HB 1431

Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1431 (Delegate Vaughn, *et al.*)

Economic Matters Finance

Linked Deposit Program - State Depository Financial Institutions - Loans to Minority Business Enterprises

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This bill establishes a linked deposit program in the Department of Housing and Community Development (DHCD) to provide low-interest loans to State-certified minority business enterprises (MBEs).

The bill terminates September 30, 2021.

Fiscal Summary

State Effect: General fund revenues would decrease by $1 million to $15 million over the next 15 years, which reflects lost investment returns stemming from the purchase of certificates of deposit (CDs) worth $50 million carrying interest rates 2% below market rates. Specific annual and total revenue losses depend on the timing of the purchase of low-interest CDs by the Treasurer and the value of the loans made by participating depository institutions. General fund expenditures in DHCD would increase by $44,800 in FY 2007 to implement the bill's provisions; out-year expenditures reflect annualization and inflation.

(in dollars)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	(-)	(-)	(-)	(-)	(-)
GF Expenditure	44,800	58,500	61,900	65,600	69,500
Net Effect	($44,800)	($58,500)	($61,900)	($65,600)	($69,500)

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

Local Effect: None.

Small Business Effect: Meaningful. The bill would enable MBEs that are small businesses to obtain 10-year loans with a combined value of up to $50 million that carry interest rates 2% below market rates.

Analysis

Bill Summary: The State is authorized to use up to $50 million to purchase CDs with interest rates 2% below the market rate. Banks from which the State purchases those CDs would then make loans to certified MBEs as long as the loan period does not exceed 10 years, and the criteria used for making the loans are the same used for other loans. The loans made to MBEs must carry interest rates also 2% below market rates for similar loans.

The bill requires DHCD to establish procedures for obtaining up-to-date listings of State-certified MBEs, for notifying lending institutions when MBEs lose their certification, and for processing loan applications from MBEs. If a loan recipient loses its MBE certification, its loan is reduced by the amount of the loan's remaining balance.

The bill provides that the State is not liable to any bank for unpaid loan payments made under the linked deposit program, and a loan under the linked deposit program is not a debt of the State.

The bill authorizes the Treasurer and DHCD to adopt regulations to carry out the provisions of the bill. It also requires DHCD to submit annual reports to the Governor, Treasurer, and General Assembly on the overall performance of the linked deposit program. DHCD, in consultation with the Treasurer's Office, must submit a report to the Governor and the General Assembly on or before December 31, 2007, on the status of the establishment of the linked deposit program.

Current Law: The State does not have a linked deposit program.

An MBE is a legal entity, not including a joint venture that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

MBEs include not-for-profit entities organized to promote the interests of physically and mentally disabled individuals.

MBEs must be certified by the Maryland Department of Transportation before being eligible for benefits available to MBEs. The State has as a goal that 25% of the value of each agency's procurements be made directly or indirectly to MBEs, including 7% to African American-owned businesses and 10% to women-owned businesses.

Background: A linked deposit program allows the State to purchase CDs from a bank at a reduced interest rate. The bank then makes low-interest loans to MBEs, using the savings it incurs from paying reduced interest on State-owned CDs to cover the loss it incurs from making low-interest loans to MBEs. Under this arrangement, the State does not assume any risk for loans made to MBEs. Therefore, the loans made under a linked deposit program are subject to the same lending criteria that a bank would use to make other similar loans.

Chapter 114 of 2004 established the Task Force on Lending Equity within Financial Institutions Providing State Depository Services. The purpose of the task force was to: (1) develop meaningful criteria for evaluating MBEs' access to credit and capital from financial institutions providing or desiring to provide depository services to the State; and (2) advise the State Treasurer on developing additional or supplemental criteria to be considered in the selection of depositories for State funds.

During its deliberations, the task force studied the feasibility and desirability of instituting a linked deposit program in Maryland. It assigned a workgroup to study the issue and make recommendations to the full task force. After reviewing the workgroup's recommendations, the task force generally supported the idea of a linked deposit program, but overriding concerns about the workgroup's recommendations kept it from including a linked deposit program in its legislative package. Specifically, the task force objected to the workgroup's recommendation that depository institutions fund the program.

State Revenues: Over the next 15 years, the bill authorizes the Treasurer to purchase up to $50 million in CDs with interest rates 2% below market rates. To illustrate the possible effect of this bill, consider the following scenario. With 12-month CD rates at about 4%, if the full $50 million was purchased in fiscal 2007, the State would earn 2% on the principal each year and lose 2% in interest each year, or $1 million. If the banks made $1 million in loans to MBEs each year, the principal would remain unchanged (earning 2%), but the lost interest would be compounded annually. The total loss after 15 years would be $15 million.

More likely, the Treasurer would use lesser amounts to purchase CDs each year to keep the program viable, so the losses would be smaller and spread out. Without a clear sense of how the Treasurer would manage the program or the value of the loans made by the banks, it is not possible to calculate the bill's precise effect, except to say that it would result in lost interest revenue of between $1 million and $15 million over 15 years.

State Expenditures: General fund expenditures in DHCD would increase by $44,751 in fiscal 2007, which accounts for the bill's October 1, 2006 effective date. This estimate reflects the cost of hiring one program manager to monitor the program, establish and implement procedures for canceling loans to MBEs that lose their certification, and prepare annual reports. It includes a salary, fringe benefits, one-time start-up costs, and one-time and ongoing operating expenses as shown below.

Salary and Fringe Benefits	$42,646
One-time Equipment Costs	2,000
Operating Expenses	105
Total FY 2007 State Expenditures	**$44,751**

Future year expenses reflect (1) a full salary with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

The Treasurer's Office could implement the program with existing resources.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of General Services; Board of Public Works; Treasurer's Office; Maryland Department of Transportation; Department of Labor, Licensing, and Regulation; Department of Legislative Services

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