

Approved 3-14-89
Date

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

The meeting was called to order by Senator Dave Kerr at
Chairperson

8:00 a.m./p.m. on March 7, 1989 in room 123-S of the Capitol.

All members were present except:

Senator Lana Oleen, Excused
Senator Wint Winter

Committee staff present:

Bill Edds, Revisor of Statutes' Office
Lynne Holt, Kans Leg Research Dept
Carol de la Torre, Secretary to the Committee

Conferees appearing before the committee:

Lynne Holt, Kansas Legislative Research
Charles Warren, Kansas, Inc.
Chuck Krider, Inst. for Public Policy and Research, K.U.
Jeff Rockett, Kansas Asso. for Small Business

The meeting was called to order by Senator Dave Kerr, Chairman.

Lynne Holt, Kansas Legislative Research, briefed the Committee on House Bill 2020. (See supplemental note on HB2020, Attachment 1)

House Bill 2020 - an act concerning economic development; establishing the Kansas basic enterprises loan program; authorizing issuance of certain bonds for financing of loans thereunder; prescribing powers, duties and function for the Kansas development finance authority; amending K.S.A. 1988 Supp. 74-8902 and 748905 and repealing the existing sections.

Lynne also referred the Committee to testimony received from Allen Bell, President, Kansas Development Finance Authority, concerning this bill. His written testimony is found in Attachment 2. The two key features he felt deserved attention were the Loan Guarantee Fund which is the essential feature of the program, without it bonds cannot be issued, and the participating lenders, who are the key to making the loan program work administratively.

The next conferee was Charles R. Warren, President, Kansas, Inc. He felt that the program in HB2020 would be very useful

CONTINUATION SHEET

MINUTES OF THE _____ COMMITTEE ON _____,
room _____, Statehouse, at _____ a.m./p.m. on _____, 19____.

in providing small businesses the necessary working capital to finance expansion and growth. (Attachment 3). Mr. Warren stated that the Board of Directors of Kansas, Inc. endorses HB2020 and urges its enactment.

Senator Steineger questioned on the 15% participation of the originating banks, who would have first call on the collateral? The Chairman stated that the Committee staff needed to get an answer. Later in the meeting, staff pointed out that line 266 of the bill states that the participating bank is providing a subordinated loan.

Charles Krider, Professor of Business, University of Kansas, was the next conferee. His testimony is found in Attachment 4. He stated that HB2020 provides for direct loans from the state for Kansas Basic Enterprises. He stated that he supported this program, aimed at the financing of such small businesses, but believed that consideration should be given instead to a loan guarantee. The research their institute has done indicates loan guarantees are very cost effective.

Senator Karr questioned whether HB2020 overlapped SB21, the export finance bill. Dr. Krider stated that he did not see a duplication.

The last conferee was Jeff Rockett, Kansas Association for Small Business. He testified in support of HB2020 (Attachment 5). He stated the program outlined in HB2020 would provide a source for financial assistance for firms where more traditional forms of financing are unavailable. Small businesses would find the Kansas basic enterprise loan program a viable alternative and a welcome addition.

Minutes of the March 1, and 2, 1989, meetings were reviewed. It was moved by Senator Francisco and seconded by Senator Karr that the minutes be approved. Motion carried, minutes approved.

There being no further business, the meeting was adjourned.

SESSION OF 1989

SUPPLEMENTAL NOTE ON HOUSE BILL NO. 2020

As Amended by House Committee on
Economic Development

Brief*

H.B. 2020, as amended, authorizes the Kansas Development Finance Authority to develop and implement the Kansas Basic Enterprises Loan Program and issue bonds to finance program loans. The Authority is authorized to enter into agreements with financial institutions which are to qualify, originate program loans, and service the loans. A participating financial institution acts as an agent for the Authority and receives a fee for its services. The minimum amount of the loan is \$20,000 and the maximum amount is \$200,000. Each loan has to be matched by a subordinated loan from a participating financial institution, in an amount of not less than 15 percent of the amount of the program loan. The loan recipient would contribute equity capital equaling at least 10 percent.

The businesses eligible for a loan must meet the definition of "Kansas basic enterprise," specified in the bill. In addition, a business must have had gross revenues in its most recently completed year of not more than \$1.5 million and must be ineligible for a loan or loan guaranty from the U.S. Small Business Administration or the Farmers Home Administration, other than as part of a packaged loan arrangement from one or both of the federal agencies, for the same project for which an application has been made under the program in this bill. The bill specifies the purposes, one of which is working capital, for which program loans may be made.

A loan guarantee fund would be created in the state treasury. Moneys credited to the fund would be used for purposes of pledging security for bonds issued to finance program loans. All expenditures from this fund would be subject to appropriations.

* Supplemental Notes are prepared by the Legislative Research Department and do not express legislative intent.

Sen Eric Alvo
3-7-89
Attachment 1

Background

H.B. 2020 was recommended for introduction by the 1988 Joint Committee on Economic Development. A bill containing similar provisions to H.B. 2020 was enacted by the 1988 Legislature but was vetoed. Proponents of the bill included representatives from the Institute of Public Policy and Business Research, the University of Kansas and the Kansas Association for Small Business, in addition to the President of the Kansas Development Finance Authority.

The Kansas, Inc. Board of Directors recommended the establishment of a small business loan program and appropriation of \$1 million to a loan guarantee fund. The Governor's FY 1990 budget contains no funding for the program.

In addition to a technical amendment, the House Committee amended the bill to include refinancing of facilities as an authorized purpose for program loans. A third amendment requires the Authority to prescribe monitoring and reporting requirements for participating financial institutions regarding all program loans.

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

ALLEN BELL, PRESIDENT



Suite 100
Capitol Tower
400 S.W. 8th
Topeka, KS 66603

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

MARTY BLOOMQUIST, ASSISTANT

March 6, 1989

M E M O R A N D U M

TO: Members of the Senate Committee on
Economic Development

FROM: Allen Bell, President
Kansas Development Finance Authority

SUBJECT: Testimony in Support of House Bill 2020

House Bill 2020 calls for the implementation of a major economic development financing program by the Kansas Development Finance Authority. In fact, KDFa was created by the 1987 Legislature for just this purpose. We therefore support the general concept of HB 2020.

We believe that the bill would be improved if the definition of Kansas basic enterprises was amended so that any private sector job creating enterprise could qualify. It would then be left up to the KDFa Board of Directors to determine a criteria for the type of businesses that could participate in the program. This flexibility is needed to insure the success of the program. We believe that a minimum volume of loans is needed for this program to succeed. With a narrow definition of the types of businesses that can participate, we may not be able to generate enough loan volume.

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. Bonds are issued by KDFa and the net proceeds are lent to participating lenders who in turn lend the proceeds, along with their own funds, to qualified borrowers. The cashflow resulting from repayment of the loans is passed through to a trustee bank and then paid to the bondholders.

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

Sen Eco Devs
3-7-89
Attachment 2

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 up to two or three times the size of the guarantee fund. The loan guarantee fund must contain at least one million dollars in order to attract bond underwriters to the program with at least a two million dollar bond issue.

2. **The Participating Lenders** are the key to making the loan program work administratively. KDFA 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.

The cost of administering this program is another reason to use participating lenders. As an inherently self-financing operation, it is important to KDFA that each of the programs it undertakes pays for itself. KDFA could not expect to earn more than \$15,000 on the issuance of bonds under this program, which 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.

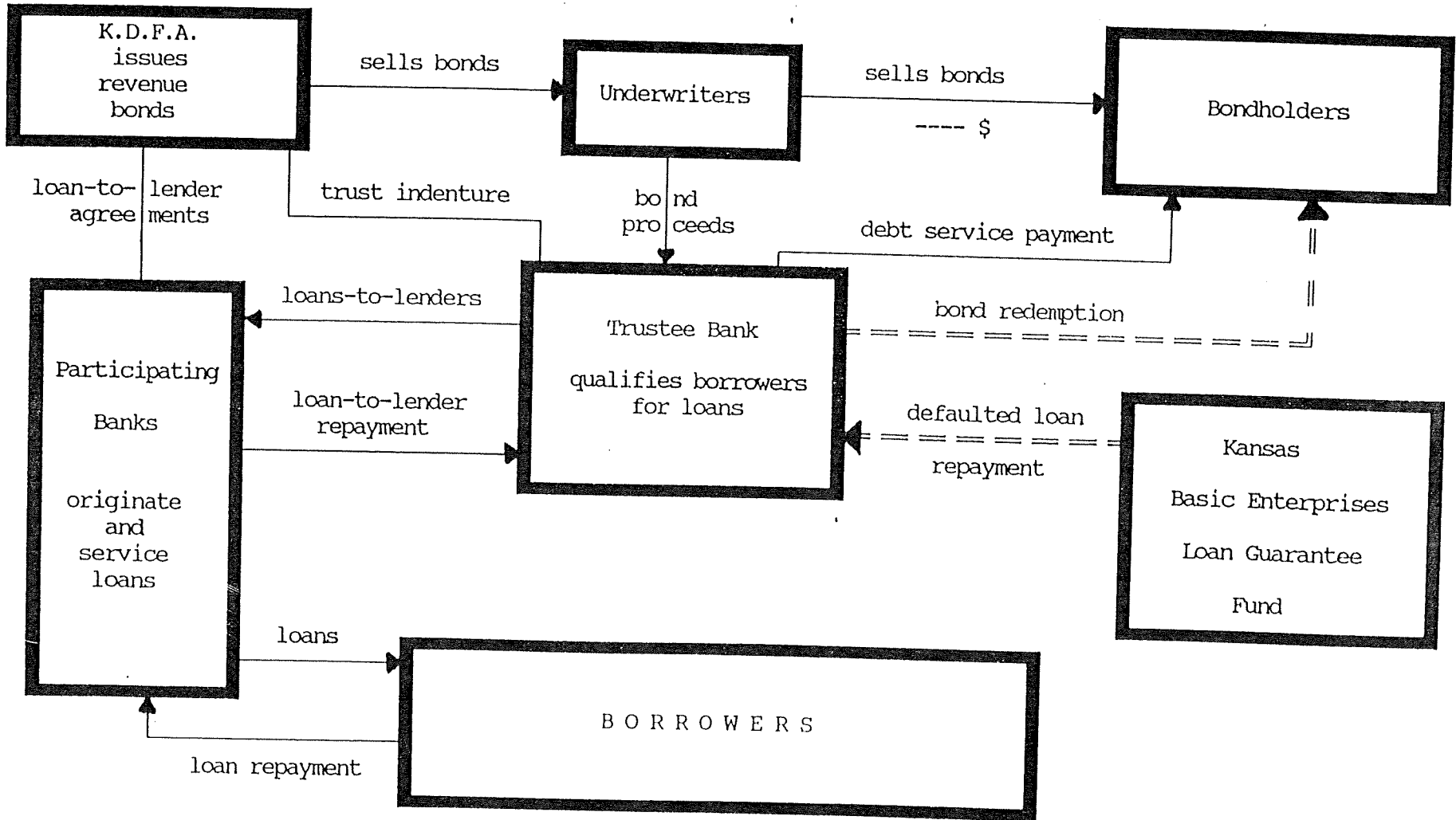
The following table shows how interest rates and up-front points might be set:

<u>Borrower Rate</u>	
Index Rate (90-day T-Bill)	8.00%
Spread	+1.00%
Bond Rate	9.00%
Trustee Fee	.25%
Lender Service Fee	.50%
Total	9.75%

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

KANSAS BASIC ENTERPRISES LOAN PROGRAM

Preliminary Flow of Funds



Testimony before the Senate Economic Development Committee
H.B. 2020 - Small Business Loan Fund

by

Charles R. Warren
President
Kansas, Inc.

March 7, 1989

Sen Leo - Devo
3-7-89
Attachment 3

Thank you Mr. Chairman and committee members, for giving me an opportunity to speak to you on H.B. 2020 - the Small Business Loan Guarantee Fund.

I believe that the program provided for in H.B. 2020 is an important economic development tool which should be strongly supported by your committee. Kansas, Inc.'s Board of Directors voiced its solid support for such a loan guarantee program by passing a proposal at its January 12 meeting which urged the Legislature to establish a "Small Business Loan Fund" and provide \$1,000,000 in initial funding. As you know a similar bill was enacted by the the 1988 Legislature but vetoed by the Governor because it was incorporated into S.B. 470, the Basic Industry Act. The Governor's veto message indicated that he was not opposed to the small business loan fund and encouraged the Legislature to re-establish it. The House has given this bill its strongest support, adopting it unanimously by a vote of 123 to 0.

We believe that the program in H.B. 2020 can be very useful in providing small businesses the necessary working capital to finance expansion and growth. In our recently completed study on capital availability and the Kansas banking industry, it was found that the commercial loan-to-deposit ratio at the end of 1987 in Kansas was 17.4%, significantly below the national average of 25.4%. This indicates that, for possibly various reasons, businesses are not able to borrow the capital necessary to their continued growth. This program would provide small businesses throughout the state a new source of capital; a

source specifically designed to assist the unique financing needs of small, stable companies. Unlike larger companies which have a stronger borrowing capacity, small firms desiring to expand may find it difficult to acquire the capital they need. This program would be able to provide funds directly to those types of firms.

H.B. 2020 is well designed. It does not duplicate the Small Business Administration programs, but can be used in conjunction as part of packaged loan arrangement. These loans are not high risk, because of the provision that they be matched by a subordinated loan in an amount of not less than 15 percent of the program loan. These loans in effect must be "bankable" deals.

I believe there will be substantial demand. You may hear testimony that the requirement that eligibility be restricted to basic enterprises will lessen demand. If you study the definition within the bill, you will see that only retail firms and professional services delivered locally, such as doctors, lawyers, chiropractors, etc. are excluded. The bill is directed toward those small firms we most want to assist.

One million dollars is needed to establish a loan guaranty fund in the state treasury. This should be financed from the Economic Development Initiatives Fund. It is precisely this type of program for which EDIF was established. It is a new initiative, and a non-recurring expenditure. If managed properly, the \$1 million loan guaranty fund should be intact for several years.

For these reasons, The Board of Directors of Kansas, Inc. endorses H.B. 2020 and urges its enactment.

TESTIMONY ON HOUSE BILL 2020:
SMALL BUSINESS LOAN PROGRAM

Presented to

The Senate Committee on Economic Development

Presented by

Charles Krider
Professor of Business,
University of Kansas
and

Director of Business Research,
Institute for Public Policy and Business Research
February 9, 1989

For further information contact:

Roger P. Nelson
Research Assistant, IPPBR
607 Blake Hall, Univ. of Kansas
66045 (913) 864-3701

Sen Cr - News
3-7-89
Attachment 4

The Small Business Finance Problem

Past research by the Institute for Public Policy and Business Research has identified the lack of financing as an important factor limiting the formation and expansion capabilities of Kansas small businesses. The 1986 Kansas Economic Development Study conducted by IPPBR included a number of recommendations regarding financing for small businesses. The state legislature has addressed the problem through support of venture and seed capital programs. What has not yet been addressed is the financial need of those small businesses which do not need specific venture or seed capital, but simply require financing for continuing or expanding their existing operations.

Recommendation 23 of the Redwood/Krider report is to establish a loan guarantee program to facilitate financing of new or expanding businesses in primary (basic) industries. HB 2020 would accomplish the same goal, "to provide access capital for basic job-creating manufacturing, research and development, or other special enterprises when either adequate financing is not available, or financing terms are prohibitive."

Other states have acted on this problem, through implementation of a variety of financing programs, such as the Connecticut Development Authority, which includes a number of different programs targeted at different regions and business types within the state. The CDA provides for both direct loans

and loan guarantees with its programs. Maine has a very active Loan Insurance Program, insuring over \$5,000,000 worth of lending activity in FY 1987.

Eligible Kansas Basic Enterprise

I support the definition of basic enterprise as included in the bill, as it would target state financial assistance to Kansas small businesses that are engaged in export-related activities, and thus bring in wealth from outside the state. I also believe that the restriction to those businesses who either could not qualify for SBA financing at all, or were not approved by the SBA for an amount sufficient for their needs, is a positive point. Through this provision, the state program would act as a supplement to federal financing, by:

1. providing assistance where no federal funding is available; or
2. providing financing as part of a package with financing from the SBA and other sources to bring the amount of financing up to the required sum.

Bank / Business Participation

I also believe that the provision requiring participation by banks for 15% of the loan amount is also a good component. Making the loan part of their own personal interest will help to ensure objective and honest evaluation of the prospective loan recipient, and local banks would also have much greater knowledge

of the performance, structure, and other characteristics of the business than would the state. The 10% matching requirement for the business itself is also a positive aspect of the program as outlined in the bill.

Loans or Loan Guarantees?

As I have stated in prior testimony related to both a small business loan program and the proposed export finance program, I support the implementation of a loan program based on guarantees. The major advantages of guarantees are that they provide a greater degree of leverage for a limited pool of funds, thus allowing for a greater amount of assistance and economic stimulation. Also, other states have been successful with loan guarantee programs, and have found that they carry relatively low risk for the state. Guarantees overall are more cost effective than direct loans. A 1986 report prepared for the state by ASLAN strongly recommended that Kansas consider a loan guarantee program, based on their findings that:

"Loan guarantees are highly cost-effective. They are an excellent tool for leveraging private investment resources. Well managed programs require only initial capitalization and become self-sustaining thereafter."
(ASLAN, sec. 1-7, March 1986)

Direct Loan Alternative

One issue that has been raised in reference to this proposed program is that of whether smaller banks actually have sufficient depository funds to grant loans to eligible businesses, even with

a guarantee from the state. This is an important point, and although I am in favor of a guarantee-based program in general, I believe that the flexibility of a program able to make direct loans under those particular circumstances could be the best alternative available. This would allow banks of any size to take part in the program, despite limitations on available capital.

Conclusion

House Bill 2020 provides for direct loans from the state for Kansas Basic Enterprises. I am in support of this program aimed at the financing of such small businesses, but I believe that consideration should be given to adding loan guarantee authority to this program. This would allow the Finance Authority to offer either direct loans or guarantees as appropriate.



TESTIMONY H.B. 2020

HOUSE ECONOMIC DEVELOPMENT COMMITTEE

MARCH 7, 1989

Chairman Kerr, Members of the Committee, I am Jeff Rockett, representing the Kansas Association for Small Business, an organization of over 150 small businesses. The majority of these businesses are subcontract manufacturers for the aerospace, farm machinery, and electronics industries, thus coming under the definition of basic industries as defined in H.B. 2020.

I am testifying today in support of H.B. 2020.

Manufacturing technology is changing. To stay in business, even 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 five to six 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. Strong aviation, farm machinery and electronics manufacturing in Kansas will maintain the existing jobs and new ones will be created if more subcontract work can be done by Kansas firms.

*Sen Eco - Alvo
3-7-89
Attachment 5*

Access to both working and collateralized capital is a problem for some of these parts manufacturers. The program outlined in H.B. 2020 provides a source for financial assistance for firms where more traditional forms of financing are unavailable. Small businesses would find the Kansas basic enterprise loan program a viable alternative and a welcome addition.

During the past year, the Kansas Association for Small Business has worked with 30 businesses that are making their first moves into high technology equipment. They cannot meet either the low bid or quality demands of prime contractors without changing their manufacturing technology.

While these companies may not move to another state, the subcontractors they have been given could. The prime contractors could award these subcontracts to companies in other 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. 2020 will allow more Kansas companies to modernize, keeping subcontract work and jobs in Kansas.

Thank you for your attention. I will try to answer any questions you might have.