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COMMUNITY DEVELOPMENT AND VENTURE CAPITAL ACT OF 1999

AUGUST 25, 2000.—Ordered to be printed

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Mr. BOND, from the Committee on Small Business, submitted the following

REPORT

[To accompany S. 1594]

On July 26, 2000, the Committee on Small Business considered S. 1594, the Community Development and Venture Capital Act of 1999. The Committee adopted by unanimous voice votes a substitute amendment offered by the Ranking Democrat, Senator John F. Kerry, the sponsor of the bill, and two amendments offered by the Chairman, Senator Christopher S. Bond, with respect to investments in low-income urban areas and the percentage of investments to be made in HUBZone areas. As amended, S. 1594 would authorize the establishment of a comprehensive economic development program that seeks to stimulate venture capital investment and intensive management assistance in small businesses located in the country's most distressed and under-invested communities. Having considered S. 1594, as amended, the Committee reports favorably thereon and recommends that the bill do pass.

I. INTRODUCTION

Community development venture capital is a growing practice that ties venture capital investment to economic development and community revitalization. Unlike traditional venture capital funds that are solely profit-driven, community development venture capital funds (CDVCs) are both mission-driven and profit-driven. The industry refers to this as a "double bottomline"—investments that show promise not only of a financial return, but also of a social return. Social returns range from creating sustainable local jobs with

79–010

liveable wages to providing a much-needed service to the community.

CDVC investments are much smaller than traditional venture capital funds, typically ranging between $50,000 and $500,000, and go to small businesses located in distressed urban and rural areas. However, while many of the existing active CDVCs seek out and make investments based on location, some CDVCs, such as Coastal Enterprises in Maine, make the majority of their investments based on job creation potential. Another important distinction between traditional funds and mission-driven funds is that CDVCs provide on-going, intensive business counseling and assistance.

It is generally accepted among economists and business experts that venture capital has significantly contributed to the success of the U.S. economy over the last 20 to 30 years. Accordingly, CDVC funds have set out to demonstrate that the same model of business development that has driven economic expansion in California's Silicon Valley and Route 128 in Massachusetts can also make a powerful difference in areas like the inner-city areas of Boston's Roxbury and New York's East Harlem, or the rural desolation of Kentucky's Appalachia and Mississippi's Delta region.

The Committee has reviewed S. 1594 and the field of community development venture capital on three occasions: On March 16, 1999 as part of the SBA's FY2000 Budget Hearing; on May 12, 1999 as part of the roundtable entitled "SBA's SBIC and Microloan Programs"; and on February 24, 2000 as part the SBA's FY2001 Budget Hearing. The testimony and statements from those hearings and roundtables demonstrate a real need for this legislation. For example, while there is a growing industry of community development venture capital companies, there are virtually no institutional sources of equity capital in distressed communities. Specifically, there are currently 26 active CDVCs. They manage approximately $157 million combined, and only 14 of those funds are capitalized at $5 million or more, which is the absolute minimum for economic viability of a fund.

Mr. Kerwin Tesdell,[1] one of the roundtable participants and president of the Community Development Venture Capital Alliance in New York, explained why Congress should implement a community development venture capital program: "Why is Federal support needed for this program? * * * right now we depend on social capital, from foundations and others with a social interest as well as an economic interest in investment. That is a very small pool of capital. Therefore, our funds are often undercapitalized, operate at an inefficient level, and are unable to meet the needs of their communities."

This legislation creates a community development venture capital program that is modeled on the Small Business Administration's existing venture capital program, called the Small Business Investment Company (SBIC) program. Congress created the SBIC program in 1958 to fill the gap between the scarcity of venture capital available to small businesses and the needs of start-up and growing small businesses.

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[1] Kerwin Tesdell is the president of the Community Development Venture Capital Alliance and an adjunct professor at New York University School of Law. He holds an economics degree from Harvard College, law and business degrees from New York University, and a certificate from the Venture Capital Institute.

The SBIC program has proven to be an extremely successful public-private sector partnership with the government. Since the program was started, it has provided more than $22 billion of investments in more than 86,000 small U.S. companies. In the last five years, it has returned $238 million in profit participation to the U.S. Department of Treasury. As successful as the SBIC program is, it does not sufficiently reach areas of our country that need economic development the most. According to Don Christensen, the Associate Administrator of the SBA's Investment Division, who participated in the Committee's roundtable in 1999: "* * * Although the SBIC Program is extremely effective in addressing the needs of small business in general, it comes up short in terms of the needs of small businesses located in distressed urban and rural areas * * * In the HUBZones, for example. A number of investments are being made by SBICs in those areas, but they are the larger ones. What we need is a new program to address the specific needs * * *"

For example, in 1999, SBICs invested $771 million in low-and moderate-income areas. However, "the vast majority of those investments were very large and not at all comparable to the type of investments [NMVC] funds would make."[2] Based on SBA data, in 1998, only 1.8 percent, or $59 million, went to investments of $1 million or less in low- and moderate-income areas. In 1999, the percentage shrunk. Out of the total $4.2 billion that SBICs invested in 1999, only 1.6 percent, or $66 million, went to such investments. It is estimated that $60 million will be invested in low-income areas through the NMVC program in FY2001, with the remaining $140 million to be invested over the subsequent four-year period.

In approving this legislation, it is not the Committee's intention to criticize the SBIC program or the investment pattern of currently licensed SBICs. On the contrary, the Committee encourages the SBICs to continue making investments in low- and moderate-income (LMI) areas and provides an incentive through a recently implemented debenture, called an LMI debenture, which has favorable terms. The Committee recognizes the vital role that SBIC investments play in the economy and the financing gap they fill by making investments of $300,000 to $5 million in small businesses, which traditional venture capitalists do not typically make. Traditional venture capitalists make average investments of $9 million.[3]

The Committee is approving S. 1594 to expand the number of smaller investments being made to small businesses in the poorest areas, low-income geographic areas, and to fill another gap in access to capital that small businesses face. Investments for NMVC funds typically will range from $50,000 to $300,000 versus the $300,000 to $5 million range found in the Agency's SBIC program.

According to Julia Sass Rubin,[4] a community development venture capital expert at Harvard University who participated in the

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[2] Quote from the statement of Julia S. Rubin, a community development venture capital expert described in footnote no. 3, submitted for the record as part of the SBA's FY2000 Budget Hearing on March 16, 1999.

[3] Price Waterhouse Venture Capital Survey 1999/2000.

[4] Julia S. Rubin is a doctoral candidate at Harvard University examining the field of community development venture capital (CDVC). She advises the Small Business Administration on the President's New Markets Venture Capital Initiatives, which is modeled after the CDVC industry. She also advises community development venture capital funds on how to attract more

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1999 roundtable and submitted a statement for the hearing record on SBA's FY2001 budget, the situation is compounded by the fact that "these [SBIC] investments were narrowly distributed. Only five states received 59 percent of these dollars in 1999, and only four states accounted for 55 percent of these dollars in 1998. In 1999, California alone accounted for 30 percent of all SBIC LMI investments of $1 million or less. [Similarly], in 1998, California accounted for 28 percent of all investments. Meanwhile, 21 states in 1999, and 20 states in 1998, received no [SBIC] capital at all. [Finally], in 1998, only two SBIC investments went to rural LMI areas."

The need for targeted venture capital investment is not only clear from these statistics, but from investment experts and economists who recognize the vital role of venture capital in our economy. At the Federal Reserve System Research Conference on Business Access to Capital and Credit held in March of 1999, Federal Reserve Board Chairman Alan Greenspan said: "* * * Credit alone is not the answer. Businesses must have equity capital before they are considered viable candidates for debt financing. * * * Continued efforts to develop markets for private equity investments will be rewarded by an innovative and productive business community. This is especially true in lower-income communities, where the weight of expansive debt obligations on small firms can severely impede growth prospects, or more readily lead to business failures."

We can make a difference in the country's poor, under-invested and under-served areas by investing in a new industry of community development venture capital funds that target investment capital and business expertise into low- and moderate-income areas to develop and expand local businesses that create jobs and alleviate economic distress.

II. DESCRIPTION OF THE BILL

The "Community Development Venture Capital Act of 2000" addresses the venture capital financing needs of small businesses located in low-income urban areas and low- and moderate-income rural areas, referred to by the Administration as "new markets." The SBA defines new markets as rural and inner city communities, including HUBZones and Rural and Urban Empowerment Zones. New markets are areas of the country where entrepreneurs have experienced barriers to the marketplace and there is little to attract investors. At the same time, these areas need so much, there are significant opportunities. According to Michael Porter,[5] a respected professor at Harvard University and business analyst who has written extensively on competitiveness, "* * * inner cities are the largest underserved market in America, with many tens of billions of dollars of unmet consumer and business demand." The Committee believes comparable opportunities exist in poor rural areas.

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venture capital. Formerly a consultant for McKinsey & Co., she received her M.B.A., M.A. and B.A. degrees from Harvard University.

[5] Michael E. Porter is the C. Roland Christensen Professor of Business Administration at Harvard Business School. He is the author of many best-selling books on strategy, including "The Competitive Advantage of Nations, Competitive Advantage: Creating and Sustaining Superior Performance," and "Competitive Strategy: Techniques for Analyzing Industries and Competitors." The quote is taken from "The Competitive Advantage of the Inner City" of the Harvard Business Review.

This legislation has three parts: the New Markets Venture Capital Program, a venture capital program to funnel investment money into distressed communities; the Community Development Venture Capital Assistance Program, a capacity building program to expand the number of venture capital firms and professionals who are devoted to investing in such communities; and BusinessLINC, a mentoring program to link established, successful businesses with small business owners in stagnant or deteriorating communities in order to facilitate the learning curve to develop and grow their small businesses.

Title I—New Markets Venture Capital Program

The center piece of S. 1594 is the New Markets Venture Capital Program. Its purpose is to stimulate economic development through public-private partnerships called New Markets Venture Capital Companies (NMVCs) that invest venture capital in and provide technical assistance to smaller businesses located in distressed rural and urban areas, including HUBZones and Urban and Rural Empowerment Zones.

Through this legislation, the SBA will create a separate venture capital program that will fund up to 20 venture capital companies dedicated to new markets. Unlike the SBIC program which focuses on small businesses with high-growth potential and claims successes such as Staples and Calaway Golf, the NMVC program will focus on smaller businesses that show promise of a double bottomline. While these smaller businesses can be higher risk, need patient capital and technical assistance, and have modest growth prospects, they can also provide quality jobs and create productive wealth in and among our neediest communities.

During the Committee's roundtable, Ms. Elyse Cherry, president of the Boston Community Venture Fund in Massachusetts, one of the country's premier community development venture capital funds, gave an example of an investment with a double bottomline: City Fresh Foods. Run by two young African-American brothers, the company provides African-American, Hispanic and Caribbean food to the Meals-on-Wheels program in the Roxbury/Dorchester area of Boston, a low- and moderate-income area in the inner-city "that had no investment in the last 20 years." [6] The ethnic meals were in demand and needed because the typical menus were too bland, and the elderly and disabled who relied on Meals-on-Wheels were not eating their food. In spite of the market demand, the company had lost money in every one of its three years of existence. It was faced with shutting down or getting more financing. After Boston Community Venture Fund invested in City Fresh and started providing the owners with management assistance, the company developed a positive cash flow in about six months and was a year ahead of schedule at the time of the Committee's Roundtable. In addition to providing a needed service, City Fresh Foods has created more than 20 jobs. It also hires from the community, pays its employees from $8 to $16 per hour, and offers training and opportunity for employees to move from entry-level jobs to supervisory positions.

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[6] Ms. Elyse Cherry, transcript of the May 12, 1999, Roundtable, "SBA's SBIC and Microloan Programs." Page 18, line 6.

S. 1594 as reported authorizes the SBA to make matching grants to new markets venture capital companies (NMVCs) and specialized small business investment companies (SSBICs), licensed under Section 301(d) of the Small Business Investment Act, so that they can provide technical assistance to prospective and financed portfolio companies. Though the legislation does allow SSBICs to use these funds to provide technical assistance to small businesses at the pre- and post-investment stages, priority should be given for LMI investments that are already financed (post-investment). The Committee wants to stress that SSBICs cannot use these matching TA grants for any investments they have made prior to implementation of this legislation.

S. 1594 also authorizes the SBA to guarantee debentures issued by the NMVCs. The debentures leverage the private capital that NMVCs raise and enable NMVCs to make venture capital investments in small businesses located in low-income urban areas and low- and moderate-income rural areas.

In order to participate in the program, a New Markets Venture Capital Company must be a newly formed, for-profit entity. It must have demonstrated management expertise in community development venture capital. It must have raised a minimum of $5 million in private capital. Generally, it must have obtained matching fund commitments for each dollar of technical assistance (TA) to be used over a five- to ten-year period. TA matching grants will be provided to an NMVC in an amount equal to 30 percent ($1.5 million) of the $5 million it raised in private funds. If an NMVC cannot raise the TA matching contribution up front, the legislation permits the SBA to issue a TA grant if an NMVC has a plan for (1) how it will match the TA grant money, and (2) the NMVC has already raised 20 percent of the required match. Lastly, an NMVC applicant must have developed a plan and operational structure that focuses investments in low-income areas, illustrating that it is mission-driven. This last provision is important because it is a safeguard against NMVC companies that might take advantage of the program.

This bill authorizes the SBA to match up to 1½ times an NMVC company's private capital through guarantees of debentures, called Low-Income Debentures (LIDs). An NMVC company will not be required to make interest payments on an LID for five years. This deferred interest feature, similar to the LMI debenture available under the SBIC program, is designed to encourage the NMVC companies to make patient investments in smaller enterprises located in low-income geographic areas. This type of patient funding, sometimes referred to as an "equity-type" investment, will allow an NMVC company to nurture the development of a smaller enterprise for long-term success and help the NMVC company to obtain a reasonable return on its investment.

While an NMVC will not be required to make interest payments on an LID for five years, it will be charged interest. The accumulating interest is built into the LID, which discounts (reduces) the face value of the LID from a 1½ match ($7.5 million) to a net cash value of a one-to-one match ($5 million). For example, under S. 1594, an NMVC company is required to raise a minimum of $5 million in private capital. The SBA will match that private capital through the guarantee of a LID, up to 1½ times, or $7.5 million.

However, assuming an 8 percent interest rate on that $7.5 million for five years, the net proceeds (cash value) of that LID then would be approximately $5 million, same as the amount of private capital raised by the NMVC company. That one-to-one match gives the NMVC a total portfolio of $10 million to invest.

While the Administrator is authorized to issue and guarantee trust certificates of these LID debentures, Federal securities laws still apply. The Committee wants to make clear that nothing in this legislation is intended to undermine the authority of the Securities and Exchange Commission.

The reported legislation provides many protections to maximize the chances of NMVC funds succeeding financially and having a significant impact on their communities. The structure of NMVC companies comes from the experience of existing CDVCs and current research. It also draws upon the lessons learned by the SBA from administering the SBIC and SSBIC programs. Accordingly, this bill sets a minimum fund size of $5 million in order for an organization to qualify for SBA leverage. It requires NMVC companies to have qualified and experienced management. It reduces the potential leverage that NMVC funds can draw upon, to a 1 to 1½ ratio. And, like the SBIC program, NMVC funds lose all of their capital before any government guaranteed funds are placed at risk. As reported, S. 1594 also prevents an NMVC company from filing for bankruptcy to guarantee that NMVC companies repay any federal financial assistance it receives under the new markets venture capital program.

Restricting investments in urban communities to low-income areas

At the markup, the Committee Chairman Bond expressed concern that the program benefit only businesses located in low-income (LI) areas, rather than low- and moderate-income (LMI) areas. By unanimous consent, the Committee adopted the Chairman's amendment to change the geographic investment areas for urban areas from low- and moderate-income areas to only low-income areas. The amendment did not change the criteria for defining rural areas in which NMVC companies may invest.

Targeting twenty-five percent of the debentures to HUBZone areas

The Chairman offered an amendment at the markup requiring new markets venture capital companies to invest 25 percent of the money raised through SBA-backed debentures in small companies that are located in Historically Underutilized Business Zones (HUBZones). The Committee created the HUBZone program as part of the SBA Reauthorization of 1997 (PL 105–135). The Committee unanimously adopted the amendment.

Title II—The Community Development Venture Capital Assistance Program

S. 1594 authorizes the SBA to establish the Community Development Venture Capital Assistance Program. The purpose is to promote the growth of the field of community development venture capital through training, technical assistance, knowledge sharing and the expansion of best practices among venture funds. Existing community development venture capital companies have emphasized to the Committee that capacity-building is especially important in areas not currently served by the active CDVCs. There are many states and communities where there is an urgent need for equity investments that will result in the creation of jobs, wealth and opportunities for low-income people, but where there may not yet be a venture fund with the capacity to become a New Markets Venture Capital company. Initially, this title has the potential to help the venture capital program for low-income areas.

The need is clear. The Community Development Venture Capital funds across the country have a proven track record in making smart, responsible investments in small businesses in their communities, but the capital needs of firms in economically distressed areas far outweigh the existing capacity of these organizations. Compared to the more than 1,143 traditional and SBIC venture capital firms in the U.S., only 26 funds nationwide currently concentrate on investing in companies that show promise of financial and social returns. The industry needs more community development venture capital funds to reach more of these underserved communities. The bill authorizes $20 million total in program level over four years (FY2000–2003).

First, the Community Development Venture Capital Assistance program would authorize at least $15 million for SBA grants to private, nonprofit organizations with expertise in making venture capital investments in poor communities. These organizations would use these grants to provide hands-on technical assistance to spawn and develop new and emerging CDVC or NMVC companies. The intermediary organizations would match the grants dollar for dollar with non-Federal sources.

Second, this program would provide up to $5 million in SBA grants to colleges, universities, and other firms or organizations—public or private—to create and operate training and intern programs, organize a national conference, and fund academic research and studies dealing with community development venture capital.

Senator Wellstone originally introduced this legislation during the 105th Congress as an amendment to H.R. 3412, the Small Business Investment Company Technical Corrections Act of 1998. It passed both the Senate Committee on Small Business and the full Senate, but the House did not get to act on the bill before the Congress adjourned so it was not enacted. Senator Wellstone reintroduced this legislation this Congress as S. 619 on March 15, 1999. His bill has been incorporated as Title II of S. 1594.

Title III—BusinessLINC

This legislation amends the Small Business Act to authorize matching grants for BusinessLINC, a program which links large businesses with small business owners. The Administrator of the Small Business Administration is authorized to make grants to and enter into participation agreements with coalitions of public and private-sector participants to promote, expand and facilitate mentor-protege relationships in low-income areas and provide the additional money needed to identify existing and potential small businesses for linkage to appropriate larger businesses.

BusinessLINC builds upon an already successful public-private partnership that began June 5, 1998 between the U.S. Small Business Administration (SBA), the U.S. Department of the Treasury, and the private business sector. The Business Learning, Investment, Networking, and Collaboration (LINC) initiative was formed to encourage the linkage of large businesses to small businesses, enhancing the economic vitality and competitive capacity of small businesses located in economically distressed urban and rural areas.

The Committee authorizes $6.6 million per year for BusinessLINC grants for six years, from FY2000–2005.

Authorization levels

For the New Markets Venture Capital Program, this amended legislation authorizes a total of program level of $150 million for debentures and a total of $30 million for technical assistance matching grants for fiscal years 2000 though 2005. For the Community Development Venture Capital Assistance Program, this bill authorizes a total of $20 million for fiscal years 2000 though 2003. For BusinessLINC, this bill authorizes $6.6 million annually for fiscal years 2000 though 2005. The amounts for all three programs shall remain available until expended.

III. COMMITTEE VOTE

In compliance with rule XXVI(7)(b) of the Standing Rules of the Senate, the following votes were recorded on July 26, 2000. A motion by Senator Kerry to adopt the substitute amendment by Senator Kerry passed by unanimous voice vote. A motion by Senator Kerry to adopt two amendments by Senator Bond concerning investments in low-income urban areas and the percentage of investments to be made in HUBZone areas passed by unanimous voice vote. A motion by Senator Bond to adopt the "Community Development Venture Capital Act of 1999," as amended, was approved by a 16–1 recorded vote, with the following Senators voting in the affirmative: Bond, Kerry, Burns, Bennett, Snowe, Enzi, Fitzgerald, Crapo, Abraham, Levin, Harkin, Lieberman, Wellstone, Cleland, Landrieu and Edwards. Voting in the negative: Senator Voinovich.

IV. EVALUATION OF REGULATORY IMPACT

In compliance with rule XXVI(11)(b) of the Standing Rules of the Senate, it is the opinion of the Committee that no significant additional regulatory impact will be incurred in carrying out the provisions of this legislation. There will be no additional impact on the personal privacy of companies or individuals who utilize the services provided.

V. COST ESTIMATE

In compliance with rule XXVI(11)(a)(1) of the Standing Rules of the Senate, the Committee estimates the cost of the legislation will be less than the amounts indicated by the Congressional Budget Office (CBO) in the following letter. CBO estimates a subsidy rate of 20 percent for the New Markets Venture Capital program. However, as part of its responsibilities under the Credit Reform Act of 1990, the Office of Management and Budget (OMB) estimates a subsidy rate of 14.44 percent for the program for FY2001.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

S. 1594—Community Development and Venture Capital Act of 2000

Summary: S. 1594 would authorize appropriations for fiscal years 2000 through 2005 for the New Markets Venture Capital (NMVC) program within the Small Business Administration (SBA). This program would provide federal loan guarantees to venture capital corporations that invest in small businesses located in low-income communities. The bill also would establish a program—the community Development Venture Capital program—to provide training and assistance to venture capital companies that promote community development. Finally, S. 1594 would authorize appropriations for the BusinessLINC program, also within SBA. This program would promote relationships between large and small businesses.

CBO estimates that implementing S. 1594 would cost a total of $104 million over the 2001–2005 period, assuming appropriation of the necessary amounts. Because S. 1594 would not affect direct spending or receipts, pay-as-you-go procedures would not apply.

S. 1594 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the cost of the mandate would not be significant. The bill contains no new private-sector mandates.

Estimated cost to the Federal Government: For this estimate, CBO assumes that S. 1594 will be enacted near the start of fiscal year 2001 and that funds will be provided for its implementation each year. The estimated budgetary impact of S. 1594 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By fiscal year, in millions of dollars					
	2000	2001	2002	2003	2004	2005
SPENDING SUBJECT TO APPROPRIATION						
Spending for NMVC and business LINC:						
Under current law:						
Budget authority [1]	11	0	0	0	0	0
Estimated outlays	4	5	2	[2]	0	0
Proposed Changes:						
Estimated authorization level	0	35	34	18	12	12
Estimated outlays	0	20	31	24	16	13
Spending under S. 1594:						
Estimated authorization level [1]	11	35	34	18	12	12
Estimated outlays	4	25	33	24	16	13

[1] The 2000 level is the amount appropriated for that year. It includes $9 million for NMVC technical assistance and $2 million for Business LINC assistance. In addition, Public Law 106–113 had earmarked $6 million for the subsidy cost of NMVC loan guarantees; but Public Law 106–259 (enacted August 9, 2000) repealed that earmark.

[2] Less than $500,000.

Basis of estimate

S. 1594 would authorize appropriations for three programs within SBA. Based on historical spending patterns of similar programs, CBO estimates implementing the New Markets Venture Capital program would cost $54 million, the Community Development Venture Capital program would cost $20 million, and the BusinessLINC program would cost $30 million.

New markets venture capital

S. 1594 would authorize the NMVC programs for six years (fiscal years 2000 through 2005), with appropriations limited to $30 million for technical assistance grants and such sums as necessary to subsidize and administer up to $150 million in NMVC loan guarantees. For this estimate, CBO assumes SBA would guarantee 100 percent of any loans under this program.

CBO estimates that S. 1594 would authorize the appropriation of an additional $56 million over the 2001–2005 period for the NMVC program. This cost reflects the difference between the total amounts authorized in the bill and the $9 million appropriated for the current year.

Specifically, S. 1594 would authorize the appropriation of up to $30 million over the 2000–2005 period for technical assistance, which is $21 million more than has been appropriated for fiscal year 2000. In addition, CBO estimates that it would cost about $30 million to subsidize $150 million in NMVC loan guarantees. Finally, experience with other SBA programs suggests that it would cost an average of about $1 million a year to administer the program, net of any examination fees paid by borrowers.

CBO estimates that the subsidy cost of the NMVC program would be about 20 percent of the amount guaranteed. This estimate is based on trends in defaults and recoveries for similar SBA programs and on information regarding the likely terms and conditions of the guarantees. Experience with other programs suggests that NMVC borrowers would default on about 45 percent of guaranteed loans. In the event of a default, CBO expects that the agency would liquidate the NMVC investments and that recoveries would average about 50 percent of the loan balance three years after default. Based on information from the Office of Management and Budget, we assume that SBA would allow borrowers a grace period of five years during which they would not pay interest; instead, such interest would be added to the outstanding debt. Because S. 1594 would authorize SBA to guarantee up to $150 million of loans, we estimate that this program would require the appropriation of about $30 million for credit subsidies.

Community development venture capital

S. 1594 would authorize the Community Development Venture Capital program for four years (fiscal years 2000 through 2003), with appropriations limited to $20 million for grants and contracts to provide technical assistance. Based on the spending patterns of similar programs, CBO estimates that outlays for this program would total about $20 million over the 2001–2005 period.

BusinessLINC

S. 1594 would authorize appropriations of $6.6 million each year over the 2001–2005 period to promote relationships between large and small businesses. Based on the spending patterns of SBA's other grant and assistance programs. CBO estimates that outlays for this program would be $30 million over the 2001–2005.

Pay-as-you-go considerations: None.

Impact on state, local, and tribal governments: Title I would preempt state laws by prohibiting them from limiting the Administration's ability to exercise its ownership rights in certain debentures issue by a new markets venture capital company. Such a preemption of state law is an intergovernmental mandate as defined by UMRA, but CBO estimates that the mandate would impose no significant costs on state, local, or tribal governments.

Impact on the private sector: S. 1594 contains no new private-sector mandates as defined by UMRA.

Previous CBO estimates: This estimate differs from previous estimates of related legislation because of a change in the amounts being spent under current law. CBO's previous estimates included $6 million that was appropriated in 2000 for the subsidy cost of NMVC loans. The Department of Defense Appropriations Act, 2001 (Public Law 106–259, enacted on August 9, 2000) allows SBA to spend such funds on other loan programs. CBO transmitted three related estimates prior to this change in law.

On August 4, 2000, CBO transmitted a cost estimate for S. 1594, the Community Development and Venture Capital Act of 2000, as ordered reported by the Senate Committee on Small Business on July 26, 2000. That version of the bill would authorize the BusinessLINC program only through fiscal year 2003. CBO estimated that implementing S. 1594, as ordered reported, would cost total of $87 million over the 2001–2005 period.

On June 26, 2000, CBO transmitted a cost estimate for H.R. 2848, the New Markets Initiative Act of 1999, as ordered reported by the House Committee on Banking and Financial Services on April 13, 2000. H.R. 2848 would authorize loan guarantees under the NMVC program of up to $100 million and technical assistance to borrowers. CBO estimated those provisions would cost $40 million over the 2001–2005 period.

On July 16, 2000, CBO transmitted a cost estimate for H.R. 4530, the New Markets Venture Capital Program Act of 2000, as ordered reported by the House Committee on Small Business on May 25, 2000. S. 1594 would authorize loan guarantees under the NMVC program of up to $150 million and technical assistance to borrowers. CBO estimated that implementing H.R. 4530 would cost $47 million over the 2001–2005 period.

Estimated prepared by: Federal Costs: Mark Hadley; Impact on State, Local, and Tribal Governments: Victoria Heid Hall; and Impact on the Private Sector: Lauren Marks.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

VI. SECTION-BY-SECTION

Section 1. Short title

The title of the bill is "The Community Development and Venture Capital Act of 2000."

Title I—New Markets Venture Capital Program

Sec. 101. New Markets Venture Capital Program

This section amends Title III of the Small Business Investment Act of 1958 to establish the New Markets Venture Capital Program, a mission-driven venture capital program designed to attract investment capital and business expertise to smaller businesses in new markets. New markets are low-income urban and rural areas of the country where entrepreneurs have experienced barriers to the marketplace and there is little to attract investors. At the same time, these areas need so much, there are significant opportunities.

Subsection 351. Definitions

This subsection sets forth the definitions for the terms used in the legislation.

Subsection 352. Purposes

The purpose of the New Markets Venture Capital program is to encourage venture capital investment in smaller businesses located in urban and rural areas; to promote the creation of wealth, economic development, and job opportunities in low-income areas; and to establish a venture capital program at the Small Business Administration, separate from its Small Business Investment Company (SBIC) venture capital program, that focuses on economic development.

Subsection 353. Establishment

This subsection establishes the new markets venture capital program, which authorizes the SBA to (1) make grants to new markets venture capital (NMVC) companies and Specialized Small Business Investment Companies (SSBICs) so that they can provide technical assistance to prospective and financed portfolio companies, and (2) to guarantee the debentures issued by NMVCs to enable such companies to make venture capital investments in low-income areas.

Subsection 354. Selection of NMVC companies

This subsection sets forth the criteria the SBA must follow in selecting NMVC companies. The criteria is designed to ensure that selected NMVC companies are fiscally sound, well-managed, and experienced to identify and make responsible, successful community development venture capital investments that will benefit low-income communities and the investors. The Committee expects the SBA to select NMVC companies that have a primary objective of economic development of low-income geographic areas, particularly in regard to quality job creation for the people who live in the area.

In order to participate in the program, NMVC companies must satisfy the following requirements:

(1) Each NMVC company must be a newly formed, for-profit entity.

(2) Each NMVC company's management team must have demonstrated experience in making venture capital investments in smaller companies that result in creating jobs and promoting economic development in the community.

(3) Each NMVC company must provide a plan that concentrates its activities on serving the eligible investment areas, and submit a proposal that will expand economic opportunities and address the unmet capital needs within the eligible areas.

(4) Each applicant must submit a proposal describing how it will provide marketing, management and technical assistance to smaller companies expected to be financed by the NMVC.

(5) Each NMVC company must raise at least $5 million of contributed capital or binding capital commitments from non-Federal investors, which SBA will match with guarantees.

(6) Each NMVC company must obtain matching fund commitments, cash or in-kind, from non-SBA sources, for marketing, management and technical assistance equal to 30 percent of the $5 million ($1.5 million) in funds it raises. SBA matches the money dollar-for-dollar.

There is an exception for the technical assistance matching requirements. The Committee understands that it may be difficult for some NMVC companies to raise their entire 30–percent match during the application stage. In those circumstances, the Administrator may approve an NMVC company if it has a viable plan to raise the $1.5 million in cash or in-kind and has binding commitments for at least 20 percent of that $1.5 million on hand.

(7) Each NMVC must make at least 80 percent of its investments in low-income geographic areas. In order for an investment to be counted toward the 80% goal under this legislation, the investment must be made in a small business concern located in a low-income area. This ensures that the New Markets Venture Capital Company Program will focus investment capital where it is most needed, rather than duplicating SBA's existing venture capital program, the Small Business Investment Company program.

It is also the Committee's view that by investing the majority of funds in low-income communities, we will not only provide the benefit of increased job opportunities for people who live in the area, but also provide the benefit of improving the physical community. This double benefit ensures that the resources spent under S. 1594 will provide the maximum economic impact on the low-income communities to which this bill is targeted.

In addition to the criteria outlined above, this legislation requires the SBA to consider geographic distribution of applicants when selecting NMVC companies. The Committee expects the SBA to select qualified NMVC companies that are located in different areas around the country, to the extent possible, so that the program is not concentrated in one or two regions.

Subsection 355. Technical assistance grants

Under the New Markets Venture Capital Program, the SBA is authorized to make technical assistance (TA) grants to NMVC companies established under this legislation and to certain Specialized Small Business Investment Companies (SSBICs). However, the conditions are different.

NMVC companies are eligible for one or more grants equal up to 30 percent of the $5 million in capital and commitments that they must raise for investment capital. They must match their grant funds dollar for dollar, and they can use the funds to provide marketing, management and technical assistance to small businesses pre- and post-investment, meaning small businesses that have already been financed or are expected to be financed through this program. The grant funds will be made available to NMVCs over a multi-year period not to exceed 10 years.

SSBICs are also eligible for TA grant funds. They are eligible without entering into a participation agreement with SBA to act as an NMVC company, but they must submit a plan to SBA explaining how the funds will be used. The participation of the SSBICs is limited only to investments they make in low-income areas after the date of enactment, and the grant amount is limited to 30 percent of those investments. Like NMVC companies, SSBICs must match the grant funds dollar for dollar, the grant funds will be made available over a multi-year period not to exceed 10 years, and they can use the funds to provide marketing, management and technical assistance to small businesses pre- and post-investment.

Though the legislation does allow SSBICs to use these funds to provide technical assistance to small businesses pre- and post-investment, priority will be given for low-income investments that are ultimately financed. The Committee wants to emphasize that SSBICs cannot use matching TA grant funds for any investments they have made prior to implementation of this legislation.

This legislation also authorizes SBA to make supplemental grants. They are for NMVC companies and SSBICs to provide extra technical assistance to the smaller enterprises that they finance. These grants must also be matched one for one. The purpose of supplemental grants is to provide an extra incentive for NMVC companies and SSBICs to invest in small companies that have potential but are more time-consuming and thus more expensive to manage.

The Program limits the use of grant funds to marketing, management and technical assistance to smaller enterprises financed by NMVC companies and SSBICs. The purpose of this limitation is to ensure that NMVC companies and SSBICs do not use the funds to support other business costs and projects.

Subsection 356. Debentures

S. 1594 authorizes the SBA to guarantee debentures that NMVCs issue to raise capital for equity and equity-type investments. The term cannot exceed 15 years, and the debentures are subject to the interest rate and terms approved by the Administrator. Interest payments will be deferred on these debentures for the first five years of their term. To protect taxpayer investment in NMVCs, the total face value of debentures cannot exceed 150 percent of the NMVC's private capital.

This legislation also requires that 25 percent of the proceeds from debentures be invested in smaller enterprises located in HUBZones (Historically Underutilized Business Zones). The Committee created the HUBZone program as part of the SBA Reauthorization of 1997 (PL 105–135). The Committee notes that the HUBZone definition for eligible inner city census tracts and nonmetropolitan counties is a comprehensive definition that includes more than 7,000 metropolitan census tracts, more than 900 nonmetropolitan counties, 527 Native American reservations and Native Alaskan villages.

Subsection 357. Issuance and guarantee of trust certificates

This subsection authorizes the SBA to issue and guarantee trust certificates representing ownership of all or part of the debentures issued by an NMVC company and guaranteed by the Administration. Each guarantee issued under this section is limited to the amount of the principal and interest on the guaranteed debentures that compose the trust or pool of certificates. This section grants SBA subrogation and ownership rights over the trust certificates guaranteed under this section, but the SBA is prohibited from collecting a fee for any guarantee of a trust certificate issued under this section. Finally, this section allows SBA to contract with an agent to carry out the pooling and central registration functions for the trust certificates issued.

While the Administrator is authorized to issue and guarantee trust certificates of these debentures, Federal securities laws still apply. The Committee wants to make clear that nothing in this legislation is intended to undermine the authority of the Securities and Exchange Commission.

Subsection 358. Fees

This subsection authorizes SBA to charge such fees as it deems appropriate with respect to any guarantee or grant issued to an NMVC company. This authorization is subject to the prohibition contained in Subsection 357 that prohibits SBA from collecting a fee for any guarantee of a trust certificate issued under that section.

Subsection 359. Bank participation

This subsection allows any national bank, and any member bank of the Federal Reserve System, to invest in an NMVC company formed under this legislation so long as the investment does not exceed 5 percent of the capital and surplus of the bank.

Banks that are not members of the federal Reserve system are allowed to invest in an NMVC company formed under this legislation so long as such investment is allowed under applicable State law, and so long as the investment would not exceed 5 percent of the capital and surplus of the bank.

Subsection 360. Federal financing bank

This subsection establishes that Section 318 of the Small Business Investment Act does not apply to any NMVC company created under this legislation.

Subsection 361. Reporting requirements

Under this legislation, NMVC companies are required to provide to SBA such information as the Administration requires, including: information related to the measurement criteria that the NMVC company proposed in its program application; and, for each case in which an NMVC company makes an investment or a grant to a business located outside of a low-income area, a report on the number and percentage of employees of the business who reside in an low-income area.

Subsection 362. Examinations

This subsection requires that each NMVC company shall be subject to examinations made at the direction of the Investment Division of SBA. This section allows for examinations to be conducted with the assistance of a private sector entity that has both the necessary qualifications and expertise. It is the intent of the Committee that the oversight of the NMVC program be modeled after that developed for the SBIC program and administered by the SBA's Investment Division. Oversight should include a close working relationship between the SBA analysts and NMVC management teams, detailed reporting requirements, frequent on-site examinations to evaluate performance and conformance with the operating plan, and careful analysis of the firm's economic impact.

Subsection 363. Injunctions and Other Orders

This subsection grants SBA the power of injunction over NMVC companies and the authority to act as a trustee or receiver of a company if appointed by a court. This section of the legislation closely tracks the existing injunction provision (Section 311) of the Small Business Investment Act of 1958. It is the Committee's intent that oversight of the NMVC program be modeled after that developed for the SBIC program and administered by SBA's Investment Division.

Subsection 364. Unlawful Acts and Omissions; Breach of Fiduciary Duty

This subsection defines what is to be considered as a violation of this legislation, who is considered to have a fiduciary duty, and who is ineligible to serve as an officer, director, or employee of any NMVC company because of unlawful acts. It closely tracks the unlawful acts provision (Section 314) of the Small Business Investment Act of 1958. It is the Committee's intent to grant SBA the same authority over NMVC companies that it has over Small Business Investment Companies with respect to unlawful acts and the breach of fiduciary responsibility. This subsection also grants the SBA the authority to use the procedures set forth in Section 313 of the Small Business Investment Act of 1958 to remove or suspend any director or officer of an NMVC. company.

Subsection 365. Regulations

This subsection authorizes the SBA to issue such regulations as it deems necessary to carry out the provisions of this legislation.

Subsection 366. Authorizations

This subsection authorizes a program level of $150 million for SBA-guaranteed debentures and $30 million for matching technical assistance grants.

Sec. 102. Bankruptcy exemption for NMVC companies

This section prohibits NMVC companies from filing for protection under bankruptcy laws. The purpose of this section is to guarantee that NMVC companies repay any federal financial assistance it receives under the new markets venture capital program.

Sec. 103. Federal savings associations

This section amends the Home Owners' Loan Act to allow a federal savings association to invest directly in new markets venture capital companies instead of forming a service subsidiary to make the investments. It also limits investment to five percent of a thrift's capital and surplus. The purpose of this section is to put thrifts on even footing with national banks in making these types of investments.

Title II—Community Development Venture Capital Assistance

Sec. 201. Findings

This section sets forth Congressional findings on the value of community development venture capital and the need to expand the number of professionals and organizations experienced to do this type of specialized investing.

Sec. 202. Community development venture capital activites

This section amends the Small Business Act to establish a one-to-one matching grant program to increase the number and expertise of community development venture capital funds (CDVCs) around the country, such as new markets venture capital companies. It also provides grant money to colleges, universities, and other firms or organizations—public or private—to increase training and research.

Subsection (a) sets forth the definitions of a Community Development Venture Capital Organization, a Developmental Organization, and an Intermediary Organization.

Subsection (b) sets forth the authority given to the Administrator of the Small Business Administration to carry out this program. (1) It gives the Administrator the authority to enter into contracts with one or more organizations that either research community development venture capital or develop specialized venture capital professionals and organizations. (2) It gives the Administrator the authority to make grants to developmental organizations to carry out training and research activities related to community development venture capital, and grants to intermediary organizations to provide marketing, management and technical assistance to community develoment venture capital organizations.

Subsection (c) sets forth the four training and research activities for which a developmental organization can use a grant. (1) It can be used to strengthen the professional skills of individuals in or operating a CDVC by creating training programs. (2) It can be used to increase interest in community development venture capital by creating a program to place students and graduates as interns in CDVCs or internmediary organizations for one year with a stipend. (3) It can be used to promote best practices by organizing and funding a national conference for CDVCs to share information regarding starting and operating CDVCs. And (4), it can be used for mobilizing academic resources by encouraging graduate schools to form centers that study community development venture capital; providing funding for the development of related materials for courses; and providing funding for research on community development venture capital.

Subsection (c) limits to 25 percent the amount of grant money that can be used for the aforementioned training and research activities.

Subsection (d) clarifies that an intermediary organization that receives a grant under this section must use that money to provide intensive marketing, management and technical assistance and training to promote the development of community development venture capital organizations. It further clarifies that the grant money can be used for the start-up and operating costs of new CDVCs.

Subsection (e) sets forth the conditions of receiving a grant. An intermediary organization must provide a one-to-one match of non-federal money in order to receive a grant.

Subsection (f) authorizes a total of $20 million for fiscal years 2000 through 2003 to carry out the provisions of the Community Development Venture Capital Capacity Building and Professional Development Act.

Title III—BusinessLINC

Sec. 301. Grants authorized

This section amends the Small Business Act to authorize matching grants for BusinessLINC, a program which links large businesses with small business owners. The Administrator of the Small Business Administration is authorized to make grants to and enter into participation agreements with a coalition of public and private-sector participants that will expand business-to-business relationships between large and small businesses and provide businesses with information about companies that are interested in mentor-protege programs. Grants require a one-to-one match in cash or in-kind, unless the Administrator waives the requirement.

This section authorizes $6.6 million per year for BusinessLINC grants for six years, from FY2000–2005.

Sec. 302. Regulations

This section requires the Administrator to issue program regulations.

VII. CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirement of rule XXVI(12) of the Standing Rules of the Senate in order to expedite the business of the Senate.

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