FIRST ARKANSAS DEVELOPMENT FINANCE CORPORATION

This article by Herbert L. Thomas, Sr. was written for the Arkansas Economist, published by the University of Arkansas, Industrial Research and Extension Center.

I

One of the most unique agencies which this nation has seen arise from the post World War inter-state competition for industrial development is the First Arkansas Development Finance Corporation. This organization, which in the field of industrial development is limited in purpose to the problems of financing, is patterned after, but is significantly different from the pioneering development credit corporation of the New England states which were born in the past decade. It is unique in its organization. in its potential size and effectiveness.

One of the most unusual and outstanding features of this corporation is that it is a potential $10 million (or more) credit agency which is privately owned, but which will not provide its owners with any profit on their investment. It is an example of cooperation among private citizens, and business and government institutions which is unprecedented in the history of Arkansas and unparalleled in other states. This non-profit lending agency is one answer which Arkansas has found to the question of how to finance an aggressive industrial expansion program.

II

Within a short time after Arkansas began its active program of industrial development, with the creation of the Arkansas Industrial Development Commission in 1955, it became evident that the existing methods of industrial financing were not sufficient to keep Arkansas in a competitive position with other states in the bidding for outside industries. It had been further evident for some time before that too frequently the birth of, or expansion of an Arkansas owned industry was thwarted by lack of credit or capital funds. For several years, ideas had been brought forth and discussed on how to solve this problem. Various people throughout the State began discussing the possibility of creating a state-wide development credit agency, similar to those in some Eastern and New England states. After being sold on this idea, a group of businessmen, lawyers and members of the State Legislature began what turned out to be a long and difficult task of creating FADFC.

The enabling legislation for First Arkansas Development Finance Corporation was introduced in the 1957 session of the General Assembly of Arkansas and through the efforts of a group of enthused legislators was passed unanimously by the Senate and with only five dissenting votes in the House. The bill was signed by Governor Faubus on April 2, 1957 and became Act 567 of 1957. The Act declared that the State Government, through the State Board of Finance could invest money in FADFC and thereby provide funds for industrial development financing. The law does not limit FADFC to industrial financing, but specifies that its purpose is to promote the industrial, business, agricultural and general economic welfare of the state through the creation of employment opportunity of Arkansas citizens.

Before State funds are invested in this private corporation, the enabling legislation specifies that it must be organized so as to truly represent the entire state, and that the citizens of the state must express their interest through investing their money in the organization. In accordance with the law, the organizers of FADFC were successful in getting more than 100 private citizens of Arkansas to purchase common stock in a total amount in excess of $100,000. A minimum of 10% of the common stock is owned in each of the Congressional districts of the state, as required by the Act. The common stockholders elect the Board of Directors of the Corporation, with each Congressional district represented on the Board.

Under the law, preferred stock must be sold in a minimum amount of $900,000. The problem of obtaining this sum of non-interest, non-dividend paying money was solved when 35 of the utility companies operating in Arkansas answered the request to purchase preferred stock. Approval by the Public Service Commission and the Securities & Exchange Commission was required in some instances for this purchase, and obtaining this approval resulted in a significant delay in the organizing of FADFC. The utilities invested in preferred stock in amounts proportionate to the number of Arkansas customers served. While the preferred stock pays no dividends, the owners will eventually be reimbursed from reserves accumulated by FADFC.

After the First Arkansas Development Finance Corporation met all requirements and became incorporated under Act 567, in August 1958, it was necessary to determine if such unique legislation and such an organization were to be considered as constitutional under Arkansas law. Of the many applications submitted to FADFC immediately after its incorporation, the one from the Scott County Industrial Development Corporation, a local non-profit development organization, was selected for use in a test case to be taken to the courts of Arkansas. This loan application was approved on December 11, 1958, and on January 15, 1959 a test case involving this loan from FADFC was filed in Chancery Court. On May 18, 1959, the Arkansas Supreme Court ruled that Act 567 of 1957 was constitutional, that State funds could be thus invested, and that First Arkansas Development Corporation was legally organized under the Act. It appeared that after two years of frustrating and difficult effort, FADFC was ready to begin functioning.

III

In February 1958, the common stockholders had met and elected members of the Board of Directors. This Board consists of 25 members from all parts of the state, and 4 honorary members who are: the President of the Arkansas State Chamber of Commerce, President of the Arkansas Bankers Association, the Dean of the University of Arkansas College of Business, and the Chairman of the Arkansas Industrial Development Commission. The Directors elected three officers and an Executive Committee, The officers are: Herbert L. Thomas, Sr., Chairman; J.V. Satterfield, Jr., President; Wayne Stone, Secretary-Treasurer. In addition to the officers, the Executive Committee includes Harvey Couch, Jr.; James H. Penick, Sr.; and Raymond Rebsamen.

With the organizational and legal details finally resolved, the next step was to obtain the resources necessary for an effective industrial finance agency. The purchase of common stock by 117 citizens of Arkansas in an amount of $109,500, and the purchase of preferred stock by 35 utilities in an amount of $923,725, provided a starting fund of $1,033,225 of interest free money.

From this start, additional funds could be obtained from at least three other sources; the Arkansas State Board of Finance; the commercial banks in Arkansas;

and the Small Business Administration. During the 1957 session of the General Assembly, when Act 567 was passed, the fiscal legislation enacted included an appropriation of $2 million for investment by the State Board of Finance in interest-bearing notes or bonds of First Arkansas Development Finance Corporation. The maximum legal limit for such investment is set forth in Act 567 which states that a total of $5 million may be invested by the State Board of Finance, and an additional $2.5 million may be invested if FADFC obtains matching funds from other sources. After favorable ruling in the test case, in May 1959, the Executive Committee began negotiating with the State Board of Finance for the purchase of $2 million of notes of FADFC. The Board of Finance offered to purchase these notes with a 1 to 10 year maturity. Of necessity, industrial loans of the type to be made by FADFC are long term, maturing from 10 to 20 years. Since the State Board of Finance is to be the primary source of funds for FADFC, it was felt by the Executive Committee that borrowing money from that body for such short terms as 10 years would not allow FADFC to fulfill its function. When this case was presented to the Board of Finance, it rescinded its commitment to purchase notes with 10 year maturity and informed FADFC that the matter would be given further consideration. On June 30, 1959, the appropriation of $2 million, made in 1957, expired. No appropriation had been included in the fiscal legislation of the 1959 session of the Legislature. This meant that the Board of Finance would not be able to invest in FADFC until such time as a session of the Legislature was held and another appropriation was authorized.

The Board of Directors of FADFC held a special meeting to decide whether the Corporation should remain dormant until the next regular session of the Legislature, or should dissolve and repay the $1 million raised to organize the Corporation, or should try to obtain funds from another source to permit at least limited activity as a lending agency until the next Legislative session. The Directors decided to attempt to obtain at least an additional $1 million to $1.5 million from the banks in Arkansas by selling to them interest-bearing serial notes of FADFC. Because banks must deal only in short term securities, and because the banks were to provide only a limited amount of resources for FADFC and would not be the major source of funds, the notes would be offered with 1 to 10 year maturity. The Arkansas Bankers Association through its President, Mr. Cecil Cupp, announced its desire to sponsor this sale of notes to the 233 banks in Arkansas. A Special Committee on Industrial Finance of the ABA was formed to promote the sale of notes. At the request of FADFC, the U. S. Comptroller of Currency and the State Bank Commissioner gave approval for state and national banks in Arkansas to purchase these notes in an amount equal to 2½% of their combined capital and surplus. On October 16, 1959, each bank in the state received a descriptive circular offering these interest-bearing notes, along with some information about the corporation, and a forwarding letter from the Special Committee on Industrial Finance of the Arkansas Bankers Association. By October 23, 1959, more than $1 million had been subscribed by banks for the purchase of these notes. Letters of commitment to purchase FADFC notes are still being submitted by banks, and the total obtained is expected to be more than $1.5 million. With the proceeds of the sale of these notes and its capital funds, FADFC can and has already begun operations as a lending agency. It is anticipated that these funds will be sufficient to meet the demands during the period until the Legislature, in its next regular session, can provide funds for industrial financing through FADFC.

First Arkansas Development Finance Corporation is eligible to borrow money under a new program of the Small Business Administration. An SBA "501" loan may be granted to a state development company such as FADFC. FADFC is eligible to borrow under this program an amount equal to that which it can borrow from all other sources combined, provided that all other sources of funds have first been exhausted. The only restriction on use of such funds obtained from SBA is that only small businesses may be financed. No restrictions are imposed upon funds obtained by FADFC from other sources. After obtaining the maximum amount possible from the State Board of Finance and the banks of Arkansas, FADFC can turn to the SBA for supplementary funds.

IV

At the present time, one loan has been made by FADFC, commitment has been made for another, and preliminary approval has been given to a third application. The first loan was that used in the test case. The Scott County Industrial Development Corporation borrowed $130,000 to construct a feed mill and hatchery for the Scott County Milling Company, a new Arkansas industry. A commitment has been made to the Star City Industrial Corporation for a loan of $265,000 for the expansion of a garment factory of Byrd Manufacturing Company. This expansion will create 600 new jobs.

Loan applications are reviewed and ruled upon by the six man Executive Committee, which is called upon to meet frequently and on short notice for consideration of applications, and for other matters of policy and operation. Because FADFC as yet does not have a staff either large enough or qualified for the investigation of and appraisal of the many applications submitted, various men in the financial field throughout the state have volunteered to assist in this work. Bankers and investment brokers from Fort Smith, Pine Bluff and Little Rock have given freely of their time and services in assisting the officers of FADFC in investigating and processing loan applications. This is another example of the cooperation of many individuals and groups in the state which has made the existence of FADFC possible.

Act 567 allows the Directors of FADFC a great deal of freedom in operating the Corporation and accomplishing the purposes of the Act. FADFC funds may be used for any type of prudent investment, except that loans will not be made where credit is readily available elsewhere. At no time will FADFC compete with private, or conventional, sources of credit. In fact, an important function of FADFC is to try to find sources of funds for industrial projects through private or government channels. Many of the applications originally submitted to FADFC have been placed with private financial institutions or have been referred directly to the Small Business Administration. In this capacity as a loan broker, FADFC works in cooperation with, rather than in competition with commercial brokers. This function is important because even when the maximum possible level of resources is attained, FADFC will still have only a fraction of the total resources necessary to finance the industrial expansion of Arkansas. It means, therefore, that FADFC will accept loans only where conventional sources of credit will not accept them because of the long term of the loan or because of other technical details which do not appeal to private lenders.

FADFC will be used in combination with the other primary methods of industrial financing in Arkansas and will thereby greatly enhance the effectiveness of the whole program. FADFC can be used in conjunction with AIDC, or Act 404, bond financing by local industrial development corporations, and with Amendment 49 bond financing by city or county governments. The loan to Star City Industrial Corporation will supplement an Amendment 49 bond issue by that city. The purchase of part of a forthcoming issue of 404 bonds is currently being considered by the Executive Committee.

Even though experience is limited, some policies have already been established for FADFC loans. Among the many factors considered in reviewing a loan application is the number of new jobs to be created by the project. Act 567 is specific in listing the creation of employment opportunity as a primary goal. There is no legal or policy limit as to the size of a loan which can be made to any one borrower. An obvious policy will be to strive to distribute FADFC funds equitably to the various geographical areas of the state, although such a policy must be subordinated to the use of prudent credit judgment. Diversification of types of industry is also an important, but secondary consideration. Where construction of buildings and improvements are a factor in an industrial project, FADFC is not expected to participate in the interim financing. Great flexibility in operation and policy is an essential characteristic of the organization, however, and allows for the acceptance of any sound proposal.

Each borrower will be required to purchase from FADFC a long term, non-interest bearing, subordinated debenture. These debentures will be purchased in amounts equal to 5% of the total loan figures. The proceeds from these debentures will be used to retire the preferred stock held by the utilities. More than $18 million in loans must be made before all the preferred stock will be retired. This level of loans can be reached within a few years through a turn-over in loans and through developing a secondary market for seasoned loans held by FADFC.

Interest rates charged by FADFC on industrial loans are determined by the Executive Committee and may be assumed to vary with market conditions. Because there is no obligation to create a profit, interest rates may be expected to always be very reasonable, but still in line with current money market conditions. Any profits which accrue to FADFC, above what is needed for operating expenses, will be used to create reserves to expand the capabilities of the Corporation. Upon dissolution of First Arkansas Development Finance Corporation any profits which have been earned will revert to the Treasury of the State of Arkansas.

While FADFC will never reach the point of being able to fill all the financing needs of Arkansas' industrial development, it is an important and effective addition to the program. It is the answer to many problems and has great potentialities for contributing to the growth of Arkansas.