

New Mexico Small Business Investment Corporation

**P.O. Box 22547
Santa Fe, NM 87502
505-670-1329 • 505-466-2022 (fax)**

November 15, 2010

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

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

Dear Governor Richardson and Chair Varela:

As you know, the New Mexico Small Business Investment Corporation (NMSBIC) is required to report its financial status annually. 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 7-25-5.15. The NMSBIC has received its audited financial statements and an unqualified opinion letter from Pulakos CPAs, and a copy of said report for the fiscal year ending June 30, 2010 is enclosed in accordance with the provisions of the Act.

As Board Chair and President of the NMSBIC, I am charged pursuant to NMSA 58-29-6(B) with reporting the following results for the fiscal year ending June 30, 2010. Before I do so, let me quickly remind you of two critical items; namely, what the NMSBIC does and why.

The NMSBIC Board of Directors, consisting of six volunteer board members, appointed by the Governor and confirmed by the Senate, and the State Treasurer and the State Investment Officer (or their designees) meets monthly to determine, review and assess the organization's investment activities, and to determine the impact of its efforts and capital commitments on New Mexico small businesses.

WHAT WE DO:

- Act as financial stewards of the capital entrusted to the NMSBIC
- Ensure that the organization is following the mandates of the Act
- By partnering with financial professionals, help expand access to capital
- Through its financial partners, make economically targeted equity and debt investments in New Mexico small businesses
- Act as a catalyst to help create and strengthen capital delivery systems
- Leverage the NMSBIC's capital by attracting other equity and debt providers
- Offset the NMSBIC's operating expenses via generation of interest income

WHY:

- By partnering with financial professionals, capital can be delivered more effectively to small businesses across the State. By partnering with alternative lenders, the NMSBIC's capital can be recycled again and again in new loans
- Small businesses create and support most of the job base in the State
- A strong business fabric generates annual tax revenues from gross receipts taxes and payroll taxes, while often providing employee benefits and creating stronger communities. To date over 1,900 loans have been made statewide to businesses that employed almost 4,500 people
- By acting as a cost effective, user friendly conduit of capital, the NMSBIC has no staff, no offices and limited operating expenses, which historically have totaled less than \$265,000 per year
- Capital attracts capital; Capital attracts intellectual capital (people); both help create a more competitive and stronger business environment for New Mexico

FINANCIAL OVERVIEW

Set out below is an overview of the financial condition of the organization as of June 30, 2010, as reflected in the enclosed independent audit report.

INCOME

• Interest and Dividend Income (Loss)	\$ 570,851
• NMSBIC Direct Operating Expense	\$ 264,758
• Excess of Income over Direct Operating Expense	\$ 306,093

PROGRAM EXPENSES

• Equity Management Fees and Expenses	\$ 702,731
• Realized Loss on Investment	(\$2,033,282)
• Unrealized Loss on Investment	(\$ 500,232)
• Loan Loss	(\$ 123,074)
• Total Income or (Loss)	(\$3,053,226)

- Net Asset Value at Year-end \$38,451,268

LENDING ACTIVITIES

The NMSBIC provides lending capital to nonprofit lending organizations in the State with experience in the placement of loans to small businesses. NMSBIC has committed almost \$13,000,000 to its lending program, which is used by the nonprofit lending organizations to make loans to New Mexico small businesses that are unable to secure loans from more traditional lending sources. Because the monies provided by NMSBIC are primarily used for short-term loans, repayment of the loans with interest allows the nonprofit lenders to re-lend the monies again and again. This has resulted in the NMSBIC's \$13,000,000 commitment being used to make nearly \$29,000,000 in loans to New Mexico small businesses.

With total NMSBIC lending of nearly \$29,000,000 since the introduction of the program in early 2004, the NMSBIC's lending program has been of critical importance to small businesses all around the State. By partnering with nonprofit lending organizations like The Loan Fund, ACCION NM, and WESST Corp, the NMSBIC's capital has been used to provide loans to over 1,900 businesses.

The New Mexico Community Development Loan Fund (The Loan Fund) is the oldest alternative lender in the State, and the largest alternative lending partner of the NMSBIC. It manages a loan facility from NMSBIC of \$7,500,000, which will be increased to \$8,500,000 this month. Actual loans made by The Loan Fund utilizing the NMSBIC facility stood at \$7,180,307 as of June 30, 2010, an increase of \$2,341,958 over June 30, 2009. The size of the average loan made by The Loan Fund is approximately \$48,000 and its portfolio performance has been exceptional. Based on its performance and aided by the significant, increasing support of the NMSBIC, The Loan Fund has been able to significantly expand its funding sources from other organizations.

ACCION NM continues to be the most prolific lending partner of the NMSBIC. It is a micro-lender and is often the only capital source available to the small businesses and start-up companies that they serve. ACCION NM manages an approximate \$5,000,000 loan participation program for the NMSBIC, which had \$3,221,421 outstanding at June 30, 2010. While the average loan size is quite small, just over \$10,000, the NMSBIC's capital at ACCION NM has been used to provide loans to over 1,600 small businesses.

WESST Corp manages the NMSBIC's smallest lending facility, \$375,000, but also provides technical assistance and training to its clients. With the completion of the WESST Enterprise Center, an Albuquerque business incubator, its lending activity may increase in the new fiscal year. Outstanding loans by WESST Corp utilizing NMSBIC capital stood at \$120,480 at June 30, 2010.

Since inception in 2004 through June 30, 2010, NMSBIC lending program activity is as follows:

<u>Organization</u>	<u>Commitment</u>	<u>Dollars Lent</u>	<u># of Loans</u>	<u>Employees</u>
The Loan Fund	\$7,500,000	\$14,750,000	310	1,570
ACCION NM	\$4,941,416	\$13,750,000	1,600	2,830
WESST Corp	\$ 375,000	\$ 220,000	23	124
Totals	\$12,816,416	\$28,720,000	1,933	4,524

ECONOMIC IMPACT

Given the increasing need for access to capital due to the contraction of lending by traditional banking sources, many small businesses have been pushed toward alternative lenders like The Loan Fund and ACCION NM. Due to the constant repayment of principal and subsequent re-lending of NMSBIC funds, the NMSBIC's capital in its loan programs have been recycled nearly 3 times. Lending commitments currently total \$12,800,000, yet almost \$29,000,000 has been lent over the six year period. Loan losses have averaged less than 2% annually and were \$123,074 or 1.24% in fiscal year 2010.

While neither a \$10,000 loan from ACCION NM nor a \$48,000 loan from The Loan Fund may create a significant number of new jobs, these loans help sustain and expand businesses and are critical to retaining employment. When the loans were originated, these companies reported over 4,500 employees. The related payroll taxes, together with gross receipt taxes paid by these businesses are incrementally significant to the State's budget on an annualized basis.

EQUITY ACTIVITIES

Since 2003 the NMSBIC has been catalytic in the creation of 9 New Mexico headquartered equity funds, each targeting a specific funding need. The smallest fund, The Gap Fund, makes micro-equity investments, typically \$75,000 to \$100,000, in start-up companies that would not be able to attract professional capital. Verge Funds focus on early stage technology companies, and will make investments from \$250,000 to \$1,000,000. Together The Gap Fund and the Verge Funds have invested in 28 New Mexico companies with a combined labor force of nearly 175 employees. These funds, and the companies they have invested in, would not have been established in New Mexico without the NMSBIC's ability to provide equity capital.

The NMSBIC is typically the first institutional investor in each fund, and often the largest investor. Part of the strategy of the NMSBIC is to act as a magnet to help these funds attract added capital from other investors. The NMSBIC has committed a total of \$31,300,000 to these 9 funds, but the total size of these funds is now greater than

\$91,000,000. In addition, each one of these funds attracts other equity investors into almost every portfolio company, so the leverage achieved by the NMSBIC's capital commitments is over 6 times. Equity capital also allows these businesses to establish credit facilities.

As of June 30, 2010 the NMSBIC, through its equity fund partners, has made indirect equity investments in 35 New Mexico companies. Since the initial investment, many of these companies have added employees, increased revenues and are approaching profitability. For the past two years equity values of public and private companies have been significantly reduced. Likewise, the NMSBIC's investments have been negatively impacted in both 2009 and 2010 fiscal years. In 2010 the NMSBIC reported realized losses of \$2,033,282 and unrealized losses of \$500,232 from its equity investments.

The typical equity fund has a 10 year life and the average holding period of portfolio companies is 8 years. Due to a depressed stock market and reduced equity valuations, these holding periods have been extended. There were no New Mexico headquartered equity funds prior to 2003, so these funds are very new, and their investment portfolios are less than 4 years old. The NMSBIC experienced its first profitable exit and related capital distribution during this past fiscal year. Investment results will improve in 2011 and 2012 as the economy improves and as the credit and capital markets return. That in turn will help generate wealth for the founders, key employees, the investment funds and the State.

OPERATING EXPENSES

The NMSBIC strives to be a highly cost effective conduit of capital, while endeavoring to deploy capital broadly across a wide range of companies and communities. Since inception it has successfully offset all of its operating expenses via generation of interest income from investment of its funds in certificates of deposit and other interest-bearing accounts. The NMSBIC's operating expenses were \$261,053 in 2009 and \$264,758 in this fiscal year, while income from interest-bearing accounts was \$820,545 and \$570,851 respectively. The reduced interest income is directly related to historically low short-term interest rates. Despite the historically low interest rates, the NMSBIC believes that it will continue to be able to successfully offset all of its operating expenses in this current fiscal year.

FINANCIAL EDUCATION

Through its support of Finance New Mexico, the NMSBIC has also been the catalyst in producing and distributing key financial and operational information to business owners and entrepreneurs in the State. Accountants, Attorneys, and Financial Professionals all contribute high value content and business savvy, which is published weekly in numerous local papers and broadcast electronically to a wide audience. The Website, www.financenewmexico.org also features regional schedules for economic development meetings, training sessions and business networking events, in addition to

containing an archive of over 150 business related articles from experts. The website www.financenewmexico.org was cited by the Albuquerque Chamber of Commerce as one of the best sources of business information content in 2009.

STATUTORY REPORTING REQUIREMENTS

As required by NMSA 58-29-6 (B), I also provide you with the following information:

1. Primarily due to the realized and unrealized losses reported by our equity fund partners of just over \$2,500,000, the NMSBIC reported a reduction in Net Asset Value of \$3,053,226 for the fiscal year ended June 30, 2010, reducing the value of the NMSBIC's assets to \$38,451,268 as of June 30, 2010. This translates to a negative (7.36%) return for the fiscal year. Based on the reported loss, the NMSBIC will not be distributing any net excess income to the Severance Tax Permanent Fund.
2. The NMSBIC will continue to offset 100% of its operating expenses in the foreseeable future as it has historically done by generating excess interest income from its deposits and lending portfolios. One of the core principles of the NMSBIC is the protection and preservation of its capital, which has been challenging over the past two years. All deposits of the NMSBIC in financial institutions are 100% insured by the FDIC.
3. With respect to the continuing operations of the corporation, the NMSBIC Board recommends that the corporation continue to prudently and judiciously deploy its uncommitted capital, approximately \$3,000,000, by increasing the availability of lending and equity capital through its financial partners while minimizing investment risk. This is consistent with the mandate of being an economic development and job creating catalyst. Access to investment and lending capital is critical to the success of small businesses throughout the State.

The NMSBIC Board is extremely grateful for the continued support of the Governor, Lt. 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, cost effective, non-bureaucratic conduit of capital that has helped expand the capacity of its lending partners and led to the development of equity capital delivery systems to support small businesses statewide.

Respectfully submitted,



Andrew Baca
NMSBIC Board Chair

**The Honorable Bill Richardson
The Honorable Luciano Varela
November 15, 2010
Page 7**

C w/enc. to:

**The Honorable Diane Denish, Lt. Governor
Steven K. Moise, New Mexico State Investment Officer**