

REVISED--UPDATED AS OF 4/17/01

PRELIMINARY OVERVIEW

The New Markets Venture Capital Program

New Markets Venture Capital Program

Low-income communities in the United States face multiple and varied barriers to sustainable growth. A common obstacle for virtually all such communities is that they are unable to attract sufficient equity capital and technical assistance for starting and expanding businesses. Federal Reserve Board Chairman Alan Greenspan has observed that equity capital is crucial to the existence of an innovative and productive business community, especially in lower-income areas. Yet such communities do not have access to private equity-type capital.

In December 2000, to address the unmet equity needs of low-income communities, Congress passed and President Clinton signed into law legislation creating the New Markets Venture Capital (NMVC) Program. Congress also appropriated FY2001 funding of \$150 million for debenture guarantees and \$30 million for operational assistance grants to supplement the private capital that is raised by NMVC companies. The U.S. Small Business Administration (SBA) will administer the program.

New Markets Venture Capital companies will be newly formed, for-profit investment funds with private management. Their objective will be to promote economic development and the creation of wealth and job opportunities in low-income geographic areas and among individuals living in such areas. NMVC companies will pursue this objective by making equity-type investments in smaller enterprises located in low-income geographic areas.

Obtaining New Markets Venture Capital Designation

The NMVC program is modeled on the SBA's very successful Small Business Investment Company (SBIC) program. Unlike the SBIC program, however, the SBA will not license NMVC companies. Instead, the SBA will designate and enter into a participation agreement with each NMVC company that details, among other things, the specific low-income areas that it will serve, how it will serve them, what results it expects to achieve, and how its success will be measured.

Individuals interested in forming a New Markets Venture Capital company can apply for this designation by submitting to SBA an application that provides information about

- their proposed business plan and management team,
- the need for developmental venture capital investments in the geographic areas in which they intend to invest;
- the extent to which they will concentrate their activities on serving these areas;
- the anticipated impact of their activities on economic opportunities in these areas,
- their plan for providing operational assistance to their portfolio companies, and
- their ability to raise the required minimum investment capital and operational assistance funding.

The actual form of Application and associated Exhibits can be found on the SBA Investment Division internet homepage at <http://www.sba.gov/inv>

The SBA will select NMVC companies for initial "conditional" approval after considering this information, the availability of appropriated funding, and the need to ensure that the benefits of the program are distributed nationally and in both urban and rural areas.

The conditionally approved NMVC companies must raise a minimum of \$5 million of private capital for investments. This capital cannot come from agencies or departments of the Federal Government. Binding capital commitments from investors meeting criteria established by SBA will qualify as private capital.

The conditionally approved NMVC companies also will need to raise matching resources to be used to provide operational assistance to their portfolio companies. NMVC companies must raise these resources to match, on a dollar-for-dollar basis, the grant funds that they will receive from SBA. They can be in the form of cash or binding commitments obtained from any source other than SBA, or as in-kind contributions. The grant matching resources must equal at least 30 percent of the total private investment capital that the NMVC companies raise, or be used to purchase a multi-year annuity that pays over time an amount equal to at least 30 percent of capital, or a combination of the two. In-kind contributions may not exceed 50 percent of the total contributions.

Under special circumstances in approving a NMVC company, SBA may accept binding commitments for operational assistance matching resources equal to at least 20% of the required minimum if the company has a viable plan to raise the balance. In no case, however, will SBA disburse grant funds for operational assistance in excess of the amount actually raised, including in-kind contributions.

The statute creating the NMVC program provides that a conditionally approved applicant may have up to two years to raise its required private capital and grant matching resources. However, it will be necessary in 2001 for the NMVC company to have raised its grant matching resources by August 15, 2001 and its capital by September 14, so that SBA is able to commit its currently appropriated operational assistance and leverage funding by September 30, 2001.

If the conditionally approved NMVC company meets these requirements and enters into a participation agreement with the SBA, it will be designated a New Markets Venture Capital company. If it fails to meet these requirements within the required time periods specified by SBA, SBA's conditional approval will expire.

Matching Funding for New Markets Venture Capital Companies

The SBA will provide NMVC companies with matching investment funds in the form of SBA-guaranteed deferred payment debentures, and matching operational assistance funding in the form of grants. The debentures can equal up to 150 percent of the total investment capital raised by the NMVC company. They will be issued at a discount equal to the first five years' interest to eliminate the need for the NMVC company to make payments during that period. For example, a \$10,000,000 debenture at a rate of 7% would provide \$6,890,158.50 at issuance.

SBA will guarantee and market the debentures for the NMVC companies. They will have a 10-year maturity, with no payments required during the first five years and semi-annual payments of interest on the face amount required during years six to ten. The face amount will be payable in full at maturity. Thus, the 10-year \$10,000,000 debenture at 7% would have no payments for the first 5 years, semi-annual interest payments of \$350,000 in years 6 to 10, and a balloon principal payment of \$10,000,000 at the end of year 10.

Disbursement of matching operational assistance grants generally will be spread over a 4.75 year period, and may not be used for any overhead or general and administrative expenses of the NMVC company.

New Markets Venture Capital Investment Criteria

At least 80 percent of the businesses receiving a NMVC company's investments must be *Smaller Enterprises* located in *Low-Income Geographic Areas*, and must have received *Equity Capital Investments*. In addition, SBA proposes that 80 percent of the investments a NMVC company makes (in total dollars) must be *Equity Capital Investments* in *Smaller Enterprises* located in *Low-Income Geographic Areas*.

Smaller Enterprises are defined by SBA regulations as companies with net annual after-tax profits not exceeding \$2 million for the previous 2 years, and net worth not exceeding \$6 million. Investments in larger companies are permitted if they qualify as *Smaller Enterprises* based upon employment or revenue criteria for their industry.

Low-Income Geographic Areas are defined by any of the following criteria:

- Any census tract or equivalent county division as defined by the Bureau of the Census of the U.S. Department of Commerce in which the poverty rate is 20 percent or more. Any census tract or equivalent county division defined by the Bureau of the Census that is located within a metropolitan area and in which 50 percent or more of the households in that tract or division have an income below 60 percent of the area median gross income (These locations correspond to those of the Low Income Housing Tax Credit)
- Any census tract or equivalent county division as defined by the Bureau of the Census that is not located in a metropolitan area and in which the median household income does not exceed 80 percent of the statewide median household income.
- Any area located within a HUBZone
- Any area located within an Urban Empowerment Zone or Urban Enterprise Community.
- Any area located within an Rural Empowerment Zone or Rural Enterprise Community.

Equity Capital Investments are common or preferred stock, or a similar instrument. They may include subordinated debt with equity features provided that the debt is not amortized and provides for interest payments contingent upon and limited to the extent of earnings.

The SBA's Role

A NMVC company's management will make all investment decisions, within the constraints of NMVC statutes, SBA regulations, and the terms of the NMVC's participation agreement. SBA's role will be essentially the same as with the Small Business Investment Company program. The Agency will select participants for the NMVC program, provide funding for their investments and operational assistance, and regulate their operations to ensure that public policy objectives are being met. SBA will require NMVC companies to provide regular performance reports and have annual financial examinations by SBA.

Possible Income Tax Benefits

An Investor in a New Markets Venture Capital company may be able to take advantage of a New Markets tax credit if the investment meets all of the requirements of the federal tax code. This would provide a credit against the investor's federal income taxes equal to 39 percent of the amount invested over a seven year period. More information on the tax credit will be available on

the U.S. Department of Treasury's Community Development Financial Institutions web site <http://www.treas.gov/cdfi>.

Next Steps to Forming a NMVC Company

This Overview is only a very general description of the program. If you think that you might be interested in forming a NMVC company, you should first read **all** of the information on the NMVC program at SBA's web site <http://www.sba.gov/inv> including the statute, regulations, Notice of Funds Availability, and the Application and its associated Exhibits. To participate in the program this year, you must file your application, along with a \$5,000 fee, by May 21, 2001. We expect to have selected the companies for conditional approvals by mid-July. You are also encouraged to contact the SBA Office of New Markets Venture Capital at 202/205-6510 or e-mail us at sbic@sba.gov.