OLR RESEARCH REPORT

February 19, 2013 2013-R-0054

ANALYSIS OF STATE SMALL BUSINESS LOAN GUARANTEE PROGRAMS

By: Michelle Kirby, Associate Analyst

You asked for an analysis of state small business loan guarantee programs.

SUMMARY

A loan guarantee program expands the availability of capital to businesses by shifting some of the risk from lenders to the party that issues the guarantee, thus providing an incentive to lenders to offer loans that they would not otherwise make. In a loan guarantee program the party that guarantees the loan compensates the lender for uncollected loan payments when the borrower defaults on them. Loan guarantee programs can be used to achieve a variety of economic development purposes, such as export assistance, brownfields remediation and redevelopment, new business development, business expansion, rural business development, and agricultural initiatives. A loan guarantee program is only one form of credit support that is available to small businesses. Other credit support programs include collateral support and loan participation programs.

State small business loan guarantee programs have specific stakeholders who each play a specific role. They include the state and its implementing agency or entity, participating financial institutions, and borrowers. The operating mechanics of a state loan guarantee program

include selecting participating lenders, originating loans, and underwriting them. Loans guaranteed under state loan guarantee programs are typically based on borrower eligibility criteria, allowable loan uses, guarantee terms, and guarantee fees.

This report focuses on state small business loan guarantee programs, but partial guarantees are also available from the U.S. Small Business Administration (SBA) through its 7(a) program, which is designed for start-up and existing small businesses. The program guarantees loans with up to 10 year terms for working capital and generally up to 25 years for fixed assets. The following link provides additional information on the SBA 7(a) Loan Program: SBA 7(a) Loan Program.

The US Treasury also provides funds for state loan guarantee programs and other forms of credit support through the State Small Business Credit Initiative (SSBCI). Connecticut received $13.3 million in SSBCI funding to support its Capital Access Program (CAP), which provides loan portfolio insurance to encourage private financial institutions to lend to creditworthy small businesses. The following link provides a full listing of states participating in SSBCI and includes the amount from the fund that has been allocated to each state: State Programs Funded by SSBCI.

LOAN GUARANTEES AS A FORM OF ECONOMIC DEVELOPMENT ASSISTANCE

A loan guarantee program is a means by which the availability of private capital to businesses is expanded. A loan guarantee shifts some of the risk from the lender to the party that issues the guarantee, thus providing an incentive to lenders to offer loans that they would not otherwise make. In a loan guarantee program the party that guarantees the loan compensates the lender for uncollected loan payments when the borrower defaults on them. Loan guarantee programs can be used to achieve a variety of economic development purposes, such as export assistance, brownfields remediation and redevelopment, new business development, business expansion, rural business development, and agricultural initiatives.

State loan guarantee programs enable small businesses to obtain the private credit they need to grow and expand their businesses by providing lenders with the necessary security, in the form of a partial guarantee for a loan, line-of-credit, or other form of credit. In most loan guarantee programs, the state sets aside funds in a dedicated reserve or account to guarantee a specified percentage of each approved loan.

A loan guarantee program can be distinguished from other economic development programs in which the state lends or grants money directly to a business. Instead, private intermediaries, such as banks, do the lending and the state provides the security in the form of a partial guarantee in case the borrower defaults on payment. Loan guarantees are only one form of credit support that states provide to small businesses. Other credit support programs include collateral support and loan participation programs.

STATE SMALL BUSINESS LOAN GUARANTEE PROGRAMS

Most state small business loan guarantee programs have specific stakeholders who each play a unique role. The other factors distinguishing these programs are their operating mechanics and loan characteristics.

The Stakeholders and Their Roles

The stakeholders are the state and an implementing agency or entity, participating financial institutions, and eligible borrowers.

The State and Its Implementing Agency or Entity. The state informs lenders and small businesses about the programs. The state also establishes the administrative rudiments to support the program, including reporting requirements. The state, through its implementing agency or entity, issues loan guarantees to lenders. The entity can be a state quasi-public agency such as a development authority, or a state-designated non-profit corporation.

Financial Institutions. The financial institutions are the lenders who originate, process, and service the loans. Lenders determine the eligibility of borrowers and submit applications to the state for review and approval. Eligible lenders include banks, credit unions, and community development financial institutions.

Borrowers. Borrowers are the small businesses receiving loans guaranteed by the state. As explained below, borrowers must meet the state's eligibility criteria, which vary from state to state.

Operating Mechanics

In state loan guarantee programs, the state determines the kinds of lenders who are eligible to participate in the program and the parties responsible for originating and underwriting loans.

Lender Eligibility. States generally approve lenders who have sufficient commercial lending experience and financial and managerial capacity.

Loan Origination. Lenders or states can originate loans. In most states lenders originate the loan and apply to the state for guarantee approval. Some states pre-approve borrowers for a guarantee.

Underwriting. Typically, lenders underwrite the loans and apply to the implementing agency or entity for a guarantee. Once approved, the agency or entity issues a commitment letter to the lender outlining the terms of the guarantee. Some states have lending programs in which pre-approved lenders underwrite the loans and approve them for guarantees, based on program guidelines.

Loan Characteristics

The characteristics of a loan guarantee program reflect the state's economic development objectives. As Table 1 shows, the characteristics include eligibility criteria, allowable uses of loan proceeds, guarantee terms and conditions, and guarantee fees.

Borrower Eligibility. Each state determines eligibility based on criteria that reflect the program's objectives. Most programs are open to corporations, partnerships, and sole proprietorships. Some programs target specific industries, regions, and or types of businesses. In some states, non-profits and cooperatives are also eligible for loan guarantees. Some programs target guarantees to businesses meeting employee or annual revenue limits. Others give priority to business owners with a net worth below a specified dollar amount. Some states, like Minnesota, also require that the small business be in operation for a set minimum time period. All states require borrowers to demonstrate they can repay the loan.

Allowable Loan Use. Most programs guarantee loans for a wide range of business purposes, including:

1. start-up costs;
2. working capital;
3. business procurement;
4. equipment;
5. machinery;
6. inventory;
7. receivables;
8. livestock;
9. land;
10. foreign trade transactions;
11. leasehold improvements;
12. purchase, construct, expand or upgrade facilities;
13. refinancing existing debt; and
14. brownfield remediation and redevelopment.

Guarantee Terms. As Table 1 shows, small business loan guarantee programs' terms and conditions vary from state to state. The most prevalent terms and conditions include

1. a maximum guarantee dollar amount,
2. guarantee percentage of actual loss,
3. order of loss paid,
4. interest rate,

5. maturity,
6. collateral and appraisal,
7. job creation, and
8. periodic reporting.

Interest rates, maturity, collateral, and other loan terms are fixed by the agency or negotiated between the borrower and the lender. In many cases, the state and lender discuss and negotiate loan terms and guarantee options prior to reaching agreement to approve the loan and issue a guarantee. In some cases loan terms are subject to the state's approval.

Guarantee Fees. Guarantee fees are generally charged to borrowers and are sometimes included in the loan amount. Some states refer to the fee as a commitment or an enrollment fee. In some states, like Connecticut, a guarantee fee is also charged to the lender. In most states the guarantee fee is a one-time fee, however, some states, such as Missouri, impose an annual guarantee fee. The fee is generally expressed as a percentage of the amount of the guarantee. Some programs, such as Alaska, have a specified percentage; others allow a fee to be within an established range. Guarantee fees generally range from 1% to 3.5%. Some states, such as Minnesota, also set a specified dollar minimum. In addition to the guarantee fee, some states, like California, also charge a small documentation fee. Some states also charge renewal fees for guarantees of lines of credit (LOC).

Table 1: Characteristics of Selected States Loan Guarantee Programs

State/Agency or Entity	*Program Title*	*Borrower Eligibility*	*Allowable Loan uses*	*Guarantee Terms*	*Guarantee fees*
Alaska Industrial Development and Export Authority	Alaska Business and Export Assistance Program	• Small to medium-sized businesses • Inability to obtain commercial financing	• Working capital • Real property • Tangible personal property • Export transactions	• 80% guarantee for up to $1 million loans • Guarantee covers principal balance, accrued interest, and liquidation expenses • Guarantee unsecured loans up to $100,000 for qualifying small businesses and entrepreneurs in rural Alaska for loan terms up to 5 years	• $200 non-refundable application fee • 2% one-time guarantee fee
Connecticut Innovations (CI)	Guaranteed Loans	• Economic base businesses (i.e., businesses bring wealth to the state by selling most of their products or services to customers outside the state) • Inability to satisfy the lender's standard loan underwriting criteria • Residential, non-owner occupied real estate, retail, or personal services, and not-for-profits are ineligible for guarantees.	• Working capital • Machinery and equipment • Facility acquisition, construction, expansion, or upgrade • Mortgages on owner-occupied real property • Performance guarantee • Finance foreign trade or receivables • Brownfields remediation and redevelopment	• Business owner's personal guarantee • Assistance up to $20,000 per job created or retained • Ability to repay loan • Interest rate, terms, and maturity are determined by lender • Lender services the loan • Loans with maximum 20-year terms	• 1.5% commitment fee, up to $25,000 • 2.0% annual guarantee fee (based on amount guaranteed)
CI	URBANK	• Any Connecticut business • Lender unable to approve loan without URBANK assistance • URBANK-protected loans are not available for: non-owner occupied real estate; residential buildings	• Working capital • Machinery • Equipment • Purchase, construct, expand or upgrade facilities	• Loans up to $500,000 • Loan maturity, interest rate, and other terms determined by the bank – maximum term of 15 years • Debt service capability is evident	• Borrower and the lender each pay a one-time fee of 1.5% to 2.5% • Fees may be included in loan amount

Table 1 (continued)

State/Agency or Entity	Program Title	Borrower Eligibility	Allowable Loan uses	Guarantee Terms	Guarantee fees
CA, Business Transportation and Housing Agency	California Loan Guarantee Program	• Small business and farms • Borrower needs of additional collateral to finance loan	• Revolving Line of Credit (LOC) • Term loans for asset purchases • Purchases of existing businesses • Establishing a new business • Refinancing existing business debt	• Guarantee up to 80% with a $2.5 million maximum • Seven years maximum on term loans • One year on revolving LOC • Quarterly reporting	• 2% guarantee fee for loans or revolving LOC • 1% guarantee renewal fee on revolving LOC • Documentation Fee: $250
Indiana Economic Development Corporation	Agricultural Loan and Rural Development Project Guaranty Program	• Value-added agricultural projects • Rural business development projects	• Real and personal property constituting farms • Acquiring, enlarging, or improving farms • Purchasing livestock, poultry, and farm equipment • Purchasing feed, seed, fertilizer, insecticides, and farm supplies and other essential farm operating expenses • Acquiring land or interests in land • Site and infrastructure improvements • Buildings and structures rehabilitation, renovation, and enlargement • Machinery, equipment, and furnishings purchases • Facilities	• Loan guarantees of up to $300,000 • Guarantees for loans secured by either real estate or a real estate lease may not exceed 90% of the unpaid principal balance or 90% of the amount of any lease payment, as applicable and the original principal amount of the loan or the total amount of the lease payments, as applicable, may not exceed 90% of the appraised fair market value of the real estate • Guarantees for loans secured by personal property or, for a personal property lease, may not exceed 75% of the unpaid principal balance of the loan or 75% of the amount of any lease payment, as applicable and the original principal amount of the loan or the total amount of the lease payments, as applicable, may not exceed 75% of the appraised fair market value of the personal property. • Loans must mature within 20 years of the date of the guarantee • Project results in the creation of new jobs in Indiana	No fees

Table 1 (continued)

State/Agency or Entity	*Program Title*	*Borrower Eligibility*	*Allowable Loan uses*	*Guarantee Terms*	*Guarantee fees*
Missouri Department of Agriculture	Missouri Livestock Feed and Crop Input Loan Guarantee Program	• Farmer • State residents • 18 years or older	• Finance the purchase of livestock feed used to produce livestock and inputs used to produce crops for feeding of livestock	• Loan maximum of $40,000 • Guarantee covers 50% of amount or maximum of $20,000 • Interest rate negotiated between the lender and the borrower, but cannot exceed the rate normally charged by the lender for similar loans • No penalties for accelerated payment of the loan • Borrower must provide a down payment or provide equity of at least 10% toward the project's cost	• $50 participation fee due at loan closing • Loan guarantee fee of 1% of the outstanding principal due at closing and annually on the anniversary of the loan
MN, Community Planning and Economic Development	Working Capital Guaranty Program	• Business operating for at least 12 months (newer businesses eligible on a case by case basis) • Borrower must demonstrate the ability to repay the loan and be an acceptable credit risk • Borrower must in compliance with all city code/licensing; and no building or health-code violations	• General business operations • Working capital • Production Contracts • Inventory • Receivables	• Up to five years on term loans and up to two years on revolving lines of credit • Bank loan interest rate may not exceed prime plus 3% • Borrower must make efforts to hire Minneapolis residents by working with the City's Workforce Coordinator	• 1 % with a minimum of $150
Oregon Business Development Department	Oregon Credit Enhancement Fund	• Existing or new business (program sunsets June 30, 2015)	• Working capital • Fixed-asset • Export financing • Clean up a brownfield site	• 80% guarantee up to $2.5 million maximum • Maximum term that does not exceed the useful life of assets securing the loan or a maximum term of 15 years • Up to 75% of operating lines of credit with a maximum insurance exposure of $1,500,000 • Maximum initial term of one year for operating lines of credit	• Enrollment fee between 1.25% and 3.5%

MK:mp