

MINUTES OF THE

NEW MEXICO SMALL BUSINESS INVESTMENT CORP.

July 24, 2015

A meeting of the New Mexico Small Business Investment Corporation was called to order on this date at 9:00 AM in the WESST Enterprise Center, 609 Broadway Blvd. NE, Albuquerque, New Mexico.

A quorum was present:

Members Present

Mr. Alan Fowler, Chair
Ms. Roxanna Meyers, Vice Chair
The Hon. Tim Eichenberg, NM State Treasurer
Mr. Joseph H. Badal, Past Board Chair
Mr. Lupe Garcia
Mr. Steven E. Morgan, Secretary/Treasurer
Ms. Launa Waller

Members Excused:

None.

Financial Advisor to Board

Mr. Russell Cummins

Legal Counsel Present:

Mr. Randy McDonald

Recording Secretary:

Ms. Charmaine Clair, for Judith Beatty

Guests:

Mr. Michael Schafer, New Mexico Community Capital
Ms. Holly Bradshaw Eakes
Mr. Mike Doolittle, NMMP

REVIEW AND ACCEPTANCE OF AGENDA

Mr. Eichenberg moved to accept the agenda, as published. Mr. Morgan seconded the motion, which passed unanimously by voice vote.

REVIEW AND ACCEPTANCE OF MAY 22, 2015 BOARD MINUTES

Mr. Eichenberg moved approval of the May 22 minutes, as submitted. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

NMCC

Mr. Cummins noted that the Board granted an extension of the NMCC Fund I end date from June 30, 2015 to June 30, 2016 at its last meeting. It is likely that NMCC will request two more one-year extensions after this one.

NMCC fund manager Michael Schafer presented an update to the Board, including the status of the six investments in the Fund I portfolio. He noted that a total of \$14.65 million was raised, and a current value of \$9.96 million. With fees, the returns are negative, however. He stressed that NMCC values its companies very conservatively. He commented on the challenges he faces with GAAP accounting rules that require mark-to-market reporting, which can cause large valuation swings from one quarter to the next, and can be misleading to investors.

Mr. Badal stated that Mr. Schafer is certainly familiar with the debate on this Board about the prudence of putting money into venture capital, as the NMSBIC has had significant losses in equity investments. He asked Mr. Schafer to provide Mr. Cummins with a “realistic valuation” of a company in the portfolio.

FINANCIAL REPORTS MAY 31 – JUNE 30, 2015

Mr. Cummins distributed and reviewed the financial reports. He noted that the June 30 financial statements from the equity partners would not be available until the end of August.

Ms. Meyers asked that a future agenda include discussion on the meaning of “net excess funds” in statute and what the implications of that might be in terms of any requirement to return money to the Severance Tax Permanent Fund. Her concern is whether the NMSBIC should pursue a change in the statutory language in order to remain self-sustaining.

Mr. Cummins stated that the statutory language allows the NMSBIC to reduce realized earnings with operating expenses and loss reserves, but anything left over must be returned to the Severance Tax Permanent Fund. The NMSBIC’s concern is that, under this formula, if there are investment losses, the NMSBIC’s asset shrink. If there are gains, then Net Excess Funds are returned to the Severance Tax Permanent Fund. Given the NMSBIC’s assets can only shrink and can’t grow, it might eventually result in the NMSBIC going out of business.

Ms. Meyers moved to accept the financial reports. Mr. Badal seconded the motion, which passed unanimously by voice vote.

Mr. Badal and Board members thanked Mr. Cummins for his management of the NMSBIC's resources. At a time when interest has been extremely low, the organization has been able to operate on a self-sustaining basis; and as evidenced in the financial report, the NMSBIC is below budget on the expense side and above budget on the income side, which is a remarkable achievement during a very challenging period.

EXECUTIVE DIRECTOR/INVESTMENT ACTION REPORT

Equity Partner Detail

Take Away Report

Mr. Cummins presented highlights.

Accion

Mr. Cummins stated that Accion has maxed out on their funding. The NMSBIC increased their funding in January this year from \$5 million to \$5.75 million. They have gone through those funds and are requesting additional funding, which will be addressed later in today's agenda.

Mr. Cummins stated that Accion has been approved as an SBA lender under the SBA "Community Advantage" program. This gives institutions like Accion access to the SBA 7A guarantee, but without the same level of requirements of the traditional SBA 7A program. They can make loans up to \$250,000 with 85 percent of the loans guaranteed by the SBA, and the risk is shared from the first dollar lent. He said Accion has indicated that they haven't made any of these loans. He said Accion plans to make these loans, but not until it has staff with the appropriate background and expertise in SBA lending.

The Loan Fund

Mr. Cummins said The Loan Fund asked for an exception to go over the \$500,000 loan limit, for a good customer with strong credit who had two loans totaling \$554,000. Mr. Cummins said he responded that the NMSBIC agreement does not allow for loan-level exceptions. Also, presenting an individual loan to the NMSBIC Board for special approval would not be appropriate, because customer loan packages contain confidential information.

Mr. Cummins said Executive Director Leroy Pacheco is thinking about requesting a higher limit based on a proposal that might have more conservative underwriting guidelines for loans over \$500,000.

Mr. McDonald stated that the language in the agreement doesn't permit The Loan Fund to lend more than \$500,000 to a single entity with NMSBIC funds. Loaning \$500,000 with NMSBIC funds, and then loaning additional funds from another source, would put the NMSBIC's \$500,000 at risk with a borrower that has a higher debt ceiling.

Mr. Cummins said The Loan Fund will likely request a \$2 million increase in their maximum funding level, from \$11 million to \$13 million, later this year.

NMSIC Audit Committee

Mr. Cummins reported that he and Chairman Fowler made a presentation to the NMSIC Audit Committee on June 22; it was a good meeting, and he believes helped provide NMSIC members with better understanding of the NMSBIC's activities and focus. There were good comments and questions from the members. Chairman Peter Frank stated that the NMSIC supports the Board's decision to not make equity investments.

Mr. Cummins said the Committee also discussed liquidating equity investments. The NMSIC indicated they had recently liquidated some of its equity funds. NMSIC staff commented that the NMSBIC's equity investments are relatively small, and it would probably require deep discounts in order to sell them.

Mr. Cummins stated that Chairman Frank indicated he had reviewed the legal opinion prepared by Mr. McDonald on the definition of net excess funds. While he said he probably wouldn't have come up with the same opinion, he did not dispute it and commented that he found it interesting.

Mr. Badal suggested the Board hold a strategic planning session on legislative topics.

Mr. Cummins noted that the NMSIC recommended the Board consider an NMSIC investment pool for its short-term investments, which will be discussed in more detail under a separate Agenda item.

ACCION REQUEST FOR ADDITIONAL FUNDING FROM NMSBIC

Mr. Cummins presented his recommendation regarding a request from Accion to increase the NMSBIC participation agreement by \$1.25 million. As discussed earlier, the NMSBIC has \$1.76 million in available funds, which will increase to \$2.7 million by the end of the year. An increase in Accion's funding of \$1.25 million would leave the NMSBIC with about \$1.5 million in available capital. He also noted that under the statutory requirements, the NMSIC provided Severance Tax Permanent Fund monies to NMSBIC last year and that there might be additional provided to NMSBIC from the Severance Tax Permanent Fund before the end of this year.

Mr. Eichenberg indicated that there was some discussion at the IPOC about eliminating the NMSBIC. He also stated that the Severance Tax Permanent Fund would not have any money to distribute from the June 30, 2015 fiscal year.

Mr. Badal noted that he and Mr. Cummins met with the Governor's Chief of Staff, Keith Gardner, who commented to them that the NMSBIC is the only economic-development-oriented operation in New Mexico that has made money. He said the Board has come to believe that the program is valuable and not only needs to be sustained, but also needs to grow.

Mr. Cummins reviewed Accion's updated financials. In summary, assets grew, loan balances grew, and there was an increase in net assets. Fundraising ability continues to be a strength, and Accion does a good job of making loans throughout the entire state. Based on Accion's lending growth this year, he said the requested increase would give them about eight months' worth of additional lending capacity from the NMSBIC.

Ms. Meyers said she was not prepared to say that Accion was a success story at this point. In December, just over six months ago, their delinquency rate was significantly higher than the present level.

Mr. Badal suggested reducing the request to six months' worth of money, or \$750,000. He said Accion is doing well, but with the new 2013 Lending Program in place, this will allow the NMSBIC to evaluate another six months' worth of results.

Mr. Cummins said he thought that would be appropriate.

Mr. Badal moved to increase the amount of the participation agreement with Accion by \$750,000, and reevaluate it later this year. Mr. Eichenberg seconded the motion, which passed unanimously by voice vote.

Ms. Meyers proposed that Accion not be permitted to restructure loans more than once per loan if this stipulation is not already in the loan policy. Mr. Cummins responded that he believed that requirement is already part of the existing agreement with Accion, but he will verify that.

[Break.]

FINANCE NEW MEXICO UPDATE

Holly Bradshaw Eakes presented highlights from Finance New Mexico's report.

Chairman Fowler thanked Ms. Eakes for her continued efforts "behind the scenes." He said the Board truly appreciates FNM's success in making NMSBIC more effective.

NEW MEXICO MEZZANINE PARTNERS, L.P.

NMMP fund manager Mike Doolittle made a presentation to the Board.

Mr. Doolittle stated that the Fund was founded about seven years ago, with total committed capital of \$6.25 million. There has been a total of five investments, with two paid off and a third partially paid. The total amount of outstanding principal and interest is about \$2.8 million, and the fund end-date is September 25, 2015. He noted that the remaining loans could be paid within the next six to twelve months.

Mr. Doolittle requested that the Board approve an amendment to the partnership agreement that would extend the partnership for 12 months, until September 25, 2016. He commented that the additional time could bring in a higher return on the investments in the portfolio.

Ms. Meyers asked Mr. Doolittle what the result would be if the Board did not approve this request. Mr. Doolittle responded that they would have to wind down the fund as rapidly as possible over a period of three to six months. He said it could put a couple of businesses in peril and would potentially be at odds with the mandate of the NMSBIC as far as supporting local economic development.

Mr. Doolittle said there are other alternatives to extending the fund, including putting the assets into a trust, managed by a third party. The actual investments in the portfolio companies would not be actively managed, and the trustee would have the responsibility of returning as much capital as possible.

Mr. McDonald asked when the last loan is due.

Mr. Doolittle responded that the last maturity date is November 6, 2015, and the warrants go out to April 2018. The reason for the lag in the maturity date of the warrants is they like to have a two and a half year period, after the loan maturity date, for the value of the underlying companies to increase. If the fund extension is approved, they would offer an extension of perhaps six months to the portfolio companies, and focus on the companies getting financing to pay NMMP off. He said that two of the three companies should be able to pay NMMP within the next six to nine months. They are working on a possible sale of the third company.

Mr. Cummins stated that, based on scenarios that were run, the highest management fee under this proposed structure would be \$84,000 over the next year, which is significantly less than in the past.

Mr. Cummins noted that the Board discussed this issue at its January meeting, and the discussion at that time was focused on the warrants expiring in two and a half years versus the fund end date. He said he has been discussing this with Mr. Doolittle over the past two years, and Mr. Doolittle had proposed managing the warrants at no charge for the next two and a half years, if the fund end date was extended. He said now they are at the fund end date, and it is not just the warrants that are an issue, but also the outstanding loans. He said it appears more active management is needed to achieve the best possible return out of those loans. He said that is why this proposal is before the Board.

Mr. Cummins also stated that, at a meeting of NMMP's Limited Partner Advisory Committee, the members agreed that this structure has the best probability of being approved by two other major partners in the fund.

Mr. Badal asked Mr. Cummins if he sees a better alternative to this proposal, putting the compensation aside.

Mr. Cummins responded that these mezzanine companies are start-ups, and in two cases, Mr. Doolittle is very involved with the companies in terms of serving a role in helping them get bank financing, and structuring their finances in a way that makes the bank financing possible. It is not a traditional lender relationship; Mr. Doolittle is much more involved, and there is a level of trust that has been established between him and the company owners. Mr. Cummins expressed concern about replacing Mr. Doolittle with an asset manager who is looking to liquidate and foreclose. He said he recommends a one-year extension to allow an opportunity to achieve positive results.

Mr. Badal moved to accept the proposal, as presented. Mr. Morgan seconded the motion, which passed unanimously by voice vote.

PROFESSIONAL SERVICES CONTRACT AND SERVICES AGREEMENT: ACCOUNTING SERVICES

Mr. Cummins stated that Dee Brescia, who handles the NMSBIC's accounting and does an excellent job, is requesting an increase in compensation from \$131 to \$135 per hour, the first increase in two years. He said there is also a change to language in the contract to include updated accounting standards information. The contract term would end on June 30, 2016. He recommended approval.

Ms. Meyers so moved. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

FINANCE NEW MEXICO

Mr. Cummins stated that the proposed contract period is from October 1, 2015 to September 30, 2016, with the same scope of work as before. He commented that Ms. Eakes provides a lot more than what is listed in the contract along with a tremendous amount of support for the NMSBIC's annual Community Meeting. He said the proposed contract amount remains unchanged at \$17,500.

Ms. Waller moved to approve the Finance New Mexico contract renewal, as presented. Ms. Meyers seconded the motion.

Mr. Badal noted that they were originally being paid \$35,000 per year, which was cut in half two years ago. At that time the Board encouraged Finance New Mexico to find additional sources of funding.

Mr. Cummins responded that they have been successful in finding other sources of funding.

The motion passed unanimously by voice vote.

VERGE I, REQUEST TO EXTEND LIMITED PARTNERSHIP END-DATE

Mr. Cummins noted that the NMSBIC has 11.8 percent ownership in Verge I, which is requesting a one-year extension. The current partnership agreement provides for three one-year extensions, which require approval of 67 percent of the limited partners. In this instance, the Board's vote is not necessary, as they have secured commitments from over 67 percent of the other partners; however, Verge is requesting that the Board vote on the extension. The management fee would remain unchanged.

Ms. Meyers moved to approve the request, as presented. Ms. Waller seconded the motion, which passed unanimously by voice vote.

INVESTMENT POLICY, PROPOSED REVISIONS

Mr. Cummins stated that two changes are being requested. The first is a change that would align NMSBIC collateral requirements for bank deposits with the collateral requirements used by the State Treasurer's Office (STO). Currently, the NMSBIC requires its deposits to be 100 percent collateralized with government securities. He said STO publishes a report each month in their State Treasurer's Investment Committee binder that lists the banks designated as depositories of state funds, with collateral requirements ranging from 50 percent to 102 percent based on an analysis of the banks' capital ratios and financial performance.

Mr. Cummins noted that he has been contacted on more than one occasion by US Bank and First National Santa Fe requesting that the NMSBIC align its collateral requirements with STO's.

Mr. Cummins said the second proposed amendment would give the NMSBIC the authority to invest in an NMSIC bond pool, which came from a discussion that he and Chairman Fowler had with the NMSIC's Audit Committee, where it was recommended that the NMSBIC consider investing its excess funds in one of their investment pools. The NMSIC bond pool is managed by three investment advisors.

Mr. Badal asked if NMSIC approval would be required to add and subtract money from the bond pool, and Mr. Cummins responded that NMSBIC could deposit or remove money at any time. He said that NMSIC typically asks that funds remain in the pool for at least a year, but because the size of the NMSBIC investment would be relatively small, they would have no problem if the NMSBIC needed to withdraw funds sooner than that.

Mr. Cummins said today's request is to amend the Investment Policy. Whether or not the NMSBIC wants to actually allocate funds to the bond pool would be another discussion.

Ms. Meyers moved to approve the proposed revisions to the Investment Policy, as presented. Mr. Badal seconded the motion, which passed unanimously by voice vote.

STATE INVESTMENT COUNCIL JOINT POWERS AGREEMENT

Mr. Cummins presented an example of a joint powers agreement (JPA) with the NMSIC, this one with the San Juan College Foundation. He said the JPA would be an agreement for the NMSBIC to invest in an NMSIC bond pool.

Mr. Badal commented that, if the NMSBIC can withdraw money from the bond pool within 24 hours, he saw little reason for it to have money in a money market account, particularly given the higher yield.

Mr. Cummins responded it was not his intention to withdraw funds from the NMSIC bond pool every two weeks; his recommendation is to keep three to six months of funds in a money market account, and deposit \$3 million in the bond pool.

Mr. Cummins said today's proposal is to invest \$3 million in the bond pool, but he would not do that until there was language in the JPA addressing the Board's concerns.

Ms. Meyers moved to approve entering into the agreement with the provision that the NMSBIC have access to funds within five business days.

Chairman Fowler proposed a friendly amendment to add, "and other features and caveats that Mr. Cummins feels are reasonable and necessary for it to be smoothly functioning."

The amendment was accepted as friendly, and the motion, as amended, passed unanimously by voice vote.

Mr. Badal stated that, upon termination, if the NMSIC decided they wanted to take no more deposits, that would be fine, as long as the NMSBIC has the right to liquidate when it wants to. His concern is that the NMSBIC be able to avoid liquidating at a loss in a down market.

Mr. McDonald stated that he and Mr. Cummins would negotiate an agreement with the NMSIC and bring it back at the October 23 meeting for final review.

Mr. Cummins noted that the Board has initiated the following steps: 1) approved the Investment Policy, as amended; 2) authorized him and Mr. McDonald to negotiate the JPA and bring it to the Board for final approval at the October 23 meeting; and 3) agreed to wait until step 2 is completed before approving any funds to invest.

SHORT TERM INVESTMENTS, \$1.5 MILLION ONE-YEAR CD INVESTMENT

Mr. Cummins noted that the US Corp+ Bonds Pool (page 70 in Board packet) reflects that the NMSIC has \$2.2 billion dollars invested in that pool. FYTD return is 3.18 percent, one-year return is 4.98 percent, and three-year return is 4.99 percent. He stressed that historical returns are no indication of future returns, and the NMSIBC would have credit risk as well as interest rate risk when investing in a bond pool.

Mr. Cummins referred to two options: 1) to invest \$3 million in the NMSIC core bond+ pool, which has been decided against, based on today's discussion; or 2) to add another \$1 million to the CD ladder strategy. He recommended, based on today's discussion, leave funds invested in money market accounts, pending negotiation with NMSIC on a JPA. Board members agreed with his recommendation to leave the money for now in the money market fund pending the Board's decision at the October 23 meeting.

INSURANCE POLICY RENEWAL

Mr. Cummins stated that the policy has been renewed, and a copy is included in the Board packet.

COMMUNITY MEETING

Mr. Cummins stated that the Community Meeting is scheduled on October 23, and he and Mr. Morgan are working on a location for the meeting. Mr. Cummins attended a Rotary Club meeting at Mr. Morgan's invitation, which was a good opportunity to make connections.

NMSBIC ABILITY TO BORROW FUNDS

As a follow up to a discussion at the previous Board meeting regarding borrowing from the SBA-SBIC, Mr. McDonald said he has looked at the statute, and it is specifically directed toward the idea of taking money from the Severance Tax Permanent Fund and investing that money in accordance with statute. He said the NMSBIC has the power to get other sources of funding, but the sources will have certain restrictions attached them, depending on the source. In addition, there is no way to isolate funds from other sources from of the "net excess funds" calculation. He said the NMSBIC might be able do it, but would have to segregate the other sources of funding into a separate program, but this could require a statutory change.

FEDERAL HOME LOAN BANK MEMBERSHIP

Responding to a previous question from Mr. Badal, Mr. Cummins said he looked into whether the NMSBIC could become a member of the Federal Home Loan Bank (FHLB), and learned that it could not. He noted that Community Development Financial Institutions (CDFIs),

which include The Loan Fund, Accion, and WESST, are eligible for FHLB membership. The FHLB makes loans to CDFIs, only funds loans at roughly 50% of collateral provided by the CDFI.

CONTINUING EDUCATION

[Deferred.]

ADJOURNMENT

Its business completed, the NMSBIC Board adjourned the meeting at 12:30 p.m.



Alan Fowler, Chairman and President



Date