

Capital **A**ccess **P**rograms

**A Summary of
Nationwide
Performance**

Department of the Treasury
(Updated) October 1999



**CAPITAL ACCESS PROGRAMS:
A Summary of Nationwide Performance**

**Department of the Treasury
November 1999**

This report is available on-line at <http://www.ustreas.gov/reports/cap.pdf>.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

November 1, 1999

UNDER SECRETARY

Dear Friend:

Since 1986, when Michigan first developed the Capital Access Program (CAP) as a method to increase the availability of credit to small businesses, many states have gradually enacted CAPs of their own. In fact, by the end of 1998, the nationwide cumulative CAP lending was approximately \$1.2 billion.

Under the leadership of former Secretary Robert E. Rubin and now under Secretary Lawrence H. Summers, the Treasury Department has undertaken a series of initiatives to expand access to capital and encourage business investment in economically distressed communities. We compiled this report in order to assess the reach of CAPs and to explore the features that contribute to their success.

This report, Capital Access Programs: Nationwide Financial Performance, reviews the following areas:

- nationwide CAP lending statistics through 1998 from the 19 states and 2 municipalities that operate CAPs;
- CAP lending performance through 1998 to underserved communities;
- lessons learned from states' CAPs.

I hope that this report will contribute to greater understanding of CAPs' performance and their future potential as a tool to foster a vibrant small business financing market.

I'd like to thank Cliff Kellogg, the principal author of this report, and acknowledge the research assistance he received from Jim O'Connor, Alan Berube, and Greg Zucca. If you have any questions, please contact Michael Barr, Deputy Assistant Secretary (Community Development Policy) at (202) 622-0016.

Sincerely,

Gary Gensler
Under Secretary
Domestic Finance

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Executive Summary

In March, 1999, the Treasury Department's Community Development Policy Office compiled this report summarizing the performance of state-level Capital Access Programs (CAPs) based on a survey of the states with such programs. This report is the second national review¹ to compile and assess:

- nationwide CAP lending statistics through 1998 from the 19 states and 2 municipalities that operate CAPs;
- CAP lending performance through 1998 to targeted groups of borrowers such as those in low- and moderate-income communities;
- lessons learned from states' CAPs.

The 13-year track record of state-run CAPs suggests that these programs encourage small business lending in a cost-efficient and simple way. Under CAPs, the bank and the borrower pay an up-front insurance premium, typically between 3% and 7% of the loan amount at the bank's discretion, which goes into a reserve fund held at the originating bank. The state matches the combined bank and borrower contribution with a deposit into the same reserve fund. The CAP reserve fund allows a lending bank to make slightly higher risk loans than conventional underwriting, with the protection of the reserve fund for its entire pool of CAP loans.

CAPs allow banks to use their own underwriting standards for eligible loans, without governmental approval of the loan-making decision. Compared with the staff intensiveness of other credit enhancement programs, CAPs require little administrative cost for banks, borrowers or the government. States report that CAPs are staffed by 1 to 1.5 full-time equivalents. In most states, almost all small businesses are eligible for the CAP, though some states limit maximum loan sizes and eligible industries. A state's up-front payment of 3%-7% of the loan amount into a bank's CAP reserve fund supports a bank loan that is 14 to 33 times larger than that amount.

Currently, 19 states and 2 cities operate CAPs, with total lending since 1986 of approximately \$1.2 billion and a cumulative average loan size of \$59,151. For three consecutive years, the CAP dollar volume has increased, from \$187 million in 1996, to \$202 million in 1997 (8% growth), and to \$246 million in 1998 (22% growth). Over 315 banks actively originated loans in 1998. Nationally, cumulative CAP loan losses total \$37.7 million, or 3.1% of all loan volume; net of these losses, remaining CAP loan loss reserves amount to \$51.9 million, equal to 4.3% of cumulative volume.

In 1998, Louisiana and Florida undertook to create CAPs in their states, with implementation to begin in 1999; West Virginia discontinued its CAP program due to state budget constraints. Ohio announced that it will extend its coverage for CAP beyond Akron to encompass the entire state. Once these programs are launched, CAPs will operate in 22 states and one city.

¹ The Treasury Department published the first report, *Capital Access Programs: A Summary of Nationwide Performance*, in October, 1998.

Data on CAPs show that CAP loans reach some groups of borrowers not as well served by other credit enhancement programs:

- CAPs reach minority-owned businesses and low- and moderate-income communities in substantial numbers.
- CAP lending retains and creates a significant number of jobs.
- CAPs reach types of businesses, such as building contractors and wholesale trade companies, that are not typically reached by other small business lending programs.
- In some states, CAPs are used significantly for start-up businesses and for working capital, both of which are often cited as needs unsatisfied by the private market without public support.

The survey also revealed key aspects of the largest CAPs. Active marketing to banks appears to be a central feature of large CAPs. Assuring adequate funding for states' CAPs may also increase the volume of lending; even when funding limits are not hit, states that provide insufficient appropriations may discourage both bank participation and full engagement by the state agency administering the program. Similarly, restrictions on maximum loan size or eligible industries may hinder overall program development without demonstrable advantage.

1. Introduction

The expansion of private sector small business lending under CAPs in the 19 states and 2 municipalities currently operating such programs suggests that CAPs provide an innovative way to encourage banks to make loans to a portfolio of individually risky but cumulatively profitable small business loans. CAPs provide financial backing for a bank to make slightly more risky loans than through conventional methods, while still preserving a bank's motivation to underwrite applications rigorously and avoid high losses. CAPs help banks overcome the risks of small business lending by funding a reserve account to cover losses from loans that have defaulted. The risk of the loan is partially subsidized by the state and spread over the portfolio of all CAP loans. CAP loans are not guaranteed, and therefore lenders still bear the ultimate financial risk. However, CAPs have proven helpful in encouraging banks prudently to extend smaller business loans to new customers and, for existing customers, to offer CAP loans in addition to conventional financing.

This report is an update and extension of the October, 1998 report by the Department of the Treasury that summarized financial statistics on nationwide CAP lending and distilled some of the states' best practices. Many of the initial findings from the 1998 report still hold true. This report offers additional information in several areas, including marketing techniques and administrative support, while providing the most up-to-date information on the key CAP statistics. Policymakers and lenders would benefit from a more comprehensive study of CAP job creation impact and the reach of CAP to communities and individuals out of the financial mainstream as well as to particular industries. This report offers a nationwide overview of CAP lending, and we hope it will stimulate further research and discussion.

1.1 How CAPs Work: Program Mechanics

In a CAP, the borrower obtains a loan and loan approval directly from the bank. There is no governmental role in approving or reviewing the application. When making a CAP loan, the bank and borrower pay an up-front insurance premium that, combined, is generally ranges from 3% to 7% of the loan amount. The exact percentage is at the discretion of the individual bank, and in practice, the bank may pass most of its portion of the premium on to the borrower by financing the premium in the loan proceeds. Banks have the discretion to set interest rates on CAP loans as they see fit. In most states, all small businesses are eligible, although some states restrict maximum loan sizes and eligible industries (discussed in more detail later in this report).

The bank holds all of the CAP premiums in a single, pooled reserve account. The bank enrolls the loan by faxing a one- or two-page form to the state, providing the particulars and certifying that it meets program eligibility requirements. The state then deposits a matching amount, most often a one-to-one match, into the originating bank's CAP reserve account. In this way, each bank creates its own funded loan loss reserve to cover a loss on any of its CAP loans. The bank recovers any CAP loan losses by offsetting against the CAP reserve fund it holds. The bank itself must absorb any losses over its accumulated CAP reserve fund.

The state government provides only the up-front matching premium. A few states do provide a start-up credit line to give banks, in effect, an advance of future CAP premiums. This helps a

bank in the event the bank experiences an early CAP loss before the reserve fund has built up enough to absorb the full loss. A bank would then repay the credit line from future CAP premiums. Some states also increase their match rate for loans to targeted borrowers or areas, such as state-designated Enterprise Zones.

CAPs are designed to encourage banks to underwrite loans to a higher risk threshold than conventional lending criteria. Whereas most banks experience loan losses on their traditional loan portfolio of under 0.5% of loan principal outstanding annually, CAPs allow banks to absorb greater losses with its CAP-funded reserve. CAPs thus serve the risk category just slightly outside the scope of traditional bank lending.

1.2 How CAPs Work: Public Policy

The innovative feature of CAPs is the reserve fund that accumulates at each bank. This fund helps the bank to hold and pool its risk, thereby enabling the bank to make profitable loans to small business owners that would otherwise, on an individual basis, be viewed as too risky.

Capital Access Programs have five notable properties as public policy:

- First, CAP loans generally do not appear to “crowd out” loans that the private sector would otherwise make. Borrowers are always able to shop around to see whether another bank would make the loan without requiring the CAP premium. In choosing a CAP loan, borrowers signal that they are unable to find comparable funding elsewhere. Thus, CAPs do not supplant unsubsidized loans made by the private sector but rather make capital available to otherwise sidelined entrepreneurs.²
- Second, individual loan decisions in CAPs are made by those with the best information available -- the private parties involved.
- Third, CAPs align the incentives of the borrower, the bank, and the state in the lending process. Private incentives work to encourage CAP loans up to the loss level provided by the reserve fund. Banks may not use the CAP reserve for any purpose other than backing CAP loans. Banks would be disinclined to set the CAP premium too high and thereby miss the opportunity to approve a greater number of profitable loans. At the same time, banks will underwrite CAP loans rigorously, because they must absorb any losses that exceed the CAP reserve account.
- Fourth, the leveraging effect of public funds is large, and the state’s investment is certain at the outset. For example, if the state matches a borrower and bank contribution of 5% of the loan amount, its contribution is backing the bank to make a loan that is 20 times larger than the state investment (5% premium x 20 = 100% loan amount) . Moreover, the state does not carry any contingent liability for potential future losses on CAP loans, as it would for a loan guarantee program.

² *An in-depth 1998 study of the Michigan CAP by Roger Hamlin of Michigan State University estimated that only 12% of CAP loans would have occurred in the absence of the program.*

- Fifth, program administration is straightforward, according to the participating states and banks. Once the CAP is designed and enacted, the daily administration involves sending the matching premiums to each bank's reserve fund as new loans are enrolled, marketing the program to banks, and keeping accounts. In contrast, government guarantee programs may require staffing of loan review officers, recordkeeping staff, workout officers, legal staff and supervisory staff. All of the states that reported CAP administrative staffing levels reported from 1.0-1.5 full time equivalents. This level of support is consistent across state survey respondents regardless of size of the total volume of loans.

The states with CAPs as well as the most active CAP lenders report that CAPs provide a comparatively simple tool for banks to increase marginally their risk tolerance and, in so doing, to bring capital to an expanded population of viable small businesses.

2. CAP Performance

The data presented here are the results of a nationwide survey conducted by the Treasury Department during February and March of 1999. Comparisons are made to data collected by the Department of Treasury in its October 1998 CAP Report. The complete data set is presented in the Appendix.

2.1 General Financial Performance

This survey covered 19 states and 2 municipalities with operating CAPs. Two of these states, Texas and Illinois, enacted CAPs and began operating their programs in 1997. Two other states, Louisiana and Florida, are launching CAP programs; however, due to the premature nature of their programs, none of their data is included in this report. Since the last survey in 1998, West Virginia has discontinued its CAP program, which had supported over \$2 million in CAP lending, and reallocated its funding for other projects.

Loan Volume and Growth

CAP lending has grown at increasing rates in the last three years. By the end of 1998, total CAP lending volume had increased to \$1.2 billion. For three consecutive years, the CAP dollar volume has increased, from \$187 million in 1996, to \$202 million in 1997 (8% growth), and to \$246 million in 1998 (22% growth). Figure 1 shows the rise in both total lending volume and the total number of loans over the last three years, and Figure 2 shows the new loan volume and new number of loans in 1997 and 1998.

CAP growth rates are strong across the country. Of the 19 states surveyed with CAPs, only three state programs grew at less than a 10% rate in 1998, while the growth rates in eight states were in excess of 30%. Illinois grew by 179% (its first full year in operation) while North Carolina and Colorado achieved growth rates above 55% and 51% respectively. Figure 3 shows the distribution of growth rates across states.

CAP lending remains especially pronounced in three states: California, Michigan, and Massachusetts are responsible for nearly 68% of 1998 volume. California represents the largest 1998 volume with \$80 million followed by Michigan with \$52 million and Massachusetts with \$35 million (See Figure 5a).

CAP lending per capita provides another measure of the relative magnitude of states' CAPs. By this measure, New Hampshire has the most far-reaching program in the country, with a cumulative CAP loan volume of \$57.23 per resident.³ Figures 4a and 4 b present the largest programs in both absolute and per capita terms. The fact that some small states operate large CAPs on a per capita basis indicates much greater market penetration.

Another benchmark of CAPs' relative size is CAP lending per firm in a state. Using the 1992 Economic Census to calculate CAP lending per firm produces nearly identical results as the per capita measure since, at the state level, the number of businesses closely correlates with the total population. Cumulatively, Michigan's CAP lending per firm is the largest at \$725.33 per firm, followed by New Hampshire at \$693.64 and Massachusetts at \$305.11. Looking at CAP lending in 1998 only, New Hampshire is the largest at \$121.16 per firm, followed by Michigan at \$95.03 per firm, and Massachusetts at \$78.33 per firm.

The collected data show no evidence that CAP demand is saturated: First, the expansion of existing programs is generating more volume increases than the creation of new programs. Second, examining the largest programs -- those most likely to tap-out demand -- shows that in both absolute terms and per capita terms these programs continued through 1998 to extend the largest volume of new loans (see Figures 5a and 5b).

Average Loan Size

While the cumulative nationwide average size of a CAP loan is \$59,151, there is considerable variance across states. Banks in California and Texas originate the largest average loans, at \$150,526 and \$106,338 respectively. Wisconsin and Vermont banks originate the smallest, at \$23,985 and \$18,223 respectively. However, three of these four states are relatively large in per capita terms, and analysis of the data for all states shows that there is no evident correlation between loan size and any simple measure of CAPs' performance, such as total loan volume or loan losses.

In particular, examination of the data shows that states with larger average CAP loans do not appear to experience a larger percentage of loan losses. (California, however, is an exception, producing both the largest average loans and loan losses, although well within the limits of its CAP reserve fund.) Figure 6 shows the distribution of average loan size across states.

Financial Products

Different banks use CAPs to make different types of loans. Under CAPs, banks decide how to deploy the risk-protection afforded by the loan loss reserve. For example, some banks use CAPs

3 *Akron, Ohio reported cumulative CAP lending of \$61.91 per resident.*

to target a new customer base of small businesses. Other banks use CAPs for the unsecured portion of a financing package in which the bank will also provide some conventional secured financing.

The small business community often cites the financing of start-up businesses as an important funding need not fully satisfied by the private market. The available data appears to show that CAPs can address some of this need. Oregon reports that in 1998, almost 30% of its CAP loans went to start-up businesses. In Massachusetts and Arkansas, in 1998, almost 19% of CAP loans similarly went to start-ups. This suggests that start-ups are a market niche suitable to the CAP product.

In California, one of the most distinguishing characteristics of CAP lending is its use for working capital, another need often cited by small businesses that is difficult to accommodate under other credit programs. In 1997, California reported that a significant 56% of its CAP lending was for working capital revolving lines of credit, and 30% was for working capital term loans. The concentration in working capital and revolving facilities may be due to CAPs' straightforward loan administration and the banks' desire to limit its forward exposure, since these loans are generally for short maturities.

Loan Losses and Reserve Funds

Through the end of 1998, of those states that reported data for both 1997 and 1998, 506 banks were enrolled in CAPs nationwide and 315 of these were actively originating CAP loans. Many of these banks have large branch networks. State CAP administrators suggest that bank mergers have caused a slight decline in bank participation in some states, notably California, Connecticut, and Michigan.

Through the end of 1998, cumulative CAP loan losses nationwide totaled approximately \$38.2 million, or 3.2% of all loan volume extended. Net of these losses, banks nationwide held approximately \$52 million in their CAP reserve funds at the end of 1998, equal to 4.3% of the total loan volume extended. CAP reserves as a percentage of loans *currently outstanding* would, of course, be a much higher percentage since much of the cumulative loan volume (\$1.2 billion) has been repaid.⁴ Adding the cumulative losses and remaining loss reserve indicates that banks' total public and private CAP reserve fund contributions have been 7.5% of cumulative lending, with the state usually contributing half of that amount (some states contribute more than a one-to-one match under certain circumstances). This is a measurable drop from 1997, when the total contributions were 8.8% of cumulative lending, suggesting that the average CAP premium is decreasing.

The data, as well as bank behavior, suggest that current CAP reserves may be adequate to meet future losses, absent unforeseen circumstances. First, in some states, many CAP loans are for short maturities. Since remaining current reserves are 1.4 times as large as cumulative historical

⁴ Data on CAP loans outstanding are unavailable for most states, and therefore CAP reserves as a percentage of loans outstanding -- the usual measure of the adequacy of a loan loss reserve -- cannot be calculated.

losses and most programs are more than a few years old with presumably a substantial loan volume having been repaid (“runoff”), it appears that the coverage available on outstanding loans is sufficient.⁵ Second, banks made a record 3,660 loans totaling \$246 million in 1998, so it would appear that those banks believe themselves to be adequately covered. Finally, some banks with CAP experience in one state are expanding CAP lending where new states have enacted programs.

State Leverage

States have varying policies with regard to how much they require banks, borrowers, and the state to contribute to the reserve fund. States typically match private contributions one-to-one (that is, dollar-for-dollar), with many states increasing their match rate for target groups or areas, as is discussed in the next section. All in all, state contributions to the reserve funds typically range from 3% to 7% of the loan amount, implying public leverage of private funding in a range from 33:1 to 14:1.

Some states have special strategies to help banks overcome a start-up dynamic in which the first few loans do not on their own generate enough of a reserve pool to cover a default. For instance, Vermont and Pennsylvania provide an initial \$50,000 line of credit to their participating banks. Other programs address this issue by increasing the public match rate for banks’ initial loans. For example, Michigan provides a two-to-one match for a bank’s initial \$2 million in loans and then reduces the match to one-to-one. New York and Oklahoma also match at higher rates up to the \$2 million and \$3 million thresholds respectively. At the same time, many states -- and some with very large CAPs -- do not use start-up incentives at all.

One might expect to see a relationship between the size of a state’s contributions to the reserve funds and the resulting size of its CAP. New Hampshire’s experience supports this expectation: The average percentage of the loan contributed by New Hampshire to the loan loss reserve is the second largest in the country, exceeding 9% of the total loan volume, and New Hampshire has the most far-reaching program in the nation on a per-capita basis. However, across all programs, only a weak correlation exists between public contributions and the size of a program. The fact that there is not a stronger correlation suggests that state contributions are only one part of a larger story in determining the relative magnitude of state programs. These factors are discussed in Section 3.

Job Creation and Retention

As stated in the 1998 report, the data for jobs created or retained by CAP lending should be viewed cautiously. While the field would benefit from more studies, the reported data suggest the potential impact of CAP lending. Six states provided data on the number of jobs created or retained through CAP lending. Calculating the amount of CAP loan dollars per job created or

⁵ *Programs with the lowest ratio of current reserves to historical losses tend to be the largest CAPs in the country. One explanation of this correlation is simply that larger CAPs tend to be older programs, so that there has been a longer time frame over which existing loans can go into default. This cannot be the full explanation because not all large CAPs are relatively old. A second explanation for the correlation might be that CAPs are larger in states where banks lend more aggressively -- and hence coverage ratios are lower.*

retained in these six states shows a significant variation, from \$28,000 per job in one state to \$9,000 per job in another. These job retention and creation numbers are self-reported by the borrower and by the state, and these figures are not independently reviewed. However, with these caveats, applying the average employment effect for the six reporting states across the 19 states with operating CAPs suggests that as many as 84,248 jobs may have been created or retained as a result of CAPs. These jobs created by the CAPs are efficiently generated at very little cost to the government. Of the six states that reported this job creation data, the average state subsidy cost per job created/retained is \$777.

2.2 Performance in Lending to Specific Groups

Of the 19 states surveyed, eight states augment their CAP contributions for targeted groups. Table 1 shows that four states target state-designated Enterprise Zones, while two target on the basis of other geographical areas. Four states augment their contributions for minority-owned businesses and one for female-owned businesses, disabled-owned businesses, and “welfare-graduate-owned” businesses.

Most states target by increasing their matching contribution to a bank’s reserve fund, usually by 1.5 or 2 times their ordinary match. For example, California adds another 50% to its loan loss reserve contribution for loans in severely affected communities, areas around closed military bases, and for loans made by banks just entering the program. Thus, for these loans, California contributes 150% of the combined premium payments made by the lender and borrower. For example, if the lender and the borrower each contribute 2% to the loan loss reserve account, California will contribute 6% instead of its usual 4%. Other states such as Illinois, Indiana, and Pennsylvania increase their match rates if the loans are made to minorities. Connecticut targets by providing a 20% supplemental loan guarantee for certain urban areas. This “first-loss” guarantee reduces the lender’s exposure and creates an additional incentive for banks to invest in the targeted communities.

While data were limited, some states reported data showing that -- whether the state targets specific groups or not -- significant percentages of CAP loans are reaching low and moderate income areas as well as minority and female borrowers. In addition, CAPs appear to reach a broad spectrum of industries.

Table 1: Targeted State Programs

| | State-Designated Zones | Other Geographic Zones | Minority Owned Businesses | Female Owned Businesses | Disabled Owned Businesses | Welfare Graduates | Industry Targeting |
|--------------|------------------------|------------------------|---------------------------|-------------------------|---------------------------|-------------------|--------------------|
| Arizona | | | | | | ✓ | |
| California | ✓ | ✓ | | | | | |
| Connecticut | | ✓ | | | | | |
| Illinois | ✓ | | ✓ | ✓ | ✓ | | |
| Indiana | ✓ | | ✓ | | | | |
| Pennsylvania | | | ✓ | | | | |
| Texas | | | ✓ | | | | |
| Utah | ✓ | | | | | | ✓ |

- 1) *Low- and Moderate-Income Areas / Geographic Targeting.* According to its own definition of “distressed areas,” Connecticut data showed that 34% of 1998 CAP loans by volume were to businesses in low and moderate income areas. Wells Fargo Bank, which continues to originate approximately 85% of all CAP loan volume in California, reported in 1997 that 28% of its CAP loans went to businesses in census tracts with median incomes at the low to moderate level. In Connecticut, the average loan size for low and moderate income areas is 20% larger than the state average, while Wells Fargo loans in these census tracts were 7% larger on average.

- 2) *Minority-Owned Businesses.* In Illinois’ first full year of CAP operations, 26% of all loans have gone to minority entrepreneurs. In New York City, 36% of all loans have gone to minority entrepreneurs while in Wisconsin, this number remains high at 26% (down slightly from 29% in 1997). Comparing these figures with the percentage of businesses which are minority-owned in these states shows that CAP lending reaches a higher proportion of these businesses. In Illinois, 9.3% of businesses are minority owned compared to 2.5% in Wisconsin. Notably, Wisconsin’s CAP does not specifically target minority-owned businesses. Across seven states that reported data, the average loan size for minority borrowers is \$50,275, which is slightly larger than the average loan for these same seven states (though still below the overall nationwide average CAP loan size of \$59,151).

- 3) *Female-Owned Businesses.* Of the five programs that reported lending data for female-owned businesses, the percentage of female borrowers ranges from a low of 14% in Texas to a high of 37% in Wisconsin. The average loan size for females ranges from 42% to 210% of the state average. Vermont and New York City both exceed 100% of the overall average loan size at 113% and 210% respectively.

- 4) *Lending by Industry.* Sixteen states provided industry-specific loan information, and the data show that CAP loans are able to cover a broad spectrum of business types. CAP loans in these states are made most often to service businesses, construction, and manufacturing, while also reaching wholesale and transportation firms with significant frequency. Notably, CAPs are reaching certain industries, such as building contractors and wholesale trade companies, that are typically not well served by other types of credit enhancement programs. The available data also indicate that CAP lenders adapt the program to the needs of particular states. For example, for nine of the thirteen states reporting, agribusiness loans represent only 1-3% of the state total, but in Arkansas agribusiness lending comprises 53% of all CAP loans. Also, for nine of the thirteen states reporting, 19% of all loans went to manufacturing businesses, with Indiana reporting a high of 57% of its CAP loans to manufacturers.

3. Key Program Features of Large CAPs

Follow-up conversations with CAP agencies have suggested that there are several other elements that are important to the growth of CAPs:

- 1) Active marketing of the CAP

Many of the largest programs report that regular marketing is extremely important, particularly in the initial stages of the program. Marketing to banks appears to be most important, while marketing to borrowers is less important in developing a high-volume CAP. Massachusetts, Illinois, and New Hampshire and others emphasize the importance of reaching out to banks individually. Such one-on-one marketing, beyond informing banks of the CAP's existence, provides an opportunity to answer questions about the program. States point out that CAPs should be understood as a tool for expanding business lending parameters and should be offered by banks on a careful and deliberate business basis. State officials in California, Vermont and Virginia said that reaching directly to banks through calls and seminars was an effective means of marketing their CAP programs. Texas, which started its CAP in 1997, noted that press releases were one of the most effective means of marketing their CAP. Texas's success using press releases may be attributable to the fact that some Texas banks had CAP experience in other states and simply needed to know that Texas was offering a similar product. Some states, including Michigan, have chosen not to market their CAP at all, preferring to rely on banks to market the program themselves through their own in-house marketing efforts.

Table 2: CAP Marketing Programs

| Marketing Channels | | | | | | |
|---|--|---|--|--|--|---|
| | Seminars/ Meetings with Lending Institutions | Brochures/ Mailings Sent to Lending Institutions | Direct Calls to Lending Institutions | Newsletters/ Quarterly Reports Produced and Distributed to Public and Lending Institution | Bank Marketing/ Advertising the CAP Program | Press Releases Sent To Public and Lending Institutions |
| Number of States Utilizing Marketing Channel | 14 | 8 | 6 | 4 | 3 | 2 |

2) Adequate state appropriations for the CAP

Eight state CAPs receive only limited appropriations, either through a one-time appropriation or through an annual ceiling. Colorado and Oregon actually hit their limits in 1997, and Colorado suspended its program until new funding was obtained. Oregon kept its program operating uninterrupted by transferring funds from other budget sources. West Virginia faced similar budget hurdles and has recently suspended its program, choosing instead to allocate funding for other state credit enhancement programs. Even if a state is not hitting its funding limit, low funding may discourage banks from joining the program given lenders' need to originate a volume of loans sufficient to build an adequate loss reserve. Some banks reported that they chose not to participate in a state's CAP because it was funded at too low a level for them to offer the CAP product throughout their entire state branch network or to build up a sufficient reserve account. Interestingly, three of the four states that reported no funding limits are also among the largest programs in the country: California, Massachusetts, and New Hampshire.

States use a variety of funding sources for their CAPs. Pennsylvania generates the funds for its CAP contributions from bond financing programs, while Illinois' CAP program receives its funding from the state's Small Business Capital Revolving Loan Fund. California charges a 1% Small Business Assistance Fund fee to large companies obtaining environmental revenue bond financing through the state's bond issuing conduit.

3) Fewer eligibility and size restrictions for CAP loans

Some states restrain potential CAP lending by limiting the types of loans allowed under their program. In these states, CAP loans appear to work well for eligible businesses and eligible loans, but the state's authorizing statute does not make the program available for all small business loans.

- Some states place a ceiling on allowable loan size. For example, in one state, the maximum loan size is capped at \$150,000. This limits the availability of CAP

lending for small businesses that require larger loans, and it potentially discourages bank participation. As discussed above, it does not appear that loan size and loan default rate are correlated. Some states limit the permissible CAP loan size as a means of targeting the smallest borrowers and conserving state resources; however, this creates the side effect of constraining the program's broadest use.

- Some states only lend to a limited set of industries. Most notably, public CAP funds in California are generated through environmental bond issues, and regulations require that these dollars only be used to support businesses that affect the environment (this requirement excludes most retail and service businesses from CAP eligibility). California's program estimates that 40-50% of possible borrowers are excluded by this limitation, including all retail and service industries. Discussions are currently underway in California to expand the reach of the CAP program to other industries outside of those focused on the environment.

CAP lending data suggest that the program successfully encourages small business lending with a small average loan size to borrowers who might not otherwise meet bank underwriting criteria. At the same time, the program's reach is limited to the states where enacted, and may be further limited by specific funding and program limits in some states.

APPENDICES

Figure 1: Nationwide Cumulative CAP Loan Volume and Cumulative Number of CAP Loans

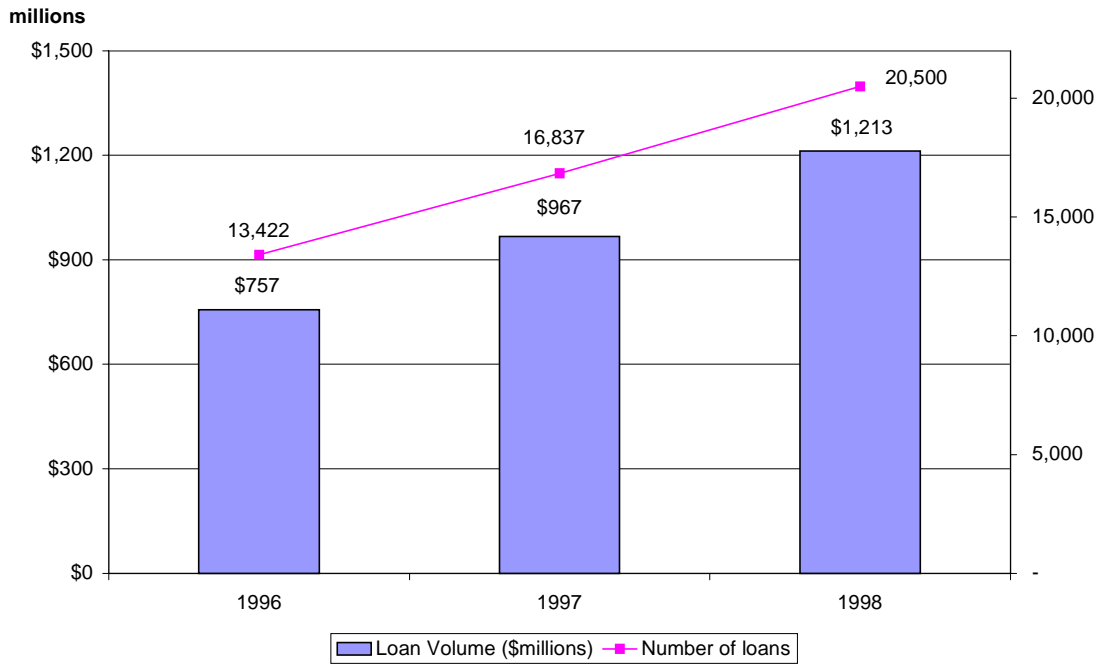


Figure 2: New CAP Loan Volume and Number New CAP Loans 1997-1998

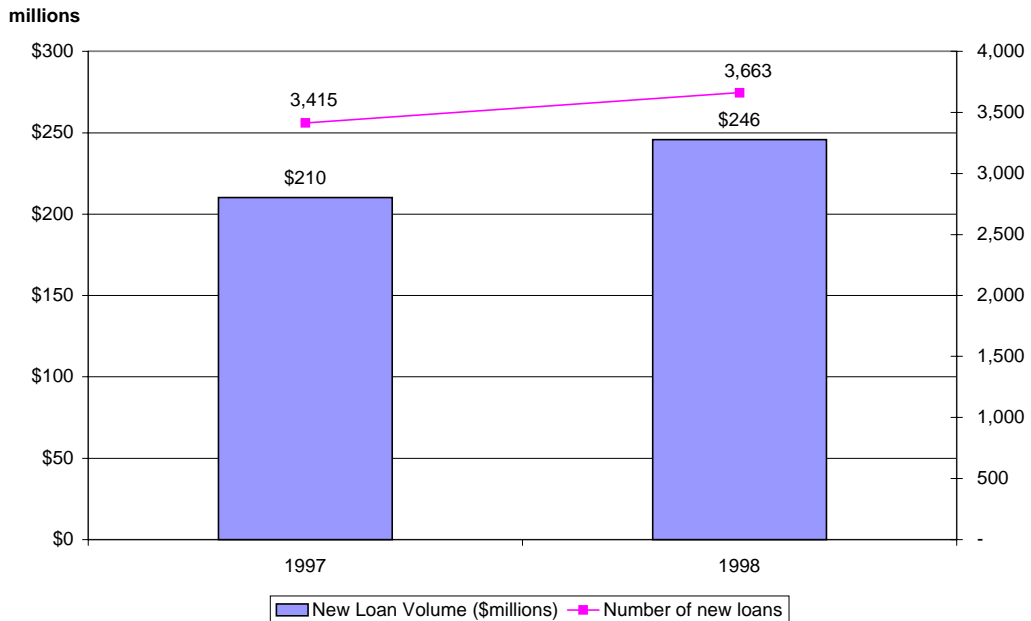


Figure 3: Distribution of State CAP Growth Rates 1998

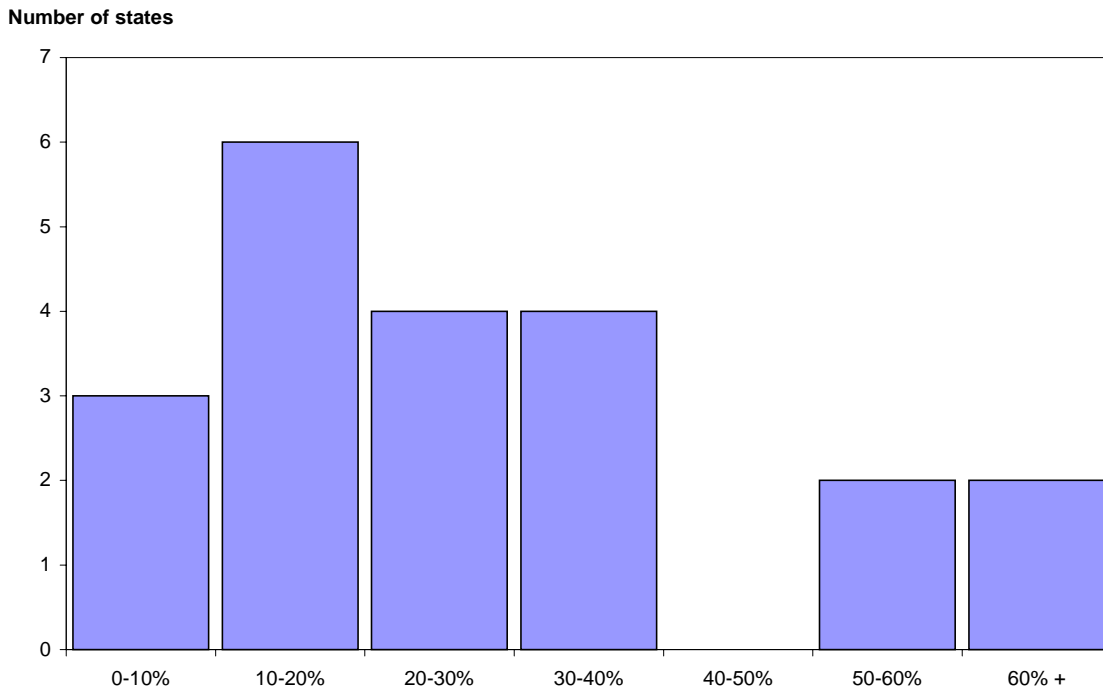
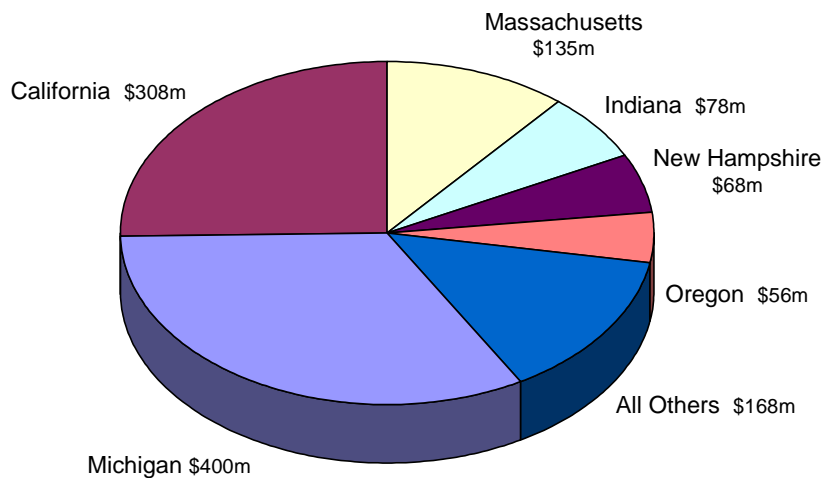


Figure 4a: Cumulative CAP Loan Volume by State through 12/31/98 (\$millions)



Total Volume = \$1.2 billion

Figure 4b: Cumulative CAP Loan Volume per Capita through 12/31/98

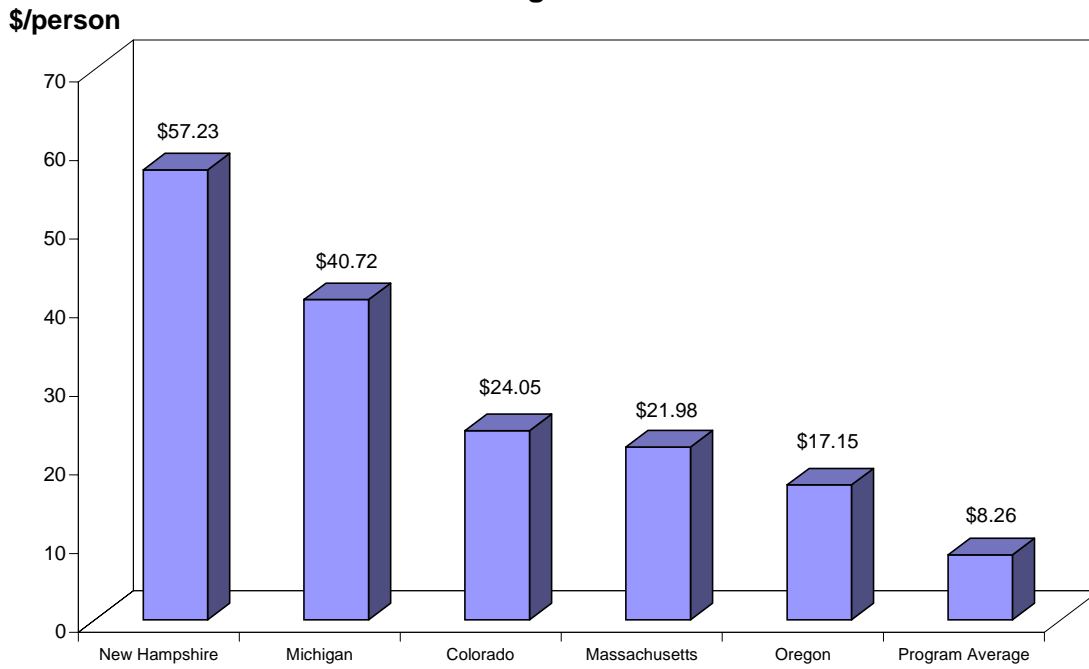
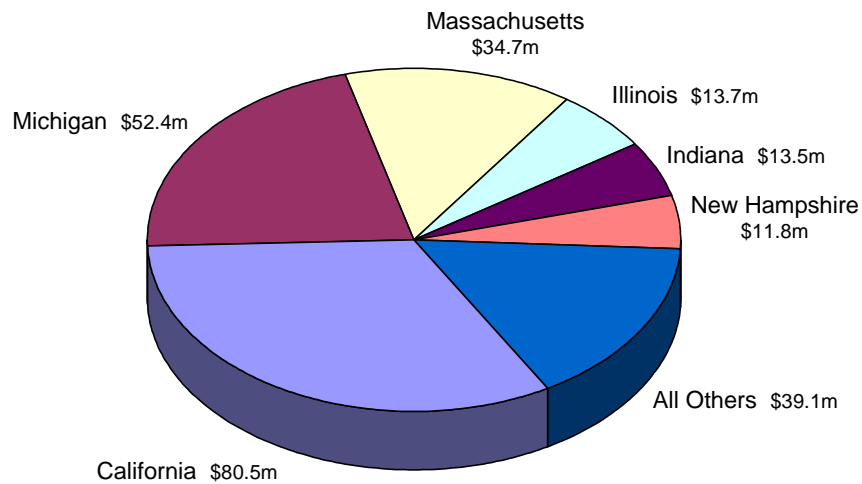


Figure 5a: New CAP Loan Volume by State 1998 (\$millions)



Total New Volume = \$246 million

Figure 5b: New CAP Loan Volume per Capita 1998

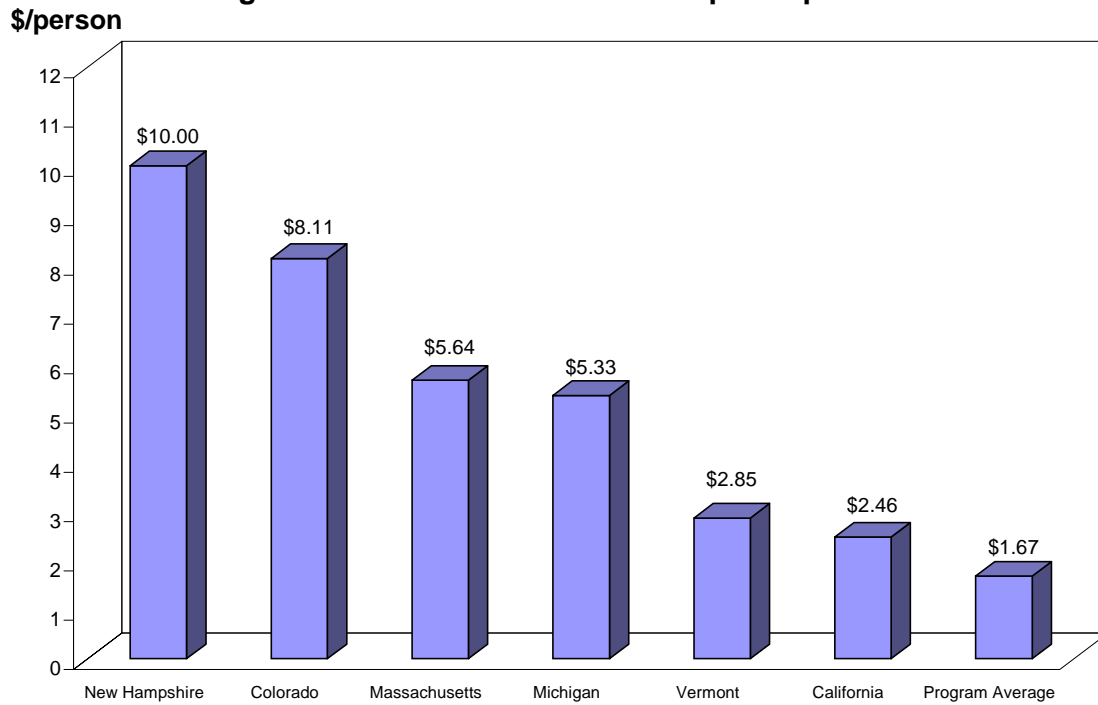
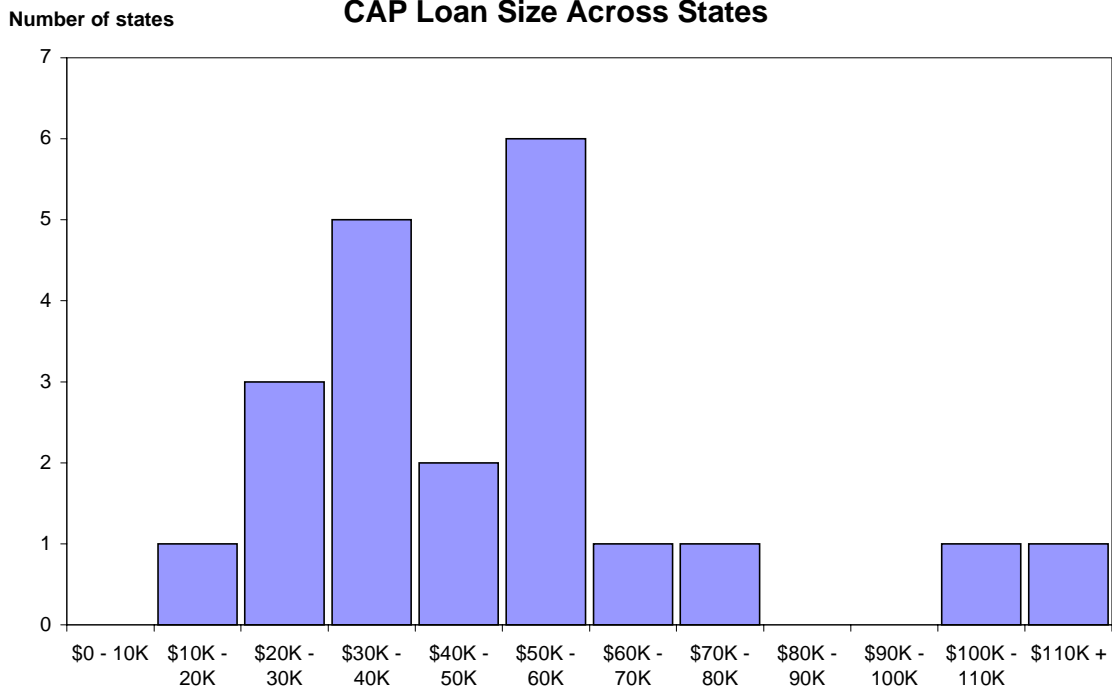


Figure 6: Distribution of Cumulative Average CAP Loan Size Across States



CAP Data Summary
 Data collected as of March 1999
 Data based on self-reporting by states

| State | State pop'n | Total # Firms | Cumulative Volume (\$) 12/31/98 | Cumulative Volume (\$) 12/31/97 | Cumulative Volume (\$) 12/31/96 | New Vol. (\$) 1998 | Cum. # loans 12/31/98 | Cum. # loans 12/31/97 | Cum. # loans 12/31/96 | New # 1998 | Avg. Loan Size (\$) | Cum. Vol. (\$) Per capita | Cum. Vol. (\$) Per firm | 1998 Vol. (\$) Per firm |
|----------------|-------------|---------------|------------------------------------|------------------------------------|------------------------------------|-----------------------|--------------------------|--------------------------|--------------------------|------------|---------------------|------------------------------|----------------------------|----------------------------|
| Arkansas | 2,538,303 | 159,820 | 8,128,718 | 7,572,608 | 6,255,223 | 556,109 | 205 | 182 | 149 | 23 | 39,652 | 3.20 | 50.86 | 3.48 |
| California | 32,666,550 | 2,259,327 | 308,276,553 | 227,795,093 | 186,953,701 | 80,481,460 | 2048 | 1640 | 1388 | 408 | 150,526 | 9.44 | 136.45 | 35.62 |
| Colorado | 397,091 | 323,147 | 9,549,412 | 6,328,344 | 3,672,094 | 3,221,068 | 250 | 189 | 138 | 61 | 38,198 | 24.05 | 29.55 | 9.97 |
| Connecticut | 3,274,069 | 237,705 | 25,426,052 | 21,807,211 | 15,378,032 | 3,618,841 | 332 | 264 | 197 | 68 | 76,584 | 7.77 | 106.96 | 15.22 |
| Illinois | 12,045,326 | 726,974 | 21,443,969 | 7,697,456 | 0 | 13,746,513 | 415 | 129 | n/a | 286 | 51,672 | 1.78 | 29.50 | 18.91 |
| Indiana | 5,899,195 | 364,253 | 77,544,687 | 64,093,204 | 47,555,900 | 13,451,483 | 1693 | 1414 | 1037 | 279 | 45,803 | 13.14 | 212.89 | 36.93 |
| Massachusetts | 6,147,142 | 442,848 | 135,119,329 | 100,431,404 | 67,000,000 | 34,687,925 | 2284 | 1793 | 1363 | 491 | 59,159 | 21.98 | 305.11 | 78.33 |
| Michigan | 9,817,242 | 551,091 | 399,721,976 | 347,349,705 | 284,286,235 | 52,372,271 | 7251 | 6349 | 5355 | 902 | 55,126 | 40.72 | 725.33 | 95.03 |
| Minnesota | 4,725,419 | 358,921 | 5,437,666 | 4,858,400 | 3,968,466 | 579,266 | 199 | 183 | 150 | 16 | 27,325 | 1.15 | 15.15 | 1.61 |
| New Hampshire | 1,185,048 | 97,772 | 67,818,168 | 55,972,130 | 40,190,552 | 11,846,038 | 1794 | 1407 | 984 | 387 | 37,803 | 57.23 | 693.64 | 121.16 |
| New York City | 7,322,564 | n/a | 16,368,913 | 14,243,913 | 13,113,860 | 2,125,000 | 308 | 283 | 266 | 25 | 53,146 | 2.24 | n/a | n/a |
| North Carolina | 7,546,493 | 439,301 | 11,112,535 | 7,164,116 | 4,580,698 | 3,948,419 | 220 | 133 | 88 | 87 | 50,512 | 1.47 | 25.30 | 8.99 |
| Akron, OH | 223,019 | n/a | 13,806,881 | 13,421,881 | 13,271,881 | 385,000 | 261 | 257 | 255 | 4 | 52,900 | 61.91 | n/a | n/a |
| Oklahoma | 3,346,713 | 248,936 | 22,951,353 | 18,929,991 | 16,086,366 | 4,021,362 | 760 | 578 | 436 | 182 | 30,199 | 6.86 | 92.20 | 16.15 |
| Oregon | 3,281,974 | 239,967 | 56,297,985 | 48,680,879 | 39,653,275 | 7,617,106 | 1479 | 1325 | 1129 | 154 | 38,065 | 17.15 | 234.61 | 31.74 |
| Pennsylvania | 12,001,451 | 728,063 | 6,852,642 | 5,042,543 | 2,970,112 | 1,810,099 | 168 | 126 | 43 | 42 | 40,790 | 0.57 | 9.41 | 2.49 |
| Texas | 19,759,614 | 1,256,121 | 8,081,697 | 450,000 | 0 | 7,631,697 | 76 | 4 | n/a | 72 | 106,338 | 0.41 | 6.43 | 6.08 |
| Utah | 2,099,758 | 129,202 | 172,765 | 172,765 | 117,065 | 0 | 6 | 3 | 3 | 3 | 28,794 | 0.08 | 1.34 | 0.00 |
| Vermont | 590,883 | 58,924 | 6,673,095 | 4,990,228 | 3,801,140 | 1,682,867 | 366 | 257 | 177 | 109 | 18,233 | 11.29 | 113.25 | 28.56 |
| Virginia | 6,791,345 | 391,451 | 3,981,982 | 3,270,761 | 2,234,586 | 711,221 | 59 | 34 | 21 | 25 | 67,491 | 0.59 | 10.17 | 1.82 |
| Wisconsin | 5,223,500 | 300,348 | 7,819,172 | 6,595,867 | 5,539,777 | 1,223,305 | 326 | 287 | 243 | 39 | 23,985 | 1.50 | 26.03 | 4.07 |
| Totals | 146,882,699 | 9,314,171 | 1,212,585,550 | 966,868,499 | 756,628,963 | 245,717,051 | 20,500 | 16,837 | 13,422 | 3,663 | 59,151 | | | |
| Average | | | 57,742,169 | 46,041,357 | 36,029,951 | 11,700,812 | 932 | 765 | 610 | 167 | | 8.26 | 126.95 | 26.11 |
| Growth in 98 | | | | | | 25.4% | | | | 21.8% | | | | |

Note: In response to the survey, a number of states made minor corrections to 1996 and 1997 data. The most recently received data are reported here, and therefore are not identical to the data reported in last year's edition.

| State | Existing Reserves 12/31/98 | Cumulative Losses 12/31/98 | Total Reserves Contribution | Total Public Contribution | 1998 Public Contribution | Participating Banks 12/31/98 | Participating Banks 12/31/97 | Participating Banks 12/31/96 | New Banks 1998 | Active Banks 12/31/98 |
|----------------|----------------------------|----------------------------|-----------------------------|---------------------------|--------------------------|------------------------------|------------------------------|------------------------------|----------------|-----------------------|
| Arkansas | 506,350 | 163,195 | 669,545 | 287,529 | 15,389 | 10 | 9 | 8 | 1 | 3 |
| California | 6,553,451 | 19,753,493 | 26,306,944 | 13,343,091 | 3,372,548 | 45 | 42 | 39 | 3 | 10 |
| Colorado | 562,088 | 144,083 | 706,171 | n/a | n/a | 12 | 14 | 12 | -2 | 7 |
| Connecticut | 2,665,301 | 145,582 | 2,810,883 | 1,700,806 | 180,942 | 30 | 33 | 27 | -3 | 12 |
| Illinois | 1,612,854 | 43,731 | 1,656,585 | 944,157 | 590,077 | 51 | 43 | 0 | 8 | 23 |
| Indiana | 3,767,881 | 2,749,982 | 6,517,863 | 3,445,452 | 495,963 | n/a | 125 | 125 | n/a | 34 |
| Massachusetts | 7,401,563 | 3,082,507 | 10,484,070 | n/a | n/a | n/a | 90 | 90 | n/a | n/a |
| Michigan | 14,600,000 | 4,515,514 | 19,115,514 | 14,893,437 | 1,883,942 | 69 | 77 | 72 | -8 | 51 |
| Minnesota | 718,454 | 218,117 | 936,571 | 570,958 | 60,824 | 34 | 34 | 34 | 0 | 34 |
| New Hampshire | 6,605,552 | 2,104,665 | 8,710,217 | 6,134,497 | 1,048,282 | 37 | 36 | 32 | 1 | 25 |
| New York City | 1,383,497 | 599,775 | 1,983,272 | 1,048,036 | 107,625 | 11 | 12 | 11 | -1 | 4 |
| North Carolina | 840,125 | 61,487 | 901,612 | 480,580 | 148,057 | 26 | 26 | 26 | 0 | 9 |
| Akron, OH | 274,227 | 500,210 | 774,437 | 274,227 | 29,000 | 8 | 8 | 8 | 0 | 8 |
| Oklahoma | 725,465 | 840,964 | 1,566,429 | 931,000 | 124,287 | 74 | 74 | 73 | 0 | 29 |
| Oregon | 2,050,163 | 2,644,287 | 4,694,450 | 2,416,598 | 287,294 | 29 | 28 | 28 | 1 | 19 |
| Pennsylvania | 323,918 | 128,863 | 452,781 | 300,000 | n/a | 6 | 6 | 6 | 0 | 5 |
| Texas | 687,352 | 0 | 687,352 | 348,353 | 330,353 | 11 | 7 | 0 | 4 | 5 |
| Utah | 24,652 | 0 | 24,652 | 10,000 | 0 | 2 | 4 | 4 | -2 | 2 |
| Vermont | 871,925 | 282,629 | 1,154,554 | 204,554 | n/a | 24 | 24 | 21 | 0 | 19 |
| Virginia | 226,744 | 45,871 | 272,614 | 35,000 | n/a | 6 | 1 | 1 | 5 | 4 |
| Wisconsin | 66,411 | 217,968 | 284,379 | 272,225 | 41,228 | 21 | 21 | 21 | 0 | 12 |
| Totals | 52,467,972 | 38,242,923 | 90,710,895 | 47,640,500 | 8,715,811 | 506 | 714 | 638 | 7 | 315 |
| Average | 2,498,475 | 1,821,092 | 4,319,566 | 2,507,395 | 544,738 | 27 | 34 | 30 | | 16 |

Capital Access Program State Laws

| State | State Law | Date Enacted |
|-----------------------|--|--------------|
| Arkansas | Arkansas Statutes Annotated 15-5-1101 et seq. | 1993 |
| California | California Health & Safety Code § 44559.1 et seq. | 1994 |
| Colorado* | Colorado Revised Statutes 29-4-710.5 et seq. | 1993 |
| Connecticut* | Connecticut General Statutes § 8-167 et seq. | 1993 |
| Florida* | Florida Statutes 19-288.901 et seq. | 1996 |
| Illinois* | 30 Illinois Compiled Statutes 750/9 et seq. | 1997 |
| Indiana | Indiana Code 4-4-26 | 1992 |
| Louisiana* | Louisiana Revised Statutes 51.2311 et seq. | 1998 |
| Massachusetts | General Laws of Massachusetts chap. 23A, § 57 | 1993 |
| Michigan* | Michigan Statutes Annotated 3.541 (201) et seq. | 1986 |
| Minnesota | Minnesota Statutes chapter 116J.876 | 1989 |
| New Hampshire | New Hampshire Revised Statutes chap. 162-A:12 | 1992 |
| New York City* | New York State Consolidated Laws chap. 15 | 1993 |
| North Carolina | North Carolina 1993 Session Laws, chap. 769, § 28.1 (a7) | 1994 |
| Ohio (Akron)* | Ohio Revised Code 1.166 | 1995 |
| Oklahoma* | 74 Oklahoma Statutes 5085.2 et seq. | 1992 |
| Oregon | Oregon Revised Statutes 285B.126 | 1989 |
| Pennsylvania* | 73 Pennsylvania Statutes 376.2 | 1994 |
| Texas | Texas Government Code chap. 481, subchap. BB, § 481.401 et seq. | 1997 |
| Utah | Utah Code Annotated 9-2-1303 et seq. | 1991 |
| Vermont* | Vermont Statutes Title 10, chap. 12, § 279 | 1993 |
| Virginia | Virginia Code 9-228.5 et seq. | 1996 |
| West Virginia* | West Virginia Code 31-15A-1 et seq. | 1991 |
| Wisconsin* | Wisconsin Statutes chap. 560.03 | 1992 |

* No specific CAP legislation; generic economic development statute used.