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FISCAL IMPACT REPORT

ORIGINAL DATE 02/05/13
 SPONSOR Egolf/Wirth LAST UPDATED 02/11/13 HB 240/aHBIC
 SHORT TITLE Small Business Development Fund Act SB _____
 ANALYST Clark

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY13	FY14		
	Up to (\$100,000.0)	Nonrecurring	Severance Tax Permanent Fund
	Up to \$100,000.0	Nonrecurring	Small Business Development Fund

(Parenthesis () Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY13	FY14	FY15		
	Indeterminate		Recurring	Small Business Development Fund

(Parenthesis () Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	\$7,500.0	\$8,060.0	\$15,560.0*	Recurring	Severance Tax Permanent Fund

(Parenthesis () Indicate Expenditure Decreases)

*This is the projected opportunity cost. See Fiscal Implications

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Investment Council (SIC)

Attorney General's Office (AGO)

Economic Development Department (EDD)

New Mexico Finance Authority (NMFA)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of HBIC Amendment

The House Business and Industry Committee amendment to House Bill 240 removes Section 2, stating the findings and purpose, from the original bill and renumbers succeeding sections accordingly. Removing this section does not impact the effects of the bill.

Synopsis of Original Bill

House Bill 240 (HB 240) is the Small Business Development Fund Act; it creates the Small Business Development Fund (Fund), a board of directors with staggered terms, and allows up to \$100 million from the severance tax permanent fund to be invested in the Small Business Development Fund to participate in loans with community banks for the sole purpose of promoting economic development in the state, without the additional purpose of making a profit.

The Fund shall not be subject to the supervision or control of any other board, bureau, department, or agency of the state except as specifically provided in this Act. The Fund would be governed by the Small Business Development Fund Board (Board), consisting of seven members, three appointed by the governor and three by the Legislative Council. All members shall be residents of the state with expertise in banking, lending, and finances. The six members shall elect a seventh person, with similar expertise, to serve as chair. The Board shall appoint and prescribe the duties of an executive director and other officers as necessary, all of whom will not be subject to the Personnel Act.

The severance tax permanent fund may be invested in the Fund in an amount no greater than \$100 million. Up to \$5 million of that investment may be used to establish and operate the Fund. The remainder shall be used to fund the loan program as set forth by the Act.

The bill provides the Board with the necessary powers to operate the Fund, including the ability to make and renegotiate loans, prosecute and enforce judgments, and invest money of the Fund not required for immediate use.

All loans made by the Fund shall be to a New Mexico resident or business; be in the form of loan participations of up to 49 percent financing with community banks; have rates equal to those of the participating bank unless a lower rate may legally be charged; provide that the Fund and the bank have equal security interest; if the loan is for real estate, have a maximum term of 25 years; if the loan is for personal property or operating capital, have a maximum term of 10 years; and be for an economic development project.

FISCAL IMPLICATIONS

The provision for an investment of up to \$100 million contained in this bill is a nonrecurring expense to the severance tax permanent fund (STPF).

The bill indicates these loans would not be made for profit, therefore the State Investment Council (SIC) states it would project investment returns of zero or less, versus the otherwise targeted STPF rate of return of 7.5 percent. The SIC analysis shows the 10-year impact of zero return (versus the current 7.5 percent target) on \$100 million is \$106 million less in investment return to the corpus over a decade, not including the original \$100 million investment outlay. The projected opportunity cost for the first year is \$7.5 million and for the second year is an additional \$8.06 million.

Additionally, up to \$5 million may be used for start-up and operational costs. The SIC notes there may also be ongoing operational costs not contemplated for the Fund and its infrastructure.

SIGNIFICANT ISSUES

Analysis from the Department of Finance and Administration (DFA) notes this bill creates a new fund that will provide support and assistance for New Mexican residents and small businesses, intended to improve the economy through an increased flow of private capital for investment.

The SIC provides analysis that shows as of December 31, 2012, the STPF is valued at \$4.019 billion; \$100 million is approximately 2.49 percent of the fund. The SIC currently has several STPF “carve outs” for New Mexico focused, economically-targeted investments (ETIs); in total, the STPF currently has 69 percent of its funds earmarked for possible ETI investment.

The SIC reports it would take a cautious approach regarding these types of investments. “The core reason is the poor performance associated with ETIs, and the historically negative impact on the bottom line of STPF performance and returns. The SIC, LFC and others have criticized below-benchmark STPF returns resulting from ETI impact on the portfolio.”

The New Mexico Finance Authority (NMFA) provides the following information in its analysis.

Analysis from the NMFA shows this bill duplicates some of the NMFA’s existing powers under the Statewide Economic Development Finance Act. The NMFA operates two loan participation programs that provide below market rate participations, one of which is able to subordinate its security interest to the community bank. However, the loan participations made by the NMFA must first receive legislative authorization which is not required by this bill, allowing the Fund to be more responsive to businesses seeking help.

However, this bill provides for loans to be made at the same interest rate and security interest as the bank, which does not help the small business currently unable to meet banks’ ever-tightening underwriting criteria. Providing for a lower interest rate, which would help lower debt service payments and therefore increase cash flow coverage, would help small businesses. Additionally, allowing for a subordinate security interest in the collateral would increase a bank’s security position in the loan would increase the chances of banks making loans and thereby increase the amount of capital able to flow to small businesses impacted by changes in underwriting criteria over the past four years.

The SIC analysis identified the following significant issues.

HB 240 provides that any person having a conflict of interest (e.g. any personal benefit related to a loan provided by the Fund) only faces a potential misdemeanor criminal

penalty. Given previous misdeeds at the SIC and other state entities, the SIC feels such a violation should more appropriately be a fourth degree felony.

There does not appear to be a statutory mechanism for the treatment of necessary ongoing operational expenses. Such costs include staffing, benefits, business and other appropriate insurance, attorneys, auditors, and accountants. The statute suggests that the Fund will have the necessary resources to conduct business and manage local community bank loan participations, yet there may be a lack of enumerated funding sources other than a possible investment by the STPF.

ADMINISTRATIVE IMPLICATIONS

In its analysis, the SIC notes in Section 9 of this legislation, the SIC is required to “...select an independent third party to examine the development fund at least once every 24 months and conduct any investigation of the development fund that may be necessary.” This requirement is in addition to audit requirements also required in Section 9, and also apparently exclude any review by the State Bank Examiner under the Financial Institutions Division of Regulation and Licensing. It is not clear who would bear the burden of the related expenses, either for the audit or the biannual investigation and reporting, either the SIC or the new fund entity.

TECHNICAL ISSUES

The Economic Development Department (EDD) analysis states that the bill should further define “small business” and “economic development project.” Additionally, the bill limits lender to a “community bank,” so that micro-lenders such as ACCION, WESST, NM Community Capital, and The Loan Fund would not be eligible to participate. The analysis also notes the bill allows loans to be made to a resident in addition to a business and that negative issues could arise if loans are made to a resident without requiring the resident to form a business.

The bill provides for up to \$100 million to be invested in the Fund from the severance tax permanent fund, but does not require a minimum investment. Analysis from the NMFA notes that if the SIC invests less than \$5 million the entire investment could be used for start-up costs of the Fund, including the construction of a building and hiring of staff, without any funds being invested in small businesses as intended.

The Attorney General’s Office (AGO) provides the following legal issues.

Section 6(D) gives the Fund the power to acquire, hold, improve, mortgage, lease, and dispose of real property for its public purpose. Real property belonging to the state falls under the jurisdiction of the Property Control Division. However, Section 4(D) of HB 240 states that “[t]he development fund shall not be subject to the supervision or control of any other board, bureau, department or agency of the state except as specifically provided” in the Act. Therefore, this section might exempt the Fund from the jurisdiction of the Property Control Division. Language to clarify this issue may be helpful.

Section 6(F)(3) gives the Fund the authority to prosecute and enforce judgments. The Fund may need a Commission from the Attorney General for its attorneys to commence such litigation.

Section 6(K) allows the Fund to invest its money in community banks. The Fund should be aware of anti-donation issues associated with such investments.

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