

Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE

Senate Bill 1072

(Senator Middleton)

Finance

Economic Matters

Linked Deposit Programs for Small Businesses and Minority Business Enterprises

This bill alters the interest rate necessary for a loan to qualify under the Linked Deposit Program and the Linked Deposit Program for Small Businesses. The bill also alters under what conditions the Treasurer may make an interest-bearing deposit in a financial institution under both programs.

The bill takes effect July 1, 2013. Provisions related to the Linked Deposit Program terminate with the program on September 30, 2021.

Fiscal Summary

State Effect: The Department of Housing and Community Development (DHCD) can handle any increased program activity with existing budgeted resources. To the extent that the bill encourages participation in one or both of the linked deposit programs that would otherwise not occur under current and future interest rate conditions, general fund revenues decline from foregone interest revenue on Treasurer deposits. However, the amount cannot be reliably estimated at this time. Altering the requirements under which the Treasurer may make an interest-bearing deposit in a financial institution under the linked deposit programs is not anticipated to materially affect State finances.

Local Effect: None.

Small Business Effect: Meaningful for any small businesses that receive loans under either linked deposit program as a result of increased participation in the programs by financial institutions.

Analysis

Bill Summary: For each linked deposit program, a qualifying loan made under the program by a participating financial institution must have an interest rate that the financial institution charges on a loan for a similar purpose and a similar term that is reduced by at least the lesser of (1) 2% or (2) the difference between the financial institution's rate on a 60-month certificate of deposit and the interest rate acceptable to the Treasurer for its deposits.

The Treasurer is authorized to accept a rate for its interest-bearing deposits under the program that is *up to 2%* below current market rates.

The Treasurer is authorized to make an interest-bearing deposit under either linked deposit program without the security required under § 6-202 of the State Finance and Procurement Article under specified conditions.

Current Law: The Linked Deposit Program and the Linked Deposit Program for Small Businesses are nearly identical programs administered by DHCD to support Minority Business Enterprises (MBEs) and small businesses, respectively.

For each linked deposit program, a qualifying loan made under the program must have an interest rate that is 2% below the interest rate the participating financial institution would charge for a loan for a similar purpose and a similar term.

For each program, the Treasurer may make one or more interest-bearing deposits that are equal to the amount of the loan made by the financial institution, or equal to the total amount of two or more loans made by one or more financial institutions.

For each program, the Treasurer may use up to \$50.0 million to make such deposits. In making the interest-bearing deposit, the Treasurer may accept a rate that is *either* 2% below current market rates *or* an index selected by the Treasurer.

A loan assisted by a linked deposit is not a debt of the State or pledge of the credit of the State and the Treasurer and the State are not liable for payment of the principal or interest on such a loan. DHCD and the Treasurer may adopt regulations to implement the programs. DHCD must report annually to the Governor, the General Assembly, and the Treasurer on overall performance of the linked deposit program.

Background: Chapter 396 of 2006 (HB 1431) established a Linked Deposit Program in DHCD to provide low-interest loans to MBEs. Chapters 585 and 586 of 2012 (SB 792/HB 571) established the Linked Deposit Program for Small Businesses in DHCD to support small businesses.

The Treasurer's Office advises that the Linked Deposit Program has issued 14 loans totaling approximately \$4.0 million, but that the Linked Deposit Program for Small Businesses has issued no loans as of March 2013.

During the summer of 2012, a workgroup was formed to examine the barriers to the effective use of the linked deposit programs. Although the workgroup's final report has not yet been released, DHCD advises that the bill reflects the findings of the workgroup.

State Fiscal Effect: To the extent that the bill encourages participation in one or both of the linked deposit programs that would otherwise not occur under current and future interest rate conditions, general fund revenues decline from foregone interest revenue earned on Treasurer deposits. However, the amount cannot be reliably estimated at this time. The bill authorizes financial institutions to issue loans to MBEs and small businesses that are less than 2% below market rates. In the current interest rate climate, this encourages participation in the program by financial institutions, as discussed below.

The general purpose of the linked deposit programs is to offset the cost to financial institutions of offering loans at below-market rates to MBEs and small businesses. This is accomplished by the financial institution paying below-market interest payments on deposits from the Treasurer. For example, with sufficiently high interest rates, a financial institution could offer a 7% loan (instead of a 9% loan) to an MBE. The Treasurer then could deposit an amount equal to the loan with the financial institution at 3% interest (instead of 5%). In the current interest rate climate, however, market interest rates paid by financial institutions to depositors are not sufficiently high to allow for a 2% reduction in interest payments to the Treasurer.

With interest rates on deposits at or below 2%, a 2% reduction from the market rate requires the Treasurer to accept 0% interest – which it has declined to do. Instead, the Treasurer has chosen to accept an interest rate on deposits of the 90-day U.S. Treasury Bill rate, but not less than 0.25%. At this time, the 0.25% minimum is the effective minimum.

Therefore, under current law, a participating financial institution is required to issue a loan at a 2% discount, but cannot be compensated for the full 2% through discounted deposits from the Treasurer. This situation does not incentivize participation in the linked deposit programs by financial institutions.

To address this issue, the bill authorizes a financial institution to issue a loan at a below-market rate that is consistent with the reduction the Treasurer can accept on deposits under historically low-interest-rate conditions. For example, the financial institution could offer a 7% loan (rather than 7.75%) to an MBE. The Treasurer then

could deposit an amount equal to the loan with the financial institution at 0.25% interest (instead of 1%).

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Governor's Office, Department of Housing and Community Development, Maryland Department of Transportation, Maryland State Treasurer's Office, Department of Legislative Services

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