



New Mexico  
Small Business Investment Corporation

2016 Annual Report

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Alan Fowler, CMB  
*Board Chair and President*  
New Mexico Small Business  
Investment Corporation



September 26, 2016

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, 2016 is also enclosed.

The NMSBIC Board of Directors (the "Board") is comprised of all new members appointed by you beginning in mid-2011, and the State Treasurer who holds a permanent seat on the Board. 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.

Alan Fowler, CMB  
Board Chair and President



Alan Fowler, CMB  
*Board Chair and President*  
New Mexico Small Business  
Investment Corporation



September 26, 2016

The Honorable John Arthur Smith, Chairman  
New Mexico Legislative Finance Committee  
325 Don Gaspar, Suite 101  
Santa Fe, NM 87501

Dear Chairman Smith:

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, 2016 is also enclosed.

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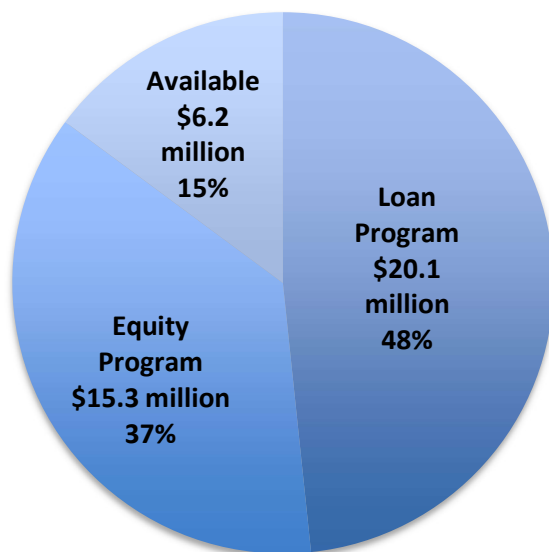
Alan Fowler, CMB  
Board Chair and President

## 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, 2016, the organization's invested, committed, and available funds were as follows.



	Equity Program	Loan Program
Outstanding	\$ 14,994,617	\$ 17,052,981
Committed	\$ 321,440	\$ 3,072,019
Total	\$ 15,316,057	\$ 20,125,000

## 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"), Rio Vista Growth Capital, and WESST Corp. Since its inception, and in connection with its lending partners, the NMSBIC has funded 3,793 loans to New Mexico start-up and small businesses that have supported an estimated 10,139 jobs throughout New Mexico.

**3,793 loans**  
**10,139 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 47 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 Altela, Aspen Avionics, BoomTime, IntelliCyt, Wellkeeper, and Miox. These are only a few of the active companies started with equity provided by NMSBIC.

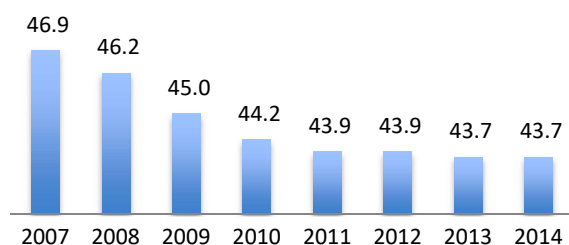
**Equity Investments in  
47 New Mexico  
Companies**

## 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.

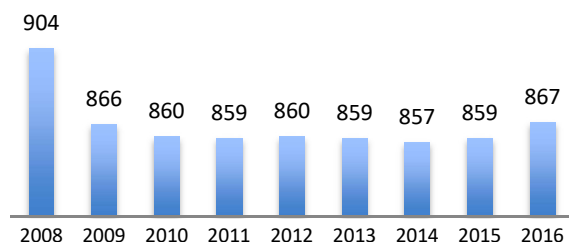
Recently released data for 2014 (most recent data available) from the Census Bureau's County Business Patterns series show that the number of New Mexico business establishments has decreased since 2007.<sup>1</sup>

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



New Mexico employment increased in 2016 to 866,658, but has still not recovered to the June 2008 level of 904,430<sup>2</sup>.

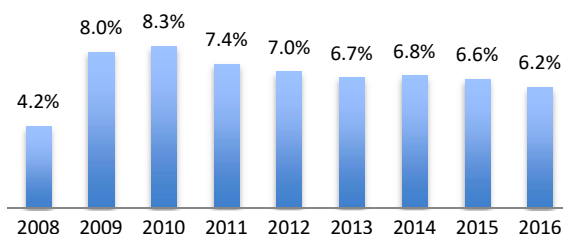
**New Mexico Employment  
as of June 30 (in thousands)**



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

New Mexico's unemployment rate dropped from 6.6% at June 30, 2015, to 6.2% at June 30, 2016. The unemployment rate has declined from a high of 8.3% as of June 2010. However, unemployment has not returned to the June 2008 level of 4.2%<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, *FOR-UNM Bulletin, A Quarterly Forecast of the New Mexico Economy, Summer 2016*:

### New Mexico Review and Outlook

According to the Bureau of Labor Statistics' QCEW employment data, New Mexico added just 780 jobs (0.1%) in the final quarter of 2015. Job loss was entirely due to the collapse of the oil & gas sector: 5,449 jobs (-18.9%) were lost in the mining sector alone. More generally, employment in non-metro regions of the state was down 5,400 jobs (-1.7%). In sharp contrast, Albuquerque MSA gained 5,997 jobs (1.6%) in 2015Q4, the metro area's best performance since 2006.

Layoffs in the oil & gas industry are likely causing people to leave the labor force (if not the state). After growing by 10,060 persons (1.1%) during the first three quarters of 2015 – the first increase since early-2009 – the New Mexico labor force contracted by 1,450 (-0.2%) in 2015Q4 and 6,984 (-0.8%) in 2016Q1. The contraction of the labor force is mainly in non-metro areas.

The weak labor market is depressing personal income growth. In 2015Q4 and 2016Q1,

<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)

wage & salary disbursements were up only 0.3% and 2.5%, respectively, holding total personal income growth to just 2.0% and 2.9%. Relatively slow growth of proprietors' income, closely tied to oil & gas earnings, also hurt the cause.

Housing sales were up by more than 10% in 2015 and 5.8% in the first half of 2016. Higher sales have begun to spur an increase in residential construction, at least for single-family homes. In 2015, permits issued for the construction of single-family homes in New Mexico were up 6.4% (3,664 units); available data indicate that the number of single-family residential building permits were up about 10% in the first half of 2016 (1,997 units), the best performance since 2013. Multifamily residential construction, however, has not kept pace.

FOR-UNM's outlook for the New Mexico economy is little changed from the April forecast. We expect 0.5% job growth in 2016 with the second half of the year slightly stronger than the first half. Employment growth in 2017 will be an improvement over 2016 (9,400 jobs, 1.2%) as job cuts in the mining sector fade. Looking ahead, job growth will likely peak in 2018.

The health care & social assistance sector will continue to drive employment growth in the near term. FOR-UNM anticipates that the sector will add 4,100 jobs (3.6%) in 2016. Leisure & hospitality, which includes arts, entertainment & recreation and accommodation & food service (1,785 jobs, 1.9%), professional & technical services (660 jobs, 1.2%) and construction (575 jobs, 1.3%) will also add jobs in 2016. Cuts in mining employment will be deeper than anticipated in April (-3,200 jobs, -12.6% for year). Constrained by tight finances, the public sector payrolls will be reduced (-1,250 jobs, -0.7%). We expect a similar pattern of growth in 2017 except, significantly, cuts to oil & gas payrolls will begin to fade.

With half of the year in the books, New Mexico's labor force will close the year in negative territory (-5,200, -0.6%). Small employment gains are expected to result in a small expansion of the labor force in 2017 (5,500 persons, 0.6%). New Mexico's unemployment rate, currently 6.2%, will remain above the national rate throughout the forecast

period. The headline rate is expected to average 6.2% in 2016, 5.9% in 2017.

The outlook for income growth for the remainder of 2016 is disappointing (\$2.3 billion, 2.9%). A weak labor market, especially in the well-paid oil & gas sector, will cap the growth of wage & salaries (\$935 million, 2.5%). Soft commodity and equity markets will hold down the growth of both investment (\$380 million, 2.6%) and proprietors' income (\$175 million, 3.2%). Transfer payments will increase by \$815 million (4.3%), only half the rate of the past two years when Medicaid transfers increased by more than two-thirds.

As always, the state's housing markets are a critical factor in this forecast. FOR-UNM anticipates that the market will be stronger than in the past several years, but not strong enough to catalyze economic growth. We expect permits to be issued for the construction of 4,670 housing units in 2016, 5,430 in 2017, and an average of 7,350 per year during the period 2018-2022. At the end of the forecast period, total residential construction will remain less than one-half of the pre-recession high.

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 the continued 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 environment. Expanding our lending program enables the NMSBIC to better preserve capital and to increase the turnover 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

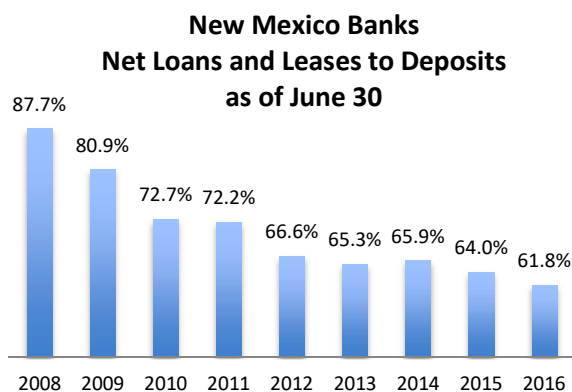
NMSBIC's investment history has provided valuable experience and revealed significant challenges regarding venture capital investing as follows:

- 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 economic downturn;
- Management fees paid to equity fund managers has reduced investment returns;
- Equity investments are typically long-term, which reduces the ability to turnover 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 decreased from 64.0% at June 30, 2015, to 61.8% at

June 30, 2016, and is well below the June 2008 level of 87.7%.<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.

#### Expansion of Lending Program

The NMSBIC has been, and is continuing to expand its lending program. Advantages of the lending program include:

- Helping to fill a funding gap for small businesses in New Mexico;
- Smaller transaction size benefits more businesses;

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



- 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 all of 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 that appropriate covenants are in place to protect both the NMSBIC and its lending partners, 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 change:

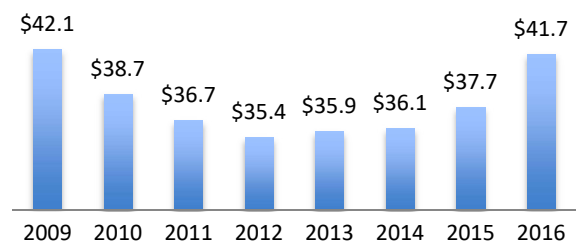
- The NMSBIC increased the maximum funding level for ACCION's loan participation agreement from \$5.75 million to \$6.5 million, under new terms put in place in 2013. Under the new 2013 lending program with Accion, the NMSBIC earns interest of 3.0% annually, and the NMSBIC's loan losses are capped at 1.0% annually.

## **Financial Highlights**

Attached to this report are NMSBIC's audited financial statements for the fiscal year ended June 30, 2016. Financial highlights are as follows:

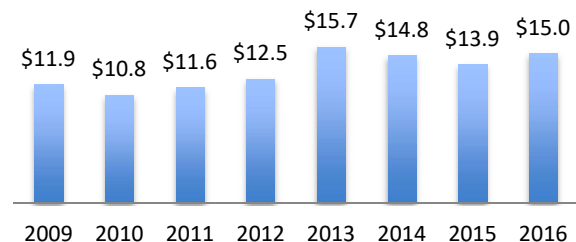
As of June 30, 2016, the NMSBIC ended its fiscal year with \$41.7 million in total assets, an increase from \$37.7 million the previous year. The increase was primarily due to realized gains on the sale of a company, in which two NMSBIC equity partners were investors, New Mexico Community Capital and Verge Fund.

**Total Assets  
(in millions)**



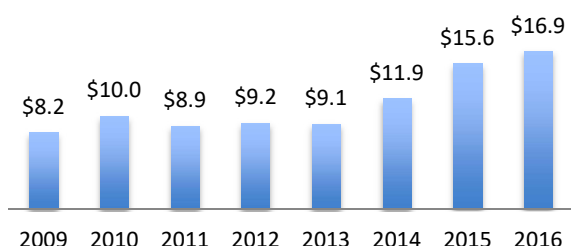
Equity investments increased to \$15 million from \$13.9 million the previous year. Activity was comprised of net realized gains of \$3.7 million, capital contributions of \$1.2 million, investment valuation gains of \$346,807, less capital distributions received of \$3.9 million, and equity partner operating expenses of \$240,340.

**Equity Investments  
(in millions)**



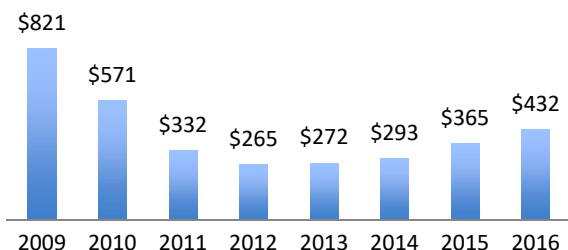
Loans, net of allowance for loan losses, increased to \$16.9 million from \$15.6 million the previous year. From 2010 to 2013, new loan demand was offset with loan payoffs, resulting in NMSBIC outstanding loan balances that were relatively flat. Since 2014, new loan demand has outpaced payoffs. Growth in outstanding loan balances, for the year ended June 30, 2016, was primarily from The Loan Fund with net growth of \$487,295, MFA with net growth of \$387,879, and Accion with net growth of \$351,651.

**Loans Outstanding  
(in millions)**



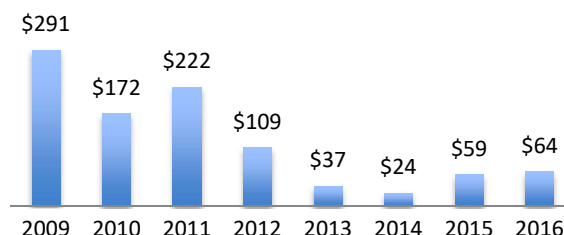
Interest and dividend income has declined since 2008 due to (i) a significant reduction in market interest rates paid on short-term investments, and (ii) movement of funds into non-interest bearing equity investments, to fund existing equity fund commitments. Interest income increased in 2016 from 2015, primarily due to the increase in outstanding loan balances.

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



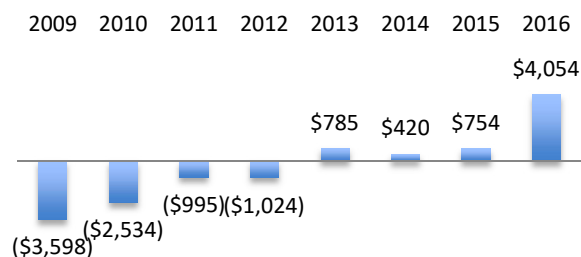
Loan charge-offs were relatively modest throughout the financial crisis. Loan charge-offs peaked in 2009 at \$290,600, which was 2.6% of outstanding loan balances. Loan losses declined in 2014 to a low of \$24,453, which was 0.2% of outstanding loans. Loan charge-offs have since increased in 2016 to \$64,256, which was 0.4% of outstanding loans. The 2016 charge-offs were primarily from the new 2013 lending program with Accion, under which the NMSBIC earns interest of 3.0% annually, and loan charge-offs are capped at 1.0% annually.

**Loan Charge Offs  
(in thousands)**



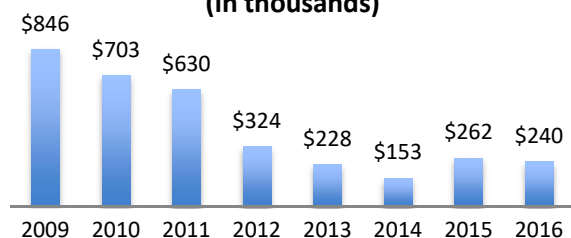
A trend of several years of losses on equity investments was reversed in 2013. The 2016 net gain of \$4.1 million was comprised of \$3.7 million in realized gains on investments, and \$346,807 in positive investment valuation adjustments.

**Gain (Loss) on Equity Investments  
(in thousands)**



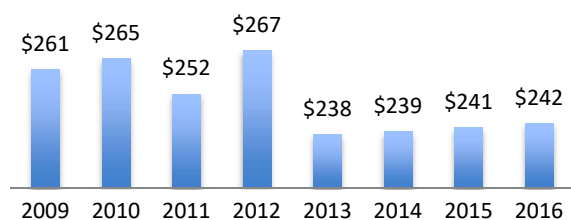
Management fees and expenses paid to equity funds, net of other income from equity funds, have declined primarily due to several equity funds reaching the end of their fund lives, and declines in outstanding fund investments. The low point in 2014 was impacted by non-recurring other income of \$141,000, that offset management fees in that year.

**Equity Fund Management Fees, Operating Expense, and Other Income**  
(in thousands)

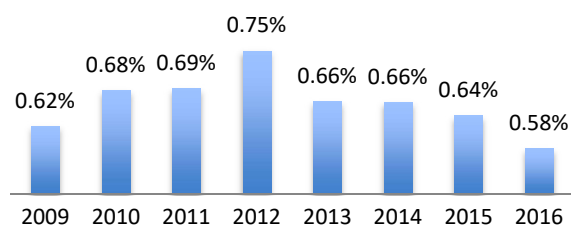


NMSBIC's direct operating expenses of \$242,331 in 2016, were slightly higher than the previous year, and were comprised of \$117,043 included in other program services, and \$125,265 in management and general expenses. With \$41.7 million in total assets, operating expenses were 0.58% of total assets in 2016.

**NMSBIC Operating Expense**  
(in thousands)

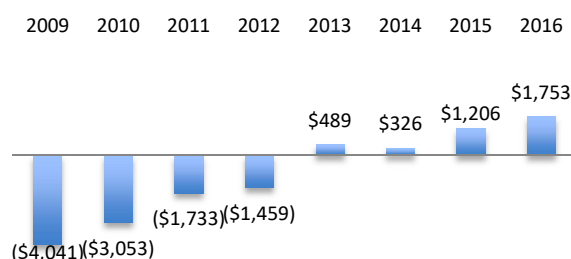


**NMSBIC Operating Expense as a percent of Total Assets**



A trend of several years of losses was reversed in 2013. The NMSBIC had a positive change in net assets in 2016 of \$1,752,514. The positive change in net assets was primarily due to realized gains on equity investments of \$3.7 million, less a \$2.2 million accrued payment to the severance tax permanent fund based on the current legislative requirement.

**Net Income (Loss)**  
(in thousands)



#### NMSBIC Lending Partners



Rio Vista Growth Capital

#### Lending Program

The NMSBIC's lending program provides funding to Accion, The Loan Fund, MFA, Rio Vista Growth Capital, and WESST.

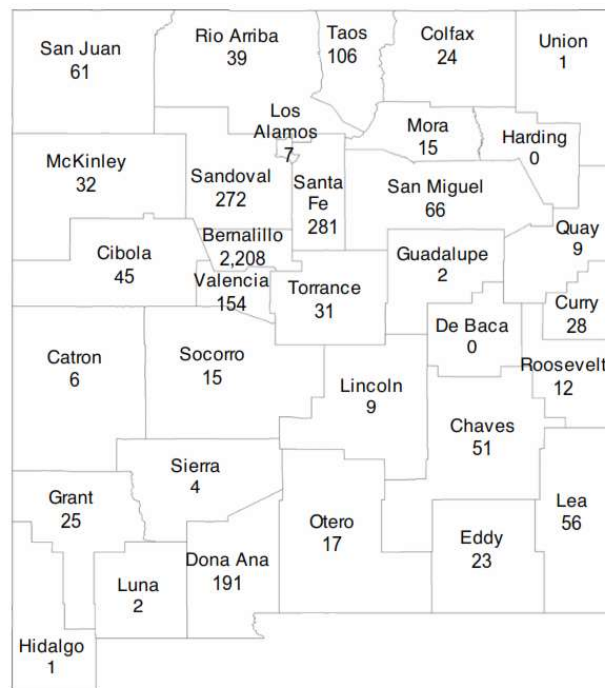
### Community Development Financial Institutions

Accion, The Loan Fund, and WESST, are designated as Community Development Financial Institutions (CDFIs) by the U.S. Department of the Treasury. CDFIs have a mission of providing financing in low-income communities and to people who lack access to financing.

### New Mexico Mortgage Finance Authority

In December 2013, the NMSBIC made a \$1.5 million revolving line of credit to the New Mexico Mortgage Finance Authority (MFA). The purpose of the loan is to help fund multifamily development and construction loans in areas of the state where lack of affordable housing is considered an obstacle to job growth. MFA is a well-capitalized organization, and the NMSBIC's loan to MFA is considered to have relatively low risk. While MFA has funding available for long-term permanent financing, there is a shortage of funding available for development and construction loans. This innovative program is helping to support construction employment, and is also providing affordable housing to support longer-term job growth. Since 2014, the MFA has used NMSBIC funds for the development and construction of affordable multifamily housing in Roswell, Las Vegas, and Zuni.

The NMSBIC's lending partners have provided 3,793 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 \$64 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 3,793 loans in 31 of 33 counties in New Mexico.*

Since inception and through June 30, 2016, 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	3,193	6,621	\$28,927,478
The Loan Fund	548	3,253	\$32,782,772
MFA	3	0	\$1,500,000
RVGC	1	16	\$750,000
WESST	<u>48</u>	<u>249</u>	<u>\$551,254</u>
	3,793	10,139	\$64,511,504

As noted above, the three MFA loans are for construction of multi-family housing in areas of the state where lack of affordable housing is an obstacle to job growth. Analysis of the estimated job impact related to the construction phase, and longer-term employment, is in process.

As of June 30, 2016, the NMSBIC had the following amounts outstanding from, and committed to, its lending partners. Figures shown below for Accion are combined for the prior and new loan participation agreements.

	# of		
	<u>Loans</u>	<u>Outstanding</u>	<u>Committed</u>
Accion	460	\$5,926,483	\$6,500,000
The Loan Fund	123	\$9,338,652	\$11,000,000
MFA	2	\$900,000	\$1,500,000
RVGC	1	\$750,000	\$750,000
WESST	<u>9</u>	<u>\$87,847</u>	<u>\$375,000</u>
Totals	595	\$17,002,982	\$20,125,000

The above figures show over \$64 million in loans have been funded with \$20.1 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 0.4% 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 ten venture capital partnerships. Two of the venture capital partnerships that were managed by Mesa Capital Partners, are now closed.

Cash invested (contributions made less distributions received) and current fair values as of June 30, 2016 are as follows:

(Dollars amounts in thousands \$000)

<u>Partner</u>	<u>Cash Invested</u>	<u>Current Value</u>
Flywheel-I NMSBIC	\$1,500	\$38
NM Gap Fund I	\$1,912	\$3,236
NM Comm. Capital	\$2,503	\$2,299
NM Mezzanine Ptrs	\$1,689	\$855
Verge I	\$1,041	\$1,370
Verge I.5	\$2,237	\$2,807
Verge II	\$1,974	\$3,345
Verge II.5	<u>\$1,000</u>	<u>\$1,045</u>
Totals	\$13,856	\$14,995

Capital committed to the above equity partners has been fully funded, with the exception of \$56,899 for New Mexico Community Capital, and \$264,551 for Verge II.

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, into 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 \$10.3 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 \$3.9 million in net capital returned from equity funds in 2016.

### Equity Program Activity

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

- New Mexico Community Capital (NMCC) realized a gain on the successful sale of a company, which was partially offset by a loss on the sale of another company. NMCC distributed \$3.8 to the NMSBIC in July, 2016 related to net proceeds on the sale of a company. The limited partners approved a one-year extension of the fund's termination date.
- For New Mexico Gap Fund I, the NMSBIC approved a third, one-year extension for the payment of management fees of \$50,000, and up to \$16,000 in fund expenses. The NMSBIC board believes the extension will likely protect and enhance the value of NMSBIC's investment in this fund. During the fiscal year, the fund reported a positive investment valuation adjustment of \$953,799.
- New Mexico Growth Fund II was closed. The NMSBIC incurred losses of \$2.7 million from this fund. The losses were recognized in previous years.
- New Mexico Mezzanine Partners (NMMP) reached the end of its scheduled fund life. The limited partners agreed to extend the fund for

one year. NMMP had three loans outstanding. One of the loans was fully charged off; the NMSBIC's share of the loss was \$611,541.

- The Verge Funds had a successful sale of company in June 2016, and distributed \$3.4 million to the NMSBIC in July, 2016, related to the sale. The limited partners approved one-year extensions of the fund termination dates for Verge I, and Verge I.5.
- The NMSBIC made a \$1 million investment in Verge II.5, a fund designed primarily to make follow-on investments in existing Verge Fund companies. While the NMSBIC has not made any new equity commitments since 2009, the investment was made in Verge II.5 for the following reasons: (i) Verge II.5 is making follow-on investments in established Verge Fund companies. These later-stage investments are in companies with established products, markets, and management teams, resulting in a lower level of risk as compared to an early-stage equity investment; (ii) the investment time horizon is expected to be five years, which is shorter than a typical early-stage equity investment; and (iii) the NMSBIC has investments in Verge I, Verge I.5, and Verge II. Additional capital raised by Verge II.5 was resulting in dilution of value in the NMSBIC's prior Verge Fund investments. The investment in Verge II.5 helped to mitigate dilution of the NMSBIC's prior Verge Fund investments. In connection with the investment, the NMSBIC paid \$85,290 in interest to other Verge II.5 investors who made capital contributions earlier in the fundraising process.

## 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 \$9.1 million, with 398 jobs reported at June 30, 2016, resulting in an estimated cost per job of \$22,848. Equity investments are long-term in nature, therefore year-to-date results are not considered meaningful.
- Lending program life-to-date results are a net interest income (after loan losses) of \$1,344,676, with 10,139 jobs reported, for an estimated *profit* per job of \$133. For the twelve months ended June 30, 2016, net interest income was \$333,123, with 775 jobs reported, for an estimated *profit* per job of \$430.

**Equity Program Costs and Benefits (1):**

	Net <u>Investment</u>	Estimated <u>Value</u>	<u>Gain (Loss)</u>	Jobs Reported (2) <u>at 6/30/16</u>	Estimated Profit (Cost) <u>per Job</u>
Santa Fe Windows and Doors	(\$25,000)	\$0	\$25,000	n/a	n/a
Flywheel Ventures (2 funds)	\$3,411,989	\$3,273,846	(\$138,143)	78	(\$1,771)
NM Community Capital	\$2,502,791	\$2,299,090	(\$203,701)	201	(\$1,013)
Mesa NM Growth Funds (2 Funds)	\$10,257,750	\$0	(\$10,257,750)	18	(\$569,875)
NM Mezzanine Ptrs	\$1,688,976	\$855,006	(\$833,970)	41	(\$20,341)
Verge Funds (4 funds)	\$6,251,467	\$8,566,675	\$2,315,208	128	\$18,088
Adjustment for multiple funds invested in the same company (4 companies)				-68	
Total Equity Program	\$24,087,973	\$14,994,617	(\$9,093,356)	398	(\$22,848)

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

(2) Includes jobs reported as of the date when a company was sold.

**Lending Program Costs and Benefits:**

	Interest <u>Income</u>	Loan Charge <u>Offs</u>	Net Interest <u>Income (Loss)</u>	Jobs Reported at time of <u>Origination</u>	Profit (Cost) per Jobs <u>Reported</u>
<b><u>Since Inception</u></b>					
ACCION 2003 Participation Agreement (3)	\$991,013	(\$1,282,468)	(\$291,455)	4,516	(\$65)
ACCION 2013 Participation Agreement	\$226,398	(\$70,617)	\$155,781	2,105	\$74
New Mexico Mortgage Finance Authority	\$18,625	\$0	\$18,625	-	-
THE LOAN FUND Participation Agreement (4)	\$77,631	(\$11,518)	\$66,113	-	-
THE LOAN FUND Line of Credit	\$1,319,333	\$0	\$1,319,333	3,253	\$406
Rio Vista Growth Capital Line of Credit	\$69,988	\$0	\$69,988	16	\$4,374
WESST Participation Program	\$23,986	(\$17,695)	\$6,291	249	\$25
Total Lending Program	\$2,726,974	(\$1,382,298)	\$1,344,676	10,139	\$133

**12 months ended June 30, 2016**

ACCION 2003 Participation Agreement (3)	\$28,663	(\$29,066)	(\$403)	-	-
ACCION 2013 Participation Agreement	\$131,070	(\$43,690)	\$87,380	538	\$162
New Mexico Mortgage Finance Authority	\$18,625	\$0	\$18,625	-	-
THE LOAN FUND Line of Credit	\$182,055	\$0	\$182,055	226	\$806
Rio Vista Growth Capital Line of Credit	\$42,488	\$0	\$42,488	-	-
WESST Participation Program	\$2,978	\$0	\$2,978	11	\$271
Total Lending Program	\$405,879	(\$72,756)	\$333,123	775	\$430

(3) 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.

(4) 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.

### Los Lunas Community Meeting:

#### Accessing Capital in New Mexico

NMSBIC's October 2015 Board meeting was held in Los Lunas, New Mexico. In connection with its Board meeting, the NMSBIC presented a community meeting in Los Lunas entitled, *Accessing Capital in New Mexico*. The meeting included presentations from representatives of the Los Lunas Economic Development Department, the Small Business Development Center, The Loan Fund, Accion, Rio Vista Growth Capital, WESST, Enchantment Land Certified Development Corporation, and the NMSBIC. This meeting continued the tradition of holding community outreach meetings throughout the state. In prior years the Board has held community outreach meetings in Clovis, 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, 2016 and 2015 are attached to this report.

### Rate of Return

For the fiscal year ended June 30, 2016, the NMSBIC's total revenues of \$4,530,648 exceeded total expenses of \$2,778,134, resulting in a positive change in net assets of \$1,752,514. The positive change in net assets of \$1,752,514, plus \$2,191,561 due to the severance tax permanent fund, totals \$3,944,078, which is a 10.58% increase in the net assets of \$37,281,002 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, 2016, \$2,191,561 is due to the severance tax permanent fund, which is calculated as follows:

Interest and dividends received, cash basis	\$ 404,228
Operating expenses, net of loan losses	(567,957)
Accumulated reserve for debt and equity losses	(1,351,626)
Capital gains realized	3,706,916
Net excess funds	<u>\$ 2,191,561</u>

### 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 3,793 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 \$64 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 an important 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,

Alan Fowler, CMB  
Board Chair & President

## **NMSBIC Board of Directors**

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

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

Launa Waller  
Regulatory Manager, Plateau  
Clovis, New Mexico

The Honorable Tim Eichenberg, State Treasurer  
State of New Mexico Office of the Treasurer  
Santa Fe, New Mexico

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

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

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

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

Russell Cummins  
Owner, RDC Advisors LLC  
Tijeras, New Mexico



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## **EXHIBIT A**

Independently Audited Financial Statements  
as of and for the years ended  
June 30, 2016 and 2015

**Small Business Investment Corporation**

**FINANCIAL STATEMENTS**

**June 30, 2016 and 2015**

## **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, 2016 and 2015, 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, 2016 and 2015, 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, 2016 and 2015, that portion of NMSBIC's investments was \$14,994,617 and \$13,896,757, respectively, which represents 38% and 37% 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 audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of activity of debt cooperative agreements and the schedules of activity of equity cooperative agreements on pages 16 and 17 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 26, 2016

  
Pulakos CPAs, PC



# Small Business Investment Corporation

## STATEMENTS OF FINANCIAL POSITION

June 30, 2016 and 2015

<u>Assets</u>	<u>2016</u>	<u>2015</u>
Current assets		
Cash and cash equivalents	\$ 3,168,048	\$ 6,930,088
Investment held with NM State Investment Council	3,051,478	-
Certificates-of-deposit	-	1,000,000
Interest and dividends receivable	-	201
Equity fund receivable	3,536,230	195,387
Prepaid expenses	4,239	4,220
Total current assets	9,759,995	8,129,896
Deferred interest receivable	32,446	12,521
Equity investments in New Mexico entities	14,994,617	13,896,757
Cooperative loan agreements, net of allowance for losses	16,876,599	15,613,175
	<u>\$ 41,663,657</u>	<u>\$ 37,652,349</u>
<u>Liabilities and Net Assets</u>		
Current liabilities		
Accounts payable	\$ 4,000	\$ -
Debt funding payable, net	434,580	371,347
Due to severance tax permanent fund	2,191,561	-
Total current liabilities	2,630,141	371,347
Temporarily restricted net assets	39,033,516	37,281,002
	<u>\$ 41,663,657</u>	<u>\$ 37,652,349</u>

# Small Business Investment Corporation

## STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Years Ended June 30, 2016 and 2015

	2016			2015		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
Revenues and other support:						
State of New Mexico Severance Tax	\$ -	\$ -	\$ -	\$ -	\$ 639,792	\$ 639,792
Interest and dividend income	-	431,950	431,950	-	364,994	364,994
Realized gain (loss) on investments	-	3,706,916	3,706,916	-	(435,185)	(435,185)
Investment valuation adjustments	-	391,782	391,782	-	1,189,181	1,189,181
Net assets released from restrictions	2,778,134	(2,778,134)	-	552,738	(552,738)	-
Total revenues and other support	2,778,134	1,752,514	4,530,648	552,738	1,206,044	1,758,782
Expenses:						
Program services						
Equity investment operating expense, net	240,340	-	240,340	261,797	-	261,797
Provision for loan losses	18,612	-	18,612	50,085	-	50,085
Other program services	202,333	-	202,333	115,574	-	115,574
Net excess funds expense	2,191,561	-	2,191,561	-	-	-
Total program services	2,652,846	-	2,652,846	427,456	-	427,456
Management and general	125,288	-	125,288	125,282	-	125,282
Total expenses	2,778,134	-	2,778,134	552,738	-	552,738
Change in net assets	-	1,752,514	1,752,514	-	1,206,044	1,206,044
Net assets at beginning of year	-	37,281,002	37,281,002	-	36,074,958	36,074,958
Net assets at end of year	\$ -	\$ 39,033,516	\$ 39,033,516	\$ -	\$ 37,281,002	\$ 37,281,002

See Notes to Financial Statements and Independent Auditors' Report.

# Small Business Investment Corporation

## STATEMENTS OF CASH FLOWS

Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Change in net assets	\$ 1,752,514	\$ 1,206,044
Adjustments to reconcile change in net assets to net cash (used) provided by operating activities		
Provision for loan losses	18,612	50,085
Net gain on investments and investment fees	(3,864,861)	(492,199)
Changes in operating assets and liabilities		
Interest and dividends receivable	201	7,069
Equity fund receivable	(3,340,843)	(99,704)
Prepaid expenses	(19)	(19)
Deferred interest receivable	(19,925)	(12,521)
Accounts payable	4,000	(197)
Debt funding payable	63,233	339,795
Due to severance tax permanent fund	2,191,561	-
	<u>(3,195,527)</u>	<u>998,353</u>
Cash flows from investing activities:		
Maturity of certificates-of-deposit	1,000,000	5,025,076
Purchase of investment held with NM State Investment Council	(3,000,000)	-
Investments in New Mexico entities	1,433,487	(2,401,010)
	<u>(566,513)</u>	<u>2,624,066</u>
Change in cash and cash equivalents	(3,762,040)	3,622,419
Cash and cash equivalents, beginning of year	6,930,088	3,307,669
Cash and cash equivalents, end of year	<u>\$ 3,168,048</u>	<u>\$ 6,930,088</u>

# **Small Business Investment Corporation**

## **NOTES TO FINANCIAL STATEMENTS**

**June 30, 2016 and 2015**

### **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 2013, 2014 and 2015 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, 2016 and 2015, 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, 2016 and 2015

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

#### Investments

NMSBIC reports gains and losses on investments 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, 2016 and 2015, allowances have been established for loan losses incurred as a result of debt investments made under Cooperative Agreements are as follows:

	<u>2016</u>	<u>2015</u>
Allowance for loan losses, beginning	\$ 222,026	\$ 230,634
Loan losses incurred in current period	(64,256)	(58,693)
Provision for loan losses	<u>18,612</u>	<u>50,085</u>
Allowance for loan losses, ending	<u>\$ 176,382</u>	<u>\$ 222,026</u>

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, 2016 and 2015**

### **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.

#### Subsequent Events

NMSBIC has evaluated all events occurring subsequent to June 30, 2016 and through September 26, 2016, which is the date that the financial statements were issued, and believes that no 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, 2016 and 2015

### 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. 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, 2016:

<u>Description</u>	<u>Assets at Fair Value</u>			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cooperative loan agreements	\$ 16,876,599	\$ -	\$ 16,876,599	\$ -
Equity investments in New Mexico entities	14,994,617	-	-	14,994,617
Investment held with NM State Investment Council	3,051,478	-	3,051,478	-
	<u>\$ 34,922,694</u>	<u>\$ -</u>	<u>\$ 19,928,077</u>	<u>\$ 14,994,617</u>

# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

### 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, 2015:

<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	\$ 15,613,175	\$ -	\$15,613,175	\$ -
Equity investments in New Mexico entities	13,896,757	-	-	13,896,757
Certificates of deposit	<u>1,000,000</u>	<u>-</u>	<u>1,000,000</u>	<u>-</u>
	<u>\$ 30,509,932</u>	<u>\$ -</u>	<u>\$16,613,175</u>	<u>\$ 13,896,757</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.

*Investment held with NM State Investment Council:* Valued at NMSBIC's percentage share in the pooled fund in which the pooled securities are measured using the closing price of the traded security at the statement of financial position date.

*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.



# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

### NOTE 3 – FAIR VALUE MEASUREMENT – CONTINUED

#### 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, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Balance, beginning of year	\$ 13,896,757	\$ 14,810,398
Total gains or losses (realized/unrealized) included in earnings	4,053,723	753,996
Operating income and expenses, net	(240,340)	(261,797)
Cash calls and redemptions, net	<u>(2,715,523)</u>	<u>(1,405,840)</u>
Balance, end of year	<u>\$ 14,994,617</u>	<u>\$ 13,896,757</u>

### 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>2016</u>	<u>2015</u>
Cumulative severance tax permanent fund capital contributions	\$ 47,682,573	\$ 47,682,573
Cumulative return of net excess funds	(2,191,561)	-
Cumulative expenses in excess of other revenues	<u>(6,457,496)</u>	<u>(10,401,571)</u>
	<u>\$ 39,033,516</u>	<u>\$ 37,281,002</u>

Temporarily restricted net assets were released as follows:

	<u>2016</u>	<u>2015</u>
Satisfaction of purpose restrictions	<u>\$ 2,778,134</u>	<u>\$ 552,738</u>

# **Small Business Investment Corporation**

## **NOTES TO FINANCIAL STATEMENTS**

**June 30, 2016 and 2015**

### **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. Funding received from the State Investment Officer due to the net market value of the New Mexico Severance Tax Permanent Fund was zero and \$639,792 in 2016 and 2015, respectively.

### **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. NMSBIC had excess funds of \$2,191,561 and zero as of June 30, 2016 and 2015, respectively that are required to be returned to the Severance Tax Permanent Fund. The net excess funds are reflected as a liability in the accompanying financial statements.

NMSBIC’s calculations of net excess fund balances as of June 30, 2016 and 2015 are as follows:

	<u><b>2016</b></u>	<u><b>2015</b></u>
Interest and dividends received, cash basis	\$ 404,228	\$ 342,905
Operating expenses, net of loan losses	(567,957)	(502,943)
Accumulated reserve for debt and equity losses	(1,351,626)	(1,790,721)
Capital gains (losses) realized	<u>3,706,916</u>	<u>(435,185)</u>
Net excess (deficient) funds	<u>\$ 2,191,561</u>	<u>\$ (2,385,944)</u>

# **Small Business Investment Corporation**

## **NOTES TO FINANCIAL STATEMENTS**

**June 30, 2016 and 2015**

### **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, 2016 and 2015, interest income of \$162,711 and \$140,750, respectively, was recognized related to these investments. See supplementary schedules for detail on these agreements.

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. The corporation did not draw on the line-of-credit until June 2015.

# **Small Business Investment Corporation**

## **NOTES TO FINANCIAL STATEMENTS**

**June 30, 2016 and 2015**

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

During the years ended June 30, 2016 and 2015, interest income of \$18,625 and zero, respectively, was recognized related to this investment. See supplementary schedules for detail on this agreement.

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, 2016 and 2015, interest income of \$182,055 and \$165,627, respectively, was recognized related to this investment. See supplementary schedules for detail on this agreement.

In September 2014, NMSBIC entered into a line of credit agreement with a New Mexico limited liability company (Rio Vista Growth Capital, LLC or 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 NMSBIC. Loans are serviced by RVGC, with monthly reports and principal and interest remittances provided to NMSBIC. The outstanding principal balance of the loan matures in August 2021. During the years ended June 30, 2016 and 2015, interest income of \$42,488 and \$27,500, respectively, was recognized related to this investment. Part of the interest is paid quarterly, and the balance is deferred until received by RVGC. Deferred interest receivable was \$32,446 and \$12,521 at June 30, 2016 and 2015, respectively. 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 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 through 2022. See supplementary schedules for detail on these agreements.

# Small Business Investment Corporation

## NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

### NOTE 8 – CAPITAL COMMITMENTS

At June 30, 2016, NMSBIC had committed \$41,916,881 of capital through its various debt and equity agreements, of which \$38,523,422 has been called, leaving a remaining commitment of \$3,393,459. At June 30, 2016, NMSBIC has approximately \$3,168,000 of cash-on-hand to immediately handle capital calls. Additionally, NMSBIC has approximately \$3,051,000 invested with the NM State Investment Council in a liquid bond pool as of June 30, 2016. 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, 2016:

	<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	\$ 6,500,000	\$ 5,926,483	\$ 573,517
2. NMCDLF	11,000,000	9,388,652	1,611,348
3. WESST CORP	375,000	87,846	287,154
4. NMMFA	1,500,000	900,000	600,000
5. RVGC	750,000	750,000	-
	<u>20,125,000</u>	<u>17,052,981</u>	<u>3,072,019</u>
<b>Equity Cooperative Agreements</b>			
1. Flywheel	1,500,000	1,500,000	-
2. NMCCF	7,000,000	6,943,111	56,889
3. Verge I	1,800,000	1,800,000	-
4. Verge I.5	3,000,000	3,000,000	-
5. NM Gap Fund I	2,000,000	2,000,000	-
6. NMGF II		Investment Closed in 2016	
7. NM Mezzanine Fund	2,491,881	2,491,881	-
8. Verge II	3,000,000	2,735,449	264,551
9. Verge II.5	1,000,000	1,000,000	-
	<u>21,791,881</u>	<u>21,470,441</u>	<u>321,440</u>
	<u>\$ 41,916,881</u>	<u>\$ 38,523,422</u>	<u>\$ 3,393,459</u>

## **SUPPLEMENTARY SCHEDULES**

# Small Business Investment Corporation

## SCHEDULES OF ACTIVITY OF DEBT COOPERATIVE AGREEMENTS

### Years Ended June 30, 2016 and 2015

	<u>Loan Commitments</u>	<u>Beginning Gross Loan Balance</u>	<u>Loan Funding Net of Repayments</u>	<u>Realized Loan Loss</u>	<u>Ending Gross Loan Balance</u>	<u>Allowance for Loan Losses</u>	<u>Ending Net Loan Balance</u>
For the year ended June 30, 2016							
1. ACCION #1*	\$ -	\$ 1,393,218	\$ (694,162)	\$ (20,566)	\$ 678,490	\$ (54,279)	\$ 624,211
2. ACCION #2	6,500,000	4,181,614	1,110,069	(43,690)	5,247,993	(52,480)	5,195,513
3. NMCDLF	11,000,000	8,901,360	487,292	-	9,388,652	-	9,388,652
4. WESST CORP	375,000	96,888	(9,042)	-	87,846	(7,027)	80,819
5. NMMFA	1,500,000	512,121	387,879	-	900,000	-	900,000
6. Rio Vista Growth Capital	750,000	750,000	-	-	750,000	(62,596)	687,404
	<u>\$ 20,125,000</u>	<u>\$ 15,835,201</u>	<u>\$ 1,282,036</u>	<u>\$ (64,256)</u>	<u>\$ 17,052,981</u>	<u>\$ (176,382)</u>	<u>\$ 16,876,599</u>
For the year ended June 30, 2015							
1. ACCION #1*	\$ -	\$ 2,588,111	\$ (1,163,126)	\$ (31,767)	\$ 1,393,218	\$ (111,457)	\$ 1,281,761
2. ACCION #2	5,750,000	1,656,346	2,552,194	(26,926)	4,181,614	(41,816)	4,139,798
3. NMCDLF	11,000,000	7,754,799	1,146,561	-	8,901,360	-	8,901,360
4. WESST CORP	375,000	87,789	9,099	-	96,888	(7,751)	89,137
5. NMMFA	1,500,000	-	512,121	-	512,121	-	512,121
6. Rio Vista Growth Capital	750,000	-	750,000	-	750,000	(61,002)	688,998
	<u>\$ 19,375,000</u>	<u>\$ 12,087,045</u>	<u>\$ 3,806,849</u>	<u>\$ (58,693)</u>	<u>\$ 15,835,201</u>	<u>\$ (222,026)</u>	<u>\$ 15,613,175</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.

## Small Business Investment Corporation

## SCHEDULES OF ACTIVITY OF EQUITY COOPERATIVE AGREEMENTS

Years Ended June 30, 2016 and 2015

	<u>Investment Capital Commitments</u>	<u>Beginning Investment Fair Value</u>	<u>Cumulative Capital Calls and Redemptions</u>	<u>Realized Gain (Loss) on Investments</u>	<u>Investment Valuation Adjustments</u>	<u>Operating Income (Expense), net</u>	<u>Ending Investment Fair Value</u>
For the year ended June 30, 2016							
1. Flywheel	\$ 1,500,000	\$ 200,616	\$ -	\$ (165,035)	\$ 34,828	\$ (32,469)	\$ 37,940
2. NMCCF	7,000,000	3,667,273	(3,277,897)	2,079,512	-	(169,798)	2,299,090
3. Verge I	1,800,000	1,141,319	(97,660)	399,910	(52,136)	(21,893)	1,369,540
4. Verge I.5	3,000,000	2,195,444	(91,158)	847,852	(101,103)	(43,621)	2,807,414
5. NM Gap Fund I	2,000,000	2,403,984	-	(99,953)	953,799	(21,924)	3,235,906
6. NMGF II	-	123,309	(158,328)	23,805	-	11,214	-
7. NM Mezzanine Fund	2,491,881	1,364,024	-	(611,541)	-	102,523	855,006
8. Verge II	3,000,000	2,800,788	(90,480)	1,101,733	(421,134)	(46,181)	3,344,726
9. Verge II.5	1,000,000	-	1,000,000	130,633	(67,447)	(18,191)	1,044,995
	<u>\$ 21,791,881</u>	<u>\$ 13,896,757</u>	<u>\$ (2,715,523)</u>	<u>\$ 3,706,916</u>	<u>\$ 346,807</u>	<u>\$ (240,340)</u>	<u>\$ 14,994,617</u>
For the year ended June 30, 2015							
1. Flywheel	\$ 1,500,000	\$ 349,272	\$ -	\$ -	\$ (115,432)	\$ (33,224)	\$ 200,616
2. NMCCF	7,000,000	3,561,342	(33,315)	60,672	247,621	(169,047)	3,667,273
3. Verge I	1,800,000	1,259,002	(159,062)	(77,870)	146,926	(27,677)	1,141,319
4. Verge II.5	3,000,000	2,044,373	(161,170)	(84,373)	452,629	(56,015)	2,195,444
5. NM Gap Fund I	2,000,000	2,036,181	-	(178,645)	584,985	(38,537)	2,403,984
6. NMGF II	3,500,000	139,080	(21,472)	(215,455)	219,912	1,244	123,309
7. NM Mezzanine Fund	3,000,000	2,070,818	(360,000)	-	(443,997)	97,203	1,364,024
8. Verge II	3,000,000	3,350,330	(670,821)	60,486	96,537	(35,744)	2,800,788
	<u>\$ 24,800,000</u>	<u>\$ 14,810,398</u>	<u>\$ (1,405,840)</u>	<u>\$ (435,185)</u>	<u>\$ 1,189,181</u>	<u>\$ (261,797)</u>	<u>\$ 13,896,757</u>



**Small Business Investment Corporation**

**COMMUNICATION OF  
NO MATERIAL WEAKNESSES**

**June 30, 2016**

September 26, 2016

To the Board of Directors  
Small Business Investment Corporation

In planning and performing our audit of the financial statements of the Small Business Investment Corporation, also known as the New Mexico Small Business Investment Corporation (NMSBIC) as of and for the year ended June 30, 2016, 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 NMSBIC's internal control. Accordingly, we do not express an opinion on the effectiveness of 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.

September 26, 2016

  
Pulakos CPAs, PC