

MINUTES

MONTANA SENATE 54th LEGISLATURE - REGULAR SESSION

FREE CONFERENCE COMMITTEE ON SENATE BILL 038

Call to Order: By **CHAIRMAN STEVE BENEDICT**, on April 10, 1995, at 10:35 a.m.

ROLL CALL

Members Present:

Sen. Steve Benedict (R)
Sen. John R. Hertel (R)
Rep. Royal C. Johnson (R)
Rep. Mike Kadas (D)
Rep. Bruce T. Simon (R)

Members Excused: Sen. J.D. Lynch (D)

Members Absent: None

Staff Present: Bart Campbell, Legislative Staff
Jennifer Gaasch, Secretary

Discussion:

CHAIRMAN BENEDICT stated he would like to see this bill to go through in some form. It is important for creating jobs.

REPRESENTATIVE MIKE KADAS asked **Linda Reed** what the interest rates would be that the loans would going out at? **Linda Reed** said they would be above market rate. She said they did not see them as being a subsidized interest rate. The goal was to return yield to the trust fund that would be comparable to what it was currently earning. She said it would not be below a bank rate.

REP. KADAS asked what a bank rate would be for those types of loans? **Andy Poole** replied the interest rate they used on the fiscal note was 8%. That was the number based on the current trust fund earnings. **REP. KADAS** asked what a bank rate be? **Andy Poole** said the prime lending rate was around 8%. **REP. KADAS** said if they can match the long term investment pool rate then in all likely hood they will be under what a commercial rate would be for a loan of this type. He said so they would be able to give that borrower a better rate than what the bank can give. He said they would be an incentive for the bank to give for the bank to go ahead and participate the loan even though they were not on first position on the lien. He said that was the problem he was having. He said he wanted the state to be ahead of the principal

financial institutions in order to offer security to the state. He said that it seemed there was an incentive there to allow that to happen.

Linda Reed replied the difficulty is going to become in the fact that a lot of the loans are going to have Small Business Administration (SBA) guarantees attached to them and there is no way to participate.

CHAIRMAN BENEDICT asked what kind of collateral do they have with the micro business development loans? **Andy Poole** replied they have collateral on everything they can get from the micro business enterprise person. He said the asset would be financed. **CHAIRMAN BENEDICT** asked if he would characterize those as a little bit more unstable than the collateral position would be developing from these loans? **Andy Poole** replied absolutely. The experience they have in the Department of Commerce is basically with the Community Development Block Grant (CDBG) program. They are typically not financing the assets that the bank is. The bank usually does the land and buildings and the state usually ends up financing equipment or working capital. He said they end up with the first collateral position on the assets that they are financing with CDBG and he would expect that to be the same with this program. **CHAIRMAN BENEDICT** replied his point was when they do other types of loans like that the collateral position is the best the state can get, but it still risks capital and it still is to try to develop jobs. They have done a good job lately in CDBG and the micro business development. Those are small loans to start up companies that have an idea and hope they can get going. He said they have created quite a few jobs with that. He said the collateral position they are in here is even better than what they are in with micro business development because they are not companies that hope they can get going, they are companies that want to expand.

REP. KADAS said the two major differences with this program and with micro business at least are the size of the loans and the potential political pressure that will always be there. He said there was not that kind of pressure with the micro business program. He said leaving it as open as it is invites a certain aspect of political corruption. He said this was the kind of program that would get instituted and go on and that will happen some time or another. He said the state can not afford that fiscally or even politically. He said he would like to do it in a way that would offer more security.

Andy Poole replied that technically there was not a way for them to take an equal collateral from the bank because of the mechanics of lending when there are 2 or 3 different lenders does not work.

REP. KADAS asked how the SBA guarantee works? Is that the only money that a bank would be putting up? **Andy Poole** replied the majority of the loans that are made in Montana through lending

institutions for commercial purposes are made with SBA guarantees. **Linda Reed** replied the bank funds the entire loan. The SBA only guarantees repayment of a certain portion of that loan if it was to go into default. The percentage varies depending on the loan type and the quality of the borrower.

REPRESENTATIVE ROYAL JOHNSON said it was usually in the 90% range.

Linda Reed replied that no, that is no longer true.

REP. R. JOHNSON asked what percentage was it today. **Linda Reed** replied at the highest 75% was typical.

CHAIRMAN BENEDICT asked under uniform commercial codes, can there be a shared first position under UCC's? **Andy Poole** replied he did not have any first hand knowledge. He said the director of the department has said that there can not be a shared first position on a UCC. **Linda Reed** replied the only way that could happen was if the 2 parties were indicated to be 1 creditor.

REP. R. JOHNSON said there is a way to have collateral equality and that is by using a partnership arrangement on the loan. He said what they really do is ask the bank to loan at a greater rate, the state to take a lessor rate, the bank to take the best collateral and the state to take the lessor collateral and working capital, accounts receivable and equipment are a much lessor collateral than buildings and land. He said they were going to charge them a lower interest rate. He said the banks in Montana would like to see that state grow in the same way the legislature in the state does. He said he was concerned about where the money was going to come from. There will be more risks taken. They should take the money out of a place that was already authorized the money to be used from which would be out of the Seed Capital end of the Montana Science and Technology. There is over \$7 million left in there. **REP. R. JOHNSON** said they have that amount of money in there. It would give them 2 years to see if that program would be any more successful than Montana Science and Technology and if they take \$4 million of that it would still leave them some money to use. He said in the bill it stated there would be a committee appoint to make the loan and they do not need any more committees. He said that was the position he would risk being in.

CHAIRMAN BENEDICT said when using the Seed Capital money is that money is venture capital which is more risky than this. Actually they were creating something less risky than they originally intended the Seed Capital money to.

REP. R. JOHNSON replied he said it had not done anything for them. He said they should go back to the way it came out of the house except that they would say they would take the best negotiated position. He said the best negotiated position of lessor interest is not the best possible position.

Andy Poole replied he did not think they would have any objection to indicating that the financial institution has to be a part of the deal. They would be at least at the rate that they other lender would.

CHAIRMAN BENEDICT said they had prime and plus 2%.

Andy Poole replied the 2% was in the market rate of return and that would basically be used for servicing.

CHAIRMAN BENEDICT replied they have to put together a reserve.

Linda Reed replied there should be sufficient funds with that 2%.

REP. KADAS replied he was not pleased with the R and D program either. He said he was still not comfortable on their position on the collateral. It could be the same or better.

CHAIRMAN BENEDICT said they should just cut the banks out of the loop and make direct loans.

REP. KADAS replied that would make it worse.

CHAIRMAN BENEDICT replied they would have first position on everything.

REP. KADAS replied that was correct, but they would not have any expertise.

Andy Poole said the program was designed so that banks would have to be included in the loan review process. The majority of the people who are on the CDBG committee are economic development finance professionals and they know a lot about lending. He said that group is as good as they would find in almost every loan review they would want to look at.

REP. KADAS replied he would feel better about it if someone else was putting their money up and us not being in a worst position to recover than them.

Andy Poole replied typically what they have found was that micro business enterprises that they have been funding through the micro business program. Those people would graduate from that program and would be large enough that they need to move on to another company. They do not have any equity and so they cannot go to the bank to get the first round financing. The programs are designed so that the money that is coming in from the state looks like equity to them. If they are going to create employment in the state they need to say they are partners in that. If the state is not involved in a program like that a lot of the deals are not going to happen because the owner does not have the equity to put into that.

REPRESENTATIVE DUANE SIMON asked what would the kinds of assets that would be financed by this kind of financing and how that might break down? He asked how the money was going to be used?

REP. KADAS replied he had to be excused from the meeting. He said he would not feel comfortable signing the free conference committee report. He said if they could think of a way to satisfy him in another way he would be interested in that. He understood the need to create jobs, but he was leery of the state in that area.

CHAIRMAN BENEDICT replied he did not see those potential problems with the micro business development.

REP. KADAS replied there are similar problems, but there was clearly a place where the industry was not involved.

CHAIRMAN BENEDICT replied that was underneath the threshold where they wanted to get the loan.

REP. KADAS replied the program was set up to provide assistance of the type that those businesses need. The other thing was a track record of those businesses having those loans without of state money and that was working.

CHAIRMAN BENEDICT replied he was having a hard time figuring out where the difference was between the type of risk involved in this and the risk involved in that.

REP. KADAS replied the amount of money and the political pressure that can come to bear.

CHAIRMAN BENEDICT said there was political pressure on the micro business too.

REP. KADAS replied no, not at all.

CHAIRMAN BENEDICT replied that there is a lot of politics in that.

REP. KADAS replied it was not like what he could anticipate could happen here.

Andy Poole replied he had been involved in the committee process for a number of years and the issues he was talking about have never been an issue. They do not make loans for CDBG or any other thing unless the financial shows that is a risk in design with the program.

SENATOR JOHN HERTEL asked how much had they made in loans in the last biennium? **Andy Poole** replied about \$4.5 million from CDBG.

SEN. HERTEL asked how much out of that program would be in default? **Andy Poole** replied zero. Some of those loans have 2 to 3 month deferrals to get the company running. Each of those loans is current with their payments.

SEN. HERTEL asked what the percentage of the defaults would be? **Andy Poole** replied since 1990 there has not been a default.

REP. SIMON asked if it would be to have a new conference committee report that would be amendments 2 and 3 on the previous conference committee report?

CHAIRMAN BENEDICT replied the new free conference committee report would be 1,4, and 5 of the conference committee report.

REP. R. JOHNSON replied the fiscal note showed they were going to add \$18,000 to the Department of Commerce for that situation. **Andy Poole** had said they have the expertise over there and there should be no reason for another \$18,000 over there. He said the fiscal note indicates they would be using contracted service for loan servicing and administration using \$80,000. He said if they do have that kind of expertise and they do make the kind of loans they were talking about they should not need that kind of additions in the staff.

Andy Poole replied the \$18,000 and the \$80,000 is 20% of the projected interest of the loans that would be made and that would all go toward loan servicing based upon a schedule of making a loan every 3 months equal to \$300,000 and making a loan every month, \$300,000 and receiving the first payment 3 months after the loan is made.

REP. JOHNSON asked if the banks wait 3 months for their interest payment? **Andy Poole** said the set of loan payment and principal and interest begins on each loan 2 months after funds are lent. He stated that was the way the fiscal note was developed.

REP. JOHNSON asked why they needed \$18,000 and \$80,000 if they have the people who can make the loans and they have the expertise? **Andy Poole** replied that was for loan servicing. They pay that to the banks who are receiving the loan payments. They would typically be getting 1% to 1.5% of the loan interest for loan servicing.

REP. JOHNSON replied they were going to let the banks service their loan and pay them that kind of money that we were supposedly subservient to in that loan arrangement. **Andy Poole** replied it may be the bank, it may be a local development organization and it may be the Department of Commerce, but each loan was going to try and have service by the person in the most efficient way they can. They would be negotiating rates. The \$18,000 and the \$80,000 was intended to be used by a service for servicing the loan. He said they would spend some money in

adopting rules and having application forms printed and other expenses like that, but that money was not intended for internal operation by the Department of Commerce.

REP. JOHNSON asked if they contracted with one bank to do all of those things? **Andy Poole** replied they wanted to do it in the most efficient way they can. If the bank was participating in the loan it would be best to negotiate with them and ask if they would service the loan for them for a reasonable fee. He said that would keep them from having to hire someone to keep track of all of that.

REP. JOHNSON replied that for \$80,000 they can hire a lot of people at the Department of Commerce. He said they were talking about them being in a junior position for them to be able to make a loan.

CHAIRMAN BENEDICT replied that it was only \$40,000. There is 1% on \$8 million.

REP. JOHNSON replied they were taking a position less. They were helping those people make a loan and then they would be giving them servicing money on top of that.

Andy Poole replied they were not going to do the servicing unless they were going to get paid something.

REP. JOHNSON replied unless they make a loan with them.

Andy Poole replied if they wanted them to do it at the Department of Commerce that would be fine, but he did not think that would be the most efficient way to do it.

REP. SIMON replied he did not think there would be that many total loans and it seems like an awful lot of money to service a small number of loans. He asked what they had to do to service a loan and why would it take \$40,000 to accept loan payments.

Andy Poole replied they also have to fund the loan loss reserve.

Linda Reed replied that amount would also fund a loan loss reserve. There is some working in terms of collecting payments and keeping track of principal and interest from the servicing side. Most of the banks in Montana are not large enough to have automated systems and so the work is done manually. She said the loan loss reserve was the very important part.

REP. JOHNSON asked what about the loan loss reserve.

Linda Reed replied they have talked about in the past was over time building up the loan loss reserve to 3% of out standing balances. They cannot start at 3%, but they would build that up.

REP. JOHNSON asked how do they envision the first loans they make as far as the loan loss reserve?

Linda Reed replied that they would have 1% in the first year, 2% in the second year and then looking at the history to see if they would want to increase that to 3% in the third year or not.

REP. JOHNSON asked what was the percentage of the servicing fee?

Linda Reed replied she did not know what that would be because it would be negotiated with the banks and it would depend on the type of loan they were talking about.

REP. JOHNSON asked having recently come from that industry would Linda Reed give him a guess? Linda Reed replied they had never negotiated a service fee with the state because they were all dictated to them. For the Board of Housing those fees start at .%5 and go up from there to the Board of Investment.

REP. JOHNSON replied they were talking about quite a lot more money in the Board of Investments. Linda Reed replied it was a percentage of the payment collected. It had nothing to do with the size of the portfolio or the loan. It was a function of each payment collected.

CHAIRMAN BENEDICT replied the banks would probably be willing to live with a little bit less on a lot larger portfolio.

Linda Reed replied that was true.

REP. SIMON said he hoped that there was some pathway to the loans so they would not have everyone having loans unless they tried to go through "normal" channels first.

Linda Reed replied especially since they have reduced the funding to \$4 million they would be motivated to spread that money as far as they can.

Motion:

CHAIRMAN BENEDICT MOVED to amend SB 38. That would be taking the conference committee amendments numbers 2 and 3 on those amendments and deleting the rest of those amendments.

Discussion:

Bart Campbell said they would be recommending the salmon copy to be amended as follows, number 1 would come out of the bill, number 2 would become number 1, and number 3 would be number 2 and 4 and 5 would be deleted.

REP. SIMON asked if REP. JOHNSON would carry SB 38 on the floor.

REP. JOHNSON replied he would. He said that if REP. KADAS opposed it on the floor then the bill might not pass any way.

REP. SIMON replied it would be better for someone else to carry the bill this time around.

Vote:

The MOTION CARRIED with SENATORS HERTEL, BENEDICT and LYNCH (voting by proxy) voting yes, and REPRESENTATIVES JOHNSON and SIMON voting yes. REPRESENTATIVE KADAS did not vote.

Discussion:

REP. JOHNSON asked if the section 8 was coordinated with the new section 11.

Bart Campbell replied he did not know, but he would check on that.

CHAIRMAN BENEDICT replied that they should put a coordination clause in there. He said they could make them report to the legislative auditor.

REP. JOHNSON replied they should report to the Finance Committee because that is where the revenue oversight committee will go.

Andy Poole said that in terms of operating authority they were going to need the 20% of the interest to do what they have to do to make the program operate.

REP. JOHNSON replied that was alright. He asked if they were going to hold onto the 20 % for operating. He said they had less work to do now with the Science and Technology loans.

Andy Poole replied he had been on both sides of the issue and they do not have enough they cannot do the job. If they have too much they will not spend it.

REP. JOHNSON stated that REP. JOHNSON is not comfortable with the way it is and the way they are suggesting. REP. JOHNSON stated if REP. KADAS is absolutely against that then he would not want to carry SB 38 on the floor of the House.

ADJOURNMENT

Adjournment: 11:30 p.m.



SENATOR STEVE BENEDICT, Chairman



JENNIFER GAASCH, Secretary

SB/jg

Free Conference Committee
on SB 38
Report No.1, April 10, 1995

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Mr. President and Mr. Speaker:

We, your Free Conference Committee on SB 38, met and considered:

SB 38 in its entirety

We recommend that SB 38 (reference copy - salmon) be amended as follows:

1. Page 3, line 27.

Strike: "SAME"

Insert: "most favorable"

2. Page 3, line 28.

Strike: "AS THE FINANCIAL INSTITUTION PARTICIPATING IN THE"

Insert: "possible on any"

And that this Free Conference Committee report be adopted.

For the Senate:

Benedict

Chair

Hertel

Lynch

Amd. Coord.

Sec. of Senate

For the House:

R. Johnson

Chair

Simon

Kadas

ADOPT

REJECT

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