# Other DTED Loan Programs

**CHAPTER 4**

Though the Economic Recovery Grant program is the state's primary business lending tool, the 1995 Legislature asked us to look at other business assistance programs as well. In this chapter we focus on the other business financing programs administered by the Business and Community Development Division of the Department of Trade and Economic Development (DTED). We describe the Challenge Grant programs, the Capital Access program, and the Small Business Development Loan program. For each program, we asked:

- **How much loan activity has occurred through the program? How many jobs has the program helped to create?**

- **What are the perspectives of people who have used the program?**

To answer the first two questions we used data reported by program participants to DTED. Though job creation data are self-reported and unverified for accuracy, we have no reason to believe that companies are consistently misreporting job creation figures, especially given our findings about the self-reported data for the Economic Recovery Fund programs. To learn about the perspectives of program users, we contacted some of them by phone to get their feedback.

## CHALLENGE GRANT PROGRAMS

There are two Challenge Grant programs: one focused on rural businesses and the other on urban businesses. The Rural Challenge Grant program was initiated in the 1980s in response to a faltering economy in outstate Minnesota. The purpose of the Rural Challenge Grant program is to provide job opportunities for low-income individuals, stimulate private investment, and promote economic activity in rural areas.[1] The Urban Challenge Grant program was modeled after the Rural Challenge Grant program following the Los Angeles riots in 1992. The purpose of the Urban Challenge Grant program is to stimulate private investment and create job opportunities in low-income areas of the Twin Cities by assisting minority-owned and operated businesses and others.[2]

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1 *Minn. Stat.* §116N.08, Subd. 1.

2 *Minn. Stat.* §116M.18, Subd. 1.

# RURAL CHALLENGE GRANT PROGRAM

In the early to mid-1980s, the McKnight Foundation was establishing six initiative funds around the state to encourage economic activity in the non-metro area. The initiative funds cover the six non-metro economic development regions outlined in Figure 2.2. The foundation approached the Legislature to see if the state would be interested in working with the initiative funds by matching initiative fund economic development loans dollar-for-dollar. In response, the 1987 Legislature created the Rural Development Board and the Rural Challenge Grant program.[3]

The original appropriation for the Rural Challenge Grant program included $5 million of federal funds and $1 million of state funds. The Rural Development Board capitalized a rural rehabilitation account with the appropriation and designated $1 million for use by each of the six regional initiative funds according to statute. In 1993, the Legislature appropriated an additional $6 million to the Rural Challenge Grant program to re-capitalize the funds.

**Regional initiative funds accept and evaluate applications for Challenge Grants.**

The Regional Initiatives Office in the Business and Community Development Division of DTED administers the Rural Challenge Grant program at the state level. Businesses apply to the regional initiative funds for a loan. Though legislation sets some restrictions on the use of funds, the initiative funds set their own application review and loan approval policies and procedures. Upon approval of a loan by an initiative fund, the initiative fund requests a disbursement of funds through the Regional Initiatives Office. Because of the project review processes carried out by the initiative funds, the Rural Development Board, chaired by the Commissioner of DTED, has rarely had to deny a request for disbursement. Money from the rural rehabilitation account provides up to half of the Challenge Grant dollars and the initiative fund provides the rest. A Challenge Grant can cover no more than 50 percent of total project costs with private sources financing the remaining costs.

When a business repays a loan, the initiative fund returns the state's contribution and interest to the state rural rehabilitation account for additional loans to the region. An initiative fund must first exhaust the original appropriation for the region before it can make loans from repayments of the original Challenge Grants. Loans using funds from the loan repayments do not require a match by the initiative funds.

The Challenge Grant program provides smaller loans than the Economic Recovery Fund, on average. The minimum Challenge Grant to a business is $5,000 and the maximum is $100,000. Changes by the 1995 Legislature allow the initiative funds to make microenterprise loans to "qualified retail businesses" to assist people who are trying to escape poverty.[4] The loans may range from $1,000 to $10,000 and do not require a match of private funds.[5]

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*3* *Minn. Stat.* §116N.

*4* The original legislation prohibited loans to retail establishments.

*5* *Minn. Laws* (1995), Ch. 224, Section 65, Subd. 5a.

## Loan Activity

**The average Challenge Grant loan is smaller than the average Economic Recovery award.**

Between fiscal years 1989 and 1994, initiative funds made 393 Challenge Grant loans for a total of almost $23 million. The average loan size statewide was $58,032, but the average varied by region from approximately $49,000 in the Southeast region to about $81,000 in the Northwest region. Table 4.1 shows that the Southeast Minnesota Initiative Fund made the greatest number of loans, accounting for 24 percent of all loans made. Table 4.2 shows that the initiative funds distributed approximately 44 percent of Challenge Grant loans and dollars in fiscal years 1989 and 1990. Initiative funds made a decreasing number of loans from 1991 through 1993 with a slight upturn in fiscal year 1994.

### Table 4.1: Rural Challenge Grant Program, FY 1989-94, Distribution of Loans by Region

| Region | Number of Projects | Percent of Projects | Amount of Loans | Percent of Dollars Lent | Average Loan |
|---|---|---|---|---|---|
| Central | 81 | 21% | $4,355,420 | 19% | $53,771 |
| Northeast | 50 | 13 | 2,973,000 | 13 | 59,460 |
| Northwest | 43 | 11 | 3,491,097 | 15 | 81,188 |
| Southeast | 93 | 24 | 4,523,925 | 20 | 49,644 |
| Southwest | 72 | 18 | 3,936,300 | 17 | 54,671 |
| West Central | 54 | 14 | 3,526,750 | 15 | 65,310 |
| Total | 393 | 100 | $22,806,492 | 100% | $58,032 |

Source: Program Evaluation Division analysis of Department of Trade and Economic Development and Initiative Fund data.

**Between 1989 and 1994, 393 loans were made through the Rural Challege Grant program.**

### Table 4.2: Rural Challenge Grant Program, FY 1989-94, Distribution of Loans by Fiscal Year

| Fiscal Year | Number of Projects | Percent of Projects | Amount of Loans | Percent of Dollars Lent | Average Loan |
|---|---|---|---|---|---|
| 1989 | 82 | 21% | $4,639,450 | 20% | $56,579 |
| 1990 | 89 | 23 | 5,573,020 | 24 | 62,618 |
| 1991 | 61 | 16 | 3,390,285 | 15 | 55,578 |
| 1992 | 51 | 13 | 2,420,917 | 11 | 47,469 |
| 1993 | 37 | 9 | 1,929,750 | 8 | 52,155 |
| 1994 | 73 | 19 | 4,853,070 | 21 | 66,480 |
| Total | 393 | 100% | $22,806,492 | 100% | $58,032 |

Source: Program Evaluation Division analysis of Department of Trade and Economic Development and Initiative Fund data.

Table 4.3 shows that about 10 percent of state dollars lent and 16 percent of loans were written off or were more than 12 payments past due as of June 30, 1995.[6] The percent of loans written off or past due varied by region with a range of 6 percent in the Northeast to 25 percent in the Southwest. The Northwest region has the lowest percent of dollars past due or written off (4.9 percent) and the Southeast has the highest (16.6 percent).

## Table 4.3: Rural Challenge Grant Program, June 30, 1995, Loan Status by Region

| Region | Number of Projects | Amount of Loans | Total State Share | State Amount Written Off[1] | State Amount Past Due[2] | Percent of State Dollars Past Due[2] or Written Off[1] | Percent of Loans Past Due[2] or Written Off[1] |
|---|---|---|---|---|---|---|---|
| Central | 81 | $4,355,420 | $1,979,074 | $34,730 | $143,821 | 9.0% | 12.3% |
| Northeast | 50 | 2,973,000 | 1,588,001 | 87,749 | 0 | 5.5 | 6.0 |
| Northwest | 43 | 3,491,097 | 1,607,841 | 79,456 | 0 | 4.9 | 9.3 |
| Southeast | 93 | 4,523,925 | 2,249,463 | 280,716 | 93,312 | 16.6 | 23.7 |
| Southwest | 72 | 3,936,300 | 1,956,400 | 177,374 | 117,390 | 15.1 | 25.0 |
| West Central | 54 | 3,526,750 | 1,751,125 | 89,783 | 75,738 | 9.5 | 14.8 |
| Total | 393 | $22,806,492 | $11,131,904 | $749,808 | $430,261 | 10.6% | 16.5% |

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[1]Loans that have been written off by the Department of Trade and Economic Development Fiscal Services Unit as of June 30, 1995, are included in this figure.

[2]Loans more than 12 payments past due according to the Department of Trade and Economic Development Fiscal Services Unit as of June 30, 1995, are included in this figure.

# Job Creation

We were interested in finding out how many jobs were created by companies with the assistance of Challenge Grant loans and what wages and benefits the jobs provided. We examined information on job creation through fiscal year 1994 reported by companies to the initiative funds. The figures on job creation that we present are those appearing in the initiative funds' 1994 annual reports.

We have some concerns about the consistency of the data across initiative funds. The initiative funds reports data in different formats and do not clearly define job creation, wage, and benefit information presented in the annual reports.[7] We compared the 1995 annual reports from the initiative funds to figures reported separately for inclusion in DTED's performance report.[8] Some job creation, wage, or benefit information was different in the annual and department reports for over half of the companies receiving loans in 1994. It is our understanding that the con-

*6* Figures for loans written off and past due were obtained from the Department of Trade and Economic Development Fiscal Services Unit. If initiative funds negotiated refinancing of or wrote off past due loans and did not communicate the information to the Fiscal Services Unit prior to June 30, 1995, these figures do not reflect those actions.

*7* For example, it is unclear whether the number of jobs created represents full-time, part-time, or full-time equivalent jobs. It is also unclear if the companies' report of average wage for new jobs represents all jobs or all new jobs, and whether companies weighted the average for full and part-time employment.

*8* Both reports were as of June 30, 1995.

tracts the department has with the initiative funds require an annual report by November 15 of each year for the fiscal year ending June 30 of that year. However, before November 15, the department must obtain job creation, wage, and benefit information on the previous year's loans for inclusion in the performance report. It is in the process of reporting this information twice--once for the performance report and once for the annual report--that the initiative funds' annual reports disagree with the information provided for the department's performance report. In our view, these discrepancies should be reconciled and consistent data should be reported in the future. We recommend that:

- **DTED should provide guidance and instruction to the initiative funds on collection, calculation, and reporting of data. Further, the department should standardize the reporting format.**

We found:

**The average wage of jobs created with Challenge Grants was $7.67 per hour.**

- **Challenge Grants to 369 projects between fiscal years 1989 and 1994 created over 6,400 full-time and over 740 part-time jobs.**

As of June 1994, 262 of the 369 projects (71 percent) experienced growth in full-time employment since the time of their awards.[9] Eighty-nine projects (24 percent) reported no full-time employment growth, and 18 projects (5 percent) reported a decrease in full-time employment. Companies in the Southwest region accounted for approximately one-third of all jobs created.

As Table 4.4 shows, the average wage of new full-time jobs created by projects that reported wage information was approximately $7.67 per hour.[10] Of the companies reporting benefit information, approximately 54 percent offered health care, 11 percent offered dental, 36 percent offered life, and 23 percent offered retirement benefits.[11]

## Perspectives of Firms Receiving Loans

We contacted 15 companies that received loans through the Challenge Grant program to get their feedback about the program. Approximately half of the companies had considered other locations for their project. Seven of the 15 company representatives cited loyalty to the area as an important factor in their location decision. We asked decision makers in the companies whether they would have done the same project in the same place without the Challenge Grant loan. Ten of them reported that they would probably not or definitely not have proceeded with the same project. Without the loan, according to what we were told, four projects would not have happened at all. A representative from a company receiving two challenge grant loans said, "Without the first loan we would not have opened the

9 Job creation information was not available for 24 projects.

10 Ninety-eight percent of projects reporting positive full-time job growth also provided wage information.

11 Ninety-seven percent of projects reporting positive full-time job growth provided benefit information. The Central Minnesota Initiative Fund does not collect information on dental insurance.

## Table 4.4: Rural Challenge Grant Program, FY 1989-94, Average Wage by Region

| Region | Full-Time Jobs Wage Information[1] | Average Wage |
|---|---|---|
| Central | 1,135 | $8.50 |
| Northeast | 329 | 8.10 |
| Northwest | 733 | 6.46 |
| Southeast | 859 | 9.89 |
| Southwest | 2,171 | 7.49 |
| West Central | 1,055 | 6.05 |
| Total | 6,282 | $7.67 |

Source: Program Evaluation Division analysis of Department of Trade and Economic Development and Initiative Fund data.

[1]Includes all projects with wage information and positive full-time employment growth.

doors and without the second loan we would have had to close them." Others said their project would have been smaller, taken longer, or occurred at a different location.

All but one of the company representatives felt that the program was easy to work with and effective. Many of the businesses (at least one from each region) indicated that the initiative funds were very helpful throughout the process. Companies suggested that additional technical support before and after the loan approval, reducing paperwork, and speeding up the application and approval process would improve the program.

# URBAN CHALLENGE GRANT PROGRAM

**The first loans through the Urban Challenge Grant program were made in mid-1995.**

In response to the Los Angeles riots in 1992, Governor Arne Carlson convened a task force to address issues of economic opportunities for minorities and other low-income people in urban areas. The Urban Challenge Grant program was one of the recommendations that emerged from the task force. The purpose of the Urban Challenge Grant program is the creation of job opportunities in low-income areas of the Twin Cities by assisting minority-owned and operated businesses and others.

The Legislature created the Urban Challenge Grant program in 1993,[12] modeling it after the Rural Challenge Grant program, and appropriated $6 million to the program. Rules for the Urban Challenge Grant program were written in 1994 and 16 local non-profit organizations were chosen to make and manage loans. The minimum and maximum loan amounts are $5,000 and $150,000, respectively, except for microenterprise loans that may range from $1,000 to $10,000. Because of the time taken to write rules for the program and select the non-profits organizations

12 *Minn. Stat.* §116M.18.

that would administer the program, the first Urban Challenge Grant loans were made in the summer of 1995.

# CAPITAL ACCESS PROGRAM

The 1989 Legislature created the Capital Access program to encourage banks to make loans to businesses, particularly small and medium-sized businesses, that have difficulty obtaining commercial loans.[13] Although initiated in 1990, the program actually started two years later. The program lost its funding in the first year and a change in the language of the bank agreement caused additional delays.

**The Capital Access program allows banks to make loans that are slightly riskier than conventional loans.**

Banks apply to DTED to participate in the Capital Access program. Participating banks make loans to businesses for industrial, commercial, or agricultural projects and apply to the department to enroll the loans in the program.[14] The Commissioner of DTED opens a reserve fund at the lending institution upon enrollment. The borrower and lender each contribute between 1.5 and 3.5 percent of the loan to the reserve fund.[15] For the first $2 million of loans enrolled by a bank, the state contributes 150 percent of the combined contributions of the borrower and lender to the reserve fund. After the bank has enrolled $2 million in loans, the state contributes 100 percent of the combined contributions. For example, a bank approaches the department to enroll a $50,000 loan. Upon approval, the bank and the borrower each contribute $1,000 (2 percent of the $50,000 loan) to a reserve fund opened by the department and maintained by the bank. If the bank has under $2,000,000 enrolled with the Capital Access program, the state contributes $3,000 to the reserve fund (150 percent of the combined contributions of the lender and borrower). In this example, the bank now has a reserve fund of 10 percent of the principal of the loan. The balance in the reserve fund will increase with interest and additional enrolled loans.

The idea behind the program is that a bank will enroll several loans, creating a portfolio covered by the reserve fund containing the contributions for all of the enrolled loans. The loans are to be financially sound, but the reserve fund allows the banks to make loans that are slightly riskier than conventional loans. The banks set the terms of the loans with the borrowers and administer the loans. The non-refundable contribution to the reserve account may act to deter businesses with less expensive borrowing options from using the program. Banks tend to use this program for smaller loans that either do not justify the amount of paper work required by Small Business Administration (SBA) programs or for projects that require faster turn-around than the SBA programs provide.

Minnesota modeled the program after Michigan's Capital Access program. According to the Director of Strategic Planning in Michigan, their program is very successful with an increasing number of banks choosing to participate. In Minne-

*13* *Minn. Stat.* §116J.8761.

*14* The Department of Trade and Economic Development will reject a loan only if it is for housing, for passive ownership of real estate, or to refinance a bad loan that is not enrolled in the program.

*15* The lender may recover its contribution from the borrower.

**Only 6 percent of commercial banks in Minnesota paticipate in the Capital Access program.**

sota, the department has approved 34 banks to participate in the program (approximately 6 percent of commercial banks in Minnesota) but only half have enrolled loans. The department suggested that the low level of bank participation might be due to the program's slow start, the popularity of SBA programs in Minnesota, and economic factors, such as the strength of the state's lending community.

## Loan Activity

As of October 30, 1995, 17 banks had enrolled 128 loans worth over $4.5 million in the Capital Access program.[16] Banks enrolled fewer than 30 loans in 1992, 1993, and 1995. Fifty-two loans were enrolled in fiscal year 1994, accounting for over 40 percent of loans. The average loan enrolled in the Capital Access program is $36,315. However, loans have ranged from under $2,000 to $300,000, with the median being $21,500. The state contributed almost $340,000 to reserve funds to cover these loans. Borrowers and lenders contributed over $225,000. Three banks have made a total of about $46,400 in claims on reserve funds due to loan defaults.

We were interested in finding out if there is an even distribution of participating banks and enrolled loans around the state and what types of businesses have received loans enrolled in the program. Table 4.5 shows that banks in the Central, Southeast, and Metro areas accounted for most of the loans and dollars enrolled in the Capital Access program. Banks in the Central region used the program the most accounting for 60 percent of the loans and almost 40 percent of dollars enrolled in the program. Companies in the Southeast region received 24 percent of the loans and 33 percent of the enrolled dollars. The Metro area received approximately 15 percent of both loans and dollars. The regional distribution of loans reflects the location of banks that have enrolled in the program. The Northeast, Northwest, Southwest, and West Central areas show little activity in this program. One explanation for this is that a small percentage of Minnesota's banks are located in these regions.

### Table 4.5: Capital Access Program, FY 1992-95, Loan Information by Region

| Region | Number of Projects | Percent of Projects | Covered Loan Amount | Percent of Loan Amount | Bank and Borrower Contribution | State Contribution | Average State Contribution | Job Creation Estimates at Application[1] |
|---|---|---|---|---|---|---|---|---|
| Central | 77 | 60% | $1,763,858 | 38% | $109,570 | $164,355 | $2,134 | 59 |
| Metro | 15 | 12 | 744,100 | 16 | 27,992 | 41,988 | 2,799 | 19 |
| Northeast | 0 | 0 | 0 | 0 | N/A | N/A | N/A | N/A |
| Northwest | 1 | 1 | 300,000 | 6 | 21,000 | 31,500 | 31,500 | 0 |
| Southeast | 31 | 24 | 1,547,433 | 33 | 54,470 | 81,705 | 2,636 | 67 |
| Southwest | 4 | 3 | 292,870 | 6 | 13,450 | 20,195 | 5,049 | 20 |
| West Central | 0 | 0 | 0 | 0 | N/A | N/A | N/A | N/A |
| Total | 128 | 100% | $4,648,261 | 100% | $226,482 | $339,743 | $2,654 | 165 |

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[1]This number is an estimate of the number of jobs the company would create. Information is provided by the bank when a loan is enrolled.

16 The fiscal year was recorded for 125 of the 128 loans.

Table 4.6 shows that most of the loans enrolled by banks were loans to companies in the trade, manufacturing, and services industries. Companies in each of these industries received between 20 and 30 percent of all loans.

## Table 4.6: Capital Access Program, FY 1992-95, Loan Information by Industry Type

| Industry | Number of Projects | Percent of Projects | Covered Loan Amount | Percent of Dollars Lent | Bank and Borrower Contribution | State Contribution | Average State Contribution | Job Creation Estimates at Application[1] |
|---|---|---|---|---|---|---|---|---|
| Agriculture, Forestry, Fishing | 11 | 9% | $574,000 | 12% | $40,180 | $60,270 | $5,479 | 7 |
| Construction | 11 | 9 | 360,957 | 8 | 15,022 | 22,533 | 2,048 | 12 |
| Manufacturing | 32 | 25 | 1,303,818 | 28 | 60,650 | 90,975 | 2,843 | 60 |
| Transportation, Public Utilities | 4 | 3 | 81,961 | 2 | 4,600 | 6,900 | 1,725 | 2 |
| Trade | 39 | 30 | 1,405,417 | 30 | 59,345 | 89,037 | 2,283 | 36 |
| Finance, Insurance, and Real Estate | 3 | 2 | 65,400 | 1 | 3,162 | 4,743 | 1,581 | 0 |
| Services | 28 | 22 | 856,708 | 18 | 43,523 | 65,285 | 2,332 | 48 |
| Total | 128 | 100% | $4,648,261 | 100% | $226,482 | $339,743 | $2,654 | 165 |

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[1]This number is an estimate of the number of jobs the company would create. Information is provided by the bank when a loan is enrolled.

# Job Creation

**Job creation is not an explicit goal of the Capital Access program.**

Job creation is not an explicit goal of the Capital Access program. However, at the time of application, companies estimate the number of jobs that they will create with assistance from the program. The department reported that companies receiving Capital Access loans between fiscal years 1992 and 1995 estimated that they would create 165 jobs. The department does not regularly follow up on job creation and retention estimates.

# Perspectives of Participating Banks

We contacted 12 banks participating in the Capital Access program to find out about their perceptions of the program. All of the loan officers that were familiar with the application and loan enrollment processes felt that the processes were both simple and easy. Five of the banks we contacted had applied to the program but had yet to enroll a loan. Three of the loan officers stated that the loan officer who was the original Capital Access program contact was no longer with the bank and no other loan officers were familiar with the program. One of the bankers said that customers found the Capital Access loan fee to be too high. Another felt that unless the bank enrolled a number of loans, the reserve fund would be too low to secure the loans.

Seven of the banks we contacted had enrolled at least one loan with the program. Bankers told us that they used the Capital Access program to fund riskier projects such as start up companies and companies low in capital. All but one of these loan officers stated that the Capital Access program had allowed their banks to increase the number and volume of loans to small businesses and businesses that ordinarily would not be financed. Many of the bankers stressed their enthusiastic support for the program. One loan officer said, "The program is too good to be true." Another said, "The Capital Access program is the best program that any state or federal government entity has come up with."

**Bankers who had used the Capital Access program spoke favorably about it.**

We asked all of the loan officers for possible reasons why so many banks have chosen not to participate in the Capital Access program. Some stated that banks that have "preferred lending status" with the Small Business Administration may not feel the need for another program. The most common response, though, was that banks may not know enough about the program and do not understand how easy and beneficial other banks have found it to be. Some loan officers reflected that there was very little marketing after the initial introduction of the program in 1992.[17] Many suggested that there be another push to market the program not only to banks but also to businesses.

- **We found the Capital Access program to be one of the best received and least utilized of all the programs we reviewed.**

DTED indicated that the few banks that use the program are satisfied with it, but there is little interest among bankers who have not used the program in the past. As a result we recommend:

- **The Department of Trade and Economic Development should investigate why more banks do not use the Capital Access program.**

It may be that there is not a need for the program in its present form or that there is not enough marketing of the program, as suggested by participating banks.

## SMALL BUSINESS DEVELOPMENT LOAN PROGRAM

**Small Business Development loans are financed with tax-exempt bonds.**

The Minnesota Agricultural and Economic Development Board administers the Small Business Development Loan program.[18] The purpose of the program is to provide loans to small businesses and create jobs. The board finances business expansion or relocation through the issuance of tax-exempt revenue bonds. The businesses must be manufacturers and have fewer than 500 employees. The use of tax-exempt bonds to finance loans allows the board to make loans to businesses at an attractive, fixed interest rate.

Since the federal government loses the tax revenue from tax-exempt industrial revenue bonds, it caps the annual amount of tax-exempt bonds each state can issue to $50 per capita based on the most recent Census estimates, or $150 million, whichever is greater. The Department of Finance administers Minnesota's total allocation of tax-exempt bonds, dividing the industrial revenue bonding capacity

*17* The department says that it markets the Capital Access program at banking conferences and meetings.

*18* *Minn. Stat.* §§41A.036 - 41A.04.

among three loan pools: the small issue loan pool, the housing pool, and the public facilities pool. The Minnesota Agricultural and Economic Development Board is only one of several issuers that apply for bond allocations through the small issue loan pool. The small issue loan pool's allocation is approximately 25 percent of aggregate capacity each year.[19]

For the Small Business Development Loan program, the Legislature specified in statute a preference for businesses that: are in distressed rural areas; will provide permanent employment in rural areas; are in border communities and are experiencing a competitive disadvantage; have been unable to obtain other financing; are in enterprise zones; and use state resources, reduce dependence on outside resources, and produce products or services consistent with long-term needs of the state.[20] The maximum allowed loan amount is 20 percent of all outstanding bond issues.

**Businesses can apply directly for Small Business Development loans.**

A business may apply to the board through DTED. Although the state requires a resolution from the local government unit in which the project will be located, businesses can approach the board directly for financial assistance. The department determines the project viability based on a business plan and other financial documents. The 1990 Legislature passed a law requiring all bond issuers, including the board, to score manufacturing projects using a public purpose scoring worksheet when applying for a bond allocation. Statute specifies the scoring details.[21] The scoring system considers job creation and payroll goals, estimated property tax increase, and the unemployment rate in the project's community. So far, only one project in the Small Business Development Loan program has required the use of the score sheet.

DTED staff present the project to the board to get project approval. By agreement, underwriters buy all of the bonds issued and sell the bonds to the public. A separate bond issue funds each new project. The board maintains a reserve fund called the general guaranty fund to back each project in case of default. This guaranty fund provides a credit enhancement for the business, allowing the business to obtain financing at a lower interest rate than would be available without the reserve fund.

*19* Prior to 1995, the annual allocation for the small issue loan pool was about 30 percent of aggregate capacity. The 1995 Legislature reduced the cap for the small issue loan pool and increased the cap for the housing pool. (*Minn. Laws* (1995) Ch. 167, Section 6.)

*20* *Minn Stat.* §§ 41A.036, Subd. 2. If a loan is made in excess of $1,000,000, additional criteria must be met. (Minn. Stat. §§ 41A.036, Subd. 5)

*21* *Minn. Stat.* §474A.045.

# Loan Activity

There have been 38 small business development loans to date, ranging from $250,000 to over $4 million.[22] The average Small Business Development loan is approximately $1.4 million, with a median of $1 million. Table 4.7 shows the status of loans made through the Small Business Development Loan program. Companies have paid off eight of the 38 loans. Four loans have defaulted resulting in a loss of over $2 million. Between July 1, 1985, and July 31, 1995, the program issued over $50 million in bonds.

## Table 4.7: Small Business Development Loan Program, FY 1985 - July 1995, Loan Information by Loan Status

| Loan Status | Number of Projects | Percent of Projects | Amount of Loans | Percent of Dollars Lent | Current Balance | Default Amount[a] |
|---|---|---|---|---|---|---|
| Paid in full | 8 | 21% | $10,285,000 | 18% | $ 0 | $ 0 |
| Current | 26 | 68 | 38,730,000 | 69 | 28,342,500 | 0 |
| Defaulted | 4 | 11 | 7,000,000 | 12 | 965,000 | 2,870,000[b] |
| Total | 38 | 100% | $56,015,000 | 100% | $29,307,500 | $2,870,000 |

Note: Figures are as of August 1, 1995.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[a]The "Default Amount" equals the amount of the loan written off minus funds recovered from the guaranteur or sale of property.

[b]This number includes a $1.35 million default that was subsequently partly recovered by the sale of a building for $850,000, resulting in a loss of $500,000.

Companies in some regions of the state have used the Small Business Development Loan program more than others. Table 4.8 shows that companies in the Central and Metro regions each received approximately one third of both loans and dollars loaned. There was little or no participation by companies in the Northwest and West Central regions.

Table 4.9 shows the number of loans made through the program by fiscal year. The department made no Small Business Development loans in 1992, 1993, or 1994. First, the federal law permitting the sale of tax-exempt industrial revenue bonds expired in 1992. Congress reauthorized the sale of such bonds in late 1993. Second, the board was unable to make new loans until 1995 because of the four loan defaults. The board must maintain a general guaranty fund balance of at least 25 percent of outstanding bonds. The defaults brought the general guaranty fund below the required level. Reserved funds have recently recovered and the program resumed lending in fiscal year 1996. The current balance of the general guaranty fund is approximately $12 million.

22 In 1992, a company with a small business development loan sold property to two different companies who assumed the remainder of the loan. The state did not issue additional bonds to fund the two new loans. We included all three loans in this figure. The board currently oversees a loan of over $5 million to a company who received funds through the now defunct Agricultural Resource Loan Guaranty program.

## Table 4.8: Small Business Development Loan Program, FY 1985 - July 1995, Loan Information by Region

| Region | Number of Projects | Percent of Projects | Amount of Loans | Percent of Dollars Lent | Current Balance |
|---|---|---|---|---|---|
| Central | 13 | 34% | $17,725,000 | 32% | $9,915,000 |
| Metro | 13 | 34 | 16,320,000 | 29 | 9,515,000 |
| Northeast | 3 | 8 | 8,815,000 | 16 | 4,347,500 |
| Northwest | 0 | 0 | 0 | 0 | N/A |
| Southeast | 5 | 13 | 4,625,000 | 8 | 2,210,000 |
| Southwest | 3 | 8 | 7,530,000 | 13 | 2,590,000 |
| West Central | 1 | 3 | 1,000,000 | 2 | 730,000 |
| Total | 38 | 100% | $56,015,000 | 100% | $29,307,500 |

Note: Figures are as of August 1, 1995.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

**No Small Business Development loans were made in fiscal years 1993 through 1995.**

## Table 4.9: Small Business Development Loan Program, FY 1985 - July 1995, Loan Information by Fiscal Year

| Fiscal Year | Number of Projects | Percent of Projects | Amount of Loans | Percent of Dollars Lent | Current Balance |
|---|---|---|---|---|---|
| 1985 | 9 | 24% | $6,470,000 | 12% | $2,005,000 |
| 1986 | 6 | 16 | 8,625,000 | 15 | 3,770,000 |
| 1987 | 3 | 8 | 8,015,000 | 14 | 5,067,500 |
| 1988 | 2 | 5 | 1,690,000 | 3 | 1,290,000 |
| 1989 | 2 | 5 | 4,075,000 | 7 | 1,515,000 |
| 1990 | 8 | 21 | 9,920,000 | 18 | 6,190,000 |
| 1991 | 5 | 13 | 13,605,000 | 24 | 5,920,000 |
| 1992 | 2 | 5 | 1,085,000 | 2 | 1,020,000 |
| 1996[a] | 1 | 3 | 2,530,000 | 5 | 2,530,000 |
| Total | 38 | 100% | $56,015,000 | 100% | $29,307,500 |

Note: Figures are as of August 1, 1995.

Source: Program Evaluation Division analysis of Department of Trade and Economic Development data.

[a]No loans were made from FY1993 - FY 1995.

## Job Creation

**The department reports that 20 of 23 companies contacted had met or exceeded their job creation goals.**

The department requires companies that receive Small Business Development loans to report job creation information. But, due to the age of most of the loans, the department did not have job creation reports for this program. However, 27 companies provided an estimate of the number of jobs they expected to create on their application and DTED obtained job creation information for 23 of these 27 companies through phone calls conducted over a period of approximately five years. The 23 companies promised to create 642 jobs, and ended up creating 1,312. Twenty of the companies reported meeting or surpassing their job creation goals.[23]

## Perspectives of Firms Receiving Loans

We talked to ten companies that received Small Business Development loans. We wanted to determine whether the projects would have occurred without the loans and to get the companies' feedback on the program. We asked the companies if they had considered other locations for the projects and what the most important factors were in the location decisions. About half of the companies considered other locations and only one considered another state. The most important location factor for six of the companies was that they were already established at the location. Three companies cited the importance of city or state financial incentives. One representative said that the company never really wanted to move but used the possibility of relocation to gain leverage with the city.

We asked the companies if they would have done the same project in the same location without the small business development loan. Five of the companies said that they probably would have proceeded without the loan. Others said the project would have been smaller, taken longer, or would have moved out of state. One company said their project would not have gone through in any form without the loan.

We then asked the companies for their comments about the program. Four of the representatives reported that there was too much paperwork and they spent too much money on attorney fees to put the loan agreement together. Almost all of the company representatives stated that the Small Business Development Loan program had worked very well for them.

# SUMMARY

The three programs reviewed in this chapter are smaller than the Economic Recovery Fund, but each serves a different niche and addresses economic development in different ways. The Challenge Grant program helps regions pursue economic development activities, with the state contribution increasing the amount of money available to pursue those activities. The Challenge Grant program pro-

*23* Companies had received loans one to five years prior to the follow-up phone call.

vides, on average, smaller loans to businesses. The Capital Access program encourages sound but riskier-than-conventional lending by banks. Administration at the state level is minimal, since banks process, approve, and administer the loans. By requiring the borrowers to make contributions to the reserve fund, the program does not attract businesses that could obtain less expensive financial assistance from private sources and requires the borrowers to help cover the added risk of their loans. Finally, the Small Business Development Loan program can assist businesses with larger financing needs than can be met by the other state programs reviewed in the report.

Because we found the available job creation data to be wanting in the case of the Challenge Grant program and the Small Business Development Loan programs, it is hard to reach any conclusions about their effectiveness or make any recommendations about how they might be improved, beyond improving the data. It appears that businesses assisted by these programs do create jobs, but the effect of the public assistance cannot be isolated. In the case of the Challenge Grant program, the wage level of jobs becomes a consideration, as it did with the Economic Recovery Fund.

As mentioned in the chapter, the Capital Access program is well-received by users and administrators of the program. We recommend that the Department of Trade and Economic Development investigate why more banks do not use the program and modify the program or its marketing, as appropriate. It might increase the opportunity for small or risky businesses to find borrowing opportunities, making the program more successfully achieve its purpose.