



SSBCI PROGRAM PROFILE: LOAN GUARANTEE PROGRAM

May 17, 2011

State Small Business Credit Initiative (SSBCI)

U.S. Department of the Treasury



LOAN GUARANTEE PROGRAM

State Small Business Credit Initiative

What is a Loan Guarantee Program?

A Loan Guarantee Program enables small businesses to obtain term loans or lines of credit to help them grow and expand their businesses. The program provides a lender with the necessary security, in the form of a partial guarantee, for the lender to approve a loan or line-of-credit.

What are the Credit and Loan Characteristics?

Like all credit programs, a Loan Guarantee Program can be tailored to meet a state's objectives. The table below describes key credit and loan characteristics that should be considered when designing a Loan Guarantee Program.

Characteristics	Description
What kinds of borrowers are eligible to participate?	<ul style="list-style-type: none">• Determined by each state and may target specific industries, regions and/or types of businesses, depending on the state's objectives.• Under SSBCI, lenders should target an average borrower size of 500 employees or less and not exceed a maximum borrower size of 750 employees. In practice, small businesses are typically much smaller than 500 employees.• Corporations, partnerships, and sole proprietorships are eligible, including non-profits and cooperatives.• SSBCI Policy Guidelines provide specific guidance on certain borrowers who are prohibited from participating in this program.
What sizes of loans are eligible?	<ul style="list-style-type: none">• Under SSBCI, should target an average principal amount of \$5 million or less and cannot exceed \$20 million on any individual loan. In practice, the average small business loan is typically much less than \$5 million.
What types of loans are eligible?	<ul style="list-style-type: none">• Varies, but usually term loans and lines of credit.• Small Business Administration (SBA) guaranteed loans may not be enrolled in state Loan Guarantee Programs.
How can loan proceeds be used?	<ul style="list-style-type: none">• For any business purpose, including, but not limited to start-up costs, working capital, business procurement, franchise fees, equipment, inventory, as well as the purchase, construction, renovation, or tenant improvements of an eligible place of business that is not for passive real estate investment purposes.• Restrictions apply to refinancing and other uses; please refer to the SSBCI Policy Guidelines for additional details.
Who negotiates the terms of the loan?	<ul style="list-style-type: none">• Interest rates, maturity, collateral and other loan terms are negotiated between the borrower and the lender.• In some cases, loan terms are subject to approval by the state.• In many cases, the state and lender will discuss and negotiate loan terms and guarantee options prior to reaching agreement to approve the loan and issue a guarantee.
What are the program's strengths?	<ul style="list-style-type: none">• Guarantees are a familiar structure for commercial lenders.• Because the state typically holds the cash to cover expected losses on loan guarantees, the programs generate higher leverage than loan participation or collateral support programs.

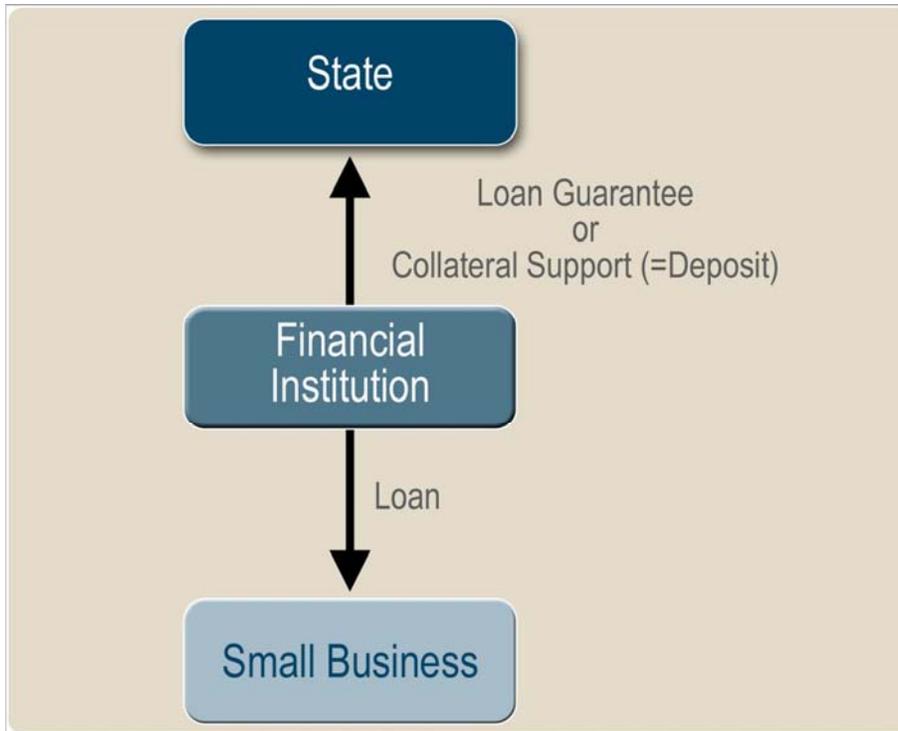


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How Does a Loan Guarantee Program Work?

In most Loan Guarantee Programs, a state sets aside funds in a dedicated reserve or account to guarantee a specified percentage of each approved loan.



Operating Mechanics	Description
What kinds of lenders are eligible to participate?	<ul style="list-style-type: none"> • Under SSBCI, any insured depository institution, insured credit union, or community development financial institution, as defined in section 103 of the Riegle Community Development and Regulatory Improvement Act of 1994. • SSBCI recommends that states screen lenders to demonstrate sufficient commercial lending experience and financial and managerial capacity to participate.
Who originates loans in this program?	<ul style="list-style-type: none"> • Participating lenders and other eligible lenders originate loans and apply to the state program for guarantee approval. • However, some states permit borrowers to seek “pre-approval” from the guarantee program before negotiating with prospective lenders.
Who has underwriting responsibility?	<ul style="list-style-type: none"> • Lenders are responsible for underwriting the loans initially. • States review and approve guarantee applications that are submitted by the lenders; upon approval, a commitment letter is issued to the lender outlining the terms of the guarantee. • Some states operate preferred lending programs in which pre-approved lenders have sole underwriting responsibility, including enrollment of loans in the guarantee program, based upon pre-approved program guidelines.



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Operating Mechanics	Description
How are these loans monitored?	<ul style="list-style-type: none">States should establish a program to monitor both the repayment progress of borrowers and the servicing performance of participating lenders.
What kinds of guarantee fees may be charged?	<ul style="list-style-type: none">Origination and annual utilization fees are determined by each state to defray the cost of program operations and ensure sustainability. Fees may range from 0% to 3% of the loan amount.
What is the guarantee term?	<ul style="list-style-type: none">Varies from state to state and from loan to loan; but a maximum term of 7 years is typical.
What percentage of the loan can the guarantee cover?	<ul style="list-style-type: none">Coverage is determined by the states and lenders, but may not exceed 80% of loan losses; a lender must have at least 20% of its own capital at risk in each loan.
What happens in the case of a default?	<ul style="list-style-type: none">If a borrower defaults on a loan, a lender may submit a claim to the state or its agent in accordance with the terms of the guarantee agreement.The guarantee agreement should specify the responsibilities of the lender in pursuing available remedies to collect unpaid principal and interest prior to submitting a claim.
How does a reserve fund work?	<ul style="list-style-type: none">Money is set aside in a reserve fund to pay anticipated claims on defaulted loans.The reserve fund is maintained by a trustee outside of the lender; invested conservatively, as dictated by the state's investment guidelines.Interest earnings may be used to replenish the reserve and/or pay for some of the administrative costs.
What if a single lender depletes all of the reserves?	<ul style="list-style-type: none">States often set limits on the amount of loans any one lender can originate in the program and/or the amount of credit exposure each dollar in reserves can support (also known as a leverage ceiling).Limits help ensure that catastrophic losses of a single lender do not deplete the entire reserve fund; during program design, states may consider the best way to minimize concentration risk as this can significantly impact overall program leverage; in a typical program, the state sets aside 20% to 25% of each dollar of guarantee exposure to protect lenders against catastrophic losses.
What leverage requirements exist?	<ul style="list-style-type: none">Under SSBCI, all OCSP programs must individually demonstrate a minimum private financing ratio of 1:1.States must demonstrate a plan that creates a reasonable expectation that the approved programs, when considered in sum, will result in 10:1 leverage over the lifespan of the SSBCI Allocation Agreement or Allocation Time Period.
What is the state's liability?	<ul style="list-style-type: none">Most states are required to limit their liability for guaranteed loans to the funds in the reserve fund.



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Who are the Key Stakeholders and What are Their Roles?

The stakeholders in a Loan Guarantee Program include the state, participating financial institutions and an implementing agency/entity, if assigned by the state to manage the program. Implementing entities may include a specific department, agency, or political subdivision of the state, or an authorized agent of, or entity supervised by, the state. Additionally, the funds set aside to pay for defaults are kept in a reserve that is managed by a trustee.

Stakeholder	Role
What is the role of the state?	<ul style="list-style-type: none"> • Enters into agreements with implementing agency/entity. • Issues the loan guarantee to the lender. • Establishes contracts, budgets, reporting requirements, databases to support the program, and other administrative elements. • Conducts outreach to inform lenders and trade associations of the existing program; introduces the program by letter or in person, distributes press releases and/or speaks at industry or small business conferences.
What is the role of a lender?	<ul style="list-style-type: none"> • Originates, processes, and services loans. • Submits guarantee applications to the state for review/approval, and obtains assurances of eligibility from each borrower.
What is the potential role of an implementing agency/entity?	<ul style="list-style-type: none"> • Acts on behalf of the state to administer the Loan Guarantee Program. • Assists in marketing the program in their region or community.
What is the role of the trustee and the reserve fund?	<ul style="list-style-type: none"> • Invests conservatively as dictated by the state’s investment guidelines. • Pays claims in instances of loan defaults. • Supplements administrative costs through interest earnings.

What Kind of Operating Model is Needed to Manage a Loan Guarantee Program?

Loan Guarantee Programs may have higher operating costs than other credit support programs due to the underwriting and ongoing program monitoring requirements. The state’s or agent’s knowledge and experience should include credit analysis and underwriting, portfolio monitoring and reporting, loan guarantee purchase process management, and management of small business and state government programs. States may acquire these skills in-house or through agents such as Economic Development Corporations or other state program offices.

How Does a Loan Guarantee Program Help to Achieve a 10:1 Private Financing Ratio?

To be eligible for federal funding, a state should reasonably demonstrate that, when considered with all other SSBCI programs of the state, such programs together have the ability to generate private lending of at least 10 times the new federal contribution amount, also known as the private leverage ratio by December 31, 2016. Eligible private lending includes all loans or investments from a private source to an eligible borrower or eligible portfolio company, whether occurring at or subsequent to loan/investment closing, and whether funded or unfunded as well as any new infusions of cash by the borrower.



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SSBCI requires a minimum 1:1 leverage and considers the total loan originations and any borrower cash infusions to constitute “private financing.” In the context of Loan Guarantee Programs, Treasury considers the aggregate federal contributions to support guarantees to constitute the “SSBCI funds used.” The following is an example of a projected “allocation time period private leverage ratio” for a Loan Guarantee Program:

a. Total Loan Originations	\$60,000,000
b. Amount Guaranteed (Assumes 50% Guarantee)	\$30,000,000
c. SSBCI Funds Used To Support Guarantees (Assumes 5:1 Leverage Ceiling)	\$6,000,000
Private Leverage Ratio (a to c)	10:1

In addition, when calculating the private leverage ratio, states may assume that SSBCI funds are reused to generate new private lending when loan guarantees expire or as the underlying loans are repaid. States may also assume that program income is leveraged to generate new private lending.

Treasury recognizes that state guarantee programs are often subject to state-imposed regulations requiring the program to set aside a specific amount of funds to cover the guarantee obligation. In some cases, these regulations make it difficult for the state to achieve the 10:1 leverage ratio in the early years of the program. States that have guarantee programs in place may rely on historical data. States that plan to enact new programs may rely on data from other analogous state Loan Guarantee Programs to provide a reasonable estimate of future leverage.

Where Has a Loan Guarantee Program Worked Well?

Key features of California’s program were discussed in an SSBCI conference call on Loan Guarantee, and in a follow-up discussion between representatives from California and Treasury, and are summarized below. This information is not drawn from California’s SSBCI application.

Highlights from California’s Loan Guarantee Program

- **Overview:** Loan guarantees are issued on behalf of the state by 11 non-profit Small Business Financial Development Corporations (FDCs) located throughout the state. The regional non-profit FDCs are based in the community and encourage investment in low- and moderate-income areas.
- **Mechanics:** FDCs review and approve applications. A reserve fund of \$26 million exists to support loan guarantees and a portion is allocated to each FDC. The reserve fund has a leverage ceiling of 5:1 (implying a maximum 20% loss rate). When defaults occur, lenders who service the loans submit claims to the FDCs and the reserve fund pays the claims.
- **Guarantee Amount:** Normally, about 75% of the loan amount is guaranteed, not to exceed \$500,000. The amount guaranteed is subject to negotiation between the FDC and the lender.
- **Transaction Volume:** Using SSBCI funding, the program expects to issue approximately 800 to 1,000 loan guarantees per year and target an average guarantee amount of \$250,000 per transaction.
- **Term:** The maximum guarantee term is seven years, and the average term is about three years.



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Who Can You Contact With Questions on Loan Guarantee Programs?

Treasury has posted policy guidelines and application materials on its website, available here:

<http://www.treasury.gov/ssbci>. Questions may be asked via phone (202-622-0713) or via email at SSBCIquestions@treasury.gov.