DIVISION OF FINANCE PROGRAMS

MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY

(MSBDFA)

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History and Program Description

The Maryland Small Business Development Financing Authority (MSBDFA) was created by the General Assembly in 1978. The purpose of this Authority is to assist socially or economically disadvantaged entrepreneurs in the creation and expansion of Maryland businesses. 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 potential client base has been broadened to include all small businesses rather than only those that are determined to be socially or economically disadvantaged. The statute has been expanded to include small businesses that do not meet the established credit criteria of conventional or traditional financial institutions, and consequently are unable to obtain adequate business financing on reasonable terms through normal financing channels**.**

Over the years, MSBDFA has grown through the expansion and revision of its core programs. Loan underwriting and marketing responsibilities of MSBDFA's financing programs are provided through Meridian Management Group (MMG). In March of 1998, Morgan Advisory Group, an affiliate of MMG, assumed the portfolio management responsibilities of the MSBDFA portfolio. With the exception of the Surety Bond Program, the problem loans continue to be managed by DBED's Special Assets Unit (SAU). The portfolio management responsibilities consist of monitoring loan covenants, analysis of the borrower's financial statements and detection of loans that are in default or have problems that need closer monitoring. The evaluation of risk is performed in accordance with the Division's *Quality Risk Rating System.* Loans deemed to be at especially high risk are transferred to the SAU for monitoring and identifying work out strategies. Working with the Attorney General's office, the SAU will formulate plans to assist the company in improving its performance and to minimize, or eliminate, the State's potential losses from those companies in default.

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 programs administered by 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, among other things, 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. Directly issued bonds will remain in effect for the duration of the qualified contract and any related warranty period. Also, a surety bond 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 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. Briefly, the details of the three individual components of the program are:

- Franchising Investments are limited to 45 percent of the total project cost or a maximum of $500,000. 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 ranges from $50,000 to $1 million. This was the only component when the program was first established.

- Business Acquisitions are limited to 25% of the initial investment or a maximum of $500,000. 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 $500,000 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 $500,000 to start or expand their business entity. This component was recently added to the program on July 1, 2005. An independent appraisal of the business entity may be required to determine its value at the retirement of the debt or investment. Project costs are also expected to range from $100,000 to $3,000,000.

Collectively, the agency has financed approximately 642 transactions for nearly 420 businesses since beginning operations in January 1980. These transactions totaled $117.3 million. The agency’s programs have had a substantial impact on the Maryland economy by helping local businesses retain and create approximately 16,000 employment opportunities for Maryland residents.

MSBDFA continues to maintain its capital base by minimizing loan losses. The programs experienced estimated losses on 3 accounts in the 71-account portfolio during fiscal year 2005. These losses totaled an estimated $200,000. The programs also recovered previous losses from 6 current and past portfolio companies totaling $215,979, resulting in net recoveries of $15,979 for fiscal year 2005. During the last 5 years, MSBDFA incurred losses of $1.95 million on $31.2 million in financings. This equates to a loss rate of 6.25%. The loss rate for the most recent 10-year period was 3.84%.

The program strives to help businesses achieve their long-term objectives of growth and prosperity. To do so, the financing must be structured to build equity and expand their market presence, ultimately graduating from the program by paying off their loans and obtaining financing from conventional financing sources (banks and commercial sureties). MSBDFA had 42 such companies graduate during the past 5 years.

The program's current portfolio is comprised of seventy-one (71) loans or transactions with an aggregate exposure to MSBDFA of $15.7 million. As of June 30, 2005, seven (7) other loans were pending closing requiring $2.27 million in committed funds from MSBDFA. The program manager was evaluating requests for another twenty three (23) loans totaling $10.4 million that would require some $8.8 million in assistance from MSBDFA.

CONTRACT FINANCING PROGRAM

Performance Since Inception

Since the program began, 256 transactions have been funded totaling $35.5 million. Substantially all of the loans provided directly by MSBDFA. The others received funding from financial institutions backed by a MSBDFA loan guaranty.

Program Performance 2005

During fiscal year 2005, eleven (11) applications were approved for financing under the program totaling $2.8 million. Seven (7) of these loans closed for a total of $1.03 million, with another four (4) in the amount of $1.6 million pending closing at the end of the fiscal year. Total exposure for the program at the end of the fiscal year was $4.8 million covering twenty-one (21) loans. Nineteen (19) of those loans ($4.7 million) in the portfolio were made in the form of a revolving line of credit. Eight (8) of the loans totaling $2.2 million were renewed during the fiscal year.

Projected Performance for FY 2006

Management expects the Authority to approve at least fifteen (15) applications during FY 2006. A minimum of twelve (12) loans are expected to be closed and funded. The total financing involved is estimated to be $5.4 million and $4.6 million, respectively. All of the loans made during the last five fiscal years have been direct loans. No guarantees were made in conjunction with loans made by other financial institutions. This trend will probably hold true well into the future, because the use of proceeds under the Guaranty Fund are not limited to government and utility contracts.

Projected Performance for FY 2007

Activity is anticipated to increase during FY 2007 to twenty (20) approvals for more than $7.2 million. We expect to close as many as fourteen (14) of the loans - requiring approximately $5.3 million in funding assistance.

Remarks

This program is generally the first level of debt assistance obtained by small firms. These firms do not qualify for bank financing because they are in the start up or early phase of operations, do not have a performance track record, lack sufficient collateral to secure the loans or otherwise do not meet the banking industry's credit criteria for commercial loans on reasonable terms.

The mission of this program is to develop the companies to a level that will qualify them for a bank loan, first with a program guarantee, and eventually to a financially viable and bankable firm. This process generally takes an average of 3 years.

LONG TERM GUARANTY PROGRAM

Performance Since Inception

Since legislation was enacted to kick off program operations in 1984, MSBDFA has guarantied 260 transactions by banks and other lending institutions totaling $46.7 million.

Program Performance 2005

During fiscal year 2005, the program closed (13) guarantee transactions for $3.3 million, with exposure to MSBDFA of $2.2 million. Three of these transactions evolve from loans approved in the prior fiscal year (FY04). Fifteen (15) applications in all were approved for just under $4.4 million requiring support by the program of $3.0 million. At the end of the fiscal year, the program had one (1) loan pending closing requiring $100,000 of MSBDFA funds and four (4) loans had been rescinded.

Projected Performance for FY 2006

A total of sixteen (16) loans for roughly $5.0 million are expected to be approved during fiscal year 2006. At least twelve (12) are expected close and fund. Assistance from this program will be approximately $4.3 million.

Projected Performance for FY 2007

Activity for the following year will increase moderately to a minimum of sixteen (16) approvals for up to $5.0 million with twelve (12) closing - requiring another $4.5 million in program support.

Remarks

This program is generally the first level of financial assistance obtained by small firms that fall short of meeting the lending industry's credit criteria. This program was established to encourage the financial institutions to make the loans and give these businesses the opportunity to develop into the bank's exclusive customer. This process may take from 1 to 3 years.

SURETY BOND PROGRAM

Performance Since Inception

Sixty-three (63) projects have been secured with bonds issued directly, or guaranteed, by MSBDFA. Monetary risk taken by the program exceeds $25.1 million. Since inception, three (3) claims totaling less than $300,000 have been paid as a result of defaults by portfolio companies.

Program Performance 2005

The program approved six (6) new bond transactions for a total of $1.8 million. Four (4) bond transactions closed during fiscal year 2005, obligating $1.2 million in program funds. All of the commitments made were for assistance directly from the program and were made in the form of bonding lines of credit that the clients can use for several contracts simultaneously. There were ten (10) bonding lines in the portfolio as of June 30, 2005 with bonds outstanding totaling $2.4 million. Total commitments under the bonding lines of credit totaled $4.4 million. Two (2) of the lines, which total $850,000, were renewed during the fiscal year.

Projected Performance for FY 2006

Management anticipates obligating another $3.0 million during FY 2006 to secure bonding for seven (7) new businesses. Most are expected to be in the form of direct bonding lines, while two (2) will probably be in the form of bond guaranties. Requests should increase significantly because the bonding industry is still overly cautious as it continues to recover from $3.5 billion in losses suffered during the past four years. The tighter underwriting standards will force many bonding agents to seek the support of MSBDFA for existing clients as well as new clients.

Projected Performance for FY 2007

Incremental increases should occur in FY 2007 with up to nine (9) new companies using another $4.1 million of program funds. As many as eleven (11) may be approved during the course of the year.

Remarks

This program is generally the first level of bonding assistance obtained by small firms. These firms do not qualify for commercial bonding because they are in the start up phase of operations; do not have a track record of performance, lack adequate working capital to fund contracts and collateral to secure any losses under the bonds.

The mission of this program is to develop the companies to a level that will qualify them for commercial bonding, first with a program guarantee, and eventually to a financially viable firm that can obtain bonds on its own. This process may take 2 to 3 years.

EQUITY PARTICIPATION INVESTMENT PROGRAM

Performance Since Inception

The program has extended sixty three (63) loans or equity investments to forty-one (41) different companies since it began operating in early 1987. The assistance provided to these companies totaled close to $9.4 million. During the early years of the program, most of the transactions were made to franchise businesses. Over the past nine (9) years, however, the trend shifted significantly towards technology-based companies.

Program Performance 2005

The program approved three (3) loans, totaling $425,000, and closed four (4) loans, totaling $575,000 in FY 2005. Of those loans that closed, one (1) loan totaling $150,000 was approved in FY 2004. The four closed loans consist of one (1) made to a fast food franchise located at Baltimore-Washington International Airport, two (2) loans were made to a Baltimore-based broadband services company providing telephone, cable and internet services to homes and businesses throughout the Mid-Atlantic region. The other was for the expansion of an existing technology firm based in Prince George's County. No other approved loans were pending closing as of June 30, 2005. There were thirteen (13) active accounts as of that date with aggregate outstanding balances of $2.4 million.

Projected Performance for FY 2006

Program approvals are expected to total six (6) applications during FY 2006 for $1.5 million. Three (3) will likely be technology firms, two (2) will likely be to traditional small businesses and the other will be to the franchise located at Baltimore-Washington International Airport to open an additional store in a separate wing of the airport. Four (4) of the transaction should close requiring assistance in the amount of $1 million.

Projected Performance for FY 2007

For Fiscal Year 2007, at least nine (9) applications will be approved for amounts ranging from $250,000 to $1,000,000. Loan closings are expected to total six (6) companies – using another $2.7 million in program funds.

Remarks

This program generally provides the gap financing needed to consummate the financial package required by the small businesses to fund their first project. These funds usually help leverage matching senior debt and/or other equity-type funding to complete the project.

Program Highlights for Fiscal Year 2005

During fiscal year 2005, MSBDFA **approved** a total of thirty-six (36) transactions. This total consisted of thirty (30) financing transactions for new clients and six (6) financing transactions for existing clients that represent a significant increase to their credit availability, totaling $8.0 million. In addition, MSBDFA approved twelve (12) **renewals** of existing credit facilities totaling $3.85 million. The Contract Finance Program had eleven (11) approved requests for a total of $2.8 million. The Guaranty Program had fifteen (15) requests approved for a total of $3.0 million. Under the Surety Bond Program there were six (6) financings approved totaling $1.8 million. The Equity Participation Investment Program had three (3) loans approved totaling $425,000.

The renewals were for the lines of credit for ten (10) existing portfolio companies – eight (8) through the Contract Financing Program for $2.2 million, two (2) through the Guaranty Fund in the amount of $800,000 and two (2) Surety Bonds totaling $850,000.

During that same period, twenty-eight (28) financings were **closed** in the form of loans, guaranties and surety bonds, totaling over $6.1 million, with an insured amount of $5.02 million,. The allocation by program is: seven (7) transactions under the Contract Financing Program totaling $1.03 million; thirteen (13) transactions requiring $2.2 million in insurance under the Guaranty Program; four (4) Surety Bonds totaling $1.2 million and four (4) EPIP transactions $575,000.

Graduations for Fiscal Year 2005

Companies whose performance has reached the point where they no longer need financial assistance from MSBDFA are classified as graduates. Such companies are able to continue their financial relationship with a commercial lender or surety and in some cases increase that relationship with no further assistance from MSBDFA. 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 ten (10) companies listed below graduated:

GRADUATIONS FY 05

PROGRAM	BORROWER	ORIGINAL LOAN AMOUNT
Guaranty	Eagles Technologies, Inc.	$1,250,000
Guaranty	The Smile Herb Shop	$115,000
Guaranty	New Carrolton Veterinary Hospital	$520,000
Guaranty	MidAtlantic Animal Specialty Hospital	$200,000
Surety Bond	Areawide Electronics Security, Inc.	$64,752
Surety Bond	Knight Protective Services, Inc.	$311,812
Surety Bond	AmDyne Corporation	$360,000
Contract Financing	Infrastructure Architect Group, Inc.	$175,000
Contract Financing	QuitsUSA, Inc	$100,000
Contract Financing	Douglas Consulting & Computer Services, Inc	$250,000

Delinquency and Default Status as of June 30, 2005

As of June 30, 2005, four (4) EPIP accounts, two (2) 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 $791,702, which is in process of collection. The combined amount of original approval of the two Contract Financing accounts is $800,000, with a principal balance outstanding equal to $556,650, which is in process of collection. The amount of original approval of the Loan Guaranty account is $200,000, with a principal balance outstanding equal to $177,092, 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 bank financing the loan initiates a default on a guaranteed loan. The delinquency and default status of MSBDFA's portfolio administered by SAU for the past three fiscal years is summarized in the following charts. In FY02, Loan Administration initiated a policy to "charge off" all loans that are 180 days past due. These loans are then monitored by the Special Assets Division, if they had not already been transferred to that unit for monitoring. Special Assets will actively work with the charged off accounts, to determine where assets may be liquidated to recover monies as well as to restructure the debt so that the losses by DBED may be reduced or mitigated.

Portfolio Year End Summary

The following is a summary of the key measures used to evaluate the status of the different portfolios supported by MSBDFA. It 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 charged off, the Special Asset's staff will continue to monitor a credit in an attempt to recover the losses.

MSBDFA Year End Highlights as of June 30, 2005				
CATEGORY	**Contract Financing Program**	**Guaranty Fund Program**	**Surety Bond Program**	**Equity Participation Investment Program**
Cash Balance and Investments[1]	$497,540	$941,248	$1,576,671	$846,343
Loans/Guaranty Outstanding	1,227,520	-0-	-0-	2,279,025
Committed Cash [2]	1,075,000	440,000	500,000	-0-
Loan Loss Reserve [3]	-0-	141,674	-0-	-0-
Claims Paid	-0-	-0-	-0-	-0-
Charge Off	-0-	-0-	-0-	-0-
Recoveries	2,400	4,248	1,000	208,331

[1] Cash Balance and Investments as stated on the FY2003 unaudited Statement

[2] Committed Cash represents loans approved and funds committed pending disbursement. This will reduce the cash fund balance when direct loans are disbursed.

[3] The reserve for losses is an estimated amount that may have to be paid to financial institutions for losses sustained by them on loans guaranteed by MSBDFA less the amount of any liquidated collateral.

Equity Participation Investment Program Update

Franchising Component
There were two (2) loans active with a balance outstanding of $166,000, of which one (1) equal to $38,000 is managed by the Special Assets Unit.

Business Acquisition Component
There were two (2) loans active with a balance outstanding of $514,919.

Technology Component
There were six (6) loans active with a balance outstanding of $1,253,162, of which three (3) equal to $753,162 are managed by the Special Assets Unit.

EPIP Portfolio Year End Summary

The following is a summary of the key measures used to evaluate the portfolio's status. 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 FY05

EPIP Year End Highlights as of June 30, 2005	
Category	**EPIP**
Cash Balance	$846,343
Loans/Guaranty Outstanding	$2,279,025
Committed Cash [4]	-0-
Loan Loss Reserve [5]	-0-
Charge-Offs (Recoveries)	$208,331

[4] Committed Cash represents loans approved and funds committed pending disbursement. This will reduce the cash fund balance when disbursed.

[6] The loan loss reserve is a portion of the loan balances set aside to possibly be written off on doubtful loans at a future date.

Loans and Guarantees in FY 05

Region*	County	Approved			Funded		
		No.	% Total Amt	Original Loan Amt.	No.	% Total Amt	Original Loan Amt.
I Central Maryland	Anne Arundel	3	7.0	655,000	1	2.1	125,000
	Baltimore City	11	30.1	2,827,500	12	48.1	2,922,500
	Baltimore	3	4.0	375,000	2	4.5	275,000
	Carroll	1	1.1	100,000	1	1.6	100,000
	Cecil	0	0.0	0	0	0.0	0
	Howard	2	12.8	1,200,000	1	11.5	700,000
	Harford	0	0.0	0	1	4.2	250,000
	Sub-Total :	20	55.0	5,157,500	18	72.0	4,372,500
II Greater Washington	Frederick	0	0.0	0	0	0.0	0
	Montgomery	0	0.0	0	0	0.0	0
	Prince George's	14	43.4	4,075,000	9	26.8	1,625,000
	Sub-Total :	14	43.4	4,075,000	9	26.8	1,625,000
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	0.0	0	0	0.0	0
IV Southern Maryland	Calvert	0	0.0	0	0	0.0	0
	Charles	2	1.6	150,000	1	1.2	75,000
	St. Mary's	0	0.0	0	0	0.0	0
	Sub-Total :	2	1.6	150,000	1	1.2	75,000
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	0	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:	36	100.0	9,382,500	28	100.0	6,072,500