

Approved 2-6-90  
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 January 31, 1990 in room 123-S of the Capitol.

All members were present except:

Senator Alicia Salisbury  
Senator Jack Steineger

Committee staff present:

Bill Edds, Revisor of Statutes' Office  
Lynne Holt, Kans. Leg. Research Dept.  
Sue Pettet, Secretary to the Committee

Conferees appearing before the committee:

Mr. Jack Alumbaugh, Director of South-Central Kansas Economic Development District on Business & Industry Development Co. (BIDCOS)  
Chairman Kerr called the meeting to order. Senator McClure made a motion to accept the minutes of the January 30, 1990 meeting as corrected. Senator Francisco seconded. Motion carried.

Chairman Kerr introduced Mr. Jack Alumbaugh, who supplied the committee with Att. 1. He explained that BIDCOS is a strategic program for financing industrial development projects in rural Kansas.

BIDCOS would assume the bank's liability on government-guaranteed loans. Only loans referred by Kansas banks would be processed.

The BIDCO concept would provide an entity that could make available to Kansas business and industry a source for moderate risk loans that is not presently available. It is a source of financing for projects of generally less than \$500,000 that cannot be accommodated by banks and are not appealing to venture capital companies. The BIDCO would work with the banking community to provide a service banks do not presently have access to.

Because of the BIDCO's interest in generation of income for its investors and net worth for itself, it would not be interested in participating in making loans to basic enterprises, except through referrals from Kansas banks as outlined.

Private investors will be asked to contribute \$2,000,000 to the fund. The program is also reliant upon a \$4,000,000 low interest (4%) loan from the State of Kansas, bringing the total fund to \$6,000,000 initially.

Mr. Alumbaugh reported that other states have had failed BIDCOS because of under capitalized funds to start the program, sometimes \$2,000,000 or less. Other reasons for failure are lack of staff and lack of focus. He felt that Kansas is on target in these areas.

Senator Francisco made a motion that the committee introduce the bill as requested concerning BIDCOS. Senator Oleen seconded. Motion carried.

Meeting adjourned.



## BIDCO/Kansas

- A strategic program for financing industrial development projects in rural Kansas, especially the rural areas
- Assumes the bank's liability on government-guaranteed loans
- Would only package and process loans referred by Kansas banks
- Offer first right of refusal to bank who referred the loan with the following conditions:
  1. 2% commission (refunded if loan prepaid in first year)
  2. Loan at New York prime annually adjusted, accepted by BIDCO from bank of reference for guaranteed portion of loan
  3. BIDCO packages, processes and services loan for life of loan and accepts all risks
- BIDCO would be capitalized a minimum of \$6 MM
- BIDCO would complete 20 to 40 projects annually
- \$6 MM annually would consume less than 10% of Kansas SBA-guaranteed investments

Proposal for  
FORMATION OF KANSAS STRATEGIC FUNDS, INC.

A BIDCO in Kansas

January 22, 1988/Updated: March 17, 1988; August 30, 1988  
November 2, 1989

**1. EXECUTIVE SUMMARY**

The BIDCO concept would provide an entity that could make available to Kansas business and industry a source for moderate risk loans that is not presently available. The specific target for the majority of the funds from this concept would be primary industries as defined by the State. This product is a source of financing for projects of generally less than \$500,000 that can not be accommodated by banks and are not appealing to venture capital companies. The BIDCO, through its professional staff, would select certain projects that have strong "vital signs" to offset elements of moderate risk associated with them, and invest in them utilizing SBA guarantees or other federal guarantees to reduce the significant risk associated with each investment. The BIDCO would utilize the secondary market as a means of increasing the income from the initial investments. The BIDCO would be reliant on the banks, the CDC's and other developers in the state as a marketing source and a preliminary packaging resource. The BIDCO would work with the banking community to provide a service banks do not presently have access to; that being exclusive entry to the **non-bank lender**.

As required protection for the investor and the government loan guarantee sources, the BIDCO would be regulated by a State Examiner. Enabling legislation will be required authorizing the BIDCO and establishing the examiner. This legislation would be solicited when an investor is committed. State investment tax incentives would be requested to be a part of the legislation.

Because of the BIDCO's interest in the generation of income for its investor(s) and net worth for itself, it would not be interested in participating in making loans to basic enterprises, except through referral from a Kansas Bank as is outlined in this proposal. Furthermore, BIDCOs would look to the Kansas banking community as a primary source for placement of the guaranteed portion of any loans and provide an exclusive first offering to the bank that made the referral on a guaranteed BIDCO investment project. Private investors will be asked to contribute \$2,000,000 to the fund. The BIDCO proposes to provide an average annual return estimated to be in excess of 16% to its fund investors. This program is also reliant upon a \$4,000,000 low interest (4%) loan from the State of Kansas bringing the total fund to \$6,000,000 initially. The private investor(s) would guarantee repayment of the State's investment.

## 2. ORIENTATION AND BACKGROUND

Over the past several years, leadership in the public and private sectors has come to agree that economic development is reliant upon an adequate range of financial and investment products available to underwrite projects of business and industry in Kansas. Recent efforts by the Kansas Legislature and the Governor's Office have resulted in the State's developing incentives to encourage and accommodate creation of risk capital programs in the private sector, which would invest into intermediate risk projects of business and industry in Kansas.

Kansas business and industry should have every opportunity to work with their lender prior to or in association with bringing on equity investors.

The creation of a state wide BIDCO entitled Kansas Strategic Funds is proposed. It will focus on offering Kansas business and industry access to a moderate risk lender if their bank provides a reference. Kansas strategic Funds would offer a special resource for accessing government guarantee programs on behalf of all Kansas banks.

### 3. DESCRIPTION OF A BIDCO

Other states have identified lack of moderate and high risk capital as issues in their states as well. One product that other states; for example California, Michigan, Washington, Oregon and others; are looking into and, in fact, have some experience with is the concept of a "BIDCO", described as "Business and Industry Development Companies". These organizations are created in the private sector, monitored by the state and through annual public audits. A BIDCO's primary initiative is, like any bank, to make money. However, BIDCO's do function in different ways than those in which Kansas banks presently are allowed to operate. A BIDCO, for example, is allowed to make loans which are not fully secured by collateral. BIDCO's are also allowed to negotiate for equity "kickers" in the deal. In addition, BIDCO's are allowed to have a measure of involvement in the management of the companies into which they are investing.

BIDCO's provide a financial product for a market which has yet to be addressed in Kansas by Kansas finance and equity products in the public and private sectors. Through their flexibility, BIDCO's are able to invest into business and industry projects ranging from \$50,000 to \$500,000, though there are no restrictions should they invest into smaller or larger projects. They are allowed more flexibility in regard to investing into projects than are allowed through certain restrictions of the Small Business Administration (SBA). BIDCO's do not ordinarily engage in projects with the risk factor of venture capital company projects. Also, venture capital companies have stated that they are interested in investing into projects requiring \$500,000 or more equity injection. Venture capital companies look for a minimum return on investment or 40%. BIDCO's, however, can look for a return on investment in the 10% to 25% range and still be feasible. Therefore, BIDCO's really fill an important gap between bank financing and venture capital financing. In addition, BIDCO's may be more closely associated with the wishes of the Legislature and the local economic developers than are venture capital companies.



#### 4. THE MARKET AND ITS PENETRATION

##### 1. THE MARKET

We have a situation in Kansas, where a BIDCO could be implemented in very short order. Because of the constraints on the Kansas banking industry, the time is right; and because there is an absence of any State wide product for moderate risk lending available in Kansas, the market is right. In recent years the state has been establishing Certified Development Companies (CDC's), so a promotion and screening system has already been established through not only CDC's but banks, chambers of commerce, Kansas Department of Commerce field offices, Small Business Development Centers and other organizations brought into being in recent years. The Wichita SBA District office which services 77 of 105 Kansas Counties approved \$41,000,000 in loan guarantees last year. CDC's estimate that an additional 15-20% of potential projects are not considered by SBA because no participating bank can be found. The CDC's also identify numerous inquires from banks seeking guarantees for existing loans but not wanting to transfer the account to a competing bank. At the present time rural banks are lending well under capacity. Simple inquiries reveal that many banks would be willing, if not anxious, to purchase guaranteed loans at a 2-3% commission at prime rate. However these same banks are unwilling to accept the 10-20% risk associated with an SBA guaranteed loan not to mention the administrative burden of transacting and servicing the guarantee.

##### 2. MARKET PENETRATION

In addition to prime market availability, there are certain marketing aspects which make the concept of a BIDCO very attractive.

The BIDCO would have as its marketers the CDC's, banks and other economic development companies throughout the state. Banks and CDC's are accustomed to working with borrowers to develop the financial information from which investments can be made. Also, CDC's are equipped to operate from a perspective of public service to business and industry to develop financial packets for evaluation. In many instances CDC's and banks are not able to accommodate the requests but have no after markets for this project. We perceive the BIDCO would be a good product for SBA and other federal loan program guarantees in



**4. THE MARKET AND ITS PENETRATION (Continued)****2. MARKET PENETRATION (Continued)**

which banks are not willing to accept the 10% to 20% risk involved with these products. We perceive for projects that go beyond the loan limits of the banks the BIDCO could be used in a creative way.

At the option of the investor but not included in this proposal, we perceive that the BIDCO could be used as a source of first position financing on SBA 504 programs in connection with the CDC's. There appears to be a great market for loan guarantees for operating capital and other feasible uses of loans of \$50,000 or less. At the same time, while SBA loan guarantees are available to banks on these smaller loans, the hassle and paperwork involved with filing applications and going through closing procedures and servicing do not always make them realistic to pursue from the bank's or small business' perspective. The BIDCO could function as a direct lender in many instances but in this proposal we are using a strategy of securing government guarantees of the funds loans. This strategy neutralizes 2 potential risks. One, government guarantees provide a source of collateral to shore up that offered by the borrower. Two, the government agency which guarantees the loan also provides a service by underwriting and servicing the loan along with the BIDCO staff.

At the present time the CDC's have 13 offices located in Kansas. These 13 offices serve each of the 105 counties in the state. The combined efforts of the CDC's the past year amounted to over \$51 million of finance packages for business and industry in our state. If the BIDCO only achieved 12% productivity of the CDC's it would fulfill its projection of investment. The CDC's, through their state association, can vouch for the need for such a product and we would ask their cooperation and involvement in the creation of a BIDCO initially relying on SCKEDD and Great Plains. The banking community in Kansas would be the primary source for prospects as well as other regulated lenders. Chambers of commerce, local development and regional development organizations would also be solicited for referrals on projects to the BIDCO. The banks would be looked to exclusively for referrals on SBA 7A projects and would be accepted only from the Kansas banking community. The bank making the referral on

4. THE MARKET AND ITS PENETRATION (Continued)

2. MARKET PENETRATION (Continued)

the project would have the exclusive first access to the guaranteed portion of the investment in the secondary market at prime rate adjusted quarterly.

CDC's would be most helpful and provide a very good evaluation and packaging network and provide a key resource to identify potential projects as well as screen out those projects that are not suitable for consideration within the investment strategy of the BIDCO. This is also true for the Kansas banking community, particularly banks in rural areas.

**5. FORMULATION**

What is needed to form a BIDCO are principally four parts: capital; staff with the capability to evaluate and manage projects; a loan committee to that would make the actual loan decision; and, appropriate legislation to allow a BIDCO to be formed and monitored in the State of Kansas.

The capital to be obtained is initially \$6,000,000. Private investors will contribute \$2,000,000 and the State will provide \$4,000,000 in the form of a low interest loan. The interest rate is projected to be 4%. This loan would be paid off once each year and secured by a guarantee from the investors and the loan portfolio which will be no less than 75% government guaranteed.

The loan committee would be comprised of the 5 principles of the BIDCO, a Kansas banker selected from the KBA membership, and representative selected from the investor group. The 4 members of the BIDCO are Jack Alumbaugh, Jack Harris, Ron Nicholas and Bob Healy.

Draft legislation is available from the state of Washington. This draft has been discussed with legislative leadership. Staff would be provided through administrative contracts with SCKEDD and Great Plains.

November 3, 1989

KANSAS STRATEGIC FUNDS, INC.

## 6. PROFITABILITY

The profitability of the BIDCO can be looked at in two ways: profitability to the investors; and the profitability to the BIDCO operation.

The concept of the BIDCO is to assume moderate risk, but not high risk, in placing investments in Kansas business and industry. We suggest the BIDCO invest \$6 million in the first year in 75% to 90% loan guarantees that are currently offered through the SBA, FmHA, and on larger projects, the EDA.

Through a means of developing these projects on the secondary market with a spread for servicing loans, etc., we project the BIDCO would offer a return on investment averaging approximately 6% to 8% over prime rate over 10 years. The BIDCO plans to finance 315 projects averaging \$200,000 over its 10 years of projected operations. These investments would yield approximately 2,000 jobs for Kansas over the 10 year period.

KANSAS STRATEGIC FUNDS, INC.

PRO FORMA

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	1st Year	2nd Year	3rd Year	4th Year	5th Year	6th Year	7th Year	8th Year	9th Year	10th Year	TOTAL
PRIVATE INVESTMENT	\$2,000,000										
STATE INVESTMENT	\$4,000,000										
TOTAL INVESTMENT	\$6,000,000										
REINVESTMENT		\$310,000	\$649,006	\$868,436	\$1,097,850	\$1,343,992	\$1,614,406	\$1,916,134	\$2,175,935	\$2,390,049	
RECAPTURE OF SEC. SALE		\$5,100,000	\$4,598,500	\$4,460,380	\$4,529,494	\$4,783,242	\$5,208,149	\$5,799,171	\$6,558,009	\$7,423,853	
% STATE INV. GUARANTEED	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	
% PRIVATE INV. GUARANTEED	55%	130%	123%	126%	139%	160%	190%	228%	271%	317%	
UTILIZATION											
GOVT GUARANTEED PORTFOLIO											
Liquid Investment (8%)	\$240,000										
Annual Amount Loaned	\$6,000,000	\$5,410,000	\$5,247,506	\$5,328,816	\$5,627,343	\$6,127,234	\$6,822,554	\$7,715,305	\$8,733,944	\$9,813,901	\$60,826,604
Guaranteed Portion	\$5,100,000	\$4,598,500	\$4,460,380	\$4,529,494	\$4,783,242	\$5,208,149	\$5,799,171	\$6,558,009	\$7,423,853	\$8,341,816	
Interest on Loaned Funds (12%)	\$306,000	\$551,820	\$535,246	\$543,539	\$573,989	\$624,978	\$695,901	\$786,961	\$890,862	\$1,001,018	
Recap. from secondary sale (2%)									\$60,399	\$108,994	
First Year/Ninth Year	N/A										
Second Year/Tenth Year		\$46,971	\$84,762	\$74,562	\$62,934	\$49,878	\$35,190	\$18,666	\$9,180	\$68,374	
Third Year			\$42,352	\$76,427	\$67,230	\$56,745	\$44,973	\$31,730	\$16,831	\$8,277	
Fourth Year				\$41,080	\$74,132	\$65,211	\$55,041	\$43,623	\$30,777	\$16,325	
Fifth Year					\$41,717	\$75,280	\$66,221	\$55,894	\$44,298	\$31,254	
Sixth Year						\$44,054	\$79,497	\$69,931	\$59,025	\$46,780	
Seventh Year							\$47,967	\$86,559	\$76,143	\$64,269	
Eighth Year								\$53,410	\$96,382	\$84,784	
Subtotal		\$46,971	\$127,114	\$192,069	\$246,012	\$291,168	\$328,890	\$359,813	\$393,035	\$429,056	\$2,414,129
NON-GUAR. ANNUAL LOANS	\$900,000	\$811,500	\$787,126	\$799,322	\$844,101	\$919,085	\$1,023,383	\$1,157,296	\$1,310,092	\$1,472,085	
NON-GUARANTEED PORTFOLIO	\$900,000	\$1,711,500	\$2,408,626	\$3,036,798	\$3,618,437	\$4,171,166	\$4,707,003	\$5,233,449	\$5,822,244	\$6,550,077	
Int. on Non-Guaranteed (12%)	\$54,000	\$205,380	\$289,035	\$364,416	\$434,212	\$500,540	\$564,840	\$628,014	\$698,669	\$786,009	
2% Comm. on scndry sale		\$91,970	\$89,208	\$90,590	\$95,665	\$104,163	\$115,983	\$131,160	\$148,477	\$166,836	
Loan Losses	(\$90,000)	(\$81,150)	(\$78,713)	(\$79,932)	(\$84,410)	(\$91,909)	(\$102,338)	(\$115,730)	(\$131,009)	(\$147,209)	(\$1,002,399)
Less: Operating Budget	(\$200,000)	(\$210,000)	(\$220,000)	(\$230,000)	(\$240,000)	(\$250,000)	(\$260,000)	(\$270,000)	(\$280,000)	(\$290,000)	(\$2,450,000)
Servicing Budget		(\$45,985)	(\$44,604)	(\$45,295)	(\$47,832)	(\$52,081)	(\$57,992)	(\$65,580)	(\$74,239)	(\$83,418)	(\$517,026)
Accumulation of STATE Debt	\$4,000,000	\$4,160,000	\$4,326,400	\$4,499,456	\$4,679,434	\$4,866,612	\$5,061,276	\$5,263,727	\$5,474,276	\$5,693,247	(\$5,693,247)
Accumulation of PRIVATE	\$2,310,000	\$2,709,006	\$3,239,892	\$3,902,223	\$4,699,881	\$5,639,562	\$6,730,182	\$7,982,370	\$9,417,617	\$11,060,939	(\$11,060,939)
Total Return	\$310,000	\$559,006	\$697,286	\$835,387	\$977,636	\$1,126,859	\$1,285,284	\$1,454,638	\$1,645,796	\$1,862,293	\$1,862,293
Annual Return on PRIVATE Inv.	15.50%	17.27%	19.60%	20.44%	20.44%	19.99%	19.34%	18.61%	17.98%	17.45%	18.66%
Accumulated Total Assets	\$6,310,000	\$6,869,006	\$7,566,292	\$8,401,679	\$9,379,315	\$10,506,174	\$11,791,458	\$13,246,097	\$14,891,893	\$16,754,186	\$0
	\$0	\$90,000	\$171,150	\$262,463	\$366,356	\$487,547	\$630,850	\$721,297	\$744,252	\$805,218	