ISSUE:

San Fernando Valley Financial Development Corporation (SFV), a Financial Development Corporation for purposes of the California Infrastructure and Economic Development Bank (IBank) Small Business Loan Guarantee Program (SBLGP) is appealing the decisions made by IBank's Executive Director (Executive Director), communicated to SFV in the Executive Director's August 1, 2014 (Exhibit A) (August 1, 2014 Letter) and the August 7, 2014 (Exhibit B) (August 7, 2014 Letter) and collectively, (Executive Director Letters)) to (i) not renew SFV’s annual contract to provide program management services for SBLGP (Non-Renewal Decision) and (ii) to terminate SFV’s authority to issue loan guarantees or otherwise act as a financial development corporation (FDC) under SBLGP ((Termination Decision) and collectively, (Executive Director’s Decisions)). SFV’s appeal to the IBank Board of Directors was made in the letter dated August 22, 2014 from SFV’s legal counsel (SFV Letter) (Exhibit C).

The Executive Director stated in the Executive Director Letters that the repeated instances of non-compliance by SFV under the State of California (State) Small Business Loan Guarantee Program (State SBLGP) and the U.S. Treasury’s State Small Business Credit Initiative (SSBCI) program, which is administered under SBLGP, constituted violations of that certain Agreement (Number 13GOB038) for the term July 1, 2013 through June 30, 2014 by and among SFV, the Governor’s Office of Business and Economic Development (GO-Biz) and IBank (Exhibit D) (Contract). The Executive Director also determined that SFV’s failure to comply with the Contract and the requirements of applicable State law could potentially cause irreparable harm to the State in accordance with Sections 63089.2(d) of the State’s Government Code. As a result of those findings and determinations, the Executive Director specifically terminated SFV’s status as an FDC for purposes of SBLGP, as well as SFV’s authority to administer loan guarantees under SBLGP.

Summary of SFV Failures

Below is a summary of the basis for the Executive Director’s Decisions:

1. SFV failed to issue any eligible and compliant loan guarantees under SSBCI for fiscal year 2013-2014.

2. SFV failed to provide any information to GO-Biz or IBank to assist Governor Edmond G. Brown, Jr., GO-Biz and IBank to prepare the required SBLGP Administrative Costs Annual Report, January 2014 (Pursuant to the 2013-2014
State Budget) of fees, charges, and administrative costs for the ten year period 2003-2004 through 2012-2013 to the Legislative Analyst’s Office (Administrative Cost Annual Report). The Administrative Cost Annual Report can be found on IBank’s website under Small Business Loan Guarantee Program.

The Administrative Cost Annual Report covers the last 10 years of the administrative costs of the State SBLGP and the federal SSBCI programs. Pages 17 through 26 of the Administrative Cost Annual Report each has a footnote clarifying for the Legislature that SFV did not submit data for any of the ten years of the report. SFV’s unwillingness to provide the requested data is in breach of SFV’s Contract under Section E of Exhibit D, Additional Terms and Conditions to the Contract. Furthermore, such failures, as well as other failures described in the Executive Director Letters constitute the failure by SFV to satisfy the applicable performance-based criteria set forth in §§ 63089.56(b) and 63089.56(c)(2) of the California Government Code and the reporting requirements imposed by §§63089.97 and 63089.98 of the California Government Code.

3. SFV failed to maintain staff to administer and manage SBLGP for fiscal year 2013-2014. Roberto Barragan, President of SFV (SFV President), advised Panorea Avdis, Chief Deputy Director of GO-Biz, via email that SFV’s manager had left, and SFV had no other state/FDC paid staff. This is a violation of § 14018 of the California Corporations Code, which requires each FDC to provide for and maintain a central staff to perform all administrative requirements of the FDC, including all the functions required of the FDC by its Contract.

4. SFV failed to remain fiscally solvent for fiscal year 2013-2014. The SFV President stated that because SFV had not received payment from the State since December 2012, SFV could not hire a new manager and would not comply with GO-Biz’s request for information to complete the Administrative Cost Annual Report. IBank understood the SFV President’s statement to mean SFV did not have adequate funds available to meet its obligations as they became due and accordingly was effectively fiscally insolvent.

5. SFV failed to provide to IBank by the due date imposed by the U.S. Treasury, information regarding the loan guarantee for Loan #SFF022 as required by the U.S. Treasury for the quarterly report in 2014 under the SSBCI program. SFV’s failure to provide this information is a breach of the Contract.

6. SFV failed to give priority to the issuance of loan guarantees under the federal SSBCI program. All of the FDCs, including SFV, were informed by SBLGP Staff that priority was to be given to issuing guarantees under the SSBCI program before issuing guarantees under the State SBLGP. Priority to SSBCI was important so that the State could receive the full $168 million in SSBCI disbursements (described in more detail under Response to SFV Letter below) from the U.S. Treasury as quickly as possible.
On January 2, 2014, Dan Apodaca, the Assistant Program Manager of SBLGP, (Assistant Program Manager) sent an email to the SFV President requesting an updated report with respect to SSBCI. At the end of that email, the Assistant Program Manager wrote:

“Unless the projects do not qualify under SSBCI, your program guarantees should be focused on SSBCI. You currently show no recent guarantees under the SSBCI Program.”

In response to Dan’s email, the SFV President wrote:

“As I have indicated, our state guarantee program has no employees with the departure of Andrea DeLuna. And lacking payment by the state of amounts due under our state contract since December 2012, I am not in a position to hire a new manager or employee. Therefore we are unable to produce the reports requested nor able to secure any new guarantees under the SSBCI program.”

**Conclusion**

IBank’s Executive Director decided not to renew the Contract with SFV, in part, because SFV (i) was unable to secure eligible and compliant SSBCI loan guarantees during the fiscal year ending June 30, 2014, (ii) was unable to provide information required for the Administrative Cost Annual Report, (iii) was unable to staff and manage SBLGP in conformance with Section 14018 of the California Corporations Code, (iv) was fiscally insolvent, (v) failed to substantially meet compliance requirements and follow the directives, requirements and guidelines of the SBLGG and SSBCI programs, and (vi) failed to follow the SBLGP directive to give priority to the issuance of loan guarantees under the federal SSBCI program.

SFV’s repeated failures to perform constitute violations of its Contract with IBank as well as applicable provisions of the Corporations Code and Government Code discussed further in this Staff Report.

**SFV’s Requested Board Action:** SFV is requesting an IBank Board determination that (i) rescinds the Executive Director’s Decisions and (ii) directs the Executive Director to negotiate, in good faith, with SFV for renewal of an annual contract for fiscal year 2013-14.

**Staff Recommendation:** The Staff recommends that the Board approve Resolution 14-19, specifying for purposes of Section 3 of Resolution 14-19, that it is affirming the Executive Director’s actions with respect to the Non-Renewal Decision and the Termination Decision.
**BACKGROUND:**

The Small Business Loan Guarantee Program had been housed in different departments and agencies throughout the State in the years since its establishment in the 1970’s. However, commencing in the spring of 2013, the California Legislature elected to move SBLGP to IBank in order to, among other things, provide a better vehicle to direct additional capital to small businesses in California. Thus, new legislation, referred to as the Small Business Financial Assistance Act of 2013, (Small Business Act) was enacted in October 2013 with an eye towards the aforementioned broader legislative goals. The Small Business Act accomplished more than just moving SBLGP to IBank. It also established the California Small Business Finance Center to enable IBank to offer additional financing products beyond loan guarantees. The Small Business Act also reordered the administrative structure for SBLGP by providing that, the Program Manager for the Program, acting under the guidance of IBank’s Executive Director, administers SBLGP and the IBank Board, among other things, is authorized to review the decisions of the Executive Director. Under Government Code § 63088.3(o), the Program Manager is designated by the Executive Director. Once SBLGP was moved to IBank, at the request of GO-Biz, the Executive Director designated herself as the Program Manager.

In accordance with the Small Business Act, SBLGP is currently operating under one of the permitted models whereby SBLGP provides funding for loan guarantees issued by FDCs for loans made by commercial lenders to qualified small businesses in California.

**RESPONSE TO SFV LETTER:**

In the letter dated August 22, 2014 from SFV’s legal counsel, SFV attempts to characterize renewal of annual FDC contracts as an entitlement. Nothing in the Small Business Act requires IBank to renew an annual FDC contract. Instead, the Small Business Act specifies, in detail, the conditions for terminating an FDC’s authority to issue loan guarantees and for withdrawing an FDC’s ability to “encumber” or obligate State funds. As discussed in more detail below, the Executive Director followed these statutory requirements in making the decision to terminate SFV’s authority and consequently, the decision not to renew SFV’s contract.

SBLGP is authorized to provide funding for loan guarantees and to pay for the program management services performed by the FDCs from State funds appropriated by the Legislature. SSBCI funds totaling approximately $168,000,000 for federal loan guarantees were awarded to two different State entities, SBLGP and the California Pollution Control Finance Authority (CPCFA) pursuant to the Allocation Agreement dated May 19, 2011 between the State of California and the U. S. Department of the Treasury, as amended (Allocation Agreement) (Exhibit E). CPCFA is administered under the State Treasurer’s Office. The SSBCI funds are disbursed to the State by the U.S. Treasury in three tranches. The payment of each tranche is subject to the State meeting certain SSBCI requirements promulgated by the U.S. Treasury. If the FDCs, as a group, fail to issue enough loan guarantees to meet the SSBCI requirements, the State
as a whole (through SBLGP as well as through CPCFA) may risk losing the third and final tranche of SSBCI funds.

SFV’s legal counsel states in the SFV Letter when speaking about prior Program Managers and Executive Directors,

“In addition, there were absolutely no claims made by a program manager or executive director of SFV’s material breach or failure to comply with the applicable contract. Any such matters were addressed and resolved expeditiously and responsibly without the specter of cancellation or termination of the applicable contract.” [Emphasis added]

On January 28, 2013, the Business, Transportation and Housing Agency (BTH) issued its Annual Compliance and Credit Review of SFV for the Year Ended June 30, 2012 (BTH 2012 Audit) (Exhibit F). In addition to the audit findings and audit concerns identified in the BTH 2012 Audit, BTH stated,

“San Fernando Valley has under-performed in providing service coverage under the SSBCI contract when compared to the other southern California FDCs. San Fernando only issued fourteen loan guarantees over a twelve month SSBCI contract period. The production under the State program (SBLGP) should reflect only maintenance-level activity, as all the FDCs have been provided guidance that the federal SSBCI program is to be their focus of production; and making guarantees under the SBLGP only in cases where the borrower could not meet the federal requirements; or renewals under the SBLGP.” [Emphasis added]

The BTH 2012 Audit identified eight (8) audit findings and concerns and requested corrective action to be taken by SFV and reported to BTH by October 31, 2013. The BTH 2012 Audit found for example that in a number of loan guarantees the loan committee consisted solely of the SFV President, who reviewed and approved these loan guarantees. This practice violates the State SBLGP and SSBCI policies that require all FDCs to establish independent loan committees to review, consider and either approve or decline a loan guarantee. On January 27, 2014, the Assistant Program Manager, sent an email to the SFV President requesting SFV’s response to the BTH 2012 Audit. As of the date of this Staff Report, SFV has not provided a response to the BTH 2012 Audit as to the corrective actions, if any, SFV may have taken to address the audit findings and concerns.

In January 2014, IBank engaged Sjoberg Evashenk Consulting, Inc. (Sjoberg) to conduct a Compliance and Credit Review of all SSBCI loan guarantee files for all FDCs since the inception of the federal program in 2011 through December 31, 2013. Attached is Sjoberg’s Compliance and Credit Review for SFV (Sjoberg 2013 Audit) (Exhibit G). SFV presented 21 SSBCI guaranteed loan files to Sjoberg for review. Of those 21 guarantees, two had already been unenrolled for non-compliance with SSBCI federal requirements and transferred into the State SBLGP. Of the remaining 19 guaranteed loans, Sjoberg
found only three such loans to be compliant. The Sjoberg 2013 Audit found three guaranteed loans non-compliant and 13 questionable.

The non-compliant issues included (i) incomplete default data and (ii) borrower and lender certifications not dated. With respect to the remaining 13 questionable guaranteed loans, the issues included, for example (i) no loan or guarantee amounts on the board minutes, (ii) loan committee minutes not available, (iii) promissory note $30,000 < loan guaranteed $35,000, (iv) promissory note $25,000 > loan guaranteed $20,000.

From 2011 through June 30, 2014, SFV was reimbursed $346,001 for administrative fees and expenses (2010-2011 $138,833, 2011-2012 $81,968, 2012-2013 $88,377, 2013-2014 $36,823) to give priority to issuing the federal SSBCI loan guarantees. During this time only three compliant SSBCI guaranteed loans were issued by SFV for a total aggregate amount of $715,000 in loans and $542,500 in guarantees.

<table>
<thead>
<tr>
<th>Loan #</th>
<th>Guarantee Date</th>
<th>Loan Amount</th>
<th>Guarantee Amount</th>
<th>Guarantee %</th>
</tr>
</thead>
<tbody>
<tr>
<td>SFF006</td>
<td>12/29/11</td>
<td>$500,000.00</td>
<td>$375,000.00</td>
<td>75%</td>
</tr>
<tr>
<td>SFF012</td>
<td>04/04/12</td>
<td>$200,000.00</td>
<td>$160,000.00</td>
<td>80%</td>
</tr>
<tr>
<td>SFF019</td>
<td>12/21/12</td>
<td>$15,000.00</td>
<td>$7,500.00</td>
<td>50%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$715,000.00</strong></td>
<td><strong>$542,500.00</strong></td>
<td></td>
</tr>
</tbody>
</table>

None of the three compliant SSBCI guaranteed loans was issued in fiscal year ending June 30, 2014.

SFV’s counsel states in the SFV Letter that “SFV had produced at least one eligible loan guarantee under the SSBCI for the fiscal year 2013-2014.” The IBank Staff has not been able to identify any eligible SSBCI guarantee issued by SFV within fiscal year 2013-2014 to confirm the validity of this claim. In November 2013 the U.S. Treasury conducted a mini-audit of IBank’s SSBCI program in connection with the State’s request for the second disbursement of SSBCI funding. That audit identified a compliance issue under SSBCI guidelines for the guaranteed loan issued by SFV to the lender to Loan #SFF022. The loan proceeds of Loan #SFF022 were not used to refinance the outstanding balance of an eligible loan or line of credit as required by the federal program. Consequently, Loan #SFF022 was not an eligible loan guarantee under the SSBCI program and SFV and IBank were required by the U.S. Treasury to un-enroll Loan #SFF022 from the SSBCI program.

All SSBCI guaranteed loans require a “Certification Receipt and Authorization for the CA Small Business Loan Guarantee Program – SSBCI” signed and dated by the Program Manager or the Assistant Program Manager (SSBCI Approval) before they can be approved and enrolled in the SSBCI program. SFV has not provided an SSBCI Approval for any SSBCI guaranteed loan issued in 2013-2014. Furthermore, after the un-enrollment of Loan #SFF022 from the SSBCI Program, no SFV guaranteed loans were reported by IBank or the State in any quarterly or annual report in 2013-2014 submitted.
to the U.S. Treasury with respect to the SSBCI Program. No SSBCI trust funds have been obligated for a SFV guarantee in 2013-214.

SFV’s counsel states, “Indeed, SFV reported information in connection with the SSBCI loan directly to Ms. Barnes in an email dated July 30, 2014. (See email 7/30/14, attached hereto as Exhibit “3”.)” Indeed, Alex Penaloza, Manager of SFV did send an email on July 30, 2014 to the Executive Director that stated, “San Fernando FDC had one loan guarantee under the SSBCI program for fiscal year 2013-2014.” However, there was no SSBCI Approval attached to that email, and SFV has not produced a copy of an SSBCI Approval for an eligible and compliant loan guarantee issued by SFV under SSBCI for the term July 1, 2013 through June 30, 2014.

Counsel for SFV states in the SFV Letter that

“Overall, SFV has maintained the lowest loss record among FDCs during its tenure with the Program as a result of its stellar collection process and procedures. Even on the rare occasion when a guarantee had to be paid due to unsuccessful collection efforts by the bank, SFV took appropriate action and measures to ensure that the State and the Program ultimately suffered no loss.” [Emphasis added]

Under the SSBCI program from inception through June 30, 2014, 9 of the 11 FDC’s at that time had lower loss rates than SFV. Moreover, 8 of the other FDC’s had a zero loss rate under the SSBCI program. While SFV’s loss rate under the SSBCI program is low, it is certainly not the lowest loss record among FDCs during its tenure with SBLGP. In addition, while SFV had to pay only $12,906 in guarantee claims against the SSBCI guarantee trust funds in fiscal year 2013-2014, SFV has not taken appropriate action and measures to ensure that the State and SBLGP ultimately suffered no loss. No recoveries have been received for the $12,906 loss as of the date of this Staff Report. The SSBCI program has suffered a loss under an SSBCI guarantee issued by SFV.

### SSBCI

<table>
<thead>
<tr>
<th>Financial Develop Corp:</th>
<th>San Fernando Valley</th>
</tr>
</thead>
<tbody>
<tr>
<td>Updated Through:</td>
<td>Jun 2014</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fiscal Year Results</th>
<th>Guarantee Encumbrance</th>
<th>Total Guarantee Payments</th>
<th>Total Recoveries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per Quarter Periods</td>
<td>Loss Rate</td>
<td>Guarantee Amount</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5-Year Moving (2)</td>
<td>5-Year Average Amount</td>
<td></td>
</tr>
<tr>
<td>2010-11 (Feb 17-Jun 30)</td>
<td>0.00%</td>
<td>90,000</td>
<td>0</td>
</tr>
<tr>
<td>FY 2011-12</td>
<td>0.00%</td>
<td>473,305</td>
<td>0</td>
</tr>
<tr>
<td>Sep-11 (1)</td>
<td>0.00%</td>
<td>90,000</td>
<td>0</td>
</tr>
<tr>
<td>Dec-11 (1)</td>
<td>0.00%</td>
<td>525,500</td>
<td>0</td>
</tr>
<tr>
<td>Mar-12 (1)</td>
<td>0.00%</td>
<td>598,000</td>
<td>0</td>
</tr>
<tr>
<td>Jun-12</td>
<td></td>
<td>679,718</td>
<td></td>
</tr>
</tbody>
</table>
Under the State SBLGP for the past 3 fiscal years, there are 5 FDC’s with loss records lower than SFV, including one FDC with a loss record as low as set out in the table below:

**STATE SBLGP**

<table>
<thead>
<tr>
<th>FISCAL YEAR</th>
<th>5-YEAR MOVING (2)</th>
<th>ANNUAL LOSS</th>
<th>AVERAGE AMOUNT</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-12</td>
<td>1.35%</td>
<td>3.07%</td>
<td>1,478,884</td>
</tr>
<tr>
<td>2012-13</td>
<td>1.60%</td>
<td>0.00%</td>
<td>2,557,953</td>
</tr>
<tr>
<td>2013-14</td>
<td>0.37%</td>
<td>0.00%</td>
<td>2,760,623</td>
</tr>
</tbody>
</table>

However, SFV’s loss record and collection process and procedures are far from stellar under the State SBLGP. SFV’s annual loss rate has been as high as 15.03% in the last 3 years.

SFV’s counsel stated in the SFV Letter that
SFV complied with the requests for information and data as directed by program managers up through and including July 30, 2014. Thereafter, SFV unfortunately was prevented from fully supplying data and reports due to lack of sufficient and timely funding from the State. However, SFV substantially complied with the reporting requirements given its limited resources and unique circumstances. [Emphasis added]

SFV did not provide any information in connection with the Administrative Cost Annual Report as required by GO-Biz. As mentioned above, pages 17 through 26 of the Administrative Cost Annual Report have a footnote on every page clarifying for the Legislature that SFV did not submit any data for any of the ten years of that report.

The Assistant Program Manager, concerned about the lack of reports from SFV, sent an email on January 10, 2014 to the SFV President, requesting priority be given by SFV to the submittal of approved SSBCI certificates and executed documents so that the approved SSBCI loan guarantees could be placed in the SSBCI database. Two days later, January 10, 2014, the SFV President responded with his email (Exhibit H) regarding “late quarterly report for SSBCI” and wrote, “Dan, I will be in Sacramento Tuesday, afternoon. It might be a good idea for me to stop by and see you and Tevia (sic) and tell you why we are not submitting our reports.”

SFV’s counsel stated in the SFV Letter that

“SFV’s manager had recently left SFV’s employ, in large part due to lack of state funding. The lack of payment from the State also made it impossible for SFV to pay for new staff and hire a new program manager. Therefore, SFV’s inability to comply with Ms. Barnes’ request for data was certainly excusable due to external circumstances imposed upon SFV that were not the fault or responsibility of SFV.” [Emphasis added]

SFV’s failure to provide for adequate staffing of SBLGP generally is in violation of its statutory and contractual obligations. SFV confirmed on multiple occasions that it had no staff to perform various administrative obligations, including the reporting requirements mentioned above, as well as the compliance functions necessary to adequately and prudently manage State SBLGP and SSBCI. Nothing in the Small Business Act excuses such staffing failure in the event that State payments are delayed.

In addition, SFV’s argument that the delays in payment from the State caused SFV to be unable to issue guarantees under the SSBCI program is disingenuous as the delays in 2012 and 2013 were predominantly caused by SFV’s failure to provide the following required documentation before payments under the Contract could be made:

a. Statement of Economic Interest (Form 700)
b. Default Recovery Report
c. Economic Benefits Report
d. Operational Plan
Moreover, the delays in April and May of 2014 also were caused by SFV’s failure to provide adequate documents supporting the expense claims submitted for reimbursement.

THE SMALL BUSINESS ACT

In considering corrective action against an FDC under Government Code § 63089.3(f), the Executive Director is required to consider the FDC’s history and past performance. Further, in Government Code §§ 63089.56(b) and 63089.56(c) the Legislature specifies factors to be considered (i) when withdrawing guarantee funds from a less effective financial development corporation and (ii) in the event that the Executive Director elects to reallocate Program funds in order to avoid wasting valuable State resources on underperforming or non-performing FDCs. Such factors for consideration include, but are not limited to, the FDC’s fiscal solvency, its ability to honor loan guarantee defaults, its ability to maintain a viable presence within the region it serves, the default record of the FDC, the number and amount of loans guaranteed by the FDC and the number of jobs created or retained due to the FDC’s SBLGP activity. In evaluating SFV’s performance as an FDC and in weighing the relative importance of such factors, the Executive Director looked to Government Code § 63089.3(f).

Counsel for SFV argues that the Executive Director misinterprets the Small Business Act when referencing Government Code § 63089.56(c) in the August 7, 2014 Letter. Once an FDC’s guarantee authority is terminated, and the IBank Board upholds any appeal of such a decision, the Small Business Act directs the IBank Board to reallocate FDC funds to the remaining FDCs. The Executive Director’s reliance on the performance based criteria provided under Government Code § 63089.56(c) in evaluating SFV’s performance as an FDC, as well as the factors set forth in Government Code § 63089.3(f) and § 63089.56(b) is appropriate in making the Executive Director Decisions.

The Small Business Act provides that so long as the Executive Director made a finding of irreparable harm and a finding of failure to comply with the Small Business Act, the Executive Director is authorized to terminate FDC authority. Specifically, pursuant to Government Code §§ 63089.3(b)(4), 63089.3(c)(4) and 63089.3(e), in order to take an action, such as the Termination Decision, the Executive Director is required to make the following findings: (i) that FDC actions or inactions are causing irreparable harm; (ii) that further irreparable harm will occur unless such Executive Director action is taken; and (iii) that the FDC has failed to comply with its obligations under the Small Business Act.

Failures Causing Irreparable Harm:
1. SFV’s failure to issue a single guarantee that qualified, under SSBCI national standards established by the U.S. Treasury and SBLGP guidelines, for the use of SSBCI funds for fiscal year 2013-14. This failure created multiple distinct yet related harms:

   a. Most immediately SFV harmed the SSBCI program by delaying the State’s ability to receive the third and final tranche of the SSBCI federal funds, and further irreparable harm endangers the ability of the State to draw down the remaining approximately $60 million in federal funds under the SSBCI program for immediate use in promoting economic development in the State.

   b. SFV numerous compliance issues under the SBLGP and SSBCI are undermining lender’s and participant’s confidence in the credibility and survival of SBLGP and will continue to cause irreparable harm to the viability of SBLGP unless the Executive Director’s Decisions are affirmed by the IBank Board. During the financial crisis in 2009, the State shut down the loan guarantee program. While outstanding guarantees were still valid and enforceable, lenders believed that the State had reneged on its commitment to guarantee small business loans. Trust and confidence by lenders in the small business loan guarantee program was lost. It was not until 2011 with the approval of the $168,000,000 SSBCI funding from the U.S. Treasury to the State that confidence was again renewed in SBLGP. This confidence is essential to SBLGP’s effectiveness and must be protected and promoted through a robust commitment to full application of SSBCI resources in compliance with the national standards and guidelines of the federal program.

2. SFV’s failure to issue loan guarantees under SBLGP in a volume consistent with other FDCs. SFV issued and properly registered only nine state guarantees under SBLGP for fiscal year 2013-14. Based on historical performance, FDC’s have issued between 20 and 60+ guarantees per fiscal year, depending on the overall economic climate. SFV’s anemic performance in the State SBLGP program coupled with its complete failure to issue any eligible SSBCI guarantees in the fiscal year ending June 30, 2014, risks irreparable harm to the viability and credibility of SBLGP. SFV’s failure to issue adequate guarantees demonstrates SFV’s inability to maintain a viable presence within the region it serves.

3. SFV’s failure to provide the requested information that is required by the State Legislature to the Legislative Analyst’s Office and required by the U.S. Treasury in connection with SSBCI. The Small Business Act explicitly requires that each FDC provide routine data reports, as well as any “other statistical or other data, reports, or other information required by” law or the Program Manager. SFV expressly stated that it would not honor GO-Biz’s request to provide the necessary information for the Administrative Cost Annual Report. After causing a substantial delay in the release of the Administrative Cost Annual Report, the report ultimately had to be released with a footnote clarifying that SFV did not submit the requested data on fees and administrative costs for any of the ten years covered in the report. This was a clear violation of SFV’s obligations under the Small Business Act.
a. SFV’s failure to provide the required information for the Administrative Cost Annual Report creates the potential compliance risks of irreparable harm directly to the Governor, GO-Biz and IBank that are statutorily required to report to the California Legislature on the operation of SBLGP.

b. SFV’s failure to provide the information required by the U.S. Treasury in a timely manner creates the potential compliance risks of irreparable harm directly to the Governor, GO-Biz, IBank, the State Treasurer and CPCFA since “failure to submit complete and timely quarterly reports or annual reports to the U.S. Treasury is a violation of Section 6.1 (b) of the Allocation Agreement which would constitute a “general event of default” for the State, jeopardizing future disbursements.

c. SFV’s failure to provide the information requested by IBank and GO-Biz creates a broader risk of non-compliance by the other FDC’s in administrative matters necessary to the proper functioning of SBLGP. SFV was the only FDC that refused to provide the requested information. If the other FDC’s observe that there are no adverse consequence or other sanctions against an FDC for refusing to provide the requested information, all of the FDC’s could decide not to provide any requested information that the Governor, the State Treasurer, GO-Biz, IBank and CPCFA are required to provide to the Legislature, the U.S. Treasury, the Treasury Inspector General or as otherwise required by law or contract.

d. SFV’s reporting failures further create a real risk of undermining the Legislature’s continued support of SBLGP. If reporting failures become a chronic problem, the Legislators could decide not to appropriate any funds for the reimbursement of the administrative expenses of the FDC’s participating in SBLGP. Without those appropriated funds, the FDCs would not be reimbursed for their administrative expenses in connection with SBLGP and could decide to stop issuing guarantees all together which would seriously jeopardize and irreparably harm SBLGP. More importantly, the Legislators could also enact legislation to close down the small business loan guarantee program all together.

Findings Regarding Irreparable Harm Unless SFV’s Authority is Terminated:

1. Upon evaluating the foregoing failures, the Executive Director determined that, irreparable harm will occur unless SFV’s authority is terminated. These include:

   a. Since 2011, SFV has been paid $346,001 for administrative fees and expenses for only three fully compliant SSBCI loan guarantees. Irreparable harm associated with SFV’s receipt of reimbursement from SSBCI funds for administrative cost that could be found to be unreasonable creates the potential compliance risks of irreparable harm directly to the Governor, GO-Biz, IBank, the State Treasurer and CPCFA since failure to properly use administrative funds is a violation of Section 6.3 of the Allocation Agreement which would constitute a “specific event of default” for the State.
b. Irreparable harm associated with IBank’s inability to fully and properly report to state and federal authorities, including the State Legislature, the U.S. Treasury and the Treasury Office of Inspector General in connection with SSBCI funds and any adverse consequences, liabilities, sanctions and fees that could result, including being in violation of the Allocation Agreement which would constitute an “event of default” for the State under the Allocation Agreement.

c. Irreparable harm associated with the State not being able to receive the full $168,000,000 in federal funds from the U.S. Treasury by the March 2017 deadline, as a consequence of the State incurring an “event of default” under the Allocation Agreement.

d. Irreparable harm to the State associated with allocating limited State appropriations to an FDC with limited or no staff and to an FDC unwilling to fully participate in the SSBCI program.

e. Irreparable harm to the State associated with an FDC that has such significant non-compliance issues as reflected in the BTH 2012 Audit and the Sjoberg 2013 Audit; particularly given that some of the BTH 2012 Audit findings date back to 2012 and remain unresolved in 2014.

f. Irreparable harm to the State associated with allowing a non-performing and non-compliant financial development corporation to continue to draw public funds without providing any material and tangible public benefit or value.

Considerations of Fiscal Solvency, Ability to Honor Loan Guarantee Defaults and Maintain Viable Presence

The Small Business Act also provides that if funds are withdrawn from a less effective financial development corporation as part of a reallocation, the Executive Director shall make that withdrawal only after giving consideration to that corporation’s fiscal solvency, its ability to honor loan guarantee defaults and its ability to maintain a viable presence within the region it serves. SFV’s admitted failure to provide adequate staffing because of its lack of funds and the resulting compliance issues identified in the BTH 2012 Audit and the Sjoberg 2013 Audit, clearly demonstrate that SFV is not capable of effectively using its guarantee funds and is fiscally insolvent. The numerous compliance issues that have been identified specifically in SFV’s SSBCI loan guarantees puts at risks SFV’s ability to honor loan guarantee defaults and its ability to maintain a viable presence within the region it serves.

In making the Executive Director Decisions, the Executive Director considered (i) SFV’s low number of compliant loan guarantees in the SSBCI program, (ii) SFV’s compliance issues identified in the BTH 2012 Audit and the Sjoberg 2013 Audit that call into question SFV’s ability to honor loan guarantee defaults, (iii) SFV’s inability to effectively manage its Contract responsibilities under the SBLGP and SSBCI programs, (iv) SFV’s
failure to comply fully with its obligations under the Small Business Act, (v) SFV’s inability to maintain a viable, productive and compliant presence for the SBLGP and SSBCI programs within the region SFV claims to serve, and (vi) SFV’s fiscal insolvency.

**RECOMMENDATION**

The Staff recommends that the Board approve Resolution 14-19, specifying for purposes of Section 3 of Resolution 14-19, that it is affirming the Executive Director’s actions with respect to the Non-Renewal Decision and the Termination Decision.

**STAFF REPORT PREPARED BY**

Teveia R. Barnes  
Executive Director and Program Manager  
Small Business Finance Center

November 9, 2014