# HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 1301 Economic Development
**SPONSOR(S):** Nelson and others
**TIED BILLS:** **IDEN./SIM. BILLS:** SB 1862

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR or BUDGET/POLICY CHIEF |
|---|---|---|---|
| 1) Economic Development & Tourism Subcommittee | 13 Y, 1 N | Kruse | Kruse |
| 2) Transportation & Economic Development Appropriations Subcommittee | | | |
| 3) Economic Affairs Committee | | | |

## SUMMARY ANALYSIS


The bill creates a new business loan guarantee program to provide an incentive to Florida-based mezzanine funds to make investments in businesses that otherwise may represent a level of risk the fund is unwilling to take, which may have the effect of encouraging private sector economic activity. The source of funding for the loan guarantees comes solely from the repayments made to the state from the Economic Gardening Loan Pilot Program that otherwise would have been returned to General Revenue.

The bill also repeals an inactive microenterprise program section of law.

The bill has no fiscal impact.

## FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

**ISSUE BACKGROUND**

The bill creates a new business loan guarantee program to provide an incentive to Florida-based mezzanine funds to make investments in businesses that otherwise may represent a level of risk the fund is unwilling to take.

Loan Guarantee Programs, State and Federal

Some states and the Federal government currently offer various types of loan guarantee programs. The state of Georgia administers the Entrepreneur and Small Business Development (ESBD) Loan Guarantee Program. The ESBD Loan Guarantee Program provides partial guarantees to banks for loans to small businesses that cannot otherwise obtain all of their financing needs. The ESBD Loan Guarantee Program's objective is to fund viable ESBD loans that leverage private investment while creating new or expanding existing businesses that will create employment opportunities for mostly rural Georgia. Loan guarantees to lenders are up to 50% of the original principal amount of the lender's loan, or up to $112,500, whichever is less, with the sub-recipient business providing no less than 10% cash equity in the project. The loan guarantee does not cover outstanding or capitalized interest charges. Lenders provide a 1% loan guarantee fee of the guarantee amount to the OneGeorgia Authority at the loan closing. In addition, OneGeorgia requires an on-going annual fee of 0.5% of the outstanding loan balance.

An eligible lender must use the ESBD Loan Guarantee Program to partially guarantee a new loan made to an eligible sub-recipient business who then must use the lender's funds for sound business purposes which may include, but not be limited to the following:

- acquisition of land (by purchase or lease);
- improvement of a site (e.g., grading, streets, parking lots, landscaping);
- acquisition of one or more existing buildings;
- conversion, expansion or renovation of one or more existing buildings;
- construction of one or more new buildings; acquisition (by purchase or lease); or
- installation of fixed assets and working capital.

A working capital loan must be adequately secured by accounts receivable or inventory of the sub-recipient business properly margined according to the lender's normal collateral guidelines. Working capital can also be secured by tangible assets owned by the principals of the business. An ESBD guaranteed loan cannot exceed 90% of the value of the underlying collateral. Proper collateral documents must be executed and recorded as necessary including security agreements, deeds to secure debt, and UCC financing statements.

Borrowers may be entrepreneurs, start-ups and small business owners. The borrower must be a "for-profit" business enterprise properly organized in Georgia and located in an eligible county or a conditionally eligible county with population less than 150,000. The business owner or majority principal must live in an eligible county. The business must meet ESB eligibility requirements and lender's underwriting criteria for consideration.

Federal

The Federal Small Business Administration (SBA) administers several loan guarantee programs and one in particular, the 7(a) loan, for working capital expenses. 7(a) loans are only available on a guaranty basis. This means they are provided by lenders who choose to structure their own loans by SBA's requirements and who apply and receive a guaranty from SBA on a portion of this loan. Under the guaranty concept, commercial lenders make and administer the loans.

The business applies to a lender for their financing. The lender decides if they will make the loan internally or if the application has some weaknesses which, in their opinion, will require an SBA guaranty if the loan is to be made. The guaranty which SBA provides is only available to the lender. It assures the lender that in the event the borrower does not repay their obligation and a payment default occurs, the Government will reimburse the lender for its loss, up to the percentage of SBA's guaranty. Under this program, the borrower remains obligated for the full amount due. In order to obtain positive consideration for an SBA supported loan, the applicant must be both eligible and creditworthy.

In order to get a 7(a) loan, the applicant must first be eligible. Repayment ability from the cash flow of the business is a primary consideration in the SBA loan decision process but good character, management capability, collateral, and owner's equity contribution are also important considerations. All owners of 20 percent or more are required to personally guarantee SBA loans.

All applicants must be eligible to be considered for a 7(a) loan. The eligibility requirements are designed to be as broad as possible in order that this lending program can accommodate the most diverse variety of small business financing needs. All businesses that are considered for financing under SBA's 7(a) loan program must meet SBA size standards, be for-profit, not already have the internal resources (business or personal) to provide the financing, and be able to demonstrate repayment. Eligibility factors for all 7(a) loans include size, type of business, use of proceeds, and the availability of funds from other sources. [1]

Microenterprises

In 1997, the Legislature authorized the Governor's Office of Tourism, Trade, and Economic Development to contract with a nonprofit or governmental organization to foster microenterprise development in Florida. The program provided a number of competitive grants to community-based nonprofit organizations located throughout the state, which in turn provided technical assistance and loans to low and moderate income individuals to help them achieve self-sufficiency through self-employment. However, the program experienced a high number of failures and the Legislature has not subsequently funded the program.

Mezzanine Funds

A typical mezzanine investment consists of a debt or debt-like instrument, paired with an equity "sweetener." The equity component of the investment gives the mezzanine lender upside potential, while the debt component, which generates steady interest payments and ranks senior to the company's common stock, provides a measure of downside risk protection. The most common formulation is a note which may provide for both current-pay cash interest and pay-in-kind, or PIK, interest, paired with warrants to acquire stock of the borrower. Mezzanine investments can be made using other types of securities as well, such as with preferred stock in place of a debt instrument.[2]

Mezzanine capital is often a more expensive financing source for a company than secured debt or senior debt. The higher cost of capital associated with mezzanine financings is the result of its location as an unsecured, subordinated (or junior) obligation in a company's capital structure (i.e., in the event of default, the mezzanine financing is less likely to be repaid in full after all senior obligations have been satisfied). Additionally, mezzanine financings, which are usually private placements, are often used by smaller companies and may involve greater overall leverage levels than issuers in the high-yield market; as such, they involve additional risk. In compensation for the increased risk, mezzanine debt holders require a higher return for their investment than secured or other more senior lenders.

Economic Gardening

In the 2009 Special Session, the Legislature created the Economic Gardening Business Loan Pilot Program within the Office of Tourism, Trade, and Economic Development (OTTED). The loan program is focused on businesses desiring to expand jobs in the state. Those include businesses that:

1. are for-profit, privately held, investment grade;
2. employ between ten and 50 employees;

[1] Small Business Administration, "Basic 7(a) Loan Program" located at http://www.sba.gov/services/financialassistance/sbaloantopics/7a/ last viewed 12/30/08.

[2] Definition of Mezzanine Fund-InvestorDictionary.com, found at http://www.investordictionary.com/definition/mezzanine-fund (last visited March 18, 2011).

3. have been in existence in the state for at least two years;
4. generate between $1 million and $25 million in annual revenue;
5. qualify for the Qualified Target Industry (QTI) tax refund program; and
6. have increased, during 3 of the previous 5 years, both the number of full-time employees in the state and its gross revenues.

The loans must be used to finance working capital purchases, employee training, or salaries associated with newly created jobs. Job retention does not qualify under the loan program. The maximum loan amount is $250,000 with no minimum loan amount prescribed. The bill establishes a two percent interest rate and requires that the loan be collateralized with all available corporate assets. In the first year of the loan, only interest is due. The loan is paid off over the remaining term of the loan. If the job creation criterion is not met in the first two years of the loan, the interest rate on the loan is raised to the prime rate plus four percent which will provide an incentive to the business to refinance the loan in the private sector and pay off the loan.

The $8.5 million loan program is currently administered by the non-profit Black Business Investment Fund of Central Florida under contract with OTTED. The loan administrator reports that 37 loans have been made across the state for a total of $7.3 million. No new loans may be made after June 30, 2011. Loan approval decisions are made based upon confirmation of a business' application materials and a determination of which applicants are in the best position to utilize a loan to continue making a successful long-term business commitment to the state. The lending entity receives an origination fee of one percent of the loan amount at closing and a nominal monthly servicing fee. The entity returns principal and interest payments as well as any funds collected from a defaulted borrower to OTTED and also makes a report of loan activity and results to OTTED quarterly. The report describes, among other things, the number and wages of jobs created and the type and location of business activity funded. Any funds not disbursed by OTTED are returned to General Revenue. The lending entity estimates the expected return to General Revenue from loan payments as follows:

| **YEAR** | **EXPECTED LOAN REPAYMENTS** | **PERCENTAGE OF LOAN FUND** |
|---|---|---|
| 2010 | $79,070 | 1% |
| 2011 | $1,186,050 | 15% |
| 2012 | $1,581,400 | 20% |
| 2013 | $1,976,750 | 25% |
| 2014 | $1,976,750 | 25% |
| 2015 | $1,106,980 | 14% |
| **TOTAL ESTIMATED LOAN FUNDS RETURNED TO STATE:** | **$7,907,000** | 100% |

**Changes made by the bill**
The bill creates a new business loan guarantee program to provide an incentive to Florida-based mezzanine funds to make investments in businesses that otherwise may represent a level of risk the fund is unwilling to take. The source of funding for the loan guarantees comes solely from the repayments made to the state from the Economic Gardening Loan Pilot Program.

Loan Guarantee Administration and Parameters
The bill provides that the program is administered by the Governor's Office of Tourism, Trade, and Economic Development (OTTED). OTTED is provided authority to use funds deposited from the Economic Gardening Loan Pilot Program for the loan guarantees. A loan guarantee may be made to a Florida-based mezzanine fund to offset the funds portion of risk that prevents the fund from making an investment, either debt or equity. A loan guarantee may be made for terms up to 36 months and in amounts of up to 70 percent of a loan, not to exceed $500,000. After establishing application review guidelines, OTTED may charge a fee of 0.5 percent of a proposed loan guarantee to review a mezzanine funds application. OTTED is required to review and approve or deny the application within 30 days after receipt.

A business must meet the following criteria:

1. Is a privately held, second-stage business;
2. Has revenues of at least $5 million but not more than $75 million;
3. Has earnings of at least $1 million before interest, taxes, depreciation, and amortization;
4. Has a total debt-to-earnings ratio, before interest, taxes, depreciation, and amortization, of less than 3.0;
5. Has proven and committed management teams;
6. Has a competitive advantage in market segment or defensible niche position; and
7. Has a sound historical financial performance.

OTTED may partner with a financial institution to make additional loan guarantees if the financial institution agrees to place a meaningful amount of its own capital at risk in the loan guarantee made by OTTED. The bill requires OTTED to make an annual report on the loan guarantee programs progress based on performance measures to the Governor and the Legislature.

The bill provides that the Business Loan Guarantee Program is repealed July 1, 2017. The bill also repeals the law that created the microenterprise program, which has been inactive since 1998.

The bill does not have a fiscal impact because it uses loan repayment funds from the Economic Gardening Loan Pilot Program that otherwise would have been returned to General Revenue to fund loan guarantees .

The bill provides an effective date of July 1, 2011.

B. SECTION DIRECTORY:

Section 1. Creates s. 288.9619, F.S., to establish the Business Loan Guarantee Program.

Section 2. Amends s. 288.1081(5)(e), F.S., to provide authority for the loan repayments from the Economic Gardening Loan Pilot Program to be used for the Business Loan Guarantee Program.

Section 3. Repeals s. 288.9618, F.S., which created the microenterprise program.

Section 4. Provides an effective date of July 1, 2011.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may encourage private sector economic activity if, through a loan guarantee, a Florida-based mezzanine funds is able to make additional investments in businesses that in turn expand and create jobs.

D. FISCAL COMMENTS:

The bill does not have a fiscal impact because it uses loan repayment funds from the Economic Gardening Loan Pilot Program. HB 775 promotes a competing use of the funds by making the Economic Gardening Loan Pilot Program permanent and having the loan repayments available for additional economic gardening loans.

## III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

## IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

None.