<u>Sub-Committee on Rural Development</u>
<u>October 21, 2009</u>

Thank you for the opportunity to appear here today. MMCDC is a nonprofit company, based in Northwest Minnesota, which has partnered with USDA since 1988. Rural Development is unique due to its delivery mechanism which involves local and state offices as well as their National Office. No other federal agency combines as much local knowledge with federal policy making as USDA.

Our company provides loans to home owners via the Section 502 guaranteed program and we are one of the largest providers of those loans in Minnesota. But my comments today focus on commercial lending. We are a commercial lender having accessed $4 million of Intermediary Relending Program funds; we are a Rural Business Enterprise grantee; and a 'specialty lender' under the Business and Industry Guarantee program.

Overcoming the economic crisis which began just over one-year ago will require resumption of the free flow of credit to businesses and home owners. Unfortunately, commercial loans are not only difficult to come by, but banks faced with stiff regulatory pressures, are calling in loans versus making new ones.

Fortunately for individuals, businesses and communities Rural Development is active and aggressive in extending credit. I would like to provide both recent and historical examples of our use of these Rural Development programs.

We are presently working with our state RD office to obtain a <u>B&I guarantee</u> for a $7 million loan to support a local manufacturing company and help retain 800 jobs. Last year the company lost money causing the bank to pull in their line of credit. This loan will be well secured and allow the company enough time to overcome a difficult year.

In the mid-90's a local community lost its major employer and a total of 550 jobs. The <u>RBEG program</u> provided us a $450,000 grant to support the creation of a replacement business. Not only were 70 jobs created but that business became the first tenant in a new industrial park. That industrial park is now full and generates tens of thousands of annual property tax revenues and nearly as many jobs as were originally lost. The RBEG program also helped us establish a cooperatively owned construction company that has produced over 140 homes, supporting the workforce for local employers.

The <u>Intermediary Relending Program</u> that began with a $4 million loan and $500,000 of our own equity has provided over $18 million in total loans and has leveraged another $27.2 million in other capital since its inception. I think the IRP program is important in good economic times, but absolutely vital in times like these.

These USDA programs are important but, at least from my perspective, could be improved. Specifically:

- The B&I program should implement a ‘low-doc’ component for smaller loans similar to the SBA. Access to credit enhancement will expedite banks again lending to small and medium sized businesses and diversify USDA’s portfolio.
- The Intermediary Relending Program should allow both the sale of participations as well as the purchase of participations. Participations are loans sold in fractions of the total. This will not impair USDA’s collateral position but greatly improve the flow of capital and the ability to manage portfolios that span wide geographic distances.
- Rather than attempting to spread IRP funds among applicants with more but smaller loans, I would recommend making fewer and larger loans to allow intermediaries to generate economies of scale.
- Rural Business Enterprise Grants should have an expiration of reporting after five to ten years, rather than in perpetuity, subject to the requirement that the nonprofit use these federal funds for a similar intent.
- There should be greater flexibility to combine the B&I guarantee with the New Markets Tax Credit program; specifically allowing guarantees for upper-tier lenders in a leveraged NMTC transaction.

These Rural Development programs are valuable to rural America. The IRP, RBEG and the B&I programs create real jobs in rural areas. They are particularly important in good times, but they become critical when the flow of credit has slowed and will play an important part in economic recovery.

<u>End of Oral Testimony with added information on RBEG and IRP below</u>

<u>RBEG</u>

Concerning the RBEG program, the five RCDCs surveyed are using the grant funds for a variety of projects. They are also leveraging other sources of funding and are having a significant impact on the rural communities they serve. For example:

- Northern Communities Investment Corporation (NCIC), Coastal Enterprises, Inc. (CEI), and Northeast Economic initiatives Corporation (NEIC) have used their RBEG grant dollars to capitalize revolving loan funds, thereby maximizing the impact of the grant and enabling the CDCs to provide an ongoing source of business financing. NCIC has utilized its six RBEG grants totaling $1,180,000 to establish four revolving loan funds, which together have extended 56 loans totaling $2,171,587. These funds have also leveraged $4,869,241 in additional funds and created/maintained 209 jobs. Among the small businesses NCIC has assisted with its revolving loan funds are a building construction firm in Northern Vermont that wanted to expand and a catering firm in New Hampshire that desired to move into the restaurant business. CEI’s $1,149,000 in RBEG grant dollars have supported a wide range of small businesses in rural Maine, including a tortilla maker, a trucking company, a metal construction company, an aquaculture firm, and a business that combines seafood and blueberry process wastes to manufacture high-end gardening compost. These funds have leveraged dollars from other sources on a 3-to-1 basis such that the $1,149,000 has brought in an additional $3,447,000 for a total financing of over $4,600,000. NEIC have used its two RBEG grants totaling $1,500,000 to capitalize two revolving loan funds targeted to small businesses. NEIC has made 17 loans for $715,819 in financing, which have leveraged an additional $300,000 from other sources.

- MMCDC received a total of $650,000 in RBEG grant funds in 1995 and 2004. Of that amount, $450,000 was used to build a 22,000 square foot manufacturing facility, creating 45 jobs in rural Minnesota. This project also leveraged an additional $450,000. In addition, MMCDC made a $150,000 loan for working capital to a producer of Native American foods located on the White Earth Indian Reservation as well as a $50,000 technical assistance grant. This loan allowed the producer to purchase its raw inventory (wild rice, syrup, etc.) from low income Native American households.
- Kentucky Highlands Investment Corporation (KHIC) has received a total of $1,793,000 in RBEG grant funds over the last six years. In FY2006, it used its $199,000 Non-EZ/EC RBEG Grant to fund loans to two companies – Wells Collision Center, LLC ($143,280) and Information Capture Solutions, LLC ($55,720). Wells Collision Center, an automotive body, paint and repair shop located in Somerset, Kentucky. The RBEG funds already have leveraged $166,720 in additional KHIC program dollars. Information Capture Solutions, a Williamsburg, Kentucky-based company providing such services as document imaging, data capture, and document storage/destruction, plans to hire an additional 30 to 40 people as a result of this financing. These RBEG funds have leveraged an additional $99,280.

Since 1993, Impact 7 (I-7) in Wisconsin has made 16 RBEG loans totaling $1,227,500. The list of businesses benefiting from the program includes American Bronze Castings, Ltd., Benchmark, Dynatronix, Inc., Eagle Security, LLC, Horizon Manufacturing, Inc., Just In Time Machine Corporation, Lake Country Dairy, Lake Country Tool, Living Adventure, Northern Optiks, Inc., OEI, Scope Moldings, Stevens Point Deli, and Traxx Motorsports. These businesses have leveraged other sources of funds for an additional $2,768,840. In addition, these projects have made a substantial contribution to the employment prospects in these rural areas, creating 83.5 new jobs and retaining 153 existing positions.

IRP

In rural America small businesses (business with 500 or fewer employees) account for 90% of rural business establishments. According to the Federal Reserve Bank of Kansas City, over 1 million rural businesses have fewer than 20 employees. This is almost 75 % of all businesses located in rural America. Yet these businesses are increasingly unable to gain access to capital.

The upheaval in the financial services industry has resulted in credit drying up for businesses in low income communities – loan to value ratios are falling, lines of credits are disappearing, and commitments are evaporating. As a result of the precipitous decline of the availability of credit from private financial institutions, demand is increasing for the entire range of local, regional and national loan funds, micro loan programs, venture capital and intermediary organizations to fill this expanding void created by the reluctance of private financial institutions to provide credit. At the same time these same mission driven organizations are also facing a liquidity shortage as traditional non-governmental sources of capital – from private philanthropic organizations, the bond market, and private financial institutions – are no longer available.

To offset the change many rural communities and organizations have put to use an Agriculture Department program: Intermediary Relending Program (IRP). The IRP makes loans to public and private non-intermediaries that in turn loan to private business enterprises in rural areas. In many cases the loans made available through the IRP are one of the few sources of fix rate term financing for small rural businesses for working capital, lines of credit and equipment. With an average loan size of $100,000 and an upward limit of $250,000, the IRP is targeting small businesses that are the backbone of the rural economy.

USDA has administered the IRP since 1988. At this time, USDA had some 400 borrowers of over $700 million in IRP funds. The agency has not suffered a single default.

Beyond the importance of the patient, flexible capital provided by the IRP, there are two other factors of note:

1. *Job Creation* – The average IRP loan is $100,000. According to USDA, on average, each loan for that amount creates or saves 76.5 jobs. A recent survey of the CDCs indicates a cost per job of $3,000;
2. *Continuing Source of Capital* – A typical intermediary revolves IRP funds three times over the life of the 30 year, USDA loan; and
3. *Leverage* – a recent survey of IRP borrowers indicates that projects financed with IPR are able to leverage significant of additional capital. IRP borrowers surveyed leveraged as much as $7.3 per every dollar of IRP funds.

Other Specific Recommendations for IRP:

<u>Under Instruction 4274-D:</u>

Recommendation: Increase the cap on loans to ultimate recipients
(§ 4274.331 (b-c)):

(b) Ultimate recipients. Loans from intermediaries to ultimate recipients using the IRP revolving fund must not exceed the lesser of:
(1) $250,000; or
(2) Seventy five percent of the total cost of the ultimate recipient's project for which the loan is being made.
(c) Portfolio. No more than 25 percent of an IRP loan approved may be used for loans to ultimate recipients that exceed $150,000. This limit does not apply to revolved funds.

The current cap on IRP lending has been in place since 1994. To keep pace with inflation the cap of $250,000 should be increased to $297,000. In addition, there are greater credit demands of IRP lenders than ever before. With many private financial institutions pulling back, IRP is a key source of fixed rate credit for rural businesses.

Our recommendation is to allow intermediaries to lend up to 10% of their portfolio in any one project.

Recommendation: Reduce or eliminate points for match, double points offered for leverage.

(§ 4274.344 (c) (1)):

"(i) The intermediary will obtain non-Federal loan or grant funds to pay part of the cost of the ultimate recipients' projects…"

"(ii) The intermediary will provide loans to ultimate recipients from its project contribution funds to pay part of the costs of ultimate recipient projects. Project contribution funds must be separate and distinct from any loan or grant dollars provided to the intermediary under the IRP as well as the intermediary's equity contribution."

(§ 4274.344 (c) (3)):

Intermediary contribution. All assets of the IRP revolving fund will serve as security for the IRP loan, and the intermediary will contribute funds not derived from the Agency into the IRP revolving fund along with the proceeds of the IRP loan.

The current scoring system, as outlined above, gives more weight to applicants that have the ability to commit matching funds than an applicant that commits to leveraging private financing. Applicants who are able to commit matching funds must do so for the full 30-year term of the loan. These are the first dollars to be put into the fund and the last to come out. The current economic situation makes it very difficult for many organizations to commit these funds for that period of time.

Additionally, encouraging private leverage would ensure that federal dollars could go farther and have a greater impact. Such a system would also encourage IRP lenders to assist borrowers in accessing private credit and developing relationships with conventional lenders. As indicated above, many IRP borrowers have shown great success in leveraging private sector participation in IRP-financed businesses.

We recommend that USDA double the number of points awarded to an IRP applicant committed to leveraging significant private financing, on a deal by deal basis, with IRP dollars.

These difficult economic times have reduced the sources of funds for match. Private foundations and state and local governments are facing greater limitations and demands for resources. Earned income of borrowers is also limited because of the recession. Congress has authorized other federal agencies including Commerce Environmental Protection and Treasury to drop or reduce matching requirements for community development programs. We recommend that USDA consider a similar measure for the IRP.

Eliminate the fourteen-county limit which is used to award points accountability.
(§ 4274.344 (c) (5))

The instruction limits the target area for an application to not more than 14 counties. An application can receive up to 15 points for having community representation on its board or oversight committee.

From state to state, counties vary greatly in size from one another. San Bernardino County, California, for example, is larger in size and population than the entire state of New Hampshire. Limiting the number of counties served puts some applicants at an unfair disadvantage. The 14 county ceiling also limits the participation of statewide, multi-state or national organizations with service areas greater than fourteen counties.

We suggest that USDA drop 14 county limit. We suggest that other measures of accountability be adopted. USDA should ensure that applicants have a board of business, civic and community leader make up the board or advisory committee of the applicant and that community leader be residents of rural communities.

Recommendation: Allow for the sale and purchase of loan participations.
(§ 4274.361 (e))

"(e) Current regulations do not allow the intermediary to sell their ultimate recipient loans. (Added 08-19-05~ SPECIAL PN.)"

In general, the IRP rules should provide for better coordination and cooperation with private financial institutions. In tight budget times, leveraging the maximum participation of private loans is essential to stretching federal IRP funds. Because this is not expressly authorized in the rule, USDA has recently indicated that intermediaries are not authorized to buy or sell participation agreements or notes from the IRP revolving fund. This includes any revolved funds as well.

We recommend that USDA eliminate the prohibition on buying and selling participations on private loans. Buying participations has proved to be useful for encouraging private sector participation in rural lending and stretching federal resources.

Selling participations allows intermediaries to more quickly revolve their funds. This activity would not change the nature or character of the IRP funds, and simply serves to increase the volume of lending provided by intermediaries. In addition, for statewide or regional organizations, IRP borrowers buying participations can rely on the local bank to service and monitor loans.

Small rural bank quickly reach their lending limits. Allowing these banks to buy or sell a participation is a way to keep them in small business lending.

Recommendation: Allow borrowers with multiple loans to consolidate these for purposes of repayments and reporting requirement.

Many IRP intermediaries have multiple loans from USDA. In order to ensure that deposited funds are protected by federal deposit insurance, intermediaries maintain multiple bank accounts. For example, one borrower has nine loans, maintains 27 bank accounts and files nine separate reports to USDA. We would like to encourage USDA to consider ways that this reporting could be streamlined.

Recommendation: Ensure that clear and consistent guidance is given to IRP Intermediaries.

While the IRP is administered as a national program, some state offices have weighed in with IRP intermediaries to give direction. For example, some state offices are requiring documentation that the IRP lender has met *lender of last resort* requirements even though this requirement is in neither the rule nor instructions governing the program.

Some intermediaries are interested in lending in more than one state. That option does not appear in the rule or instructions. Yet intermediaries have in fact received IRP loans to work in more than one state with the state on which the IRP is located taking the lead in administering the loan. USDA should clarify the instructions on this.

Recommendation: Establish a "preferred lender" program for seasoned IRP lenders.

USDA has made hundreds of IRP loans totaling hundreds of millions of dollars since the program's inception. A select few of the organizations receiving these loans are high volume lenders and, therefore, many of them apply to USDA on an annual basis for additional IRP dollars to replenish their loan funds. We recommend that the USDA consider instituting a "preferred lender" program that would provide additional liquidity to high-performing, high-volume IRP lenders.

Through a "preferred lender" program, USDA could grant a moratorium on the principal and interest payments of an intermediary as long as the intermediary could demonstrate a successful track record in terms of deploying loans to qualified businesses, being current in payments to USDA, and meeting additional performance goals such as targeting "high distress" rural areas and/ or creating and retaining jobs.

The annual demand for IRP funding outweighs the availability of IRP funds. Many seasoned IRP lenders are left unable to secure the new IRP loans that they need to meet the local demand from new and returning borrowers. By relieving these qualified lenders of principal and interest payments, additional capital would be freed. Intermediaries could put those dollars into loans, thus alleviating the need to apply for additional IRP funds on an annual basis.

ARLEN KANGAS, Ph.D.

PROFESSIONAL EXPERIENCE:

President – Midwest Minnesota Community Development Corporation June 1988 to Present.

Chief Operating Officer and President of the Corporation responsible for the administration of $85.0 million in Corporate Assets. The four major areas of responsibilities are: (1) providing the leadership in developing and executing corporate plans regarding job creation, research, investments and housing; (2) representing MMCDC in all public appearances; (3) delegating authority to appropriate subordinates for the implementation of MMCDC plans and programs and reviewing, on a continuous basis, all such activity; and (4) directing and reviewing all systems and procedures for the administration and fiscal control of MMCDC and its subsidiary operations under the control and direction of the Board.

Vice President Business Development - April 1986 – June 1988

Adjunct Faculty in Economics Moorhead State University, Moorhead, MN– March – June 1987

Economist Montana Department of Natural Resources and Conservation – June 1984 – May 1985

Research/Teaching Assistant Washington State University– August 1979 – June 1984

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Ph.D. in Economics 1984
M.A. in Economics 1982
Emphasis on International Trade and Econometrics
Bemidji State University, Bemidji, MN
B.A. in Economics 1978; Summa Cum Laude

Directorship/Memberships:

CDC Bancshares – Director
Wolf Lake Wolf Pack, Inc. – President/Chairman/CEO
Holmes Center, Inc. – Founding CEO
TEAMWORKS- Director/CEO
General Partner of numerous single asset Limited Partnerships or LLC's
SJE Rhombus – Past Director/Chairman
White Earth Investment Initiative – Director/Chairman
Renneberg Hardwoods, Inc. – Advisory Member
On-Line Builder – Director
Minnesota's CDC - Director

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2006.

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Organization you represent (if any): Midwest Minnesota Community Development Corporation

1. **Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2006, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source:__________ **Amount:**__________

Source:__________ **Amount:**__________

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2006, as well as the source and the amount of each grant or contract:**

Source: **SEE ATTACHED DOCUMENTATION** **Amount:**__________

Source:__________ **Amount:**__________

Please check here if this form is NOT applicable to you: __________

Signature: [signature], CFO, MMCDC

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.

Midwest Minnesota Community Development Corporation (MMCDC)

2006 Grants

Applicant	Source	Amount

2007 Grants

Applicant	Source	Amount
MMCDC	HUD	$180,000
MMCDC	OCS	$327,625
MMCDC	RHED	$180,000

2008 Grants

Applicant	Source	Amount
MMCDC	HUD	$200,000
MMCDC	FHLB	$250,000
MMCDC	CDFI	$2,000,000
MMCDC	OCS	$267,500
MMCDC	RHED	$200,000

2009 Grants

Applicant	Source	Amount
MMCDC	HUD	$200,000
MMCDC	OCS	$765,827

2006 Sub-Grants

Applicant	Source	Amount
MMCDC	OFN	$0

2007 Sub-Grants

Applicant	Source	Amount
MMCDC	GMHF	$5,000
MMCDC	Rural LISC	$10,000
MMCDC	MHFA	$2,000,000
MMCDC	MHFA	$1,000,000
MMCDC	ECHO: MHFA	$75,000
MMCDC	MHFA-LIHTC	$185,670

2008 Sub-Grants

Applicant	Source	Amount
MMCDC	MHFA	$1,000,000
MMCDC	Rural LISC	$25,000
MMCDC	Rural LISC	$25,000

2009 Sub-Grants

Applicant	Source	Amount
MMCDC	MHFA	$2,000,000
MMCDC	MHFA	$1,000,000

2006 Contracts

Applicant	Source	Amount
MMCDC	CDFI: NMTC	$80,000,000

2007 Contracts

Applicant	Source	Amount
MMCDC	CDFI: NMTC	$85,000,000

2008 Contracts

Applicant	Source	Amount
MMCDC	CDFI: NMTC	$90,000,000

2009 Contracts

Applicant	Source	Amount

Midwest Minnesota Community Development Corporation (MMCDC)

Subsidiary List

2006 Grants

Applicant	Source	Amount
CD Bank	CDFI	$455,000

2007 Grants

Applicant	Source	Amount
WEII	CDFI	$269,500

2008 Grants

Applicant	Source	Amount
WEII	USDA: IRP	$750,000
WEII	Spanish HECAT	$7,000
WEII	CDFI	$590,000

2009 Grants

Applicant	Source	Amount
CD Bank	CDFI	$116,055

2006 Sub-Grants

Applicant	Source	Amount

2007 Sub-Grants

Applicant	Source	Amount

2008 Sub-Grants

Applicant	Source	Amount
WEII	OWEESTA	$100,000

2009 Sub-Grants

Applicant	Source	Amount

2006 Contracts

Applicant	Source	Amount

2007 Contracts

Applicant	Source	Amount

2008 Contract

Applicant	Source	Amount
PSAH	Department of Human Services	$51,300

2009 Contracts

Applicant	Source	Amount