Senator Len Suzio: Proposed Small Business and Jobs Investment Program, HB 5265

Memo to:

- Senator Gary LeBeau, Co-Chair Commerce Committee
- Senator John McKinney, Senate Minority Leader

From:

- Senator Len Suzio

Topic: The Connecticut Small Business and Jobs Investment Program – a program to support small business financing and growth for at least 5,000 Connecticut businesses in partnership with the United States Small Business Administration (SBA), Connecticut banks, the State of Connecticut and Connecticut Pension Funds

According to Census Bureau statistics 97.5% of Connecticut business establishments employ fewer than 100 people. It is obvious therefore that the key to economic recovery and job creation in Connecticut is the revitalization of Connecticut small businesses. Connecticut has more than 90,000 businesses of which nearly 88,000 employ between 1 and 99 employees according to the latest (2009) US Census Bureau County Business Patterns statistics. Furthermore, small business lending reported under the Community Reinvestment Act (CRA) for 2010 shows that 121 lenders extended 53,612 loans valued at $1.7 billion dollars during that year. This activity is estimated by the Federal Financial Institutions Examination Committee (FFIEC) to represent about 82% of total small business lending (not all lenders are required to report small business lending). Clearly, the size and scope and financing needs of the small business loan market in Connecticut are extensive and beyond the ability of any single state agency. What is needed is a program that has the capacity to reach and support the thousands of small businesses that are the backbone of Connecticut's economy and that employ well more than half the Connecticut workforce.

The US Small Business Administration provides financing assistance to small companies through various programs. The biggest such program would be the so-called 7-A program under which lenders extend loans to small businesses guaranteed up to 80% by the SBA. The SBA guarantee is a "full faith and credit" obligation of the US government. The SBA guarantee program allows banks to extend financing to businesses that would not be eligible for traditional bank loans because the risk would be too great for normal bank lending standards. By incorporating a government guarantee of a significant portion of a loan the risk exposure of a bank is substantially reduced to an acceptable level that allows a bank to safely extend credit to many businesses that would not qualify for normal bank loans. In today's recessionary environment with higher credit risk a very large segment of the small business community cannot attract conventional bank financing. This represents a serious impediment to small business survival and growth in Connecticut. According to my recent conversation with SBA District Director Bernie Sweeny, during 2011 the SBA Connecticut District Office financings have been growing as banks seek an alternative to conventional small business lending. During 2011 the District Office approved $325 million of small business financing under the 7A and 504 and micro-finance programs.

As explained above, SBA guaranteed loans help resolve the credit risk dilemma for banks. But SBA loans also have another feature that is potentially valuable to banks. Sometimes banks will sell the guaranteed part of SBA 7A loans into the "Secondary Market". The SBA loan secondary market was developed about 30 years ago by the SBA to promote liquidity for SBA loans extended by banks. Many small businesses are undercapitalized and need extended (7 years or more) term loans to compensate for lack of capital. Long term loans present a "liquidity" problem for banks because of the need to match assets with liability maturities. Thus, the secondary market solves the liquidity problem inherent in long term SBA lending and the need to match that against shorter term deposits. Even when banks don't sell loans immediately into the secondary market, its existence makes SBA-guaranteed loans liquid because they can be converted to cash when needed.

SBA-guaranteed loans are attractive to investors because they represent a "full faith and credit" US government obligation and because loans in the SBA secondary market may pay a higher rate than a conventional US government security of similar maturity. Also, SBA loans by their nature are "self liquidating" with regular payments of principal and interest scheduled. This makes them attractive particularly for pension funds that have ongoing cash flow needs.

The foregoing conditions reveal an opportunity for Connecticut to stimulate the availability of capital needed by small businesses to survive the recession and to grow as economic recovery begins. The State of Connecticut has billions of dollars of pension fund money, but no policy that explicitly directs the Treasurer to prioritize investment in Connecticut businesses. Investing in SBA-guaranteed loans extended to Connecticut businesses is an opportunity to earn a reasonable rate of return at no risk and simultaneously provide badly needed capital to thousands of Connecticut employers. The State can allocate a segment (say $1 billion) of its pension fund money and direct its investment in SBA guaranteed loans extended to Connecticut companies (in fact, the State may already have SBA guaranteed loans in its pension portfolio, although they may not be to Connecticut businesses). This would be a safe investment ("full faith and credit" investment) with a market or better rate of return for comparable investments. If the State chooses to enhance the attractiveness of the program for lenders and/or borrowers it could subsidize the program by partly underwriting the closing costs or paying the guarantee fee (about 2% of the guaranteed portion of the loan) which would help Connecticut small businesses lower their borrowing costs. Any such subsidy could be a part of Connecticut's General Fund expenditures and not reduce pension fund investment returns. If such subsidy were to equal a maximum of 2 points and if a quarter of a billion dollars of annual transactions were achieved the cost to the State would not exceed $4 million per annum (2% of guaranteed portion of $200 million), but the State could support a thousand Connecticut companies or more annually (assume average loan size of $250,000). Perhaps the program could be called the "First Five Thousand Program" (potential impact during first 5 years). If each loan supported the creation or preservation of 5 jobs we would be talking about 5,000 jobs created or preserved each year (total 25,000 jobs over 5 years) that would cost the State only $4 million per year (the subsidy would be only once, when each loan is made, and would not be repeated annually for a number of years for each participant like tax credit programs are). In the first year it would potentially serve 200 more times the companies (and 5 times the number of jobs) served under the First Five Program and a cost of only $4 million per year in comparison to far greater annual costs under the First Five Program.

Why would banks utilize the Connecticut Small Business Investment Program?

- Banks would be strongly attracted to the program because it would allow them to make a safe and liquid loan with a built-in advantage, lower borrower costs at no expense to the bank. Any bank participating in the program would have a competitive advantage. Because the program would be available to any bank extending a qualified loan the market would drive banks to participate in the program.

Why would Connecticut pension funds find the investment attractive?

- Connecticut pension funds would be attracted to the investment because it would be safe, the return would be competitive and the investment would help Connecticut businesses and job creation.

Why would the State government find the program appealing?

- The State would find the program attractive because the cost would be very low in comparison to other state economic development programs (no incremental administrative costs and no ongoing tax credit costs or loan losses) and the State could leverage the subsidy costs more than 60 times (subsidies would average about 1.5%). Four million dollars would translate potentially into $250 million of loans and thousands of jobs. And the $4 million is a one-time up-front cost for each pool of $250 million. Although jobs and economic activity would continue for years for each loan, the only costs are one-time and up-front.

Why would Connecticut small businesses want to borrow under the program?

- Some Connecticut small businesses cannot borrow money under current tight credit market conditions. Other "bankable" Connecticut small businesses can borrower more money for longer terms under the SBA 7A program. Since the guarantee fee would be subsidized under this program it would have enhanced widespread appeal to the small business community.

Would the SBA be interested in this cooperative program?

- The writer (Senator Suzio) has discussed this concept with SBA District Director Bernard Sweeney who has expressed strong interest in the program