

**CALIFORNIA POLLUTION CONTROL FINANCING AUTHORITY
CALIFORNIA CAPITAL ACCESS PROGRAM (CalCAP)
Meeting Date: December 11, 2012**

***Consideration and Approval of Updates to the Collateral Support Program to be Administered
by the California Capital Access Program (CalCAP)***

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Summary. On February 17, 2011, CPCFA was awarded approximately \$84M in State Small Business Credit Initiative (SSBCI) funds by the U.S. Department of the Treasury (Treasury) to fund programs that help small businesses obtain capital. Currently, only CPCFA's CalCAP is utilizing these funds as an approved participating State program. In March 2012, CPCFA requested Treasury approval to include a Collateral Support Program ("CalCAP CS") to utilize a portion of the allotted SSBCI funds.

In May 2012, staff obtained CPCFA board approval, including proceeding with the adoption of emergency regulations, to roll out the Collateral Support Program upon Treasury's approval. Subsequent to the May board meeting, CalCAP staff has actively solicited stakeholder input on the CalCAP CS outline. As a result of Treasury and stakeholder input, CalCAP staff is requesting approval of various refinements to CalCAP CS. These modifications *may* require updates to the regulations at some future point as staff moves forward in the process.

Background. The SSBCI funds awarded to California totaled approximately \$168M and are split between CPCFA and Business, Transportation, and Housing (BT&H). The funds have been approved to facilitate CPCFA's Capital Access Program (CalCAP or the Program) and BT&H's Loan Guarantee Program. CPCFA has received the first \$27.8M of its share of the award. Per SSBCI guidelines, 80% of the first disbursement must be utilized prior to the receipt of additional funds. Since CPCFA and BT&H share the total Federal award, this 80% requirement must be met by both before either can receive additional funds. As of December 31, 2011, BT&H has reported using \$5,152,994 of its allotted funds and, as of February 29, 2012, CalCAP has used \$1,825,299 of its allotted funds. Per the SSBCI Allocation Agreement, the SSBCI Program ends March of 2017. CalCAP continues to build on the Program's success through the enrollment of new lenders and expanded Program use by existing lenders. However, some of the large regional and national banks that have indicated an interest have not yet become active in the Program. Without broader participation in the Program, it is uncertain whether CalCAP will be able to use the full allocation.

Program Implementation. Staff is finalizing development of CalCAP CS while waiting for Treasury approval. Upon approval of the amended application, Treasury expects implementation of the programs within 90 days. Staff will also continue to develop and refine the parameters of the proposed programs so they will be ready to launch within the 90 day timeline.

CalCAP CS would provide up to 40% coverage on: construction loans for energy efficiency/environmental improvement projects; bridge loans needed prior to obtaining permanent financing; and qualified small business loans. An additional 10% coverage may be given to loans where the borrower's business is located in a Severely Affected Community. The exact amount of collateral support for each loan can be requested by the lender along with their collateral assessment of the borrower. The final determination of the support amount would be at the discretion of the CPCFA Executive Director. The collateral support would be pledged, in the form of cash, to cover the collateral shortfall of a loan in order to enable financing that might otherwise be unavailable. This cash collateral will be held at the lending institution where the loan is issued or CPCFA's trustee bank, at the Executive Director's discretion. The funds will be held in an interest bearing demand deposit account, owned by CPCFA, specific to each loan. The interest accrued in each collateral support account will be the property of CPCFA and swept on a periodic basis.

CalCAP CS is designed to allow term loans and lines of credit with a maximum collateral support of seven years. This Program will target loans with a principal loan amount of \$5,000,000 or less. However, loans can have a principal balance of \$100,000 to \$20,000,000 and the maximum collateral deposit will be \$5,000,000. The collateral support for each loan will be reduced on an Incremental Recapture Schedule. These returned support funds will be recycled back into CPCFA to be used for support on future loans. The lender can also request a reduction in support at its discretion if it determines that the current level of support is no longer necessary.

A fee is charged at closing on the support amount for loans with an original term of up to 48 month. For loans with an original term greater than 48 months, a fee is charged at closing and annually on the support amount. The annual fee is charged in conjunction with the loan anniversary once the Incremental Recapture is taken. There is a minimum fee of \$1,000 for all loan terms at closing. Fees will not be charged on the Severely Affected Community portion of the support.

| <u>Term of Loan</u> | Up to 40% Support with an Additional 10% Contribution for Businesses in a Severely Affected Community (fee will not be charged on the additional 10%) Minimum Fee of \$1,000 at Closing |
|-------------------------|--|
| ≤ 12 months | 0.50% |
| 12.1 months -24 months | 0.75% |
| 24.1 months - 36 months | 2.00% |
| 36.1 months - 48 months | 2.75% |
| ≥48.1 months | 2.00% at closing and annually |

Attachment A is the most up to date program summary that will be provided on the Authority’s website for lenders who are interested in the CalCAP CS.

Stakeholder Involvement. During the approval process of the Amended Allocation Agreement with U.S. Treasury which described the proposed Collateral Support Program, Treasury asked CPCFA to re-evaluate and clarify several items including the pro-rata repayment and eligible financial institutions. Upon examination of the Program’s parameters, CalCAP staff solicited additional feedback from various lending institutions, including Pacific Enterprise Bank, CDC Small Business Development, Plaza Bank, Murphy Bank, Fresno CDFI, Plaza Bank, and Wells Fargo. Through these interactions it was discovered that updates are needed in order to make the Program practical for lenders.

Proposed Updates to the Program.

Maximum Collateral Support of Seven Years. Staff originally presented at the May 15, 2012 CPCFA board meeting that loans enrolled in the program be limited to 7 years. It was clarified in the Executive Director’s report at the August 21, 2012 board meeting that the Program would permit loans of any term; however, collateral support will only be provided for seven years. This clarification allows lenders to request collateral support for more loans while protecting CalCAP leverage ratio on the SSBCI funds.

Incremental Recapture Schedule. Staff originally presented at the May 15, 2012 CPCFA board meeting that longer term loans would require an incremental recapture. It was refined in the Executive Director’s report at the August 21, 2012 board meeting that all loans in the Program would be subjected to an Incremental Recapture Schedule. Subjecting all loans to the Incremental Recapture Schedule aids CalCAP in meeting SSBCI’s required leverage ratio of 10:1.

Restructure of Fee Schedule. Staff originally presented at the May 15, 2012 CPCFA board meeting that fees would be charged on an annual basis. Through many conversations with various lenders, it was discovered that the originally proposed fee schedule for the Program could make it difficult for lenders to utilize CalCAP CS. All lenders consulted stated that the fees were affordable and would not inhibit them from utilizing the Program. The prospect of having to charge and collect an annual fee after the loan was already made, when refinancing is prohibited, seemed daunting. As a result, lenders asked for the fee to be charged at the time of loan closing. In response, staff is proposing the fee schedule be adjusted. For loans with an original term of 48 months or less, a one-time fee will be charged at closing. It is expected this adjustment will make the Program more usable for lenders while encouraging shorter term loans, thus aiding the required SSBCI leverage ratio requirement. There is no fiscal impact to the Program as a result of this change. While the fee structure has been changed, the actual dollar amount charged for each loan remains the same.

Removal of Pro Rata Language in Claim Process. The original draft program summary presented at the May 15, 2012 board meeting stated in regards to claim payments, “a lender will receive only the proportionate ratio of collateral support to the original principal on the outstanding principal amount.” Staff proposes removing this language for two reasons. First, the language was included in the program summary prior to the request that all loans will be subjected to the Incremental Recapture Schedule. Such an assertion negates the need for language of this nature. Second, this language is not only confusing to the lenders, it also creates uncertainty in lenders that the final claim payment in such a situation may not be worth requesting collateral support on a loan in the first place. Keeping this language could diminish the Program’s usability and ultimate success.

Staff Recommendation. Staff recommends the approval of the updates to CalCAP CS, consistent with SSBCI standards and CPCFA statute, in an effort to utilize the Federal funds prior to the deadline.

Attachment A

California Pollution Control Financing Authority

CalCAP Collateral Support

CalCAP Collateral Support (CalCAP CS) encourages banks and other financial institutions to make loans to small businesses that have difficulty obtaining financing. CalCAP CS pledges cash to cover the collateral shortfall of a loan in order to enable financing that otherwise might not be available to a small business.

Eligible Uses of Loan Proceeds

Loans can be used to finance the construction or renovation of buildings, the purchase of equipment, other capital projects, working capital, energy efficiency/environmental improvement projects, and bridge loans needed prior to obtaining permanent financing (including SBA 504 bridge loans). There are limitations on loan refinancing.

Ineligible Uses of Loan Proceeds

CalCAP CS prohibits financing of passive real estate, residential real estate, acquisition of a business, any portion of a SBA loan, and those uses prohibited by the State Small Business Credit Initiative [guidelines](#).

Terms

CalCAP CS provides up to 40% of the loan value, in the form of a cash deposit, with the possibility of an additional 10% for businesses located in a [Severely Affected Community](#). The minimum loan amount is \$100,000, the maximum loan amount is \$20 million, and the maximum support amount is \$5 million per borrower. Lenders set all the terms and conditions of the loans. Loans can be short- or long-term, have fixed or variable rates, and bear any type of amortization schedule. However, **CalCAP CS will only provide support for a maximum of 7 years on any one loan**. Lenders are free to determine the amount of collateral support they wish to request and may also choose to reduce the collateral coverage at any time for any reason.

Eligible Lenders

Any federal or state-chartered bank, savings association, federally certified Community Development Financial Institution (CDFI), or credit union is eligible to participate in CalCAP CS. A lender must certify that it is in good standing with its regulatory body (Federal Reserve, Federal Deposit Insurance Corporation (FDIC), Comptroller of Currency, Thrift Supervision, National Credit Union Administration (NCUA), or state banking authority). Existing CalCAP lenders, who meet the above requirements, are already eligible to participate in CalCAP CS.

A Qualified Lender must sign the [Certification to Participate in Federal Fund](#) to participate in any Federally funded program and is required to abide by the assurances.

To become a participating lender in the CalCAP CS, submit [Financial Institution Application](#) and [Certification to Participate in Federal Fund](#) to CalCAP@treasurer.ca.gov.

Eligible Small Businesses

An eligible borrower's business must be in one of the industries listed in the [North American Industry Classification System \(NAICS\)](#) codes list, must not be prohibited by the State Small Business Credit Initiative [guidelines](#), and have fewer than 750 employees. The borrower must have their "Primary Economic Effect" in California where one of the following conditions exists: at least 51% of the total revenues of the business activity are generated in California; or at least 51% of the total jobs of the business are created or retained in California.

How to Request Collateral Support for a Loan

Prior to the issuance of a loan, a lender must submit a [Collateral Support Request](#) and a risk assessment of the borrower. The risk assessment includes: the value of the collateral based on the industry standard of measurement (eg. appraisal); the lender's valuation of the collateral; borrower's risk rating; summary of relationship and history of the business; and the lender's cash flow and financial analysis of the borrower. Once the request has been approved by the CPCFA Executive Director, a Collateral Support Approval will be sent to the lender. This commitment can be called upon for up to 90 business days after issuance. The Collateral Support Approval will include instruction from CalCAP CS that a loss reserve account be opened when the loan is finalized. This collateral support loss reserve account is owned by CPCFA. A separate account will need to be opened for each loan that is included in the Program.

Within 15 business days of the closing of the loan, the lender will submit the Collateral Support Approval with the final loan information, notifying CalCAP CS that the loan has been funded. The lender and the borrower will be required to sign their respective SSBCI certifications for each loan to be submitted to CalCAP CS with the final loan information. ([Link to assurance doc to be created](#)). At this time, the lender is required to give the borrower a [Privacy Notice](#). The final loan information must be accompanied by evidence the collateral support loss reserve account has been opened and applicable fees deposited. In turn, CalCAP CS's trustee bank will wire the cash collateral support amount into the bank's loss reserve account for each loan. The lender is required to provide a confirmation of receipt of funds.

Collateral Support Loan Loss Reserve Account

The Collateral Support Loan Loss Reserve Accounts are Interest Bearing Demand Deposit Accounts, owned by CPCFA, held at the lending institution, and specific to each loan. Non-depository financial institutions' loan loss reserve account will be held at CalCAP CS's trustee bank and the CPCFA Executive Director may require any account be held at the trustee bank.

The collateral support for each loan will be reduced annually on an Incremental Recapture Schedule. The lender can also request a reduction in support at their discretion if they determine that the current level of support is no longer necessary.

The interest earned on the collateral support loss reserve account is the property of CPCFA and will be periodically swept.

Fees

| <u>Term of Loan</u> | <u>Energy Efficiency or Environmental Improvement</u> | <u>Bridge Loans</u> | <u>Small Business Loans</u> |
|-------------------------|---|-------------------------------|-------------------------------|
| ≤ 12 months | 0.50% | 0.50% | 0.50% |
| 12.1 months - 24 months | 0.75% | 0.75% | 0.75% |
| 24.1 months - 36 months | 2.00% | 2.00% | 2.00% |
| 36.1 months - 48 months | 2.75% | 2.75% | 2.75% |
| ≥48.1 months | 2.00% at closing and annually | 2.00% at closing and annually | 2.00% at closing and annually |

A fee is charged at closing on the support amount for loans with an original term of up to 48 month. For loans with an original term greater than 48 months, a fee is charged at closing and annually on the support amount. The annual fee is charged in conjunction with the loan anniversary once the Incremental Recapture is taken. There is a minimum fee of \$1,000 for all loan terms at closing. Fees will not be charged on the Severely Affected Community portion of the support.

Incremental Recapture Schedule

| <u>Term of Loan</u> | <u>Annual Review</u> | | | | | | |
|-----------------------|----------------------|-------|-------|-------|-------|-------|---|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 0-12 Months | | | | | | | |
| 12.1-24 Months | 50 | | | | | | |
| 24.1-36 Months | 33.33 | 33.33 | | | | | |
| 36.1-48 Months | 25 | 25 | 25 | | | | |
| 48.1-60 Months | 20 | 20 | 20 | 20 | | | |
| 60.1-72 Months | 16.67 | 16.67 | 16.67 | 16.67 | 16.67 | | |
| 72.1-84 Months | 14.29 | 14.29 | 14.29 | 14.29 | 14.29 | 14.29 | |
| more than 84.1 Months | 14.29 | 14.29 | 14.29 | 14.29 | 14.29 | 14.29 | |

| | |
|---|--|
|  | equal to the percent of the original contribution amount |
|  | repayment of entire support upon maturity of the loan |
|  | repayment of entire support upon support expiration |

On an annual basis, in conjunction with the loan anniversary, a portion of the support will be returned to CFCFA according to an Incremental Recapture Schedule. The portion to be returned will be based on the original term of the loan. Any additional reductions requested by the lender will also be taken at this time. Once the Incremental Recapture is taken, the annual fee will be charged on the remaining support.

Default and Charge-Off

Lender must submit a Collateral Support Default Notification upon loan default, or within 30 calendar days after the maturity of the support, in order to freeze further reductions from the support account and additional fees. Within, 30 calendar days of collateral liquidation, the lender will submit a Collateral Support Claim Application, history of the account payments, a short narrative of the loan, collection history, and information about the liquidation of collateral. CalCAP CS will evaluate the claim and authorize the disbursement of funds accordingly. The lender must return any recoveries to CPCFA.

Reporting

Participating lending institutions shall be required to make quarterly reports to the Program.

Lenders are required to send monthly bank statements to CalCAP CS by the 15th of the following month for all collateral support loss reserve accounts.

**RESOLUTION OF THE
CALIFORNIA POLLUTION CONTROL FINANCING AUTHORITY
APPROVING THE DEVELOPMENT AND IMPLEMENTATION OF A
COLLATERAL SUPPORT PROGRAM**

December 11, 2012

WHEREAS, the California Pollution Control Financing Authority (the "Authority") is authorized by California Health and Safety Code Sections 44520(a) and 44559.5(f) to adopt regulations to implement and make specific the statutory provisions governing the Authority; and

WHEREAS, the Authority is authorized by California Health and Safety Code Section 44520(b) to adopt regulations relating to small business as emergency regulations; and

WHEREAS, at its May 15, 2012 board meeting the Authority adopted a resolution directing staff to proceed with the development of a Collateral Support Program ("CSP"); and

WHEREAS, at its May 15, 2012 board meeting the Authority adopted a resolution directing staff to proceed with the emergency rulemaking process for the development of the CSP (the "May 2012 Emergency Regulations"); and

WHEREAS, the Authority has determined that various refinements to the CSP (as more fully described in the December 11, 2012 staff report to the Authority) are necessary for successful implementation of the program.

NOW, THEREFORE, BE IT RESOLVED by the California Pollution Control Financing Authority as follows:

Section 1. The proposed program description presented at the December 11, 2012, meeting is hereby approved in substantially the form submitted. The Chair, Executive Director, or Deputy Executive Director is hereby authorized, for and on behalf of the Authority, to proceed with the implementation of a Collateral Support Program, upon approval from the U. S. Department of the Treasury, with the supporting documentation required by law.

Section 2. The Chair, Executive Director, or Deputy Executive Director of the Authority are hereby authorized and directed to take such actions, including making or causing to be made such changes to the May 2012 Emergency Regulations as may be required for approval thereof by the Office of Administrative Law, and to execute and deliver any and all documents that they may deem necessary or advisable in order to effectuate the purposes of this resolution.

Section 3. The Chair, Executive Director, or Deputy Executive Director of the Authority are hereby authorized and directed to take such actions, including making or causing to be made such changes to the May 2012 Emergency Regulations as may be required to address comments made after the date of this resolution and to execute and deliver any and all documents with the

Office of Administrative Law for the purposes of adopting any such changes in the form of emergency regulations and later as permanent regulations.

Section 4. This resolution shall take effect immediately upon its approval.