

Date of Hearing: June 19, 2018

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sharon Quirk-Silva, Chair

SB 551 (Hueso) – As Amended June 13, 2018

SENATE VOTE: 39-0

SUBJECT: Capital Access Loan Program for Small Businesses

SUMMARY: Transfers certain funding and loan portfolios from the California Pollution Control Financing Authority (CPCFA) to the Small Business Finance Center administered by the California Infrastructure and Economic Development Bank (IBank). Specifically, **this bill:**

- 1) **Legislative Findings:** Makes findings and declarations that include, but are not limited to:
 - a) In October 2010, US Congress passed and the President signed the Small Business Jobs Act. Among other things, the act created the State Small Business Credit Initiative (SSBCI), which allowed expenditures up to \$1.5 billion for state sponsored small business finance programs. California utilized its federal SSBCI money to capitalize three programs: a loan guarantee program, a loan loss reserve program, and a collateral support program;
 - b) In February 2011, CPCFA was allocated approximately \$84 million pursuant to the SSBCI for use by the authority in administering the California Capital Access Program for Small Business (CalCAP for Small Business) and the CalCAP Collateral Support program;
 - c) On April 25, 2017, the State Treasurer’s office alerted the public and interested stakeholders that the federal moneys allocated to California to support CalCAP were near exhaustion, as were the 2010 General Fund moneys appropriated to expand CalCAP. In order to avoid shutting down CalCAP, CPCFA adopted regulations to recapture some funds it had previously contributed to CalCAP;
 - d) On May 30, 2017, AB 964 (Calderon), relating to CalCAP and the establishment of the California Affordable Clean Vehicle Program, was amended to remove “for Small Businesses” from the title of the Capital Access Loan Program to read “Capital Access Loan Program;” and
 - e) Without direction from the Legislature, a distinct possibility exists that federal funds that were allocated for the purpose of assisting small businesses might be redirected to support programs separate and apart from small business assistance, which runs counter to the intent set forth in the federal Small Business Jobs Act of 2010.
- 2) **More Legislative Findings:** Makes legislative declarations and expresses legislative intent that include, but are not limited to:
 - a) It is appropriate, as federal program funding expires, or as the funds have been fully disbursed, that the portfolio of CalCAP for Small Business and the portfolio of the Collateral Support program be transferred from the CPCFA to the California Small Business Finance Center within the IBank; and
 - b) Nothing in this act shall impede the ability of the CPCFA to operate the California Capital Access Program with other program funds, as well as to administer the California Americans with

Disabilities Small Business Capital Access Loan Program, as specified, and the California Seismic Safety Capital Access Loan Program, as specified.

- 3) **Capital Access Reserve Fund:** Establishes the Capital Access Reserve Fund within the State Treasury under the administrative control of the California Small Business Finance Center within the IBank for the purpose of receiving state, federal, or local government moneys and other public or private moneys to make loans, credit enhancements, and other financial products, as specified. Related provisions in the bill include, but are not limited to:
 - a) Providing similar provisions and authorities as those provided to the California Small Business Expansion Fund, an existing fund that is authorized to hold collateral and other moneys administered by the California Small Business Finance Center;
 - b) Specifying that the money in the Capital Access Reserve Fund is continuously appropriated without regard to fiscal years, for the purposes of this chapter; and
 - c) Limiting state and bank liability and obligation to only those moneys allocated in the Capital Access Reserve Fund for these purposes.
- 4) **Transfer of Funds:** Requires the transfer of specified federal and state funds from the CPCFA to the Capital Access Reserve Fund, which is under the administrative control of the California Small Business Finance Center. Related provisions in the bill include, but are not limited to:
 - a) Specifying that these funds include all federal and state funds the source of which was the federal SSBCI or the 2010 General Fund appropriation under Assembly Bill 1632 of the 2009–10 Regular Session, Chapter 731 of the Statutes of 2010, including funds that have been returned to or recaptured by the CPCFA and are currently under its control;
 - b) Requiring, for the purpose of initiating the transfer, that the IBank board adopt a resolution providing the terms and conditions of the transfer. The IBank may confer with the CPCFA on the terms and conditions of the resolution;
 - c) Requiring the CPCFA to provide requested information in a timely manner and, upon adoption of the resolution, transfer the moneys; and
 - d) Providing that the final transfer of the funds shall occur no later than January 1, 2020.
- 5) **Contracts with Lenders:** Authorizes the IBank program manager to enter into a contract between the IBank and any financial institution or financial company in connection with one or more programs or financial products, as specified.
- 6) **Loss Reserve Accounts:** Authorizes the IBank to create one or more loss reserve accounts in the Capital Access Reserve Fund or a trust fund for a financial institution or financial company participating as a lender in the Capital Access Loan Program for Small Businesses. Related provisions in the bill include, but are not limited to:
 - a) Specifying that funding in the account is to be used for the following purposes:

- i) Depositing all required fees paid by the financial company or financial institution, and the small business;
 - ii) Depositing contributions made by the state and, if applicable, the federal government or other sources; and
 - iii) Covering losses on enrolled loans sustained by a financial company or financial institution by disbursing funds accumulated in the loss reserve account;
- b) Requiring the IBank to manage all moneys in a loss reserve account, as specified;
 - c) Requiring all interest or income earned on money credited to a loss reserve account to be deemed to be part of the loss reserve account; and
 - d) Authorizing the IBank to withdraw from a loss reserve account all, or a portion, of the interest or other income that has been credited to the account.
- 7) **Holding Accounts:** Authorizes the creation of one or more holding accounts in the Capital Access Reserve Fund to accommodate the temporary or permanent transfer of funds pursuant to requirements and directives adopted by the IBank board relating to the suspension and termination of a financial institution's or financial company's participation in a program or offering of a service, as specified.
- 8) **Capital Access Loan Program:** Establishes the Capital Access Loan Program for Small Businesses, a loan loss reserve program, under the administrative control of the California Small Business Finance Center. Related provisions in the bill include, but are not limited to:
- a) Authorizing the IBank to contract with any financial company or financial institution for the purpose of serving as a lender in the Capital Access Loan Program for Small Businesses;
 - b) Requiring that a program priority be placed on loans and microloans that benefit low-income areas and women- and minority-owned businesses;
 - c) Requiring the IBank to develop directives and requirements to implement the Capital Access Loan Program for Small Businesses, including, but not limited to:
 - i) The initiation of new and extension of existing agreements to participate in the program;
 - ii) The filing of claims for reimbursement for losses incurred as a result of qualified loan defaults;
 - iii) The terms and conditions for a financial company or financial institution to assign, transfer, pledge, or securitize all or a portion of any enrolled loan or loss reserve account, pursuant to directives and requirements developed by the IBank;
 - iv) The terms and conditions by which the program manager may temporarily suspend and terminate a contract with a financial institution or financial company for cause, including provisions for appeals; and
 - v) Annual reporting requirements on the use and outcomes of the program;

- d) Limiting the liability of the state and the IBank to the financial institution or financial company under contract to only the amount of money credited to the loss reserve account of the financial institution and financial company under contract; and
 - e) Establishing a process whereby a financial company or financial institution is authorized to withdraw from the Capital Access Loan Program for Small Businesses, including, but not limited to, providing written notice to the IBank that all loans secured by its loss reserve account have been repaid, that there are no pending claims for reimbursement for losses incurred as a result of loan defaults, and that the financial company or financial institution waives all rights to submit claims for reimbursement for losses incurred, as specified.
- 9) **Transfer of Loan Portfolios:** Transfers the loss reserve loan portfolio and the collateral support loan portfolio of the California Capital Access Loan Program administered by the CPCFA to the IBank. Related provisions in the bill include, but are not limited to:
- a) Limiting loans transferred to only those which were secured by state funds received by CPCFA in a 2010 general fund appropriation, as specified, and federal funds awarded to the state pursuant to the SSBCI, as specified;
 - b) Specifying that the loan portfolio transfers are to be initiated by the IBank board adopting resolutions which provide for the terms and conditions of the transfers;
 - c) Authorizing the IBank to confer with the CPCFA in developing the resolutions and requiring the CPCFA to provide requested information in a timely manner; and
 - d) Requiring the CPCFA to transfer the portfolios upon the adoption of the resolutions. Both loan portfolios are required to be transferred no later than January 1, 2020.
- 10) **Transitioning Regulations:** Specifies that all related regulations adopted by the CPCFA pursuant to the California Capital Access Program and the Collateral Support Program are to remain in effect until the IBank board adopts directives and requirements addressing those issues. The bill sets a September 1, 2019, deadline for the IBank to adopt the directives and requirements.
- 11) **Progress Report:** Requires a progress report be made to the Legislature on the implementation of the transfer of funds and loan portfolios, as specified. The first report is due no later than July 1, 2019, and the last letter is to be submitted no later than July 1, 2020.

EXISTING LAW:

- 1) Establishes the Governor's Office of Business and Economic Development (GO-Biz) within the Governor's Office for the purpose of serving as the lead state entity for economic strategy and marketing of California on issues relating to business development, private sector investment and economic growth.
- 2) Establishes the IBank within GO-Biz and authorizes it to undertake a variety of infrastructure related financial activities, including, but not limited to, the administration of the Infrastructure State Revolving Fund ISRF, the oversight of the Small Business Finance Center, and the issuance of tax-exempt and taxable revenue bonds.

- 3) Establishes the CPCFA with specified powers and duties, and authorizes it to approve financing for pollution control projects and facilities, administer a loss reserve program to serve the credit needs of small businesses, and provide grants and loans to remediate brownfields, among other activities.
- 4) Establishes CalCAP for the purpose of providing a small business loss reserve account program through participating financial institutions. In implementing the program, CPCFA is authorized to establish a loss reserve account for each financial institution with which the authority makes a contract. The loss reserve account shall consist of moneys paid as fees by borrowers and the financial institution, moneys transferred to the account from CPCFA's Small Business Assistance Fund, any matching federal moneys, and any other moneys provided by the authority or other source.

FISCAL EFFECT: Unknown

POLICY FRAMEWORK: California was allocated \$168.4 million from the federal government through the SSBCI under the federal Small Business Jobs Act of 2010. These funds were split between two state entities which coordinated the implementation of their separate programs to ensure that the state drew down all applicable dollars in a timely fashion and met the very particular federal requirements.

The federal Allocation Agreement expired in March 2017, and all federal funds have been fully obligated or expended. Under the terms of SSBCI, all federal restrictions on the use of the moneys are removed, leaving the only restrictions being those that the state has placed upon itself and those contained in previously entered into contracts.

A key policy question before the Legislature is how these moneys should be re-deployed to meet the financial needs of small businesses. Since the initial conversations about the possible uses for the federal allocation, a number of organizational changes have occurred within the state, including the establishment of a Small Business Finance Center within GO-Biz and the IBank and the transfer of one-half of the state's SSBCI allocation to the new center.

SB 551 proposes to move the other half of funds, including related loan portfolios, to the Small Business Finance Center. The author and sponsor, Opportunity Fund, believe that the transfer represents the best decision based on the current operations of the small business programs and for the future discussions on re-deploying upwards of \$50 million as it becomes available for extending existing and developing new small business financial products. The California State Treasurer, who Chairs CPCFA, opposes the transfer and has expressed concerns that it could undermine other financial products CPCFA administers on behalf of other agencies and may undercut its ability to expend the \$20 million it is holding to capitalize two additional loss reserve programs.

The Comment section of the analysis includes information on JEDE's first review of SB 551 (June 2017) when the author tried to broker a compromise between the lender community and the CPCFA on how to continue the program following the completion of the federal funding cycle. In addition, the Comment section includes background on the CalCAP-related financial products; the establishment of the Small Business Finance Center; and how SB 511 proposes to transfer the funds and management of the loan portfolios. A statement of the State Treasurer's opposition and the author's response are included in Comment 9. Technical amendments are proposed in Comment 11.

COMMENTS:

- 1) **Second Review of SB 551 by JEDE:** As SB 551 passed JEDE in June of 2017 on a 6 to 0 vote, the measure proposed to codify the limited recapture of state moneys that were deposited in a small

business loss reserve account held by a private financial institution participating in the CalCAP for Small Business program. Existing law limits recapture by CPCFA to only interest and income earned on the account, which was generally used to cover CPCFA administrative costs with the remaining amount available for other program-related activities.

At the same time that SB 551 was moving through the Legislature, CPCFA was proposing to adopt a similar, but not identical, regulatory change to allow for expanded recapture provisions, including setting mandatory annual sweeps of principal and interest and committing all recaptured funds toward the ongoing operation of the loss reserve program. The impetus for these expanded recapture provisions, according to CPCFA, was the otherwise imminent shutdown of the CalCAP for Small Business program due to a lack of substantial new funding.

For his part, Senator Hueso had introduced SB 551 to help negotiate a compromise between CPCFA and the lender community, many of whom felt the CPCFA proposed recapture provisions were too aggressive. Opportunity Fund, a national leader among community development financial institutions and sponsor of SB 551, was particularly concerned that a shutdown of the program could have a serious impact on the microenterprise owners which have very limited financial options in the marketplace.

How Loss Reserve Programs Work

The loss reserve account serves as a revenue pool for a participating lender to be reimbursed for the value of a defaulted loan that has been enrolled in CalCAP. The lender may only be reimbursed to the extent that moneys are available in the account.

As each loan is enrolled in CalCAP, the financial institution, the borrower, and the state each contribute funds. These moneys remain in the loss reserve account to offset future losses.

In July 2017, SB 551 was set to be heard in Assembly Committee on Banking and Finance. Prior to the hearing, the California Bankers Association, among other stakeholder groups, expressed growing concerns that any recapture of CPCFA's principal contribution to the loss reserve account could jeopardize the fiscal integrity of the whole account. As these new recapture provisions were not included in the initial CalCAP lender agreements, financial institutions argued, they would not have considered this possible circumstance when underwriting loans for inclusion in the program. Based on these concerns, Senator Hueso pulled the bill from the Assembly Banking Committee hearing and made SB 551 a two-year bill.

At CPCFA's July 18, 2017, meeting, the recapture changes were agendized, discussed, and approved utilizing its authority to adopt emergency regulations. Based on the official minutes from the meeting, previously submitted public comments were discussed as part of that hearing, including concerns that CPCFA lacked the statutory authority to recapture more than interest earned on the loss reserve accounts. The CPCFA's executive director cited three Health and Safety Code sections, including 44559.2(e); 44559.3(c); and 44559.3(d), which, the board was told, provided CPCFA with the ability to adopt policies to increase sustainability of the program. Additionally, the executive director stated that the lack of specific statutory authority found in statutes related to other CalCAP programs "in no way limits discretion of the Authority to do the same in legacy programs."

With the CalCAP for Small Business regulation amended, lenders were required to affirm their election to the new recapture provisions and remit the required funds or "be deemed ineligible to submit loan enrollments on or after August 15, 2017."

Following the CPCFA's July 2017 meeting, the author requested that SB 551 be withdrawn from the Assembly Committee on Banking and Finance and returned to the Assembly Committee on Jobs,

Economic Development, and the Economy, where further work could be undertaken. In September 2017, the recapture provisions were removed from the bill and replaced with legislative intent to transfer CalCAP to the Small Business Finance Center where the other SSBCI program was located.

- 2) **California's use of Federal SSBCI Funds:** In 2011, California received a significant allocation of federal funds through the SSBCI, a program established under the federal Small Business Jobs Act of 2010. Under the initial federal Allocation Agreement, \$168.4 million was divided equally between the CalCAP for Small Business program administered through CPCFA and the Small Business Loan Guarantee Program administered through the Business Transportation and Housing Agency (BTH) and later the IBank under the Governor's Reorganization Plan GRP2.

Receipt of these funds was very timely as debt markets were frozen and state resources were very limited for these two small business credit enhancement programs. In fact, both CPCFA and BTH were short on revenues to operate their programs and had received General Fund appropriations in 2010, with \$6 million being approved for CalCAP and \$20 million for Small Business Loan Guarantee Program; AB 1632, Chapter 731, Statutes of 2010. Unfortunately for small business borrowers, BTH's \$20 million was eliminated in the following year's budget.

Due to federal accounting practices and slight variations in federal SSBCI loss reserve and guarantee program requirements, CPCFA and the IBank each established new reserve accounts and adopted new federal versions of their programs. Once CPCFA and the IBank received the federal funds, the program priorities for each of the programs were to use the federal funds first and leave the state funds for either nonconforming loans or for use when the federal moneys had been exhausted.

Over the course of the six program years (2011 to 2017), the state amended the federal Allocation Agreement several times, and in the latter years, CPCFA sought authorization to administer a third credit enhancement program, a Collateral Support Program. CPCFA used the federal funds as follows: Loss Reserve Program (\$20 million) and a Collateral Support Program (\$65 million).

The federal Allocation Agreement expired in March 2017. Both CPCFA and the IBank report that all federal funds have been expended or allocated, meaning that as these moneys become unencumbered from their current loans the moneys can be re-deployed. As an example, funds in the Collateral Support Program could be used to continue enrolling loans under the CalCap for Small Business program or be used to fill another small business financing gap.

In preparation for the reuse of these federal funds, SB 551 proposes to transfer the loan portfolios and current cash reserves related to the SSBCI allocation and the \$6 million appropriated in 2010. This transfer is supported by a number of lenders and organizations representing lenders who are or were participating in the CalCAP for Small Business program, including the California Bankers Association, the California Credit Union League, CDC Small Business Finance, and California Association for Micro Enterprise Opportunity. The transfer is opposed, as noted earlier by the California State Treasurer, who chairs CPCFA.

Below are 2017 SSBCI funded program activities for CPCFA, which represents only a partial year, as first time federal funding was exhausted in August of 2107 (3rd quarter of the program year).

- ***SSBCI Funds Loan Volume*** – In 2017 CalCAP enrolled 1,706 loans to California small business owners using SSBCI funds, bringing the total number of CalCAP loans funded by SSBCI up to 10,127.

- **SSBCI Funds Loan Dollars** – CalCAP lenders loaned approximate \$71 million in 2017, bringing the total loaned since the SSBCI program began to approximately \$468 million.
 - **SSBCI Funds Loan Contributions** – CPCFA contributed \$2.5 million of SSBCI funds to loss reserve accounts for enrolled CalCAP loans in 2017. Total loan contributions since inception are \$17 million, which represents the full federal allocation for the loan loss reserve program.
- 3) **Transferring Portfolio and Funding:** Rather than mandating the immediate transfer of funds and related loan portfolios, SB 551 set a process that can be controlled by the IBank in order to maintain the integrity and financial viability of the transferred assets.

To initiate the transfer of cash deposits and the loan portfolios related to the SSBCI and General Fund moneys, the IBank board is required to adopt a resolution outlining the terms and conditions of the transfers. The bill provides that the IBank may consult with and receive information from CPCFA prior to adopting the resolution. SB 551 does, however, set an outside timeline of January 1, 2020.

All CPCFA program regulations are to remain in place, under the provisions of SB 551, until the IBank board adopts directives and requirements related to the oversight and management of the program. As noted previously and described later in the analysis, some portions of federal funding related to the Collateral Support Program may become available within the next year. Given that \$65 million in federal funds were committed to the Collateral Support Program, this money could be substantial.

- 4) **The Small Business Finance Center:** The Small Business Finance Center was established in 2013, following the implementation of the Governor's Reorganization Plan GRP2, which transferred the IBank and the Small Business Loan Guarantee Program from the soon to be defunct Business, Transportation, and Housing Agency to GO-Biz.

That same year, AB 1247 modified the GRP2 proposal for the placement of the Small Business Loan Program and established the Small Business Finance Center within the IBank; AB 1247 (Median and Bocanegra), Chapter 537, Statutes of 2013. It was the authors' intent that the center could become a multipurpose small business financing entity. To accomplish this objective, the statutory framework of the Small Business Finance Center was drafted to be different from those of many departments. While the Small Business Loan Guarantee Program was specifically codified within the administrative control of the Small Business Center, general statutory authority was also provided for the IBank board to approve and modify a range of financial products, including loans and other debt instruments, as well as loan guarantees and other credit enhancements.

As small businesses have different financial needs and business circumstances, having a range of financial products available is important. As an example, the loan guarantee model has been shown to be most useful for mid-to-larger size loans, while the loss reserve model is very effective in facilitating microloans.

In fiscal year 2016-17, there were 252 guarantees made on a total loan package of \$206.6 million with a loan guarantee amount of \$74.1 million. The leverage amount of SSBCI moneys vary under the Small Business Loan Guarantee Program based on the assessed risk in the loan portfolio. Borrowers reported that 6,847 jobs were created or retained during 2016-17. By law, the reserve amount could be as low as 10%, meaning \$10 is in reserve for every \$100 of loans guaranteed.

In 2016-17, 17 new lenders agreed to participate in the Small Business Loan Program. As of May 2018, there were 84 participating lenders.

The SBLGP is over 30 years old and has historically maintained a low default rate which is a testament to the diligence and skill of the small business financial development corporations which manage the program locally under a contract with the IBank. In 2016-17, the net loss reserve rate was 1.59%.

- 5) **California Capital Access Program for Small Businesses:** CalCAP for Small Business program was established through legislation enacted in 1994 for the purpose of incentivizing financial institutions to provide small businesses with the capital to maintain and grow their businesses.

The program uses a portfolio-based credit enhancement model, whereby a loss reserve account is established to offset losses incurred in connection with small business loans enrolled in the program. Funding in the loss reserve account consists of moneys paid by the participating borrower and financial institution, with CPCFA matching these contributions.

Unlike a loan guarantee which ensures payment on a certain percentage of the defaulted loan (*80% in the guarantee program*), under the loss reserve fund model, the amount of the default payment is based on the amount of funds available in the reserve account. This means a lender could potentially recover 100% of the value of the defaulted loan, if sufficient moneys are in the account. The model encourages lenders to maintain good underwriting practices because utilization of the loss reserve too often can quickly draw-down the reserve leaving little for other potential defaults of enrolled loans within the portfolio.

CalCAP loans can be used for working capital and to finance the acquisition of land, construction or renovation of buildings, the purchase of equipment, other capital projects. There are some limitations on real estate loans and loan refinancing. The maximum loan amount is \$2.5 million. 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 loss reserve account, are set by the lender and are in the range of 2% to 3.5% of the total loan amount. Loans can be short- or long-term, have fixed or variable rates, be secured or unsecured, and bear any type of amortization schedule.

In 2017, participating lenders enrolled 2,271 small business loans for \$91 million, representing \$99 million in total loan dollars. The average size loan in 2017 was \$43,682 and loans were enrolled from businesses located in 44 counties. In 2017, loans enrolled in CalCAP helped to create 1,052 new jobs and retain 9,445 existing jobs.

Of the 2,271 total loans made in 2017, 1,771 were microloans representing \$20 million of the \$91 million of loans. These figures demonstrate the unique ability of loss reserve programs to serve the small-size financing needs of owner operators and microbusinesses.

Between 1994 and the close of 2017, 68 lenders participated in CalCAP for Small Business program. In 2016, 39 lenders participated in the program and by the close of the 2017 report period, there were 20 participating lenders. As of May 31, 2018, there were 15 participating lenders in the CalCAP for Small Business program.

CPCFA processed and approved 130 claims for \$3.8 million from lenders against their loss reserve account in 2017. This represents a 6% default rate in 2017, up from 5% in 2016. Below is a chart showing 2017 loan activities by industry sector.

2017 CalCap Small Business Program – All Funding Sources				
NAICS Sector	Description	Number of Enrollments	Dollars Loaned	Dollars Enrolled
11	Agriculture, Forestry, Fishing and Hunting	8	\$ 318,340	\$ 144,955
21	Mining, Quarrying, and Oil and Gas Extraction	2	\$ 42,000	\$ 42,000
22	Utilities	0	\$ 0	\$ 0
23	Construction	88	\$ 6,921,646	\$ 4,656,176
31-33	Manufacturing	130	\$ 9,452,713	\$ 9,411,850
42	Wholesale Trade	85	\$ 4,772,065	\$ 4,534,252
44-45	Retail Trade	445	\$ 10,928,342	\$ 10,824,624
48-49	Transportation and Warehousing	570	\$ 22,317,486	\$ 18,090,845
51	Information	26	\$ 645,530	\$ 645,530
52	Finance and Insurance	24	\$ 436,537	\$ 436,537
53	Real Estate and Rental and Leasing	50	\$ 5,985,994	\$ 5,985,994
54	Professional, Scientific, and Technical Services	117	\$ 3,649,578	\$ 3,505,959
55	Management of Companies and Enterprises	0	\$ 0	\$ 0
56	Administrative Support and Waste Management and Remediation Services	108	\$ 2,827,250	\$ 2,819,060
61	Educational Services	30	\$ 1,863,683	\$ 1,863,683
62	Health Care and Social Assistance	82	\$ 2,827,292	\$ 2,805,089
71	Arts, Entertainment, and Recreation	21	\$ 634,997	\$ 627,497
72	Accommodation and Food Services	284	\$ 21,644,374	\$ 20,917,713
81	Other Services (except Public Administration)	201	\$ 3,934,891	\$ 3,919,891
92	Public Administration	0	\$ 0	\$ 0

Source: California Pollution Control Financing Authority June 14, 2018

Moneys to operate CalCAP originally came from excess bond issuance fees. From 2004 to 2010, about \$35 million was allocated by CPCFA to finance the CalCAP for Small Business Program. In 2010, CalCAP received its first General Fund moneys, \$6 million as part of a comprehensive \$32 million small business budget proposal, and in 2011, CalCAP was selected to administer a portion of federal funds for a small business access to capital program. It is staff's understanding that CalCAP for Small Business Program currently operates exclusively on funds received from federal and non-CPCFA sources.

- 6) **Collateral Support Program:** The Collateral Support Program was approved in January 2013 by the US Treasury. As noted earlier, it comprises the largest component of federal SSBCI money being administered through CPCFA, \$65 million of the approximately \$85 million in total funds.

Under the collateral support model, a business which would otherwise be turned down by a lender due to insufficient collateral becomes eligible after a supplementary cash deposit is made with the lender. These supplementary funds serve as partial collateral against a potential loss. In the event the borrower defaults on the loan, the lender generally collects against the borrower's collateral first and then collects against the cash deposit for any remaining loss.

Under CPCFA's program, after making the initial deposit with the lender, CPCFA is later able to recapture a portion of these funds as the business pays down the loan. This is important because collateral support programs can require significantly more capital to operate than loan loss reserve programs.

Two examples of how the amount of collateral support may be determined by a lender, as explained in the SSBCI best practices report, are as follows: "When applied to working capital loans or lines of credit, the amount of collateral support can be determined as the difference between the proposed loan amount and the value the lender assigns to the working capital assets such as accounts receivable and inventory. For loans to finance fixed assets, collateral support can fill the financing gap between the amount a bank is willing to lend against the assets without credit enhancement and the borrower's equity contribution."

In 2017, CPCFA enrolled 38 loans to 37 individual businesses owners. The average loan size was \$746,987 with the largest loan being \$11.8 million. These loans were supported with \$7 million in cash deposits.

Fifteen of the 38 loans were in "severely disadvantaged areas" and CPCFA paid additional cash deposits of \$375,000. In 2017, the Collateral Support Program helped to create 165 new jobs and retain 336 existing jobs. Below is a chart showing loans supported through the Collateral Support Program by industry sector.

2017 Collateral Support Program – All Funding Sources				
NAICS Sector	Description	Number of Enrollments	Dollars Loaned	Dollars Enrolled
11	Agriculture, Forestry, Fishing, and Hunting	0	\$ 0	\$ 0
21	Mining, Quarrying, and Oil and Gas Extraction	0	\$ 0	\$ 0
22	Utilities	1	\$ 2,030,000	\$ 2,030,000
23	Construction	2	\$ 1,029,600	\$ 1,029,600
31-33	Manufacturing	1	\$ 700,000	\$ 700,000
42	Wholesale Trade	3	\$ 1,700,000	\$ 1,700,000
44-45	Retail Trade	3	\$ 8,046,014	\$ 8,046,014
48-49	Transportation and Warehousing	16	\$ 1,490,900	\$ 1,490,900
51	Information	0	\$ 0	\$ 0
52	Finance and Insurance	1	\$ 100,000	\$ 100,000
53	Real Estate and Rental and Leasing	1	\$ 474,000	\$ 474,000
54	Professional, Scientific, and Technical Services	1	\$ 11,882,000	\$11,882,000
55	Management of Companies and Enterprises	0	\$ 0	\$ 0
56	Administrative Support and Waste Management and Remediation Services	2	\$ 293,000	\$ 293,000
61	Educational Services	0	\$ 0	\$ 0
62	Health Care and Social Assistance	0	\$ 0	\$ 0
71	Arts, Entertainment, and Recreation	1	\$ 65,000	\$ 65,000
72	Accommodation and Food Services	3	\$ 575,000	\$ 575,000
81	Other Services (except Public Administration)	0	\$ 0	\$ 0
92	Public Administration	0	\$ 0	\$ 0

Source: California Pollution Control Financing Authority June 14, 2018

- 7) **Loss Reserve Model and other Programs:** Since its inception in 1994, the CalCAP loss reserve model has been used in a number of other targeted credit enhancement programs. Resource- and environmental-related state agencies have contracted with CPCF to administer programs on their behalf, including the California Air Resources Board. Each of these credit enhancement programs requires separate capitalization. Among CalCAP's programs capitalized by other funding sources, the authority operates or has the authority to operate:
- The On-Road Heavy-Duty Diesel Vehicle Program for small business truck owners (*\$127.3 million available with \$107.3 received by CPCFA*);
 - A Proposition 1B Loan Assistance Program to help finance 2007 or newer heavy-duty diesel or LNG fueled trucks;
 - The Electrical Vehicle Charging Station Financing Program (*\$2 million pilot*);
 - A program to assist small businesses in making facility upgrades to meet Americans with Disabilities Act (ADA) requirements (*\$10 million capitalization*); and
 - A program to assist small businesses and homeowners make seismic safety related improvements (*\$10 million capitalization*).

According to the 2016-17 CPCFA report to the Legislature on all of the CalCAP programs, the separately capitalized programs represented 62% of enrolled loans and approximately 72% of loan amounts in 2017; 3,860 of 6,169 total loans; and \$261.5 million of the \$359.5 million in active CalCAP-type loss reserve programs.

- 8) **Loss of Small Business Focus:** In April of 2015, the JEDE Committee heard AB 1393 (Burke) which proposed to expand the authority and program focus of the CPCFA from providing financial assistance to addressing the control and remediation of pollution and the capital access challenges of small businesses.

Under the provisions of the bill, CPCFA would have had the ability to offer unlimited types of financial products to an expansive list of public and private entities, including, but not limited to, a loss reserve program that benefits any person, company, corporation, public agency, partnership, or firm engaged in activities in the state that require financing. The JEDE Committee expressed concern that expanding the scope of the bill would dilute CPCFA's focus on small businesses.

The committee analysis proposed amendments to define the specific scope of the expansion and the author committed to making amendments in Assembly Appropriations, but AB 1393 ultimately died in the Senate Committee on Appropriations. Budget Trailer Bill language was, however, adopted to authorize CPCFA to implement an alternative loan reserve program using moneys provided by a public source or quasi-public source. In implementing this alternative loss reserve program, CPCFA is authorized through the Budget Trailer Bill to "establish alternate provisions as necessary to enable the authority to participate in the alternative funding source program." From an implementation position, the budget language is counter to the limits the JEDE Committee placed on AB 1393.

Supporters of SB 551 have also expressed concerns that the broad expansion of loss reserve account programs represents a dilution of CPCFA's focus on small business. These supporters include over 30

organizations and financial institutions, including, but not limited to, the following small business organizations: NFIB, Small Business Majority, Small Business California, and Small Manufacturers Association of California.

CPCFA disputes this charge and has offered a number of examples of their commitment to small business, which are included in the following Comment.

9) **Summary of Opposition:** The following is a statement submitted by the California State Treasurer regarding his opposition.

“SB 551 would create the potential for redundancy and impede my offices ability to effectively run our most effective small business program. The CalCAP program, which was established in 1994 by CPCFA has been a success by any measure, mobilizing over \$3 billion to more than 35,000 businesses in 56 counties and every industrial sector.

"Last year, CalCAP helped create 3,475 new jobs and retain 15,072 existing jobs, and leveraged \$18 in private lending for every \$1 in public funds. Forty-six percent of the portfolio was invested in disadvantaged communities.

"Under my leadership, the CalCAP program has adopted important improvements that have been replicated by state agencies and legislators to find new and creative ways to fund hard-to-fund businesses. The instability that would be caused under this bill to our proven programs is concerning especially at a time when our state is trying to spur small business and job growth.”

In addition, the CPCFA sent a list of the ways the authority has supported small businesses, several of which are provided below.

- Since 1981, CPCFA has been an effective facilitator of financing for small businesses, establishing a Small Business Assistance Fund by collecting fees from large corporate issuers of tax-exempt bonds to reimburse the costs shouldered by small business issuers.
- Due to its leadership, CPCFA converted these fees to fund the CalCAP for Small Business Program in 1994.
- CPCFA has reprogrammed federal funding previously dedicated to energy efficiency projects to supplement the program funds for CalCAP for Small Business and Collateral Support.
- In its 2017 rulemaking, the current administration ensured that all funds recaptured under the sustainability provisions of CalCAP for Small Business and Collateral Support Program are returned for use in those same programs.
- In 2017, 78% of the loans enrolled in CalCAP for Small Business were under \$50,000. Microlending organizations have applauded the CalCAP model for reaching micro-enterprise so effectively.

10) **Author Response to Opposition:** The following is the author's statement in response to the opposition letter sent to the Committee regarding SB 551:

"While we respect the concerns raised by the State Treasurer's Office, we believe that they fail to grasp the primary objective and intent of SB 551. SB 551 does not seek to abolish the California Capital Access Loan Program (CalCAP) but simply seeks to transfer already-expended federal SSBCI funds and associated loan portfolios to the California Infrastructure Economic Development Bank's (IBank) Small Business Finance Center, whose statutory mission is to provide financial assistance to small businesses. This is consistent with conditions attached to receipt of federal SSBCI funding. The existing CalCAP program located at the State Treasurer's Office will remain in place.

"From the outset our office has attempted to work with the State Treasurer's Office to develop a sound strategy to ensure the continued success for the CalCAP program. Last year, after the introduction of SB 551 we sought to work with the State Treasurer's Office in an effort to help ensure long term sustainability of CalCAP. SB 551 originally authorized lenders to enroll loans against their existing loss reserve account balances without state contributions, empowering lenders to assess risk and underwrite loans based on loss reserve balances.

"In addition, the State Treasurer's Office was authorized to charge servicing fees, reducing the need for recapture. The State Treasurer's Office opposed these changes. Instead and to the detriment of the program the State Treasurer's Office elected to sweep funds retroactively from lenders' loss reserve accounts. This recapture policy increases lenders' loan underwriting risk due to diminishing reserves, and discourages continued lender participation, calling into question long term program sustainability.

"Many small businesses and other stakeholders overwhelmingly support transferring these federal small business financial assistance funds to strengthen the California entity that the Legislature created specifically to support financing of small, micro and start-up businesses."

11) **Proposed Amendments:** The Committee may wish to consider the following amendments:

- a) Clarify the differences between a financial company or financial institution which is participating as a lender versus a trustee for state monies held in a trust fund outside the state treasury;
- b) Delete the establishment of a new fund and, instead, establish an account within the existing Small Business Expansion Fund;
- c) Streamline the operation of the loss reserve program by more specifically identifying which actions a program manager may undertake as compared to the IBank board;
- d) Specify that funds in the loss reserve accounts are the exclusive property of the IBank and that administrative costs may be paid from the interest earned on the accounts;
- e) Clarify the program priority to be loans and microloans that benefit low-income areas of the state and underserved business ownership groups, including women- and minority-owned businesses;
- f) Conform the reporting requirements with other annual reports of the Small Business Center;
- g) Modify and update the details in the legislative intent; and
- h) Make other related technical and nonsubstantive changes.

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

a) Current Session:

- i) ***AB 964 (Calderon, Gonzalez Fletcher, Gomez, and Cervantes) California Affordable Clean Vehicle Program:*** This bill changes the name of an article within the Health and Safety Code from "Capital Access Program for Small Business" to "Capital Access Program." Consistent with this change, the bill establishes the California Affordable Clean Vehicle Program within the Capitol Loan Access Program to assist low-income individuals in purchasing or leasing zero-emission vehicles or plug-in hybrid electric vehicles for personal or commercial use by providing affordable financing mechanisms. Status: Pending in the Senate Committee on Appropriations.
- ii) ***AB 1547 (Quirk-Silva) Community Development Financing Reforms:*** This bill modifies definitions, updates eligible activities to reflect market conditions, and streamlines processes of programs administered through the California Capital Access ADA Program, California Capital Access Program Seismic Safety Program, California Industrial Development Financing Advisory Commission, California Alternative Energy and Advanced Transportation Financing Authority, Sales & Use Tax Exclusion Program, and PACE Loss Reserve Program. Status: Pending in the Senate Committee on Business, Professions, and Economic Development.
- iii) ***AB 1553 (Cervantes) Direct Payments to Borrowers:*** This bill authorizes the use of moneys in the California Americans with Disabilities Act Small Business Capital Access Loan Program (ADA program) fund for payments to participating financial institutions or borrowers to provide incentives to participate in the ADA program. The bill also allows small business assistance funds to include contributions and nonreimbursable payments made directly to borrowers or participating programs. Status: Signed by the Governor, Chapter 644, Statutes of 2017.

b) Prior Sessions:

- i) ***AB 29 (John A. Pérez, Feuer and V. Manuel Pérez) Office of Business and Economic Development:*** This bill established GO-Biz to include a newly codified California Business Investment Services Program and the existing Office of the Small Business Advocate. Status: Signed by the Governor, Chapter 475, Statutes of 2011.
- ii) ***AB 796 (Blumenfield) Matching Funds:*** This bill, as it related to the CPCFA, would have increased the maximum contribution by the financial institution to \$200,000, if the matching contribution made by CPCFA were funded exclusively from funds made available pursuant to the federal Small Business Jobs Act of 2010. The bill would also have limited the amount of matching funds used for deposits exceeding \$100,000 to not more than 50% of the available funds. Status: Vetoed by the Governor, 2012, for provisions unrelated to CPCFA.
- iii) ***AB 901 (V. Manuel Pérez) Expand Financial Partners and Reporting Requirements:*** This bill expanded the CalCAP definition of financial institution and increased reporting requirements. CalCAP is one of the programs which received millions of dollars in federal and

state funding for small business through the federal Small Business Jobs Act of 2010. Status: Signed by the Governor, Chapter 483, Statutes of 2011.

- iv) **AB 981 (Hueso) Expand Financial Partners:** This bill expanded the CalCAP definition of a 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 businesses in severely affected communities, such as areas with high unemployment. CalCAP is one of the programs which received millions of dollars in federal and state funding for small businesses through the federal Small Business Jobs Act of 2010. Status: Signed by the Governor, Chapter 484, Statutes of 2011.
- v) **AB 1247 (Medina and Bocanegra) Small Business Finance Center:** This bill establishes the California Small Business Finance Center at the IBank, within the Governor's Office of Business and Economic Development, and transfers the authority to administer the small business loan guarantee program and other related programs to the California Small Business Finance Center. Status: Signed by the Governor, Chapter 537, Statutes of 2013.
- vi) **AB 1632 (Blumenfeld) Small Business Capital Infusion:** 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 transferred \$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 went 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: Signed by the Governor, Chapter 731, Statutes of 2010.
- vii) **SB 225 (Simitian) Loss Reserve Accounts Trucking:** 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: Signed by the Governor, Chapter 492, Statutes of 2011.
- viii) **SB 832 (Senate Committee on Environmental Quality) Code Maintenance:** This bill revised the Revenue and Tax Code definitions of "project" and "pollution control facility" to conform with those used by the California Pollution Control Financing Authority Act under its sales and use tax exclusion program and includes public agencies within the definition of a "participating party" that is 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.
- ix) **SB 1311 (Simitian) Changes in Deposits and Withdrawals:** 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 of offsetting administrative costs and contributions. Status: Signed by the Governor, Chapter 401, Statutes of 2008.

13) **Double Referral:** The Assembly Committee on Rules has assigned SB 551 to both the Assembly Committee on Jobs, Economic Development, and the Economy and the Assembly Committee on Banking and Finance (B&F). Should this measure pass JEDE, the bill will be referred to B&F for further policy review.

REGISTERED SUPPORT / OPPOSITION:

Support

Opportunity Fund (sponsor)
ACCION San Diego
Arcata Economic Development Corporation
California Asian Pacific Chamber of Commerce
California Association for Micro Enterprise Opportunity (CAMEO)
California Association of Competitive Telecommunications Companies
California Black Chamber of Commerce
California Hispanic Chamber of Commerce
California Metals Coalition
CDC Small Business Finance
Coalition of Small and Disabled Veteran Businesses
Economic Development Financing Corp
Flasher Barricade Association
Golden Gate Business Association
Golden Gate Restaurant Association
Greater Geary Boulevard Merchants Association
Mainstreet Launch
National Association of Women Business Owners, Sacramento Valley
National Federation of Independent Businesses (NFIB), California Chapter
North East Mission Business Association
Northern California Independent Booksellers Association
Northern California Community Loan Fund
PACE Finance Corporation
Pacific Enterprise Bank
Plumbing Heating Cooling Contractors of California
Sacramento Metropolitan Chamber of Commerce
San Diego County Hispanic Chamber of Commerce
San Francisco Builders Exchange
San Francisco Chamber of Commerce
San Francisco Locally Owned Merchants Alliance
Sierra Business Council
Small Business California
Small Business Finance Fund
Small Business Majority
Small Business Network
Small Manufacturers Association of California

Opposition

John Chiang, California State Treasurer and Chair of California Pollution Control Financing Authority

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