

Testimony of Ray Moncrief, Kentucky Highlands Investments Corporation
Community Development Financial Institutions (CDFI's): Their Unique Role and
Challenges Serving Lower-Income, Underserved and Minority Communities

United States House of Representatives
Committee on Financial Services

March 9, 2010

Thank you, Chairman Frank and Ranking Member Bachus for the opportunity to testify as a witness regarding the challenges facing CDFIs and specifically our experience at Kentucky Highlands Investment Corporation (KHIC) working with the CDFI Fund. I also want to thank you and your staff for convening an experienced and insightful group of practitioners to participate, and for facilitating a powerful conversation about how CDFIs are helping residents of lower-income, underserved and minority communities to achieve a better life for themselves and their families.

I should tell you that I sit before you today not only as the CEO of KHIC, but also as a member of the CDFI Coalition's Board of Directors, a member of the NMTC Coalition's Board of Directors, and as the chair of the Community Development Venture Capital Alliance (CDVCA). In addition, I am in my fourth year of serving on the CDFI Fund's Advisory Board.

With that said, I will now address the questions posed by Chairman Frank in his letter of March 3, 2010.

What has been your general impression of the usefulness of the community development financial institutions (CDFI) Fund?

As a practitioner of community development financing in a rural, distressed part of our nation for nearly 32 years, I have seen firsthand the profound difference in the lives of our people that the CDFI Fund has helped to facilitate. KHIC, in its role as a CDFI, has been able to help small businesses and self-employed entrepreneurs start up, expand and survive in a challenging economic climate. These businesses offer good, living-wage jobs to people who are eager to work, in an economically disadvantaged area in which few quality employment opportunities exist.

CDFIs fill a vital niche in the nation's financial services delivery system, offering loan products and financial services to families or in communities that are difficult for traditional financial institutions to serve. As CDFIs we provide loans and investments to support the development of quality affordable housing, finance businesses, and finance community facilities, including health centers, daycare and education facilities, all with the level of technical assistance needed by their borrowers.

What makes the CDFI Financial Assistance (FA) Program unique is that it is provided to build the capacity of the CDFI as an institution, not as a pass-through directing the CDFI to fund

specific types of projects. This enables CDFIs to use their awards to build their capital accounts, use the funds for reserves, for general lending capital or for similar purposes. In return, each CDFI that receives an award is required to demonstrate that it is providing loans, investments and other financial services in its community over the course of the award period. This valuable source of capital has been critical to KHIC, and as a result our asset size has grown 107% over the last 13 years, since becoming a CDFI.

Could you explain the exact nature of the economic activities in which your institution has been engaged through the CDFI program?

Kentucky Highlands Investment Corporation (KHIC), headquartered in London, Kentucky, was founded in 1968 as a Job Start Corporation as a part of the War on Poverty. KHIC's purpose is "to plan, promote, initiate, and coordinate community, economic and social development efforts." KHIC entered the community development venture capital field in 1976. It has a strong base of capital with a portfolio that allows it to be self-sustaining, a dedicated and experienced staff, a committed and supportive Board of Directors, and a clear definition of its mission and method. It accomplishes its mission by providing both financial support and management assistance to new and existing businesses. It has sought to recruit companies from areas outside the region to provide much-needed jobs for residents in its service area. KHIC originally served nine counties, but has expanded its service area to twenty-two counties in Southeastern Kentucky. This hilly, rural Appalachian area has only five population centers with more than 5,000 residents and has chronically high rates of unemployment and poverty. The investing activities of KHIC include a wide range of instruments such as equity investments, subordinated debt, term loans for real estate and equipment, revolving lines of credit, and micro loans. As one of very few venture capital sources in the area, KHIC plays a unique role in providing funds for highly leveraged, expansion businesses. Because KHIC can put money at risk as equity and subordinated debt, it can go beyond regulated full-service banks in helping portfolio companies. Having this range of investment instruments available allows KHIC to help expanding companies provide jobs to chronically poverty-stricken Appalachian Eastern Kentucky.

It's been our experience that technical assistance is one crucial need of small businesses in lower income areas that is almost always inadequately addressed. We have also been a huge supporter of the business incubator concept, having had a successful incubator in our building for several years now. As part of our commitment to providing technical assistance, we are constructing a new building adjacent to our existing offices in London, Kentucky, to house a much larger business accelerator facility that will provide a supportive environment for new and small businesses to grow and prosper in our service area. The goal of our new facility will be to move companies through the business development process toward self-sustainability, which typically may take up to three years or more, while building a more entrepreneurial community in the region.

In terms of historical activities, KHIC has invested in excess of \$165 million in more than 500 businesses since its inception in 1968, and has created more than 17,000 jobs. Collectively, those businesses have paid more than \$1.0 billion, unadjusted for inflation, in salaries and wages since 1968. In addition to its lending and investing activities, KHIC provides technical assistance to more than 90 businesses annually. KHIC has developed over \$10 million in real estate projects and provided \$75 million in financing to support industrial and commercial real

estate in the area. Our success notwithstanding, our service area remains hard hit by job losses. At 10.5%, Kentucky's 2009 unemployment was the worst since 1983; however, the unemployment rates in 20 of the 22 counties in KHIC's service area have easily topped that, with one county in excess of 18%.

What specific economic or neighborhood impact can you point to that has resulted from CDFI Fund investment?

KHIC's service area is rural, and is frequently overlooked by traditional sources of capital. We know the specific and unique needs in our service area and with CDFI Fund investment, we have been able to greatly improve the lives of the persons living here. One particularly interesting example is Patriot Industries. After struggling for years, the company has become a very profitable business making a substantial, positive community impact. Patriot began operations in 1998 with 15 employees in one location. KHIC provided both equity and debt for the company to start and had financed its growth over the years. KHIC also built the building and leased it to Patriot Industries. I have served as a member of the company's board of directors since its inception and have participated in strategies that have guided the company through its startup, expansion and growth into the successful company that it is today. At the end of 2009, Patriot employed 545 persons in two plants that make various backpacks and protective gear for military infantrymen. Both plants are located in low income census tracts in Monticello and Albany, Kentucky. In the past six years alone, the company has provided nearly \$33 million in salaries and wages, and because Patriot is a locally owned company, those dollars, as well as the company's profits, which have grown significantly in the past five years, stay in rural, lower income areas.

How has the economic downturn affected your entity's activities?

Our service area is in a region that has historically been starving for investment capital. During this economic downturn, the number of investment and financing requests that we receive continues to grow. Additionally, and fairly unique to this past couple of years, KHIC has been financing businesses that have been pushed out of the nest by traditional banks, especially when those former locally owned community banks are purchased by larger regional or national banks. Larger banks often decide that the businesses do not fit their portfolio objectives. Many of these businesses have demonstrated long-term profitability, but have simply hit a bump in the road, and are on the bubble, because of recent losses or lower profits due to an economic downturn that's affected all businesses.

One such business that found itself in that situation this past year is Highlands Diversified in London, Kentucky. Highlands Diversified provides metal stamping and fabrication, powder coat painting and electro-mechanical assembly, as well as various other services, for automotive, appliance, telecommunication and office equipment companies. When the company's bank was purchased by a large regional bank in 2009, the acquiring bank informed Highlands Diversified that its working capital line of credit would not be renewed for another term. Ironically, this happened just as the company was on the brink of receiving more than \$5 million in new business. Highlands Diversified was historically profitable, but had operated at a loss during the previous year, and was forecasting a loss for the upcoming year; however, KHIC saw the upside

of investing in the company, and established a \$2.5 million revolving line of credit to replace the one that was being dropped. At the time that KHIC established Highlands Diversified's line of credit a year ago, the company had 194 employees. The company is now profitable again and employs 220 persons, with employment expected to increase.

If KHIC had not been there to intervene and provide the financing needed to maintain operations, we would have lost more than 200 jobs in our community.

Has it affected the demand for your institution's services, your liquidity, your balance sheet?

KHIC has experienced a huge increase in demand for services that, as a result, has placed significant pressure on our liquidity. We use our resources to provide the financing necessary to keep small businesses afloat while they weather this economic downturn, until they can return to more normal operations. While this has put considerable strain on our resources, we have also viewed this as an opportunity to provide financing and technical assistance that is unavailable from traditional financing sources, and thus, further our mission of creating wealth for persons in lower income, minority and underserved communities in our service area.

How have you had to manage your portfolio in light of these circumstances?

Because we have limited financial resources, we have been required to invest very prudently. While our goal is always to invest in small businesses that become profitable and self-sustaining, we could have invested in additional businesses this past year that were on the line and most likely could have become successful enterprises if we had more funds available to invest. In addition, with the tough economic challenges facing our portfolio companies today, we have been forced to provide them more technical assistance, both in quantity and intensity. We feel that technical assistance is critical to the success of these businesses; however, with limited resources, providing this service can be sometimes overwhelming to our staff.

What could be done to help you serve more people and communities in your area, in the short term and the long term, including any legislative changes to the CDFI statute?

The American Recovery and Reinvestment Act (ARRA) passed by Congress last year included language to waive the one to one private matching funds required of CDFIs applying for Financial Assistance from the Fund. In waiving this match requirement Congress acknowledged the difficulty that CDFIs like KHIC face in securing private sources of matching in a slowing economy.

Unfortunately the economic climate has not changed in southeastern Kentucky and I know that I speak for other CDFIs when I say that we continue to confront serious challenges in securing private match and yet we don't want this to stand in the way of pursuing additional capital from the Fund.

Therefore, we are asking that you include language in the Fiscal 2011 appropriations bill that would continue the waiver of the matching funds requirement through fiscal 2011 so that CDFIs can focus on addressing the capital and financing needs of their communities.

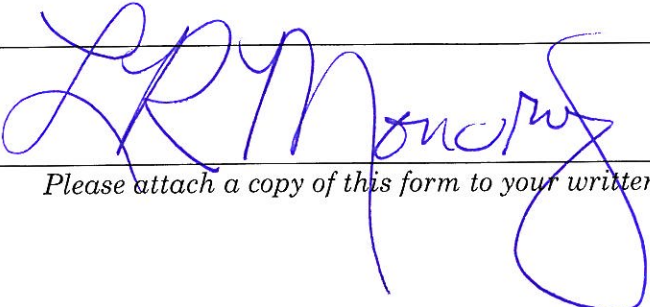
I want to be clear that I am not suggesting that Congress permanently do away with the one to one matching requirement. I believe, as do my colleagues in the CDFI community, that CDFIs should be called upon to show they leverage the CDFI funds as much as possible, but at the same time we need to be realistic as to what is possible in this economic environment.

In summary, I want to once again thank Chairman Frank, Ranking Member Bachus, and members of the United States House of Representatives Committee on Financial Services for this opportunity to tell you about the work that CDFIs, like Kentucky Highlands Investment Corporation, do to address the challenges of serving lower income, underserved and minority communities. It is our desire that the CDFI Fund become an even more robust program, as there is a need for the benefits it provides that far outstrips our ability to serve.

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“TRUTH IN TESTIMONY” DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name: L. Ray Moncrief	2. Organization or organizations you are representing: Kentucky Highlands Investment Corporation
3. Business Address and telephone number: P.O. Box 1738 London, Kentucky 40743 606-864-5175	
4. Have <u>you</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006, related to the subject on which you have been invited to testify? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	5. Have any of the <u>organizations you are representing</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006, related to the subject on which you have been invited to testify? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
6. If you answered “yes” to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets. See Attached Sheet	
7. Signature: 	

Please attach a copy of this form to your written testimony.

Kentucky Highlands Grants and Loans Awarded
10/01/2006 through 12/31/2009

Awarding Agency	Date	Grant No./loan No.	Amt
United States Department of Agriculture			
Rural Business Enterprise Grant	6/8/2006	200630610673339	\$199,000.00
	6/18/2007	200630610673339	324,915.00
	6/29/2007	200630610673339	349,000.00
	5/30/2008	200630610673339	299,000.00
	5/30/2008	200630610673339	199,000.00
Self-Help Housing Technical Assistance	4/25/2008	20270611253192	250,000.00
Intermediary Relending Program	11/29/2007	61-24	750,000.00
	11/29/2007	61-22	750,000.00
Rural Business Opportunity Grant	9/9/2008	210630610673339	50,000.00
United States Department of Treasury			
Community Development Financial Institutions	2/10/2009	081FA007436	443,664.00
	2/10/2009	081FA007436	100,000.00
	11/5/2009	091FA007855	1,000,000.00
Bank Enterprise Award	9/30/2007	N/A	44,000.00
Appalachian Regional Commission			
ARC	10/1/2006	CO-15528-06	500,000.00
Energy Boot Camp	8/1/2007	CO-315789-07	75,000.00
Revolving Loan Fund (2)	10/1/2008	CO-16094-08	75,000.00
	Revolving	KY-15038-05	400,000.00
ARC-CEG	9/1/2007	KY-15648-07	199,000.00
ARC-CEG	9/1/2008	KY-16071-214-08	300,000.00
United States Small Business Administration			
Microloan Grant Program	1/1/2007	SBAHQ-03-Y-0006	182,346.00
	1/1/2008	SBAHQ-03-Y-0006	236,871.00
	1/1/2009	SBAHQ-03-Y-0006	373,706.00
United States Department of Health and Human Services			
Office of Community Services, Discretionary Grants	9/30/2007	90EE0778	677,000.00
Urban and Rural Economic Development	9/30/2006	90EE0770	700,000.00
	9/30/2009	90EE8076	765,828.00
United States Department of Housing and Urban Development			
Office of Rural Housing and Economic Development	1/28/2008	RH-07-KY-I-0019	300,000.00
	12/29/2005	RH-07-KY-I-0010	400,000.00
Economic Development Administration			
Incubator	9/11/2008	04-01-06095	1,080,000.00
Total Grants Received			<u>\$11,023,330.00</u>

Lloyd Raymond Moncrief

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Senior Executive Officer

- Currently serves in senior executive level positions in six companies.
- Extensive experience as an entrepreneur.
- Nationally and internationally recognized speaker and writer on the use of equity as an economic development strategy.
- Regarded as one of the founders of the community development venture capital industry

Skills

- Strategic and Operational Leadership
- Successful Entrepreneur Experience
- Fund Raising Experience
- Corporate Communications
- Accomplished Writer
- Respected Speaker
- Business Turnaround Experience
- Advanced Negotiating Skills

Selected Awards and Accomplishments

- **Appointed to the Community Development Fund Advisory Board by President George W. Bush**
- **Founding director of the Community Development Venture Capital Alliance (CDVCA), which provides equity capital to businesses in underinvested areas**
- **Received the CDVCA Lifetime Achievement Award in 2004**
- **Has provided testimony to U.S. Congress on various economic topics on multiple occasions**
- **Published author of numerous papers on community development venture capital**

Professional Experience

Meritus Ventures, LP (a Rural Business Investment Company (RBIC), currently the only RBIC in U.S.)
\$36.4 Million Venture Capital Fund with offices in London, KY and Oak Ridge, TN, actively seeking new investments, that invests in all or part of 11 states in rural areas in central and southern Appalachia

Principal and Fund Manager, 9/2006 to Present

Manages \$36.4 million venture capital fund with co-manager. Has invested in five companies to date. Serves as a director on the boards of two of those companies. Works with entrepreneurs, providing managerial and operational assistance from startup to exit. Responsible for various compliance and reporting requirements to the Small Business Administration and USDA Rural Development.

Selected Accomplishments:

- Successfully completed licensure requirements of U.S. Small Business Administration to establish a Rural Business Investment Company
- Was the only applicant that successfully raised required private equity funds to obtain RBIC license.
- Has invested 21% of the fund's planned investment dollars as of 9/3/09 and helped portfolio companies to attract other sources of capital, achieving a leveraged funds ratio of 4:1.

Southern Appalachian Fund, LP (a New Markets Venture Capital Company)

\$12.5 Million Fully-Invested Venture Capital Fund with offices in London, KY and Oak Ridge, TN, formed to provide equity capital and operational assistance to qualifying businesses in low income communities in southern Appalachia.

Principal and Fund Manager, 7/2000 to Present

Manages \$12.5 million venture capital fund with co-manager. Has invested in eight companies. Serves, or has served, as a director on the boards of four of those companies. Works with entrepreneurs, providing managerial and operational assistance from startup to exit. Fund is now making follow-on investments only. Responsible for various compliance and reporting requirements to the Small Business Administration and the Community Development Financial Institutions Fund.

Selected Accomplishments:

- Invested in eight companies within five years of the fund's establishment
- Achieved exits from three companies, achieving overall investment metrics within planned projections
- Helped portfolio companies attract capital from other sources, achieving a leveraged funds ratio of 7:1.
- Successfully utilized New Markets Venture Capital and New Markets Tax Credit programs concurrently in investing activities

Kentucky Highlands Investment Corporation, London, KY

Community Development Corporation formed in 1968 to stimulate economic growth that operates in 22 counties in southern and eastern Kentucky and has created more than 10,000 jobs by providing debt and equity financing, as well as extensive technical assistance to small businesses

Executive Vice President and Chief Operating Officer, 10/1984 to Present

Responsible for investing activities. Provides managerial and operational assistance to entrepreneurs throughout business life cycle, including serving as CEO or other member of senior management in portfolio companies. Negotiates sales of portfolio companies. Currently serves on boards of several portfolio companies.

Selected Accomplishments:

- Also serves as President and Chief Executive Officer of Mountain Ventures, Inc., a Small Business Investment Company licensed by the U.S. Small Business Administration and wholly-owned by Kentucky Highlands.
- Negotiated several very successful exits from portfolio companies.
- Successfully turned around or recapitalized several portfolio companies, and is responsible for such operations on an as-needed basis.
- Participated in numerous studies analyzing capital needs in rural America, including a White House economic roundtable discussion.
- Served as President and Chief Executive Officer of Kentucky Highlands from 10/1984 to 2/1009, before founding own small business.

Shadow, Inc., London, KY

Manufacturer of high-performance, customized bass fishing boats

President and Chief Executive Officer, 3/1988 to 11/1989

Founded company. Responsible for overseeing all functions of the company. Helped design and develop strategic products. Shadow Boats are still regarded as quality fishing boats that have retained resale value well, many of which are still being used.

Medical Management Corporation, Whitley City, KY
Provided emergency room management services to hospitals
Chairman and Chief Executive Officer, 6/1983 to 10/1984

Joined unprofitable company as significant owner and successfully turned around company. Responsible for day to day, as well as strategic, operations of the company. Successfully sold company to larger emergency room management company.

Outdoor Venture Corporation, Stearns, KY
Manufacturer of tents and other camping equipment
Vice President and Chief Operating Officer, 8/1978 to 6/1983

Managed all phases of company's finances and data processing. Performed treasury function. Responsible for risk management procedures. Performed significant role as part of management team that grew the company from startup to \$25 million annual sales.

Firestone Synthetic Rubber and Latex Company, Akron, OH
Manufacturer of rubber and latex products
Held various accounting positions leading up to Manager of Accounting Division, 6/1972 to 8/1978

Responsible for general and cost accounting functions for division that included four domestic plants and one foreign plant, including annual, as well as long-term budget planning. Managed personnel in accounting division.

Professional Organizations

- Community Development Venture Capital Alliance – Current Director and Chairman
- National Association of Small Business Investment Companies – Past Member of Board of Governors
- Southern Kentucky Economic Development Corporation – Co-Founder and Past President
- New Markets Tax Credit Coalition – Board Member
- Community Development Financial Institutions Coalition – Board Member
- Community Development Advisory (Presidential Appointment) – Advisor to the Director of the Community Development Financial Institutions Fund

Education

LOUISIANA TECH UNIVERSITY – Ruston, LA
Bachelor of Science, Accounting 1972

LAMAR UNIVERSITY – Beaumont, TX, Graduate Courses
