

Client Alert

Economic Crisis Response Group

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Treasury's Plan to Aid Small Business Met with Low Lender Participation

The Obama administration's Unlocking Credit for Small Businesses Plan may be in danger of failure due to lack of participation from lenders. The plan, announced on March 16, is funded with \$15 billion of Troubled Asset Relief Program (TARP) funds. Participating lenders would be subject to the Treasury's executive compensation limits, as well as the provisions of the Emergency Economic Stabilization Act of 2008 (EESA) mandating the issuance of warrants to the government. Lenders who traditionally participated in the Small Business Administration's (SBA) loan programs have cited these restrictions as the basis for their non-participation.

Financial institutions receiving assistance from the TARP program are required under the EESA to issue warrants to the Secretary of the Treasury to provide further security to the taxpayer. The warrants are convertible to common stock, preferred stock or senior debt at an exercise price set by the Treasury.

The Treasury did not release details about the warrant requirement in its March 16 announcement, stating that the pricing and exact nature of the warrants would be revealed at a later time. In addition, the Treasury must still determine how the warrant requirements will apply to the subsidiaries of parent companies that have already received TARP funds. The Treasury Department has delayed the launch of the program to resolve these issues, but is expected to release details shortly. Lenders were initially scheduled to issue loans under the program as of the end of March.

Details of the Program

Under the Unlocking Credit for Small Business plan, the Treasury Department, in conjunction with the SBA, will take three principal actions:

- Purchase up to \$15 billion of securities backed by SBA loans on the secondary market;
- Temporarily increase the maximum loan guarantee to 90% for certain types of SBA loans; and
- Temporarily suspend certain fees imposed on the issuance of SBA loans.

In addition, the Treasury Department will impose new requirements on banks to provide periodic reports detailing the amount of small business lending activity.

Direct Purchases of Securities Backed by Loans from SBA's 7(a) and 504 Programs:

Under the plan, the Treasury would directly purchase securities backed by the guaranteed portion of loans issued under the SBA's 7(a) Loan Program ("7(a) securities") and first-lien mortgage securities issued under 504 Community Redevelopment Program ("504 securities"). The Treasury Department would begin purchasing 7(a) securities packaged between July 1, 2008 and December 31, 2009.

The Treasury would also purchase 504 securities packaged on or after July 1, 2008 that meet (unspecified) eligibility criteria designed to protect taxpayers. In addition, the SBA is currently working to develop a secondary market guarantee program for 504 securities, and the Treasury will begin purchasing the guaranteed securities once the program is fully implemented.

The SBA currently does not provide a guarantee to lenders for loans issued under the SBA's 504 Community Development Loan Program. Private lenders provide up to 50% of the financing for projects under this program in the form of first-lien mortgage loans. (The next 40% is financed by local certified development companies and is guaranteed by an SBA debenture. The owner is expected to finance the remaining 10%.)

Increased Maximum Loan Guaranty for SBA Loans: The SBA increased its guaranty of SBA 7(a) loans to 90% of the loan amount from the prior limit of at least 75%. Previously, loans under the 7(a) program were guaranteed up to 85% for loans at or below \$150,000 and up to 75% for larger loans.

Elimination of Certain Loan Fees: The plan temporarily eliminates the Certified Development Company (CDC) processing fees charged to borrowers and the third-party participation fees charged to lenders on loans under the 504 program. The plan will also temporarily eliminate up-front fees on loans under the 7(a) program.

Increased Reporting: The Treasury Department will also require the 21 largest banks receiving capital assistance from the government to submit monthly reports detailing its small business lending activity. In addition, the Treasury will encourage all banks to report their small business lending activity in their quarterly reports.

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