



Commercial Insights



## *Risk Management Insights*

### **Treasury's State Small Business Credit Initiative: A Funding Resource Option for Small Business Lenders**

*Clifton Kellogg, Director of the State Small Business Credit Initiative*

Local banks are well-situated to meet the credit needs of small businesses. Small businesses are a critical component of job creation and a healthy local economy. That is why the United States Treasury Department administers the State Small Business Credit Initiative (SSBCI), which provides direct funding to states for programs that expand access to credit for small businesses.

As the program director of the SSBCI and as a former community bank CEO, I understand the challenges of providing credit to borrowers. Community banks face difficulty extending loans that both meet their standards and are acceptable to the examiners. Likewise, credit-worthy small businesses continue to face difficulties finding the credit they need to expand and grow. This mismatch between available credit and credit-worthy borrowers is where SSBCI can be most useful.

To help support and improve access to credit for small businesses, Congress passed and the President signed the Small Business Jobs Act, which created the SSBCI to build on existing programs or design new ones that support private sector loans and investments. Through Treasury's SSBCI, the Small Business Jobs Act allocated \$1.5 billion to states, territories, and the District of Columbia with the overarching goal of leveraging ten dollars in private lending for every one dollar in public funds invested in small businesses. Together, the SSBCI is expected to spur up to \$15 billion in additional private sector lending and investing. (SSBCI defines small businesses as those having fewer than 500 employees for the Capital Access Program and fewer than 750 employees for all other programs.)

To ensure that SSBCI-funded programs address local economic and market conditions, Congress gave ample latitude to the states to tailor their programs to work best in their communities. States submitted applications to Treasury for SSBCI funds that detailed how they planned to expand credit to small businesses in underserved communities. SSBCI program staff reviewed these applications and to date, has approved more than 140 state programs, including loan guarantee programs, loan participation programs, collateral support programs and Capital Access Programs.

The states have made every effort to make these programs easy to use. Most allow the lenders to retain full control of the underwriting and credit decision-making. Approved SSBCI Program Types include the following:

#### **Capital Access Programs (CAP):**

Allow lenders to insure against the risk of small business lending by creating a reserve account that the lender may draw upon should it incur losses. In a CAP, the lender and small business borrower contribute between 2-7% of the loan amount to a reserve account, which is matched by funding to the state through the SSBCI program.

**Collateral Support Programs:** States use SSBCI funding to deposit cash at a lender that serves as collateral for an approved loan when the small business borrower's tangible property, real estate, or equipment has depreciated as a result of economic conditions and does not provide sufficient collateral for a loan.

**Loan Participation Programs:** There are two types of Loan Participation Programs. The first type uses SSBCI funding to purchase a portion of a loan originated by a lender to a small business borrower. The second type uses SSBCI funding to provide a direct loan to the borrower that is a companion loan to one originated by a lender. States may structure their purchased participation or companion loan at a lower interest rate than the financial institution's loan.

**Loan Guarantee Programs:** States use SSBCI funds to guarantee a portion of an approved loan.

**Venture Capital Programs:** States use SSBCI funds to invest in a privately managed fund as a limited partner. States may also make direct venture investments in small businesses.

Congress established a funding formula for the allocation of SSBCI funds to states based on population and job loss; no state was allocated less than \$13 million. The window for states to draw their allocation of SSBCI funds ends in March 2017. A real benefit of this program is that the funds remain with the state in perpetuity; as funds are repaid, they can be used to support other state small business lending programs.

Community banks should look at the SSBCI program as another tool to help make small business loans. Bankers may find that some SSBCI programs complement Small Business Administration (SBA) programs. For instance, loans that need credit enhancement but do not justify the cost of securing the 75 percent SBA guarantee may be a good fit for SSBCI programs.

States are allowed to use SSBCI funds for unique opportunities, such as providing loans to non-profits. Another possible use of SSBCI funds is for bridge loans during the construction phase of a 504 transaction until take out by the SBA debenture. Some states are focused on short-term working capital financing, which helps meet the SSBCI's leverage requirements. In other instances where additional public money is involved, SSBCI approved programs may use funds to support short-term working capital financing transactions.

SSBCI has had discussions with bank regulators about the program so that examiners will be familiar with program requirements. The Office of the Comptroller of the Currency (OCC) created a dedicated page on its website with an overview of the program and an FAQ. It is important to note that some small business loans made under this program may qualify for CRA credit.

As a former commercial lender, I know that every small business borrower is unique. The SSBCI program offers an opportunity for financial institutions to serve small business borrowers in their state that they may not have otherwise been able to support. Increased lending to credit-worthy small businesses leads to jobs and more stable communities. We invite you to learn more about the SSBCI and the programs you may participate in through your state. For more information, please visit us at [www.treasury.gov/ssbci](http://www.treasury.gov/ssbci).

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### **Creating a Successful State Small Business Lending Program**

*Clifton Kellogg, Director of the State Small Business Credit Initiative*

The Treasury Department's State Small Business Credit Initiative (SSBCI) is a federal program that provides \$1.5 billion in funding to states, territories, and the District of Columbia for a variety of different programs that support private lending and investing. The article in the October, 2012 issue of **Commercial Insights** on Treasury's SSBCI encouraged readers to learn more about the options available in their states. Since each state designs its own programs, I thought it would be helpful to hear from a few state officials who run different SSBCI operations on the ground.

#### **North Carolina**

First, I spoke with Scott Daugherty, Commissioner for Small Business at the North Carolina Department of Commerce. Scott believes that his state's program would not be the success it is today "without the great assistance and support of the North Carolina Bankers Association (NCBA)." Scott notes that having a strong relationship with the NCBA "has helped to grow the use of the program."

North Carolina's SSBCI funding builds on previously successful state loan programs. Currently, North Carolina offers two financing programs accessible to bankers, a Capital Assistance Program (CAP) and a loan participation program. The CAP program is a long-running state program; the addition of loan participations was based on feedback from the lending community. Scott says he "fully expects to leverage [North Carolina's] \$46 million in SSBCI funding to much more than the ten to one required by law, making this a win-win program for all parties."

To administer its program, the state contracted with the North Carolina Rural Economic Development Center. The Center furthered its connectivity to the lending community by establishing a close working relationship with the state's Small Business and Technology Development Center, a program with which the state's bankers were familiar and had used in the past.

#### **Montana**

Next, I spoke with Evan Barrett, Chief Business Development Officer for the Montana Governor's Office of Economic Development. Montana was one of the first states to seek its SSBCI allocation, and the state has drawn all three installments of its allocation. The SSBCI program is a high priority for the state. Evan said "we wanted the money out in the community as quickly as possible to get as much benefit as possible. We determined that the loan participation program would be one most easily understood and would allow us to get the funds deployed as fast as possible."

Evan explains that Montana has a well-developed network of CDFIs that the banks know and work with regularly, noting, "We did a lot of work up front to familiarize the banks with the program and wanted to ensure they were comfortable with our approach." Montana quickly engaged more than 30 banks using the program, working closely with local CDFIs. According to Evan, the state has decided that, after seven years, Montana will grant the funds to the CDFIs involved so that they can continue to invest in local businesses. He also says that CDFIs can further leverage the SSBCI funding with their own internal funds.

Like other states, Evan emphasizes the importance of using people knowledgeable about lending and how banks operate. "We hired a former local SBA official who knew the banks and knew how to talk about lending programs with bankers," Evan said. He adds that doing the outreach to the banking community convinced everyone that the SSBCI was a good program and easy to use. "As a result we have deployed almost all of our allotment," Evan said, "and everyone benefits from the program."

#### **Michigan**

Finally, I spoke with Paul Brown, Vice President of Capital Markets for the Michigan Economic Development Corporation (MEDC). The MEDC administers a long-running small business loan program that was one of the models for the creation of the SSBCI. Paul is a strong promoter of the SSBCI. During our discussion, he offered his thoughts on the lessons Michigan learned over the years operating its program.

The most important consideration, Paul says, when developing a successful loan program is to “keep it simple.” He believes that bankers can be cautious about loan programs that are too complicated and bureaucratic, and “that made [Michigan] commit to having a program that could be implemented quickly.”

Paul notes that “the Michigan Bankers Association (MBA) was absolutely critical to the successful development and implementation of this program.” He adds that “the bankers’ involvement ensured that we developed a program they would use.” Michigan’s SSBCI-approved programs include a loan participation program, a collateral support program, and a CAP. Their program selections are designed to build on what has been successfully operating in the state.

Another principle of Michigan’s success is to “keep it broad,” meaning the state did not impose any more stringent limits on the size of businesses than the statute itself (up to 750 employees). He also notes that it is important that the program becomes a true partnership with the lending community. He says that the SSBCI program cannot improve a borrower’s creditworthiness, but it can improve a borrower’s chance of receiving a positive response from their banker due to the program’s flexibility. Paul emphasizes that “banks are in the job of lending and the SSBCI programs can turn a less bankable customer into a bankable customer.”

Over 100 Michigan banks use the program today. Working with the MBA, the MEDC has trained scores of bankers in how to use the program. At the conclusion of each training session, Paul asks the bankers “not to say ‘no’ to a borrower until they consider the SSBCI.” To date, the MEDC has participated in over 300 loans, leveraging the \$40 million the state received into \$300 million in bank loans, without a single default. “This is a program that works—for the banks, the borrowers, and for Michigan,” Paul concludes.

From just three brief conversations, it is clear the state banking associations and good communication by state officials play key roles in the success of SSBCI programs. The more those bankers are involved in their states’ development of the SSBCI programs, the more likely the programs are to reach their potential. In this challenging environment, easy to use and flexible loan programs that let lenders make sound loans in their communities are beneficial.

Our next article will highlight some bankers using the programs to see how they use the program and what insights they can offer. In the meantime, to check out what your state is doing, you can go to the SSBCI website at <http://www.treasury.gov/ssbci>.

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### **Bankers' Perspectives on Treasury's State Small Business Credit Initiative (SSBCI)**

*Clifton Kellogg, Director of the State Small Business Credit Initiative*

The ability of credit-worthy small businesses to obtain loans is essential to the ongoing economic recovery and to healthy communities generally. As a former community bank CEO, I understand the challenges that banks encounter in extending loans that both meet their standards and are acceptable to the examiners. This mismatch between available credit and credit-worthy borrowers is where the Treasury's State Small Business Credit Initiative (SSBCI) can be most useful. SSBCI provides direct funding to states for a variety of programs that expand access to credit for small businesses and leverage private investing. The article in the October 2012 issue of **Commercial Insights** provided an overview of SSBCI programs and was followed in the December 2012 issue with the perspectives of SSBCI state officials. To wrap up this series, I felt that speaking to bankers themselves would be a useful complement to the perspectives offered in earlier articles.

I first spoke with Blake Marchant, senior vice president and chief credit officer from Ireland Bank, a community bank in southeastern Idaho and a long-standing participant in SSBCI's collateral support program.

Q: How did you learn about the SSBCI program and what attracted you to it as a banker?

A: I first heard about it at a meeting hosted by the Idaho Banker's Association where it was spoken of very highly. I also had the chance to speak with a banker who had been able to use SSBCI funding to move some "almost bankable" loans to "fully bankable" with the collateral support program. Having recently dealt with a few similar loans which had fallen just short of our credit criteria, I began to investigate SSBCI as a possibility for our organization.

Q: Can you provide an example of a collateral support loan you've issued recently?

A: There was a retail establishment looking to expand its operations but didn't quite have the collateral necessary. With SSBCI collateral support program, they met collateral requirements, qualified for the loan, were able to maintain their existing workforce of about ten employees and were able to add an additional seven employees. For an Idaho town with only a few thousand people, that can mean a lot.

Q: What lessons have you learned as an experienced user of the SSBCI programs?

A: It's important for states to make their programs as user-friendly as possible. Here in Idaho, they did an excellent job in making them simple. We have a good relationship with the state and when we feel collateral for a loan is insufficient, we can deal directly with them to quickly find a collateral support solution. We've done approximately 14 percent of the total collateral support loans issued by Idaho's SSBCI program. I would recommend SSBCI to other bankers who want a convenient credit enhancement tool.

Next I spoke with Alex Jones, vice president and commercial lending officer at United Bank, a community bank that serves southern Alabama and uses Alabama's loan guarantee program funded with SSBCI funds.

Q: What initially drew you to Alabama's SSBCI programs?

A: Our ADECA(Alabama Department of Economic and Community Affairs) representative was enthusiastic about the program as an additional tool to use in making loans more bankable, so we decided to give it a try. We've done about 15 to 20 loan guarantees thus far with promising results.

Q: Can you describe a recent loan guarantee you participated in?

A: We were able to lend to an existing borrower who operates nursing homes and wanted an additional loan to construct a new facility. The borrower was on the edge for credit approval but with SSBCI loan participation, the proposed loan was saved. As a result, the borrower was able to add around 20 jobs.

Finally, I spoke with David Jackson, vice president and national director of SBA Lending for Fifth Third Bank, a regional bank based in Cincinnati that participates in SSBCI's collateral support program across several states.

Q: You are now the nation's biggest institutional participant in SSBCI. Can you talk about the origins of your partnership with SSBCI?

A: We had some experience with a similar state collateral support program instituted successfully in Michigan, so when we found out that other states would be offering credit enhancement programs through SSBCI, we knew we wanted to participate. We've now done over \$35 million in loans in Michigan alone.

Q: Under SSBCI, each state administers its own programs. Has working across state lines been an issue for you?

A: We haven't faced significant hurdles, despite Fifth Third using centralized underwriting for the loans. There are different reporting requirements which required some logistical work, but things are running quite smoothly. Our biggest task now is extending the success we had in Michigan in working with local state and trade associations in promoting the program in the other states where we are operating.

Q: Being such a successful participant, could you offer a word of advice to banks looking at the program?

A: If you decide to participate, keep the lines of communication open beyond your borrowers' relationship managers. Make sure you educate your credit staff as well as others who will be seeing the requests for the first time. You may find that the credit staff will identify opportunities to use the program as frequently as relationship managers. Also, I would suggest a bank pick the programs that it believes will provide the biggest benefits to its customers. Don't feel compelled to offer all the programs that your state offers if you feel they may not be as useful. I was looking at a whole host of programs initially, which is rather daunting. I ended up picking the collateral support program which was the most successful of the two in Michigan.

Bankers agree that SSBCI offers user-friendly credit enhancement tools that can facilitate lending to borrowers who would not have been able to obtain credit otherwise. Increased lending to credit-worthy small businesses will lead to jobs and more stable communities. We invite you to learn more about the SSBCI and the programs offered by your state. For more information, please visit us at [www.treasury.gov/ssbci](http://www.treasury.gov/ssbci).

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