

**CALIFORNIA POLLUTION CONTROL FINANCING AUTHORITY
CALIFORNIA CAPITAL ACCESS PROGRAM (CalCAP)**

Meeting Date: June 18, 2013

***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. At the time of the award, only CPCFA's CalCAP was utilizing these funds as an approved participating State program. In March 2012, CPCFA requested Treasury approval to include a Collateral Support Program (CalCAP CS or the Program) 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 begin administering the Collateral Support Program upon Treasury's approval. Subsequent to the May board meeting, CalCAP staff actively solicited stakeholder input on the CalCAP CS Program Summary. As a result of Treasury and stakeholder input, CalCAP staff requested and obtained board approval for various refinements to CalCAP CS in December 2012.

Treasury approved the launch of CalCAP CS effective January 17, 2013 and staff launched CalCAP CS statewide on January 28, 2013. Additional stakeholder input, as well as CalCAP CS staff experience enrolling loans, necessitates some additional refinements to the Program. Staff is requesting the changes described in this item to increase participation and facilitate the flexibility and ease of use of the Program, and to allow CalCAP CS to provide the best benefit to the small business lending community.

Background. The SSBCI funds awarded to California totaled approximately \$168M and are split evenly between CPCFA and Business, Transportation, and Housing (BT&H). The funds have been approved to facilitate CPCFA's Capital Access Program (CalCAP) and BT&H's Loan Guarantee Program. CPCFA received an initial disbursement of \$27.8M, which is the first of three "tranches" of its share of the award. Per SSBCI guidelines, 80% of the first disbursement to California must be utilized prior to the receipt of subsequent tranches of funds, meaning that CPCFA and BT&H together must meet this 80% requirement before either can receive additional funds. As of March 31, 2013, BT&H has reported using \$17,833,483.43 of its allotted funds and, CalCAP (including CalCAP CS) has used \$3,919,524.34 of its allotted funds. CalCAP continues to build on its progress through the enrollment of new lenders and expanded 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. Per the SSBCI Allocation Agreement, the SSBCI Program ends March of 2017. With broader participation in the Program

through the CalCAP CS refinements proposed here, CPCFA will be able to utilize the full allocation before its expiration.

Program Implementation. CalCAP CS provides up to 40% coverage in the form of a cash deposit 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 is given to loans where the borrower's business is located in a Severely Affected Community. The exact amount of collateral support for each loan is requested by the lender along with their collateral assessment of the borrower. The final determination of the support amount is at the discretion of the CPCFA Executive Director. The collateral support is 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 is held at the lending institution where the loan is issued or CPCFA's trustee bank, at the Executive Director's discretion. The funds are held in an interest bearing demand deposit account, owned by CPCFA, specific to each loan. The interest accrued in each collateral support account is 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 targets loans with a principal loan amount of \$5,000,000 or less. However, CalCAP CS allows loans with 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. The returned support funds will be recycled back into CPCFA to be used for support on future loans. The lender may 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 requesting a term of support up to 48 months. For loans with a term of support greater than 48 months, a fee is charged both 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 are not charged on the Severely Affected Community portion of the support.

During the development of the Collateral Support Program, CalCAP staff solicited feedback from various lending institutions, including Pacific Enterprise Bank, CDC Small Business Development, Plaza Bank, Murphy Bank, Fresno CDFI, Plaza Bank, and Wells Fargo. Staff has continued to engage interested stakeholders while promoting the Program's launch. Through multiple events and trainings throughout the State, as well as one-on-one interactions, CalCAP engaged newly reached lenders and received additional input on the Program. While most input received was positive, some areas for improvement were identified, prompting staff to propose these Program revisions.

Proposed Updates to the Program. This section provides the rationale for each of the proposed updates to the CalCAP CS Program. If these updates are approved by the Board, Attachment A is the revised program summary that will be posted on the Authority's website for lenders who are interested in the CalCAP CS.

Revised Provisions for Bridge Loans. Early in the Program's development, it was acknowledged that bridge loans (funding needed prior to obtaining permanent financing) are a niche in need of support. Additionally, inclusion of bridge loans could make CalCAP CS extremely successful. However, in the first four months of the Program, there were no enrollments of bridge loans, leading to the determination that more needed to be done to make CalCAP CS a benefit to the lenders providing bridge financing. Not only would the proposed refinements encourage program usage through greater risk mitigation, the added benefit to the lender would allow for more bridge loans to small business borrowers in need.

- Exemption from Incremental Recapture Schedule.

In order to provide a benefit to lenders issuing bridge loans, staff is proposing to make these loans exempt from the Incremental Recapture Schedule until the balance of the loan has been paid off or the related guarantee goes into effect. Due to the nature of the bridge financing, lenders do not experience a decline in principal balance; therefore, they do not see a benefit from support that declines. Furthermore, such declination in support would cause the support to be removed when the lender is most vulnerable. Bridge loans tend to be shorter term than the average loan due to the takeout by permanent financing. As a result, exempting bridge loans from the Incremental Recapture Schedule will not only encourage the disbursement of SSBCI funds into the community, it will ensure the funds are quickly recycled back into the Program to support further collateral support contributions.

- Permit extensions for bridge loans.

Lender feedback also disclosed a need for extensions due to the sometimes unpredictable nature of bridge financing. To continue the enhanced benefit to bridge financing, staff is proposing that bridge loans be allowed extensions of support with the approval of the CPCFA Executive Director. Extensions are proposed only for bridge loans.

- Modifications to the fees for bridge loans.

In order to facilitate the ability of a lender to seek an extension on a bridge loan, staff is proposing that the fees be restructured as reflected in Table A of the Program Summary. Specifically, the fee for bridge loans 12.1 to 24 months in length would be reduced to 0.5%. In addition, while there would not be any fee associated with an approved extension *per se*, if the effect of any extension or series of extensions would increase the total term of support for the bridge loan into a tier associated with a higher fee, then any difference between the fees paid at

closing and the newly calculated fees associated with the amended term of support would be charged upon approval of the extension.

Term of Support. Under the original design of the Program, the term of each collateral support loan was determined by the duration of the associated business loan. This parameter of the Program has yielded an unforeseen level of rigidity that is counterproductive to the Program's spirit. Increased malleability through the proposed refinements would not only encourage lender participation, but also would allow lenders to customize the Program to each of their loans, allowing them to reach more small business borrowers.

Staff proposes that the term of the collateral support pledged on a specific loan be at the lender's discretion. The term of support would not be able to exceed the original term of the loan or 7 years, whichever is less. This option would build flexibility into the Program due to its customizable nature. In addition, allowing lenders to request the length of support needed would reduce overreliance on the Program, as well as increase the recycling of the funds. Current language states that the Incremental Recapture Schedule is based on the original term of the loan. Since lenders will be allowed to choose the term of support that best fits their loan and borrower, the Incremental Recapture Schedule will be based on the term of collateral support so that the support reduces proportionately.

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

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, business acquisitions, 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. 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. Loans can be short- or long-term, have fixed or variable rates, and bear any type of amortization schedule. **The term of the support will be at the lender's discretion, not to exceed the original term of the loan or 7 years, whichever is less. For bridge loans only, lenders may request extensions on the original term of support.**

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.

Attachment A

Eligible Small Businesses

An eligible borrower 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 (e.g., 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 and closing fees assessed according to Table A, notifying CalCAP CS that the loan has been funded. The SSBCI [Lender Certification](#) and [Borrower Certification](#) must be signed and submitted with the final loan information. 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, generally 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. In addition, the CPCFA Executive Director may require any account be held at the trustee bank.

The collateral support for each loan will be reduced annually according to the Incremental Recapture Schedule (Table B). 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.

Attachment A

Fees

TABLE A

<u>Total Term of Support</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%	0.50%	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 months. 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. For extended bridge loans, the total fees owed will be calculated based upon the total term of support; any difference between the fees paid at closing of the original loan and the total term of support will be collected upon the approval of the extension.

Incremental Recapture Schedule

TABLE B

Original Term of Support	Annual Review						
	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	

*Inapplicable to bridge loans

Attachment A

- equal to the percent of the original contribution amount
- 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 CPCFA according to the Incremental Recapture Schedule. The portion to be returned will be based on the original term of the support. However, bridge loans will experience the recapture once the balance of the loan is paid off or the related guarantee goes into effect. Any additional reductions requested by the lender will also be taken at this time. Once the Incremental Recapture is taken, the annual fee on collateral support commitments longer than 48 months 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

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 UPDATES TO THE COLLATERAL SUPPORT PROGRAM**

June 18, 2013

WHEREAS, the California Pollution Control Financing Authority (“Authority”) was created under the provisions of Section 44500 of the Health and Safety Code; and

WHEREAS, Article 8 (commencing with Section 44559) of Chapter 1 of Division 27 of the Health and Safety Code provides that the Authority is authorized to establish a Capital Access Program for Small Businesses (“CalCAP”); and

WHEREAS, Section 44519 of the Health and Safety Code provides that the Authority may employ an Executive Director and any other persons as are necessary to enable it to properly perform the duties imposed upon it by the Authority’s statutes; and

WHEREAS, the Authority received an award from the United States Treasury (“Treasury”) under the federal State Small Business Credit Initiative (“SSBCI”) to further the objectives of the Authority’s CalCAP, and for a Collateral Support Program funded by the SSBCI award; and

WHEREAS, the Authority has determined that specific revisions to the Collateral Support Program (as more fully described in the June 18, 2013 staff report to the Authority) are necessary for the successful implementation of the program.

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

Section 1. The proposed program summary presented at the June 18, 2013, 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 approved updates to the Collateral Support Program.

Section 2. The Chair, Executive Director, or Deputy Executive Director of the Authority are hereby authorized and directed to take such actions to implement these approved updates, make such changes to the Collateral Support Program as may be required by Treasury under the terms of the SSBCI award, make or cause to be made such changes to the Regulations as may be required, 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. This Resolution shall take effect immediately upon its approval.