CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (IBank)

SMALL BUSINESS FINANCE CENTER (SBFC)
SMALL BUSINESS LOAN GUARANTEE PROGRAM (SBLGP)
STAFF REPORT

DIRECTIVES AND REQUIREMENTS

ISSUE:

The Small Business Financial Assistance Act of 2013 (Law) governs the implementation of programs administered under the Small Business Finance Center (SBFC) within the California Infrastructure and Economic Development Bank (IBank). The proposed changes to the Directives and Requirements primarily affect the State and Federal funded Small Business Loan Guarantee Programs (SBLGP), as well as address direct loan programs such as the Farm Loan Program, the Surety Bond Guarantee Program, and the Secondary Market for Guaranteed Loans, all of which are programs under the Small Business Finance Center. In the event that other programs or other financing products are offered by the Small Business Finance Center in the future, the Directives and Requirements may be supplemented to address those new programs and financing products.

BACKGROUND:

The California Small Business Loan Guarantee Program (SBLGP) was established in 1968 to provide access to capital for small businesses, create jobs and opportunities for small businesses, targeting those owned by minorities, women, and disabled persons. IBank promotes local economic development by providing guarantees for loans made to small businesses that have difficulty accessing capital. The loans are made by financial institutions, typically banks, credit unions and Community Development Financial Institutions (CDFIs), and guaranteed by Financial Development Corporations (Corporations) that contract with IBank. As a result of the SBLGP, participating small businesses are able to secure financing that allows them to grow and expand their business. The loan guarantee serves as a credit enhancement and an incentive for financial institutions to make loans to small businesses that otherwise may not be able to obtain financing.

The SBLGP was approved to receive $84.2 million in federal funds from the U.S. Treasury under the State Small Business Credit Initiative (SSBCI), a component of President Obama's Small Business Jobs Act of 2010. The SSBCI funds have unique requirements. Consequently, the SSBCI funded loan guarantees are administered separately as a subset of the SBLGP (and are referred to here as the Federal Program). Since 2011, the SBLGP has consisted of two subsets: the state-funded portion (State Program) and the federal SSBCI-funded portion (Federal Program). The Federal Program is the primary fund source and program being utilized at this time. The State Program is used as a backup since some rules differ between the two subsets.

In addition to collection guarantees for term loans and lines of credit, the Small Business Finance Center has an active Farm Loan Program. Through this program, IBank loans money directly to participating Corporations for farm-related loans that are guaranteed by the U.S. Department of Agriculture (USDA). The loans provide capital for farm operating, equipment, and ownership of family farms.

The proposed adoption of the changes to the Directives and Requirements are intended to preserve its legacy programs still being utilized and provide a streamlined and compliant process for the guarantees of loans to small businesses in California that provide economic expansion and job creation. Although the funding for the subsets of the Program will remain separate at this time, it is the intent of the proposed changes to the Directives and Requirements to add clarity, as well as create a continuity of similarity for both the Federal Program and the State Program which will give a much needed update to the State Program policies to bring them in line with the Federal Program. The following proposed Directives and Requirements changes allow for changing technology, conform to partnering programs, will better assist IBank in managing the program and will provide a seamless transition for the consolidation of the State and Federal Programs in 2017.

ANALYSIS:

The SBFC staff collaborated with the nine participating Corporations that administer the programs and encouraged their participation in suggesting necessary changes to the policies and procedures. Since the adoption of the Directives and Requirements in May 2015, IBank and the Corporations have recognized some inconsistencies, obsolescence, and omissions that have caused confusion.

The following are recommendations for the significant changes to the Directives and Requirements. Other changes that are not specifically addressed below are non-substantive changes meant to enhance clarity for the reader, or changes of the same nature that are added in multiple areas for consistency, that are addressed once in the significant recommendations. However, all changes to the Directives and Requirements are reflected in the proposed new Directives and Requirements in Exhibit A. It is proposed that these changes to the Directives and Requirements be implemented as soon as possible for uniformity and clarity.

PROPOSED CHANGES TO THE DIRECTIVES AND REQUIREMENTS:

1. **The proposed Directives and Requirements have been reformatted.**
   For ease of understanding and program administration, it is proposed to remove from the Directives and Requirements the previous attachments thereto: A. Surety Bond Guarantees, B. Secondary Market for Guaranteed Loans, and C. Farm Loans, and include language from the attachments to reconstruct the Directives and Requirements into one document. In addition, staff proposes to remove the numbering of the definitions and move all definitions for all programs to the front of the document in alphabetical order. Rules of construction have also been added to the definitions.

§ 5000 DEFINITIONS

2. **"Allocation" and "Allocated"**
   The proposed change to the Directives and Requirements remove defined terms.
   It is proposed to remove the definition of "Allocation" and "Allocated." A section in the definition presently refers to a code that is no longer valid and the defined terms Allocation and Allocated are no longer used in the Directives and Requirements or program related documents.

3. **“Borrower”**
   The proposed change to the Directives and Requirements expand a definition.
   The Directives and Requirements state that a small business must have at least one full time equivalent employee. It is proposed to remove this requirement for nonprofit organizations. This proposed change will allow a 501(c)3 or 501(c)4 not for profit public benefit corporation or social welfare organization to participate in the program without the requirement of one full time employee. Some nonprofits do not have paid employees, only volunteers. This change will ensure 501(c)3 and 501(c)4 not for profit public benefit corporations or social welfare organizations are not excluded from the Small Business Finance Center programs. IBank proposes to allow flexibility to accommodate unique situations and prevent small business loan exclusion.

4. **“Executive Director”**
   The proposed change to the Directives and Requirements adds a defined term.
   The term “Executive Director” has been added to clarify the Executive Director referred to in the Directives and Requirements is the Executive Director of the California Infrastructure and Economic Development Bank. (IBank).

5. **“Encumbrance”**
   The proposed change to the Directives and Requirements clarifies when funds are encumbered.
   Presently, funds are encumbered for the SBLGP based on the executed date of the

Guarantee. Since the date of the Guarantee and the date of the promissory note executed by the Lender do not always coincide, it is proposed that the effective date is either 1. the date of the executed Guarantee agreement or 2. the date of the promissory note, whichever is last, provided that the guarantee is approved by IBank before both the date of the guarantee and the promissory note. This clarifies that the guarantee is not valid without a note, and vice versa. It also clarifies the specific date that funds are encumbered to support the guarantee.

In addition:

The proposed change to the Directives and Requirements changes the methodology of the Encumberance calculation.

The proposed calculation assures funds are set aside based on the original principal amount of the guarantee on a Term loan, Line of Credit, or Revolver Loan, rather than just the disbursed portions at loan closing. This is a more conservative approach to assure lenders that the Program has adequate reserves to cover guarantee demands made against the fund.

Also:

The proposed change to the Directives and Requirements removes Farm Loans from the Encumbrance definition.

The present Directives and Requirements require an Encumbrance of 40% of the outstanding balance of a Farm Loan. Farm Borrower Loans are not Guarantees, they are direct loans to participating Corporations for USDA guaranteed loans to farms. One hundred percent of the funds are committed to the Corporation immediately upon approval by IBank; therefore, immediately expended. Any undisbursed portion is already fully obligated.

6. **"Farm"**

   The proposed change to the Directives and Requirements removes reference to the trust fund.

   Now that the individual trust accounts of the Corporations have been pooled, reference to the trust fund in the definition of a "Farm" is no longer necessary and confusing. The trust fund is defined appropriately in the Corporations Code. It is proposed that reference to the trust fund be removed from the definition of a "Farm".

7. **"Farm Borrower Agreement"**

   The proposed change to the Directives and Requirements changes the interest rate.

   This proposed change will increase the rate from 4% above prime to 5% above prime to allow the Lender to increase the interest rate to offset the increased cost of lending in this market and coincide with the rate increase of Guarantees approved by the IBank board on May 26, 2015.

8. **"Farm Loan"**

   The proposed change to the Directives and Requirements deletes a definition.

   The Farm Loan definition presently refers to a section of the Directives and Requirements that no longer exists, and the defined term Farm Loan is no longer used in these Directives and Requirements or in any program related documents. The proper terminology used in the Directives and Requirements is Farm Borrower Loan.

9. **“Full Time Equivalent” (FTE)**
   The proposed change to the Directives and Requirements clarifies the FTE calculation method.
   Reporting FTE’s is a requirement of the Federal Program. This change clarifies the calculation criteria of an FTE is the same as that of the IRS Federal hourly calculation criteria.

10. **“Goals”**
   The proposed change to the Directives and Requirements removes a definition.
   The goal for the number of loan guarantees for each Corporation is set out in section 5005 of the Directives and Requirements approved by the IBank board on May 26, 2015. The set number is a requirement, not a goal, and the term “Goal” is not used in this document or in any program related documents.

11. **“Guarantee”**
   The proposed change to the Directives and Requirements corrects terminology.
   It is proposed to remove the word “Claim” from the definition of “Guarantee.” The program no longer refers to a request for payment on a guarantee as a Claim. Claim as defined in these Directives and Requirements refers to Surety Bonds, not Guarantees. The wording “guarantee payment request” is the proper terminology in this section. Now that the individual trust accounts of the Corporations have been pooled, it is no longer necessary or appropriate to reference the Corporation’s trust account.

12. **“Holder"**
   The proposed change to the Directives and Requirements changes a definition.
   It is proposed to remove the term “up to 80%” from the definition of a “Holder” that purchases or is assigned a percentage of a loan. This will allow flexibility in the program that does not restrict the percentage to 80% of a loan that an entity can purchase or be assigned. It has been the program practice that the Holder owns 90% of the Farm Borrower Loan. Eighty percent is also contradictory to section 5020 of the Directives and Requirements, the Secondary Market, where the Lender may assign all or part of the guaranteed portion of the Loan to one or more Holders, except that the Lender is required to retain a minimum of ten percent (10%). This change will create a consistency with the use of the term “Holder”.

13. **“Leverage”**
   The proposed change to the Directives and Requirements removes a reference.
   It is proposed to remove the reference to the individual Corporation’s trust account such that the leverage is calculated on the basis of the pooled trust fund account balance.

14. **“Line of Credit Loan”**
   The proposed change to the Directives and Requirements clarifies the structure of a Line of Credit.
   Lines of Credit are typically structured as interest only, however can be structured for principal payments also. To allow for structures other than interest only, it is proposed to refer to a Line of Credit as a Loan “usually” structured as interest only. IBank proposes to

allow flexibility to accommodate unique situations and prevent small business loan exclusion.

Also:

The proposed change to the Directives and Requirements clarifies the term of a Farm Enterprise Loan.

Farm Enterprise Loan terms are determined by the USDA. To comply with USDA requirements it is proposed to align IBank's term requirement of a Farm Enterprise Loan with current USDA terms, yet not to exceed IBank's maximum of seven years.

15. **"Loan Guarantee"**

The proposed change to the Directives and Requirements clarifies conditions of interest payments.

The proposed change clarifies the interest to be paid at the time of a guarantee demand request is "up to" ninety (90) days and that the interest must be "earned and unpaid." This will avoid considering an interest payment that is not yet due to a Lender.

16. **"Micro Loan"**

The proposed change to the Directives and Requirements increases the amount.

The current amount of a Micro Loan is $25,000. IBank proposes to change the definition of the amount of Micro Loan to $100,000.00. As Micro Loan is used in the Directives and Requirements, its only meaning relates to IBank's requirement for less documentation from Corporations on Micro Loans in order to help relieve the burden and expense of guaranteeing smaller loans.

17. **"Multi-party Contract"**

The proposed change to the Directives and Requirements removes a definition.

Multi-party Contracts are no longer used; therefore, it is proposed to delete the definition. The proper terminology for a contract between IBank and the Corporation is "Contract" and is already defined in the Directives and Requirements.

18. **"Program Manager"**

The proposed change to the Directives and Requirements adds a defined term.

The addition of this defined term clarifies the "Program Manager" referred to in the Directives and Requirements means the manager of the California Small Business Finance Center as designated to this title by the Executive Director.

19. **"Proposal", "Proposer", "Remedial Action Plan", "Temporary Withdrawal"**

The proposed change to the Directives and Requirements removes certain definitions.

It is proposed to remove "Proposal", "Proposer", "Remedial Action Plan", and "Temporary Withdrawal" as definitions in the Directives and Requirements. The defined terms are no longer used in these Directives and Requirements or in any program related documents. The definitions are included in the Corporations Code and relate to a Corporations qualification to participate in IBank Programs.

20. "Revolver Loan".

The proposed change to the Directives and Requirements changes term requirements.
It is proposed that a Line of Credit Loan convert to a Term Loan after a specified time indicated in the loan agreement rather than the current requirement of one year. This allows flexibility in the program. IBank proposes to allow flexibility to accommodate unique situations and prevent small business loan exclusion.

21. "Term Loan"

The proposed change to the Directives and Requirements expands a definition.
It is proposed to add the word "usually" as it relates to a Term Loan having regularly scheduled reductions in principal balance to allow flexibility for a situation that a Term Loan does not have regularly scheduled reductions in principal balance. IBank proposes to allow flexibility to accommodate unique situations and prevent small business loan exclusion.

§ 5001 GUARANTEE PROCEDURES

22. "Guarantee Procedures"

The proposed change to the Directives and Requirements addresses necessary changes to the guarantee procedures.
The present language in this section incorrectly states that the Borrower applies for the Guarantee, when in fact a Lender applies for a Guarantee. It is proposed to correct the language to clarify that a Lender applies for a Guarantee and a Borrower completes the application.

Also:
It is proposed that if a Corporation's Board of Directors has delegated authority to approve a proposed Guarantee to the Corporation's loan committee such delegation must be in accordance with IBank policy.

In addition:
It is proposed to add language that clarifies that no Guarantee shall be approved or executed by a Corporation if the Lender is the same entity as the Corporation or an affiliate of the Corporation or Lender.

§5002 GUARANTEE TERMS

23. The proposed change to the Directives and Requirements addresses necessary changes to the guarantee terms.
The present language in this section incorrectly states that the Guarantee is issued to the Borrower. It is proposed to correct the language to clarify that a Guarantee is issued to a Lender.

Also:
It is proposed to clarify that the accrued yet unpaid interest up to ninety days is paid at the same rate as the guarantee percentage.

Also:
It is proposed to remove the requirement that a Lender send a copy of all Delinquency notices that are mailed to the borrower, to the Corporation. The Lender currently notifies the Corporation of the status of guaranteed accounts on a quarterly basis. The mailing of delinquency notices is in addition to the quarterly notifications. This proposed change will eliminate the effort and expense of tracking, mailing and filing of delinquency notices for both the Lender and the Corporation.
In addition:
All other proposed changes to this section are to create uniformity with previously proposed changes to the definitions.

§ 5003 GUARANTEE DEMAND PROCEDURES

24. The proposed change to the Directives and Requirements addresses necessary changes to the Guarantee Demand Procedures.
The present language in this section incorrectly states that a Borrower is required to comply with liquidation requirements. It is proposed to correct the language to clarify that the Lender is required to comply with liquidation requirements and to provide proof of satisfaction of such requirements to the Corporation.
Also:
It is proposed to change the number of days in which action need be taken on Guarantee Demands from five calendar days to ten business days, and in the case of delivering a check to a Lender, from one business day to five business days. This change will create uniformity and allow reasonable time for Corporations and IBank to conduct business necessary to comply with Guarantee Demand Procedures.
Also:
It is proposed to change the number of days in which a Demand may be submitted to IBank from thirty-one days after the Guarantee matures to ninety days after the Guarantee matures.
In addition:
All other proposed changes to this section are to create uniformity with previously proposed changes to the definitions.

§ 5006 ADDITIONAL CLARIFICATIONS

25. The proposed change to the Directives and Requirements addresses necessary changes to the Additional Clarifications.
It is proposed to add the Executive Director in addition to the Program Manager as one authorized to create trust funds. Previously, the Program Manager and the Executive Director were one in the same. The Program Manager is now an IBank Executive Staff member that is in addition to the Executive Director.
Also:
It is proposed to add an additional source of information, rules, and guidance for the Federal Program; the FDC Policy Manual.

In addition:
Reference to the attachments was removed since the proposed Directives and Requirements will no longer have attachments.

§ 5009 SURETY BOND TERMS

26. The proposed change to the Directives and Requirements changes the fee.
It is proposed to change the fee for a Corporation Bond Guarantee from two percent (2%) to three percent (3%) to match the change in fees of the State and Federal Guarantee Programs.

§ 5111 DISBURSEMENT OF FARM LENDER LOAN FUNDS

27. The proposed change to the Directives and Requirements removes a reference.
It is proposed to remove language that the disbursement in connection with an executed Farm Loan Agreement, refers to section 5110(d) that is no longer in the Directives and Requirements. The reference is not necessary and the sentence remaining stands on its own.

28. The proposed change to the Directives and Requirements will establish fund commitment.
The proposed change will establish that IBank will set aside the original principal amount of the loan request, minus any disbursements, in the trust fund as its commitment to future disbursements. Funds will be released back to the trust fund as the balance of the loan decreases. This ensures that funds will be available upon request for Farm Loan Disbursements of previously approved Farm Loans.

ATTACHMENTS

29. The proposed change to the Directives and Requirements removes attachments.
It is proposed that the previous attachments be incorporated into the Directives and Requirements.

RECOMMENDATION:

Staff recommends approval of Resolution 16-15 in connection with the following Directives and Requirements for the Small Business Finance Center programs, including the Small Business Loan Guarantee Programs, the Farm Loan Program, the Surety Bond Guarantee Program, and the Secondary Market for Guaranteed Loans, all of which are programs under the Small Business Finance Center.