Date of Hearing: June 21, 2016

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY
Eduardo Garcia, Chair
SB 936 (Hertzberg) – As Amended June 2, 2016

SENATE VOTE: 39-0

SUBJECT: California Small Business Expansion Fund: corporate guarantees

SUMMARY: Provides for the increased leverage of moneys assigned to secure loan guarantees under the Small Business Loan Guarantee Program (SBLGP).

1) Increases the maximum amount of guarantee liability outstanding at any one time in the California Small Business Expansion Fund (Expansion Fund) from five to 10 times the amount of funds on deposit, plus any receivables due from funds loaned from the expansion fund to another fund in state government.

2) Lowers the minimum reserves from 20% to 10% of the value of outstanding loan guarantees attributed to an individual account of a small business financial development corporation (FDC). Existing law authorizes the program manager to set a higher leverage ratio, as necessary.

3) Removes the January 1, 2018, sunset on the minimum reserve amount, thereby making the provisions in this bill permanent.

EXISTING LAW:

1) Establishes the IBank within the Governor's Office of Business and Economic Development (GO-Biz) and authorizes it to undertake a variety of financial activities including, but not limited to, the administration of a revolving loan fund, oversight of the Small Business Finance Center and the issuance of tax-exempt and taxable revenue bonds.

2) Establishes the Small Business Finance Center within the IBank for the purpose of assisting businesses seeking capital resources not otherwise available in the private markets including:

   a) Loan guarantees and other credit enhancements;

   b) Direct loans and other debt instruments;

   c) Disaster loan guarantees; and

   d) Surety bond guarantees.

2) Establishes the SBLGP for the purpose of assisting small businesses obtain long term loans or lines of credit from conventional and non-traditional financial institutions, which the 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 Expansion Fund for the purpose of retaining the moneys which capitalize the SBLGP The state has no guarantee obligation beyond the amount of moneys deposited within the Expansion Fund. Until January 1, 2018, a reserve of at least 20% of the value of the guaranteed amount is

required to be on deposit in the Expansion Fund. After January 1, 2018, the minimum reserve is increased to 25%.

4) Authorizes the program manager to establish one or more accounts in the Expansion Fund for FDCs participating in one or more programs Small Business Finance Center programs.

5) Specifies that each account in the Expansion fund is a legally separate account. Funds in one account are prohibited from being used to satisfy loan guarantees or other financial product obligations of another FDC, as specified.

FISCAL EFFECT: Unknown

POLICY ISSUE FRAME:

California offers a range of financial assistance to small businesses. One of the largest programs is the SBLGP, which is administered through the Small Business Finance Center at the IBank. Moneys to capitalize the program are deposited in the Expansion Fund and are available to make payouts on defaulted loans. The state has no legal obligation to make payouts beyond the moneys within the Expansion Fund. Until January 1, 2018, a reserves of at least 20% of the value of the guaranteed amount is required to be on deposit in the Expansion Fund. After January 1, 2018, the reserve amount is scheduled to be increased to 25%.

This bill permanently lowers the minimum reserve amount to 10%. In considering the appropriateness of this change, it is important to recognize that the statutory limits are not necessarily the operational limits of the program. Within the statutory limits, the program manager is responsible for setting the reserve ratio for the overall program, as well as for the individual accounts of the FDCs. The advantage in lowering the minimum reserve is that additional guarantees may be issued for small business loans throughout the state. The analysis includes additional information on the IBank, the SBLGP, and related legislation. An amendment is suggested in Comment 6.

COMMENTS:

1) **The Role of Small Businesses within the California Economy**: California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's $2.4 trillion economy. Two separate studies, one by the U.S. Census Bureau and another by the Kaufman Foundation, found that net job growth was strongest among businesses with less than 20 employees. Among other advantages, small businesses are crucial in the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade and development within the California economy.

   Nonemployer firms make up the single largest component of businesses in California, 2.9 million out of an estimated 3.8 million firms in 2013, with the highest number of businesses (515,814) in the professional, scientific, and technical services industry sector. As these non-employer businesses grow, they continue to serve as an important component of California's dynamic economy. Excluding nonemployer firms, businesses with less than 20 employees comprise nearly 90% of all businesses and employ over 18% of all workers. These non-employer and small employer firms create jobs, generate taxes, and revitalize communities.

In hard economic times, smaller size businesses often function as economic engines. In this most recent recession the trend continued, with the number of nonemployer firms increasing from 2.6 million firms ($137 billion in revenues) for 2008 to 3.1 million firms ($162.4 billion in revenues) for 2014. In the post-recession economy, small businesses are expected to become increasingly important due to their ability to be more flexible and better suited to meet niche market needs. Their small size, however, results in certain challenges in meeting regulatory requirements, accessing capital, competing for large-size contracts and marketing their goods and services.

2) **Background on the I-Bank**: The IBank was established in 1994 to promote economic revitalization, enable future development, and encourage a healthy climate for jobs in California. Housed within GO-Biz, it is governed by a five-member board of directors comprised of the Director of GO-Biz (chair), the State Treasurer, the Director Department of Finance, the Transportation Agency, and a Governor's appointee. The day-to-day operations of the IBank 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 IBank has authority for 25 staff members.

   The IBank 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 most recent Comprehensive Annual Financial Report, its programs continue to provide revenues sufficient to cover operating expenses.

   The IBank administers four primary programs: (1) the Infrastructure State Revolving Fund which provides direct low-cost financing to public agencies for a variety of public infrastructure projects; (2) the Conduit Bond Program which provides financing for manufacturing companies, public benefit nonprofit organizations, public agencies and other eligible entities; (3) the California Lending for Energy and Environmental Needs (CLEEN) Center; and (4) the Small Business Finance Center which helps small businesses access private financing through loan guarantees, direct loans, and performance bond guarantees. There is no commitment of I-Bank or state funds for any of the conduit revenue bonds. Even in the case of default, the state is not liable.

   Since its creation in 1994, the IBank has loaned, financed, or participated in over $34 billion in infrastructure and economic expansion projects. This includes over $400 million to local and state agencies, developing a high-level of expertise in the financing of public infrastructure. The IBank also serves as the state's only general purpose financing authority with broad statutory powers to issue revenue bonds, make loans, and provide guarantees. Over $33 billion in conduit revenue bonds have been issued by the IBank since 2000.

3) **The Small Business Finance Center**: The Small Business Finance Center was established pursuant to AB 1247 (Medina and Bocanegra), Chapter 537, Statutes of 2013. In addition, to transferring the SBLGP from the soon to be defunct Business, Transportation and Housing Agency, the bill modernized the state's delivery of small business finance, which included providing greater program flexibility and authority to the IBank Board. Development of AB 1247 was a collaborative effort between the JEDE Committee, GO-Biz, and the IBank.

   The SBLGP is locally administered through nine FDCs, which review and approve state-backed guarantees on loans made through private lending institutions. In order to qualify for financial assistance under the SBLGP, a business must be able to demonstrate that they are not able to access private financing without the use of the guarantee.

In 2011, California received significant federal funding through the State Small Business Credit Initiative (SSBIC), a program established under the federal Small Business Jobs Act. Under the federal funding formula, California received $168 million, which is the largest amount of any state. The next highest award was $97 million for Florida, with every state that applies receiving a minimum of $13.1 million. One-half of California's moneys are being used to capitalize a second and slightly modified SBLGP that reflects the nuisances of the federal requirements.

Since receiving the federal funds, the priority of the SBLG Program has been to use the federal funds, rather than the state guarantee funds. In 2014-15, the state guarantee was exclusively used for renewals within the portfolio and for guarantees that were not eligible under the federal requirements. In FY 2014-15, 124 loans ($37.4 million) were guaranteed using $21.1 million in state funds. Borrowers reported that 2,813 jobs were created or retained under the state-side of the SBLGP.

In fiscal year 2014-15, 252 guarantees were made for a total of $130 million in loans using $92.8 million of federal State Small Business Credit Initiative funds. Borrowers reported that 11,781 jobs were created or retained.

4) **Default Rates**: The SBLGP is over 30 years old and has been overseen by a range of state entities. Its historically low default rate is a testament to the diligence and skill of the FDCs who provide both technical and financial assistance to the small businesses they serve.

In 2007, legislation was enacted to lower the reserve amount from 25% to 20%. [*AB 610 (Price), Chapter 601, Statues of 2007*] In the years prior to change, the SBLGP had a default rate at or below traditional lenders: 0.25% in 2005-06 and 0.10% in 2004-05. The five-year default rate in 2005-06 was 0.79%. The default rate for the comparable portfolio of the Small Business Administration is 3.5% to 5%.

Even in the challenging economic times of the great recession, the SBLGP had very limited defaults, as shown in the chart below.

Defaults in the Small Business Loan Guarantee Programs (2011-2015)		
	Federal Funds	State Funds
2011	0.000%	0.632%
2012	0.000%	0.488%
2013	0.008%	0.401%
2014	0.073%	0.150%
2015	0.030%	0.178%
		Source: GO-Biz 6/7/2016

5) **The Need for Active Management of Underserved Areas and Supporting Underserved Population Groups**: California has benefited greatly from the additional federal funding for SBLGP activities. Prior to receiving these funds, the state program was struggling to scale up after being effectively shut down in 2009 and 2010. The federal funding not only provided new capital, but more importantly ensured that the FDCs had an ongoing source of capital on which to build programs and hire financial professionals to meet the needs of small businesses within their regions.

Given California's growing income inequality, resources such as the SBLGP offer the state a rare opportunity to counter this disturbing econmic trend. Research shows that net new job growth is actually strongest among businesses with less than 20 employees and that entrepreneurial activity often serves as a catalyst for building economic stability within communities, neighborhoods, and individual households.

The 2012 Survey of Business Owners, published by U.S. Census Bureau, offers additional data as to the important role that businesses can play in dispersing economic benefits among underrepresented groups. Among other findings, the data shows a 27.5% increase in women-owned businesses between 2007 and 2012, as compared to a 7.9% increase in businesses owned by men. Women-owned businesses also experienced the greatest increase in the number of people they employed and wages paid. Chart 1 displays data on the growth of business ownership during the report period for selected groups.

Chart 1 - Comparison of Business Growth by Race, Ethnicity, and Veterans	
Business Ownership	**Percent Change 2007 to 2012 Number of all Firms**
Asian American Women	44.3%
Asian American Men	25.7%
Black Women	67.5%
Black Men	18.8%
Hispanic Women	87.3%
Hispanic Men	39.3%
White Women	10.1%
Veteran Women	29.6%
Veteran Men	7.7%
Source: 2012 Survey of Business Owners	

The SBLGP annually reports on a number of financial elements, including defaults, as well as the race/ethnicity, and gender of borrowers. Beginning in 2017, the annual report will also include data on geographic location of businesses served. [*AB 1537 (JEDE), Chapter 191, Statutes of 2015*]

Of the 376 loans guaranteed in 2014-15 using the federal and state funds, 64.63% were male, 17.02% were women, and 18.35% were co-owned by men and women. The race/ethnicity of the owners of the small businesses assisted: Caucasian 62.77%; Asian/Pacific Islander 8.51%; Hispanic 9.31%; African American 3.19%; Asian Indian 4.52%; and Native American 0.80%.

Comparing the 2014-15 loan guarantees to the overall make-up of California businesses (Chart 2), shows that, overall, the ownership of businesses accessing the SBLGP during the report period was more heavily comprised of businesses owned by white males. The percentage of businesses equally co-owned, whoever, was twice the state average, 18.35% v. 8.8%.

Chart 2 - California Businesses		
All firms	100%	3,548,449
Male	52.2%	1,852,580
Female	37.2%	1,320,085
Co-Owned M/F	8.8%	315,782
White	66%	2,343,439
Black	4.90%	177,302
American Indian and Alaska Native	1.10%	41,254
Asian	17%	604,870
Hispanic	23%	815,304
Source: 2012 Survey of Business Owners		

While there are many factors that contribute to making a program accessible to small businesses, these comparative reviews do suggest that the IBank specifically engage with FDCs on what actions they have taken and will take in the future to serve a more representative group of businesses.

Encouraging the active management of the SBLGP is an important duty of the program manager and existing law provides him or her with key tools by which to accomplish this responsibility. First, each FDC has a statutory duty to undertake program activities that provide outreach to low-resource small businesses and microbusineses and to partner with other financial and community partners to accomplish this duty, *GC§ 63088.6*. Second, existing law also requires each FDC to submit an annual written plan of operation to the program manager, which should encompass all of its contractual duties, *GC §63089.1*. Third, the program manager has the authority to distribute and even withhold Expansion Fund moneys to ensure FDCs meet program responsibilities, as outlined in their annual contract, *GC §63089.1*. Collectively, these duties and responsibilities underscore the fundamental mandate of the program to serve a wide range of small businesses from across the state that have a representative ownership that reflects the diversity of the state.

6) **Amendment for the Committee's Consideration**: By removing the sunset provisions, the bill eliminates one method by which the public and the Legislature periodically focus on leverage ratios and default rates of the SBLGP. On a going forward basis, it may be appropriate to codify the specific role of the IBank Executive Director in reviewing the setting of loan guarantee reserve ratios with the program manager.

7) **Related Legislation**: Below is a list of the related bills.

   a) ***AB 610 (Price): Leverage of the Small Business Expansion Fund***: This bill enhances the Small Business Loan Guarantee Program's ability to leverage existing program dollars resulting in the ability to serve more small businesses financial needs per year. More specifically, the bill authorizes a 20% reserve to outstanding loan guarantees rather than a 25% reserve. Status: Signed by the Governor, Chapter 601, Statutes of 2007.

   b) ***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 and Economic Development, and transfers the authority to administer the small business loan guarantee program, direct disaster loans, surety bond guarantees, and other related programs to the I-Bank. Status: Signed by the Governor, Chapter 537, Statutes of 2013.

   c) ***AB 1537 (Assembly Committee on Jobs, Economic Development, and the Economy) Small Business Finance Center***: This bill expands reporting requirements for programs financed through the California Small Business Finance Center by including annual reporting on the general geographic location of assisted businesses. This information is essential to monitoring that small businesses throughout the state have access to these programs. Status: Signed by the Governor, Chapter 191, Statutes of 2015.

   d) ***AB 2671 (Assembly Committee on Jobs, Economic Development and the Economy) Small Business Access to Capital*:** This bill extends, until January 1, 2018, the sunset date on the maximum allowable leverage of reserve funds necessary under Small Business Loan Guarantee Program. On January 1, 2013, the maximum leverage rate was scheduled to return to 25% or four dollars for every one dollar of loan guaranteed. This bill allows the program to continue to operate at the 20% reserve limit. The Director of the SBLGP has the discretion to set a lesser leverage amount for the overall program and for any individual small business financial development corporation. Status: Signed by the Governor, Chapter 648, Statutes of 2012.

REGISTERED SUPPORT / OPPOSITION:

Support
California Infrastructure Development Bank (sponsor)
Association of Financial Development Corporations
California Asian Pacific Chamber of Commerce
California Association for Local Economic Development
California Association for Micro Enterprise Opportunity
California Association of Independent Businesses
California Bankers Association
California Black Chamber of Commerce
California Capital Financial Development Corporation
California Chamber of Commerce
California City Economic Development Corporation

California Coastal Rural Development Corporation
California Community Banking Network
California Small Business Association
California Southern Small Business Development Corporation
City of Dublin
City of Fountain Valley
City of Long Beach
City of Sacramento
Northern California Financial Development Corporation
Orange County Business Council
Pacific Coast Regional Development Corporation
San Gabriel Valley Economic Partnership
Silicon Valley Economic Partnership
Small Business California
Small Business Development Corporation of Orange County
Small Business Majority
Solano Economic Development Corporation
Southwest California Legislative Council
Stanislaus Business Development Center
Sun Village park Association
Superior California Economic Development
Tuolumne County Economic Development Corporation
Valley Small Business Development Corporation

Opposition
None Received

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