

Approved April 8, 1988
Date

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

The meeting was called to order by Senator Wint Winter, Jr. at
Chairperson

12:45 ~~a.m.~~/p.m. on March 30, 1988 in room 254-E of the Capitol.

All members were present except:

Senator Ben Vidricksen - Excused

Committee staff present:

Lynne Holt, Legislative Research Department
Mary Allen, Secretary to the Committee

Conferees appearing before the committee:

Ken Grotewiel, House of Representatives
Diane Gjerstad, House of Representatives
Allen Bell, Kansas Development Finance Authority
Mary Ellen Conlee, Kansas Association for Small Business

The meeting was called to order at 12:45 p.m. by the Chairman, Senator Wint Winter, Jr.

Senator Feleciano moved that the minutes of the March 23, 1988, meeting of the Committee be approved. Senator Karr seconded the motion. The motion carried.

The Chairman announced that the minutes of the meetings which have not been approved will be circulated to the members of the Committee for approval. If the Chairman or Committee Secretary do not hear from any member that there should be a change or changes made, the minutes will be considered approved as written.

House Bill 2909 - An Act concerning economic development; establishing the Kansas basic enterprises loan program; authorizing issuance of certain bonds, loans and investments; prescribing powers, duties and functions for the Kansas development finance authority.

Chairman Winter called on Representative Ken Grotewiel, Kansas House of Representatives and co-sponsor of HB 2909, to explain the bill. Representative Grotewiel said that HB 2909 addresses small businesses in Kansas. He observed that a significant gap exists between small business and the capital markets. He cited a finding from a Redwood/Krider survey of businesses taken in ten non-metropolitan areas which pointed out that of the businesses who wanted to expand, approximately one-half were unable to secure financing through the normal channels. He cited part of the reason for this problem as the difficult situation currently facing Kansas rural banks.

Representative Grotewiel said that he and Representative Diane Gjerstad introduced HB 2909 to address these financing needs. He stated that HB 2909 creates a hybrid loan program that combines elements of traditional financing with a loan guarantee program. It is targeted toward existing small businesses. He noted that HB 2909 establishes the Kansas basic enterprise loan program. This program would take an appropriation of some kind from the Economic Development Initiatives Fund (EDIF). The loan pool created would be capitalized by an initial allocation into the basic industry loan guarantee fund from the Kansas Development Finance Authority (K DFA) who would issue bonds. He said that the proceeds from the bond sales would be used by local banks to make loans to basic enterprises. He observed that the state's exposure would be relatively low but the bond money would be at some risk. In fact, he said, the state would have to put no money into the program. He noted that three parties would share in the risk, the borrower not less than fifteen percent, the lender not more than fifteen percent, and the K DFA not more than seventy-five percent. He said that HB 2909 is written to allow great flexibility on the part of K DFA to structure a program which is able to meet the needs of business and the bondholders.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

room 254-E, Statehouse, at 12:45 ~~z.z.z.~~/p.m. on March 30, 1988

Representative Grotewiel said that a fundamental barrier to non-metropolitan economic development is the lack of financial capital at an appropriate risk-return relationship. There is a problem of availability and accessibility, he noted. By allowing banks to utilize an additional source of funds from which to make loans, their liquidity problems would be eased and they would be able to service loans they normally would not be able to make. He observed that HB 2909 not only helps people looking for capital to expand their businesses but also helps banks, particularly in rural areas who, because of the problems in the oil industry and the agricultural industry, do not have any more money to lend. (See Attachment I for Representative Grotewiel's statement.) Representative Grotewiel urged the Committee to consider HB 2909 favorably.

In answer to questions by Committee members, Representative Grotewiel stated that HB 2909 allows loans only to basic industries. He said that this fits in with the goals of economic development in Kansas. He feels that Kansas should follow the economic development policy of creating exports. Representative Diane Gjerstad, Kansas House of Representatives and co-sponsor of HB 2909, stated that Kansas has a limited amount of money for economic development programs. She noted that she wants to see wealth created and to do that Kansas needs job expansion in the area of small to medium sized businesses.

The Chairman observed that the definition of basic industry has changed as set forth in SB 470. He asked the co-sponsors of HB 2909 if they would object to amending the bill to refer to SB 470 for this definition. The co-sponsors indicated that they would not object to this.

The Chairman asked Representative Gjerstad to compare HB 2909 to Senator Eugene Anderson's bill, SB 176. Representative Gjerstad said that Senator Anderson's bill is a loan guarantee program which does a very good job of backing up loan applications. HB 2909, she said, offers a pool of money for financial institutions to use from which to loan money, especially through the one hundred seventy-nine banks in Kansas that are having "problems". She feels that Senator Anderson's bill would not allow those banks to make more loans. Under HB 2909, by allowing those banks to use the pool of money, the problem banks will have an additional resource to use in making loans. She observed that this would be a help to rural areas.

Chairman Winter observed that HB 2909 provides for a direct appropriation of \$1 million on page eight. Representative Grotewiel said that he has been operating under the assumption that an appropriation would be needed in order to place the bill into operation. The Chairman asked if the co-sponsors would object if the direct appropriation is removed from the bill, leaving the appropriation up to the proper priority among all of the other programs. Representative Gjerstad stated that it was not their intent to have a direct appropriation. It was only their intent to set up the mechanism for the transfer to the pool with a cap of \$1 million. The Chairman asked if the co-sponsors would object to taking HB 2909, if it passes, to a conference committee where it could be discussed more thoroughly, along with Senator Anderson's bill. The co-sponsors indicated that they would not object to having the two bills looked at together.

Allen Bell, President of the Kansas Development Finance Authority (K DFA), spoke to the Committee concerning HB 2909. He stated that the K DFA Board of Directors has not taken a position on this bill, so he is not appearing as a proponent; however he worked with Representative Gjerstad in designing the features of the mechanism of the bill. He said that he believes that it is a workable, financing mechanism. He observed that he has researched it with the investment banking community and that it is the opinion of most people that, given the flexibility that is inherent in the bill, something probably could be worked out in the market place. He noted that the financing mechanism is a loan to lender program. He referred to his written statement, which was provided to the Committee, and noted that there is a flow chart on the third page. (See Attachment II for his statement) This chart gives an idea of how the funds flow in this kind of transaction. Mr. Bell gave the Committee a brief overview of how this flow of funds would work and then referred to and discussed a table on page two of his testimony which shows how interest rates and up-front points might be set. He stated that he sees this program as a taxable, variable rate type of financing.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT,
room 254-E, Statehouse, at 12:45 ~~xxx~~ p.m. on March 30, 1988

He noted that from a rate standpoint, it should be a fairly attractive program, if it can be "pulled off" in the market place.

Mary Ellen Conlee, Kansas Association of Small Business, spoke to the Committee in support of HB 2909. She observed that the majority of the businesses which she represents are subcontract manufacturers for the aerospace, farm machinery, and electronics industries. She noted that there are small companies that are being forced to expand and retool in order to stay in business. They could utilize some kind of program like this or Senator Anderson's, she said. (See Attachment III for her statement.)

The Chairman called the attention of the Committee to a statement from James Maag, Kansas Bankers Association, in support of HB 2909. (Attachment IV) and to a statement from Dennis McKinney, a member of KDFA. (Attachment V) Mr. McKinney expressed his views in his written testimony in support of HB 2909 as his own, and not as those of the KDFA.

Senator Feleciano moved that HB 2909 be amended on pages three and four to refer to Kansas basic industry as it is defined in SB 470. Senator Karr seconded the motion. The motion carried.

Senator Karr moved that HB 2909 be amended on page eight in subsection (2) starting in line 298, to clarify that the transfer referred to is not an obligated transfer from the KDIF to the Kansas basic enterprises loan guarantee fund. Senator Salisbury seconded the motion. The motion carried.

Senator Feleciano moved that HB 2909, as amended, be recommended favorable for passage. Senator Karr seconded the motion. The motion carried.

The meeting was adjourned at 1:30 p.m. by the Chairman.

GUEST LIST

NAME

REPRESENTING

Mary Ellen Conlee
Holly Reardon
Diane Hjertstad
Allen Bell
Ken Gotschiel

Kansas Assoc. for Small Business
Kansas Dept of Commerce

Kansas Dev. Fin Authority
Holly Reardon

STATE OF KANSAS



TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS

MEMBER: ENERGY AND NATURAL RESOURCES
FEDERAL AND STATE AFFAIRS
TAXATION
LEGISLATIVE, JUDICIAL AND
CONGRESSIONAL APPORTIONMENT

KEN GROTEWIEL

REPRESENTATIVE, NINETY-SECOND DISTRICT

1425 W. MURDOCK

WICHITA, KANSAS 67203-3178

(316) 265-2704

March 30, 1988

SENATE ECONOMIC DEVELOPMENT COMMITTEE

TESTIMONY HB 2909

BACKGROUND:

During the development of the state's economic development strategy, we have recognized the need to target our limited resources. The success of our economic development strategy will be measured by our ability to capitalize on our strengths. HB2909 addresses one in particular -- small businesses.

Existing industry is the core of Kansas' economy.... it is always necessary to consider existing industry as the foundation upon which all other development is built (Midwest Research Institute, 1986). Redwood and Krider estimate that two-thirds of Kansas' economic growth in the next decade will likely come from the expansion of existing industry. We are a state of small and medium sized businesses and their expansion will be a major source of growth for the state's economy.

However, a significant gap exists between small business and the capital markets. Redwood/Krider recently surveyed 850 businesses in ten non-metropolitan areas and found that of the businesses who wanted to expand approximately one-half were unable to secure financing through the normal channels. Part of the reason for this problem is the difficult situation currently facing Kansas rural banks.

Attachment I
Senate Eco Devo
3-30-88

MEETING THESE NEEDS:

To address these financing needs, Rep. Gjerstad and I introduced HB2909 which creates a hybrid loan program that combines elements of traditional financing with a loan guarantee program. It is targeted toward existing small businesses.

HB2909 establishes the Kansas basic enterprise loan program overseen by the Kansas Development Finance Authority.

- 1) The loan pool would be capitalized by an initial allocation into basic industry loan guarantee fund from which KDFA will issue bonds. The proceeds from the bond sales will be used by local banks to make loans to basic enterprises. The borrower's loan repayments will be used to service the bonds.
- 2) Banks would be able to use this pool for loans to businesses which have the potential to expand employment and generate new wealth.
- 3) All three parties will share in the risk: borrower not less than 15%, the lender not more than 15%, and the authority not more than 75%.
- 4) The bill is written to allow great flexibility on the part of KDFA to structure a program which is able to meet the needs of business and the bondholders.

SUMMARY:

A fundamental barrier to non-metropolitan economic development is the lack of financial capital at an appropriate risk-return relationship. There is the problem of availability and accessibility and the intensity varies with types of capital and geography. (Job Creation in Non-metropolitan Communities, IPPBR 1987, Redwood). By allowing banks to utilize an additional source of funds from which to make loans, their liquidity problems would be eased and they would be able to service loans they normally would not be able to make.

When examing the need for additional sources of financing for small businesses, you need to ask yourself if this bill adequately answers the following questions.

....will this program efficiently utilize the state's scarce resources?

....will a basic enterprise loan program encourage urban and rural economic development?

....by investing now will this legislation help build long term job generation?

....will the types of businesses this program targets expand the economic base of Kansas?

I feel the answer to all of these questions is yes and that HB2909 is an important plank in the Kansas economic development strategy. I would appreciate your favorable consideration.

BOARD OF DIRECTORS
H. EDWARD FLENTJE, CHAIRMAN
HARLAND E. PRIDDLE
CHRISTOPHER MCKENZIE
DENNIS MCKINNEY
HARRY WIGNER

ALLEN BELL, PRESIDENT



Suite 113
Landon State Office Building
900 S W Jackson
TOPEKA, KANSAS 66612

(913) 296-6747
KANS-A-N 561-6747

MARTY BLOOMQUIST, ASSISTANT

February 25, 1988

M E M O R A N D U M

TO: Members of the House Committee on Economic Development

FROM: Allen Bell, President
Kansas Development Finance Authority

SUBJECT: House Bill No. 2909

House Bill 2909 calls for the implementation of a major economic development financing program by the Kansas Development Finance Authority. Because the KDFAS board of directors has not had a chance to review this bill, I cannot testify as either a proponent or opponent of the bill. I am here at the request of Rep. Gjerstad to try and explain how the program provided for in the bill might work, and to answer any questions you might have. I also have some minor amendments to propose.

The attached flowchart is intended to show in simplified fashion how this type of "loan-to-lender" financing would work. It is modeled after single-family mortgage bond financing with which many of you are no doubt familiar.

There are two key features to this financing structure that deserve your attention:

1. The **Loan Guarantee Fund** is the essential feature in that without it bonds cannot be issued. The guarantee fund provides the needed credit enhancement that negates the diversity-of-credit problem that plagues all private sector pooled bond issues. The guarantee fund can be leveraged through a bond issue to produce a loan pool three or four times the size of the guarantee fund. This leveraging ratio is dependent upon the stability and liquidity of the guarantee fund, and the anticipated default rate in the loan pool.

2. The **Participating Lenders** are the key to making the loan program work administratively. KDFAS is not a bank and does not

want to become one. The basic lending decisions must be made by institutions whose business that is. That is why it is crucial that the participating lenders share the exposure to loan defaults. My opinion is that a 10% matching loan from participating lenders is an absolute minimum and that the bondholders may well require a more significant participation.

One possible drawback to this program is the cost of administering it. As an inherently self-financing operation, it is important that each of the programs it undertakes pays for itself. My preliminary analysis is that K DFA could not expect to make more than \$20,000 on the issuance of bonds under this program. That is not enough to hire an additional staff person to administer it. The participating lenders and the trustee bank enjoy the economies of scale to make their administration of the program feasible.

The following table shows how interest rates and up-front points might be set:

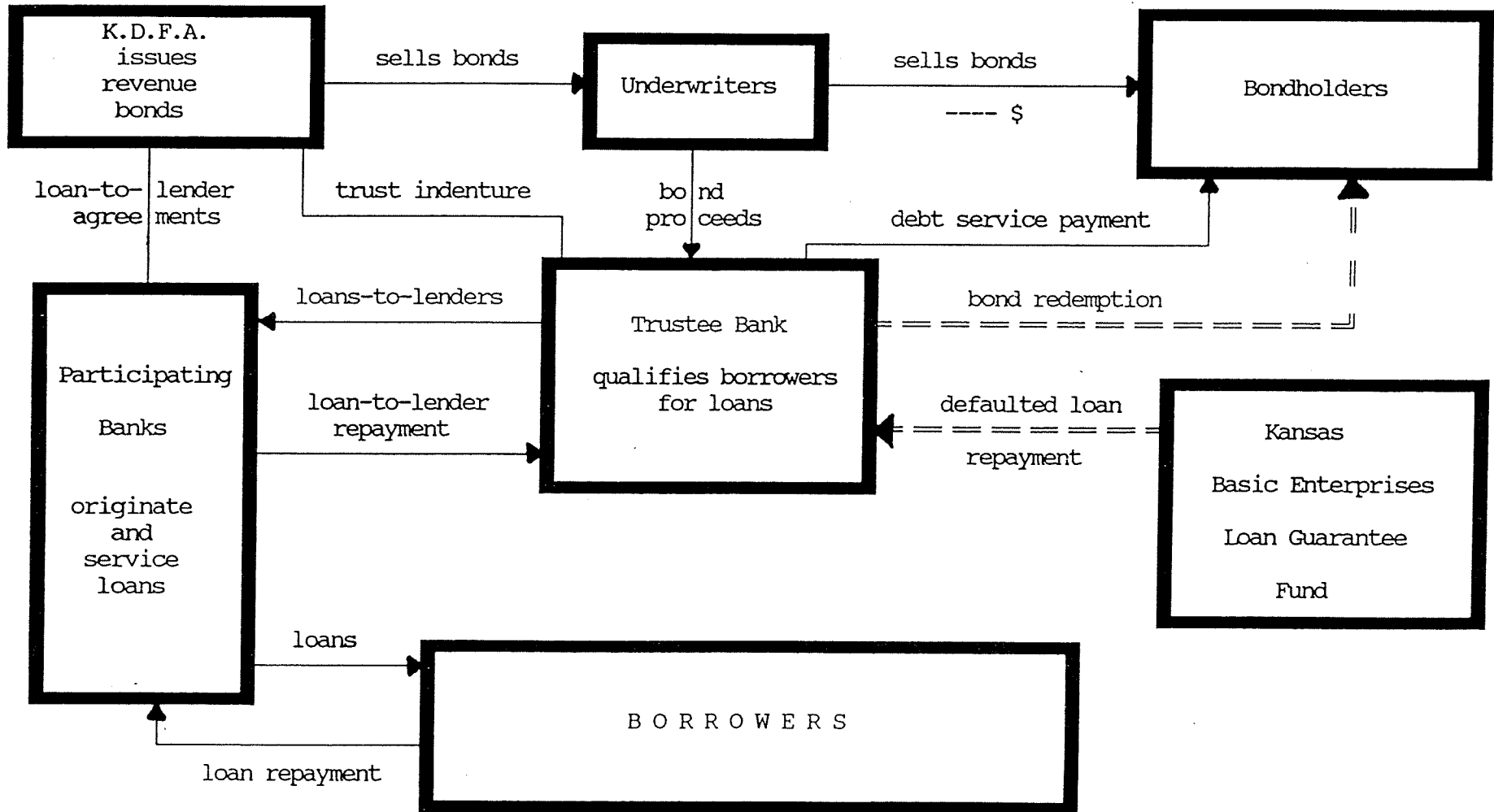
<u>Borrower Rate</u>	
Index Rate (90-day T-Bill)	6.75%
Spread	<u>+1.00%</u>
Bond Rate	7.75%
Trustee Fee	.25%
Lender Service Fee	<u>.50%</u>
Total	8.50%

<u>Points</u>	
Underwriters Discount	1.50%
Cost of Issuance	1.00%
KDFA Fee	<u>.50%</u>
Total	3.00%

To my knowledge, this particular type of loan-to-lender program has never been attempted. I have not had the time to do the type of research and development work that will ultimately be needed to come up with a workable financing model. I do believe, however, that the present bill, with the amendments I have proposed, has the flexibility needed to permit us, with the help of bond counsel and underwriters, to produce a program that works. The only way to find out if a program like this will really work in this state is to try it.

KANSAS BASIC ENTERPRISES LOAN PROGRAM

Preliminary Flow of Funds





TESTIMONY H.B. 2909

SENATE ECONOMIC DEVELOPMENT COMMITTEE

March 30, 1988

Senator Winter, Members of the Committee, I am Mary Ellen Conlee, Executive Director of the Kansas Association for Small Business, an organization of over 100 small businesses. The majority of these businesses are subcontract manufacturers for the aerospace, farm machinery, and electronics industries.

I am testifying today in support of H.B. 2909.

Manufacturing technology is changing. To stay in business even the five to ten person shops must invest in new computerized manufacturing equipment. The cost of change does not stop with the new equipment. Assistance is needed in programming the equipment. Money is needed for training employees, salaries are higher, office computers need to be upgraded.

Larger companies began retooling four or five years ago. The small shops now realize that they must change or go out of business. There are real opportunities for industrial growth in subcontract manufacturing. With strong aviation, farm machinery and electronics manufacturing in Kansas, old jobs will be maintained and new ones will be created if more subcontract work can be done by Kansas firms.

Access to both working and collateralized capital is a problem for some of these small parts manufacturers. The program outlined in H.B. 2909 provides one more source for financial assistance for expansion.

During the past month I've worked with ten businesses that are making their first moves into new high technology equipment. They cannot meet either the low bid or quality demands of prime contractors without changing their manufacturing technology.

While these companies will not move to another state, the work they do will move to the areas of the country where businesses have been able to adapt to new manufacturing technologies. The improved access to capital in the program described in H.B. 2909 will allow more Kansas companies to modernize and keep subcontract work and jobs in Kansas.

Thank you. I'd be happy to answer any questions.



The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

March 30, 1988

TO: Senate Committee on Economic Development

FROM: James S. Maag, Director of Research
Kansas Bankers Association

RE: HB 2909 - The Kansas Basic Enterprises Loan Program

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to present written testimony on HB 2909 which would create the Kansas basic enterprises loan program. The banking industry of Kansas believes this could be a valuable addition to the various means of extending credit to small businesses in the state.

The economic development package created by the 1986 Legislature is now beginning to show results in Kansas. The work of Kansas, Inc., Kansas Venture Capital, Inc., KTEC, the Small Business Development Centers and the Certified Development Companies throughout the state has created a much more positive economic atmosphere. As these various entities pursue their goals, it is apparent that some additions to the economic development plan may be necessary and one of those additions is addressed with HB 2909.

This measure is designed to assist those businesses which may otherwise "fall through the cracks" in obtaining the necessary credit with which to continue operations. The loan program is structured in such a way as to allow the state to have a maximum impact on credit availability at a minimum of risk. Particularly for developing businesses in the more rural communities, the loan program would provide a very valuable credit source. We have every reason to believe that a significant number of banks would participate in the program if it is authorized.

Your favorable consideration of HB 2909 would be greatly appreciated.

TESTIMONY

ECONOMIC DEVELOPMENT COMMITTEE

ON HOUSE BILL 2909

Thank you for the opportunity to speak to you today on House Bill 2909. My name is Dennis McKinney and I am a farmer and livestock producer from Greensburg. Our farm is located on the Comanche and Kiowa County line.

I am also a member of the Kansas Development Finance Authority. However, my views here today are my own and not of KDFA.

Four primary thoughts underlie my support for the basic enterprise loan and loan guarantee fund proposed in HB 2909.

First, the money appropriated for loan guarantees would leverage loan financing and thereby maximize the policy impact. If \$1,000,000 in guarantees facilitates \$4,000,000 in loans the impact of the development policy is multiplied by a factor of four.

Furthermore, placing monies in a guarantee fund rather than direct spending allows the state to earn additional idle funds interest and use the idle funds for certificates of indebtedness in case the State General Fund encounters a revenue shortfall. Thus, internal financial flexibility is maximized.

Second, the combination loan and loan guarantee approach creates an extra source of capital financing to higher risk new businesses at lower risk interest rates. With the combination of 10% owner equity, 10% bank participation and the state guarantee the bonds issued by the Kansas Development Finance Authority should achieve a high quality credit rating and relatively low interest rates.

Requiring 10% bank participation encourages good review of loan applications and good servicing and monitoring of loans in place.

A third and very important reason for the loan program is that it could stimulate bank liquidity. Areas under economic pressure often have banks with tight liquidity and little available lending capacity. The HB 2909 proposal provides a source of funds that permits a bank to seek and assist viable new business ventures.

Finally, the program could stimulate more operating loans to new businesses. A new business which has a good source of long term capital financing in place becomes a better credit risk. Hence, the business is more able to secure short term credit to finance its payroll, inventory, and other operating needs.

I like to parallel the creation of a program which facilitates capital financing to the creating of Federal Land Banks. Farmers were given access to long term credit markets

reasonable interest rates which allowed them to purchase land and make major improvements to the land. Once these farms were in place or expanded they became a tremendous source of business for banks making operating loans. Most banks are not set up to make many long term capital loans, especially when the applicants propose new business ventures of unknown credit risk.

In conclusion, programs which promote capital financing also facilitate short term lending and can therefore provide a strong impetus for new business development. In addition, a loan guarantee fund would multiply the effects of development policy beyond the actual appropriation.