

Alabama SSBCI Program

On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 to help increase credit availability for small businesses. The Act created the State Small Business Credit Initiative (SSBCI) and appropriated \$1.5 billion to be used by the U.S. Treasury to provide direct support to states for use in programs designed to increase access to credit for small businesses. The State of Alabama was qualified for and has been approved by the Treasury for \$31,301,498. The two underlying requirements are to leverage ten dollars for each SSBCI dollar and ensure at least 20 percent risk for private lenders.

The Community and Economic Development (CED) Division of the Alabama Department of Economic and Community Affairs (ADECA) will be responsible for implementing the SSBCI program in Alabama. The State Banking Department will advise and assist the ADECA staff in the program implementation.

Eligible Programs

The SSBCI provides funding for two state program categories: capital access programs (CAPs) and other credit support programs (OCSPs). In Alabama, the OCSPs are comprised of loan guarantee and loan participation programs.

CAPs provide portfolio insurance for business loans based on a separate loan loss reserve fund for each participating financial institution. The reserve fund will be used to provide portfolio insurance for all loans enrolled in the CAP by participating financial institutions. The loan guarantee 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. Under the loan participation program, the State will purchase a portion of the loan originated by a lender at terms advantageous to the borrower. This will also reduce exposure for the lender and make it profitable for the borrower. Collectively, these programs are expected to stimulate lending for small businesses and create and/or retain jobs in the process. Specific details are discussed below.

Corporations, partnerships, and sole proprietorships, as well as non-profits and cooperatives are eligible to participate in the SSBCI programs. The SSBCI funds can be used for a broad variety of loan types including term loans and lines of credit. The principal value of the loan value cannot exceed \$5 million, but in practice, the average loan size is expected be \$100,000 to \$250,000. The maximum borrower size is limited to 500 employees, but in practice, a typical small business borrower is expected to be much smaller.

The principal thesis behind Alabama's program is to limit the State role in underwriting and administration to a bare minimum, and instead, let the program be driven by the private lenders and borrowers. This is due primarily to the State's desire to keep the program simple, non-bureaucratic, and expeditious. However, to ensure State funds are used to generate only those loans that have reasonable chance of being repaid, the State will require lenders to exercise due diligence and follow their routine underwriting standards and guidelines. The State intends to routinely approve loans generated under the State program; nonetheless, the lenders will be required to provide the State with copies of documents showing the lender's underwriting and decision process.

The Governor has created a five-member advisory committee to provide oversight and address unique circumstances that may arise from time to time. The committee is comprised of the State Banking Superintendent (Chairman), ADECA Director, State Treasurer, ADO Director, and a member of the banking association. In addition to serving in an advisory capacity, the committee will review and approve all loans in principal amount of \$1 million or more.

Capital Access Program (CAP) – The capital access program is based on an insuring concept; however, unlike programs such as the SBA 7(a) which guarantee some percentage of a loan on a loan-by loan basis, the CAP is based on a portfolio concept. The lender participating in Alabama's CAP will set up a reserve fund to cover future losses from a portfolio of loans that the lender enrolls under the program. The special reserve will be owned and controlled by the State in the name of the lender. Each lender participating in the program will have its own earmarked reserve held at the participating bank. A lender can withdraw funds from its earmarked reserve only to cover losses on loans made under the program. In the case of discontinuance, inactivity, withdrawal or termination of the CAP program, the disposition of the CAP reserve fund will be in accordance with the Program Participation Agreement.

For each new loan enrolled in the program, the lender makes a payment of at least 2 percent and no more than 5 percent in lender/borrower contribution into the reserve fund. This amount is matched and deposited by the State into the reserve account. The lender/borrower contribution can come from the loan proceeds, or recovered by the lender from borrower through higher interest rates, up-front fees, or other methods. For loan activities taking place in “underserved areas” defined later in this document, the lender/borrower contribution and the State match can be up to 7 percent each, for a total of 14 percent.

Loan Guaranty – The State loan guaranty program is designed to enable lenders to make term loans or provide lines of credit to new or existing small businesses in this difficult credit environment. The State guarantee will be for 50 percent of the principal value of the loan, and the State will share equally with the lender in losses resulting from loan defaults. The lender will pay a loan guarantee fee of 1 percent on the guaranteed portion of the loan. For example, a loan in the principal sum of \$200,000 will carry a loan guarantee of \$100,000 and lender will pay a loan guarantee fee of \$1,000 at the time the loan is enrolled.

Loan Participation – The State loan participation program will enable small businesses to obtain medium- to long-term financing to grow and expand. In keeping with the State’s desire to defer loan underwriting to the lending institutions, the State loan participation program will take the form of a purchase transaction or purchase participation. The State will operate this program under four distinct scenarios – interest subsidy, semi-subordinate, deferred payment, and equity capital.

Interest Subsidy – Under this program, the State will purchase 25 percent of a loan from a participating lender. The loan interest rate for the State portion will be at 4 percent and the loan period will be the same as that for the lender’s loan but not to exceed ten years. The terms of the lender portion of the loan will be determined between the lender and borrower. The lender will perform underwriting and may service the loan for the State portion of the loan. In case of a default and charge-off, the State will participate fully in any recovery by the Bank with the State recovering \$1 for every \$3 recovered by the lender. For minority and women owned businesses and for loans in underserved communities, the interest rate on the State portion of the loan can be reduced to 3 percent.

Semi-Subordinate – Under this program, the State will purchase 25 percent of the loan from a participating lender at the lender’s rate. The terms of the loan will be determined between the lender and borrower. The lender will perform underwriting and may service the State portion of the loan. In case of a default and charge-off, the State will participate at one half the rate or \$0.50 for every \$3 recovered by the lender.

Deferred Payment – The State will purchase 25 percent of the loan from a participating lender at the lender’s rate. The terms of the loan will be determined between the lender and borrower. The borrower will make no payment on the State portion of the loan for three years, and the accrued interest will be added to the State principal. In case of a default and charge-off, the State will participate fully in any recovery by the Bank with the State recovering \$1 for every \$3 recovered by the lender.

Equity Capital – The State will provide up to 10 percent of the loan for the borrower’s equity. The interest rate will be at the lender’s rate for up to 5 years. In case of a default, the State will take a subordinate position to lender. For minority and women owned businesses, or businesses located in underserved areas, the State rate will be discounted by 2 percent.

Lender Experience and Capacity

The financial institutions participating in the Alabama’s SSBCI program shall possess sufficient commercial lending experience, financial and managerial capacity, and operational skills to meet the objectives as set forth in the Act. To determine adequacy of financial and managerial capacity for all classes of private lenders, the State will conduct following reviews:

For each lender participating in the State SSBCI, the banks including CDFI banks shall certify to the State that the financial institution is not operating under any supervisory enforcement action. In addition, the State will review the Uniform Banking Performance Report to determine that commercial loans and leases comprise a significant part of the financial institution’s assets and the institution’s percentage of non-current loans and leases does not exceed its peer group average. Likewise, for credit unions including CDFI credit unions, the State will require a self-certification and will review Financial Performance Reports from the NCUA for commercial loans and lease activities and non-current loans and leases. For Community Development Financial Institutions (excluding banks and credit unions), the State will perform similar reviews.

Loan Purpose Requirements and Prohibitions

Based on the requirements of the Act to prevent the use of loan proceeds for impermissible purposes, each financial institution lender must obtain an assurance from the borrower affirming:

1. The loan proceeds must be used for a “business purpose.” A business purpose includes, but is 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. The definition of business purpose excludes activities that relate to acquiring or holding passive investments such as commercial real estate ownership, the purchase of securities; and lobbying activities.
2. The loan proceeds will not be used to:
 - a. repay delinquent federal or state income taxes unless the borrower has a payment plan in place with the relevant taxing authority; or
 - b. repay taxes held in trust or escrow, e.g. payroll or sales taxes; or
 - c. reimburse funds owed to any owner, including any equity injection or injection of capital for the business’ continuance; or
 - d. purchase any portion of the ownership interest of any owner of the business.
3. The borrower is not:
 - a. an executive officer, director, or principal shareholder of the financial institution lender; or
 - b. a member of the immediate family of an executive officer, director, or principal shareholder of the financial institution lenders; or
 - c. a related interest of an such executive officer, director, principal shareholder, or member of the immediate family.

For the purposes of these three borrower restrictions, the terms “executive officer”, “director”, “principal shareholder”, “immediate family”, and “related interest” refer to the same relationship to a financial institution lender as the relationship described in part 215 of title 12 of the Code of Federal Regulations, or any successor to such part.

4. The borrower is not:

- a. a business engaged in speculative activities that develop profits from fluctuations in price rather than through normal course of trade, such as wildcatting for oil and dealing in commodities futures, unless those activities are incidental to the regular activities of the business and part of a legitimate risk management strategy to guard against price fluctuations related to the regular activities of the business; or
- b. a business that earns more than half of its annual net revenue from lending activities; unless the business is a non-bank or non-bank holding company certified as a Community Development Financial Institution; or
- c. a business engaged in pyramid sales, where a participant's primary incentive is based on the sales made by an ever-increasing number of participants; or
- d. a business engaged in activities that are prohibited by federal law or applicable law in the jurisdiction where the business is located or conducted. (Included in these activities is the production, servicing, or distribution of otherwise legal products that are to be used in connection with an illegal activity, such as selling drug paraphernalia or operating a motel that knowingly permits illegal prostitution); or
- e. a business engaged in gambling enterprises, unless the business earns less than 33% of its annual net revenue from lottery sales.

5. No principal of the borrowing entity has been convicted of a sex offense against a minor (as such terms are defined in section 111 of the Sex Offender Registration and Notification Act (42 U.S.C. 16911)). For the purposes of this certification, "principal" is defined as "if a sole proprietorship, the proprietor; if a partnership, each managing partner and each partner who is a natural person and holds a 20% or more ownership interest in the partnership; and if a corporation, limited liability company, association or a development company, each director, each of the five most highly compensated executives or officers of the entity, and each natural person who is a direct or indirect holder of 20% or more of the ownership stock or stock equivalent of the entity."

Each participating financial institution lender shall affirm as follows:

1. The loan has not been made in order to place under the protection of the approved State SSBCI any prior debt that is not covered under the approved State SSBCI and that is or was owed by the borrower to the financial institution lender or to an affiliate of the financial institution lender.
2. The loan is not a refinancing of a loan previously made to that borrower by the

financial institution lender or an affiliate of the financial institution lender.

3. No principal of the financial institution lender has been convicted of a sex offense against a minor (as such terms are defined in section 111 of the Sex Offender Registration and Notification Act (42 U.S.C. 16911)). For the purposes of this certification, “principal” is defined as “if a sole proprietorship, the proprietor; if a partnership, each partner; if a corporation, limited liability company, association or a development company, each director, each of the five most highly compensated executives, officers, or employees of the entity, and each direct or indirect holder of 20% or more of the ownership stock or stock equivalent of the entity.”

Relationship to Small Business Administration (SBA) Lending Programs

Without the express prior consent of the Treasury, the unguaranteed portions of SBA-guaranteed loans will not qualify to participate in the State SSBCI program.

Capital Access in Underserved Communities

The Act requires that each participating state use SSBCI funds to help provide access to capital for small businesses in low- and moderate-income, minority, and other underserved communities, including women- and minority-owned small businesses. Alabama’s definition for underserved communities will include all women- and minority-owned small businesses as well as businesses located in communities with households that are majority low and moderate income and/or minority. To assist with the rebuilding, Alabama has also included all communities declared presidentially declared disaster areas as a result of April 2011 tornadoes. To assist with this goal, the State has created additional benefits for businesses which qualify under these categories.

Reporting

The State is subject to quarterly and annual reporting requirements to the U.S. Treasury. In order to capture the information necessary to report to the Treasury, the State will have the participating lender collect and report select information about each loan to the State. Reporting requirements are minimal and mainly cover the borrower’s payment history and loan performance.

