



SSBCI PROGRAM PROFILE: COLLATERAL SUPPORT PROGRAM

May 17, 2011

State Small Business Credit Initiative (SSBCI)

U.S. Department of the Treasury



COLLATERAL SUPPORT PROGRAM

State Small Business Credit Initiative

What is a Collateral Support Program?

A Collateral Support Program is designed to enable financing that might otherwise be unavailable due to a collateral shortfall. The program supplies pledged cash collateral accounts to lending institutions to enhance collateral coverage of individual loans. The program may be designed to target certain geographies or industries, such as real estate lending, in which a lender may be willing to fund at 80% loan-to-value but a company may not be able to bridge the difference in cash at closing.

What are the Credit and Loan Characteristics?

Like all credit programs, a Collateral Support Program can be tailored to meet a state’s economic development strategy. The table below describes key credit and loan characteristics that should be considered when designing a Collateral Support 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, programs 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. • Borrowers that may be particularly attracted to the program include those in industries that require a high level of fixed assets (e.g., property, plant and equipment). • 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, programs must 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"> • Typically term loans and lines of credit. • Small Business Administration (SBA) guaranteed loans may not be enrolled in Collateral Support 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, and 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, and other loan terms are negotiated between the borrower and the lender. • The state and lender discuss, negotiate, and agree to the amount of cash collateral to be pledged by the state.
What are the program’s	<ul style="list-style-type: none"> • Attractive to lenders because cash collateral is on deposit at the



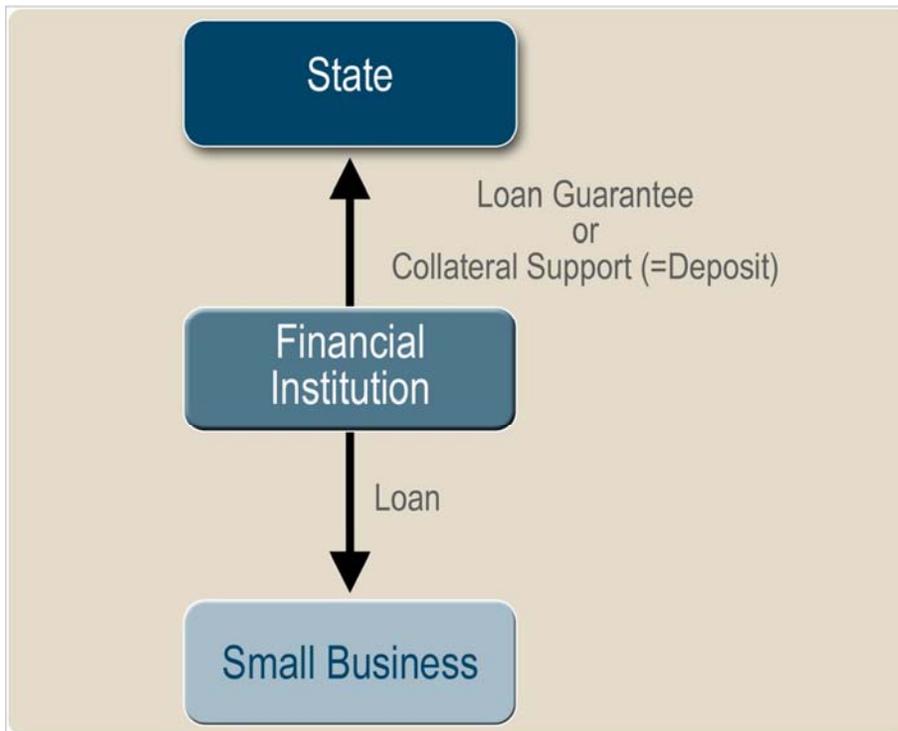
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Characteristics	Description
strengths?	<p>lending institution. This provides both tangible collateral and a source of deposits.</p> <ul style="list-style-type: none"> Collateral Support Programs are often targeted to industries with decreased access to capital due to a decline of collateral values (e.g., as a result of economic recession or storm damage).

How Does a Collateral Support Program Work?

A Collateral Support Program supplies cash collateral accounts to lenders to enhance the collateral coverage of borrowers. The accounts will cover all or a portion of the collateral shortfall identified by the lending institution.



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 ensure they possess sufficient commercial lending experience and financial and managerial capacity to participate.
Who originates loans in this program?	<ul style="list-style-type: none"> Financial institution lenders are responsible for loan origination and reporting, as required by the state.



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Operating Mechanics	Description
Who has underwriting responsibility?	<ul style="list-style-type: none"> • Lender has responsibility for loan underwriting. • State underwrites the collateral support. • State and lender typically negotiate the amount of collateral needed and the value of available collateral from the borrower.
How are these loans monitored?	<ul style="list-style-type: none"> • State should monitor collateral support programs to ensure that, as economic conditions improve, collateral is released and participation declines.
What kinds of fees may be charged?	<ul style="list-style-type: none"> • Fees are determined by each state to defray the cost of program operations and ensure sustainability. • Fee structure can be designed to encourage early release of collateral, for example by charging borrowers an annual fee for the state's collateral support.
What is the term of collateral support?	<ul style="list-style-type: none"> • Term lengths vary based on the terms of the underlying loans. • In practice, collateral support tends to be short-term to improve program leverage.
What percentage of the loan can be covered?	<ul style="list-style-type: none"> • Coverage is determined by the states and lenders, not to exceed 80% of the loan value; a lender must have at least 20% of its own capital at risk in each loan. • In practice, collateral support is rarely provided for more than 50% of the loan value.
What happens in the case of a default?	<ul style="list-style-type: none"> • In the event of default, a lender has the right to pursue all collateral but only has recourse to the state's collateral after liquidating the borrower's collateral.
What form of collateral is provided and where is it held?	<ul style="list-style-type: none"> • Collateral is typically provided in the form of highly liquid assets such as cash or Treasury securities that are held in a custodial account at each lender.
What leverage requirements exist?	<ul style="list-style-type: none"> • Under SSBCI, each OCSP approved by Treasury 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"> • A state's liability is limited to the assets pledged as collateral support.

Who are the Key Stakeholders and What are Their Roles?

The stakeholders in a Collateral Support 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.



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Stakeholder	Role
What is the role of the state?	<ul style="list-style-type: none"> • Markets the program and enrolls participating lenders. • Verifies the eligibility of individual loans submitted by the lenders, which includes confirming borrower eligibility requirements and certifying that proceeds will be used for acceptable business purposes. • Underwrites the collateral support, and may review the loan to confirm that borrower cash flows will be adequate to service debt. • Approves claims submitted by the lenders to release collateral upon default.
What is the role of a lender?	<ul style="list-style-type: none"> • Originates, underwrites, and services loans. • Submits required enrollment and claims forms to the state and obtains assurances of eligibility from each borrower. • Pursues recoveries of the borrower’s collateral before submitting a claim to the state.
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 program. • Assists with marketing the program in their region or community.

What Kind of Operating Model is Needed to Manage a Collateral Support Program?

Collateral Support Programs can have higher operating costs than other credit support programs due to their underwriting requirements and low leverage. The state’s or agent’s knowledge and experience needed to support a program include marketing, credit analysis and underwriting, collateral valuation, loan structuring and negotiating, and portfolio monitoring. States may acquire these skills in-house or through agents such as Economic Development Corporations or other states.

How Does a Collateral Support 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, as well as any new infusions of cash by the borrower.

Treasury considers the total loan originations and any borrower cash infusions to constitute “private financing.” In the context of a Collateral Support Program, Treasury considers the aggregate federal contributions to fund the state’s collateral support obligations as the “SSBCI funds used.” The following is an example of a private leverage calculation for a collateral support program:

a. Total Loan Originations	\$50,000,000
b. SSBCI Funds Used (Collateral pledged by the state)	\$25,000,000
Private Leverage Ratio (a to b)	2:1

States that have Collateral Support Programs in place may rely on historical data. States that plan to enact new programs may rely on data from similar state programs to provide a reasonable estimate of



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future leverage. Treasury recognizes that many Collateral Support Programs may not, by themselves, achieve the desired 10:1 private leverage ratio. When this occurs, states should demonstrate: how the state program will recycle the SSBCI funds into new transactions with other newly available funds (i.e., when collateral support obligations expire or are repaid), as well as with program income; or how the existing borrowers will obtain subsequent financing that is the cause and result of prior SSBCI-supported transactions.

Where Has a Collateral Support Program Worked Well?

Michigan was one of the first states to establish a Collateral Support Program. Key features of the Michigan program were discussed in an SSBCI conference call on Collateral Support and are summarized below. This information is not drawn from Michigan's SSBCI application.

Highlights of Michigan's Collateral Support Program

- **Overview:** This program assists companies in Southeast Michigan that have suffered significant devaluations (up to 80%) of the collateral they had used to obtain credit. Generally, these businesses are healthy in other categories and had strong revenues and profit margins. Existing credit support programs were not adequate to address this financing gap.
- **Eligible Industries:** Mining, manufacturing, research and development, wholesale and trade, film and digital media productions, office operations, and high technology. The entire proceeds of the credit facility must be used for projects within the state.
- **Mechanics:** The program is administered by the Michigan Economic Development Corporation and provides injections of cash collateral to support loans to otherwise credit-worthy businesses that have suffered a collateral shortfall. The lender assesses the collateral value of a potential borrower, and if the loan-to-value ratio is less than the lender requires, Michigan will inject cash in the form of a deposit at the lender. The lender has a first position lien on the cash account.
- **Loan Coverage:** The program can provide collateral support up to 49.9% of a loan, and to a maximum collateral deposit of \$500,000. The deposit balance is reduced proportionately with the principal reduction of the loan to eliminate over-reliance on program deposits as part of the collateral commitment of the loan.
- **Operations:** Michigan leverages the lenders' expertise and administrative ability in operating the program. Michigan only requires a one-page application and has minimal ongoing administrative responsibilities.
- **Fees:** The program can charge up to 4% at closing and 4% per year as a fee on our dollars pledged for the borrower. In practice, Michigan typically charges 1.5% upfront and 1% per year.
- **Portfolio:** Since inception in 2010, Michigan has committed \$26.3 million to 27 deals, of which 17 had already closed by April 2011. These funds have leveraged \$200 million in lending, achieving a leverage ratio of 7:1.

Who Can You Contact With Questions on Collateral Support 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.