Date of Hearing: July 2, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
SB 976 (Vargas) – As Amended: April 12, 2012

SENATE VOTE: 37-0

SUBJECT: Finance lenders: exemptions.

SUMMARY: Exempts certified development companies (CDCs) from the California Finance Lenders Law (CFLL). Specifically, this bill:

1) Defines "certified development companies" as a development company participating in the program under Title V of the federal Small Business Investment Act of 1958.

EXISTING FEDERAL LAW

1) Defines a "certified development company" as an entity authorized by the U.S. Small Business Administration to deliver 504 financing to small businesses. [13 CFR 120.10.]

EXISTING STATE LAW

1) Establishes the CFLL, administered by the Department of Corporations (DOC) that authorizes both secured and unsecured consumer and commercial lending and loan brokering, subject to certain restrictions, depending on the type of loan and the loan amount. [Financial Code, Section 22000]

2) Defines a commercial loan, pursuant to the CFLL, as one with a principal amount of five thousand dollars ($5,000) or more, or any loan under an open-end credit program, whether secured by either real or personal property, or both, or unsecured. The CFLL does not cap the allowable interest rate, nor limit the loan length, nor otherwise regulate the terms of commercial loans. All of the loans made by certified development corporations meet the definition of commercial loans pursuant to the CFLL. [Financial Code, Section 22502]

3) Requires all CFLL licensees to obtain and maintain a surety bond in a minimum amount of twenty-five thousand dollars ($25,000; Financial Code Section 22112), maintain a minimum net worth of $25,000; [Financial Code Section 22104], and file an annual report with the commissioner of DOC, providing information that the commissioner reasonably requires concerning the business and operations of the licensee within the state during the preceding calendar year. [Financial Code Section 22159]

4) Exempts from the CFLL any person doing business under any law of any state or of the United States relating to banks, trust companies, savings and loan associations, insurance premium finance agencies, credit unions, small business investment companies, California business and industrial development corporations, or licensed pawnbrokers. Also exempts, check cashers, a college or university making a loan for the purpose of permitting a person to pursue a program or course of study leading to a degree or certificate, a broker-dealer, to any

person who makes no more than one loan in a 12-month period as long as that loan is a commercial loan, or any public corporation. [Financial Code, Section 22050]

FISCAL EFFECT: None.

COMMENTS:

CDCs

Small Business Administration (SBA) CDCs are nonprofit organizations set up to contribute to the economic development of the communities in which they are located. CDCs are authorized by SBA to market, package and service SBA 504 loans. The SBA has requirements for an organization to operate as a CDC which include:

- Be a nonprofit corporation in good standing
- Have at least 25 members representing the following groups:
  - Government organization responsible for economic development in the specific community and acceptable to SBA;
  - Financial institutions that provide long-term fixed asset financial in the community where it operates;
  - Community organizations dedicated to the local economic development; and,
  - Businesses located in the area of operation
- Have a board of directors chosen from among the members and representing at least three of the four membership groups
- Meet a minimum level of lending activity
- Must remain independent of banks, governmental agencies and other institutions

There are over 260 CDCs nationwide each having a defined area of operations covering a specific geographic area. The area of operation for most CDCs is the state in which they are incorporated. California has 34 CDCs established in the state.

CDCs are supervised by the SBA and must submit annual reports to the SBA. The SBA's Office of Lender Oversight oversees CDC's compliance with all applicable rules and regulations. To retain its certification, a CDC must provide at least four 504 loan approvals during two consecutive fiscal years. As part of its oversight process, the SBA assigns a CDC to one of eight tiers based on annual approval volume and provides every CDC with financial data and ratios, including loan loss rate for its tier average.

The SBA is the largest backer of commercial loans for small business in the U.S. offering a variety of loan guaranty programs to accommodate most small business financial needs. The CDC/504 loan program is one of the most popular loan programs offered by SBA and is designed to encourage economic development within a community by providing small businesses with long-term, fixed rate financing to acquire major fixed assets for expansion or modernization on reasonable terms and to stimulate employment through a job retention/creation goal.

SBA CDCs participate in the 504 loan program. This program is designed for financing fixed assets such as equipment or real estate. Typically it is structured as follow:

- A loan or first mortgage secured with a senior lien from a private sector lender covering 50 percent of the project cost,
- A second mortgage secured with a junior lien from an SBA CDC backed by a 100 percent SBA guaranteed debenture covering up to 40 percent of the cost, and
- A contribution of at least 10 percent equity from the small business borrower

The SBA 504 Loan program is a powerful economic development loan program that offers small businesses another avenue for business financing, while promoting business growth, and job creation. As of February 15, 2012, the $50 Billion in 504 loans has created over 2 million jobs. This program is a proven success and win-win-win for the small business, the community and participating lenders.

The 7(a) Loan Program is a SBA program to help start-up and existing small businesses obtain financing when they might not be eligible for business loans through normal lending channels. The name comes from section 7(a) of the Small Business Act, which authorizes the SBA to provide business loans to American small businesses. The SBA itself does not make loans, but rather guarantees a portion of loans made and administered by commercial lending institutions.

7(a) loans are most flexible, because financing can be guaranteed for a variety of general business purposes, including working capital, machinery and equipment, furniture and fixtures, land and building (including purchase, renovation and new construction), leasehold improvements, and debt refinancing (under special conditions). Loan maturity is up to 10 years for working capital and generally up to 25 years for fixed assets.

Most American banks participate in the program, as do some non-bank lenders, which expands the availability of loans. Participating lenders agree to structure loans according to the SBA's requirements, and apply for and receive a guaranty from the SBA on a portion of each 7(a) loan. The SBA does not fully guarantee 7(a) loans; instead, the lender and the SBA share the risk that a borrower will be unable to repay the loan in full.

Community Advantage Pilot Loan Program

Previously, CDCs did not fall under DOC regulation under the CFLL. This measure was brought forward because recently the SBA launched a new pilot program that allows CDCs to act as lenders under the Community Advantage Pilot Loan Program. As of June 14, 2012, 8 CDCs are Community Advantage Approved Lenders. As amended, this measure will exempt Community Advantage Lenders from the CFLL.

The sponsor of the measure, California Small Business Finance, who is an approved lender to participate in the new Community Advantage Pilot Loan Program, wants to make sure that under this program they do not fall under DOC's regulation under the CFLL. The sponsor believes they are heavily regulated by the SBA. CDCs are audited on a regular basis by the SBA and the SBA Office of the Inspector General. Onsite reviews and examinations cover portfolio performance, operations management, and credit administration, compliance with loan program requirements, capital adequacy, asset quality, management quality, earnings, and liquidity.

On February 15, 2011, SBA created a new pilot program. SBA created the pilot program to increase and expand access to capital for businesses and entrepreneurs in underserved communities. Community Advantage is a pilot initiative aimed at increasing the number of SBA 7(a) lenders who reach underserved communities, targeting community-based, mission-focused financial institutions which were previously not able to offer SBA loans. The maximum loan Size is $250,000 with a guarantee of 85 percent for loans up to $150,000 and 75 percent for those greater than $150,000. Community Advantage is open to mission-focused lenders, including Community Development Financial Institutions, SBA's Certified Development Companies and SBA's nonprofit micro-lending intermediaries. Community Advantage lenders will be expected to maintain at least 60 percent of their SBA loan portfolio in underserved markets. Community Advantage is a three-year pilot initiative. Community advantage will operate through March 15, 2014 and may be extended or made permanent at SBA's discretion.

According to the SBA, community advantage loans will enable mission-oriented lenders to increase the flow of capital to underserved communities and achieve a greater impact. Through participation in the pilot program, community advantage lenders should be able to build capacity and stronger balance sheets and may have greater access to the kind of patient capital that complements mission lenders proven track record of low overall defaults and high percentage of loan repayments. Community advantage lenders will be responsible through the lending process for administering their loans in compliance with all SBA loan programs requirements and furnishing to SBA all appropriate information.

RECOMMENDED AMENDMENTS:
The recommended amendments clarify the intent of the sponsor. According to the sponsor, CDCs do not fall under the CFLL for 504 financing but under the new pilot program CDCs may be regulated both under the CFLL and SBA. These amendments makes sure those CDCs approved to participate under the Community Advantage Pilot Program do not also have to be regulated under the CFLL since the SBA has strict guidelines and regulations.

1) Delete on page 1, line 7- "certified development companies" and insert "community advantage lenders"

2) On page 2, delete lines 2-5 and insert "Community advantage lenders" means an entity authorized by the U.S. Small Business Administration to deliver community advantage loans.

REGISTERED SUPPORT / OPPOSITION:

Support

CDC Small Business Finance

Opposition

None on file.

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