



New Mexico  
Small Business Investment Corporation

2014 Annual Report

## Table of Contents

LETTER FROM THE NMSBIC BOARD CHAIR AND PRESIDENT .....	iii
INTRODUCTION .....	1
INVESTMENT OVERVIEW .....	1
IMPACT .....	1
THE NEW MEXICO ECONOMY .....	1
OBSERVATIONS .....	3
ACTIONS AND CHANGES .....	3
FINANCIAL HIGHLIGHTS.....	4
LENDING PROGRAM .....	7
EQUITY PROGRAM .....	8
PROGRAM COSTS AND BENEFITS .....	10
FINANCIAL EDUCATION .....	12
BOARD ENGAGEMENT .....	12
STATUTORY REQUIREMENTS .....	12
CONCLUSION .....	13
NMSBIC BOARD OF DIRECTORS.....	14
EXHIBIT A.....	15



Roxanna Meyers  
*Board Chair and President*  
New Mexico Small Business  
Investment Corporation



September 19, 2014

The Honorable Susana Martinez  
Office of the Governor  
490 Old Santa Fe Trail, Suite 400  
Santa Fe, New Mexico 87501

Dear Governor Martinez:

On behalf of the members of the Board of Directors of the Small Business Investment Corporation, doing business as the New Mexico Small Business Investment Corporation ("NMSBIC"), I want to thank you for appointing us to this important organization and giving us the opportunity to serve our State.

The NMSBIC was formed in 2001 by the Small Business Investment Act, NMSA 58-29-1 et. seq., to create new job opportunities in communities statewide, and is funded by an allocation from the Severance Tax Permanent Fund pursuant to NMSA 7-27-5.15. Upon receipt of the independent audited financial statements, the NMSBIC Board of Directors is charged with reporting the organization's financial results to you in accordance with the provisions of the Act. The enclosed report is intended to serve that purpose. A copy of the report of the independent auditors for the NMSBIC's fiscal year ended June 30, 2014 is also enclosed.

The NMSBIC Board of Directors (the "Board") is comprised of all new members (with the exception of the State Treasurer) appointed by you beginning in mid-2011. The new Board members have reviewed and learned from the organization's investment history and implemented a strategy focused on expanding the NMSBIC's lending program. The enclosed report includes observations regarding past activities and actions taken by the Board to strengthen and grow the NMSBIC.

On behalf of the members of the Board, I am pleased to report the changes we have made, and are making, to move the organization forward in a positive direction. We are committed to building a viable and sustainable structure to enable the NMSBIC to fulfill its mission of stimulating the state's economy and creating job opportunities throughout New Mexico, while preserving the NMSBIC's capital.

Roxanna Meyers  
Board Chair and President



Roxanna Meyers  
*Board Chair and President*  
New Mexico Small Business  
Investment Corporation



September 19, 2014

The Honorable Luciano Varela, Chairman  
New Mexico Legislative Finance Committee  
325 Don Gaspar, Suite 101  
Santa Fe, NM 87501

Dear Chairman Varela:

On behalf of the members of the Board of Directors of the Small Business Investment Corporation, doing business as the New Mexico Small Business Investment Corporation ("NMSBIC"), I want to express our appreciation for having the opportunity to serve our State.

The NMSBIC was formed in 2001 by the Small Business Investment Act, NMSA 58-29-1 et. seq., to create new job opportunities in communities statewide, and is funded by an allocation from the Severance Tax Permanent Fund pursuant to NMSA 7-27-5.15. Upon receipt of the independent audited financial statements, the NMSBIC Board of Directors is charged with reporting the organization's financial results to you in accordance with the provisions of the Act. The enclosed report is intended to serve that purpose. A copy of the report of the independent auditors for the NMSBIC's fiscal year ended June 30, 2014 is also enclosed.

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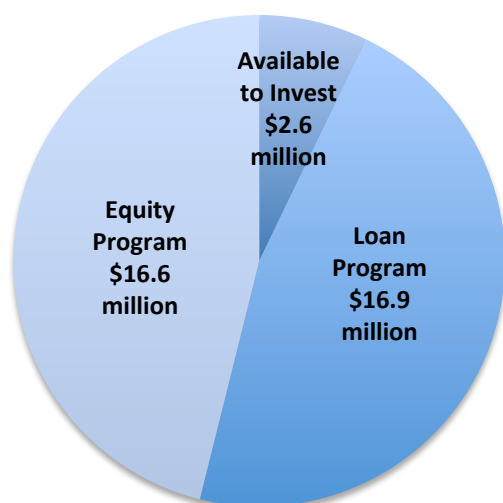
Roxanna Meyers  
Board Chair and President

## Introduction

The Small Business Investment Corporation, doing business as the New Mexico Small Business Investment Corporation (“NMSBIC”), was formed by the Small Business Investment Act in 2001 to create new job opportunities in communities statewide, and is funded by an allocation from the Severance Tax Permanent Fund.

## Investment Overview

The NMSBIC invests in New Mexico businesses through its lending and equity programs. As of June 30, 2014, the organization had \$36.1 million in total assets, in the following categories.



	Equity Program	Loan Program
Outstanding	\$14,810,398	\$12,087,045
Committed	\$1,836,697	\$4,787,955
Total	<u>\$16,647,095</u>	<u>\$16,875,000</u>

## Impact

Through its lending program, NMSBIC is an important source of funding for New Mexico nonprofit organizations engaged in micro-lending and small business lending in New Mexico. Lending partners include Accion, New Mexico Community Development Loan Fund (“The Loan Fund”), the

New Mexico Mortgage Finance Authority (MFA), and WESST Corp. Since its inception, and in connection with its lending partners, the NMSBIC has funded 3,056 loans to New Mexico start-up and small businesses that have provided an estimated 8,097 jobs throughout New Mexico.

**3,056 loans**  
**8,097 jobs**

Since its inception in 2001, and in connection with its equity partners, the NMSBIC has committed \$32.3 million in equity investments to start or grow 46 New Mexico businesses. Equity partners include Flywheel Ventures, Mesa Capital Partners, New Mexico Community Capital, New Mexico Mezzanine Partners, and Verge Fund. New Mexico businesses that are growing with equity funding from NMSBIC include Aero Mechanical Industries, Altela, Aspen Avionics, BoomTime, IntelliCyt, Wellkeeper, and Miox. These are only a few of the active companies started with equity provided by NMSBIC.

## Equity Investments in 46 New Mexico Companies

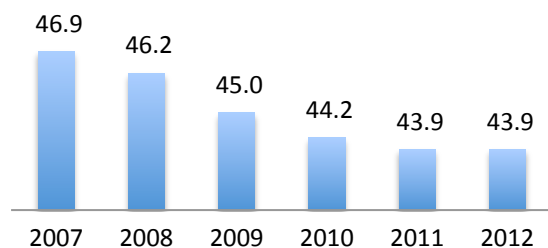
### The New Mexico Economy

New Mexico was impacted by the financial crisis that began in 2008. Employment and the number of business establishments declined, and the unemployment rate increased.

Recently released data for 2012 (most recent data available) from the Census Bureau’s County Business Patterns series show that the number of New Mexico business establishments decreased after 2007. The number of New Mexico business

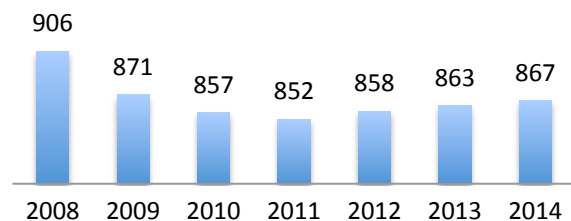
establishments increased slightly in 2012 to 43,883, from 43,860 in 2011.<sup>1</sup>

**New Mexico Business Establishments  
(in thousands)**



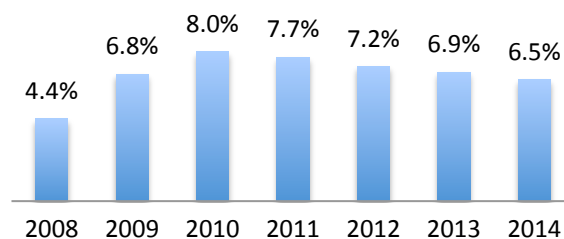
New Mexico employment increased in 2014 to 866,738, but has still not recovered to the June 2008 level of 906,269<sup>2</sup>.

**New Mexico Employment  
as of June 30 (in thousands)**



New Mexico's unemployment rate dropped from 6.9% at June 30, 2013, to 6.5% at June 30, 2014. The unemployment rate has declined from a high of 8.0% as of June 2010. However, unemployment has not returned to the June 2008 level of 4.4%<sup>3</sup>.

**New Mexico Unemployment Rate  
as of June 30**



UNM's Bureau of Business and Economic Research provided the following forecast in their report, *New Mexico Business Current Economic Report*, July 2014:

*"FOR-UNM forecasts that total employment in New Mexico will grow by 1.1% in 2014, and accelerate only minimally to 1.4% by 2016. Most new jobs will be in the private sector, though we expect a small increase in local and state government payrolls. With time and as new information becomes available, FOR-UNM increasingly sees the reasons for the anemic recovery of the state's economy to be structural rather than cyclical, and thus anticipates the slow rate of growth to persist for the long term. Specifically, with cuts to federal purchasing limiting the growth of employment in the professional & technical services industries, greater caution in residential construction markets, and market and natural limitations to sustain very rapid growth of the mining industries, there is no single sector of the economy poised to drive the expansion of the state's economy. Lacking a leading sector, FOR-UNM anticipates modest, if more stable growth across a number of economic sectors."*

The financial crisis that began in 2008 had an impact on several companies that received equity capital from NMSBIC and, at least in part, contributed to NMSBIC equity losses. While unemployment has improved since 2010, there is still a critical need for providing funds to protect existing jobs and promote job growth. NMSBIC believes expansion of its lending program addresses a serious funding gap created by retrenchment in the banking community, and is the most effective way to deliver funding to New Mexico businesses in the current

<sup>1</sup> Source: US Census Bureau County Business Patterns, <http://censtats.census.gov/cgi-bin/cbpnaic/cbpsect.pl>

<sup>2</sup> Bureau of Labor Statistics, [www.bls.gov](http://www.bls.gov)

<sup>3</sup> Bureau of Labor Statistics, [www.bls.gov](http://www.bls.gov)

environment. Expanding our lending program enables the NMSBIC to better preserve capital and to increase the velocity of that capital, thereby benefitting more small businesses in our state.

## Observations

The NMSBIC Board of Directors (“Board”) has reviewed and learned from the organization’s investment history. The following are the Board’s observations.

### Concentrations

Beginning in 2001, the NMSBIC committed \$32.3 million to equity capital investments. While these investments resulted in the establishment and growth of several New Mexico businesses, this was a high concentration of dollars in high-risk investment vehicles. When the financial crisis began in 2008, this high concentration of high-risk investments resulted in significant losses.

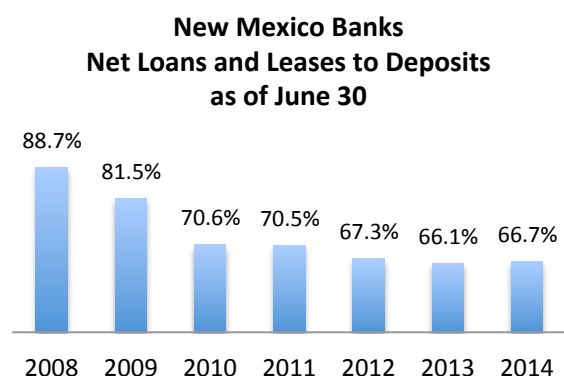
### Equity Investments in New Mexico

NMSBIC’s investment history has provided valuable experience and revealed significant challenges regarding venture capital investing as follows:

- NMSBIC’s total asset size relative to the historical amount invested in each company resulted in limited diversification;
- NMSBIC only invests in New Mexico companies, which further limits diversification;
- High risk and limited diversification appears to have contributed to significant venture capital investment losses during the recent economic downturn;
- Management fees paid to equity fund managers has reduced investment returns;
- Equity investments are typically long-term, which reduces the ability to turn over capital in additional new small businesses;
- Equity investments do not provide current income to offset NMSBIC’s operating expenses; and
- Equity investments have been geographically concentrated, with limited funding outside the Rio Grande Corridor.

## Lending Gap

As a result of the financial crisis, there has been a tightening of bank lending to small businesses. The loan-to-deposit ratio for New Mexico-based banks increased slightly from 66.1% at June 30, 2013, to 66.7% at June 30, 2014. However, the loan-to-deposit ratio is well below the June 2008 level of 88.7%.<sup>4</sup> This tight credit market provides an opportunity for NMSBIC to expand its lending program and help fill the current lending gap, especially for start-up and small expanding businesses.



## Actions and Changes

The NMSBIC has made the following changes and is taking action to strengthen the organization and capitalize on opportunities to stimulate economic growth in New Mexico.

### Prudent Investor Rule

In 2011, the board adopted the Prudent Investor Rule as a basis for all future investments. The NMSBIC will continue to employ that rule in evaluating loan and investment opportunities. NMSBIC loans and investments shall be underwritten in a way that balances yield, safety, diversification, and economic development.

### Expand Lending Program

The NMSBIC is working to expand its lending program. Advantages of the lending program include:

<sup>4</sup> Source [www.fdic.gov](http://www.fdic.gov), *Statistics on Depository Institutions*

- Helping to fill a funding gap for small businesses in New Mexico;
- Smaller transaction size benefits more businesses;
- Shorter-term investments result in higher turnover of funds;
- No dilution from management fees;
- Current interest income offsets NMSBIC operating expenses;
- Borrower equity and collateral reduces risk of loss; and
- Funds are provided to communities throughout New Mexico.

### Policies and Underwriting Criteria

The NMSBIC continues to evaluate lending partner policies and underwriting criteria to ensure proper controls are in place to mitigate loan loss risk related to an expansion of lending.

### Lending Partner Agreements

The NMSBIC continues to review its agreements with lending partners to ensure appropriate covenants are in place to protect both the NMSBIC and its lending partners, that loan terms provide appropriate risk versus reward balance, and there is a reasonable expectation of a positive financial return and preservation of NMSBIC capital. During the fiscal year the NMSBIC made the following changes:

- The NMSBIC terminated its prior loan participation agreement with Accion. Loans outstanding under the prior agreement will run off in the normal course of business. The NMSBIC entered into a new loan participation agreement with Accion under which NMSBIC earns interest at 3.0% per year, and NMSBIC losses are capped at 1.0% per year. Accion's maximum loan amount that can be made with NMSBIC funds was increased from \$200,000 to \$225,000, and funds committed to Accion were increased from \$3.5 million to \$5.0 million.
- The NMSBIC revised its revolving line of credit with The Loan Fund. The collateral requirement for small business loans pledged as collateral was reduced from 110% to 100%, given The

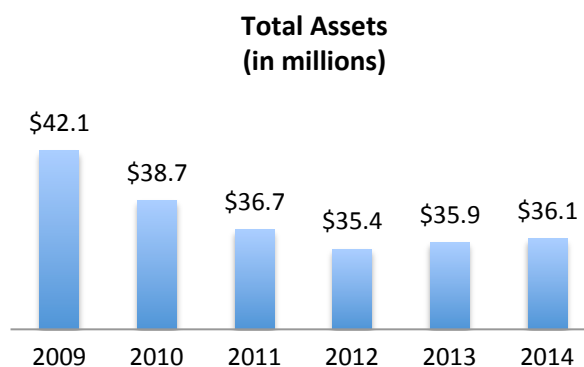
Loan Fund's history of low loan losses. The interest rate of 2% was extended to 2018, and previously staggered maturity dates were extended to a single, 10-year maturity date. The Loan Fund's maximum loan amount that can be made with NMSBIC funds was increased from \$350,000 to \$500,000, and funds committed to The Loan Fund were increased from \$8.5 million to \$10.0 million.

- The NMSBIC entered into a new revolving line of credit with the New Mexico Mortgage Finance Authority (MFA). The purpose of this loan is to provide funds to develop multi-family housing in areas of the state where lack of affordable housing is restricting job growth. The loan has an annual interest rate of 2%, maturity date of 5-years, and is unsecured, with MFA bearing all risk of loan losses. As of June 30, 2014, no funds had been advanced on this loan.

### Financial Highlights

Attached to this report are NMSBIC's audited financial statements for the fiscal year ended June 30, 2014. Financial highlights are as follows:

As of June 30, 2014, the NMSBIC ended its fiscal year with \$36.1 million in total assets, an increase from \$35.9 million the previous year. The increase was primarily due to interest income, realized gains on equity investments, and positive investment valuation adjustments on equity investments.



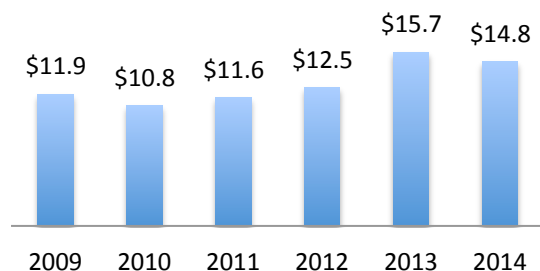


Equity investments decreased to \$14.8 million from \$15.7 million the previous year, primarily due to \$1.1 million in capital returned to NMSBIC from equity fund investments. Capital was returned to NMSBIC during the fiscal year from equity funds as follows:

NM Community Capital Fund I	\$192,444
Mesa NM Growth Fund II	44,731
Verge I	405,166
Verge I.5	359,561
Verge II	<u>107,051</u>
Total capital returned	<u>\$1,108,953</u>

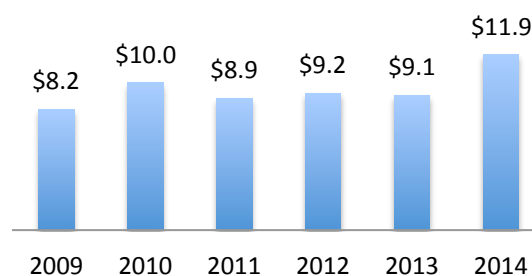
Equity investments are all related to commitments made in 2009 or prior. The NMSBIC has not made any new equity commitments since 2009.

**Equity Investments  
(in millions)**



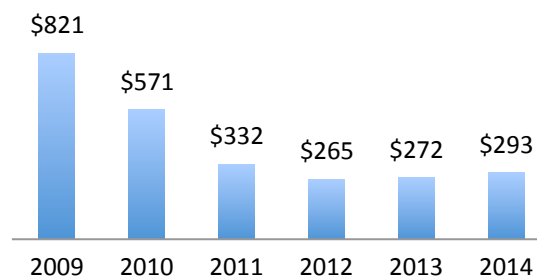
Loans, net of allowance for loan losses, increased to \$11.9 million from \$9.1 million the previous year. For the past several years, new loan demand was offset with loan payoffs, resulting in NMSBIC outstanding loan balances that were relatively flat. In 2014, new loan demand outpaced payoffs. Growth in outstanding loan balances, for the year ended June 30, 2014, was primarily from The Loan Fund and Accion, with net increases of \$1.6 million, and \$1.1 million, respectively.

**Loans Outstanding  
(in millions)**

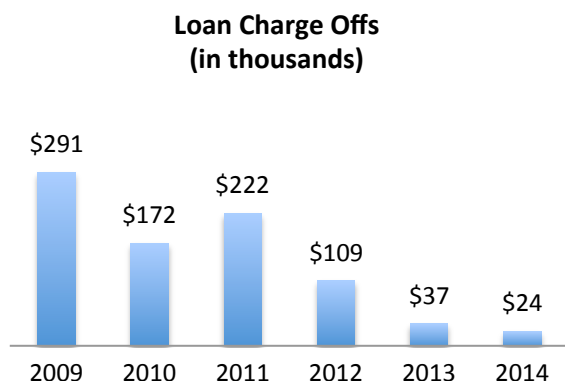


Interest and dividend income has declined since 2008 due to (i) a significant reduction in market interest rates paid on short-term investments, and (ii) movement of funds into non-interest bearing equity investments, to fund existing equity fund commitments. Interest income increased from \$272,284 in 2013, to \$293,411 in 2014, primarily due to the increase in outstanding loan balances.

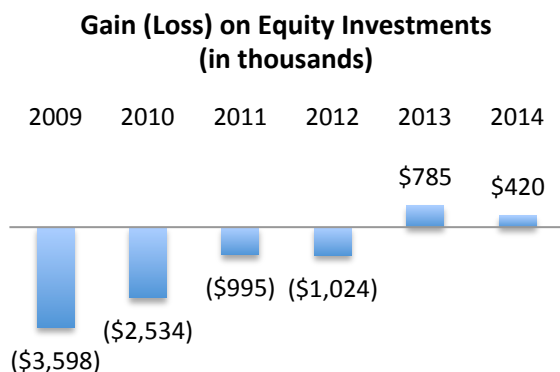
**Interest and Dividend Income  
(in thousands)**



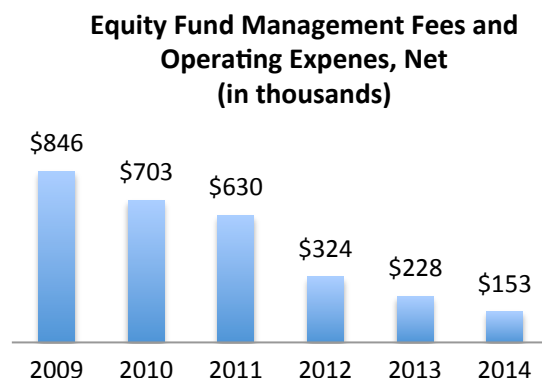
Loan charge-offs were relatively modest throughout the financial crisis. Loan charge-offs peaked in 2009 at \$290,600, which represented 2.6% of outstanding loan balances. Loan losses declined in 2014 to \$24,453, which represented 0.2% of outstanding loans. As noted above, NMSBIC renegotiated its agreement with Accion during the fiscal year to reduce exposure to loan losses.



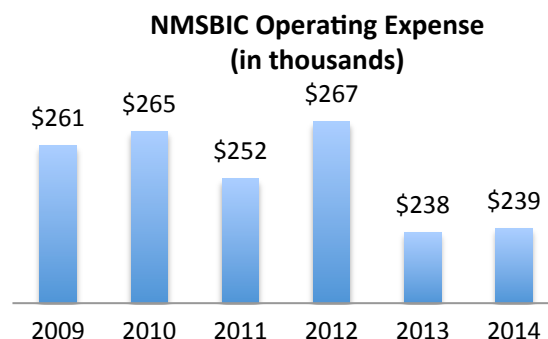
A trend of several years of losses on equity investments was reversed in 2013. The 2014 net gain of \$419,583 was comprised of \$224,788 in realized gains on investments, and \$197,795 in positive investment valuation adjustments.



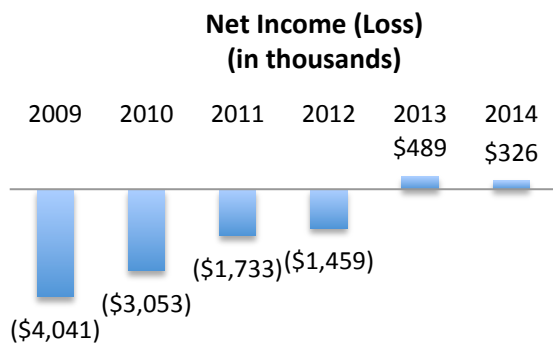
Management fees and expenses paid to equity funds have declined primarily due to some equity funds reaching the end of their fund lives. Equity fund other income offsets management fees and expenses.



NMSBIC's direct operating expenses of \$239,411 in 2014, were slightly higher than the previous year, and were comprised of \$114,143 in other program services, plus \$125,267 in management and general expenses. With \$36.1 million in total assets, operating expenses were 0.66% of total assets in 2014.



A trend of several years of losses was reversed in 2013. The NMSBIC had a positive change in net assets in 2014 of \$326,111. The positive change in net assets was primarily due to interest income on loans, realized gains on equity investments, and positive investment valuation adjustments on equity investments. As noted above, interest income increased in 2014, but was offset by lower gains on equity investments in 2014.

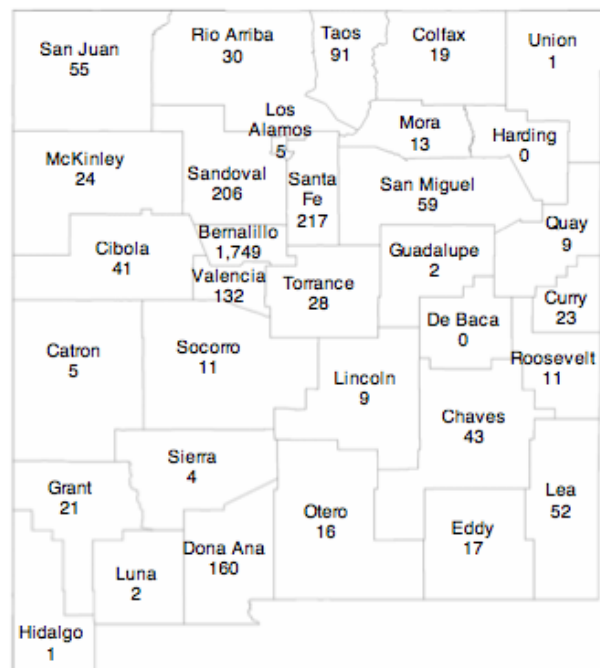


## NMSBIC Lending Partners



## Lending Program

The NMSBIC's lending program provides funding to nonprofit companies, including The Loan Fund, Accion, and WESST. Lending partners have provided 3,056 loans to businesses in communities statewide, in many cases preserving jobs that would have been eliminated without access to capital. Through its lending program, the NMSBIC has provided over \$54 million in loans since 2001 to businesses that would likely not have had access to such loans from other sources. Loans typically range in size from \$2,500 to \$250,000 to small businesses throughout New Mexico. Loans have been made in 31 of 33 New Mexico counties.



*Through its lending partners, the NMSBIC has provided funds for 3,056 loans in 31 of 33 counties in New Mexico.*

Since inception and through June 30, 2014, the NMSBIC funded the following volume of loans through its lending partners:

	# of <u>Loans</u>	Jobs <u>Supported</u>	Loan <u>Volume</u>
Accion	2,554	5,057	\$28,629,433
The Loan Fund	462	2,835	\$25,270,057
WESST	<u>40</u>	<u>205</u>	<u>\$584,944</u>
	3,056	8,097	\$54,484,434

As of June 30, 2014, the NMSBIC had the following amounts outstanding from, and committed to, its lending partners. Figures shown below for Accion have combined the prior and new loan participation agreements.

	# of <u>Loans</u>	<u>Outstanding</u>	<u>Committed</u>
Accion	473	\$4,244,457	\$5,000,000
The Loan Fund	93	\$7,754,799	\$10,000,000
MFA	0	\$0	\$1,500,000
WESST	<u>7</u>	<u>\$87,789</u>	<u>\$375,000</u>
Totals	573	\$12,087,045	\$16,875,000

The above figures show over \$54 million in loans have been funded with \$16.875 million of committed funds. Over three times the committed capital has been loaned and recycled via repayments of interest and principal, providing tremendous leverage of the NMSBIC's capital. As noted above, loan losses to the NMSBIC were about 0.2% of the outstanding balances. Given many of the borrowers would not qualify for traditional lending, the low loan losses under this program are impressive. The NMSBIC is working with its lending partners to expand the lending program in a responsible manner, placing more emphasis on this investment mechanism.

## NMSBIC Equity Partners



### New Mexico Mezzanine Partners

## Equity Program

Equity investments in New Mexico were virtually unheard of prior to 2000, but the efforts of the State Investment Council and the NMSBIC have attracted funds and investment professionals to New Mexico. Prior to 2004 there were no equity funds headquartered in New Mexico and no funds focused their capital and expertise exclusively on New Mexico companies. It was the NMSBIC's capital and early commitments that led to the investment in venture capital funds based in New Mexico.

Most large equity funds look to deploy \$5 to \$10 million in any one investment, whereas New Mexico had smaller, early stage companies that warranted investments of only \$250,000 to \$1 million. Few, if any, local companies would have been able to attract national attention and, without equity, could not have secured any credit relationships.

Beginning in 2004, the NMSBIC committed capital to Flywheel Ventures, Mesa Capital Partners, New Mexico Community Capital, New Mexico Mezzanine Partners, and Verge Fund to address the need for capital access for local start-ups, technology transfer licensees, and other small businesses looking to expand. With these five partners, NMSBIC has participated in nine venture capital

partnerships. One partnership, Mesa New Mexico Growth Fund I, reached final termination date of the partnership and was closed as of November 30, 2012.

Amounts committed, funded, and the current fair values as of June 30, 2014 are as follows:

(Dollars amounts in thousands \$000)

<u>Partner</u>	<u>Committed</u>	<u>Funded</u>	<u>Value</u>
Flywheel-I NMSBIC	\$1,500	\$1,500	\$349
NM Gap Fund I	\$2,000	\$2,000	\$2,036
NM Comm. Capital	\$7,000	\$6,555	\$3,561
NM Growth Fund II	\$3,500	\$2,988	\$139
NM Mezzanine Ptrs	\$3,000	\$2,487	\$2,071
Verge I	\$1,800	\$1,800	\$1,259
Verge I.5	\$3,000	\$3,000	\$2,044
Verge II	<u>\$3,000</u>	<u>\$2,735</u>	<u>\$3,350</u>
Totals	\$24,800	\$23,066	\$14,810

As previously noted, a trend of several years of losses on equity investments was reversed in 2013. Nevertheless, equity program performance was poor for several years, particularly for new and relatively small funds that carry the burden of management fees and expenses. The NMSBIC was especially adversely impacted by losses in the New Mexico Growth Funds I and II, to which NMSBIC made investment commitments in 2004 and 2007, respectively. Both funds were designed to make investments in lower risk non-tech companies that had existing clients, revenues, and profits. There was no equity capital in New Mexico that targeted these more traditional manufacturing and distribution sectors. These funds were designed to meet those needs. Approximately \$10.9 million was lost in these two funds.

Many private equity funds go through a period called the J-Curve, with losses during the early years of a fund's life, followed by gains as companies achieve successful "exits." Exits might be a sale of the company or new funding that pays off existing investors. Management fees, expenses, and early company failures result in losses in the early years. For many companies, the early stage of the J-Curve

was lengthened by the financial crisis that began in 2008. Given that most of the NMSBIC's equity investments were made during a similar time period, most of the investments are experiencing the same extended J-curve environment. Although the J-curve has been extended, NMSBIC did receive \$1.1 million in capital returned from equity funds in 2014, as noted above in Financial Highlights.

### **Equity Program Activity**

The following is a recap of equity fund activity during the past year:

- New Mexico Community Capital completed its two-year payout of capital from a successful company exit, and distributed quarterly payments to NMSBIC totaling \$370,507 during the fiscal year ended June 30, 2014.
- For New Mexico Gap Fund I, the NMSBIC approved a one-year extension for the payment management fees of \$50,000, and up \$16,000 in fund expenses. The NMSBIC board believes the one-year extension of these fees and expenses will likely protect and enhance the value of NMSBIC's \$2 million investment in this fund.
- New Mexico Growth Fund II had one remaining active company investment. The value of this company was fully diluted by follow-on debt and investments from other investors, and NMSBIC reduced the value of this remaining company to \$0 in during the fiscal year. The remaining value in this fund is related to receivables from the sale of a building and equipment, which are scheduled to be repaid by September 2015.
- New Mexico Mezzanine Partners recognized value from exercising an option on warrants. This option income of \$120,000 (NMSBIC's share), plus interest income on loans, were used to offset management fees and expenses for this fund.
- The Verge Funds had successful exits for two companies, and returned capital to NMSBIC

totaling \$1,040,000, of which \$261,358 (NMSBIC's share) was realized gain on investments.

### **Program Costs and Benefits**

The following page provides detailed historical costs and benefits related to the NMSBIC's equity and lending programs.

- Equity program life-to-date results are a loss of \$13.4 million, with 397 jobs reported at June 30, 2014, resulting in an estimated cost per job of \$33,876. Equity investments are long-term investments, therefore year-to-date results are not considered meaningful.
- Lending program life-to-date results are a net interest income (after loan losses) of \$716,396, with 8,097 jobs reported, for an estimated *profit* per job of \$88. For the twelve months ended June 30, 2014, net interest income was \$216,792, with 1,372 jobs reported, for an estimated *profit* per job of \$158.

### Equity Program Costs and Benefits:

	Net Investment	Estimated Value	Gain (Loss)	Jobs Reported at 6/30/14	Estimated Profit (Cost) per Job
Santa Fe Windows and Doors	(\$25,000)	\$0	\$25,000	n/a	n/a
Flywheel Ventures (2 funds)	\$3,411,989	\$2,385,453	(\$1,026,536)	65	(\$15,793)
NM Community Capital	\$5,814,003	\$3,561,343	(\$2,252,660)	253	(\$8,904)
Mesa NM Growth Funds (2 Funds)	\$10,437,551	\$139,080	(\$10,298,471)	18	(\$572,137)
NM Mezzanine Ptrs	\$2,048,976	\$2,070,818	\$21,842	64	\$341
Verge Funds (3 funds)	\$6,521,817	\$6,653,704	\$131,887	100	\$1,319
Adjustment for multiple funds invested in the same company (4 companies)				-103	
Total Equity Program	\$28,209,336	\$14,810,398	(\$13,398,938)	397	(\$33,750)

Equity fund investments are long-term investments. Life-to-date results are considered more meaningful than year-to-date information.

### Lending Program Costs and Benefits:

	Interest Income	Loan Charge Offs	Net Interest Income (Loss)	Jobs Reported at time of Origination	Estimated Profit (Cost) per Job
<b>Since Inception</b>					
ACCION 2003 Participation Agmt (1)	\$904,229	(\$1,230,134)	(\$325,905)	4,516	(\$72)
ACCION 2013 Participation Agreement	\$14,547	\$0	\$14,547	541	\$27
THE LOAN FUND Participation Agmt (2)	\$77,631	(\$11,519)	\$66,112	-	-
THE LOAN FUND Line of Credit	\$959,178	\$0	\$959,178	2,835	\$338
WESST Participation Program	\$19,159	(\$17,695)	\$1,464	205	\$7
Total Lending Program	\$1,974,744	(\$1,259,348)	\$715,396	8,097	\$88

#### 12 months ended June 30, 2014

ACCION 2003 Participation Agmt (1)	\$93,255	(\$24,453)	\$68,802	228	\$302
ACCION 2013 Participation Agreement	\$14,547	\$0	\$14,547	541	\$27
THE LOAN FUND Line of Credit	\$131,298	\$0	\$131,298	586	\$224
WESST Participation Program	\$2,145	\$0	\$2,145	17	\$126
Total Lending Program	\$241,245	(\$24,453)	\$216,792	1,372	\$158

(1) The ACCION 2003 participation agreement was terminated as of November 1, 2013. Loans outstanding as of the termination date will run off in the normal course of business.

(2) THE LOAN FUND 2004 participation agreement was terminated as of July 13, 2007.

## Financial Education

The NMSBIC is committed to promoting financial education and financial literacy throughout New Mexico. NMSBIC's financial education efforts are highlighted below:

### Finance New Mexico

The NMSBIC helped to create and continues to support a statewide business financial literacy resource called Finance New Mexico (see [www.financenewmexico.org](http://www.financenewmexico.org)). The organization was selected in 2009 as the Albuquerque Chamber of Commerce Small Business Advocate of the Year. Each week, business-related articles are published in several New Mexico newspapers and also circulated electronically to businesses and economic development organizations throughout the state. In 2013, Finance New Mexico introduced its "Grow It!" program in partnership with the New Mexico Municipal League. When a business registers in their local community, a Grow It! package is delivered to the business with information about financial resources and services available to small businesses in New Mexico. Finance New Mexico plays an important role in publicizing the NMSBIC's programs in all corners of the State.

### Clovis Community Meeting:

#### Accessing Capital in New Mexico

NMSBIC's October 2014 Board meeting will be held in Clovis, New Mexico. In connection with its Board meeting, the NMSBIC will present a community meeting in Clovis entitled, *Accessing Capital in New Mexico*. The meeting will include presentations from representatives of the Clovis Industrial Development Corporation, the Small Business Development Center at Clovis Community College, the Clovis Chamber of Commerce, The Loan Fund, Accion, WESST Corp., and the NMSBIC. This meeting continues the tradition of holding community outreach meetings throughout the state. In prior years the Board has held community outreach meetings in Española, Hobbs, Taos, Farmington, Las Cruces, and Santa Fe. It is the Board's intention to

continue to hold at least one of its meetings in communities around New Mexico each year.

## Board Engagement

NMSBIC Board members have actively engaged in various activities to support the organization. Board members have attended numerous community events, attended meetings with existing and potential equity and lending partners, and performed detailed loan and operational reviews at lending partner offices. The NMSBIC Board members are qualified professionals who are applying their collective and diverse business experience in reviewing activities and making sound decisions. The Board members have demonstrated their dedication and commitment to strengthening and improving the NMSBIC.

### Board Strategic Plan

The NMSBIC's strategic plan is focused on key initiatives to:

- Continue to focus on expanding the lending program throughout the entire state of New Mexico with existing and potential new partners; and
- Increase loan balances to maintain organizational self-sufficiency where interest income from loans and other interest earning assets exceeds operational expenses.

## Statutory Requirements

The following information is provided in accordance with NMSA 58-29-6(B) and 58-29-7.

### Audited Financial Statements

NMSBIC independently audited financial statements for the years ended June 30, 2014 and 2013 are attached to this report.

### Rate of Return

For the fiscal year ended June 30, 2014, the NMSBIC's total revenues of \$712,994 exceeded total of \$386,883, resulting in a positive change in net assets of \$326,111. This resulted in an increase



of 0.91% in net assets of \$35.9 million from the beginning of the fiscal year.

### **Desired Changes in the Corporation**

The NMSBIC Board recommends NMSA 58-29-7 be repealed, thereby removing the requirement that “net excess funds” be returned to the severance tax permanent fund. The effect of this change would be to help the NMSBIC self-fund the future expansion of its lending program, which is providing much needed capital to small businesses, and protecting and supporting jobs throughout New Mexico.

### **Continued Operation of the Corporation**

The NMSBIC Board recommends continued operation of the corporation with a focus on expanding lending programs to address a gap in available bank financing as described in this report.

### **Severance Tax Fund Distribution**

Under NMSA 58-29-7, the NMSBIC is charged with making a distribution of “net excess funds” to the severance tax permanent fund, calculated as return on investments to the corporation in the amount of dividends and interest actually received, plus any capital gains actually realized, less the operating expenses of the corporation and less amounts reasonably reserved for losses. For the fiscal year ended June 30, 2014, there is no distribution of funds to the severance tax permanent fund. A calculation of “net excess funds” is included in Note 6 of the attached audited financial statements.

### **Conclusion**

The NMSBIC is grateful for the support of the Governor, State Legislators, the State Investment Council, and its financial partners. Through the creation and expansion of the NMSBIC, New Mexico has created a unique delivery system of loans and investment capital for new and growing businesses.

Lending partners have provided 3,056 loans to businesses in communities statewide, in many cases

preserving jobs that would have been eliminated without access to capital, and creating jobs that would not exist without NMSBIC funds. Through its lending program, the NMSBIC has provided over \$54 million in loans to businesses that would likely not have had access to capital.

A trend of several years of losses on equity investments reversed in 2013. While equity investment losses since 2008 have been substantial, there are several new companies that are growing and prospering with equity provided by NMSBIC. The impact NMSBIC has had in helping to create an equity/venture community has been positive, but the role the NMSBIC has been asked to play in this arena was, in some instances, ill-conceived. The NMSBIC Board plans to continue to decrease the investment concentration in these high-risk investments.

With the reduction in traditional lending activity and heightened regulatory constraints imposed on banks, access to loans continues to be challenging for New Mexico small businesses. The NMSBIC, through its lending partners, plays a significant role in helping to fill that void. This program, created by the legislature, has been and continues to be a valuable State resource in investing taxpayer dollars in New Mexico businesses, in creating jobs for New Mexicans, and in having a positive impact on our State’s economic health.

Going forward, the NMSBIC plans to continue reducing the concentration of equity investments, and to continue increasing the level of its lending activities to achieve a more balanced level of risk for the organization, while delivering much needed funding for loans to New Mexico businesses.

Respectfully Submitted,

Roxanna Meyers  
Board Chair & President

## **NMSBIC Board of Directors**

Roxanna Meyers  
NMSBIC Board Chair and President  
President/Owner, Century Sign Builders  
Albuquerque, New Mexico

Joseph Badal  
NMSBIC Past Board Chair  
President and CEO, Joseph Badal & Associates  
Sandia Park, New Mexico

Lupe Garcia  
Owner, Garcia's Tires  
Santa Cruz, New Mexico

The Honorable James B. Lewis, State Treasurer  
State of New Mexico Office of the Treasurer  
Clarence L. Smith, Chief Operations Officer  
Designate for Treasurer Lewis  
Santa Fe, New Mexico

Alan Fowler, CMB  
NMSBIC Vice Chair and Vice President  
Executive Vice President, First Mortgage  
Company Albuquerque, New Mexico

Steven Morgan  
NMSBIC Secretary/Treasurer  
President, Bosque Consulting Group  
Bosque Farms, New Mexico

Launa Waller  
Regulatory Manager, Plateau  
Clovis, New Mexico

## **NMSBIC Executive Director/Investment Advisor**

Russell Cummins  
Owner, RDC Advisors LLC  
Tijeras, New Mexico



New Mexico Small Business Investment Corporation  
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(505) 274-7789 phone (505) 213-0048 fax  
[www.nmsbic.org](http://www.nmsbic.org)  
email: [russ.cummins@nmsbic.org](mailto:russ.cummins@nmsbic.org)

## **EXHIBIT A**

Independently Audited Financial Statements  
as of and for the years ended  
June 30, 2014 and 2013

**Small Business Investment Corporation**

**FINANCIAL STATEMENTS**

**June 30, 2014 and 2013**

## TABLE OF CONTENTS

	<u>Page</u>
Independent Auditors' Report.....	1-2
Financial Statements:	
Statements of Financial Position .....	3
Statements of Activities and Changes in Net Assets.....	4
Statements of Cash Flows .....	5
Notes to Financial Statements .....	6-14
Supplementary Schedules:	
Schedule of Activity of Debt Cooperative Agreements .....	15
Schedule of Activity of Equity Cooperative Agreements .....	16

## **INDEPENDENT AUDITORS' REPORT**

Board of Directors  
Small Business Investment Corporation

We have audited the accompanying financial statements of Small Business Investment Corporation, also known as the New Mexico Small Business Investment Corporation (NMSBIC), which comprise the statements of financial position as of June 30, 2014 and 2013, and the related statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to NMSBIC's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NMSBIC's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NMSBIC as of June 30, 2014 and 2013, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis-of-Matter Regarding Investments**

As discussed in Note 1 and Note 7, these financial statements include investments in partnerships valued by the general partner of each partnership in the absence of readily ascertainable market values. At June 30, 2014 and 2013, that portion of NMSBIC's investments was \$14,810,398 and \$15,652,588, respectively, which represents 41% and 44% of NMSBIC's net assets at those dates. Because of the inherent uncertainty of valuation of these investments, the estimate by each general partner of these values may differ significantly from values that would have been used had a ready market for those investments existed, and the difference could be material. Our opinion is not modified with respect to this matter.

**Other Matter**

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedule of activity of debt cooperative agreements and the schedule of activity of equity cooperative agreements on pages 15 and 16 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

September 19, 2014

  
Pulakos CPAs, PC

# Small Business Investment Corporation

## STATEMENTS OF FINANCIAL POSITION

June 30, 2014 and 2013

<u>Assets</u>	<u>2014</u>	<u>2013</u>
Current assets		
Cash and cash equivalents	\$ 3,307,669	\$ 6,219,243
Certificates of deposit	6,025,076	4,004,808
Interest and dividends receivable	7,270	630
Equity fund receivable	95,683	-
Prepaid expenses	4,201	3,923
Debt funding receivable	-	874,466
Total current assets	9,439,899	11,103,070
Equity investments in New Mexico entities	14,810,398	15,652,588
Cooperative loan agreements, net of allowance for losses	11,856,410	9,113,189
	<u>\$ 36,106,707</u>	<u>\$ 35,868,847</u>
<u>Liabilities and Net Assets</u>		
Current liabilities		
Accounts payable	\$ 197	\$ -
Capital calls payable	-	120,000
Debt funding payable	31,552	-
Total current liabilities	31,749	120,000
Temporarily restricted net assets	36,074,958	35,748,847
	<u>\$ 36,106,707</u>	<u>\$ 35,868,847</u>



## Small Business Investment Corporation

### STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Years Ended June 30, 2014 and 2013

	2014			2013		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
Revenues and other support:						
Interest and dividend income	\$ -	\$ 293,411	\$ 293,411	\$ -	\$ 272,284	\$ 272,284
Realized gain (loss) on investments	-	224,788	224,788	-	(509,721)	(509,721)
Investment valuation adjustments	-	194,795	194,795	-	1,294,651	1,294,651
Net assets released from restrictions	386,883	(386,883)	-	568,319	(568,319)	-
Total revenues and other support	386,883	326,111	712,994	568,319	488,895	1,057,214
Expenses:						
Program services						
Equity investment operating expense, net	152,820	-	152,820	228,121	-	228,121
Provision for loan losses	(5,347)	-	(5,347)	101,807	-	101,807
Other program services	114,143	-	114,143	117,469	-	117,469
Total program services	261,616	-	261,616	447,397	-	447,397
Management and general	125,267	-	125,267	120,922	-	120,922
Total expenses	386,883	-	386,883	568,319	-	568,319
Change in net assets	-	326,111	326,111	-	488,895	488,895
Net assets at beginning of year	-	35,748,847	35,748,847	-	35,259,952	35,259,952
Net assets at end of year	\$ -	\$ 36,074,958	\$ 36,074,958	\$ -	\$ 35,748,847	\$ 35,748,847

See Notes to Financial Statements and Independent Auditors' Report.

# Small Business Investment Corporation

## STATEMENTS OF CASH FLOWS

Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Change in net assets	\$ 326,111	\$ 488,895
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities		
Provision for loan losses	(5,346)	101,807
Net gain on investments and investment fees	(266,763)	(556,809)
Changes in operating assets and liabilities		
Interest and dividends receivable	(6,640)	8,892
Equity fund receivable	(95,683)	-
Debt funding receivable	874,466	(778,857)
Prepaid expenses	(278)	6,436
Accounts payable	197	-
Debt funding payable	31,552	(161,520)
Capital call payable	(120,000)	120,000
	<u>737,616</u>	<u>(771,156)</u>
Cash provided (used) by operating activities		
Cash flows from investing activities:		
(Purchase) maturity of certificates of deposit	(2,020,268)	8,515,870
Investments in New Mexico entities	(1,628,922)	(2,621,550)
	<u>(3,649,190)</u>	<u>5,894,320</u>
Cash (used) provided by investing activities		
Change in cash and cash equivalents	(2,911,574)	5,123,164
Cash and cash equivalents, beginning of year	<u>6,219,243</u>	<u>1,096,079</u>
Cash and cash equivalents, end of year	<u>\$ 3,307,669</u>	<u>\$ 6,219,243</u>

# **Small Business Investment Corporation**

## **NOTES TO FINANCIAL STATEMENTS**

**June 30, 2014 and 2013**

### **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Organization**

The Small Business Investment Corporation, also known as the New Mexico Small Business Investment Corporation (NMSBIC), is a nonprofit, independent, public corporation established by the New Mexico Small Business Investment Act, §58-29-1 et. Seq., NMSA1978, as amended (the Act). NMSBIC was formed to create new job opportunities by making equity investments in land, buildings or infrastructure for facilities to support new or expanding businesses in the State of New Mexico and to otherwise make debt investments and equity investments to create new job opportunities to support new or expanding businesses. NMSBIC's sole funding source is the New Mexico Severance Tax Permanent Fund.

NMSBIC seeks to establish programmatic, contractual relationships with existing and newly created providers of financial services to efficiently and effectively deliver capital for the purpose of creating new job opportunities and economic growth in the State of New Mexico. NMSBIC accomplishes this by providing capital for equity investments or loans for land, buildings or infrastructure to support new or expanded businesses, or equity investments or loans to New Mexico small businesses, to help support economic growth and job creation, and to otherwise enhance economic development objectives of the State of New Mexico.

#### **Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual events and results could differ from those assumptions and estimates. The most significant estimates involve the fair value of debt and equity securities. Because of inherent uncertainty in valuing these investments, the estimated fair value may differ from the values that would have been used had a ready market for the investments existed.

#### **Income Taxes**

NMSBIC is a nonprofit charitable corporation and has been recognized as tax-exempt under Section 501(c)(4) of the Internal Revenue Code. NMSBIC has adopted accounting principles generally accepted in the United States of America as they relate to uncertain tax positions, and has evaluated its tax positions taken for open tax years. Currently, the 2011, 2012 and 2013 tax years are open and subject to examination by the Internal Revenue Service and New Mexico Taxation and Revenue Department. Management believes that the activities of NMSBIC are within their tax-exempt purpose, and that there are no uncertain tax positions.

#### **Cash Equivalents**

Cash and cash equivalents at June 30, 2014 and 2013, consist of demand deposit accounts and money market deposit accounts held at New Mexico branches of state and national banks.

# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

### NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

#### Investments

NMSBIC reports gains and losses on investments in the Statements of Activities and Changes in Net Assets as increases or decreases in temporarily restricted net assets unless their use is permanently restricted by explicit donor stipulations or by law.

For purposes of making equity investments in accordance with the Act, NMSBIC enters into limited partnership agreements (Cooperative Agreements) as a limited partner. Investments are carried at market value as determined in good faith by the general partner of each such limited partnership, in accordance with Cooperative Agreements. The general partners of these limited partnerships determine market value based upon fair value of the underlying investments of the limited partnerships, as there is no ready market for these investments. Realized gains and losses are recorded on a specific identification method upon the sale or write-off of investment assets of the limited partnerships. Investment valuation adjustments are determined by general partners based on an increase or impairment in value in underlying investments during the investment-holding period. Management and operating fees of equity investments are determined by the general partners in accordance with the Cooperative Agreements and are reflected as a decrease in partner capital accounts.

A loan receivable is considered to be past due if any portion of the receivable balance is unpaid and outstanding for more than one month. For the years ended June 30, 2014 and 2013, allowances have been established for loan losses incurred as a result of debt investments made under Cooperative Agreements are as follows:

	<u>2014</u>	<u>2013</u>
Allowance for loan losses, beginning	\$ 260,434	\$ 195,710
Loan losses incurred in current period	(24,453)	(37,083)
Provision for loan losses	<u>(5,346)</u>	<u>101,807</u>
Allowance for loan losses, ending	<u>\$ 230,635</u>	<u>\$ 260,434</u>

Certificates of deposit are carried at their face value.

NMSBIC may only make debt and equity investments in New Mexico businesses and in accordance with restrictions imposed by the Act.

#### Net Asset Classifications

NMSBIC classifies net assets and revenues, expenses, gains and losses based on the existence, or absence, of donor-imposed restrictions. Unrestricted net assets have no donor-imposed restrictions. Revenues that are donor restricted are reported as increases in unrestricted net assets if the restrictions expire in the reporting period in which the revenue is recognized.

# **Small Business Investment Corporation**

## **NOTES TO FINANCIAL STATEMENTS**

**June 30, 2014 and 2013**

### **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

#### Other Program Services

Other program services are comprised of an allocation of management and general expenses directly related to delivery of program services.

#### Fair Value Measurements

Accounting Standards Codification Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 – Unadjusted quoted prices in active markets for identical investments that NMSBIC has the ability to access at the measurement date.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the investment, either directly or indirectly. These inputs may include quoted prices for the identical instrument in an inactive market, inputs other than observable quoted prices, or inputs derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

#### Financial Instruments

The carrying amounts of cash and cash equivalents, receivables, payables, and other liabilities approximate fair value due to the short maturity periods of these instruments.

#### Financial Statement Presentation

Certain reclassifications were made to the 2013 financial statements to conform with the 2014 presentation.

#### Subsequent Events

NMSBIC has evaluated all events occurring subsequent to June 30, 2014 and through September 19, 2014, which is the date that the financial statements were issued, and has disclosed or recorded any events occurring during this period require either recognition or disclosure in the accompanying financial statements.

# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

### NOTE 2 – CONCENTRATIONS

#### Concentration of Funding

NMSBIC receives 100% of its funding from the New Mexico Severance Tax Permanent Fund.

#### Concentration of Credit Risk

NMSBIC maintains its cash and cash equivalent balances in New Mexico branches of state and national financial institutions. The amounts on deposit with these financial institutions are insured by the Federal Deposit Insurance Corporation, are 100% collateralized by government-backed securities, or are 100% secured by a letter of credit from the Federal Home Loan Bank of Cincinnati. In 2011, NMSBIC had placed Certificates of Deposit into a CDARS® program where certificate of deposits were placed with a number of FDIC-insured depository institutions in amounts fully insured by the FDIC. In 2012, these CDARS® accounts were transferred into CDs that are 100% collateralized by government-backed securities. NMSBIC has not experienced, and believes it is not exposed, to significant credit risk from these deposits.

NMSBIC enters into Cooperative Agreements with parties that have demonstrated the ability to provide business assistance to new and expanding businesses and that are primarily engaged in the business of providing business services and debt and equity capital to new and expanding businesses. Under Cooperative Agreements with lenders, the lenders use their own funds and funds provided by NMSBIC to make loans to new and expanding businesses. Concentrations of credit risk arise from a number of loans made by such third parties utilizing NMSBIC funds to start up businesses. The lenders with which NMSBIC has entered into Cooperative Agreements have discretion as to whether or not to require, and the amount of, collateral taken, on the loans.

### NOTE 3 – FAIR VALUE MEASUREMENT

The following table presents the fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2014:

<u>Assets at Fair Value</u>				
<u>Description</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cooperative loan agreements	\$ 11,856,410	\$ -	\$ 11,856,410	\$ -
Equity investments in New Mexico entities	14,810,398	-	-	14,810,398
Certificates of deposit	6,025,076	-	6,025,076	-
	<u>\$ 32,691,884</u>	<u>\$ -</u>	<u>\$ 17,881,486</u>	<u>\$ 14,810,398</u>

# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

### NOTE 3 – FAIR VALUE MEASUREMENT - CONTINUED

The following table presents the fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2013:

<u>Assets at Fair Value</u>				
<u>Description</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cooperative loan agreements	\$ 9,113,189	\$ -	\$ 9,113,189	\$ -
Equity investments in New Mexico entities	15,652,588	-	-	15,652,588
Certificates of deposit	4,004,808	-	4,004,808	-
	<u>\$ 28,770,585</u>	<u>\$ -</u>	<u>\$ 13,117,997</u>	<u>\$ 15,652,588</u>

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used.

*Cooperative loan agreements:* Valued at the net asset value of debt investment at year-end.

*Equity investments in New Mexico entities:* Valued at market value as determined in good faith by the general partner of each such limited partnership.

*Certificates of Deposit:* Valued at face value plus accrued earnings, which approximate fair value.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while management believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

### Level 3 Investments

The following tables present NMSBIC's activities for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Balance, beginning of year	\$ 15,652,588	\$ 12,455,423
Total gains or losses (realized/unrealized) included in earnings	419,583	784,930
Operating expenses and management fees	(152,820)	(228,121)
Purchases and settlements, net	<u>(1,108,953)</u>	<u>2,640,356</u>
Balance, end of year	<u>\$ 14,810,398</u>	<u>\$ 15,652,588</u>

# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

### NOTE 4 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are restricted for funding debt or equity investments in accordance with the Act.

Temporarily restricted net assets are restricted for the following purposes:

	<u>2014</u>	<u>2013</u>
Cumulative severance tax permanent fund capital contributions	\$ 47,042,781	\$ 47,042,781
Cumulative expenses in excess of other revenues	<u>(10,967,823)</u>	<u>(11,293,934)</u>
	<u>\$ 36,074,958</u>	<u>\$ 35,748,847</u>

Temporarily restricted net assets were released as follows:

	<u>2014</u>	<u>2013</u>
Satisfaction of purpose restrictions	<u>\$ 386,884</u>	<u>\$ 568,320</u>

### NOTE 5 – STATE INVESTMENT OFFICER COMMITMENT

Prior to July 1, 2007, Section 7-27-5.15 NMSA 1978 required that the State Investment Officer make a commitment to NMSBIC pursuant to the Act to invest three-fourths of one percent of the market value of the New Mexico Severance Tax Permanent Fund. If at any time the commitment fell below that level, further commitments must be made until the invested capital is equal to three-fourths one percent of the market value of the fund. Effective July 1, 2007, the commitment was increased to one percent. However, during fiscal years 2014 and 2013, no funding was received from the State Investment Officer due to the net market value of the New Mexico Severance Tax Permanent Fund.

### NOTE 6 – NET EXCESS FUNDS

Pursuant to Section 58-29-7 NMSA 1978, the NMSBIC shall return to the Severance Tax Permanent Fund an amount equal to the net excess funds held by the NMSBIC. "Net excess funds" are calculated as the return on investments to the corporation in the amount of dividends and interest actually received plus any capital gains actually realized, less the operating expenses of the NMSBIC and less amounts reasonably reserved for losses. As of June 30, 2014, NMSBIC has not generated cumulative net excess funds that would require funds to be returned to the Severance Tax Permanent Fund.



# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

### NOTE 6 – NET EXCESS FUNDS - CONTINUED

NMSBIC's calculations of net excess fund balances as of June 30, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Interest and dividends received, cash basis	\$ 282,210	\$ 243,696
Operating expenses, net of loan losses	(392,230)	(466,514)
Accumulated reserve for debt and equity losses	(1,707,437)	(1,694,404)
Capital gains (losses) realized	<u>224,788</u>	<u>(509,721)</u>
Net (deficient) excess funds	<u>\$ (1,592,669)</u>	<u>\$ (2,426,943)</u>

### NOTE 7 – INVESTMENTS IN NEW MEXICO ENTITIES

#### Cooperative Loan Agreements

NMSBIC is party to two loan participation Cooperative Agreements with New Mexico non-profit corporations (ACCION and WESST Corp.). Under these agreements, NMSBIC has made capital commitments to provide revolving funding for loans to be made by these corporations to New Mexico small businesses. For each loan made, these corporations provide 25% of the funding and NMSBIC provides the remaining 75%. Under the participation agreement with WESST Corp., the NMSBIC shares in 75% of loan losses and recoveries. In November 2013, NMSBIC terminated its loan participation agreement with ACCION and entered into a new participation agreement. Loans outstanding under the terminated participation agreement will run off in the normal course of business. The NMSBIC shares in 75% of loan losses and recoveries under the terminated participation agreement. The new agreement limits loan losses that can be passed through to NMSBIC to 1% of the outstanding loan balance during any fiscal year. The terms, pricing, and size of any loan are subject to the discretion of these corporations. These corporations make non-traditional loans. Collateral for the loans may also be non-traditional, or in some cases no collateral at all.

The loans are considered risky and may have a higher rate of default than traditional loans. Loan amounts made under the program are limited under the agreements. These corporations undertake good faith efforts to make loans outside the Albuquerque metropolitan area. Loans are serviced by these corporations, with monthly reports and principal and interest remittances provided to NMSBIC. NMSBIC's agreements with these corporations have no maturity date, but may be terminated by either party upon ninety days written notice, with any loans outstanding at the time of termination handled in the ordinary course of business until the loans are collected or written off. During the years ended June 30, 2014 and 2013, \$109,948 and \$77,793, respectively, of interest income was recognized related to these investments. See supplementary schedules for detail on these agreements.

# **Small Business Investment Corporation**

## **NOTES TO FINANCIAL STATEMENTS**

**June 30, 2014 and 2013**

### **NOTE 7 – INVESTMENTS IN NEW MEXICO ENTITIES – CONTINUED**

In December 2013, NMSBIC entered into an unsecured line-of-credit agreement with a New Mexico nonprofit corporation (New Mexico Mortgage Finance Authority, or NMMFA) to provide funds for the development of affordable housing in areas of New Mexico where job growth is restricted by a shortage of such housing. Under this agreement, NMSBIC provides a revolving, unsecured loan to this corporation, which matures in November 2018. NMSBIC does not share in any loan losses or recoveries. Loans are serviced by the corporation, with quarterly reports and principal and interest remittances provided to NMSBIC. The agreement contains provisions that the corporation agrees to maintain a certain level of net assets, and agrees to undertake good faith efforts to make loans outside the Albuquerque metropolitan area. During the year ended June 30, 2014 the corporation did not draw on the line-of-credit, resulting in a zero balance at June 30, 2014, and zero interest income recognized for the fiscal year ended June 30, 2014.

NMSBIC is party to a revolving loan Cooperative Agreement with a New Mexico nonprofit corporation (New Mexico Community Development Loan Fund, or NMCDLF). Under this agreement, NMSBIC provides a revolving loan to this corporation, which in turn is fully collateralized by pledged loans. Certain delinquent loans are not eligible to be used as collateral. NMSBIC does not share in any loan losses or recoveries. The agreement includes other provisions under which the corporation has agreed to:

- Maintain certain levels of liquidity, leverage, and net assets
- Limit the maximum loan size under the program
- Restrict loan modifications on nonperforming loans
- Undertake good faith efforts to make loans outside the Albuquerque metropolitan area

Loans are serviced by the corporation, with quarterly reports and principal and interest remittances provided to NMSBIC. The outstanding principal balance of the revolving loan matures in January 2024. Either party can terminate the agreement with 90 days written notice, with the outstanding balance repaid based on balances of collateralized loans.

During the years ended June 30, 2014 and 2013, \$131,298 and \$148,836 of interest income was recognized related to this investment. See supplementary schedules for detail on this agreement.

#### Equity Cooperative Agreements

NMSBIC is party to several Subscription Agreements and Limited Partnership Agreements under which it has acquired interests during calendar years from 2004 to 2009 as a limited partner in various limited partnerships. Under these agreements, NMSBIC has made capital contribution commitments to provide funding to these limited partnerships to be used for debt or equity investments made in New Mexico small businesses. The limited partnerships have termination dates through 2019. Under the terms of the limited partnership agreements, the partnerships may be extended to dates that range from 2014 to 2022. See supplementary schedules for detail on these agreements. In November 2012 the NM Growth Fund I closed down per the terms of the equity cooperative agreement. The final cash was distributed to partners during 2013.

# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

### NOTE 8 – CAPITAL COMMITMENTS

At June 30, 2014, NMSBIC had committed approximately \$41,675,000 of capital through its various Debt and Equity Agreements, of which \$35,050,348 has been called, leaving a remaining commitment of \$6,624,652. NMSBIC has approximately \$3,310,000 of cash-on-hand to immediately handle capital calls. Additionally, NMSBIC has staggered the maturity dates of its four certificates of deposit such that \$1,500,000 matures every 90 days. NMSBIC's investment policy allows for capital commitments in excess of capital.

The following table presents capital commitments for each Debt and Equity Agreement as of June 30, 2014:

	<b>Loan and Equity Capital Commitments</b>	<b>Outstanding Loan Balance, Life-to-Date Equity Capital Funded</b>	<b>Remaining Loan and Equity Capital Commitments</b>
<b>Debt Cooperative Agreements</b>			
1. ACCION	\$ 5,000,000	\$ 4,244,457	\$ 755,543
2. NMCDLF	10,000,000	7,754,799	2,245,201
3. WESST CORP	375,000	87,789	287,211
4. NMMFA	1,500,000	-	1,500,000
	<u>16,875,000</u>	<u>12,087,045</u>	<u>4,787,955</u>
<b>Equity Cooperative Agreements</b>			
1. Flywheel	1,500,000	1,500,000	-
2. NMGF I	-	Investment closed in 2012	
3. NMCCF	7,000,000	6,555,017	444,983
4. Verge 1	1,800,000	1,800,000	-
5. Verge 1.5	3,000,000	3,000,000	-
6. NM Gap Fund I	2,000,000	2,000,000	-
7. NMGF II	3,500,000	2,987,837	512,163
8. NM Mezzanine Fund	3,000,000	2,385,000	615,000
9. Verge II	3,000,000	2,735,449	264,551
	<u>24,800,000</u>	<u>22,963,303</u>	<u>1,836,697</u>
	<u>\$ 41,675,000</u>	<u>\$ 35,050,348</u>	<u>\$ 6,624,652</u>

### NOTE 9 – SUBSEQUENT EVENT

Subsequent to June 30, 2014, NMSBIC entered into a loan agreement in the amount of \$750,000 with Rio Vista Growth Capital, LLC (RVGC). Funds provided to RVGC under the terms of the loan agreement will be used to make, acquire, or maintain loans with New Mexico businesses in accordance with the mission and purpose of the NMSBIC.

## **SUPPLEMENTARY SCHEDULES**

## Small Business Investment Corporation

### SCHEDULES OF ACTIVITY OF DEBT COOPERATIVE AGREEMENTS

#### Years Ended June 30, 2014 and 2013

	Loan Commitments	Beginning Gross Loan Balance	Loan Funding Net of Repayments	Loan Recovery (Loss), Realized	Ending Gross Loan Balance	Allowance for Loan Losses	Ending Net Loan Balance
For the year ended June 30, 2014							
1. ACCION #1*	\$ -	\$ 3,186,554	\$ (573,990)	\$ (24,453)	\$ 2,588,111	\$ (207,049)	\$ 2,381,062
2. ACCION #2	5,000,000	-	1,656,346	-	1,656,346	(16,563)	1,639,783
3. NMCDLF	10,000,000	6,118,196	1,636,603	-	7,754,799	-	7,754,799
4. WESST CORP	375,000	68,873	18,916	-	87,789	(7,023)	80,766
5. NMMFA	1,500,000	-	-	-	-	-	-
	<u>\$ 16,875,000</u>	<u>\$ 9,373,623</u>	<u>\$ 2,737,875</u>	<u>\$ (24,453)</u>	<u>\$ 12,087,045</u>	<u>\$ (230,635)</u>	<u>\$ 11,856,410</u>
For the year ended June 30, 2013							
1. ACCION #1	\$ 3,500,000	\$ 2,396,356	\$ 827,281	\$ (37,083)	\$ 3,186,554	\$ (254,924)	\$ 2,931,630
2. NMCDLF	8,500,000	6,983,125	(864,929)	-	6,118,196	-	6,118,196
3. WESST CORP	375,000	50,031	18,842	-	68,873	(5,510)	63,363
	<u>\$ 12,375,000</u>	<u>\$ 9,429,512</u>	<u>\$ (18,806)</u>	<u>\$ (37,083)</u>	<u>\$ 9,373,623</u>	<u>\$ (260,434)</u>	<u>\$ 9,113,189</u>

\*The ACCION #1 commitment was terminated in 2014 and replaced by ACCION #2. Active loans under the ACCION #1 agreement will run off under their normal course.

See Independent Auditors' Report.

# Small Business Investment Corporation

## SCHEDULES OF ACTIVITY OF EQUITY COOPERATIVE AGREEMENTS

### Years Ended June 30, 2014 and 2013

	Investment Capital Commitments	Beginning Investment Fair Value	Cumulative Capital Calls and Redemptions	Realized Gain (Loss) on Investments	Investment Valuation Adjustments	Operating Income (Expense), net	Ending Investment Fair Value
For the year ended June 30, 2014							
1. Flywheel	\$ 1,500,000	\$ 429,067	\$ -	\$ -	\$ (40,324)	\$ (39,471)	\$ 349,272
2. NMGF I	-	-	-	-	-	-	-
3. NMCCF	7,000,000	3,697,162	(192,444)	-	217,405	(160,781)	3,561,342
4. Verge I	1,800,000	1,619,609	(405,166)	71,314	(7,265)	(19,490)	1,259,002
5. Verge 1.5	3,000,000	2,715,001	(359,561)	18,486	(279,997)	(49,556)	2,044,373
6. NM Gap Fund I	2,000,000	1,962,610	-	(36,570)	162,193	(52,052)	2,036,181
7. NMGF II	3,500,000	403,616	(44,731)	-	(219,912)	107	139,080
8. NM Mezzanine Fund	3,000,000	1,852,976	-	-	-	217,842	2,070,818
9. Verge 2	3,000,000	2,972,547	(107,051)	171,558	362,695	(49,419)	3,350,330
	<u>\$ 24,800,000</u>	<u>\$ 15,652,588</u>	<u>\$ (1,108,953)</u>	<u>\$ 224,788</u>	<u>\$ 194,795</u>	<u>\$ (152,820)</u>	<u>\$ 14,810,398</u>
For the year ended June 30, 2013							
1. Flywheel	\$ 1,500,000	\$ 461,001	\$ -	\$ -	\$ -	\$ (31,934)	\$ 429,067
2. NMGF I	-	3,729	(2,842)	-	-	(887)	-
3. NMCCF	7,000,000	3,417,050	261,672	-	111,664	(93,224)	3,697,162
4. Verge I	1,800,000	1,467,244	99,000	-	83,286	(29,921)	1,619,609
5. Verge 1.5	3,000,000	2,420,923	225,000	-	121,378	(52,300)	2,715,001
6. NM Gap Fund I	2,000,000	1,215,632	(64,658)	-	787,498	24,138	1,962,610
7. NMGF II	3,500,000	907,380	13,208	(509,721)	-	(7,251)	403,616
8. NM Mezzanine Fund	3,000,000	886,568	953,976	-	-	12,432	1,852,976
9. Verge 2	3,000,000	1,675,896	1,155,000	-	190,825	(49,174)	2,972,547
	<u>\$ 24,800,000</u>	<u>\$ 12,455,423</u>	<u>\$ 2,640,356</u>	<u>\$ (509,721)</u>	<u>\$ 1,294,651</u>	<u>\$ (228,121)</u>	<u>\$ 15,652,588</u>

See Independent Auditors' Report.

September 19, 2014

To the Board of Directors  
New Mexico Small Business Investment Corporation

In planning and performing our audit of the financial statements of Small Business Investment Corporation, also known as the New Mexico Small Business Investment Corporation (NMSBIC) for the year ended June 30, 2014, in accordance with auditing standards generally accepted in the United States of America, we considered NMSBIC's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the NMSBIC's internal control. Accordingly, we do not express an opinion on the effectiveness of the NMSBIC's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of NMSBIC's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

This communication is intended solely for the information and use of management, the Board of Directors, and others within NMSBIC, and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

  
Pulakos CPAs, PC