NMFA and Leveraging of Federal Funds

PRESENTATION TO THE
NEW MEXICO FINANCE AUTHORITY
LEGISLATIVE OVERSIGHT COMMITTEE

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Opportunities for Leverage of Federal Funds

Primary federal program that fund infrastructure:

- USDA Rural Utility Services Programs

NMFA Programs that effectively leverage federal funds:

- Drinking Water State Revolving Fund
- Local Government Planning Fund
- Colonias Infrastructure Fund

Primary federal programs that fund Economic Development:

- USDA Rural Development Loan
- SBA 7(a)
- SBA 504 Program

NMFA Programs that effectively leverage federal funds:

- New Markets Tax Credit
- Smart Money Loan Participation Program
- Collateral Support Participation Program (State Small Business Credit Initiative)

Drinking Water State Revolving Loan Fund

Established in 1998. NMFA is partnered with the New Mexico Environment Department in the administration of federal funds received annually from the Environmental Protection Agency (“EPA”).

NMFA makes low-cost loans to a variety of public water systems for construction and improvements to drinking water facilities for projects identified by NMED using a Fundable Priority List. NMFA accepts applications in the order in which they are prioritized by NMED.

To date, New Mexico has received $172.5 million in federal loan funds which was matched with $31.5 million in state funds. Approximately $38.6 million in loan repayments and interest earnings have been earned

Currently, New Mexico is one of the states on track to meet the federal targets for federal fund balances (“Unliquidated Obligations”)

USDA Funding Programs for Infrastructure

Rural Utility Services Water and Waste Disposal Program

- Provides financial (grant/loans) for development and operation of safe and affordable water supply systems and sewage and other forms of waste disposal facilities.
- Entities include: public entities, Indian Tribes, non-profit corporations and cooperatives.
- Annual budget contains earmarks for projects in Tribal communities and designated Colonias

Applications must be accompanied by a Preliminary Engineering Report

Local Government Planning Fund

- Provides grants of up to $50,000 to a variety of local governments, including mutual domestic water and wastewater associations, to fund planning of vital water and wastewater projects, economic development plans, water conservation plans, asset management plans, environmental information document, infrastructure plans and Metropolitan Redevelopment Act plans
- Initially, statute required that entity repay "grant" if funding for project was received; this provision was eliminated in 2012. This statutory change, coupled with policy and rules changes implemented last year, has significantly increased the use of the fund
- Funding provided by planning grants is key to securing federal funds for infrastructure projects

Colonias Infrastructure Program

- Funded from 5% of the Senior Severance Tax Bonds annually, the Colonias Infrastructure Program provides grant/loan funding packages to a variety of infrastructure projects in designated Colonia communities

- Overseen by the Colonias Infrastructure Board, administered by the NMFA. Is used to directly leverage (co-fund) or indirectly leverage (funding that occurs as a result of the Colonias application process) USDA, BECC and CDBG funds earmarked for Colonias projects.

- For the first three years of the program, approximately $44.1 million has been made available from senior STB for Colonias projects. These funds have directly and indirectly leveraged more than $32 million of federal funds.

New Markets Tax Credits

- Operated under the Statewide Economic Development Finance Act which was amended in 2006 to explicitly allow NMFA to participate in the federal NMTC program by Rep. Lundstrom (HB 277). NMFA partnered with NM Community Capital to form Finance New Mexico, LLC, ("FNM") which was certified by the US Dept. of Treasury as a Community Development Entity in 2006.

- FNM has received three allocations of federal NMTCs totaling $201 million; approximately $151 million has been invested. Financings may only occur in federally designated low income communities.

- Projects funded through NMTC are 100% funded with private dollars; NMFA receives fees which funds 100% of staff time and overhead for the program.

- FNM is one of a few government controlled CDEs with a statewide territory and has established a solid reputation for best practices.

Economic Development Revolving Fund (EDRF)

- The EDRF is segregated into two sub-accounts to account separately for State and Federal Appropriations:

- Smart Money: $5.1 million in net State Appropriations
  - $10 million General Fund appropriation in 2005; $5 million was reverted for solvency in 2010
  - $2 million appropriation in 2007; $1.9 million was reverted for solvency in 2011

- $13,168,350 in Federal funds has been received through the State Small Business Credit Initiative (SSBCI)

- Currently, the Economic Development Revolving Fund is used solely to fund loan participations. A loan participation allows NMFA to participate in a business loan by buying a portion of a loan made by a local bank

Why Bank Loan Participations?

- The bank applies to the NMFA on behalf of a business by submitting the information the bank used to reach its lending decision. The bank originates and services the loan as it otherwise would.
- NMFA offers a low interest rate – typically lower than the bank's – which fills financing gaps and lowers the borrowing costs for New Mexico businesses. Borrower pays no additional fees as a result of NMFA participation
- In short, participations allow NMFA to partner with, not compete against, local banks to fund New Mexico businesses
- Under amendments made in 2005, NMFA may only make loans to projects determined eligible by the New Mexico Economic Development Department and authorized for funding from the Legislature. Legislation passed in 2011 temporarily halted (until June 30, 2016) the authorization requirement

Smart Money Loan Participation Program

- State-funded program allows NMFA to purchase interests in loans made by banks to private for-profit and not-for-profit entities; borrowers must agree to hire a specific number of employees in exchange for the financing
- NMFA may purchase up to 49% interest in any one loan as long as the borrower creates at least 1 job per $50,000 of Smart Money borrowed. A rider to loan agreement requires reporting and contains remedies to NMFA if job creation is not met
- NMFA shares equally with the bank in collateral used to secure the loan
- Prior to accepting an application, the New Mexico Economic Development Department must first determine that the project serves an economic development purpose and is suitable for financing

Collateral Support Participation Program

- In June 2011, the NMFA signed an MOU with the NM Economic Development Department to administer the $13.2 million in funding made available through the Federal Small Business Jobs Act of 2010. The program is overseen by the US Dept. of Treasury
- The funds are intended to help mitigate bank risk and increase the flow of capital to small businesses
- New Mexico uses the funds to help provide funding where Smart Money has been unable to help
- The State is required to leverage 10 private dollars for each Federal dollar by December 31, 2016
- Under current market conditions, there is a very strong appetite for subordinated participations whereby the bank is able to gain a senior interest in the collateral. Due to Anti-Donation concerns, NMFA can only fund these subordinate participations using federal SSBCI funds

USDA Business & Industry Guarantee

Provides qualified lenders with federal guarantees for loans made to qualifying small businesses in rural areas (defined as any areas other than a city or town that has a population of greater than 50,000 inhabitants)

- Maximum percent of guarantee is based on loan size:
  - 80% on loans up to and including $5 million
  - 70% on loans greater than $5 million up to and including $10 million
  - 60% guarantee loans greater than $10 million
  - A limited amount of guarantee authority for 90% guarantees on loans of $10 million and less is available on an annual basis for high priority projects.
- Typically, B&I loans range from $200,000 to $5 million, with an average size of about $3 million.

USDA Business & Industry Guarantee (cont)

- Typically, B&I loans range from $200,000 to $5 million, with an average size of about $3 million.

- Loan terms are negotiated between the lender and borrower, but are subject to the following caps:
  - Working Capital 7 years
  - Machinery and Equipment 15 years or useful life, whichever is less
  - Real Estate 30 years

- Personal guarantees required

Small Business Administration

7a Guaranty Program

Provides qualified lenders with federal guarantees for loans made to qualifying small businesses

- **Loan Size:** Maximum loan amount is $5 million; many banks have imposed non-SBA set minimums loan size. The average 7(a) loan amount in fiscal year 2012 was $337,730.
- **SBA Fees:** Based upon maturity and amount guaranteed, not the total loan amount. The fees are typically passed onto the borrower and can be wrapped into the financing. Currently:
  - no fees for loans <$150,000
  - Fee of .25% on loans >$150,000 with maturities <1 year,
  - Fee of 3% on loans $150,000 - $700,000 with maturities >1 year
  - Fee of 3.5% on loans >$700,000
  - Additional fee of .25% on any portion >$1 million

Small Business Administration

- **Interest Rates:** Banks are able to charge up to the following spreads:
  - 2.25% for loans with maturities <7 years
  - 2.75% for loans with maturities >7
  - The spread on loans of less than $50,000 and loans processed through Express procedures have higher maximums
- **Percentage of Guarantee:** Maximum guarantee is based upon size
  - Up to 85% on loans <$150,000
  - 75% on loans >$150,000
  - SBA's maximum exposure amount is $3,750,000.
  - SBA Express loans have a maximum guarantee set at 50%
- No restrictions on location of business; minor restrictions on type of business

SBA 504 Program

SBA 504 Program

- Funding is provided through a third party Community Development Corporation ("CDC")
- Funds come from the sale of SBA-guaranteed debentures and are loaned directly by the CDC to the qualifying business
- SBA 504 loans are subordinated to the bank's collateral interest
- Minimum equity contribution from the borrower is required.
- Funds may be used for the purchase of land, building and equipment
- Funds cannot be used for working capital or inventory, refinancing debt or rental/investment/speculative real estate
- Collateral: Generally, the project assets being financed are used as collateral. Personal guarantees of the principal owners are also required

SBA 504 Program (cont.)

- Collateral: Generally, the project assets being financed are used as collateral. Personal guarantees are required.
- Maturity Terms of 10 and 20 years are available.
- Interest rates on 504 loans are pegged to an increment above the current market rate for 5-year and 10-year U.S. Treasury issues.
- Fees equal 3 percent of the debenture and may be financed with the loan.
- Maximum loan size depends on the nature of the business
  - $4 million for businesses that qualify as Small Manufacturing maximum and create or retain at least one job per $100,000. Can be increased to $5.5 million when public policy goals are met
  - $5 million for businesses that meet job creation (at least one job for each $65,000 provided by the SBA) or community development goal requirements.

Opportunities for Leverage

Federally funded (SSBCI) Collateral Support Participation Program

- Cannot be blended with federal guarantee programs
- Can be used to blended with 504 program to help bank:
  - complete construction when the 504 has committed to the “take out” financing for the building and/or equipment
  - fund working capital lines or credit or purchase order lines of credits when the 504 has funded the building and/or equipment

State funded Smart Money Loan Participation Program

- Can be used to help banks fund the unguaranteed portion of the SBA 7a or USDA Business & Industry
- Can be used with 504 program, but offers little advantage to the bank other than to reduce exposure to a particular borrower or guarantor