Date of Hearing: June 26, 2012

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE ECONOMY
V. Manuel Pérez, Chair
SB 1116 (Leno) – As Amended: April 26, 2012

SENATE VOTE: 39-0

SUBJECT: California Pollution Control Financing Authority: Capital Access Program

SUMMARY: Provides programmatic and administrative flexibility to the requirements of the California Capital Access Program (CalCAP) for the purpose of improving access to debt financing through private sector financial institutions. Specifically, this bill:

1) Extends a financial institution's notification deadline to the California Pollution Control Financing Authority (CPCFA) that a loan has been enrolled into CalCAP from 10 to 15 days.

2) Lowers the minimum fee that a financial institution may choose when enrolling a small business loan within the CalCAP program from 2% to 3.5% to 1% to 3.5% of the total value of the loan. These fees are paid by both the lender and the borrower and set the base for CPCFA's contribution to the loss reserve account.

3) Provides that the fee provision changes in this bill sunset on April 1, 2017.

EXISTING LAW:

1) Establishes CalCAP for the purpose of providing a small business loss reserve account program through participating financial institutions.

2) Requires CPCFA to establish a loss reserve account for each financial institution participating in CalCAP, specifies that all fees paid by the institution, borrowers, state or other entity related to the CalCAP program and the individual institution be deposited into the account, and that the withdrawal of any moneys in the account be approved by CalCAP.

3) Provides that the liability of the state and the CPCFA to the financial institution is limited to the amount of money credited to the loss reserve account of the specific financial institution.

FISCAL EFFECT: Unknown

COMMENTS:

1) Bill Purpose: According to the author, "Since 1994, California Capital Access Loan Program (CalCAP) lenders have loaned almost $2 billion and created thousands of jobs. CalCAP encourages banks and other financial institutions to make loans to small businesses that are having difficulty obtaining capital. In 2010, the Legislature voted to assist CalCAP small business financing, granting it a $6 million appropriation from the General Fund. In addition, CalCAP received State Small Business Credit Initiative Act federal funds in the

amount of $84 million. SB 1116 expands the CalCAP program making it more flexible and convenient for lenders and borrowers to access this additional funding.

In order to increase access and participation, SB 1116 lowers the CalCAP minimum contribution requirement for lenders and borrowers from 2% to 1%. CalCAP lender participation is largely dictated by the contribution requirements of the lender, borrower and CalCAP to the loan loss reserve account. The reduction to a 1% minimum loan requirement will encourage more lenders to enroll small business loans in the program. The lowered contribution amounts will sunset in 2017 to coincide with the expiration of the federal funds. The bill also extends the amount of time lenders have to submit the necessary paperwork to enroll a loan in CalCAP from ten days to 15 days. Smaller lenders have found it difficult to meet the tight ten-day timeline to submit the necessary paperwork to enroll the loan in the CalCAP program. SB 1116 will support increased access to much needed small business loans and will help create more jobs."

2) How Loss Reserve Account Models Work: Even as many areas of California are pulling out of the recession, small businesses continue to report that they face challenges in accessing and retaining credit through traditional financial institutions. For their part, financial institutions report that stricter federal regulations have left them with little flexibility in applying underwriting criteria to a small business community that has been especially hard hit during the recession.

   Credit enhancements, such as loan loss reserve accounts, can play an important role in helping small businesses access private lending, which would otherwise not be available. Under the loan loss reserve model, a participating financial institution establishes a loss reserve account in which fees, based on a small percentage of the value of each enrolled loan, are deposited into the by the lender, borrower and the government financing authority. The financial institution, with the approval of the government financing authority, can later draw against the money in the loss reserve account to cover defaults.

   In the case of CalCAP, fees for the lenders and the borrower are limited by statute to between 2% and 3.5% of the total value of loan and are set on a loan by loan basis by the lender. CalCAP's contribution to the loss reserve is at least equal to the combined total contribution of the lender and borrower, but can be higher based on the source of CalCAP's funds and the location of the small business borrower, with CalCAP contributing more in areas severely affected by high unemployment and other poor economic conditions.

   As an example, if the lender and the borrower each contribute an amount equal to 2% of the loan amount, CalCAP would contribute 4% into the loan reserve account. For loans in "severely affected areas," CalCAP contributions can go as high as 10.5% of the loan amount, i.e. 3.5% of the loan amount paid by both the borrower and the financial institution and CalCAP paying an amount equal to their contribution (7%), plus an additional 3.5% that reflects the potentially higher risk of the geographic region.

   The state has no financial responsibility to cover defaults beyond the fees that are deposited in the individual financial institution's loss reserve account. This model encourages the financial institution to use sound underwriting criteria and to set appropriate loss reserve account fees, which reflect the risk associated with the loan. If the institution does a poor job of either selecting loans or setting fees, the money in the loss reserve account will be depleted prior to the repayment of all enrolled loans.

Historically, funding for CalCAP came from fees related to the issuance of private activity revenue bonds. In late 2010, legislation passed (AB 1632, Chapter 731, Statutes of 2010) to provide additional funds to CalCAP and to expand the definition of severely affected communities to include communities with high unemployment. With the $6 million in additional state, and later $84 million in federal funds from the Small Business Jobs Act, CalCAP has significantly increased its role within small business capital markets.

Among other distinctions, the CalCAP program is one of the few sources of funding for business start-ups and microentrepreneurs. By partnering with community development financial institutions and other microlenders, CalCAP enrolled 896 loans to microenterprises (business with less than 5 employees) out of the 1,509 total loans made in 2011, which leveraged $11.3 million in loans.

With 80% to 90% of net new job growth coming from businesses with less than 20 employees, addressing the capital access challenges of these smallest size and new businesses is essential to the state's recovery and long term growth.

3) Regulatory Relief: SB 1116 proposes to increase the number of days a financial institution has to notify CPCFA regarding an enrolled loan by an additional five days. According to the CPCFA, this additional time is necessary to accommodate some of the smallest size lenders that may have challenges in meeting all the paperwork requirements in a short period of time.

   The Committee may wish to consider whether additional administrative flexibility would be useful and authorize the CPCFA Executive Director to grant, on a case by case basis, an additional amount of time to submit a complete enrollment report. There may be instances beyond the reasonable control of the financial institution, such as natural disasters, extended federal and state holidays, or serious illness of the borrower that could impede the completion of all of the enrollment materials. Completed paperwork is an important administrative criterion; however, regulatory flexibility may provide a better functioning program and allow the program to better serve the access to capital needs of small businesses.

4) California Capital Access Program for Small Businesses: CalCAP was established by legislation enacted in 1994. The program assists small businesses in obtaining loans through participating financial institutions using a loss reserve account model, which is described in comment #2.

   The objective of CalCAP is to incentivize financial institutions to provide small businesses with the capital to maintain and grow their business. Unlike a direct loan, a loss reserve account serves as a credit enhancement to loans made by private for-profit and non-profit financial institutions. Loans can be used to finance the acquisition of land, construction or renovation of buildings, the purchase of equipment, other capital projects and working capital. There are limitations on real estate loans and loan refinancing.

   The maximum loan amount is $2.5 million; however, no loan of that size has been made since 2008. The average loan size in 2011 was $66,000. Lenders set the terms and conditions of the loans and decide which loans to enroll into CalCAP. Loan fees, which are used to capitalize the loan reserve account, are set by the lender as a small percentage of the total loan amount. SB 1116 proposes to increase the percentage from 2% to 3.5% to 1% to 3.5%. Loans can be short- or long-term, have fixed or variable rates, be secured or unsecured, and bear any type of amortization schedule.

In 2011, CalCAP enrolled 1,509 loans, which leveraged $101 million in loans to 1,441 California small businesses. Approximately, $2.3 million was paid from the loss reserve accounts in 2011; representing an 85% reduction in claims from 2010.

Legislation passed in 2011 [AB 901 (V.Manuel Pérez), Chapter 483, Statutes of 2011], required CPCFA to begin to separately track new and retained jobs and to also report loans by the industry sector of the small business borrower. CPCFA begins disclosing information under this more refined system following the first quarter of 2011, therefore the reporting is divided into two parts. In the first quarter of 2011, CalCAP facilitated lending created or affected 866 jobs. In the final three quarters, 836 new jobs and 6,393 jobs were retained through CalCAP supported loan activity.

Small transportation and warehousing firms had the largest proportion of loans accessed through CalCAP in 2011, representing 589 loans, which leveraged $37.9 million. Manufacturing businesses received the second largest number of loans, which accessed $12.1 million in loans and accounted for 11% of all dollars enrolled in loss reserve accounts.

As of December 31, 2010, the total number of loans enrolled in the program since 1994 was 10,301. CalCAP lenders have cumulatively loaned over $2.07 billion since the program's inception in 1994.

5) 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 they 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. According to the Small Business Administration's Small Business Economy 2011, small businesses nationally outperformed large firms in net job creation nearly three out of four times from 1992 through 2010 when private-sector employment rose.

During the most recent recession, however, small businesses have been especially hard hit. Equifax reported that bankruptcies in California rose by 81% in 2009, as compared to 44% nationally. This trend continued in 2010. While in general bankruptcies were down across the nation in 2011 (a 26% decrease), Equifax reported small business bankruptcies in California accounted for almost 20% of all small business bankruptcies in the nation. In 2011, the metropolitan statistical areas (MSAs) in western states continued to lead the nation in small business bankruptcies. Bankruptcies in the western region overall, however, experienced the most significant decrease in bankruptcy filings year over year from Q1 2011 to Q1 2012 in the nation - more than a 40% decline in some MSAs.

6) Related Legislation: Below is a list of related legislation from current and previous legislative sessions relating to CalCAP:

a) *AB 796 (Blumenfield)*: This bill would increase the maximum contribution by the financial institution to $200,000, if the matching contribution made by CPCFA is funded exclusively from funds made available pursuant to the federal Small Business Jobs Act of 2010. The bill would limit the amount of those funds used for matching contributions for deposits exceeding $100,000 to not more than 50% of the available funds. Status: The bill was heard in the Senate Committee on Governance and Finance on June 20, 2012.

b) *AB 901 (V. Manuel Pérez)*: This bill expanded the CalCAP definition of financial institution and increased reporting requirements. CalCAP is one of the programs which received multimillions of dollars in federal and state funding for small business through the federal and state Small Business Jobs Act of 2010. Status: The bill was signed by the Governor, Chapter 483, Statute of 2011.

c) *AB 981 (Hueso)*: This bill expanded the CalCAP definition of financial institution, authorized the withdrawal of a lower portion of the interest or other income from a loss reserve account to cover program costs, and required additional financial assistance to qualified business in severely affected community such as an area with high unemployment. CalCap is one of the programs which received multimillions of dollars in federal and state funding for small business through the federal and state Small Business Jobs Act of 2010. Status: The bill was signed by the Governor, Chapter 484, Statute of 2011.

d) *AB 1632 (Blumenfield):* This bill provided 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.

e) *SB 225 (Simitian):* This bill authorized the authority to establish loss reserve accounts for the purposes of terminal rental adjustment clause leasing, if funds are available for contribution into the loss reserve account from any source other than the authority. Status: The bill was signed by the Governor, Chapter 492, Statutes of 2011.

f) *SB 832 (Senate Committee on Environmental Quality)*: This bill revised, under the tax-related provisions, the terms "project" and "pollution control facility", as defined in the California Pollution Control Financing Authority Act that are eligible for the sales and use tax (SUT) exclusion and includes public agencies in the definition of "participating parties" that are eligible for financial assistance in connection with the projects designed to control or eliminate environmental pollution. Status: Signed by the Governor, Chapter 643, Statutes of 2009.

g) *SB 1311 (Simitian):* This bill reduced the CalCAP monetary contribution of the CPCFA to an amount equal to the amount of fees paid by a participating financial institution. The bill also authorizes the withdrawal of interest or other income from the loss reserve accounts for the purpose offsetting administrative costs and contributions. Status: The bill was signed by the Governor, Chapter 401, Statutes of 2008.

REGISTERED SUPPORT / OPPOSITION:

Support

California State Treasurer (sponsor)
California Bankers Association

Opposition

None received

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