DIVISION OF FINANCE PROGRAMS

MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY

(MSBDFA)

ANNUAL FINANCIAL STATUS REPORT
FISCAL YEAR 2006
ARTICLE 83A

SECTION 1047 (g)

Submitted by:

Maryland Department of Business and Economic Development

June 30, 2006

MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY (MSBDFA)

TABLE OF CONTENTS

MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY (MSBDFA)

History and Program Description

The Maryland Small Business Development Financing Authority (MSBDFA) program was created by the Maryland General Assembly in 1978. The purpose of the program is to promote the viability and expansion of businesses owned by economically and socially disadvantaged entrepreneurs. In the 2001 session of the Maryland General Assembly, House Bill 945 and Senate Bill 789 modified the MSBDFA statute concerning eligibility. The program's client base has been broadened to include all small businesses rather than only those that are owned by economically and socially disadvantaged entrepreneurs. The statute has been expanded to include small businesses that do not meet the established credit criteria of financial institutions, and consequently are unable to obtain adequate business financing on reasonable terms through normal financing channels. The Department has engaged Meridian Management Group (MMG) to manage the program on the Department's behalf.

MSBDFA's financing activity continues to be supported through the repayment of loans, generation of interest income and the collection of fees. A brief summary of the program components of MSBDFA is provided below:

Contract Financing Program (CFP) provides financial assistance to eligible businesses in the form of direct loans. The funds may be used for working capital and the acquisition of equipment needed to begin, continue, or complete work on contracts where a majority of funds are provided by a federal, state or local government agency or utilities regulated by the Public Service Commission. Financing in either form is limited to $1,000,000 and must be repaid during the term of the contract. Interest rates range from the prevailing prime to prime plus 2 percent. Applicants may qualify for financing prior to contract award.

Guaranty Fund Program (GFP) provides financial assistance to eligible businesses in the form of loan guaranties and interest rate subsidies for loans made by financial institutions. A loan guaranty cannot exceed the lesser of 80 percent of the loan or $1,000,000. Guaranties cannot exceed 10 years with an interest rate charged by the financial institution limited to prime plus two percent. GFP can also subsidize up to four percentage points of the interest being charged by the financial institution making the loan. The subsidy is subject to an annual review. Terms of repayment of the subsidy are negotiated directly with the borrower. Loan proceeds can be used for working capital, the acquisition and installation of machinery or equipment, refinancing of existing debt and the purchase of, and improvements to, real property owned or leased by the applicant.

Surety Bond Program (SBP) assists eligible small businesses in obtaining bid, performance or payment bonds necessary to perform on contracts where the majority of funds are provided by a government agency or public utility. SBP directly issues bid, performance or payment bonds or guarantees a surety's losses incurred as a result of the contractor's breach of a bid, performance or payment bond. Bonds that are directly issued are limited to $1,000,000. Guaranties are limited to 90% of the face value of the bond not to exceed a maximum participation of $1,350,000. Guaranties on bonds remain in effect for the duration of the surety's exposure under the bond. Bonds issued directly will remain in effect for the duration of the qualified contract and any related warranty period. Also, a surety bond revolving line may be established to directly issue or guaranty multiple bonds to a principal within pre-approved terms, conditions and limitations.

Equity Participation Investment Program's (EPIP) purpose is to expand business ownership by socially and economically disadvantaged entrepreneurs and small businesses that do not meet the established credit criteria of financial institutions and are unable to obtain adequate business financing on reasonable terms through normal financing channels. Financial assistance is provided through the use of loans, loan guaranties, and equity investments. The proceeds are used for the specific purpose of purchasing a franchise, acquiring an existing profitable business, developing a technology-based business and to start or expand other types of small businesses. Equity investments may take the form of the purchase of qualified securities, certificates of interest, interest in a limited partnership or other debt and equity investments. All equity investments must be disposed of by the end of the seventh year. Before a financing relationship is begun, a general agreement regarding the probable method of liquidation must be developed. The most common form of repayment is for the owner to buy back the EPIP investment at a predetermined pricing formula between the fourth and seventh year. In all cases, the recovery amount shall be the greater of its percentage of the current value of the business or the initial investment. The details of the three individual components of EPIP are:

- Franchising Investments are limited to 45 percent of the total project cost or a maximum of $1,000,000. The applicant is required to make an equity investment of no less than 10 percent of the total project costs. An independent appraisal of the business entity may be required to determine its value at the retirement of the debt or investment. Project costs generally range from $50,000 to $1 million. This was the first EPIP component to be established.

- Business Acquisitions are limited to 25% of the initial investment or a maximum of $1,000,000. The applicant is required to make an equity investment of not less than $75,000. An independent appraisal of the business entity may be required to determine its value at the retirement of the debt or investment. Project costs generally range from $100,000 to $3 million. This component was added to the program in 1989.

- Technology Investments are limited to a maximum of $1,000,000 in a business entity with a proven technological product or service. An independent appraisal of the business entity may be required to determine its value at the retirement of the debt or investment. Project costs generally range from $100,000 to $3,000,000. This component was added to the program in 1992.

- Other Small Businesses are limited to a maximum of $1,000,000 to start or expand their business entity. An independent appraisal of the business entity may be required to determine its value at the retirement of the debt or investment. Project costs generally range from $100,000 to $3,000,000. This component was added to the program on July 1, 2005.

Collectively, the MSBDFA program has financed approximately 669 transactions for nearly 435 businesses since operations begin in January 1980. Financial assistance for these transactions totaled $124.3 million. The MSBDFA program has had a substantial impact on Maryland's economy by helping local businesses create and retain approximately 16,500 employment opportunities in Maryland.

The MSBDFA program continues to maintain its capital base by minimizing loan losses. The program charged off one (1) account in the portfolio, which consists of sixty-seven (67) accounts, during fiscal year 2006. The charge off was in the amount of $490,731. The program recovered $272,704 from prior years charge offs, resulting in a net loss of $218,027 for fiscal year 2006. During the last 5 years, MSBDFA incurred losses of $1.13 million on $32.1 million in financings. This equates to a loss rate of 3.52%. The loss rate for the most recent 10-year period was 2.90%. With the exception of the Surety Bond program component, problem loans are managed by the Department's Special Assets Unit (SAU). Loans deemed to be at especially high risk are transferred to the SAU for monitoring and resolution.

The program strives to help businesses achieve their long-term objectives of growth and profitability. To accomplish this objective, the financing must be structured to build equity and expand market share, ultimately enabling the business to graduate from the program by repaying their loan (or satisfying bonding requirements) and obtaining financing from traditional sources (banks and commercial sureties). MSBDFA had 60 companies graduate during the past 5 years. This process generally takes an average of approximately 3 years.

The program's current portfolio is comprised of sixty-seven (67) transactions with an aggregate exposure equal to $18 million. As of June 30, 2006, ten (10) additional loans were pending closing requiring a $4.7 million commitment of funds from the program. Additionally, requests for another fifteen (15) loans that would require a $6.3 million commitment of funds are under consideration.

CONTRACT FINANCING PROGRAM

Performance Since Inception

Since the program began, 261 transactions have been funded totaling $37.1 million. Substantially all of the loans were provided directly by MSBDFA. The others received funding from financial institutions supported by a MSBDFA loan guaranty.

Program Performance 2006

During fiscal year 2006, seven (7) applications were approved for financing totaling $2.4 million. Five (5) of these loans closed for a total of $1.6 million. One (1) approval in the amount of $720,000 is anticipated to close (settle) during the next fiscal year and one (1) approval in the amount of $60,000 was rescinded. Total exposure for the Contract Financing component of the program as of the end of the fiscal year was $4.2 million covering twelve (12) loans. Ten (10) of the loans ($4.1 million) are in the form of a revolving lines of credit. Seven (7) of the loans totaling $2.3 million were renewed during the fiscal year.

Projected Performance for FY 2007

The program is expected to approve twenty (20) applications during FY 2007. A minimum of fourteen (14) loans are projected to be closed and funded. The total amount of funds extended is estimated to be $7.2 million and $5.3 million, respectively. All of the financings during the last five fiscal years have been in the form of direct loans. No guarantees were made in support of loans made by other financial institutions. This trend will probably continue because the use of proceeds under the Guaranty Fund is not limited to government and utility contracts.

LONG TERM GUARANTY PROGRAM

Performance Since Inception

This program component has guarantied 268 financings by banks and other lending institutions totaling $47.6 million since legislation was enacted to commence program operations in 1984.

Program Performance 2006

During fiscal year 2006, seventeen (17) applications were approved for $11.7 million, requiring guarantee support by the program of $4.7 million. The program closed eight (8) guarantee transactions for $1.7 million, requiring guarantee support equal to $838,900. Three (3) approvals in the amount of $3.0 million, requiring $1.6 million of guarantee support are anticipated to close (settle) during fiscal year 2007 and six (6) approvals in the amount of $6.9 million were rescinded.

Projected Performance for FY 2007

A total of sixteen (16) loans equal to approximately $5.0 million are projected to be approved during fiscal year 2007. At least twelve (12) are projected to close and fund. Assistance from this program is anticipated to be approximately $4.3 million.

SURETY BOND PROGRAM

Performance Since Inception

Seventy (70) projects have been supported with bonds issued directly, or guaranteed, by the MSBDFA program. This equates to approximately $28.2 million of financial assistance since inception. During this time period, only three (3) claims totaling less than $300,000 have been paid as a result of defaults by portfolio companies.

Program Performance 2006

During fiscal year 2006, eight (8) applications were approved for a total of $4.2 million. Seven (7) bond transactions closed, requiring the commitment of $3.0 million in program funds. One (1) approval in the amount of $1.0 million was rescinded. All of the commitments were direct assistance in the form of bonding lines of credit that clients can use for several contracts simultaneously. There were eight (8) bonding lines in the portfolio as of June 30, 2006 with bonds outstanding totaling $3.4 million. Total commitments under the bonding lines of credit totaled $5.0 million. Two (2) of the lines, equal to $1.5 million, were renewed during the fiscal year.

Projected Performance for FY 2007

Management projects the approval of approximately $4.1 million during FY 2007 to facilitate bonding for seven (7) new businesses and significant increases for two (2) current clients. Most of the transactions are anticipated to be in the form of direct bonding lines, but we hope to get a commercial surety to participate in two (2) transactions with the support of a bond guaranty from this program component. Requests should increase significantly because a new House Bill (HB 169) was passed during the 2006 Legislative Session that increased the maximum amount of bonding assistance the program is authorized to provide to $5 million. Although the program does not have the financial capacity to support $5 million in bonding to a single client, approval of bonds or bonding lines of credit of up to $2.0 million are anticipated.

EQUITY PARTICIPATION INVESTMENT PROGRAM

Performance Since Inception

The program has provided seventy (70) loans or equity investments to forty-six (46) companies since inception in 1987. The assistance provided is equal to approximately $11.5 million. During the early years of the program, most of the transactions were made to franchise businesses. Over the past ten (10) years, however, the trend shifted significantly towards technology-based companies and companies in more traditional industry sectors. .

Program Performance 2006

During fiscal year 2006, thirteen (13) loans were approved for a total of $3.9 million. Seven (7) loans closed requiring the commitment of $2.1 million in program funds. Four (4) loan approvals in the amount of $740,000 are anticipated to close during fiscal year 2007 and two (2) loan approvals in the amount of $1.1 million were rescinded. There were twenty (20) active accounts as of that date with aggregate outstanding balances of $4.9 million.

Projected Performance for FY 2007

Management projects approval of a total of nine (9) applications during FY 2007 equal to approximately $3.7 million of financing assistance. Three (3) approvals are anticipated to be for technology firms, five (5) will likely be to small businesses in more traditional industry sectors and one will be to a franchise operation located in Baltimore City. Six (6) of the transactions are anticipated to close during the fiscal year requiring the commitment of approximately $2.7 million of financial assistance.

Program Highlights for Fiscal Year 2006

During fiscal year 2006, MSBDFA approved a total of forty five (45) financing transactions for both new and existing clients. The Contract Financing component had seven (7) approved requests for a total of $2.4 million. The Guaranty Fund component had seventeen (17) approved requests for a total of $4.7 million. The Surety Bond component had eight (8) approved requests totaling $4.2 million. The Equity Participation Investment Program component had thirteen (13) approved requests totaling $3.9 million.

In addition, MSBDFA approved twelve (12) renewals of existing credit facilities totaling $4.6 million. The renewals were for the lines of credit for twelve (12) existing clients; seven (7) through the Contract Financing component for $2.3 million, three (3) through the Guaranty Fund component in the amount of $717,500 and two (2) through the Surety Bond component in the amount of $1.5 million.

During that same period, twenty-seven (27) transactions were closed in the form of loans, guaranties and surety bonds, totaling over $8.4 million, with an insured amount of $7.6 million,. The allocation by program is: five (5) transactions under the Contract Financing component equal to $1.6 million; eight (8) transactions under the Guaranty Fund component requiring $1.7 million of insurance; seven (7) Surety Bonds equal to $3.0 million and seven (7) EPIP transactions equal to $2.17 million.

Graduations for Fiscal Year 2006

Small businesses that progress beyond the need for financial assistance from the MSBDFA program are classified as graduates. In most instances, these businesses are now able to qualify for loans or surety assistance from private lenders or surety companies with minimal or no support from the MSBDFA program. Graduations also include companies that successfully repay their loans or satisfactorily have their bonds released, and no longer require financial assistance. During the past year, the five (5) companies listed below graduated from the MSBDFA program:

GRADUATIONS FY 06

PROGRAM	BORROWER	ORIGINAL LOAN AMOUNT
Guaranty	Maximum Home Improvement, Inc.	$160,000
Guaranty	Cadenas Aycock, LLC	$323,000
Contract Financing	Worldwide Corporation	$100,000
Contract Financing	Integrated Technology Solutions, Inc.	$300,000
Contract Financing	Omni Elevator Company, Inc.	$250,000

Problem Loan Status as of June 30, 2006

Problem loans are managed by the Special Assets Unit (SAU). As of June 30, 2006, four (4) EPIP accounts, three (3) Contract Financing accounts and one (1) Loan Guaranty account were being serviced by the Special Assets Unit. The combined amount of original approval of the four EPIP accounts is $1,520,000, with a principal balance outstanding equal to $691,908, which is in process of collection. The combined amount of original approval of the two Contract Financing accounts is $1,100,000, with a principal balance outstanding equal to $838,324, which is in process of collection. The amount of original approval of the Loan Guaranty account is $500,000, with a principal balance outstanding equal to $462,000, which is in process of collection.

A loan administered through SAU is considered to be delinquent when the payment of principal and/or interest is over **30** days past due and in payment default when the payment is over **90** days past due. The lender initiates a default on a guaranteed loan. In FY02, DBED initiated a policy to "charge off" all loans that are 180 days past due. These loans are then monitored by the SAU, if they had not previously been transferred to that unit for resolution. SAU works actively with small business clients that have defaulted in an effort to recover the State's resources.

Portfolio Year End Summary

The following is a summary of important measures used to evaluate the status of the four components of the MSBDFA program. The summary data highlights the size of the different funds, the amount of insurance and loans outstanding, and other pertinent items. After a claim has been paid or a loan has been charged off, SAU continue to monitor the account in an effort to recover the proceeds of the failed loan.

MSBDFA Year End Highlights as of June 30, 2006

CATEGORY	Contract Financing Program	Guaranty Fund Program	Surety Bond Program	Equity Participation Investment Program
Cash Balance and Investments	$333,389	$1,142,065	$1,787,689	($223,003)
Loans/Guaranty Outstanding	$751,137	-0-	-0-	$2,095,815
Committed Cash 1	$800,000	$3,076,850	$1,600,000	$740,500
Loan Loss Reserve 2	-0-	141,674	-0-	-0-
Claims Paid	-0-	-0-	-0-	-0-
Charge Off	$490,731	-0-	-0-	-0-
Recoveries	$1,272	$57,032	$4,900	$209,500

1 Committed Cash is funds reserved for closing (settlement) of approved loans.
2 Loan Loss Reserve is the estimated amount that may need to be paid to lenders for losses sustained by them on loans guaranteed by the program.

Equity Participation Investment Program Update

Franchising Component

There are two (2) accounts with a balance outstanding equal to $106,559.

Business Acquisition Component

There is one (1) account with a balance outstanding equal to $500,000.

Technology Component

There are ten (10) accounts with a balance outstanding equal to $2,982,726. Three (3) of this group with a balance outstanding equal to $653,855 are managed by the Special Assets Unit.

Other Business Types

There are seven (7) accounts with a balance outstanding equal to $1,374,995.

EPIP Portfolio Year End Summary

The following is a summary of important measures used to evaluate the status of the EPIP component. It highlights the fund size, the amount of insurance and loans outstanding, the committed cash, the year-end loan loss reserve, any amounts charged-off or recovered in FY06

EPIP Year End Highlights as of June 30, 2006	
Category	**EPIP**
Cash Balance	($223,003)
Loans/Guaranty Outstanding	$2,846,952
Committed Cash	$740,500
Loan Loss Reserve	-0-
Charge-Offs (Recoveries)	($209,500)

Geographical Distribution of MSBDFA

Loans and Guarantees FY 2006

Region*	County	Approved			Closed		
		No.	% Total Amt	Original Expos. Loan Amt.	No.	% Total Amt	Original Expos. Loan Amt.
I Central Maryland	Anne Arundel	5	11.1	2,025,000	4	14.8	1,875,000
	Baltimore City	16	35.6	13,425,500	8	29.6	2,545,000
	Baltimore	3	6.7	315,000	2	7.4	235,000
	Carroll	0	0.0	0	0	0.0	0
	Cecil	0	0.0	0	0	0.0	0
	Howard	1	2.2	500,000	1	3.7	500,000
	Harford	0	0.0	0	0	0.0	0
	Sub-Total :	25	55.6	16,265,500	15	55.5	5,155,000
II Greater Washington	Frederick	0	0.0	0	0	0.0	0
	Montgomery	3	6.7	750,000	3	11.1	750,000
	Prince George's	15	33.3	5,066,350	9	33.3	2,525,000
	Sub-Total :	18	40.0	5,816,350	12	44.4	3,275,000
III Western Maryland	Allegany	0	0.0	0	0	0.0	0
	Garrett	0	0.0	0	0	0.0	0
	Washington	0	0.0	0	0	0.0	0
	Sub-Total :	0	00	0	0	0.0	0
IV Southern Maryland	Calvert	0	0	0	0	0.0	0
	Charles	2	4.4	181,000	0	0.0	0
	St. Mary's	0	0.0	0	0	0.0	0
	Sub-Total :	2	4.4	181,000	0	0.0	0
V Upper Eastern Shore	Caroline	0	0.0	0	0	0.0	0
	Kent	0	0.0	0	0	0.0	0
	Queen Anne's	0	0.0	0	0	0.0	0
	Talbot	0	0.0	0	0	0.0	0
	Sub-Total :	0	0.0	0	00	0.0	0
V Lower Eastern Shore	Dorchester	0	0.0	0	0	0.0	0
	Somerset	0	0.0	0	0	0.0	0
	Wicomico	0	0.0	0	0	0.0	0
	Worcester	0	0.0	0	0	0.0	0
	Sub-Total :	0	0.0	0	0	0.0	0
	TOTAL:	45	100	22,262,850	27	100	8,430,000