

**MINUTES OF THE**  
**NEW MEXICO SMALL BUSINESS INVESTMENT CORP.**

**REGULAR MEETING**

**February 14, 2011**

A regular meeting of the New Mexico Small Business Investment Corporation was called to order on this date at approximately 9:00 a.m. in the conference room of the New Mexico Mortgage Finance Authority, 344 S. Fourth Street, S.W., Albuquerque, New Mexico.

A quorum was present:

**Members Present:**

Mr. Andrew Baca, Chair  
Mr. Kit Caldwell  
Mr. Sam Cobb, Vice Chair  
Ms. Mary A. Garza, Secretary  
Mr. Billy Knight  
Ms. Marie Longserre, Treasurer  
Mr. Clarence L. Smith [designee of State Treasurer James Lewis]  
[joining proceedings by teleconference at 10:45 a.m.]

**Members Excused:**

Mr. Greg Kulka [State Investment Council designee]

**Legal Counsel to Board:**

Mr. Randy McDonald

**Financial Advisor to Board:**

Mr. Paul Goblet

**Recording Secretary:**

Ms. Judith Beatty

**Guests Present:**

Mr. Brian Birk, Sun Mountain Capital (teleconference)  
Ms. Leslie Shaw, Sun Mountain Capital (teleconference)

## **APPROVAL OF AGENDA**

Upon motion by Ms. Garza, seconded by Ms. Longserre, the Agenda was approved by voice vote, as amended.

## **APPROVAL OF MINUTES: January 24, 2011**

Upon motion by Mr. Cobb, seconded by Mr. Caldwell, the Minutes of the January 24 meeting were approved by voice vote, as submitted.

## **FINANCIAL REPORT**

Mr. Goblet reviewed the January financials.

Mr. Goblet discussed financials detailing NMSBIC activities from 6/30/2002 to date (statement of activities, statement of financial position, and statement of cash flows).

Mr. Goblet noted that, of the \$1.1 million of loan losses incurred since inception, \$30,000 has come from The Loan Fund and WESST Corp. He stated that the remainder has come from ACCION, which amounts to an annualized net cost of \$42,000 to the NMSBIC after receipt of interest income.

Reviewing equity relationships, Mr. Goblet stated that the NMSBIC has incurred a total of \$3.7 million of management fees and fund expenses (\$850,000 in 2009). If one puts realized losses on investments together with the \$3.7 million of management fees, that total is the \$10.5-\$11 million that the NMSBIC has incurred in "losses" and expenses since it began operating. He stated that, if one credits the \$5.4 million of earned interest income to that figure, it has cost the State \$7 million to run this program since 2002. He stated his belief that much of that loss will be recaptured over the next few years.

Mr. Goblet said he has projected that the NMSBIC will have \$15 million of cash on 6/30/11 and \$12 million of cash on 6/30/12 net of any distributions that may come back to the NMSBIC. He estimated that this year's expenses would be about \$270,000 – up \$3,000 from the previous year – and there would be approximately \$450,000 of interest income. Even with CD rates going down, the NMSBIC should have \$100,000 to \$125,000 of net operating earnings before management fees and expenses.

**Ms. Garza moved to accept the Financial Report. Mr. Knight seconded the motion, which passed by voice vote.**

Mr. Caldwell asked that future financial reports include information on restricted versus unrestricted cash.

### **DISCUSSION AND POSSIBLE VOTE ON HAVING IRR CALCULATED BY SUN MOUNTAIN CAPITAL**

[Sun Mountain Managing Partner Brian Birk and CFO Leslie Shaw joined the proceedings by telephone.]

Mr. Goblet read a letter addressed to the Board from Mr. Kulka, stating that the SIC and legislative committees want better reporting and analysis of the economic impact of economically targeted investments (ETIs) as well as a detailed financial performance analysis on the underlying investments, as both entities are focusing on financial performance as a determinate to whether or not these programs make a positive economic impact.

The letter stated that SIC staff furnishes "institutional quality" investment analysis on the SIC's New Mexico Private Equity Program but has not been able to do the same for the NMSBIC because the necessary data is not available, and suggested that Sun Mountain directly collect the necessary information from the investment managers and perform the analysis, which would be paid for by the SIC. Mr. Kulka stated in his letter that he has suggested this, yet the Financial Advisor's response has been that the potential costs associated with having another entity review and calculate annual internal rate of return would not be justified.

Mr. Kulka stated in his letter that he personally felt very strongly that the NMSBIC "must produce a professional financial performance report on its investments (something that he felt has not done up to now) in order to give full transparency to our clients, the citizens of New Mexico. We have to show, in detail, what we are doing with their money."

Mr. Cobb asked Mr. Birk to discuss what confidentiality agreements, if any, are in place with the SIC with respect to providing detailed financial reports on businesses in the NM Private Equity Program. He commented that, were he someone with investment money from the SIC or NMSBIC on the verge of a potential merger or sale of his business, he would be deeply concerned about confidentiality.

Mr. Birk responded that this is a key issue – when people talk about full transparency, just how full is that transparency. He noted that a number of states have passed legislation specifically addressing to what depth such reporting can go, and all of those states have excluded any information related to company performance, amounts invested in each company, or anything at the company level itself.

Mr. Birk said the SIC is grappling with this matter, and it would appear that there is not a full understanding of the negative ramifications of disclosing information at the company level. Based on what he has seen from the SIC and has heard from the Attorney General's Office, he believes that what New Mexico has done historically is follow best practices from other states. A ruling in Texas and CalPERS supports total non-disclosure at the company level – with disclosure only at the fund level – and Sun Mountain believes that might be the case here, but there is no firm policy at this point. He said he personally believed that the SIC would not go below the fund level because the consequences to the State would be potentially catastrophic.

Assuming the NMSBIC engages Sun Mountain, Mr. Cobb asked Mr. Birk if he would be amenable to bringing the information back to the NMSBIC Board first so it could be reviewed and approved prior to dissemination to the SIC.

Mr. Birk responded yes. He said Sun Mountain would be working with Mr. Goblet and relying on him to collect the information. He added that Sun Mountain has industry benchmarks and other performance data that will be useful references in the context of the financial analyses.

Ms. Longserre said it was her understanding that, while the SIC's job is to be fiduciary to the funds it manages and to simply earn an investment return, the NMSBIC's purpose is to create companies, jobs and economic opportunity in New Mexico. She observed that Mr. Kulka's memorandum separates economic impact from financial performance of the funds, but to her the economic impact of jobs also has financial value. She expressed concern about how this would be addressed, given the differences in mission and purpose, since she felt it crucially important that the report include this additional data.

Mr. Birk noted that the NMSBIC program was designed to help support small companies and create jobs, not to be a program that has a financial return competitive with the SIC's national programs. He said the statute creating the NMSBIC does not discuss financial performance.

Mr. Caldwell asked if Sun Mountain has the ability to measure the generation of GRT that comes off of these New Mexico businesses.

Mr. Birk responded that Sun Mountain could provide that, assuming it could get aggregate revenue figures. He added that Sun Mountain could also provide numbers based on payroll and withholding taxes.

Mr. Goblet stated that, based on his memorandum, Mr. Kulka is looking for reporting identical to that which Sun Mountain Capital provides on the New Mexico Private Equity Program and New Mexico Co-Investment Program, which is an

annualized internal rate of return. He said this will require recapturing, on a month-by-month basis, all the flow of the funds.

Mr. Birk commented that some SIC members and legislators have looked at programs like this with skepticism, and are demanding more financial accounting and reporting in order to understand whether the State is making money or not and how much is it "costing" the State to create these jobs.

In the interest of clarity, Mr. McDonald asked Mr. Birk to describe exactly what Mr. Kulka is asking him to do, and what the anticipated cost would be to the SIC.

Mr. Birk responded that Sun Mountain has not met with Mr. Kulka to discuss cost at this point, but the cost would depend on how much time would be involved in collecting the financial information from the funds.

[Further discussion and action reflected on pages 6-7 of these minutes.]

#### **DISCUSSION AND POSSIBLE VOTE REGARDING FIRST COMMUNITY/ US BANK**

Mr. Goblet stated that, with the seizure of First Community by the FDIC and the sale to US Bank, the NMSBIC now has its primary deposit and checking account with the fifth largest bank in the country, and all personnel with whom Ms. Longserre and Ms. Brescia have worked with remain in place. He said there were no service interruptions and there has been complete access to all capital. He stated that Ms. Brescia feels more comfortable that the existing banking relationship is sound and does not need to be replaced.

Mr. Goblet asked if the Board feels a need to establish redundant banking relationships.

Ms. Longserre, Board Treasurer, stated that if the Board is comfortable leaving its primary deposit and checking accounts at what is now US Bank, she was fine with that. She added, however, that she felt it important to have an established account at another financial institution in the event the Board decides to make a switch. She said this does not mean setting up duplicate accounts – the idea is just to have a banking relationship elsewhere.

**Ms. Longserre moved that the NMSBIC leave the accounts as they are at this time and keep the status quo with its banking relationships. Mr. Caldwell seconded the motion, which passed by voice vote.**

#### **CDARs Renewal**

Mr. Goblet stated that the NMSBIC has a strip of CDs maturing on March 10 in the amount of \$6,670,000. He commented that the current rates are extremely low: 3 months, .20%; 6 months, .30%; and one year, .33%. He recommended rolling this block of CDs for an additional three-month period.

Mr. Goblet stated that another strip of CDARs matures on March 31, for \$5 million, so the Board can discuss alternatives for these funds at the next meeting.

Mr. Goblet also suggested that the NMSBIC open or change to an interest bearing money market NOW account at FCB/USB for \$250,000, which would be FDIC insured, at a rate of .45%.

**Mr. Knight moved to roll the block of CDs for an additional three-month period, as recommended; and that the NMSBIC change to an interest bearing money market (NOW) account at FCB/USB, as recommended. Ms. Garza seconded the motion, which passed by voice vote.**

Mr. Goblet stated that the NMSBIC will still have about \$1.5 million in FCB/USB, of which \$250,000 would be put in a NOW account, leaving \$1,250,000 in a non-interest-bearing checking account. In order to maintain FDIC insurance, it has to be in a non-interest-bearing account or collateralized CD.

Mr. Caldwell asked Mr. Goblet to look into alternatives for investing the balance, such as an overnight repo or sweep account.

## **ADVISOR'S REPORT**

### **Report to SIC**

Mr. Goblet said he felt the NMSBIC should do everything possible within reason to provide the data that Mr. Kulka is suggesting as necessary, but cautioned that he felt that there is a slippery slope when the SIC pays a third party to do financial reporting on behalf of the NMSBIC. As an alternative, he suggested that the NMSBIC Board ask permission to present to the SIC once or twice a year; begin regular communications with key legislative administrative people; seek to present at mid-session committee meetings where appropriate; and prepare and circulate semiannual reporting highlights to all legislators and key administrative officials.

Board members recommended instead that Mr. Goblet and Mr. McDonald begin a dialogue with Sun Mountain about entering into a separate agreement with them; and that separate legal documents should be in place relative to the dissemination of the requested information, which the Board should review before releasing to the SIC. The Board has a fiduciary responsibility to its equity partners, who should also be informed about what kind of information is going to be released, and the NMSBIC

should also attempt to address any confusion among the equity partners about potential breaches of confidentiality.

Board members also agreed that the finished product would be a good model for future presentations.

Mr. McDonald advised the Board that the NMSBIC is only required to do an annual report and deliver it to the Governor and LFC, and is not legally required to answer to the SIC.

Board members agreed with Mr. McDonald but felt that, in the spirit of cooperation, and because the NMSBIC has a good story to tell, it would like to further explore Mr. Kulka's request.

[Mr. Smith joined the proceedings by telephone.]

**Mr. McDonald recommended that Mr. Goblet be empowered to enter into discussions with Sun Mountain, and to consider independently, from the NMSBIC's standpoint, the appropriate scope of reporting to calculate internal rates of return, economic development impact, etc.; and to discuss what kind of relationship with Sun Mountain might be possible; and that the Board members consider internally whether an RFP should be issued in order to engage someone other than Sun Mountain to do this reporting; and to move forward in an attempt to address these issues over the next few months.**

**Mr. Cobb so moved. Ms. Garza seconded the motion, which passed by voice vote.**

#### Preliminary Financial Results

Mr. Goblet reviewed interest payments received by the NMSBIC since inception from ACCION, The Loan Fund, WESST Corp, dividend income plus fee, and CDs, for a total of \$5.4 million.

Mr. Goblet stated that contributed capital to the equity fund partners now totals \$23 million, while fund valuations at year end 2010 showed \$11.5 million, representing a 50% loss, most attributable to markdowns and management fees. While this performance is worse than most national vintage year funds and is also worse than the SIC's New Mexico program's returns since inception, it reflects the very early stage nature of the funds, the economic development focus and losses incurred in NMGF 1 and 2. He said a significant portion of these losses has been offset by \$5.4 million of interest income, leading to a negative (18.7%) return over the life of the NMSBIC. Virtually all of the losses occurred in 2008-2010.

## **DISCUSSION AND POSSIBLE VOTE REGARDING ACCION NM FACILITY**

Mr. Goblet stated that he has discussed with ACCION the possible reduction in NMSBIC commitment to \$4,000,000; and while they are disappointed in the potential reduction of commitment, they also realize that the outstanding loan portfolio has been in decline since 2006 and that loan volume remains light.

Mr. Goblet said the current portfolio stands at \$2.54 million, and ACCION anticipates originating \$1.8 million in new loans in 2011. They are paying the NMSBIC about \$1.3 million a year of principal, so this fund very likely will not grow beyond \$3 million. He recommended that the Board seek to amend the agreement with ACCION to be \$4,000,000, with all other conditions remaining the same.

Ms. Longserre asked how this will change the ratio of the NMSBIC's lending relationships. Mr. Goblet responded that this would reduce the approximate \$14 million in lending commitments to \$13 million, but the NMSBIC clearly has the potential to commitment some additional monies to lending partners in the future as opportunities present themselves.

**Ms. Longserre moved to amend the agreement with ACCION to reduce the NMSBIC's commitment to \$4,000,000. Ms. Garza seconded the motion, which passed by voice vote.**

## **DISCUSSION AND POSSIBLE VOTE ON LOAN FUND FACILITY AMENDMENT**

Mr. Goblet reviewed his six-page special report on The Loan Fund.

Mr. Goblet stated that The Loan Fund's obligation to NMSBIC is 105% secured by a portfolio of loans, and The Loan Fund is obligated to replace any loan that is greater than 180 days past due. The current facility now stands at \$7,500,000, and the Board approved an expansion of the facility to \$8,500,000 in November 2010 subject to certain added covenants. He said The Loan Fund has requested that the NMSBIC remove or reduce some of those added restrictions because they believe it will curtail their ability to meet their strategic goals.

Mr. Goblet said The Loan Fund has generated \$16.6 million of loans to over 330 businesses since inception, with total losses to date at \$15,000, all in 2005, before the facility was amended. The portfolio currently stands at \$7.3 million in 131 loans. The NMSBIC has not suffered any loan losses since the change in relationship with



The Loan Fund and The Loan Fund has experienced positive net loan loss results for the last four years of \$27,992.

Based on the progress made by The Loan Fund over the past year, and the commitments they have secured, Mr. Goblet said he felt it appropriate for the NMSBIC Board to consider amending its requirements as they relate to the expansion of the facility.

Mr. Goblet said the \$8,500,000 facility had the following proposed amendments requested by the NMSBIC:

- That the NMSBIC's portfolio represents no more than 70% of The Loan Fund's total portfolio.
- That the debt to equity ratio not exceed 9 to 1.
- That the NMSBIC's portfolio remain 100% collateralized with specifically identified loans, none of which are greater than 180 days past due.
- That the increased capital be used for new loan origination, not loans that have been part of the total portfolio longer than 90 days.
- That none of the NMSBIC loans are amended or restructured more than once in any calendar year beginning 6/30/2010.

In addition, the Board added a later condition:

- That The Loan Fund maintain a liquidity position of 10% of net assets.

Mr. Goblet stated that The Loan Fund Board has requested two changes to the proposed amendments:

1. Increase the debt to equity ratio to 10 to 1.
2. Reduce the liquidity ratio to 5%.

Mr. Goblet distributed The Loan Fund's collateral/performance report for the quarter ending 12/31/10. In reviewing the loans, he noted that 3.9% were removed, 2.72% were written off, and 1.8% were restructured, giving him a high degree of comfort about future loan portfolio performance.

Mr. Goblet reviewed summaries of the unaudited financial report (12/31/10); 2009-2013 strategic plan; 6-year income and balance sheet recap; 2007-2010 lending activity summary; 2010 funding effort; and 2011 budget forecast, projecting that the loan portfolio would grow to over \$13 million in 2011, up from \$11.2 million.

Mr. Goblet stated that, based on the information provided by The Loan Fund, including historically audited financial reports, he believed the Board should commit \$8,500,000. Since they have secured additional sources of funding and will expand those further in 2011, The Loan Fund is less reliant on the NMSBIC and is in a far stronger financial position. A breach of any of the covenants would allow the NMSBIC to cease funding additional loans; and if the problems were deemed significant, the NMSBIC could push for a significant reduction in loan commitment.

Mr. Goblet said the recommended agreement would contain all of the terms and conditions that the Board initially approved, although two items would be slightly changed.

**The amended proposal calls for an \$8,500,000 credit facility subject to the following:**

- 1. That the NMSBIC's called capital represents no more than 70% of the total outstanding loan portfolio.**
- 2. That the debt to equity ratio is no greater than 10 to 1.**
- 3. That the NMSBIC's credit facility remains 100% collateralized with specific loans of which no loans are greater than 180 days past due.**
- 4. That the NMSBIC's credit facility be over-collateralized by 5% with specifically identified loans of which none are greater than 180 days past due.**
- 5. That the increased capital be used for loans originated in the last 90 days.**
- 6. That none of the NMSBIC's pledged loans are restructured more than once in any calendar year.**
- 7. That The Loan Fund maintain a liquidity ratio of 5% of its loan portfolio.**

Chairman Baca expressed concern about oversight, given the size of this commitment. He asked if their auditors are aware of these covenants.

Mr. McDonald said he believed The Loan Fund is required to certify annually that they are meeting any covenants.

Chairman Baca asked Mr. Goblet to find out who the auditor is and how often they change auditors.

Mr. Goblet noted that only two covenants are in place at the current time: 100% collateralization, and 5% over-collateralization. He said The Loan Fund sends a listing of the over-collateralization pledged assets every quarter.

Ms. Longserre commented that the NMSBIC's job is to get money to the lending partners and help small businesses, but it has to do it in a way that chooses partners and agreements that meet the NMSBIC's fiduciary responsibility. She expressed concern that, while things look healthy right now with The Loan Fund, there could be an impact downstream from the restructuring of loans.

Mr. Cobb agreed. He pointed out that there is the potential for businesses to draw down credit lines in order to pay their obligations to The Loan Fund. Mr. Goblet noted that 20% of the loans in the portfolio are lines of credit, and Mr. Cobb said it would be useful to take a quick look at monthly cash flow numbers and find out what is being generated versus what the expenditures are.

Ms. Longserre asked Mr. Goblet to research what kind of liquidity ratio should be expected from a company like The Loan Fund.

Mr. Caldwell observed that their cash ratio is 20+%, and the NMSBIC wants 10%, and The Loan Fund wants 5%. He said their debt to equity is at 7 to 1, and they want it to be 10 to 1. He also noted that they have never had less than \$2 million in cash on the balance sheet, so going to a 5% liquidity ratio would not seem like a problem. He commented that, if any one of the covenants is triggered, it simply brings the NMSBIC and Loan Fund back to the table as opposed to closing down the deal.

Ms. Longserre said she felt the change in liquidity ratio from 10% to 5% was huge, and she was not comfortable with it.

**Ms. Longserre moved approval of the \$8,500,000 credit facility subject to the seven covenants, but amending #7 to reflect a 10% liquidity ratio. Ms. Garza seconded the motion, which passed by voice vote.**

#### **DISCUSSION AND POSSIBLE VOTE: GAP FUND HOLDING**

Mr. Goblet stated that nine portfolio companies remain inside the Gap Fund, and it appears as though there may be a significant event about to take place with a company in which the NM Gap Fund has a \$50,000 investment. If completed, it would create a new valuation at approximately 8 times the cost of the investment, and the NMSBIC might be able to sell its pro rata portion of that and generate a cash distribution back to the NMSBIC. He noted that the company in question is no longer headquartered in New Mexico.

Board members agreed that the NMSBIC should be receptive to getting its capital back.

Mr. Caldwell suggested exploring the idea of taking 75% out and leaving the balance in the fund.

**Mr. Cobb moved to consider permitting the sale of the equity interest. Mr. Knight seconded the motion, which passed by voice vote.**

**ADVISOR'S REPORT**

**NMCC**

Mr. Goblet reviewed Fund 1 current and projected value.

**FINANCE NEW MEXICO REPORT**

This report was in the packet for review.

**NEXT MEETING: Monday, March 21, 2011, WESST Enterprise Ctr**

**ADJOURNMENT**

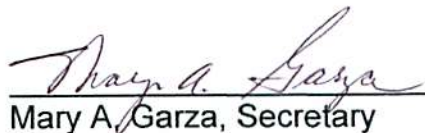
Its business completed, the NMSBIC Board adjourned the meeting at approximately 12:00 p.m.



Andrew Baca, President

4/26/11

Date



Mary A. Garza, Secretary

4/26/11

Date