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## Banks, Michigan Group Collaborate on Small-Business Lending Push

By Jackie Stewart

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A partnership in Michigan that involves nine banks is hoping to jump-start small-business lending in the state.

Grow Michigan aims to help small businesses expand by offering lower-cost subordinated debt financing. Participating banks want to strengthen relationships with customers and earn Community Reinvestment Act credit, industry experts say.

The group has raised \$30 million in initial funding, including \$4.5 million from the fund managed by the Michigan Economic Development Corp. Plans are to double the size of the pool over time.

The different "pieces of the program can be an engine for job growth and for economic development," says Russell Youngdahl, a founder of Grow Michigan. "It makes a lot of sense to provide a couple of million dollars of funding to real businesses and do it on terms that aren't indenturing."

Participating banks include PNC Financial Services, Fifth Third Bancorp, Huntington Bancshares, Bank of Holland, Bank of Northern Michigan, Private Bank, Crestmark Bank, Seaway Community Bank, and Mercantile Bank of Michigan. Each bank contributed \$1 million to \$6 million to the fund.

The effort will blend public and private capital to provide subordinated debt at lower rates to a largely underserved market, industry experts say. Banks will be heavily involved in recruiting borrowers and underwriting debt.

Funding decisions will focus on potential growth and job creation, says Eric Hanna, director of debt capital programs at the Michigan Economic Development Corp.



Many states have economic development programs that offer incentives such as tax abatements or grants. Others offer low-cost loans or financing similar to venture capital. The federal government launched the State Small Business Credit Initiative in 2010, which provides funding to support state programs that leverage private lending to small businesses.

Grow Michigan is different because it is structured to create jobs and increase the tax base, while recouping the state's investment, Hanna says. It is filling financing needs that can't be met with traditional loans, capital markets or the State Small Business Credit Initiative, industry experts say.

The initiative is likely to fund businesses that need capital for rapid expansion or to finance buyouts at closely held companies where executives are retiring in an effort to keep these businesses in Michigan, Hanna says.

"You've got the mega corporations that can go out to the capital markets and get big dollars," says Robert Worthington, risk management director and general counsel at Mercantile Bank of Michigan in Grand Rapids. "The middle-market tier really had a void. We wondered how we could support those companies, and this is a really innovative way to do that."

The fund will make three- to five-year subordinated loans ranging from \$500,000 to \$3 million to established small businesses. Other funds generally aim to make investments of at least \$10 million because of the cost of due diligence, Hanna says. Those funds also charge at least 20% in interest; Grow Michigan's loans will have rates of 8% to 10%, Hanna says.

"We didn't want companies to feel like they were financing their businesses with a credit card," Youngdahl says.

The relationship with banks was key in keeping costs down and making the fund efficient. Banks will help identify businesses with capital needs that cannot be met through more-traditional forms of lending.

For instance, a small business might need funds to buy new equipment and hire employees. A bank may be able to provide a loan for the equipment purchase but has a harder time financing hiring because of problems with collateral, Hanna says. That bank could recommend Grow Michigan to the business.

"There's really no single type of funding that's perfect for every situation," says Garth Deur, president and chief operating officer of Lake Michigan Financial, the parent of Bank of Holland and Bank of Northern Michigan. "Small-business owners are challenged to find the right funding at the right price."

Since banks are recommending borrowers, those prospects will have already completed an underwriting process. Grow Michigan will only have to complete some added analysis before making a loan, keeping costs down.

A chance to deepen relationships with customers was a big draw for banks, which are likely to receive only a "modest" return from their investment, Hanna says. The banks are not "a financial investor in Grow Michigan but rather a strategic investor."

~~Mercantile has a "very vanilla investment portfolio," Worthington says. The bank agreed to join Grow Michigan because it will allow the bank "to do more deals and ultimately serve the customer better."~~

Mercantile was also pleased that the program included a loss-sharing agreement with the Michigan Strategic Fund and the potential for the bank to gain CRA credit. Grow Michigan plans to lend to businesses that employ hourly wage laborers or have main offices in low- to moderate-income areas, criteria that would help banks meet CRA requirements.

Grow Michigan is a "creative opportunity to try to weave together the private and public sector," says Eliot Stark, managing director at Headwaters MB. There is "very little downside for the banks" even if it is a little riskier than traditional loans, he adds. The fund should help smaller banks make loans in their "sweet spot" of \$750,000 to \$3 million to businesses that are growing and may need more banking services in the future, he says.

Michigan has developed a more-robust set of tools to spur economic development because it has long suffered from the declining automobile industry, Stark says. At 8.9% in December, the state has one of the nation's highest unemployment rates, according to the Bureau of Labor Statistics. The state has tried to stay at the forefront of understanding businesses' capital needs, Hanna says.

Lake Michigan Financial has a reputation for being "bullish on Western and Northern Michigan," Deur says. Grow Michigan offers "an alternative for small businesses in our communities to expand," which is "good for our small businesses and good for Michigan's economy."

It would be simple for other states to craft similar programs, "assuming that the state is actively involved in economic development and is willing to commit a little bit of resources to this type of joint venture," Stark says.

But state governments might be reluctant to get involved with a public-private partnership, which can be politically sensitive. States must make sure that risks and rewards are equally shared between taxpayers and banks, Stark says.

Grow Michigan should eventually become self-sufficient, Hanna says. Youngdahl is in talks with more than a dozen new banks that are interested in joining the fund. Eight funding deals are lined up, with the first one on track to close by late March.

"We would like to get one success story and once we have that, we will really roll it out full steam with the rest of our commercial lenders," Worthington says. "Once they know it is a tool in their toolbox, they can use it as needed."



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