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**Base Agency:** WHEDA - Small Business Loan Guarantees in Gaming Communities

**Recommendations:**

**Paper No.** 174     **Alternative:** 2b(1),c(3),d

**Comments:**

Approves Governor's request to provide a one-time transfer from tribal gaming revenues to the Wisconsin Development Reserve Fund (WDRF) for a loan guarantee program for small businesses located in a county or adjacent to a Wisconsin county with a casino.

*However,* modifies the request as follows:

*2b(1)*

Provides that the maximum allowable guarantee would not exceed the lesser of \$200,000 and *80% of the principal of the loan*, rather than 100% under the bill. This would bring the program in line with the small business loan guarantee program which only guarantees up to 80%. Providing a lesser guarantee percentage will ensure that loan risks are shared between the lender and the WDRF. Further, it could lower the default rates of loans and consequently the exposure of the WDRF. It could also increase the amount of loans that can be guaranteed under the program.

*2c(3)*

Eliminates the annual interest subsidy of up to 3.5% on loans to bring it in line with the small business loan guarantee program which provides no interest subsidy. This would increase the amount of money available for loans.

*2d*

Expands the borrower eligibility requirements to include businesses located in WI counties that are adjacent to counties in neighboring states where American Indian casinos are operated. This is consistent with the purpose of the program to provide loans to small businesses located near gaming communities.

**Prepared by:** Deb



## Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

May 21, 1999

Joint Committee on Finance

Paper #174

### *Tribal Gaming Revenue Allocations*

## **Small Business Loan Guarantees in Gaming Communities (WHEDA)**

[LFB 1999-01 Budget Summary: Page 650, #4]

### **CURRENT LAW**

WHEDA administers several loan guarantee programs related to business development and environmental contamination remediation. The loan guarantee programs are backed by the Wisconsin Development Reserve Fund (WDRF), which generally must contain at least one dollar in its cash balance for every \$4.50 in total outstanding guarantees.

### **GOVERNOR**

Provide a one-time transfer of \$2,500,000 from tribal gaming revenues to the WDRF for a loan guarantee program for small businesses located in a county or adjacent to a Wisconsin county with a casino. Allow WHEDA to provide interest subsidies by paying the lender an annual amount of up to 3.5% of the outstanding loan balance. Loans to eligible small businesses located near gaming communities could be guaranteed by the general fund in the WDRF, and interest subsidies to these same businesses could be paid by the general fund in the WDRF. However, no guarantee program except those eligible small businesses located near gaming communities could use the \$2.5 million appropriated in the bill to guarantee loans. The bill also increases the total outstanding guaranteed principal amount of all loans under the small business loan guarantee program (including gaming related loans) by \$11,250,000, from \$9,900,000 to \$21,150,000.

*Guarantee Amounts.* WHEDA would be allowed to guarantee repayment of the principal of any loan eligible for guarantee not to exceed 100% or \$200,000, whichever is less. WHEDA would be required to establish the amount of the principal of an eligible loan to be guaranteed in an agreement with the participating lender. The Authority would be allowed to establish a single guarantee rate for all guaranteed loans that do not exceed \$200,000 and a separate

guarantee rate for loans that exceed \$200,000, or WHEDA could establish, on an individual basis, a different guarantee rate for eligible loans.

*Eligible Loans.* Loan eligibility under the small business loan guarantee for gaming communities would be determined by the same statutory factors as in the existing small business development loan guarantee program. Namely, loans would be eligible for guarantees if all of the following apply:

a. The loan proceeds are used for direct or related expenses associated with the expansion or acquisition of a business, including the purchase or improvement of land, buildings, machinery, equipment or inventory;

b. Loan proceeds are not used for refinancing existing debt, entertainment expenses, expenses related to the production of an agricultural commodity or expenses related to a community based residential facility;

c. The loan term may not extend beyond 15 years after the date on which the lender disburses the loan unless WHEDA agrees to an extension of the loan term;

d. The total principal amount of guaranteed loans to any one borrower may not exceed \$750,000;

e. The lender obtains a security interest in the physical plant, equipment, machinery or other assets;

f. The lender believes it is reasonably likely that the borrower will be able to repay the loan in full with interest;

g. The lender agrees to the guarantee percentage established for the loan by WHEDA; and

h. WHEDA believes the loan will have a positive impact in terms of job creation or retention.

*Eligible Borrowers.* To be eligible for a loan guarantee under this program, the borrower must be a business owner: (a) who is unable to obtain adequate business financing on reasonable terms; (b) who is actively engaged in the business (primarily an in-state business or those committed to locating in the state); (c) who employs 50 or fewer persons; (d) whose name does not appear on a statewide list of delinquent child support payers or if it does appear, the owner of the business has provided a payment agreement approved by the county child support agency; and (e) who is located in a Wisconsin county or in an adjacent Wisconsin county to where a federally recognized American Indian tribe or band operates a Wisconsin casino. Of Wisconsin's 72 counties, 52 either have casinos or are adjacent to counties that do.

*Interest Subsidies.* In addition, the bill would allow WHEDA to pay lenders under the small business loan guarantee for gaming communities program an annual interest subsidy of up to 3.5% on the outstanding balance of the loan. These interest subsidies would be paid either under the separate account created for guaranteeing loans to businesses in gaming communities or under the general WDRF.

## **DISCUSSION POINTS**

### **Wisconsin Development Reserve Fund (WDRF)**

1. The WDRF was created by 1991 Wisconsin Act 39 through the consolidation into a single fund of several existing guarantee funds: the agricultural production loan fund (CROP fund), the drought assistance and development loan fund, and the recycling loan fund. Each of these separate funds had been created to back guarantees made under one or more legislatively authorized loan guarantee programs. This consolidated WDRF now backs guaranteed loans made by private lenders under separate programs, reserving funds to repay lenders for any losses from defaulted loans made under any of these guaranteed programs. The WDRF also funds the administrative costs of the loan guarantee programs.
2. The consolidation of the WDRF maximized the available guarantee authority for loan guarantee programs through an enlarged reserve fund. It also streamlined WHEDA's administrative functions which reduces administrative charges to the WDRF. Creating a separate account within the WDRF to guarantee only a specific type of loan is contrary to the goal of consolidation of the WDRF, since these funds may not be used to guarantee other programs under the WDRF. With the exception of the funds allocated for the brownfields remediation loan guarantee program in the 1997-99 budget, funds allocated to the WDRF in the past have been eligible to guarantee any authorized loan under the WDRF.
3. The government-to-government memoranda of understanding regarding tribal gaming revenues list several desired, specific purposes for the expenditure of the revenues, including (a) economic development initiatives to benefit tribes and/or American Indians within Wisconsin, and (b) economic development initiatives in regions around casinos. The current small business loan guarantee program backed by the WDRF specifically includes the elected governing body of a federally recognized American Indian tribe or band in the state as an eligible borrower. For the other guarantee programs, American Indians, along with any other individual business owners, are eligible for business development and environmental contamination remediation loans guaranteed by the WDRF. The small business loan guarantee program is intended to promote economic development of areas near native American gaming operations. In addition, Native American businesses would be eligible for loan guarantees. This program appears to meet the specific state-tribal agreement for uses of gaming compact monies.

### **Small Business Loan Guarantee Program**

4. The small business loan guarantee program was created in the 1997-99 budget bill. As of May 1, 1999, the WDRF is liable for \$3,182,700, or approximately 80% of the loans made under the program.

5. Besides the provision requiring businesses to be located in casino areas, the small business loan guarantee program differs from the proposed gaming guarantee program mainly in that the small business loan guarantee program provides no interest subsidy and may only guarantee up to 80% of the principal of a loan while the gaming guarantee provides an interest subsidy of up to 3.5% and would allow guarantees of up to 100% of the principal of a loan.

6. While both the small business loan guarantee and gaming guarantee programs exclude agricultural loans, remaining WHEDA loan guarantee programs would involve agricultural financing; (a) \$27 million in guarantee authority for the combined loans under the CROP program and the farm asset reinvestment program (FARM), which provides loans for the acquisition of agricultural assets (machinery, equipment, land); and (b) \$5 million in guarantee authority associated with the agribusiness loan program, which makes loans to businesses involved in the development of viable methods of marketing or processing raw agricultural commodities in Wisconsin.

7. It is anticipated that the gaming guarantee program would be in greater demand than the general small business loan guarantee program in the 52 counties where it is offered, due primarily to the interest rate subsidy and higher guarantee provided for gaming loans.

### **Gaming Small Business Loan Guarantee Program**

8. WHEDA has recently reduced administrative expenses in part by relying more heavily on local lender underwriting to assess loan risks. Guaranteeing 100% of a loan may eliminate risk to the lender, which would make WHEDA the sole possessor of loan risks. While WHEDA would have the option of guaranteeing a lesser amount of any loan, as shown in Table 1, WHEDA is not authorized to provide a 100% guarantee for any other loan program. Providing a lesser guarantee percentage, such as the 80% in the similar small business loan guarantee program, would ensure that loan risks are shared between the lender and the WDRF. Further, a lower loan guarantee percentage could lower the default rate of loans and consequently the exposure of the WDRF under the proposed program.

TABLE 1

Maximum Authorized Loan Guarantee Amounts

<u>Loan Guarantee Program</u>	<u>Maximum Percent Guarantee Authority</u>
Small Business	80%
CROP	90
FARM	25
Agribusiness	90
Cultural and Architectural Landmark (Taliesin)	90
Brownfields Remediation	80
Safe Drinking Water	80

9. Lowering the maximum guarantee percentage to 80% of the principal of the loan may also increase the amount of loans that can be guaranteed under the program. With a guarantee rate of 100%, the \$2.5 million could guarantee \$11,250,000 in loans, but with a guarantee rate of 80%, the \$2.5 million could guarantee \$14,062,500 in loans.

10. Authorizing WHEDA to provide an annual interest subsidy of up to 3.5% on loans would also reduce the \$2.5 million in funds allocated to guarantee loans for small businesses in gaming communities. If 25 gaming loans were made for \$200,000 each, the interest subsidy could cost the WDRF up to \$175,000 per year, whereas this amount could be used otherwise to guarantee an additional \$787,500 in loans each year. Lowering the maximum annual interest subsidy to 2% on loans, under the same scenario, could cost the WDRF up to \$100,000 per year, which could otherwise guarantee an additional \$450,000 in loans. A 1% interest subsidy could cost \$50,000, which could guarantee an additional \$225,000 in loans.

11. WHEDA officials indicate they would determine the interest rate subsidy on an individual loan basis, with the amount of interest subsidy dependent on the affordability of the financing offered by the lender. Those businesses that are currently paying higher amounts of debt with limited revenue would generally be given higher interest subsidies.

12. From 1990-1997, WHEDA operated a tourism loan guarantee program, which also used funds in the WDRF to provide an annual interest subsidy of up to 3.5% for the expansion or startup of travel-related businesses. For tourism loans, WHEDA used needs based criteria to provide interest subsidies of 1 to 3.5%, based on the debt service coverage of the borrower. The average interest subsidy paid on tourism loans was 2.8%, and approximately \$830,000 was spent on interest subsidies for over \$9 million in loans.

13. However, the higher the percentage of loan guarantees provided by WHEDA, the more incentive lenders have to encourage borrowing under the program. Since a 100% guarantee would place the lender at virtually no risk, generally the more loans they provide, the higher the profit expected. Further, an interest subsidy encourages borrowing under the program, as borrowers

would be able to obtain loans subsidized at below market rates. However, while a maximum 100% loan guarantee and 3.5% interest subsidy would encourage use of the gaming community small business loan guarantee program by both lenders and borrowers, these provisions may also more quickly reduce the funds available for these and other loan guarantee programs.

14. The loan guarantee program is specifically to be used for eligible businesses that are located in a Wisconsin county or in an adjacent Wisconsin county to where a federally recognized American Indian tribe or band operates a casino. Of Wisconsin's 72 counties, only persons in 20 counties would be geographically ineligible for the loan. These 20 counties are Buffalo, Crawford, Dodge, Fond du Lac, Grant, Green, Green Lake, Jefferson, Kenosha, Lafayette, Lincoln, Marquette, Pepin, Pierce, Rock, Sheboygan, Taylor, Walworth, Waushara and Winnebago.

15. Since, to be eligible the county must be adjacent to a Wisconsin county with a casino, the provision would exclude persons from Crawford, Grant, Pepin and Pierce counties from obtaining gaming loan guarantees even though these Wisconsin counties are adjacent to counties in neighboring states where American Indian casinos are operated.

16. Further, some businesses may be more than 80 miles from the nearest casino and still be eligible for the loan guarantees while other businesses could be much closer and remain ineligible for guarantees simply because of county borders.

17. Although not specified in the bill, it is thought that some loan guarantees would be used by businesses that have been adversely affected by Indian gaming. A recent report commissioned by the National Gambling Impact Study Commission, (created by the 104<sup>th</sup> Congress in PL 104-169) which was conducted by the University of Chicago and three consulting firms found that while hotel, lodging, recreation and amusement facilities tend to see earnings rise in areas near casinos, bar, restaurant and general merchandise earnings decrease in areas near casinos. Also, the economic effects of gaming may be felt beyond areas near a casino. A 1995 Wisconsin Policy Research Institute study found that gaming had a negative economic impact on areas distant from casinos. Therefore, eligibility could be expanded to be statewide.

18. Under WHEDA lending manuals, businesses engaged in adult entertainment activities or where more than: (a) one-third of gross receipts are from gambling or (b) three-fourths of gross receipts are from alcohol sales are ineligible to receive small business loan guarantees, which would include the proposed gaming guarantees. Some of these businesses, especially taverns, may be negatively affected by Indian gaming in their community. WHEDA indicates, if enacted, they would review these policies as they may relate to gaming guarantees.

## **ALTERNATIVES TO BASE**

1. Approve the Governor's recommendation to: (a) provide a one-time transfer of \$2,500,000 from tribal gaming revenues to the WDRF specifically for a loan guarantee program to provide up to \$200,000 or 100% guarantee of loans for small businesses located in a county or adjacent to a Wisconsin county with a casino; and (b) allow WHEDA to provide interest subsidies by paying the lender an annual amount of up to 3.5% of the outstanding loan balance.

<u>Alternative 1</u>	<u>PR</u>
1999-01 FUNDING (Change to Base)	\$2,500,000
<i>[Change to Bill]</i>	<i>\$0</i>

2. Approve the Governor's recommendation as modified by one or more of the following:

a. Allow WHEDA to use the \$2.5 million gaming revenue transferred to the WDRF to guarantee any loans under the WDRF.

b. Provide that the maximum allowable guarantee would not exceed the lesser of \$200,000 and:

(1) 80% of the principal of the loan.

(2) 90% of the principal of the loan.

c. Reduce the maximum allowable interest subsidy to one of the following:

(1) 2%.

(2) 1%.

(3) 0%.

d. Expand the borrower eligibility requirements to include businesses located in Wisconsin counties that are adjacent to counties in neighboring states where American Indian casinos are operated.

e. Expand the borrower eligibility requirements to include businesses located in any Wisconsin county.

f. Prohibit WHEDA from denying the guarantee of a gaming loan to a statutorily qualifying business based on the alcohol sales of the business. (Currently, businesses with more than 75% of gross receipts from alcohol sales are ineligible for loan guarantees under WHEDA policy.)

3. Maintain current law.

<u>Alternative 3</u>	<u>PR</u>
1999-01 FUNDING (Change to Base)	\$0
<i>[Change to Bill]</i>	<i>-\$2,500,000</i>

Prepared by: David Schug