Date of Hearing: April 23, 2013

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE ECONOMY
Jose Medina, Chair
AB 780 (Bocanegra) – As Amended: February 21, 2013

SUBJECT: Small business financial development corporations

SUMMARY: Appropriates $2 million from the General Fund for the purpose of providing administrative funding to the state's small business financial development corporations (FDCs). Each FDC is eligible to receive $150,000. This bill also states that it is the Legislature's intent that the FDCs are to be under the jurisdiction of the Governor's Office of Business and Economic Development (GO-Biz).

EXISTING LAW

1) Authorizes the approval of 11 FDCs by BTH for the purpose of administering a number of small business finance programs including the Small Business Loan Guarantee Program (SBLGP), direct loans, disaster assistance loans and surety bond guarantees.

2) Establishes the SBLGP for the purpose of assisting small businesses in obtaining long-term loans or lines of credit from conventional financial institutions, which small businesses would not otherwise qualify for without the guarantee. Under this program, FDCs act as financial intermediaries between the state, the small business, and the financial institution.

3) Establishes the California Small Business Expansion Fund (Expansion Fund) for the purpose of retaining the moneys which separately capitalize the SBLGP and paying out defaulted loan guarantees issued under the SBLGP. Each account within the Expansion Fund is legally separate and is prohibited from securing loan guarantees or other obligations of another FDC. The state is not liable or obligated beyond the funds allocated and deposited in an individual trust fund account within the Expansion Fund.

FISCAL EFFECT: Unknown

COMMENTS:

1) Author's Purpose: According to the author, "FDCs serve the backbone of the California economy—small businesses. Established more than 40 years ago, FDCs have a proven track record of helping businesses create and retain jobs. In the last decade they've helped retain 101,248 jobs and created 19,970. More specifically, FDCs have excelled with help from the Small Business Loan Guarantee Program [SBLGP].

   In 2010, the federal Jobs Act brought $168 million to California to help stimulate job growth. Despite their track record, since 2008 FDCs' administrative budgets have taken unnecessary reductions. As a result, staffing levels—and by extension the ability of these FDCs to get loans out the door—dropped significantly. In 2006, California funded FDCs' administrative budgets to the tune of $4 million. Loans reached 1357. Since 2008, when their budgets were slashed, loans dipped to less than 356. The federal rules require California to obligate its share of funds by 2017 or the funds remit back to the US Treasury. Without the administrative support that we've historically given them, our FDCs stand to lose out on more than $50 million in federal funding and more than $500 million in leveraging opportunities. That's less job creation at a time when California's unemployment rate is tied for last in the country."

2) Framing the Policy Issue: The measure proposes the appropriation of $2 million for the purpose of supplementing FDC administrative funds, which will allow them to assist small business access up to $84 million in loan guarantees.

   Paying administrative costs for delivering federal block grants is an issue that the state has long struggled. From the federal government's perspective, it does not seem unreasonable to expect states to cover state-side administrative costs when they are sending $168 million to implement the capital access program of the state's choice.

   In the past, California's failure to provide administrative funds has resulted in the loss of federal dollars to other states, as in the case of the Small Business Development Center Program; penalties in future program years, as is the case of the Small Cities Community Block Grant Program; and an inability to obtain the maximum leverage of federal dollars, as in the case of the disabled veteran opportunity. The analysis includes additional details on California's small business economy, the SBLG Program, the federal Small Business Jobs Act, and related legislation. Amendments requested by the Business Transportation and Housing Agency, (BTH) are discussed in comment 7.

3) California Small Business: 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. California small businesses comprised 96% of the state's 60,000 exporters in 2009, which accounted for over 44% of total exports in the state. Nationally, small businesses represented only 31.9% of total exports. These numbers include the export of only goods and not services.

   Historically, small businesses have functioned as economic engines, especially in challenging economic times. During the nation's economic downturn from 1999 to 2003, microenterprises (businesses with fewer 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. From 2000 to 2001, microenterprises created 62,731 jobs in the state, accounting for nearly 64% of all new employment growth. More recently, the federal Small Business Administration's Small Business Economy 2011 report, stated that 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 recent economic downturn, however, small business owners were especially hard hit. Equifax reported that bankruptcies in California rose by 81% in 2009, as compared to 44% nationally. This trend continued in 2010 where the Equifax report stated that while in general bankruptcies were down across the nation including some regions in the west, small business bankruptcies in California accounted for almost 20% of all small business bankruptcies in the nation.

4) Small Business Loan Guarantee Program: The SBLGP enables a small business to obtain a term loan or line of credit when it cannot otherwise qualify for a loan on its own. The state, working through 11

FDCs, offers direct loans or loan guarantees that a qualifying small business borrower could not otherwise obtain.

Applicants must meet the definition of a small business (100 or fewer employees) with the specific market rate loan terms and interest rates being negotiated between the borrower and the lender. Proceeds of the loan must be used primarily in California for any standard business purpose applicable to the applicant's business. The guarantee program provides guarantees covering up to 90% of the loan, but not exceeding $500,000. The guarantee program allows a business to not only obtain a loan but to also establish credit with a lender. The business is then more likely to obtain additional future financing on its own.

In 2011-12, approximately $5.7 million was made available for loan guarantees under the state SBLGP, which leveraged $9.9 million in small business loans from financial institutions. During this period 178 guarantees were provided, creating and/or retaining over 1,200 jobs. There are currently 1,046 loans being guaranteed under the state program.

5) Small Business Jobs Act and Federal Guarantee Program: In October 2010, Congress passed and the President signed the Small Business Jobs Act (Act). Among other things, the Act created the State Small Business Credit Initiative (SSBIC), which is authorized to expend up to $1.5 billion for state sponsored small business finance programs. Over the life of the program, every federal dollar must be matched by $10 private sector dollars. September 2017 is the deadline for using the funds. Funding for the administration, outreach, and oversight of the program is primarily the responsibility of the state.

Under the funding formula, California is eligible to receive up to $168 million, which is the largest amount of any state. The next highest award is $97 million for Florida, with every state that applies receiving a minimum of $13.1 million. California uses its moneys to capitalize the SBLGP administered through BTH and a loss reserve program and collateral support program administered through the California Pollution Control Financing Authority at the state Treasurer's Office.

Funding is awarded to states in three tranches with participating jurisdictions allowed to apply for the next round of funding when 80% of their current funds are expended. Nine of the 57 participating jurisdictions have received second round funding and three states are into their third and final round.

Of the $68 million California received in the first round, California has encumbered $16.6 million, with approximately $13.4 million set aside to cover loan guarantees under the federal portion of the SBLG Program. Over 18, 600 jobs have been created or retained by the close of 2012.

In 2011-12, approximately $36.2 million in guarantees were made under the federal SBLGP, which leveraged $58.2 million in small business loans from financial institutions. During this period, 203 guarantees were provided, creating or retaining 6,000 jobs through guarantee activities.

There are currently 297 loans being guaranteed under the federal program, 85% have been to businesses in low- and moderate-income areas. Approximately 19% of the loans have been in the accommodation and food services, 15% in construction, and 9.5% in real estate and leasing, and 9.2 in retail trade. Relative to size of business, 46.7% has had 11 to 50 employees and 36.8% have had less than 10 employees.

According to the FDCs, one impediment to getting the SBLGP portion out is the lack of state administrative support. Repeated budget actions have severally limited ongoing management funds and crippled the state portion of the program, which allowed greater programmatic flexibility in serving the needs of small businesses.

JEDE will hear three measures which are designed to enhance the program and help to facilitate the drawdown of additional federal dollars. AB 201 (Holden) encourages greater private financial institution participation; AB 1247 (Medina) makes programmatic changes to streamline the program; and, AB 780 (Bocanegra) appropriates $2 million for FDC administrative costs.

6) FDC Funding: Historically, the state has provided for a portion of the FDCs administrative costs through an annual payment that has ranged from $120,000 to $418,000 a year. FDCs are paid an additional fee per loan based on a percentage of the loan value. In the last few years, both the state administrative costs and program dollars available for FDC guarantees have shrunk significantly requiring many of the 11 FDCs to lay-off employees and/or not replace vacated positions. As an example, total loan guarantee volume went from 1,035 in 2008/09 to only 178 in 2011/12.

   As California was preparing to receive the federal funding the Legislative Analyst Office opined that the receipt of the federal dollars would mean the state could begin to back out its administrative support for the program. This decision to pay lower administrative costs is jeopardizing the state's ability to draw down all available federal funds. Most recently, administrative costs to the FDCs under both the state and federal program were only $185,090, which is hardly sufficient to successfully deliver tens of millions in loan guarantees to the state's small businesses.

   In discussion with committee staff, the U.S. Treasury was quite clear that each state was expected to address administrative costs for the programs that chose to operate. Federal guidelines limit administrative costs in the first tranche to 5%, 3% in the second and no administrative costs are allowed in the final installment. AB 780 is an important step in ensuring FDCs have the capacity to deliver the federal and existing state program by providing each FDC with an additional $150,000.

7) BTH Amendments: In an unusual move for a state agency so early in the year, BTH offered to go neutral on AB 780 if the author was willing to take an amendment that $1.65 million of the funds would be distributed to FDCs in accordance to set of performance indicators which would be developed by the program manager and approved by GO-Biz. The purpose of the additional $350,000 would also need to be clarified, pursuant to the letter. The author is still considering the amendments.

   If the amendments are taken, the committee may wish to provide some framework as to how the performance indicators would be applied, as possibilities vary widely. As an example, the funds could be awarded based on which FDCS moved the largest volume of guarantees, or the FDCs that had to least current capacity to deliver the program, or the region with the greatest unmet small business capital need, or which FDCS fill paperwork out the best. As currently designed, the bill proposes each FDC would receive $150,000.

8) Governor's Office of Business and Economic Development: In April 2010, the Governor's Office of Economic Development was established to provide a One-Stop-Shop for serving the needs of businesses and economic developers. While initially established through Executive Order S-01-10, the office was later codified and renamed as GO-Biz, in AB 29, Chapter 475, Statues of 2010. In 2012, GO-Biz directly assisted 5,308 companies, resulting in the creation and/or retention of 9,050 jobs and $1.45 billion in investments.

Among other programs, GO-Biz provides permit and other business assistance for new and expanding businesses, as well as administering the California Innovation Hub Program under an initial partnership with the statewide network of SBDCs. GO-Biz also oversees the Office of the Small Business Advocate, who advocates for and provides key information to small businesses. Up until January 1, 2013, the California SBDC Program was co-located at GO-Biz.

In March 2012, the Governor initiated a reorganization process to realign the state's administrative stricture. Key changes were proposed and agreed to by the Legislature including the dismantling of the Business, Transportation and Housing Agency (BTH) and the shifting of a number of key programs and services to GO-Biz including:

- The Small Business Loan Guarantee Program;
- The California Travel and Tourism Commission;
- The California Film Commission;
- The Film California First Program; and
- The Infrastructure and Economic Development Bank (I-Bank).

In addition, the Governor called for the placement of the California SBDC Program within GO-Biz. Programmatic approval of the reorganization was granted in July 2012 and will become effective July 2013. Legislation is, however, also necessary to statutorily reflect the reorganization changes.

9) Audit of Federal Program: In May of 2012, the U.S. Treasury Office of the Inspector General (OIG) submitted its first audit of the SSBIC Program. As the largest recipient of federal funds and the being one of the earliest program providers, California was the subject of the first audit. OIG found that a majority of the $3.6 million that had been expended at the time of the audit had been properly used, however, three issues arose during the course of the audit. First, $133,250 in SBLGP funds were found to not comply with program requirements and the amount of those funds had to be returned to Treasury.

Second, approximately 58% of the loans did not have all the required borrower and lender assurances. U.S. Treasury agreed to address the collection of the lender and borrower assurance, but asserted that the documents were unnecessary as each state's quarterly reports were already mandated to serve that purpose, pursuant to Article 4.7 of the Allocation Agreement between each state and Treasury. While California had provided the quarterly reports, the OIG sample of loan documentation suggested that the reports were materially inaccurate. Since this time, required documentation has been provided.

Finally, $160,000 in state administrative costs was determined to have inadequate documentation. The state agreed to provide supplemental information on the use of the funds and staff is not aware of the final disposition of this finding.

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

a) *AB 29 (John A. Pérez) Codification of GO-Biz*: This bill establishes GO-Biz within the Governor's Office for the purpose of serving as the lead entity for economic strategy and marketing of California on issues relating to business development, private sector investment and economic growth. The bill also transfers the Office of the Small Business Advocate from BTH to GO-Biz. Status: Signed by the Governor, Chapter 475, Statutes of 2011.

b) *AB 1247(Medina) Restructure of the FDC Programs*: This bill repeals and recasts the provisions of the FDC small business financing programs from BTH to GO-Biz. Status: Pending in the Assembly Committee on Jobs, Economic Development and the Economy.

c) *AB 201 (Holden) Financial Institution Participation in FDC Programs:* This bill requires the names of the financial institutions and financing companies that make direct loans that include credit enhancements offered by FDCs be posted on the website of the Business and Consumer Services Agency. Status: Pending in the Assembly Committee on Jobs, Economic Development and the Economy.

REGISTERED SUPPORT / OPPOSITION:

Support

California Coastal Rural Development Corporation
The Valley Economic Development Center

Opposition

None received

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