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

		ORIGINAL DATE	2/02/22		
SPONSOR	Dow/Martinez	**LAST UPDATED**		**HB**	148
SHORT TITLE	Small Business Recovery Loan Applications			**SB**	
				ANALYST	Torres

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	**FY23**	**FY24**	**FY25**	**FY26**		
	($1,350-$3,450)	($2,700-$6,750)	($2,700-$6,750)	($2,700-$6,750)	Recurring	Severance Tax Permanent Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

House bill 148 (HB148) extends the application deadline for the Small Business Recovery Loan Fund ("SBRLF") from May 31, 2022 to December 31, 2022, and extends the fund reversion date from December 31, 2022 to December 31, 2023.

There is no effective date of this bill. It is assumed that the effective date is 90 days following adjournment of the Legislature.

FISCAL IMPLICATIONS

NMFA staffs the SBRLF through a five-person Recovery Programs team that is anticipated to stay intact through FY23 as it continues to service draws under the LEDA Recovery Grants. Extension of the application deadline will divert some staff time, however, the processing of SBRLF applications requires far less time than the processing of LEDA Recovery Grant reimbursement requests.

The State Investment Council (SIC) notes:

HB148's request is an expansion by 7 months to the window for making business loans from the Small Business Recovery Loan Fund, operated and overseen by the New Mexico Finance Authority, with funding appropriated from the Severance Tax Permanent Fund. The bill also extends the processing window for NMFA to administer loan applications and agreements by one year.

The magnitude of the fiscal impact associated with extending the loan period of the program will be determined by two key variables - the demand for new loans during the expanded loan period should HB148 pass, and the subsequent default rates associated with those new loans.

Since inception, and as of January 2022, the drawdowns from the STPF to the Small Business Recovery Loan Fund have been as follows:

Date	Activity	Amount	Impact on Cash (Other)	Note
8/1/2020	Subscription	100,000,000.00	(100,000,000.00)	8/1/20 $100 million drawdown request from NMFA
11/1/2020	Redeem	60,000,000.00	60,000,000.00	11/1/20 $60 million NMFA receipt
12/17/2020	Interest Income	32,384.35	32,384.35	interest earned per Oscar Rodriquez at NMFA
12/17/2020	Interest Income	4,245.36	4,245.36	early debt service payment per Oscar Rodriguez at NMFA
2/1/2021	Subscription	1,000,000.00	(1,000,000.00)	2/16/21 $1mildrawdown request from NMFA
5/3/2021	Subscription	20,000,000.00	(20,000,000.00)	5/3/21 $20mil drawdown request from NMFA
6/1/2021	Subscription	40,000,000.00	(40,000,000.00)	6/1/21 $40 mil drawdown request from NMFA
8/25/2021	Subscription	40,000,000.00	(40,000,000.00)	8/25/21 $40 mil drawdown request from NMFA
11/1/2021	Subscription	20,000,000.00	(20,000,000.00)	11/1/21 $20 mil drawdown request from NMFA
	Total Subscriptions	$ (221,000,000.00)		
	Total Redemptions	60,000,000.00		
	Total Interest received	36,629.71		

In summary, drawdowns so far total slightly more than $160 million of the $500 million statutorily authorized, with the last drawdown of $20 million coming at the start of November 2021. NMFA has recently indicated they will also be drawing down an additional $20 million from the STPF for February 2022. This assessment is revisited on a month-by-month basis, with new loan demand being the driver for additional capital needs from the STPF.

Thus far losses to the loan fund fair-market value are largely due to expenses required to run the program (which by law can be up to 2% of the allocation, or $10 million), and a "bad loan" allowance that estimates expected loan defaults.

As of 12/31 the Small Business Recovery Loan Fund was valued at $149,368,502, on the ~$161 million drawn down so far. That valuation is the equivalent of 2.22% of the Severance Tax Permanent Fund as of the end of calendar year 2021.

Concerns remain regarding the high potential for loan losses due to limited underwriting and no personal guarantees associated with most of the loans, and it is still unlikely the full principal will be repaid. This fact and the "opportunity costs" – how much the STPF would otherwise earn had these dollars been invested as traditional STPF investments estimated to earn 6.75% annually – should be considered when granting the loan program an extension.

A reasonable estimate of opportunity cost on each $20 million borrowed – conservatively assuming a 0% return on the Recovery Loans and a 6.75% annual STPF return – is ~$1.35 million per year, per $20M in loans. It is reasonable to assume that an additional loan period could result in $40M-$100M in additional loans during the extension, for a range of $2.7M-$6.75M per year in lost investment earnings, with those lost earnings compounding and growing in value by another ~6.75% every year thereafter. Market volatility resulting in lower investment returns could mitigate opportunity costs, but the converse also applies, as it did in CY2021 which saw STPF returns of about 16%, more than double their annual target.

SIGNIFICANT ISSUES

New Mexico Finance Authority submits:

The SBRLF was created during the First Special Session of 2020 to address the needs of small businesses, many of which were unable to access federal Paycheck Protection Program. The enacting legislation contained very specific requirements for evidencing impact, resulting in lower subscription rates than anticipated, with a decline rate exceeding 50%. Ultimately NMFA made 880 loans totaling $40,250,237 from the initial legislation.

Changes made to the SBRLF in the 2021 session substantially broadened the use of the funds by eliminating the specific definitions of impact, broadening eligibility of qualifying businesses, and increasing the amounts available to small businesses. As a result, the current decline rate of applications is less than 15%. Through January 18, 2022, NMFA has made 1,460 loans totaling $95,352,085 and was processing approximately 350 applications in various stages of approval.

Currently, a total of $135 million in loans have been made and NMFA is processing approximately $25 million in applications. NMFA anticipates utilizing $200 million of the $500 million committed to the SBRLF.

The State Investment Council notes:

Existing concerns we have previously highlighted regarding the original NM Recovery Act still apply.

- Potential for high rates of loans in default. The most recent pre-pandemic estimates (2015) on US Small Business Administration loans had a default rate of 17.4%, and SBA loans have more stringent underwriting than NM Recovery Act loans. The SBA indicates that ~60% of small businesses fail within 10 years.
- The loans are still without much of any recourse in recovering loans that slip into default.
- Questions of legality in appropriating from STPF. The STPF is governed the New Mexico Constitution, (Article VIII, Section 10(A)) which indicates the STPF must be invested as provided by law. NMSA Section 7-27-5 requires that STPF investments shall be “intended to… provide income” to the STPF and be invested in accordance with the Uniform Prudent Investment Act (NMSA Section 45-7-603(C)(8). While the statute says that the Small Business Recovery Act “may” provide income and that it is “deemed to be in compliance” with UPIA, this is arguable, and has not yet been challenged in the courts.

- Previous analysis from NMFA indicated that shortening the duration of the program would "substantially decrease" the administrative costs of the program. Extending the loan window will certainly cost additional funding as well.

It should be recognized that with the expiration of other business loan stimulus programs like the Paycheck Protection Plan and other programs, the extension of the loan period for the SBRA could make a critical difference for certain struggling New Mexico businesses and also be helpful in the broader recovery of New Mexico's economy.

Is demand for the loans robust enough to justify the ongoing opportunity cost and administrative fees required to extend the loan program? While it is impossible to judge what demand may be in the second half of CY2022, the initial investment period and first extension only resulted in a little more than 1/3 of the available capital being drawn. Businesses that have not evolved to the new realities and dynamics of the pandemic by this point may not be ultimately sustainable regardless of business conditions.

PERFORMANCE IMPLICATIONS

Extending the loan application period is likely to negatively impact the severance tax permanent fund (STPF) investment performance. The STPF has experienced underperformance of about 178 basis points (1.78 percent) over the past three years annualized, and 318 basis points (3.18 percent) over the last year relative to the land grant permanent fund for the period ending 9/30/21, the latest available performance quarter. The primary reason for this difference is attributable to economically targeted investments (ETIs) being lower-earning financially than other, similar risk assets they took the place of in the portfolio. ETIs include both the Recovery Loans ($161 million), Small Business Investment Corporation loans ($98 million), and New Mexico Private Equity Investments (~$500 million). New Mexico Private Equity investments earned more than 10 percent over the past year, while the recovery loans and SBIC dollars earnings percentages were slightly negative.

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