SUBJECT: Establishing a community investment program

COMMITTEE: Economic Development — committee substitute recommended

VOTE: 6 ayes — Jim Solis, Deshotel, Homer, Keffer, Seaman, Yarbrough

0 nays

3 absent — Van de Putte, Luna, McClendon

WITNESSES: For — Susan Coulter; Gilbert Gonzalez; Dolores Hunter, Texas Association of Mexican American Chambers of Commerce; Douglas Kuenstler; Rick McManigle, Greater Austin Chamber of Commerce; Ben Ogbodiegwu, Push-Up Foundations, Inc.; David Pinkus, Small Business United of Texas and Texas Capital Access Forum; Steve Stokes, Central Texas Credit Coalition; Dan Villegas; Margo Weisz, Austin Community Development Corp.

Against — None

On — Elena Peinado, Texas Department of Housing and Community Affairs; Craig Pinkley, Texas Department of Economic Development

BACKGROUND: Multibank community development corporations (CDCs) and community development financial institutions (CDFIs) can take the form of a bank, credit union, or nontraditional loan fund. They make low-interest loans to small businesses in economically depressed communities that are considered too risky for traditional financing institutions. Their primary borrower base is minority- and women-owned businesses in distressed urban areas.

Eight other states have community development investment programs in place. Their programs make funds available in amounts from $5 million to $28 million.

DIGEST: CSHB 64 would require the Texas Department of Economic Development (TDED) to establish the Texas Community Investment Program, through which the agency would make funds available to CDFIs and CDCs. These community development investors would make loans to or invest in businesses that are located in distressed areas of the state and that cannot qualify for conventional bank loans.

The bill would require TDED's governing board to adopt rules to implement the program. A community development investor would be eligible for the program if the entity had raised at least $400,000 in private investments. TDED would have to determine the eligibility of investors and could set a limit on the number of eligible investors that could participate.

An eligible investor would have to agree to comply with the terms and conditions under which TDED would make a grant or loan to the investor or buy the investor's stock. The participation agreement would have to provide for an annual audit of all money received by the investor under the program. The governing board would have to adopt rules relating to the format of the audit, including rules prohibiting more than $5,000 of the funds received by the investor to be used to finance the audit.

An eligible investor would have to file a grant or loan application with TDED and include the type and number of businesses to which the investor planned to make a loan or invest using money from the program. TDED's executive director would have to decide on an application no later than 30 days after it was filed.

The maximum amount that a community development investor could loan to a single business would be $200,000 if all of the loan was direct or $100,000 if any of the company's debt to the investor was subordinated. The maximum term of a loan would be 15 years. A community development investor could make a maximum investment of $50,000 in a single business with a seven-year maximum term and could acquire at most 50 percent of a single company's equity. All income received on a loan or investment made with money received under this program would be the property of the investor.

CSHB 64 would require a community development investor that received a grant or loan from TDED to use the money, or commit the money to be used, within 18 months of receiving the funds. An investor would have to return to TDED any funds not used for grants or loans to businesses in distressed areas by the 10th day after the 18-month period.

An investor that had losses of more than 25 percent on loans or investments made with money received under this program would have to return all unencumbered money to TDED and give the executive director all documentation concerning loans and investments.

CSHB 64 would require a participating investor to establish an investment committee to approve requests for loans or investments. The committee would have to include at least five members, of whom 30 percent would be bankers and 30 percent would be representatives of the community. An investor would have to use at least 60 percent of funds received under this program for loans to or investments in businesses that were at least one year old at the time the loan or investment was made.

A community development investor could make a loan or investment under the program through a partnership or joint investment with one or more financial institutions and could make a loan that was subordinated debt.

CSHB 64 would require a participating investor to submit a report, on a form prescribed by TDED, every six months to the executive director detailing the status of each investment or loan made under the program.

CSHB 64 would not make an appropriation but would require TDED to establish the community investment program if money were appropriated specifically to fund the program.

The bill would take effect September 1, 1999.

SUPPORTERS SAY:

CSHB 64 would help promote economic development that is critical for low-income areas, especially for inner cities. The creation of a sustainable economic base can provide employment, generate wealth, attract newcomers, lower the cost of living, expand the tax base, and encourage socioeconomic stability.

The economic health of the inner city also plays a critical role in keeping entire regions economically competitive. Cities that have taken steps to promote the economic vitality of inner cities have experienced more successful and sustainable economic growth in the whole region. Conversely, regions that do not invest in these areas have experienced a slow drain on the economic and social vitality of the region.

Businesses in economically depressed areas often find it hard to obtain funds because of the higher risk involved in this type of investment. CDFIs and CDCs are highly disciplined financial institutions working locally to promote economic vitality in low-income communities. Unlike conventional financing institutions, community development investors focus on promoting business that will have a long-term impact and a stabilizing effect on communities. In making loans, these investors consider criteria such filling demand for basic goods and services and developing products that will bring new capital, job creation, and physical improvements to the area.

CSHB 64 would authorize the Legislature to provide funding for the community investment program through the general appropriations bill. The $5 million envisioned for the program in fiscal 2000-01could assist more than 1,000 inner-city businesses, bring an additional $20 million in private funding, and create more than 4,000 jobs in distressed areas of Texas. This program would have an ongoing impact in low-income areas of Texas by building private institutions that are strong enough to serve communities over the long term.

Currently, the federal program promoting CDFIs and CDCs provides only matching funds. CSHB 64 would enable these investors to leverage millions more in private and federal funding through matching grants.

CDCs and CDFIs do not compete with conventional banks and other financial institutions because they provide loans to businesses that do not qualify for traditional financing. However, community development investors facilitate relationships with banks through partnerships or joint investments with one or more financial institutions. These partnerships decrease risk to the banks and encourage more traditional financial institutions to invest in businesses in low-income areas.

The success rate for community development loans is very high. The average default rate in Texas is about 2 percent. Community development investors maintain close contact with businesses in which they invest to head off potential problems before they start. CDCs and CDFIs bridge a gap in the private business investment sector. They connect the businesses in which they invest to people in the community who can provide technical assistance, such as accountants and attorneys.

CSHB 64 would not be a guaranteed loan program. The bill would require community development investors who lose 25 percent or more on investments to give money back to the state. This would ensure that only qualified investors are using state money.

Currently, about eight CDFIs exist in Texas. CSHB 64 would provide incentives for more investors to make loans to businesses in distressed areas. This would enhance the economic development of the entire state.

OPPONENTS SAY:

The program proposed by CSHB 64 is not needed because a variety of economic incentive programs aimed at economically depressed areas administered by the state and federal government already exist.

Taxpayers should not have to support another expensive government program that would spend millions of dollars in an attempt to increase economic development. The private sector is the best way in which to invest in these communities. Texas economic conditions are very good, and many venture capitalists are willing to make high-risk investments. When government steps in to play a role that private business normally would play, potential private investors are crowded out.

The businesses targeted by the program created by CSHB 64 might not be good investments at all. Successful, viable companies survive because they have good management and a good business plan, and they attract investors for those reasons. If private venture capitalists are not investing in these businesses, state government probably should not invest in them either.

NOTES:

The committee substitute amended the original bill to give rulemaking authority to TDED instead of to the Texas Department of Housing and Community Affairs.

An item in the Article 11 “wish list” for the House-passed version of HB 1 by Junell, the general appropriations bill, would appropriate $5 million for community investment program for fiscal 2000-01, contingent upon enactment of HB 64.

The companion bill, SB 471 by Lucio, has been referred to the Senate Border Affairs Committee.