

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE
Revised

House Bill 571

(Delegate Frick, *et al.*)

Economic Matters

Finance

Linked Deposit Program for Small Businesses - Lend Local Act of 2012

This bill establishes a Linked Deposit Program for Small Businesses in the Department of Housing and Community Development (DHCD) to support small businesses that qualify for the Small Business Reserve Program in gaining access to credit by assisting these businesses in obtaining loans at lower-than-market interest rates. The Department of General Services (DGS) must confirm the small business status of a business at the point of the initial loan and notify DHCD if a business receiving a loan under the program no longer qualifies as a small business.

The bill takes effect July 1, 2012.

Fiscal Summary

State Effect: General fund revenues decrease by up to \$1.0 million annually due to lost investment returns resulting from interest rates that are two percentage points below market rates. Revenue reductions will be considerably less in the current interest rate environment and will depend on the number and value of loans made and actual market rates at the time of each loan. Given the low program activity for the current linked deposit program, DHCD can implement the bill with existing budgeted resources.

Local Effect: None.

Small Business Effect: Meaningful. Qualified small businesses will have access to loans with a combined value of up to \$50.0 million that carry interest rates that are two percentage points below market rates.

Analysis

Bill Summary: DHCD must confirm with DGS that each loan under the linked deposit program is made to a qualified small business and establish procedures for notification by DGS if a business that has an outstanding loan under the linked deposit program no longer qualifies as a small business under the Small Business Reserve Program. DHCD must also require small businesses and lenders to provide notice concerning final loan disposition.

The Treasurer may establish the Linked Deposit Program for Small Businesses for investment of deposits in any financial institution that the Treasurer designates as a depository for State money and makes a loan under the Small Business Reserve 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. The Treasurer may use up to \$50 million to make such deposits. In making the interest-bearing deposit, the Treasurer may accept a rate that is two percentage points below current market rates or an index selected by the Treasurer.

If DHCD provides notice that a business no longer qualifies as a small business, the Treasurer must reduce the amount of the interest-bearing deposit with the participating financial institution by the outstanding balance of the loan made under the bill to the business; however, a business that loses its small business qualification due to revenue or employee growth is not subject to such a reduction in its deposit.

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 carry out provisions of the bill. DHCD must report annually to the Governor, the General Assembly, and the Treasurer on overall performance of the linked deposit program.

The State Treasurer must meet with Maryland banking industry representatives and related stakeholders and identify impediments to participating in the procurement process for the selection of designated State depositories, including State agency and linked deposit programs, and identify possible solutions to these impediments. By December 31, 2012, the Treasurer must report to the General Assembly on the results of the meetings.

Current Law:

Small Business Reserve Program

Chapter 75 of 2004 established SBR and defined a small business as either a certified minority-owned business enterprise (MBE) or a business other than a broker that is independently owned and operated, not a subsidiary of another firm, and not dominant in its field of operation. In addition, a business must meet *both* of the following criteria to qualify for small business certification by the State:

- the firm did not employ more than 25 people in its retail operations; 50 people in either its wholesale or construction operations; or 100 people in either its service, manufacturing, or architectural and engineering operations; *and*
- average gross sales over the last three fiscal years did not exceed \$2.0 million for manufacturing firms, \$3.0 million for retail firms, \$4.0 million for wholesale distributors, \$4.5 million for architectural and engineering firms, \$7.0 million for construction firms, and \$10.0 million for service firms.

DGS is responsible for certifying small businesses. Small businesses self-report their small business status, which DGS does not independently verify. The program's termination date has been extended twice since its inception, and it is currently scheduled to terminate on September 30, 2016.

SBR requires most State procurement units to structure their procurements so that at least 10% of the total dollar value of their procurements is made directly to small businesses. Currently, more than 6,000 certified small businesses in Maryland are eligible to participate in SBR.

Minority Business Enterprise Program

The State's MBE program establishes a goal that at least 25% of the total dollar value of each agency's procurement contracts be awarded to MBEs. There are no penalties for agencies that fail to reach the 25% target. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurements.

An MBE is a legal entity, other than 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.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. An MBE owned by a woman who is also a member of an ethnic or racial minority group is certified as either owned by a woman or owned by a racial or ethnic minority, but not both. The Maryland Department of Transportation is the State's MBE certification agency and is responsible for conducting the mandated disparity study.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of their membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of \$1.5 million, adjusted annually for inflation, is not considered economically disadvantaged. The inflation-adjusted limit for calendar 2012 is \$1,577,377. The MBE program is scheduled to terminate July 1, 2012.

Linked Deposit Program

Chapter 396 of 2006 established a Linked Deposit Program in DHCD to provide low-interest loans to MBEs. Under Chapter 396, the State is authorized to use up to \$50 million to purchase certificates of deposit (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 two percentage points below market rates for similar loans.

Chapter 740 of 2009 allowed borrowers under the MBE linked deposit program to apply for loans directly from participating lenders rather than through DHCD. It also exempted decertified MBEs from having their loans reduced if their decertification is due to revenue or employment growth. Chapters 250 and 251 of 2010 changed the types of investments that the State Treasurer may make with financial institutions participating in the MBE linked deposit program from CDs to interest bearing accounts. The MBE linked deposit program terminates September 30, 2021.

Background: According to DHCD, the MBE linked deposit program has made 19 loans, or approximately 6 new loans annually, since its creation in 2009 totaling \$5.3 million.

To date in fiscal 2012, only two loans have been enrolled in the program. The State Treasurer's Office advises that it is currently earning a market rate of 0.25% interest on the MBE linked deposits.

State Fiscal Effect: Given the \$50.0 million limit on deposits for the linked deposit program, and a loss of two percentage points on the deposit rate, general fund revenues will decrease by up to \$1.0 million annually. However, the loss in general funds may be considerably less depending upon the number of loans made and the dollar value of each loan, actual interest rates at the time of each loan, and the degree of participation by qualified lending institutions. Revenue losses will be less in the current interest rate environment, but the State Treasurer's Office advises that as interest rates increase as expected in the next five years, revenue losses will increase.

Additional Information

Prior Introductions: None.

Cross File: SB 792 (Senator Garagiola, *et al.*) - Finance.

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

Fiscal Note History: First Reader - February 20, 2012
mm/rhh Revised - House Third Reader - March 28, 2012

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