

MINUTES OF THE

NEW MEXICO SMALL BUSINESS INVESTMENT CORP.

June 21, 2019

A meeting of the New Mexico Small Business Investment Corporation was called to order on this date at 9:07 a.m. at WESST Enterprise Center, 609 Broadway Blvd NE, Albuquerque, New Mexico. A quorum was established after roll call.

Members Present

Mr. Joseph H. Badal, Chair
Mr. Alan Fowler, Secretary/Treasurer
Mr. Guadalupe Garcia
Mr. Steven E. Morgan

Members Excused

Ms. Roxanna Meyers, Vice Chair
The Hon. Tim Eichenberg, New Mexico State Treasurer

Financial Adviser to Board

Mr. Russell Cummins

Board Legal Counsel:

Mr. Randy McDonald [by telephone; signing off at 10:30 a.m.]

Recording Secretary

Ms. Charmaine Clair, for Judith Beatty

Guests Present:

Ms. Monica Abeita, Ventana Fund
Mr. Michael Shafer, New Mexico Community Capital
Mr. Leroy Pacheco, The Loan Fund
Mr. Nick Nagy, Board Chairman, The Loan Fund
Mr. Manny Ortiz, Director, The Loan Fund
Mr. George Kenefic, Enterprise Development Director, The Loan Fund
Ms. Conchie Searle, Controller, The Loan Fund

REVIEW AND ACCEPTANCE OF AGENDA

Mr. Fowler moved acceptance of the agenda, as published. The motion was seconded by Mr. Garcia, and passed unanimously.

REVIEW AND ACCEPTANCE OF APRIL 26, 2019 BOARD MINUTES

Mr. Morgan moved acceptance of the April 26 minutes, as presented. The motion was seconded by Mr. Fowler and passed unanimously.

VENTANA FUND, PROPOSED REVOLVING LINE OF CREDIT: MONICA ABEITA, VENTANA FUND BOARD MEMBER

Monica Abeita introduced herself and discussed the background of Ventana Fund, a spinoff of the New Mexico Mortgage Finance Authority that has been in operation since 2014. The purpose of Ventana Fund is to access additional funding of CDFI grants, focus on multifamily housing projects in the state, and allow for mixed-income housing, including in rural areas of the state where low-income housing is often needed. Their primary product, Threshold, is aimed at older properties that typically charge below-market rent and borrow from a bank. To date, Ventana Fund has done six or seven loans; last year, they acquired Valencia Park Apartments to keep rentals affordable and to provide operating income to the organization.

Ms. Abeita said their newest program, Gateways, is for small rural communities needing workforce housing. Ventana Fund's plan is to develop a total of 250 units, with one designer and one contractor. The units would be at scattered sites in areas where the need is greatest. Their target is anything under 50 units, with most projects expected to be 10 to 20 units. As with the Threshold product, NMSBIC funding would be blended with their grant funding to provide a low rate to borrowers. Local governments, including municipalities, counties, hospital districts, and school districts, would be asked to donate land and infrastructure.

Responding to Chairman Badal on how this would be structured, Mr. Cummins stated that Ventana Fund would be approved as a lending partner, and would have the ability to make all of the underwriting decisions and fund the loans. Any losses by Ventana Fund would not be passed through to the NMSBIC.

Ms. Abeita noted that Ventana Fund has a loan loss reserve policy, and a history of underwriting multifamily projects. She said Ventana Fund has funded 18 projects to date.

Mr. Cummins said Ventana Fund is requesting a \$2 million revolving line of credit, with a 2 percent interest rate. The SBIC's loan would be secured by notes and collateral so that NMSBIC's loan would be equal to or less than 50 percent of the collateral value, with value being the lower of appraisal value or cost. NMSBIC funds would be used for construction and mini-perm loans until permanent financing can be obtained. As with the NMSBIC's loan to MFA, the purpose funding to the Ventana Fund would be to provide housing in areas of New Mexico where lack of housing is an impediment to job growth.

Mr. Cummins noted that the cash related to \$4.8 million of equity has been used for the Ventana Fund's 18 projects has been completely expended. Since many of their existing

projects would qualify for the NMSBIC program, he indicated Ventana Fund could pledge currently existing projects to the NMSBIC to replenish their liquidity.

Mr. Badal commented that, given the demand for NMSBIC funds, the agreement should include a time limit on how long money is held for a project. He said he did not want to see NMSBIC funding used for long-term financing, and recommended (1) giving NMSBIC the ability to call the loan if a certain percentage of the funding is not deployed within a certain time period, and (2) properties would be eligible as collateral for NMSBIC's loan for a maximum of 5 years.

Chairman Badal suggested that, if the board decides it wants to support this program, Mr. McDonald and the counsel for Ventana Fund could lay out the terms of the agreement and bring it back to the board.

Chairman Badal noted that the majority of economic activity in New Mexico is concentrated in the Albuquerque area and stressed that the board wants to see funds deployed throughout the state.

Mr. Garcia moved to approve the \$2 million in support of this request with the caveat that the terms would be drafted by the NMSBIC's attorney and would be subject to final board approval. Mr. Fowler seconded the motion, which passed unanimously.

FINANCIAL REPORTS AS OF APRIL 30, 2019 AND MAY 31, 2019

Mr. Cummins presented these reports. He said the conversion to GASB is on track and scheduled to be completed for the June 30 fiscal year-end.

Mr. McDonald said he is reviewing his memorandum addressing net excess funds to address the change in the accounting method. It appears the conversion to GASB could result in double payment on gains already paid to the State Investment Council. He is reviewing the double payment issue, and will update his memorandum to address this and other changes related to the GASB conversion.

[Mr. McDonald signed off from the meeting.]

Mr. Cummins stated that funds available for investments and operations are at about \$9.5 million, which includes the \$700,000 cash reserve approved by the board.

Mr. Morgan moved to accept the financial reports, as presented. Mr. Fowler seconded the motion, which passed unanimously.

PROPOSED ROYALTY FUND CONCEPT, PRELIMINARY DISCUSSION: MICHAEL SCHAFER

Mr. Schafer made a presentation to the board on the concept of a royalty fund in New Mexico. Characteristics of a royalty fund might include:

- Secured loans to businesses that are similar to mezzanine-stage investments; however, there would be no stock warrants with a royalty loan.
- A royalty loan would have a term that might be 2 to 4 years with a specified return during that term.
- Payments would be percentage of sales. If sales (and royalty payments) were higher during the loan term, the payoff at maturity would be lower. Conversely, if sales were lower during the loan term, the payoff at maturity would be higher. The lender would receive the specified loan yield, with the payments and payoff amount being variable.

Mr. Schafer asked the board to consider making an equity investment commitment to a royalty fund that would require an equal match of up to \$12.5 million, and to provide a letter of commitment.

Mr. Schafer stated that Arthur Fox, an expert in royalty-based investing, is serving as an advisor and second partner. He said Mr. Fox would be willing to come to New Mexico and appear before the board.

Mr. Schafer noted that New Mexico has a low amount of growth capital, and SBA data for the period 2009 to 2019 shows that the number of loans and banks has decreased. He said the bulk of the economy is in companies that would benefit from royalty financing. There are several good reasons for using royalty investing, including expanding sales and good margins, but there is no access to capital because companies are not growing fast enough, so have no collateral and may be too small for acquisition.

Responding to Mr. Fowler, Mr. Schafer said these companies would be more likely to stay in New Mexico. He commented that often good companies go elsewhere in search of growth capital, not because they want to move.

Chairman Badal thanked Mr. Schafer for his presentation. He said the board would discuss this proposal in the planning session after the meeting.

NEW MEXICO COMMUNITY DEVELOPMENT LOAN FUND, PROPOSED CHANGES TO REVOLVING LINE OF CREDIT: LEROY PACHECO, PRESIDENT & CEO

Mr. Pacheco introduced his team and made a slide presentation.

Mr. Pacheco requested that the board increase the maximum funding amount from \$14 million to \$20 million. He said that loans outstanding with NMSBIC are already up to \$12 million, so they are running low on available NMSBIC funds.

Chairman Badal noted that the SBIC increased the funding by \$2 million in December 2018, the assumption being the increase at the time would carry The Loan Fund another two years.

Mr. Pacheco responded that The Loan Fund exceeded expectations and have already reached \$16 million in total loans, which is \$1 million more than the goal set for calendar year 2019.

Chairman Badal asked Mr. Pacheco how long he would expect the additional \$6 million to last. Mr. Pacheco responded that he was projecting that The Loan Fund would need that amount to get through to the end of the year.

Chairman Badal asked if he understood correctly that the \$6 million increase to \$20 million presumed that The Loan Fund would continue to operate with the current loan limits. Mr. Nagy, The Loan Fund's board chairman, said the requested increase to \$20 million is their priority at this time. He said changes individual loan limits are not as important as the increase to \$20 million. Chairman Badal said the board would discuss the request for individual loan limits as part of the planning process following today's meeting.

Mr. Fowler moved to increase The Loan Fund's credit line to \$20 million. The motion was seconded by Mr. Morgan and passed unanimously.

[Break.]

EXECUTIVE DIRECTOR/INVESTMENT ADVISOR REPORT

Accion

This item was deferred until Ms. Meyers, who had requested a list of loan delinquencies by loan type, could be present to hear the report.

Mr. Cummins reported that charge-offs are being monitored. Loan growth has been slow because Accion has tightened credit standards to bring down delinquencies.

Mr. Cummins said Accion is changing their name to DreamSpring. They will continue to be the same company, operating in the same states as before, but using DreamSpring their new name. They will no longer be affiliated with the national Accion franchise.

Flywheel Ventures, NM Gap Fund I; New Mexico Community Capital

Mr. Cummins stated that both NM Gap Fund I and New Mexico Community Capital, which are scheduled to terminate (NM Gap Fund I on February 28, 2020 and NMCC on December 31, 2019), are discussing either distributing shares, or establishing a liquidating trust for companies that will not have achieved exits by the fund end-dates. Chris Traylor (NM Gap Fund) and Michael Schafer (NMCC) both have said that they do not feel that their continued involvement past the current end-dates would add value. Therefore, extending the funds and collecting additional management fees does not appear to make sense for the limited partners.

NM Mezzanine Partners

Mr. Cummins stated that NMMP managing partner Mike Doolittle continues to work to achieve payoffs for the two remaining loans in the portfolio.

SIC Core Plus Bond Pool

Mr. Cummins reported that, as of April 30, the value is \$11.834 million versus \$11.0 million in original net principal invested.

Advantage Capital

Mr. Cummins reported that Advantage Capital, an investment firm with \$3 billion in investments under management that operates in 40 states, is considering making a proposal at the NMSBIC's next meeting.

Nusenda and Albuquerque Community Foundation

Mr. Cummins reported that he and Mr. Fowler met with Robin Brule of Nusenda Credit Union, and Kelli Cooper and Ryan Marie Decker of Albuquerque Community Foundation on June 3. They held preliminary discussions regarding possible opportunities for NMSBIC involvement. They will schedule a follow-up meeting in July to discuss this in more detail.

GASB Conversion Update

Mr. Cummins stated that he, Ms. Brescia, Mr. McDonald and Pulakos, CPAs have been working on the conversion. The key change will be that equity investments will be reported using the Cost Method rather than the Equity Method. He said for all of the active equity investments, they went back to the inception of the funds, and adjusted the activity using the Cost Method. Under the Cost Method, invested capital is reduced by (1) returned capital, (2)

life-to-date management fees and operating expenses, and (3) "Other Than Temporary Impairment." He noted that given the length of time the funds have been operating, life-to-date management fees and operating expenses reduced the Cost Method basis by over \$4 million.

Based on the analysis, Mr. Cummins stated that, as of June 30, 2018, the equity investments had a balance based on fair market value of \$9.76 million, and would have been \$3.43 million under the Cost Method.

Mr. Cummins stated that, under the equity method, there were no Net Excess Funds prior to 2016. Based on a review of historical realized gains under the Cost Method, it appears there also would not have been any Net Excess Funds prior to 2016. However, from 2016 through 2018, it appears there could be approximately \$1,016,614 of net excess funds already paid to the State Investment Council (SIC), that could be paid to the SIC again under the Cost Method, resulting in a double counting of gains paid to the SIC. He said Mr. McDonald is reviewing his memorandum regarding the net excess funds calculation related to the GASB conversion, including the issue of double counting.

NMSBIC BUDGET FOR FISCAL YEAR ENDING JUNE 30, 2020

Mr. Cummins presented the proposed budget for the fiscal year ending June 30, 2020, with the following highlights:

- Minor growth is projected in the outstanding loan balance for Accion, from \$7.2 million to \$7.5 million, which is assumed to remain below Accion's maximum funding amount of \$7.75 million. Charge-offs will be monitored before any increase in their maximum loan amount is considered.
- Stronger growth in the outstanding balance for The Loan Fund, from \$11.3 million to \$14.6 million. The board earlier in this meeting approved a \$6 million increase to their credit line.
- Balances for MFA and WESST are assumed to be flat.
- SIC Core Plus Bond Pool: We budget for a yield of 2 percent on this investment. While the expectation is for a longer-term yield of about 3 percent, we budget conservatively. We anticipate about \$50 million in new funding in January 2020. The budget assumes these funds will be invested in the SIC Core Plus Bond pool until the funds are deployed.
- Interest income is budgeted to increase to about \$1,174,994 from about \$866,674 this year, primarily due to an increase of about \$50 million to be invested in the SIC Core Plus Bond pool starting in January 2020.
- Operating expenses are budgeted to increase to about \$271,000 from about \$247,000 forecasted for this year.

- Net income from operations is budgeted to increase to about \$903,770 from about \$618,760 forecasted for this year.
- Given unpredictable volatility of equity investments, we do not budget for exits, distributions or valuation changes.

Mr. Cummins noted that the accounting change to GASB might result in net excess funds of roughly \$400,000 this year.

Mr. Fowler pointed out that with additional funding in the coming year, and we should consider increasing budgeted expenses.

Chairman Badal said Mr. Fowler had raised a good point, and recommended increasing the legal services budget from \$18,000 to \$25,000. In addition, we might consider hiring a consultant to do credit analysis or loan review work related to deployment of additional funds, and suggested adding \$10,000 to the budget to cover loan review consulting fees.

Mr. Garcia suggested the board do something to recognize WESST for the use of its conference room. Board members said they thought this a good idea. Chairman Badal recommended approving a \$2,000 contribution to WESST, and increasing the Dues and Contributions budget by \$2,000 to \$3,600 to budget for the contribution to WESST.

Mr. Cummins noted that, while membership was approved to join the ICBA, there might be opportunities to do sponsorships as part of their annual conference and/or their lending conference. These expenses would be covered in the proposed \$4,850 for meeting expenses.

Chairman Badal suggested adding \$10,000 to the Other/Miscellaneous category.

Mr. Morgan moved to approve the budget ending June 30, 2020, as amended. Mr. Garcia seconded the motion, which passed unanimously.

RENEWAL OF PROFESSIONAL SERVICES AGREEMENTS

- **Randall McDonald, Legal**
- **Brescia Consulting, Accounting**
- **Judith Beatty, Administrative**

Mr. Cummins stated that Mr. McDonald and Ms. Beatty have proposed a one-year renewal with no changes to pricing or terms.

Mr. Cummins stated that Brescia Consulting has proposed an increase from \$139 per hour to \$143 per hour.

Mr. Cummins recommended approval.

Mr. Fowler moved approval of the three professional services agreements, as presented. The motion was seconded by Mr. Morgan and passed unanimously.

NON-PROFIT LIABILITY INSURANCE RENEWAL

Mr. Cummins recommended renewal of the Non-Profit Management Liability insurance policy for one year beginning June 23, 2019. Last year's premium was \$3,230, and he does not anticipate any significant change.

Mr. Garcia so moved. Mr. Fowler seconded the motion, which passed unanimously.

ESTABLISH NMSBIC LOAN COMMITTEE

Mr. Cummins stated that The Loan Fund has indicated it would help them deploy more NMSBIC funds if they could do larger loans. They feel there is demand for larger loans. The NMSBIC's current agreement with The Loan Fund allows them to do loans up to \$500,000, and up to \$750,000 if it is a real estate secured first lien with an LTV up to 76 percent, or furniture, fixtures or equipment up to 50 percent LTV. Having the ability to consider larger loans, which are conservatively underwritten, would allow The Loan Fund to deploy additional NMSBIC funds and create more jobs.

Mr. Cummins said he discussed this with Chairman Badal, who suggested that, if the NMSBIC is going to deploy additional funds, the board should consider creating a loan committee rather than changing loan covenants.

Mr. Cummins commented that the NMSBIC had talked about a loan committee a few years back. Mr. McDonald's legal opinion was that the Open Meetings Act would require a committee of the board to hold public meetings. There was concern that it would be inappropriate to review confidential information contained in a potential borrower's loan file, in a public meeting. At that time, the board decided not to establish a loan committee.

Mr. Cummins said an alternative could be that these larger loan requests could come to a loan committee with the name of the borrower and any identifying information redacted. Decisions by the committee would be restricted to loans under originated under existing loan partner arrangements, with terms outside the parameters of existing loan partner agreements. The board would give authority to the committee to approve individual borrower loans, which would be ratified by the board at the next board meeting. He suggested that the committee could meet once a month, with board meetings taking place about every two months. Chairman Badal commented that an advantage to this is that applicants would not have a lengthy wait for an application to be reviewed and approved.

Mr. Fowler commented that looking at individual borrowers is not the way the NMSBIC has operated in the past. Chairman Badal agreed. Mr. Fowler said he would prefer raising The Loan Fund's loan limit from \$750,000 to \$1,000,000, but lowering the LTV to 65 percent. He said the

number of loans above \$750,000 should also be limited to a certain percentage of their total portfolio.

Mr. Morgan said the loan committee would be looking at a specific loan, but the NMSBIC's practice has been to manage taxpayer money at a higher level. He recalled that the board had a discussion about this several months back and agreed that the NMSBIC didn't want to get into approving individual loans.

Mr. Garcia said he believes the entire board should approve any exceptions. He did not think that waiting two or three months for a large loan decision was unreasonable and is something an applicant should be prepared to anticipate.

As an alternative, Chairman Badal suggested increasing The Loan Fund's loan limit to \$1 million with a 70 percent LTV, not to exceed 5 percent of The Loan Fund's outstanding balance. Mr. Cummins suggested using the maximum funding amount rather than outstanding balance, so the cap does not fluctuate each period. He also noted that 5 percent of \$20 million is \$1 million, which would be one loan. It was agreed that 20 percent of the maximum funding amount would make more sense.

Mr. Garcia moved to increase The Loan Fund's loan limit to \$1 million for one borrower provided that loans between \$750,000 and \$1,000,000 are secured by a first lien on real estate with a loan to value of no more than 70 percent, or secured by furniture, fixtures, equipment receivables with a loan to value of no more than 50 percent, and that the total amount of loans over \$750,000 does not exceed 20 percent of the NMSBIC's maximum funding amount. Mr. Morgan seconded the motion, which passed unanimously.

INVESTMENT POLICY ANNUAL REVIEW

Mr. Cummins said he had no recommended changes to the loan policy, but would like to discuss a request made of him at the last board meeting, which was that he see if the State Investment Council (SIC) wanted to make recommendations regarding investment of the additional \$50 million the NMSBIC expects to receive at the end of this year. The SIC responded that they would be glad to have informal conversations regarding market outlook but could not advise on investment allocations. They offered to direct the NMSBIC to fiduciaries who currently provide these services for a fee to some state agencies and clients, and strongly recommended the NMSBIC look into these services if the board wanted to do something beyond the Core Plus Bonds Pool allocation.

Mr. Cummins noted that that all other available investment options under the Joint Powers Agreement with the SIC are in stocks, which have a longer-term investment horizon. The NMSBIC's investment policy indicates that currently available funds be invested in short-term investments, therefore stock investments would not appear to be appropriate. He recommended continuing with the 100 percent allocation to the Core Plus Bonds Pool.

Mr. Fowler moved to maintain status quo with no changes in the current investment policy. Mr. Morgan seconded the motion, which passed unanimously.

PLANNING FOR DEPLOYMENT OF APPROXIMATELY \$50 MILLION IN NEW FUNDING

Mr. Cummins provided the following information on ideas and discussions he has had regarding deployment of additional funding:

- Mr. Cummins said he has connected with RCAC, a California CDFI that makes loans in rural communities and has a representative in New Mexico. He will meet with a representative next week. They do residential and small business loans, and water and wastewater loans in rural communities. He will seek clarification on what is included under rural communities.
- Mr. Cummins said Advantage Capital might make a presentation at the next board meeting. They do economic development loans in rural areas in 40 states. In his meeting with a representative, they said they typically work with states by getting state tax credits approved through their legislatures, which they then monetize and use to subsidize their rural lending program. Advantage then makes loans to small businesses in rural communities throughout the state, and tracks the number of jobs and economic impact they have generated, which is how they justify the value of the tax credits they receive. They do not pay back the money, unless they fail to meet benchmarks for job creation. Mr. Cummins said a representative from the Montgomery & Andrews law firm was also present at the meeting, representing Advantage Capital. They noted it was unlikely the New Mexico legislature would approve this state tax credits, which is why Advantage Capital would like to see if they might be able to partner with the NMSBIC. Mr. Cummins said Advantage Capital does research in rural areas throughout the country, and has a proprietary database of businesses in rural areas that are targets for the type of lending they do. The types of loans they do are similar to mezzanine lending, where the companies are later stage and have cash flow. Advantage looks for collateral and often has higher interest rates than traditional bank loans, and sometimes includes an equity kicker.
- Mr. Cummins said he plans to reach out to independent community banks in the state. He said there might be an opportunity for the NMSBIC to purchase loan participation from banks, to assist them with loans over their loans-to-one-borrower limit, or to help with bank concentration limits.
- Mr. Cummins said Paul Cassidy mentioned that there might be opportunities in a \$14 million deal for a power line transmission for alternative energy.
- Mr. Cummins noted that the Albuquerque International Airport is interested in developing the industrial land around the airport. The airport has bonding capabilities,

but it can be difficult for them to move fast enough for some development opportunities. A line of credit might help them with development projects.

- Mr. Cummins said he plans to contact the New Mexico Finance Authority regarding their New Market Tax Credit program, to see if there might be an opportunity to partner with the NMSBIC.
- Chairman Badal asked Mr. Cummins to meet with Sun Mountain Capital and the SIC to hear their thoughts on the idea of a royalty fund.

CHAIRMAN'S COMMENTS

Chairman Badal asked board members how they felt about continuing to serve on the NMSBIC board, should the Governor choose to retain them. He commented that, for him, serving on this board has been one of the best experiences of his entire career.

Mr. Garcia and Mr. Morgan indicated that they would be happy to continue serving on the board.

Mr. Cummins stated that Ms. Meyers had told him she would be willing to stay on the board.

Chairman Badal asked Mr. Cummins to draft a letter to the Governor's Chief of Staff, John Bingaman, with a copy to the Governor, confirming the board members who are willing to remain on the board.

ADJOURNMENT

The meeting adjourned at 2:25 p.m.



Joseph Badal, Chairman

8-23-2019

Date