

CAPITAL FORMATION/MICROENTERPRISES

Details of SBA Proposals

SUMMARY OF SBA ONE-STOP SHOP PROPOSAL

OVERVIEW

Proposal would result in coordinated technical, business and financial assistance for the 104 EZs and ECs, with each of the 9 EZs having a shop physically located in the zone and 2 to 3 paid staff to run the EZ shops.

Proposal would result in the following loan/investment volume in EZs and ECs:

- **Micro-Loans:** \$12.9 million in first leverage; \$30 million over five years in 9 EZs with effect of revolving funds
- **SBIC Equity Investment:** \$60 million in all 104 EZs and ECs
- **SSBIC Equity Investment:** \$80 million in all 104 EZs and ECs
- **SBLC Loans:** \$1.8 Billion in 9 EZs (and potentially all ECs)
- **504 CDC Real Estate and Related Equipment Loans:** \$1.2 Billion in 9 EZs
- In addition businesses in each EZ and EC would receive concentrated business technical assistance and counseling, which is critical to successful business lending

Total Loan and Investment Volume over 5 years: \$3.17 Billion, some \$300 million per EZ

Total additional federal cost over 5 years: \$ 65 million -- \$13 million a year; approximately \$1 million per EZ

Implementation issues:

- Subgroup generally favors the proposal but is looking into fine tuning
- Subsequent appropriation could be sought on annual basis
- Local commitments to use portion of CDBG and Title XX funds
- RFP information to assist communities in planning for shops -- rewarding communities that integrate state, local and private sector capital access tools in their one-stop shop proposals

1. MICRO LOAN INTERMEDIARY LENDERS

Function: Loans of less than \$25,000 to small businesses located in the zones.

Location: 1 in each Empowerment Zone ("EZ").

Federal Commitment: SBA Micro Loan program provides technical assistance and loan and grant subsidies to micro-lenders. SBA commits to supporting up to 9 new micro-lenders. Fewer than 9 may be necessary as communities may be able to get an existing SBA micro-lender to relocate to its EZ. It would take about 60 days to license a new micro-lender.

Local Commitment: Free or low-cost office space (where the entire one-stop shop, including micro-lender, is located); 15% cash injection to start new fund (CDBG funds can be used for this purpose).

Private Sector Involvement: could contribute either office space or the 15% cash injection.

Additional Federal Funds Needed (over five years): \$2.25 million for loan subsidy funds and \$11.25 million for statutorily required grants -- to support 9 new micro-lenders. Also, would need a legislative amendment to allow more than four intermediaries in one state.

2. SMALL BUSINESS INVESTMENT COMPANIES (SBICS)

Function: Equity investment (and some lending) for small businesses located in the zones.

Location: 3 new national-level SBICs would service all 9 EZs and 95 Enterprise Communities ("ECs").

Federal Commitment: SBA commits to licensing 3 new SBICs that would be dedicated exclusively to "community development" investing. SBA would require that a certain percentage -- possibly 60 to 70% -- of their investment portfolios be dedicated to the 104 EZs and ECs. The SBA (and possibly the Enterprise Board) will recruit investors to start the new SBICs. It would take about 4-6 months to get the new SBICs started.

Local Commitment: appointing a local entity to help identify and refer EZ and EC investment opportunities to the SBICs.

Private Sector Involvement: each new SBIC must be capitalized with about \$6.5 million from private sector investors. There are no tax benefits for investing in

SBICs.

Additional Federal Funds Needed (over five years): none.

3. SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES (SSBICs)

Function: Equity Investment (and some lending) for socially or economically disadvantaged small businesses located in the zones.

Location: 3 new national-level SSBICs would service all 9 EZs and 95 ECs.

Federal Commitment: SBA commits to licensing 3 new SSBICs that would be dedicated exclusively to "community development" investing. SBA would require that a certain percentage -- possibly 60 to 70% -- of their investment portfolios be dedicated to the 104 EZs and ECs. The SBA (and possibly the Enterprise Board) will recruit investors to start the new SSBICs. Although minority ownership of SSBICs is not required, SBA says it is likely that these SSBICs would be minority owned and they already have a potential group of investors. It would take about 4-6 months to get the new SSBICs started.

Local Commitment: appointing a local entity to help identify and refer EZ and EC investment opportunities to the SSBICs

Private Sector Involvement: each new SSBIC must be capitalized with about \$5 million from private sector investors. There are tax benefits for investing in SSBICs.

Tax Benefits: Individual investors in SSBICs can qualify for the 50% "Bumpers" capital gains exclusion and all restrictions on the types of businesses eligible are waived for SSBICs. Thus, one could claim the Bumpers exclusion for investments in an SSBIC even though the SSBIC itself may be investing in types of businesses not normally eligible for the Bumpers exclusion. The exclusion applies only to direct investments that provide start-up or new capital for the SSBIC -- purchases of shares from SSBIC shareholders would not qualify.

Individual and corporate investors can qualify for the "rollover." An investor can defer the gain on the sale of a publicly-traded security if the proceeds of the sale are reinvested, within 60 days of sale, in a SSBIC.

Additional Federal Funds Needed (over five years): \$17.3 million to pay for statutorily mandated 4 to 1 leverage for the three new SSBICs (28% subsidy rate).

4. SMALL BUSINESS LENDING COMPANY (SBLC)

Function: Loans of over \$25,000 to small businesses located in the zones.

Location: 1 or 2 national-level SBLCs would service all 9 EZs and 95 ECs.

Federal Commitment: SBA commits to licensing one or two new SBLCs that would be dedicated exclusively to "community development" lending. (Currently there are only 8 active SBLC licensees, one of which -- the Grow America Fund (GAF) -- is dedicated to community development financing.) SBA would require that a certain percentage -- possibly 60 to 70% -- of their lending portfolios be dedicated to the 104 EZs and ECs. The SBA would issue an RFP for the new SBLC license(s) and estimates that it would take at least 6 months to get a new SBLC started. (SBA recommends that we have more than one SBLC servicing the zones in order to create competition. The GAF currently has the capacity to be an SBLC for all 104 EZs and ECs.)

Local Commitment: CDBG or other funds would have to be committed to pay for the unguaranteed portion of SBA supported loans, which SBA estimates will total \$188 million over 5 years for all zones. Using the GAF model, the local community would also appoint a local board and staff to identify and process potential loans, although the national-level SBLC is the ultimate lender.

Private Sector Involvement: Pension funds and other large investors currently purchase the guaranteed portion of SBLC loans. SBA has an agent in NYC that sells these investments. Capital needed to support the SBLC's overhead costs in excess of operational income would have to come from private investors.

Additional Federal Funds Needed (over five years): none; support for new SBLCs would be achieved through program reallocations.

5. CERTIFIED DEVELOPMENT COMPANIES (SBA Section 504 CDCs)

Function: Loans to small businesses for real estate and related large equipment. (Limited to projects that would be located in the zones and acquisitions that are needed for the operation of the borrower's business. No housing.)

Location: 1 in each EZ (plus possible priority consideration given to ECs for participation in the 504 program).

Federal Commitment: Under CDC program SBA finances 40% of project costs (50% financed by private lender and 10% paid by borrower or CDC.) SBA commits to expanding the program to support 9 new CDCs and to raising the normal subsidy rate for loans in the EZs.

Local Commitment: seed capital for starting or operating a CDC.

Private Sector Involvement: Currently there is a secondary market for debentures that SBA issues to back the CDC loans. Local private entities might also contribute seed capital to start the CDCs.

Additional Federal Funds Needed (over five years): \$24.3 million for cost of a 5% subsidy rate (up from a current rate of .5%).

6. SMALL BUSINESS DEVELOPMENT CENTERS (SBDCs), SERVICE CORPS OF RETIRED EXECUTIVES (SCORE) and BUSINESS INFORMATION CENTERS (BICs)

Function: SBDCs (technical assistance), SCORE (hands-on, elementary counseling and technical assistance), and BICs (technical assistance) to small businesses located in the zones.

Location: 1 SBDC, 1 SCORE assistant, and 1 BIC in each EZ. Coordination and priority service by existing SBDCs, SCORE and BIC network in all 95 ECs.

Federal Commitment: Project management costs, including on-site and central management for the 9 centers and coordination for the 95 ECs. SBA envisions placing 2 professionals and 1 support person at each of the 6 urban EZ centers; 1 professional and 1 support person for the 3 rural EZ centers.

Local Commitment: Free or low cost office space; commitment of Title XX grant funds to cover statutorily-required match (normally paid by SBA) for half of operating costs of the 9 SBDCs. SBA also requests that Title XX funds be committed to pay for all of the SCORE assistance in the 9 EZs. Total Title XX commitment over 5 years for all 9 zones: about \$12 million.

Private Sector Involvement: The SBDC itself must commit to pay the other half of its operating costs. (Most of the existing 965 SBDCs are run by universities). Private sector could also contribute office space or substitute for requested Title XX funds.

Additional Federal Funds Needed (over five years): \$1.8 for BICs; \$8.6 million for project management.

**REPORT OF THE EMPOWERMENT ZONES SUB-GROUP
ON CAPITAL FORMATION FOR
BUSINESS AND ECONOMIC DEVELOPMENT**

I. One Stop-Capital Shops - SBA proposal for business capital access in Empowerment Zones and Enterprise Communities

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II. Additional Tools

Tax-Exempt Zone Facility Bonds: Treasury has offered suggestions that might be included in the RFP to ensure that localities make use of these bonds, e.g., allocation of a percentage of the state loan volume cap. Total potential loan volume for all EZs and ECs: \$ ___

Tax Breaks for Investments in SSBICs and "Bumpers" Businesses: The working group is still investigating the potential for marketing these tools to investors and/or

inducing third parties to pool and market these investments.

Commerce MBDA Megacenters: Commerce has set-aside funds for state-of-the art MBDA Megacenters in certain locations, including Los Angeles. Commerce is currently exploring how its six regional Megacenters might provide technical assistance to businesses in EZs.

CDFI Bill: The President's CDFI bill is pending in Congress. Assuming passage, EZs and ECs will have priority for participation and the CDFI fund will be a source of matching capital to capitalize a CDFI for community development lending in the zones.

II. Role of Outside Investors:

Pension Funds: DOL preliminarily is of the view that pension funds could, within existing regulations and constraints, invest in or purchase at least some of the products that will result from EZs and ECs. Pension funds currently purchase the guaranteed portion of SBA loans. DOL is working with SBA to investigate the potential role of pension funds more fully.

Banks: Treasury preliminarily states that banks could invest a small percentage of their unimpaired capital in CDCs, SBICs, and SSBICs. It is still exploring the extent to which banks could play a role at the national and local level in providing capital to EZs and ECs.

III. Integrating Indian Country into Capital Formation and Community Enterprise Board Strategies

Interior and the Bureau of Indian Affairs have requested that the Community Enterprise Board's efforts to implement empowerment zones include coordinated implementation strategies for Indian Country. In addition, they have requested a coordinated capital formation strategy. (Under the Budget Reconciliation, businesses that locate in Indian nations automatically receive tax incentives for accelerated depreciation and employment of Indians.)

**ISSUES FOR BUSINESS AND ECONOMIC DEVELOPMENT
CAPITAL FORMATION IN EMPOWERMENT ZONES
AND ENTERPRISE COMMUNITIES**

1. SBA ONE STOP CAPITAL SHOP PROPOSAL

-- How much of the additional funding sought by SBA is really necessary? What adjustments can be made to reduce the need for proposed new costs, particularly project management costs? Do other agencies have resources that could be coupled with or substitute for pieces of the SBA model? Could we require to community to commit more resources to lessen federal costs?

-- Other options that may substitute for the CDC piece of the proposal, e.g. tax exempt zone facility bonds; HUD initiative for CDCs, including harnessing the tax breaks for cash contributions to CDCs.

-- Do we want to go with a one-stop capital shop model in which we require the EZ applicant to plan for all the pieces in the model, i.e., all or nothing.

-- Usage of CDBG funds for unguaranteed portion of SBLC loans; whether it should be stipulated that such CDBG funds must be used only for loans to businesses located in EZs and ECs; marrying the section 108 loan guarantee and the SBLC program (Mark Gordon)

-- Usage of Title XX funds -- \$12 million from Title XX funds for SBDC/SCORE (Sheryll Cashin, Kumiki Gibson)

-- What percent of investment by SBICs, SSBICs, and SBLCs must be dedicated to empowerment zones? (John Cox)

-- Clarification of extent of involvement in ECs (as opposed to EZs) (e.g., SBA costed the SBLC program based on servicing of only 9 EZs but John Cox states that the SBLCs could also service the 95 ECs)

2. ROLE FOR PENSION FUNDS

-- 7(a) guaranteed loans sold by SBLCs, SSBICs and SBICs

-- other possibilities?

-- direct investments in the new SBICs or SBLCs?

3. ROLE FOR BANKS

- Eligible activities? i.e., extent of allowable investment in SSBICs, CDCs, etc.
- CRA credit for investments at the local level? e.g., investments in microloan funds, CDCs, SSBICs, other?
- contributing office space, technical assistance, etc. for the one-stop capital shop

4. ROLE FOR INDIVIDUAL AND CORPORATE INVESTORS

- In addition to (or in lieu of) marketing new SSBICs and SBICs to outside investors, is there any potential for an "empowerment zones mutual fund" that would allow outside investors to buy shares in a fund that pools investments, most likely bumpers business investments, in empowerment zones? (To lower risk such a fund would not invest exclusively in empowerment zones.)

5. ROLE FOR CORPORATE ANGELS AT THE LOCAL LEVEL

- investments at the local level? e.g., investments in microloan funds, CDCs, SSBICs, other?
- contributing office space, technical assistance, etc. for the one-stop capital shop

6. CONTENT OF THE RFP (TO INFLUENCE CAPITAL FORMATION PLANNING BY EZ APPLICANTS)

- what must go in the rfp to bring about the model(s) and activities we envision?