

Date of Hearing: April 23, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Mike Eng, Chair

AB 2523 (Hueso) – As Amended: April 18, 2012

SUBJECT: Infrastructure and Economic Development Bank: participation loans.

SUMMARY: Authorizes the California Infrastructure and Economic Development Bank (I-Bank) to enter into participation loan agreements with financial institutions for the I-Bank to purchase participation interests in loans made or held by financial institutions to small businesses. Specifically, this bill:

- 1) Allows the I-Bank to establish a California Preferred Broker-Dealer program (program) for the purpose of closing financial and information gaps within the network of public and private financial institutions and intermediaries that serve small businesses.
- 2) Requires the financial institution to demonstrate a long-term relationship with community development financial institutions in order to be eligible to participate in the program as well as:
 - a) Adhere to a prescribed set of underwriting criteria which would be designed to meet the needs of small businesses and provide a high-quality loan-backed security.
 - b) Demonstrate the ability to facilitate participation loan agreements.
 - c) Commit a minimum percent of capital to any syndication or participation agreement entered into under the program.
 - d) Annually report on the number of small businesses served, jobs created, geographic locations and industry sectors.
- 3) Provides that financial institutions that participate in the program shall have priority access to guarantees under the Small Business Loan Guarantees.
- 4) Defines "financial institutions" as a banking or savings organization, including, but not limited to, banks, savings and loan associations and credit unions, authorized to conduct business in California and state chartered commercial banks, trust companies, and savings and loan associations. Financial institutions also include nonprofit organizations that serve as a financial intermediary and microbusiness lender.
- 5) Defines "participation loan agreement" as an agreement whereby the bank would purchase portions of outstanding loans without servicing, managing, or otherwise administrating the underlying loan. A participation loan agreement may include an agreement to refinance a loan or package of loans where the term of the loan or loans to be refinanced is within 18 months of coming due.
- 6) Defines "small business" as any of the following:

- a) An independently owned and operated business that is not dominant in its field of operation, the principal office of which is located in California, the officers of which are domiciled in California, and which, together with affiliates, has 100 or fewer employees, and average annual gross receipts of ten million dollars (\$10,000,000) or less over the previous three years.
 - b) As a business that meets the requirements under Part 121 of Chapter 1 of Title 13 of the Code of Federal Regulations.
 - c) As a business that is eligible for a loan guarantee under the California Small Business Financial Development Corporation Law.
 - d) A business that is eligible for a loan guarantee under Article 8 of Chapter 1 of Division 27 of the Health and Safety Code.
 - e) A nonprofit organization that meets the size limitations of a-d.
- 7) Requires the I-Bank to include in its annual report a summary of the participation loan agreement program, including, but not limited to, the number of jobs impacted and created, the number of businesses assisted, the geographic areas the businesses were located, and the industry sectors of the businesses served.
- 8) Makes various findings and declarations.

EXISTING LAW

- 1) Establishes the I-Bank, within Business Transportation and Housing (BTH). I-Bank is located within the BTH Agency and is governed by a five-member Board of Directors. The I-Bank was created in 1994 to promote economic revitalization, enable future development, and encourage a healthy climate for jobs in California. The I-Bank operates pursuant to the Bergeson-Peace Infrastructure and Economic Development Bank Act. The I-Bank has broad authority to issue tax-exempt and taxable revenue bonds, provide financing to public agencies, provide credit enhancements, acquire or lease facilities, and leverage State and Federal funds. The I-Bank's current programs include the Infrastructure State Revolving Fund (ISRF) Program, 501(c)(3) Revenue Bond Program, Industrial Development Revenue Bond Program, Exempt Facility Revenue Bond Program and Governmental Bond Program. [Government Code Section 63000 et seq.].
- 2) Defines "Microbusiness lender" as a nonprofit or nonbank lender that serves very small businesses in low- and moderate-income communities that experience barriers in accessing capital. These businesses are often owned by minorities, immigrants, women, and persons with disabilities. Microbusiness lenders generally provide loans under fifty thousand dollars (\$50,000) and offer business technical assistance, both preloan and postloan, to improve an applicant's ability to qualify and successfully repay a loan. [Government Code, Section 13997.2]
- 3) Defines a "Financial intermediary" means an institution, firm, organization, or individual who performs intermediation between two or more parties in a financial context, such as connecting sources of funds with users of funds. A financial intermediary is typically an

entity that facilitates the channeling of funds between lenders, investors, foundations, or other entities that have money and are interested in connecting with businesses or communities where their money can be deployed. Financial intermediaries include, but are not limited to, banks, financial development corporations, economic developers, microbusiness lenders, and community development organizations. [Government Code, Section 13997.2]

FISCAL EFFECT: Unknown.

COMMENTS:

According to the Author, AB 2523 is needed to, "broaden the scope of the I-bank and its current funding programs to further strengthen economic development of this state. Small businesses are a vital component of California's economy. Coordinating state-managed fund, in partnership with financial institutions, will enhance the availability of capital for California small business and farmers thus contributing to sustainable job growth. "

THE I-BANK

The mission of the I-Bank is to finance public infrastructure and private development that promote economic development, revitalize communities and enhance quality of life for Californians. The I-Bank has extremely broad statutory powers to issue revenue bonds, make loans and provide credit enhancements for a wide variety of infrastructure and economic development projects and other government purposes. As we approach \$32 billion in various financings, we continue to be motivated by the financing challenges faced by infrastructure projects throughout our State.

The I-Bank oversees 5 programs.

1) Infrastructure State Revolving Fund Program

The Infrastructure State Revolving Fund (ISRF) Program provides low-cost financing to public agencies for a wide variety of infrastructure projects. ISRF Program funding is available in amounts ranging from \$250,000 to \$10,000,000, with terms of up to 30 years. Interest rates are fixed for the term of the financing.

2) 501(c) (3) Revenue Bond Program

The 501(c) (3) Revenue Bond Program provides tax-exempt financing to eligible nonprofit public benefit corporations for the acquisition and/or improvement of facilities and capital assets. Typical borrowers include cultural, charitable and recreational organizations, research institutes and other types of organizations that provide public benefits.

3) Industrial Development Revenue Bond Program

The Industrial Development Revenue Bond (IDB) Program provides tax-exempt financing up to \$10 million for qualified manufacturing and processing companies for the construction or acquisition of facilities and equipment. IDBs allow private companies to borrow at low interest rates normally reserved for state and local governmental entities.

4) Exempt Facility Revenue Bond Program

The Exempt Facility Revenue Bond Program provides tax-exempt financing for projects that

are government-owned or consist of private improvements within publicly-owned facilities, such as private airline improvements at publicly-owned airports.

5) Governmental Bond Program

The I-Bank is a self-supporting governmental entity that pays its cost of operations from service fees and interest earnings on loans and investments. The Infrastructure State Revolving Fund (ISRF) Program, a direct loan program, was originally funded with seed money from the State's General Fund in the late 1990's and early 2000's, and later funded with the proceeds of tax-exempt revenue bonds described below. The I-Bank issued approximately \$150 million of tax-exempt revenue bonds secured by the ISRF Program repayment revenues that provided additional ISRF Program funding. The bank has leveraged the initial State General Fund infusion to finance approximately \$400 million in infrastructure projects over the life of the program.

AB 2523 would create an additional program under the I-Bank, the California Preferred Broker-Dealer Program for the purpose of closing financial and information gaps within the network of public and private financial institutions and intermediaries that serve small businesses. Under current law, broker dealers are regulated under the Department of Corporations (DOC). A broker dealer under the Corporations Code Section 25004 is any person engaged in the business of effecting transactions in securities in this state for the account of others or for his own account. Broker-dealer also includes a person engaged in the regular business of issuing or guaranteeing options with regard to securities not of his own issue. Generally speaking, broker-dealers are persons that act as securities dealers or brokers or perform both functions. A broker is an individual or firm who acts as an intermediary between a buyer and seller, usually charging a commission. A dealer is any person in the business of buying and selling securities for his or her own account, through a broker or otherwise. While the program is voluntary, it is unclear as to how the program would work under the I-Bank and what financial institutions would participate.

Several states have participation loan programs such as New York, Illinois, Minnesota, Vermont, Oregon, Iowa, Connecticut, and North Dakota.

According to the U.S. Treasury, a Participation Loan Program enables small businesses to obtain medium to long-term financing, usually in the form of term loans, to help them grow and expand their businesses. States may structure a Participation Loan Program in two ways: purchase transactions, also known as purchase participation, in which the state purchases a portion of a loan originated by a lender; and companion loans, also known as co-lending participation or parallel loans, in which a lender originates a senior loan and the state originates a second (usually subordinate) loan to the same borrower. This program enables the state to act as a lender, in partnership with a financial institution lender, to provide small business loans at attractive terms.

Participation loans are considered loans that are shared by a group of banks that join to make a loan too big for any one of them alone. The benefits of a Participation Loan program are:

- The state benefits from seeing the financial institution lender's credit analysis, though the state should also conduct its own underwriting of each loan.
- The financial institution lender diversifies its risk by sharing exposure with the state.

- The state may decide to offer its participation at low interest rates, which reduces the blended rate paid by a small business.
- In a purchased participation, the financial institution lender conducts all of the customer interaction, including monthly invoicing, collections, and loan workouts.

Reorganization of the I-Bank: On March 30, 2012, the Governor proposed to dismantle BTH and move programs to other existing and new government entities. The I-Bank is proposed to be relocated to the Governor's Office of Business and Economic Development.

The Little Hoover Commission has 30 days to analyze the reorganization plan and submit its recommendations to the Governor and Legislature. The Legislature then has 60 days to consider the plan. The plan goes into effect unless the Legislature takes an action to disapprove the plan with a majority of the Members in each house voting.

QUESTIONS:

AB 2523 is on the right track by allowing the I-Bank to work with financial Institutions but then also adds the California Broker Dealer Program. In regards to the California Broker Dealer Program:

- 1) Why is the program needed and is it worth the limited resources of the I-Bank to create and administer this program? As written, the program is not mandated so what will it actually accomplish?
- 2) How will financial institutions demonstrate a long-term relationship with community development financial institutions and how will the I-Bank determine this?
- 3) Why would financial institutions participate in such a program?
- 4) How will financial institutions determine through the program how many jobs were created and what will the I-Bank do with this annual report? What happens if the financial institutions do not submit an annual report?
- 5) A broker-dealer as referred to in this program seems to have a very different meaning of what a broker-dealer is under corporations code, is this intentional?
- 6) Do financial and information gaps exist currently that this program will fix and if so, what needs are not being met that this program will fix?

AMENDMENTS:

The Committee is recommending the following amendments:

Delete the provisions of the California Broker-Dealer Program. The program is not needed since AB 2523 gives the I-Bank the authority to work with financial institutions on participation loan agreements.

If it is the intent of the Author to create a Participation Loan Program within the I-Bank then the author may want to move that direction rather than create the California Preferred Broker-Dealer Program.

REGISTERED SUPPORT / OPPOSITION:

Support

California Bankers Association (CBA)

California Independent Bankers (CIB)

Opposition

None on file.

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