Appalachian Capital Policy Initiative
Project Summary

May 2011

Introduction

The Appalachian Regional Commission (ARC) has determined that accessibility to capital and credit is one of the major factors limiting business creation, expansion, and growth in the Appalachian region. This has been a historic problem in the region relative to many other parts of the country. Previous ARC studies in 1998 by Mt Auburn Associates and in 2007 by the National Community Reinvestment Coalition found that:

- That there was a significant gap in the availability of equity capital relative to other areas of the country. For example, just 1.3% of professionally managed venture capital is invested in Appalachia annually.[1]

- Established small businesses in the region -- and particularly small firms with fewer than 10 employees -- had insufficient financing to expand. For example, lenders using the SBA 7a program made 15% fewer loans in Appalachian as compared to the nation, while 7a loans in ARC designated Distressed Counties were just 1/3 the national average.[2]

- Non-metropolitan and distressed counties had considerably smaller shares of bank assets, which resulted in these communities receiving less community development financing.

Other data reveal that of the $26 billion in New Markets Tax Credit allocations provided across the nation, only 11 funds are located in Appalachia (4.4% of funds) and have received just $290 million in tax credit allocations (1.1% of allocations). Similarly, of the nearly 3,000 projects that have received $15.8 billion in financing from New Markets funds, just $600 million has been invested in Appalachia - or 3.8% of total New Markets investment dollars. Appalachia made up about 8% of the U.S. population in 2009, while 45% of Appalachia by geography is eligible to participate in the New Markets program.[3]

These challenges have only been intensified by the severe recession and by longer-term trends that have been increasingly driving economic activity and population into larger metropolitan areas. According to a recent report by the Brookings Institution, the top 100 metro areas are now home to approximately two-thirds of all Americans.

[1] National Venture Capital Association, PricewaterhouseCoopers/Money Tree Report, 2010.
[2] US Small Business Administration, 2003.
[3] US Department of Treasury, CDFI Fund, CIIS data, September 2010.

In addition, Appalachia and other rural regions have also been hurt by the ongoing consolidation and related changes taking place in the banking industry. Larger banks have been consolidating in major cities and urban regions, and there are fewer community banks, particularly in smaller towns and rural areas. These trends have been building for many years but have been accelerated by the current economic downturn. This is particularly noteworthy as the presence of banks, bank branches, and bank capital positively correlates with increased business lending in rural Appalachian communities (2007, National Community Reinvestment Coalition study).

Over the past several decades, a number of programs and initiatives have been mounted to deal with the issues of capital and credit availability and access to debt and equity capital in Appalachia, often with ARC support. A network of Community Development Financial Institutions (CDFIs) has been created at leading regional non-profits in most Appalachian states, and there are 35 publicly supported Revolving Loan Funds (RLFs) operating in the Region as well. ARC has supported the formation and expansion of microenterprise loan funds. And it has directed funding to seven active development venture capital funds in the region, as well as helped create New Markets Tax Credit CDEs.

These efforts provide a foundation to build upon as ARC and its local and state partners consider what additional actions are needed to deal with current and future economic challenges.

Objectives

The Appalachian Capital Policy Initiative has four objectives:

1. To expand bank lending for business expansion and growth;
2. To attract new sources of equity investment into the region from private corporations, pension funds, national financial institutions, philanthropic institutions, and intermediaries;
3. To build the capacity of local/state CDFIs, loan funds and other providers of capital, and to help existing CDFIs expand (where needed) into underserved communities;
4. To increase the volume and quality of deal flow and financeable transactions.

Strategy

To accomplish this, ARC proposes to develop a multi-faceted strategy that can: influence public policy; educate key constituencies and enlist their support and participation; develop and expand programs that deliver capital to business; and attract new sources of capital to the region.

This initiative will be aimed at developing an overall policy framework for addressing capital and credit availability over the long-term, and identifying and implementing specific actions that can improve and expand capital access in the near-term.

Staffing and Timeline

This initiative is a key element in the current ARC Work Program. The Commission has contracted with Ray Christman, former head of the Federal Home Loan Banks of Atlanta and Pittsburgh, to advise the Federal Co-Chair and serve as a consultant to this project and to provide strategic guidance and oversight. He will be supported by staff at ARC and other resources as required.

An action plan is under development, with the help and input of a Capital Policy Advisory Committee, comprised of representatives from financial institutions, CDFIs, state governments, venture funds, and other key points in the region (see attached). The Advisory Group will provide oversight and direction for the assessment of strategic options to address the Region's capital and credit challenges. To date, two day-long Advisory Committee meetings have been held in December 2010 and February 2011.

This initiative is expected to continue through 2012 with key work program items being acted upon and implemented at different stages.

Work Program

The current work program for this effort, developed with the help of the Advisory Committee, includes four major areas of emphasis:

I. **Attracting New Capital to Appalachia**

a. Capital raising for CDFIs: Develop and implement a strategy to attract new capital from traditional (philanthropy, federal programs, financial institutions, etc) and non-traditional (Fortune 50 companies, utilities, etc) sources. Efforts could lead to facilitating new investment in selected CDFIs, or the creation of a new Appalachian community capital fund (perhaps through an entity like the Calvert Social Investment Fund) to finance existing CDFIs.

b. Sponsor an "Investing in Rural America" conference: Develop this conference in partnership with the Federal Reserve, Office of Comptroller of the Currency, Treasury, and selected philanthropies. The purpose of this event would be to target financial institutions, corporate investors, state economic development leaders, and others who have interest in investing in Appalachia and more broadly in underserved rural communities, and identify effective strategies for bringing additional capital to promising opportunities A best practices publication would be developed and disseminated in connection with this event.

c. CRA regulatory enhancements: Advocate for modifications to CRA regulation that would make investments and loans in rural areas like Appalachia more attractive to financial institutions.

d. Develop Angel Investing education programs: Work with the Angel Capital Association, NASVF, and other leading rural angel investment groups to bring successful existing activities to the Region.

e. Explore opportunities associated with new CDFI bond program: Work with local CDFIs to develop potential partnerships with national intermediaries like Enterprise, CRF, or the Opportunity Finance Network to participate in new CDFI Fund Bond program and access new source of capital.

f. Explore creation of new NMTC CDE: Support formation of a new Appalachian-based New Markets Tax Credit CDE at a meaningful scale to help expand NMTC investment in the region;

II. Develop a 'Startup Appalachia' Initiative

In partnership with JumpStart America and Startup America, develop an action plan for implementing a related initiative in the Region. Focal points include: entrepreneurship education; clean energy opportunities; building operational, financial, and physical support networks (incubators, angel networks, etc); and fostering business-university connections (tech transfer). Initial discussions with JumpStart include assessing different parts of Appalachian Region that might serve as a prototype or model for this initiative.

III. Increase Bank Lending in the Region

a. Expand use of SBA 7A program: In partnership with SBA, prepare feasibility study on options and costs for utilization of new or existing 7a loan servicing and packaging providers by community banks.

b. Providing educational and technical resources to community banks: Develop educational workshop series with Fed/OCC/FDIC aimed at helping community banks understand the availability federal resources and programs (USDA, SBA, CDFIs, etc) to help finance their business customers. Work with state banking trade associations and state banking supervisors to publicize and encourage banks to attend sessions.

c. Develop export finance workshop series: Work with leading International Trade Centers in the Region to craft suitable training programs around export finance.

IV. Expand and Improve ARC's Internal Capacity to Support Capital Needs in the Region

a. Economic and financial sector research: Carry out research study to update data on capital and credit gaps, bank presence and lending activity, and related issues in Appalachia.

b. Revolving loan funds: Revise, in partnership with Development District Association of Appalachia, ARC Revolving Loan Fund guidelines to make program more flexible and market friendly.

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