VSBFA
Virginia Small Business Financing Authority

September 22, 2016

The Honorable Terence R. McAuliffe
Governor of the Commonwealth of Virginia
Office of the Governor
Patrick Henry Building, 3rd Floor
1111 East Broad Street
Richmond, Virginia 23219

The Honorable Todd Haymore
Secretary of Commerce and Trade
Patrick Henry Building, 4th Floor
1111 East Broad Street
Richmond, Virginia 23219

The Honorable Thomas K. Norment, Jr.
Co - Chairman
Senate Finance Committee
201 North 9th Street
10th Floor, General Assembly Building
Capitol Square
Richmond, VA 23219

The Honorable Emmett W. Hanger, Jr.
Co - Chairman
Senate Finance Committee
201 North 9th Street
10th Floor, General Assembly Building
Capitol Square
Richmond, VA 23219

The Honorable S. Chris Jones
Chairman
House Appropriations Committee
201 North 9th Street
9th Floor, General Assembly Building
Capitol Square
Richmond, Virginia 23219

Dear Governor McAuliffe, Secretary Haymore, Chairman Norment, Chairman Hanger, and Chairman Jones:

Pursuant to Section 2.2-2312 of the Code of Virginia, the Executive Director of the Virginia Small Business Financing Authority (VSBFA) *"…shall within 120 days of the close of each fiscal year, submit an annual report of its activities for the preceding fiscal year to the Governor and the chairmen of the House Committee on Appropriations and the Senate Committee on Finance. Each report shall set forth, for the preceding fiscal year, a complete operating and financial statement for the Authority and any loan fund or loan guarantee fund the Authority administers or manages."*

During Fiscal Year 2016 the VSBFA committed $10.3 million through its direct loan and credit enhancement programs to assist Virginia's economic development efforts, especially those impacting small businesses. One hundred, forty-four small businesses or local Industrial or Economic Development Authorities benefitted from these loans and credit enhancements, an increase of 21% over the previous FY. More importantly, VSBFA assisted Virginia's businesses by enabling total private debt and private equity of $52.9 million as a result of VSBFA's participation in these projects. This means that our loans and credit enhancements produced an overall leveraging factor of $5.10:1 (private to public) during FY '16 and the leveraging factor on our overall performance since the VSBFA's inception has been $18:1. In FY '16, the VSBFA also facilitated an additional $119 million in private activity bond financings for manufacturers, and 501 (c) 3 non-profits. The combined loan, credit enhancement, and bond financing assisted Virginia's businesses and non-profits in creating or retaining 4,810 jobs, an increase of 118% from the previous year. Since inception, the VSBFA has assisted 2,578 small businesses in creating and saving 31,520 jobs.

In addition, the VSBFA has been heavily involved in such initiatives as administering the Small Business Investment Grant Fund, Virginia SAVES Clean Energy Program, and Virginia Velocity entrepreneurial competition and the Virginia Velocity Tour.

On behalf of the Board of Directors and staff of the Virginia Small Business Financing Authority, I want to thank you for giving us the opportunity to provide vital programs and services as a part of the Commonwealth's economic development effort. Through these financing programs, we will continue to partner with Virginia's financial institutions in providing the credit necessary for Virginia's businesses to grow, prosper, and increase employment.

Please feel free to contact me should you have any questions regarding this report or the attached financial statements.

Respectfully,

Scott E. Parsons
Executive Director

Cc: Ms. Tracey G. Jeter, Director, Virginia Department of Small Business & Supplier Diversity
Ms. Gail L. Letts, Chairman of the Board, Virginia Small Business Financing Authority
Mr. Neil Amin, Vice Chairman of the Board, Virginia Small Business Financing Authority

Attachments

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

(A Component Unit of the Commonwealth of Virginia)

Management's Discussion and Analysis and
Basic Unaudited Financial Statements and Supplementary Information
for the Fiscal Years ending June 30, 2016 and 2015

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

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VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

Management's Preparation and Presentation of Basic Financial Statements

For the Fiscal Years ending June 30, 2016 and 2015

Management's Responsibility for the Financial Statements

The financial statements, management discussion and notes which follow herein have not been prepared or audited by a certified public accountant. The management of the Virginia Small Business Financing Authority (the "Authority") is responsible for the preparation and presentation of these accrual based financial statements, management discussion and notes which follow and for the implementation and maintenance of internal controls relevant to the preparation and fair presentation of financial statements which are free from material misstatement, whether due to fraud or error.

In management's opinion, the financial statements, management discussion and notes presented herein present fairly, in all material respects, the financial position of the Virginia Small Business Financing Authority as of June 30, 2016, and the changes in net position from the 2015 fiscal year-end to the 2016 fiscal year-end.

Non-GASB Compliant Financial Statements

While these statements have been prepared with generally accepted accounting principles in mind, these statements do not meet all U.S. Governmental Accounting Standards Board (GASB) requirements and therefore cannot be considered to be fully compliant with GASB.

Change in Reporting Methodology

The Authority made significant changes in reporting methodology, during fiscal year 2015 and again in fiscal year 2016, with regard to program funds related to the Authority's *SSBCI Cash Collateral Program* and *State Cash Collateral Program* (collectively referred to as "CCP") which the Authority began offering in 2013. The Authority's *SSBCI Cash Collateral Program* is funded with federal funds which are subject to specific eligibility guidelines and federal regulations governing their use. From time to time loans which do not meet these federal eligibility guidelines and regulations are supported with state funds through the State *Cash Collateral Program.*

- The CCP program utilizes reserve accounts at participating banks to offset potential losses the participating bank may incur in the future on the CCP enrolled loans. VSBFA obligates these CCP reserves by committing transaction-specific collateral support - relative to a specific loan at a specific bank - for a specified period of time and up to a specified maximum amount.

- The funds held in CCP Reserve Accounts were classified on VSBFA's financial statements for FY 2013 and FY 2014 as *Cash Not Held with Treasurer*. This reporting methodology could imply these funds were liquid and available immediately to be deployed for additional *CCP* activity when, in fact, these funds had been committed for the participating bank's potential future use should that bank incur a loss on an enrolled CCP loan.

- In order to more accurately reflect the Authority's liquidity position and insure an accurate representation of VSBFA's support obligations to participating banks under the *Cash Collateral Program,* VSBFA made a change in reporting methodology in FY 2015 by reclassifying funds held in

CCP Reserve Accounts as Restricted Assets and by recording an equivalent, offsetting Restricted Liability. Additionally, the Authority classified CCP support distributions made to participating banks during FY 2015 as an expense and recorded a prior period adjustment of $5.6 million to reflect the net adjustments to the Authority's FY 2015 beginning net position had this reporting methodology been utilized in FY 2013 and FY 2014.

- In FY 2016, the Virginia Department of Accounts determined that the support distributions provided under the *Cash Collateral Program* constituted a non-exchange financial guarantee under the Governmental Accounting Standards Board (GASB) Statement No. 70. The Virginia Auditor of Public Accounts subsequently provided similar guidance on this subject in early FY 2017 prior to the filing of the Authority's 2016 financial reports with the Department of Accounts.

- A non-exchange financial guarantee – or in this case, the collateral support provided by the Authority's *Cash Collateral Program* – is typically provided by a government for the obligations of a not-for-profit organization, a private entity, or an individual and the government providing the guarantee or support has not directly received equal or approximately equal value in exchange for that guarantee or support. Given that the CCP support provided by the Authority to participating banks in the *Cash Collateral Program* has been extended without remuneration (except for a nominal application fee) since the program's inception, a basis clearly exists for this determination.

- Under GASB 70, the Authority would record a liability and related expense *only when* there was a likelihood (greater than 50% chance) that the Authority would be required to make a future payment related to a non-exchange financial guarantee, including support provided under the *Cash Collateral Program*.

- Consistent with the Authority's FY 2015 financial statements, the Authority's FY 2106 financial statements continue to recognize the funds held in CCP Reserve Accounts as Restricted Assets. However, in order to comply with GASB 70, the Authority's FY 2016 financial statements *do not* reflect an offsetting liability against the funds held in the CCP Reserve Accounts as of June 30, 2016 given that there were no *Cash Collateral Program* support obligations as of that date where the Authority believed there was a likelihood that a future payment would be necessary.

- In accordance with GASB 70, no expense was recorded in FY 2016 for *Cash Collateral Program* support distributions made during FY 2016. Additionally, in order to eliminate impact of the Restricted Liability and expenses previously recorded for the *Cash Collateral Program* in FY 2015, a prior period adjustment of $5,650,676 was recorded in FY 2016.

VIRGINIA SMALL BUSNESS FINANCING AUTHORITY

Management's Discussion and Analysis
For the Fiscal Years ending June 30, 2016 and 2015

This section of the Virginia Small Business Financing Authority's (the "Authority") annual financial report presents management's discussion and analysis of the Authority's financial performance during the fiscal years that ended June 30, 2016 and 2015. Please read the information below in conjunction with the Authority's financial statements, which follow this section. The annual financial report consists of three parts, management's discussion and analysis, the basic financial statements and the notes to the financial statements.

FINANCIAL HIGHLIGHTS

The following information represents a comparative analysis of key financial aspects of the Authority's operations between the fiscal years ended June 30, 2016 and June 30, 2015.

- The Authority's *Cash Collateral Program* continued to enjoy increased demand statewide throughout 2016. *Cash Collateral Program* support distributions increased to $5,154,542 during FY 2016 from $4,578,420 in FY 2015, a 12.5% increase. As of June 29, 2016 there were 29 banks enrolled to participate and active in the *Cash Collateral Program*.

- At the 2016 fiscal year-end, VSBFA had $11.8 million in SSBCI CCP reserve accounts and $1.9 million in State CCP reserve accounts, respectively, at participating *Cash Collateral Program* banks compared with $8.1 million and $1.4 million respectively at the 2015 fiscal year-end. Amounts held in CCP reserve accounts are impacted by new CCP support distributions throughout the year and also by CCP support returned to or "clawed back" to the Authority as a result of the expiration of the Authority's CCP support, CCP supported loans which have repaid prior to maturity, principal reductions in CCP supported loans which are still outstanding or due to a modification in bank terms which subsequently eliminates the need for continued CCP support.

- Following a 29% increase in net outstanding loans during 2015, the Authority's net loans fell by 10% in 2016 from $13.4 million in FY 2015 to $12.0 million as of June 30, 2016. A significant portion of the $1.4 million decline can be attributed to a single write-off of $988,531 related to a loan issued under the *Economic Development Loan Fund Program*.

- Total Assets for the Authority fell by $818,919 from $54,968,923 at June 30, 2015 to as $54,150,004 as of June 30, 2016. This reduction in Total Assets was substantially attributable to a single write-off of an *Economic Development Loan Fund* loan, as mentioned above. Also contributing to the reduction in the Authority's Total Assets was a transfer of most of the remaining assets related to the *Environmental Compliance Assistance Fund* (ECAF) back to the Department of Environmental Quality. Total Assets related to ECAF fell from $462,914 at June 30, 2015 compared with $60,617 as of June 30, 2016.

- During 2016, the Authority distributed $89,810 to banks for the purpose of extending credit enhancement support through the *SSBCI Capital Access Program* (SSBCI CAP), the *Virginia Capital Access Program* (VCAP) and the *Tobacco Capital Access Program* (TCAP.) Although the Authority's VCAP and TCAP programs continue to support outstanding loans previously enrolled by participating banks, these programs are no longer accepting new loan enrollments and both programs have been discontinued in FY 2016 due to a lack of continued funding. The Authority's *SSBCI Capital Access Program* continues to accept new loan enrollments provided that these meet all federal eligibility guidelines and regulations required for SSBCI funding.

- Following a decline from 2013 to 2014, fee income from the Authority's bond issuances increased for the second consecutive year, growing by 14% from $827,050 in FY 2015 to $946,449 in FY 2016.

Historically, the Authority's revenue from bond issuances has fluctuated from year-to-year. Demand for these bonds is driven a number of external factors, including the U.S. Internal Revenue Service (IRS) regulations governing their use and by the U.S. capital markets. In addition to the fluctuating demand for bonds, the Authority's revenues from bond issuance revenue is also affected by other factors, including the repayment of bonds in the Authority's existing portfolio (given that the Authority's bond fees are paid on the outstanding principal balance of existing bonds, bond fee revenues decline as those bonds are repaid.) Bond fee revenue for the Authority also continues to be impacted by the Memorandum of Understanding the Authority voluntarily entered into in March 2012 whereby VSBFA agreed to share 40% of its bond fee revenue from non-profit bond issuances with local economic development authorities around the Commonwealth.

- The Authority's agreement with the federal Economic Development Administration (U.S. Department of Commerce) requires that the Authority lend or commit 85% of the EDA *American Safety Razor Fund* and 75% of both the *Craddock-Terry RLF* and *Defense Conversion RLF* funds which the Authority utilizes to provide direct loans through the *Economic Development Loan Fund* program. Having not met that EDA requirement as of September 30, 2015, the Authority was required in February 2016 to sequester $1.9 million of cash from the Authority's *Economic Development Loan Fund* program. During a period of sequestration, the Authority must remit all interest earned on the sequestered funds to EDA. On early September 2016, the Authority was notified by EDA of an additional sequestration requirement and consequently, the Authority will sequester an additional $3.5 million for a total of $5.4 million in sequestered EDA funds as of September 20, 2016.

- In 2014, the Authority entered into a Memorandum of Understanding (MOU) with the Center for Innovative Technology (CIT) to provide up to $2 million in funding from the Authority's SSBCI funds for use in CIT's Gap Fund, the Commonwealth's venture capital fund. The Authority's agreement with CIT provides a limited amount of SSBCI funding which can be utilized to make debt or equity investments in small Virginia technology businesses for purposes which are compliant with U.S. Treasury SSBCI policies and guidelines. By late 2015, CIT had exhausted the initial $2 million in funding originally allocated for this purpose and the Authority subsequently requested and received U.S. Treasury Department approval to increase the total SSBCI funding allocated to the CIT Gap Fund to $3 million. During FY 2016, the Authority provided $810,000 of that additional $1,000,000 in SSBCI funding to CIT for qualified SSBCI investments.

VIRGINIA SMALL BUSNESS FINANCING AUTHORITY

Management's Discussion and Analysis
For the Fiscal Years ending June 30, 2015 and 2014

This section of the Virginia Small Business Financing Authority's (the "Authority") annual financial report presents management's discussion and analysis of the Authority's financial performance during the fiscal years that ended June 30, 2015 and 2014. Please read it in conjunction with the Authority's financial statements, which follow this section. The annual financial report consists of three parts, management's discussion and analysis, the basic financial statements and the notes to the financial statement.

FINANCIAL HIGHLIGHTS

The following information represents a comparative analysis of key financial aspects of the Authority's operations between the years ended June 30, 2015 and June 30, 2014.

- The Authority received its third and final tranche of funding under the U.S. *State Small Business Credit Initiative* ("SSBCI") from the U.S. Treasury Department during FY 2015.
- The Authority's *Cash Collateral Program* has continued to enjoy strong demand statewide throughout 2015. Usage among participating *Cash Collateral Program* banks increased during 2015 and at the 2015 fiscal year-end, VSBFA had $8.1 million in reserve accounts at participating *Cash Collateral Program banks* compared with $5.2 million in CCP reserve accounts at the 2014 fiscal year-end.
- As demand for our programs increased, the Authority experienced strong loan growth during 2015. Net loans outstanding increased by 29% from $10.4 million in 2014 to $13.1 million in 2015. This compares favorably to the change between FY 2013 and FY 2014 when net loans outstanding fell by 7%.
- Total assets for the Authority increased from $50,742,891 at June 30, 2014 to $54,968,923 as of June 30, 2015. The increase was due to the Authority's receipt of its third and final tranche of funding from the U.S. *State Small Business Credit Initiative.*
- Although the Authority's total assets increased in 2015, <u>net</u> assets declined from $48,392,909 at June 30, 2014 to $43,900,598 at June 30, 2015. This decline in net assets was primarily due to a change in reporting methodology for restricted assets which are held in reserve funds at banks participating in the *SSBCI Capital Access Program*, the *Cash Collateral Program* ("CCP) and the *Virginia Capital Access Program ("VCAP*.") The majority of these restricted assets are federal in nature and attributable to funding through the U.S. SSBCI program. (See additionally, immediately below.)
- The Authority made a significant change in reporting methodology as of our June 30, 2015 year-end. This change was motivated by the Authority's desire to more accurately reflect our liquidity position in the SSBCI *Cash Collateral Program* and State Cash Collateral Program, and, additionally, to more accurately reflect the Authority's support obligations to participating banks under both programs-.
    - The CCP program utilizes reserve accounts at participating banks to offset potential losses the bank may incur in the future from the enrolled CCP loans. VSBFA obligates these CCP reserves by committing transaction-specific collateral support (relative to a specific loan at a specific bank) for a specified period of time and up to a specified maximum amount. Funds in these reserve accounts are "clawed back" and returned to our SSBCI program when commitments expire or loans are repaid in full, or periodically, as the bank collects payments and the principal balance of the loan declines.
    - From time to time, the Authority has utilized VSBFA funds to support a loan through the CCP program which did not qualify for SSBCI funding. Those State CCP funds have been maintained in the same reserve accounts as SSBCI funds.
    - Since the Authority's receipt of SSBCI funding in 2013, the Authority has shown the CCP reserve accounts at participating banks as Restricted Cash Not Held with the Treasurer. This

reporting methodology implied these funds were liquid and available immediately to be deployed for additional *CCP* activity. In fact, the funds maintained in CCP reserve accounts at participating banks cannot be considered as cash because these funds have been committed to participating banks for their potential future and because of the federal regulations governing their use.

- Consequently, effective June 30, 2015, the Authority reclassified all SSBCI CCP and State CCP funds held in CCP reserve accounts as Restricted Assets, resulting in Total Restricted Assets of $10,667,144 as of the 2015 fiscal year-end. In order to accurately reflect the Authority's legal obligations to participating banks under the CCP program – arising from the Authority's commitments to provide these funds for the participating bank's use in the event of future losses on a CCP enrolled loan –the Authority has recorded an offsetting liability of $10,667,144.

- As a result of this change, the Authority additionally recorded a prior period adjustment which reduced the Authority's Net Position for prior periods by $5,650,676.

- In addition to the changes described above which impacted the Authority's balance sheet, the Authority also recorded aggregate operating expenditures of $3,883,110 for the *Cash Collateral Program* to reflect the distribution of SSBCI CCP and State CCP funds the CCP reserve accounts at participating banks. These distributions were offset by $330,664 in SSBCI and VSBFA funds which were "clawed-back" by the Authority from participating CCP banks (as a result of reductions in the principal balance of loans supported by the CCP reserve funds) and $1,378,846 of SSBCI and VSBFA funds which were returned from participating CCP banks because the Authority's CCP support had expired or the loan had been paid in full.

- During 2015, the Authority distributed $3,974,018 to banks for the purpose of extending credit enhancement support through the SSBCI CCP, State CCP and CAP programs (including SSBCI CAP, VCAP and TCAP.) Although these distributions are included in the Authority's operating expenses, it is important to note these distributions are not "operating expenses" in the traditional sense. They are classified as such due to the limitations in the Commonwealth's accounting system.

- Fee income from the Authority's bond issuances increased very slightly by $20,084 from $806,966 in 2014 to $827,050 in 2015, following a decline in bond fee income from 2013 to 2014. The Authority's revenue from this source is inconsistent from year-to-year given that demand for these bonds is driven by U.S. Internal Revenue Service (IRS) regulations governing these bonds and by the U.S. capital markets. The Authority's revenue from bond issuances is also affected by other factors, including the repayment of bonds in our existing portfolio. (VSBFA bond fees are paid on the outstanding principal balance of existing bonds, VSBFA fees decline as those bonds are repaid.) Additionally, the Authority continues to be impacted by the Memorandum of Understanding it voluntarily entered into in March 2012 whereby VSBFA agreed to share 40% of its bond fee revenue from non-profit bond issuances with local economic development authorities around the Commonwealth.

- In 2014, the VSBFA entered into a Memorandum of Understanding (MOU) with the Center for Innovative Technology (CIT) to provide up to $2 million in funding from the Authority's SSBCI funds for CIT's Gap Fund, the Commonwealth's venture capital fund. The Authority's agreement with CIT allows CIT to utilize SSBCI funding to make debt or equity investments in Virginia small technology businesses for purposes which are compliant with U.S. Treasury SSBCI policies and guidelines. In late 2015, CIT had exhausted that initial funding and the Authority agreed, contingent upon approval by the U.S. Treasury Department, to increase the SSBCI funding allocated to the CIT Gap Fund to up to $3 million. As of November 2015, Treasury approval of the increased CIT allocation was expected but still pending.

- In June 2015, the Chief Credit Officer of the Authority retired after an eighteen year career with the Authority. She was replaced by a Regional Lending Manager and senior staff member of the Authority staff who has been employed by the Authority since 1992. In June 2015, the Authority hired a new staff member for a newly created position within its loan accounting function. In November 2015, the Authority hired a new Regional Lending Manager to fill the position vacated by the Authority's new Chief Credit Officer.

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

For the Fiscal Years Ending June 30, 2014 through June 30, 2016

FINANCIAL ANALYSIS OF THE AUTHORITY

The following table summarizes select financial information regarding the Authority's operations as of the dates and for the periods indicated:

	6/30/2016	6/30/2015	6/30/2014	% change 2016 vs 2015	% change 2015 vs 2014
Cash	$14,999,792	$17,843,688*	$23,523,003*	(16%)	(24%)
Investments	$12,221,382	$12,982,897	$15,704,249	(6%)	(17%)
Loans receivable (net)	$12,030,715	$13,426,321	$10,441,587	(10%)	29%
Restricted Assets (CCP and CAP reserve accounts)	$14,879,825	$10,667,144*	$1,045,063*	39%	921%*
Other assets (Accrued Interest Receivable	$18,290	$48,873	$28,989	63%	68%
Total assets	$54,150,004	$54,968,923	$50,742,891	1%	8%
Obligations under Securities Lending Program	$63,294	$364,211	$1,089,881	(83%)	(67%)
Support Obligations under CCP, CAP, & Other programs	$1,166,846	$10,667,144	$1,045,063	3%	8%
Other Liabilities	$72,731	$36,970	$65,160	97%	(43%)
Total liabilities	$1,302,871	$11,068,325	$2,200,104	15%	(30%)
Net Assets	$52,847,133	$43,900,598	$48,542,787	(1%)	(1%)

*Impacted by the change in reporting methodology for the *SSBCI Cash Collateral Program* and the *State Cash Collateral Program*.

	2016	2015
Restricted	$44,233,501	$37,964,407
Unrestricted	$8,613,632	$4,936,191
Total Net Assets	$52,847,133	$43,900,598

Description of Net Assets The Authority's Net Assets are reported on the Statement of Net Assets. The Authority has Restricted Assets and Unrestricted Assets as described below:

1. Restricted These net assets represent funds that have been received by the Authority for specific financing programs from various funding sources, including: the federal government, the state government for use in conjunction with certain federal grants, funds which are administered by the Authority on behalf of other state agencies, funds which are restricted by federal grants or by state legislation, and funds that are restricted due to commitments, deficiency guaranties and loan portfolio insurance agreements that represent legal obligations of the Authority to the respective banks.

   Federally restricted net assets managed by the Authority are the *Child Care Financing Program*, the *State Small Business Credit Initiative* - U.S. Treasury, and the Federal *Economic Development Loan Fund* – U.S. Economic Development Administration. As of June 30, 2016, the Net Assets under these programs are $3,716,744, $14,906,613 and $18,786,053 respectively totaling $37,409,410.

State net assets are “restricted” by deficiency guaranties, guaranty commitments, loan commitments, outstanding checks issued by the Authority and accrued payroll. The state restricted net assets at June 30, 2016 were $6,824,091 which included outstanding *Loan Guaranty Program* guaranties, *Loan Guaranty Program* commitments, outstanding checks and accrued payroll.

2. Unrestricted As of June 30, 2016, unrestricted net assets totaled $8,613,632, which include VSBFA operating/LGP ($3,035,348), State EDLF ($1,778,015), State CCP ($1,868,574), Microloan ($1,462,264), SWaM ($253,694), VCAP ($40,617), ECAF ($60,617), TCAP ($114,123), and PACE ($380).

VIRGINIA SMALL BUSINESS FINANCING AUTHORITY

Statements of Revenues, Expenses and Changes in Net Assets
June 30, 2016 and 2015

	2016	2015
Operating revenues:		
Interest on loans receivable	$455,175	$503,292
Charges for sales and service	$946,449	$838,802
Other	$421,441	$42,593
Total operating revenues	$1,823,065	$1,384,687
Operating expenses:		
Personal services (11XX)	$665,634	$567,078
Contractual Services (12XX)	$26,215	$18,636
Supplies (13XX)	$695	$5,191
Equipment (15XX)	$705	$278
Distributions (*Capital Access Program* fee matching distributions) (14XX)	$89,810	$90,908
Other (including charge-offs and miscellaneous)	$999,810	$3,909,267*
Allowance for Bad Debt	$245,525	$274,007
Total operating expenses	$2,028,394	$4,865,365*
Net operating income (loss)	($205,329)	($3,480,678)*
Non-operating revenues:		
Interest income	$110,769	$98,721
Other	$128,543	($1,637,226)*
Total Non-Operating Revenue (Expenses)	$239,312	$171,005*
Net Income before transfers	$33,983	($5,019,183)*
Transfers		
Net Operating transfers (including intrafunds)	$2,437,532	$4,591,077
Transfer in from U S Treasury SSBCI program	-0-	$6,104,083
Transfers out to CIT	($839,992)	($1,977,532)
Total net transfers	$1,597,540	$5,814,576
Change in net assets	$1,631,523	$795,393

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

The Virginia Small Business Financing Authority was created by the Virginia General Assembly in 1984 as a public body corporate and a political subdivision of the Commonwealth of Virginia. The Authority is governed by an eleven-member board, appointed by the Governor of the Commonwealth of Virginia. The Authority's major activities are to provide financial assistance to businesses in the Commonwealth through bond issuances, direct loans, loan guaranties, portfolio loan loss reserves, and other assistance.

For financial reporting purposes, the Authority is a component unit of the Commonwealth of Virginia. The accounts of the Authority and other Authority-administered state and federal funds, are combined to form the Component Unit - Proprietary Funds of the Commonwealth of Virginia. The financial statements of the Authority include the activities of the *SSBCI Cash Collateral Program***,** the *SSBCI Capital Access Program* and the *SSBCI EDLF Program* which are all funded through the State Small Business Credit Initiative through the U.S. Treasury, the *Child Care Financing Program* direct loan program*,* the U.S. Department of Commerce - Economic Development Administration funded *Economic Development Loan Fund* direct loan program, a VSBFA funded *Economic Development Loan Program* direct loan program, a VSBFA funded *Cash Collateral Program*, the *Small Business Environmental Compliance Assistance Fund* direct loan program, the *Small Business Micro Loan Program* direct loan program, the *Small Business Growth Fund* (also known as the *Virginia Capital Access Program*), the *PACE Program*, formerly of the Department of Minority Business Enterprise, the *Southside Tobacco Region Capital Access Program,* the *Industrial Development Bond Program*, and the *Loan Guaranty Program*, which are described in more detail in Section (2).

(b) Basis of Accounting

The Authority utilizes the accrual basis of accounting in preparing its financial statements where revenues are recognized when earned and expenses when incurred. The accounts are organized on the basis of funds, which are set up in accordance with the authorizing act, the various grants, and agreements between the Authority and the other state agencies.

(c) Conduit Debt Obligations

From time to time, the Authority has issued Industrial Revenue Bonds to provide financial assistance to private sector entities for the acquisition and construction of industrial and commercial facilities deemed to be in the public interest. The bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Upon repayment of the bonds, ownership of the acquired facilities transfers to the private sector entity served by the bond issuance. Neither the Authority, the State, nor any political subdivision thereof is obligated in any manner for repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the accompanying financial statements.

(d) Loans Receivable

Loans receivable are stated at their unpaid principal balance, less an allowance for loan losses. The interest method is computed on a loan-by-loan basis, but is typically on the basis of actual days/365.

(e) Allowance for Loan Losses

There will be a discussion of loan losses, if any, under each program discussion. If actual charges-offs exceed this amount, the Authority will increase the allowance.

For the direct loan programs, receivables are charged-off when a 120-day delinquency is reached and we determine that repayment is deemed highly unlikely. For non-bankruptcy cases, the Authority's collections are sent to the OAG for collection and debts are reported as required under the Debt Set-Off Program.

Based upon the nominal losses incurred from the *Loan Guaranty Program* over the Authority's thirty year history, the Authority has determined that a loss reserve of 2% of our notes receivable is appropriate. This is due to the fact that our loan portfolios have continued to perform better than one would expect for a government lending program. In addition, if a loan is deemed at risk under the *Loan Guaranty Program*, the Authority will deduct the full amount of the principal balance from the guaranty capacity calculation in order to account for any potential loss from that specific transaction.

Funds distributed to banks through the Authority's CAP programs (including the *SSBCI CAP, VCAP,* and *TCAP* programs) fund an actual loan loss reserve account at the participating banks. By virtue of the nature of these programs, the Authority's liability is limited to funds distributed; consequently, no additional allowance for loan losses is required for these programs.

(f) Compensation

Compensation for all employees of the Authority is based upon the Commonwealth's compensation plan for state employees. The Executive Director is an employee of the Commonwealth and is non-restricted. The remaining staff members are employees of the Authority and are "restricted" in that their employment and compensation are tied to the various funds administered by the Authority. Compensation expense is charged to several of the programs that allow for such administrative costs.

(g) Retirement Plans

Employees of the Authority participate in a defined benefit pension plan administered by the Virginia Retirement System (VRS). The VRS also administers life insurance and health related plans for employees. Information relating to these plans is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The Commonwealth, not the Authority, has overall responsibility for contributions to these plans.

(h) Compensated Absences

Authority employees are granted vacation and sick pay in varying amounts as services are provided. Employees may accumulate, subject to certain limitations, unused vacation and sick pay earned and, upon retirement, termination or death, may be compensated for certain amounts at their then current rates of pay. The amount of vacation and sick pay recognized as expense is the amount earned each year.

(2) Description of Account and Fund Groups

(a) The *Industrial Development Bond Program*

The Authority is a conduit issuer of tax-exempt and taxable Industrial Development Revenue Bonds to provide creditworthy businesses with access to long-term, fixed asset financing for new and expanding manufacturing facilities and exempt projects, such as solid waste disposal facilities. During fiscal 2003, the Authority was given the legislative authority to issue bonds for qualified 501c3s for projects such as hospital expansions and college and university foundations. The repayment of the Authority issued bonds is the responsibility of the respective for-profit or 501 (c)(3) not-for-profit entity and the financing of such bonds is provided by the private sector and not provided by the Authority or the Commonwealth. Neither the Authority nor the Commonwealth guarantee payment and, as described in Section 9-221 of the Code of Virginia, no bonds issued by the Authority constitute a debt, liability, or general obligation of the Commonwealth.

The Authority charges an annual administrative fee based upon the outstanding principal amount of the bonds it has issued, payable on each anniversary date of the closing of the bond issue. Such fees may vary upon the amount and type of issuance, but typically the issuance fee for a for-profit entity is one-eighth of one percent annually on the then outstanding principal balance of the loan supporting the bond. For bonds issued on behalf of 501c3s the annual fee is one-tenth of one percent annually on the then outstanding principal balance of the loan supporting the bond, with a cap of $250,000. Per an agreement with certain localities of the Commonwealth, the VSBFA shares 40% of its bond fee revenue generated from 501 (c)(3)'s with all localities in Virginia. The VSBFA collects the full amount of the fee due from the 501 (c)(3) and then calculates the appropriate amount due to the localities on a pro-rata basis based on the amount of the issuance per locality. The VSBFA then pays the amount due to the locality per the agreement. The remaining monies collected are put in the VSBFA Operating account and are used to support the loan programs for the VSBFA and some administrative costs.

In 2009 the VSBFA's legislation was amended to expand the definition of "Business Enterprise to include any "*entity acquiring, constructing, improving, maintaining, or operating a qualified transportation facility under the Public-Private Transportation Act of 1995 (§ 56-556 et seq)."* In the 2013-2014 budget and again in the 2015-2016 budget there was language that references an agreed upon fee structure for a road project financed by a bond that was approved by the VSBFA this year. It states: "*For the I-95 HOV/HOT Lanes project as evidenced by the Comprehensive Agreement approved pursuant to the Public-Private Transportation Act of 1995, the maximum fee and/or premium charged by the Virginia Small Business Financing Authority pursuant to §§ 2.2-2291 and 2.2-2285, Code of Virginia, for acting as the conduit issuer for any bond financing is not to exceed $25,000 per annum."* We expect this budget language to continue for future budgets.

See attached Trial Balance Bond Report for a listing of outstanding bonds issued by the Authority.

(b) VSBFA Operating Fund/*Loan Guaranty Program*/*Microloan Program*/*State EDLF*/*State Cash Collateral Program*

Net Assets totaling $13,968,292 are divided into four separate loan funds, in addition to the operating funds of the VSBFA.

The ***Loan Guaranty Program*** provides guaranties up to the lesser of $750,000 or 75% of lines of credit and term loans. This program was funded by $900,000 of the initial $1,000,000 appropriation received by the Authority in 1984. In 2002 and again in 2004, $500,000 and $600,000 respectively were transferred from the state Economic Development Loan Fund (EDLF (0921)) to provide for continued funding of the program. In FY 2007, FY 2011 and FY 2012 the Virginia General Assembly provided additional funding of $1,250,000, $1,000,000 and $5,000,000 respectively. As of June 30, 2016 there were $6,995,110 in outstanding guaranties and $75,000 in commitments under the *Loan Guaranty Program*. The Authority charges an upfront guaranty fee of 1.5% of the guaranteed portion of the loan.

The ***Microloan Program*** had net outstanding loans of $904,394 and no outstanding loan commitments at the 2016 year-end. Allowance for Doubtful Accounts for the *Microloan Program* at the 2016 year-end was $18,457. Charge-offs in this program totaled $9,868 for the 2016 fiscal year.

The ***State Economic Development Fund*** had $1,450,741 net outstanding loans and no outstanding commitments at the 2016 year-end. Allowance for Doubtful Accounts for the *State Economic Development Fund* at the 2016 year-end was $29,607. There were no charge-offs in this program during the 2016 fiscal year.

The ***State Cash Collateral Program*** (State CCP) is a collateral support program, supporting eligible loans at participating banks that have a deficiency in collateral. Loans that are deemed ineligible for participation in the *State Small Business Credit Initiative* CCP, but still deemed eligible for funding from VSBFA funds are funded through this program. At the 2016 year-end the Authority had funded $1,868,574 in State Cash Collateral Program deposits. These cash collateral deposits are on deposit at participating lenders in accounts owned by the VSBFA. They are considered public funds.

As of June 30, 2016 VSBFA had $1,829 in outstanding checks and $70,862 in accrued payroll and benefits.

In the current budget there is language that was intended to expand our ability to provide guaranties. The budget language states *"The Virginia Small Business Finance Authority is authorized to insure additional loans for eligible small businesses, pursuant to § 2.2-2290, Code of Virginia, up to an aggregate amount not to exceed four times the principal amount in the Insurance or Guarantee Fund, or up to an aggregate amount of* $15,000,000, whichever is less. *In the event that the authority is called upon to pay on guaranties of loans of more than 10 percent of the aggregate amount of all outstanding insured loans, the authority shall not insure any further loans and shall immediately notify the Governor and the Chairmen of the House Appropriations and Senate Finance Committees. Pursuant to § 4-1.03.5 of this act, the Director, Department of Planning and Budget, is authorized to transfer a sum sufficient to the Insurance or Guarantee Fund in the event the amount in the fund falls below the amount needed to honor any guarantee."*

This change was intended to allow the Authority to once again market the program at a more significant level and provide for additional guaranties to help more small businesses. The "whichever is less" language was inserted in error and must be corrected in order to accomplish the intended goal.

This program's funds are carried under the Authority's operating account which also receives the income from the bond program. Earnings from the bonds and the continued funding from the Virginia General Assembly have enabled the Authority to provide the capital for the *Loan Guaranty Program*, the *State EDLF* and *Cash Collateral Program*, the *Microloan Program* and the V*irginia Capital Access Program* (VCAP).

(c) *State Small Business Credit Initiative* (0715)

On August 15, 2011 we entered into an agreement with the U.S. Treasury to accept Virginia's allocation of the money available under the State Small Business Credit Initiative (SSBCI). Virginia has now received $17,953,191 in three funding tranches. The VSBFA received the second tranche in April 2014 and the third tranche in April 2015. Under our SSBCI program, the VSBFA offers a *Cash Collateral Program*, *SSBCI Capital Access Program*, and a venture fund in partnership with Virginia's Center for Innovative Technology (CIT). The SSBCI has established a goal for participating states to reach a leverage of private sector dollars to SSBCI dollars of 10:1. At the 2016 year-end, the Authority had CAP reserve accounts totaling $557,108, one direct SSBCI loan in the amount of $247,705 and *Cash Collateral Program* reserve accounts totaling $13,712,979. (Also included in the CCP reserves accounts was $1,868,574 of VSBFA funds utilized to support CCP transactions which did not qualify for SSBCI funding.) All of the federal dollars are Restricted.

(d) *Child Care Financing Program* (0380)

This program is funded by a federal Child Care and Development Block Grant received by the Virginia Department of Social Services. Under a Memorandum of Agreement the Authority is charged to administer the Child Care and Development Fund. Such administrative duties include creating the program, including the amounts and terms of such loans, processing loan applications, closing and funding of loans, marketing the loan program, and managing the loan portfolio. The *Child Care Financing Program* offers regulated childcare providers or pending regulated providers low-interest installment loans to fund quality enhancement projects or projects to meet or maintain state or local child care requirements, including health, safety and fire codes. A provider must be either a family day provider or operate a child care center. Loan repayments must flow back into the fund to be used to fund future loans and the operating expenses to administer the program. As such, the net assets of this fund are Restricted due to the restraints imposed by the federal grant (GASBS #34) and the MOA mentioned above. At June 30, 2016 net loans receivable totaled $382,715 and the Authority had $0 in outstanding loan commitments. Allowance for Doubtful Accounts as of the 2015 year-end was $7,811 and there were no charge-offs for the 2016 year.

(e) Federal *Economic Development Loan Fund* (0243)

The Federal *Economic Development Loan Fund* provides loans generally up to $1,000,000 to bridge the gap between private debt financing and private equity for projects that will result in job creation or retention. The *Defense Conversion Revolving Loan Fund* provides loans up to $1,000,000 to assist defense-dependent companies seeking to expand into commercial markets and diversify their operations. Loans can be made to Virginia businesses and to economic development authorities. In an effort to assist our distressed communities, the amount and terms of the loans can be higher and less restrictive for economic development authorities located in highly distressed areas of the Commonwealth. The EDLF was capitalized by three U.S. Economic Development Administration (EDA) grants and the required state matching funds, which are restricted to this fund to be in compliance with the original terms and conditions of the EDA grants. The monies in this program are *non-general funds*. Net loans receivable totaled $8,991,680 at June 30, 2016 and there were $999,675 in outstanding loan commitments. Allowance for Doubtful Accounts was $183,503 at June 30, 2016 and there were no charge-offs during 2016. The net assets in this fund are Restricted due to the restraints imposed by the federal grant.

(f) *Small Business Environmental Compliance Assistance Fund* (0930)

This program is funded by the Department of Environmental Quality (DEQ). The Authority administers the Fund for DEQ pursuant to a tri-party cooperative agreement which was executed between the Authority; the former Department of Business Assistance, and DEQ. Under this agreement the Authority is charged to administer the Fund. Such administrative duties include creating the program, including the amounts and terms of such loans, processing loan applications, closing and funding of loans, marketing the loan program, and managing the loan portfolio. Under the enabling legislation, the DEQ fund provides direct loans to small businesses for the purchase of equipment to comply with the federal Clean Air Act, equipment to implement voluntary Pollution Prevention measures, or equipment or structures to implement Agricultural Best Management Practices. The Net Loans Receivable as of June 30, 2016 were $58,434 and there were no outstanding loan commitments. Allowance for Doubtful Accounts was $1,193 and there were no charge-offs during 2016 in this program. As of December 2015, the program has been discontinued and the cash is transferred back to DEQ as funds are collected. The Authority will continue to service two remaining outstanding loans until paid in full. The Authority and DEQ have agreed to transfer collections from these remaining loans prior to each fiscal year-end until the remaining loans have been paid in full.

(g) Small Business Growth Fund aka *Virginia Capital Access Program* (0957)

The Virginia Small Business Growth Fund, also known as the Authority's *Virginia Capital Access Program* (VCAP), provides a form of loan portfolio insurance for participating banks through special loan loss reserve accounts which are funded by loan enrollment premiums paid by the bank/borrower and matched by the Authority from the Fund. The monies in these loan loss reserve accounts are available to cover losses on loans enrolled by the participating bank. The Fund has been largely capitalized by state general fund appropriations, and VCAP was initially launched with $74,717 from the Authority's operating account. In 2005 the Authority received a $300,000 appropriation form the General Assembly to continue the funding of this program. During '06 $133,000 was transferred from the Authority's operating/LGP fund to the Virginia Capital Access Program (VCAP) to keep VCAP funded and therefore operational a few more months. Effective July 1, 2006, the General Assembly appropriated $1,250,000 to the Authority. $500,000 of this appropriation was transferred to VCAP to recapitalize the program and the loan from the VSBFA was paid back. Again in 2008 and 2009 the VSBFA had to loan $200,000 and $140,577 respectively to this fund to keep it operational. During 2010, $235,000 was transferred to the fund from the VSBFA operating account to cover payroll processing and matches. $200,000 was transferred in during 2011 and $100,000 in 2012 for matching fees. The total balance of the loan loss reserve accounts at participating banks at FY 2016 year-end was $168,193. This balance includes premiums paid by the bank/borrower; matching contributions from the Fund; account interest earned; less any withdrawals to cover loan losses. The balances in the bank accounts are Restricted by the enabling legislation and the terms and conditions of the participating agreements executed by the Authority and the participating banks. This fund has been discontinued.

(h) *Tobacco Southside Region Capital Access Program* (0900)

The *Tobacco Capital Access Program* (TCAP) provided a form of loan portfolio insurance for participating banks through special loan loss reserve accounts, which were funded by loan enrollment premiums paid by the bank/borrower and matched by the Authority from the Fund. The TCAP program was discontinued effective November 16, 2015. The remaining monies in these loan loss reserve accounts will continue to be available to cover losses on loans enrolled by the participating bank. The balances in the bank accounts are Restricted by the constraints placed upon the fund by the Tobacco Commission, the terms and conditions outlined in the Tri-party MOA, and the terms and conditions of the participating agreements executed by the VSBFA and the participating banks. At FY 2016 year-end, there was $441,545 in the TCAP reserve accounts.

(i) *P.A.C.E* Fund (0215)

This Department of Minority Business Enterprise (DMBE) fund provided credit enhancements to participating banks through a capital access program (CAP) as described under the Small Business Growth Fund or loan guaranties up to 90% as described under the *Loan Guaranty Program*. The Fund was initially capitalized with $309,569 from DMBE. The administration of the cash holdings in the fund is pursuant to a tri-party cooperative agreement between the Authority, the former Department of Business Assistance and the former DMBE. During FY2007 Authority assumed all duties for the fund including the accounting for the loan guaranties and enrolled loans under the CAP, marketing, guaranty approvals, enlisting and executing participation agreements with the CAP banks and approving all claims under the guaranty aspect of the program. At FY 2016 year-end, there were no outstanding guaranties and no money left in CAP reserve accounts under this fund and $380 in unrestricted cash. In September 2015, the remaining cash in this program was transferred to 0215 in order that the funds could be combined with new funding from the Virginia General Assembly for the *SWAM Microloan Program.*

(3) **Loans Receivable**

Substantially all loans receivable are secured by liens on business assets of the borrower or personal assets of the guarantor(s), and by the personal guaranties of all majority business owners. Rates and terms vary depending upon the program and the market rates at the time of loan closing.

(4) Cash and Investments

Cash includes cash on hand and amounts in checking accounts, which are insured by the Federal Depository Insurance Corporation or are collateralized under provisions of the Virginia Security for Public Deposits Act, Section 2.2-4400 et.seq. of the Code of Virginia (a multiple financial institution collateral pool). Under the Act, banks holding public deposits in excess of the amounts insured by FDIC must pledge collateral in the amount of 50% of excess deposits to a collateral pool in the name of the State Treasury Board. Deposits covered by the Act are considered insured since the Treasury Board is authorized to make additional assessments. Generally the immediate operating cash in the VSBFA fund (Bond, loan program and LGP) and the *Child Day Care Financing Program* are on deposit at Wells Fargo and SunTrust in an amount sufficient to cover service charges and expected loan fundings. The VSBFA keeps some cash at a commercial bank to allow for ACH payments on loans. The excess operating money of the funds is held in three separate LGIP accounts. All other funds are invested with the Treasurer of Virginia.

(6) Securities Lending Transactions

$63,294 of the Investments held by the Treasurer of Virginia represents the Authority's allocated share of cash collateral received and reinvested and securities received for the State Treasury's securities lending program. Information related to the credit risk of these investments and the State Treasury's securities lending program is available on a statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report. The Commonwealth's policy is to record unrealized gains and losses in the General Fund in the Commonwealth's basic financial statements. When gains or losses are realized, the actual gains and losses are recorded by the affected agencies.

(7) Relationships with the Department of Small Business and Supplier Diversity

The Executive Director of the Authority is appointed by the Director of the Department of Small Business and Supplier Diversity in accordance with Section 9-204 of the Code of Virginia. The Director of the Department of Small Business and Supplier Diversity is a voting ex-officio member of the Authority's Board. The Department of Small Business and Supplier Diversity also provides the Authority with office space and pays certain administrative expenses.

(8) Surety Bond

The Executive Director of the Authority was covered by a Faithful Performance Duty Bond administered by the Commonwealth of Virginia's Department of General Services, Division of Risk Management with liability limits of $500,000 for each occurrence.