proceeds from the particular stock (or other equity ownership) issuance with respect to which the credit is claimed.

[9] A community development entity would be treated as indirectly making "qualified low-income community investment" when it purchases loans previously made by another community development entity which, in turn, uses the proceeds from the transaction to provide additional capital to qualified active businesses located in low-income communities.

[10] Expenditures made by a community development entity to provide financial counseling and certain other services to businesses located in, and residents of, low-income communities would also be treated as "qualified low-income community investment."

reports demonstrating that they continue to meet all the requirements for initial certification, and would be required to identify the amount (and purchasers) of equity interests with respect to which allocated credits may be claimed by the purchaser and to demonstrate that the entity monitors its investments to ensure that capital is used in low-income communities.

If an entity fails to be a community development entity during the five-year period following the taxpayer's purchase of an equity interest in the entity, or if the equity interest is redeemed by the issuing entity during that five-year period, then any credits claimed with respect to the equity interest would be recaptured and no further credits would be allowed.

Low-income communities.--For purpose of the credit, "low-income communities" would be defined as census tracts with either (1) poverty rates of at least 20 percent (based on the most recent census data), or (2) median family income which does not exceed 80 percent of metropolitan area income (or for a non-metropolitan census tract, 80 percent of non-metropolitan statewide median family income).

Qualified active businesses.--"Qualified active businesses" generally would be defined as businesses[11] which meet the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in low-income communities; (2) a substantial portion of the use of the tangible property of such business is used within low-income communities; (3) a substantial portion of the services performed for such business by its employees are performed in low-income communities; and (4) less than 5 percent of the average of the aggregate unadjusted bases of the property of such business is attributable to certain financial property (e.g., debt, stock, partnership interests, options, futures contracts) or to collectibles (other than collectibles held primarily for sale to customers).

For purposes of the credit, there would be no requirement that employees of a "qualified active business" be residents of the low-income community. Rental of improved commercial real estate located in a low-income community (e.g., an office building or shopping mall) would be a qualified active business, regardless of the characteristics of the commercial tenants of the property. In addition, a qualified active business that receives a loan from a community development entity could include an organization that is organized and operated on a non-profit basis. The purchase and holding of unimproved real estate would not be a qualified active business. In addition, a qualified active business would not include (a) any business consisting predominantly of the development or holding of intangibles for sale or license; (b) operation of any facility described in sec. 144(c)(6)(B) (e.g., commercial golf course, country club, massage parlor, hot tub facility, suntan facility, liquor store); or (c) any business if a significant equity interest in such business is held by a person who also holds a significant equity interest in the community development entity.

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[11] As under current-law section 1394(b)(3)(D), the term "qualified active business" would include any trade or business which would qualify as such a business if the trade or business were separately incorporated.

Regulatory authority.--The Treasury Department would be granted authority to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the proposal, including regulations limiting the benefit of the proposed tax credit in circumstances where investments are directly or indirectly being subsidized by other Federal programs (e.g., low-income housing credit and tax-exempt bonds), and regulations preventing abuse of the credit through the use of related parties. The Treasury Department would issue regulations describing the certification process for community development entities, annual reporting requirements for such entities, and application of the low-income community investment requirements to start-up entities.

Effective date.--The proposal would be effective for qualified investments made after December 31, 1999.

SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY TAX INCENTIVES

Current Law

Certain existing tax incentives are intended to encourage investment in specialized small business investment companies ("SSBICs"). SSBICs are partnerships or corporations that are licensed by the Small Business Administration to make long-term loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged.

One such incentive allows any C corporation or individual to elect to roll over without payment of tax any capital gains realized upon the sale of publicly-traded securities where the corporation or individual uses the proceeds from the sale to purchase common stock or a partnership interest in a SSBIC within 60 days of the sale of the securities. The amount of gain that an individual may elect to roll over under this provision for a taxable year is limited to the lesser of (1) \$50,000 or (2) \$500,000 reduced by the gain previously excluded under this provision. For corporations, these limits are \$250,000 annually and \$1,000,000 cumulatively.

Another incentive provides favorable qualification requirements, relative to other small businesses, for purposes of section 1202. Under section 1202, 50 percent of the gain realized by an individual upon the sale of qualifying small business stock is excluded from income. In order to be qualified, the small business must be engaged in an active business. The incentive provides that a SSBIC automatically is deemed to satisfy the active business requirement.

Certain regulated investment companies are entitled to deduct dividends paid to shareholders. To qualify for this favorable tax treatment, which effectively eliminates some or all of the tax on corporate earnings that would otherwise be imposed at the corporate level, the regulated investment company must meet certain requirements. These include a requirement that 90 percent of the company's gross income be derived from dividends, interest, and other specified categories of passive income, a requirement that the company currently distribute 90 percent of its income in certain categories, and a requirement that at least 50 percent of the value of the company's assets be adequately diversified in accordance with rules specifying the amount of investment in the securities of specific issuers.

Reasons for Change

Additional tax incentives would further encourage investment in SSBICs, thereby increasing the amount of equity capital available to small businesses owned by persons who are socially or economically disadvantaged.

Proposal

The proposal expands the tax-free rollover incentive in several ways. First, the 60-day rollover period is extended to 180 days. Second, a taxpayer who uses the proceeds of the sale of publicly-traded securities to purchase preferred stock in the SSBIC is also eligible for the exclusion. Third, the proposal increases the lifetime cap on the SSBIC rollover gain exclusion from $500,000 to $750,000 in the case of an individual, and from $1,000,000 to $2,000,000 in the case of a corporation. The annual caps on gain exclusion of $50,000 per individual and $250,000 per corporation are eliminated.

The proposal also provides that a SSBIC that is organized as a corporation may convert to a partnership within 180 days of enactment, without giving rise to tax at either the corporate or shareholder levels (although the shareholders would be taxed on gain to the extent of boot received in addition to partnership interests). To qualify for this treatment, the corporation must first distribute all of its accumulated earnings and profits (as taxable dividends), then contribute its assets to a partnership (in which it holds an interest of at least 80-percent immediately after the contribution), distribute the partnership interests to its shareholders, and immediately liquidate. The shareholders' basis in the partnership interests generally would carry over from their basis in the SSBIC stock. The partnership would remain subject to an entity-level tax immediately upon ceasing activity as a SSBIC or at any time that it disposes of assets that were held at the time of conversion on the amount of "built-in" gains inherent in such assets at the time of conversion.

The proposal relaxes several of the requirements for a SSBIC's qualification as a regulated investment company. First, income derived by a SSBIC from its limited partner interest in a partnership whose normal business operations the SSBIC does not actively manage will be treated as passive income which counts toward satisfaction of the 90 percent qualifying income test. Second, a SSBIC will be deemed to satisfy the 90 percent distribution requirement if it distributes all of the income that it is permitted to distribute under the Small Business Investment Act of 1958 (as in effect on May 13, 1993). Third, the SSBIC will be deemed to satisfy the diversification of assets requirement to the extent that its investments are permitted to a SSBIC under the Small Business Investment Act of 1958 (as in effect on May 13, 1993).

In the case of a direct or indirect sale of SSBIC stock that qualifies for treatment under section 1202, the proposal raises the exclusion of gain from 50-percent to 60-percent.

A SSBIC would be defined as any partnership or corporation which is licensed by the Small Business Administration under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993).

The tax-free rollover and section 1202 provisions are effective for sales occurring after the date of enactment. The regulated investment company provisions are effective for taxable years beginning on or after the date of enactment.

EXTEND WAGE CREDIT FOR TWO NEW EMPOWERMENT ZONES

Current Law

The Omnibus Budget Reconciliation Act of 1993 (OBRA '93) authorized a Federal demonstration project in which nine empowerment zones and 95 enterprise communities would be designated in a competitive application process. Of the nine empowerment zones, six were to be located in urban areas and three were to be located in rural areas. State and local governments would nominate distressed areas and propose strategic plans to stimulate economic and social revitalization.

Among other benefits, businesses located in the nine original empowerment zones are eligible for three Federal tax incentives: a wage credit; an additional $20,000 per year of section 179 expensing; and a new category of tax-exempt private activity bonds. Businesses located in enterprise communities are eligible for the new category of tax-exempt bonds. OBRA '93 also provided that Federal grants would be made to designated areas.

The Taxpayer Relief Act of 1997 authorized the designation of two additional empowerment zones located in urban areas (the "additional empowerment zones") which generally are eligible for the same tax incentives as are available within the empowerment zones authorized by OBRA '93. The two additional empowerment zones, which have now been designated, are located in Cleveland, Ohio and Los Angeles, California. The tax incentives provided for these new zones take effect on January 1, 2000 and generally remain in effect for 10 years. The wage credit, however, is phased down beginning in 2005 and expires after 2007.

Reasons for Change

The Administration believes that the availability of the tax incentives for the two additional empowerment zones should be expanded in order to help combat the pervasive poverty, and to stimulate the revitalization, of these areas.

Proposal

The proposal would provide that the wage credit would remain in effect for a 10-year period from that date and would be phased down using the same percentages that apply to the original empowerment zones designated under OBRA '93.

The proposal would be effective as of January 1, 2000.