Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

Senate Bill 148 (Senator Exum, *et al.*)
Finance Economic Matters

Economic Development - Maryland Small Business Development Financing Authority

This bill raises the limits of assistance that can be offered by the Maryland Small Business Development Financing Authority (MSBDFA) under the Contract Financing Fund and the Equity Participation Investment Program. It also allows MSBDFA to fund other businesses under the Equity Participation Investment Program besides franchises and technology-based businesses. This bill also authorizes the Department of Business and Economic Development (DBED) to extend the management contract of MSBDFA. It also requires that any payments made to businesses through the Enterprise Fund using money from funds managed by MSBDFA be repaid to MSBDFA.

Fiscal Summary

State Effect: None. Of the two applicable Enterprise Fund investments, one is not due for repayment until at least 2012, and the other is likely to be written off as a bad investment and not repaid. The Governor's proposed FY 2006 budget includes $19.4 million for the continued operation of MSBDFA. Future year expenditures are dependent on MSBDFA funding in future budgets.

Local Effect: None.

Small Business Effect: Small businesses would be eligible to receive increased assistance from MSBDFA and more businesses would be eligible for MSBDFA assistance. However, increased use of capacity for financing could result in fewer businesses being helped.

Analysis

Bill Summary: MSBDFA may utilize the Contract Financing Fund to make a loan or guarantee a loan made to an eligible applicant if the loan or guarantee does not exceed $1 million, increased from the current $500,000 cap. MSDBFA may guarantee a bid, performance, or payment bond for an eligible small business up to the lesser of 90% or $1.35 million or may issue bonds directly of up to $1 million, up from the current $750,000 limit.

MSBDFA may fund businesses other than franchises and technology-based businesses under the Equity Participation Investment Program. For these other businesses, MSBDFA's investment must be recoverable within seven years of investment. The maximum amount of equity participation by MSBDFA for any franchise, enterprise acquiring an existing business, technology-based business, or other business is raised to $1 million from the existing $500,000 limit.

DBED may extend the contract of MSBDFA in effect on June 30, 2007 to June 30, 2012, and may renew the contract for up to two additional five-year terms.

Any investments or grants made under the Enterprise Fund under DBED that were funded by a transfer of money from MSBDFA funds, including an investment in Meridian Management Group (MMG) Ventures LLP, are repayable to MSBDFA rather than the Enterprise Fund.

Current Law: MSBDFA administers four programs to support small and minority owned businesses in Maryland: the Contract Financing Fund; the Equity Participation Investment Program; the Long-Term Guaranty Fund; and the Surety Bond Fund.

MSDBFA may guarantee a loan for an eligible firm with funds from the Contract Financing Fund; it also may provide a direct loan for working capital and equipment. These guarantees or loans may be offered only to fulfill contracts on projects financed by federal, State, or local government, or by a regulated utility. The amount of the loan cannot exceed $500,000.

MSBDFA may also assist eligible small businesses obtain bid, performance, or payment bonds to fulfill contracts funded primarily by government agencies or public utilities. MSBDFA may either guarantee a bond to a maximum of 90% of the value of the bond or $900,000, or may issue bonds directly, with a maximum value of $750,000.

The Equity Participation Investment Program was created to encourage and assist the start-up, development, and retention of Maryland-based franchises and technology businesses owned and operated by socially or economically disadvantaged persons. MSBDFA may invest the lesser of: (1) 45% of necessary funds; or (2) $100,000 to start a franchise operation. MSBDFA also may invest the lesser of: (1) up to 25% of necessary funds; or (2) $500,000 to acquire a profitable business. MSBDFA requires the initial investment to be recovered within seven years. MSBDFA also may invest up to $500,000 in technology-based businesses to be repaid within 10 years.

The Enterprise Fund makes direct equity investments in emerging technology companies with patented or proprietary products or manufacturing processes and a marketing strategy in place. The amount of investment ranges from $150,000 to $500,000. DBED must divest itself from any enterprise in which an equity investment is made under the Enterprise Fund within 15 years of making the investment.

Background: In 1992, the U.S. Congress allowed states to use public funds to establish specialized small business investment companies to serve disadvantaged business owners. Two years later, MSBDFA organized itself into such a company. Since 1994, funds under MSBDFA have been managed privately by MMG. The current contract expires June 30, 2007.

DBED advises that around the time that MSBDFA was organized into a private company (approximately 1994), MSBDFA invested in two venture capital funds, MMG Ventures, LLP and the Community Development Venture Fund. The funds were transferred to these funds through the Enterprise Fund. If the money invested in these funds is subject to Enterprise Fund rules on repayment and ownership, then MSBDFA must divest itself of its investment in either venture fund in fiscal 2009. Any monies received from that sale would be repaid to the Enterprise Fund. Further, if the investments have been successful, the capital gains received from the value of the stock would also be repayable into the Enterprise Fund. DBED advises that it would prefer that any money realized by increase of investment in MMG Ventures or Community Development Venture Fund stay in those funds, and not be subject to repayment to the Enterprise Fund.

MMG Ventures received $9.7 million from DBED's Enterprise Fund. To date, MMG Ventures has not shown a positive return on its investments. In 1994, the combination of financing from the State, the federal government and private investment gave MMG Ventures $31.7 million. DBED was supposed to receive its initial investment back, plus 6% interest, and 80% of the profits from its share of any investment that MMG Ventures made. As of December 31, 2003, the time of the last financial statement, MMG Ventures had a portfolio of assets and investments worth $600,000.

Community Development Ventures received $2 million from DBED. DBED was not able to provide information as to exactly when this funding was transferred, however the fund was established in 1998.

State Revenues: In fiscal 2009, the Enterprise Fund is expected to divest itself of its assets in MMG Ventures. At that time, if it receives its initial investment back, it will receive $9.7 million, plus 6% interest, or $10.3 million. However, DBED advises that if the enterprise that received the funding is incapable of repaying the grant, then DBED will write off the investment as a bad investment. It is also supposed to receive benefits from any investments that have been made by MMG Ventures using MSBDFA funds. Given the size of the portfolio and the amount of money MMG Ventures has lost, no money is anticipated from this revenue source by Legislative Services.

Community Development Ventures was established in 1998. Assuming that funding came no more than one year before the official start of the fund, money from this fund will not be due for repayment until fiscal 2012 at the earliest.

The Governor's proposed fiscal 2006 budget has an allowance of $19.4 million in general and special funds for MSBDFA, including $17.9 million for financial assistance to small businesses and $1.5 million to continue the contract with MSBDFA. DBED advises that it could handle any additional transaction costs for increased financing on any given project with existing resources.

Small Business Effect: Small businesses that are currently eligible for MSBDFA assistance would have access to increased levels of assistance through loans, loan guarantees, or increased bond issuance. More types of small businesses would be eligible for funding under the Equity Participation Investment Program. Depending on the amount available for financing and the number of businesses receiving increased financial assistance available under the higher limits provided in this bill, the total number of businesses served could decrease below DBED's projections.

Additional Information

Prior Introductions: None.

Cross File: HB 674 (Delegate Conway, *et al.*) – Economic Matters.

Information Source(s): Department of Business and Economic Development, Department of Legislative Services

Fiscal Note History: First Reader - February 14, 2005
n/rhh

Analysis by: Nora C. McArdle

Direct Inquiries to:
(410) 946-5510
(301) 970-5510