



Report on Improvements to the Small, Minority, and Women-Owned Business Account

In accordance with the 2016 Joint Chairmen's Report

Submitted by
Maryland Department of Commerce

December 2016



Larry Hogan | Governor
Boyd Rutherford | Lt. Governor
R. Michael Gill | Secretary of Commerce
Benjamin H. Wu | Deputy Secretary of Commerce

December 6, 2016

The Honorable Edward J. Kasemeyer
Chairman, Senate Budget and Taxation Committee
3 W Miller Senate Office Building
Annapolis, MD 21401

The Honorable Maggie McIntosh
Chairman, House Appropriations Committee
House Office Building, Room 121
Annapolis, MD 21401-1991

RE: Small, Minority and Women-Owned Business Account – 2016 JCR, Page 141

Dear Chairmen Kasemeyer and McIntosh:

In accordance with Page 141 of the 2016 Joint Chairmen's Report, the Maryland Department of Commerce is pleased to present the Report on Improvements to the Small, Minority and Women-Owned Business Account. This report includes suggested legislative and administrative improvements to the procurement, oversight, and reimbursement of fund managers, geographic distribution of program assistance, and program performance evaluation. I look forward to your review of the report and will be pleased to respond to any questions. Upon review of this report, Commerce respectfully requests the release of \$100,000 for the purpose of fund manager expense reimbursement that is being withheld. If my staff can be of further assistance, or if you have any questions regarding this report, please feel free to contact me at 410-767-6301.

Sincerely,

R. Michael Gill
Secretary

Enclosure

cc: Members, Senate Budget and Taxation Committee
Members, House Appropriations Committee
Jody Sprinkle, Department of Legislative Services

Executive Summary

In 2007, the Maryland General Assembly established the *Small, Minority, and Women-Owned Businesses Account* (“the Account”) under the authority of the Board of Public Works (BPW). Since Fiscal Year 2011, The Department of Commerce (Commerce) has received an appropriation from the Account. Commerce, under a Memorandum of Understanding with the BPW, is responsible for the procurement of financial services of eligible Fund Managers, reconciliation of Account proceeds, monitoring of Fund Manager Reports, and forwarding those reports to the BPW. In Fiscal Year 2015, the Department of Legislative Services Office of Legislative Audits (OLA) audited the Account and made recommendations for improving oversight of the Account. As a result, OLA recommended withholding \$100,000 until such time Commerce submits a report outlining recommendations for improving oversight of the program. This report briefly outlines the performance of the Account, and the steps Commerce has taken to improve oversight of the Account. Six of the seven audit recommendations provided by OLA in the October 23, 2015 Performance Audit report have been implemented. Furthermore, Commerce is continuing to work with the BPW to carry out all recommendations from the audit. Changes to the administration of the Account were based on the audit findings and recommendations. However, these changes have also created an overly onerous administrative process for both Commerce and the Fund Managers. This is due in part to several factors; (1) Commerce’s lack of authority over the program, and (2) Implementation of the Account is not like other Commerce finance programs. In order to improve operational efficiency, Commerce recommends a change to the statute that transfers authority of the program from the BPW to Commerce so that it can administer the Account similar to its other finance programs. These changes would include eliminating the checking account requirement, eliminating loan servicing and loan monitoring by the Fund Managers by bringing those functions in-house, but keeping the Fund Managers as loan originators and underwriters. Furthermore, these changes would allow Commerce to streamline marketing and delivery of the program to small businesses by developing a single application process, uniformed terms and documentation as well as a cohesive marketing plan.

I. Introduction

In accordance with the 2016 Session Joint Chairmen's Report (JCR), p.141, the Maryland Department of Commerce is required to submit a report on ways to improve the administration of the Small, Minority-Owned Business Account ("the Account"). Specifically, the report should address any legislative and administrative changes related to the procurement, oversight, and reimbursement of fund managers, geographic distribution of program assistance, and program performance evaluation.

Commerce respectfully requests the budget committees to review the report and if they are satisfied to release the \$100,000 special fund appropriation to Commerce under T00F00.

II. Program History and Background

When Maryland voters ratified video lottery terminals in the November 2008 general election, 1.5% of video lottery terminal proceeds were allocated for deposit into the Small, Minority, and Women-Owned Businesses Account.¹ This Account is used "to make grants to eligible fund managers to provide investment capital and loans to small, minority, and women-owned businesses in the State, of which at least 50 percent must be allocated to such businesses in the jurisdictions and communities surrounding a video lottery facility."²

The General Assembly established the Account under the authority of the Board of Public Works. Since Fiscal Year 2011, Account proceeds have been annually appropriated to the Department of Commerce to implement the Program.³ The Board of Public Works in 2012 designated Commerce to manage the Program.⁴ The Account is subject to an annual audit by the Office of Legislative Audits.

Currently, five facilities produce Video Lottery Terminal (VLT) revenues under State licenses:

- Cecil County [Hollywood Casino] (opened September 2010)
- Worcester County [Casino at Ocean Downs] (opened January 2011)
- Anne Arundel County [Maryland Live] (opened June 2012)
- Allegany County [Rocky Gap Casino Resort] (opened May 2013)
- Baltimore City [Horseshoe Casino] (opened August 2014)

A sixth licensed facility, in Prince George's County [MGM National Harbor], opens December 2016.

With approval from the BPW, Commerce entered into contracts with Fund Managers who carry out the intent of the program to deploy the Account proceeds by lending and investing in small, minority, and women-owned businesses throughout Maryland ("Maryland Businesses"). Since

¹ Chapter 4, section one (Maryland Laws Special Session 2007), codified at § 9-1A-27, State Government Article, Annotated Code of Maryland.

² § 9-1A-35, State Government Article, Annotated Code of Maryland.

³ The Account began receiving funds in fiscal year 2011 when the first VLT facility began operations. See Chapter 482 (Maryland Laws 2010).

⁴ Board of Public Works Secretary Agenda Item 22 (8/22/2012)

fiscal year 2014, Commerce has entered into contracts with eight Fund Managers.⁵ The Fund Managers are awarded as follows:

Fund Manager	Secretary Item 15 (4/17/13)	Secretary Item 9 (6/18/14)	Secretary Item 10 (06/18/14)	Secretary Item 4 (6/23/15)	Secretary Item 7 & 8 (6/22/16)
\$ Amounts MILLIONS					
Anne Arundel Economic Development	\$3.36	\$2.00		\$1.85	\$4.00
Baltimore County Economic Development			\$1.50	\$1.60	\$3.00
Baltimore Development Corporation			\$1.00	\$1.75	\$3.00
FSC First					\$2.00
Howard County Economic Development			\$1.50	\$1.75	\$3.00
Maryland Capital Enterprises	\$1.00			\$1.00	\$2.68
Meridian Management Group	\$3.50	\$2.00		\$2.15	\$4.00
Tri County Council of Western MD			\$1.10	\$1.00	\$2.50
Total Awarded	\$7.86	\$4.00	\$5.10	\$11.10	\$24.18

Presented below is a summary of Account activity for fiscal year 2016. Funds transferred into the Account during the fiscal year were \$10.8 million, with disbursements of \$9.8 million. Remaining funds set aside for Fund Managers to use for loans and investments at the end of fiscal year 2016 was \$13.3 million. The available balance at June 30, 2016 was \$1.4 million.

Small, Minority, and Women-Owned Businesses Account

Starting FY16 Balance	13,877,004
	FY 2016 Funds Transferred
	10,815,061
Total Balance	<u>24,692,065</u>
	FY 2016 Disbursements
	(9,874,773)
Ending FY16 Balance	14,817,292
(less) Encumbrances as of 6/30/16	(13,353,764)
Available funds	<u>1,463,528</u>

⁵ See Secretary's Agenda Items 15 (4/17/2013); 9-10 (6/18/2014); 4-5 (6/23/2015).

As required in the Request for Proposal, Fund Managers must establish an interest-bearing checking account in the name of and for the benefit of the State of Maryland. Funds from the Account are deposited into the checking accounts. The Fund Managers then use those funds to make loans and investments to small, minority, and women-owned businesses. Commerce requires the Fund Managers to submit bank statements and reconciliations monthly, detailing the activity in the checking accounts. Total funds in the State checking accounts that can be used to lend to businesses at June 30, 2016 was \$3.6 million. For an overview of Account activity, please refer to the Appendix.

Fund Manager	Checking Account Balance as of 06/30
Anne Arundel Economic Development	\$586,729.54
Baltimore County Economic Development	\$309,051.08
Baltimore Development Corporation	\$329,562.05
Howard County Economic Development	\$542,770.48
Maryland Capital Enterprise	\$224,618.85
Meridian Management Group	\$1,624,175.25
Tri County Council of Western MD	\$44,005.73
Total Funds in State Checking Accounts	\$3,660,912.98

III. Administrative and Oversight Improvements Implemented

Commerce has implemented considerable oversight and administrative improvements to the program based on OLA recommendations as follows:

Finding #	Legislative Audit Recommendations	Commerce Actions
Finding 1	Establish Program goals, objectives, and measures for evaluating performance	Established goals and performance measures (see page 10, "Goals and Performance Measures")
Finding 2	Require interim reporting and enforce compliance	Established a ticklers for financial reports using Commerce's Portfol system; created a Partner Portal within Commerce's Salesforce for Fund Managers to input loans and investment transactions, and upload supporting documentation
Finding 3	Establish formal process for verifying Fund Manager compliance with key contractual requirements	Created Agreed Upon Procedures letter to be used during the Fund Managers Audit to ensure compliance with the contract
Finding 4	Establish a formal evaluation process to assess the performance of Fund Managers	Established specific criteria in the RFP process; require information regarding portfolio performance, charge offs, income, and expenses in the Annual Report
Finding 5	Recommend that BPW require Commerce approval all contract modifications	Commerce submits all and any changes to BPW for approval
Finding 6	Establish effective checking account monitoring	Require monthly submission of bank statements and reconciliations; Commerce has online access to all checking accounts
Finding 7	Establish comprehensive policies and procedures specifically as it relates to requesting additional funds	Commerce is working with BPW to establish procedures; Commerce tighten up its procedures for requesting funds i.e. supporting documents uploaded into Salesforce, reconciliations, loans must close within 30 days of request

Elaboration on Finding One:

Specific goals, performance measures, and other improvements include:

Goal 1: Increase access to capital of small, minority, and women-owned businesses in Maryland.

Goal 2: Increase access to capital of small, minority, and women-owned businesses in Targeted Areas.

Goal 3: Increase access to capital to small, minority, and women-owned businesses in key industry sectors: clean energy, manufacturing, and cyber.

Goal 4: Develop and implement policies and procedures so that audits do not produce any material findings.

Performance Measures

- At least one loan or investment to a veteran-owned business
 - At least two loans or investments to women-owned businesses
 - At least one loan or investment to a disabled-owned businesses
 - At least one loan or investment in the clean energy sector
 - At least one loan or investment in manufacturing sector
 - At least one loan or investment in cyber-industry sector
 - Board of Public Works approves Policies and Procedures
 - All Account activity is captured and up-to-date in Commerce records.
 - Fund Managers have implemented *Agreed Upon Procedures*
 - No repeat findings.
- Consolidated Appropriations extending Procurement cycle from one year to two years
 - Required copies of the Fund Managers' credit underwriting procedures and conflict of interest policy
 - Established New Hybrid Targeted Areas to cover more rural areas of the State

IV. Recommendations

1. Transfer authority of the Account from BPW to Commerce

The Department has made significant strides to implement and improve oversight and administration of the Account based on the OLA recommendations. However, Commerce's lack of authority over the Account has created significant administrative hurdles. Namely, all changes and recommendations by Commerce, including policies and procedures must be approved by the BPW. This layer of bureaucracy inhibits Commerce's ability to make meaningful, flexible, and effective administrative changes.

Compounding these difficulties is a broadly written statute, which offers little guidance on management of the Account. Furthermore, the yearly procurement process of Fund Managers, Treasury's requirement that Fund Manager's establish joint State checking accounts to manage the

Account activity, and monthly oversight of Account activity is administratively burdensome. No other finance program under Commerce’s control has such onerous requirements. Furthermore, Commerce’s role in administering the Account is grossly out of scope with the current MOU. Initially, Commerce’s role in managing the Account was to assist with procuring Fund Managers, reconcile the Account, monitor and collect reporting of the Fund Managers. Since the Legislative Audit, Commerce has assumed a greater role in administration of the Account but with no increased authority to make changes that would ease the administrative burden.

Under other Commerce programs, funds are awarded directly to recipients and performance is enforced through claw back provisions in the contract because of this checking accounts are not required. Administratively, the checking accounts is the most burdensome requirement of the program. The reporting is akin to a monthly audit. Commerce is currently managing eight Fund Manager checking accounts, which require the collection of monthly bank statements and reconciliations. Commerce has essentially become the authority over the Fund Managers but with no power to make or enforce any changes. **Below is how the Account would work under Commerce if given authority over the Program:**

Fund Managers as Originators and Underwriters

- Eliminates State checking account requirement
- Commerce services the Portfolio (billing, disbursements, compliance reporting)
- Flat fee to Fund Manages for origination and underwriting services
- Principal repayments redirected to Commerce to phase out existing Fund Manager checking accounts
- Streamline marketing and delivery of the program

The charts below gives an example of reporting requirements of EDA, which is a federal program, as well as MEAF and MEDAAF, which are Commerce programs, compared to the reporting requirements of the Small, Minority, and Women-Owned Businesses Account.

Revolving Loan Fund Requirements Comparison	SMWOBA	EDA	MEAF	MEDAAF
Disbursement form Request for Funds for each loan, Draws limited to \$250,000	Yes	No	No	No
Fund usage report, each loan	Yes	No	No	No
Loan commitment letter submitted for funding	Yes	No	No	no
Time to receive funds	Avg. 7 days	No	No	No
Duel control checking account	Yes	No	No	No
Bank Reconciliations- monthly	Yes	n/a	n/a	n/a
Due by the 10 th of each month	Yes	n/a	n/a	n/a
Reporting of principal, interest, and fees	Yes	Yes	No	No
Reporting of disbursements & expenses	Yes	Yes	No	No
Copy of promissory note, settlement sheet,	Yes	No	No	No
Copy of bank statement	Yes	No	No	No
Back up documents for admin. fee expenses				
Invoice copies	Yes	n/a	n/a	n/a

Write amount charged to SMWOBA on each invoice	Yes	n/a	n/a	n/a
Copy of cancelled check verifying payment	Yes	n/a	n/a	n/a
Independent Audit of the Fund as part of a comprehensive audit	Yes	Yes	Yes	Yes
Monthly (Dashboard) Salesforce	Yes	No	No	No
Annual Programmatic Report	Yes	Yes	Yes	Yes

Recommendation number one models the Account similar to other Commerce finance programs and eliminates the eight State checking accounts. The checking accounts are inherently risky because they are outside of the State’s financial control. Operation of these accounts rests solely on the Fund Manager’s internal operating procedures. Furthermore, while the Fund Manager, according to the contracts, assumes all of the risk, the State again has to rely on the due diligence of the Fund Manager in ensuring compliance and repayment of the State’s principal funds in the event of a default situation. For example, the Fund Manager could charge off an account without conferring with Commerce or BPW since they assume all of the risk. However, in the end it is still the State’s principal funds at risk.

Keeping the origination and underwriting function with the Fund Managers keeps the lending at the community level, but keeps funding, billing, and risk management in the hands of Commerce thereby better securing the State’s principal. All transactions would be tracked in one accounting and portfolio management system for reporting and would require an annual programmatic and audited finance statement like other Commerce finance programs.

2. Define specific terms

- Define in statute “*jurisdictions and communities surrounding a video lottery terminal facility*” better known as the “targeted area”

The “targeted area” defined by the BPW workgroup included businesses within a 10-mile radius of a video lottery terminal facility. However, the targeted areas have expanded to include other jurisdictions and communities that do not have a video lottery facility in order to reach underserved communities. The lack of a clear definition in the statute has created confusion in both the community and in the legislature.

- Define “*investment capital*” or eliminate the capability

The Fund Managers are not accredited investors and cannot make traditional equity investments. If the term remains, it should be defined as meaning a “patient loan” with repayments scheduled to begin within no later than 5-years from the initial disbursement of fund.

- Fund Managers, Compensation, Marketing

The number of Fund Managers should be evaluated. In order to bring on new Fund Managers, BPW requires an RFP, which is a long and cumbersome process. Furthermore, the more Fund Managers, the less funds to go around, which limits the Fund Manager's income to cover operating expenses and to turn a modest profit. Accordingly, "the minimum amount of assets under management to achieve cash flow break-even is approximately \$5 million"⁶. This fits in with reevaluating the compensation structure of the Fund Managers. Under the current contract, Fund Managers are allowed an 8% stand-up fee to cover expenses for starting up the program. Thereafter, Fund Managers may ask for additional principal funds to cover expenses. Reimbursement requires numerous documentation, invoices, and analysis. Establishing a management fee structure based on a fixed rate or a declining structure to cover shortfalls would be a better option.

While having multiple Fund Managers across the State is a good way to reach out to the business community, it also creates confusion in the marketplace. For instance, each Fund Manager has its own marketing message, which does not always acknowledge the State as the source of the funds, application process, and lending terms. The legislature could consider standardizing the Account by setting minimum and maximum interest rates, and fees for the program. Furthermore, a single application would make collection of Borrower information more consistent, easier for reporting, and would be less confusing to businesses seeking assistance. Additionally, there is no one clear message in marketing the program. Each Fund Manager has its own marketing materials with its own unique name with no unifying message or theme. A statewide marketing outreach effort may result in greater opportunities to generate more transactions to small businesses.

V. Conclusion

These recommendations are not without consequences. Transitioning the existing Fund Manager loans to Commerce would take time and significant coordination. This could create confusion for the borrower. Secondly, Commerce would need at least one additional accounting staff to manage the influx of the existing Fund Managers' portfolios, which is over two-hundred loans. To ease the transition and make it as seamless as possible, Commerce would need to work closely with the Fund Managers to communicate the transition to its borrowers. The transfer could happen in stages, transiting one Fund Manager's portfolio at a time. Coordinated outreach between Commerce, the Fund Manager, and the businesses would need to occur to ease any concerns regarding changes to payment terms or conditions, and ensure good customer service.

Overall, the small, minority, and women-owned business is a success. Funds from the Account have assisted over 200 companies and given them access to capital of \$32.3 million. After three years of assisting BPW administer the Account using Fund Managers, and getting much needed capital deployed, Commerce has identified several ways to enhance efficiency and simplify the process while ensuring the financial accountability, legislative intent, and positive customer service experience for the end users.

⁶ Center for Regional Economic Competitiveness Maryland Economic Development Finance Program Study, January 2016

Appendix

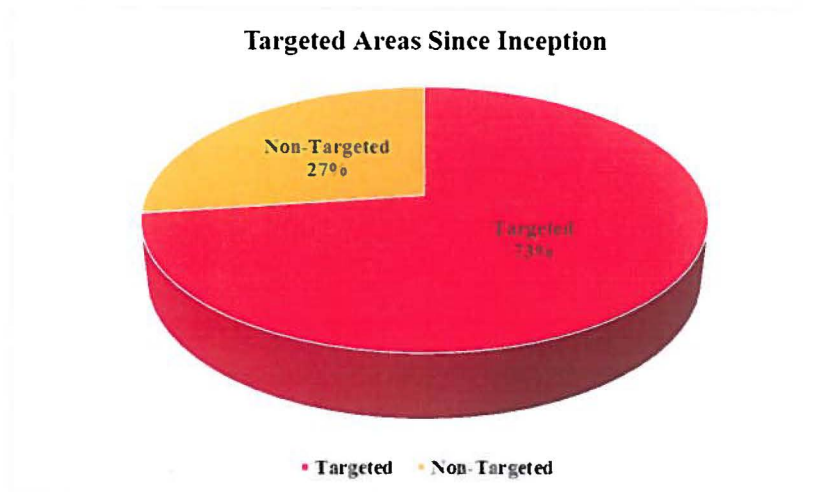
Overview of Activity of the Program

Since Inception of the Fund, 276 transactions have been approved for \$32.3 million, projected to create 575 new jobs and retain 591, leveraging \$26.3 million in private sector capital.

Fund Manager	# Approved Since Inception	Amount	Private Sector		At Risk/Retained Jobs
			Dollars Leveraged	New Jobs	
Anne Arundel County Economic Development	51	\$ 7,703,000	\$ -	0	0
Baltimore County Economic Development	27	\$ 3,095,800	\$ 19,400,000	282	204
Baltimore Development Corporation	12	\$ 2,456,000	\$ -	0	0
Howard County Economic Development	24	\$ 3,590,000	\$ 6,958,513	204	235
Maryland Capital Enterprise	61	\$ 2,000,263	\$ -	89	152
Meridian Management Group	89	\$ 11,281,792	\$ -	0	0
Tri County Council of Western MD	12	\$ 2,253,173	\$ -	0	0
Since Inception	276	\$ 32,380,028	\$ 26,358,513	575	591

As required by statute, fifty-percent of funds were deployed to targeted areas with \$19.3 million going to the targeted areas and \$7.3 million deployed to other non-targeted areas.

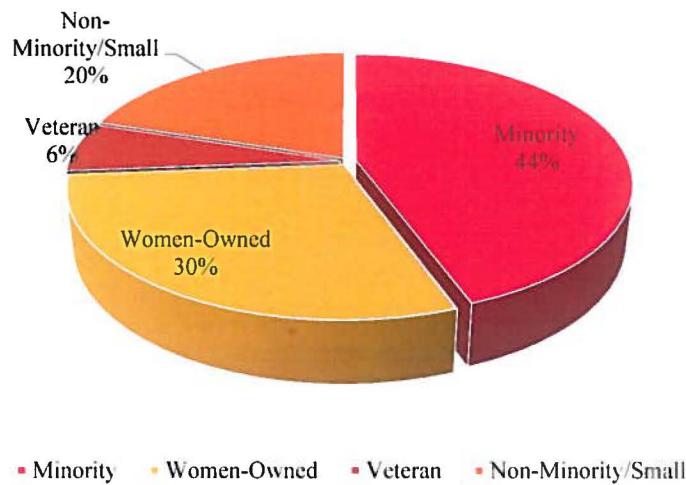
TARGETED AREAS



Since Inception	Targeted	Non-Targeted
Anne Arundel County Economic Development	\$3,784,750	\$2,544,250
Baltimore County Economic Development	\$2,465,500	\$630,300
Baltimore Development Corporation	\$2,286,000	\$170,000
Howard County Economic Development	\$3,505,000	\$85,000
Maryland Capital Enterprise	\$1,149,068	\$851,195
Meridian Management Group	\$5,651,802	\$2,602,500
Tri County Council of Western MD	\$870,000	\$468,173
	\$19,712,120	\$7,351,418

Since Inception, \$25.7 million has been deployed to small, minority, and women-owned businesses broken down as follows: \$11.4 million to minority owned businesses, \$7.5 million to women-owned businesses, \$1.5 to veteran owned businesses and \$5.1 million to non-minority small businesses.⁷

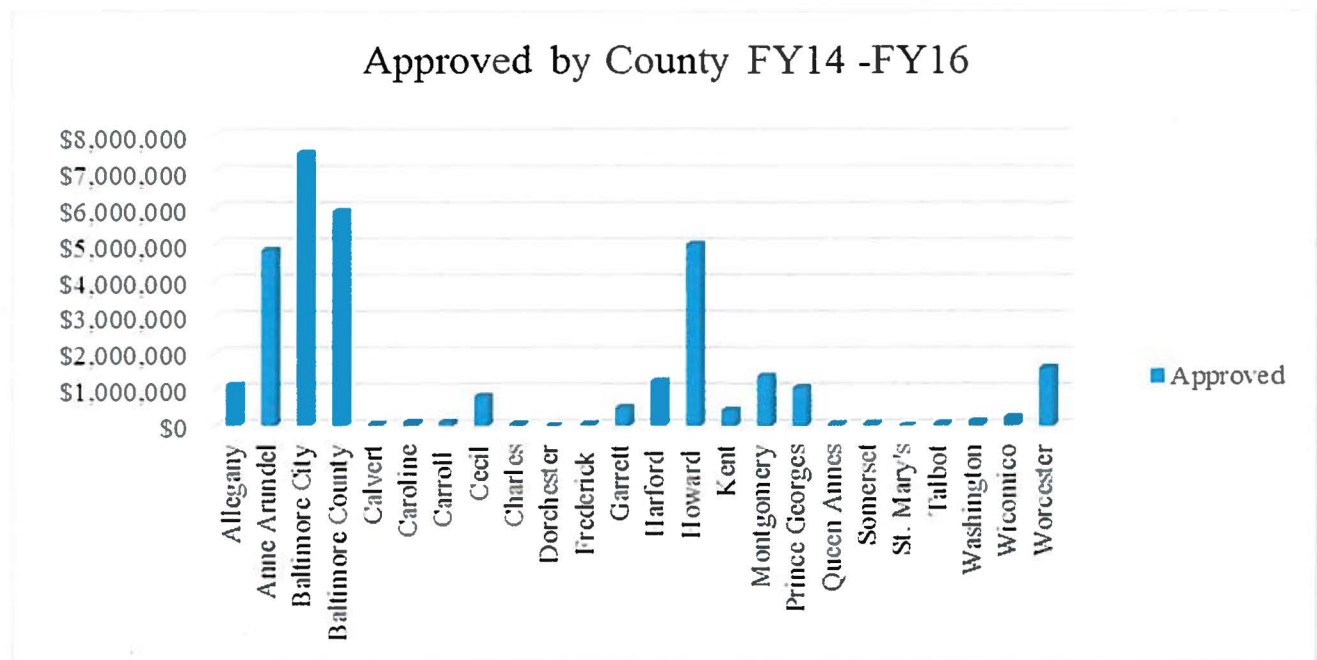
Small, Minority, and Women-Owned Businesses



⁷ Minority status is self-selected by the borrower

Since Inception	Transactions	Minority	Transactions	Women	Transactions	Veteran	Transactions	Non-Minority/Small
Anne Arundel County Economic Development	14	\$1,907,000	15	\$2,332,000	6	\$671,000	8	\$1,419,000
Baltimore County Economic Development	7	\$585,300	10	\$1,275,000	4	\$600,000	2	\$85,500
Baltimore Development Corporation	2	\$320,000	2	\$260,000	0	\$0	8	\$1,876,000
Howard County Economic Development	9	\$1,529,000	5	\$296,000	1	\$250,000	3	\$785,000
Maryland Capital Enterprise	15	\$633,694	28	\$827,073	5	\$45,397	13	\$494,099
Meridian Management Group	37	\$5,747,302	17	\$2,037,500	0	\$0	18	\$469,500
Tri County Council of Western MD	3	\$710,000	5	\$557,965	0	\$0	1	\$70,208
Total	87	\$11,432,296	82	\$7,585,538	16	\$1,566,397	53	\$5,199,307

The Chart below shows the distribution of Approved transactions across the State.



Approvals covered businesses in seventeen of the twenty-four jurisdictions. Fund Managers have submitted detailed marketing plans outlining their efforts to reach out to the rural areas of the State. For example, Fund Managers have committed to establishing partnerships with rural counties economic development offices, connecting with minority affairs and purchasing departments, and establishing membership to local chambers of commerce. Recognizing the importance of ensuring funds from the Account are distributed across the State, Commerce developed specific goals for the Fund Managers in the latest contract to encourage loans and investments to businesses located in rural targeted areas, which are identified as Allegany, Cecil, Garrett, Harford, Kent, Somerset, Washington, Wicomico, and Worcester counties. However, the majority of activity illustrated above is located in areas that are more heavily populated and have a casino facility.