

SUBJECT: Guarantee of loans under the linked deposit program

COMMITTEE: Economic Development — committee substitute recommended

VOTE: 8 ayes — Oliveira, Yarbrough, Davis, Luna, Raymond, Shields, Solomons, Van de Putte

0 nays

1 absent — Moffat

WITNESSES: For — David Pinkus, Small Business United of Texas; Kelly Rodgers, Texas Bankers Association

Against — None

On — Dan McNeil

BACKGROUND: The Legislature established the linked deposit program in the Texas Department of Commerce (TDOC) in 1993 to encourage banks to give low-interest commercial loans of up to \$100,000 for the development of historically underutilized businesses (HUBs) and small businesses in distressed areas. A linked deposit is a time deposit governed by an agreement between the state and a bank.

To induce the bank to make these loans, the agreement provides that the bank pays interest on the deposit at a rate equal to the greater of 1.5 percent or the current market rate or a U.S. Treasury bill minus 2 percent. At the same time, the bank agrees to lend the value of the deposit to an eligible borrower (HUB or small business) at a maximum of a U.S. Treasury bill market rate plus 4 percent — for a spread of six percent.

Not more than \$1 million may be placed in linked deposits at any one time on or before September 1, 1995, and not more than \$3 million may be placed in linked deposits after September 1, 1995. At present, the state's money is not at risk because the state does not guarantee any of the loans made by the banks.

DIGEST:

HB 1997 would add Sections 481.198 through 481.202 under the Government Code in the subchapter on the linked deposit program. The TDOC could make a loan guarantee of up to 50 percent of the cost of the capital assets upon the approval of a qualified application submitted by a borrower or eligible lending institution, if the eligible borrower holds available funds or property in an amount or value equal to not less than 10 percent of the cost of those capital assets.

The bill would require the TDOC to determine for each guarantee:

- the amount of equity the eligible borrower would need to pledge to construct or purchase capital assets,
- the fees the TDOC would need to charge for administration of the guarantee,
- the maximum and minimum guarantee amounts, and
- any other terms or conditions relating to a guarantee.

Before making a loan guarantee, the TDOC would need to determine that the eligible borrower has a firm commitment for all other funds in excess of the loan guaranteed by the department, and that the finances lined up would be adequate to purchase or construct the capital assets.

The bill would require the TDOC to report to the comptroller the name of any eligible borrower who is in default and on whose behalf TDOC made a guarantee. Neither the comptroller nor a state agency could issue funds to that person while in default. The comptroller or state agency could only issue funds to an assignee of the eligible borrower if the assignment took place before the default. This section would not prohibit the comptroller or state agency from compensating a state officer or employee. The comptroller could not reimburse a state agency for a payment made in violation of these provisions.

The bill would allow the TDOC to guarantee loans in an amount that exceeds the amount available in the loan guarantee reserve fund. Loan guarantees could not exceed the guarantee-to-reserve ratio set by the policy

board, and the policy board could not set a ratio that exceeds five to one. The policy board would review the guarantee-to-reserve ratio every year and adjust as appropriate. In addition, the state auditor would be required to review the loan guarantee program and make recommendations every September 1st based on that review about the program and the ratio.

An applicant who knowingly provides false information in an application would not be able to submit another application under this subchapter and would be liable to the state and any eligible lending institution for any expense incurred by the state or the eligible lending institution that would not have been incurred but for the giving of false information.

The TDOC could accept gifts, grants, and donations from any source for this program. The bill would take effect September 1, 1995.

**SUPPORTERS
SAY:**

HB 1997 would give banks a greater incentive to loan to small businesses and HUBs. Of the \$1 million authorized to be deposited with lending institutions for linked deposit loans, only \$365,000 has been so deposited. In a time when interest rates are high and lending institutions make at least nine percent on loans, the linked deposit small business loans seem meager with earnings for the bank of six percent. In addition, when loaning to small businesses there is always the chance the borrower will default. HB 1997 would give the bank the added assurance of a loan guarantee to further encourage banks to make these beneficial and truly needed loans to small businesses and HUBs.

The loan guarantee provisions are based on similar loan guarantee provisions in the rural economic development program similarly administered by the TDOC. Since the rural economic development program's inception in 1990, not a single loan has been defaulted, and the linked deposit guarantee criteria would take even less risk. For instance, the rural economic development program allows a guarantee of up to 90 percent, whereas the linked deposit program would allow a guarantee of only up to 50 percent.

In addition, the linked deposit program could not exceed a five to one guarantee-to-reserve ratio. This means that if the state guaranteed

\$1,500,000, which would be 50 percent of the total linked deposit funds authorized after September 1, 1995, then the state would have to keep \$300,000 in reserve to cover defaulted loans. This should be ample money to cover the defaulted loans on this program since the bank would not change its high underwriting standards to issue these loans — so the loans should be very secure.

OPPONENTS
SAY: No apparent opposition

NOTES: The original version would have provided that the TDOC determine, for each guarantee:

- that the project was sponsored by a HUB or small business in a distressed community,
- the permissible interest rates and amortization requirements for a guaranteed loan, and
- the acceptable security of the TDOC's participation in a project.

The original version would have prohibited an applicant who provided false information from submitting another application for two years, rather than ever. The original required the TDOC to cooperate with industrial and economic development agencies. The original did not prohibit the use of money in this fund in conjunction with any other money available for the purposes of this chapter.

The fiscal note states that the administrative cost to the TDOC would be \$89,776 in 1996, \$72,884 in 1997, \$26,543 in 1998, \$14,249 in 1999, and \$14,249 in 2000; however, revenue gain would be equal to that cost.