

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK

**SMALL BUSINESS FINANCE CENTER
SMALL BUSINESS LOAN CATALYST PROGRAM**

STAFF REPORT

DIRECTIVES AND REQUIREMENTS

ISSUE:

The California Infrastructure and Economic Development Bank (“IBank”) staff recommends the IBank Board of Directors (the “Board”) approve Resolution No. 20-14, adopting Amended and Restated Directives and Requirements (the “A&R Directives and Requirements”) to establish the Small Business Loan Catalyst Program (the “SBLCP”) under IBank’s Small Business Finance Center (the “Center”). If approved, the A&R Directives and Requirements and the SBLCP would enable IBank to enter into agreements with financial institutions and other entities that will increase the number and volume of small business loans in California. Doing so is especially critical at this juncture. While the economic havoc wreaked by the novel coronavirus rages on, revenue-choked small businesses are suffering from a lack of customers and a large-scale downturn in general economic activity. Without an economic lifeline in the form of low-interest small business loans, California’s small businesses are in danger of mass insolvency, taking with them thousands of jobs and depriving Californians of the goods and services they turn to these small businesses to provide. Creation of the SBLCP will enable IBank to partner with institutions and mission-driven entities to generate low-interest lending activity in California that will provide an economic bridge to help California small businesses navigate the coronavirus-inspired economic downturn.

This Staff Report and Resolution No. 20-14 are being presented contemporaneously with affiliate Resolution No. 20-15, seeking authority for IBank’s Executive Director to enter into negotiations for an agreement under the new SBLCP that will leverage one or more IBank loans, together with additional loans from other private and philanthropic organizations, to create a fund to generate needed small business loans in California. IBank believes the changes effected by the A&R Directives and Requirements could help rebuild numerous small businesses and save countless jobs.

BACKGROUND:

IBank is established pursuant to the Bergeson-Peace Infrastructure and Economic

Development Bank Act (the “IBank Act”) for the purpose of providing financial assistance to eligible entities in the State of California (the “State”) through a variety of financing mechanisms. The Small Business Financial Assistance Act of 2013, (the “Small Business Act”) was added to the IBank Act in 2013 to: (i) establish the Center within IBank, and (ii) transfer administration of the State’s small business financing programs to the Center. Currently, the Center’s programs are its Small Business Loan Guarantee Program, the Farm Loan Program, the Surety Bonds Guarantee Program, the Secondary Market for Guaranteed Loans Program, the Jump Start Loan Program, and the Disaster Relief Loan Guarantee Program (the “Existing Programs”).

The Existing Programs have served California’s small businesses well during normal economic times and during periods where disasters have occurred in limited geographic areas. However, the Existing Programs were not designed to address a severe economic downturn caused by a statewide and nationwide pandemic. The premier program among the Existing Programs is IBank’s Small Business Loan Guarantee Program (the “SBLGP”). The SBLGP operates through a series of “Financial Development Corporations” (“FDCs”). The FDCs work with small business lenders to issue partial loan guarantees. IBank’s SBLGP program provides the necessary funds to back these guarantees and to pay part of the outstanding debt when a small business defaults on its loan. These partial guarantees enable lenders to make loans that may not otherwise be made and may drive down the cost of credit for small businesses.

To operate effectively, the SBLGP requires that lenders have sufficient balance sheet capacity to make the loans in the first place. During normal economic times this system functions well. But, during this widespread economic downturn, many lenders who participate in the SBLGP find themselves without sufficient liquidity to make small business loans. An SBLGP loan guarantee doesn’t help get money to small businesses when these lenders do not have funds to lend.

To address this “hole” in the small business capital markets, IBank staff began to analyze potential options to get money where it was needed for small business loans. IBank staff developed two primary strategies. The first strategy was to develop a program where IBank, either by itself or with other financial institutions lends money to, participates in loan originations with, or purchases loans outright from, small business lenders. This would allow small business lenders to recapitalize and make additional small business loans. The second strategy was to allow IBank to work with financial institutions and philanthropic organizations to create one or more entities for the purpose of lending money to or purchasing small business loans from small business lenders (each a “Special Purpose Entity” or “SPE”). Under this strategy, IBank, commercial lenders, and philanthropic organizations would loan money to one or more Special Purpose Entities that could act as a “warehouse lender” for a group of small business lenders, could purchase loans from small business lenders, or a combination of the two activities. This would provide needed funds to small business lenders to allow them to make additional small business loans.

IBank’s next step was to obtain the necessary change in the Small Business Act to allow it to develop these new small business programs under the Center. IBank staff worked with the Governor’s Office of Business and Economic Development, the Department of Finance, and others to make the needed statutory revisions. This step was accomplished on June 29,

2020, when Government Code Section 63088.5(b) was amended to read “The bank board may continue programs funded by the Small Business Expansion Fund or establish one or more programs administered by the bank directly, in conjunction with financial companies or financial institutions, in direct or indirect participation with special purpose entities established for small business finance, or under contract with small business financial development corporations.” This provided the needed statutory authority for IBank to partner with financial institutions and Special Purpose Entities to develop financial vehicles designed to make loans to California’s small businesses.

The next step is what IBank seeks to do with Resolution No. 20-14, adopt the A&R Directives and Requirements creating the Board-approved SBLCP. This step is necessary because Government Code Section 63088.5(b) requires that any new Center programs be established by the Board. Government Code Section 63089 requires the Board adopt directives and requirements to implement the Small Business Act. Therefore, taken together, the appropriate way to establish the SBLCP within the Center is for the Board to adopt the A&R Directives and Requirements.

The final step in IBank’s efforts is to seek Board approval to participate in a transaction under the new SBLCP. Affiliate Resolution No. 20-15 begins that process.

ANALYSIS:

The A&R Directives and Requirements create the new SBLCP. The Board last approved revisions to the Directives and Requirements on October 24, 2017. The changes from the prior version proposed by the A&R Directives and Requirements are shown on Attachment B to Resolution No. 20-14.

The portion of the A&R Directives and Requirements creating the SBLCP are designed to ensure maximum flexibility to allow rapid response to changing economic conditions, while at the same time maintaining complete Board oversight and approval. Instead of proscribing strict confines for the operation of the SBLCP, the A&R Directives allow IBank to propose small business financing transactions to the Board for approval. The A&R Directives outline the structure of potential transactions: (1) entry into agreements with an SPE, or an SPE controlling entity, for the purpose of increasing the number or volume of California small business loans, (2) entry into one or more agreements, directly or indirectly, with one or more financial institutions to purchase, in whole or in part, California small business loans, or to obtain one or more participation shares in California small business loans, or (3) entry into one or more agreements to loan money, directly or indirectly, to one or more financial institutions to provide a source of capital for small business loans . The A&R Directives and Requirements also allow IBank to retain attorneys and advisors necessary for any SBLCP transaction

Importantly, the A&R Directives and Requirements require Board approval before entering into any SBLCP transaction. The Board makes the ultimate decision of whether IBank should enter into a transaction under the SBLCP. Like any other financing transaction, IBank staff would present the Board with a staff report discussing the potential transaction and a proposed authorizing resolution. The Board would have time in advance of the

meeting to review the staff report and then have the ability to ask IBank and any other interested parties attending the meeting whatever questions the Board members may have before voting on the matter. Following this pattern, IBank staff is presenting related Resolution No. 20-15 seeking Board authorization for IBank's Executive Director, or designee, to negotiate the terms of and execute an agreement for IBank's potential loan of money to an SPE created to provide capital to small business lenders so they can make additional small business loans in California.

RECOMMENDATION:

Staff recommends approval of Resolution No. 20-14 approving the A&R Directives and Requirements to create the SBLCP within the Center.