F I S C A L I M P A C T R E P O R T

SPONSOR Matthews/Ely **ORIGINAL DATE** 6/18/20 **LAST UPDATED** 6/19/20(v2) **HB** 4

SHORT TITLE Small Business Recovery Act of 2020 **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue*				Recurring or Nonrecurring	Fund Affected
FY20	**FY21**	**FY22**	**FY23**		
($400,000.0)				Nonrecurring	Severance Tax Permanent Fund
$400,000.0				Nonrecurring	Small Business Recovery Loan Fund
($100,000.0)				Nonrecurring	Severance Tax Permanent Fund
($100,000.0)				Nonrecurring	NMFA Local Government Fund
-	-	($4,700.0)	($9,700.0)	Recurring	General Fund (STPF distributions)

(Parenthesis ( ) Indicate Revenue Decreases)

* Scoring of this bill has been updated per analysis from State Investment Council staff, which assumes an immediate draw-down of the funds to provide loans then gradual repayment. See fiscal implications. Note: The table above reflects SIC analysis; however, the bill does not specifically send the STPF commitment to NMFA for small business recovery loans to the Small Business Recovery Fund, and there are constitutional concerns whether that could be done.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
NMFA	$1,000.00	$750.00	$750.00	$2,000.0	Recurring	NMFA Operating Fund
Loan Servicers and Service Providers	$3,000.00			$3,000.0	Nonrecurring	Small Business Recovery Loan Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Economic Development Department (EDD)
State Investment Council (SIC)
New Mexico Finance Authority (NMFA)

SUMMARY

Synopsis of Bill

House Bill 4 creates the Small Business Recovery Act of 2020 and requires the State Investment Council (SIC) to commit the lesser of $400 million or 10 percent of the value of the severance tax permanent fund (STPF) to the New Mexico Finance Authority (NMFA) for "small business recovery loans". The bill also requires 1 percent of the STPF be committed to NMFA for loans to local governments to provide emergency economic relief. The bill contains reporting requirements to relevant legislative committees for both loan programs.

Lastly, the bill maintains the increase of the STPF commitment to the New Mexico private equity program from 9 percent to 11 percent that was passed in the 2020 legislative session, and repeals Laws 2020, Chapter 75 to prevent conflict with this bill.

This bill contains an emergency clause and would become effective immediately upon signature by the governor.

Small Business Recovery Loans

The Small Business Recovery Act ("the Act") allows businesses with an annual gross income of less than $1.5 million that closed or reduced operations due to the March 23, 2020 public health order to borrow 2 months' worth of operational funds. Qualified small businesses must:

- if a for-profit, have at least 80 percent of the equity owned by one or more New Mexico residents,
- if a nonprofit, must have 100 percent of the assets owned or leased by a New Mexico resident.
- have lost more than 30 percent of gross receipts or revenue during the months of April and May 2020, and
- be classified within one of the following industries: retail trade, accommodation and food services, construction, administrative and support services, health care and social assistance, or child daycare services; or, is a small independent movie theater or tribal entity.

The bill requires NMFA to develop procedures for applications and loan disbursements in accordance with the Act. NMFA may also contract with one or more qualified lenders to process small business recovery loans and pay a 2 percent fee for the lenders' administrative costs. However, the bill prohibits NMFA and community financial institutions from creating additional requirements for the loans other than those provided by the Act.

If qualified lenders are used to administer the loans, the bill provides for NMFA to purchase the loan from the lender if:

- the loan terms are identical to the terms provided by the Act,
- the applications were processed in the order they were received,
- the lender did not require any additional information other than the information required by the Act,
- the lender did not impose any additional costs on the applicant,
- the loans was made to a qualifying small business, and
- funds are available for NMFA to purchase the loan.

The Act states qualified lenders shall not be liable for disclosing information to NMFA and, after the loans are sold to NMFA, shall not be liable if recipients fall to comply with the loan terms.

The maximum loan amount is 200 percent of the business's average monthly expenses, up to $75,000. The Act provides the loan terms must require that:

- a minimum of 80 percent of the loan proceeds be used for ordinary and necessary business expenses other than compensation for employees' owning equity in the business,
- an appropriate officer of the small business sign a written certification confirmed the officer (1) understands the loan must be repaid with interest, (2) all documents are true and accurate to the best of their knowledge, (3) they do not have reason to believe the business will cease operations or file for bankruptcy, and (4) the proceeds will be used in accordance with the Act.

The Act states the loan terms cannot require the qualifying small business to provide a personal guarantee or collateral to secure the loan.

Small business recovery loans will have an initial loan period of 3 years, with a required annual interest rate of one-half of the Wall Street Journal prime rate (today's rate is 3.25%, so a hypothetical loan today would charge 1.625% per annum). The loans will require annual interest-only payments for the first 3 years, after which the business can repay the principal or convert any remaining principal and interest into a loan with monthly principal and interest payments over an additional 3 years. There will be no penalty for prepayment of the loan balance.

Receipts from loan repayments will be deposited back into the severance tax permanent fund. The bill states NMFA cannot be held liable for any of these investments that do not provide a return on investment that is comparable to other differential rate investments made pursuant to the Severance Tax Bonding Act.

Small businesses with annual revenue under $500,000 may seek assistance from a service provider to apply for the loan. The bill allows a 1 percent fee to be paid to the service provider. The bill requires the service provided to continue working with the business until the loan terms expire or the service provider certifies the business no longer needs their assistance.

The bill also creates a "small business recovery loan fund" that can receive grants, donations, or transfers and provides for continuing appropriations to the Authority. The bill does not appear to provide for an initial balance of the fund.

The required commitment to NMFA to administer loans pursuant to the Act is amended into Section 7-27-5.15 NMSA 1978, which is subject to standards in the Uniform Prudent Investor Act.

Local Government Loans

Within 30 days of the bill's effective date, the bill requires SIC to commit 1 percent of STPF's five-year average market value to NMFA to make loans to local governments to provide emergency economic relief. Loans are required to be consistent with the standards in the Uniform Prudent Investor Act.

The bill requires loan applicants to demonstrate the local government experienced at least a 10 percent decline in FY20 operating revenue due the economic impacts of COVID-19.

NMFA is required to create application procedures and requirements for loan disbursements. The bill requires loan applications to be received by September 30, 2020.

Local governments may borrow 50 percent of their projected budget shortfall for FY20 as determined by the Local Government Division (LGD) of the Department of Finance and Administration. The bill requires the loans to carry a 2 percent interest rate, and proceeds may be used for "general operating expenses and revenue replacement". Loans will be backed by a dedication of future gross receipts tax (GRT) revenue.

Loan periods cannot exceed 5 years. The bill requires that the interest on the loan will not compound for the 12 months, and payments will be interest-only for the first 3 years, after which the local government must make monthly principal and interest payments. There is no penalty for prepayment of the loan balance.

FISCAL IMPLICATIONS

State Investment Council staff provided the following fiscal analysis:

> SIC, working with our general investment advisor RVK has used Monte Carlo simulations to develop the following estimates based on likely program variables available to us prior to today. The assumptions are that the drawdown from the STPF would occur upon passage of the new law, with limited returns of principal to the STPF during the first three years, and more substantial repayment coming thereafter. This is in line with expectations and helps establish the "opportunity cost" of taking investment dollars and deploying them into a strategy that will deliver less than the 6.75% long-term investment return target of the STPF. The projections show the opportunity cost impact at various funding levels for the 10, 20 and 30-year time periods, as the costs of potentially "lost" investment financial returns below the 6.75% target grow over time.
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> This updated projection shows the longer-term impact of diminished STPF returns that would accompany the loan programs, assuming default rates of 15% on business loans and 0% on local government loans, and a secondary example, for comparison sake, at a 30% loan default rate:

15% Default Rate on $400M @ 1.625% Annual Interest; Principal Repaid Years 4 & 5
0% Default Rate on $100M @ 2.90% Annual Interest; Principal Repaid Years 4 & 5

	Median Market Value ($M) at:			
Withdrawal Case:	10 Years	20 Years	30 Years	Difference vs. Base Case at 30 Years ($M)
Base Case	$9.443	$16.896	$30.103	$0
Updated Scenario	$9.224	$16.503	$29.404	-$699

30% Default Rate on $400M @ 1.625% Annual Interest; Principal Repaid Years 4 & 5
0% Default Rate on $100M @ 2.90% Annual Interest; Principal Repaid Years 4 & 5

	Median Market Value ($M) at:			
Withdrawal Case:	10 Years	20 Years	30 Years	Difference vs. Base Case at 30 Years ($M)
Base Case	$9.443	$16.896	$30.103	$0
Updated Scenario	$9.135	$16.343	$29.120	-$983

The optimistic estimate shows that under terms prescribed by the Small Business Recovery Loan Fund, the STPF would earn approximately $699 million less over the next three decades assuming a 5-year loan program of $500 million and otherwise normal STPF returns. Smaller program drawdowns would have smaller impacts accordingly. A higher rate of default would result in an opportunity cost of approximately $983 million in reduced earnings. Similarly, smaller drawdowns on the fund would have lesser impact, as would a lower default rate among borrowers.

It's important to note that lower than average portfolio investment returns – which is a current SIC expectation for the coming decade of investment – could also mitigate this impact to some degree. On the opposite end of this projection, outsize or larger than average investment returns over the next five years would amplify the impact on the fund's growth prospects. That expectation is not one many are predicting currently, but certainly it is possible.

A concern we would note regarding the Small Business Recovery Loan Fund is the limited extent of underwriting (advance research on each company's financial status and forward-looking prospects) expected to be associated with each loan, and the lack of potential fraud protections in the bill which could result in a greater number of loan defaults.

A study publicized by financial website Wallethub in recent years showed an average SBA loan default rate of 1 in 6 (~16%) from 2008-2015. Loans made under the Small Business Recovery Loan Fund would have a lesser level of underwriting than standard SBA loans, which would imply a reasonable expectation of an equal or greater default rate. There is however, too much uncertainty related to the pandemic and economic recovery to pinpoint the future with much certainty.

SIC estimates the impact of an immediate $500 million drawdown of the STPF will cause general fund distributions in FY22 to be $4.7 million lower than under current law. Because reduced earnings would lower the growth potential of the fund, the growth-potential of the STPF distributions to the general fund would be lower as well, widening the cost to the general fund over time.

The New Mexico Finance Authority provided the following fiscal analysis:

> NMFA's costs will be higher in the first year of the program which cover the set-up of the program and temporary staff. NMFA anticipates that costs will drop in the second and third years as the primary activities become loan servicing and monitoring. NMFA will be paid on a reimbursement basis for actual costs associated with the program, not to exceed 1% of the total investment. Additional costs to the program include payments to third party Loan Servicers and Service Providers. NMFA assumes that half of the funding will go to businesses whose loan applications were submitted by Loan Servicers and Service Providers at an average fee of 1.5% of the loans.

Small Business Recovery Loans. Fiscal impact reports typically receive static scoring, looking exclusively at direct revenue impacts, rather than dynamic scoring that would take into account economic effects and resulting secondary impacts on revenues. EDD notes there are very valid reasons why this is the case, but it is important to note the scoring for this bill will not take into account the general fund revenue impacts due to the economic lift the bill could provide.

The bill limits the maximum loan amount to $75 thousand per business. A conservative assumption of each business applying for and receiving that maximum loan amount could result in 5,333 New Mexico businesses receiving assistance. According to EDD, if these loans help sustain business operations and prevent permanent closures, or if they allow businesses to hire back employees faster and ramp up operations to be more in keeping with prior levels, these businesses will likely generate more gross receipts and revenues and provide more income to their employees than they would other be able to under the current circumstances.

EDD states the economic benefits of this bill would translate into more general fund revenues through increased gross receipts tax (GRT) revenues at the state and local levels and more personal and corporate income tax revenues for the state. However, EDD also notes the general fund impact of this economic benefit is impossible to estimate with current modeling. The agency states the general fund effect would be positive and likely significant, to some degree offsetting the general fund reductions caused by smaller STPF distributions to the general fund, and the impacts to local governments would be positive.

This bill creates a new fund and provides for continuing appropriations. The LFC generally has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities. The small business recovery fund created in this bill does not contain an initial funding mechanism, but the fund could receive future appropriations, grants, or donations.

Local Government Loans. It is unclear whether local governments would be able to dedicate a portion of their existing GRT revenue to the repayment of these loans, or whether they must enact a new, additional GRT increment to pledge for the repayment of these loans.

SIGNIFICANT ISSUES

Small Businesses. The demand for non-forgivable business loans during the COVID-19 economic downturn is unclear. Low economic activity caused by mandatory closures and stay-at-home orders is expected to result in some permanent losses to businesses. Even as economic activity recovers, many businesses will not generate enough revenue to repay loans, even at low interest rates, which is why many businesses with the highest needs are seeking grants or forgivable loans. Some owners of the hardest-hit businesses may knowingly be unable to repay the loans and therefore not seek out the benefit of this program, which would make the program unusable by some of the businesses it is targeting.

NMFA points out the following issues with the Act requiring the loans to be unsecured:

> The loans made under the Fund are unsecured loans and will not enjoy personal guarantees by the owners. As a result, NMFA will have limited ability to collect delinquent or defaulted loans. HB 4 fails to include adequate protections or authority for the NMFA to enforce defaults. Additionally, the interest rate is limited to 50% of the Prime Rate and principal under the Small Business Recovery Loan program will not be due until the end of the third year. As a result, the return on the Fund will be less than the SIC is accustomed to receiving.

SIC staff also notes that, as drafted, the program for small business loans will draw down $400 million right away, taking those dollars out of other liquid investments (stocks and bonds rather than illiquid private-market investments).

SIC staff further point out:

> Under the current proposal, it's not clear the $400 million and $100 million for local government loans would remain on STPF's books (rather than in NMFA's account), which would negatively impact distributions, in a small way at first but with increasing impact as time passes. The STPF, at current values, is projected to distribute $241 million in FY22 and $1.26 billion over the next five years. Less the $400 million, the STPF would deliver $237 million in FY22 (about $4 million less) and $1.20 billion over five years (~$60 million less for beneficiaries during that time period) with impact and opportunity cost growing every subsequent year.
>
> Based on those reasonable expectations, it is likely advantageous to the state to limit the amount of time these funds are not invested in a standard way. As drafted, drawn down but un-lent dollars do not revert from NMFA to the STPF, but only return to the fund in the form of loan repayments years later. Clarity as to the appropriate disposition of un-loaned dollars, alternatives that would limit withdrawals to an "as needed" basis and any mechanisms that would return inactive capital to the STPF promptly should be considered for addition to the bill.

Additionally, SIC staff state:

> As drafted, there are no obvious anticorruption protections or prohibitions in the bill. There are no explicit personal guarantees or collateral requirements from borrowers, leaving the question as to what level of repayment these loans can ultimately achieve.

This concern, as to who will ensure repayment of a maximum number of these loans is problematic, as there are no collection "teeth" provided as tools to ensure repayment, either for SIC, NMFA, or the non-state lending entities that will administer the loans. Without such protections, there is a heightened risk of substantial loan defaults.

The bill, while offering some protection to the Council in their fiduciary roles, by stating that "…investments made pursuant to and in compliance with the Small Business Recovery Act of 2020 shall be deemed to be in compliance with the prudent investor rule set forth in the Uniform Prudent Investor Act", there remains a concern that there is little to justify the assertion that these investments will meet the UPIA standard. This may be addressed with additional statutory language that emphasizes that beneficiaries of the STPF are simply the "people of the state" [NM Const Art VIII § 10(A)], and as the UPIA provides significant leeway to make investments to further "the purposes of the trust" [UPIA, § 45-7-603(C)(8), Standard of care; portfolio strategy; risk and return objectives]. As currently drafted, the blanket exemption provided by Section 10 for all such investments may be overly broad, exempting the SIC from all responsibility for any reasonable oversight of the investment/loan program.

As previously mentioned, a new legislative finding and purpose section for this bill (like § 7-27-5.14, NMSA 1978) stating these investments will in fact be for the benefit of the fund beneficiaries, namely the people of New Mexico, may serve to remedy this concern.

Local Governments. On average, matched taxable gross receipts across New Mexico's counties fell 10.6 percent in April (excluding receipts from online sales). Some local governments experienced over 50 percent declines in their April GRT distributions from the same month last year, and 37 counties and municipalities experienced declines of at least 10 percent.

There are policy concerns regarding local governments pledging future revenues for current operations. First, it is unclear whether local governments would need to enact new local GRT increments to dedicate to repayment of the loans, or whether they could pledge existing GRT revenues. This is particularly concerning during a period of falling revenues.

Second, the proposed legislation amounts to the issuance of what are essentially known as deficit financing bonds. Some state or municipal governments may take similar measures after a determination that the current economic downturn has hit so hard so quickly that severe budget crises are unavoidable. However, these approvals are generally made on the assumption that the economic turmoil currently experienced state and local governments is a temporary event, which will soon be replaced by revenue growth and economic expansion. While these types of financings may result in a short-term budget fix, there are potential disadvantages that accompany them as well.

The primary disadvantage of using medium to long-term debt to address a recurring deficit is the forfeiture of future tax revenues for a current one-time situation. The issuance of debt for this purpose amounts to a one-time fix in which no long-term assets are built or improved but future resources are still depleted. In order for proposals such this to work properly, future years must be accompanied by an economic rebound and strong revenue outlook. This economic rebound must not only be strong enough to solve the existing budgetary deficit, it must also be strong enough to account for the loss of future revenues committed to the one-time fix.

LEGAL ISSUES

This bill allows local governments to borrow funds to replace lost revenue for general operations. Article IX, Section 7 of the New Mexico Constitution prevents the state from borrowing more than $200 thousand to meet causal deficits or for revenue failure. Article IX, Section 10 of the New Mexico Constitution states counties can only borrow for infrastructure and makes no allowances for counties to borrow for operations. Although it may be a gray area on whether special fund borrowing (e.g. against pledged GRT revenues) for operations would be subject to constitutional restrictions. However, it could be argued that municipal governments cannot do what the state cannot do.

It appears that HB479 in the 2019 de-earmarking bill had (likely inadvertently) allowed local government GRT revenue bonds to be pledged for "any municipal purpose", not limiting those pledges to the same infrastructure-related limitations that were in place prior to the amendment. Although that 2019 amendment to Section 3-31-1 NMSA 1978 presumably expanded the statutory allowances for local government GRT revenue bonds, such issuances would still be subject to constitutional restrictions.

Article VIII, Section 10 states "Money in the severance tax permanent fund shall be invested as provided by law." This provision allows the legislature to direct investments for the STPF, and the legislature has previously established "differential rate" investments for the STPF, such as those in this bill. Those investments have specific protections for the fund in case of defaults, however, such provisions to ensure recourse for nonrepayment are either not established or are unclear in this bill. Therefore, it is unclear whether the small business recovery loans would meet the constitutional standard of an "investment" for the STPF.

PERFORMANCE IMPLICATIONS

NMFA states the Authority has the ability to hire additional workforce to administer both programs and does not anticipate that the programs will negatively impact any of NMFA's other programs, nor their bond ratings.

NMFA also states:

> The loans contemplated in [this bill] provides NMFA with non-discretionary lending authority. The bill provides qualifying criteria and limits NMFA to the terms that can be offered to qualifying small businesses and local governments which allows the NMFA to set up the loan program quickly and administer both programs in an efficient manner. NMFA responsibilities under [this bill] are focused on establishing rules, qualifying applicants, processing loan applications, disbursing loan funds and monitoring performance.

The bill requires NMFA to submit an annual report to the relevant legislative committees providing certain details on the small business recovery loans, including: the number of loans and loan applications, the average amount of money provided to loan applicants, the number and amount of loans in a delinquent status or default, the number of loan recipients that have filed for bankruptcy, the number of employees currently employed by businesses receiving the loans, and an overview of the industries and types of business entities represented by loan recipients. NMFA may disclose broad demographic information regarding the loan recipients and totals on loan amounts and outstanding balances, but the bill also states individual loan information received by NMFA is confidential and not subject to the Inspection of Public Records Act.

The small business recovery loan program targets the businesses hardest hit by the effects of mandatory business closures and stay-at-home orders. While these businesses are arguably those with the greatest need, they may also the least likely to recover normal business operations. This calls into question their ability to repay a loan, even at low interest rates. Generally, high-risk loans carry high interest rates to provide a prudent risk-to-return ratio. The Small Business Recovery Loans contemplated in this act would require SIC to make high-risk investments with low return potential.

SIC staff note the following:

> The Council will have to restructure its STPF portfolio to accommodate a $400 million (or more included in other proposals) withdrawal and establish whether its current targeted return rate of 6.75% is viable on a risk-adjusted basis. When ~10% of the endowment fund is earning 0% or less over a 5-year span, additional risk-taking may be necessary to balance those losses to achieve the STPF's long-term target and avoid substantially cutting into the fund's corpus.
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> Historically, some ETIs, like SBIC's 2% of the STPF, in aggregate, have not generated financial returns, but have lost principal. That and other ETIs, including the New Mexico private equity program have seen volatile results, returning 25.8% in CY2018, but giving back a lot of those gains with a -12.6% return in CY2019. A quarter of a billion dollars in film loans made from 2001-2008 cost the state about $40 million on lost earnings, though all principal was returned, due to irrevocable letters of credit that guaranteed repayment. Such guarantees are not contemplated here.
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> As a rule of thumb, below-market ETI returns have been a drag on total returns and the substantial benefits provided to NM by the STPF, and this proposal will amplify that underperformance for several years. This fact should be taken into consideration while also recognizing that the STPF was created with the intent of improving and stabilizing NM's economy and also establishing a revenue engine for consistent budgetary inflows to the legislature. It has also been noted that there are few, if any, options other than the STPF for a funding source of this magnitude.

ADMINISTRATIVE IMPLICATIONS

SIC staff states there will be additional administrative burdens and oversight associated with the loan programs for all involved, including SIC, NMFA and the private lending institutions.

SIC further notes:

> While banks that facilitated the federal PPP programs were generally compensated in the 5% range for their work, this legislation would limit those underwriting fees significantly to 2%, which may limit the level of administrative oversight lenders can provide. There may be a question whether a processing fee of $1,500 on a $75,000 loan is enough compensation for the administrative work involved with such loan agreements. There are

also undefined liabilities and reputational risk to those lenders should loans they issue not be paid back or prove to be fraudulent.

TECHNICAL ISSUES

Section 2-G(4), page 4: The bill requires small businesses qualifying for recovery loans to be classified according to by the most recent edition of the United States census bureau's North American industry classification system (i.e. by NAICS code). However, the bill does allow NMFA or qualified lenders to confirm a business's reported NAICS code with TRD or the Workforce Solutions Department. It is possible businesses could report a different NAICS code to NMFA or a qualified lender in order to qualify for the loan. To prevent this, the bill could require the loan applicant to provide documentation regarding their NAICS code classification with the Workforce Solutions Department.

Section 3, page 5: The bill creates a "small business recovery loan fund", the balances of which will revert to the severance tax permanent fund at the end of fiscal year 2022. Constitutional limitations prevent the legislature from transferring STPF money into a fund from which it would appropriate, and this bill provides for no such transfer. However, it is unclear why the balance of the fund – consisting of any donations, grants, or other appropriations – would revert to the STPF.

Section 4-A, page 6: The bill states NMFA cannot create any additional requirements for eligibility other than those provided by the Act, and it also prevents banks from requiring in any additional information from loan applicants other than what is required in this Act. This bill does not make credit-worthiness a condition of approval for a small business recovery loan, therefore NMFA and qualified lenders would not be able to gather information on applicants' credit-worthiness in their application process.

Section 4-C(1), page 7: The bill requires small business recovery loans to be in an amount "equal to" 200 percent of the qualifying business's monthly expenses. Changing this requirement to "up to" would prevent the business from taking out the maximum amount of the loan if a smaller loan is desired.

Section 5-D, page 9: The bill requires receipts from the repayment of the loans be deposited into the severance tax permanent fund; however this could be interpreted to mean only the payments on the principal of the loan. This could be clarified to mean receipts from principal and interest payments shall be deposited into the STPF.

Section 8-B, page 12: The bill requires an applying local government to demonstrate to NMFA that it experienced at least a 10 percent decline in "operating revenue", but it does not define or apply criteria to the term. Additionally, it requires a 10 percent decline in FY20 to qualify for the loans. However, some local governments may have experienced surpluses throughout the fiscal year prior to the pandemic and may have suffered large losses in April-June, but those losses may not offset the prior surpluses enough to qualify for these loans.

Section 8-G(2), page 13: The bill states local government loan amounts shall be "in an amount equal to fifty percent of the local government's projected budget shortfall for fiscal year 2020" as determined by the Local Government Division at DFA. This requirement prevents local governments from borrowing less than this amount if so desired. Additionally, the language stating the LGD must do the revenue projections is vague, and it is questionable whether LGD should be responsible for doing those projections.

SIC staff note the following technical issues:

> As defined in the bill, the "Small Business Recovery Act of 2020" does not include the SIC's new investment obligations. Accordingly, the protection set forth does not apply to the actual investments the SIC is being required to make.
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> A suggested solution would be to amend section 1 to read as follows [new language is in ***red***] : SECTION 1. [NEW MATERIAL] SHORT TITLE.--***Sections 1 through 9 and the amendments made by Section 10*** of this act may be cited as the "Small Business Recovery Act of 2020".
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> Regarding the $100 million earmarked for NMFA in the bill to be used to support local governments, the investments to be made by SIC are not substantially defined. We suggest the following:
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> > SECTION 9. A new section of the Severance Tax Bonding Act is enacted to read:
> > "[NEW MATERIAL] INVESTMENT IN LOCAL GOVERNMENTS.— The state investment officer shall make a commitment to the New Mexico finance authority to invest the lesser of one hundred million dollars ($100,000,000) or two percent of the market value of the severance tax permanent fund ***in bonds or other indentures, with maturities of 5 years or less, at a 2% interest rate to be issued by local by local governments.***"
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> Similar to the business loans, the proposed statute does not thoroughly contemplate consequences should the loans not be repaid.

NMFA notes several technical issue and requests some amendments for proper functioning of the programs:

> NMFA requires the powers contained in the NMFA Act (Section 6-21-1 et seq., NMSA 1978) to effectively administer the two new loan programs, especially to enforce loan agreements and the ability to intercept the tax revenue pledge for the local government emergency loans.
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> [This bill] provides that NMFA may contract with "Loan Servicers" but is silent on the amount of fee that can be charged by the "Loan Servicers". HB 4 also provides that a 1% fee may be paid to a "Service Provider" that is funded from the loan but not repaid by the borrower. NMFA requests that these third parties be paid in a similar manner so that NMFA may project expenses for the program and not artificially limit the amount of loans being submitted by either Loan Servicers or Service Providers.
>
> For both the Local Government Emergency Economic Relief and Small Business Recovery Loan programs, NMFA requests that the new sections of law grant the NMFA all powers and authority under the NMFA Act, including specifically the ability to intercept local government local option gross receipts tax revenue.

NMFA recommends that fees paid to Loan Services and Service Providers be charged to the program either directly or as part of a loan that is not required to be repaid by the borrower. NMFA recommends that the total amount of fees paid to Loan Services and Service Providers by the program not exceed 2% of the investment.

On page 13, line 3, change the date from September 30, 2020 to December 31, 2020. By September, most local governments will have finished their budgets but won't necessarily know how they closed out FY2020 as most local governments use the audit process to close their books. The amount they need to borrow may likely be informed by the year end results.

Page 13, Section 8(C)(2), NMFA suggests that NMFA be required to consult Local Government Division of DFA on the requested loan amounts instead of requiring DFA to determine the amounts of the loan. Determining the proper amount of the loan for certain larger local governments that may have shortfalls in all of its revenue will be very difficult without an intimate knowledge of the operations.

Clarify that NMFA has the ability to determine the lien level of the pledged revenue. Specifically: on page 13, line 16 insert after the word loan, "at a lien level determined by the authority".

Add the ability for NMFA to recover from the Emergency Economic Relief Fund the costs of administration in an amount not to exceed 1%.

On page 14, Section 8(F), Line 11, insert "in accordance with the provisions of the New Mexico State Audit Act" after "shall audit the loan program…"

On page 14, line 20, NMFA requests the words "certification and justification of" be inserted following the word "of."

OTHER SUBSTANTIVE ISSUES

The Economic Development Department provided the following discussion:

The economic crisis resulting from the COVID-19 pandemic is the sharpest economic downturn in generations, and even with easing restrictions through recent health orders, many businesses are
e struggling to reopen, regain sales, and bring back laid off employees.

Many businesses in New Mexico were able to qualify for and receive federal assistance through the Small Business Administration's (SBA) economic injury disaster loans (EIDL) and paycheck protection program (PPP) forgivable loans, but each program carried its own restrictions and hurdles to apply and qualify. As a result, despite significant efforts by EDD, SBA, and the statewide network of Small Business Development Centers (SBDC), many more businesses were not able to access these funds.

SBA provided an update on June 12, 2020 that gave the following information.

> PPP has been by far the most used of the two programs, in large part because of the possibility of loan forgiveness if certain requirements are met. It had two national rounds of funding allocations, and the second and last round closes on June 30, 2020. The first round was for $350 billion and the second round was for $310 billion. Overall, PPP received roughly $660 billion in funding. The first round quickly exhausted the committed funding, and overall, $512 billion has been approved, leaving nearly $148 billion in funding available for PPP loans.
>
> The average loan nationwide for PPP is $111.9 thousand. For New Mexico, 20,991 PPP loans have been approved for a total of $2.2 billion. The average loan size in New Mexico was $105.5 thousand.
> SBA has approved nearly $91 billion through EIDL, for 1,332,955 loans. The average loan amount nationwide was $68.2 thousand. For New Mexico, SBA approved 6,571 EIDL loans, totaling $421 million. The average loan amount for New Mexico was $64 thousand, and the state ranked 38th out of 56 in the average EIDL loan amount.

EDD further states:

According to the federal Bureau of Labor Statistics quarterly census of employment and wages, the 2019 annual average (the most recent data) shows New Mexico has 62.7 thousand total covered business establishments. The PPP and EIDL programs provided a combined 27.6 thousand loans for New Mexico businesses. Available data is insufficient to determine what overlap exists between the two programs, and it is likely many of the businesses received both PPP and EIDL funding.

However, if we conservatively assume every SBA loan represents a unique business, there are 35.2 thousand businesses in the state that did not receive assistance. That is over 56 percent of New Mexico businesses who were not able to receive federal assistance through PPP or EIDL for various reasons and may still need financial assistance to survive the economic crisis. It is impossible to determine how many businesses would utilize this bill's loan program, but given how many businesses used the SBA programs and how many did not receive assistance, it appears a loan program of this magnitude might have a high use rate.

In addition, the structure of this bill is designed to target small businesses as much as possible, and there is some evidence these businesses disproportionately did not receive assistance through the federal loan programs. Helping small businesses, particularly in the most rural areas of the state, is critical to helping many of our smaller communities maintain essential local services. The local GRT revenues that would be generated by these businesses is also critical for the local governments. April 2020 GRT revenue distributions to local governments show significant year-over-year declines. Below are a few notable examples:

- Wagon Mound declined 99 percent
- San Ildefonso Pueblo declined 76 percent
- Bayard declined 72 percent

- Folsom declined 70 percent
- Laguna Pueblo declined 70 percent
- Jemez Springs declined 61 percent
- Sandia Pueblo declined 55 percent
- Nambe Pueblo declined 54 percent
- Red River declined 49 percent

> The local government loan section of the bill could also help these communities. Each local government would need to carefully evaluate how much debt they could reasonably assume, but even a small emergency loan could help many local governments avoid shutdowns of critical government services.

The State Investment Council provided the following analysis:

> While there have already been several programs, both nationally and in New Mexico which support those businesses and the broader economy, those programs have taken varied approaches. Some relief programs have been grants, or alternatively loans like the Payroll Protection Program (PPP), which can be forgiven by the federal government.
>
> That is not the case here, nor could it be, as the Severance Tax Permanent Fund cannot be used to provide grants or forgivable loans - it can only be invested.
>
> However, the bill addresses that these loans will be offered as investments at a "differential" or "below-market" rate, which is allowed under existing STPF law (Severance Tax Bonding Act) if there are offsetting benefits to the New Mexico economy. There are multiple existing allowances in law for various economically-targeted investment programs currently for the STPF, and this bill would create a new allowance under law.

In April 2020, the State Investment Council authorized a $100 million emergency short-term loan fund for medium-to-large size New Mexico businesses with approximately 40 or more employees that have been especially hard hit by the COIVD-19 pandemic – this recovery fund was channel through the STPF's existing dedication of up to 9% of the STPF for New Mexico private equity investments. Additionally, the SBIC also committed $25 million to assist small businesses with below-market interest rate loans for those impacted by COVID-19. Both of these commitments, totaling $125 million, are STPF investments done without the need for additional legislation.

Additionally, through the Statewide Economic Development Finance Act (Section 6-25 NMSA 1978), NMFA is already administering an Essential Services Working Capital Program that provides loans of up to $1 million to for-profit and nonprofit organizations at a 1% interest rate with term loans of up to 5 years. The program provides short-term working capital loans to health care and other critical service providers whose operating funds are insufficient to meet the demand resulting from the health crisis and Emergency Health Orders. For these loans, NMFA states it will not recommend loan approvals if the Authority believes the applicants projected revenues and other dedicated repayment sources would be insufficient to repay the loan and it requires program requires the value of collateral to exceed the value of the loan.

ALTERNATIVES

The State Investment Council already has authority to provide small business loans through the Small Business Investment Corporation (SBIC) and loans to New Mexico businesses through the New Mexico Private Equity Program (NMPEP). Under current law, SIC is required to commit 2 percent of the STPF value to the SBIC and may commit up to 9 percent (increased to 11 percent in this bill) of the STPF value to the NMPEP. Those programs could be expanded to provide small business loans as contemplated in this bill without having to create a new program.

SIC states the following:

> The intent of the bill would seem to be something akin to the investments SIC makes in the SBIC, which then invests in small businesses via lending partners (pursuant to § 7-27-5.15, NMSA 1978). Unlike the legislative terms addressing SBIC's function and SIC's investment, the SIC's investing relationship to NMFA is not clearly addressed in the bill. If the SIC's investment is intended to be the capital with which the Small Business Recovery Act is funded, the terms of that should be clearly defined to ensure the investments are never viewed as grants, as grants are not investments.

POSSIBLE QUESTIONS

Why create this new program instead of having SIC expand its loan programs through the Small Business Investment Corporation (SBIC) or through the New Mexico Private Equity Program (NMPEP)?

Will NMFA have the resources to deploy this bill's capital commitments quickly, and will community banks be able to quickly issue the small business loans in a manner consistent with this bill's requirements?

What are the constitutional, legal, and policy concerns with providing for local governments to pledge future revenues to pay for current operations, especially at a time when gross receipts tax revenues are falling?

How will SIC manage its prudent investor requirements while providing high risk, low return loans?

Small business recovery loans are targeted to industries hardest hit by the effects of the public health orders in response to COVID-19. What is the demand for non-forgivable loans for these businesses? What is the potential default rate on those loans?

What recourse will NMFA and SIC have if small business recovery loans are not repaid, particularly since the bill prevents requiring collateral or a personal guarantee?

Would approval of loans with the potential for high default rates and limited recourse for non-repayment violate constitutional anti-donation provisions? Would these loans meet the constitutional definition of an "investment" to which the legislature can direct for the STPF?

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