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 $500,000 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 $750,000. Guaranties are limited to 90% of the face value of the bond not to exceed a maximum participation of $900,000. 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 and developing a technology-based business. 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 cost generally range from $100,000 to $3,000,000. This component was added to the program in 1992.

Collectively, the agency has financed approximately 614 transactions for more than 400 businesses since beginning operations in January 1980. These transactions totaled $112.3 million. The agency's programs have had a substantial impact on the Maryland economy by helping local businesses retain and create approximately 15,500 employment opportunities for Maryland residents.

Over the course of this 24-year period, combined loan losses totaled just 7.68%. This represents a significant improvement over the initial 15-year mark of 10.6% - a reduction of 28%. More importantly, a closer analysis indicates a continuing favorable trend over the last 5 years as MSBDFA incurred losses of just $1.95 million on $32 million in financing. This equates to a loss rate of 6.11%. The loss rate for the most recent 10-year period was 5.67%.

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 28 such companies graduate during the past 5 years.

The program's current portfolio is comprised of sixty-one (61) loans or transactions with an aggregate exposure to MSBDFA of $15.2 million. As of June 30, 2004, nine (9) other loans were pending closing requiring $1.8 million in committed funds from MSBDFA.

Currently, the program manager is evaluating requests for another eighteen (18) loans totaling $9.1 million that would require some $5.4 million in assistance from MSBDFA.

CONTRACT FINANCING PROGRAM

Performance Since Inception

Since the program began, 249 transactions have been funded totaling $34.5 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 2004

During fiscal year 2004, ten (10) applications were approved for financing under the program totaling $1.9 million. Seven (7) of these loans closed for a total of $1.6 million, with another two (2) in the amount of $200,000 pending closing at the end of the fiscal year. Total exposure for the program at the end of the fiscal year was $3.9 million covering seventeen (17) loans. Fourteen (14) of those loans ($3.5 million) in the portfolio were made in the form of a revolving line of credit. Six (6) of the loans totaling $1.5 million were renewed during the fiscal year. The amount of advances made under the lines of credit during fiscal years 2002 and 2003 were $16.1 million and $13.2 million, respectively.

Projected Performance for FY 2005

Management expects the Authority to approve at least eighteen (18) applications during FY 2005. A minimum of twelve (12) loans are expected to be closed and funded. The total financing involved is estimated to be $4.5 million and $3.3 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 2006

Activity is anticipated to increase during FY 2006 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 247 transactions by banks and other lending institutions totaling $44.4 million.

Program Performance 2004

During fiscal year 2004, the program guarantied eight (8) loans for $2.9 million, with exposure to MSBDFA of $1.5 million. Fifteen (15) applications in all were approved for just under $7.3 million requiring support by the program of $3.7 million. At the end of the fiscal year, the program had four (4) loans pending closing requiring $1.2 million on MSBDFA funds.

Projected Performance for FY 2005

A total of fifteen (15) loans for roughly $4 million are expected to be approved during fiscal year 2005. At least ten (10) are expected close and fund. Assistance from this program will be approximately $2.4 million.

Projected Performance for FY 2006

Activity for the following year will increase moderately to a minimum of sixteen (16) approvals for up to $7.8 million with twelve (12) closing - requiring another $5.9 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

Fifty-nine (59) projects have been secured with bonds issued directly, or guaranteed, by MSBDFA. Monetary risk taken by the program exceeds $23.9 million. Since inception, three (3) claims totaling less than $300,000 have been paid as a result of defaults by portfolio companies.

Program Performance 2004

Eight (8) bonding commitments were made by the program during fiscal year 2004, obligating $2.9 million in program funds. All except one 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 eleven (11) bonding lines in the portfolio as of June 30, 2004 with bonds outstanding totaling $3.8 million. Total commitments under the bonding lines of credit totaled $5.1 million. Four (4) of the lines, which total $1.7 million, were renewed during the fiscal year.

Projected Performance for FY 2005

Management anticipates obligating another $2.7 million during FY 2005 to secure bonding for eight (8) 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 2001 and 2002. The tighter underwriting standards will force many bonding agents to seek the support of MSBDFA for existing clients as well as new clients.

<u>Projected Performance for FY 2006</u>

Incremental increases should occur in FY 2006 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.

<u>Remarks</u>

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

<u>Performance Since Inception</u>

This program has extended fifty nine (59) loans or equity investments to thirty-nine (39) different companies since it began operating in early 1987. The assistance provided to these companies totaled close to $8.8 million. During the early years of the program, most of the transactions were made to franchise businesses. Over the past eight (8) years, however, the trend shifted significantly towards technology-based companies.

<u>Program Performance 2004</u>

Two (2) transactions were financed during FY 2004, one (1) was made to a Baltimore based franchise sign company to fund a federal government contract and the other, to a Laurel based technology firm to fund the marketing and sale of computer software products. The financing provided by the program was $550,000. Three (3) other applications were approved for $375,000, and were pending closing as of June 30, 2004. There were seven (7) active accounts as of that date with aggregate outstanding balances of $1.3 million.

<u>Projected Performance for FY 2005</u>

Program approvals are expected to total four (4) applications during FY 2005 for $1.5 million. Two (2) will likely be technology firms and should close requiring assistance in the amount of $1 million.

<u>Projected Performance for FY 2006</u>

For Fiscal Year 2006, 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

During fiscal year 2004, MSBDFA **approved** a total of fifty-one (51) transactions. This total consisted of thirty-eight (38) new financing transactions totaling $13 million and thirteen (13) renewals of existing credit facilities totaling $5 million. The Contract Finance Program had ten (10) approved requests for a total of $1.9 million. The Guaranty Program had fifteen (15) requests approved for a total of $7.3 million. Under the Surety Bond Program there were eight (8) financings approved totaling $2.9 million. The Equity Participation Investment Program had five (5) loans approved totaling $925,000.

The renewals were for the lines of credit for thirteen (13) existing portfolio companies – six (6) through the Contract Financing Program for $1.5 million, three (3) through the Guaranty Fund in the amount of $1.8 million and four (4) Surety Bonds totaling $1.7 million.

During that same period, twenty-three (23) financings in the form of loans, guaranties and surety bonds, totaling over $7.5 million, with an insured amount of $6.1 million, were **closed**. The allocation by program is: seven (7) transactions under the Contract Financing Program totaling $1.6 million; eight (8) transactions requiring $1.5 million in insurance under the Guaranty Program; six (6) Surety Bonds totaling $2.5 million and two (2) EPIP totaling $550,000.

Graduations

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. Over the past year thirteen (13) companies graduated and are listed below:

GRADUATIONS FY 04

PROGRAM	BORROWER	ORIGINAL LOAN AMOUNT
Guaranty	Ferguson & Ramey Electrical	$450,000
Guaranty	American Skyline Insurance	$295,000
Guaranty	Allstate Carpet, Inc.	$100,000
Guaranty	Errands Plus	$1,245,000
Guaranty	Kids Time Out	$200,000
Contract Financing	Victory Global Solutions	$500,000
Contract Financing	Exceed Corporation	$300,000
Contract Financing	Protelex, LLC	$350,000
Contract Financing	Legal Services Associates	$100,000
Contract Financing	Norris Electro Optical	$180,000
Contract Financing	MainStreet Technologies	$300,000
Contract Financing	Artic Systems	$250,000
Contract Financing	Myriad	$300,000

Delinquency and Default Status as of June 30, 2004

As of June 30, 2004, five (5) EPIP accounts, one (1) Contract Financing account and two (2) Loan Guaranty accounts were being serviced by the Special Assets Unit.

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.

The following chart lists the status of those accounts.

PROGRAM	ACCOUNT	ORIGINAL AMOUNT	BALANCE	COMMENTS
Guaranty	International Food & Wine	$85,000	$52,174	Insured Amount $36,522
	Narrows Partnership	$200,000	$182,672	Insured Amount $146,138 Loan to be restructured
EPIP	K-D Medical, Inc.	$370,000	$563,766 (Includes interest and late fees)	Loan to be restructured
	Carnegie Morgan Information Services	$500,000		Loan to be restructured
	Nexgen Solutions	$500,000	$385,562	Filed Proof of Claim in the amount of $385,562
	Osteo-Implant	$480,000		$379,369 Charged Off; $35,000 paid as settlement of debt
	Progressive Engineering	$200,000	$101,313.48	Forbearance Agreement; Recovery of $90,000
Contract Finance	The Perara Group	$15,000	$3,257.04	Forbearance Agreement; $6,539 Charge off with $3,800 recovery

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, 2003				
CATEGORY	**Contract Financing Program**	**Guaranty Fund Program**	**Surety Bond Program**	**Equity Participation Investment Program**
Cash Balance and Investments[1]	$483,866	$745,879	$1,321,781	$1,229,322
Loans/Guaranty Outstanding	1,236,198	3,106,089	3,511,558	2,253,157
Committed Cash [2]	200,000	1,235,000	-0-	375,000
Loan Loss Reserve [3]	129,708	182,660	-0-	438,040
Claims Paid	-0-	-0-	13,752	-0-
Charge Off	-0-	-0-	-0-	-0-
Recoveries	3,400	-0-	-0-	93,300

[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 is one (1) loan outstanding with a balance outstanding of $38,052. that is being handled by the Special Assets Unit.

Business Acquisition Component

There were two (2) loans open with a balance of $901,388.

Technology Component

In FY 04, there were three (3) loans approved in the total amount of $375,000. The current portfolio has four (4) loans open with a total outstanding balance of $1,351,768.

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 FY04

EPIP Year End Highlights as of June 30, 2004	
Category	**EPIP**
Cash Balance	1,229,322
Loans/Guaranty Outstanding	2,253,157
Committed Cash [4]	375,000
Loan Loss Reserve [5]	438,040
Charge-Offs (Recoveries)	93,300

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

[5] 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.

Geographical Distribution of MSBDFA Loans and Guarantees in FY 04

Region*	County	Approved			Funded		
		No.	% Total Amt	Original Loan Amt.	No.	% Total Amt	Original Loan Amt.
I Central Maryland	Anne Arundel	3	5.8	755,000	1	4.8	360,000
	Baltimore City	13	52.1	6,766,400	6	42.9	3,233,400
	Baltimore	1	2.3	300,000	1	0.8	60,000
	Carroll	0	0.0	0	0	0.0	0
	Cecil	0	0.0	0	0	0.0	0
	Howard	3	6.9	900,000	2	5.3	400,000
	Harford	3	8.5	1,110,000	2	11.4	860,000
	Sub-Total :	23	75.6	9,831,400	12	65.2	4,913,400
II Greater Washington	Frederick	0	0.0	0	0	0.0	0
	Montgomery	2	2.7	350,000	4	8.0	600,000
	Prince George's	10	16.7	2,167,328	6	23.5	1,772,328
	Sub-Total :	12	19.4	2,517,328	10	31.5	2,372,328
III Western Maryland	Allegany	1	2.3	300,000	0	0.0	0
	Garrett	0	0.0	0	0	0.0	0
	Washington	0	0.0	0	0	0.0	0
	Sub-Total :	1	2.3	300,000	0	0.0	0
IV Southern Maryland	Calvert	0	0.0	0	0	0.0	0
	Charles	1	0.8	100,000	0	0.0	0
	St. Mary's	0	0.0	0	0	0.0	0
	Sub-Total :	1	0.8	100,000	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	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	1	1.9	250,000	1	3.3	250,000
	Worcester	0	0.0	0	0	0.0	0
	Sub-Total :	1	1.9	250000	1	3.3	250,000
	TOTAL:	38	100	12,998,728	23	100	7,535,728