

Date of Hearing: April 17, 2012

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE ECONOMY
V. Manuel Pérez, Chair
AB 2619 (V. M. Pérez) – As Introduced: February 24, 2012

SUBJECT: Start-Up California Impact Investment Fund Program

SUMMARY: Establishes the Start-Up California Impact Investment Venture Fund Program for the purpose of providing equity investments to start-ups and small businesses. Specifically, this bill:

- 1) Requires the Infrastructure and Economic Development Bank (I-Bank) to establish criteria, priorities, and guidelines for the selection of eligible businesses, which shall, at a minimum:
 - a) Encourage the establishment of start-ups and growth of small businesses.
 - b) Offer financial opportunities to emerging managers.
 - c) Support business development in lower income areas of the state.
 - d) Encourage business development that includes the export of products from California.
 - e) Encourage manufacturers to bring production lines back to California.
- 2) Authorizes the I-Bank to contract with professional equity fund managers who have demonstrated expertise in economically targeted and impact investments.
- 3) Requires the I-Bank to consult with appropriate state and local agencies and investors that have investment policies that target businesses in lower income communities.
- 4) Defines "start-up equity capital" as money and resources invested in start-up firms and small businesses with exceptional growth potential. In exchange for this capital, the I-Bank receives an equity stake in the firm represented by shares of common or preferred stock.
- 5) Provides that no liability is incurred by the I-Bank or the state as related to the startup equity fund beyond the extent to which funds are on deposit in the start-up equity fund account.
- 6) Requires the I-Bank to establish a reasonable schedule of administrative fees, which shall be paid by the applicants to reimburse the state for the costs of administering this program.
- 7) Requires annual reporting of equity investments by number, size and type of firm, by industry sector. The report is required to also include a description of the direct and indirect employment impact.

EXISTING LAW:

- 1) Creates the I-Bank, within the Business, Transportation and Housing Agency (BTH), to promote economic revitalization, enable future development, and encourage a healthy climate for jobs in California. The I-Bank is authorized to offer a variety of financial products and services including,

but not limited to, direct loans for the purpose of financing infrastructure and issuing tax-exempt and taxable revenue bonds to underwrite the cost of infrastructure development.

- 2) Authorizes the I-Bank to receive contributions or grants in the form of money, property, labor, or other things of value from any source for the purpose of advancing a project.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Author's purpose: According to the author, "California has the ability to do a better job of encouraging private investment in California's historically underserved capital markets. With the Kaufman Foundation's research showing that more than 90% of all jobs created between 1977 and 2005 came from small and early stage firms, it is essential that the capital access needs of these business be addressed. Other states have been stepping up their game and re-committing to a broader range of financing programs, including direct loans, guarantees and credit enhancements in partnership with private lenders and equity financing in conjunction with experienced private sector financial asset managers."

"California has a very limited set of tools and only operates direct loan and credit enhancement programs to assist small businesses and start-ups. This bill provides an important new tool for small businesses, many of which are woman and minority owned, to attract early stage private investors."

- 2) California's small business economy: California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$1.9 trillion economy. Businesses with less than 100 employees comprise nearly 98% of all businesses, and are responsible for employing more than 37% of all workers in the state.

Among other advantages, small businesses are crucial to the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy. Small businesses have consistently functioned as economic engines, especially in challenging economic times. During the nation's economic downturn from 1999 to 2003, microenterprises (businesses with less than five employees) created 318,183 new jobs or 77% of all employment growth, while larger businesses with more than 50 employees lost over 444,000 jobs.

In this current recession, however, small businesses have been particularly hard hit by the problems in the capital markets resulting from the financial crisis and a drop in consumer spending. Equifax reports that small business bankruptcies were up 81% for the 12 months ending September 2009, as compared to the same period in the previous year. Nationally, bankruptcy filings were up 44% during the same term.

- 3) New drivers of the California economy: As California moves slowly out of the recession, key demographic trends will place additional hurdles on the state's economic growth and recovery. Baby boomers, who are aging out of the marketplace, will be replaced by a second, but significantly smaller, wave of new workers and entrepreneurs. This demographic trend not only reflects a generational shift in the U.S., but it also reflects a shift in the majority race and ethnicity of the

working age population. The California Budget Project estimates that by 2020, nearly 60% of the working age population in California will be comprised of Latinos, African-Americans, and Asian-Americans.

Accompanying these demographic shifts is a substantial increase in minority purchasing power. In the U.S., minority purchasing power is expected to triple from \$1.3 trillion in 2000 to over \$4 trillion by 2045. This represents over 70% of the growth of total U.S. purchasing power during the same time period. Latino and African-American purchasing power is already so significant in the U.S. that if it were compared to national GDPs it would be greater than all but nine economies in the world. As the purchasing power of minority communities expand, traditional product lines and services will need to evolve, while markets for new products will increase.

AB 2619 addresses one of the significant needs of the emerging minority and ethnic-based marketplace – the need for business capital. Research shows that the growth of minority owned firms in the beginning of the decade surpassed the growth of all U.S. businesses, growing at a rate of 17% per year, which is six times the growth rate of all other firms. Sales from minority owned firms also outpaced revenues in general - growing 34% per year - more than twice the rate of all other firms.

However, even with these impressive growth numbers, minority and women-owned businesses face systemic capital constraints. Unlike the Baby Boomers, the emerging working age population is less likely to have inherited wealth or have pre-existing ties to the business community. In fact, research shows that African-Americans and Latinos are turned down for loans at three times the rate of similarly situated white applicants. Their participation rates in private equity and venture capital, in particular, are also low.

- 4) Start-ups key to job creation: In 2011, the Kaufman Foundation released a study that found that more than 90% of all jobs created between 1997 and 2000 came from small and early stage firms and that a lion's share of these jobs came from firms in existence fewer than five years. Consistent with these findings, data from the U.S. Census Bureau shows that from 1990 to 2003 nearly 80% of jobs created came from firms employing 20 or fewer employees. This means that addressing the capital access needs of small businesses and start-ups is essential to the state's economic recovery and job creation priorities.

California currently provides several loan and loan guarantee programs including the Capital Access Program, administered through the State Treasurer's Office, and the Small Business Loan Guarantee Program, administered through BTH and a statewide network of small business financial development corporations. AB 2619 expands these financing options by providing a state-sponsored equity financing program to partner with private sector investment money managers.

- 5) Competition from other states: California has historically been a national leader in start-ups and venture capital. The state's slow recovery from the recession has offered a unique opportunity for other states to be innovative and provide new access to business capital programs.

As evidence, a large number of states have recently created or will soon create venture funds to support entrepreneur-centered economic development strategies. Among other sources of new

capital, states have allocated a portion of their federal Small Business Credit Initiative (SBCI) funding including the following: Arkansas, Florida, Hawaii, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Missouri, Nebraska, New Hampshire, New Jersey, New York, Ohio, Oklahoma, Puerto Rico, Rhode Island, Tennessee, Texas, Washington, West Virginia and Wisconsin.

Washington State used its \$19.6 million in federal SBCI moneys to fund direct and guarantee loan programs, as well as capitalizing a new venture fund. The \$5 million in federal money allocated for Washington's venture fund is reported to have attracted another \$20 million in private investor capital. The Washington Department of Commerce reports that for every \$1 the state invests, approximately \$15 to \$18 will be generated in private lending or investment, potentially injecting \$300 million into the state economy and generating 3,000 to 6,000 direct and indirect jobs.

In another example, the Missouri Technology Corporation, a public-private partnership created by the Missouri Legislature, established the Missouri TechLaunch, which offers pre-seed funding to start-ups for intellectual property development, including market analysis, proof of concept, and prototype design and development. Individual awards cannot exceed \$100,000 and may be in the form of equity or convertible debt.

Competition among states for attracting start-ups goes beyond California's traditional competition, such as Texas and Washington. Nebraska has a new venture program and a tax credit for angel investors. The North Dakota Development Fund, a new venture capital program through the Bank of North Dakota, provides debt and equity investments for early stage companies in strategically targeted industries.

- 6) Emerging managers and their role in increasing diversity: Like many other professions, minority and woman representation among investment managers at the highest financial levels has been limited. As the economic opportunities in minority and women owned businesses grows, investors are also looking to diversify their internal and external management teams. Several California-based pension funds have taken steps to increase diversity among their asset managers including: the California Public Employees Retirement System, the California State Teachers Retirement System, Los Angeles City Employees Retirement System, Los Angeles Police and Fire, and Los Angeles County Employees.

Based on fiduciary duty and the need to demonstrate prudent management of their beneficiary's assets, institutional investors select asset managers based on a strict set of criteria that generally requires, among other things, extended years of experience managing large investment funds (over \$500 million), and having your own money to invest, as a means for demonstrating alignment of financial interests, sometimes called "skin in the game." Some believe that this high-experience based selection criteria can become a "catch-22" for emerging managers. This potential disconnect between qualified and highly motivated emerging managers and the more experienced money managers threatens the long term success of large institutional investment funds. AB 2619, which would be established as a small size equity investment fund, addresses this disconnect by providing an opportunity for qualified emerging managers to link with large institutional investors around impact investments.

- 7) Background on the I-Bank: The I-Bank was established in 1994 to promote economic revitalization, enable future development, and encourage a healthy climate for jobs in California. Housed within BTH, it is governed by a five-member board of directors comprised of the BTH Secretary (chair), State Treasurer, Director of the Department of Finance, Secretary of State and Consumer Services Agency, and a Governor's appointee. The day-to-day operations of the I-Bank are directed by the Executive Director who is an appointee of the Governor and is subject to confirmation by the California State Senate. Currently, the I-Bank has authority for 24 staff members.

The I-Bank does not receive any ongoing General Fund support, rather it is financed through fees, interest income and other revenues derived from its public and private sector financing activities. According to its 2009-10 independent audit, its programs continue to provide sufficient revenues to support all operating expenses. The I-Bank administers two categories of programs: 1) The Infrastructure State Revolving Fund (ISRF) which provides direct low-cost financing to public agencies for a variety of public infrastructure projects; and 2) Bond Financed Programs which provide financing for manufacturing companies, nonprofit organizations, public agencies and other eligible entities. There is no commitment of I-Bank or state funds for any of the category #2 conduit revenue bonds. Even in the case of default, the state is not liable.

Since its creation in 1994, the I-Bank has loaned over \$400 million to local agencies, developing a high-level of expertise in the financing of public infrastructure. The I-Bank also serves as the state's only general purpose financing authority with broad statutory powers to issue revenue bonds. Over \$30 billion in conduit revenue bonds have been issued by the I-Bank since 2000.

- 8) Oversight hearing: In March 2011, the Assembly Jobs, Economic Development and the Economy (JEDE) Committee held an oversight hearing to examine how the I-Bank's activities impacted local, state and federal economic recovery efforts and California's economic position in the post-recession economy. Following the hearing, JEDE released a preliminary list of recommendations to better align the authorities of the I-Bank with the state's current and future economic development and infrastructure needs. JEDE Members voted to amend four bills to address many of the structural and infrastructure related recommendations including: AB 696 (Hueso), AB 700 (Blumenfield), AB 893 (V. Manuel Pérez) and AB 1094 (John A. Pérez). The Governor vetoed these measures and, instead, proposed to reorganize the I-Bank within the administrative structure of the Governor's Office of Business and Economic Development.

Recommendations related to increasing the I-Banks engagement on economic and business development issues were deferred for additional research and discussion. This year, two measures were introduced by JEDE Committee Members that would heighten the I-Bank's role in meeting the access to capital needs of small businesses: AB 2523 (Hueso) relating to debt finance and AB 2619 (V. Manuel Pérez) relating to equity capital.

- 9) Reorganization of the I-Bank: On March 30, 2012, the Governor submitted a reorganization plan to the Little Hoover Commission, which proposes to dismantle BTH and move programs to other existing and new government entities. The I-Bank is proposed to be relocated to the Governor's Office of Business and Economic Development (GO-Biz), along with Small Business Loan Guarantee Program; The California Travel and Tourism Commission; The California Film Commission; and the Film California First Program. The Secretary of BTH is replaced by the

Director of GO-Biz as Chair of I-Bank. The newly established Secretary of Transportation replaces the Secretary of State and Consumer Services on the I-Bank board.

The Little Hoover Commission has 30 days to analyze the reorganization plan and submit its recommendations to the Governor and Legislature. The Legislature then has 60 days to consider the plan. The plan goes into effect unless the Legislature takes an action to disapprove the plan with a majority of the Members in each house voting. A repositioned I-Bank within GO-Biz offers a range of cost effective and innovative options for advancing the state's economic position. AB 2619 is one of several bills being heard by JEDE in April 2012 that leverages existing programs and resources.

10) Related legislation: Below is a list of related bills.

- a) AB 901 (V. Manuel Pérez) Implementation of Small Business Jobs Act: This bill expands the definition of financial institutions and increases reporting requirements in the California Capital Access Program, which is one of the programs receiving millions of dollars in federal and state funding the federal and state Small Business Jobs Act of 2010. Status: The bill was signed by the Governor, Chapter 483, Statutes of 2011.
- b) AB 981 (Hueso) Implementation of the Small Business Jobs Act: This bill modifies the administrative procedures to the California Capital Access Program in order to encourage greater participation by financial institutions. This is one of the programs receiving millions of dollars in federal and state funding through the federal and state Small Business Jobs Act of 2010. Status: The bill was signed by the Governor, Chapter 484, Statutes of 2011.
- c) AB 1632 (Blumenfeld) State Small Business Jobs Act: This bill provides the necessary statutory changes in the area of job creation and small business development in order to implement the 2010 Budget Act. The bill transfers \$32.4 million from the General Fund to support four small-business and jobs programs that exist in current law. The funding appropriated in this bill goes to the Small Business Loan Guarantee Program (\$20 million); California Capital Access Fund (\$6 million); Small Business Development Centers (\$6 million); and the Federal Technology Centers (\$350,000). Status: The bill was signed by the Governor, Chapter 731, Statutes of 2010.

11) Double referral: The Assembly Committee on Rules voted to refer this measure to JEDE and the Assembly Committee on Banking and Finance. Should this measure be approved at the April 17, 2012 hearing, the bill will be referred to the second policy committee for additional policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

Assembly Committee on Jobs, Economic Development and the Economy (sponsor)
Calexico County Enterprise Zone
California Association for Microenterprise Opportunity
Coachella Valley Economic Partnership
Imperial Valley Enterprise Zone

Sacramento Black Chamber of Commerce

Opposition

None Received

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