Date of Hearing: April 25, 2011

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
AB 981 (Hueso) – As Introduced: February 18, 2011

SUBJECT: California Pollution Control Financing Authority: Capital Access Loan Program.

SUMMARY: Provides additional incentives within the California Capital Access Program (CalCAP) to encourage lenders to lend to small businesses. Specifically, this bill:

1) Expands the financial institution definition to include insured depository institutions, insured credit unions, and community development financial institutions.

2) Authorizes the California Pollution Control Financing Authority (CPCFA) to withdraw a portion of the interest or other income that has been credited to the loss reserve account.

3) Requires the CPCFA to contribute an amount not less than 150% of the amount of the fees paid by the participating financial institution if the business is located within a severely affected community.

EXISTING FEDERAL LAW enacted the Small Business Jobs Act (H.R. 5297) on Sept. 27, 2010 which creates the Small Business Lending Fund Program to direct the Secretary of the Treasury to make capital investment in eligible institutions in order to increase the availability of credit for small business and to amend the Internal Revenue Code of 1986 to provide tax incentives for small business job creation. (15 U.S.C. Sec. 631 et seq.)

EXISTING STATE LAW

1) Defines "California Capital Access Fund" as a fund created within the (CPCFA) to be used for the purposes of the program. (Health and Safety Code, Section 44559.1)

2) Defines a "community development financial institution" as person (other than an individual) that has:

   a) a primary mission of promoting community development;

   b) serves an investment area or targeted population;

   c) provides development services in conjunction with equity investments or loans, directly or through a subsidiary or affiliate;

   d) maintains, through representation on its governing board or otherwise, accountability to residents of its investment area or targeted population; and,

   e) is not an agency or instrumentality of the United States, or of any State or political subdivision of a State. (Section 4701 of Title 12 of the United States Code)

3) Defines an "insured depository institution" as any bank or savings association with deposits of which are insured. (Section 1813 of Title 12 of the United States Code)

4) Defines an "insured credit union" as any credit union member accounts of which are insured. (Section 1752 of Title 12 of the United States Code)

5) Defines "severely affected community" as any area classified as an enterprise zone pursuant to the Enterprise Zone Act, any area, designated by the executive director, and any other comparable economically distressed geographic area so designated by the executive director from time to time. (Health and Safety Code, Section 44559.1)

6) Requires the CPCFA to transfer to the loss reserve account an amount equal to 150% of the amount of the fees paid by the participating financial institution if the business is located within a severely affected community. (Healthy and Safe Code, Section 44559.4)

FISCAL EFFECT: Unknown

COMMENTS:

Why is this bill necessary? Unlike other small business loan assistance programs, CalCAP, enacted in 1994, provides a form of portfolio insurance for participating lenders. CalCAP will contribute funds to a loan loss reserve account associated with a lender. The lender and borrower also contribute funds. These funds are pooled and can then be used to cover losses associated with any enrolled loan that is charged off.

CalCAP has traditionally been funded using fee revenues charged by the CPCFA to private companies that receive the benefit of tax-exempt bonds. These revenues were adequate to sustain the CalCAP program through 2006. However, increased use of the program in combination with declining revenues led to necessary statutory and regulatory changes to constrain the program. The changes allowed CalCAP to continue at a reduced level as compared to prior years.

In late 2010, the legislature allocated funds to CalCAP through AB 1632. These funds allowed CalCAP to increase the contribution to loan loss reserve accounts. Prior to AB 1632, CalCAP was contributing an amount equal to the lender contribution (between 2% and 3.5%). After the funds became available, CalCAP increased the CalCAP contribution to 3% to 5.25%. AB 1632 also contained language to expand the definition of severely affected communities to include high unemployment areas. When CalCAP raised the contribution for all enrolled loans, it became restricted in severely affected communities to 150% of the lender contribution. Thus, when CalCAP increased the contribution to a minimum of 3%, it could not provide any further added incentive in severely affected communities. AB 981 would fix this anomaly in the statute and allow CalCAP to provide an increased incentive to encourage lending in high unemployment and other severely affected areas.

The U.S. Department of the Treasury certifies Community Development Financial Institutions (CDFIs) and does not make a distinction between for-profit and non-profit CDFIs. There are for-profit CDFIs in California that would like to participate in CalCAP and make more loans to small businesses. AB 981 would remove the requirement that a CDFI be a non-profit CDFI to participate in CalCAP. Other for-profit entities such as banks participate in CalCAP.

Current statutory language implies that if CalCAP sweeps interest from a loan loss reserve account, all interest must be swept. When this provision was placed in statute, it was not envisioned that CalCAP would have a noticeably growing amount of funds in loan loss reserve accounts. CalCAP is the recipient of over $84 million from U.S. Treasury to expand the program. It is possible that these funds will result in more interest in loan loss reserve accounts than CalCAP needs. CalCAP would like the flexibility to reduce the amount of interest collected from accounts to an amount less than 100% of the interest earned.

Background: CalCAP encourages banks and other financial institutions to make loans to small businesses that fall just outside of their conventional underwriting standards.

CalCAP is a form of loan portfolio insurance which may provide up to 100% coverage on certain loan defaults. By participating in CalCAP, lenders have available to them a proven financing mechanism to meet the financing needs of California's small businesses. CalCAP insures loans made to small businesses to assist them in growing their business. Loans can be used to finance the acquisition of land, construction or renovation of buildings, the purchase of equipment, other capital projects and working capital. There are limitations on real estate loans and loan refinancing. CalCAP prohibits financing certain projects. Examples of ineligible uses of loan proceeds include gambling facilities, bars and adult entertainment businesses.

The maximum loan amount is $5 million and the maximum enrolled amount is $2.5 million. The maximum premium the Authority will pay is $100,000 (per loan). Lenders set all the terms and conditions of the loans and decide which loans to enroll into CalCAP. Lenders determine the premium levels to be paid by the borrower and lender. Loans can be short or long-term, have fixed or variable rates, be secured or unsecured, and bear any type of amortization schedule.

Under CalCAP almost any business loan is eligible with a few exceptions. CalCAP provides insurance on a lender's portfolio of loans. Funds are placed in the loss reserve account as each CalCAP loan is enrolled. A Lender can enroll all or a portion of a loan. CalCAP allows a lender to cover loans beyond its conventional risk threshold whether it is for all of a loan or only a portion. Lenders can restructure loans by extending the terms of CalCAP loans, amending covenants or releasing collateral. Loans up to $5 million ($2.5 million enrollment max) can be included in the CalCAP portfolio.

Any federal or state-chartered bank, savings association or credit union is eligible to participate in CalCAP. A lender must certify that it is in good standing with its regulatory body (Federal Reserve, Federal Deposit Insurance Corporation (FDIC), Comptroller of Currency, Thrift Supervision, National Credit Union Administration (NCUA), or state banking authority). As of March 25, 2011, 46 financial institutions participate in CalCAP.

The process of the program works like this: when a lender's first loan is enrolled, CalCAP establishes a loss reserve account for that lender. Each time a loan is enrolled under CalCAP, premiums are paid into the portfolio loss reserve account and CalCAP matches the premiums. For instance, if the lender and borrower each pay a 2% premium, CalCAP will typically pay 4%. For this one loan a total of 8% is added to the lender's loss reserve account for its entire CalCAP portfolio. The more loans a lender makes, the more dollars are deposited into the loss reserve account for its CalCAP portfolio.

Over time, as more loans are enrolled, a lender's loss reserve account grows, providing 8% to 14% loss coverage on a portfolio of loans that will likely only experience a lower rate of loss. For example, if a lender makes 10 loans totaling $500,000, the lender may have as much as $60,000 in its loss reserve account (using an average premium of 3% each from the lender and borrower, 6% from the Authority). If one loan of $50,000 defaults, the lender has immediate coverage of 100% of the loss. The lender must return recoveries from the borrower, less expenses, to the portfolio loss reserve account.

SUPPORT: According to the Sponsor, the California State Treasurer, "AB 981 would do three things: would allow CalCAP to provide added incentives for loans to businesses in high unemployment areas and other distressed communities, would allow CalCAP to make more lenders eligible to provide assistance-specifically, for-profit community development financial institutions, and would allow CalCAP to reduce the amount of interest it takes from loan loss reserve accounts to cover program costs."

In addition, the Treasurer states, "Over the next few years, CalCAP is projected to create over $1.3 billion in small business lending. AB 981 makes changes that will allow CalCAP to attract new lenders and better assist small businesses in our most distressed communities."

FEDERAL ACTION:

Federal Small Business Jobs Act of 2010 (HR 5297) On Sept. 27, 2010, President Obama signed into law the Small Business Jobs Act, the most significant piece of small business legislation in over a decade. The new law provides critical resources to help small businesses continue to drive economic recovery and create jobs. The new law extended the successful small business enhanced loan provisions while offering billions more in lending support, tax cuts, and other opportunities for entrepreneurs and small business owners. It established State Small Business Credit Initiative that provides up to $15 billion to support state-run small business lending programs. It is estimated that the incentives included in the act could provide up to $300 billion in new small business credit in the coming years and create 500,000 new jobs.

California, so far, has received $56 million from the Small Business Jobs Act. If California makes use of the money, California could end up receiving $168 million to go to small business loan programs such as CalCAP and the Small Business Loan Guarantee Program (SBLGP).

RELATED LEGISLATION:

AB 901 (V.Manuel Perez) expands the definition of financial institutions in CalCAP and increases CalCAP reporting requirements. To be heard in Assembly Banking and Finance Committee on April 25, 2011.

PREVIOUS LEGISLATION:

AB 1632 (Blumenfield) (Chapter 731, Statutes of 2010) transferred $32.4 million from the General Fund to support four small-business and jobs programs that exist in current law.

SB 832 (Comm. Env. Quality) (Chapter 643, Statutes of 2009) allowed CalCAP to include Finance Lenders for programs that are funded by other agencies.

SB 1311 (Simitian) (Chapter 401, Statues of 2008) permitted CalCAP to contribute an equal amount to an enrolled loan's loss reverse account as the lender, and to withdraw all accrued interest from enrolled loss reserve accounts to assist with administrative cost.

REGISTERED SUPPORT / OPPOSITION:

Support

California State Treasurer (Sponsor)

Opposition

None on file.

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