HOUSE RESEARCH ORGANIZATION bill analysis | 5/23/97 | SB 266 Ellis, et al. (Oliveira)

SUBJECT: Creating the Capital Access Fund

COMMITTEE: Economic Development — favorable, with amendment

VOTE: 8 ayes — Oliveira, Yarbrough, Greenberg, Keffer, Luna, Seaman, Siebert, Van de Putte

0 nays

1 absent — Raymond

SENATE VOTE: On final passage, February 20 — voice vote

WITNESSES: For — C.D. Heinen, Comerica Bank; Linda S. McKitrick, Texas Commerce Bank; Karen Neeley, Independent Bankers Association of Texas; Jim Wyatt, Texas Association of African-American Chambers of Commerce; David Pinkus, Small Business United of Texas

Against — None

On — Brenda Arnett, Dan Wattles and Jim Albright, Texas Department of Commerce

BACKGROUND: The Texas Department of Commerce administers the exporters loan fund, a loan guarantee fund to assist small export businesses, and the rural economic development fund program, a loan guarantee program for small businesses located in rural areas that has 10 outstanding loans, totalling $890,000.

DIGEST: SB 266 would establish a capital access fund to assist financial institutions in making loans to small or medium-sized businesses with 500 or fewer full-time employees and nonprofit organizations. The fund would be administered by the Texas Department of Commerce (TDOC) and used to make deposits into reserve accounts established by participating financial institutions as a source for reimbursement for loss attributable to loans made under the program.

SB 266 would take effect September 1, 1997.

Loans. Under the capital access program, loans or credit lines could be used for working capital or for the purchase, construction or lease of capital assets, including building and equipment. Uses for working capital could include the cost of exporting, accounts receivable, payroll, inventory, and other financing needs.

Loans for construction or purchase of residential housing, simple real estate investments, excluding the development or improvement of commercial real estate occupied by a borrower's business, refinancing of existing loans not originally enrolled in the program, and inside bank transactions would not be eligible.

A financial institution would have to enter into an agreement with the department that specified its criteria for capital access loans. A line of credit issued under the program would have to contain the same restriction, to the extent practicable, placed on other capital access loans. A capital access loan could be sold on the secondary market as determined by TDOC.

Reserve accounts. The borrower would be required to pay a fee of between two and three percent of the principal amount of the loan for deposit into the reserve account. The institution would also be required to deposit an amount equal to the fees charged into the reserve account, but could recover all or part of this amount in any manner agreed to by the borrower.

TDOC would then deposit into the bank's reserve account an amount equal to that deposited by the institution for each loan if the institution had assets of more than $1 billion or had previously enrolled loans in the program with an aggregated amount of more than $2 million. Otherwise, the department would deposit an amount equal to 150 percent of the total amount deposited by the financial institution and the borrower. The department's deposit would increase to 200 percent of the previously deposited amounts if the borrower was located in or financing a project in an enterprise zone or operated or proposed to operate a day care center or group day care home.

A financial institution could specify an amount to be covered by the program that was less than the total amount of the loan.

TDOC could not deposit more than six percent of the loan, up to $35,000, into a reserve account for each capital access loan. The limit would be raised to eight percent of the loan if the borrower was located in or financing a project in an enterprise zone or was a small or medium-size business or nonprofit organization operating or proposing to operate a day care center or group day care home. The department could not deposit into any one reserve account for any single loan recipient more than $150,000 within any three-year period.

Funding. SB 266 would eliminate the exporters loan and rural economic development fund programs on August 31, 1997, and would transfer funds in these programs to the capital access program.

At the beginning of each fiscal year, TDOC would be required to calculate the amount sufficient to cover loan guarantees, repay bonds, and make loan repayments for loans made under the Texas exporters loan and the Texas rural economic development fund programs. Any positive amount that remained in each of those funds would be transferred to the capital access fund.

TDOC would withdraw the interest earned on state contributions to reserve accounts on a monthly or quarterly basis for deposit into the capital access fund. If the amount in a reserve account exceeded 33 percent of the balance of the financial institution's outstanding capital access loans, TDOC could withdraw the excess amount and deposit it into the capital access fund. A withdrawal could not reduce an active reserve account to less than $200,000.

TDOC would be required to withdraw the total amount in a reserve account and any interest earned and deposit it into the capital access fund when an institution was no longer eligible to participate in the program or a participation agreement expired and the bank had no outstanding capital access loans and had not made such a loan within the past 24 months.

The department also could accept gifts, grants and donations to carry out the program.

TDOC authority. The TDOC policy board would adopt rules to implement the program by December 1, 1997. The board could establish criteria for certain lines of credit issued by a financial institution and authorize a consortium of financial institutions to participate in the program subject to common underwriting guidelines. The department would be required to determine eligibility of financial institutions to participate and could limit the number of participants.

SB 266 also would allow the department to execute contracts and conveyances, invest money in its discretion obligations, select and use depositories for its money, employ personnel and counsel and pay these persons from money in the capital access fund available for that purpose, collect fees resulting from transactions, and provide for reasonable penalties for delinquent payments of fees.

TDOC could not determine recipients, amounts of loans, interest rates, fees, or other requirements related to loans. The state would not be liable for payment of principal, interest, or late charges on a loan made under the program.

Reporting requirements. SB 266 would require participating banks to submit an annual report to TDOC with information regarding outstanding capital access loans, losses and other pertinent information. The report would also have to include the total amount of loans for which the TDOC had made contributions from the fund and a copy of the institution's most recent financial statement. These reports also would be submitted to the Legislature.

SUPPORTERS SAY:

SB 266 would facilitate private lending to small and medium-size businesses in Texas. Approximately 80 percent of all businesses in Texas are small businesses and employ fewer than 20 full-time employees. However, many of these businesses are financed through credit cards and loans from friends because they cannot qualify for conventional bank loans. SB 266 would help these economic generators overcome a large hurdle that impedes their success.

SB 266 would give banks an incentive to make capital access loans. Banks hesitate to make loans to businesses that have been operating for less than a year, which is the crucial time for capital to ensure a business' viability. Often, banks do not loan to small businesses because they are a higher credit risk or do not have enough collateral to qualify. Decreasing the risk to banks would increase the number of loans made to small and medium sized businesses.

SB 266 would maximize the state's contributions to small business capital and would allow the state to leverage its contribution by 15 to 20 times more than provided by current programs. The minimal contribution required from the state for reserve accounts would spread limited resources across many different businesses and lending institutions and would provide security for an increased number of loans. In addition, the bill would reduce the state's exposure to defaults because the program would not be a direct guarantee program.

SB 266 would have not have a negative fiscal impact because funding would be provided by a contingency rider in the appropriations bill. Funds would be transferred from two dormant state loan guarantee programs. Businesses that had been targeted by these programs still would be eligible for loans and lines of credit under the new capital access fund. This is especially important for exporters who need capital for projects on an ongoing basis. In addition, lines of credit could help a business make payroll, pay taxes, and cover other operating expenses.

SB 266 would fill a gap in government small business assistance programs. The federal Small Business Assistance loan program provides direct loans in amounts greater than $50,000; however, many Texas businesses do not need this much capital.

In addition, SB 266 would help provide funding to non-profit organizations that provide services, such as child care and affordable housing. These organizations provide services that are sorely needed and should be eligible for loans under the capital access program.

Many other states have capital access programs, including Michigan, Oregon, and California. A Texas capital access program would help our small businesses remain competitive in the global marketplace.

OPPONENTS SAY: The definition of small business should be amended to exclude nonprofit organizations. Nonprofit organizations have a broad range of other funding sources available to support their projects and activities.

NOTES: The committee amendment would allow banks to use the program for only a portion of a loan and allow them to recover all or part of amount they deposit into the reserve account.

A related bill, SB 265 by Ellis, which would establish a linked deposit program for small businesses, was placed on the House General Calendar for May 22.