Department of Legislative Services

Maryland General Assembly
2000 Session

FISCAL NOTE
Revised

House Bill 98 (Chairman, Economic Matters Committee, *et al.*)
(Departmental - Housing and Community Dev.)
Economic Matters

Department of Housing and Community Development - Neighborhood Business Development Program - Capital Access Program

This departmental bill establishes the Capital Access Program (CAP) within the Neighborhood Business Development Program (NBDP) of the Department of Housing and Community Development (DHCD) to stimulate private sector lending to small businesses in priority funding areas throughout the State. The bill allows DHCD to use funds from the Neighborhood Business Development Fund (NBDF), an existing special fund, to make contributions to loan reserve accounts established by private lenders. The bill limits DHCD's annual contributions to $1 million.

Fiscal Summary

State Effect: Special fund expenditure increase of $1,027,000 in FY 2001 to implement the CAP. Future year expenditures are annualized, adjusted for inflation, reflect ongoing contributions to loan reserve accounts, and, in FY 2002 only, reflect ongoing operating expenses. The FY 2001 budget includes $8 million in PAYGO general and special funds for the NBDP, including funds to implement the CAP.

(in dollars)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
SF Revenues	$0	$0	$0	$0	$0
SF Exp.	1,027,300	1,036,000	1,000,000	1,000,000	1,000,000
Net Effect	($1,027,300)	($1,036,000)	($1,000,000)	($1,000,000)	($1,000,000)

Note: ( ) = decrease; GF = general funds; FF = federal funds; SF = special funds; - =indeterminate effect

Local Effect: Minimal.

Small Business Effect: DHCD has determined that this bill will have a meaningful impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: This bill establishes the CAP within the NBDP to stimulate private sector lending to small businesses. The bill allows DHCD to enter into participation agreements with eligible lenders and to use funds from the NBDF to make contributions to loan reserve accounts established by private lenders. The bill limits loans enrolled under the CAP to projects located in priority funding areas. Loan reserve funds would be funded through fees paid by DHCD, borrowers, and lenders. If a borrower defaults on a loan, and the lender has exhausted its normal methods to collect on the loan, the lender could then withdraw funds from its loss reserve fund to cover its net losses. The bill establishes eligibility requirements for lenders and borrowers, exempts the contributions from specified provisions of State law regarding State finance and procurement, and limits contributions made from DHCD to $1 million in any fiscal year. The bill also limits the State's liability to the contributions it makes to each lender's loss reserve fund, contains provisions regarding defaults, and directs DHCD to adopt regulations necessary to implement the CAP. The bill also clarifies the allowable funding sources for the NBDF.

Current Law: No such program exists. However, DHCD provides other types of financial assistance to specified small businesses, including loans, grants, and tax credits.

Background: CAPs provide an innovative means of encouraging banks to make profitable but individually risky loans to small businesses. Many small businesses in Maryland fall slightly below financial institutions' lending criteria because they lack sufficient collateral or are in a high risk activity. If the risk to lenders could be reduced, lenders would be more willing to make loans to those entities. Whereas typical loan guarantees cover only 75% to 80% of losses, a CAP can cover 100% of losses. Unlike traditional guarantee programs, where the government assumes all of the risk, CAP spreads the risk among the State, the lender, and the borrower.

The CAP has not been proposed previously in Maryland. As of October 1998, a CAP had been implemented in 20 other states and two local jurisdictions. Generally, in those states, the CAPs work in the following way:

- The borrower obtains a loan and loan approval directly from the bank.
- The state has no role in approving or reviewing the application.

- When making a CAP loan, the lender and borrower pay an up-front insurance premium that combined generally ranges from 3% to 7% of the loan amount. The exact percentage is determined by the individual lender.
- The lender deposits all of the CAP premiums into a pooled reserve account which it holds.
- The state deposits a matching amount into the lender's CAP reserve account.
- The bank recovers any losses on CAP loans by deducting the loss from the CAP reserve fund which it holds. The bank itself absorbs any losses in excess of its accumulated CAP reserve fund.

The United States Department of the Treasury (the Treasury), in a 1998 report reviewing existing CAP programs, identified three key features of large CAP programs: (1) active marketing of the program; (2) adequate state support; and (3) fewer eligibility and size restrictions for CAP loans.

Typically, the state provides only the up-front matching premium. According to the Treasury, nationally the state match averages 5% of the loan amount. A few states provide a start-up credit line to give lenders an advance of future CAP premiums in the event of an early CAP loss before the reserve fund has accumulated enough to absorb the full loss. Some state CAPs receive only a one-time appropriation or are limited through an annual ceiling.

According to the Treasury, CAP lending increased by 27% nationally from 1996 to 1997. CAP lending has been concentrated in Michigan, California, and Massachusetts which, combined, total almost 70% of the cumulative national volume. Through 1997, 694 banks were enrolled in CAPs nationwide, with 347 of the banks actively originating CAP loans. Cumulative CAP loan losses through 1997 totaled approximately $38 million, or 3.9% of all loan volume extended.

State Fiscal Effect: The fiscal 2000 budget includes $7 million in PAYGO general and special funds for the NBDP. The fiscal 2001 budget includes $8 million in PAYGO general and special funds for the NBDP.

The difference between the fiscal 2000 budgeted PAYGO funds and the fiscal 2001 budgeted PAYGO funds is $1 million. DHCD advises that the increase in the budgeted amount will be used to implement the CAP.

Within the existing NBDF, expenditures could increase by an estimated $1,027,300 in fiscal 2001, which accounts for the bill's October 1, 2000, effective date. This estimate assumes that the State will contribute the maximum allowable amount, $1 million annually, to loan reserve accounts. Actual contributions will depend on the number of loans made, the amount of the loans, and the interest rate determined by participating financial institutions. This estimate also reflects the cost of hiring one full-time contractual employee to set up the program and market it to lenders. It includes a salary, fringe benefits, and one-time start-up costs including supplies, advertisements, and travel to financial institutions across the State. Currently, DHCD is authorized to use up to 15% of the NBDF for administrative purposes. The increase in operating expenses associated with implementing the CAP will be absorbed within the allowable administrative portion of the existing NBDF.

Contributions to Loan Reserve Accounts	$1,000,000
Contractual Services	26,500
Other Operating Expenses	800
Total FY 2001 Special Fund Expenditures	**$1,027,300**

In fiscal 2002, special fund expenditures could increase by $1,036,000, which reflects: (1) ongoing contributions to loan reserve accounts; (2) full salary with a 2.4% annual increase and 3% employee turnover; and (3) 1% annual increases in ongoing operating expenses. Beginning in fiscal 2003, special fund expenditures could increase by $1 million annually, which reflects ongoing contributions to loan reserve accounts only. DHCD advises that once the CAP is implemented, operating costs are expected to be negligible.

It is assumed that special fund revenues will not be affected. However, to the extent that the bill's provisions clarifying the funding sources for the NBDF result in an increase in federal or other funds, special fund revenues will increase accordingly.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Housing and Community Development, United States Department of the Treasury, Department of Legislative Services

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