COMMUNITY REINVESTMENT
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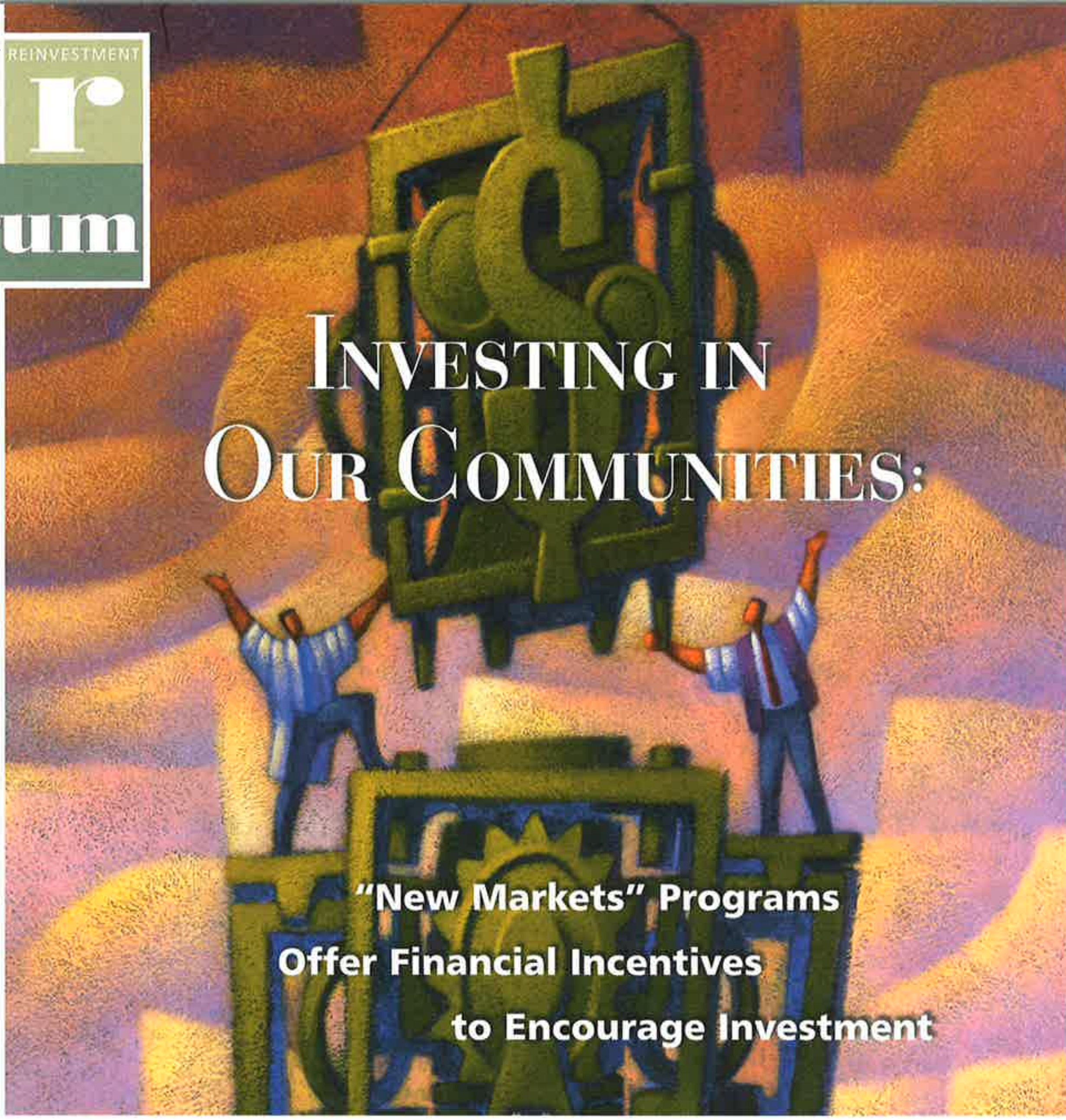
SUMMER | 2001 | PUBLISHED BY THE FEDERAL RESERVE BANK OF CLEVELAND



Investing in Our Communities:

"New Markets" Programs Offer Financial Incentives to Encourage Investment

In a flurry of activity late last year, Congress produced two pieces of legislation focusing on economic development in low-income communities. The legislation falls under the aegis of the New Markets Initiative, which was introduced by the Clinton administration in 1999 and includes two programs: The Treasury Department's New Markets Tax Credit program, and the Small Business Administration's New Markets Venture Capital program. Both efforts aim to encourage investment in America's economically distressed communities.

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AN EXCHANGE OF COMMUNITY DEVELOPMENT ISSUES AND IDEAS

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New Markets Tax Credit Program

On December 21, 2000, a bipartisan group from the Senate and House signed the Community Renewal Tax Relief Act of 2000. An important piece of this legislation—the New Markets Tax Credit—is expected to encourage the investment of billions of dollars in new private capital into community development entities (CDEs) that make loans and equity investments in New Markets businesses.

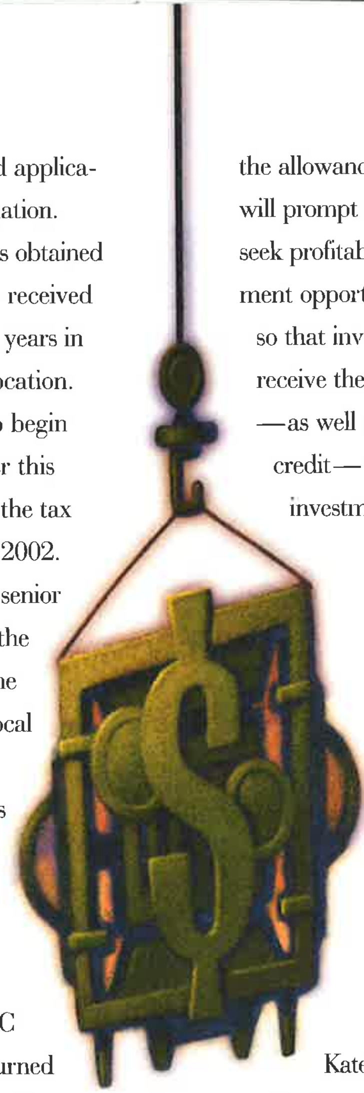
"The tax credits will help spur up to $15 billion of much-needed equity into underserved communities," says Matt Josephs, financial and program analyst at the Treasury Department's Community Development Financial Institutions (CDFI) Fund, which administers the tax credit program.

Under the New Markets Tax Credit program, corporate and individual investors may receive tax credits for making equity investments in eligible CDEs, defined in the legislation as organizations whose primary mission is to provide investment capital for urban and rural low-income communities. These may include community development financial institutions, community development corporations, New Markets Venture Capital companies, and specialized small business investment companies focused on low- and moderate-income areas.

Investors receive a tax credit equaling 39 percent of the investment amount, or approximately 30 percent in terms of net present value. The credit spans seven years, during which time investors receive 5 percent of their investment in each of the first three years and 6 percent in each of the following four years. In 2001, $1.0 billion in investments are eligible for New Markets Tax Credits; that figure will rise to $1.5 billion in 2002–2003, $2.0 billion in 2004–2005, and $3.5 billion in 2006–2007.

The CDFI Fund will award the New Markets Tax Credits on a competitive basis to eligible CDEs that apply for them. Organizations seeking the credits must be certified as CDEs by the CDFI Fund, according to the eligibility requirements outlined in the legislation. Small business investment companies and CDFIs are automatically eligible, though they must complete abbreviated applications for CDE designation.

Once an entity has obtained certification and has received its credits, it has five years in which to use the allocation. The Fund is likely to begin certifying CDEs later this year and will award the tax credit allocations in 2002.



India Pierce Lee, senior program director in the Cleveland office of the New York–based Local Initiatives Support Corporation, believes the tax credits are a good vehicle for getting businesses reinvested in neighborhoods. "Our CDC groups have really turned neighborhoods around in Cleveland," she says. "Now that we're attracting people back into neighborhoods, we want to attract business and shopping back into neighborhoods as well."

Lee is concerned with the program's impact on communities, considering the level of the credit allowance. "As we see how the program works, then perhaps the credit amount will be raised." Some believe the allowance amount will prompt CDEs to seek profitable investment opportunities, so that investors will receive the princpal—as well as the tax credit—from their investment.

Kate Monter Durban, director of the Enterprise Foundation's Cleveland office, says that organizations in Cleveland are considering how the tax credits could assist existing neighborhood development projects in the area. "We're not looking at creating new programs, but rather benefiting the programs already in existence," she says. "Our hope is that this will be an additional tool to continue to revitalize neighborhoods in Cleveland."

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A participant in the "Manchester Works" Pre-Apprentice Construction Training Program.

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Pittsburgh Neighborhood Group Facilitates Local Partnerships, Community Renewal

A visit to Pittsburgh's north-side Manchester neighborhood reveals fresh housing construction and renovation of historic buildings. This activity points to the ongoing efforts of individuals, organizations, and government to roll back the effects of a 40-year drop in income levels among Manchester residents and a steady population decline. This community of 3,100 is reaping the benefits of work that focuses on developing an appreciation for Manchester's historically rich architecture.

After rehabilitation, the historic Chatham Building will contain 15 units for senior citizens.

Behind the neighborhood's renewal is the Manchester Citizens Corporation (MCC), a community development organization with an annual budget of approximately half a million dollars that works on real estate development projects and promotes public–private partnerships. MCC has supported the Manchester community for 35 years by initiating or participating in programs to improve the quality of life for Manchester's citizens. In 1995, MCC was awarded a $7.5 million HOPE VI+ grant by the Department of Housing and Urban Development to help rehabilitate the community.

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Support group meetings for affordable-housing residents.

Like other community development corporations in the Pittsburgh area, MCC's staff has witnessed a change in funding priorities among foundations and the government since the mid-1990s. These groups are no longer focusing on the traditional brick-and-mortar development of the 1980s and early 1990s; rather, they are focusing on economic development and job creation. MCC's leadership has adapted to this change.

In 1997, MCC and its corporate sponsor, Duquesne Light Company, secured the first Neighborhood Assistance Program (NAP) partnership in Pittsburgh. The program, authorized by the state of Pennsylvania and administered by the Pennsylvania Department of Community and Economic Development (DCED), revitalizes impoverished communities by creating local partnerships between community-based organizations and the corporate community. Following MCC's 1998–99 project year, Duquesne left the program as a result of corporate restructuring, and Dollar Bank, with whom MCC had a prior working relationship, stepped in as MCC's partner.

The Neighborhood Assistance Program will provide MCC with key operating and programmatic support over 10 years. Its Comprehensive Service Program gives MCC the economic stimulus for a 10-year, Manchester-wide community revitalization plan for a range of services and assistance. Corporations participating in NAPs administered by DCED can contribute up to $250,000 per year over an extended period of time, and they are expected to participate in the development and implementation of community improvement projects. Corporations may claim up to 70 percent of the contribution as a tax credit with the Pennsylvania Department of Revenue.

"This program allows community groups to breathe more freely by providing funds to support their operating expenses," says Colin Kelley, MCC's program officer. The NAP/Comprehensive Service Program supports MCC's seven initiatives, which focus on homeownership, employment, community safety initiatives, and a 10-year revitalization plan. The NAP provides additional support for housing development for Manchester's HOPE VI+ project.

To qualify for DCED's program, organizations must serve low-income individuals or residents of economically distressed neighborhoods; MCC serves low-income individuals in the Manchester community. Kelley says that MCC's projects must address five categories identified by the NAP: community services, crime prevention, education, job training, and neighborhood assistance. The NAP requires MCC to report quarterly on how corporate contributions are used. This documentation confirms corporate contributors' right to the tax credit and indicates the money was used for its intended purpose.

Prior to 1997, only corporations and community-based organizations in the Philadelphia region had utilized the NAP. During that year, however, enough tax credits became available to make it possible for MCC to apply for the program. According to Kelley, the application process is extensive, requiring organizations to indicate how they would meet the NAP requirements. He recommends that "the organization have a community strategic plan in place before applying for the NAP, or at least have one in the making."

Kelley advises organizations interested in securing NAPs to ensure their capacity exists before beginning the NAP application process: "The organization can't complete the application, and then expect to create the organization's capacity after the grant has been awarded."

For more information about Manchester Citizens Corporation, contact Colin Kelley at 412/323-1743 or paddieboi@aol.com.

NAA Legislation Varies across Fourth District

The Neighborhood Assistance Act, first passed in Pennsylvania in 1967, encourages activities focusing on child care, job training and education, crime prevention, health and counseling services, physical revitalization of housing or buildings, and economic development.

Three programs exist under the umbrella of the act: The Neighborhood Assistance Program (NAP) links the private and nonprofit sectors by offering tax credits to businesses that contribute to projects run by state-approved nonprofit organizations. The NAP/Enterprise Zone, which complements the state Enterprise Zone program, allows businesses to receive tax credits on real property investments in designated enterprise zones. The NAP/Comprehensive Service Program provides tax credits to corporations that make a 10-year commitment to a single community- or neighborhood-based organization.

NAA legislation exists in 12 states (including Pennsylvania and West Virginia), according to Carol Wayman, policy director for the National Congress for Community Economic Development in Washington, D.C. Wayman says the legislation is authorized but not appropriated in two states and is pending in Ohio and four other states.

Together with the Cleveland Neighborhood Development Corporation and other organizations, the Columbus-based Ohio CDC Association has formed a coalition—the Ohio Community Development Policy Group—to define the elements of Ohio's NAP and determine the best way to present it to the public. Sen. Jeffry Armbruster (13th District) sponsored and introduced the NAP legislation, referred to as Senate bill 88, in November 2000. The legislation is currently under consideration in the Ohio Senate Ways and Means Committee.

For information about NAA legislation, contact Carol Wayman, National Congress for Community Economic Development, at 202/354-3909. For information about NAP legislation in Ohio, contact Patricia Barnes at the Ohio CDC Association (614/461-6392) or Robyn Roche at the Cleveland Neighborhood Development Corporation (216/928-8100).

The Federal Reserve Bank of Cleveland serves the Fourth Federal Reserve District (Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky).

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The CRA Investment Test: How Do Regulators Determine What Qualifies?

by Craig H. Schwartz
COMMUNITY AFFAIRS EXAMINER

When regulators evaluate financial institutions' efforts in meeting the requirements of the Community Reinvestment Act, one aspect that is considered is the institution's performance in making qualified investments.

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A qualified investment is defined as "a lawful investment, deposit, membership share or grant that has as its primary purpose community development." Community development purposes may include affordable housing (including multifamily rental housing) for low- or moderate-income (LMI) individuals; community services targeted to LMI individuals; activities that promote economic development by financing businesses or farms with gross annual revenues under $1 million; and activities that revitalize or stabilize LMI geographies.

A lawful qualified investment may be an investment (municipal bonds, general obligation bonds, and mortgage-backed securities), deposit, membership share, or grant. Activities considered under the lending or service tests may not be considered under the investment test, although elements of the same activity may be considered under separate tests. For example, certain investments and support for a community development corporation may be evaluated under both the investment and service tests.

Types of Investments

CRA does not distinguish between direct and indirect investments. An investment in an equity fund that provides affordable housing to LMI individuals, for example, is an indirect investment; a direct investment might be a donation of computers to an organization that provides job training for LMI individuals. Investments must, however, benefit the institution's assessment area or a broader statewide or regional area that includes one or more of the institution's assessment areas.

Qualified investments commonly include debt securities (municipal and general-obligation bonds), which qualify if the bonds' primary purpose is community development. Mortgage-backed securities (mortgages for LMI housing) also qualify, as do deposits in community development banks that are used to make additional loans or investments to support a qualified development activity. Investments in low-income housing tax-credit projects and investments in small-business investment or development companies automatically qualify for credit.

Investments are also evaluated for their innovation. For instance, a non-profit organization that provides loans for low-income housing development through the sale of tax-exempt bonds secured by low-income real estate properties would be considered innovative.

Determining Investment Ratings

Examiners determine whether each investment meets the credit needs of the bank's assessment area or a broader statewide or regional area and whether it meets all of the requirements for a qualified investment. Banks should provide the requisite documentation to support each submitted investment. Documentation should provide evidence of the investment's community development purpose, as well as any information that may assist examiners in determining whether the investment qualifies.

Financial institutions should not limit their discussions with examiners to qualified investments; they should also cover all of the institution's efforts to obtain qualified investments, even those that were unsuccessful. Specifically, discussions should include any limitations on investment opportunities that currently exist or opportunities that the bank reviewed but was not able to participate in.

A financial institution's overall CRA investment performance is evaluated according to several criteria: (1) the dollar amount of qualified investments; (2) the innovation or complexity of qualified investments; (3) the responsiveness of qualified investments to credit and community developments; and (4) the degree to which the qualified investments are not routinely provided by private investors.

In evaluating a financial institution's overall investment performance, examiners will also consider the context in which the institution operates. Considerations may include (but are not limited to) the bank's location and assessment area; information about investment opportunities obtained from community groups, government organizations, or economic development agencies; institutional capacity and constraints; current economic climate; and the performance of similarly situated lenders.

New Markets Venture Capital Program

Between 1997 and 1998, Congress recognized that—despite the nation's overall economic prosperity—a significant number of Americans were still living below the poverty line, many of them in inner cities and rural areas. This information led Congress to decide that more needed to be done to help these areas than could be accomplished solely by creating more jobs.

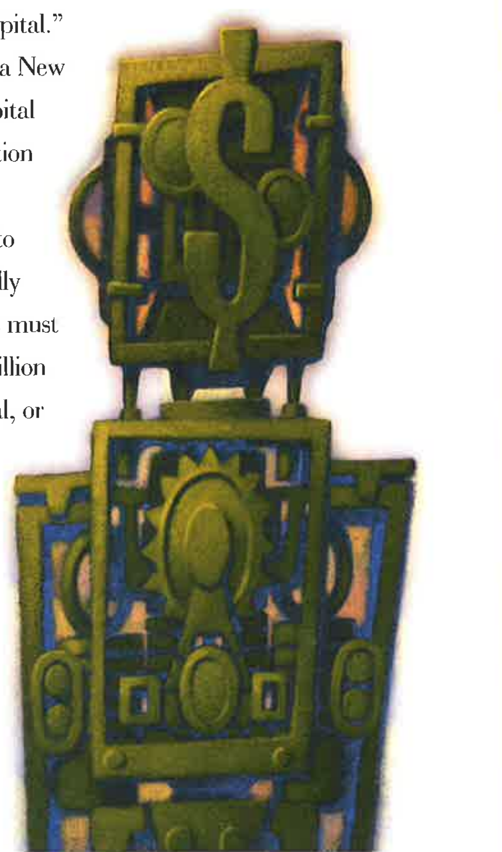
In December 2000, legislation was signed into law to provide funding support for the Small Business Administration's (SBA) programs and to authorize the New Markets Venture Capital program. This pilot program is designed to create economic infrastructure in failing communities by encouraging business growth through program-supported investment. The program's effectiveness will be measured over a five-year period to determine whether it should be expanded.

The SBA oversees the venture capital program under the authority of the New Markets Venture Capital Program Act of 2000, a product of the Consolidated Appropriations Act of 2001. The act authorizes the SBA to provide $152.0 million for debenture guarantees in fiscal year 2001, and $30.0 million for operational assistance grants to supplement the private capital raised by the New Markets Venture Capital companies. These companies will make equity-type investments in smaller enterprises located in low-income areas.

SBA spokesman Michael Stamler characterizes the venture capital program as a public–private partnership that will leverage private-sector money with government guarantees. "The program gets away from the cookie-cutter approach to community development," he says. "It is unique in that it is trying to bridge two worlds—community development and venture capital."

To be designated a New Markets Venture Capital company, the legislation requires prospective companies to apply to the SBA. Conditionally approved companies must raise at least $5.0 million in contributed capital, or binding capital commitments, from investors (other than the federal government or agencies). They also must raise resources to match the SBA grant funds dollar for dollar; the matching resources provide operational assistance for companies in the venture capital company's portfolio.

The legislation specifies that companies have two years in which to raise the required matching resources and private capital. In 2001, New Markets Venture Capital companies are required to raise their grant-matching resources by August 15 and capital by September 14, to allow the SBA to commit funding by September 30. As of late May, the SBA had received 23 applications.



For details of the New Markets Tax Credit, contact the CDFI Fund at 202/622-8662 or *www.treas.gov/cdfi*. For information on the New Markets Venture Capital program, see the Small Business Administration's Web site at *www.sba.gov/INV/venture.html*

Initiative Enjoys Support from Fourth District Legislators

The House Committee on Small Business—whose membership includes two Fourth Federal Reserve District legislators, Rep. Stephanie Tubbs Jones (D-OH) and Rep. Steve Chabot (R-OH)—is particularly interested in reviewing the New Markets programs. According to the committee's mission statement, "Small businesses are essential to prosperity and community and create hope and economic opportunity."

"Even where there have been strong efforts at revitalizing housing," Rep. Tubbs Jones comments, "the small business infrastructure is still lagging. This infrastructure is key to the economic stability of communities and of families." She believes the venture capital program will support the investment needs of small entrepreneurs in low- and moderate-income communities, including inner-city and rural areas. "This program represents the heart and soul of the New Markets Initiative."

Rep. Chabot, who has focused on community renewal legislation that provides tax credits, expresses hope that "the small business tax credit will spur billions of dollars of private investment in our nation's inner cities and rural communities." The legislation should encourage businesses to move into urban cores, he explains, rather than relocate to the suburbs, where costs and regulatory issues are less burdensome. He believes the tax credit program, along with other programs under the New Markets Initiative, will help to overcome some of the hurdles that stand in the way of economic growth.

For information on the Committee on Small Business' activities, see *http://www.house.gov/smbiz*.

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ACKNOWLEDGMENTS

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We welcome your comments and suggestions.

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# of interest

Agencies to Review CRA Regulations in 2002

When the federal regulatory agencies revisited CRA regulations in 1995, they committed to reviewing the regulations in 2002 to determine whether they have met the goal of providing more objective, performance-based CRA evaluations. The joint interagency notice of proposed rulemaking (ANPR) regarding the Community Reinvestment Act, published in the *Federal Register* on July 19, 2001, initiated this review.

The agencies invite comment on key issues that have been raised by representatives of financial institutions, consumer and community groups, members of Congress, and the public since 1995. The agencies also request comment on other issues related to the CRA regulations—in particular, whether any change to the regulations would be beneficial or is warranted, and what steps the agencies might take instead of, or in addition to, revising the regulations.

The Federal Reserve Bank of Cleveland will be holding a series of information-gathering meetings throughout the Fourth District in September and October to solicit comments. Please check our Web site at *www.clev.frb.org* for details.

Autumn Workshop Will Sharpen Finance Skills

Financial service organization executives, managers, and board members will learn the tools and skills needed to understand the financial operations of CDFIs by attending **"Developing Financial Projections"** on October 2–4, 2001, at the Federal Reserve Bank of Cleveland.

The workshop, conducted by the Credit Institute for Economic Development, will enable participants to understand the financial statements of CDFIs; to calculate and interpret key financial ratios used by CDFIs; to develop and assess assumptions incorporated in financial projections; and to project the financial statements of CDFIs. For more information, contact the Dickerson Knight Group at 718/624-4596, or visit *www.clev.frb.org/CommAffairs/index.htm.*

Conference Proceedings Available Online

Proceedings of the Federal Reserve System's Second Community Affairs Research Conference, "Changing Financial Markets and Community Development," are now available online. Papers presented at the conference and Federal Reserve Chairman Alan Greenspan's keynote address can be found at *www.chicagofed.org/cedric/2001/Aprilconference.cfm.*

Cleveland Fed Welcomes New Staff

Jeff Gatica has joined the Federal Reserve Bank of Cleveland's Cincinnati branch as a senior community affairs advisor. He will provide technical assistance and regulatory guidance to financial institutions, community groups, and government agencies in southern Ohio and eastern Kentucky. His work includes identifying community development needs and developing programs that foster community reinvestment and equal access to credit. Prior to joining the Bank, Gatica was the neighborhood development division manager for the City of Cincinnati. He holds a master's degree in community planning from the University of Cincinnati.

Virginia Hopley will serve as a research analyst in the Cleveland Community Affairs Office. She will research and analyze community development and fair lending issues, and the effectiveness of public and private programs that support community development and equal access to credit. Prior to joining the Bank, Hopley worked on neighborhood revitalization initiatives in New York City and participated in community development research projects in North Carolina. Most recently she was the director of the Business and Research Services of the North Carolina Small Business and Technology Development Center in Raleigh. Hopley is a doctoral candidate at the University of North Carolina, specializing in regional economic development.

Jacqueline King—who joined the Cleveland Fed's Community Affairs program in 1998 after working at the Board of Governors of the Federal Reserve System in Washington, D.C.—is moving to the Bank's Pittsburgh branch. The move will allow King to expand the Fed's community development initiatives in western Pennsylvania and the northern panhandle of West Virginia. She will retain her responsibilities as community affairs manager and will continue to provide technical assistance to constituents throughout the Fourth District.