



Legislative Fiscal Bureau

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April 19, 2010

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Substitute Amendment 1 to 2009 Assembly Bill 532: Commerce -- Capital Access Program and Funding

Assembly Bill 532 was introduced on October 29, 2009, and referred to the Assembly Committee on Jobs, the Economy and Small Business. On January 11, 2010, Assembly Substitute Amendment 1 was offered, and on January 12, ASA 1 was recommended for adoption by a vote of 12 -1. ASA 1 to AB 532 was passed by the Assembly on January 28, 2010, by a vote of 96 to 0. The bill was messaged to the Senate and referred to the Senate Committee on Small Business Emergency Preparedness, Technical Colleges and Consumer Protection which recommended concurrence on March 9, 2010, on a vote of 5 to 0. The bill was referred to the Joint Committee on Finance on April 8, 2010.

BACKGROUND

In general, capital access programs (CAPs) are designed to encourage banks to underwrite loans to a higher risk threshold than conventional lending criteria to provide an incentive for the banks to issue loans to small businesses that might otherwise be too risky. Under a CAP, the borrower obtains a loan and loan approval directly from the bank. The bank and the borrower pay an up-front insurance premium that, combined, generally ranges from 3% to 7% of the loan amount. The exact percentage is at the discretion of the individual bank and, in practice, the bank may pass most of its portion of the premium on to the borrower by financing the premium in loan proceeds. Banks also have the discretion to set interest rates on CAP loans.

The bank holds all of the CAP premiums in a single, pooled reserve account. The bank enrolls the loan in the CAP program by sending a form to the state providing required information, and certifying that it meets program eligibility requirements. The state then deposits a matching amount, typically a one-to-one match, into the originating bank's CAP reserve account. In this way,

each bank creates its own funded loan loss reserve to cover a loss on any of its CAP loans. The bank recovers any CAP loan losses by offsetting them against the CAP reserve fund it holds. The bank must absorb any losses over its accumulated CAP reserve fund.

The Wisconsin Business Development Finance Corporation (WDBFC) is a community development corporation (CDC) that assists small businesses in Wisconsin in gaining access to capital. CDCs are private, non-profit organizations set up to contribute to the economic development of the CDC's community. CDCs, including WDBFC, work with the U.S. Small Business Administration (SBA) and private sector lenders to provide financing to small businesses through the federal Certified Development Company Economic Development Loan Program or the SBA 504 loan program. The CDC/504 Loan Program provides growing businesses with long-term, fixed-rate financing to acquire major fixed assets for expansion or modernization. In addition to SBA 504 loans, WDBFC provides consulting and loan packaging services. WDBFC operates from regional offices in Madison, Waukesha, Oshkosh, Eau Claire, Stevens Point, Hudson, Racine, and Green Bay.

SUMMARY OF BILL

The bill, as passed by the Assembly (ASA 1 to AB 532), would provide \$350,000 GPR beginning in 2010-11 for the Wisconsin Development Fund (WDF) and require the Department of Commerce to award annual grants from the WDF to the Wisconsin Business Development Finance Corporation (WDBFC) to fund a state capital access program.

WDBFC would be authorized to administer the CAP program, or to enter into a contract with another third party to administer the program or any portion of it. The third party would have to be an Internal Revenue Code (IRC) section 501 (c) 3 tax exempt organization and have the promotion of community development as its primary purpose and mission.

The administrator of the CAP would be required to do the following:

- a. Enter into written agreements with banks desiring to participate in the CAP that specify the rights and obligations of the administrator and the bank under the program.
- b. Develop a standard agreement form for use with banks that want to participate in the CAP, and any other standard forms necessary for use in the program.
- c. Review applications and approve enrollment of loans in the CAP.
- d. Contribute premiums to reserve accounts.
- e. Manage and control reserve funds.
- f. Review and approve withdrawals from reserve accounts.

Under the CAP program, a participating bank would be required to make loans to borrowers for eligible projects for which financing might not otherwise be available due to the borrower's lack of adequate collateral, net worth, or credit history. When a participating bank made a loan under the CAP, the borrower and the participating bank each would be required to contribute a premium to a reserve fund account held by the bank. The premium would be determined by the bank, but could not be less than 1.5% nor more than 3.5% of the principal amount of the loan to be covered under the CAP. The CAP administrator would be required to contribute a premium in an amount of between 100% and 150% of the total combined premium paid by the borrower and the participating bank. The CAP administrator could not pay more than \$150,000 into a bank's reserve fund on behalf of any borrower in a three-year period, unless the borrower had given written approval in advance. Premiums would be deposited in a reserve account at the participating bank that contained premiums from all the CAP loans made by the bank, and interest accrued on those premiums. The reserve fund account could also contain premiums and interest accrued under a CAP administered by the Milwaukee Economic Development Corporation, if the bank participated in that program. A refinanced prior loan to a borrower for an eligible project could not be enrolled in the CAP, except for any additional funds that would be loaned.

Reserve funds would be owned and controlled by the CAP administrator, but could only be used by the participating bank that made the loans related to those funds. Reserve funds could only be withdrawn to cover losses on loans enrolled in the CAP. In order to withdraw funds to cover an enrolled loan, the bank would be required to submit a claim to the CAP administrator. The amount of the claim, up to the total amount of reserve funds held by the bank, could not exceed the amount of the CAP loan's principal covered under the CAP and actually charged off by the participating bank, plus accrued interest, and verifiable out-of-pocket collection expenses. The CAP administrator would be subrogated to the rights of the participating bank to recover against a borrower, including a right to enforce a security interest in collateral.

Each participating bank would be required to reimburse the CAP administrator for any funds, less out-of-pocket expenses, paid to the bank from its reserve funds that are later recovered by the bank. Each participating bank would have to file a report with the CAP administrator, at times requested by the administrator, listing the outstanding balance for each loan enrolled in the CAP by the bank.

Upon notice to a bank, the administrator could inspect the records and files of the bank related to any enrolled or charged-off loan. The administrator would be authorized to terminate a participating bank's right to make CAP loans.

The Wisconsin Business Development Finance Corporation could withdraw up to 50% of the interest component of CAP reserve funds, and use the withdrawn moneys to promote the CAP program, and to contract with a third party to administer the program.

The CAP administrator would be required to provide the Governor and presiding officer of each house of the Legislature: (a) an interim report on the effects of the CAP program, by

December 31, 2011; and (b) a comprehensive evaluation of the CAP program by June 30, 2013.

"Bank" would mean either of the following: (a) a financial institution regulated by the state or federal government that is in good standing with regulatory authorities; or (b) an entity that has an existing portfolio of revolving loans to small businesses and that has as its primary purpose and mission the promotion of community development primarily in a limited geographic area of the state that is experiencing economic distress. "Participating bank" would mean a bank that enters into an agreement with the CAP administrator and makes loans under CAP.

"Reserve funds" would be defined as premiums contributed under CAP, and interest accrued on the premiums.

"Borrower" would mean any organization or enterprise, operated for profit, or not for profit, that fulfills all of the following conditions:

- a. Is authorized to do business in this state.
- b. Does not sell alcohol beverages as defined under state alcohol beverages statutes.
- c. Is not an executive officer, director, or principal shareholder of a participating bank, a member of the immediate family of an executive officer, director, or principal shareholder of a participating bank, or an organization or enterprise controlled by any of those individuals.

"Eligible project" would mean any business purpose in this state, except for any of the following: (a) construction or purchase of residential housing; or (b) passive real estate investment.

FISCAL EFFECT

As passed by the Assembly, the bill (ASA 1 to AB 532) would provide \$350,000 GPR beginning in 2010-11 to the Wisconsin Development Fund [s. 20.143 (1) (c)] for grants to the Wisconsin Business Development Finance Corporation to fund a capital access program. In addition, the bill specifies that no grants could be made for CAP after the first day of the sixth month beginning after the effective date of the bill. The bill would increase GPR expenditures by \$350,000 in 2010-11. In addition, base level funding for the WDF for future fiscal years would be increased by this amount. Under current law, the WDF is provided \$6,492,900 GPR, and \$3,801,500 PR (repayments) in 2010-11.

Because the gross balance in the general fund as of June 30, 2011, is currently estimated to be less than the \$65 million balance required under s. 20.003(4) of the statutes, the bill should be amended to include a notwithstanding clause relative to s. 20.003(4).

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